


CREDIT OPINION

1 June 2023

Update



RATINGS

Agence France Locale

Domicile	France
Long Term CRR	Aa3
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Aa3
Type	Senior Unsecured - Fgn Curr
Outlook	Stable
Long Term Deposit	Not Assigned

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Agence France Locale

Semi-annual update to credit analysis

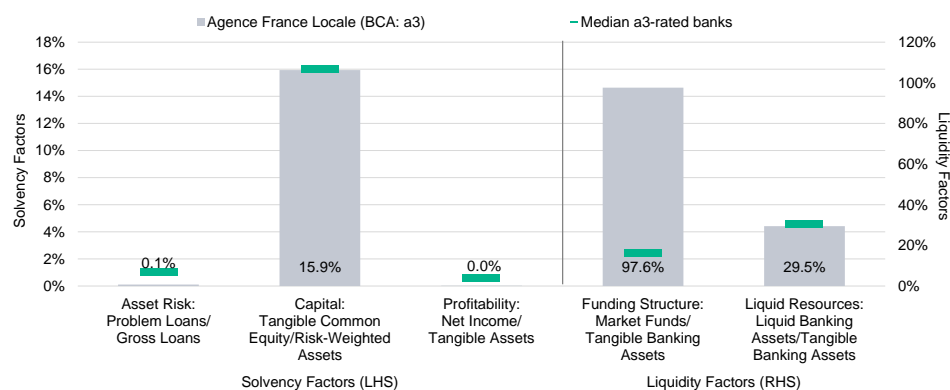
Summary

[Agence France Locale's](#) (AFL) BCA of a3 reflects our view that (1) the entity's fundamentals remain robust; (2) its two-tier governance structure provides appropriate oversight ; and (3) AFL will be able, over the outlook horizon, to maintain high asset quality, a stable funding structure and adequate solvency. The continuous increase in membership alongside loan production since 2018 led AFL to meet, and sometimes exceed, the objectives set in the 2017 strategic plan, including posting positive profitability since 2020.

The issuer and senior unsecured ratings of Aa3/Prime-1 reflect (1) AFL's a3 standalone credit strength; (2) the application of our Advanced Loss Given Failure (LGF) analysis, resulting in a two-notch LGF uplift from the Adjusted BCA of a3, given the significant volume of senior debt; and (3) the government support uplift of one notch, reflecting a high support assumption, incorporating the joint and several guarantee provided to AFL's creditors by all the member local authorities (limited to the level of their respective outstanding loans extended by AFL) and the likelihood of moderate support from the central government.

Exhibit 1

Rating Scorecard - Key financial ratios



Source: Moody's Financial Metrics

Credit strengths

- » The institution is owned by, and dedicated to the financing of the French local authorities.
- » The loan portfolio is of high quality.
- » The total capital ratio is unlikely to be lower than 12.5%.

- » Liquidity and market risks are limited.

Credit challenges

- » AFL's long-term viability hinges on its capacity to grow its loan book with adequate margins, which is contingent upon its ability to continue attracting new members.

Outlook

The outlook on AFL's long-term issuer and senior unsecured ratings is stable as we do not expect any significant changes in the bank's creditworthiness in the next 12-18 months. The outlook is also driven by the stable outlook on the Aa2 rating of the [Government of France](#), because we currently assume a high level of public support, incorporating both the members' joint and several guarantee and the moderate likelihood of government support, leading to a one-notch uplift.

Factors that could lead to an upgrade

Although unlikely over the outlook horizon, an upgrade of the BCA could be contemplated once AFL has built up a more stable franchise, increased its market share, generated sustainable profit and accumulated capital that will support its growth. However, at present it is unlikely that an upgrade of AFL's BCA would result in an upgrade of its long-term issuer and senior unsecured ratings to Aa2 i.e. at par with the sovereign rating of France, because we believe that the likelihood of direct support from the French government remains moderate.

Factors that could lead to a downgrade

AFL's BCA could be lowered if the viability of AFL's business model was challenged. This could arise if the bank (1) failed to sustain its profitable business model; (2) were unable to raise funding at a cost that would allow it to originate competitive loans; or (3) if asset risk were to deteriorate unexpectedly. A deterioration in France's Macro Profile (currently Strong+) could also trigger a downgrade of AFL's BCA.

AFL's long-term issuer and senior unsecured ratings could be downgraded if (1) its BCA were to be downgraded; (2) the probability of parental or central government support were to reduce; or (3) the French government's rating were to be downgraded.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody's.com> for the most updated credit rating action information and rating history.

