MOODY'S INVESTORS SERVICE

CREDIT OPINION
21 April 2022

Update

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RATINGS

CAF

	Rating	Outlook
Long-term Issuer	Aa3	STA
Short-term Issuer	P-1	--

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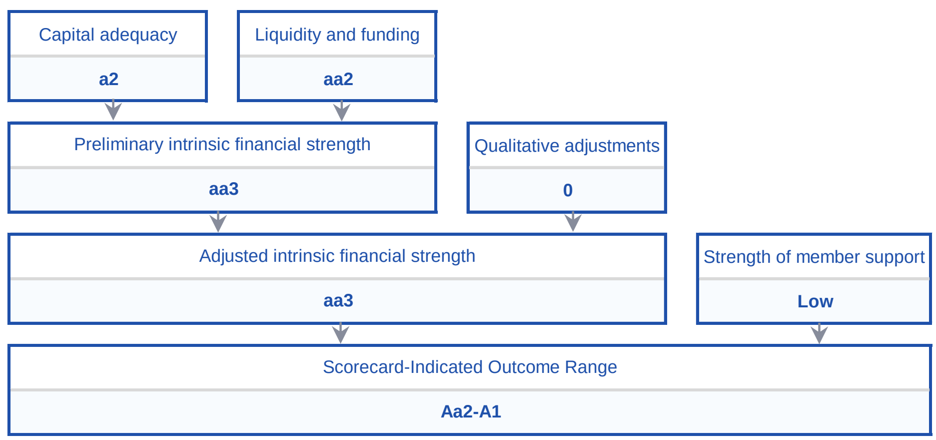
Corporacion Andina de Fomento (CAF) – Aa3 stable

Regular update

Summary

The credit profile of Corporacion Andina de Fomento (CAF) balances the bank's history of strong asset performance and sound growth against its high exposure to low borrower credit quality. CAF's credit profile also incorporates its healthy liquidity, underpinned by a robust liquidity risk management policy and prudent financial management. While CAF's loan book remains concentrated, 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 availability of liquid resources underpinned by a conservative liquidity policy

» Prudent financial management reflected in diversified funding sources

» Record of strong asset performance and very low nonperforming loans (NPLs)

Credit challenges

» Significant, although declining, credit exposure to low-rated countries

» Very limited presence of highly rated shareholders

» Although declining, exposure to Venezuela could weigh on future asset performance

Rating outlook

The stable outlook reflects our expectation that CAF will manage its sustained increase in lending prudently, while maintaining 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will be able to successfully manage operating and credit risks from its exposure to Venezuela (issuer rating withdrawn, senior unsecured C stable). 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.

Factors that could lead to an upgrade

Upward credit pressure on CAF's rating is unlikely, save if CAF were to meaningfully reduced its 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.

Factors that could lead to a downgrade

Downward credit pressure would arise if the Venezuela exposure were to cause a deterioration of 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.

Key indicators

Exhibit 2

Corporacion Andina de Fomento (CAF)	2016	2017	2018	2019	2020	2021
Total Assets (USD million)	35,669.0	38,111.6	40,014.2	42,293.6	46,845.9	47,592.4
Development-related Assets (DRA) / Usable Equity [1]	213.5	216.3	215.5	210.9	219.7	225.8
Non-Performing Assets / DRA	0.6	0.6	0.5	0.3	0.3	0.4
Return on Average Assets	0.4	0.2	0.6	0.8	0.5	0.2
Liquid Assets / ST Debt + CMLTD	288.9	277.0	418.5	266.1	295.6	232.4
Liquid Assets / Total Assets	33.6	33.4	32.6	32.8	31.4	33.9
Callable Capital / Gross Debt	7.7	6.9	6.8	6.2	5.6	5.5

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

Source: Moody's Investors Service

Profile

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. 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.

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, the first two factors combine to form the assessment of intrinsic financial strength, as shown on the cover page graphic. Additional factors can affect the intrinsic financial strength, such as risks stemming from the operating environment or the quality of management. 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: a2

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 relatively high portfolio concentration and 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.

