FitchRatings

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Fitch Affirms International Fund for Agricultural Development at 'AA+'; Outlook Stable

Fitch Ratings - Paris - 29 Sep 2021: Fitch Ratings has affirmed International Fund for Agricultural Development's (IFAD) Long-Term Issuer Default Rating (IDR) at 'AA+' with a Stable Outlook and Short-Term IDR at 'F1+'.

A full list of rating actions is at the end of this rating action commentary.

Key Rating Drivers

IFAD's 'AA+' Long-Term IDR is based on the institution's Standalone Credit Profile (SCP). IFAD's SCP assessment is driven by its solvency (aa+) and liquidity (aa+) profiles. The medium-risk business environment does not translate into any notch adjustment to the rating. Our assessment of IFAD's shareholders' capacity and propensity to support does not provide any uplift above our assessment of its SCP.

IFAD is a United Nations agency focusing on supporting rural economies and food systems. The bulk of its lending portfolio consists of concessional loans to low and lower-middle income countries, and it also extends grants to some of its members. IFAD's main financial resources are contributions from its member states, paid though three-year replenishment cycles, with the most significant contributors the G8 countries, including the US (AAA/Negative, 11% of contributions), Japan (A/Negative, 7%) and Germany (AAA/Stable, 7%). The fund's next replenishment cycle, IFAD 12 (which runs from 2022-2024), is expected to be just under USD1.3 billion in size, of which over 90% has already been pledged by contributors (IFAD 11: USD1.1 billion).

Fitch considers IFAD's 'excellent' capitalisation as a key rating strength, primarily driven by our view that IFAD's equity/assets ratio will continue to far exceed the 25% 'excellent' threshold over the medium term. As of end-2020, this ratio was around 83%. Our assessment is also supported by the fund's usable capital/risk-weighted assets (FRA) ratio, which also far exceeds the 35% 'excellent' threshold (YE20: 72%). IFAD is inherently loss-making, owing to its business model, but this is offset by the paid-in contributions it receives from its member states. We expect both ratios to remain well above the 'excellent' thresholds in the medium term, despite the fund gradually increasing its leverage.

Our assessment of IFAD's solvency combines the institution's 'excellent' capitalisation and 'low-risk' profile. IFAD's loan portfolio comprises sovereign borrowers, about two-thirds of which are low and lower-middle income countries and one-third upper-middle-income countries. Fitch estimates the average rating of IFAD's loan portfolio at 'B+' at YE20, which is unchanged from last year. Fitch continues to expect the average rating of the fund's lending portfolio to deteriorate by one notch to 'B' by end-2023, owing to a moderate decline in asset quality caused by the impact of the Covid-19 crisis. We assess IFAD's strength of preferred-creditor status (PCS) as 'excellent', which translates into a plus three notch adjustment above the average rating of loans. The average rating of IFAD's lending portfolio after PCS adjustment for end-2020 is therefore 'BB+'.

Non-performing loans (NPLs) represented 2.6% of total loans at end-2020. As of June 2021, there were four sovereigns classified as NPLs to IFAD (North Korea, Somalia, Venezuela, Yemen), which is unchanged from last year. While the borrower paid outstanding bills in July 2021, Fitch notes that IFAD's exposure to Cuba (0.1% of total loans) was re-classified as Stage 3 under IFRS guidelines in June 2021. In line with IFAD's own expectations, Fitch forecasts that NPLs will increase from a 'low' level (below 3%) to a 'moderate' level (3%-6%) over the medium term, reflecting the impact of the Covid-19 crisis on loan performance. Fitch forecasts the NPL rate to be closer to 4.0%-4.5% by the end of the forecast period (2023).

We assess IFAD's concentration risk as 'low', reflecting the fund's well-diversified lending book, with over 100 sovereign borrowers in its portfolio. Fitch expects that IFAD's top five exposures will continue to amount to between 25%-30% of the institution's total banking exposure by 2023. Fitch assesses both IFAD's equity participation risks and market risks as 'very low'.

Risk management policies are assessed as 'strong' by Fitch. IFAD has a broad range of internal policies that govern its risk management framework and the fund is fully compliant with these limits. Consistent with the ongoing transition towards a more levered balance sheet, IFAD has adjusted some of its internal policies, including its capital adequacy framework based on deployable capital. A record of operations under the revised framework could lead to an upward revision of our assessment of risk management. The assessment is further supported by the very high level of expertise of the fund's management.

