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Research

African Development Bank

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Credit Rating AA+/Stable/A-1+

Rating History

Outlook revised to stable.....2001

Outlook revised to negative.....2000

Short-term rating of 'A-1+' assigned.....1998

Senior unsecured debt rating lowered to 'AA+' and subordinated debt rating lowered to 'AA-'.....1995

Senior unsecured debt rating raised to 'AAA' and subordinated debt rating raised to 'AA'.....1990

Senior unsecured debt rating raised to 'AA+'.....1987

Senior unsecured debt rating of 'AA' and subordinated debt rating of 'AA-' assigned.....1984

Year

2001

Total Assets

\$11.2 billion

Number Of Shareholders

77 (all the 53 African countries and 24 non-African countries)

Purpose

The African Development Bank's (AfDB) mandate is to contribute to the economic development and social progress and reduce the poverty level of its 53 regional members. The bank primarily lends to the public sector for long-term projects and to sub-regional and national development banks to finance investment programs.

General Capital

AfDB's membership has approved five general capital increases since the inception of the bank in 1964. The fifth general capital increase (GCI-V), approved in May 1998, increased the authorized capital by \$7.1 billion. The paid-in portion is payable over a period of eight years, from 1999 to 2007. With the fifth general capital increase, the nonregional members' share of the bank has increased to 40%.

Rationale

The ratings on the African Development Bank (AfDB) are based on:

- Its conservative leverage policies. Management policies limit senior debt to 80% of callable capital of nonborrowing members, and cap total debt at 100% of usable capital (defined as paid-in capital, reserves, and callable capital of 'AA' and 'AAA' rated shareholders), and at 80% of callable capital of all shareholders. AfDB is operating comfortably within its leverage limits. With a fifth capital increase and growing reserves, all of AfDB's leverage ratios will improve.
- Its improving shareholder base. A fifth capital increase, concluded in 1998, has strengthened AfDB's ownership structure. Following this capital increase, AfDB is owned 60.0% (down from 66.7%) by 53 African countries and 40.0% by 24 non-African countries. This demonstrates strong membership support for the bank group's mandate, which includes poverty alleviation and capacity building in Africa.
- Close cooperation with the Bretton Woods institutions. The World Bank and the IMF do not usually disburse their loans until countries have settled their arrears with AfDB or have a definitive and monitorable plan to do so.

■ Outlook

The outlook reflects AfDB's strengthening public policy mandate. Standard & Poor's expects that AfDB, in conjunction with its concessional lending arm, the African Development Fund (ADF), will become more active in designing and implementing programs to alleviate poverty and promote development among its regional members. Although AfDB may only lend to 15 of its 53 regional members, its technical assistance and support will be essential to help the 32 other African countries that are eligible for the Highly Indebted Poor Country (HIPC) initiative, to meet successfully the conditions required to receive debt relief.

The outlook also reflects the reduced embedded risk of AfDB's portfolio. The portfolio's ratio of nonaccrual loans to total loans remains relatively high, at 19.9% at the end of 2001, down from 24.7% one year earlier. Nevertheless, Standard & Poor's expects this figure to decline markedly due to the HIPC initiative and cooperation with the donor community. In March 2002, Côte d'Ivoire cleared all of its arrears to AfDB, which has reduced nonaccrual loans to 13.8% of the total loan portfolio. Over time, the deployment of HIPC resources should help AfDB's weaker borrowers to settle and/or avoid arrears with the bank, leading to an improvement in the credit quality of the bank's loan portfolio.

Management, with the support of AfDB's members, should bolster the bank's role in promoting economic reform and development on the continent. Sustained improvements in asset quality and an effective expanded regional role could result in higher ratings. Conversely, recurring pressure on the bank's preferred creditor status and other signs of a slackening in member support would result in downward pressure on the ratings.

■ Mission

AfDB is a multilateral development bank engaged in promoting social progress, economic development, and economic integration in African countries. Promoting sustainable economic growth and reducing poverty are the bank's main priorities. Key areas include agriculture and rural development, human resources development, private sector development, and economic integration and cooperation. For borrowing member countries, AfDB is a source of long-term funding at interest rates that are typically below those available from the private sector, especially for lower-rated countries. The bank is also an important source of financial advice and training for African countries. Furthermore, the bank is involved in capacity building--mainly providing technical assistance grants and training. A relatively new area in which the bank is involved is the HIPC initiative. A requirement for HIPC eligibility is the preparation of Poverty Reduction Strategy Papers (PRSPs), for which the bank is providing technical support.

