MOODY'S INVESTORS SERVICE

CREDIT ANALYSIS

# Caribbean Development Bank

Supranational

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This Credit Analysis provides an in-depth discussion of credit rating(s) for Caribbean Development Bank and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on Moody's website.

**Caribbean Development Bank**

| Category | Moody's rating |
|---|---|
| Outlook | Stable |
| Long Term Issuer Rating | Aa1 |

## Rating Rationale

On 19 November 2013 we affirmed the Caribbean Development Bank's (CDB) Aa1 rating and revised the outlook to stable from negative. The affirmation considered the significant steps the Bank has taken over the past 18 months to address shortcomings in its risk management and financial planning capacity, as well as the successful extension of its debt maturity schedule and the corresponding re-establishment of compliance with its strict liquidity policy. The Aa1 rating reflects a number of significant credit strengths, including: (i) moderate leverage and capital adequacy ratios that remain strong relative to those of lower-rated multilateral development banks (MDBs) despite recent deterioration; (ii) higher liquidity levels than those of most MDBs despite past failures to comply with the liquidity policy; (iii) strong financial support from both borrowing and non-borrowing members, reflected in the recent general capital increase and the Bank's relatively high percentage of paid-in capital; and lastly, (iv) a preferred creditor status that has ensured a good repayment performance even from borrowing members that have gone through debt restructurings in recent years, coupled with limited private sector exposure. The rating also considers the relatively weak and deteriorating average credit quality of the Bank's borrowing member countries and its high borrower concentration, as well as comparably little callable capital from highly rated members.

The stable outlook considers our expectation that the Bank's capitalization and liquidity ratios will remain strong, that loan portfolio performance will remain stable, and that borrowing members will continue to grant the Bank a preferred creditor status despite any financial stress they may be undergoing. The rating could face upward pressure if the Bank meaningfully diversifies its loan portfolio and reduces its exposure to troubled credits. However, given the Bank's mission to serve the Caribbean coupled with the severe economic and financial challenges facing the region, we view this as unlikely in the near-to-medium term, notwithstanding management's plans to increase lending to higher rated members and try to attract new regional members. The rating could face downward pressure if the bank's capitalization and/or liquidity levels decline; if its borrowing member credit quality experiences further deterioration and loan portfolio performance suffers as a result; if the bank again fails to comply with any of its financial policies; or if its new risk management framework proves to be ineffective.

## Organizational Structure and Strategy

The Caribbean Development Bank (CDB or the Bank) is a multilateral lending institution founded in 1969 and headquartered in Barbados. The Bank's purpose is to contribute to the economic growth and development of its Caribbean member countries and to promote their economic cooperation and integration. The CDB has developed a particular niche in assisting less developed Caribbean members, where often the Bank is the only source of borrowing. With a loan portfolio of just under $1 billion, the CDB is among the smallest of the MDBs rated by Moody's. Due to its relatively small size, the CDB focuses on having a greater economic impact in smaller countries rather than in larger economies where other MDBs can provide more funding.

CDB makes loans to its borrowing member countries (BMCs) from its Ordinary Capital Resources (OCR) and from various other concessional funds, which make up its Special Funds Resources (SFR). Moody's rating applies just to the CDB's OCR operations. As such, these are referred to as the CDB in this report. The SFR was established to provide resources on concessional terms primarily for poverty reduction. The resources, assets, and liabilities of the OCR, which account for about 60% of total lending, and the SFR are completely segregated. Though the SFR is partially funded with transfers from net income of the OCR, the SFR has no recourse to OCR resources.

CDB has 18 founding member countries - 16 regional states and autonomous dependent territories of the UK and 2 non-regional countries. There are currently 27 members: 22 regional countries, including Colombia, Mexico and Venezuela (who are non-borrowers), and five non-regional countries (Canada, People's Republic of China, Germany, Italy, and the United Kingdom). Suriname is the newest member, having joined in September. The Governors of the Bank have agreed on the conditions under which Brazil could be admitted as a member and Brazil continues to work on its domestic legal arrangements to attain membership. The CDB is also in discussions with the former members of the Netherlands Antilles and it continues to actively pursue the expansion of its membership base beyond the Caribbean.

All powers are vested in the Board of Governors, where each member country is represented by a governor or an alternate, except for Anguilla, British Virgin Islands, Cayman Islands, Montserrat, and the Turks and Caicos Islands, which are considered as a single member for this purpose. Provided there is a quorum, all decisions of the Board of Governors, such as amendments to the Bank's Charter, are determined by a majority of the voting power of the members represented at the meeting, unless otherwise specified. Each member's voting power is directly related to its relative share of the bank's capital. Amendments to the Bank's Charter require a vote of not less than two-thirds of the total number of Governors representing not less than three-fourths of the total voting power of the members. At its annual meeting, the Bank's Board of Governors determines how to allocate net income. However, CDB does not pay dividends back to its member countries.

### Lending Levels Lower Than Contemplated By Strategic Plan But Policy-Based Loans Likely to Rise

The CDB operates under a five-year strategic plan. The current plan was approved in May of 2010 and extends through 2014. In addition to focusing on how to maximize the CDB's development effectiveness, the plan also addresses the concern that many of the social gains of the past decades may be lost as a result of the ongoing global financial and economic crisis. The plan details the ways in which the Bank intends to enhance its role in economic adjustment, regional cooperation and integration, good governance and environmental sustainability. The plan originally contemplated a significant increase in the Bank's lending relative to the prior period. Over the five years of the plan, average annual lending was expected to rise to $200 million, which was 70% higher than the average annual lending over the previous five years. However, these plans were adjusted significantly as a result of the pressures the Bank faced to comply with its liquidity policy, coupled with reduced demand for project loans from borrower member countries due to the economic and financial difficulties confronting many of them and the Bank's internal cap on policy-based lending. After disbursing just $50 million in loans in 2012, management currently expects to disburse about $80 million this year and at least $90 million in 2014.

The Bank has recently begun work on its new 5-year strategic plan, which will cover the period 2015-19. In addition to balancing the needs of the Bank's less developed countries and a planned rise in private sector lending against an increased focus on risk management, the new plan will likely emphasize increased policy-based lending. The expected emphasis is in line with the Board's recent decision to increase the limit for Policy-Based Loans (PBLs) to 30% of the loan portfolio from 20%. This increase should initially provide the Bank with the capacity to extend an additional $126 million in PBLs. Rather than fund specific projects, PBLs are used to provide general budgetary support to the borrowers and to refinance existing debt at concessional rates and thereby improve the borrowers' debt dynamics. Often provided in tandem with technical assistance, PBLs incorporate conditions intended to encourage the borrowers to adopt reform policies and practices that will contribute to economic growth and help strengthen their institutions. PBLs may be extended by pooling funds from both the OCR and SFR to provide lower costs for BMCs (though they are primarily funded out of the OCR due to funding constraints of the SFR).

