



FINANCIAL OPERATING POLICY

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NORTH AMERICAN DEVELOPMENT BANK

FINANCIAL OPERATING POLICY

1. Purpose

The purpose of this policy is to delineate the foundational principles that govern the financial operations of the North American Development Bank (NADBank).

INVESTMENTS FOR ENVIRONMENTAL INFRASTRUCTURE PROJECTS

2. Eligibility for Financing

NADBank provides financing for environmental infrastructure that improves the health and well-being of the people and communities of the U.S.-Mexico border region, as defined in its Charter.

NADBank is authorized to provide financing to public and private entities, including public-private partnerships, for projects that have been certified by its Board of Directors in accordance with established certification criteria. Environmental infrastructure projects eligible for financing include:

- a) Water. Projects that improve water and sanitation services and protect water resources, including drinking water production, treatment and distribution; wastewater collection, treatment and reuse; water conservation; and stormwater management.
- b) Solid waste. Projects for the adequate management of solid waste, including municipal solid waste collection and disposal, solid waste recycling and reduction, and industrial and hazardous waste management.
- c) Air quality. Projects to improve air quality and reduce air emissions, such as street paving, international border crossings, emissions control and mobility. Mobility includes the efficient mobilization of people and cargo in public and private transportation systems with low- or zero-emissions and non-motorized transport, as well as infrastructure for more efficient cargo transportation, such as railways, transfer stations or distribution systems.
- d) Sustainable energy. Projects include renewable wind and solar energy generation, other clean energy generation, energy efficiency projects that reduce the carbon footprint of existing infrastructure or operations, and energy storage that reduces the intermittency of renewable energy generating assets or enhances grid stability, resiliency, and reliability.
- e) Urban development. Projects that promote sustainable urban planning, design, and development, such as low-impact and green infrastructure; sustainable land

development (mixed-use, re-densification, transport-oriented development) and “smart city” elements to improve sustainability.

- f) *Sustainable buildings and industrial parks.* Projects that replace traditional design, sourcing and construction techniques with sustainable design and construction principles. Projects may include the construction or retrofitting of residential, institutional, commercial or industrial buildings. Sustainable building and industrial parks incorporate practices for the efficient use of energy and resources and reduce greenhouse gas emissions or waste.
- g) *Green manufacturing and manufacturing of green products.* Green manufacturing practices with reduced environmental impact or the “greening” of production processes to use resources more efficiently and produce less pollution and/or waste. Projects may include manufacturing facilities and equipment that are more resource and energy efficient. Manufacturing of green products results in goods that use fewer natural resources or produce less pollution during their life cycle, when compared to conventional products.
- h) *Sustainable food value chains.* Projects that support sustainable food value chains by promoting the more efficient use of resources such as water, energy, and land, as well as the reduction of pollutants, throughout their lifecycle. Projects may include investments in agricultural practices or equipment that reduces the use of water, energy, fertilizers, or pesticides; investments in agricultural practices or equipment that reduces erosion, runoff, GHG emissions and/or other forms of pollution or environmental degradation; and investments to reduce the use of resources or generation of waste during food processing, packaging, storage, transportation, distribution, and commercialization.
- i) *Climate change adaptation and climate resilience.* Projects that help communities increase resiliency to the effects of climate change, including changes to long-term weather patterns (e.g., precipitation) as well as the increased frequency and intensity of extreme weather-related events (e.g., droughts, floods, and heat waves). Projects may include investments in low-impact, green or gray infrastructure designed to diversify and/or drought-proof water supplies, increase flood protection and/or adapt to more severe heat waves; and retrofits of existing infrastructure to operate in extreme weather conditions.
- j) Any other type of environmental infrastructure project approved by the Board of Directors.

3. Financing Instruments

NADBank can provide financing using a variety of instruments, including:

- a) direct loans, bonds and finance leases, which may be combined with grants to create blended financing.
- b) indirect loans to projects through financial intermediaries, which for purposes of this policy are considered the same as loans or bonds;

- c) Guarantees, in whole or in part, of loans made to, or securities issued in connection with, projects;
- d) subordinated debt;
- e) quasi-equity investments;
- f) equity investments funded from the Bank's undesignated retained earners; and
- g) any other instrument permitted by the Charter and approved by the Board of Directors.

