

**CREDIT OPINION**

17 September 2019

Update

 Rate this Research

**RATINGS**
**Agencia Financiera de Desarrollo**

Domicile	Paraguay
Long Term CRR	Ba1
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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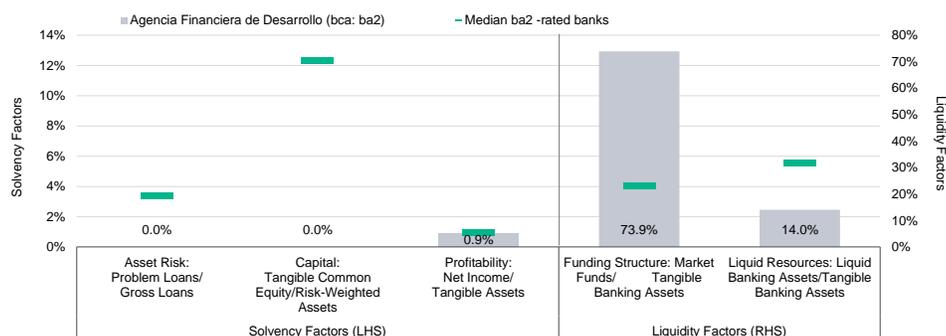
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# Agencia Financiera de Desarrollo

## Annual update to credit analysis

**Summary**

Moody's assigns a Ba1 issuer rating to Agencia Financiera de Desarrollo (AFD), which incorporates the agency's role as a fully government-owned "second floor" bank in Paraguay that onlends to other financial institutions for the government's development goals. AFD is the sole provider of long-term funding to leading financial institutions in Paraguay and its financial obligations in both local and foreign currency are guaranteed by the Paraguayan government. AFD's issuer rating is determined by (i) the institution's baseline credit assessment (BCA) of ba2, as determined by Moody's Banks rating methodology, which reflects the agency's sound standalone credit fundamentals and Paraguay's Weak + Macro Profile, and (ii) the incorporation of support from its owner, the Government of Paraguay (Ba1, stable). AFD's issuer rating receives one notch of uplift from its BCA as Moody's assesses it as being backed by the Paraguayan government, in light of its strategic importance to the development goals of the government and the government's guarantee.

**Exhibit 1  
 Rating Scorecard - Key Financial Ratios**


Source: Moody's Financial Metrics

**Credit strengths**

- » Very strong asset quality as shown by no history of delinquencies
- » Strong levels of capitalization
- » Government backed level of ongoing public support as evidenced by annual capital injections and debt guarantees

## Credit challenges

- » Complete dependence on wholesale funding as a non-deposit taking institution
- » Low profitability, reflecting the agency's development role

## Rating outlook

The stable outlook is in line with the stable outlook on the Government of Paraguay and also reflects our expectation that AFD's asset risk will remain very low and capital will remain robust

## Factors that could lead to an upgrade

- » AFD's issuer rating will face upward pressure if the Government of Paraguay's rating is upgraded.
- » AFD's BCA could be upgraded if it were to diversify its funding, improve its profitability and/or increase its holdings of liquid assets. Absent an upgrade of Paraguay's sovereign rating, however, this would have no effect on AFD's issuer rating.

## Factors that could lead to a downgrade

- » A downgrade in the bond rating of Paraguay would lead to a downgrade in AFD's issuer ratings
- » AFD's BCA would be downgraded should its asset risk show deterioration and its already low profitability decline markedly through rising provisioning costs. Absent a downgrade of Paraguay's sovereign rating, however, this is unlikely to effect AFD's issuer rating.

