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Corporacion Andina de Fomento (CAF) - Aa3 stable

Annual credit analysis

OVERVIEW AND OUTLOOK

The credit profile of Corporación Andina de Fomento (CAF) reflects the development bank's ample market access as well as the strong performance of its loan portfolio despite its high exposure to low-rated borrowers. High levels of paid-in capital have not only led to improved capital adequacy, but also reflect members' strong commitment to the bank's mandate. Very strong asset quality continues to support portfolio quality, with nonperforming loans consistently below 1% of total loans. CAF's preferred creditor status has helped ensure that debt owed to the bank is excluded from debt restructurings carried out by official debtors. CAF serves as a lender of last resort to some of its members.

CAF's strengths are offset by its continued high exposure to its lowest-rated members, the absence of Aaa-rated members, and low levels of callable capital, which result in capital adequacy ratios that remain marginally weaker than peers despite recent improvements. These challenges reflect CAF's development mandate, which exposes its loan portfolio to a high degree of regional concentration and results in narrow profitability as the institution seeks to provide its members with the lowest possible cost of funding.

Upward credit pressure on CAF's rating is unlikely unless CAF meaningfully reduced exposure to its lowest-rated borrowers, decreased its leverage, and if its capitalization and liquidity ratios improved significantly. The inclusion of new highly rated non-borrowing members responsible for a significant amount of callable capital, which reduced the correlation between members and assets, would also support improved creditworthiness.

Conversely, downward credit pressure would arise if the Venezuela (senior unsecured C stable) exposure were to cause a deterioration in asset performance due to missed payments, as it would signal the potential for material pressure on the balance sheet of the bank over a 12-18 month time horizon. Negative pressure would also develop if CAF 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 for by additional capital contributions.

This credit analysis elaborates on CAF's credit profile in terms of capital adequacy, liquidity and funding and strength of member support, which are the three main analytical factors in Moody's Supranational Rating Methodology

Organizational structure and strategy

CAF was established in 1970 by five original member countries: Bolivia (B2 stable), Colombia (Baa2 negative), Ecuador (Caa3 stable), Peru (A3 stable) and Venezuela. CAF's establishing agreement was amended in 2005 to allow other Latin American countries to become full members. As a result, the bank now has 19 member countries – 13 full members and six associated members. In addition to the five original member countries, Argentina (Ca stable), Brazil (Ba2 stable), Panama (Baa2 stable), Paraguay (Ba1 stable), Trinidad and Tobago (Ba1 negative) and Uruguay (Baa2 stable) have joined as full members along with Mexico (Baa1 negative) and Costa Rica (B2 negative), which were the two most recent countries to transition to full membership in November 2020 and March 2021, having previously held associated member status. The following countries are presently associated members of CAF: Barbados (Caa1 stable), Chile (A1 negative), the Dominican Republic (Ba3 stable), Jamaica (B2 stable), Portugal (Baa3 positive) and Spain (Baa1 stable), as well as 13 commercial banks. Management has indicated that the member base could expand marginally, particularly into Central America and the Caribbean.

All 13 full member countries are both series "A" and "B" shareholders, while associated members are series "C" shareholders. All commercial bank members are series "B" shareholders but hold less than 1% of total shares. The new full members are each allowed to appoint one principal director to the board of directors, while the founding members are allowed to appoint two directors each. The other member countries that hold series "C" shares are entitled to elect two principal directors collectively.

Although it is still officially named Corporacion Andina de Fomento, CAF prefers to go by its acronym and refers to itself as "the Development Bank of Latin America" to reflect its broadening membership, which is no longer confined to the Andean region. In addition to the 19 current member countries, Italy (Baa3 stable) and Guatemala (Ba1 negative) have signed Letters of Intent to become future shareholders. Suriname (Caa3 negative) and El Salvador (B3 negative) have approached CAF about potentially becoming members, while the Dominican Republic has committed to increasing its paid-in capital to become a full member.

CAF's mission is to support sustainable development and economic integration among its shareholder countries by helping them diversify their economies, making them competitive and making them more responsive to social needs. CAF seeks to encourage foreign investment and capital market development, promote the expansion of regional trade and exports, and support the development of small and medium-sized enterprises. However, its principal activity is to provide loans to finance economic and social infrastructure projects as well as working capital and trade activities in its shareholder countries (see Exhibit 1). Available products include short-, medium-, and long-term loans, co-financing arrangements, guarantees and selected equity investments. While the large majority of its loan operations are to the public sector, CAF offers its products to both member states and to the public and private financial institutions and corporations that operate within them.

Among the privileges afforded to CAF when operating within shareholder countries are the following: (1) free convertibility and transferability of assets; (2) exemption from all kinds of restrictions, regulations, control and moratorium measures; (3) immunity from expropriation; and (4) exemption from taxes.

Exhibit 1

Loan portfolio by industry segment

	2020 Amount (in million USD)	% of Total	2019 Amount (in million USD)	% of Total
Infrastructure	18,522	66%	15,299	58%
Electricity, gas and water supply	6,482	23%	7,022	26%
Financial intermediation	2,733	10%	3,914	15%
Other activities	164	1%	199	1%
Manufacturing industry	60	0%	82	0%
Total	27,961	100%	26,516	100%

Source: CAF

CREDIT PROFILE

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, the first two factors combine to form the assessment of intrinsic financial strength. Additional factors that can impact the intrinsic financial strength, including risks stemming from the operating environment or the quality of management, are also considered. The strength of member support is then incorporated to yield a rating range. For more information please see our Supranational Rating Methodology.

Capital adequacy score: a2

Factor 1: Capital adequacy

Scale	aaa	aa1	aa2	aa3	a1	a2	a3	baa1	baa2	baa3	ba1	ba2	ba3	b1	b2	b3	caa1	caa2	caa3	ca	c	
+						Assigned																-

Sub-factor scores

Capital position	a3
Development asset credit quality	ba
Asset performance	aaa

Capital adequacy assesses the solvency of an institution. The capital adequacy assessment considers the availability of capital to cover assets in light of their inherent credit risks, the credit quality of the institution's development assetsand the risk that these assets could result in capital losses.

Note: In case the Adjusted and Assigned scores are the same, only the Assigned score will appear in the table above.

We assess CAF's capital adequacy to be "a2," which incorporates the institution's modestly leveraged capital position and "ba" development asset credit quality (DACQ), the latter of which reflects CAF's high portfolio concentration and relatively low borrower quality. Portfolio concentration and 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 strong portfolio performance that is underpinned by a track record of very low nonperforming assets (NPAs), even in the midst of severe credit stress among some of the institution's largest borrowers.