Key indicators

Exhibit 2

Agence France Locale (Consolidated Financials) [1]

	12-22 ²	12-21 ²	12-20 ²	12-19 ²	12-18 ²	CAGR/Avg. ³
Total Assets (EUR Million)	8,011.8	6,999.3	5,729.8	4,356.7	3,221.7	25.6 ⁴
Total Assets (USD Million)	8,550.6	7,930.9	7,010.8	4,890.4	3,682.9	23.4 ⁴
Tangible Common Equity (EUR Million)	190.0	176.4	147.0	123.3	115.5	13.3 ⁴
Tangible Common Equity (USD Million)	202.7	199.8	179.9	138.4	132.0	11.3 ⁴
Problem Loans / Gross Loans (%)	0.1	0.1	0.1	0.1	0.0	0.1 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	15.9	15.5	14.9	15.7	18.9	16.2 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	2.3	2.2	2.8	3.1	0.0	2.1 ⁵
Net Interest Margin (%)	0.2	0.2	0.2	0.3	0.3	0.2 ⁵
PPI / Average RWA (%)	0.4	0.2	0.3	-0.1	-0.2	0.1 ⁶
Net Income / Tangible Assets (%)	0.0	0.0	0.0	0.0	-0.1	0.0 ⁵
Cost / Income Ratio (%)	76.2	86.7	81.7	104.6	113.5	92.5 ⁵
Market Funds / Tangible Banking Assets (%)	97.6	97.4	97.4	97.1	96.4	97.2 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	29.5	33.7	28.3	22.9	25.6	28.0 ⁵

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.

Sources: Moody's Investors Service and company filings

Profile

Created in 2013, AFL is a credit institution dedicated to providing financing to the French local authorities¹.

The institution's governance is based on a two-tier structure:

- » AFL, the operational entity, is 99.99% owned by Agence France Locale - Société Territoriale. AFL provides loans to local authorities and for this purpose raises funds in the capital markets. It is supervised by the French prudential supervisory authority (ACPR).
- » Agence France Locale - Société Territoriale, fully owned by the local authorities, is tasked with setting the strategy and vetting of new members. This structure somewhat protects AFL's management from interference into its day-to-day activities.

As of the end of December 2022, the number of members (local authorities) was 599. Each member provides a guarantee in case AFL would run into difficulties, which is limited to the loan's amount extended by AFL yet on a joint and several basis (members' guarantee). AFL security holders also benefit from a guarantee from Agence France Locale - Société Territoriale (ST guarantee), up to an amount of €15 billion (as of end-December 2022, the amount of guaranteed securities issued by AFL, comprising debt issues and financial transactions with counterparties, amounted to €9.5 billion). Both guarantees can potentially be called simultaneously. Besides, the "ST Guarantee" may be called on the creditors' behalf at the request of AFL to prevent a breach of capital regulatory ratios.

Detailed credit considerations

An institution owned by, and dedicated to the financing of, the French local authorities

AFL is owned by, and dedicated to the financing of, the French local authorities. The importance of AFL's franchise can be gauged by the percentage of its members' total indebtedness (at and outside of AFL) relative to the total outstanding debt of the French local government sector, which is estimated at over 23%.

The entity's remit consists in providing selected French public sector entities with stable and competitive financing through simple and transparent products. AFL also ensures stable and reasonable funding costs by building a well-diversified and international institutional investor base (around 74% out of France) whose confidence towards the bank stems from a very low-risk and simple business model.

AFL's business is limited to providing financing to its members, which cannot exceed 80% of their borrowings outstanding². AFL has progressively broadened its member base to 599 local authorities as of end-December 2022 (from 496 at the end of 2021 and 411 at the end of 2020). Loan origination was initially restricted to the French local governments under a narrow definition, that is, excluding hospitals, satellites and semipublic companies (societes d'economie mixte). Since 27 December 2019, by law AFL is also entitled to

finance local authority groupings and local public institutions (groupements de collectivités et établissements publics locaux), a positive development given their strong creditworthiness. AFL's long-term loans solely finance its customers' investments.

The loan portfolio is of high credit quality

AFL's portfolio is of high quality (its problem loans ratio was 0.1% at end-December 2022) and we expect it to remain so, given the very restricted scope of customers and in light of the historical performance of these borrowers. We believe that the current member pool reflects the average credit risks of the French public local sector and assume that the future composition of the portfolio will remain in line with the current risk profile as membership increases.

