MOODY'S RATINGS

CREDIT OPINION
22 July 2024

Update

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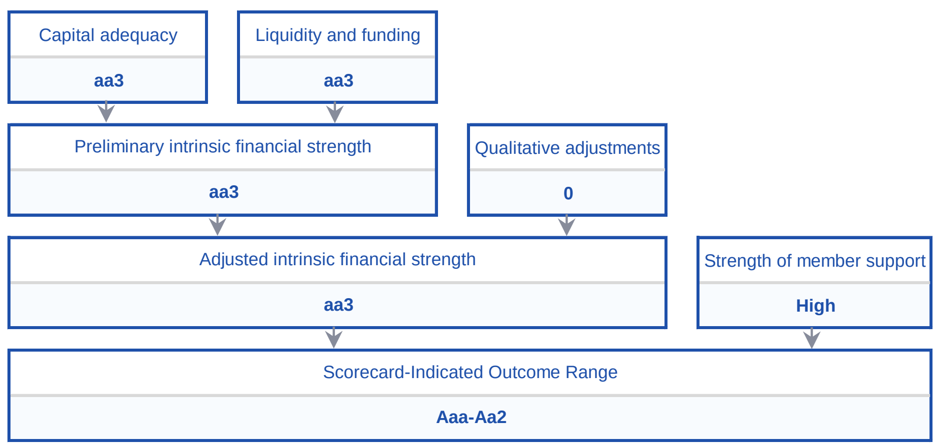
North American Development Bank – Aa1 stable

Regular update

Summary

North American Development Bank's (NADB) credit profile reflects the bank's high capital adequacy and liquidity position, and strong support from the United States of America (Aaa negative) and Mexico (Baa2 stable), its two shareholder members. These strengths are offset by a narrow geographic mandate that contributes to a relatively concentrated loan portfolio and to member concentration risk. The bank's capital and liquidity ratios remain strong.

Exhibit 1
NADB's credit profile is determined by three factors



Source: Moody's Ratings

Credit strengths

- Low leverage compared with that of peers
- Very strong liquidity policy and coverage of debt service
- High member support, underpinned by capital increase

Credit challenges

- High loan portfolio concentration by country because of a narrow geographic mandate
- Portfolio remains concentrated despite reduced focus on renewable energy
- Member concentration risk as its shareholder base has only two governments

RATINGS

NADB

	Rating	Outlook
Long-term Issuer	Aa1	Stable
Short-term Issuer	P-1	--

Contacts

Renzo Merino +1.212.553.0330
VP-Senior Analyst
renzo.merino@moodys.com

Sergio Herrera Carranza +1.212.553.8994
Ratings Associate
sergio.herreracarranza@moodys.com

Mauro Leos +1.212.553.1947
Associate Managing Director
mauro.leos@moodys.com

Marie Diron +44.20.7772.1968
MD-Global Sovereign Risk
marie.diron@moodys.com

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Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Rating outlook

The stable rating outlook reflects our expectation that moderate loan growth and compliance with its policies will support the 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 regions of operation support the economic importance assigned by its shareholders.

Factors that could lead to an upgrade

The rating could be upgraded if there is a significant increase in the relevance assigned by the NADB's shareholders to the bank, leading to an expanded mandate and to capital increases above and beyond those contemplated at present. In turn, as the bank's operations grow, we would assess the evolution of its key capital adequacy and liquidity metrics to ensure they remain aligned with robust intrinsic financial strength, and the bank's management of additional risks that would emerge as the balance sheet grows to ensure that the bank continues to adhere to its policies.

Factors that could lead to a downgrade

The the NADB's rating could be downgraded if there is a significant deterioration in asset quality or if there is a deterioration in member support, either through a substantially lower weighted average shareholder rating or if there is a shift in willingness to support the institution by either of its members.