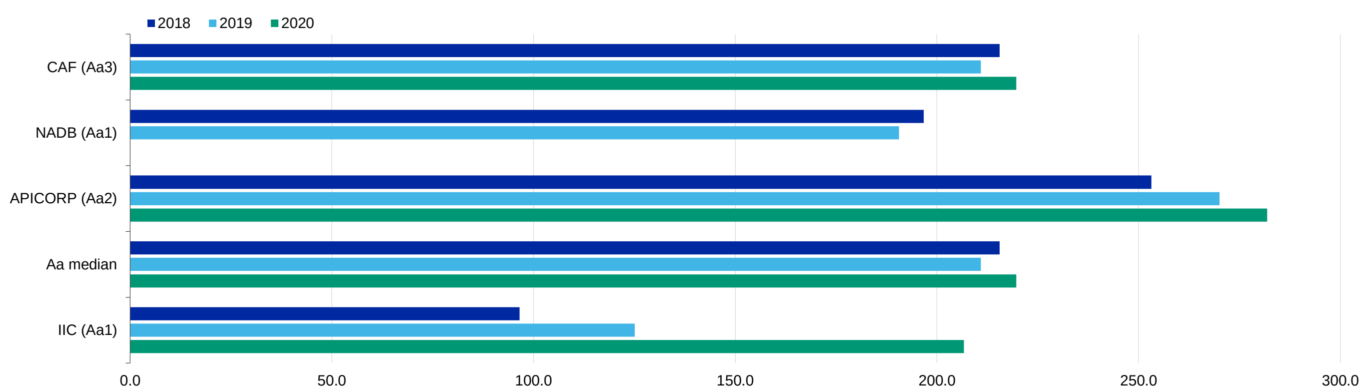
Capital position reflects modest leverage

CAF's capital position incorporates the coverage of development-related assets (DRAs) in relation to its available capital. An institution's leverage ratio is measured as DRA-to-usable equity. CAF's leverage has been stable and has improved modestly over the past five years, standing at 220% at the end of 2020, down slightly from 240% in 2012 and comparable to the Aa-rated median (see Exhibit 2).

Exhibit 2

CAF's leverage remains in line with peers

DRA-to-usable equity, %



Source: Moody's Investors Service

CAF's debt rose to $28.2 billion in 2020 from $25.5 billion the prior year. The increase was largely driven by a $1.7 billion net increase in bond debt and, to a lesser extent, increased issuance of commercial paper, which rose to $1.6 billion last year, up from $908 million in 2019. Notwithstanding the recent uptick in reliance on commercial paper, CAF has gradually reduced its reliance on short-term paper over the last five years in an effort to shift its funding base toward longer-term debt and to further decrease rollover risk. Bond obligations comprised 88% of total debt (relative to 79% in 2015), while the remainder is commercial paper (6%) and other financial obligations (6%).

Usable equity, the denominator for the leverage ratio, rose to $13.0 billion in 2020 from $12.8 billion in 2019 and $11.9 billion in 2018, reflecting the continued increase in its member base and capital contributions. CAF's capital adequacy and leverage is bolstered by high levels of paid-in capital relative to total subscribed capital, given that in 2020 66.3% of capital was paid, 14.1% was unpaid subscribed[1], and 19.6% was callable.[2]

CAF's modest leverage reflects regular capital injections from members. Shareholder countries agreed to a program of three capital increases in 2007-17, which raised $6.3 billion in total. In November 2015, CAF's board approved a new general paid-in capital increase of $4.5 billion with contributions beginning in 2017, such that payments into the institution's capital base will continue just as the previous capital increase programs end. The capital increase would allow CAF to maintain its current capital adequacy ratios with a loan portfolio growth of 11%. We expect that loan growth will remain below 8%, which would support a modest improvement in capital adequacy. The compound annual growth rate of the loan portfolio from 2016 to 2020 was 6.4%. In 2020, loan growth ticked up modestly to 6.0% from 5.6% in 2019 as the pandemic increased regional demand for multilateral financing. Nonetheless, loan growth in 2020 remained below the 6.7% annual average of the preceding five-year period (2015-19).

We expect demand for credit from public sector borrowers and sovereigns to remain above average as fiscal deficits throughout CAF's operating region widen, owing to the effects of the coronavirus outbreak. CAF offers members very favorable terms and can approve projects quicker than other MDBs that lend within the region, suggesting that many sovereigns will likely turn to CAF for additional borrowing. Moreover, the technical assistance and the financing for projects that CAF provides is of great value to borrowers, particularly in the current context where reactivating regional economies will require a great effort following extensive lockdown measures throughout Latin America.

Profitability remains above recent historical average despite 2020 dip

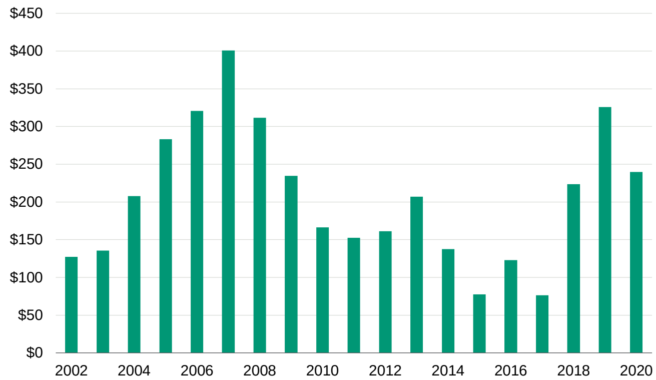
Net income dipped 26% to $239.9 million in 2020, down from $325.6 million in 2019 (see Exhibit 3). The decrease was largely driven by a much lower interest rate environment and its negative impact on net interest income. The decrease was also partly driven by a negative base effect from last year's atypically high realized gains from trading activity in CAF's treasury portfolio. Despite the decline, the strong performance of the last three years offsets a multiyear decline in net income, partially the result of a change in accounting for contributions to stockholders' special funds, which brought payments on to the balance sheet for the first time beginning in 2015.

Accordingly, return on average assets (ROA) and return on equity (ROE) fell to 0.5% and 1.9% in 2020, down from 0.8% and 2.6% the year prior, respectively, but above their 2015-19 averages of 0.4% and 1.5%. Profitability has closely tracked LIBOR movements in recent years, despite the change in accounting for contributions to special funds (see Exhibit 4).

Exhibit 3

Despite 2020 dip, CAF's net income has rebounded from multiyear declining trend

Net income, $ million

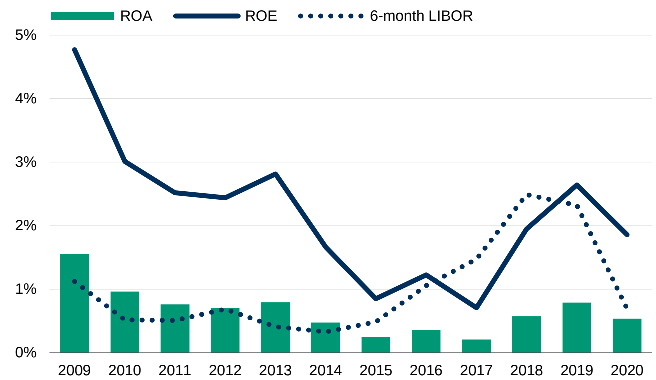


Source: CAF

Exhibit 4

LIBOR and profitability margins are closely correlated

%



Sources: CAF, Haver, Intercontinental Exchange and Moody's Investors Service

Net interest income is the major driver of profitability and its performance is strongly linked to LIBOR. When the LIBOR rate decreases, treasury assets yield lower returns as does the loan portfolio, more than offsetting the decline in CAF's financing costs. We expect the historically low interest rate environment to persist through the next year, which will negatively impact CAF's earnings on its treasury and loan portfolios. However, CAF's cost of funding will likely decline such that profitability will remain broadly stable to marginally lower.

Development asset credit quality is constrained by low ratings of sovereign borrowers and portfolio concentration

Our assessment of CAF's DACQ is constrained by a low borrower quality, which is partially mitigated by a strong track record of preferred creditor status (PCS), and a moderate degree of portfolio concentration.

Largest sovereign borrowers have faced increased credit pressures but continue to demonstrate PCS towards CAF

The two main credit challenges for CAF remain low borrower quality (which, by design, is consistent with the institution's mandate) including its exposure to Venezuela, and a relatively high level of portfolio concentration. Borrower quality, as measured by the weighted average borrower rating, is low for CAF. This is because the majority (69%) of outstanding loans were to non-investment grade countries in 2020, and has remained relatively steady over the last five years. Concurrently, the weighted average borrower rating remains below investment grade. CAF has made great strides in diversifying country exposure within its portfolio, but the top five geographic exposures – Ecuador, Argentina, Venezuela, Colombia and Brazil – still account for 59% of the portfolio (see Exhibit 5).

