CREDIT OPINION

2 August 2024

Update

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RATINGS

Agencia Financiera de Desarrollo	
Domicile	Paraguay
Long Term CRR	Baa3
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Issuer Rating	Not Available
Type	Not Available
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Agencia Financiera de Desarrollo

Update following ratings upgrade, outlook changed to stable

Summary

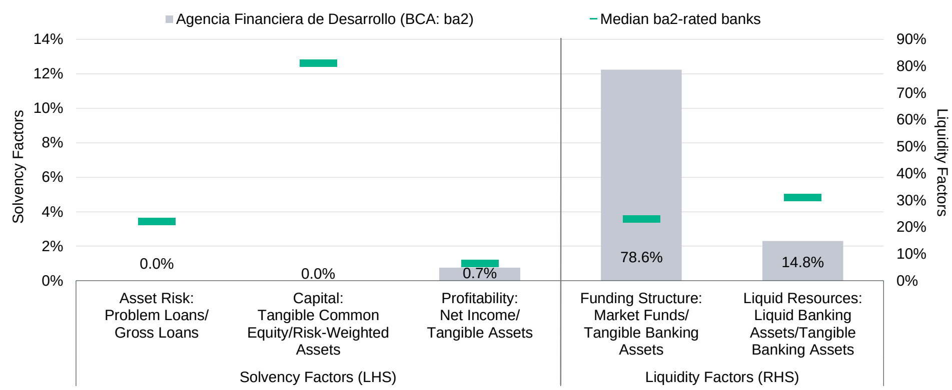
Agencia Financiera de Desarrollo's (AFD) Ba2 BCA mirrors its track record of strong asset quality and high capitalization, while it also reflects its profitability that is low relative to private sector banking peers given its public policy role, as well as its inherent reliance on market funding as a non-depository financial institution. AFD is the sole government-owned second-floor development agency in Paraguay, committed to supporting the financing of housing, small business, infrastructure and agriculture projects. The ba2 BCA incorporates the concentration and asset risks arising from a newly enacted law that allows the agency to take on direct credit exposure to heavy construction projects.

AFD's issuer rating is underpinned by the agency's ba2 Baseline Credit Assessment (BCA) and two-notches uplift stemming from our assessment of support from the Government of Paraguay (Baa3 stable). The support assessment incorporates the government´s guarantee on AFD's financial obligations and the agency's important policy role as a wholly owned government development bank. As a result, AFD's ratings are at the same level as the Paraguayan government bond rating.

Exhibit 1

Rating Scorecard - Key Financial Ratios

Scorecard data as of March 2024



For the asset-risk and profitability ratios, we calculate the average of the three latest year-end numbers and the latest quarterly data, if available, and the ratio used is the weaker of the average versus the latest period. For the capital ratio, we use the latest reported figure. For the funding structure and liquid resources ratios, we use the latest year-end figures.
Source: Moody's Financial Metrics™

Credit strengths

» Strong asset quality, as illustrated by a history of zero delinquencies

» Robust capitalization

» Strong level of government support, as attested by regular capital injections and debt guarantees

Credit challenges

» Complete dependence on wholesale funding because of its status as a non-deposit taking institution

» Low profitability, reflecting the agency's development role

Rating outlook

The stable rating outlook is in line with the stable outlook on the Government of Paraguay's rating, and reflects our expectation that AFD's asset quality and capital will remain robust.

Factors that could lead to an upgrade

» AFD's ratings would face upward pressure if the Government of Paraguay's rating is upgraded.

» We could raise AFD's BCA if it were to consistently diversify its funding or increase its holdings of liquid assets. However, without an upgrade of the sovereign rating, this would have no effect on AFD's issuer rating.

Factors that could lead to a downgrade

» A downgrade of Paraguay's bond rating would lead to a downgrade of AFD's issuer ratings.

» We would lower AFD's BCA should its asset quality materially deteriorates and its capitalization or liquidity conditions persistently weaken. However, absent a downgrade of Paraguay's sovereign rating, this is unlikely to affect AFD's issuer rating.