While PBLs are generally disbursed much more quickly than project loans, they carry the same credit risk for the Bank, and if the conditionality attached to the PBLs is successful, over the medium-to-long term the loans should actually help bring about an improvement in the credit quality of the recipients. The Bank also issues policy-based guarantees in order to help countries gain access to financing from market sources without impacting the Bank's liquidity position (though they may impact the Bank's liquidity requirement); these guarantees, however, currently total just $12 million.

## Governance and Risk Management

### New Independent Risk Management Function Aims to Address Shortcomings

In an effort to address shortcomings in asset-liability management and financial planning that led to the Bank's failure to comply with its liquidity policy, the Bank is in the process of implementing a comprehensive risk management framework, which it is fully integrating into its operational structure. While some of these efforts are ongoing, the Bank has made significant progress in a relatively short period, and management appears wholly committed to completing the remaining elements of the framework in the coming months. The Bank has already created a new independent risk management function headed by a Chief Risk Officer, who has direct access to the Board. The CRO is responsible for developing the Bank's risk assessment methodology, limit setting, and approvals, as well as oversight of risk reporting and control.

The Bank has also formed a new enterprise risk committee chaired by the CRO and formed by representatives of senior management from across the organization. The ERC's remit covers the gamut of risks faced by the organization. In particular, the ERC is responsible for the oversight of the bank's asset and liability management, liquidity, loan portfolio performance, capitalization, and investment strategy. The Bank is also in the process of significantly enhancing its risk reporting as part of this overhaul. These improvements to governance and risk management should help to ensure that the Bank does not experience a repeat of its recent problems.

Management expects the Board to formally approve a new risk appetite statement (RAS) this December. Developed with the assistance of an outside consultant, the RAS provides a unifying framework for a set of discrete financial policies and procedures. The CDB's financial policies are designed to ensure that the bank maintains adequate levels of capital and liquidity while keeping leverage manageable and lending rates as low as possible. As it developed the RAS, management deemed most of its existing financial policies sufficiently conservative given its risk profile, although as part of the process it is revising and/or strengthening some specific provisions. In particular, the risk appetite statement will include the revised capital adequacy policy and new exposure limits.

All new loan proposals must be recommended by the President for approval by the Board and are subject to the overall lending limits established by the Board, compliance with which will be enforced by the CRO. The Board's audit and post-evaluation committee, which meets three to four times annually, is responsible for monitoring compliance with internal controls and evaluation of processes and project performance. The Bank's Office of Independent Evaluation now reports directly to this committee rather than to the President's office. In addition, management has added resources to the internal audit function, increased its independence, and expanded its role to include compliance and fraud detection.

## Conservative Financial Policies Central to Managing Risk

Given its mandate to lend to its less developed member countries, most of which have relatively poor credit quality, the CDB has as its major risk exposure country credit risk and the potential losses it faces in the event that a borrowing member is unable or unwilling to repay its obligations to the Bank. The Bank's preferred creditor status partially mitigates this risk. With this status, obligations to multilateral lending institutions have priority of payment over borrowers' other obligations in the event of a restructuring. Preferred creditor status therefore makes the credit risk on the bank's loans less than what the borrowers' ratings would suggest.

The Bank also manages credit risk through its lending policies. The CDB recently revised its lending exposure limits, reducing the maximum exposure it could have to its three largest borrowers from 120% of capital to the greater of 90% of available capital or 60% of outstanding loans.[1] However, these limits still do not effectively check portfolio concentration risk. Moreover, the Bank simultaneously raised the maximum permitted exposure to its largest borrower to the greater of 40% of outstanding loans or 50% of available capital (previously it was strictly limited to 50% of available capital). Although the loan portfolio exhibits a high degree of borrower concentration, the Bank's exposures remained well below the new limits as of the end of September 2013, with loans to its largest borrower equal to 25 % of the portfolio and loans to its largest three borrowers equal to just 70% of capital.

However, the Bank maintains conservative limits on total lending and borrowing to ensure that it does not become overleveraged. The Charter limits the total amount of outstanding loans, equity investments, and guarantees to 100% of the Bank's unimpaired subscribed capital and retained earnings, net of receivables from members, derivatives, and the cumulative translation of yen borrowings. As of 30 June 2013, outstanding loans stood at 45% of subscribed capital and net retained earnings, down from an average of more than 70% from 2006 to 2010 due to the recent general capital increase. (In addition, the Bank had nearly $300 million in undisbursed loan commitments - equal to 31% of outstanding loans.)

[1] While the new limit of 60% of outstanding loans could potentially exceed the old limit of 120% of capital, that would imply a significant increase in both total lending and borrowing.

The Bank's borrowing limit is even more restrictive than its overall lending limit. The borrowing limit only permits the Bank to borrow against paid-in capital, net retained earnings, and the callable capital of its investment grade non-borrower members, though Moody's notes that this policy is not in the Bank's Charter as is the lending limit. Nevertheless, the Bank has ample headroom for additional borrowing. As of the end of September 2013, borrowings equaled just 67% of the limit. According to the Bank's revised financial plan, the headroom for additional borrowings under the bank's borrowing limitations will rise from 33% currently to 50% in 2014following upcoming scheduled debt repayments.

In addition, the Bank has a broadly written derivatives policy, an operating guideline calling for the diversification of funding sources, with no single source providing more than 25% of the CDB's total debt, and an investment policy which limits the types of investments it can make. Investments are generally limited to obligations of commercial banks that are rated at least A3 and meet certain other requirements of the bank, with certain limited exceptions, certain sovereign and MDB debt rated at least Aa3, or US Agency debt. In addition, as part of its risk management review, the Bank implemented a cap on investments in commercial entities equal to 50% of its total investment portfolio. It is important to note that the CDB had no exposure to "toxic assets" in its investment portfolio and was therefore largely unaffected by the global crisis.

## Prudent Exchange Rate and Interest Rate Risk Management

Although the Bank lacks a formal overall asset-liability management policy, management expects to improve the mechanisms for overseeing associated risks in the coming year. In the meantime, the Enterprise Risk Committee is responsible for the general supervision of asset-liability management related risks, including existing policies and procedures that specifically address exchange rate risk and interest rate risk, among others. CDB does not assume any exchange rate risk. While 22% of CDB's borrowings were in Japanese Yen (with the rest in US dollars) and 100% of all loans were in US dollars as of June 30, 2013, CDB uses derivatives to swap non-US dollar borrowings to variable US dollar borrowings. As a result, exchange rate risk is borne fully by its borrowers and its swap counterparties (though CDB does assume some counterparty risk). The yen borrowings were valued at $192 million as of June 2013, but had an original value of just $160 million. As required by IAS 39, all derivative instruments are marked-to-market (as are its non-dollar borrowings), which causes considerable volatility on the Bank's income statement. It should be noted that these derivatives are held to maturity, and that their term matches that of the underlying debt that is being swapped.