Exhibit 5
CAF's portfolio exhibits moderate concentration
Loan portfolio by country, 2020

	US$ million	% of total
Ecuador	4,122	14.7
Argentina	3,725	13.3
Venezuela	3,200	11.4
Colombia	2,795	10.0
Brazil	2,621	9.4
Bolivia	2,546	9.1
Panama	2,076	7.4
Peru	1,525	5.5
Paraguay	1,086	3.9
Trinidad and Tobago	1,049	3.8
Uruguay	991	3.5
Mexico	885	3.2
Costa Rica	564	2.0
Chile	460	1.6
Barbados	170	0.6
Dominican Republic	145	0.5
Spain	0	0.0
Jamaica	0	0.0
Gross loans	27,961	100.0

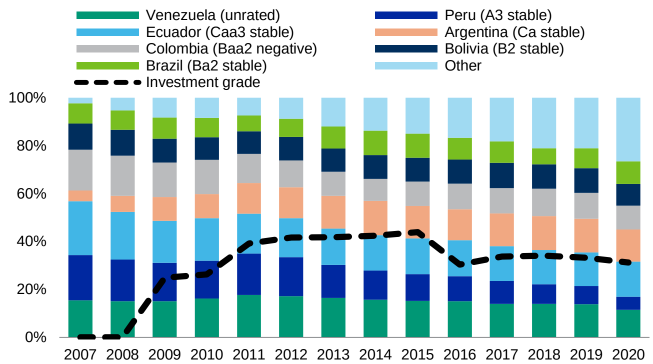
Source: CAF

Loan portfolio continues to gradually diversify

The vast majority of CAF's loans are to sovereigns (90%)[3], with non-sovereign loans[4] making up 10% of the portfolio. As a regional development bank, CAF lends primarily to Latin American countries, with the exception of small loans to Spain and Portugal, which have been repaid. The most significant concentration risk for the bank relates to the fact that its top ten country exposures make up 88% of the loan portfolio; the top five exposures amount to 59% of the portfolio – but these traits are common in regional MDBs.

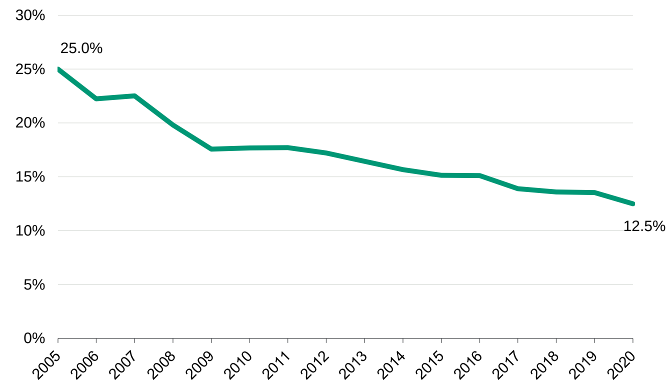
Nevertheless, management continues to diversify the loan portfolio. Whereas the five founding members comprised 93% of total lending in 2006, they now comprise only 51%. This diversification stems from increased lending to Argentina, Brazil, and other non-founding members (see Exhibit 6). Moreover, at its peak in 2005, the largest single exposure represented over 25% of the portfolio, but management has made a concerted effort to bring this number down to 12.5% in 2020 (see Exhibit 7), a historical low. Finally, whereas CAF lent to non-investment grade countries through 2008, as of 2020, 31% of loans were to investment-grade countries.

Exhibit 6
CAF continues to diversify the loan portfolio
Loan portfolio by country, % of total



Sources: CAF and Moody's Investors Service

Exhibit 7
Management has reduced the single-largest country exposure in the loan portfolio
Single-largest loan exposure, % of loan portfolio



Sources: CAF and Moody's Investors Service

Strong asset performance is a key credit strength

Despite the fact that CAF is controlled by its borrowing member countries, it maintains strict underwriting standards, as reflected in the strong performance of its portfolio, including loans to the private sector. Strong asset performance is a key credit strength that reflects prudent risk management and a strong sense of ownership by borrowing countries that serves as a strong incentive to fulfill their commitments to the institution.

Aside from strict underwriting standards, member countries with limited financing options view CAF as a lender of last resort. When Ecuador defaulted on two global bonds in 2008, or when it restructured 10 global bonds in 2020, it did not default on its debt owed to CAF. Moreover, both Ecuador and Peru (in the 1980s) remained current on their obligations to CAF even while they defaulted or were in arrears on their obligations to other MDBs, including the World Bank (IBRD, Aaa stable) and the Inter-American Development Bank (IADB, Aaa stable). Therefore, CAF is not only a preferred creditor, but is also a preferred creditor among MDBs.

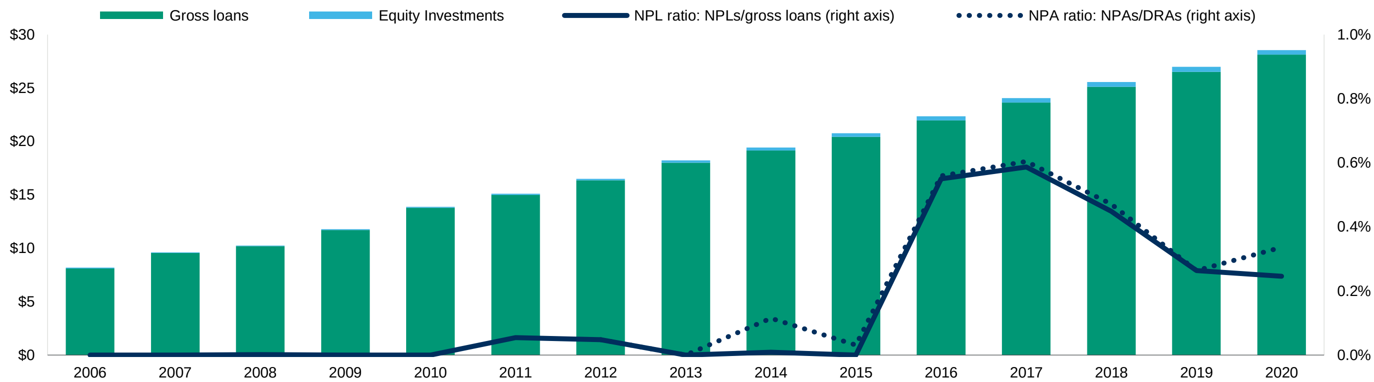
Per our methodology, we measure asset performance through the ratio of nonperforming assets (NPAs) to total development-related assets (DRAs), which includes the performance of loans, guarantees and equity investments. However, since CAF has relatively minimal equity exposure (just $433 million in 2020) and no guarantees, its asset performance is largely a reflection of the strength of its lending operations.