## Key Indicators

Exhibit 2

### Agencia Financiera de Desarrollo (Consolidated Financials) [1]

	12-18 <sup>2</sup>	12-17 <sup>2</sup>	12-16 <sup>2</sup>	12-15 <sup>2</sup>	12-14 <sup>2</sup>	CAGR/Avg. <sup>3</sup>
Total Assets (PYG Billion)	5,465.0	4,307.6	3,863.7	3,229.1	2,443.3	22.3 <sup>4</sup>
Total Assets (USD Million)	917.6	770.5	669.9	558.5	527.1	14.9 <sup>4</sup>
Tangible Common Equity (PYG Billion)	1,402.6	1,233.5	1,009.4	868.3	751.3	16.9 <sup>4</sup>
Tangible Common Equity (USD Million)	235.5	220.6	175.0	150.2	162.1	9.8 <sup>4</sup>
Net Interest Margin (%)	1.7	1.5	1.7	1.5	1.5	1.6 <sup>5</sup>
Net Income / Tangible Assets (%)	0.9	0.8	1.0	0.7	0.8	0.8 <sup>5</sup>
Cost / Income Ratio (%)	32.4	36.5	32.4	41.9	43.8	37.4 <sup>5</sup>
Market Funds / Tangible Banking Assets (%)	73.9	70.9	73.5	72.7	68.9	72.0 <sup>5</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	14.0	14.7	22.9	21.2	30.6	20.7 <sup>5</sup>

[1]All figures and ratios are adjusted using Moody's standard adjustments. [2]Basel I; LOCAL GAAP. [3]May include rounding differences due to scale of reported amounts. [4]Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5]Simple average of periods presented for the latest accounting regime.

Source: Moody's Investors Service; Company Filings

## Profile

Founded in 2006 under Law 2640, Agencia Financiera de Desarrollo is the sole "second floor" bank in Paraguay, onlending to financial institutions to promote the development and employment goals of the Paraguayan government. The agency is headquartered in Asuncion and as of December 2018 it had total loans of PGY 4,685 billion and total assets of PGY 5,465 billion.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

## Detailed credit considerations

### No history of delinquencies

Moody's assigns a score of baa2 to asset risk, which is one notch below the initial score based on the agency's delinquency rate of zero, due to its sector concentration in the banking industry. AFD's asset quality is supported by the bank's history of zero delinquencies since its founding given its conservative underwriting standards and exclusive focus on lending to solid financial institutions in Paraguay, as well as legal provisions which protect the agency's exposures.

As of June 2019, 84% of AFD's PGY 4.9 trillion (USD 780 million) loan book was directed to banks, 15% to cooperatives, and the remainder mainly to finance companies (empresas financieras). Under law, AFD's loans to financial institutions have privileged 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 also provisions against its loan exposures under a scale vetted by the Central Bank of Paraguay (BCP). As of December 2018, loan loss reserves to gross loans were 0.34%, providing a sufficient reserve against unexpected losses.

On a sector basis, over 40% of AFD's onlending is used to finance the development housing sector, through the Mi Casa, Mi Primera Casa and Primera Vivienda lines, and 29% is lent through its Procrecer lines to small to mid-sized enterprises operating in various industries that need longer term funding. Other products that AFD offers are directed to the agricultural sector (FIMAGRO, PROCAMPO), small to mid-sized enterprises (PROPYMES), as well as cooperatives (PROCOOP).

Under the terms of contracts signed with AFD, the agency's clients need to ensure that the loans they make that are funded with AFD resources are and remain classified at the lowest risk levels (I-II) on the Paraguayan Central Bank's scale. Regardless, AFD bears none of the credit risk of the ultimate borrowers of its funds. These risks are entirely borne by the banks and financial institutions that onlend AFD's resources.

### Strong levels of capitalization

Moody's assign a score of baa2 to capital as we estimate that agency has a very strong level of capitalization, even though it does not report a regulatory capital ratio or risk-weighted assets. As of June 2019, tangible common equity (TCE), as measured by Moody's, was 25.52% of total assets, which in turn implies that even if the agency's exposures were risk-weighted at over 150% (which would be extremely conservative given its focus on lending to financial institutions), it would still have a very strong capitalization ratio of 18%. In addition to reinvesting 100% of its earnings, the agency's capital is supported by annual capital injections from FONACIDE (Fondo Nacional de Inversion Publica y Desarrollo) that amount to 7% of Fonacide's resources. In 2018 and 2017, AFD received PGY 122 and 191 billion respectively from FONACIDE, approximately 9% of its tangible common equity.

However, we note that capital has been decreasing in recent years as capital consumption has grown more rapidly than capital injections. From 2015-June 2019, AFD's loan book grew at a compound annual growth rate (CAGR) of 22.2% whereas its tangible common equity grew at just over half that pace (15.7% annually). As AFD continues to expand its operations, we expect its TCE will continue to trend downward as a percentage of assets, but it will nevertheless remain at high levels.

