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Financiera de Desarrollo Territorial S.A. FINDETER

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Financiera de Desarrollo Territorial S.A. FINDETER

SACP	bb+
Support	+1
Additional Factors	0

Anchor	bb+	
Business Position	Adequate	0
Capital and Earnings	Strong	+1
Risk Position	Adequate	0
Funding	Below Average	-1
Liquidity	Adequate	

ALAC Support	0
GRE Support	+1
Group Support	0
Sovereign Support	0

Issuer Credit Rating

BBB-/Stable/A-3

Major Rating Factors

Strengths:	Weaknesses:
• Colombia-based development bank Financiera de Desarrollo Territorial S.A. (Findeter) is among the largest development banks in Colombia and has solid business stability; • Aligned to major government policies, eliciting a very high likelihood of government support; and • High-quality loan portfolio reflected in historically minimal credit losses.	• Limited funding diversification compared to the Colombian banking system; • High concentration by client in its loan portfolio due to its operations as a rediscount bank; and • Modest credit growth this year due to challenging economic conditions.

Outlook: Stable

The stable outlook on Findeter for the next 24 months reflects that on Colombia. Our ratings on Findeter reflect our current assessment of a very high likelihood of extraordinary government support--along with the bank's stand-alone credit profile (SACP).

Downside scenario

We could lower the ratings on Findeter if we reassess the likelihood of government support to a weaker category or if its SACP significantly worsens (by three or more notches); however, we consider this scenario highly improbable in the next 24 months.

Upside scenario

An upgrade of Colombia would result in a similar rating action on Findeter if our assessment of its extraordinary government support and its SACP remain unchanged.

Rationale

The issuer credit ratings on Findeter reflect our assessment of a very high likelihood of extraordinary government support based on the bank's very important role in the development of sustainable urban infrastructure aimed at promoting Colombia's regional and urban progress. We base the bank's SACP on its business position as one of the largest development banks in Colombia. The ratings also reflect the strong commitment from the government to keep the bank well-capitalized through its full-recapitalization policy, with a projected risk-adjusted capital (RAC) ratio averaging 13.2% for the next 24 months. The relatively high credit quality of Findeter's direct customers, reflected in its sound asset quality metrics, offset high-risk client concentrations. In addition, Findeter has a less diversified funding structure than the average of the Colombian banking system due to its second tier bank status, mainly consisting of wholesale funding instruments that we consider less stable than retail deposits. We also believe that ongoing government support, its long-term credit facilities, and robust market demand for its term deposit certificates will allow Findeter to rollover its upcoming debt maturities and meet its liquidity needs in the following 24 months.

Anchor: 'bb+' for banks operating in Colombia

Our bank criteria use our Banking Industry Country Risk Assessment (BICRA) economic and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. The anchor for banks operating only in Colombia is 'bb+'.

After growing slightly more than 14% in 2014 and 2015, credit expansion in Colombia slowed to 7.6% in 2016 and 6.2% in 2017. This trend is strongly correlated with the country's economic performance. Political uncertainty has diminished following Ivan Duque's presidential election victory this year. Therefore, we expect business confidence and economic activity in Colombia to pick up, resulting in higher credit demand. We project real GDP growth at 2.5% in 2018 and to average 2.7% during 2019-2021. Thus, we estimate that lending will expand by around 7.0% this year and 8.0%-8.5% in 2019. Starting in 2018, the tax reform of 2016 will gradually reduce the corporate income tax rate to enhance competitiveness, which could bolster credit demand among the corporate and commercial sectors. We expect the banking sector's non-performing assets (NPAs) to total loans to stabilize at around 3.5% by the end of this year and improve to around 3.0% in 2019 and 2020. In particular, consumer loans' performance will benefit from households' improving income capacity amid lower inflation and interest rates. In addition, the new loan restructuring practices will help improve asset quality thanks to early and greater surveillance of modified loans. In our view, stronger economic performance and increasing credit demand will improve asset quality.