CAF has had virtually no nonperforming loans (NPLs) despite the rapid growth of its portfolio and the low credit quality of some of its public sector borrowers. Although CAF registered NPLs (totaling 0.05% of its DRA) in 2011-12 for the first time since 2005[5], the NPL ratio went back down to zero in 2013. NPLs remained at virtually zero until 2016-17, at which point repayment capacity from lower quality non-sovereign borrowers deteriorated due to currency depreciations throughout most of Latin America. There have been no new NPLs since, leading to a steady decline in the NPL ratio, which fell to 0.2% in 2020, down from 0.3% the year prior. However, a small equity impairment last year led to a modest rise in the NPA ratio, which reached 0.34%, up from 0.26% in 2019 (see Exhibit 8).[6]

Exhibit 8

CAF's asset performance is very strong and its minimal NPLs are declining

$ billion - left axis, percent of total loan portfolio - right axis



Sources: CAF and Moody's Investors Service

The bank's loan loss allowance increased modestly to roughly $95 million in 2020 (0.3% of $28 billion loan portfolio), up modestly from $92 million in 2019, but well above the $62 million in average annual provisioning over the preceding five-year period. The increase in loan loss provisions reflects management's preparedness strategy in the event that the deterioration in credit quality across some of CAF's largest borrowers continues. We believe that deteriorating credit quality as a result of a lagged pass-through from the coronavirus shock within CAF's operating region could push NPLs slightly higher, and as a result, CAF is likely to continue increasing provisions, albeit at a slower pace, in anticipation of any potential deterioration in credit quality. We expect that NPLs are likely to remain stable at current levels, but even if they were to rise in 2021-22, they should remain contained well below 2% of gross loans.

Although CAF does not recognize public sector loans as impaired until they are 180 days past due (a comparatively liberal threshold relative to our 90-day threshold), no loans were overdue aside from the impaired loans noted above. Management reports that no public sector loan has ever been more than a few days late, and in those cases the delay was simply due to administrative problems.

Proactive measures have mitigated risks from Venezuela exposure

CAF has actively managed the credit risk from exposure to Venezuela, even before the sovereign defaulted on its external debt in 2017 and through its lengthy, ongoing crises.

In March 2020, in anticipation of the potential incurrence of NPLs from Venezuela, CAF approved the Support Program for Liquidity Management in Exceptional Situations. The program allows CAF to repurchase Venezuela's shares in the corporation, and apply those proceeds toward debt service owed by the sovereign to CAF. Member countries that undergo an economic contraction of more than 15% for three consecutive years, go through a three-year inflationary process with more than 100% annual inflation, and/or see a reduction in official international reserves to less than six months of import cover, can become eligible for the program if they meet any two of those conditions.

Venezuela met all three conditions and was subsequently incorporated into the program. As of December 2020, CAF had repurchased roughly $646 million of Venezuela's shares and applied it to an equivalent amount of debt service as it had come due from Venezuela's loan portfolio, effectively preventing the sovereign from falling into non-accrual status and preserving CAF's strong asset performance ratios. As more debt service comes due, CAF will likely continue applying the policy until Venezuela is able to make debt service payments, or until all of its shares have been bought and applied against debt service payments. In the event this happens, Venezuela will still retain its participation in the Board as a founding member, but will be ineligible to access new loans until the shares bought by CAF are reacquired.

By the end of 2020 the plan had reduced Venezuela's shareholding in CAF to 11.5% from just under 16% in 2019. The program has since been closed and as such would not be available to other borrowers in distress.

Although unconventional and despite the reduction in capital and loans related to Venezuela from implementing the plan, CAF's balance sheet has not compressed. This reflects CAF's continued profitability and inflow of fresh capital from the latest general capital increase program and the expansion of the membership base. We anticipate that CAF will avoid a compression of its balance sheet in the coming years until Venezuela's capital has been exhausted. However, once Venezuela's capital is exhausted, an accumulation of NPLs from Venezuela is likely, should there be no change in the sanctions that remain in place against the country. This is likely to exert pressure on CAF's creditworthiness.

Liquidity and funding score: aa2

Factor 2: Liquidity and funding

Scale	aaa	aa1	aa2	aa3	a1	a2	a3	baa1	baa2	baa3	ba1	ba2	ba3	b1	b2	b3	caa1	caa2	caa3	ca	c	
+			Assigned																			-

Sub-factor scores

Liquid resources	**aaa**
Quality of funding	**aa**

An entity's liquidity is important in determining its ability to meet its financial obligations. We evaluate the extent to which liquid assets cover net cash flows over the coming 18 months and the stability and diversification of the institution's access to funding.

Note: In case the Adjusted and Assigned scores are the same, only the Assigned score will appear in the table above.

CAF's "aa2" liquidity and funding is supported by strong liquidity coverage that scores "aaa" and a quality of funding assessment of "aa." The "aa2" liquidity and funding score is in line with APICORP (Aa2 stable) and Eurofima (Aa2 stable).

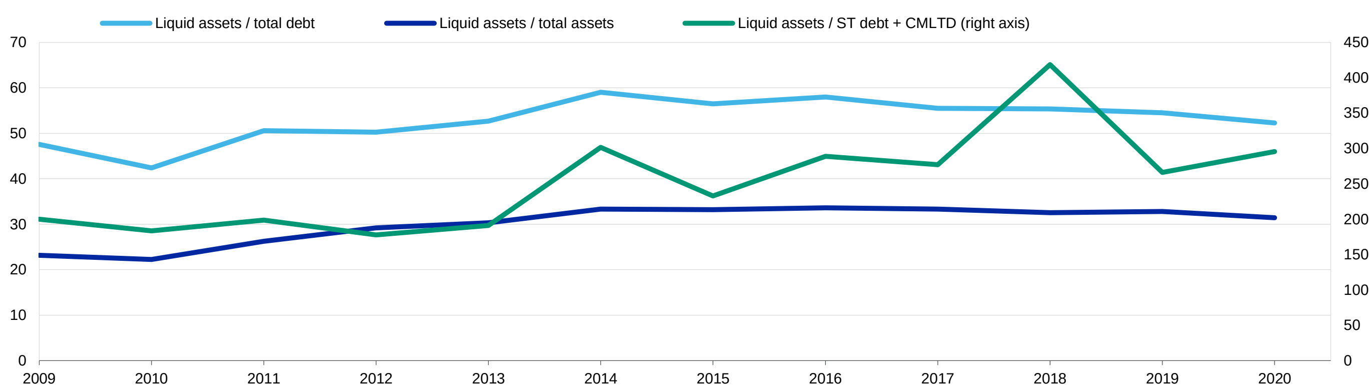
CAF's highly liquid position provides strong coverage of debt and operations

Since most MDBs are not eligible to access emergency lines offered by central banks, we assign a high value to strong liquidity positions in the credit assessment of MDBs. CAF's liquid resources ratio, which sizes its high-quality liquid assets relative to its net outflows from uninterrupted net loan disbursements, debt repayment and administrative costs, scores "aaa" and shows that the bank holds enough liquid assets to sustain operations for more than 18 months. CAF's liquid asset coverage of currently maturing debt payments over the past three years is 327%, which is above the 305% median for Aa-rated MDBs, and liquidity indicators have steadily improved since 2010 (see Exhibit 9).

Exhibit 9

Liquidity position indicators have improved over the last ten years

%



Source: Moody's Investors Service

Robust liquidity policy underpins CAF's liquid treasury portfolio and position

CAF's strong liquidity position is the result of its conservative liquidity policy, which was updated in September 2014 to bring it more in line with the bank's established practice of over-compliance with its previously more relaxed minimum liquidity requirements. The policy requires CAF to maintain sufficient liquid assets to cover at least 12 months of net cash requirements. Net cash requirements include committed disbursements and debt service minus loan collections and committed paid-in capital payments to be received from shareholders. That compares to the previous policy, which required the bank to hold the greatest of (1) 45% of the undisbursed total of committed project loans; (2) 35% of debt service plus gross expected disbursements over the next 12 months; or (3) 25% of total financial liabilities. Total liquidity as of December 2020 covers 24 months of net cash requirements, with liquidity standing at more than twice the minimum liquidity required under the more stringent liquidity policy, suggesting that CAF could stay out of funding markets for two years and still fulfill all its debt servicing commitments during that time.

