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The North American Development Bank

Introduction

The North American Development Bank (NADB) is a binational financial institution created and funded by Mexico and the United States. The NADB provides loans and grants to public and private entities for environmental and infrastructure projects on both sides of the U.S.-Mexico border. Modeled after the multilateral development banks (MDBs), such as the World Bank, the NADB is the only development bank that also finances projects in the United States.

Origins and Mandate

The NADB was created under the auspices of the North American Free Trade Agreement (NAFTA) in 1994, through a binational side agreement between the United States and Mexico. It was created to address some policymakers' concerns that NAFTA could worsen environmental conditions in the border region by increasing economic activity there.

The NADB's financing activities initially focused on projects related to water supply, wastewater treatment, and municipal solid waste disposal. In recent years, the NADB expanded its financing activities to include air quality, such as financing the development of wind farms for the generation of electricity.

NADB eligible projects must be located within 100 kilometers (about 62 miles) north of the U.S.-Mexico international boundary in the U.S. states of Texas, New Mexico, Arizona and California or within 300 kilometers (about 186 miles) south of the border in the Mexican states of Tamaulipas, Nuevo Leon, Coahuia, Chihuahua, and Sonora. Projects beyond these limits may be deemed eligible under certain conditions and subject to approval by the NADB's Board of Directors.

Funding

As of the end of FY 2016, the NADB had $2.77 billion in total capital. Of that amount, $415 million is paid directly to NADB ("paid-in" capital) and $2.35 billion is a guarantee from donor governments to the Bank ("callable" capital). Like the MDBs, callable capital may be called if and when required to meet the Bank's debt or guarantee obligations, subject to certain procedural requirements, and may not be used to make loans.

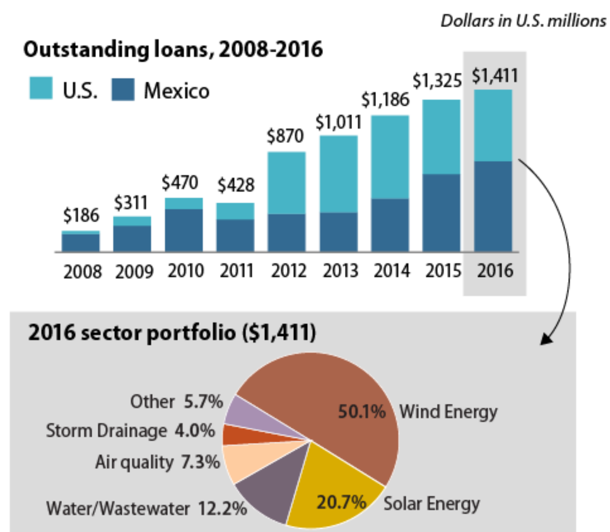
The NADB leverages its financial position by issuing debt in international capital markets in accordance with a debt limit policy that total debt outstanding may not exceed the Bank's callable capital account plus the minimum liquidity level required under the Bank's liquidity policy. The Bank borrowed a total of $2.22 million in 2016 compared to $133.23 million in 2015, which increased gross outstanding debt to a total of $1.19 billion.

Lending

During the Bank's early years, much of its lending capacity went underutilized. In the Bank's first decade (1994-2004), outstanding loans remained below $100 million. In 2000, the NADB Board expanded the range of projects that the NADB could invest in beyond water and solid-waste management into a wide range of environmental infrastructure projects. In 2004, President Bush signed legislation (P.L. 108-215), that authorized NADB to expand its geographic jurisdiction and make grants and non-market rate loans out of its paid-in capital resources with the approval of the Board.

Since 2011, NADB loans have increased sharply (**Figure 1**). During 2016, new loans totaling $96.88 million were approved for four projects. As of the end of 2016, the outstanding loan balance was $1.41 billion, an increase of 6.5% over the balance at the end of 2015 ($1.32 billion).

Figure 1. NADB Outstanding Loans: Over Time and By Sector



Source: Created by CRS from NADB Annual Reports.