■ Membership

AfDB currently has 77 shareholders, the largest of which were, at Dec. 31, 2001, Nigeria (8.87% of voting power; not rated), the U.S. (6.57%; AAA/Stable/A-1+), Japan (5.42%; AA-/Negative/A-1+), the Arab Republic of Egypt (5.12%; foreign currency BB+/Stable/B), the Federal Republic of Germany (4.09%; AAA/Stable/A-1+), the Republic of South Africa (3.97%; foreign currency BBB-/Stable/A-3), Algeria (3.81%; not rated), the Republic of France (3.72%; AAA/Stable/A-1+), Canada (3.72%; foreign currency AA+/Stable/A-1+), Libya (3.67%; not rated), and the Kingdom of Morocco (3.35%; foreign currency BB/Negative/B).

In May 1998, the shareholders approved AfDB's fifth capital increase (GCI-V), of \$7.1 billion to \$27.5 billion, of which \$427.5 million will be paid-in capital, paid over the course of eight years, and the remainder callable capital. Shares in GCI-V are allocated to the regional and nonregional members (which joined AfDB in 1982) so that the regional members hold 60% (down from 66.7%) of the total stock and the nonregional members 40%. Under GCI-V, the ratio of paid-in capital to subscribed capital was reduced to 6.0% from the 12.5% applied to earlier capital increases. With the lower portion of cash capital subscribed, the ratio of cash capital to the entire subscribed capital base will decline to 10.8% from 12.5%.

The bank has adopted revised share transfer rules to facilitate a more efficient reallocation of unsubscribed shares. As part of this process, it established an allocation mechanism that takes into account the economic strength of existing members. The bank decided that priority in the reallocation of unsubscribed and unallocated shares would be given to members that are underrepresented based on their relative economic strength. This has already taken place with Algeria, the Kingdom of Belgium (AA+/Stable/A-1+), South Africa, and the Kingdom of Spain (AA+/Stable/A-1+), which all subscribed to additional shares. The significant number of countries in arrears on their capital subscriptions to the bank (13 in total) highlights concerns about membership support. Nevertheless, the fact that many of these countries may not be in a financial position to

pay their subscriptions is somewhat offset by the fact that other members are willing to increase their shares. For example, Standard & Poor's takes comfort from the fact that South Africa, the economic powerhouse of the sub-Saharan region, is keen to raise its ownership interest and profile in the bank, an indication of its support for the bank's important role.

■ Operations

The bank provides development resources to its regional member countries, mainly through long-term loans, investments, and technical assistance for development projects granted to the public sector and, to a limited extent, to the private sector. Since late 1997, the bank has been placing more emphasis on the latter, offering risk capital through loans, equity investment, guarantees, and underwriting services. Loans extended to eligible private sector entities are made without government guarantees and finance only up to one-third of a private sector project's total costs. AfDB increasingly works in close cooperation with the commercial banking sector and other multilateral institutions.

The bank's headquarters are in Abidjan, Côte d'Ivoire. To increase the institution's visibility in its regional member countries, the bank intends to open up to 25 field offices in the medium term. Since 2000, four offices have been opened, in Egypt, Ethiopia, Gabon, and Nigeria. The bank also has national program offices (NPOs) in Cameroon, Chad, Sao Tome and Principe, and Uganda, while negotiations for opening an office in South Africa are ongoing and recruitment of a program coordinator for the Mozambique NPO is underway. For the 2002-2003 period, the current proposal is to open four new additional field offices and six new NPOs, and to second bank staff to the Democratic Republic of Congo and Angola.

As part of its business continuity preparedness, the bank concluded, in 2001, arrangements for a temporary relocation agency in Tunisia, which in the event of business disruption at the bank's headquarters in Abidjan, would accommodate approximately 600 staff for an extended period of time.

