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African Development Bank

Publication date: 25-Aug-2005
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Credit Ratings

AAA/Stable/A-1+

Note

The African Development Bank (AFDB) regularly issues notes under its global debt issuance facility and commercial paper under its €1 billion commercial paper program. Standard & Poor's Ratings Services' practice is not to issue separate rating letters for small issues under these facilities. However, as of the date of this report, Standard & Poor's rated all senior debt issued under the global debt issuance facility 'AAA' and all subordinated debt 'AA+'; Standard & Poor's rated all commercial paper issued under the commercial paper program 'A-1+'. Standard & Poor's maintains annual surveillance on facility issuances.

Major Rating Factors

Strengths:

- Strong and improving capital position and liquidity.
- Prudent financial management and policies.
- Strong support from its members, particularly its nonregional members, which include numerous 'AAA' rated countries.

Weaknesses:

- Large nonperforming loans.
- Inability of most regional member countries (RMCs) to borrow from the bank, which could make continuing shareholder support from some of its regional members dependent on the continued availability of financing from other AFDB Group entities.

Rationale

AFDB, a regional multilateral development finance institution (MDFI), was established in 1964 by 29 African countries. Non-African countries were admitted to membership beginning in 1982, and AFDB's membership now includes all 53 African countries and 24 nonregional countries. The bank is the keystone of the AFDB Group, which also includes soft-loan windows African Development Fund (AFDF; not rated) and Nigeria Trust Fund (NTF; not rated), which make grants and loans at concessional rates and together accounted for more than 45% of AFDB Group disbursements over the past five years. However, although AFDB has an equity investment in AFDF, it is not responsible for the financial obligations of either of these funds.

Since 1995, AFDB has restricted its sovereign lending to its most creditworthy RMCs. There are 15 countries that are, in principle, currently eligible to borrow from the bank. However, two—the Republics of Zimbabwe (not rated) and Seychelles (not rated)—have arrears on payments that bar new disbursements, and one—the Great Socialist People's Libyan Arab Jamahiriya (not rated)—has never borrowed from the bank. As a consequence of AFDB's credit policy, the other 38 RMCs are allowed to borrow only from AFDF and NTF on highly concessional terms. However, as a result of loans granted prior to 1995, at year-end 2004, nearly 25% of AFDB's loans were to countries and public-sector entities in countries no longer eligible to borrow from the bank, though these amounts are dropping as loans amortize.

AFDB lends to African governments and other public-sector entities with sovereign guarantees. It also lends to private-sector borrowers, makes equity investments, and has provided guarantees in small amounts. Historically, its focus has been its sovereign and public-sector entities, and at year-end 2004, such loans were almost 91% of total loans, equity investments, and guarantees.

AFDB's outstanding loans totaled 5.22 billion special drawing rights (SDR) at year-end 2004, which was 52% of its total assets. AFDB's financial accounts are expressed in units of account (UA), and UA1 is defined as equivalent to SDR1. Reflecting the weak credit standing of many of its regional members, SDR1.1 billion (nearly 23%) of AFDB's SDR4.9 billion in sovereign loans had principal or interest payments past due by more than six months at year-end 2004. Virtually all of these arrears are owed by countries either in conflict or recently emerged from conflict.

The expected losses embedded in AFDB's loan portfolio are smaller than they might appear, largely because of the payments AFDB expects to receive on behalf of its borrowers through the Highly Indebted Poor Countries (HIPC) Initiative. At year-end 2004, seven countries with loans from the bank totaling SDR206 million had reached their completion points, and five countries with loans totaling SDR500 million had reached their decision points. In addition, eight countries with loans totaling SDR549 million were in pre-decision-point status. The completion point and decision point countries together accounted for more than 14% of AFDB's sovereign loans, and the pre-decision-point countries constituted another 11%.

AFDB has steadily strengthened its financial profile in recent years: Its provisions for losses plus adjusted shareholders' equity (together, narrow risk-bearing capacity) totaled SDR3.86 billion at year-end 2004, 71% of development-related exposure, up from 67% one year earlier and 44% at year-end 1999 and one of the highest such ratios among MDFIs. In addition, AFDB's financial strength is bolstered by callable capital, nearly SDR5.5 billion of which was from countries rated 'AAA' by Standard & Poor's at year-end 2004. As a consequence, the ratio of narrow risk-bearing capacity plus 'AAA' callable capital (broad risk-bearing capacity) to development-related exposure was nearly 173% at year-end 2004, up from 153% one year earlier and 98% at year-end 1999—the highest such ratio among rated MDFIs. In addition, capital contributions totaling SDR115 million are expected to be received by year-end 2008.

AFDB's operating income increased to SDR220 million in 2004 from SDR178 million one year earlier, as higher interest from investments, lower interest expense, and lower administrative expenses outweighed

lower income from loans and a smaller release of provisions for losses on loans. The operating return on average assets was 2.2%, and average adjusted shareholders' equity was 6.5%.

AFDB's treasury assets have increased substantially in recent years. Its ratio of cash and investments to total borrowings increased to 79% at year-end 2004 from 73% one year earlier and 24% at year-end 1999, which is above that of most 'AAA' rated MDFIs. In addition, its ratio of cash and investments to undisbursed loans plus projected one-year debt service increased to almost 220% from 168% one year earlier and 42% at year-end 1999—also above that of most 'AAA' rated MDFIs.

Outlook

The outlook on AFDB is stable. The bank's capital position and liquidity should remain strong, and given the attention Africa is now receiving from the international community, its franchise value should stay high or even increase.