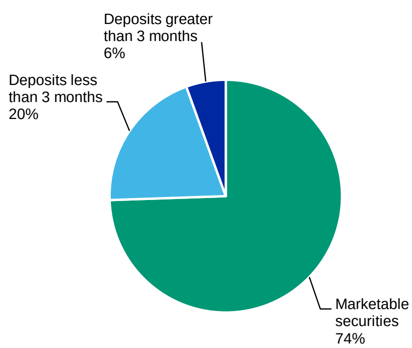
Even prior to the revision of the liquidity policy, CAF regularly maintained liquid assets well above the minimum requirement. On average over the 12 years when the previous policy was in effect, liquid assets have been double the minimum requirements. By the end of 2013, they approached three times the minimum requirements.

CAF's highly liquid treasury portfolio also reflects its conservative liquidity policy. As of year-end 2020, the bank held $14.7 billion in total liquid assets, which were comprised of $11.0 billion in marketable securities (74% of total liquid assets), $2.9 billion in deposits with a maturity of less than 90 days (20%) and $811 million in deposits with a maturity of greater than 90 days (6%; see Exhibit 10). CAF's marketable securities have an average maturity of just 1.11 years and are primarily invested in highly rated financial institutions and corporate bonds. As of year-end 2020, nearly the entire portfolio was invested in securities rated A3 or higher (see Exhibit 11).

Exhibit 10

CAF's liquid assets are primarily held in its trading portfolio and short-term deposits

CAF's liquid assets by type, % of total, 2020

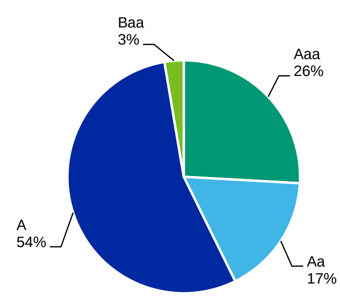


Source: CAF

Exhibit 11

CAF's liquid assets are invested in high credit quality instruments

Treasury portfolio by rating, % of total



Source: CAF

Reliance on short-term funding and deposits has fallen

While bonds comprise the majority of CAF's financial liabilities, the institution also relies on short-term funding obtained through its two commercial paper (CP) programs and deposits, which accounted for about 5% and 10% of total liabilities, respectively, as of 31 December 2020. Management seeks to mitigate the risk of a loss of access to short-term funding by maintaining separate CP programs in the US and Europe, and uses both actively. As of 31 December 2020, CAF had a total of nearly $1.6 billion in CP outstanding, up from $908 million the year prior, but in line with the $1.6 billion annual average in 2015-19 period.

Consistent and diversified access to capital markets and private funding

CAF's credit profile is supported by a relatively high quality of funding, which we score “aa,” reflected by its regular access to the capital markets across a wide range of currencies.

CAF's management recognizes the importance of establishing and maintaining strong market access and has made concerted efforts to develop diversified sources of funding. CAF has an established and recognized presence in the international capital markets and has demonstrated its ability to raise funds in difficult market conditions. The bank's broad access to capital markets has resulted in favorable funding costs and attests to investor appetite for a range of medium and long tenors as well as good secondary market trading for its debt issuances. Aside from Venezuela-related uncertainty in 2019, CAF's bond-implied rating is relatively stable and since

2015, has generally fluctuated between Aa3 and A3. The gap between the bond-implied rating (BIR) and CAF's rating has narrowed significantly since mid-2012. However, the negative association with Venezuela (where CAF's headquarters are located), has weighed marginally on the CAF's financing conditions since late 2017 when Venezuela first defaulted on its external market debt.

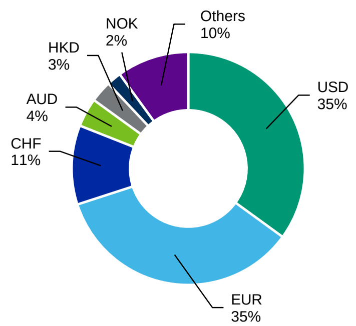
CAF benefits from significant diversification in the financial markets that it accesses. As of 31 December 2020, CAF had $24.9 billion in bonds outstanding across 16 different currencies. Nearly half of its 2020 borrowing program consisted of dollar-denominated issuances, with most of the remainder issued in euros, yen and swiss francs. The top three currencies in which CAF issues debt (US dollar, euro, and Swiss franc) represent about 86% of outstanding bond debt (see Exhibit 12). CAF's debt issuances also enjoy healthy demand from a stable investor base, with central banks and long-term pension and insurance funds holding about 42% of CAF's outstanding bonds (see Exhibit 13).

Virtually all of CAF's debt is swapped to US dollars. In addition, CAF's access to the markets allows it to opportunistically lock in funding costs for its longer-term project financings. In 2020, the average cost of market borrowings after swaps was 1.35%.

Exhibit 12

CAF has an established market presence across many currencies

Outstanding bonds by currency, % of total

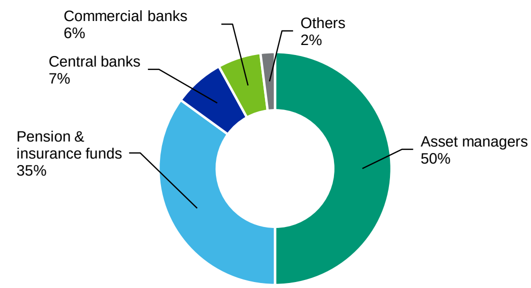


Sources: CAF and Moody's Investors Service

Exhibit 13

CAF benefits from a diverse and relatively stable investor base

Investor by type, % of total



Sources: CAF and Moody's Investors Service

The bank has also forayed into the green bond market. In 2016, the bank issued its first ever thematic bond, a "water bond," to fund specific water projects. CAF officially began its Green Bond Program in 2018 and now has approximately $950 million in green bonds outstanding. The framework follows the Green Bond Principles and has a second party opinion from Sustainalytics that certifies its compliance with international best practices. CAF issued three green bonds in 2018 via private placement in US dollars and Colombian pesos, while in 2019 CAF issued a EUR750 million bond maturing in 2026.

CAF's management expects that its cost of funding will continue falling over the next several years due to a shift in its investor base that has led to greater interest on the part of central banks, which it expects will enable it to bring down yields even further. It also plans to increase the size of its issuances to improve secondary market liquidity, although it will take some time before larger issuance sizes have a meaningful impact on CAF's average cost of funding, which continues to trend down slowly.

Qualitative adjustments

Qualitative adjustments to intrinsic financial strength

Adjustments	
Operating environment	0
Quality of management	0

The capital adequacy and liquidity and funding factors represent the key drivers of our assessment of an institution's intrinsic financial strength (IFS). However, assessments of the operating environment and the quality of management are also important components of our analysis. To capture these considerations, we may adjust the preliminary IFS outcome that results from the capital adequacy factor and the liquidity and funding factor. The result of this analysis is the adjusted IFS outcome.

We do not apply any negative adjustments to CAF's intrinsic financial strength due to its operating environment. CAF's operating environment is likely to become more challenging in 2021 given the macroeconomic shock caused by the coronavirus crisis, which will put negative credit pressure on Latin American and Caribbean sovereigns. However, we do not expect a material deterioration in terms of asset performance. The drop in commodity prices, oil in particular, has mostly reversed after the initial shock, and exchange rates have stabilized throughout the region as external accounts adjusted and absorbed the initial shock from the drop in external demand that was later offset by the decline in domestic demand and import compression.