Healthy competitive dynamics in Colombia's banking system, with moderate risk appetite and absence of market distortions, currently support the industry risk. The improving regulatory framework--including the recently approved conglomerates law, the introduction of standardized loan restructuring rules, and the expected adoption of Basel III capitalization rules--will strengthen the Colombian banking authority's capacity to address problems at earlier stages, ensuring that banks take corrective actions. Nevertheless, Colombia's financial system remains heavily dependent on wholesale funding, which we consider less stable during times of economic and market distress. This dependency is due to the low share (about 25%) of retail deposits in commercial banks' total deposits. However, the domestic debt capital market has mitigated this weakness because it has proven to be moderately broad and deep, allowing investment- and speculative-grade entities to access funds with medium- to long-term maturities. In our view, capitalization remains the main regulatory challenge for Colombia's financial institutions, but the potential implementation of Basel III capitalization rules could remove this risk.

Table 1

Financiera de Desarrollo Territorial S.A. FINDETER Key Figures					
		--Year-ended Dec. 31--			
(Mil. COP)	**2018***	**2017**	**2016**	**2015**	**2014**
Adjusted assets	9,590,710.0	9,435,651.2	8,910,843.7	7,938,073.6	7,454,600.7
Customer loans (gross)	8,645,845.0	8,357,330.1	7,901,291.5	6,876,117.0	6,015,332.1
Adjusted common equity	1,143,051.7	1,093,786.3	1,040,962.2	1,000,207.2	959,741.7
Operating revenues	194,260.9	283,249.3	264,584.4	224,334.8	160,551.6
Noninterest expenses	108,111.5	163,231.3	159,685.7	114,807.2	103,587.5
Core earnings	49,608.6	52,146.5	41,494.2	43,780.4	34,005.4

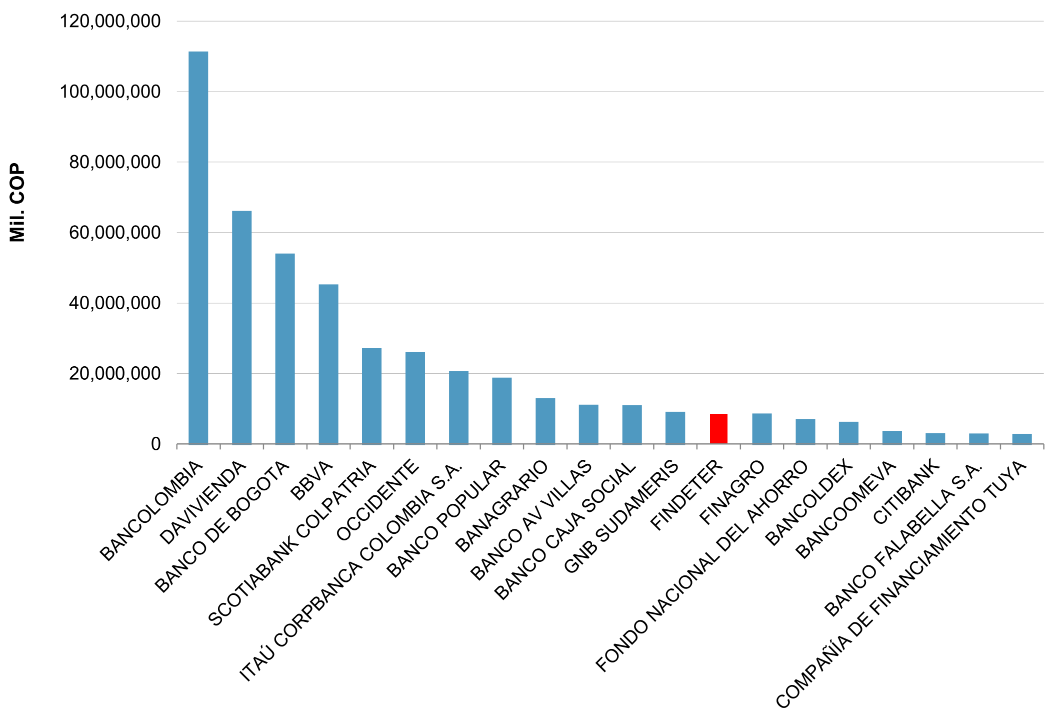
*Data as of Sept. 30. COP--Colombian peso.

