

## African Development Bank

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# African Development Bank

## Major Rating Factors

### Strengths:

- Strong liquidity and capital position.
- Prudent financial management and policies.
- Strong support from members, including 11 'AAA' rated countries, contributing Special Drawing Rights 6.9 billion in callable capital.

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

### Weaknesses:

- Relatively risky loan portfolio with nonperforming loans larger than those of multilateral peers.
- The inability of the governments of most African countries to borrow from the bank.

## Rationale

The ratings on African Development Bank (AFDB) are based on its strong liquidity and capital position, prudent financial management and policies, and strong support from its members, which include 11 'AAA' rated countries, and which contribute Special Drawing Rights (SDR, international foreign exchange reserve assets, allocated by the International Monetary Fund) 6.9 billion in callable capital. These factors offset the bank's relatively risky loan portfolio and high level of nonperforming loans (NPLs), as well as the inability of the governments of most African countries to borrow from the bank.

AFDB, a regional multilateral development finance institution (MDFI), was established in 1964 by 29 African countries. Nonregional members were admitted from 1982, and AFDB's membership now includes 53 African and 24 nonregional countries. AFDB is the keystone of the African Development Bank Group (AFDB Group), which includes soft-loan windows African Development Fund (AFDF) and Nigeria Trust Fund (NTF). AFDF and NTF make grants and loans at concessional rates; their loans and grants help to maintain support for AFDB in countries not currently eligible to borrow from the bank. However, while AFDB has an equity investment in AFDF, it is not responsible for the financial obligations of either of these funds, both of which are unrated.

Historically AFDB has provided medium- and long-term loans primarily to African governments and other public-sector entities with sovereign guarantees; however, its focus on the private sector has been increasing over the past few years. The bank also makes equity investments and has provided a few small guarantees. At year-end 2010, 97% of the bank's development-related exposure (DRE) was loans, 2% equity investments, and 1% development-related debt securities. Of outstanding loans, 81% were to governments or were government guaranteed. Financing approvals to private sector entities were about SDR1 billion in 2010, but their proportion relative to total approvals increased to about 40% owing to a sharp decrease in public sector disbursements.

Since 1995, AFDB has restricted its sovereign lending to its most creditworthy regional member countries. In principle, 16 African countries are eligible to borrow from the bank; however, of these 16 Zimbabwe (unrated) is ineligible for new disbursements due to ongoing arrears and Libya (unrated) has never borrowed. The other 37 African countries have been able to borrow only from AFDF and NTF since 1995. Lending to the private sector, however, is not restricted to eligible countries. AFDB's outstanding loan exposure increased by 10% during 2010 to

SDR8,293 million, following a 29% growth rate in 2009 and annual growth rates of 4%-5% in the two preceding years. Growth was driven by budget support loans and loans to private sector entities for infrastructure projects. As AFDB's treasury investments remained practically the same, outstanding loans remained at 45% of total assets.

Reflecting the weak credit-standing of many of its regional members, SDR457 million of public sector loans (6.8% of total public sector loans) had principal or interest payments past due by more than six months at year-end 2010, mostly from Zimbabwe; the amount of arrears was significantly reduced from year-end 2008 levels as Côte d'Ivoire (unrated) eliminated its arrears of SDR309 million in March 2009. Of private sector exposure, 1.5% was in arrears at year-end 2010.

In our view, the expected losses embedded in AFDB's loan portfolio are much smaller than they might appear. Standard & Poor's expects AFDB to receive historical treatment as preferred creditor on its sovereign and sovereign-guaranteed loans compared with that received by commercial and bilateral lenders. Given the economic distress of many of its borrowing members, however, this special status may be of limited value. More important are the payments AFDB expects to receive on behalf of its borrowers through the Highly Indebted Poor Countries (HIPC) Initiative of the International Monetary Fund and the World Bank. Twenty-three member countries had achieved HIPC "completion point" status and seven had achieved "decision point" status by year-end 2010 and a further three had been designated "predecision point" countries. Under the HIPC framework, the HIPC Trust Fund repays a substantial portion of eligible loans. In addition, we expect other debt relief initiatives to place these countries in a better position financially to service their external debts, including those to AFDB.

AFDB's narrow risk-bearing capacity (provisions for losses plus adjusted shareholders' equity) dropped to 57% of DRE at year-end 2010 from 61% of DRE at year-end 2009. AFDB's financial strength is bolstered by its callable capital, of which SDR5.6 billion is from countries rated 'AAA' by Standard & Poor's (SDR6.9 billion at year-end 2010, including callable capital from the U.S., the rating on which was lowered to 'AA+' on Aug. 2011). The bank's liquidity position continues to be one of the strongest among rated MDFIs.

AFDB's ratio of reserves for losses, adjusted shareholders' equity, and 'AAA' callable capital (its broad risk-bearing capacity) to DRE was 134.8% at year-end 2010 (120% without callable capital granted by the U.S.). AFDB's board of governors approved a sixth general capital increase in May 2010, which tripled the bank's authorized capital, and if fully subscribed, would double the bank's paid-in capital. However, AFDB's capital adequacy, despite weakening due to strong asset growth in 2010, is still strong compared with that of other MDFIs.

