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Ratings

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Agence France Locale

Primary Credit Analyst:
Pierre Hollegien, Paris + 33 14 075 2513; Pierre.Hollegien@spglobal.com

Secondary Contact:
Stephanie Mery, Paris + 0033144207344; stephanie.mery@spglobal.com

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Agence France Locale

This report does not constitute a rating action.

Credit Highlights

Issuer Credit Rating
AA-/Stable/A-1+

Overview

Enterprise risk profile	Financial risk profile
Strong management team supports credit quality.	Very strong capitalization provides financial buffers.
Moderate-size player to gradually grow its market share and attract new members in a very competitive market.	Strong liquidity position supports the likelihood that it could maintain scheduled loan disbursements to its members without external funding in a stressed scenario.
France's wealthy and resilient economy, its well-developed financial sector, and the strong institutional framework that governs the local and regional government (LRG) sector support the creditworthiness of Agence France Locale (AFL).	AFL has broad access to diversified funding and a track record of positive funding gaps.

AFL is a moderate-size player in the competitive French LRG sector, but we expect it will continue to attract new members and gradually gain markets shares. Founded in 2013 and operational since 2015, AFL remains a moderate-size player in the French LRG segment, with only about 6% of the sector's outstanding debt. Still, we expect AFL will continue to penetrate the LRG market despite the competition of commercial and public banks. In our view, the growing member base and continued loan growth will support AFL's revenue generation and increase its relevance to the French LRG sector.

We believe AFL will continue to benefit from conservative management and French LRGs' robust credit quality. We expect French LRGs to maintain very strong credit quality despite potential pressure from deteriorating economic conditions and rising interest rates. AFL's own prudent risk management and low-risk lending activities will continue to provide the foundation for its financial strength.

AFL will continue to benefit from an extremely high likelihood of support from its group of supporting members. AFL's parent company (AFL–ST) is fully owned by LRG members that provided a very strong and binding joint guarantee scheme. Therefore, those members are liable for the operating subsidiary's liabilities up to their respective outstanding borrowings at the AFL. Additionally, we believe the strong willingness of those members to diversify their funding sources through AFL, as well as members' strong credit profiles, support our rating on AFL.

Outlook

The stable outlook reflects our expectation that AFL will be able to sustain its growth targets in the next two years without significantly weakening its robust financial indicators. In addition, we expect AFL will maintain prudent funding and liquidity management, which will contain risks associated with the wholesale-funded nature of its activities.

Downside scenario

We could lower our rating if we believed that the supporting members' willingness and ability to provide extraordinary assistance to AFL had weakened, for example if the share of supporting members' borrowings through AFL were to fall, or if the average credit quality of those members were to deteriorate. We could also lower the rating if higher-than-anticipated lending growth resulted in an erosion of AFL's currently strong capital position or of its funding and liquidity position, for example due to a widening funding gap.

Upside scenario

Although remote, we could raise the rating if AFL strengthened its market share and income generation without materially weakening its capitalization and risk profile, and, at the same time, if the average credit quality of its group supporting members improved.

Enterprise Risk Profile

The competitive market for LRG funding in France somewhat constrains AFL's growth ambitions

- AFL operates in a low-risk French LRG segment. It targets LRGs whose creditworthiness is supported by the wealthy and resilient French economy and stable institutional framework, which will continue to offset risks posed by the sector's moderate direct debt burden and high contingent liabilities.
- AFL's ratings are constrained given its still limited size and market share in a highly competitive environment.
- That said, AFL has enhanced its business position through active lending growth and new members joining and thanks to an effective pricing strategy.
- Well-established and prudent management policies and practices. Hence, we do not expect rising interest rates to negatively impact AFL's creditworthiness.

AFL operates in a stable and low-risk public industry. The French LRG sector exhibits some key strengths, thanks to France's resilient economy but with some uneven wealth distribution among LRGs and some wealth concentration in the Ile-de-France region. French LRGs' institutional framework and the financial system in which they evolve are stable despite the past COVID-19 stress and the ongoing conflict in Ukraine. Following the re-election of President Macron, French LRGs are expected to achieve €10 billion (about 6% of operating expenditure) in savings by 2027. His LRG agenda includes a reduction in local taxes, mainly by abolishing the corporate value-added tax, and aims to define responsibilities between departmental and regional layers while transferring housing policy competencies to cities and intercities. It is unclear how these policies will affect French LRGs' financials. Finally, LRGs exposure to contingent liabilities is high, mainly through large guarantees and various government-related entities.

