STANDARD & POOR'S RATINGS SERVICES
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African Development Bank

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African Development Bank

Major Rating Factors

Counterparty Credit Rating
Foreign Currency
AAA/Stable/A-1+

Strengths:

- Wide support from members, including 'AAA' rated sovereigns.
- Diversified wholesale funding profile.
- Solid liquidity and capital position.

Weaknesses:

- Relatively risky loan portfolio with some risky sovereign concentrations and nonperforming loans larger than those of multilateral peers.
- Potential earnings and capital volatility from equity investments and other comprehensive income changes

Rationale

Standard & Poor's Ratings Services bases its ratings on African Development Bank (AFDB) on its assessment of the bank's business profile as very strong and financial profile as strong, as Standard & Poor's criteria define these terms. The ratings also reflect our expectation that the bank would receive extraordinary shareholder support through callable capital if necessary. We continue to assess the bank's stand-alone credit profile (SACP) at 'aa'.

Established by a treaty in 1964, AFDB is the keystone of the African Development Bank Group, which includes soft-loan windows, the African Development Fund (AFDF), and the Nigeria Trust Fund (NTF). The banks membership now includes 53 African countries and 25 nonregional countries.

Since 1995, AFDB has restricted its sovereign lending to its more economically developed regional members. However, the bank is expanding the number of countries eligible to receive funding from the bank to 26 countries from 16 because economic conditions for African sovereigns are generally improving--and with the aim of diversifying assets. Twenty-eight members may access only grants or loans, at concessional rates, from AFDF and NTF. These instruments allow AFDB to maintain support for these countries without exposing its balance sheet to the related risks.

AFDB's very strong business profile assessment benefits from its strong and stable relationship with shareholders, as demonstrated by the sixth general capital increase (GCI-VI), which became effective in 2010 and was subscribed by 73 of the bank's 77 member shareholders. The bank also has a strong history of fulfilling its mandate by providing financing for infrastructure development. The strong demand for the bank's lending, which led to a nearly 30% increase in its loan portfolio during the global financial crisis in 2009, has reinforced its role. In 2012 and 2013, sovereign and public-sector lending growth reduced, owing to financial stress experienced by North African sovereigns and the reaching of risk limits in North Africa.

While AFDB has benefited from preferred creditor treatment from many of its borrowing members, it has also experienced arrears and defaults by both public- and private-sector borrowers. We view the bank's private sector growth ambitions as a potential restraint to the business profile if not supported with a strong developmental mandate.

In 2013, private sector operations consumed 28% of the bank's total risk capital, well below the bank's 45% limit. Positively, we believe AFDB's governance and risk management rest on sound principles, and a balanced shareholder composition.

Our assessment of AFDB's financial profile as strong predominantly reflects an improvement in capital adequacy after adjustments.

Standard & Poor's risk-adjusted capital (RAC) ratio, our primary measure for assessing a bank's capital adequacy, was 25% before adjustments for AFDB on Dec. 31, 2013, improving from 24% on Dec. 31, 2012. The change reflects the $500 million encashment of installments of GCI-VI subscriptions and slight shrinkage and a change of the balance sheet mix in 2013, with a 11% rise in equity investments and fund participations (in part reflecting capital calls from funds) and our slight increase in risk weightings, based on our opinion of heightening risks in Africa.

At the same time, our RAC ratio after adjustments for AFDB improved to 17% as of Dec. 31, 2013, from 15% one year earlier, reflecting a decrease in the bank's largest sovereign concentrations relative to its capital. AFDB's five largest exposures remain somewhat high, but reduced to 127% of adjusted common equity (ACE) (outstanding balances/ACE) on Dec. 31, 2013. We expect loan book diversification and innovative capital management to reduce concentrations in the future. Conversely, these actions may also have the unintended result of bringing down asset quality.

AFDB's funding profile remains very diverse in terms of investor base, currency, and maturity. Global benchmark bonds remain the primary source of funding, with alternative sources from domestic markets, Green bonds, Uridashi bonds, private placements, and loans. The bank has a positive funding gap up to, but not beyond, the five-year static gap. Our liquidity ratio shows that AFDB would be able to pay all obligations due over the coming year, without access to capital markets, but it might need to reduce loan disbursements under such an extreme stress scenario.