Membership And Voting Power

The agreement establishing the African Development Bank was signed in 1963 and came into force in 1964. The bank began operations in 1966 with 29 members, all of which were African countries. In 1982, the agreement was amended to permit nonregional members, all of which are required to be members of, or contributors to, AFDB. At year-end 2004, AFDB's membership consisted of all 53 African countries and 24 nonregional countries.

Each member has 625 votes plus one vote for each share of stock held. Countries with the largest voting power at year-end 2004 were the Federal Republic of Nigeria (not rated), 9.0%; U.S. (AAA/Stable/A-1+), 6.6%; Japan (AA-/Stable/A-1+), 5.4%; the Arab Republic of Egypt (BB+/Stable/B), 5.1%; the Federal Republic of Germany (AAA/Stable/A-1+), 4.1%; the Republic of South Africa (BBB+/Stable/A-2), 4.0%; Algeria (not rated), 3.8%; Canada (AAA/Stable/A-1+), 3.7%; and the Republic of France (AAA/Stable/A-1+), 3.7%. (All ratings are foreign-currency credit ratings as of Aug. 23, 2005.)

In May 1998, when AFDB's shareholders approved the fifth general capital increase, the allocation of shares was such that the ownership share of nonregional members would rise to 40% from the previous 33% when fully subscribed. At the same time, AFDB changed its general voting rules for both the board of governors and the board of directors to a two-thirds majority from a simple majority, with a provision for a 70% majority upon request from any member state. The qualified majority votes promote consensus in decisionmaking and protect the interests of nonregional member countries.

A number of AFDB's regional members have run arrears on payments on their capital subscriptions, including five that were in arrears on payments at year-end 2004 for a total of SDR11 million. Subscribed shares not paid for are reallocated to other members, subject to the 60%/40% overall split between RMCs and nonregional members, with priority in reallocation given to countries with small shareholdings relative to their economic strength.

Organization And Management

All powers of the bank are vested in its board of governors, which inter alia sets policy, admits new members, determines the bank's capital structure, and elects the president. Each member country appoints a governor and an alternate, who serve nominal five-year terms. However, these terms may be abbreviated or extended by the appointing member country. The board of governors delegates most of its operational responsibilities to the board of directors, though it retains the power to override their decisions.

The board of directors is composed of 12 regional and six nonregional members, none of whom may be governors or alternates. They serve a maximum of two three-year terms. Although one director represents only the U.S., at year-end 2004, all other directors represented multi-country constituencies.

The president of the bank may serve a maximum of two five-year terms. The second term of Mr. Omar Kabbaj, the current president, ends on Aug. 31, 2005. He will be succeeded by Mr. Donald Kaberuka, Minister for Finance and Economic Planning of Rwanda (not rated), on Sept. 1, 2005. At year-end 2004, AFDB's staff totaled 1,043, up from 987 at year-end 2003. Management and professionals accounted for 649 of the total.

The bank had been headquartered in Abidjan since its inception. However, because of the unrest in Cote d'Ivoire, AFDB temporarily relocated to its backup facilities in Tunis, Republic of Tunisia (BBB/Stable/A-3), in February 2003. AFDB has been increasing its field and other offices in RMCs and plans to have 25 (including the one in Tunisia) by the end of 2006.

Balance Sheet

Table 1 summarizes AFDB's balance sheet. The most notable features from a credit perspective are the continuous decline in loans outstanding during the past four years, a similar increase in shareholders' equity, and the very sharp increase in investments.

Table 1 African Development Bank/Summary Balance Sheet					
	--Year ended Dec. 31--				
(Mil. SDR)	2004	2003	2002	2001	2000
Assets					
Cash, due from banks	48	70	96	121	66
Receivables from swaps	275	254	149	136	256
Investments	4,435	4,136	1,973	2,071	1,808
Non-negotiable instruments on account of capital	31	42	57	63	61
Gross loans outstanding	5,223	5,612	5,968	6,466	6,566
Accumulated provision for loan losses	(450)	(469)	(492)	(494)	(421)
Equity participations	179	182	182	179	178
Accumulated provision for equity losses	(4)	(18)	(18)	(19)	(13)
Other assets	307	225	282	352	229
Total assets	10,044	10,035	8,197	8,874	8,729
Liabilities					

Accounts payable	311	195	232	383	297
Securities sold under agreements to repurchase	9	114	0	0	0
Payables for swaps	513	396	62	65	63
Borrowings net of embedded derivatives	5,657	5,799	4,455	5,211	5,384
Total liabilities	6,491	6,504	4,749	5,659	5,744
Capital					
Paid-in capital after exchange adjustments	2,066	2,023	1,983	1,948	1,871
Reserves	1,486	1,528	1,465	1,266	1,114
Shareholders' equity	3,553	3,551	3,448	3,214	2,984
Memo items:					
Guarantees of securities	15	4	3	0	0
Development-related exposure	5,417	5,798	6,153	6,645	6,744
Dollars/SDR (period end)	1.5530	1.4860	1.3595	1.2567	1.3029

Risk

AFDB's activities may be separated into treasury activities—which result in holdings of cash and investments, borrowings, and risk-management products—and development-related activities, which result in holdings of loans and equity investments and the issuance of guarantees.

Treasury-related risk

Like most other MDFIs, AFDB does not view its treasury operations as a source of significant income for the bank. Rather, these operations are intended to fund the bank in a conservative yet cost-effective manner. Consequently, the risk arising from AFDB's treasury activities is limited.