Key indicators

Exhibit 2

North American Development Bank (NADB)	2018	2019	2020	2021	2022	2023
Total Assets (USD million)	1,959.1	2,007.5	2,177.2	2,114.6	1,994.1	2,246.0
Development-related Assets (DRA) / Usable Equity [1]	196.7	190.6	147.5	125.7	122.9	128.7
Non-Performing Assets / DRA	0.0	0.0	0.0	0.0	0.0	0.1
Return on Average Assets	1.0	1.5	0.7	0.6	0.0	0.9
Liquid Assets / ST Debt + CMLTD	15,186.3	295.2	19,150.5	727.7	21,255.8	20,555.7
Liquid Assets / Total Assets	40.8	37.5	46.3	53.4	56.1	48.2
Callable Capital / Gross Debt	399.4	392.2	419.6	440.9	498.3	429.0

[1] Usable equity is total shareholder's equity and excludes callable capital

Source: Moody's Ratings

Profile

Headquartered in San Antonio, Texas, the North American Development Bank (NADB) was established in 1994 under the Agreement Between the Government of the United States of America and the Government of the United Mexican States concerning the establishment of a Border Environment Cooperation Commission (BECC) and a North American Development Bank.[1]

The bank's main activity is its International Program, through which it provides loans, grants, and technical assistance and training to border municipalities and private-sector companies in both Mexico and the US. To facilitate lending to Mexican borrowers in the public sector, the bank has one subsidiary, Corporacion Financiera de America del Norte (COFIDAN), of which it owns 99.93%. The Mexican government owns the remaining 0.07%. The NADB faces a high degree of geographic concentration risk because it only operates in two countries, with an additional forced concentration to within a 400-kilometer north-south band.[2]

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on https://ratings.moodys.com for the most updated credit rating action information and rating history.

Detailed credit considerations

Our determination of a supranational's rating is based on three rating factors: capital adequacy, liquidity and funding, and strength of member support. For multilateral development banks (MDBs), the first two factors combine to form the assessment of intrinsic financial strength, as shown on the cover page graphic. Additional factors, such as risks stemming from the operating environment or the quality of management, can also affect the intrinsic financial strength. The strength of member support is then incorporated to yield a rating range. For more information, please see our Supranational Rating Methodology.

FACTOR 1: Capital adequacy score: aa3

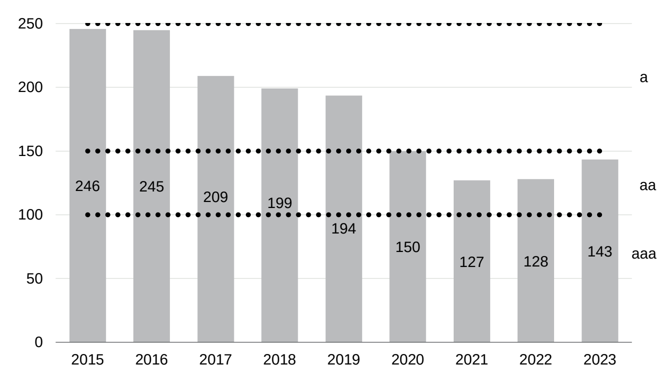
The NADB's "aa3" capital adequacy assessment balances low leverage relative to similarly rated peers, strong asset performance and moderate asset quality against high concentration risk by country and sector. We expect leverage in the coming years to remain comparatively low as a result of the bank's cautious loan-growth plans and incoming paid-in capital contributions.

Leverage will stabilize at comparatively low levels with moderate loan growth and continued flow of paid-in capital

Reserve accumulation, moderate loan growth and a consistent history of prepayments have led to a steady decrease in the NADB's leverage following a sustained expansion of its loan portfolio in 2012-16 (see Exhibit 3). In 2023, the NADB's leverage ratio (development-related assets/equity) was 143%, with a three-year average of 133% that scored "aa3." The NADB has one of the lowest leverage ratios among its Aa-rated peers (see Exhibit 4). We expect incoming paid-in capital contributions and the bank's prudent plans for loan portfolio growth to continue over the coming years, keeping leverage low.