The cost of risk relating to forward looking provisions for expected losses on financial assets under IFRS 9 increased materially in 2022 compared to the previous year yet with an allocation to provisions of less than a one million euro due to the re-estimation of the parameters of the macroeconomic scenarios following the military invasion of Russia in Ukraine. This resulted in cumulative IFRS 9 provisions of €1,2 million at end 2022 compared to € 0.9 million at end 2021 (1.7 basis points versus 1.2 basis points), still a very low level reflecting the low risk profile of the asset class.

Adequate capital ratio is unlikely to be lower than 12.5%

AFL's capital ratios are calculated on a consolidated basis, at the level of Agence France Locale - Societe Territoriale (the parent company). As of the end of December 2022, AFL's Common Equity Tier 1 capital ratio (CET1) was 15.6%, marginally lower than 15.8% at the end of December 2021 and providing a comfortable buffer above the minimum requirement of 9.25% as of end-December 2022³ and an internal target of 12.5%. While we expect the ratio to slightly decrease over the medium term as AFL continues to attract new members, we believe that the risk of AFL's solvency falling below the 12.5% threshold is very low.

As of end-December 2022, the bank's leverage ratio to 7.81% from 7.28% as of the end of 2021. Following a new banking regulation which came into force in July 2021⁴, and since AFL has been acknowledged as a public development credit institution by ACPR on 11 March 2021, exposures to central governments, regional governments, local authorities or public-sector entities in relation to public-sector investments and promotional loans/activities are now excluded from the denominator of the leverage ratio.

Because borrower concentration is high the default of a single borrower would have a material impact on the bank's net income and solvency, although the increase in memberships has materially reduced such risk. This credit concentration risk is inherent to the public-sector financing business and also applies to AFL's European peers. The concentration risk is, nevertheless, more contained given the relatively high risk-weight applied to the French local authorities (20%) in the calculation of large exposure limits. We believe that similar to the other French and Nordic specialized lenders, high asset quality strongly mitigates concentration risk.

Liquidity and market risks are limited

So far AFL has observed the rules set out in its internal policy and we do not expect any major issue to arise from its liquidity or funding. AFL has complied with the minimum requirements of the liquidity coverage ratio and net stable funding ratio from day one. AFL manages its liquidity according to the following rules : (1) the liquidity portfolio should represent 100% of the net cash outflow over the next 12 months, yet with the caveat that it can fluctuate in a 80%-125% range; and (2) the balance sheet must be match funded, with a maturity gap between assets and liabilities of a maximum of twelve months, with the possibility to deviate for limited periods and to raise the limit to 2 years (making it possible to absorb the possible drift of this indicator during the production of end-of-year loans).

We also positively note that since June 2020, AFL has access to the central bank/Banque de France's loan refinancing system (called TRiCP - Data Processing of Private Claims) which provides it with a line of credit, available at any time, for an amount of 70% of its medium-to-long-term loans.

We expect market risks to remain limited for AFL because interest rate risks are fully hedged against Euribor. This hedging strategy requires the extensive use of derivatives, and the related collateral posting needs is being closely monitored as it could involve unexpected cash outflows.

AFL's ability to break even since 2020 is testimony to the long-term sustainability of its business model

Loan origination has increased continuously since 2015, reaching €5.3 billion of outstanding loans at the end of December 2022 (up from €4.4 billion at year-end 2021 and €3.7 billion at year-end 2020) and €0.8 billion of financing commitments as of the end of

December 2022. Production of new loans continued to rise despite the constraints resulting from the application of the usury rate (official cap on interest rates on loans in France) and a sharp rise in interest rates throughout the year. In addition, there has been a continuous increase in memberships, and in turn in committed capital from newly joining local authorities, leading to €272 million of committed capital as of end-December 2022 (with €217 million paid up⁵), nearly reaching its €273 million target by year-end 2022.