■ Management

Shareholders operate the bank through two governing bodies. A board of governors sets policy, admits new members, determines the bank's capital structure, and elects the president. It delegates most of its operational responsibilities to an executive board of directors, comprising 12 regional members and six nonregional members. In 1998, AfDB changed its general voting rules at the board of directors and the board of governors to a two-thirds majority from a simple majority, with a provision for a 70% majority on request from a member state. The new voting rules promote consensus in decision-making and protect the interest of those nonregional shareholders who hold a minority stake in the institution.

The executive directors serve a maximum of two terms of three years, while the president serves a maximum of two terms of five years. The 2000 presidential election returned Omar Kabbaj, president of the bank group since 1995, to the helm of AfDB. President Kabbaj's reelection is viewed as a sign of shareholders' support for his management policies, which aim to gradually strengthen the bank's internal procedures--a key supporting factor in Standard & Poor's view.

Since 1995, under President Kabbaj's leadership, the bank has enhanced its internal management policies--with a view to gradually improving both the institution's corporate governance and its financial solidity--and redirected its focus toward borrowers' needs, while improving the quality of the bank's portfolio. In 1998, AfDB established an asset and liability management committee to enhance financial management and oversight. In 1999, the bank adopted tightened rules of procurement and supervision.

■ Financial Policies and Practices

Gearing and leverage.

Like other multilateral development banks, AfDB limits risk to creditors by limiting leverage. AfDB's capitalization ratios are governed by limits set by statute and management policies. Management policy calls for senior debt not to exceed 80% of callable capital of nonborrowing shareholder countries. Similarly, total debt must not exceed usable capital (defined as paid-in capital, reserves, and callable capital of 'AA' and 'AAA' rated shareholders), or 80% of callable capital of all shareholders. According to the bank's statutes, callable capital may be used only to meet the bank's debt obligations. Calls on callable capital must be uniform, but members' payment obligations are independent of one another.

Liquidity, receivables, and investment asset quality.

The bank's policy is to hold sufficient liquidity to meet its financial obligations. To ensure funding flexibility, the bank's prudential minimum liquidity level is based on net loan disbursements, plus the average of the next two years' debt service requirements, plus contingent liabilities. The bank's policy limits investments to highly rated financial instruments. The bank has in place elaborate back-up and other procedures to ensure continuity of service, including timely repayment of debt obligations falling due, in the event of disaster or other disruptive events.

Investments and receivables from currency swaps on AfDB's balance sheet were \$2.78 billion at year-end 2001, representing 25% of total assets. The credit risk associated with the currency- and interest-rate swaps is largely contained by the bank's eligibility criteria, which require the counterparties to be rated at least 'AA-'. Moreover, it is further mitigated by limiting exposure to a maximum of 10% of the bank's total risk capital for any single counterparty. While investments in money market instruments require a minimum rating of 'A', investments in longer-term obligations require a minimum rating of 'AA-'.

Borrower eligibility.

Since 1995, AfDB has focused its public sector lending activity exclusively on countries that are not overly indebted and that have a certain minimum per capita GDP, directing other borrowers to the ADF--the bank's soft-loan window--in order to enhance the quality of the bank's portfolio. AfDB lends only to African countries and private sector entities domiciled in Africa. Member countries fall into one of four borrower-eligibility categories. At the end of 2001, the member breakdown was as follows: nonborrowers--that is, all nonregional members (24 of 77 members); countries eligible to borrow only from AfDB (13); countries eligible to borrow from both AfDB and the ADF (2); and countries eligible to borrow only from the ADF (38).

The 13 regional member countries (out of 53) that are eligible to borrow only from AfDB are: Algeria, the Republic of Botswana (foreign currency A/Stable/A-1), Egypt, Equatorial Guinea, Gabon, Libya, Mauritius, Morocco, Namibia, the Seychelles, South Africa, Swaziland, and Tunisia. Libya, however, has decided not to borrow from the bank. In addition, only Nigeria and Zimbabwe are eligible for both AfDB and ADF funds. Currently, however, the Seychelles and Zimbabwe are in nonaccrual status on their debt to the bank, and therefore cannot receive further disbursements or new loans until the arrears are completely cleared.

Lending instruments and pricing.