Exhibit 3

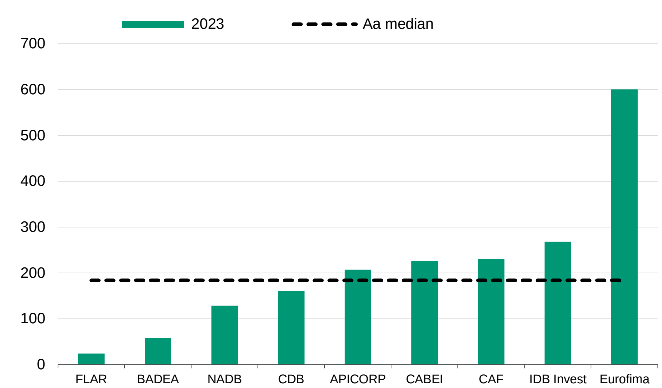
NADB's leverage ratio has stabilized following a multiyear decline
(DRA/equity as %; dotted lines show scoring ranges for capital position)



Sources: NADB and Moody's Ratings

Exhibit 4

NADB's leverage is among the lowest in the Aa rating category
(DRA/equity as %)



Source: Moody's Ratings

The ongoing increase in paid-in capital, which will continue through 2028, is also limiting leverage. In 2016, the governments of the US and Mexico agreed on a general capital increase of $3 billion for the bank, which doubled the subscribed capital to $6 billion. However, disbursements for paid-in capital, which would affect our measure of leverage, were not forthcoming. In April 2020, Mexico and the US agreed on a paid-in capital disbursement schedule that will see a paid-in capital increase from $415 million in December 2019 to $855 million by year-end 2028. This will steadily increase the NADB's usable equity throughout the next decade. As of year-end 2023, paid-in capital had reached $506 million.

Asset quality balances moderate credit quality and mandate-driven portfolio concentration

We assess the NADB's development assets' credit quality as "baa." Our assessment incorporates the weighted average borrower rating of the NADB's loan book, which was Ba1 as of year-end 2023, up from Ba2 in 2022 (see Exhibit 5).

Among all the MDBs that we rate, the NADB faces the highest degree of geographic concentration risk because it only operates in the area around the Mexico-US border — as of year-end 2023, 62% of loans were in Mexico (see Exhibit 6). Over the past decade, the NADB focused on increasing loans to clean energy projects, which contributed to an increase in sector concentration given their larger size (see Exhibit 7). The bank's strategy will shift such that there will be an increased focus in lending to water management-related projects, which will contribute toward reducing the sector concentration over time.

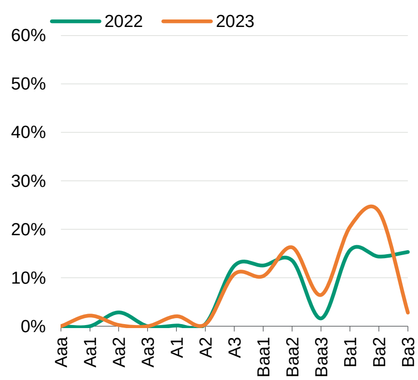
Moreover, given the high degree of sector and geographic concentration, the risk of regulatory changes in Mexico's energy sector was a key credit risk for the NADB as clean energy projects in Mexico make up more than a third of its loan portfolio. The rejection of a constitutional energy reform by the Mexican Congress in 2022 and continued litigation affecting the implementation of the 2021 electricity industry law have reduced risks related to the regulatory environment and operations of the NADB's projects.

The high degree of loan concentration has reduced considerably, with the 10 largest loans extended by the NADB accounting for 50.5% of its portfolio as of year-end 2023, down from 79% in 2012. As the bank continues to expand its operations, the share of the top 10 exposures is unlikely to rise significantly.

