Research Update:

French Public Sector Lender Agence France Locale 'AA-/A-1+' Ratings Affirmed; Outlook Stable

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Overview

- The Agence France Locale group (AFL group) continues to benefit from an extremely high likelihood of support from its supporting members, thanks to a very strong and binding joint guarantee scheme and members' strong willingness to diversify their sources of funding through AFL, the group's operating entity.
- Although AFL has a niche position in the market, its member base is growing steadily and AFL has preserved its robust funding and liquidity position.
- We therefore affirmed our 'AA-/A-1+' long- and short-term ratings on AFL, which we see as core to the group.
- The stable outlook reflects our view that The AFL group and its supporting members will maintain robust financial indicators.

Rating Action

On May 24, 2023, S&P Global Ratings affirmed its 'AA-/A-1+' long- and short-term issuer credit ratings on France-based public-sector funding agency Agence France Locale (AFL). The outlook is stable.

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 and the new high-interest-rate environment.

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

We could raise the rating if the AFL group expanded its loan book, supporting stronger market share and income generation without weakening its risk and financial management practices and, at the same, if the average credit quality of its supporting members improved.

Rationale

Our ratings on AFL reflect those on the group because we consider AFL a core subsidiary. We assess AFL's group credit profile (GCP) at 'aa-', two notches above its SACP, because we see an extremely high likelihood of AFL receiving extraordinary financial support from its group of supporting LRG members, thanks especially to a very strong and binding joint guarantee scheme. AFL's stand-alone credit profile (SACP) reflects its very strong financial profile with robust risk-adjusted capitalization and very strong funding and liquidity. This counterbalances its moderate enterprise risk profile.

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

AFL operates in a stable and low-risk public industry. The French LRG sector's key strengths reflect France's resilient economy, but there is some uneven wealth distribution among LRGs and some wealth concentration in the Ile-de-France region. We view French LRGs' institutional framework as stable despite the ongoing war in Ukraine and financial markets volatility. We expect French LRGs' creditworthiness to remain resilient to the economic slowdown and budgetary pressures. We believe French LRGs will continue prioritizing deleveraging amid tightening borrowing conditions and slower economic growth, thereby conserving their strong creditworthiness. Finally, LRGs tend to have large contingent liabilities, mainly through large guarantees and the control they have over various government-related entities.

AFL operates in a very competitive environment, which undermines its public role and weighs on its ability to grow rapidly. French LRGs continue to fund themselves through a range of players. Among AFL's competitors are well established commercial banks like BPCE, Credit Mutuel, and Credit Agricole, but also publicly owned CDC through its subsidiaries SFIL and La Banque Postale. In our view, it will take time for AFL to consolidate its position and prove essential to LRGs' funding.

AFL continues to expand its footprint in the French LRG funding market. Demand for AFL's financings have grown thanks to its offered financing terms. In 2022 its success rate in tenders with members' local authorities reached 70%, highlighting the competitiveness of the offers. 2022 marked a record year for AFL as 103 LRGs joined, bringing the total membership to 599. As of end-March 2023, the group's national footprint further extended to 618 members, representing 3.2% growth in one quarter. Lending remained vigorous in 2022 with a 12% year-on-year increase and €1.4 billion of financings disbursed. In addition, AFL benefits from a stable customer base and we expect little volatility in the future given that exit rules are very stringent.

The group's strategy is ambitious but aligned with the strong competition AFL is facing. The group aims to achieve above 10% market share by 2026. This target is ambitious but reasonable, in our view. While providing a moderate 6% of French LRGs' annual credit inflows at the national level, AFL bridged 51% of its members' financing needs in 2022 considering that its members represented a market share of about 22.5% of French LRGs' total outstanding debt.

Revenue generation capacity has improved in recent years and will continue to do so as margins should slightly improve with interest rates. We expect AFL's profitability will keep improving as lending volumes grow. Unlike commercial banks, we expect margin improvement stemming from higher interest rates to be moderate as AFL is fully wholesale funded. In 2022, AFL's net income reached €2.8 million, up from €1.7 million in 2021. Although concentration risk is significant, it has receded, with the 10 largest borrowers representing 29% of total exposure on Dec. 31, 2022, down from about 38% at year-end 2019. We see this concentration reduction as positive for revenue generation and believe it will likely continue declining in the next three-to-five years.