We incorporate two notches of uplift for extraordinary shareholder support from AFDB's SACP, leading to our 'AAA' long-term rating on the bank. If AFDB made a capital call from its 'AAA' rated shareholders, its cash capital levels could be raised by 1.5x shareholders' equity on Dec. 31, 2013 to a point consistent with an extremely strong financial risk profile.

Outlook

The stable outlook reflects our expectation that the bank will continue fulfilling its mandate, benefiting from preferred credit status, and that the amount and willingness of extraordinary shareholder support to the bank will remain unchanged. We also factor in an expectation that the RAC ratio after adjustments will remain above 15%, as internal capital generation keeps apace with asset growth, and that sovereign concentrations will slowly reduce as private sector exposure and newly eligible sovereign exposures increase. Nevertheless we expect that asset quality (below 3%) and cost of risk (below 1.5%) will be stable and that equity participations will remain at around 15% of shareholder funds and not experience any significant losses. We anticipate no structural changes in funds or liquidity ratios.

We could lower ratings if we come to believe that AFDB's public-policy mandate, potential preferred creditor treatment, or asset quality was weakening as the entity increases private sector or less creditworthy sovereign exposure. We could also lower the ratings if the RAC moved sustainably below 15% after adjustments.

Conversely, the financial profile and SACP could improve in the long term, alongside significant improvements to the RAC after adjustments, as it would provide a greater cushion to risks.

Table 1

African Development Bank Selected Indicators					
	--Fiscal year ending Dec. 31--				
(SDR '000s)	**2013**	**2012**	**2011**	**2010**	**2009**
Balance sheet characteristics					
Liquid assets / adjusted total assets (%)	33.95	35.12	39.59	41.36	45.47
Purpose-related assets (gross) / adjusted total assets (%)	57.68	53.99	47.79	44.74	45.23
Net loans / adjusted total assets (%)	54.49	51.31	45.68	42.72	43.27
Public-sector (including sovereign-guaranteed) loans / total loans (%)	78.00	78.23	80.64	80.72	81.80
Private-sector loans / total loans (%)	22.00	21.77	19.36	19.28	18.20
Other indicators					
RAC ratio after adjustments (%)	17	15	18	N/A	N/A
Static funding gap at 1 year (x)	1.1	1.3	1.4	N/A	N/A
Gross debt / adjusted common equity (x)	2.22	2.49	2.64	2.49	2.23
Short-term debt (by remaining maturity) / gross debt (%)	18.97	25.68	23.00	16.43	14.86
Net income / average adjusted assets (%)	0.35	0.43	0.26	0.37	0.46

SDR--International Monetary Fund special drawing rights. N/A--Not available.

Business Profile: Very Strong

The very strong business profile reflects our view of AFDB's policy importance and its governance and management expertise. We assess the bank's policy importance based on its role, public policy mandate, the strength and stability of the relationship with shareholders, and preferred creditor treatment.

Policy Importance Assessment

AFDB has provided financing for infrastructure development in Africa over the past five decades. The strong demand for the bank's lending during the global financial crisis in 2009 reinforced its role and led to a nearly 30% increase in its loan portfolio over the crisis, reinforcing a countercyclical role the bank played. On a broader scale, AFDB contributes to economic and social progress through the provision of development funding and technical expertise in its African member countries. AFDB also promotes financial sector development in African member countries through regional integration efforts and local currency bond issuances, which provide a cheaper cost of funding infrastructure projects in the domestic markets and also partly mitigate exchange rate risk.

The lending is directed toward African governments and the public and private sectors (see table 2). In recent years, sovereign and public-sector lending has started to grow at a slower pace, due to financial stress experienced by some

African sovereigns and the reaching of risk limits in North Africa, which had been a traditional lending base. North Africa exposures, predominantly Egypt, Morocco, and Tunisia have a combined share of 32% of total outstanding loan exposures in 2013. As a result, the bank has expanded the number of countries eligible to receive funding because economic conditions for African sovereigns are generally improving--and with the aim of diversifying assets. We do not expect rapid growth into these newly eligible countries but we do believe increasing the number of eligible borrowing sovereigns improves the public policy mandate and the role of the bank. The AFDB currently uses the AFDF and NTF to maintain support in countries (28 members) where governments are currently not eligible to borrow from the bank. For instance, 17 African governments are currently eligible to borrow only from AFDB, while 35 members may borrow only from the AFDF and NTF, and two countries are eligible to borrow under both windows. Under a recent revision to the credit policy, some countries currently unable to borrow under the AFDB window may receive limited AFDB resources on a case-by-case basis.