Exhibit 5

NADB's credit quality became more dispersed in 2023

(Loan portfolio by rating, % of total)

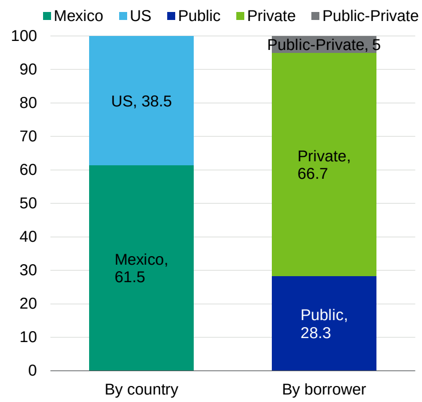


Sources: NADB and Moody's Ratings

Exhibit 6

Portfolio is concentrated in Mexico and the private sector

(Loan portfolio by country and borrower in 2023, % of total)

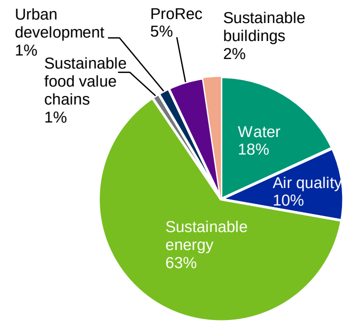


Sources: NADB and Moody's Ratings

Exhibit 7

Portfolio is concentrated in sustainable energy

(Loan portfolio by sector in 2023, % of total)



ProRec is the COVID-19 Recovery Program.

Sources: NADB and Moody's Ratings

Asset performance remains very strong

As of year-end 2023, the NADB did not register any nonperforming loans, in accordance with our definition,[3] although there were some minor equity impairments recognized that should be transitory, contributing to a non-performing asset ratio of 0.1% that scores “aaa” for asset performance. Provisions as a percentage of gross loans were 1.6% as of year-end 2023, down from 2.4% in 2022 and in line with the 1.7% in 2020. The bank's adoption of a new credit risk methodology contributed to the lower provisioning. We expect moderate loan growth and prudent risk management to keep nonperforming loans as a percentage of gross loans low.

FACTOR 2: Liquidity and funding score: aa3

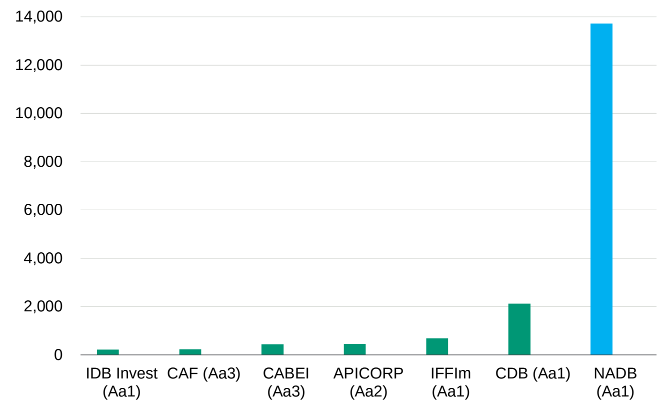
Our “aa3” liquidity and funding score for the NADB reflects its strong liquidity position, one of its key strengths. Limited debt issuance and loan disbursements have led to the accumulation of a substantial liquidity buffer.

Liquidity coverage is very strong because of low borrowing needs

The NADB’s liquidity policy requires that “the minimum amount of aggregate liquid asset holdings is equal to the highest consecutive 12 months of the following 18 months of expected debt-service obligations, plus committed net loan disbursements (if positive), plus projected operating expenses for the relevant fiscal year.” The bank determines a minimum amount before the beginning of the fiscal year and can revise it during the year to account for major changes in the outlook.