In 2022, net banking income amounted to €17.6 million compared to €14.0 million in 2021, with net interest margin increasing by 23% to €15.6 million from €12.7 million. The sharp rise in the 3-month Euribor rate throughout the year, against which most of AFL's exposures are swapped, led to a sharp rise in interest income in the loan portfolio (€31.2 million compared to €3.9 million). Conversely, interest on borrowings after hedging interest amounted to a net cost of -€18.0 million compared to a €18.9 million gain year before, when interest rates were still negative. At the end of December 2022, the average lifetime gap between assets and liabilities increased to 1.27 years compared to 0.68 years at end 2021, which will slightly lower the margin on new production in 2023, but we expect the margin to remain stable over the medium term. We also expect the increase in the total outstanding loans to remain the main catalyst of improving profitability, while margins on new production will remain broadly stable

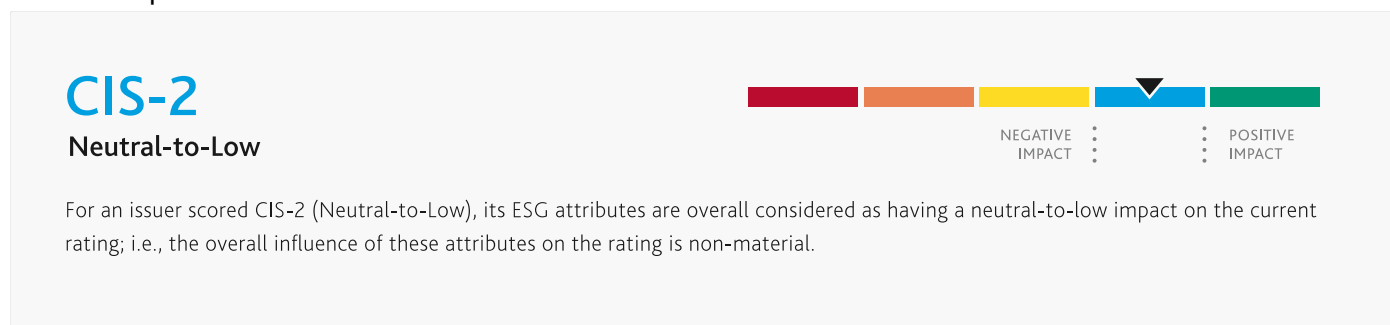
We believe that AFL's ability to break even since 2020 (net income of €2.8 million in 2022, compared to €1.7 million in 2021) is testimony to the long-term sustainability of its business model. The bank has demonstrated its ability to expand its loan book and attract new members, which was a prerequisite for the bank's capital base to keep growing. We expect further continuous increase in new memberships, and that the combination of a growing loan book, stable margins and operating costs, will lead AFL's profitability to remain positive in 2023 and beyond.

ESG considerations

Agence France Locale's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 3

ESG Credit Impact Score



Source: Moody's Investors Service

AFL's ESG Credit Impact Score is neutral-to-low (**CIS-2**), reflecting the limited credit impact of environmental and social factors on the rating to date, and neutral-to-low governance risks

Exhibit 4

ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental

AFL faces moderate exposure to environmental risks. Given its role as lender to the public sector, AFL's exposure to environmental risks is closely aligned to that of the French sovereign, which is low across all categories.

Social

AFL faces moderate social risks in relation to customer relations and associated regulatory and litigation risks, which require the bank to meet high compliance standards. Customer relations risks related to mis-selling and misrepresentation are however below the industry average, as the bank has no exposures to private companies and no retail activity.

Governance

AFL faces low governance risks. The bank's risk management policies and procedures are in line with the industry's best practices. The bank has met its financial objectives later than originally anticipated, but it managed to break even in 2020 and 2021, thereby demonstrating the viability of its business model. Ownership is concentrated within the French public sector, however the strong alignment between the bank's customers and shareholders, the large presence of independent administrators as well as the domestic developed institutional framework mitigate associated governance risks.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Structural and support considerations

Loss Given Failure (LGF) analysis

Despite its ownership and public mandate, AFL falls within the scope of the EU Bank Resolution and Recovery Directive, which we consider to be an operational resolution regime. We, therefore, apply our Advanced LGF analysis to AFL's liability structure.

We believe that AFL's senior unsecured debt is likely to face very low loss given failure. This view is underpinned by the current substantial volume of senior unsecured debt compared to total liabilities. This results in a two-notch uplift to the BCA.

Government support

The joint and several guarantee, which the member local authorities extend, up to their respective outstanding borrowings at AFL, provides adequate protection to AFL's creditors should the entity be unable to fulfill its obligations on its own. We believe that this guarantee amply covers AFL's credit risks, which are very limited, given the high quality of the loan book. Because we would generally expect AFL's lending policy to prevent the weakest borrowers from taking large amounts of debt, the most creditworthy members - the largest borrowers - would have to take a high share of the costs if the guarantee were to be activated.

At this stage of AFL's development and given its current limited market share, we believe that direct support from the French government remains moderate, essentially reflecting its willingness to avoid the reputational damage to the French sovereign and the local public sector that would result from a default of AFL.