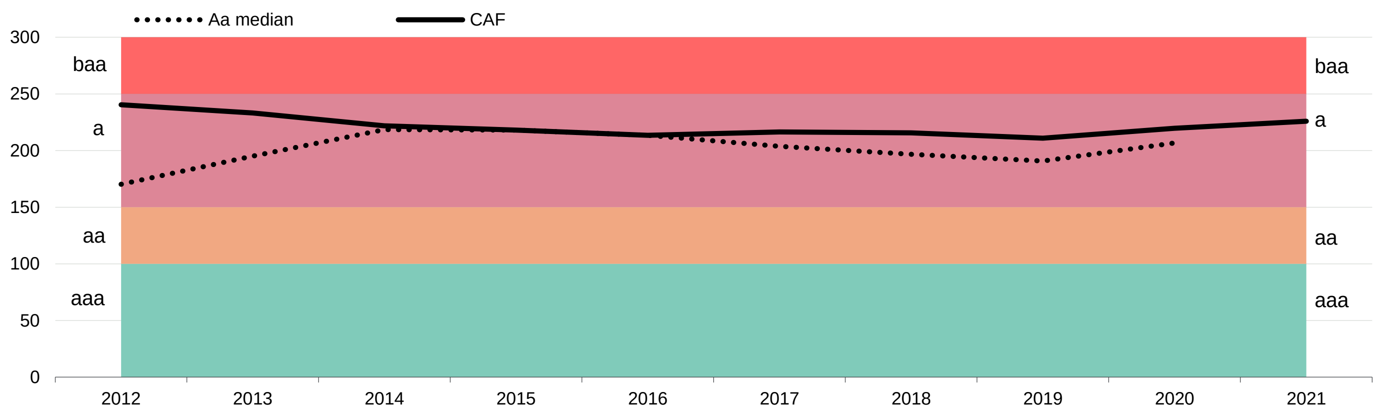
Capital position reflects modest leverage

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 226% at the end of 2021, up from 211% in 2019 but comparable to the Aa-rated median (see Exhibit 3).

Exhibit 3

Various metrics put CAF's leverage in line with peers

DRA/Usable Equity (%)



Sources: CAF and Moody's Investors Service

CAF's debt rose to $28.8 billion in 2021 from $28.2 billion the prior year. The increase was largely driven by the increased issuance of commercial paper, which rose to $2.8 billion last year, up from $1.6 billion in 2020. Notwithstanding the recent uptick in reliance on commercial paper, CAF's usage of short-term paper is lower than in the past, reflecting efforts to shift its funding base toward longer-term debt and to further decrease rollover risk. Bond obligations comprised 84% of total debt (relative to 79% in 2015), while the remainder is commercial paper (10%) and other financial obligations (6%).

Usable equity, the denominator for the leverage ratio, rose to $13.3 billion in 2021 from $13.0 billion in 2020 and $12.8 billion in 2019, 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 2021 70.4% of capital was paid, 9.0% was unpaid subscribed[1], and 20.6% was callable[2].

CAF's modest leverage reflects regular capital injections from members. Shareholders approved CAF's tenth and largest general capital increase to date in March, making available $7 billion in paid-in capital that will facilitate an expansion in lending activities; the compound annual growth rate of CAF's total portfolio from 2017 to 2021 was 5.7%. In 2021, loan growth picked up to 5.9%, compared to 5.5% in 2020.

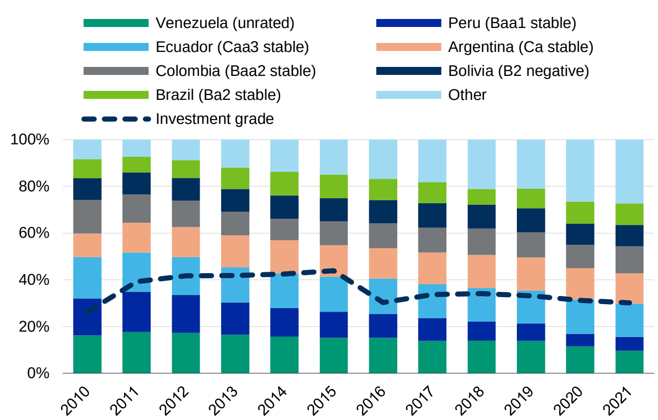
Net income continued to fall in 2021, reaching $105 million in 2021 from $239.8 million in 2020 and $325.6 million in 2019. The two-year reduction in net income was driven by weaker income from interest on interest-bearing securities, as well as income from equity investments, reflecting a lower interest rate environment and volatility in international capital markets.

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.