In recent years, AFDB has distributed most of its net income for various developmental purposes. AFDB's income before transfers approved by its board of governors was SDR214 million during 2010, down from SDR231 million a year earlier, resulting in a return on average assets plus guarantees of 1.2% and a return on average adjusted shareholders' equity of 3.1%.

In 2010, AFDB issued \$2.8 billion of debt.

## Outlook

The outlook is stable. We expect AFDB's liquidity to remain very strong and its high franchise value to increase, given the attention Africa is receiving from the international donor community. We believe that the subscription and payment of the recently approved capital increase by AFDB's shareholders could support the capital adequacy. Our

view on shareholder support could change if shareholders do not pay in the expected amounts.

## Organization, Ownership, And Management

All powers of the bank are vested in its board of governors, which, among other things, 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, although it retains the power to override their decisions.

The board of directors consists of 13 regional and seven nonregional members, none of whom may be governors or alternates. They may serve a maximum of two three-year terms. The largest single voteholder in the bank at year-end 2010 was Nigeria (B+/Stable/B) (all ratings thereafter as of August 22, 2011), with 8.6% of total votes; the next largest voteholders were the United States (AA+/Negative/A-1+, 6.4%), Japan (AA-/Negative/A-1+, 5.3%), Egypt (BB/Negative/B, 5.0%), and South Africa (BBB+/Stable/A-2, 4.5%). Shares are allocated such that when all are subscribed, regional member countries will own 60% of the shares and nonregional member countries 40%, although voting power does not precisely mirror share ownership.

The president of the bank may serve a maximum of two five-year terms. Donald Kaberuka, formerly a minister for finance and economic planning for Rwanda (unrated), assumed the presidency on Sept. 1, 2005 and was re-elected for a second term in May 2010. AFDB's had 1,789 staff at year-end 2010 (an increase of 8.2% on 2009).

The bank has formally been headquartered in Abidjan, Côte d'Ivoire, since its inception; however, political unrest in that country prompted the bank to temporarily relocate to its backup facilities in Tunis, Tunisia (BBB-/Negative/A-3) in February 2003, where it remains pending more settled conditions in Côte d'Ivoire. The bank has 25 field offices.

## Balance Sheet

The bank's financial statements are expressed in UA. Under the agreement establishing the bank, UA1 is defined as the equivalent of SDR1. Financial statements are prepared in accordance with International Financial Reporting Standards. The 2010 statements were audited by KPMG, Paris. Financial year end is Dec. 31.

On Dec. 31, 2010, AFDB had total assets of SDR19.144 billion (\$29.4 billion at SDR1 to \$1.54003), split evenly between loans and securities. The bank's assets grew by 11% in 2010, lower than the 36.7% recorded in 2009.

**Table 1**

African Development Bank--Summary Balance Sheet							
(Mil. SDR)	--Year ended Dec. 31--						
	2010	2009	2008	2007	2006	2005	2004
Assets							
Cash, due from banks, demand obligations	400	323	596	99	133	74	48
Treasury investments	7,434	7,412	4,576	5,329	6,093	5,155	4,435
Accrued income and charges receivable on loans	347	294	452	436	456	431	406
Accumulated provision for impairment on accrued income and charges receivable on loans	-169	-125	-116	-169	-223	-198	-188
Loans disbursed and outstanding	8,293	7,538	5,835	5,540	5,291	5,512	5,640

Table 1

<b>African Development Bank--Summary Balance Sheet (cont.)</b>							
Accumulated provision for impairment on disbursed and outstanding loans	-114	-102	-103	-196	-214	-195	-214
Equity participation, of which:	291	250	210	192	123	172	161
Participation in African Development Fund	63	62	64	64	63	97	97
Accumulated provision for losses on equity investments	-19	-16	-21	-2	-4	-3	0
Securities issued by entities in regional member countries	80	71	69	95	0	0	0
Non-negotiable instruments on account of capital	5	8	12	15	20	26	31
Derivative assets	1,421	764	736	425	273	286	275
Other assets	1,176	767	325	319	383	340	198
Total assets	19,144	17,185	12,571	12,082	12,332	11,601	10,792
<b>Liabilities</b>							
Borrowings, of which:	11,981	10,581	6,707	6,199	5,870	5,940	5,639
Portion of gross debt maturing during the next year	1,625	1,196	924	1,154	323	252	325
Derivative liabilities	328	477	360	591	482	317	514
Other liabilities	2,015	1,386	843	584	1,527	965	386
Total liabilities	14,324	12,443	7,911	7,374	7,879	7,223	6,539
<b>Capital</b>							
Paid-in capital	2,193	2,188	2,185	2,176	2,147	2,112	2,066
Other capital	2,627	2,553	2,475	2,532	2,305	2,266	2,187
Shareholders' equity	4,820	4,741	4,660	4,708	4,453	4,378	4,253
<b>Off-balance-sheet items</b>							
Guarantees	0	0	0	0	0	0	15
Callable capital from 'AAA' rated member countries	6,927	5,294	5,466	5,466	5,491	5,484	5,492

## Capital And Risk Bearing Capacity

### Capital

AfDB's authorized capital increased to UA67.69 billion (approximately \$100 billion) after the board of governors tripled its authorized capital base in 2010 to sustain high demand level for lending from regional member countries. The payment period is set at eight years for middle income countries, blend countries and non-regional member countries, and at 12 years for AFDB-eligible member countries. Payments under the capital increase are due to commence in 2011 and as a result UA23.92 billion (35%) had been subscribed at Dec. 31, 2010 and less than UA2.3 billion actually paid in.