The Bank's lending rate policy limits the exposure to interest rate risk. The Bank resets lending rates twice annually based on changes in the its average cost of borrowings at levels that ensure that it meets its 1.5 times minimum interest coverage requirement and builds sufficient equity to meet its capital adequacy requirements. The rate on the CDB's loans currently stands at 3.95%, scheduled to increase to 4.1% on 1 January. However, the spread the Bank charges over its own cost of funding will actually decrease by 60 basis points as it tries to offset the impact of its increased borrowing costs on its members.

## Liquidity and Funding

### Conservative Liquidity Policy Drives High Liquidity Levels

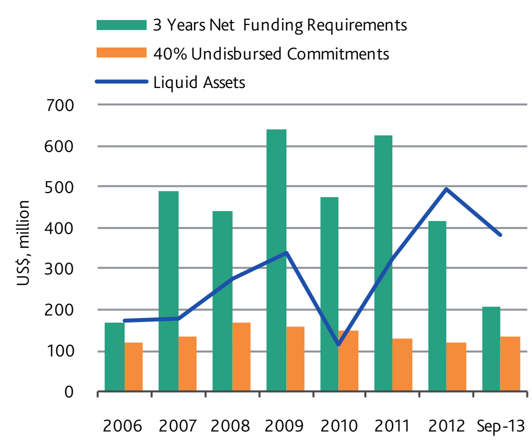
After failing to comply with its liquidity policy for five consecutive years, from 2007 to 2011, the Bank was back in full compliance at year-end 2012; it expects to remain in compliance this year. CDB's liquidity policy is among the most conservative of rated MDBs. Although the extended compliance failure raised questions regarding the adequacy of its risk management and financial planning capabilities, liquidity remained consistently stronger than that of many Aaa-rated MDBs. The Bank's ability to fulfill its financial obligations in full and on time was never endangered.

CDB's liquidity policy requires the Bank to maintain liquid assets equivalent to the greater of 1) 40% of undisbursed commitments or 2) three years of net funding requirements, including bond amortization payments. Given the small size of the bank and its high degree of geographic concentration, a conservative liquidity policy is appropriate, in management's view, despite the associated cost.

Because of the Bank's heavily front-loaded maturity schedule, three years net funding requirements spiked to $488 million at year-end 2007 and $642 million in 2009, up from $168 million in 2006 (in each case based upon actual loan disbursements over the following three years rather than projected at the time). As a result, the Bank was not in compliance with the second clause of the test from 2007 through 2011.

EXHIBIT 1

**Liquidity Levels Back in Compliance with Strict Policy Requirements...**

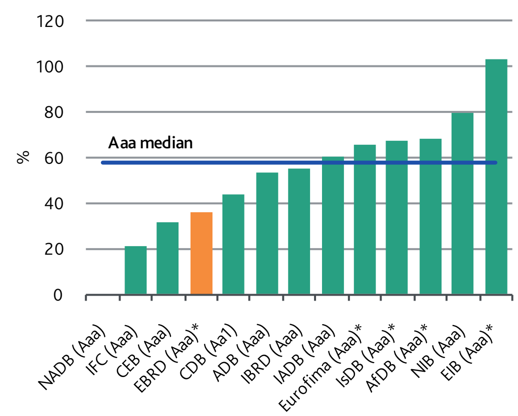



*Source: CDB and Moody's*

EXHIBIT 2

**... Supporting Robust Liquidity Levels Compared to Other MDBs**

Short-Term Debt + Currently Maturing Long Term Debt / Discounted Liquid Assets (2012)




*2011

*Source: CDB and Moody's*

In 2010, the Bank even failed to comply with the first clause of the test as investors exercised a put on $60 million of variable rate bonds, causing liquidity to drop to just 33% of undisbursed commitments, from 85% the previous year. However, following the Bank's issuance of $300 million in bonds in late 2012, total cash and investments rose to nearly $500 million, comfortably exceeding the liquidity requirement of $417 million at year-end (down from $625 million the previous year). The Bank has been using bond proceeds to repay current maturities. Nevertheless, management expects to exceed the minimum liquidity requirement by nearly 65% this year. However, it projects the cushion declining to just 6% in 2014, when the requirement will again be equal to 40% of undisbursed commitments because the net funding requirements for the following three years will have fallen so much. Nevertheless, management does not currently anticipate any additional borrowing either next year or in 2015.

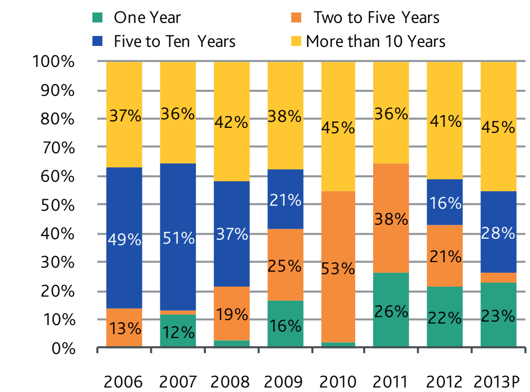
The CDB may have failed to comply with its policy, but its liquidity ratio of current maturities of long-term debt plus short-term debt to liquid assets remained strong relative to those of Aaa-rated MDBs. The CDB's liquidity ratio averaged just 20% from 2007 to 2012, which is considerably below (lower being better) the 2012 median of 58% for Aaa-rated MDBs. Even at its weakest point in 2011, this ratio rose to just 76%, indicating that the Bank still had more than enough liquidity to pay all of its short-term debt and current maturities of its long-term debt. The ratio improved to 40% in 2012, and it is projected to fall below 3% by 2014, considerably lower than the ratio for any Aaa-rated MDB currently except for the North American Development Bank and the European Investment Fund, which has no debt. Moreover, by June 2013 liquid assets exceeded 60% of total borrowings, up from a trough of just 17% in 2010. Although they will decline somewhat this year and next, liquid assets should remain at least 38% of total borrowings for the next several years, if not longer. In addition, the Bank has access to two lines of credit: a $65 million line from the European Investment Bank (EIB) designated specifically for climate change projects and a $50 million line from Royal Bank of Canada.

## Front-Loaded Maturity Schedule Has Been Successfully Re-Profiled; Leverage Remains Moderate

The payment profile of the Bank's debt became heavily front loaded in recent years; as of the end of 2011, approximately two-thirds of the Bank's debt was scheduled to mature over the following two and a half years. The change in the payment profile was due to the Bank's increased reliance on borrowings with bullet maturities rather than amortizing debt. Moreover, the $295 million in notes issued in 2009 and 2011 had relatively short terms, maturing in 2012 and 2013 respectively.

