S&P Global Ratings

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Societe de Financement Local (Sfil)

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This report does not constitute a rating action.

Credit Highlights

Overview

Key strengths	Key risks
Integral link with the French government as a 100% state-owned financial institution and thus almost certain likelihood of government support in the event of financial distress.	Structurally low profitability from LRG lending and potential downside from the rising cost of funding.
Critical role as the first lender to French local and regional governments (LRGs) and public hospitals.	
Critical mission for the French government's economic policy as the main liquidity provider of refinancing for export credit.	

S&P Global Ratings expects Societe de Financement Local (Sfil) will receive direct extraordinary support from the central government in case of need. Although the state is not legally responsible for Sfil's solvency, we believe that the French government is committed to providing sufficient liquidity and capital support for Sfil to operate on an ongoing basis, comply with regulatory requirements, and meet its financial obligations. Beyond the letter of comfort that the reference shareholder Caisse des Dépôts (CDC) has provided and by which it supports Sfil’s creditworthiness, France has also provided a letter of comfort by which it is committed to ensuring Sfil would be able to continue its activities and meets its financial obligations where CDC would fail to do so.

Outlook

The negative outlook on Sfil mirrors that on France. We expect that Sfil will retain its critical role for and integral link with the French government, and therefore we expect our ratings on the entity to move in line with those on the sovereign.

Downside scenario

We would lower the ratings on Sfil, if we lowered those on France.

We would also lower the ratings on Sfil if the central government were to change Sfil's full public-sector entity status or if Sfil's role diminished.

Upside scenario

We would revise our outlook on Sfil to stable if we took the same action on France and the likelihood of support for the entity remained almost certain.

Rationale

We equalize our ratings on Sfil with those on France (unsolicited: AA/Negative/A-1+). This is based on our view of Sfil's critical role for and integral link with the French government, we consider that there is an almost certain likelihood that the government would provide timely and sufficient extraordinary support to Sfil in the event of financial distress. We also continue to view Sfil's subsidiary, French covered bond issuer Caisse Française de Financement Local (Caffil), as a core entity of the Sfil group.

Since we consider that Sfil executes strategic government policies, we do not see the likelihood of government support being subject to transition risk. Therefore, we expect that the ratings and outlook on Sfil will move in line with those on France. More generally, we do not consider the French government’s general propensity to support its government-related entities to be in doubt.

Our opinion of an almost certain likelihood of government support hinges on Sfil's:

- Integral link with the French government as a 100% public-sector-owned financial institution benefiting from the state's strong commitment of support and tight state supervision.
- Critical role for France as the first lender to French LRGs and public hospitals and the main liquidity provider of refinancing for export credit guaranteed by the central government, with about 25% and 40% market shares respectively. In line with the bank's 2022-2026 strategic plan, we expect this role to be further reinforced by France's need for green investments over the coming decade, coupled with the country's €19 billion investment plan for public hospitals (Ségur de la Santé). French LRGs always played a key role in channeling investments because they account for close to 70% of total civil public investments. In addition, the new partnership with Banque des Territoires (BDT) will provide additional opportunities for Sfil to expand its portfolio and reinforce its critical role.

Sfil plays a key role in France's economic strategy as the first lender to LRGs and public hospitals. Sfil was created in 2013 to provide the French LRG sector with stable and continued access to long-term funding and remains the first lender to the sector. Sfil's primary mission, therefore, is to refinance new loan production generated by its partner La Banque Postale (LBP) for French LRGs, and a lower volume for public health institutions. Financial access for LRGs is key, given that they account for close to 70% of total civil public investments in France, excluding research and development, expenses in databases, and military equipment. These investments are crucial for the maintenance and development of infrastructure in France and to support the national economy. The European Commission (EC) has recognized Sfil as a development bank, in light of the EC’s acknowledgment of a structural market failure in the financing of LRGs in France. Sfil, through LBP, remains the first lender to the sector, averaging 20%-25% of new loans to French LRGs between 2014 and 2022.

At year-end 2022, Sfil inaugurated a new partnership with BDT. Similar to the current partnership with LBP, Sfil refinances new fixed-rate loans originated by BDT. The average term of these loans is longer than those Sfil usually refinances, since BDT's financing includes mainly social housing units. The signature of this partnership allows Sfil to complement loan origination by LBP while keeping a strong focus on green projects. This partnership could represent an additional €500 million of financing per year in the medium term. At year-end 2022, Sfil also launched a new loan offer with LBP with a strong focus on social projects. About €140 million of social loans were granted between October 2022 and year-end 2022. We believe resilient results in 2022, the new product offering, and the partnership with BDT have strengthened Sfil's position among the various public-sector banks operating within the CDC group, highlighting Sfil's relevance for the state.

