MOODY'S INVESTORS SERVICE

CREDIT OPINION
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Update

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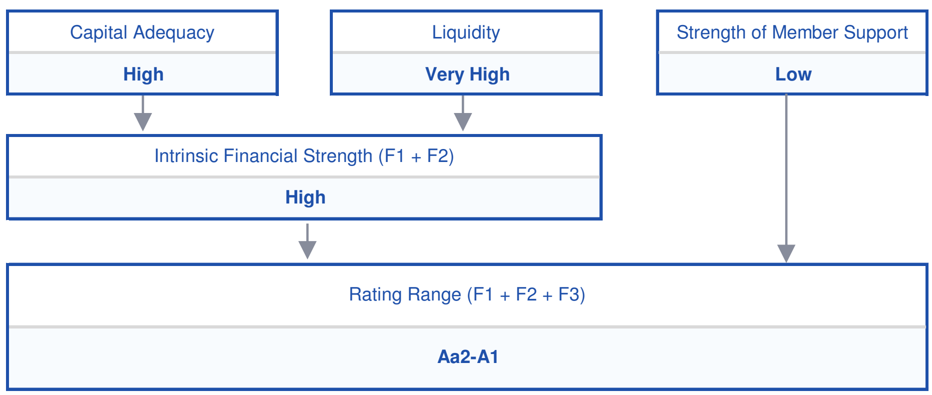
CAF (Corporación Andina de Fomento) - Aa3 Stable

Update following rating affirmation

Summary

Our credit view of CAF balances the development bank's history of strong asset performance and healthy growth with a portfolio that is exposed to low borrower credit quality and higher-than-peers leverage. CAF's credit profile also incorporates its highly liquid position, underpinned by a robust liquidity risk management policy and prudent financial management. While CAF's loan book is subject to concentration risk, it continues to diversify its lending portfolio and shareholder base.

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



Source: Moody's Investors Service

Credit strengths

- Strong willingness of members to provide financial support
- Prudent financial management reflected in diversified funding sources
- Record of strong asset performance and very low non-performing loans (NPLs)

Credit challenges

- Significant, albeit declining, credit exposure to low-rated countries
- Very limited presence of highly-rated shareholders
- Comparably high leverage relative to 'Aa'-rated peers

Rating outlook

The stable outlook reflects our expectation that CAF's capitalization and liquidity levels will remain consistent with its Aa3 rating, as CAF continues to expand its operations, balancing loan growth with adequate liquidity and capitalization buffers. The stable outlook also reflects our expectation that the institution will be able to successfully manage operating and credit risks from its exposure to Venezuela (C stable) and that the sovereign will remain current on its obligations to CAF.

Factors that could lead to an upgrade

Although unlikely in the near future, upward credit pressure would develop if CAF meaningfully reduces its exposure to its lowest rated borrowers, decreases its leverage, and if its capitalization and liquidity ratios demonstrate significant improvement. The inclusion of new non-borrowing highly rated members responsible for a significant amount of callable capital, and that would reduce the correlation between members and assets, would also support improved creditworthiness.

Factors that could lead to a downgrade

The rating outlook would be changed to negative if Venezuela were to be placed on non-accrual status due to missed payments, as it would signal the potential for material pressure on the balance sheet and profitability of the bank over a 12-18 month time horizon.

A subsequent rating downgrade would result if CAF and Venezuela were unable to quickly resolve the missed payments to limit the negative impact on CAF's capital adequacy and liquidity metrics. Downward pressure on CAF's credit profile would also develop if it were to face a strong deterioration in asset quality due to credit events involving other borrowers, or if it were to experience an erosion of its capital and liquidity buffers due to a rapid expansion of its loan book not sufficiently compensated by additional capital contributions.

Key indicators

Exhibit 2

Corporación Andina de Fomento (CAF)	2013	2014	2015	2016	2017	2018
Total Assets (USD million)	27,418	30,458	32,470	35,669	38,112	40,014
Return on Average Assets (%)	0.8	0.5	0.2	0.4	0.2	0.6
Usable Equity/Gross Loans Outstanding + Equity Operations (%) [1]	42.9	45.1	45.9	46.8	46.2	46.4
Gross NPLs/Gross Loans Outstanding (%) [2]	0.0	0.1	0.0	0.5	0.6	0.4
ST Debt + CMLTD/Liquid Assets (%) [3]	52.3	33.1	42.9	34.6	36.1	23.9
Total Debt/Discounted Callable Capital (%) [4]	1,910.9	2,039.9	2,610.2	2,833.7	3,134.1	3,257.6