Lending generally falls into one of two categories, project or policy, with both categories including a number of different programs. Project lending includes public, publicly guaranteed, and private sector project loans; policy lending includes both sector and structural adjustment loans. The bank also provides resources for debt reduction under the HIPC initiative, undertakes equity investments, and provides guarantees. All of the bank's loans are made to or guaranteed by member countries, except for private sector development loans. Historically, most AfDB loans have been for project lending; in 2001, these accounted for 58% of total approvals, up from 48% in 2000. In 2000, the bank started issuing guarantees (the bank provides a guarantee of payment of the loan). These are aimed at aiding regional member countries' financial institutions to access the capital market.

(% of total approvals)	2001	2000	1999	1998
Project lending	57.60	47.70	71.80	54.30
Policy-based lending	23.50	0.00	24.90	34.00
Special relief fund	0.10	0.70	0.10	0.10
HIPC debt relief	17.70	20.60	2.60	3.30
Equity participation	0.00	0.30	0.60	8.40
Guarantees	0.00	30.80	0.00	0.00

Consistent with its development focus, AfDB extends medium- and long-term loans, with a maximum maturity of 20 years. The bulk of outstanding loans have maturities of less than 10 years, however. The resulting maturity distribution is shown in Table 2.

(%)	2001	2000	1999	1998	1997
Less than one year	19.4	16.2	17.2	11.5	14.6
One to five years	38.1	38.7	28.2	28.1	26.4
Five to nine years	27.6	29.4	37.9	38.1	36.1
More than nine years	14.9	15.8	16.7	22.2	22.9

In 1997, AfDB replaced its products denominated in Units of Account (UA; based on a basket of currencies equal to the Special Drawing Right) with loans that offer borrowers a choice of currency and interest rate (fixed, floating, or variable rate). Moreover, to improve its price competitiveness, the bank also modified its fee structure so that the fees paid on a loan are approximately in line with other multilateral institutions, in particular, the World Bank. AfDB's pricing policy is uniform for public sector projects, but reflects risk for private sector projects. The bank uses the 'cost pass through principle' in determining the charges and fees for risk-management products, adding a transaction fee ranging from 0.125% to 0.375%. There are several fees, with the commitment fees among the most important (0.75% for guaranteed loans, and 0.50%-1.00% for nonguaranteed loans). Guaranteed loans have no front-end fees (a major difference with the World Bank, which charges a fee of 1%). For nonguaranteed loans, the late payment fees will be at least 2% per year above the interest rate on the loan, while there is none for guaranteed loans. The bank may charge a prepayment fee. For granting guarantees, the bank levies fees on a case-by-case basis, although in a range similar to the rates applied for direct loans. Finally, a 50 basis point commitment fee waiver is added for certain qualifying loans for performing countries, providing an incentive for borrowers to honor their obligations.

Loan concentration.

As of Dec. 31, 2001, 14 borrowing regional member countries accounted for 71.8% of total loans outstanding (compared with 70.5% last year). Table 3 provides a detailed breakdown of loan concentration. Three of these larger borrowing sovereigns are rated by Standard & Poor's (Tunisia, Egypt, and Morocco). The other member sovereigns rated by Standard & Poor's are Botswana, South Africa, and Senegal. The other regional member countries are not rated by Standard & Poor's. Looking forward, Standard & Poor's expects that this loan concentration will continue, due to both the limited number of countries that are eligible for loans and the even smaller number that actually make use of AfDB resources. Moreover, to limit exposure to any one borrower, the bank uses an internal credit risk rating scale that is based on expected loss rates.

Table 3 Loans Outstanding*					
	--Year ended Dec. 31--				
(% of total loans outstanding)	2001	2000	1999	1998	1997
Algeria	12.11	11.26	10.22	9.71	9.23
Cameroon	2.33	2.38	2.49	2.56	2.67
Congo¶	2.15	2.16	2.09	2.12	2.13
Côte d'Ivoire¶	6.63	6.93	7.13	7.76	7.98
Democratic Republic of Congo¶	5.31	5.41	5.3	5.06	4.88
Egypt	5.26	5.54	6.1	6.48	6.67
Ethiopia	1.72	1.93	2.1	2.19	2.15
Gabon	3.56	4.22	4.46	4.52	4.36
Morocco	17.12	16.8	15.98	15.23	14.46
Nigeria	9.82	10.71	11.2	11.36	11.74
Senegal	1.2	1.33	1.48	1.59	1.68
South Africa	1.41	1.65	0.92	0.4	0
Tunisia	16.99	14.9	15.15	14.11	13.96
Zimbabwe¶	3.28	3.18	3.08	3.41	3.61
Multinational	0.57	0.65	0.77	0.86	0.83
Private sector	1.21	0.76	0.42	0.35	0.39