### Funding derived from multilateral agencies and bond issuances

Moody's assign a score of caa3 to funding structure which maps directly off its very high market funds to tangible assets ratio of 75%. AFD does not take deposits and instead funds itself through equity, local currency bonds, and loans from multilateral agencies. As of December 2018, 24% of AFD's funding derived from multilateral agencies. The remainder of its funding came from local and foreign currency bonds. However, these are mainly held by the Paraguayan deposit guarantee fund (Fondo de Garantia de Depositos), as well as the state pension fund (Instituto de Prevision Social) and Caja Fiscal of The Ministry of Finance, significantly reducing the agency's exposure to refinancing and interest rate risk. The agency's multilateral agency lenders were Banco Interamericano de Desarrollo (IDB) and KfW, the German state owned development bank, responsible for 16.9% and 0.6% of its total funding respectively. Given the agency's government ownership and guarantee, as well as its social mission, we believe this multilateral funding will be very stable as well.

AFD's bond issuances need to be approved by the Paraguayan government and the total amount that the agency can issue is detailed in the government's budget plans for a given year. In 2018, AFD issued a maximum of PGY 860 billion (USD136 million).

### Liquid assets are low to counter market funding risk

Moody's assign a score of b2 to AFD's liquid resources score which maps directly off its liquid assets to tangible assets ratio of 14%. Under the conditions of article 14 of Law 2640, 2005, AFD's liquid assets are held at the central bank, but the amount held is rather low to cover the extent of the Agency's market funding on its own accord. In 2017, AFD's liquid assets covered less than a quarter of total funding.

### Profitability will continue to be low reflecting the agency's development role

Moody's assigns a score of b1 to profitability, which is one notch below the initial score of ba3 based on the agency's ratio of net income to tangible assets. This adjustment considers our assessment that AFD's earnings will face negative pressure as it expands its low margin lending operations. AFD's strategic focus is on development and job creation and not on maximizing profitability. As a result, AFD's profitability, as measured by net income to tangible assets, was just 0.87% in 2018, well below that of rated commercial banks in Paraguay. As almost 99% of its revenues come from interest income, its low return on assets directly stems from its concessional lending rates, as shown by its very low net interest margin of 1.67% in 2018.

In addition, the agency makes fee income through its managing of certain state funds such as FONACIDE, IPS and PPP (Public Private Partnership Projects Fund). However, this accounted for less than 10% of its pretax net income. The agency's profitability is also driven its strong efficiency levels, with operating costs equal to just 32.4% of its gross income, which is comparable to commercial banks in Paraguay and lower than regional peers.

## Support and structural considerations

### Government Support

The Ba1 local currency issuer rating assigned to AFD incorporates one notch of uplift from the entity's BCA of ba2 based on Moody's assessment of the very high likelihood that the agency will receive financial support from its sole shareholder, the Government of Paraguay (Ba1 stable) in an event of stress, based on its legal status as a development bank wholly owned by the government, legally-mandated annual capital injections from government sources, and the government guarantee of its financial obligations.

## Rating methodology and scorecard factors

Exhibit 3

### Agencia Financiera de Desarrollo

#### Macro Factors

<b>Weighted Macro Profile</b>	<b>Moderate</b>	<b>100%</b>
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Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	0.0%	a3	↔	baa2	Sector concentration	
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel I)	-	-	-	baa2	Expected trend	
Profitability						
Net Income / Tangible Assets	0.9%	ba2	↔	b1	Earnings quality	
Combined Solvency Score		baa1		baa3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	73.9%	caa3	↔	caa3	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	14.0%	b1	↔	b2		
Combined Liquidity Score		caa1		caa1		
Financial Profile				ba2		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				Ba1		
Scorecard Calculated BCA 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	0	Ba1	Ba1
Counterparty Risk Assessment	1	0	ba1 (cr)	0	Ba1(cr)	

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

Source: Moody's Investors Service

## Ratings

Exhibit 4

Category	Moody's Rating
<b>AGENCIA FINANCIERA DE DESARROLLO</b>	
Outlook	Stable
Counterparty Risk Rating	Ba1/NP
Baseline Credit Assessment	ba2
Adjusted Baseline Credit Assessment	ba2
Counterparty Risk Assessment	Ba1(cr)/NP(cr)
Issuer Rating -Dom Curr	Ba1
ST Issuer Rating -Dom Curr	NP

Source: Moody's Investors Service

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