

CREDIT OPINION

8 June 2021

Update

✓ Rate this Research

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

Update to credit analysis

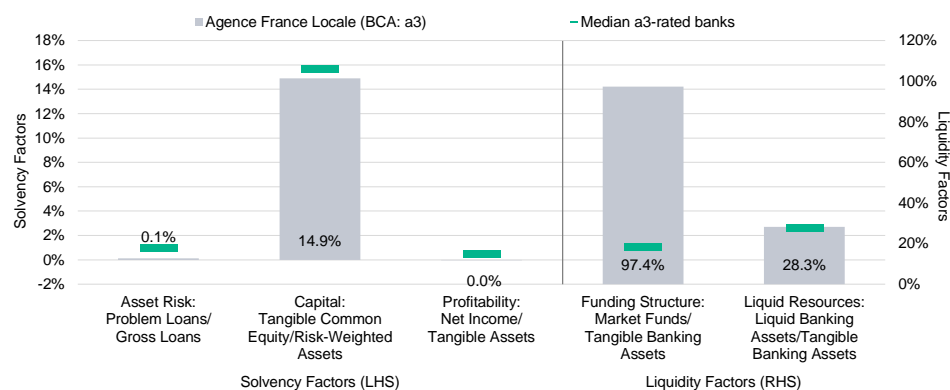
Summary

[Agence France Locale's](#) (AFL) BCA of a3 reflects our view that (1) the entity's fundamentals are robust; (2) its governance structure provides a sound operating base; 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 and loan production since 2018 led AFL to meet the objectives set in the 2017 strategic plan, including posting positive profitability for the financial year 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 (up to 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.
- » The coronavirus outbreak negatively weighs on local authorities' creditworthiness through higher operating expenditures, but we foresee sustained investments in the regions and departments

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 stable franchise, increased its market share, generated sustainable profit and accumulated capital that will support its growth. However, 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 (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 decline; 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 ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Key indicators

Exhibit 2

Agence France Locale (Consolidated Financials) [1]

	12-20 ²	12-19 ²	12-18 ²	12-17 ²	12-16 ²	CAGR/Avg. ³
Total Assets (EUR Million)	5,729.8	4,356.7	3,221.7	2,529.9	1,385.8	42.6 ⁴
Total Assets (USD Million)	7,010.8	4,890.4	3,682.9	3,037.9	1,461.6	48.0 ⁴
Tangible Common Equity (EUR Million)	147.0	123.3	115.5	109.8	87.4	13.9 ⁴
Tangible Common Equity (USD Million)	179.9	138.4	132.0	131.8	92.2	18.2 ⁴
Problem Loans / Gross Loans (%)	0.1	0.1	0.0	0.0	0.0	0.0 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	14.9	15.7	18.9	23.1	32.8	21.1 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	2.8	3.1	0.0	0.0	0.0	1.2 ⁵
Net Interest Margin (%)	0.2	0.3	0.3	0.3	0.4	0.3 ⁵
PPI / Average RWA (%)	0.3	-0.1	-0.2	0.0	-0.9	-0.2 ⁶
Net Income / Tangible Assets (%)	0.0	0.0	-0.1	0.0	-0.2	-0.1 ⁵
Cost / Income Ratio (%)	81.7	104.6	113.5	98.6	123.0	104.3 ⁵
Market Funds / Tangible Banking Assets (%)	97.4	97.1	96.4	95.6	93.2	95.9 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	28.3	22.9	25.6	39.2	32.0	29.6 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 from interference into its the day-to-day management.

As of the end of 2020, the number of members (local authorities) was 411. Each member provides a guarantee, which is worth the loan's amount extended by AFL, on a joint and several basis (members' guarantee). AFL security holders also benefit from a guarantee from Agence France Locale - Société Territoriale (ST guarantee).

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 relative to the total outstanding debt of the French local government sector, which is currently 17.1%.

The entity's remit consists in providing the French public sector 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 70% out of France) whose confidence toward 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 50% of their borrowings outstanding². AFL has progressively broadened its member base to 411 local authorities as of the end of 2020 (from 352 at the end of 2019). Loan origination was initially restricted to the French local governments under their narrowest definition, that is, excluding hospitals, satellites and semipublic companies (sociétés d'économie 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% as of year-end 2020) and we expect it to remain so, given the very restricted scope of customers and in light of the historical performance of these borrowers. During 2020, the French local public sector financing market was significantly impacted by the coronavirus outbreak, which led in particular to the postponement of the second round of municipal elections from March to June. The recession in France led to a contraction of the local authorities' tax and tariff revenues, but we remain of the view that [the financial health of the sector will remain strong](#). 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.

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 2020, AFL's Common Equity Tier 1 capital ratio (CET1) was 14.9%, providing a comfortable buffer above the minimum requirement of 9.25% as of year-end 2020³ and an internal target of 12.5%. We believe that the risk of AFL's solvency falling below the 12.5% threshold is very low.