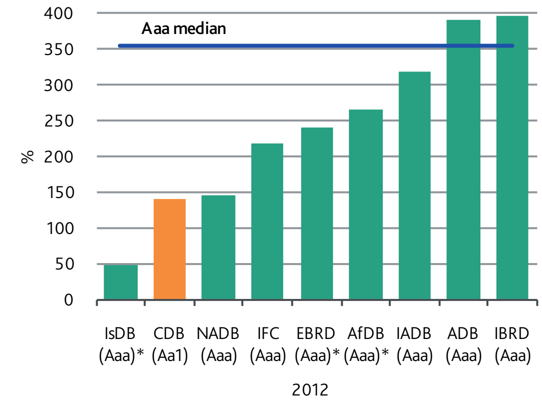
The fact that the Bank allowed short-term maturities to reach these levels reflected shortcomings in asset-liability management that were not consistent with a Aaa-rating; having a large portion of its assets consisting of long-dated, amortizing project loans created a significant maturity mismatch between the Bank's assets and liabilities. Moreover, cash flows from loan repayments were no longer sufficient to cover the Bank's debt servicing requirements, as they had been in the past. Consequently, the Bank's reliance on internal liquidity and its exposure to refinancing risk increased significantly at a time of great market uncertainty. However, the Bank was able to address this situation with its 2012 bond issuance. While the CDB has nearly $160 million in debt maturing in 2014, over the following four years it currently has a total of just $22 million coming due.

EXHIBIT 3
### Medium-Term Rollover Risk Has Been Eliminated...
Percentage of Debt Maturing In...




*Source: CDB and Moody's*

EXHIBIT 4
### ... And Leverage Remains Lower than Most Aaa-rated MDBs
Debt as % of Useable Equity




*2011
Note: Eurofima (1874%, 2011), CEB (1007%), EIB (945%, 2011), and NIB (823%) not shown in graph
*Source: CDB and Moody's*

Despite a steady increase in debt in recent years, the Bank's overall leverage remains relatively low, reflecting its high proportion of paid-in capital. The Bank's ratio of debt to usable equity, which is expected to decline further going forward, was just 140% in 2012. This placed it 60% below the median of 354% for Aaa-rated MDBs, and lower than all Aaa-MDBs except for the Islamic Development Bank.

## Profitability

### Credit Quality Not Impaired by Declining Profitability,

With the exception of a drop in 2009, the Bank's profitability as measured by return on assets and return on equity remained relatively stable between 2007 and 2011, averaging 3.1% and 6.5% respectively. In the 12 months through 30 June 2013, ROA fell to 0.6% and ROE to 1.5% as net income dropped to $11 million from $41 million in calendar year 2011. The decline in net income was largely attributable to a $20 million increase in net non-cash expenditures, including derivative fair value adjustments and foreign currency translation expense. Given the inherent volatility of these expenditure items and their non-cash nature, adjusted net operating income better reflects the underlying financial performance of the bank. However, this also declined by 30% due to a $7.8 million (76%) increase in borrowing costs that was not passed through to borrowing member countries. This was the Bank's lowest adjusted net operating income since 2005 and down from a peak of $30.3 million in 2009. In the first six months of 2013, adjusted net operating income declined by another $5 million due to a sharp rise in the Bank's borrowing costs that was once again not passed through to its borrowers. Despite the scheduled reduction in the Bank's lending spread as of 1 January 2014, management expects net income will rise next year due to growth in the loan portfolio and a reduction in borrowing costs that will not be passed through to borrowers until mid-year. However, as long as net income remains positive and equity is not eroded, profitability is not a significant focus of Moody's analysis of MDBs given their mission to provide the lowest cost funding possible to their members, rather than to maximize profitability.

## Capital Adequacy

### Capitalization Levels Remain Strong Despite Deterioration

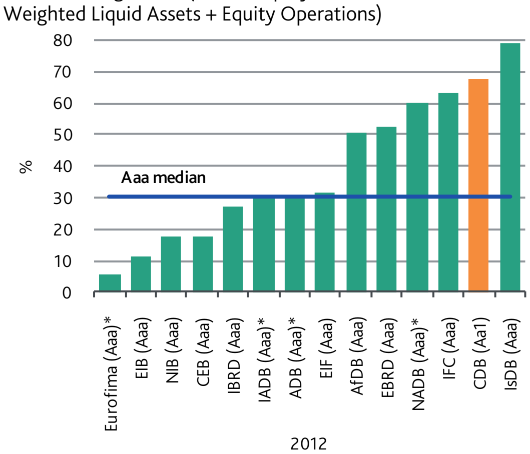
The CDB continues to exhibit strong capitalization despite a steady decline in its risk-asset coverage ratio (the sum of paid-in capital, reserves, and the callable capital of Aaa/Aa-rated member countries divided by outstanding loans to non-investment grade countries) between 2000 and 2010. Due to the expansion of the CDB's loan portfolio and a mandate to focus on its less-developed members, its risk-asset coverage ratio declined steadily to 100% in 2010 from a peak of 210% a decade earlier before rebounding to 124% in 2011 following the Bank's $1 billion general capital increase. The ratio fell back to 115% in 2012 following the downgrade of Barbados to Ba1, but it had returned to 124% by mid-2013 due to a capital increase and a contraction of the loan portfolio. Over the next few years, it is projected to stabilize as the receipt of additional capital payments offsets growth in the Bank's loan portfolio.

Despite the decline in its risk asset coverage ratio, the Bank remains very competitive with other MDBs in terms of its asset coverage ratio (usable equity divided by total loans and investments), an alternative measure of capitalization used by Moody's. The CDB's 2012 ratio of 68% was higher than all Aaa MDBs except for the Islamic Development Bank, and was more than twice the Aaa median.