Conversely, AFDB has sought to increase private-sector lending--currently about 28% of the total risk capital in 2013--because it sees private-sector financing as a key contributor to economic growth. At this stage, private-sector lending does not affect our view of AFDB's business profile. However if private-sector lending were to approach the 45% limit, it may start to affect our view of the preferential treatment and public policy mandate if it leads us to expect the recovery of loans or the development mandate to be negatively affected.

Although AFDB has benefited from preferred creditor treatment (PCT) from many of its borrowing members, it has also experienced arrears and defaults by both public- and private-sector borrowers. The Heavily Indebted Poor Countries (HIPC) and multilateral debt relief initiative (MDRI) have helped many of its borrowing members to remain current. As of year-end 2013, 29 of the 33 regional member countries eligible for those two programs qualified for HIPC debt relief and MDRI debt cancellation.

The strength and stability of AFDB's relationship with its shareholders was demonstrated by the GCI-VI, which became effective in 2010 and has been subscribed by 73 of the bank's 77 member shareholders. Subsequently, Turkey in 2013 and Luxemburg in 2014 joined the bank as new shareholders.

Table 2

African Development Principal Business Activities

	--Fiscal year ending Dec. 31--				
(SDR '000s)	**2013**	**2012**	**2011**	**2010**	**2009**
Purpose-related assets (gross) / adjusted total assets (%)	57.68	53.99	47.79	44.74	45.23
Net loans / adjusted total assets (%)	54.49	51.31	45.68	42.72	43.27
Public-sector (including sovereign-guaranteed) loans / total loans (%)	78.00	78.23	80.64	80.72	81.80
Private-sector loans / total loans (%)	22.00	21.77	19.36	19.28	18.20
Letters of credit	N/A	N/A	N/A	N/A	N/A
Total adjusted assets*	20,996,721	21,214,553	20,261,454	19,144,293	17,184,687

*Adjustments made to reported shareholders' equity to calculate adjusted common equity (an institution's cash capital) are carried through to total assets. SDR--International Monetary Fund special drawing rights. N/A--Not available.

Governance And Management Expertise

In our opinion, AFDB's governance and risk management rest on sound principles, and a balanced shareholder composition. All powers of the bank are vested with the board of governors.

AFDB prepares its financial statement in accordance with International Financial Reporting Standards. It received an unqualified opinion on its 2013 annual financial statements, as is the case each year, from its independent external auditors, KPMG Audit France. The bank publishes audited annual financial statements on its website. The bank's financial statements are expressed in units of accounts (UA). Under the agreement establishing the bank, UA1 is defined as the equivalent of International Monetary Fund (IMF) special drawing rights (SDR) 1 (approximately US$1.5). The largest single vote holder in the bank at year–end 2013 was Nigeria, with 9.3% of total voting power, followed by the United States of America (6.6%), Japan (5.5%), and Egypt (5.4%).

As specified in the resolution governing the capital increase, shares are allocated such that when all are subscribed, regional member countries will own 60% and nonregional member countries 40%, although voting power does not precisely mirror the share of ownership. AFDB has no private sector shareholding so that its public policy mandate might not be diluted by private interests.

The president of the bank, Donald Kaberuka, is completing his maximum term (two five-year terms) and the process has started to elect the next president, who will take office on Sept. 1, 2015, at the next annual meeting in May 2015. At the same time, since July this year, AFDB has also started to move its staff back to Abidjan, Ivory Coast, its official headquarters. In our view, AFDB has experienced senior staff and sufficient key personnel and its senior staff possesses considerable aggregate experience and expertise. However, its move back to Abidjan may potentially result in some personnel leaving and consequently temporarily slow its strategy or stress its risk management.

AFDB has a sound and solid risk management and liquidity policy. It requires its single country exposure not to exceed 15% of its total risk capital. Investment counterparties must have minimum credit ratings according to their type and maturity, and liquidity must be sufficient to cover cash flow needs for a rolling one-year horizon without having access to the capital markets. In this regard, AFDB also maintains a prudential minimum liquidity level, based on projected cash requirements for the coming 12 months. Furthermore, AFDB limits its equity participation to 25% of the total capital of the entity in which it invests.

Financial Profile: Strong

We assess AFDB's financial profile as strong in view of our calculation of the organization's capital adequacy, adjusted for our opinion of risk, and its funding and liquidity profiles.