*Not all borrowers are shown. Slight differences in totals may occur due to rounding. ¶Countries in nonaccrual status.

Nonaccrual loans.

A number of borrowers have defaulted on their obligations to AfDB, reflecting the embedded risk of the bank's portfolio. The bank's policy in dealing with payment delays is as follows: if a payment of principal, interest, or other charges on an AfDB loan become 30 days overdue, no new loans will be made to that member country. In addition, disbursements are halted until the member country settles all obligations to the bank. Once the payments are overdue for six months or more, the member country's borrowings are placed in nonaccrual status. Nonaccrual loans are loans for which income is not recognized until received on a cash basis. AfDB does not recognize income on loans that have been in arrears for six months or more.

Table 4 Nonaccrual Loans					
(Mil. \$)	2001	2000	1999	1998	1997
Total principal on loans in nonaccrual status	1,616.1	2,110.6	1,347.0	1,345.3	871.0
Total principal on loans in nonaccrual status (% of outstanding loans)	19.9	24.7	14.5	14.1	9.4
Accumulated provisions/total principal on loans in nonaccrual status (%)	38.4	26.0	39.5	36.7	49.0

The level of nonaccrual loans to total loans declined to 19.9% at year-end 2001, from 24.7% one year earlier. This was due to Angola and Gabon clearing their arrears. At Dec. 31, 2001, most loans in nonaccrual were concentrated in loans to Côte d'Ivoire (33%), the Democratic Republic of Congo (DRC; 27%), and Zimbabwe (17%). In March 2002, Côte d'Ivoire cleared all of its arrears to AfDB, which will reduce the portion of nonaccrual loans to total loans significantly, to 13.8% of the total loan portfolio. Efforts have been made to find ways in which the DRC's arrears could be cleared. Although arrear clearances strengthen the finances of the bank, the fact that arrears built up in the first place also highlights the embedded credit risk of the loan portfolio. Nevertheless, the deployment of HIPC resources should ensure that AfDB's weaker borrowers settle and/or avoid arrears with the bank, leading to an improvement in the credit quality of the loan portfolio.

To improve the quality of the bank's loan portfolio, AfDB has streamlined certain procedures, including cancelling undrawn credit facilities for borrowers in arrears. In addition, AfDB arranged with the IMF and World Bank that any release of funds for structural adjustment facilities would be conditional on the settlement of arrears to AfDB. This approach has already borne fruit, with the three institutions adopting a common stance with regard to Côte d'Ivoire, which cleared all of its official arrears in the first quarter of this year. AfDB does not negotiate debt reductions, as do commercial lenders. AfDB's track record shows that countries that have gone into nonaccrual status have eventually emerged by repaying the full amount of principal and interest due (although not interest on interest).

Country	In arrears since
Burundi	Aug-99
Central African Republic	Jul-94
Comoros	Jul-92
Congo	Jul-97
Côte d'Ivoire*	Oct-00
Democratic Republic of Congo	Jul-90
Liberia	Jul-84
Seychelles	Jan-00
Somalia	Jan-90
Sudan	Oct-95
Zimbabwe	Apr-00

*Has since cleared all its arrears to AfDB.

Despite the arrears for certain countries, AfDB has so far never written off a loan. Its losses have been limited to the cost of carry on past-due loans, since interest is not charged on outstanding interest.

Under the current provisioning policy, the bank makes appropriate loan-loss reserves for expected losses in its public sector loan portfolio. To enhance the bank's financial solidity, AfDB approved in 1998 a policy to generally increase the level of general provisions for public sector loans by 0.5% of loans per year, to reach 7.5% of outstanding loans by 2003, under the condition that the level of accumulated provisions will be reviewed annually and adjustments, if necessary, based on an assessment of the collectibility risk in the loan portfolio. In 2001, the level of cumulated general provisions on public loans increased and reached the targeted 7.5% of outstanding loans by the end of the year. For private sector loans and equity investment, a specific provisioning is determined on a case-by-case basis.