EXHIBIT 5

**By Some Measures, CDB's Capitalization Stronger than Most Aaa-rated MDBs (2012)...**

Asset Coverage Ratio (Usable Equity as % of Loans + Risk Weighted Liquid Assets + Equity Operations)



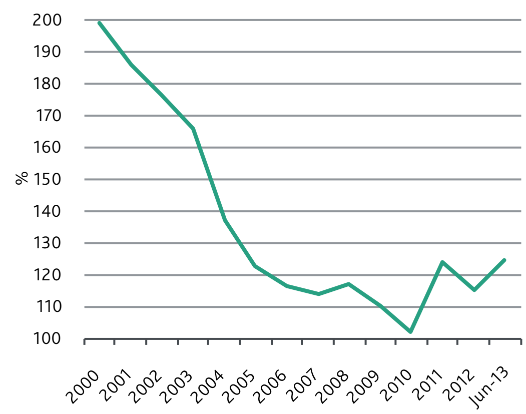

*2011

*Source: CDB and Moody's*

EXHIBIT 6

**... Despite Deterioration in Other Measures**

Risk-Asset Coverage Ratio (Usable Equity + CC of Aaa/Aa Members as % of Non-Investment Grade Loans)




*Source: CDB and Moody's*

As part of the general revisions to its risk management framework, the Bank recently adopted a revised minimum capital adequacy requirement based upon a new measure of its capital, which it refers to as "economic capital." This is defined as "capital that the bank should hold to protect itself against low-probability losses arising from credit, market, and operational events, as calculated using the capital adequacy model." In order to ensure that it has adequate capital to withstand even more extreme circumstances, the Bank has set the minimum required level at 150% of "economic capital." Currently, its capitalization is well above this threshold at 178% of "economic capital." The definition of the capital base is essentially the same as Moody's Usable Equity: paid-up capital, capital paid in advance, retained earnings, and reserves less subscriptions not yet matured or overdue.

## Asset Composition and Quality

As a result of its mission and narrow regional remit, the CDB's loan portfolio exhibits a high degree of concentration and significant exposure to borrowers with poor credit quality. Nevertheless, loan performance has historically been very strong, reflecting the Bank's preferred creditor status. The CDB is one of the smallest MDBs rated by Moody's. The outstanding loan portfolio is again below $1 billion following a 3.5% decline in 2012. Total assets, however, jumped by 6.3% to $1.64 billion, due largely to a $173.5 million, or 54%, increase in liquid assets. In the first six months of 2013, the loan portfolio contracted further while liquid assets continued to grow.

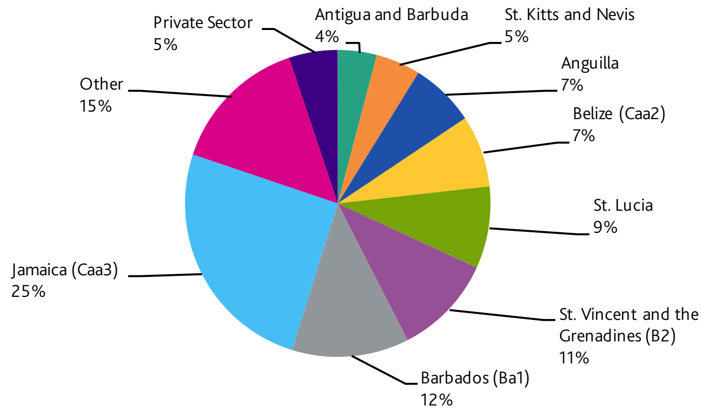
The bulk of lending has been concentrated in the public sector, and all loans to government-owned companies carry a full sovereign guarantee. The Bank allocates funding to members based on a number of factors including need as well as a country's financial, economic, and institutional performance, though there is a bias towards smaller countries.

### Loan Portfolio Highly Concentrated and Credit Quality Deteriorating

Already relatively weak, the credit quality of CDB's borrowers has deteriorated considerably since the onset of the financial crisis. The Bank's lending portfolio is also highly concentrated. Just four countries account for 57% of the total portfolio. As of 30 June 2013, 25% of total outstanding loans were made to Jamaica (Caa3 stable), 12% to Barbados (Ba1 negative), 11% to St. Vincent and the Grenadines (B2 stable), and 9% to St. Lucia (not rated). Its top-ten borrowers account for 85% of the portfolio, which is well above the median of 61% for Aaa MDBs. However, management has indicated that it expects its OCR exposure to Jamaica, its largest borrower, to decline over the next several years as Jamaica gradually repays its OCR loans, the Bank meets its new borrowing requirements with Special Funds Resources, and the OCR loan portfolio grows.

Over 40% of the portfolio is unrated, a percentage that includes nine of the CDB's member countries as well as regional and private sector loans. Assuming a rating of B2 for the unrated borrowers, the weighted average rating of the portfolio is currently B3, down from B2 in 2011 and B1 in 2007, as five of the seven rated borrowers have been downgraded up to five notches (Jamaica from B1 to Caa3). It is safe to assume that the credit quality of the unrated borrowers has deteriorated as well – in fact, a number of them have undergone debt restructurings over this timeframe. The B3 weighted average borrower rating is among the lowest of rated MDBs.

EXHIBIT 7
**Significant Concentration in Low-Rated Borrowers**




*Source: CDB and Moody's*

Most of the bank's loans are project based, although demand for its policy based loans (PBLs) has increased considerably in recent years. The level of PBLs rose rapidly from just 8.5% of the loan portfolio at the end of 2008 and 1.6% the previous year to 20% as of year-end 2010, and it is expected to increase further following the Bank's recent decision to raise the cap on the level of PBLs from 20% to 30% of the portfolio. Historically, CDB has channeled approximately one-third of its lending to Small- and Medium-sized Enterprises (SMEs) through financial intermediaries owned by the host country governments. As such, this lending carries government credit risk.

While the Bank has encountered problems with a few of its private sector loans, as of 30 June 2013 these loans accounted for only about $48 million, the equivalent of 5.1% of total loans outstanding. Management has indicated that it hopes to gradually increase private sector lending going forward both as a means of portfolio diversification and a development tool. At the same time, it is cognizant of the risks associated with this lending and of its need first to develop its capacity to adequately assess and monitor those risks. It further anticipates that much of this increased lending will be undertaken in conjunction with other international financial institutions that have more experience dealing with these risks, that it will be subject to strict exposure limits, and that it will target enterprises domiciled in higher rated jurisdictions. The Bank's private sector borrowers are exempted from general debt payment moratoria and foreign exchange controls that may be imposed by their respective national governments. That said, if private sector lending increases excessively (it can be as high as 30% of the total loan portfolio according to current policy limits), it could have a negative impact on the CDB's rating.

## Preferred Creditor Status Supports Strong Loan Performance

Although income levels remain relatively high, the Caribbean region as a whole suffers from a lack of economic diversification, low growth, large fiscal deficits, and rising debt levels, all of which have contributed to the decline in the average rating of CDB's borrowers. Nevertheless, repayment performance of the Bank's loans has remained relatively good, reflecting its preferred creditor status. Clear evidence of the benefits of preferred creditor status derives from the cases of Belize, Dominica, Grenada, Jamaica, and St. Kitts and Nevis, all of which restructured their sovereign financial obligations in recent years but remained current in their debt service payments to the Bank.