Balance sheet

AFDB's potential risk-bearing activities can be categorized as either treasury- or development-related (table 3). The former (accounting for 38% of the balance sheet) generates holdings of deposits, securities, derivatives, and borrowings, while the latter is represented by loans and equity investments (accounting for 58% of the balance sheet).

Table 3

African Development Bank Summary Balance Sheet

	--Fiscal year ending Dec. 31--				
(SDR '000s)	**2013**	**2012**	**2011**	**2010**	**2009**
Assets					
Cash and money market instruments	959,138	887,228	351,001	404,143	330,817
Securities	6,168,352	6,564,049	7,670,459	7,513,280	7,483,058
Memo:					
Total deposits	3,801	3,801	3,801	3,801	3,801
Liquid assets	7,127,490	7,451,277	8,021,460	7,917,423	7,813,875
Net loans	11,440,695	10,885,804	9,255,493	8,178,797	7,436,278
Equity interests/participations (nonfinancial)	336,397	286,419	175,935	172,377	108,523
Inv. in unconsolidated subsidiaries (financial co.)	188,616	152,136	133,827	99,864	125,955
Purpose-related assets (gross)	12,110,853	11,452,867	9,683,279	8,565,245	7,772,677
Purpose-related assets (net)	11,965,708	11,324,359	9,565,255	8,451,038	7,670,756
Derivative assets	1,018,453	1,645,187	1,746,552	1,421,480	764,007
Fixed assets	39,463	29,511	12,019	11,608	10,817
Other real estate/foreclosed assets	N/A	N/A	N/A	N/A	N/A
Accrued receivables	843,855	762,668	914,850	1,341,658	924,159
Other assets, other	1,752	1,551	1,318	1,086	1,073
Total assets	20,996,721	21,214,553	20,261,454	19,144,293	17,184,687
Total adjustments to shareholders' equity	1,205	1,974	3,044	4,625	8,188
Total adjusted assets*	20,997,926	21,216,527	20,264,498	19,148,918	17,192,875
Liabilities					
Total deposits	N/A	N/A	N/A	N/A	N/A
Other borrowings (gross debt)	12,947,444	13,278,800	12,902,957	11,980,566	10,580,640
Other liabilities	2,217,966	2,595,668	2,476,974	2,343,340	1,862,797
Memo:					
Derivative liabilities	971,852	512,596	502,289	328,296	477,118
Total liabilities	15,165,410	15,874,468	15,379,931	14,323,906	12,443,437
Shareholders' equity					
Paid-in capital and surplus	3,147,084	2,839,475	2,505,975	2,193,105	2,188,287
Revaluation reserve	0	0	0	N/A	N/A
General banking risk reserves	N/A	N/A	N/A	N/A	N/A
Reserves (including inflation revaluations)	105,283	34,571	(100,712)	4,166	(3,428)
Retained earnings	2,964,743	2,891,914	2,803,296	2,623,116	2,556,391
Capital subscriptions received in advance	N/A	N/A	N/A	N/A	N/A
Other equity	(213,145)	(259,050)	(166,403)	N/A	N/A
Accumulated other comprehensive income (loss)	N/A	N/A	N/A	N/A	N/A
Shareholders' equity	5,831,311	5,340,085	4,881,523	4,820,387	4,741,250
Memo:					
Dividends (not yet distributed)	N/A	N/A	N/A	N/A	N/A
Eligible callable capital	9,320	9,320	10,696	5,293	5,294

Table 3

African Development Bank Summary Balance Sheet (cont.)					
Total guarantees	73,780	14,270	10,430	2,310	970
Letters of credit	N/A	N/A	N/A	N/A	N/A
Undisbursed loans (100%)	4,490,132	4,463,226	5,301,024	4,855,328	5,002,530

*Adjustments made to reported shareholders' equity to calculate adjusted common equity (an institution's cash capital) are carried through to total assets. SDR--International Monetary Fund special drawing rights. N/A--Not available.