Credit risk. AFDB's operating policies call for cash and deposits to be held in institutions rated 'A' or higher, derivative counterparties to be rated 'AA-' or higher, and medium- and long-term financial instruments to be rated 'AA' or higher. The credit quality of AFDB's investment and derivatives portfolios has increased substantially from a few years ago, and at year-end 2004, 98% of the bank's exposure was to 'AAA' or 'AA' rated entities, with the remainder to 'A' entities. In addition, the bank generally executes International Swaps and Derivatives Assoc. master agreements and netting agreements with its derivatives counterparties. AFDB's ratings-based policies are supplemented by a risk-concentration policy that limits the bank's exposure to any entity to 10% of its risk capital—defined as paid-in capital, reserves, and general provisions for losses.

Exchange-rate risk. AFDB funds itself in a wide variety of currencies in an effort to minimize funding costs and ensure market access. At year-end 2004, its borrowings were concentrated in U.S. dollars (45% of total borrowings), Japanese yen (36%), and euros (6%). At the same time, AFDB's loans were concentrated in euros (42% of loans), U.S. dollars (38%), and Japanese yen (14%). AFDB's agreement requires liabilities in any one currency to be matched with assets in the same currency. To achieve this, the bank actively uses the swap market. In addition, since much of its balance sheet is funded by equity, which is denominated in SDRs, the bank also seeks to match, within a narrow range, the

currency composition of its net assets with the currency composition of the SDR. These policies have historically resulted in only modest translation adjustments to comprehensive income and, consequently, shareholders' equity.

Interest-rate risk. Interest-rate risk for the bank arises from two principal sources: the net interest margin for assets funded by debt and the interest-rate sensitivity of assets funded by equity. Management seeks to generate a stable net interest margin for the more than half of the bank's assets funded by debt by matching the interest rate characteristics of each class of assets and liabilities through the use of swaps. There is no way for the bank to fully immunize itself against the impact of interest rate changes on assets funded by equity. However, it does seek to reduce the volatility in its net interest margin by adjusting the repricing profile of the fixed-rate loans and investments funded by equity to match a 10-year repricing profile benchmark, i.e., by having 10% of assets funded by equity repriced each year. This results in the net interest margin on assets funded by equity tracking a 10-year moving average of SDR interest rates.

A third source of interest rate risk arises from prepayments for loans issued before 1997, which did not carry a prepayment penalty. The decline of interest rates in recent years has made refinancing an attractive option for some of AFDB's more creditworthy borrowers: SDR292 million in loans were prepaid in 2002, SDR471 million in 2003, and SDR542 million in 2004. The amount in 2004 was nearly 10% of year-end 2003 loans. However, management believes that future prepayments will be smaller than those of recent years.

In sum, the risk of loss from AFDB's treasury activities appears to be well contained by its policies and practices, and any losses are expected to be small.

Development-related exposure risk

The vast bulk of AFDB's risk lies in its development-related exposure. However, this risk is lower than it might appear, and it has sharply decreased in recent years.

Borrower eligibility. AFDB lends only to African countries and to public- and private-sector entities domiciled in African countries. Since 1995, the AFDB has used the same eligibility criteria as the International Bank for Reconstruction and Development (IBRD; AAA/Stable/A-1+) for determining which countries may borrow only from the bank, which may borrow from both the bank and AFDF, and which may borrow only from AFDF. Under these criteria, 13 of AFDB's RMCs at year-end 2003 were eligible to borrow only from the bank. Of these 13, Seychelles was barred from doing so because it was under sanctions for delays in servicing its loan obligations, and Libya has never borrowed from the bank. Nigeria and Zimbabwe were eligible in principle to borrow from both the bank and AFDF (though Zimbabwe was barred from doing so because it was under sanctions for delays in servicing its loan obligations). In addition, 38 members were eligible to borrow only from AFDF.

AFDB has historically focused on lending to the public sector in its RMCs, and as shown in Table 2, public-sector loans accounted for nearly 94% of total outstanding loans at year-end 2004. There has been an increasing demand for lending to highly creditworthy public-sector borrowers without sovereign guarantees. Because IBRD is unable to make such loans under its articles, AFDB expects this to become an attractive market niche in the future.

AFDB also lends to private-sector borrowers. Though still very small in volume, this lending has grown rapidly: outstanding loans increased to SDR319 million at year-end 2004 from SDR228 million at year-end 2003 and SDR169 million at year-end 2002. Management expects lending to the private sector

and to public-sector entities without sovereign guarantees to account for most of the growth in the bank's outstanding loans over the medium term.

Table 2 African Development Bank/Financing By Purpose					
	--Year ended Dec. 31--				
(Mil. SDR)	2004	2003	2002	2001	2000
Approvals	1,520	746	1,068	987	843
Project lending	417	566	690	568	402
Public and publicly guaranteed	256	360	491	376	375
Project loans	243	175	275	261	215
Lines of credit	13	185	216	115	159
Private and nonpublicly guaranteed loans	161	206	199	192	27
Project loans	0	91	98	43	4
Lines of credit	161	114	100	149	23
Policy-based lending	389	177	186	232	0
Sector adjustment	208	177	82	79	0
Structural adjustment	181	0	103	153	0
Equity participation	3	0	0	0	2
Special relief fund	3	4	5	1	6
HIPC debt relief	708	0	188	175	174
Project loan approvals as a % of total loan approvals	27.4	75.8	64.6	57.6	47.7
Public-sector approvals as a % of total approvals	89.2	72.4	81.4	79.5	65.7
Loans outstanding	5,223	5,612	5,968	6,466	6,566
Project lending	3,512	3,705	3,702	4,181	4,352
Public and publicly guaranteed	3,193	3,476	3,533	4,103	4,303
Project loans	2,043	2,300	2,544	3,037	3,154
Sector investment and rehabilitation loans	185	194	200	292	318
Lines of credit	965	982	789	774	830
Private and nonpublicly guaranteed loans	319	228	169	78	50