NADBank also provides grants to projects under the umbrella of its Environment Investment and Capacity Fund (EICF). The terms and conditions governing NADBank's various grant programs are established in the operating guidelines for those programs. In the case of blended financing, the loan component will adhere to this policy and the grant component to the corresponding grant program or policy.

4. Non-financial Products and Services

In addition to providing financing to eligible borrowers, NADBank offers non-financial products and services, including but not limited to:

- a) advisory services, including project structuring and/or financial engineering, public-private partnerships, general project management assistance, investment syndication and financial agency services;
- b) assistance for capital market development and foreign and domestic investment; and
- c) technical assistance, training and knowledge products that deliver value-added services to its private-sector clients to enhance sustainability and access to financing, create shared value and improve competitiveness and environmental, social and governance policies.

NADBank seeks to develop strategic partnerships with public and private sector donors and stakeholders to leverage its resources and expertise in the provision of non-financial products and services.

NADBank may establish and charge fees for these services based on its administrative costs, as well as market practices.

5. Investment Principles Applicable to Development Assets

The term "development assets" refers to all financing provided by NADBank that is reflected on the Bank's balance sheet, including instruments (a) through (g) listed above in section 3.

5.1. Core Principles

- a) NADBank's financial priority is to preserve its capital in order to maintain its ability to provide financing for environmental infrastructure sustainably and for the long-term.

- b) The terms and conditions of NADBank's financing, including interest rate, charges, and repayment schedule, will be appropriate to the project financed and structured to preserve NADBank's resources and credit rating.
- c) To catalyze other sources of investment and reduce concentration risk, NADBank may require financing recipients to provide a portion of the funding needed for a project through grants, equity contributions, guarantees, or other instruments.
- d) NADBank must have reasonable and verifiable assurance that the projects have capacity for payment.
- e) Financing recipients must possess the requisite capacity and expertise to implement and operate the project and ensure the attainment of its objectives.
- f) Each transaction will be assessed for financial and environmental risks utilizing the corresponding NADBank risk evaluation model and policies.
- g) All project sponsors, owners, and key managers will be subject to a due-diligence review as established in NADBank's *Money Laundering Prevention Directive*.

5.2. Maturities. NADBank offers flexible financing maturities, extending up to 30 years based on the specific needs of individual projects, considering factors such as ability to manage scheduled debt service. Grace periods for principal repayment can be established to cover some or all the anticipated construction and start-up phase of the project.

5.3. Minimum Loan Amount Held after Syndication. For transactions syndicated by NADBank (i.e., A/B loans), it will maintain at least a 15% participation.

5.4. Interest Rate and Return. NADBank will consider the risk associated with each investment, its funding and operating costs, and prevailing market rates for investments with similar maturity, terms, and conditions.

NADBank defines the base rate for financing as a market reference rate plus the Bank's cost of funding. If there is a targeted funding source for a specific project or lending program, the cost of the targeted funding will become the base rate.

- a) *Direct loans and bonds.* NADBank may make variable or fixed-rate loans. Loans will be priced at a margin over the base rate. The margin should reflect both risk and competitive market conditions.
- b) *Guarantees.* Rates will usually be comparable to the interest rate margin associated with equivalent loans.
- c) *Subordinated loans and bonds.* The pricing will include a margin over the base rate with additional consideration given to the subordination of the loan to other types of debt.
- d) *Equity and quasi-equity.* NADBank will establish a target internal rate of return comparable to a subordinated loan of similar characteristics, plus a premium reflecting the expected variability of cash flows and payments to the Bank. The return could be structured as revenue participation, dividend, and/or

conversion rights upon sale to a third party. Deployment of equity as an investment instrument will be subject to adoption of appropriate guidelines by the Board.

- 5.5. Security.** NADBank may require that borrowers secure their loan with real assets or other acceptable collateral including, but not limited to, a mortgage on fixed or movable assets, a pledge of a sponsor's shares in the project, and the assignment of the sponsor's insurance policies and other contractual benefits.

Equity investments, quasi-equity investments and subordinated loans, which are forms of unsecured financing, contain no such real guarantees, and must be financially viable on a stand-alone basis.