Table 4

African Development Bank Summary Statement Of Income					
	--Fiscal year ending Dec. 31--				
(SDR '000s)	**2013**	**2012**	**2011**	**2010**	**2009**
Interest income	506,768	556,549	539,856	551,486	495,952
Interest expense	302,992	356,410	316,823	303,041	306,321
Net interest income	203,776	200,139	223,033	248,445	189,631
Operating noninterest income	117,053	141,361	64,830	53,155	100,625
Other noninterest income	12,456	15,288	6,383	N/A	7,338
Operating revenues	623,821	697,910	604,686	604,641	596,577
Noninterest expenses	122,648	111,167	83,962	83,726	68,510
Credit loss provisions (net new)	17,852	31,715	39,389	4,215	(9,414)
Operating income after loss provisions	180,329	198,618	164,512	213,659	231,160
Net income	72,829	88,618	51,512	67,293	68,480
Other comprehensive income	116,617	42,636	(190,638)	7,026	9,011
Comprehensive income	189,446	131,254	(139,126)	74,319	77,491
Memo:					
Net increase (decrease) in cash and cash equivalents during the year	(144,323)	(171,740)	144,201	(48,436)	76,236

SDR--International Monetary Fund special drawing rights. N/A--Not available.

Capital adequacy: Improves upon SDR capital increase

Standard & Poor's RAC ratio, our primary measure of assessing a bank's capital adequacy, was 25% for AFDB before adjustments, on Dec. 31, 2013 (table 5). The RAC ratio has improved from 24% one year ago, balancing 9% growth in capital, flat asset growth, a change in mix toward sovereign exposure and away from financial institution exposures, and an 11% increase in equity and fund participations throughout the year.

Capital increased in 2013 (table 5), reflecting a SDR500 million capital increase in the year and the simultaneous improvement in paid-in capital from the GCI VI and retained earnings. AFDB is not profit maximizing, but retained earnings provide a valuable contribution to its risk-bearing capacity. The bank recorded a return on assets of 0.4% in the year ending Dec. 31, 2013, before changes in other comprehensive income, only slightly down from one year earlier. Preprovision operating income reduced by 14% in 2013, due to tighter interest rate margins, from lower spreads on the banks treasury and trading portfolio, and lower realized gains in the value of derivative instruments. Expenses also increased by 10% throughout the year, which is high, but an improvement over 2012 expenses. The reserves are supported by modest but stable internal capital generation. No dividends are paid, but the board of governors releases profits for supporting other development purposes. In 2013, 35% of operational income was distributed, which is broadly in line with historic norms.

Loan growth was a moderate 5% in 2013, reflecting some conservatism in lending and restrictions in lending to North Africa. At the same time the bank reduced is securities portfolio, derivatives and borrowings throughout the year as South African rand and Japanese yen funding matured. Conversely, equity and fund participations (including callable capital) grew at a 11% in 2013, partially due to capital calls from development funds and institutions, and largely accounted for the fact that capital didn't materially improve in the year, alongside some heightening in our risk weighting for assets in Africa in 2013.

On Dec. 31, 2013, equity and fund participations, which carry a significantly higher risk weighting under our capital measures than other asset exposures, represented only 3% of exposure at default, but almost 33% of Standard & Poor's risk-weighted assets before diversification. The bank exposes itself to equity through its banking book to facilitate the development in African member countries. Consequently, the majority of its exposure is to regional development banks or investment funds. The bank does not seek to take a controlling stake in these companies but, rather, encourages others to participate.

Table 5

African Development Bank Risk-Adjusted Capital Framework Data

(Mil. SDR)	EAD*	Standard & Poor's RWA	Average Standard & Poor's RW (%)
Credit risk			
Government and central banks	16,471	9,917	60
Institutions	2,238	755	34
Corporate	1,660	2,696	162
Retail	0	0	0
Securitization	335	316	94
Other assets	18	40	222
Total credit risk	20,721	13,724	66
Market risk			
Equity in the banking book	672	7,702	1,146
Trading book market risk	--	0	--
Total market risk	--	7,702	--
Insurance risk			
Total insurance risk	--	0	--
Operational risk			
Total operational risk	--	1,731	--
RWA before MLI diversification	--	23,158	100
(Mil. SDR)		**Standard & Poor's RWA**	**% of Standard & Poor's RWA**
MLI adjustments			
Industry and geographic diversification	--	(2,113)	(9)
Single-name concentration	--	19,995	86
Preferred creditor treatment	--	(3,151)	(14)
High risk exposure cap	--	(3,899)	(17)

Table 5

African Development Bank Risk-Adjusted Capital Framework Data (cont.)			
Total MLI adjustments	--	10,833	47
RWA after MLI diversification	--	33,991	147
(Mil. SDR)		**Adjusted common equity**	**Standard & Poor's RAC ratio (%)**
Capital ratio			
Capital ratio before adjustments	--	5,830	25
Capital ratio after adjustments	--	--	17

*Exposure at default. §Exposure and Standard & Poor's risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. SDR--International Monetary Fund special drawing rights. MLI--Multilateral lending institutions. RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of Dec. 31, 2011, Standard & Poor's. Fiscal reporting date: Dec. 31, 2013.