Key Indicators

Exhibit 2

Agencia Financiera de Desarrollo (Consolidated Financials) [1]

	03-24 [2]	12-23 [2]	12-22 [2]	12-21 [2]	12-20 [2]	CAGR/Avg. [3]
Total Assets (PYG Billion)	9,508.8	9,539.7	8,384.1	7,226.6	7,352.6	8.2 [4]
Total Assets (USD Million)	1,286.1	1,310.9	1,143.6	1,050.3	1,064.7	6.0 [4]
Tangible Common Equity (PYG Billion)	1,963.2	1,915.3	1,817.1	1,769.2	1,670.4	5.1 [4]
Tangible Common Equity (USD Million)	265.5	263.2	247.9	257.1	241.9	2.9 [4]
Net Interest Margin (%)	1.1	1.0	1.1	1.4	1.5	1.2 [5]
Net Income / Tangible Assets (%)	0.8	0.6	0.5	1.0	1.0	0.8 [5]
Cost / Income Ratio (%)	34.1	43.0	45.3	26.0	24.1	34.5 [5]
Market Funds / Tangible Banking Assets (%)	78.1	78.6	77.1	74.4	76.2	76.9 [5]
Liquid Banking Assets / Tangible Banking Assets (%)	7.0	14.8	13.6	11.4	20.0	13.4 [5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel I; LOCAL GAAP. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime.

Moody's Ratings and company filings

Profile

Founded in 2006 under Law 2640/05, modified in 2021 by Law 6769/21, Agencia Financiera de Desarrollo is the sole “second floor” bank in Paraguay, on-lending to financial institutions to promote the development and employment goals of the Paraguayan government.

The agency is headquartered in Asuncion and, as of March 2024, it had total loans of PYG8,796 billion and total assets of PYG9,509 billion.

Detailed credit considerations

Under its new mandate, AFD's credit portfolio composition could change in the mid term

We assign a baa2 Asset Risk score to reflect AFD's track record of very strong asset quality metrics, as well as the agency's inherent sector concentration in the banking industry. AFD’s asset quality is supported by its history of zero delinquencies since its inception because of its conservative underwriting standards and exclusive focus on lending to solid financial institutions in Paraguay, as well as legal provisions that protect the agency’s exposures.

As of March 2024, 81.8% of AFD's PYG6.6 trillion loan book was directed to banks, 16.9% to cooperatives, and the remainder mainly to finance companies (empresas financieras). Under the terms of the contracts signed with AFD, financial institutions need to ensure that their loans funded with AFD's resources should remain classified under the lowest-risk levels (I-II) on the Paraguayan central bank’s scale. In accordance with Paraguayan law, AFD's loans to financial institutions have a privliged status and, in bankruptcy, would have senior claims over depositors and secured creditors. Despite its history of zero delinquencies and the preferential status of its loans, AFD provisions against its loan exposures under a scale vetted by the Central Bank of Paraguay (BCP).

As of March 2024, on a sectoral basis, 44.7% of AFD’s on-lending was used to finance the development of the housing sector. The other 15 products that AFD offers are directed to the agricultural sector (FIMAGRO and PROCAMPO), small and medium-sized enterprises (SMEs) (PROPYMES and PROCRECER), cooperatives (PROCOOP), as well as education (PROEDUC).

In line with Government plans to foster the infrastructure development in Paraguay, a recently enacted law allows AFD to take on direct exposure to infrastructure projects, capped at 30% of its net worth. AFD is in the process of outlining the roles, policies and procedures associated with this new mandate, and we do not anticipate a material shift in its loan book composition over the next 12 to 18 months.

Capitalization remains sound despite consistent, double-digit balance sheet growth

We assign a baa1 Capital score based on our estimation of AFD's very strong capitalization levels, even though it does not report a regulatory capital ratio or risk-weighted assets (RWA). Development banks that we rate in the region had RWA/total assets of 78.5% on average as of March 2024. Applying the same ratio to AFD would match to a very strong 26.5% tangible common equity (TCE)/ RWA. Even assuming RWA/total assets of 150% (which would be extremely conservative for the agency because of its focus on secured lending to financial institutions), AFD would still have a capitalization ratio of 13.8% TCE/RWA.