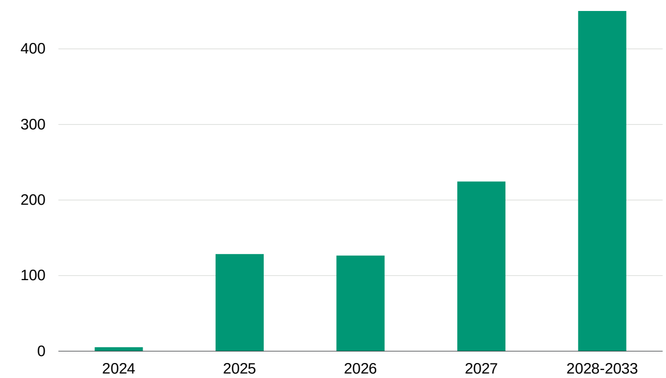
The upshot of the NADB’s liquidity policy is that the bank compares favorably with most Aa-rated peers in terms of liquidity indicators. Most years, the NADB's availability of liquid resources ratio (net cash and liquid assets as a percentage of outflows expected over the next 18 months in a stress scenario without new market issuances or capital contributions from members) is one of the highest among the MDBs that we rate (see Exhibit 8) — scoring “aaa.” Its liquid assets relative to maturing debt also rank among the strongest in its peer group. This is a reflection of the NADB's low leverage and well-spread maturity profile (see Exhibit 9), and its moderate growth plans, which help keep its borrowing needs low.

Exhibit 8
NADB has strong liquidity coverage
(Liquid assets/short term + currently maturing long-term debt, three-year average, latest in %)



Sources: NADB and Moody's Ratings

Exhibit 9
Amortization profile is spaced out, reducing rollover risk
($ million)



Sources: NADB and Moody's Ratings

Another factor supporting the long-term strength of the bank's liquidity position is the fact that one of its reserve funds (part of retained earnings) is a debt-service reserve fund. It ranks first in the order of priority for funding of any of the bank's reserve funds and is maintained in an amount equal to 12 months of interest due on the bank's outstanding debt at each fiscal year-end. The existence of this fund effectively puts aside a portion of total liquid assets for debt service, therefore complementing the liquidity policy and providing additional protection to bondholders.

Funding program is still limited
The NADB's quality of funding indicator scores "a," below the "aa" score that we assign to most of its Aa-rated peers given their longer established track record in issuing debt and larger borrowing programs. However, the bank has updated its green bond framework — this was established in 2018 and last updated in 2020 — and will continue to issue green bonds; it is also studying different issuance options that would facilitate opportunistic issuances.

The NADB's low leverage and small size have led to a modest borrowing program. The bank currently has eight bonds outstanding, issued in three currencies (US dollar, Swiss franc and Norwegian krone). It has also started borrowing in Mexican pesos, which will enable it to continue to diversify its investor base while also increasing efficiencies in currency management between its assets and liabilities.

Qualitative adjustments to intrinsic financial strength

Operating environment
We have not applied qualitative adjustments in our assessment of the NADB's credit profile. The aforementioned risks related to an uncertain regulatory environment in the Mexican electricity sector abated following the Mexican Congress' rejection of constitutional reforms that would have had detrimental effects on Mexico's private energy producers and the NADB's portfolio quality.

Quality of management
The NADB's quality of management is in line with the practices at the MDBs that we rate. In addition to having robust capital adequacy and liquidity risk policies, The bank's management has ensured compliance with these policies, which in turn has resulted in strong credit metrics. The NADB has also made efforts to continue to enhance its risk management capabilities. For example, in 2017, its internal risk department developed and implemented 13 methodologies to assess the credit risk of its loan portfolio based on a review of the bank's historical credit rating standards, Basel II IRB approaches, credit rating agencies' methodologies, industry best practices and current regulatory aspects.

FACTOR 3: Strength of member support score: High

The NADB's score of "High" for strength of member support reflects its shareholders' contractual commitment and ability to provide support in a stress scenario. These strengths are, however, offset by some policy decisions made by shareholders, namely Mexico's energy sector reform proposal that has since been discarded, which weighed on the assessment of non-contractual support, and the fact that the US is an anchor shareholder in numerous other MDBs.