Project loans	173	78	33	42	31
Lines of credit	146	150	136	36	19
Policy-based lending	1,367	1,561	1,918	2,285	2,213
Sector adjustment	636	699	854	1,135	1,150
Structural adjustment	732	862	1,064	1,150	1,063
Debt and debt service reduction loans	343	347	348	0	0
Memo items:					
Public sector loans outstanding as a % of total loans outstanding	93.9	95.9	97.2	98.8	99.2
Project loans outstanding as a % of total loans outstanding	67.2	66.0	62.0	64.7	66.3
Policy-based loans as a % of total loans outstanding	26.2	27.8	32.1	35.3	33.7

Types of development-related exposure. Table 2 also shows AFDB's financing approvals and outstanding loans by the purpose of the financing. Most of AFDB's lending is for projects; project lending has accounted for 27%-76% of approvals (27% in 2004) and 62%-67% of outstanding loans (67% at year-end 2004) over the past five years. Policy-based lending approvals have been volatile, but outstanding policy-based loans have been dropping both in absolute terms and as a percentage of total loans (to 26% at year-end 2004). A third major category of lending is lines of credit to financial institutions, both public and private sector (whereby AFDB enables them to fund medium- and long-term projects that satisfy AFDB criteria). This is a growing activity and enables the bank to finance private-sector borrowers, including small and midsize enterprises, more efficiently than it otherwise could.

Loan maturities. Consistent with its development focus, AFDB typically extends medium- and long-term loans with final maturities of up to 20 years. At year-end 2004, about 26% of loans were scheduled to mature in 2005 and 2006, with another 20% in 2007 and 2008. Additional prepayments would of course increase these payments. However, management's expectation is that prepayments will be lower than those of recent years.

Equity investments. The agreement permits AFDB to make equity investments. The bank has been cautious about doing so, and the gross value of its equity investments at year-end 2004 was SDR179 million, of which SDR112 million represented AFDB's long-standing equity investment in AFDF, SDR21 million was in a variety of regional development banks, SDR9 million was in other development institutions, and SDR38 million was in a variety of equity funds. The bank is not contemplating substantial additions to its equity holdings and in fact sold two of its equity investments in 2004.

Exposure limits and concentration. AFDB's agreement limits the total amount of both undisbursed and outstanding loans, equity investments (including the bank's contingent liability for amounts subject to call), and guarantees to the sum of its unimpaired subscribed capital, reserves, and surplus. As calculated by AFDB, the total of loans, equity investments, and guarantees was less than 34% of its subscribed capital, reserves, and surplus at year-end 2004. Accordingly, this limit is not currently a binding constraint.

Given the small number of RMCs eligible to borrow from AFDB, concentration in its development-related portfolio is a concern. Management has established a limit that reflects the bank's internal risk rating for and the economic potential of each borrowing RMC. In addition, the maximum loan equivalent exposure for any single country is limited to 15% of the bank's maximum sustainable portfolio. Loans to no country were more than 77% of the 15% limit at year-end 2004.

In practice, as shown in Table 3, AFDB's development-related exposure concentration is surprisingly low. Its total exposure to its five countries of largest exposure relative to its narrow risk-bearing capacity, less than 83% at year-end 2004, has typically been lower than that of the IBRD and other major regional MDFIs, with the exception of the European Bank for Reconstruction and Development (AAA/Stable/A-1+), and has declined by nearly one-third over the past five years.

Table 3 African Development Bank/Geographic Concentration Of Development-Related Exposure*					
	--Year ended Dec. 31--				
	2004	2003	2002	2001	2000
Largest					
Largest country exposures/ratings as of balance-sheet dates¶	Tunisia/BBB	Tunisia/BBB	Tunisia/BBB	Morocco/BB	Morocco/BB
Mil. SDR	1,304	1,157	1,107	1,107	1,103
% total loans, guarantees, and equity investments*	24.1	21.5	18.6	17.1	16.8
% accumulated provisions for losses plus adjusted shareholders' equity	33.8	29.8	29.2	31.1	34.0
Second largest					
Largest country exposures/ratings as of balance-sheet dates¶	Morocco/BB	Algeria/N.R.	Morocco/BB	Tunisia/BBB	Tunisia/BBB
Mil. SDR	683	764	912	1,098	978
% total loans, guarantees, and equity investments*	12.6	14.2	15.3	17.0	14.9
% accumulated provisions for losses plus adjusted shareholders' equity	17.7	19.7	24.1	30.9	30.1
Third largest					
Largest country exposures/ratings as of balance-sheet dates¶	Nigeria/N.R.	Morocco/BB	Algeria/N.R.	Algeria/N.R.	Algeria/N.R.