Sfil supports the government in promoting exports. In 2015, as part of the restructuring of its export promotion policy, Sfil was assigned a second mission of refinancing large export credits guaranteed by the central government. This mission has also been validated by the EC, which extended Sfil's mandate validity up to year-end 2027, recognizing that Sfil responds to market failures and confirming that private institutions do not provide these services to a sufficient extent. We believe this extension of Sfil's activity has reinforced its critical role for the government in resolving failures in the financial market. This export refinancing activity benefits from a full guarantee from the French government through its official export credit agency Bpifrance Assurance Export. Export credit results were modest in 2022 with the signature of two contracts totaling €0.7 billion. Several transactions have been delayed but quote requests increased compared to 2020-2021, reflecting the countercyclical role of export credit in a context of high geopolitical tensions and rising interest rates. Sfil remains the leading liquidity provider for large export contracts (total refinancing volume of €11.2 billion at Dec. 31, 2022) with a 40% market share. We expect export-financing activity to remain elevated, fueled by a likely increase in energy and security spending worldwide. In addition, the cruise sector is recovering from the COVID-19 pandemic and we expect demand for new ships to pick up.

Sfil has a sound financial profile. Typical for banks with a large balance sheet comprising very-low-risk assets, Sfil displays a very high common equity Tier 1 ratio (40.3% at year-end 2022) compared with commercial lenders. Given its development bank status, Sfil benefits from relaxed leverage requirements under the EU's amended capital requirements regulation. It is unclear how Basel III's output floor implementation will affect Sfil, but we expect the effect to be manageable because its current capital ratios provide a significant buffer.

Low-risk lending, issued to or guaranteed by public authorities, dominates the current asset base. The cost of risk was €0.3 million in 2022, reflecting the strong risk profile of Sfil's portfolio and the financial health of its borrowers. Underlying legal risk has also reduced, with only four litigation cases as of December 2022 from 132 in December 2015. Overall, the clean-up of Dexia's legacy nonperforming assets has ended, significantly reducing financial downside risks.

The negative effects of interest rate increases on Sfil's margin are limited. We recognize that Sfil bases its business model on its continued capacity to access funding at very low cost, given its structurally low asset margins. That said, the rapid surge in interest rates has had a limited effect on Sfil's profitability despite the inherently longer maturity of the bank's assets, and we believe Sfil has sufficient buffers to absorb pressures if needed. Sfil is entirely wholesale funded, in line with its public-sector-focused peers, and we view the ongoing support Sfil receives from its public-sector shareholders through LBP and CDC as mitigating funding risks. Sfil's liquidity is supported by its ability to use its portfolio of assets, originating from the public sector, as collateral for the lending facility from the European Central Bank. That said, in 2022, lending activities were affected by the French usury rate, which limited repricing on the asset side by restricting the volume of new fixed-rate loan disbursements. This is a common feature in the French banking system and was for a limited period given the usury rate is reassessed periodically. We do not expect margins to come under significant pressure in the coming 12-24 months.

Environmental, Social, And Governance

Sfil’s missions make environmental, social and governance (ESG) factors an integral part of both its internal and external strategies. We believe that Sfil's commitment to a green and socially responsible transition of the national economy strengthens our view of the critical role it plays in France, since funding a sustainable future is a key strategic initiative of the central government.

Environmental factors are mainly reflected in our analysis of Sfil's key role in the government's sustainable development initiatives. Since 2019, Sfil has issued several sustainable and green bonds. Sfil aims for 25% of bonds to be issued under green, social, and sustainable formats by 2024 to expand its sustainable refinancing capacities. It also targets €1 billion of social loans per year with LBP from 2026 to encourage French LRGs to invest in areas such as education, health, sport, culture, development, and regional cohesion. Additionally, Sfil has offered thematic loans since October 2022 that are distributed to French LRGs through LBP.

Social factors are important to Sfil’s funding of local projects of public interest, especially regarding local governments and hospitals. We believe Sfil will play a key part in the Segur plan, a large €19 billion investment program for French public hospitals, compared with the hospital sector’s current €30 billion of total outstanding debt. In fact, Sfil set a clear target of increasing lending activity to public hospitals 20% by 2024.

Governance factors are generally neutral to our assessment given Sfil's integral link with the state, which also informs its objectives and mandates as a key public finance institution.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- 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

Related Research

- Groupe Caisse des Depots et des Consignations (CDC) , March 14, 2023
- French LRGs' Creditworthiness Remains Resilient To Headwinds, Report Says, March 7, 2023
- France Outlook Revised To Negative On Rising Budgetary Risks; 'AA/A-1+' Ratings Affirmed, Dec. 2, 2022

Ratings Detail (as of June 05, 2023)*

SFIL	
Issuer Credit Rating	AA/Negative/A-1+
Commercial Paper	
Local Currency	A-1+
Senior Unsecured	AA
Issuer Credit Ratings History	
06-Dec-2022	AA/Negative/A-1+
25-Oct-2016	AA/Stable/A-1+
14-Oct-2014	AA/Negative/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.