As previously discussed, CAF has strong liquidity management policies and effective risk management practices, the latter of which is exemplified by the prudent management of its lending exposure to Venezuela. We make no adjustment for the quality of management.

Strength of member support score: Low

Factor 3: Strength of member support

Scale		Very High	High	Medium	Low	Very Low	
	+				Assigned		-

Sub-factor scores

Ability to support	b3
Willingness to support: Contractual	caa3
Willingness to support: Non-contractual	Very High

Shareholders' support for an institution is a function of their ability and willingness. Ability to support is reflected by the shareholders' credit quality. Willingness to support takes into consideration (1) the members' contractual obligations that primarily manifest in the callable capital pledge, a form of emergency support, and (2) other non-contractual manifestations of support to the institution's financial standing and mission. Strength of member support can increase the preliminary rating range determined by combining factors 1 and 2 by as many as three scores.

Note: In case the Adjusted and Assigned scores are the same, only the Assigned score will appear in the table above.

We assess CAF's strength of member support as “Low.” The ability of the bank’s membership to provide support – as proxied by the weighted average shareholder rating (WASR) – is low, reflecting the relatively low credit quality and limited fiscal space of the bank's largest shareholders. At the same time, since the majority of CAF's capital is paid-in, it has limited callable capital, further constraining contractual member support. However, limited shareholder ability to provide extraordinary support is partially offset by a strong and demonstrated willingness to support the institution, as evidenced by its preferred creditor status and regular capital contributions from its membership base.

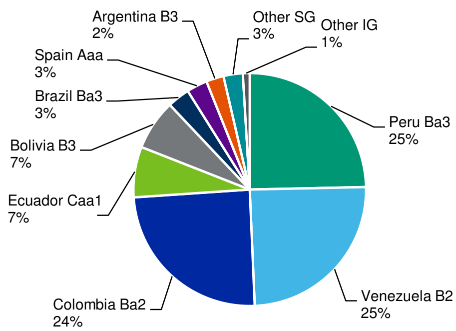
Ability to provide extraordinary support is moderate

We measure ability to provide extraordinary support using the WASR, which in the case of CAF was B2 as of end-2020. The bank's WASR is down from its 2014 high of Ba2, as the credit quality and ratings of some of its largest shareholders deteriorated in the years following the end of the commodity supercycle. As such, it is lower than APICORP’s WASR of Ba1 and lower than those of nearly all its Aa2 and Aa1-rated peers, except FLAR, which has a B3 WASR as a result of its similar membership exposure to low-rated sovereigns in the region. CAF’s relatively low WASR implies that its members would find it more difficult than peers to provide extraordinary support to the bank should it become necessary.

To overcome the membership base's high concentration in low-credit quality sovereigns in South America, CAF has sought to increase the participation of higher credit quality sovereigns from outside the region. In November 2020 and February 2021, Mexico and Costa Rica joined the bank as full member shareholders, unlocking $1.8 billion in additional paid-in capital contributions through 2035 and allowing CAF to expand its lending operations outside South America. The new, extra-regional sovereign memberships follow the Dominican Republic's 2018 formal expression of interest to join as a full member. While capital contributions are relatively small compared to the capital base, we expect these diversification efforts to lead to a marginally higher credit quality capital base over the long term.

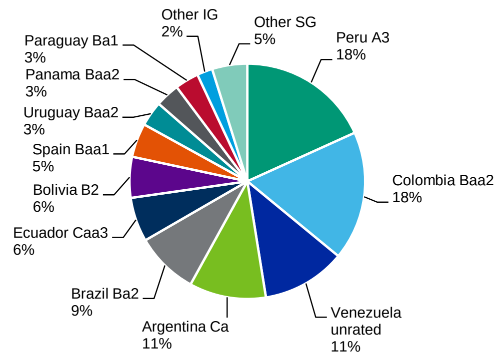
Despite meaningful progress over the years, the majority of CAF's capital and shareholder base remains below investment grade (IG). In 2020, of the total 19 shareholders, fewer than half (8 out of 19) were IG. In 2005, CAF’s only shareholder countries with IG ratings were Chile, Mexico and Spain. While all three have remained IG, in 2020 Colombia, Panama, Peru, Portugal and Uruguay were IG as well. Nevertheless, CAF is different from all of the more highly rated MDBs in that it has no 'Aaa' or 'Aa' shareholders (see Exhibits 13, 14 and 15).

Exhibit 14
CAF's shareholder base has also diversified...
Shareholder base, 2005



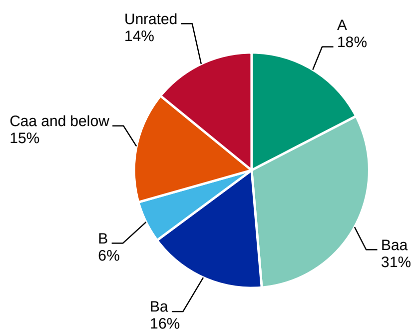
Sources: CAF and Moody's Investors Service

Exhibit 15
...and now includes modestly more investment-grade sovereigns
Shareholder base, 2020*



*ratings as of 1 April 2021
Sources: CAF and Moody's Investors Service

Exhibit 16
Just under half of subscribed capital is investment grade
Subscribed capital by rating category, % of total, 2020



Sources: CAF and Moody's Investors Service

Contractual support from members is low...

In our assessment of strength of member support, we also consider the members willingness to provide contractual support, as measured by callable capital coverage of the debt stock. Since the majority of CAF's capital is paid-in, it has limited callable capital. Only 19.6% of CAF's capital is callable. As a result, callable capital only covers 5.6% of CAF's outstanding stock of debt, resulting in a very low level of contractual support.

...but members have strong willingness to provide extraordinary, non-contractual support

CAF's greatest credit weaknesses, the absence of highly rated non-borrowing members from outside the region and low levels of callable capital, are arguably also the root of one of its key strengths. CAF is a development institution in which its borrowers are also its shareholders. This results in members' very strong willingness to support the institution. Although not counted as 'contractual support' in our Supranational Rating Methodology, the bank's high level of paid-in capital reflects this commitment, as do the significant capital increases to which members have subscribed over the last few years. Absent the recent capital increase, relatively high levels of capital contributions through 2020 would have shortened the distance to the limit of authorized capital, eventually curtailing lending growth. The continued capital increase programs demonstrates members' commitment to CAF and affords the institution more room to boost its future operations and fulfill its countercyclical mandate.

ESG considerations

How environmental, social and governance risks inform our credit analysis of CAF

Moody's takes account of the impact of environmental (E), social (S) and governance (G) factors when assessing supranational issuers' credit profile. In the case of CAF, the materiality of ESG to the credit profile is as follows:

Environmental considerations are not material for CAF's rating. However, we note that as part of its mission, CAF has committed to increase its lending for projects that look to address or mitigate climate change risks in the Latin America region.

Social considerations are not material for CAF's rating. We do not expect social risks affecting its borrowers to affect CAF's capital adequacy or liquidity.

Governance considerations are material. CAF's governance, and in particular its risk management policies and practices, are strong and in line with similarly rated MDBs.