Consistent with practices of other MDBs, the Bank has had a policy not to reschedule debt obligations of its borrowing member countries. However, it is important to note that on several occasions the Bank has used its SFR to refinance the OCR obligations of certain members, including some going through restructurings. Management stresses that borrowers must make substantial fiscal adjustments before they will be considered for such treatment and the approval of the contributors of the Bank's special resources is required as well. Furthermore, these operations are generally limited to circumstances in which the cause of the member's financial distress was something outside its direct control, such as natural disasters.

CDB maintains a strict arrears policy. Arrears start to accrue if payment is one day overdue. No loan to a borrower will be recommended to the Board of Directors if the borrower is in arrears or a loan guaranteed by the borrower is in arrears. After three months of arrears, disbursements can be suspended. Arrears of more than four months on a loan that a BMC guarantees can result in suspension of disbursements on all loans to or guaranteed by that BMC. CDB also applies a late fee of 1% on all payments that are overdue.

As a result, as of June 2013, arrears amounted to just $2.5 million, down from $9 million at the end of 2012. There was only one impaired loan (to a private sector entity) with outstanding amount of $4.9 million and $3.9 million provisioned against it. In addition, the Bank maintains a $7.9 million general banking reserve to provide further protection against potential losses. To date, the CDB has not experienced any public sector write-offs. Since CDB provides funds for investments that are considered essential for its members' economic and social progress, and arrears carry a loss of political standing for the debtor country, members have generally sought to avoid arrears at all costs and thereby ensure that their relationships with the Bank remain on good terms. We also believe the fact that planned and anticipated OCR disbursements and new commitments significantly exceed scheduled repayments for most of the borrowing member countries should continue to support timely repayment. While this is not the case for Jamaica, the Bank expects to provide Jamaica with substantial SFR assistance over the next several years.

## Strength of Member Support

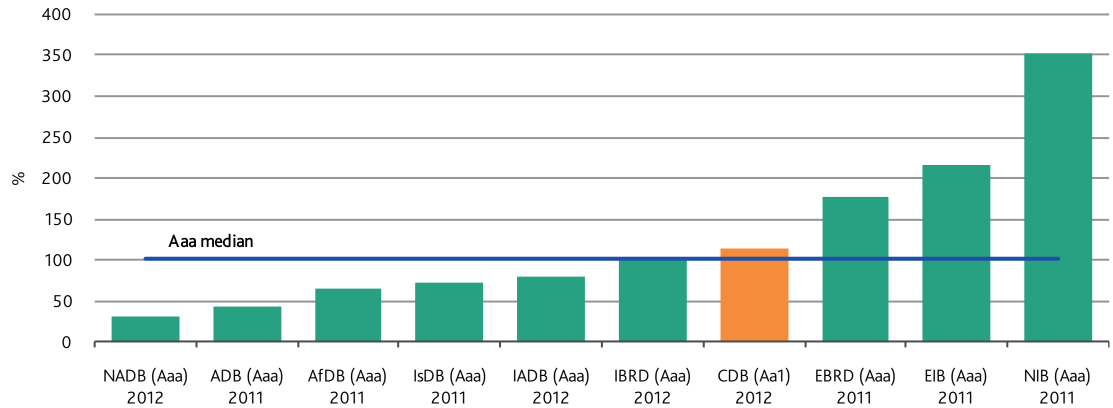
### Limited Ability to Support Reflected in Low Average Member Rating

As is the case with most MDBs, the CDB benefits from callable capital. In the CDB's case, this is nearly sufficient to repay all of its outstanding debt - the CDB's debt is just 10% more than its risk-discounted investment-grade callable capital, which places it at the median for rated MDBs.

EXHIBIT 8

**CDB's Risk-Discounted Callable Capital Nearly Equal to Debt Stock**

Debt as % of Discounted Investment Grade Callable Capital




Note: Aaa CEB (666%, 2012) and Eurofima (1576%, 2012) not shown in graph.

*Source: CDB and Moody's*

Relative to other highly rated MDBs, however, the CDB is an outlier in terms of the credit quality of its members, which is the primary means by which Moody's assesses the ability of shareholders to support the Bank in extraordinary circumstances. While CDB benefits from the support of highly-rated non-regional member countries like Canada, the UK, Germany, and China, the weighted median shareholder rating of Baa1 reflects the relatively limited share of the Bank's callable capital provided by its more highly rated members compared to most Aaa-rated MDBs. The weighted median rating for the Bank's members is weaker than that of all but two of the Aaa-rated MDBs: the African Development Bank (Baa2) and the Islamic Development Bank (Ba2).

## Strong Willingness to Support Evidenced By 2010 Capital Increase

While the ability of many of its members to provide financial support may be limited, the CDB's shareholders' willingness to support the Bank is very strong, in Moody's opinion. Moody's notes that the Bank has a special relationship with its borrowing member countries, who collectively hold a majority of the Bank's capital and therefore play an important role in determining the Bank's strategic direction. This influence drives their support for the institution and distinguishes it from many other MDBs.

This strong willingness to provide support is best reflected in the Bank's $1 billion general capital increase in May 2010, and by the relatively high portion of paid-in capital. The 2010 capital increase was the fourth since the Bank's creation, and it increased the Bank's subscribed capital by 150%. Approximately $850 million in subscriptions have been received to date. The capital increase was originally intended to enable the bank to finance the significant increase in lending called for by its 2010-14 strategic plan, though these lending plans have since been scaled back considerably.

The CDB's member subscriptions are divided into paid-up and callable portions. Twenty-two percent of the recent capital increase will consist of paid-in capital, which will be paid in cash in six equal annual installments. The paid-up proportion of the capital increase is the same as the proportion for the Bank's previously existing capital, which is relatively high for MDBs rated by Moody's. Among Aaa and Aa rated MDBs, just the IsDB (25%), and the IFC (100%) are higher. The high share of paid-in capital helps compensate for the relatively low weighted average rating of CDB's shareholders and further demonstrates strong member support for the institution.

Of the $99 million in capital payments that were payable as of September pursuant to the capital increase, the Bank has received all but $7.4 million. It expects to receive all of these arrears by the end of the first quarter of 2014. However, this was more than offset by the $13.3 million in payments in advance that it had received from other members. While subscription instruments are still due from seven countries, three of those have already made payments. Suriname became the Bank's 27th member when it joined in September 2013. It will be required to make a total paid-in capital contribution of $8.25 million and will receive a 1.54% voting share. The Bank has already received the 1st installment in accordance with the payment schedule.