AFDB's SDR21.549 billion of callable capital at year-end 2010 could be called by its board of governors, but only to meet obligations created by the bank's borrowings or guarantees. A capital call would oblige all members to contribute their pro rata shares of the amount called, but one member's failure to meet a call would not release other members from their obligations to do so. If a first-round call did not raise the amount required, subsequent calls could be made, but no member would be obliged to pay more than the amount to which it subscribed. No multilateral lending institution has ever issued a capital call to avoid default, and the willingness and ability of members to respond to such a call is undemonstrated. Accordingly, Standard & Poor's uses the callable capital from 'AAA' rated member countries as a proxy for the expected amount that would be forthcoming if there were a call on

all callable capital.

AFDB's paid-in capital was supplemented by SDR2.63 billion of reserves as at Dec. 31, 2010, bringing shareholders' equity to SDR4.82 billion. The reserves are supported by modest but stable internal capital generation. No dividends are paid but the board of governors releases profits for development purposes. In 2010, SDR146.4 million was released for such purposes. This was down from SDR162.7 million in 2009.

In our opinion, AFDB's on-balance sheet capital provides good coverage for risk undertaken. Capital reserves are supported by modest internal capital generation and the fact that no dividends are paid, although the board of governors releases profits for development purposes. On Dec. 31, 2010, capital covered 28.5% of adjusted assets and, when included with loan loss reserves, was equal to 60% of gross loans. The major threat to capital is high concentrations to sovereign borrowers with low investment grade ratings. On Dec. 31, 2010, the bank's five leading borrowers, all of which had foreign currency ratings at or below 'A-' or were unrated, accounted for borrowings amounting to more than 100% of the bank's total equity. Positively, concentrations of lending to private sector borrowers are much smaller.

### **Risk-bearing capacity**

Risk-bearing capacity is a measure of the losses that an MDFI can sustain before its liabilities exceed its assets (narrow risk-bearing capacity [NRBC]) or its assets plus 'AAA' callable capital (broad risk-bearing capacity [BRBC]). AFDB's NRBC is calculated by adding adjusted shareholders' equity and provisions for losses on its DRE.

Two adjustments are made to AFDB's reported shareholders' equity. First, AFDB's year-end 2010 balance sheet carries SDR5 million of non-negotiable instruments on account of capital as an asset; however, cash from these instruments may not be immediately available to the bank in a time of financial stress. Second, the balance sheet also carries AFDB's SDR63 million net equity holding in AFDF as an asset; this asset is illiquid and of uncertain value, and even more so in an event of severe financial stress. Accordingly, these two asset classes are assigned a value of zero, and reported shareholders' equity and total assets are reduced by the sum of the two to obtain adjusted shareholders' equity and adjusted total assets.

AFDB has three types of provisions for losses on its DRE. First, the bank's accrued income and charges receivable on loans--SDR347 million at year-end 2010--are treated as DRE. Accordingly, the provision for losses on these items--SDR169 million--is included in provisions for losses. Second, the bank had an accumulated provision for impairment of loans of SDR114 million--1.4% of loans disbursed and outstanding. Third, AFDB had an accumulated provision for impairment of equity investments of SDR19 million against its equity investments excluding AFDF at year-end 2010.

AFDB's NRBC is the sum of adjusted shareholders' equity plus provisions for losses on DRE and totaled SDR5 billion at year-end 2010, up by 3% from the previous year.

AFDB's BRBC is calculated by adding its 'AAA' callable capital to its NRBC. Of AFDB's callable capital of SDR21.5 billion at year-end 2010, SDR6.9 billion was from countries rated 'AAA' by Standard & Poor's (SDR 5.6 billion without callable capital granted by the U.S.). Accordingly, AFDB's BRBC totaled SDR12 billion at year-end 2010 (SDR 10.7 billion without callable capital granted by the U.S.).

The ratio of NRBC to DRE fell to 57% from 60% a year earlier, and 74% in 2008. At the same time, BRBC was 135% of DRE (120% without callable capital granted by the U.S.). This is still strong compared with the capacities

of other 'AAA' rated MDFIs.