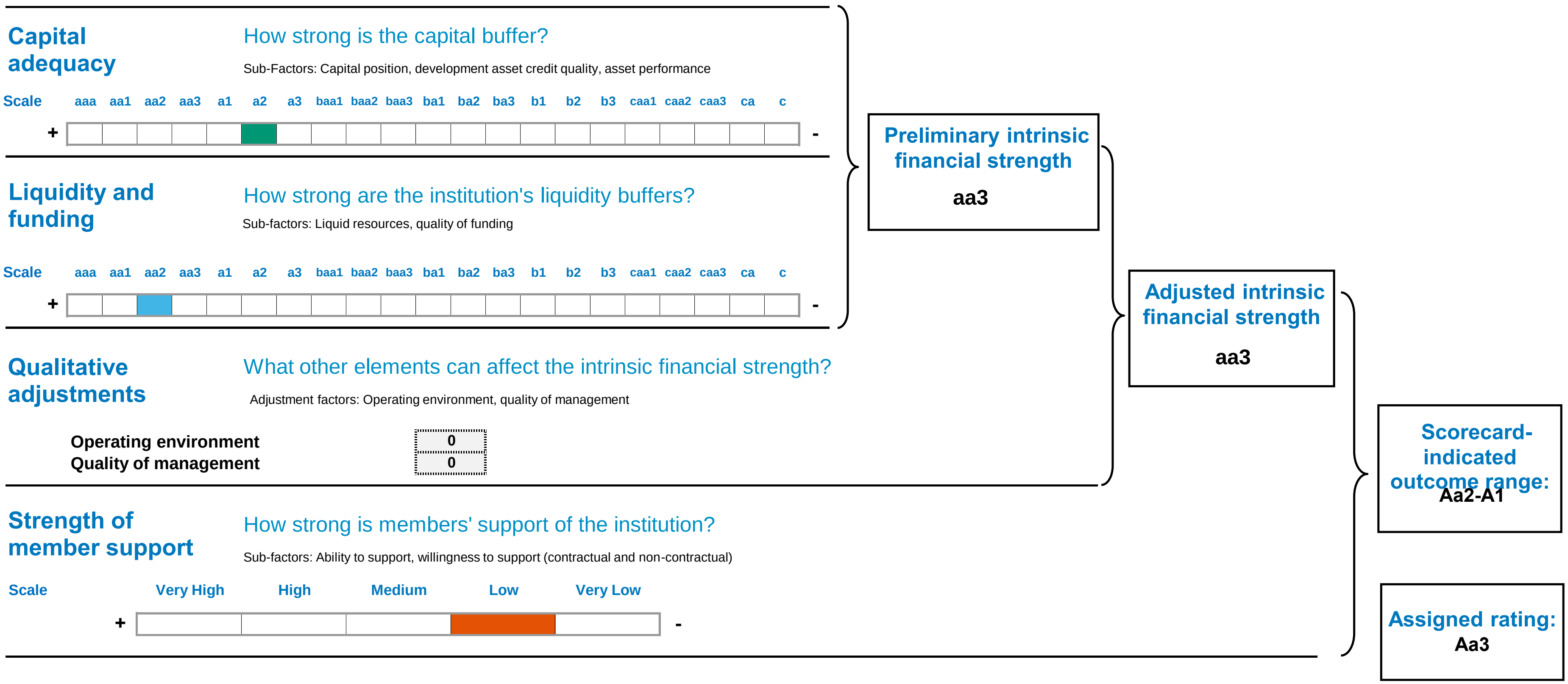
All of these considerations are further discussed in the "Credit profile" section above. Our approach to ESG is explained in our cross-sector methodology General Principles for Assessing ESG Risks. Additional information about our rating approach is provided in our Supranational Rating Methodology.

Rating range

Combining the scores for individual factors provides an indicative rating range. 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 Supranational Rating Methodology.

Exhibit 17

Supranational rating metrics: CAF



Source: Moody's Investors Service

Comparatives

This section compares credit relevant information regarding CAF with other supranational entities that we rate. It focuses on a comparison with supranationals within the same rating range and shows the relevant credit metrics and factor scores. Healthy lending growth increased CAF's total assets to $43 billion in 2019, about five times the Aa-rated median. Growth of the loan portfolio has been partially funded through increased debt, and has a contributed to a DRA/usable equity ratio of 210.9%, in line with most Aa-rated peers. CAF's liquidity position remains robust as a result of a conservative liquidity policy, which leaves the bank with enough liquid assets to maintain 24 months of operations. However, a key credit weakness is CAF's low strength of member support, with a b2 WASR, one of the lowest among Aa-rated MDBs.

Exhibit 18

CAF key peers

	Year	CAF	CABEI	FLAR	APICORP	NADB	IDB Invest	Aa Median
Rating/Outlook		**Aa3/STA**	**Aa3/STA**	**Aa2/STA**	**Aa2/STA**	**Aa1/NEG**	**Aa1/STA**	
Total assets (US$ million)	2019	42,294	11,611	6,775	7,349	2,007	3,900	9,480
Factor 1: Capital adequacy		**a2**	**a1**	**a2**	**a2**	**a3**	**a2**	
DRA / Usable equity[1] [2] [4]	2019	210.9	224.6	41.4	270.1	190.6	125.1	210.9
Development assets credit quality score (year-end)	2019	ba	baa	b	a	baa	ba	baa
Non-performing assets / DRA[1]	2019	0.3	0.0	30.2	1.7	1.1	0.6	0.6
Return on average assets[4]	2019	0.8	2.0	1.9	1.6	1.5	1.2	1.0
Net interest margin (X)[4]	2019	1.1	2.3	1.3	1.8	2.1	2.9	1.2
Factor 2: Liquidity and funding		**aa2**	**aa2**	**aa3**	**aa2**	**aa3**	**aa2**	
Quality of funding score (year-end)	2019	aa	aa	baa	aa	a	aa	aa
Liquid assets / ST debt + CMLTD[3][4]	2019	266.1	353.8	0.0	386.5	295.2	5,497.1	295.2
Liquid assets / Total assets[4]	2019	32.8	33.9	79.2	34.0	37.5	34.9	34.0
Preliminary intrinsic financial strength (F1+F2)		**aa3**	**aa3**	**a1**	**aa3**	**a2**	**aa3**	
Adjusted intrinsic financial strength		**aa3**	**a1**	**a1**	**aa3**	**a2**	**aa3**	
Factor 3: Strength of member support		**L**	**M**	**L**	**H**	**H**	**M**	
Weighted average shareholder rating (year-end)	2019	b2	ba2	b3	ba1	a1	ba2	baa3
Callable capital / Total debt	2019	6.2	54.4	--	22.7	392.2	--	89.5
Callable capital (CC) of Baa3-Aaa members/Total CC[4]	2019	54.7	38.0	--	61.0	100.0	--	91.3
Scorecard-indicated outcome range (F1+F2+F3)		**Aa2-A1**	**Aa2-A1**	**Aa3-A2**	**Aaa-Aa2**	**Aa2-A1**	**Aa1-Aa3**	

[1] Development related assets
[2] Usable equity is total shareholder's equity and excludes callable capital
[3] Short-term debt and currently-maturing long-term debt
[4] Ratio not used in Scorecard
Source: Moody's Investors Service

DATA AND REFERENCES

Rating history

Exhibit 19

CAF[1]

	Issuer Rating		Senior Unsecured	Outlook	
	Long-term	Short-term			Date
Outlook Changed				STA	04/26/2019
Outlook Changed				STA	10/26/2017
Outlook Changed				STA	09/16/2015
Rating Raised	Aa3		Aa3		06/29/2012
Rating Raised	A1		A1		06/30/2005
Outlook Assigned				STA	11/15/2003
Rating Assigned		P-1			12/18/2002
Rating Raised	A2		A2		05/02/2001
Rating Raised	A3		A3		06/04/1997
Review for Upgrade	Baa2		Baa2		01/17/1997
Rating Raised	Baa2		Baa2		01/19/1996
Rating Assigned	Baa3				12/21/1994
Rating Assigned			Baa3		06/04/1993

