MOODY'S
RATINGS

Rating Action: Moody's Ratings affirms the North American Development Bank's Aa1 rating, maintains stable outlook

12 Jul 2024

New York, July 12, 2024 -- Moody's Ratings (Moody's) has today affirmed the Aa1 long-term issuer and senior unsecured ratings of the North American Development Bank (NADB) and maintained the stable outlook. The short-term issuer rating of the NADB was affirmed at Prime-1 (P-1).

The rating affirmation is driven by NADB's high intrinsic financial strength that will remain supported by robust capital adequacy and liquidity metrics as the bank maintains compliance with its policies. Additionally, member support will continue to be driven by NADB's role in contributing to the development in the border region of the United States and Mexico.

The stable outlook reflects our expectation that moderate loan growth and compliance with its policies will support NADB's robust capital adequacy and liquidity metrics. The bank's focus on addressing environmental challenges related to renewable energy and water availability in its region of operations will ensure the economic importance assigned by its shareholders.

RATINGS RATIONALE

RATIONALE FOR AFFIRMING THE Aa1 RATING

INTRINSIC FINANCIAL STRENGTH WILL REMAIN HIGH, SUPPORTED BY STRONG CAPITAL ADEQUACY AND LIQUIDITY METRICS

The affirmation of NADB's rating at Aa1 considers its strong capital position and comparatively low leverage. After bottoming at 127% in 2021 from about 200% in 2018-19, the ratio of development related-assets and liquid assets rated A3 or lower-to-usable equity rose to 143% in 2023. We expect that modest loan growth and the increase in equity related to the ongoing capital increase process will contribute to this metric stabilizing around 150%, lower than the median for Aa-rated supranational entities of about 200%.

The bank's development asset credit quality is moderate, taking into account its mandate-driven country and sector concentration, payment enhancements for public sector loans in Mexico and the higher quality of US public sector loans. Meanwhile, asset performance will remain strong, with NADB currently not recording any non-performing assets.

NADB's liquidity is strong, reflecting moderate market access based on low market funding needs and a sizable liquidity coverage. Currently, NADB's liquid resources provide very strong coverage – in a severe stress scenario where NADB is unable to issue debt or receive any additional capital contributions from its shareholders, its liquid assets would cover far more than 18 months of debt service, planned disbursements and operational costs.

MEMBER SUPPORT TO REMAIN HIGH AS NADB CONTRIBUTES TO ADDRESS KEY ENVIRONMENTAL CHALLENGES IN OPERATING REGION

We expect that NADB's continued focus on renewable energy and increased participation in water management projects in the border region of the US and Mexico, the bank's two shareholders, will ensure that the members will continue to support the bank going forward. NADB's efforts to tackle challenges to the reliability of clean energy supply and drought affecting water availability in this region will support the ongoing process of relocation of supply chains to the North American region in future years.

We also consider that despite the fiscal challenges that affect both member governments, their ability to support the bank remains strong on a comparative basis, with the financial commitment to the bank being very manageable.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects our expectations that NADB will maintain robust capital adequacy and liquidity metrics over the coming years. This will happen as the bank grows its loan portfolio on a more consistent yet gradual basis, and with an increased focus on water-related projects. The new lending strategy will contribute to reduce to some extent the concentration risks inherent to NADB. Prudent liquidity management will ensure that coverage will remain strong, a key credit strength for the bank.

Meanwhile, the increased focus in addressing water stress in its region of operation will help to cement the importance of the institution to its shareholders.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

NADB's CIS-2 credit impact score reflects low exposures to environmental, social and governance risks on its credit profile. Although potential changes in energy regulations in Mexico exposed NADB risks to its asset quality and performance, the bank's focus on renewable energy will remain key for its development mandate. The effective execution of this mandate also supports NADB's social impact in its region of operations and highlights its robust governance.

NADB's environmental issuer profile score is E-2. Although NADB is exposed to carbon transition risks particularly in Mexico given the government's prioritization of the national utility company that depends more on hydrocarbons for electricity generation, the bank has a clear mandate on clean energy. Additionally, NADB focuses on improving water management and air quality in its region of operations, with the overall goal of mitigating environmental risks along the Mexico-US border region.

NADB has a S-2 social issuer profile score, in line with the broader sector. This assessment reflects Moody's views of NADB's strong customer relations and responsible production, which allow it to have important socioeconomic impact in its region of operations along the US-Mexico border region.

NADB's governance issuer profile score is G-2, given its prudent risk management practices that help mitigate risks from its lending operations to sub-national governments and private sector entities. This balances moderately negative risk to the issuer profile from concentrated ownership with only two shareholders, namely the US and Mexico, that can at times foster cooperation but is also susceptible to political developments in both countries.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

WHAT COULD CHANGE THE RATING UP

Upward rating momentum would emerge if there is evidence of a material increase in the relevance assigned by NADB's shareholders to the bank, leading to an expanded mandate and to capital increases above and beyond those contemplate at present. In turn, as the bank's operations increase, we would assess the evolution of its key capital adequacy and liquidity metrics to ensure they remain aligned with a robust intrinsic financial strength, and the management of additional risks that would emerge as the balance sheet grows to ensure that adherence to the bank's policies is preserved.

WHAT COULD CHANGE THE RATING DOWN

NADB's credit profile could come under negative pressure if there is a significant deterioration in asset quality or if there is a deterioration in the strength of member support, either through a materially lower weighted average shareholder rating or if there is evidence of a shift in willingness to support the institution by any of its members.

The principal methodology used in these ratings was Multilateral Development Banks and Other Supranational Entities published in February 2024 and available at https://ratings.moodys.com/rmc-documents/414557 . Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions .

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