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

[2] Non performing loans

[3] Short-term debt and currently-maturing long-term debt

[4] Callable capital pledged by members rated Baa3 or higher, discounted by Moody's 30-year expected loss rates associated with ratings

Source: Moody's Investors Service

Detailed credit considerations

On 26 April, we affirmed CAF's Aa3 issuer rating and stable outlook. The key drivers of the affirmation were: (1) CAF's instrinsic financial strength remains robust with solid asset quality, robust capital buffers, improved profitability and liquidity, despite high leverage ratios and (2) exposure to Venezuela continues to be prudently managed as Venezuela remains current on all payments to CAF despite severe economic stress.

We assess **capital adequacy** to be "High," reflecting the robust asset quality and limited leverage, counterbalanced by a moderate capital position due to greater portfolio concentration than other similarly-rated multi-lateral development banks (MDBs). Portfolio concentration and relatively low borrower quality reflect CAF's development mandate and as a result are unlikely to change significantly over the medium term. Nevertheless, prudent financial and risk management has resulted in a strong portfolio performance that is underpinned by a track record of very low nonperforming loans (NPLs).

CAF's asset coverage ratio (ACR) is stable and has improved modestly over the past five years, standing at 46.4% at the end of 2018, compared to 42.8% in 2013. Modest improvements in the ratio are reflective of continued increases in the member base and capital contributions. Strong asset coverage is coupled with close to zero NPLs between 2010 and 2015. Though NPLs rose slightly, averaging 0.5% of the loan portfolio between 2016-18, all incidents of non-performance stemmed from the Bank's non-sovereign-guaranteed loan book and reflect a deterioration in repayment capacity due to currency depreciations throught most of Latin America in 2016.

The two main challenges for CAF remain low borrower quality and a relatively high level of portfolio concentration, consistent with the institution's development mandate and regional role. CAF's top five borrowers account for over half of the lending portfolio. However, CAF has made progress in diversifying its operations, particularly in reducing exposure to founding members and single borrower exposure, the latter of which represented 14.3% of the total loan portfolio in 2018, down from 25% in 2005.

Our assessment of **liquidity** is “Very High,” recognizing CAF's strong liquidity position as a result of a conservative liquidity risk management policy. CAF's liquidity policy mandates that it hold at least 12 months net cash requirements (defined as debt service and committed disbursements less repayments), but in practice the institution holds 24 months of net cash requirements, a level that compares favorably with 'Aa' peers, making CAF one of the most liquid 'Aa'-rated multilateral development banks. CAF's average debt service coverage ratio over the past three years is 31.6%, slightly below its rated peers, but has steadily improved since 2010, in line with the 'Aa' median.

Finally, we assess **strength of member support** to be “Low,” reflective of CAF's low amount of callable capital and below average credit quality amongst shareholders. Since the majority of CAF's capital is paid-in, it has limited callable capital. Only 19.9% of CAF's capital is callable; of total callable capital, only 50% was from investment grade (IG) countries in 2018. In 2018, fewer than half of CAF's 19 shareholders were IG, contributing to a Ba1 weighted median shareholder rating. Though this is below the average of almost all of its 'Aa'-rated peers, it does reflect a significant, two-notch improvement since 2006, when the weighted median shareholder rating was two notches lower at Ba3.

Recent developments

Credit metrics remain robust as loan growth continues…

CAF's loan portfolio grew by 6.3% in 2018, bringing total assets to $40.1 billion, comfortably above the Aa-rated median of $6.2 billion. Despite robust lending growth, the Bank's asset coverage ratio (defined as usable equity / total loans) remained steady at 46.4%, up from 42.8% in 2013, supported by the first installment of a new round of annual paid-in capital increases scheduled through 2023. Based on the expected capital payments, we estimate the with a yearly loan portfolio growth of 11% key credit metrics would remain at their current levels. Given that we expect loan growth will be in the 6%-8% range through the end of 2019, capital growth will outpace portfolio growth contributing to improvements in capitalization ratios.