Liquidity is a rating strength for IFAD, with the liquidity profile assessed at 'aa+', unchanged from last year's review. In terms of IFAD's liquidity buffer, as of YE20, IFAD's coverage of short-term debt by eligible liquid assets was well above 1,000%, far above the 150% 'excellent' threshold outlined in the criteria. We expect this ratio to remain comfortably above the 150% threshold over the forecast period, reflecting IFAD's very limited debt burden. The quality of IFAD's treasury asset portfolio has improved over the past 12 months, with an increased share of 'AAA' to 'AA' rated treasury assets (2020: 72% vs. 2019: 68%). To date, IFAD has not tapped international capital markets, but the fund's Executive Board recently approved its inaugural EMTN Programme, with the first issuance under this programme expected in 2022.

IFAD's business environment is unchanged from last year and is deemed 'medium risk', which translates into a zero-notch adjustment to the solvency assessment of 'aa+', leading to a SCP of 'aa+'. Our assessment of IFAD's 'low risk' business profile is driven by the 'low risk' quality of governance, supported by the large share of non-borrowing member states and the absence of one overly dominant contributor. Our 'high risk' assessment of IFAD's operating environment reflects the relatively high share of low-income countries within the distribution of IFAD's countries of operations, along with the 'high risk"' credit quality of the fund's countries of operation.

IFAD's rating is fully driven by its SCP and support is not currently a rating driver. IFAD's support rating is unchanged at 'aa-'. This assessment is anchored on the weighted average rating of IFAD's key contributors, which Fitch defines as those member states that contribute over 50% of the fund's total replenishments. IFAD has no callable capital. An assessment of a 'strong' propensity to support the institution, based on the regularity of contributions from member states that have totalled USD9 billion since inception, leads to a zero-notch adjustment on the average rating of key shareholders, resulting in an overall support rating of 'aa-'.

IFAD's Short-Term IDR of 'F1+' is in line with the rating correspondence table outlined in Fitch's criteria and, given the Long-Term IDR is 'AA+', the only available Short-Term IDR that Fitch can assign.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

-Solvency (Risk): Resilience of the loan portfolio to the Covid-19 crisis that results in a stronger credit risk profile than currently anticipated, particularly an improvement in the fund's loan impairment ratio relative to Fitch's current expectations, to a level commensurate with a 'very low' assessment and an improvement in the average rating of the lending portfolio.

- Liquidity: Sustained maintenance of 'AAA' to 'AA' rated treasury assets at a level greater than 70% could lead to a positive adjustment to the liquidity assessment, as could an improvement in IFAD's access to capital markets (currently 'weak'), as the fund transitions towards a hybrid funding structure.

Given the solvency and liquidity assessments are at the same level (aa+), there would need to be a positive revision of both of them to result in any upward rating pressure on the Long-Term IDR.

-Business Environment (Business Profile): Improvement in our assessment of IFAD's business profile driven by a successful transition towards a gradual increase in leverage, diversification of funding sources and exposure to middle-income borrowers, while adhering to the revised risk management framework.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

-Solvency (Risk): Worse-than-expected impact of the Covid 19 crisis on the fund's loan portfolio that leads to a higher loan impairment ratio (above 6%) and/or weaker credit quality of the loan portfolio than currently expected.

-Business Environment (Business Profile): A deterioration in the fund's business profile, which could lead to a negative revision of our current 'low' risk assessment. For example, this could stem from any potential weakening in the fund's strategy risk in the context of the ongoing transition towards a more levered balance sheet. Our assessment of IFAD's policy importance could be affected if the replenishment under IFAD12 was significantly weaker than our expectation.

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

Key Assumptions

The global economy will develop in line with Fitch's Global Economic Outlook published on 16th September 2021.

Fitch assumes continued strong support to be demonstrated by IFAD's member states, in the form of multi-year replenishment cycles that will remain IFAD's main financial resource.

IFAD will gradually increase its leverage in the medium term. Its debt to equity ratio is expected to remain limited to a maximum of 50%.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

IFAD has an ESG Relevance Score of '4' for Rule of Law, Institutional & Regulatory Quality. All supranationals have a score of '4'. Supranationals are neither subject to bank regulation nor supervised by an external authority. Instead, supranationals comply with their own set of rules. Fitch pays particular attention to internal prudential policies, including compliance with these policies. This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

IFAD has an ESG Relevance Score of '4+' for 'Human Rights, Community Relations, Access & Affordability'. IFAD extends concessional loans and grants to low-income countries which supports IFAD's policy importance and has a positive impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
International Fund for Agricultural Development (IFAD)	LT IDR	AA+	Affirmed		AA+
	ST IDR	F1+	Affirmed		F1+

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Supranationals Rating Criteria (pub.20 May 2021) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

International Fund for Agricultural Development (IFAD)	EU Issued, UK Endorsed

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