As a result of the members' guarantee and the moderate support assumption from the central government, our government support assumption for AFL's long-term ratings is high, reflected in a one-notch rating uplift.

Counterparty Risk Ratings (CRRs)

AFL's CRR is positioned at Aa3/Prime-1

The CRR for AFL, before government support, is three notches higher than the Adjusted BCA of a3, based on the level of subordination to CRR liabilities in the bank's balance sheet, and assuming a nominal volume of such liabilities.

We assume a high government support assumption for the CRRs, but because of the close links between the sovereign rating and the CRR before government support, this support does not result in any uplift.

Counterparty Risk (CR) Assessment

AFL's CR Assessment is positioned at Aa3(cr)

The CR Assessment, before government support, is positioned three notches above the Adjusted BCA of a3, based on the buffer against default provided to the senior obligations represented by the CR Assessment by subordinated instruments. The main difference with our Advanced LGF approach used to determine instrument ratings is that the CR Assessment captures the probability of default on

certain senior obligations, rather than expected loss; therefore, we focus purely on subordination and take no account of the volume of the instrument class.

We assume a high government support assumption for the CR Assessment, but because of the close link between the sovereign rating and the CR Assessment before government support, this support does not result in any uplift.

Rating methodology and scorecard factors

Exhibit 5

Agence France Locale

Macro Factors							
Weighted Macro Profile		Strong +	100%				
Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2	
Solvency							
Asset Risk							
Problem Loans / Gross Loans	0.1%	aa1	↔	aa1	Quality of assets		
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	15.9%	aa3	↔	a1	Expected trend		
Profitability							
Net Income / Tangible Assets	0.0%	b3	↔	b3			
Combined Solvency Score		a2		a2			
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets	97.6%	caa3	↔	baa3	Term structure	Market funding quality	
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets	29.5%	a3	↔	a2	Quality of liquid assets		
Combined Liquidity Score		b1		baa1			
Financial Profile				a3			
Qualitative Adjustments				Adjustment			
Business Diversification				0			
Opacity and Complexity				0			
Corporate Behavior				0			
Total Qualitative Adjustments				0			
Sovereign or Affiliate constraint				Aa2			
BCA Scorecard-indicated Outcome - Range				a2 - baa1			
Assigned BCA				a3			
Affiliate Support notching				0			
Adjusted BCA				a3			
Balance Sheet		in-scope (EUR Million)	% in-scope	at-failure (EUR Million)	% at-failure		
Other liabilities		1,601	20.0%	1,601	20.0%		
Senior unsecured bank debt		6,218	77.6%	6,218	77.6%		
Equity		190	2.4%	190	2.4%		
Total Tangible Banking Assets		8,009	100.0%	8,009	100.0%		

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional Notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Rating	80.0%	80.0%	80.0%	80.0%	3	3	3	3	0	aa3
Counterparty Risk Assessment	80.0%	80.0%	80.0%	80.0%	3	3	3	3	0	aa3 (cr)
Senior unsecured bank debt	80.0%	2.4%	80.0%	2.4%	2	2	2	2	0	a1

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	3	0	aa3	0	Aa3	Aa3
Counterparty Risk Assessment	3	0	aa3 (cr)	0	Aa3(cr)	
Senior unsecured bank debt	2	0	a1	1	Aa3	

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

Source: Moody's Investors Service

Ratings

Exhibit 6

Category	Moody's Rating
AGENCE FRANCE LOCALE	
Outlook	Stable
Counterparty Risk Rating	Aa3/P-1
Baseline Credit Assessment	a3
Adjusted Baseline Credit Assessment	a3
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
Issuer Rating -Dom Curr	Aa3
Bkd Senior Unsecured	Aa3
ST Issuer Rating -Dom Curr	P-1

Source: Moody's Investors Service

Endnotes

- [1](#) Under the banking law of July 26, 2013, AFL's mandate consists of extending loans to a restricted list of local authorities. AFL was granted a banking license as a specialized credit institution on January 12, 2015.
- [2](#) Except for the borrowers whose outstanding debt is below €10 million.
- [3](#) Total capital requirement, comprised of 8% Pillar 1 requirement and a 1.25% Pillar 2 requirement.
- [4](#) [Regulation \(EU\) 2019/876 of the European Parliament](#) and of the Council of May 20, 2019 amending Regulation (EU) No. 575/2013 (the Capital Requirement Regulation)
- [5](#) committed capital corresponds to the amount of capital contributions, agreed upon at the time they join AFL-ST, in the future.

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