

Societe de Financement Local (SFIL)

July 18, 2024

This report does not constitute a rating action.

Credit Highlights

Overview

Key strengths

Integral link with the French government as a 100% state-owned financial institution.

Critical role as the first lender to French local and regional governments (LRGs) and public hospitals; as a result, there is an almost certain likelihood of government support in the event of financial distress.

Critical mission for the French government's economic policy as the main liquidity provider of refinancing for export credit.

Key risks

Contribution of French LRGs to the central government's budgetary consolidation effort, which could result in lower investment spending.

Structurally low profitability from LRG lending and potential risk from the rising cost of funding.

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S&P Global Ratings expects Societe de Financement Local (SFIL; AA-/Stable/A-1+) would receive direct extraordinary support from the central government in case of financial distress. Although the state is not legally responsible for the society'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 Depots (CDC) has provided and by which it supports the society's creditworthiness, France has also provided a letter of comfort through which it is committed to ensuring SFIL will be able to continue its activities and meet its financial obligations where CDC failed to do so.

Outlook

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

Downside scenario

We would lower the ratings on SFIL if we took a similar action on France, or if the central government were to change SFIL's full public-sector entity status or SFIL's role were to diminish.

Upside scenario

We would raise the ratings on SFIL if we took a similar 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-/Stable/A-1+). This is because, based on our view of the entity'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 society in the event of financial distress. We also continue to view SFIL's subsidiary, French covered bond issuer Caisse Francaise de Financement Local (Caffil), as a core entity of the SFIL group.

We consider that SFIL executes strategic government policies, and 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 find 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 its tight supervision; and
- Critical role for France as the first lender to French LRGs and public hospitals and the main liquidity provider of refinancing for export credit guarantees extended by the central government, with about 30% and 40% market shares, respectively. The European Commission (EC) has recognized SFIL as a development bank, in light with the EC's acknowledgment of a structural market failure in the financing of LRGs in France. Financial access for LRGs is key, given that they account for close to about 70% of total civil public investments in the country. These investments are crucial for the maintenance and development of infrastructure in France and the support of the national economy. Similarly, the export mission has also been validated by the EC, recognizing that SFIL responds to market failures and confirming that private institutions do not provide these services to a sufficient extent.

SFIL plays a key role in France's economic strategy as the first lender to LRGs and public hospitals. The entity was created in 2013 to provide the French LRG sector with stable and continued access to long-term funding. The bank's primary mission, therefore, is to refinance new loan production generated by partner La Banque Postale (LBP) for French LRGs, and for public health institutions. Since its creation, SFIL has granted €42.6 billion loans to French LRGs and €5.7 billion to French hospitals. In 2023, the society's market share in LRGs and the public hospitals financing segments reached 33% and 26%, respectively. Despite still-elevated inflation and high interest rates slowing investment activity, lending activity to French LRGs remained resilient with new loans totaling €4 billion (up 15% from 2022). We expect lending activity to French public sector to increase further amid the expected easing in lending conditions and accelerated execution of investments. With respect to the public hospitals, France's €19 billion investment plan (the "Segur Plan de la Sante") for public hospitals will likely lead to a new investment cycle for which the bank is well positioned to benefit from as the leading lender to French hospitals.

In 2023, SFIL also further extended scope of its activities through its new partnership with Banque des Territoires (BDT). Similar to the partnership with LBP, Sfil refinances new fixed-rate loans from BDT. This partnership allows Sfil to complement loan origination by LBP while keeping a strong focus on green projects that French LRGs initiate. About €200 million worth of loans were granted in 2023 and management expects an additional €500 of million loans per year. Overall, we think the resilient 2023 financial results and the new partnership with BDT have strengthened SFIL's position among the various public-sector banks operating within the CDC, reflecting the bank's relevance for the state.

SFIL remains the leading liquidity provider for large export contracts with a 40% market share and a total refinancing volume of €16.1 billion as of Dec. 31, 2023. Last year, the adverse geopolitical impact, tightening of financing conditions, and deteriorating economy have reinforced this business line's attractiveness and relevance. In this context, SFIL's export credit refinancing activity hit record highs in 2023 with six contracts signed for €5 billion (compared with two contracts and €700 million, respectively, in 2022). The expected strong rebound in naval construction sector, increase in defense spending worldwide, construction of nuclear power plants, and investment related to environmental rules and the energy transition will likely support demand for export credit.

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 (37.5% at year-end 2023) compared with commercial banks. This is also well above the minimum requirement of 7.92% set by the European supervisor for development banks as part of the Supervisory Review and Evaluation Process. It remains to be seen how Basel III's output floor implementation will affect SFIL, but we expect the effect to be manageable because current capital ratios provide a significant buffer. On top of that, low-risk lending, issued to or guaranteed by public authorities, dominates the asset base. At Dec. 31, 2023, nonperforming exposures stood at an all-time low of 0.2% of assets.

SFIL bases its business model on its capacity to access funding at very low cost, given its structurally low asset margins. The bank 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. The group aims to issue programs about €9 billion per year from 2024-2028, of which 25% of bonds issued in 2024 and 33% by 2030 are planned to be labelled green, social, and sustainable. 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 at the European Central Bank. We think that SFIL will continue to benefit from a robust liquidity position, and do not expect margins to come significantly under pressure in the coming 12-24 months.

SFIL's profitability strengthened again in 2023. Despite still-elevated inflation, the bank also decreased its operating expense from 2022 levels, illustrating a tight control of general and administrative costs. Margins were broadly stable due to the structure of SFIL's business, but the bank recorded the lowest cost of risk since its creation, leading recurring net income to increase to €65 million.

Environmental, Social, And Governance

SFIL's mission makes environmental, social and governance (ESG) factors an integral part of both its internal and external strategy. Four of the six transactions in credit exports in 2023 directly contributed to one of the sustainability development goals. On the public sector side, green and social loans accounted for 43% of production (up from 37% in 2022). We think SFIL's

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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.

We understand the bank wants to actively take part to the decarbonization effort, mobilizing €17.5 billion in green loans over 2024-2030. Also, SFIL offers thematic loans since October 2022 that are distributed to French LRGs through LBP to finance thematic such as health, sport, culture, development, and territorial cohesion. To align with France's National Low Carbon Strategy, the bank is also committed to reduce by 40% the monetary intensity of its financing to 92 grams of carbon dioxide-equivalent per euro for scopes 1, 2, and 3 (upstream and downstream) by 2030.

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

- France Long-Term Rating Lowered To 'AA-' From 'AA' On Deterioration Of Budgetary Position; Outlook Stable, May 31, 2024
- Caisse des Depots et des Consignations, March 28, 2024

Ratings Detail (as of July 17, 2024)*

SFIL	
Issuer Credit Rating	AA-/Stable/A-1+
Commercial Paper	
<i>Local Currency</i>	A-1+
Senior Unsecured	AA-
Issuer Credit Ratings History	
04-Jun-2024	AA-/Stable/A-1+
06-Dec-2022	AA/Negative/A-1+
25-Oct-2016	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.

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