Business position: Underpinned by leading position as a government arm in urban infrastructure

In our view, Findeter's business position benefits from its role as an arm of the government to promote sustainable infrastructure in Colombia. Its steady market share, its stable revenue stability in the past few years, and experienced management support our assessment. We also take into account the concentration of its operations in just a couple of revenue sources--technical assistance fees and second floor financing that are somewhat counterbalanced by its extensive regional coverage. As of Sept. 30, 2018, Findeter was one of the largest development banks in the country, with total assets ($3.2 billion) and total loans ($2.9 billion) representing market shares of 1.4% and 1.8%, respectively. However, it's currently the 13th-largest financial institution in Colombia in terms of total loan portfolio. Although sluggish economic conditions and a presidential election year took their toll on the bank's growth, we consider it will keep its key position in the urban infrastructure sector and second floor-lending segment, which should preserve its business stability in upcoming years.

Chart 1

Findeter's Share Of Total Loans In Colombia



Source: Superintendencia Financiera de Colombia.

Table 2

Financiera de Desarrollo Territorial S.A. FINDETER Business Position

		--Year-ended Dec. 31--			
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Total revenues from business line (currency in millions)	194,260.9	283,249.3	264,584.4	224,334.8	160,551.6
Commercial & retail banking/total revenues from business line	99.8	108.1	106.7	291.2	64.8
Trading and sales income/total revenues from business line	(10.0)	(15.2)	(19.4)	(222.6)	(23.9)
Other revenues/total revenues from business line	10.3	7.1	12.7	31.5	59.0
Investment banking/total revenues from business line	(10.0)	(15.2)	(19.4)	(222.6)	(23.9)
Return on average common equity	6.0	4.9	4.1	4.5	N/A

*Data as of Sept. 30. N/A--Not applicable.

Capital and earnings: Projected RAC ratio of 13.2% for 2019 and 2020

We still think Findeter's capital and earnings is its main credit strength, and our assessment reflects our projected RAC ratio of 13.2%, on average, for the next two years with high quality of capital. The bank's profitability is below the banking system's average, since that's not its main purpose. However, we expect the bank will remain self-sustainable through its internal capital generation in the long term. Our assessment also reflects the government's commitment to keep the bank well capitalized through its full recapitalization policy. We don't assign capital content to the bank's subordinated capital instrument because in our view, this instrument doesn't have the characteristics necessary to absorb losses on a going-concern basis. Moreover, the residual life of the instrument is below our parameters for instruments with intermediate capital content. Our financial forecasts for the next two years incorporate the following assumptions:

- Loan portfolio growth averaging 6% for 2019 and 2020.
- The bank's outstanding asset quality metrics to remain stable, with non-performing assets (NPAs) below 0.5%, on average, during the next 24 months with no charge-offs.
- Non-interest expense growth around 4% on average for the next couple of years, slightly above our expected inflation forecast.
- Efficiency levels--measured as non-interest expenses to operating revenues--around 60%, in line with 2018 levels.
- We expect return on assets (ROA) to average around 0.5% for the next two years.
- By law, there are no dividend payments. Findeter will reinvest all net income.

Table 3

Financiera de Desarrollo Territorial S.A. FINDETER Capital And Earnings

		--Year-ended Dec. 31--			
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Tier 1 capital ratio	19.6	18.5	10.8	12.1	13.2
S&P Global Ratings' RAC ratio before diversification	N/A	12.9	14.3	N/A	21.5
S&P Global Ratings' RAC ratio after diversification	N/A	8.8	9.8	N/A	16.4
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	66.9	67.3	75.4	48.4	67.6
Fee income/operating revenues	32.9	40.7	31.3	25.0	(2.8)
Market-sensitive income/operating revenues	(10.0)	(15.2)	(19.4)	(4.9)	(23.9)
Noninterest expenses/operating revenues	55.7	57.6	60.4	51.2	64.5
Preprovision operating income/average assets	1.2	1.3	1.2	1.4	N/A
Core earnings/average managed assets	0.7	0.6	0.5	0.6	N/A

*Data as of Sept. 30. N/A--Not applicable.

