Research Update:

DRAFT: Development Bank of Southern Africa Ltd. Outlook Revised To Positive From Stable; Ratings Affirmed

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S&PGR Revises Development Bank of Southern Africa Otlk To Pos

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Overview

- On May 20, 2022, we revised our outlook on South Africa to positive from stable, and affirmed our 'BB-/B' long- and short-term foreign currency and 'BB/B' long and short-term local currency sovereign credit ratings.
- In our view, there is an almost certain likelihood that the South African government would provide timely and sufficient extraordinary support to the Development Bank of Southern Africa Ltd. (DBSA) if needed. Consequently, we equalize our ratings and outlook on DBSA with those on South Africa.
- We therefore revised our outlook on DBSA to positive from stable, and affirmed 'BB-/B' foreign currency ratings and 'BB/B' local currency ratings.

Rating Action

On May 31, 2022, S&P Global Ratings revised its outlook on Development Bank of Southern Africa Ltd. (DBSA) to positive from stable. At the same time, we affirmed our 'BB-/B' long- and short-term foreign currency issuer credit ratings and 'BB/B' long- and short-term local currency issuer credit ratings on DBSA.

Rationale

Our rating action on DBSA following a similar action on the sovereign. On May 20, 2022, we revised our outlook on South Africa to positive from stable and affirmed our 'BB-/B' long- and short-term foreign currency and 'BB/B' long and short-term local currency sovereign credit ratings (see "South Africa Outlook Revised To Positive On Resilient External Sector; Ratings Affirmed," published on RatingsDirect).

We equalize our ratings on DBSA with those on South Africa. This reflects our opinion that there is an almost certain likelihood that the South African government would provide timely and sufficient extraordinary support to DBSA in the event of financial distress. Consistent with our criteria for government-related entities (GREs), our view of the likelihood of extraordinary government support stems from DBSA's:

- Critical role as one of the South African government's primary vehicles to promote public and private infrastructure projects and drive sustainable development in the country and the wider African continent; and
- Integral link with the South African government, through its 100% ownership of the bank, ongoing government supervision, and capital injections when required.

Our assessment of the strength and durability of the link between DBSA and the government remains integral to our ratings on DBSA. The Development Bank of Southern Africa Act of 1997 (DBSA Act) enacted by South Africa's parliament set outs DBSA's mandate, as well as the constitution and conduct of the DBSA Board of Directors. Between 2012 and 2015, the government injected South African rand (ZAR) 7.9 billion (about $0.5 billion) into DBSA (amounting to about 8% of the asset base), reinforcing the government's support for DBSA as the bank's full owner. DBSA also has callable capital of ZAR20 billion that can boost its capital base. In addition, section 19 of the DBSA Act states that the bank cannot be wound up except through an act of parliament. In August 2021, the former DBSA chairman, Enoch Godongwana, was appointed as South Africa's minister of finance, highlighting the close links between the two institutions. The finance minister is the governor of DBSA and responsible for appointing DBSA's board members.

Moreover, we recognize DBSA's role as one of the government's key vehicles for delivering infrastructure development and meeting strategic policy goals intended to support sustainable economic growth.

DBSA is mandated to promote economic development and growth, human resources development, institutional capacity building, and the support of development projects and programs in the African continent. The bank finances infrastructure in the public and private sectors. The government's infrastructure fund to fast-track infrastructure and development projects and its implementation unit sits within DBSA.

In 2020, the government announced an economic reconstruction plan to assist recovery from the COVID-19 pandemic, with 55 infrastructure projects across six sectors. However, the value of infrastructure delivered in the year ending on March 31, 2021, was lower than expected at ZAR2.6 billion ($176 million), relative to the target of ZAR3.5 billion ($237 million). This was partly because of reprioritized funding by clients toward COVID-19 initiatives and slower construction activity. During the pandemic, DBSA funded COVID-19 initiatives of about ZAR104 million ($6.8 million), including for testing capacity support and screening units. Although lending volumes were below our expectations in 2020, we expect DBSA will lend more actively in the future to support green financing, infrastructure, and other strategic priorities.

The bank plans to increase lending to poorer under-resourced municipalities and the water sector to help close infrastructure gaps. It is, however, limited by the availability and readiness of those entities to create viable, financeable projects. Consequently, DBSA's support to such municipalities often takes the form of technical-assistance grants, capacity-building initiatives, and overall project support.

In the context of South Africa's goal to reach net-zero emissions by 2050, DBSA will play an active role in providing green financing. The bank launched its first green bond of €200 million in 2021 through a private placement with the Agence Française de Développement. In October 2021, DBSA also raised a $207 million (ZAR3 billion) three-year loan from PIMCO under the Sustainable Development Goal Seven (SDG7) Program by the United Nations Economic Commission for Africa. The issuance proceeds will go to refinance DBSA's renewable energy generation and transmission projects. DBSA intends to play a catalyst role as an investor in green and carbon transition projects across Africa, including embedded generation of renewable energy.

DBSA also has a mandate to develop the Southern African Development Community (SADC), primarily infrastructure finance projects that aim to link the region economically. In 2015, DBSA received an even wider mandate to provide lending and support across the rest of Africa. Despite this wider mandate, DBSA will remain mainly concentrated in South Africa, which will make up about 70% of the loan book, with projects outside limited to approximately 30%. DBSA has active exposure in 16 countries.

While trying to fulfil government policy initiatives, DBSA is also guided by commercial considerations, as required by its structure and its sole shareholder, the South African government. It tries to blend commercial viability with the wider goals of enhancing economic growth and regional integration.

We view DBSA's capital and earnings as the main factor supporting its stand-alone creditworthiness (that is, excluding potential extraordinary government support). However, our favorable view of its capitalization is balanced by the concentration in wholesale funding and constrained liquidity position. We also note the concentration within the loan portfolio and believe that pressure on its financial metrics could materialize should the portfolio deteriorate. We assess DBSA's capital and earnings as very strong. On March 31, 2021, the risk-adjusted capital (RAC) ratio (our proprietary measure of capital adequacy) before adjustments was about 19%. We expect the RAC ratio will remain at 18.5%-19.5% in 2022-2023, balancing DBSA's countercyclical nature and developmental mandate.

We note DBSA's strengthening risk management practices in recent periods and improvement to asset quality metrics. Nonperforming loans (NPLs) improved to 6.9% of total loans as of September 30, 2021, from 7.7% on March 31, 2021 (in breach of DBSA's 6% internal limit). Nevertheless, we expect that DBSA's risk position will remain under pressure, and we expect NPLs will remain elevated at about 7% in 2022 and 2023. We still consider single-obligor concentrations to be high. The 20-largest loans accounted for nearly 69% of total loans and more than 150% of total adjusted capital (TAC; numerator of the RAC ratio) on March 31, 2021. We forecast credit losses will rise to above 2.0% in 2022 and start to reduce in 2023.

Outlook

The positive outlook on DBSA mirrors that on South Africa. Our ratings on DBSA will move in conjunction with those on the sovereign as long as we assess the likelihood of extraordinary support is almost certain.

Upside scenario

We could raise the ratings on DBSA over the next year if we were to upgrade South Africa. We do not expect to rate DBSA higher than the sovereign.

Downside scenario

We could revise the outlook to stable on DBSA following a similar rating action on South Africa. Pressure on the rating could also build if the bank's public policy role or its link with the government were to weaken.

Related Criteria

- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- South Africa Outlook Revised To Positive On Resilient External Sector; Ratings Affirmed, May 20, 2022

Ratings List

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914