Despite recent weakening, members still have strong ability and willingness to support the bank

The composition of the board of directors, which includes minister-level officials from both federal governments, including the treasury secretaries, coupled with the organization's visible progress in fulfilling its mandate, suggests strong willingness to support the institution. The presence of domestic programs, with the NADB being the only MDB to lend in the US, and the high visibility conveyed by the unique bilateral nature of the organization also suggest strong willingness to support.

In 2016, the board of directors of the NADB and the governments of Mexico and the US agreed to increase subscribed capital to $6 billion from $3 billion, with both countries subscribing in equal amounts. This capital increase process experienced delays and in 2020, following the ratification of the United States-Mexico-Canada Agreement (USMCA), which replaced the North American Free Trade Agreement (NAFTA), the shareholders agreed on a new payment schedule for the paid-in capital, with payments now scheduled to be completed by year-end 2028. The finalized paid-in capital disbursement schedule will see paid-in capital increase to $855 million by year-end 2028 from $415 million in December 2019. The US disbursed all of its scheduled payments ahead of time, but most of the funds are deemed restricted from commitment and will be released over time, in accordance with the agreement between the shareholders. As of December 2023, the US' paid-in capital stood at $263 million. The remainder will be progressively recognized as paid-in capital in the balance sheet following the agreed schedule. As of December 2023, Mexico's paid-in capital was $244 million, bringing total paid-in capital to $506 million. The expected capital contributions will bolster the bank's capital position and provide a buffer against asset-quality pressures.

We consider non-contractual support to be "High." In addition to the support demonstrated through the ongoing capital increase, we expect the 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, to ensure that the members will continue to support the bank. The bank's efforts to tackle challenges to the reliability of clean energy supply and drought affecting water availability in this region will support the ongoing relocation of supply chains to the North American region in future years.

The credit strengths of the NADB's shareholders underpin our member support score. With a weighted average shareholder rating of "a2," the bank has one of the strongest shareholder bases among regional MDBs in the Americas, and compares favorably with most of the regional MDBs outside of Europe. In view of the institution's very small size relative to the combined federal budgets of the two member countries, the costs of a recapitalization in an adverse scenario would likely be negligible.

Binational mandate leads to member concentration risk

Another weakness from the member support perspective is the fact that the organization's shareholder base is inherently highly concentrated. Equally split between its two members, the NADB's ownership structure is the least diversified among MDBs that we rate. The issue of high member concentration is further exacerbated by the close economic links between the two countries. The US accounts for around 80% of Mexico's total exports and most of the stock of foreign direct investment in Mexico, solidifying its position as the largest foreign investor in the country. Given the strong economic links, any episode of widespread economic distress in the US would be followed immediately by economic distress in Mexico, thus diminishing the benefits of shareholder diversification enjoyed by some other MDBs.

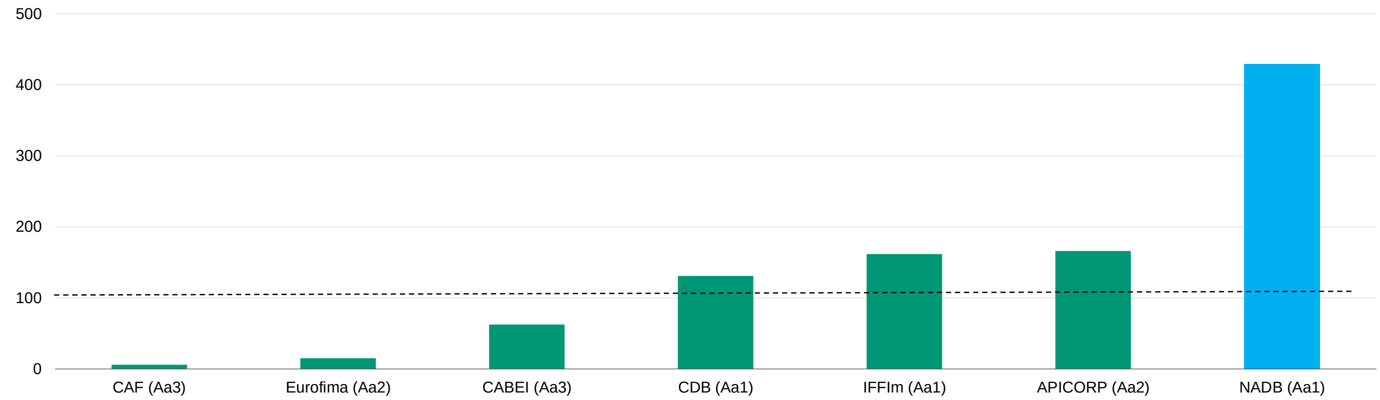
Callable capital continues to provide sizable protection to bondholders