Mil. SDR	515	596	753	783	739
% total loans, guarantees, and equity investments*	9.5	11.1	12.6	12.1	11.3
% accumulated provisions for losses plus adjusted shareholders' equity	13.3	15.3	19.9	22.0	22.8
Fourth largest					
Largest country exposures/ratings as of balance-sheet dates¶	Cote d'Ivoire/N.R.	Nigeria/N.R.	Nigeria/N.R.	Nigeria/N.R.	Nigeria/N.R.
Mil. SDR	356	492	569	635	703
% total loans, guarantees, and equity investments*	6.6	9.1	9.5	9.8	10.7
% accumulated provisions for losses plus adjusted shareholders' equity	9.2	12.7	15.0	17.9	21.7
Fifth largest					
Largest country exposures/ratings as of balance-sheet dates¶	DR Congo/N.R.	Cote D'Ivoire/N.R.	Cote D'Ivoire/N.R.	Cote D'Ivoire/N.R.	Cote D'Ivoire/N.R.
Mil. SDR	343	360	352	429	455
% total loans, guarantees, and equity investments*	6.3	6.7	5.9	6.6	6.9
% accumulated provisions for losses plus adjusted shareholders' equity	8.9	9.3	9.3	12.1	14.0
Largest two country exposures					
Mil. SDR	1,988	1,921	2,019	2,205	2,081
% total loans, guarantees, and equity investments*	36.7	35.7	33.8	34.1	31.7
% accumulated provisions for losses plus adjusted shareholders' equity	51.4	49.5	53.3	62.1	64.1
Largest three country exposures					

Mil. SDR	2,502	2,517	2,772	2,988	2,820
% total loans, guarantees, and equity investments*	46.2	46.7	46.5	46.2	43.0
% accumulated provisions for losses plus adjusted shareholders' equity	64.8	64.8	73.2	84.1	86.9
Largest four country exposures					
Mil. SDR	2,858	3,009	3,341	3,623	3,524
% total loans, guarantees, and equity investments*	52.8	55.9	56.0	56.0	53.7
% accumulated provisions for losses plus adjusted shareholders' equity	74.0	77.4	88.2	102.0	108.5
Largest five country exposures					
Mil. SDR	3,201	3,368	3,693	4,052	3,978
% total loans, guarantees, and equity investments*	59.1	62.6	61.9	62.7	60.6
% accumulated provisions for losses plus adjusted shareholders' equity	82.8	86.7	97.5	114.1	122.5
Memo items:					
Development-related exposure*	5,417	5,384	5,968	6,466	6,566
Accumulated provisions for losses plus adjusted shareholders' equity	3,864	3,885	3,788	3,553	3,246
*Loans, equity investments, and guarantees for year-end 2004; loans only for prior years. N.R.—Not rated.					

Development-related exposure quality and provisions for losses. Table 4 provides indicators of the quality of AFDB's development-related exposure and the accumulated provisions for losses embedded in that exposure. The index of the quality of development-related country exposure is an exposure-weighted average of the default rates associated with the long-term foreign currency sovereign credit ratings (or confidential credit assessments for countries that do not have public ratings) of AFDB's RMCs. This figure is adjusted for the preferred creditor treatment that obligations to AFDB are expected to receive; the higher the index, the greater the risk embedded in the portfolio. By this measure, although there has been some reduction in the embedded risk in AFDB's portfolio in the past two years, declining to 15.7 at year-end 2004 from 16.3 at year-end 2002, it nonetheless remains

the highest among rated MDFIs. However, this index does not differentiate between sovereign and nonsovereign loans, which are expected to carry more risk. It thus typically understates the total risk embedded in the portfolios of institutions dealing, in whole or in part, with nonsovereign entities.

	--Year ended Dec. 31--				
(Mil. SDR)	2004	2003	2002	2001	2000
Index of quality of development-related country exposure	15.7	16.0	16.3	15.6	16.2
Private sector loans as a % of total loans	6.1	4.1	2.8	1.2	0.8
Loan writeoffs, of which:	0	0	5	0	0
Sovereign loans	0	0	0	0	0
Nonsovereign loans	0	0	5	0	0
Impaired/nonaccrual loans	1,121	1,188	851	1,286	1,620
As a % of total loans	21.5	21.2	14.3	19.9	24.7
Principal past due	305	302	222	484	430
Accumulated provisions for losses on loans, of which:	450	469	492	494	421
Sovereign loans	422	449	479	479	407
% Sovereign loans	8.6	8.3	8.3	7.5	6.2
Nonsovereign loans	28	20	13	15	14
% Nonsovereign loans	8.8	8.6	7.5	19.4	28.6
Accumulated provisions as a % of impaired/nonaccrual loans	40.1	39.5	57.7	38.4	26.0
Accumulated provisions as a % of total loans	8.6	8.4	8.2	7.6	6.4
Accumulated provisions for losses on equity investments	4	18	18	19	13
Accumulated provisions as a % of total equity investments	2.4	9.8	9.9	10.6	7.5

As noted above, AFDB has been increasing its exposure to nonsovereign entities, albeit from a very low level, and nonsovereign loans increased to 6% of total loans at year-end 2004 from less than 1% at year-end 2000. Accordingly, the index might slightly overstate the reduction in the risk embedded in AFDB's loan portfolio.

AFDB's internal calculations indicate that, having improved substantially over the past five years, the quality of AFDB's nonsovereign loan portfolio is only modestly lower than that of its sovereign loan portfolio, and the quality of its nonsovereign loans is expected to be maintained as the portfolio grows over the medium term. Nonetheless, the performance of AFDB's nonsovereign loan portfolio will bear watching as loans age and the portfolio increases in size.

The historical performance of AFDB's loan portfolio has been well below that of other rated MDFIs. As

shown in Table 4, impaired loans as of the past five year-ends have ranged from a low of SDR851 million (14% of total loans) to a high of SDR1.62 billion (25%) and were SDR1.12 billion (22%) at year-end 2004. Principal past due at year-end 2004 was SDR305 million, up marginally from SDR302 million one year earlier.