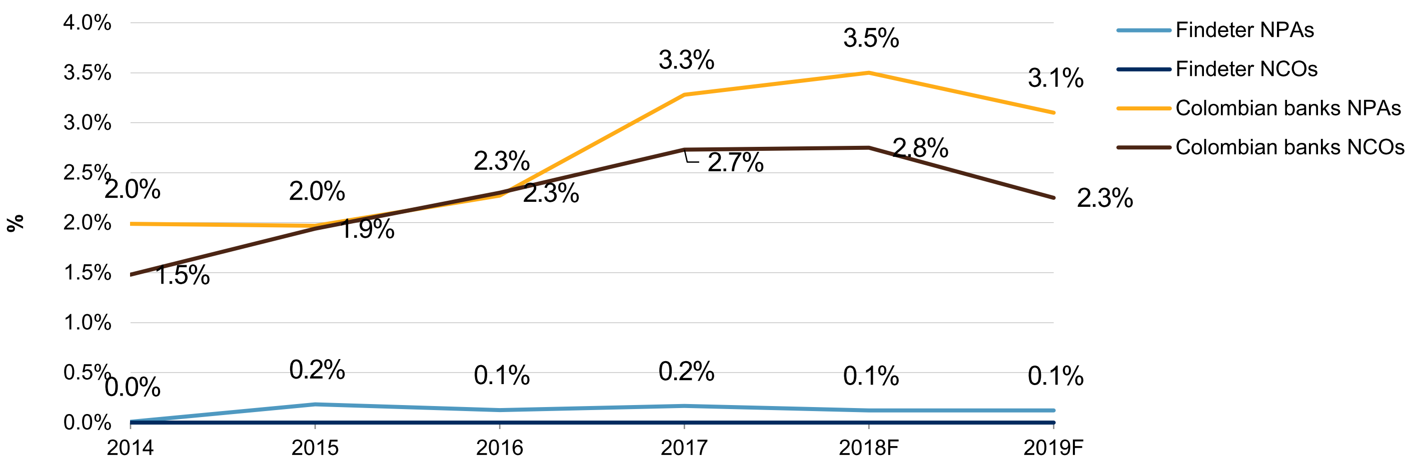
Risk position: High credit quality of clients reflected in minimum credit losses

We believe that Findeter's risk position reflects the bank's consistently sound asset quality metrics, with NPAs at 0.12% as of September 2018 and 0.17% as of Dec. 31, 2017 (0.16% on average during the past three years), and no charge-offs. We expect this trend to continue during the next two years based on the low risk profile of Findeter's main customers. As a second-floor bank, Findeter is mainly exposed to Colombian commercial banks (its top 20 customers represented 98.6% of its gross customer loans as of Sept. 30, 2018, similar to previous years). The bank also has minimal exposure to nonregulated entities (less than 1%). Findeter also has an automatic charge mechanism to financial institutions through the central bank in case these banks' credit quality worsens. These characteristics mitigate the high-risk concentrations of its loan portfolio. The bank's conservative policies have protected its balance sheet from foreign exchange exposures by hedging derivatives. Nevertheless, in our opinion the bank remains relatively exposed to interest rate movements due to a duration gap between its assets and liabilities of 1.5 years.

However, we note that the defined terms of its funding somewhat reduce the repricing risk.

Chart 2

Findeter's Asset Quality Versus Banking System Average



F--Forecast.

Table 4

Financiera de Desarrollo Territorial S.A. FINDETER Risk Position

		--Year-ended Dec. 31--			
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Growth in customer loans	4.6	5.8	14.9	14.3	N.M.
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	47.5	45.6	N/A	31.2
Total managed assets/adjusted common equity (x)	8.4	8.6	8.6	7.9	7.8
New loan loss provisions/average customer loans	0.2	0.3	0.3	1.0	N/A
Net charge-offs/average customer loans	N.M.	N.M.	0.0	N.M.	N.M.
Gross nonperforming assets/customer loans + other real estate owned	0.1	0.2	0.1	0.2	0.0
Loan loss reserves/gross nonperforming assets	720.5	580.1	668.9	507.7	12,822.3

*Data as of Sept. 30. N/A--Not applicable. N.M.--Not meaningful.

Funding and liquidity: Structure remains concentrated in term deposits

We base Findeter's funding assessment on its concentrated funding structure compared with other banks in Colombia due to its second tier bank status and the additional financial flexibility that comes with being a government-related entity. Findeter's funding structure is mainly composed of wholesale funding instruments. We believe the bank has gradually improved its funding stability and diversification, but these still compare below the average of the Colombian banking system. Findeter's stable funding ratio was 91% as of Sept. 30, 2018, compared to the system's 105% as of the same date. Findeter's funding structure consists of debt issuances (64%; term deposit certificate: CDTs [Certificados de depósito a termino]) in the local market, credit facilities from commercial and multilateral banks (23%), and bond issuances (14%). We don't expect the funding mix to have significant changes in the next few years. Our forecast includes the issuance of the proposed COP400 billion sustainable bond in the local market.