The bank continues to benefit from substantial callable capital, which forms the basis of our contractual support assessment, for which the NADB scores "aaa." Our assessment takes the callable capital from both shareholders (Mexico and the US) and compares it with the NADB's total debt stock. The NADB's low leverage, coupled with the doubling of callable capital in 2016, means that the bank's capital coverage is the second highest among Aa-rated MDBs (see Exhibit 10). Assuming that the shareholders do not amend or rescind their capital pledges in an adverse scenario, callable capital commitments offer sufficient absorption capacity to insulate bondholders from any possible credit losses even if the debt burden were to more than triple from its current levels.

Exhibit 10

NADB's callable capital as a percentage of debt is one the highest among Aa-rated MDBs

(Callable capital as a percentage of gross debt, and dotted line shows the Aa-rated median, latest in %)



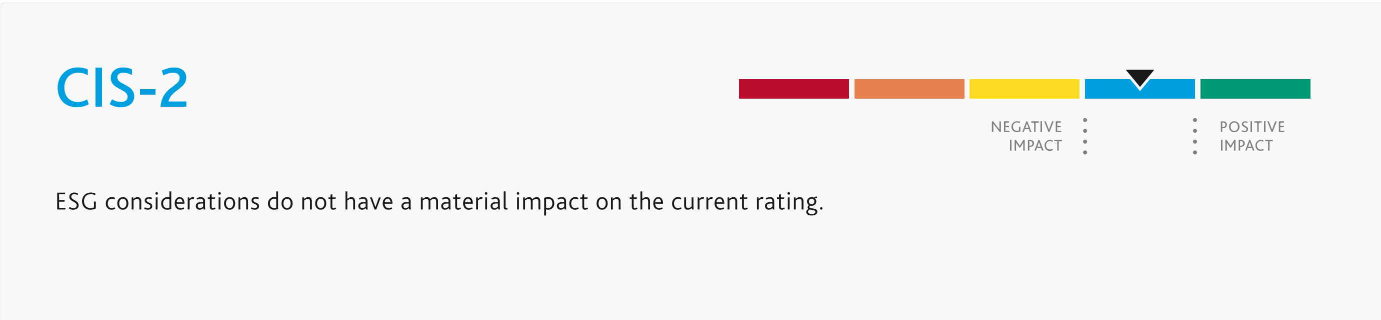
Data are from 2022 for CABEI, CDB, Eurofima and IFFIM.

Source: Moody's Ratings

ESG considerations

North American Development Bank's ESG credit impact score is CIS-2

Exhibit 11
ESG credit impact score



Source: Moody's Ratings

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.

Exhibit 12
ESG issuer profile scores

Source: Moody's Ratings

Environmental

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.

Social

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.

Governance

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.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

All of these considerations are further discussed in the “Detailed credit considerations” section above. Our approach to ESG is explained in our cross-sector methodology General Principles for Assessing ESG Risks. Additional information about our rating approach is provided in our Supranational Rating Methodology.