In addition to regular capital increases, the Bank has relied on market debt to fund the growth in its loan portfolio. CAF's debt rose to $23.5 billion in 2018, up from $22.9 billion the year prior. The increase was due to a rise in bond debt, while commercial paper decreased by about 64% to further increase reliance on longer-term debt, decrease rollover risk and guard against the steady rise in global interest rates. Despite increases in debt, leverage (debt / useable equity) has remained relatively steady over the last five years, registering at 198.5% in 2018, above the Aa-median of 106.2%. Nonetheless, CAF's debt service coverage ratio (short-term and currently maturing long-term debt / liquid assets) has declined significantly in recent years, registering at 23.9% in 2018, below the Aa-rated median of 27.2%, and down from 52.3% in 2013.

…despite small recent upticks in non-performing loans

CAF's top five borrowers account for 54% of the lending portfolio in 2018, posing concentration risks. However, CAF has made progress in diversifying its operations, particularly in reducing exposure to founding members and single borrower exposure. The continued gradual diversification of CAF's loan portfolio and prudent risk management is likely to partially offset these potential risks on loan portfolio performance.

Despite concentration risks, CAF's asset performance remains sound. Between 2005 and 2015, CAF's NPLs remained at or near zero save in three years (2011, 2012 and 2014 when they were 0.1% of all loans), and in all instances were due to private sector loan exposure. In 2018, NPLs declined to 0.45% of total loans, after rising slightly to 0.55% and 0.59% in 2016 and 2017, respectively. The small NPLs are primarily the legacy effects of significant currency depreciations in 2016 and weaker economic conditions in some markets hurt private sector borrowers' repayment capacity. Looking ahead, stronger economic activity and stable exchange rates should support asset performance. We expect that NPLs will remain very low even if renewed currency weakness from sharp depreciation weakens borrower repayment capacity.

Concentrated credit risk in the lending portfolio remains well-contained

CAF's third-largest loan exposure is to the Government of Venezuela (C stable), which represented 14.0% of the total lending portfolio at year-end 2018.

CAF's credit risk from exposure to Venezuela is manageable as the sovereign remains current on its loans. In the event that Venezuela, which was downgraded last March, were not current on its repayments, NPLs would likely remain contained below 5% unless the sovereign remained delinquent on repayments for approximately two years, at which point this would begin to weigh on CAF's large existing capital buffers and potentially on its creditworthiness

As of April 2019, Venezuela remained current on all its obligations to CAF, including interest and principal on debt service, and more importantly, on capital contributions in the context of the latest general capital increase program through 2031. Although from time to time Venezuela has been delayed with some scheduled interest payments on loans, the sovereign usually clears up the late payments within a matter of weeks if not days. The delays seem to be mainly related to operating issues, including challenges posed by US sanctions. Because Venezuela remains current on all obligations to CAF despite the severe external liquidity crunch the sovereign is experiencing, it is unlikely that CAF's loan book will be materially affected.

Moreover, we expect Venezuela's debt service on CAF lending to remain under $500 million, as it has since 2011, smaller than the yearly disbursements that the sovereign receives from CAF, resulting in a positive net yearly flow of hard currency to Venezuela.

Rating methodology and scorecard factors

Rating Factors - Corporación Andina de Fomento (CAF)

Rating Factors	Factor Weight	Factor Score
Factor 1: Capital Adequacy	60%	High
Factor 2: Liquidity	40%	Very High
Intrinsic Financial Strength (F1 + F2)	**Preliminary Rating Range**	**High**
Factor 3: Strength of Member Support	+3, +2, +1, 0 notches	Low
Rating Range (F1 + F2 + F3)		**Aa2-A1**
Assigned Rating		**Aa3**

Note: While the information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the rating range. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the indicative rating range.

For more information please see our Multilateral Development Banks and Other Supranational Entities rating methodology.

Footnotes:

(1) Rating Range: Factor 1, Capital Adequacy, and Factor 2, Liquidity, combine according to the weights indicated into a construct we designate as Intrinsic Financial Strength (IFS). A notching system combines IFS and Factor 3, Strength of Member Support.

(2) 5 Ranking Categories: Very High, High, Medium, Low, Very Low.

Moody's related publications

» **Rating Action:** Moody's affirms CAF's Aa3 rating; maintains stable outlook, 26 April 2019

» **Rating Action:** Moody's affirms Aaa.mx rating of Corporacion Andina de Fomento (CAF), 26 April 2019

» **Credit Analysis:** Corporacion Andina de Fomento - Aa3 stable, 24 September 2018

» **Issuer Comment**: Exposure risks to Venezuela vary, but strong buffers contain negative credit pressures, 7 June 2018

» **Rating Methodology**: Multilateral Development Banks and Other Supranational Entities, 17 September 2018

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