- 5.6. Reserves.** NADBank may require reserve funds in making a loan or investment for an to assure a project has the liquidity to meet certain of its obligations. Among the reserves that could be required:

- a) Debt service reserve (DSR) to meet debt payment obligations in situations when the borrower does not have available cash. The DSR provides a level of liquidity that will minimize default risks in situations that adversely affect borrower cash flows.
- b) Operations and maintenance reserve (OMR) to fund non-recurring operation and maintenance costs that might arise from catastrophic events.
- c) Repair and replacement reserve (RRR) to cover emergency repairs or replacements whose magnitude may surpass what is normally dealt with in the operational budget.

Actual reserve requirements will be based on a project's technical and financial risks.

- 5.7. Instrument-specific Principles.** Before making use of any financing instrument for the first time, NADBank will seek Board approval for instrument-specific investment principles that will supplement this policy and be applicable to that instrument.

- a) Quasi-equity investments will be structured investment projects that provide basic water or wastewater services and combine private and public investment. NADBank's investment will be subordinated to all project loans and senior to the equity of the sponsor/owner.
- b) Equity investments shall be subject to additional guidelines to be adopted by the Board, prior to being deployed by NADBank.

- 5.8. Program-specific Principles.** From time to time, NADBank may establish financing programs that contain additional investment principles in their founding documents that will supplement this operational policy, for example, its Green Loan Program. The Board of Directors approves all program-specific investment principles.

- 5.9. Use of Loan Proceeds; Procurement.** NADBank will impose no condition that the proceeds of an investment be spent in the territory of the U.S. or Mexico. NADBank will take measures to ensure that the proceeds are used only for the purposes for which they were granted. All NADBank financing must be expended in accordance with NADBank procurement policies and procedures.

6. Development Asset Portfolio Management

6.1. Financing Limits

- 6.1.1 Definition of Usable Equity.** “Usable equity” is defined as NADBank’s funded, unimpaired paid-in capital, plus undesignated retained earnings, plus special reserve, plus capital preservation reserve, where “funded” means paid-in capital that the shareholders have paid NADBank; and “unimpaired” means there is no existing obligation or designation associated with this paid-in capital.
- 6.1.2 Single Obligor Limit (SOL).** The maximum allowable credit exposure that may be approved for a particular NADBank obligor (whether through direct loans, guarantees, or any other financial instrument), net of disbursements repaid and any financing cancellations, is 20% of NADBank’s usable equity.

An additional 10% of NADBank’s usable equity will be allowed for an obligor whose credit exposure would be above the 20% limit but the relevant development asset meets one of the following criteria:

- a) the investment is fully secured by readily marketable collateral;
- b) the investment’s repayment mechanism is a Mexican municipal or state irrevocable trust (“*fideicomiso*,”) in which the payment and/or guarantee is funded by committed federal tax revenue (“*participaciones*”) or other revenue from a public entity authorized for use as a source of payment or guarantee;
- c) the investment is recognized as a general obligation of a State or political subdivision thereof; or
- d) the investment is the obligation of the U.S. or Mexican federal government or any agency thereof.

Once an investment is approved, it remains approved even if the level of usable equity falls such that the obligor exceeds the single obligor limit.

6.1.3 Maximum Exposure per Project.

- a) Loans, bonds, and subordinated loans. Based on borrower’s risk profile as measured by the Bank’s internal risk rating methodology, and in no case greater than the single obligor limit.
- b) Quasi-equity. Based on the risk profile of the investee, and in no case greater than 15% of the single obligor limit.

- c) *Equity*. Zero exposure until appropriate guidelines are approved by the Board of Directors.

Generally, NADBank will provide no more than 85% of total financing for a development asset, with exceptions made for only the highest credit quality development assets or those relating to exigent circumstances recognized by the Board of Directors. In the case of public sector loans, regardless of the amount, and private corporate loans or loans with corporate guarantees that do not exceed USD \$20 million, the Bank may finance up to 100% of project eligible costs provided the loans have an alternate source of payment or guarantee that demonstrates capacity for full repayment of the loan regardless of the ability of the project to generate revenue.

6.1.4 Maximum Equity and Quasi-Equity Portfolio. The sum of all the Bank's equity and quasi-equity investments will not surpass 20% of the development asset portfolio.

6.1.5 Additional Portfolio Considerations. NADBank will have internal methodologies to measure and mitigate the risks that its development asset portfolio faces at the individual and aggregate level. The portfolio risk will be managed through supervision and periodic reporting.