**Table 2**

<b>African Development Bank--Capital, Risk-Bearing Capacity, And Capital Adequacy</b>							
<b>(Mil. SDR, unless otherwise indicated)</b>	<b>--Year ended Dec. 31--</b>						
	<b>2010</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>Capital</b>							
Authorized capital	67,687	22,120	21,870	21,870	21,870	21,870	21,870
Subscribed capital	23,925	21,818	21,765	21,693	21,795	21,636	21,598
Callable capital, of which:	21,549	19,458	19,409	19,342	19,437	19,367	19,375
From 'AAA' rated member countries	6,927	5,294	5,466	5,466	5,491	5,484	5,492
Paid-in capital*	2,193	2,188	2,185	2,176	2,147	2,112	2,066
Reserves	2,627	2,553	2,475	2,532	2,305	2,266	2,187
Shareholders' equity	4,820	4,741	4,660	4,708	4,453	4,378	4,253
<b>Risk-bearing capacity</b>							
Non-negotiable instruments on account of capital	-5	-8	-12	-15	-20	-26	-31
Participation in African Development Fund	-63	-62	-64	-64	-63	-97	-97
Adjusted shareholders' equity	4,753	4,671	4,585	4,629	4,369	4,255	4,125
Accumulated provision for impairment on accrued income and charges receivable on loans	114	102	103	169	223	198	188
Accumulated provision for impairment on loans disbursed and outstanding	169	125	116	196	214	195	214
Accumulated provision for losses on equity investments	19	16	21	2	4	3	0
Narrow risk-bearing capacity	5,055	4,915	4,824	4,996	4,810	4,651	4,526
Callable capital from 'AAA' rated member countries	6,927	5,294	5,466	5,466	5,491	5,484	5,492
Broad risk-bearing capacity	11,983	10,209	10,290	10,462	10,301	10,135	10,018
<b>Development-related exposure</b>							
Accrued income and charges receivable on loans	347	294	452	436	456	431	406
Loans disbursed and outstanding	8,293	7,538	5,835	5,540	5,291	5,512	5,640
Securities issued by entities in regional member countries	80	71	69	95			
Equity investments excluding participation in African Development Fund	228	189	146	128	60	75	63
Guarantees	0	0	0	0	0	0	15
Total development-related exposure	8,948	8,092	6,501	6,198	5,806	6,019	6,125
<b>S&amp;P capital adequacy calculations</b>							
Narrow risk-bearing capacity/adjusted total assets** (%)	26.5	28.7	38.6	41.6	39.3	40.5	42.4
Broad risk-bearing capacity/adjusted total assets** (%)	62.8	59.6	82.4	87.2	84.1	88.3	93.9
Narrow risk-bearing capacity/development-related exposure (%)	56.5	60.7	74.2	80.6	82.8	77.3	73.9
Broad risk-bearing capacity/development-related exposure (%)	133.9	126.2	158.3	168.8	177.4	168.4	163.5

**\*After cumulative gains and losses arising from exchange rate movements affecting NRMC's capital contributions**

\*\*Total assets less non negotiable instruments on account of capital less participation in the African Development Fund

## Credit And Market Risk

### Credit Risk

AFDB lends only to African countries and to public- and private-sector entities domiciled in African countries. Since 1995, AFDB has used the same eligibility criteria as the World Bank Group for determining which countries may borrow from the bank. Under these criteria, only 13 of AFDB's 53 regional member countries are currently eligible in principle to borrow from AFDB, and one of these, Libya, has never borrowed from the bank. Three countries, Cape Verde, Nigeria and Zimbabwe (unrated) are eligible for a blend of AFDB and AFDF lending, although Zimbabwe is currently barred from borrowing because it is under sanctions for delays in servicing its obligations. Thirty-seven countries are eligible to borrow from AFDF.

AFDB's DRE consists of its outstanding loans, including the accrued income and charges receivable on its loans; securities issued by entities based in its regional country members; its equity investments, excluding its investment in AFDF (since we in effect value that at zero); and guarantees outstanding. As of year-end 2010, the bank's DRE totalled SDR8.9 billion, up by 10% from a year earlier. The strong growth in 2010 and 2009 reflected increased demand, and highlights AFDB's countercyclical role.

Historically, AFDB has focused on lending to the public sector. As of year-end 2010, 81% of outstanding loans were to public-sector borrowers. As of Dec. 31, 2010, AFDB's five largest sovereign borrowers accounted for 63.3% of the bank's total loan book. Alone, the largest sovereign borrower, Morocco (BBB-/Stable/A-3), accounts for 22% of the total loan book. The loan concentration on the five largest borrowers was 4.4% lower than in 2009. The bank's geographic concentrations remain in the more-creditworthy north and south of Africa.

The bank is focusing increasingly on lending to private sector borrowers, which accounted for 19% of the total loan book on Dec. 31, 2010. In terms of distribution by sector, loan and grant approvals in 2010 were concentrated in infrastructure (72.7%) and the multi-sector (4.6%), reflecting the medium-term strategy of the bank, and finance (7%).

The bank invests in certain debt instruments issued by entities in its regional member countries for the purpose of financing development projects and programs. The fair value of investments in debt instruments issued in regional member countries as at Dec. 31, 2010 was UA79.8 million or 1.7% of adjusted total equity.

The bank also exposes itself to equity through its banking book to facilitate the development of the private sector in regional member countries. Consequently, a majority of the exposures are to regional development banks or investment funds. The bank does not seek to take a controlling stake in these companies but rather uses its presence to encourage others to participate. Internal regulations restrict equity investments to less than 15% of the aggregate amount of the bank's paid-in capital, reserves, and surplus in terms of used risk capital. At Dec. 31, 2010 such exposure accounted for less than 6% of adjusted total equity.