Table 6 Accumulated Provisions for Loan Losses

(Mil. \$)	2001	2000	1999	1998	1997
Balance at beginning of year	529.7	504.8	481.6	445.0	380.9
Provision for loan losses	67.6	48.7	37.2	46.5	45.7
Private sector loan write-offs	0.0	(4.3)	0.0	0.0	0.0
Translation adjustment	23.7	0.0	12.9	2.6	(0.1)
Balance at year-end	621.0	549.1	531.7	494.1	426.4
Loans outstanding	8,125.6	8,554.3	9,319.7	9,520.1	9,256.5
Accumulated provisions/outstanding loans (%)	7.6	6.4	5.7	5.2	4.6

AfDB also has a wide array of sanctions, ranging from the suspension of new disbursements to the suspension of voting rights to limit slippage in debt servicing (still unused), although they are of relatively limited use given most nonservicing members' difficult economic situation. AfDB has been considering a policy to increase sanctions on regional member countries in arrears. This policy would empower the board of directors, subject to the review of the board of governors, to suspend the voting rights of member states that were more than two years in arrears to AfDB or that were servicing debt to other creditors while in default to AfDB. It remains to be seen whether AfDB actually enacts such sanctions on defaulting members.

The reactivation of the ADF soft-loan window in 1996, and the arrangement with the IMF that any release of Poverty Reduction and Growth facilities are dependent on settling arrears with AfDB, helped provide additional incentives for weak borrowers to settle their arrears with the bank. Perhaps the strongest incentive for countries to clear their arrears is HIPC, as this is one of the conditions attached to receiving debt relief.

HIPC.

Under the HIPC initiative, 32 regional member countries are eligible for debt relief. AfDB has pledged \$124 million, and the ADF another \$246 million. AfDB's contribution will come from its net income. Over time, the deployment of HIPC resources should help AfDB's weaker borrowers to settle and/or avoid arrears with the bank, leading to an improvement in the credit quality of the bank's loan portfolio.

African Development Fund

The ADF (not rated), which began operations in 1974, provides grants and loans on concessional terms to regional borrowing members that are not eligible for AfDB loans. Its guiding principles are to promote sustainable growth and reduce poverty. Its instruments include project loans, policy-based loans, technical assistance grants, and debt relief. The ADF is periodically (every 3 years) replenished by State Participants (donor nations). Although negotiations for the eleventh replenishment started in June 2001, the discussions are still ongoing. The principal reason behind the lengthy negotiations is the divergence of views among donor countries on the proportion of grant aid that concessional funds (the International Development Association for the World Bank, and the ADF for AfDB) should make available to borrowing member countries. To avoid a disruption in the fund's operations, the management convened a donor conference in April 2002. This partial replenishment demonstrated the support of the donor nations for the fund's activities and, more broadly, for the activities of the AfDB group. The salient feature of the ADF from a rating perspective is that it permits the AfDB group to provide resources to the poorer nations in Africa, which are currently ineligible to borrow from the bank, and help fulfil the group's policy mandate.

Finances

Capital and capital adequacy.

The bank's equity is summarized in Table 7. The total balance sheet equity of \$4.04 billion at year-end 2001 comprises paid-in capital of \$2.45 billion, reserves of \$2.16 billion, and a cumulative currency translation loss of \$0.57 billion.

Table 7 Equity

(Mil. \$)	2001	2000	1999	1998	1997
Total equity	4,039.6	3,888.2	3,896.7	3,823.9	3,573.0
Paid-in capital	2,448.3	2,437.1	2,502.0	2,529.8	2,429.5
Reserves	2,155.8	1,999.4	1,972.0	1,871.6	1,650.1
Other equity*	(564.4)	(548.2)	(577.2)	(577.4)	(506.7)
Callable capital	24,374.0	24,144.1	20,287.4	19,609.6	18,886.0
From 'AAA' members (%)	21.4	27.0	25.0	22.0	21.0
From other investment grade (%)	32.1	20.0	19.0	22.0	18.0
Other (%)	46.5	53.0	56.0	57.0	61.0

*Cumulative currency translation adjustment.