Table 6

African Development Bank Adjusted Common Equity

	--Fiscal year ending Dec. 31--				
(SDR '000s)	**2013**	**2012**	**2011**	**2010**	**2009**
Shareholders' equity (reported)	5,831,311	5,340,085	4,881,523	4,820,387	4,741,250
Less (-):					
Capital payments committed (subscribed) but not yet due	N/A	N/A	N/A	N/A	N/A
Capital payments due but not yet received	N/A	N/A	N/A	N/A	N/A
Promissory notes receivable*	N/A	N/A	N/A	N/A	N/A
Maintenance of value receivables on currency holdings§	N/A	N/A	N/A	N/A	N/A
Capital subscriptions in restricted currencies	1,205	1,974	3,044	4,625	8,188
Unrecognized employee pension or other post-retirement benefit liability	N/A	N/A	N/A	N/A	N/A
Other adjustments to deduct non-cash equity items	N/A	N/A	N/A	N/A	N/A
Total adjustments to shareholders' equity	N/A	N/A	N/A	N/A	N/A
Adjusted common equity (ACE)	5,830,106	5,338,111	4,878,479	4,815,762	4,733,062

*Promissory notes are notes from shareholders, which a multilateral financial institution may have accepted from shareholders in lieu of cash capital and which are carried on the balance sheet as shareholders' equity. Promissory notes exclude callable capital, which most institutions do not count as balance sheet capital. §Currency fluctuations between an institution's operating currency and capital valued in restricted currency generate maintenance of value (MOV) assets and liabilities for some multilateral financial institutions. Standard & Poor's deducts MOV assets from shareholders' equity. SDR--International Monetary Fund special drawing rights. N/A--Not available.

Risk Position: Expected Concentrations To Reduce But Potentially At The Expense Of Asset Quality

Our RAC ratio after adjustments improved to 17% as of Dec. 31, 2013 from 15% one year earlier. This ratio mostly pertains to concentration risk and the reduction on loss given default when taking into account PCT specific to MLIs under our criteria. This improvement largely reflected a small nominal drop in the bank's largest sovereign concentrations and improved capital position.

AFDB's five largest outstanding balances and undisbursed loans--Morocco, South Africa, Tunisia, Egypt, and Botswana--accounted for 176% of ACE and 80% of total public sector loans on Dec. 31, 2013 down from 196% of ACE and 83% of total public sector loans on Dec. 31, 2012. We consider the concentration to be a restraint to the ratings, for example, on Dec. 31, 2013, the bank's single-name concentration adjustment accounted for 57% of Standard & Poor's risk weighted assets after adjustments. We expect the bank to embark on some innovative capital management techniques over the next few years to reduce concentrations.

We also expect general loan book diversification to improve over the next five years. This opinion reflects the increase in the number of eligible borrowing countries, which will provide greater opportunity for public-sector lending, albeit likely to sovereigns of lower creditworthiness. We believe that this may exacerbate AFDB's higher-than-peers' credit risk for development-related exposures, according to our sovereign ratings, compared with other 'AAA' rated MLIs.

Furthermore, AFDB is focusing increasingly on lending to private-sector borrowers; private-sector development is a core operational priority of its 2013-2022 ten-year strategy. Exposures to the private sector were 22% of the total loan book on Dec. 31, 2013, up from 19% in 2011. To support the development of small and midsize enterprises in Africa, the bank also grants lines of credit for loans to private financial institutions. We expect this strategy to gradually improve both single-name and geographic diversification.

Loan loss experience

The advantages of reduced concentration risk may be somewhat overshadowed in the future owing to the decreasing quality of the loan and private equity books--in our opinion a potentially natural result of increased private sector lending and the increase in the number of eligible borrowing countries. Positively, the bank has been developing its private-sector lending and private equity risk management capacity over the past few years and we do not expect rapid growth in the list of new eligible borrowing member sovereigns.