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 2021, 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 (Caa3 stable), Argentina (Ca stable), Venezuela, Colombia (Baa2 stable) and Brazil (Ba2 stable) – account for 57% of the portfolio (see Exhibit 4). In particular, CAF has actively managed the credit risk from exposure to Venezuela (see Exhibit 5). Efforts began before the sovereign defaulted on its external debt in 2017 and have been continued through its lengthy, ongoing crises without compressing CAF's balance sheet.

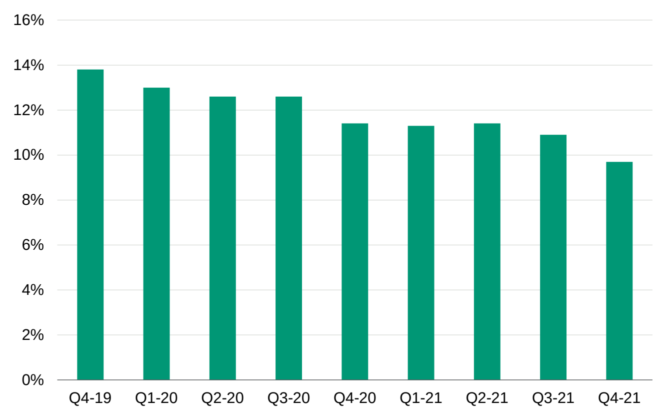
The vast majority of CAF's loans are to sovereigns (90%)[3], with non-sovereign loans[4], making up 10% of the portfolio. The most significant concentration risk for the bank relates to the fact that its top ten country exposures make up 90% of the loan portfolio; the top five exposures amount to 58% of the portfolio – but these traits are common in regional MDBs.

Exhibit 4
CAF continues to diversify its loan portfolio...
Loan portfolio by country, % of total



Sources: CAF and Moody's Investors Service

Exhibit 5
...And reduce its exposure to Venezuela
Venezuela as a % of the loan portfolio



Sources: CAF and Moody's Investors Service

Strong asset performance is a key credit strength
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 2021) and no guarantees, its asset performance is largely a reflection of the strength of its lending operations.

CAF's asset performance is very strong, reflected by our "aaa" score for this metric. Nonperforming loans (NPLs) nearly doubled in 2021 when compared to 2020, rising to $112 million from $69 million, but, relative to CAF's DRAs (0.4%), this figure remains small. Since its inception, CAF has had virtually no NPLs despite sustained growth of its portfolio and the low credit quality of some of its public sector borrowers. Repayment capacity from lower quality non-sovereign borrowers has been impaired in the past, owing to currency depreciation, but NPAs have not yet exceeded 1% of DRAs.

FACTOR 2: Liquidity and funding score: aa2

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).

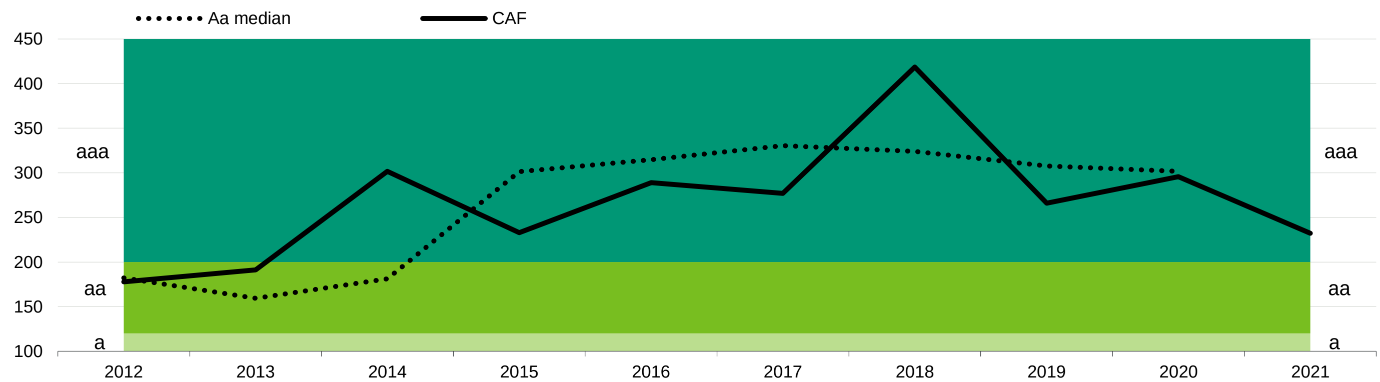
CAF's highly liquid position provides strong coverage of debt and operations

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. Despite falling in 2021, CAF's liquid asset coverage of currently maturing debt payments over the past three years is 265%, which is in line with the median for Aa-rated MDBs (see Exhibit 6).