## Annual Statistics

| Caribbean Development Bank | 2008 | 2009 | 2010 | 2011 | 2012 | Jun-13 |
|---|---|---|---|---|---|---|
| Balance Sheet Summary (US$ Mil.) | | | | | | |
| Assets | | | | | | |
| Total | 1,177.2 | 1,288.0 | 1,268.9 | 1,543.1 | 1,640.8 | 1,634.6 |
| Liquid Assets | 274.9 | 339.2 | 112.6 | 323.4 | 496.9 | 535.3 |
| Net Loans Outstanding | 769.2 | 818.3 | 993.5 | 1,007.5 | 972.3 | 942.6 |
| Derivative Instruments | 71.3 | 58.8 | 97.7 | 127.7 | 95.3 | 67.5 |
| Other Assets | 61.8 | 71.6 | 65.0 | 84.5 | 76.3 | 89.2 |
| | | | | | | |
| Liabilities | | | | | | |
| Total | 633.9 | 722.4 | 664.4 | 868.9 | 933.9 | 887.3 |
| Borrowings | 608.6 | 718.1 | 653.2 | 857.9 | 920.2 | 867.6 |
| Other Liabilities | 25.2 | 4.4 | 11.1 | 13.6 | 0.0 | 0.0 |
| | | | | | | |
| Capital and Reserves | | | | | | |
| Total | 543.3 | 565.5 | 604.5 | 674.2 | 706.9 | 747.2 |
| Matured Capital Subscriptions (Paid in Capital) | 157.4 | 157.4 | 157.4 | 186.4 | 218.7 | 254.5 |
| Reserves and Retained Earnings | 385.9 | 408.1 | 447.1 | 487.9 | 488.2 | 492.7 |
| | | | | | | |
| **Total Liability & Equity** | **1,177.2** | **1,288.0** | **1,268.9** | **1,543.1** | **1,640.8** | **1,634.5** |

| Caribbean Development Bank | 2008 | 2009 | 2010 | 2011 | 2012 | 6/13 TTM* |
|---|---|---|---|---|---|---|
| INCOME STATEMENT SUMMARY (US$ Mil.) | | | | | | |
| **Total Income** | **52.7** | **52.2** | **46.7** | **43.4** | **44.5** | **43.7** |
| Income from Loans | 46.6 | 45.7 | 42.7 | 40.6 | 39.6 | 38.6 |
| Investment Income | 5.9 | 6.2 | 3.8 | 2.7 | 3.4 | 4.0 |
| Other | 0.2 | 0.4 | 0.3 | 0.1 | 1.5 | 1.1 |
| | | | | | | |
| **Total Expenses** | **28.3** | **21.9** | **18.3** | **20.7** | **23.4** | **28.0** |
| Borrowing Expenses -- Interest | 18.0 | 13.6 | 11.7 | 10.3 | 13.2 | 18.1 |
| Other (other borrowing costs- derivatives) | 0.1 | -1.9 | -3.5 | -2.8 | -3.4 | -3.6 |
| Administrative Expenses | 9.2 | 9.2 | 10.2 | 10.2 | 11.0 | 11.0 |
| Provision for Loan Losses | 1.0 | 1.1 | 0.0 | 3.0 | 2.5 | 2.5 |
| | | | | | | |
| **Net Operating Income** | **24.4** | **30.3** | **28.4** | **22.7** | **21.2** | **15.7** |
| | | | | | | |
| Decrease/(Increase) in Fair Value of Derivatives | -56.0 | 11.5 | -41.3 | -31.9 | 31.1 | 46.6 |
| Foreign Exchange Translation expense | 39.1 | -4.6 | 27.9 | 12.9 | -24.0 | -46.9 |
| Realized and unrealized fair value losses (gains) | -1.5 | 1.2 | 0.4 | 0.9 | -1.3 | 5.3 |
| | | | | | | |
| **Net Income** | **42.9** | **22.2** | **41.5** | **40.8** | **15.4** | **10.6** |

* Trailing Twelve Months

**Caribbean Development Bank**

| | 2008 | 2009 | 2010 | 2011 | 2012 | Jun-13 |
|---|---|---|---|---|---|---|
| **BALANCE SHEET ANALYSIS** | | | | | | |
| **Capital Structure** | | | | | | |
| Total Subscribed Capital | 713.0 | 713.0 | 937.2 | 1,501.9 | 1,549.0 | 1,595.5 |
| ( - ) Total Callable Capital | 555.5 | 555.5 | 730.4 | 1,170.9 | 1,207.6 | 1,243.9 |
| (CC of Aaa/Aa members) | 177.1 | 177.1 | 255.5 | 416.9 | 416.9 | 418.4 |
| (CC of Investment Grade members) | 375.8 | 375.8 | 551.8 | 850.6 | 807.8 | 809.4 |
| Equals Paid-up Capital | 157.4 | 157.4 | 206.8 | 331.0 | 341.4 | 351.6 |
| ( - ) Subscriptions not yet due | -- | -- | 49.3 | 144.6 | 122.6 | 97.1 |
| ( + ) Subscriptions Paid in Advance | -- | -- | 6.2 | 5.2 | 4.1 | 13.3 |
| ( - ) Overdue Subscriptions | -- | -- | 1.3 | 16.0 | 11.3 | 13.8 |
| ( - ) Non-negotiable, non-interest bearing demand obligations from members | 43.8 | 43.4 | 44.4 | 44.4 | 43.8 | 43.3 |
| Equals Usable Paid-in Capital (Conv. Curr.) | 113.6 | 114.0 | 118.0 | 131.2 | 167.8 | 210.7 |
| ( + ) Total Reserves and Retained Earnings | 385.9 | 408.1 | 447.1 | 487.9 | 488.2 | 492.7 |
| Equals Usable Equity | 499.5 | 522.1 | 565.1 | 619.0 | 656.0 | 703.4 |
| | | | | | | |
| **Composition of Assets (%)** | | | | | | |
| Liquid Assets | 23.4 | 26.3 | 8.9 | 21.0 | 30.3 | 32.7 |
| Loans Outstanding | 65.3 | 63.5 | 78.3 | 65.3 | 59.3 | 57.7 |
| Derivative Instruments | 6.1 | 4.6 | 7.7 | 8.3 | 5.8 | 4.1 |
| Other | 5.3 | 5.6 | 5.1 | 5.5 | 4.6 | 5.5 |
| | | | | | | |
| **Capitalization (%)** | | | | | | |
| Borrowings | 36.6 | 40.0 | 33.5 | 32.4 | 33.1 | 30.8 |
| Reserves and Retained Earnings | 23.2 | 22.7 | 22.9 | 18.4 | 17.5 | 17.5 |
| Usable Paid-in Capital | 6.8 | 6.3 | 6.1 | 5.0 | 6.0 | 7.5 |
| CC of Aaa/Aa members | 10.6 | 9.9 | 13.1 | 15.7 | 15.0 | 14.9 |
| CC of A/Baa members | 11.9 | 11.1 | 15.2 | 16.4 | 14.0 | 13.9 |
| CC of members below IG | 10.8 | 10.0 | 9.2 | 12.1 | 14.4 | 15.4 |