However, AFD's capital to total assets ratio has been decreasing in recent years as the growth in capital consumption outpaced the effect of capital injections and earnings retention. As of March 2024 AFD’s total assets grew at 11.4% year-over-year, whereas its TCE grew 7.4%. As AFD's role is expanded, we expect its TCE to continue to decline as a percentage of assets, but nevertheless remain high.

Higher for longer rates will keep pressuring AFD's profitability

The ba3 score for profitability incorporates AFD's development role and our assessment that the continuous expansion in AFD's low-margin lending operations will particularly strain earnings in times of still-elevated interest rates.

AFD’s strategic focus is on development and job creation rather than maximizing profitability. As 91.3% of its revenue comes from interest income, its low return on assets directly stems from its concessional lending rates, as illustrated by its low net interest margin of 1.1% as of March 2024.

In addition, the agency earns fee income by managing certain state funds such as FOGAPY, FONACIDE, IPS and PPP (Public Private Partnership project funds) that accounted for 13.8% of its pretax net income as of March 2024. The agency’s strong efficiency levels also drive its profitability, with operating costs representing 34.1% of its gross income as of March 2024, which is lower that of the commercial banks in Paraguay, but higher than that of its regional peers.

Access to more stable funding sources mitigates wholesale-based funding risk

We assign a Funding score of caa3, reflecting the limitations related to AFD's mainly market-funded structure, inherent to a development agency. As a non-deposit taking institution, AFD's funding mix is primarily composed of local-currency bonds and US dollar-denominated cross-border loans. Despite AFD's heavy reliance on wholesale resources, refinancing risk is limited because of agency's government ownership and guarantee, as well as its social mission.

Most financial obligations are guaranteed by the Paraguayan government, and nearly half of its issued bonds are financed by the Central Bank of Paraguay's deposit guarantee fund (Fondo de Garantía de Depositos). AFD has been allowed to raise debt without government guarantees since the approval of Law 6769 in 2021.

The remaining financing is provided by multilateral agency lenders Banco Interamericano de Desarrolo (BID) and Kreditanstalt fuer Wiederaufbau (KfW, Aaa stable), the German state-owned development bank, which account for 18.1% and 0.4% of AFD's total funding, respectively. In 2022, Bank also raised $100 million through a 7-year tenor loan with Citibank/Commerzbank (guaranteed by the Multilateral Investment Guarantee Agency – MIGA), which represented the first AFD's funding transaction without government guarantee.

As of March 2024, liquid resources accounted for 13.8% of tangible banking assets, from 12.1% a year earlier, and was basically represented by central bank reserves and deposits at domestic banks.

AFD's scores are influenced by Paraguay's Moderate Macro Profile

AFD operates in a relative small and agriculture-dependent economy, subject to high growth volatility. Moody's acklowledges, however, that Paraguay has been on a path of economic diversification, expanding into capital-intensive sectors like infrastructure, light manufacturing, forestry, and clean energy. These shifts will bolster banks' credit origination and profitability, and help to mitigate the system's susceptibility to external and climate-related shocks.

Paraguay has a track record of institutional reforms to enhance public policy effectiveness and curtail corruption in public service delivery. Improving institutional and governance frameworks positively influence the legal and regulatory environment.

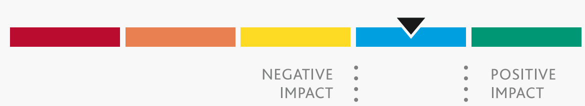
Paraguay's credit conditions remain stable, supported by a moderate intermediation level of 53% of GDP. Despite high financial dollarization, risks to banks are mitigated as foreign currency credit is mainly extended to naturally hedged exporters. Paraguayan banks enjoy favorable funding conditions, with a robust and steady customer deposit base largely meeting their funding needs.

