

Rating Action: Moody's affirms Agence France Locale's long-term issuer and backed senior unsecured rating at Aa3, stable outlook

Global Credit Research - 07 Nov 2016

Baseline Credit Assessment affirmed at a3

London, 07 November 2016 -- Moody's Investors Service has today affirmed Agence France Locale (AFL)'s long-term issuer and backed senior unsecured debt ratings at Aa3 with a stable outlook. The bank's baseline credit assessment (BCA) was also affirmed at a3. The short-term issuer and backed senior unsecured Commercial Paper ratings and the counterparty risk assessment (CRA) were affirmed at Prime-1 and Aa3(cr)/Prime-1(cr) respectively.

The affirmation of the BCA at a3 reflects Moody's view that AFL's solvency and liquidity are robust. Although business is taking off at a slower pace than initially anticipated, Moody's believes that AFL's business model is viable. Nonetheless the real test of AFL's long term viability lies with its ability to continue to attract new members and to break-even within the next two years or so.

RATINGS RATIONALE

AFFIRMATION OF THE a3 BCA

As a newly created bank owned by French local authorities and dedicated to their financing, AFL began business in 2015 and is still currently in its "ramp-up" phase. Since inception, AFL has built up a loan portfolio and increased its membership. However, business is taking off more slowly than initially anticipated due to (1) the initial delay in obtaining a banking license and the European Commission's approval; (2) the relatively low demand for loans from the regional and local government (RLG) sector; and (3) increased competition among lenders.

Moody's believes that solvency and liquidity are strong and will remain so over the outlook horizon. High asset quality and internal rules imposing a minimum nominal leverage ratio of 3.5% at all times ensure robust solvency. Liquidity is structurally good in the ramp-up phase because long-term financing is raised in advance of lending and thanks to the absence of significant repayments occurring over the outlook horizon.

However, Moody's believes that AFL's ability to break even within the next two years or so is key to ensuring its long term viability. The bank still needs to increase the size of its loan portfolio to reach this break-even point. This also implies that further capital is needed, which the bank can only achieve through attracting new members while it is not able to generate profits. The timing of break-even will therefore depend on (1) the pace at which AFL will be able to extend loans to its members; (2) its ability to continue to attract new members and increase its capital base; and (3) the competitive environment which will drive the level of margins.

Based on the revised business plan provided by AFL and incorporating the more competitive environment and continued low interest rates, we believe that the institution will likely be able to break even in 2018 or 2019. If however AFL were to significantly deviate from this revised plan, which is not the most likely scenario, Moody's could reconsider the BCA, eventually incorporating the likelihood of a run-off. Under this scenario, Moody's believes that the company would be able to honour its commitments using its own resources, thereby avoiding the activation of the members' guarantee, thanks to its committed capital which represents approximately ten times its annual cost base, and the matched-funded nature of the balance sheet which enables the timely repayment of the outstanding debt.

AFFIRMATION OF AFL'S LONG-TERM BACKED SENIOR UNSECURED DEBT RATING OF Aa3

AFL's backed long-term senior unsecured debt, representing the bulk of the bank's funding source, benefits from a very low loss-given-failure thanks to the high instrument volume. This results in an uplift of two notches from the BCA.

The government support of one notch reflects an assumption of a high probability of government support, notably the joint and several guarantee provided to AFL's creditors by all the member local authorities up to

their respective outstanding loans at AFL.

STABLE OUTLOOK

The outlook on AFL's long-term issuer and backed senior unsecured ratings is stable as Moody's do not anticipate any significant change in the bank's risk profile as long as the rating agency believes the bank's business model is viable.

WHAT COULD CHANGE THE RATING UP/DOWN

Although unlikely over the outlook horizon, an upgrade of the BCA could be contemplated when AFL has built up a stable franchise, increased its market shares, generated sustainable profits and accumulated capital to grow its business. Due to the still limited market share of AFL, an upgrade of the BCA will likely not result in an upgrade of the long-term issuer and backed senior unsecured rating unless the Government of France's rating is upgraded.

The factors that may lead to a lower BCA include any evidence that AFL's business model is not viable. This may be shown by the institution's inability to (1) increase its membership and build up a loan portfolio that would enable AFL to break even; (2) raise funding at a cost that allows it to originate competitive loans; or (3) follow the credit and funding policies initially contemplated. A significant deterioration in asset quality or operating deficiency, or a deterioration in France' macro profile (currently 'Strong+') could also trigger a downgrade of AFL's BCA.

AFL's long-term issuer and backed senior unsecured rating could be downgraded if (1) its BCA is downgraded; or (2) the probability of parental or government support declines; or (3) the French sovereign is downgraded.

LIST OF AFFECTED RATINGS

Issuer: Agence France Locale

..Affirmations:

....Long-term Counterparty Risk Assessment, affirmed Aa3(cr)

....Short-term Counterparty Risk Assessment, affirmed P-1(cr)

....Long-term Issuer Rating, affirmed Aa3 Stable

....Short-term Issuer Rating, affirmed P-1

....Backed Senior Unsecured Regular Bond/Debenture, affirmed Aa3 Stable

....Backed Senior Unsecured Medium-Term Note Program, affirmed (P)Aa3

....Backed Commercial Paper, affirmed P-1

....Adjusted Baseline Credit Assessment , Affirmed a3

....Baseline Credit Assessment , Affirmed a3

..Outlook Actions:

....Outlook remains Stable

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in January 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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