However, AFDB's actual losses are likely to be substantially lower than these figures suggest; in more than 40 years of operation, the bank has never written off a sovereign or sovereign-guaranteed loan. More generally, loans to MDFIs are typically brought current by one of three means:

- A country uses its own funds to become current. AFDB's weakest RMCs are no longer eligible to borrow from the bank, and AFDB's loans to these countries were SDR1.29 billion at year-end 2004, a SDR159 million decline from one year earlier. RMCs participating in the HIPC Initiative must eliminate their arrears to AFDB, an important incentive for these countries to remain current or become current on their obligations. The bank had more than SDR500 million in outstanding loans at year-end 2004 to countries that had reached their decision points but not their completion points.
- Reschedule loans, though MDFIs do this only rarely, in extreme circumstances. This was done in 2002 for the Democratic Republic of the Congo (DRC; not rated). However, whether or not this proves only a cosmetic improvement depends on whether the rescheduled loans are serviced. DRC was current on its loans at year-end 2004.
- Donor aid, which permits the country to at least become current on its obligations, if not have them extinguished.

The HIPC Initiative has become the principal instrument for providing donor aid to the poorest countries. At year-end 2004, 32 of the 38 countries eligible or being considered for the HIPC Initiative were RMCs. These include 12 that reached their completion points, 11 that reached their decision points, and nine that were still to be considered for relief under the HIPC Initiative (pre-decision-point countries). Of these 32 RMCs, AFDB had credit exposure to 20 at year-end 2004. Loans outstanding to RMCs that reached their completion points at year-end 2004 totaled SDR206 million (4% of total sovereign loans outstanding); loans to countries that reached their decision points, SDR500 million (10%); and loans to countries still to be considered, SDR549 million (11%). In effect, more than 14% of AFDB's loans to its highest-risk borrowers are either benefiting from or are highly likely to benefit from the HIPC Initiative. Another 11% could also benefit, though over a longer time period.

The HIPC debt-relief initiative is having a major impact on the risk profile of AFDB's sovereign portfolio in two principal ways. First, the HIPC program will provide significant debt relief for eligible countries. Once these countries reach their completion points, AFDB will receive funds covering a large portion of the present value of the debt service owed by these countries to the bank. In effect, the portion of the debts owed by these countries to AFDB that is eligible for debt relief will be guaranteed by low-risk investment of these funds. Second, the HIPC program is promoting country reforms that are likely to improve the creditworthiness of most HIPC countries. Thus, even the portion of the debt to eligible countries that is not covered by HIPC relief should be lower risk as a result of the HIPC program.

Additional debt relief or other aid to countries to which AFDB has outstanding loans would help improve the quality of AFDB's loan portfolio. The 10th replenishment of the resources of AFDF, concluded in December 2004, was 43% higher than the ninth replenishment and should bolster repayment prospects from AFDF-eligible countries with loans from AFDB. The same is true of the commitment made at the June 2005 G8 meetings to cancel 100% of the debts to AFDF of completion-point countries that are on track with their programs.

Despite never having written off a sovereign loan, AFDB maintains provisions against losses on its sovereign loans. Indeed, it has gradually increased these to 8.6% of total outstanding sovereign loans at year-end 2004 from 6.2% at year-end 2000. These provisions are high compared with those of other MDFIs. However, the embedded risk in AFDB's sovereign portfolio is also higher.

AFDB keeps similar provisions for losses against its nonsovereign loans—8.8% at year-end 2004, a substantial decrease from the 54% at year-end 1999. However, the portfolio was much smaller at that point, and AFDB believes that the quality of its nonsovereign loan portfolio has improved as it has grown. Nonetheless, AFDB's provisions for nonsovereign loans are lower than those of some other MDFIs.

The equity investment lines in Table 4 are more difficult to interpret because equity investments are qualitatively different from loans: They can, in principle, produce capital gains, whereas loans cannot. AFDB's equity investments are carried on its balance sheet at cost less provisions for losses for those investments for which there is a significant and lasting decline in value. Provisions of less than 3% of gross equity investments at year-end 2004, down from 10% one year earlier, are low compared with those of some other rated MDFIs. In addition, the value of AFDB's equity in AFDF is uncertain.

Capital, Risk-Bearing Capacity, And Capital Adequacy

Table 5 summarizes AFDB's capital, risk-bearing capacity, and capital adequacy.

Table 5 African Development Bank/Capital, Risk-Bearing Capacity, And Capital Adequacy					
	--Year ended Dec. 31--				
(Mil. SDR)	2004	2003	2002	2001	2000
Capital					
Authorized capital	21,870	21,870	21,870	21,870	21,870
Subscribed capital	21,598	21,564	21,510	21,491	20,548
Paid-in capital	2,066	2,023	1,983	1,948	1,871
Reserves	1,486	1,507	1,465	1,226	1,114
Total shareholders' equity	3,553	3,531	3,448	3,214	2,984
Risk-bearing capacity					
Callable capital, of which:	7,824	19,376	19,395	18,531	14,781
'AAA' rated member countries	5,492	4,981	4,981	4,151	4,999
Non negotiable instruments on account of capital	31	42	57	63	61
Equity participation in African Development Fund	112	112	112	112	112
Adjusted paid-in capital	1,923	1,870	1,814	1,774	1,698
Adjusted shareholders' equity*	3,410	3,377	3,278	3,040	2,812
Accumulated provisions for losses	454	487	510	513	434

Narrow risk-bearing capacity¶	3,864	3,864	3,788	3,553	3,246
Broad risk-bearing capacity§	9,356	8,845	8,769	7,704	8,245
Capital adequacy					
Narrow risk-bearing capacity/total assets (%)	38.5	38.5	46.2	40.0	37.2
Broad risk-bearing capacity/total assets (%)	93.1	88.1	107.0	86.8	94.5
Narrow risk-bearing capacity/development-related exposure (%)	71.3	66.6	61.6	53.5	48.1
Broad risk-bearing capacity/development-related exposure (%)	172.7	152.6	142.5	115.9	122.2
*Shareholders' equity minus non negotiable instruments on account of capital less equity participation in the African Development Fund. ¶Accumulated provisions for losses plus adjusted shareholders' equity. §Narrow risk-bearing capacity plus callable capital from 'AAA' rated member countries.					