Even though the bank's broad liquid assets don't fully cover its short-term wholesale funding, we predict that Findeter will be able to meet all its short-term financial obligations since it has historically maintained prudent liquidity policies and management. We also believe that the bank benefits from ongoing support from the government and access to liquidity operations with the central bank. A broad variety of long-term credit facilities support its liquidity sources, and we also consider that the robust market demand for its term deposit certificates will allow Findeter to rollover its upcoming debt maturities and pay its short-term obligation in the next couple of years.

Chart 3

Findeter's Funding Structure

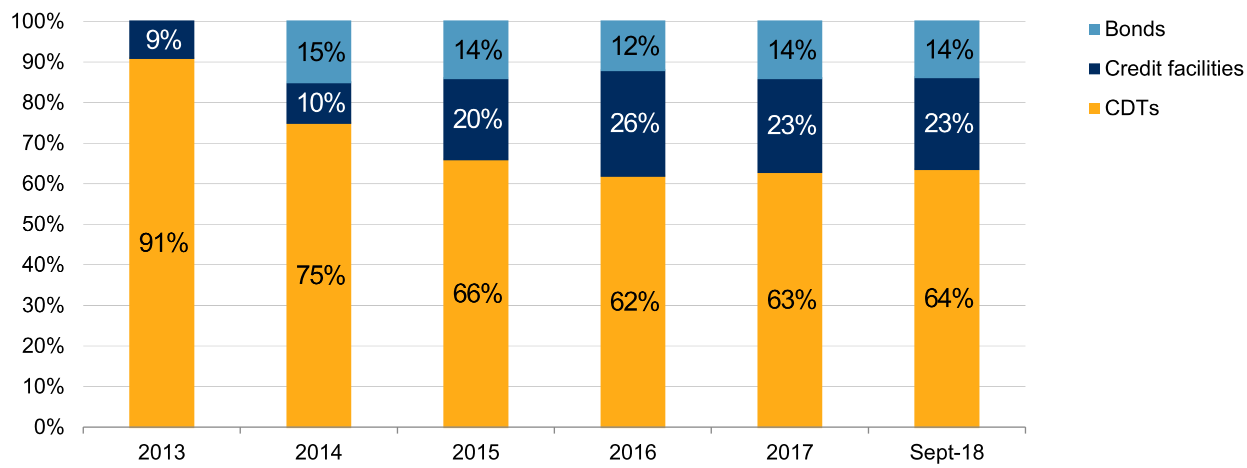


Table 5

Financiera de Desarrollo Territorial S.A. FINDETER Funding And Liquidity

		--Year-ended Dec. 31--			
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Core deposits/funding base	63.6	62.4	61.7	66.7	87.8
Customer loans (net)/customer deposits	161.5	161.3	163.6	151.2	125.7
Long-term funding ratio	85.0	96.8	87.8	82.7	83.4
Stable funding ratio	90.7	105.2	95.4	90.8	85.4
Short-term wholesale funding/funding base	17.0	3.6	13.8	19.9	19.5
Broad liquid assets/short-term wholesale funding (x)	0.5	3.0	0.8	0.6	1.2
Short-term wholesale funding/total wholesale funding	46.8	9.7	36.0	59.7	159.9

*Data as of Sept. 30.

Related Criteria

- 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
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015

Anchor Matrix

Industry Risk	Economic Risk									
	1	2	3	4	5	6	**7**	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	**bb+**	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of December 21, 2018)

Financiera de Desarrollo Territorial S.A. FINDETER	
Issuer Credit Rating	BBB-/Stable/A-3
Senior Unsecured	BBB-
Issuer Credit Ratings History	
12-Dec-2017	BBB-/Stable/A-3
17-Feb-2016	BBB/Negative/A-2
15-May-2014	BBB/Stable/A-2
Sovereign Rating	
Colombia	
Foreign Currency	BBB-/Stable/A-3
Local Currency	BBB/Stable/A-2

Ratings Detail (As Of December 21, 2018) (cont.)

*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.