Given the geographic scope of its activities, AFDB's asset quality compares poorly with that of other similar institutions; however, loss-making loans have historically been very low as defaulted debt exposure has been restructured and repaid. Nonperforming assets (defined as impaired loans plus accrued income and charges receivable on loans) accounted for 6.1% of total loans and accrued income and charges receivable on loans at Dec. 31, 2010. Reflecting the dynamics of lending, a majority of the delays consists of sovereign loans that were granted before a change to credit policy in 1995 and are more likely to be repaid than private-sector debt. Positively, asset

quality has improved since 2007 when the bank had a NPL ratio of 14.3% at year end. This improvement reflects a lowering of NPL stock in 2008 and quick loan growth since 2009. The loan book is split into public and private sector lending at 81% and 19% respectively. Public sector loans overdue by more than 180 days represent 6.8% of total public sector loans, while private sector loans overdue by more than 180 days represent 1.5% of private sector loans.

In our opinion, loan loss reserves cover a moderate amount of AFDB's NPL book. While 51% would seem low for a financial institution operating in Africa, we view the bank's preferred creditor status as a key benefit in the recovery of NPLs. This status means only that AFDB's loans are likely to be repaid before those of commercial or official bilateral lenders; it does not ensure that they will be repaid in full or on time. Given the economic distress of many of the bank's borrowing members, they have occasionally fallen behind on their payments. However, the bank has never had to write-off any sovereign debt, as defaulted debt exposure has been restructured and repaid.

Table 3

African Development Bank--Financing By Purpose							
(SDR Mil., unless otherwise indicated)	--Year ended Dec. 31--						
	2010	2009	2008	2007	2006	2005	2004
<b>Approvals</b>							
Project lending	2,107	3,791	1,373	1,462	515	597	417
Public and publicly guaranteed	1,092	2,780	642	646	245	459	256
Private and non-publicly guaranteed	1,016	1,010	731	816	270	138	161
Policy-based lending	129	1,522	136	20	411	148	389
Equity investments	190	142	146	185	0	35	3
Other	155	149	152	3	119	89	711
Total	2,581	5,604	1,807	1,670	1,045	869	1,520
<b>Outstanding loans, development-related securities, and equity investments</b>							
Private sector loans*	1,599	1,372	503	350	316	362	319
Public sector project loans*	2,960	2,577	2,432	2,459	2,587	2,849	3,193
Policy-based loans*	2,972	2,866	2,139	2,042	1,679	1,559	1,367
Other public sector loans*	762	724	760	690	1,025	1,104	1,080
Total outstanding loans	8,293	7,538	5,835	5,540	5,291	5,512	5,640
Securities issued by entities in regional member countries	80	71	69	95	0	0	0
Equity investments	291	250	210	192	123	172	161
<b>Memo items</b>							
Public sector as a % of total loans	81.0	82.0	91.4	93.7	94.0	93.4	94.3
Policy-based loan approvals as a % of total financing approvals	5.0	27.0	7.5	1.2	39.3	17.0	25.6
Policy-based loans as a % of total outstanding public sector loans	44.0	46.0	40.1	39.3	31.7	28.3	24.2

\*Does not include accrued income and charges receivable on loans

## DRE Quality And Provisions For Losses

Our index of DRE quality is an exposure-weighted average of the default rates associated with the respective long-term foreign currency sovereign credit ratings (see table 5). 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. The index has fallen since 2005, but it remains the case that, by this measure, AFDB's portfolio contained much more risk than that of most other 'AAA' rated MLIs. This measure does not differentiate between public- and private-sector loans (the latter ordinarily carry more risk and thereby favor those institutions with relatively large private-sector DRE portfolios). This has been of limited significance in recent years, given the small percentage of private-sector loans in AFDB's portfolio. However, the bank expects private-sector loans to further grow as a percentage of total loans over the medium term, and this measure would not reflect any resulting deterioration in the quality of the loan portfolio.

By some measures the historical performance of AFDB's loan portfolio has been worse than the performances of other rated MDFIs. The bank has never written-off a sovereign loan and has written-off no loans of any kind over the past five years. However, past-due payments of principal have been high; at year-end 2010, they stood at SDR242 million or 2.9% of outstanding loans. In addition, past-due interest and other charges were SDR215 million. Although this is still high for this type of institution, arrears were reduced significantly in March 2009, when Côte d'Ivoire's arrears were cleared by a combination of payments by the country, assisted by a donor country, and contributions from AFDB's Fragile States Facility.

As exemplified by the case of Côte d'Ivoire, AFDB's actual losses are likely to be substantially lower than the portfolio figures suggest; the bank has never written-off a sovereign or sovereign-guaranteed loan. However, it did clear the Democratic Republic of the Congo's loans in arrears in 2002, albeit in such a way that the present value of the scheduled repayments equalled that of the original payments.

AFDB's credit risk is mitigated by the HIPC Initiative. At year-end 2010, 23 regional member countries were "completion point countries", seven were "decision point countries", and three were "pre-decision point countries".

AFDB maintains provisions for losses on both accrued interest and charges on loans and on the principal amount of the loans themselves. The accumulated provision on total outstanding loans was a low 1.4% at year-end 2010, unchanged from a year earlier. The small size of the accumulated provision reflects the fact that the bank expects the principal, interest, and charges of all of its public-sector loans to be repaid.