Balance sheet equity alone, however, understates AfDB's capital strength. Although member countries have subscribed to 98.3% of authorized shares at end-2001, less than 9.8% of subscribed capital has been paid in and appears on the balance sheet. In addition, AfDB has another \$24.4 billion in "callable capital", which the

bank can require members to pay to meet obligations on its borrowings and loan guarantees. Of this, 21% is from 'AAA' rated countries and another 32% from other investment-grade countries. No call has ever been made on AfDB's callable capital. Table 8 provides several measures of capital adequacy. Despite the lower level of 'AAA' callable capital in 2001, due to the downgrade of Japan, most of the indicators showed improvement.

Table 8 Capital Adequacy Ratios

(%)	2001	2000	1999	1998	1997
Disbursed loans/paid-in capital + reserves	189.5	210.1	231.7	243.6	258.3
Disbursed loans/subscribed capital + reserves	26.2	28.4	36	38.1	38.9
Nonaccrual loans outstanding/disbursed loans outstanding	19.9	24.7	14.5	14.1	9.4
Nonaccrual loans outstanding - loan-loss provisions/'AAA' callable capital + paid-in capital + reserves	10.8	15.1	9.1	10.7	6
Debt/paid-in capital + reserves	165.3	184.2	188	203.4	214.8
Debt/'AAA' callable capital + reserves + paid-in capital	71.4	68	79.6	95	98.3
Net debt/'AAA' callable capital + reserves + paid-in capital	41.7	44.5	60.3	69.7	74.7
Liquid assets/undisbursed loans + one-year debt service	57.6	67.8	37.3	50.9	36.7

As shown in Table 9, which summarizes principal balance sheet assets, AfDB's equity and callable capital supported balance sheet assets of \$11.2 billion at year-end 2001. At end-2001, net loans were 67.3% of balance sheet assets, down from 70.4% the year before and a peak of 78.2% in 1997.

Table 9 Principal Assets

(Mil. \$)	2001	2000	1999	1998	1997
Investments	2,603.0	2,356.2	1,550.7	1,909.1	1,623.6
Accounts receivable	418.8	277.5	287.6	296.6	315.4
Net loans	7,504.6	8,005.2	8,788.0	9,026.0	8,830.1
Equity participations, net	200.5	215.0	219.1	185.7	175.7
Other	424.6	518.8	537.2	349.9	351.8
Total assets	11,151.4	11,372.7	11,382.7	11,767.2	11,296.4
Net loans/total assets (%)	67.3	70.4	77.2	76.7	78.2

Loan portfolio.

Total approvals, including HIPC debt relief, amounted to \$1.24 billion in 2001, up 17% from 2000 and 24% from 1999. Loan approvals doubled in 2001 to \$1.01 billion from \$523 million in 2000. Although, gross disbursements increased by 18% over 2000, they remained below the levels reached in 1999 (\$701 million).

Table 10 Loans

(Mil. \$)	2001	2000	1999	1998	1997
Approved loans	11,342.1	11,561.9	13,370.8	13,100.7	12,752.9
Unsigned loan amounts	549.3	539.1	971.6	622.1	782.5
Undisbursed balance	2,667.3	2,468.6	3,079.4	2,958.6	2,713.9
Outstanding balance	8,125.6	8,554.3	9,319.7	9,520.1	9,256.5

Net income.

As a development institution, AfDB does not attempt to maximize income, but rather to earn a return adequate to ensure its financial strength and maintain its development activities. Operating income (before mandated allocations to capital reserves and before IAS 39 adjustment) in 2001 was \$157 million. Net income, which includes the IAS 39 adjustment--that is, unrealized net gains or losses on nontrading derivatives--was \$261 million, or \$103 million higher than operating income. Operating income provides a better indication of the bank's profitability than net income, due to the IAS 39 adjustment. Accordingly, the management of the bank makes operating decisions on the basis of operating income.