Paid-in capital

SDR21.6 billion of AFDB's nearly SDR21.9 billion in authorized capital (capital that its board of governors has authorized to be issued) was subscribed (claimed by members) at year-end 2004. However, only SDR2.07 billion (after the effects of exchange rate changes on the SDR value of capital contributions in members' national currencies or U.S. dollars) was paid in at year-end 2004; the remainder was callable. Carried as assets on AFDB's balance sheet are nonnegotiable instruments on account of capital (SDR31 million at year-end 2004) and AFDB's equity holding in the AFDF (SDR112 million). Because the former might not be immediately available to AFDB in a time of financial stress and because the value of the latter is uncertain and could well be overstated, Standard & Poor's deducts the amount of these assets from AFDB's paid-in capital to calculate adjusted paid-in capital, which totaled SDR1.92 billion at year-end 2004.

Reserves and shareholders' equity

AFDB's paid-in capital is buttressed by its reserves, which consist of the general reserve and the current year's net income less sums allocated or transferred outside the bank by its board of governors and the adjustment for translation gains and losses other than those relating to capital subscriptions. Reserves totaled SDR1.49 billion at year-end 2004. AFDB's adjusted shareholders' equity (the sum of adjusted paid-in capital plus reserves) thus totaled SDR3.41 billion at year-end 2004, up SDR33 million from one year earlier.

Callable capital

AFDB's adjusted shareholders' equity is, in turn, buttressed by its subscribed callable capital. Governors can issue a call on this capital—but only to meet obligations created by AFDB's borrowing or the issuance of a guarantee. Calls are made on a pro rata basis, but one member's failure to meet a call does not excuse other members from meeting that call. If a first-round call does not raise the amount required, subsequent calls can be made—up to the limit of each country's subscription. The ability and willingness of members to meet a capital call and to do so in a timely fashion are uncertain and cannot easily be quantified. Accordingly, Standard & Poor's focuses exclusively on the callable capital from member countries rated 'AAA'. AFDB's 'AAA' callable capital totaled SDR5.49 billion at year-end 2004, up from SDR4.98 billion one year earlier, the result of the upgrades of the Kingdom of Sweden and Kingdom of Spain to 'AAA' in 2004.

Risk-bearing capacity

Standard & Poor's has two different measures of risk-bearing capacity:

- Narrow risk-bearing capacity, which includes accumulated provisions for losses and adjusted shareholders' equity.
- Broad risk-bearing capacity, which includes narrow risk-bearing capacity and callable capital from 'AAA' rated member countries.

Table 5 includes four measures of capital adequacy. The two comparing narrow and broad risk-bearing capacity to total assets are of limited relevance because most of AFDB's nondevelopment-related assets have little risk (credit or market) associated with them. However, these ratios were 39% and 93%, respectively, at year-end 2004.

The more relevant comparison is between risk-bearing capacity and development-related exposure. The more conservative ratio of narrow risk-bearing capacity to development-related exposure was 71% at year-end 2004, having steadily increased from 48% four years earlier as the result of an absolute reduction in development-related exposure and an increase in adjusted shareholders' equity. The less-conservative ratio of broad risk-bearing capacity to development-related exposure increased to a very robust 173% from 122% four years earlier. This even greater percentage increase reflects the absolute increase in the amount of 'AAA' callable capital, as Canada, the Republic of Finland, the Kingdom of Denmark, Sweden, and Spain gained 'AAA' ratings, while the rating on Japan was lowered from 'AAA'. The 71% ratio of narrow risk-bearing capacity to development-related exposure means that assuming no losses from AFDB's other assets, 71% of the bank's development-related portfolio could be deemed worthless before the bank would become insolvent. The 173% ratio of broad risk-bearing capacity to development-related exposure means that assuming all 'AAA' rated member countries met a capital call in full, all of the bank's development-related exposure and nearly 85% of its other assets could be deemed worthless before the bank would become insolvent. This is a cushion unsurpassed by other rated MDFIs.

Net Income

As a development institution, AFDB does not seek to maximize income but rather to earn a return adequate to ensure its financial strength and to permit it to meet its development and other financing goals. Although AFDB is currently benefiting from increases in paid-in capital, increases in reserves from retained earnings are likely to be the primary source of growth in its risk-bearing capacity over the medium term.

The principal drivers of AFDB's operating income are the level of interest rates (because equity funds a large portion of its interest-earning assets), the spread on loans and investment assets funded by borrowings, provisions for losses, and noninterest expense, primarily administrative. Table 6 summarizes the principal components of AFDB's net income.