Recent developments

New Mexican-peso denominated debt financings

During the first quarter of 2024, the NADB issued Mexican peso notes equivalent to $25 million, which will mature in five years. This issuance complements the previous $65 million equivalent in Mexican peso notes issued in Q4 2023, also maturing in 2029. Despite stringent credit conditions in Mexico, the proceeds from these resources enable the bank to diversify its investments into projects requiring Mexican peso financing, potentially yielding high returns. As a result of these issuances, the NADB’s peso treasury continues to expand. This growth began in 2022 when the bank received a loan of $100 million equivalent in Mexican peso, set to mature in 2028. At that time, the net proceeds from this transaction were allocated to financing green projects, in alignment with the bank’s Green Bond Framework.

Loans for water-related projects to increase as a share of the bank's portfolio

In previous years, the NADB consistently disbursed funds primarily for renewable energy projects along the border. However, in 2024, there is a notable shift in the loan disbursement pipeline. Around $100 million is likely to be allocated to water-related projects for this year. Despite this change, the NADB will continue to support other sectors. However, the increased focus on water projects underscores Mexico’s water scarcity challenges, especially in the northern region. As a result, these funds could not only benefit Mexican businesses and households but also send a positive signal to potential investors and businesses considering establishing or relocating operations near the US-Mexico border. This signal is particularly relevant for those who might be hesitant because of the current water scarcity issue.

Rating methodology and scorecard factors: NADB - Aa1 stable

Factor / Subfactor	Metric	Initial score	Adjusted score	Assigned score
Factor 1: Capital adequacy (50%)			aa3	aa3
Capital position (20%)			aa3	
	Leverage ratio	aa3		
	Trend	0		
	Impact of profit and loss on leverage	0		
Development asset credit quality (10%)			baa	
	DACQ assessment	baa		
	Trend	0		
Asset performance (20%)			aaa	
	Non-performing assets	aaa		
	Trend	0		
	Excessive development asset growth	0		
Factor 2: Liquidity and funding (50%)			aa3	aa3
Liquid resources (15%)			aaa	
	Availability of liquid resources	aaa		
	Trend in coverage outflow	0		
	Access to extraordinary liquidity	0		
Quality of funding (35%)			a	
Preliminary intrinsic financial strength				aa3
Other adjustments				0
Operating environment		0		
Quality of management		0		
Adjusted intrinsic financial strength				aa3
Factor 3: Strength of member support (+3,+2,+1,0)			High	High
Ability to support (50%)			a2	
	Weighted average shareholder rating	a2		
Willingness to support (50%)				
	Contractual support (25%)	aaa	aaa	
	Strong enforcement mechanism	0		
	Payment enhancements	0		
	Non-contractual support (25%)		High	
Scorecard-Indicated Outcome Range				Aaa-Aa2
Rating Assigned				Aa1

Note: Our ratings are forward-looking and reflect our expectations for future financial and operating performance. However, historical results are helpful in understanding patterns and trends of an issuer's performance as well as for peer comparisons. Additional considerations that may not be captured when historical metrics are used in the scorecard may be reflected in differences between the adjusted and assigned factor scores. Furthermore, in our ratings we often incorporate directional views of risks and mitigants in a qualitative way. For more information please see our Multilateral Development Banks and Other Supranational Entities rating methodology.

Related websites and information sources

» Moody's Supranational web page

» Moody's Sovereign and supranational rating list

» North American Development Bank web page

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Endnotes

1 The BECC has since been merged with the NADB.

2 Pursuant to its charter, the NADB works closely with border communities, state agencies and other entities to develop affordable and self-sustaining projects in the areas of potable water, wastewater treatment and solid waste management, and on projects aimed at improving air quality, conserving water, reducing energy consumption and developing renewable energy sources, combating climate change and transitioning to a greener economy, among others, located within 100 kilometers (about 62 miles) north or 300 kilometers (about 186 miles) south of the international boundary between the two countries.

3 For comparability across institutions, we include loans with interest or principal payments that are 90 days or more overdue.

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REPORT NUMBER 1412471