On Dec. 31, 2013, impaired loans accounted for 2.8% of total loans, and the cost of risk (loan loss provisions to net loans) has improved to 1.3% of total loans over the past few years, despite tighter economic conditions. In our view, this attests to the quality of the bank's risk management and lending decisions. Nevertheless, reflecting its focus on private- and public-sector borrowing in geographic areas that carry intrinsically higher operating and credit risks, the historical performance of AFDB's loan portfolio has been worse than that of other rated development MLIs.

Loan loss reserves cover a moderate amount of AFDB's current nonperforming loans book, which amounted to SDR330 million at year-end 2013 (2.8% of total loans and 1.6% of total assets). While 44% coverage is low for a financial institution operating in Africa, we view the bank's PCT as a key benefit in the recovery of bad debts. This means that AFDB's loans will likely be repaid before those of commercial or official bilateral lenders. However, it does not ensure that they will be repaid on time. Due to the economic distress, some of the countries have occasionally fallen behind on payments; currently these are Sudan, Somalia, and Zimbabwe, and these countries are currently eligible to borrow only from the ADF.

Additional risks not covered by the risk-adjusted capital

Foreign-exchange-rate risk. The agreement establishing AFDB requires liabilities in any currency to be matched with assets in the same currency. Because the bank borrows disproportionately in fixed-rate U.S. dollars, it employs interest-rate and cross-currency swaps to achieve the required currency matching. To avoid creating new currency mismatches, the bank requires borrowers to service their loans in the currency disbursed. However, the bank is still left with a net asset position that is exposed to translation risk when exchange rates fluctuate. It addresses this problem by matching, to the extent practicable, the composition of its net assets with the composition of SDRs.

Interest-rate risk. Interest-rate risk is minimized by matching assets and liabilities. About 23.8% of loans have a floating rate and a smaller proportion of the loan book has variable lending rates that are re-priced twice a year. This is matched to a larger borrowing pool. The fixed-rate loans and investments are held at amortized cost and components are limited to match the equity portion of funds. When direct matching is not available, the bank uses interest rate swaps, with creditworthy counterparties, to manage the risk.

Equity risk. We perceive the bank's investment in equity as a risk not completely captured by our RAC model. This arises because we consider that, should one of the development finance institutions (DFIs) in which AFDB has a stake be in need of recapitalization, AFDB might feel compelled to inject additional capital as needed owing to its role as the leading DFI in Africa.

Other comprehensive income. In our opinion other comprehensive income provides some volatility to the bottom line, exposing the bank's capital to potential fluctuations. In 2013 the result was firmly positive, benefitting from gains on financial assets at fair value, unrealized gains on fair-valued borrowings arising from own credit, and remeasurements of defined benefit liability.

Funding And Liquidity

Our static funding ratios indicate AFDB is structurally able to cover its scheduled debt repayments without recourse to new issuance for up to five years (table 7), but this does not take into account new disbursements of loans. AFDB's borrowing portfolio shrank by about 2.5% in 2013, reflecting an equal reduction in the bank's asset book.

Global benchmark issuance accounts for the bulk (61% on Dec. 31, 2013) of the borrowings, but the bank is continuing to diversify its funding base in terms of investor base, currency, and maturity. In 2013, domestic issuance accounted to 16.3% of total borrowings, including an increasing presence in 2013 in the Australian markets, and also new issuances in the New Zealand and Brazilian markets in 2014. Furthermore, the bank successfully tapped a growing and alternate investor base through its green bond issuance, which now accounts for a significant 9% of total borrowings (can be used only for eligible green projects). African domestic and currency-linked issuance remains a small provider of total funds. But with transactions in Ghanaian cedi, Nigeria naira, Kenyan shilling, Botswanan pula, and Zambian kwacha over the past few years, the bank is providing additional depth and quality to local capital markets and a more creditworthy option for African soft-currency investors.

The U.S. dollar remains the major currency of funding after swaps (46%), followed by the euro (45%) and the South African rand (8 %). The maturity profile of borrowings is evenly spread, with refinancing spread up to and more than a five-year period. On Dec. 31, 2013, approximately 15.4% of the bank's borrowings matured within one year, and 23.2% within two years.

Liquidity

Our liquidity ratio shows that AFDB would be able to pay all obligations due over the coming year, without access to capital markets, but it might need to reduce loan disbursements under an extreme stress scenario.

AFDB's liquidity policy calls for maintaining liquidity in excess of a "prudential minimum level," which is defined as the sum of: debt-service payments over the next year, plus the projected net loan disbursements for the next year, plus the loan equivalent of guarantees, plus undisbursed equity investments. The bank typically carries liquidity far above the prudential minimum level.