AFL's business stability is supported by a growing franchise and increased business diversification. In 2021, the group expanded its national footprint with 85 new members and an increase of 18% in loans granted. As of Dec. 31, 2021, there were 496 members, including five regions, 11 departments, and 14 metropolitan areas. We believe the law approved in December 2019 (Loi Engagement et Proximité), that extended the perimeter of LRGs' membership to syndicates, was a positive development for AFL's group. French syndicates represent 5.1% of capital and voting rights and enjoy solid creditworthiness. In addition, AFL benefits from a stable customer base and we expect little volatility in the future since exit rules are very stringent. In 2021, AFL was recognized by the French regulator as a public development credit institution for the role it plays in French LRGs' operations.

AFL operates in a very competitive environment undermining the public role of AFL and its willingness to grow rapidly. Strong competition constrains growth and a public policy role of AFL in the French LRG market. In our view, it will take time for the AFL to consolidate its position among French LRGs. We believe the current financing terms AFL offers are competitive. While providing a moderate 6% of French LRGs' annual credit inflows at the national level, the AFL bridged 41% of its members' financing needs in 2021, reflecting that AFL manages to provide adequate pricing to its members. The current upward trend in the interest rate could boost AFL's competitiveness as spreads on covered bonds issued by its competitors are normalizing following years of excess liquidity in the European funding market. However, French LRGs continue to fund themselves through a range of players, including public and commercial banks, and through issuing directly on the market.

While the group is still well below its long-term target of reaching 25% of market share, we believe growth potential is building. In 2021, AFL's market share represented 6%, versus its long-term target of 25%. That said, AFL is aiming at doubling its market share by 2026 and we believe the financing growth potential is sizable. This is because its members' total indebtedness represents 20.7% of the total outstanding debt of the French LRG sector as of year-end 2021, while AFL provides 41% of those members' new financing needs.

Revenue generation capacities have improved over recent years and will continue as lending expands. In 2021, AFL's net income reached €1.7 million, and we expect its profitability to improve in coming years as lending volumes increase. Although concentration risk is significant, it is receding, with the 10 largest borrowers representing 28% of total exposure on Dec. 31, 2021, against slightly less than 31% at year-end 2020. We see this decline as positive for revenue generation and believe that concentration is likely to continue declining in the next three to five years.

AFL's overall risk and financial management is prudent and it proactively manages regulatory requirements. AFL's management has longstanding expertise and experience in the LRG sector and its funding. AFL reported two nonperforming loans (NPLs) that represented only 0.1% of the total lending portfolio in 2021. We do not expect AFL to report losses on these NPLs and we understand that these have been classified as Stage 3 loans under International Financial Reporting Standard 9 because the counterparty defaulted on a credit line provided by a third-party lender. We expect new NPLs to remain exceptional and losses virtually zero with very limited spillovers from the conflict in Ukraine on French LRGs. In addition, AFL's internal risk management policies are enhanced by compliance with the French Monetary and Financial Code regulatory rules due to its status as a financial company. Moreover, as a specialized credit institution, AFL is a fully regulated financial institution supervised by the French banking regulator, Autorité de contrôle prudentiel et de resolution, and therefore has to abide by solvency and liquidity regulatory ratios, among others.

Financial Risk Profile

High capitalization and very strong liquidity provide financial buffers.

- Strong capitalization, supported by a consistent increase in AFL's membership base.
- Broad and diversified access to capital markets and robust asset liability management underpin AFL's very strong funding and liquidity profile.
- AFL recently gained access to the French central bank, further strengthening its liquidity position.