ESG considerations

Agencia Financiera de Desarrollo's ESG credit impact score is CIS-2

Exhibit 3
ESG credit impact score

CIS-2

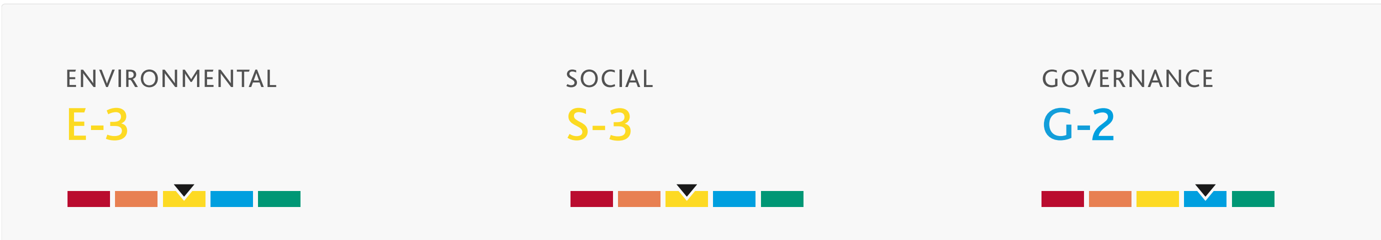


ESG considerations do not have a material impact on the current rating.

Source: Moody's Ratings

AFD's **CIS-2** indicates that ESG considerations are not material to the rating. Social risks are limited at AFD given its development role as the only on-lender in Paraguay's financial system, focused on housing. Although AFD is part of the Government of Paraguay, governance risks are mitigated by adequate risk management and policies.

Exhibit 4
ESG issuer profile scores



Source: Moody's Ratings

Environmental
AFD's **E-3** score reflects its indirect exposures to physical climate risks because of its credit portfolio concentration on domestic financial institutions that in turn provide funding for agricultural development projects as well as housing.

Social
AFD's **S-3** score factors agency's only moderate exposure to social risks related to customer relations, because, as a second-floor bank, it lends only to financial institutions and cooperatives and has no direct relationships with the end client. Responsible production has low risk for AFD as it provides long term funding for housing development and other development projects in line with the government's policy objectives.

Governance
AFD's **G-2** score takes into account that the agency's risk management, policies and procedures are in line with industry best practices. AFD is part of the Government of Paraguay, which sets its board members.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Support and structural considerations

Government Support
The Baa3 local-currency issuer rating assigned to AFD incorporates two notches of uplift from the entity's BCA of ba2 based on our assessment that the Government of Paraguay will support the agency in an event of stress, because of its legal status as a development bank wholly owned by the government, legally mandated annual capital injections from government sources, and the government guarantee on its financial obligations.

Rating methodology and scorecard factors

Exhibit 5
Rating Factors

Macro Factors		
Weighted Macro Profile	**Moderate**	**100%**

Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	-	-	-	baa2	Sector concentration	Quality of assets
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel I)				baa1		
Profitability						
Net Income / Tangible Assets	0.7%	ba2	↔	ba3	Earnings quality	
Combined Solvency Score				baa3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	78.6%	caa3	↔	caa3		
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	14.8%	ba3	↔	ba3		
Combined Liquidity Score		b3		b3		
Financial Profile				ba2		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				Baa3		
BCA Scorecard-indicated Outcome - Range				ba1 - ba3		
Assigned BCA				ba2		
Affiliate Support notching				0		
Adjusted BCA				ba2		

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	1	0	ba1	-	Baa3	Baa3
Counterparty Risk Assessment	1	0	ba1 (cr)	-	Baa3(cr)	

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Ratings

Ratings

Exhibit 6

Category	Moody's Rating
AGENCIA FINANCIERA DE DESARROLLO	
Outlook	Stable
Counterparty Risk Rating	Baa3/P-3
Baseline Credit Assessment	ba2
Adjusted Baseline Credit Assessment	ba2
Counterparty Risk Assessment	Baa3(cr)/P-3(cr)
Issuer Rating -Dom Curr	Baa3
ST Issuer Rating -Dom Curr	P-3

Source: Moody's Ratings

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CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454