As of December 31, 2020, the bank's leverage ratio stood at 2.83%. However, the calculation of the leverage ratio at AFL will change going forward. Indeed, following a new banking regulation⁴, 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 shall be excluded from the denominator of the leverage ratio. This will enter into effect on 28 June 2021. The pro-forma leverage ratio would be 8.63% as of the end of 2020 under this new approach.

Borrower concentration is however high for AFL, so 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 risk is inherent to the public-sector financing business and AFL will have to manage it, similar to its European peers. The concentration risk is, nevertheless, more contained given the high risk weight applied to French local authorities (20%) in the calculation of large exposure limits, which is not the case at peers where exposures are typically 0% risk weighted. 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 at least 100% of the net cash outflow over the next 12 months; and (2) the balance sheet must be match funded, with a maturity gap between assets and liabilities no greater than eighteen months (maturity gap cap will be reduced to one year after 2022).

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

We expect market risks to remain limited for AFL because interest rate risks are hedged against Euribor. This hedging strategy requires the extensive use of derivatives, and the related collateral posting needs will have to be closely monitored to avoid unexpected cash outflows.

AFL's ability to break even in 2020 gives credit to the viability of its business model

While AFL's business initially grew at a slower pace than expected, primarily because of low demand for loans from the RLG sector and fierce competition among French lenders, loan origination has increased continuously since 2015, reaching €3.8 billion of outstanding loans at the end of 2020 (up from €3.2 billion at year-end 2019) and €0.4 billion of financing commitments as of the end of 2020. In addition, there has been a continuous increase in memberships, and in turn in committed capital from newly joining local authorities, leading to €186.4 million of committed capital as of end-December 2020 (with €177.8 million paid up), on track to reach the €200 million target by year-end 2021.

We believe that AFL's ability to break even in 2020 (net income of €2.3 million compared to €-1.2 million in 2019) gives credit to the long-term viability of its business model, by demonstrating the bank's ability to increase lending to its current members, and attracting new members, which will inject new capital in the bank.

However, given the likelihood that competition will remain fierce and the limited borrowing prospects from the French RLGs in the coming quarters, we believe that AFL's lending capacity will remain somewhat constrained. Although we view AFL as relatively insulated from the disruption stemming from the coronavirus outbreak, AFL's profitability is affected by higher provisioning for expected loss under IFRS9. The cost of risk in 2020 stood at €352,000 compared to a reversal of impairment losses of €5,000 in 2019. The material increase - although still accounting for a mere 0.01% of gross exposures - relates to stage 1 amounts, and stems from the change in the weighting of the underlying macroeconomic scenarios in the model, as a result of the coronavirus outbreak. The pandemic has also led to an increase in spreads which impacted the cost of refinancing transactions carried out by AFL between April and October 2020.

Despite such headwinds, we expect that the continuous increase in membership and loan production should enable AFL's profitability to remain positive in 2021.

Environmental, social and governance considerations

In line with our general view for the banking sector, AFL has a low exposure to environmental risks and moderate exposure to social risks. See our [Environmental risks heat map](#) and [Social heat map](#) for further information.

Governance is highly relevant for AFL, as it is to all participants in the banking industry. Corporate governance weaknesses can lead to a deterioration in a company's credit quality, while governance strengths can benefit its credit profile. We do not have particular concerns for the bank; however, corporate governance remains a key credit consideration and requires ongoing monitoring.

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 provide up to their respective outstanding loan amounts extended by 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 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)

Our CRRs are opinions of the ability of entities to honor the uncollateralized portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honored. CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralized portion of payables arising from derivatives transactions and the uncollateralized portion of liabilities under sale and repurchase agreements. CRRs are not applicable to funding commitments or other obligations associated with covered bonds, letters of credit, guarantees, servicer and trustee obligations, and other similar obligations that arise from a bank performing its essential operating functions.

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

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default, and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (for example, swaps), letters of credit, guarantees and liquidity facilities.

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 3

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)	14.9%	a1	↔	aa3	Expected trend		
Profitability							
Net Income / Tangible Assets	0.0%	caa1	↔	caa1			
Combined Solvency Score		a3		a2			
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets	97.4%	caa3	↔	baa3	Term structure	Market funding quality	
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets	28.3%	a3	↔	a3	Quality of liquid assets		
Combined Liquidity Score		b1		baa2			
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		425	7.4%	425	7.4%		
Senior unsecured bank debt		5,156	90.0%	5,156	90.0%		
Equity		147	2.6%	147	2.6%		
Total Tangible Banking Assets		5,728	100.0%	5,728	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	92.6%	92.6%	92.6%	92.6%	3	3	3	3	0	aa3
Counterparty Risk Assessment	92.6%	92.6%	92.6%	92.6%	3	3	3	3	0	aa3 (cr)
Senior unsecured bank debt	92.6%	2.6%	92.6%	2.6%	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 4

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 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)

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