**Caribbean Development Bank**

| | 2008 | 2009 | 2010 | 2011 | 2012 | Jun-13 |
|---|---|---|---|---|---|---|
| **Financial Ratios** | | | | | | |
| **Profitability (%)** | | | | | | |
| Return on Total Average Assets | 3.9 | 1.8 | 3.2 | 2.9 | 1.0 | 0.6 |
| Return on Average Equity | 8.1 | 4.0 | 7.1 | 6.4 | 2.2 | 1.5 |
| Interest Income on Loans as a % of Average Loans Outstanding | 6.1 | 5.8 | 4.7 | 4.0 | 4.0 | 4.0 |
| Interest Coverage Ratio (Net Operating Income + Interest Expense as % of Interest Expense) (X) | 2.4 | 3.6 | 4.5 | 4.0 | 3.2 | 2.1 |
| **Capital adequacy and leverage ratios (%)** | | | | | | |
| Asset Coverage Ratio (Usable Equity as a % of Loans + Liquid Assets) | 65.8 | 64.7 | 57.4 | 61.8 | 67.7 | 75.1 |
| Risk Asset Coverage Ratio (Usable Equity + CC of Aaa/Aa Members as a % of Risk Assets) [1] | 117.0 | 110.2 | 101.7 | 124.0 | 115.1 | 124.1 |
| Total Borrowings as a % of Usable Equity | 121.9 | 137.5 | 115.6 | 138.6 | 140.3 | 123.3 |
| Total Borrowings as a % of CC of IG members | 162.0 | 191.1 | 118.4 | 100.9 | 113.9 | 107.2 |
| **Liquidity ratios (%)** | | | | | | |
| Liquid Assets as a % of Total Borrowings | 45.2 | 47.2 | 17.2 | 37.7 | 54.0 | 61.7 |
| Short Term Debt + Current Maturities of Long Term Debt as % of Liquid Assets | 5.2 | 34.3 | 10.2 | 69.9 | 39.8 | 29.5 |
| Liquid Assets as a % of Undisbursed Commitments [2] [3] | 60.4 | 84.5 | 33.1 | 96.2 | 152.4 | 126.4 |
| Liquid Assets as a % of 3 Years' Net Funding Requirements [2] [4] | 62.5 | 52.8 | 23.8 | 51.7 | 119.0 | 258.0 |
| **Lending, borrowing, and exposure limits (%)** | | | | | | |
| Loans Outstanding as a % of Subscribed Capital+ Retained Earnings and Reserves [2] [5] | 74.0 | 74.8 | 73.8 | 52.4 | 47.7 | 45.1 |
| Total Borrowings as a % of CC of IG Non-borrowing Members+ Retained Earnings and Reserves [2] [5] | 88.9 | 98.0 | 78.3 | 81.1 | 89.3 | 86.3 |
| Exposure to Largest Borrower (as % of Available Capital) [6] | 31.9 | 34.6 | 38.7 | 44.0 | 40.0 | 37.0 |
| Exposure to 3 Largest Borrower (as % of Available Capital) [7] | 72.1 | 74.6 | 79.1 | 84.0 | 77.3 | 78.2 |

[1] Risk assets defined as loans to countries rated below investment grade by Moody's

[2] As reported by the CDB.

[3] Must be at least 40% per CDB's liquidity policy requirement.

[4] Must be at least 100% per CDB's liquidity policy requirement.

[5] Must be less than 100% per CDB's lending and borrowing limitations.

[6] Revised limit is the greater of 40% of Outstanding Loans or 50% of Available Capital

[7] Revised limit is the greater of 60% of Outstanding Loans or 90% of Available Capital

**Country Distribution of Outstanding Loans (% of Total)**

| | 2008 | 2009 | 2010 | 2011 | 2012 | Jun-13 |
|---|---|---|---|---|---|---|
| Jamaica | 20.7 | 22.1 | 22.0 | 24.0 | 24.4 | 25.4 |
| Barbados | 14.1 | 13.6 | 12.8 | 12.6 | 12.4 | 12.3 |
| St. Vincent and the Grenadines | 6.9 | 8.0 | 11.0 | 10.4 | 10.4 | 10.6 |
| St. Lucia | 12.0 | 11.9 | 10.2 | 9.2 | 8.7 | 8.7 |
| Belize | 7.6 | 8.2 | 7.4 | 7.3 | 7.4 | 7.6 |
| Anguilla | 1.8 | 1.6 | 6.8 | 6.6 | 6.6 | 6.8 |
| St. Kitts and Nevis | 6.8 | 6.6 | 6.0 | 5.8 | 5.5 | 4.7 |
| Antigua and Barbuda | 2.8 | 2.7 | 3.2 | 4.0 | 4.1 | 4.1 |
| Trinidad and Tobago | 7.1 | 5.6 | 3.9 | 3.2 | 2.7 | 2.4 |
| British Virgin Islands | 2.8 | 2.4 | 1.7 | 1.5 | 1.4 | 1.3 |
| Other | 17.4 | 17.3 | 15.0 | 15.4 | 16.4 | 16.1 |

**Member Voting Power (% of Total)**
(as of June 30, 2013)

| Regional States and Territories | |
|---|---|
| Jamaica | 18.8 |
| Trinidad and Tobago | 18.8 |
| Bahamas | 5.6 |
| Guyana | 4.1 |
| Barbados | 3.6 |
| Colombia | 3.1 |
| Venezuela | 3.1 |
| Mexico | 1.3 |
| British Overseas Territories | 0.1 |
| Other Regionals | 6.8 |
| **Total Regional States and Territories** | **65.1** |

| Non-Regional States | |
|---|---|
| Canada | 10.1 |
| United Kingdom | 10.1 |
| Germany | 6.1 |
| China | 6.1 |
| Italy | 2.5 |
| **Total Non-regional States** | **34.9** |

## Rating History

| | Issuer Rating | | | |
|---|---|---|---|---|
| | Long Term | Short Term | Outlook | Date |
| **Caribbean Development Bank (CDB)** | | | | |
| Outlook Changed | -- | -- | Stable | November-13 |
| Rating Affirmed | Aa1 | -- | -- | November-13 |
| Outlook Changed | -- | -- | Negative | May-12 |
| Rating Lowered | Aa1 | -- | -- | May-12 |
| Outlook Changed | Aaa | -- | RUR - | February-12 |
| Outlook Assigned | -- | -- | Stable | November-03 |
| Rating Assigned | Aaa | -- | -- | March-92 |

## Moody's Related Research

### Credit Opinion:

» Caribbean Development Bank

### Rating Action:

» Moody's Affirms the Caribbean Development Bank's Aa1 Rating, Outlook Revised to Stable, November 2013

### Related Website:

» For additional information, please see the Bank's website: Caribbean Development Bank

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Report Number: 160715

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