Table 11 Net Income: Principal Components

(Mil. \$)	2001	2000	1999	1998	1997
Loan income	562.8	570.9	645.7	658.3	742.4
Investment income	152.5	116.6	82.5	97.8	81.8
Interest expense	(433.8)	(436.0)	(461.3)	(501.6)	(561.7)
Loan-loss provisions	(67.6)	(48.7)	(37.2)	(46.4)	(45.7)
Net noninterest expenses	(56.3)	(50.7)	(60.2)	(50.0)	(59.1)
Operating income	157.5	152.2	169.5	158.1	157.8
IAS 39 adjustment	103.4	0.0	0.0	0.0	0.0
Net income	261.0	152.2	169.5	158.1	157.8

IAS 39--International Accounting Standard No. 39 on financial instruments recognition and measurement. IAS 39 requires that all derivative financial instruments be marked to market and reported on the balance sheet.

Net interest income (which includes income from investment) to average assets increased to 2.38 from 2.08 in 2000 (reflecting interest income from Angola and Gabon as they cleared their arrears, as well as higher investment income). This is also attributable to the cancellation of unneeded undisbursed loan balances. Noninterest income derives principally from commitment fees and has dropped continuously from 1994, when it stood at 0.77% of average assets, to 0.16% in 2001. This trend is reflected in the make-up of revenues; the net interest income share of revenues has been increasing steadily since 1995 and reached 93.7% in 2001, from just 75.0% in 1996. Operating expenses increased in 2001 to 0.51% of average assets from 0.46% in 2000, mainly reflecting higher personnel expenses.

Table 12 Profitability*

(%)	2001	2000	1999	1998	1997
Net interest income/average assets	2.38	2.08	2.05	1.84	1.82
Noninterest income/average assets	0.16	0.19	0.28	0.33	0.47
Net income/average assets (ROA)	1.42	1.37	1.48	1.34	1.38

*Before IAS 39 adjustment.

AfDB forecasts that its net income will be maintained at about \$125 million in the foreseeable future. Potential deviations in net income are mainly explained by changes in nonaccrual activities. The impact of nonperforming loans on AfDB's net income is considerable, as AfDB's nonaccrued interest income over 1994-1998 represented 41% of what net income would have been if all the bank's loans had been performing. For 1999 and 2000, the ratios were 34% and 45%, respectively. At December 2001, cumulative nonaccrued interest income amounted to more than \$750 million, despite the recognition of Angola's and Gabon's interest income following their arrears clearance.

Barring capital increases, development banks such as AfDB depend on increasing retained earnings to increase equity. Although AfDB does not pay dividends to its shareholders, a portion of its net income each year is typically allocated by the board of governors during the following year to support a variety of developmental activities. Table 13 shows the allocation of net income during the past five years. Over the past five years, cumulative net income totalled \$850 million, while \$78 million, an amount equal to 9.2% of cumulative net income, was transferred to those programs.

Although net income usually supplements general reserves, income is also allocated to the HIPC initiative and other funds. In 2001, \$7.5 million was transferred to the HIPC initiative, \$12.6 million to the ADF, \$7.7 million to the special reserve, and the remaining \$118 million to the general reserve.

Through to the end of fiscal 2001, AfDB has allocated about 30% of its pledge to the HIPC Trust Fund.

Funding.

At year-end 2001, 58.7% of AfDB's balance sheet assets were funded by borrowings. With AfDB's outstanding loans declining, outstanding debt dropped marginally by 3% to \$6.55 billion in 2001. Outstanding debt amounted to 27% of total callable capital in 2001, down from 29% in 2000, well within the 80% ceiling imposed by the bank. AfDB funds itself primarily on a long-term basis, through its own resources and the capital markets. The average maturity of AfDB's debt was 8.4 years at year-end 2001. At year-end 2001, senior debt was \$4.74 billion and subordinated debt \$1.81 billion. In 2001, senior debt represented 44% of nonborrowing members' callable capital. This ratio is also within the conservative borrowing limit of 80%

established by the bank.

At December 2001, total outstanding debt after swaps was denominated in U.S. dollars (49.2%), Japanese yen (20.5%), and euros (21.1%). In future, the euro should become more important. In 2002, \$1.91 billion will mature (including \$340 million of callable borrowings), which represents 17% of assets.

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