In our view, AFL's overall risk and financial management is prudent and it proactively manages regulatory requirements. Management has longstanding expertise and experience in the LRG sector and its funding. AFL reported two nonperforming exposures (NPEs) representing only 0.1% of the total lending portfolio in 2022. We do not expect AFL to report losses on these NPLs and we expect new NPEs to remain exceptional. In addition, AFL's internal risk management policies are enhanced by compliance with the French Monetary and Financial Code regulatory rules given 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 profile: High capitalization and very strong liquidity provide financial buffers.

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%. 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.

AFL's funding position is strong with a broad range of investors and limited maturity mismatches. It has established debt programs and is a regular benchmark issuer with a diversified funding profile in terms of geographies, maturities, currencies, and investor types. In 2022, and for the first time since it was created, AFL held two syndicated issues in the same year amid its expanding operations. AFL is also active on the sustainable bonds market and has issued a second €500 million sustainable bond in January 2022 with a seven-year maturity. Despite rising rates the pricing on AFL's issuances remained attractive--just above that of French agencies such as the Agence Française de Développement. 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 of six months. It has no notable refinancing risk, with most of the funding being long term. The cumulative maturing assets cover 1.8x cumulative maturing liabilities for the next 12 months and support its strong funding profile.

AFL has robust liquidity. Its dependence on wholesale market funding is mitigated by its prudent liquidity policies and a comprehensive treasury portfolio. AFL manages its liquidity with the aim of maintaining 100% of net cash outflows over the next 12 months, within a range of 80% minimum and 125% maximum. AFL's S&P Global Ratings-calculated liquidity ratio was 1.27x as of Dec. 31, 2022, while its regulatory liquidity coverage ratio was 500%. AFL's total liquidity reserve stood at €2.2 billion as of Dec. 31, 2022, among which 47% was cash. The non-cash liquidity portfolio is invested in liquid fixed-income securities issued by governments, states, regional governments, multilateral development banks, and financial institutions. Positively, AFL has access to the French central bank's automated interface for pledging credit claims (TRICP). This enables AFL to repurchase LRGs' claims at the central bank and benefit from central bank funding of up to €2.4 billion as of Dec. 31, 2022.

We do not foresee any risks other than those captured in our RAC calculations and funding and liquidity metrics, 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

The AFL group consists of two entities, allowing 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 is a guarantee from AFL-ST to investors. AFL-ST's board (Conseil d'administration) determines the amount of this guarantee. The second is the LRG 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 preemptively activate 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 directly call 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 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 that allowed 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.

Selected Indicators

Table 1

Agence France Locale Group -- Selected Indicators

	--Year ended Dec. 31--				
(Mil. €)	2022	2021	2020	2019	2018
Business position					
Total adjusted assets	8,009	6,996	5,728	4,355	3,218
Customer loans (gross)	4,691	4,431	3,832	3,161	2,230
Growth in loans	5.9	15.6	21.2	41.7	55.9
Net interest revenues	15.6	12.7	11.8	10.1	7.9
Non interest expenses	13.4	12.1	11.2	11.6	10.5
Capital and risk position					
Total liabilities	7,824	6,819	5,580	4,233	3,105
Total adjusted capital	185	171	142	118	110
RAC ratio before diversification	39.4	44.6	42.8	49.5	55.4
RAC ratio after diversification	13.9	14.9	14.6	17.7	19.1
Gross nonperforming assets/gross loans	0.1	0.1	0.1	0.1	0
Funding and liquidity* (x)					
Liquidity ratio with loan disbursement	1.3	1.4	2.9	2.1	2.0
Liquidity ratio without loan disbursement	2.0	2.1	6.4	9.0	7.7
Funding ratio with loan disbursement	>1	>1	>1	>1	>1

Ratings Score Snapshot

Agence France Locale Group - Ratings Score Snapshot

Stand-Alone Credit Profile	a

Agence France Locale Group - Ratings Score Snapshot (cont.)

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-
Issuer Credit Ratings	AA-/Stable/A-1+
Group Credit Profile	aa-
Group status	Core

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021
- 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

Ratings List

Ratings Affirmed	
Agence France Locale	
Issuer Credit Rating	AA-/Stable/A-1+

Ratings Affirmed

Agence France Locale	
Senior Unsecured	AA-
Commercial Paper	A-1+

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