Table 4

African Development Bank--DRE Country Concentration							
--Year ended Dec. 31--							
Largest country sovereign exposures*/ratings*	2010	2009	2008	2007	2006	2005	2004
Largest	Morocco/BBB-	Morocco/BB+	Morocco/BB+	Morocco/BB+	Tunisia/BBB	Tunisia/BBB	Tunisia/BBB
Mil. SDR	1,828	1,824	1,445	1,229	1,180	1,227	1,211
% DRE	20.4	22.5	22.2	19.8	20.3	20.4	19.8
% Narrow risk-bearing capacity	36.2	37.1	30.0	24.6	24.5	26.4	26.7
2nd largest	Tunisia/BBB	Tunisia/BBB	Tunisia/BBB	Tunisia/BBB	Morocco/BB+	Morocco/BB+	Morocco/BB
Mil. SDR	1,188	1,177	1,087	1,145	1,095	853	683
% DRE	13.3	14.5	16.7	18.5	18.9	14.2	11.2
% Narrow risk-bearing capacity	23.5	23.9	22.5	22.9	22.8	18.4	15.1
3rd largest	Egypt/BB+	Egypt/BB+	DR Congo/NR	DR Congo/NR	DR Congo/NR	DR Congo/NR	Nigeria/NR
Mil. SDR	652	734	760	690	709	743	426
% DRE	7.3	9.1	11.7	11.1	12.2	12.3	6.9
% Narrow risk-bearing capacity	12.9	14.9	15.8	13.8	14.7	16.0	9.4

Table 4

African Development Bank--DRE Country Concentration (cont.)							
4th largest	DR Congo/NR	DR Congo/NR	Egypt/BB+	Egypt/BB+	Nigeria/BB-	Nigeria/NR	Cote d'Ivoire/NR
Mil. SDR	821	724	653	561	401	463	361
% DRE	9.2	8.9	10.0	9.0	6.9	7.7	5.9
% Narrow risk-bearing capacity	16.2	14.7	13.5	11.2	8.3	10.0	8.0
5th largest	Botswana/A	Botswana/A	Cote d'Ivoire/NR	Nigeria/BB-	Cote d'Ivoire/NR	Cote d'Ivoire/NR	DR Congo/NR
Mil. SDR	762	643	312	375	360	362	343
% DRE	8.5	7.9	4.8	6.0	6.2	6.0	5.6
% Narrow risk-bearing capacity	15.1	13.1	6.5	7.5	7.5	7.8	7.6
Share of DRE of five countries of largest exposure	58.7	63.0	65.5	64.5	64.5	60.6	49.4
Percentage of narrow risk-bearing capacity of five countries of largest exposure	103.9	103.8	88.3	80.1	77.9	78.4	66.8

\*Ratings as of balance sheet dates

Table 5

African Development Bank--Loan Quality And Accumulated Provisions For Losses							
(Mil. SDR, unless otherwise indicated)	--Year ended Dec. 31--						
	2010	2009	2008	2007	2006	2005	2004
Indicators of DRE quality							
Index of quality of development-related country exposure	9.1	9.5	12.9	13.3	14.4	15.1	13.9
Private sector loans as a % of total loans	19.3	18.2	8.6	6.3	6	6.6	5.7
Loan writeoffs			0	0	0	0	0
<b>Arrears on public sector loans and charges</b>							
Côte d'Ivoire	0	0	346	331	292	222	153
Zimbabwe	332	302	279	245	222	199	167
Sudan	111	97	94	77	71	67	62
Somalia	14	12	12	11	10	10	10
Liberia	0	0	0	0	124	125	120
Comoros	0	0	0	0	13	13	12
Seychelles	0	0	0	0	0	22	20
Central African Republic	0	0	0	0	0	4	4
Total arrears on public sector loans and charges	457	412	731	664	731	661	547
Arrears on private sector loans and charges	24	25	26	23	16	5	8
Total arrears on loans and charges	481	437	757	687	747	666	555
Impaired/nonaccrual loans**	314	270	275	603	670	702	700
As a % of total loans**	3.8	3.6	4.7	10.9	12.7	12.7	12.4
<b>Provisions for losses</b>							
Accumulated provision for impairment on disbursed and outstanding loans	114	102	103	196	214	195	214
Accumulated provision for loans as a % of disbursed and outstanding loans	1.4	1.4	1.8	3.5	4	3.5	3.8
Accumulated provision for sovereign loans	98	90	90	184	199	179	203
As a % of sovereign loans	1.5	1.5	1.7	3.5	4	3.5	4.1

Table 5

African Development Bank--Loan Quality And Accumulated Provisions For Losses (cont.)							
Accumulated provision for private sector loans	16	12	12	12	15	16	11
As a % of private sector loans	1	0.9	2.5	3.5	4.9	4.4	3.3
Accumulated provision for loans as a % of impaired loans	36.4	37.7	37.3	32.5	32	27.7	30.5
Accumulated provision for accounts receivable for accrued income/charges receivable on loans	169	125	116	169	223	198	188
As a % of accounts receivable for accrued income/charges receivable on loans	48.7	42.7	25.6	38.7	48.9	45.8	46.3
Accumulated provision for equity losses**	67.2	66.1	68.7	50.7	52.6	18.1	18.8
As a % of total equity investments**	19.8	22	26.7	21.1	30.6	9.7	10.5