In our opinion, AFDB's management of liquidity is sound and solid, aided by the high level of liquid assets the bank holds on its balance sheet. The bank maintains a strong liquid asset cushion, albeit it has reduced over the past two years. We expect that liquid assets will cover 34% of total assets, 55% of gross debt, and represent 2.9x short-term debt (maturing in one year) on Dec. 31, 2014. Liquid assets comprise high quality bonds, cash, and a small portfolio of asset-backed securities.

Table 7

African Development Bank Summary Liquidity And Funding Ratios					
	--Fiscal year ending Dec. 31--				
	2013	**2012**	**2011**	**2010**	**2009**
Liquidity ratios					
Liquid assets / adjusted total assets (%)	33.95	35.12	39.59	41.36	45.47
Cash and cash equivalents / liquid assets (%)	13.46	11.91	4.38	5.10	4.23
Securities / liquid assets (%)	86.54	88.09	95.62	94.90	95.77
Liquid assets / gross debt (%)	55.05	56.11	62.17	66.09	73.85
Liquid assets / short-term debt by remaining maturity* (%)	290.24	218.51	270.26	402.20	497.12
Liquid assets net of deposits / total adjusted assets (%)	33.95	35.12	39.59	41.36	45.47
Liquid assets net of deposits / gross debt (%)	55.05	56.11	62.17	66.09	73.85
Liquid assets net of deposits / short-term debt by remaining maturity* (%)	290.24	218.51	270.26	402.20	497.12
Funding ratios					
Static funding gap§ at 1 year (x)	1.1	1.3	1.4	N/A	N/A
Short-term debt (by remaining maturity) / adjusted total assets (%)	11.70	16.07	14.65	10.28	9.15
Gross debt / adjusted total assets (%)	61.66	62.59	63.68	62.58	61.57
Gross debt net of liquid assets / adjusted total assets (%)	27.72	27.47	24.09	21.22	16.10
Short-term liabilities (by remaining maturity) / total liabilities (%)	16.19	21.48	19.30	13.74	12.63
Total liabilities / adjusted total assets (%)	72.23	74.83	75.91	74.82	72.41
Gross debt / adjusted common equity (x)	2.22	2.49	2.64	2.49	2.23
Short-term debt (by remaining maturity) / gross debt (%)	18.97	25.68	23.00	16.43	14.86

N.A.--Not available. N.M.--Not meaningful. *Short-term debt by remaining maturity includes short-term debt (maturing in less than 12 months) and long-term debt maturing in the next 12 months. §The static funding gap is maturing assets divided by maturing liabilities. It is cumulative and based on scheduled receipts and payments.

Likelihood Of Extraordinary Shareholder Support

AFDB benefits from the equivalent of SDR9 billion (approximately US$15 billion) in callable capital from 'AAA' rated shareholders. This amount equals 1.5x shareholders' equity on Dec. 31, 2013. If AFDB made a capital call, its cash capital levels could be raised to a point consistent with an "extremely strong" financial risk profile. Therefore, we incorporate two notches of uplift for extraordinary shareholder support from AFDB's SACP, leading to our 'AAA' long-term rating on the bank.

Related Criteria And Research

Related Criteria

- Multilateral Lending Institutions And Other Supranationals Rating Methodology, Nov. 26, 2012
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Related Research

- South Africa Long-Term FC Rating Lowered To 'BBB-'; LC Rating Lowered To 'BBB+' On Ongoing Weak Growth; Outlook Stable, June 13, 2014
- Supranationals: Special Edition 2013: Comparative Data For Multilateral Lending Institutions, March 11, 2014
- How An Erosion Of Preferred Creditor Treatment Could Lead To Lower Ratings On Multilateral Lending Institutions, Aug. 26, 2013

Ratings Detail (As Of November 13, 2014)		
African Development Bank		
Counterparty Credit Rating		
Foreign Currency		AAA/Stable/A-1+
Commercial Paper		
Foreign Currency		A-1+
Senior Unsecured		AAA
Short-Term Debt		A-1+
Subordinated		AA+
Counterparty Credit Ratings History		
24-Jul-2003	*Foreign Currency*	AAA/Stable/A-1+
06-Jun-2001		AA+/Stable/A-1+
09-Aug-2000		AA+/Negative/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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