6.2. Project Restructurings

From time to time, NADBank will have invested in a project that experiences financial difficulty. In order to maximize the likelihood of repayment and ensure project success, the Bank may need to change the maturity date, interest rate, or principal amount owed under an expedited process in instances where an accelerated modification timeline is essential.

Amendments and workouts which call for an increase in the approved financing commitment for the lender require approval by the Board of Directors.

6.3. Loss Provisions on Investments

Following accounting standards established by U.S. General accepted accounting principles (GAAP) or International Financial Reporting Standards (IFRS), as determined by NADBank, the Bank will establish loss provisions on its investments at a level that is adequate to absorb estimated probable losses in the development asset portfolio. The allowance shall be based on NADBank's risk rating methodologies, the performance of individual development assets, prevailing economic conditions and other relevant factors.

FINANCIAL MANAGEMENT

NADBank manages its debt, liquidity and exposure to interest rate and currency risks so that it can fulfill its financing and debt obligation, preserves its capital, and prudently assumes financial risks needed to fill market gaps.

7. Debt Limit

NADBank's total principal outstanding debt at any time shall not exceed the callable portion of the Bank's subscribed capital shares plus the minimum liquidity level required by section 8 of this policy.

The Managing Director shall inform the Board when he or she reasonably estimates that the outstanding debt will reach 80% of subscribed callable capital.

8. Minimum Liquidity

NADBank's minimum required amount of aggregate liquid asset holdings is equal to the highest consecutive twelve months of the following eighteen months of expected debt service obligations, plus committed net development asset disbursements (if positive), plus projected operating expenses for the relevant fiscal year. The minimum amount will be determined prior to the beginning of each fiscal year and may be revised in the event of major changes in outlook.

9. Hedging

NADBank will use appropriate hedging strategies to cover currency and/or interest rate risks associated with its debt and development asset portfolios. Hedging strategies include the use of derivatives, including forward contracts, options, future contracts, currency exchange agreements and interest exchange agreements to eliminate exposure to market fluctuations and cover reasonably expected losses.

The Bank also executes International Swap and Derivatives Association (ISDA) agreements with appropriate support annexes as part of its hedging strategies to facilitate these operations with its counterparties.

NADBank does not use derivatives for speculative purposes. It avoids using derivative securities with complex coupon formulas and/or coupons that are tied to long-term or lagging interest rate indices or other structured notes.

10. Asset-Liability Value at Risk

NADBank will review at least annually the structural match of the duration of its asset-liability positions at the portfolio level.

LIQUIDITY PORTFOLIO MANAGEMENT

NADBank's objective for its Liquidity Portfolio will be the maintenance of sufficient cash and liquid securities to (i) meet all operating expenses; (ii) fund development asset investment commitments; (iii) meet payments of short-term debt service; and (iv) fulfill the Bank's commitment to fund the EICF from its annual cash earnings.

11. Safety of Principal

NADBank's investment portfolio prioritizes the preservation of capital by mitigating credit and interest rate risks and ensuring diversification of the overall portfolio.

- a) *Credit Risk*. To protect against incurring unsuitable levels of credit risk, NADBank is restricted from investments rated below investment grade by any statistical rating organization (SRO), such as Standard and Poor's, Moody's, or Fitch Ratings, or as otherwise restricted under section 14. of this Policy entitled, *Permissible Investments*.
- b) *Diversification*. NADBank places specific limitations on the total principal amount that may be invested in any one issuer of securities or entities that guarantee, enhance, or otherwise support the repayment of securities (i.e., insurance companies, banks, credit enhancers, counterparties to investment agreements). These guidelines are more specifically described in section 17 of this policy entitled *Investment Portfolio Diversification*.

12. Maturity Guidelines and Interest Rate Risk

To ensure the maintenance of adequate liquidity and to protect NADBank's portfolio from significant losses caused by interest rate movements, NADBank's total investment portfolio has an average duration not to exceed four years.

13. Total Return

While of lesser importance than liquidity and safety of principal, the total return earned on NADBank's investment portfolio should be a consideration in order to support the Bank's environmental objectives. Total optimized return on investments consists of two components:

- a) *Current Yield*. NADBank's investment portfolio is designed to attain a current yield throughout budgetary and economic cycles commensurate with the level of risk inherent in such portfolio, as determined by this policy; and
- b) *Capital Gains*. Within the limits of this policy, the investment portfolio is managed to take advantage of capital gains opportunities to maximize the portfolio's total return.