\* 2004 figure is nonaccrual loans

\*\*End-2008 figure reflects impairment on exposure to Côte d'Ivoire being eliminated based on

March 2009 elimination of arrears

## Market Risk

AFDB's investment portfolio is very diverse. As at Dec. 31, 2010 the treasury portfolio consisted of government and agency bonds (48%), supranational bonds (11%), and financial institutions and corporate bonds (23%) and cash and time deposits constitute 18%. The portfolio is of good quality, with 63% rated 'AAA', 26% 'AA' and 11% 'A' or lower as of year-end 2010. In addition, the bank has a small asset-backed security portfolio.

ADFB's structural exchange- and interest-rate risk are well monitored and controlled. The agreement establishing AFDDB 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 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. These policies resulted in translation adjustments of less than 0.1% of average assets at the ends of each of the past three years, despite sharp movements in the values of major currencies.

Interest rate risk is minimized by matching assets and liabilities. About two-thirds of loans and investments are floating rate and match the bulk of AFDDB's liabilities. A smaller proportion of the loan book has variable lending rates, repriced twice a year, and this is matched to a larger borrowing pool. The fixed-rate loan and investment held at amortized cost 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.

AFDB generally executes International Swaps and Derivatives Association master agreements and netting agreements with its derivative counterparties. Its bank and corporate investment counterparties are required to have ratings of 'A' or higher for exposures of six months or less, 'AA-' for exposures of six months to five years, and 'AAA' for exposures beyond 10 years.

## Funding

AFDB's outstanding borrowings increased moderately in 2010, by 13%, just short of general balance sheet growth throughout the year. Positively, there were clear signs of continued appetite for AFDB paper and the bank's bonds continued to tighten in the secondary market.

In our opinion, AFDB's debt is very diverse in terms of investor base, currency, and maturity. Global benchmark bonds remain the primary source of funding, contributing to 60% of total borrowing, with Uridashi bonds (bonds in various currencies held by Japanese households) contributing to 24%, private placement 13%, and loans 3%. The investor base remains well-diversified geographically. The U.S. dollar remains the major currency of funding (52% before swaps and 49% after), followed by the euro (37% after swaps). The maturity profile of borrowings is fairly evenly spread. The largest refinancing needs occur in the two-to-three year bucket when 39% of borrowings fall due. At Dec. 31, 2010, 15% of the bank's funds matured within one year, and 39% within two years.

In our opinion refinancing is a minimal risk for AFDB, given its AAA rating, and the high liquid asset cushion held by the bank but also due to the cost pass-through policy whereby funding costs are passed on to the borrowers. At Dec 31 2010 liquid assets (including cash, deposits and treasury investments) accounted for 43% of total assets, 68% of total borrowings. Positively liquid assets were of high quality, with 63% of such assets in AAA instruments or with AAA counterparties AA rating exposures amounted to 26% of liquid assets and 'A' rated or lower to 11%. The bulk of A or lower rated exposures were less than 6 months.

AFDB's internal capital framework caps total outstanding debt at 100% of usable capital (equity plus callable capital from nonborrowing members rated 'A-' or higher). At Dec. 31, 2010, outstanding debt represented 85% of usable capital. We expect this ratio to fall as a result of the sixth capital increase.

## Leverage

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

- Gross debt to adjusted shareholders' equity (252% at year-end 2010);
- Gross debt to adjusted shareholders' equity plus 'AAA' callable capital (102.6% at year-end 2010, or 115.4 without callable capital from the U.S.);
- Gross debt net of liquid assets to adjusted shareholders' equity (87%); and
- Gross debt net of liquid assets to adjusted shareholders' equity plus 'AAA' callable capital (36%, or 40% without callable capital from the U.S.).

**Table 6**

African Development Bank--Leverage							
(Percentage, unless otherwise indicated)	--Year ended Dec. 31--						
	2010	2009	2008	2007	2006	2005	2004
Gross debt/adjusted shareholders' equity	252.1	226.5	146.3	133.9	134.4	139.6	136.7
Gross debt/adjusted shareholders' equity + 'AAA' callable capital	102.6	106.2	68.1	61.4	59.5	61.0	58.6
Gross debt net of liquid assets/adjusted shareholders' equity	87.3	60.9	33.5	16.7	(8.1)	16.7	28.0
Gross debt net of liquid assets/adjusted shareholders' equity + 'AAA' callable capital	35.5	28.6	15.6	7.6	(3.6)	7.3	12.0

## Liquidity

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, the projected net loan disbursements for the next year, the loan equivalent of guarantees, and undisbursed equity investments. The bank typically carries liquidity far above the prudential minimum level.