Despite AFL's sustained loan growth, its capital position remains structurally strong, in our view. We expect that the risk-adjusted capital (RAC) ratio after adjustments will remain above a solid 10%. Our initial assessment is based on our RAC ratio at a very strong 44.6% before adjustments as of end-2021. When factoring in our adjustments, in particular from high single-name concentration, the RAC ratio after adjustments declines to 14.9%. The RAC reduction in recent years primarily reflects the rapid increase in lending, although after adjustments RAC stabilized, thanks to increased diversification. In the future, we expect increased diversification, capital injections from new joiners, and enhanced earnings generation to offset the negative impact of the growing lending book on our RAC ratio. Our current view of a strong capital position also captures the credit quality of AFL's exposures to French LRGs across its entire loan book. In a regulatory context, the group reported a Tier 1 ratio of 15.73% as of end-2021 (15.13% as of end-2019). We note that AFL's regulatory ratios are lower than some of its peers' since AFL applies a 20% risk weight on French LRG exposures under the standardized approach, which is higher than those of most peers, including some that apply a zero risk-weighting in accordance with their home regulator. AFL has no hybrid instruments and all equity is eligible as Tier 1 capital, which we also incorporate in our total adjusted capital calculation.

Increasing membership will continue to drive AFL's diversification of its lending portfolio. The largest exposure, as a percentage of total lending, was down to 3.8% as of end-2021, from 8.8% as of end-2017, and the exposure to the 10 largest borrowers has decreased to 28% in 2021 from 38% in 2019.

We assess AFL's funding and liquidity position as strong. AFL has established debt programs and is a regular benchmark issuer, with a diversified funding profile in terms of geographies, maturities, and investor types. AFL's asset and liability management policy limits the difference between average maturity of assets and liabilities to one year, temporarily extended to 24 months for a maximum period of six months. It has no notable refinancing risk, with most of the funding being long term. The cumulative maturing assets cover 1.6x cumulative maturing liabilities for the next 12 months and support its strong funding profile.

Recently, AFL has issued two sustainable bonds of 500 million euros each with a seven-year maturity. The first one took place in July 2020 and the second one in January 2022. These issues have made a significant contribution to strengthening AFL's debt placement by bringing new investors.

AFL has robust liquidity. Although the agency is exposed to risk through its dependence on wholesale market funding, we consider that this is mitigated by prudent liquidity policies and a comprehensive treasury portfolio. AFL manages its liquidity aiming to maintain 100% of the net cash outflow over the next 12 months, within a range of 80% minimum and 125% maximum. Positively, AFL gained access to the French central bank's automated interface for pledging credit claims (TRICP) during the second quarter of 2020. This enables AFL to repurchase LRGs' claims at the central bank and benefit from central bank funding of up to €3.2 billion as of June 30, 2022.

Our liquidity sources-to-uses ratio indicates that AFL would be able to meet its financial obligations over a one-year period, factoring in stressed market conditions. We calculate AFL's liquidity ratio was 1.37x as of Dec. 31, 2021, while its liquidity coverage ratio stood at 923%. We factor into our calculations stressed market conditions, under which we assume the agency would not have access to the capital markets. The liquidity portfolio is invested in liquid fixed-income securities issued by governments, states, regional governments, multilateral development banks, and financial institutions.

We do not foresee any risks other than those captured in our RAC calculations and funding and liquidity metrics, since AFL hedges risk through derivatives. This is because AFL hedges risk through derivatives. However, this hedging creates significant counterparty exposures to financial institutions, especially to the clearinghouse, LCH Clearnet, although entirely and mutually collateralized. In addition, there are a few exceptions regarding interest rate risk with a limited pocket of fixed-rate assets managed within the limits of the economic value of equity.

Extraordinary Shareholder Support

Extremely high likelihood of support, mainly based on a very strong and binding guarantee scheme, resulting in a two-notch uplift to the SACP

- Under the joint guarantee scheme, we expect that a group of the largest potential supporting members will effectively provide support to AFL in case of need.
- We assess the likelihood of extraordinary support provided by the group of supporting entities as extremely high, thanks to what we view as the agency's integral link to, and very important role for, its LRG members.

The AFL group consists of two entities to allow operations to be separated and independent from the LRG members. The parent company is AFL–ST, a financial company fully owned by LRG members. Its operating subsidiary is AFL, which carries lending and funding operations. AFL is a specialized credit institution more than 99.9% owned by AFL–ST. In our view, AFL is integral and fully integrated with the AFL group's identity, strategy, and operations.