Table 6 African Development Bank/Summary Income Statement					
	--Year ended Dec. 31--				
(Mil. SDR)	2004	2003	2002	2001	2000
Income from loans	311	325	415	448	438
Income from investments	124	100	74	121	90
Borrowing expenses	(199)	(220)	(259)	(350)	(340)
Net income from loans and investments before provision for losses	235	206	230	220	188
Release of (provision for) losses on loans	18	22	(4)	(60)	(39)
Net interest income after provision for losses	253	227	227	160	149
Administrative expense net of management fees	(37)	(45)	(32)	(30)	(30)
Other income (net)	4	(4)	(6)	(4)	(2)
Operating income	220	178	189	125	117
Unrealized net (loss)/gain on nontrading derivatives	(113)	(82)	37	82	0
Net income	107	97	226	208	117
Memo items:					
Return on average assets (%)	2.2	2.0	2.2	1.4	1.3
Return on average adjusted shareholders' equity (%)	6.5	5.4	6.0	4.3	4.3
Allocation of net income to:					
Post conflict assistance—Democratic Republic of Congo	54	13	0	0	0
Post Conflict Countries Fund	45	0	0	0	0
African Development Fund	10	25	10	10	10
HIPC Initiative	6	9	6	6	6
Special Relief Fund	0	10	5	0	3
Technical Assistance Fund for AFDF-only countries	0	0	1	0	0
Total	115	57	22	16	19

AFDB's operating income increased to SDR220 million in 2004 from SDR178 million one year earlier. Income from loans declined, reflecting the reduction in loans outstanding; income from investments increased, mirroring the increase in investments; and borrowing costs declined as outstanding borrowings dropped. Together, these resulted in an increase in net income before provisions for losses to SDR235 million from SDR206 million the previous year. For the second year running, provisions for losses were written back, though the amount fell marginally to SDR18 million from SDR22 million the previous year. Administrative expenses, net of reimbursement by AFDF and NTF for costs incurred on their behalf, dropped sharply to SDR37 million from SDR45 million the previous year, the latter number boosted by extraordinary one-time expenses relating to the temporary relocation of the bank to Tunis from Abidjan. The operating return on average assets was 2.2%, and the operating return on average adjusted shareholders' equity was 6.5%.

Like those of most other MDFIs, AFDB's board of directors and management believe that operating income rather than net income is the better focus for economic and managerial decisions. IAS 39 fair valuation losses increased to SDR113 million from SDR82 million the previous year, resulting in a smaller increase in net income than operating income—to SDR107 million from SDR97 million the previous year.

AFDB had SDR784 million in nonaccrued income at year-end 2004. As and when AFDB's nonaccrual loans are repaid, this income will be recognized, boosting operating and net income and shareholders' equity.

Although AFDB does not pay dividends to its shareholders, not all of its net income is retained to bolster its risk-bearing capacity. Depending on the performance of the bank, a portion of reserves may be allocated to support development-related initiatives for Africa. As shown in Table 6, these amounts have varied from SDR19 million (in 2000) to SDR115 million (in 2004) over the past five years. The principal beneficiaries of these allocations in 2004 were post-conflict assistance to the DRC and the Post Conflict Countries Fund. The allocation to post-conflict assistance to the DRC goes to a special account that is separate from the assets of the bank, disbursements from which are used to repay a portion of DRC's borrowings from the bank. The Post Conflict Countries Fund, which is also separate from the assets of the bank, receives allocations from the net incomes of AFDB and AFDF (and, potentially, other interested parties), to be used to assist post-conflict countries to reach their HIPC decision points.

Borrowing And Liquidity

Under the agreement, development-related exposure plus undisbursed loans cannot exceed subscribed capital plus reserves; expressed differently, debt cannot exceed callable capital plus investments. In addition, there are currently three other debt-related policies:

- Total debt may not exceed 80% of total callable capital.
- Total debt may not exceed 100% of usable capital, which is paid-in capital in convertible currencies, reserves, and callable capital of countries rated 'AA' or higher.
- Total senior debt (AFDB is unique among rated MDFIs in having some subordinated debt outstanding) may not exceed 80% of the callable capital of nonborrowing member countries.

AFDB has been well within these limits in recent years. For instance, at year-end 2004, total debt was less than 30% of total callable capital and less than 53% of usable capital, and senior debt was 58% of nonborrowing members' callable capital.

Standard & Poor's calculates four leverage ratios for comparative purposes:

- Gross debt to adjusted shareholders' equity.
- Gross debt to adjusted shareholders' equity plus 'AAA' callable capital.
- Gross debt net of liquid assets to adjusted shareholders' equity.
- Gross debt net of liquid assets to adjusted shareholders' equity plus 'AAA' callable capital.

AFDB's leverage has declined substantially in recent years, and at year-end 2004, its leverage by all of these measures was among the lowest of 'AAA' rated MDFIs.

The bank's liquidity policy calls for maintaining liquidity in a zone between:

- The prudential minimum level of liquidity, which is equal to the sum of debt-service payments for the next year, the projected net loan disbursements for the next year, the loan equivalent value of signed guarantees, and undisbursed equity investments.
- The operational level of liquidity, which is equal to the prudential minimum level of liquidity plus 50% of the stock of undisbursed loans.

Standard & Poor's calculates two liquidity ratios for comparative purposes: liquid assets to gross debt and liquid assets to undisbursed loans and equity investments plus estimated one-year debt service. By both of these measures, there has been a huge improvement in AFDB's liquidity in recent years, and AFDB had one of the strongest liquidity positions among 'AAA' rated MDFIs at year-end 2004.

In sum, although Africa remains a challenging environment in which to operate, AFDB's management in recent years has greatly strengthened the bank's financial profile. AFDB's capital and liquidity, as well as its qualitative features, place it solidly in the 'AAA' rating category.

Comparative Data

Comparative data for AFDB and 14 other MDFIs may be found on pages 57-60 of Standard & Poor's annual Supranationals Special Edition 2004. This report is available at www.standardandpoors.com. (Enter Supranationals Special Edition in the search box and click on the title under "Credit Ratings" in the center of the screen.)

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