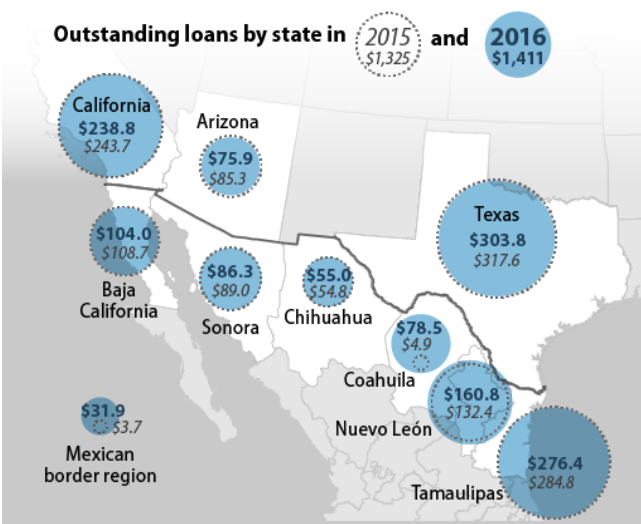
In recent years, the Bank's portfolio has become concentrated in wind and solar energy projects. In 2016, wind and solar loans accounted for over 70% of the NADB's outstanding loan portfolio. In addition, the NADB invested heavily in 2016 in public transportation, which grew from $3.69 million in 2015 to $31.87 billion in 2016. While the NADB provides loans to nine of the ten states allowed by its mandate, the top three states in which it lends, Texas, California, and the Mexican state of

Tamaulipas, account for 58% of the NADB's portfolio (**Figure 2**). In total, 56.2% of outstanding NADB lending is in Mexico, compared to 43.8% in the United States. According to the Bank, NAD lending in Mexico covers a broader area of sectors than in the United States, where borrowers have access to more financing options.

NADB Governance Structure

The NADB works closely with Border Environment Cooperation Commission (BECC), created concurrently with the NADB. Originally separate organizations, the two organizations merged in 2017. Whereas the NADB focuses on project financing and oversight for project implementation, the BECC focuses on technical, environmental, and social aspects of project development. Before a project can be financed by NADB, it must be certified by the BECC as technically and financially feasible. The NADB and BEEC are governed by a ten-member Board of Directors with equal U.S. and Mexican representation on the Board. The chairmanship alternates between the United States and Mexico each year. All powers of the NADB are vested in the Board of Directors, which determines policy and approves the Bank's programs and financing proposals involving NADB funds.

Figure 2. NADB Outstanding Loans: 2015-2016 (Millions of USD)



Capital Increase

In January 2015, then-President Obama and Mexican President Enrique Peña Nieto agreed to support a doubling of the NADB's capital base, from $3 billion to $6 billion, subject to the necessary legislation and availability of appropriations. The capital increase requires $450 million in paid-in capital and $2.55 billion in callable capital, split equally between both countries. This would be the first capital increase at the Bank since it was created and is motivated by the Bank's substantial increase in lending over the past five years, which has strained its capital adequacy ratios.

Additionally, a change in credit rating agency methodology requires the NADB to maintain higher capital adequacy ratios than other MDBs. NADB financing is more concentrated than other MDBs, because by mandate projects are geographically constrained to the border region and targeted in specific sectors.

Issues for Congress

Implementation of the capital increase at the NADB would require congressional approval in both Mexico and the United States. Mexico has already allocated funds for the capital increase, including an initial contribution of $10 million in 2016. aThe U.S. Congress is considering the Administration's request for authorization and funds to participate in the capital increase.

One concern may be the strength of the NADB's finances. In 2014, Moody's, a major credit rating agency, downgraded its assessment of the NADB's creditworthiness. The downgrade was linked to a change in Moody's methodology that placed more weight on geographic concentration risk, but Moody's also flagged the concentration of NADB lending in a relatively small number of specific projects. In the two years preceding the downgrade, the 10 largest loan exposures accounted for 75% of the total portfolio. Moody's also expressed concerns about a deterioration of the Bank's asset quality, as lending shifted from primarily the Mexican public sector to the U.S. private sector. Lending to Mexico fell to less than 40% and the end of 2012, from 80% on average between 1998 and 2011. Exposure to the private sector grew to over 65%, from 19% in 2011.

The proposed capital increase has also raised policy debate about the future of the NADB more broadly. Some analysts question the continuing need for NADB financing two decades after NAFTA was created, and whether it is crowding out private sector financing. Other analysts argue that the NADB is critical to supporting needed environmental and infrastructure projects in the border region that would not be otherwise funded by private investors. Some analysts further call for the NADB to expand its activities for the border region and all of Mexico.

Legislation Action

For FY2016, the Administration requested authorization to participate in the NADB's capital increase and requested $45 million for paid-in capital and $255 million for callable capital, as the first of five installments for the U.S. portion. The Consolidated Appropriations Act, 2016 (P.L. 114-113) did not include the requisite authorization language for U.S. participation in the capital increase. It did, however, allot $10 million for paid-in capital and $255 million for callable capital to the NADB to remain available until expended, meaning these funds will be available for the increase if Congress authorizes it at a later date. For FY2017, the Administration again requested authorization for U.S. participation in the NADB capital increase, as well as funds for the second installment of the U.S. portion. No funds were authorized or appropriated in FY2017 and the Trump Administration made no NADB request in its FY2018 budget.

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