AFL benefits from a dual guarantee mechanism. The first one is a guarantee from AFL-ST to investors. AFL-ST's board (Conseil d'administration) determines the amount of this guarantee, which currently stands at €15 billion. The second one is the LRGs members' guarantees. On joining AFL, all members must sign a joint guarantee scheme granted to AFL-ST that makes them liable up to their amount of long-term debt borrowed through AFL. The guarantee of those LRG members currently covers more than 70% of AFL's financial liabilities.

We consider that within the guarantee scheme the strongest and most timely mechanism is the possibility of a "preventive call" by AFL on the AFL-ST guarantee, which in turn would call the LRG members. AFL could activate preventively this guarantee to avoid a default on its debt obligations or a potential breach of regulatory ratios. The executive board (directoire) of AFL needs the approval of the supervisory board of AFL (Conseil de surveillance) to call on this guarantee, but does not need the approval of AFL-ST's Conseil d'administration, meaning that the final decision is in the hands of AFL, and not in the hands of the LRG members. In case of default, an investor could also call the AFL-ST guarantee or call directly the guarantee of any LRG member.

In our view, AFL plays a very important role for its LRG supporting members group. These LRGs participated in the creation or joined AFL in order to diversify their sources of funding and are willing to support its development through disbursement of capital. LRG members currently fund 41% of their needs through AFL, testifying to the relevance of the institution.

In our view, the legislation put in place to allow the creation of AFL does not imply any support from the French central government to AFL's credit standing. AFL is not a state public agency and the law explicitly states that the entity will fund itself mainly through debt issuance, excluding any direct revenue from the central government or any guarantee provided by the central government.

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Governments | International Public Finance: Public-Sector Funding Agencies: Methodology And Assumptions, May 22, 2018
- 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

Table 1

Agence France Locale--Selected Indicators

	--Year ended Dec. 31--					
(Mil. €)	**2021**	**2020**	**2019**	**2018**	**2017**	**2016**
Business position						
Total adjusted assets	6,996.2	5,728.0	4,355.0	3,218.0	2,525.0	1,380.0
Customer loans (gross)	4,431.2	3,832.0	3,161.0	2,230.0	1,431.0	892.0
Growth in loans	15.6	21.2	41.7	55.9	60.4	132.6
Net interest revenues	12.7	11.8	10.1	7.9	6.6	4.7
Non interest expenses	12.1	11.2	11.6	10.5	10.5	10.6
Capital and risk position						
Total liabilities	6,818.9	5,580.0	4,233.0	3,105.0	2,416.0	1,292.0
Total adjusted capital	171.4	142.0	118.0	110.0	105.0	82.0
Assets/capital	40.8	39.3	35.9	28.2	23	15.8
RAC ratio before diversification	44.6	42.8	49.5	55.4	N/A	N/A
RAC ratio after diversification	14.9	14.6	17.7	19.1	N/A	N/A
Gross nonperforming assets/gross loans	0.1	0.1	0.1	0	0	0
Funding and liquidity* (x)						
Liquidity ratio with loan disbursement	1.4	2.9	2.1	2	N/A	N/A
Liquidity ratio without loan disbursement	2.1	6.4	9	7.7	N/A	N/A

Table 1

Agence France Locale--Selected Indicators (cont.)						
	--Year ended Dec. 31--					
(Mil. €)	**2021**	**2020**	**2019**	**2018**	**2017**	**2016**
Funding ratio with loan disbursement	>1	>1	>1	>1	N/A	N/A

N/A--Not applicable.

Table 2

Group Agence France Locale--Ratings Score Snapshot	
Stand-Alone Credit Profile	a
Enterprise Risk Profile	Moderate (4)
PICRA	Adequate (3)
Business Position	Moderate (4)
Management & Governance	Moderate (4)
Financial Risk Profile	Very Strong (1)
Capital Adequacy	Strong (2)
Funding	Positive
and Liquidity	Very Strong (1)
Support	2
GRE Support	2
Group Support	0
Additional Factors	0
Group Credit Profile	aa-
Agence France Locale	
Issuer Credit Ratings	AA-/Stable/A-1+
Group Credit Profile	aa-
Group status	Core

Ratings Detail (As Of August 25, 2022)*	
Agence France Locale	
Issuer Credit Rating	AA-/Stable/A-1+
Commercial Paper	
Local Currency	A-1+
Senior Unsecured	AA-
Issuer Credit Ratings History	
20-May-2019	AA-/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.