14. Permissible Investments

The following types of securities will be eligible for investment purposes (purchase or sale) by NADBank:

- U.S. Treasury securities.
- Mexican Government securities
- U.S. Government agency securities
- Bank deposits

- Repurchase agreements
- Negotiable certificates of deposit
- Banker's acceptances
- Commercial paper
- Money market funds
- Sweep accounts
- Corporate debt securities
- Asset-backed securities
- Supranational debt
- Municipal debt securities
- Pooled investments
- Investment agreements

The investment portfolio will not have exposure to the oil, tobacco, firearm, gambling, or recreational drug industries.

15. Other Permissible Activities

NADBank may, subject to the limitations specified in this policy:

- a) open and operate such demand, time deposit, custody and customer accounts with central banks, commercial banks and other financial institutions as may be necessary or advisable to carry on Bank operations and to arrange for the deposit in such accounts of currencies, currency units, or securities;
- b) borrow from commercial banks and other financial institutions in any currency or currency unit;
- c) engage in offset borrowings from commercial banks and other financial institutions to reverse all or part of any investment made with such institutions for periods up to the then-remaining term of such investments; and
- d) enter into such agreements and execute such other instruments and documents as necessary or advisable to effect the investments authorized by this policy.

16. Rating Downgrades

From time to time, NADBank may be invested in a security whose rating is downgraded below the quality criteria permitted by this policy. Any security held as an investment whose rating falls below the investment guidelines or whose rating is put on notice for possible downgrade is immediately reviewed for action. The decision to retain the security until maturity, sell (or put) the security, or other action is reviewed on a case-by-case basis.

17. Investment Portfolio Diversification

To reduce the overall credit risk of its liquidity investment portfolio, NADBank follows maximum investment percentages and minimum credit quality guidelines shown in the next table.

Type	Maximum percentage	Minimum credit rating (S&P/Moody's)*
U.S. treasury securities	none	-
Mexican government securities	none	-
U.S. government agency securities	none	-
Bank deposits	25	-
Repurchase agreements	25	A-1/P-1
Negotiable certificates of deposit	25	A1/P-1
Banker's acceptances	25	A/A
Commercial paper	25	A-1/P-1
Money market funds	25	AA/Aa
Sweep accounts	25	-
Corporate debt and supranational debt	25	A/A
Asset-backed securities	25	AAA/Aaa
Municipal debt securities	25	-
Pooled investments	25	-
Investment agreements	25	AA/Aa
Other securities	25	-

*Or its equivalent by any SRO.

Additionally, NADBank is restricted from investing more than five percent (5%) of its investment portfolio in the securities of any one issuer, excluding obligations of the U.S. Government and its agencies and the Mexican Government. Holdings of these obligations are unlimited. Furthermore, NADBank is restricted from investing more than five percent (5%) of its investment portfolio in securities that are guaranteed, enhanced, or otherwise supported by any one entity (i.e., insurance companies, banks, credit enhancers, counterparties to investment agreements), excluding the U.S. Government and its agencies and the Mexican Government.

No more than fifty percent (50%) of NADBank's portfolio may be controlled by an individual money manager or broker/dealer, including their respective affiliates.

18. Asset Collateralization

NADBank uses investments held in its investment portfolio as collateral for purposes of borrowing, provided that:

- a) the term of such borrowings does not exceed the maturity of the securities pledged as collateral; and
- b) the amount of such borrowings does not exceed the expected value of the pledged securities upon maturity of such securities.

19. Custody and Settlement of Securities

To reduce operational risk associated with NADBank's investment program, all securities purchased from any bank or broker/dealer, including appropriate collateral, are placed with an independent third party for custodial safekeeping. Depository institutions that provide such services ordinarily are independent of NADBank and NADBank's selected money managers and broker/dealers. However, in those cases where there is sufficient evidence of adequate internal controls and oversight and appropriate separation of responsibilities within the depository institution, such financial institution may offer multiple services to NADBank, including custodial and investment management services, so long as it also results in cost and operational efficiencies for NADBank.