In our opinion, AFDB's management of liquidity is adequate, aided by the high amount of liquid assets the bank holds on balance sheet. At year-end 2010, liquid assets (including all cash and deposits and treasury investments, regardless of maturity) accounted for more than 41% of total assets and more than 65% of total borrowings; liquid assets as a percentage of undisbursed loans and equity investments and projected one-year debt service stood at 115%.

AFDB's access to emergency liquidity largely comes through callable capital from its shareholders. The only alternative source is a long-established euro commercial paper program. This is being used regularly for amounts up to €500 million to maintain presence in that market.

Early in 2010, the program was increased to €2 billion from €1 billion. The bank does not intend to use the program as a primary funding source, but rather to bridge possible cash flow mismatches. Given the bank's ample liquidity and T+2 settlement convention, there are no backup lines in place for this program. As of December 2010, there were no amounts outstanding under that program.

**Table 7**

African Development Bank-- Liquidity							
(Mil. SDR, unless otherwise indicated)	--Year ended Dec. 31--						
	2010	2009	2008	2007	2006	2005	2004
AFDB liquidity							
Prudential minimum liquidity	2,967	5,382	1,102	1,600	1,430	1,260	1,150
Liquidity	5,886	6,500	1,540	2,680	3,060	3,020	2,670
Liquidity as a % of prudential minimum liquidity	198.4	120.8	139.7	167.5	214.0	239.7	232.2
<b>S&amp;P liquidity measures</b>							
Liquid assets/total assets	41	45	41	45	50	45	42
Liquid assets/gross debt	65	73	77	88	106	88	80
Liquid assets/undisbursed loans + equity investments + estimated one-year debt service	115	119	139	178	240	225	212

## Profitability

As a development institution, AFDB does not seek to maximize income, but rather to earn a sufficient return to ensure its financial strength and to permit it to meet its development and other financing goals. Nevertheless, AFDB achieves moderate and stable returns for the risks undertaken. Profitability decreased further in 2010 with core earnings amounting to 1.18% of average adjusted assets as at Dec. 31, 2010 compared with 1.56% in 2009 and 2.47% a year earlier.

Net interest income contributes the largest proportion of operating revenues. Interest income is split between loans (48%), securities (37%) and interest on derivatives after fair valuing (15%). The net interest margin faced pressure

again throughout 2010 as lending interest rates were kept at lower rates and yields on securities remained restrained. However, the AFDB managed the spread upwards as it re-priced its liabilities down at a quicker rate than assets. Interest expenses reduced to 2.69% of interest-bearing liabilities in 2010, demonstrating good funding price flexibility through the period of low market confidence. Nevertheless, operating revenues had very muted growth during the year as lower translation gains in 2010 than 2009 detracted from the gains made in net interest income.

The reduced earnings in 2010 were therefore the result of higher costs. Operating costs grew by 20% in 2010, while the cost of risk (new loan loss provisions for loans and equity investments) nominally doubled to 8.5% of revenues. Positively the efficiency of AFDB remains very strong, with noninterest expenses accounting for only 25% of total revenues. Nevertheless, the banks costs have been increasing quicker than revenues for over three successive years.

Table 8

African Development Bank--Summary Income Statement							
(Mil. SDR, unless otherwise indicated)	--Year ended Dec. 31--						
	2010	2009	2008	2007	2006	2005	2004*
Income from loans and debt securities	300	296	362	347	329	324	323
Income from investments and related derivatives	219	223	203	232	214	155	124
Interest and amortized issuance costs	303	(306)	(252)	(268)	(245)	(219)	(231)
Other borrowing-related expenses	(167)	(76)	(70)	(7)	(3)	(22)	16
Provision for impairment on loan charges	(16)	(11)	62	53	(29)	(7)	(2)
Provision for impairment on loan principal	(11)	-	101	17	(23)	21	(51)
Provision for impairment on equity investments**	(1)	(2)	(18)	(1)	(35)	1	3
Provision for impairment on investments	19	3	(38)	-	-	-	-
Other income (net)	3	27	9	(2)	28	17	7
Administrative expense	(75)	(63)	(47)	(42)	(37)	(42)	(38)
Other expense	(7)	(5)	(7)	(6)	(5)	(8)	(7)
Operating income	214	231	305	324	194	221	144
Distribution of income approved by the board of governors	(146)	(163)	(257)	(120)	(139)	(144)	-
Net income	67	68	47	204	55	77	144
(Loss)/gain on available-for-sale investments taken to equity	8	(19)	(18)	33	(9)	6	2
Actuarial losses on defined benefit plans	(1)	28	(86)	(11)	(7)	(4)	(31)
Total recognized income	74	77	(56)	226	39	80	115

**\*Figures for 2004 are not strictly comparable with later years**

\*\*Includes other receivables prior to 2007

### Ratings Detail (As Of September 30, 2011)\*

#### African Development Bank

Counterparty Credit Rating

*Foreign Currency*

AAA/Stable/A-1+

Certificate Of Deposit

*Foreign Currency*

AAA

Commercial Paper

*Foreign Currency*

A-1+

Senior Unsecured (246 Issues)

AAA

Subordinated (6 Issues)

AA+

**Ratings Detail** (As Of September 30, 2011)\***(cont.)****Counterparty Credit Ratings History**

24-Jul-2003	<i>Foreign Currency</i>	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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