Exhibit 6

Liquidity remains healthy despite slight dip in 2021

Liquid Assets / Short-term debt and currently maturing long-term debt (%)



Sources: CAF and Moody's Investors Service

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.

Total liquidity as of December 2021 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.

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 has an established and recognized presence in the international capital markets and has demonstrated its ability to raise funds in difficult market conditions. CAF benefits from significant diversification in the financial markets that it accesses. As of 31 December 2021, CAF had $24.3 billion in bonds outstanding across 16 different currencies. The top three currencies in which CAF issues debt (US dollar, Euro, and Swiss franc) represent about roughly 80% of outstanding bond debt.

Qualitative adjustments to intrinsic financial strength

Operating environment

We do not apply any negative adjustments to CAF's intrinsic financial strength due to its operating environment. Although we expect that some shareholder countries are likely to face macroeconomic challenges in the near term, considering elevated consumer prices and more moderate economic growth when compared to 2021, we do not believe these factors will materially weigh on CAF's credit metrics beyond what is already captured by the intrinsic financial strength ratios.

Quality of management

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.

FACTOR 3: Strength of member support score: Low

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 support is moderate

We measure ability to provide support using the WASR, which in the case of CAF was “b2” as of end-2021. This metric declined from “ba3” in 2017. One factor that particularly weighed on this metric in the past few years has been the volatility in the ratings of Argentina and Venezuela, which pulled down the WASR given their important share at 10.2% and 12.4% of total subscribed capital, respectively. Notwithstanding Argentina and Ecuador's rating downgrades in recent years, these governments have made their paid-in capital payments on time, demonstrating their ability to support CAF despite their own macroeconomic challenges.

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 20.6% of CAF’s capital is callable. As a result, callable capital only covers 5.5% 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 recent capital increases, 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 underscores members’ commitment to CAF and affords the institution more room to boost its future operations and fulfill its countercyclical mandate.

ESG considerations

Corporacion Andina de Fomento's ESG Credit Impact Score is Neutral-to-Low CIS-2

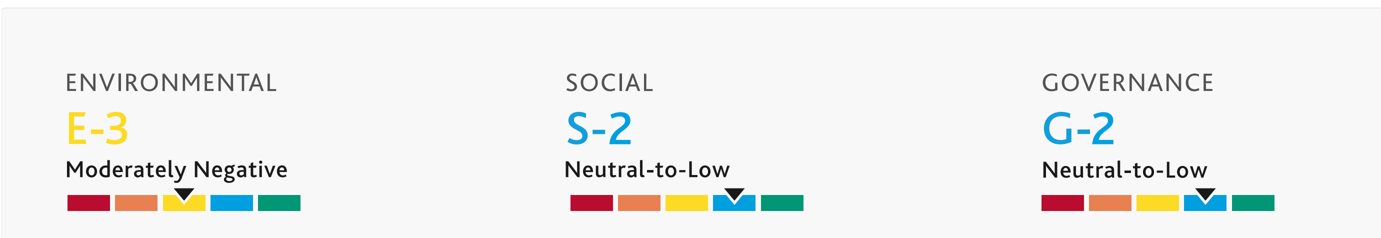
Exhibit 7
ESG Credit Impact Score

For an issuer scored CIS-2 (Neutral-to-Low), its ESG attributes are overall considered as having a neutral-to-low impact on the current rating; i.e., the overall influence of these attributes on the rating is non-material.

Source: Moody's Investors Service

CAF's credit impact score is neutral to low (**CIS-2**) reflecting a moderately negative environmental risk exposure as well neutral-to-low exposures to social and governance risks. Low support by member states could weigh on the entity's resilience.

Exhibit 8
ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental

CAF's environmental issuer profile score is moderately negative (**E-3**) as a result of carbon transition risks through its lending exposure within hydrocarbon-producing countries in Latin America. These risks affect CAF's balance sheet indirectly given that CAF has had a longstanding commitment to developing sustainable projects, including hydroelectric generation and clean energy. Exposure to other environmental risks is neutral-to-low, reflecting CAF's diversified lending exposures throughout Latin America.