Notes: [1] Table excludes rating affirmations. Please visit the issuer page for CAF for the full rating history.
Source: Moody's Investors Service

Annual statistics

Exhibit 20

CAF

Balance Sheet, USD Thousands	2014	2015	2016	2017	2018	2019	2020
Assets							
Cash & Equivalents	3,017,022	3,992,817	2,721,324	3,516,929	3,380,417	3,517,986	3,759,495
Securities	7,130,791	6,787,875	9,267,953	9,194,991	9,654,956	10,357,805	10,961,847
Derivative Assets	383,703	215,509	118,353	532,668	184,805	426,260	1,766,932
Net Loans	18,998,913	20,276,867	21,817,650	23,463,318	24,943,716	26,318,270	27,888,841
Net Equity Investments	292,345	328,390	386,051	433,025	459,667	463,825	432,600
Other Assets	635,397	868,237	1,357,657	970,635	1,390,686	1,209,488	2,036,188
Total Assets	**30,458,171**	**32,469,695**	**35,668,988**	**38,111,566**	**40,014,247**	**42,293,634**	**46,845,903**
Liabilities							
Borrowings	17,191,398	19,081,389	20,679,489	22,906,568	23,545,657	25,459,713	28,153,416
Derivative Liabilities	383,086	808,097	1,021,292	553,594	876,784	642,725	404,842
Other Liabilities	4,120,450	3,056,115	3,494,564	3,529,668	3,728,406	3,394,468	5,292,744
Total Liabilities	**21,694,934**	**22,945,601**	**25,195,345**	**26,989,830**	**28,150,847**	**29,496,906**	**33,851,002**
Equity							
Subscribed Capital	5,804,155	6,511,460	7,219,455	7,987,370	7,989,620	8,095,260	7,867,755
Less: Callable Capital	1,553,660	1,553,660	1,589,660	1,589,660	1,589,660	1,589,660	1,589,660
Less: Other Adjustments	0	466,525	846,250	1,413,415	1,233,240	1,124,885	912,045
Equals: Paid-In Capital	6,161,982	6,845,812	7,673,636	8,243,766	8,761,853	9,369,599	9,327,950
Retained Earnings (Accumulated Loss)	137,639	77,630	122,717	76,399	223,577	325,582	239,822
Accumulated Other Comprehensive Income (Loss)	32	-571	-1,563	0	0	0	0
Reserves	2,463,583	2,601,223	2,678,853	2,801,571	2,877,970	3,101,547	3,427,129
Other Equity	0	0	0	0	0	0	0
Total Equity	**8,763,236**	**9,524,094**	**10,473,643**	**11,121,736**	**11,863,400**	**12,796,728**	**12,994,901**

Source: Moody's Investors Service

Exhibit 21
CAF

Income Statement, USD Thousands	2014	2015	2016	2017	2018	2019	2020
Net Interest Income	**227,638**	**238,532**	**292,510**	**315,674**	**412,778**	**426,563**	**365,386**
Interest Income	526,181	573,216	752,966	925,020	1,234,339	1,367,872	948,407
Interest Expense	298,543	334,684	460,456	609,346	821,561	941,309	583,021
Net Non-Interest Income	**48,927**	**39,918**	**78,855**	**74,023**	**74,646**	**240,496**	**130,273**
Net Commissions/Fees Income	40,868	39,982	31,961	31,845	34,324	34,307	30,330
Income from Equity Investments	3,061	-3,432	10,906	2,824	1,126	-6,523	-19,809
Other Income	4,998	3,368	35,988	39,354	39,196	212,712	119,752
Other Operating Expenses	**117,374**	**182,117**	**210,377**	**243,396**	**250,655**	**289,082**	**252,914**
Administrative, General, Staff	116,678	125,072	140,973	150,135	158,288	154,807	149,324
Grants & Programs1	0	54,000	68,000	92,064	87,830	129,226	72,015
Other Expenses	696	3,045	1,404	1,197	4,537	5,049	31,575
Pre-Provision Income	**159,191**	**96,333**	**160,988**	**146,301**	**236,769**	**377,977**	**242,745**
Loan Loss Provisions	21,552	18,703	38,270	69,902	13,192	52,395	2,923
Net Income (Loss)	**137,639**	**77,630**	**122,718**	**76,399**	**223,577**	**325,582**	**239,822**
Other Accounting Adjustments and Comprehensive Income	349	-603	-992	1,563	0	0	0
Comprehensive Income (Loss)	**137,988**	**77,027**	**121,726**	**77,962**	**223,577**	**325,582**	**239,822**

Source: Moody's Investors Service

Exhibit 22
CAF

Financial Ratios	2014	2015	2016	2017	2018	2019	2020
Capital Adequacy, %							
DRA / Usable Equity	221.8	218.0	213.5	216.3	215.5	210.9	219.7
Development Assets Credit Quality (Year-End)	--	--	--	--	ba	ba	ba
Non-Performing Assets / DRA	0.1	0.0	0.6	0.6	0.5	0.3	0.3
Return On Average Assets	0.5	0.2	0.4	0.2	0.6	0.8	0.5
Net Interest Margin	0.8	0.8	0.9	0.9	1.1	1.1	0.9
Liquidity, %							
Quality of Funding Score (Year-End)	--	--	--	--	aa	aa	aa
Liquid Assets / ST Debt + CMLTD	301.7	233.0	288.9	277.0	418.5	266.1	295.6
Liquid Assets / Total Debt	59.0	56.5	58.0	55.5	55.4	54.5	52.3
Liquid Assets / Total Assets	33.3	33.2	33.6	33.4	32.6	32.8	31.4
Strength of Member Support, %							
Weighted Average Shareholder Rating (Year-End)	Ba2	B1	Ba3	Ba3	B2	B2	B2
Callable Capital / Gross Debt	9.0	8.1	7.7	6.9	6.8	6.2	5.6
Callable Capital (CC) of Baa3-Aaa Members/Total CC	58.8	58.8	51.8	49.6	54.7	54.7	54.7

Source: Moody's Investors Service

Moody's related publications

- **Rating Action**: Moody's affirms Corporacion Andina de Fomento's Aa3 rating, maintains stable outlook, 20 April 2021
- **Credit Opinion**: Corporacion Andina de Fomento – Aa3 stable: Update following rating affirmation, outlook unchanged, 20 April 2021
- **Rating Methodology**: Multilateral Development Banks and Other Supranational Entities, 28 October 2020

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Related websites and information sources

- Sovereign and supranational risk group web page
- Sovereign and supranational rating list
- CAF website

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Endnotes

1 Unpaid subscribed capital is capital that has been subscribed and will be paid in future years.

2 As with most MDBs, CAF has a share of its capital that is callable – an unconditional and full-faith obligation of each member country to provide additional capital for the sole purpose of servicing debt, the fulfillment of which is independent of the action of other shareholders.

3 Sovereign loans include those granted to national, regional, or local governments or decentralized institutions and other loans fully guaranteed by national governments.

4 Non-sovereign loans include those granted to corporate and financial sectors, among others, which are not guaranteed by national governments (for both public and private sectors).

5 There was an isolated NPL in 2008 for $112,359 (0.001% of gross loans) that was quickly resolved.

6 In 2012, a single loan for $4.1 million (0.025% of the total loan portfolio) was written off.

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

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