Social

CAF's social issuer profile score is neutral-to-low (**S-2**) reflecting a strong track record of customer relations that has helped the institution grow its member base and lending portfolio substantially. CAF's public consultation processes are an integral part of its lending decision and include affected communities and key stakeholders, which supports our assessment of responsible production.

Governance

CAF's governance issuer profile score is neutral-to-low (**G-2**) reflecting its prudent risk management and the pro-active approach to dealing with problematic loan exposures.

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

Shareholders pledge substantial capital increase

In March, shareholders unanimously ratified a $7 billion capital increase, the largest in CAF's history. The paid-in capital subscription will take place in 2022, with $7 billion to be made available for series “A” and “B” shareholders (full member countries) and $500 million for series “C” shareholders (associated members). At end-2021, CAF had a capital base of $13.3 billion that included $9.5 billion in paid-in capital and $3.8 billion in retained earnings and reserves. Contributions will facilitate the expansion of the regional development bank's lending activities and supporting CAF's credit metrics.

The capital increase is evidence of the importance that shareholders ascribe to the institution's role in the region. Indeed, at the same time as CAF's assembly approved the capital increase, it also raised CAF's authorized capital to $25 billion from $15 billion previously. The change will accommodate the general capital increase and also reflects the organization's intention to incorporate new shareholders. El Salvador (Caa1 negative) was approved to be incorporated as a full member in March and the Dominican Republic (Ba3 stable) received the same approval in December 2021 after being an associate member since 2004. Notwithstanding diversification efforts that are likely to lead to a marginally higher credit quality equity buffer over the long term, the majority of CAF's capital and shareholder base remains below investment grade, which remains a key credit challenge.

CAF signals intent to become region's predominant green bank

In line with a trend among other MDBs, CAF expects to play a greater role in climate-related financing. In a statement from December 2021, the board of directors stated its intent to convert CAF into the region's leading “green bank.” CAF intends to allocate $25 billion over the next five years for operations that enhance countries' climate resilience, strengthen conservation efforts, and promote a transition to greener energies. The bank's leadership is also targeting an increase in green financing for CAF, bringing such financing to 40% of its total financing operations in 2026 from 24% in 2020. Consistent with CAF's stated objectives, in January CAF issued a $382 million green bond in the swiss market to finance climate change-related projects.

In our view, climate-related financing and alignment with Paris Agreement goals will increasingly drive lending decisions among larger MDBs. Such institutions are already among the largest financiers of climate adaptation and mitigation and their role as standard-setters for reporting and impact measurement will only grow in the coming years. We expect CAF to fit into this larger trend as it aligns its objectives with the Paris Agreement goals.

Rating methodology and scorecard factors

Exhibit 9

Rating factor grid - Corporacion Andina de Fomento	Initial score	Adjusted score	Assigned score
Factor 1: Capital adequacy (50%)		a2	a2
Capital position (20%)		a3	
Leverage ratio	a3		
Trend	0		
Impact of profit and loss on leverage	0		
Development asset credit quality (10%)		ba	
DACQ assessment	ba		
Trend	0		
Asset performance (20%)		aaa	
Non-performing assets	aaa		
Trend	0		
Excessive development asset growth	0		
Factor 2: Liquidity and funding (50%)		aa2	aa2
Liquid resources (10%)		aaa	
Availability of liquid resources	aaa		
Trend in coverage outflow	0		
Access to extraordinary liquidity	0		
Quality of funding (40%)		aa	
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)		Low	Low
Ability to support - weighted average shareholder rating (50%)		B2	
Willingness to support (50%)			
Contractual support (25%)	caa3	caa3	
Strong enforcement mechanism	0		
Payment enhancements	0		
Non-contractual support (25%)		Very High	
Scorecard-Indicated Outcome Range			Aa2-A1
Rating Assigned			Aa3

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.

Source: Moody's Investors Service

Moody's related publications

» **Outlook:** Multilateral development banks – Global: 2022 outlook is stable given resilience to challenging economic and financial conditions in emerging markets, 31 January 2022

» **Sector In-Depth:** Multilateral Development Banks - Global: ESG credit impact is neutral for most, positive for many MDBs, 18 January 2022

» **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

» Moody's Supranational web page

» Moody's Sovereign and supranational rating list

» Corporacion Andina de Fomento web page

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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).

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