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Research Update:

Financiera de Desarrollo Territorial S.A. FINDETER 'BBB/A-2' Ratings Affirmed, Outlook Still Negative

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Financiera de Desarrollo Territorial S.A. FINDETER 'BBB/A-2' Ratings Affirmed, Outlook Still Negative

Overview

- We're affirming our 'BBB/A-2' issuer credit and 'BBB' issue-level ratings on Findeter.
- We lowered our stand-alone credit profile (SACP) on Colombia-based development bank Findeter to 'bb+' from 'bbb-' following our revision of our capital and earnings assessment on it to strong from very strong. This stemmed from a weaker risk-adjusted capitalization that we expect to remain so amid expected loan growth in 2016 and 2017.
- Our ratings reflect our view of a very high likelihood of extraordinary government support to Findeter due to its government-related entity (GRE) status.
- The negative outlook on the bank reflects that on Colombia.

Rating Action

On March 31, 2016, Standard & Poor's Ratings Services affirmed its 'BBB' long- and 'A-2' short-term foreign and local currency issuer credit ratings (ICR) on Financiera de Desarrollo Territorial S.A. FINDETER (Findeter). We also affirmed our 'BBB' issue-level rating on the bank's $500 million fixed-rate senior unsecured notes due 2024, or its equivalent in Colombian pesos. The outlook remains negative.

Rationale

The ICRs on Findeter reflect its adequate business position, as one of the largest development banks in the country, and its strong capital and earnings based on our projected risk-adjusted capital (RAC) ratio of 13%-14% for the next 12-24 months thanks to its internal capital generation. The ratings also incorporate our assessment of the bank's adequate risk position with sound asset quality metrics that offset risk concentrations, and our view of its below-average funding and adequate liquidity. We lowered Findeter's SACP to 'bb+' from 'bbb-'.

Our ratings on the bank continue to reflect our view of a very high likelihood of extraordinary government support thanks to Findeter's GRE status, given our assessment of its characteristics:

- Very strong link with the government, which currently owns 92.5% of the bank and will continue to exert a strong influence on it. We expect the government to remain Findeter's main shareholder.

- Very important role in Colombia's economic development strategy, providing financial and technical support to public and private entities involved in development of sustainable infrastructure, mainly transportation, housing, energy, technology, innovation, healthcare, and education.

Our bank criteria use our Banking Industry Country Risk Assessment's (BICRA) economic risk 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+'.

Our economic risk assessment of Colombia reflects its slowing economy and a deterioration in the country's trade balance, which is mainly due to the low prices of oil and coal. We believe that Colombia's external debt and liability position will weaken further amid reliance on higher debt financing during the next two years to partly cover the widening current account deficit. As a result, higher economic imbalances risks, in our view, would pressure Colombia's financial institutions. Moreover, low-income household levels, along with a potentially rapid credit expansion, could raise credit risk in the economy. Peso's depreciation, inflation, and the impact of low oil prices on the domestic economy could further pressure household income capacity. Given lower global commodity prices, we estimate that Colombia's GDP growth slowed to 2.9% in 2015 and will likely be 2.6% in 2016 and 3.3% in 2017, down from 4.5% in 2014. We believe that slowing economy could act as a drag on domestic credit growth. Overall, we expect total loans to grow 13%-14% in 2016 and about 15% by the end of 2017, compared with the compound annual growth rate (CAGR) of 20% for the past six years.

Moderate risk appetite in the Colombian banking sector supports our industry risk assessment. In our view, there are no major distortions in the domestic financial system. Core deposits have proven stable even during periods of market turmoil; however, lending is expanding at a faster pace than total deposits in the system, and the share of retail deposits as a percentage of total deposits remains low. The latter could increase risks to the financial system because of greater dependence on wholesale funding sources, which we consider less stable during times of economic and market distress. Moreover, despite recent regulatory changes to strengthen the system's capitalization, we still believe there is room for improvement. However, transparency in Colombia's financial system is, in general, greater than those of its regional peers.

The trend in the economic risk remains stable. This is because the negative outlook on Colombia reflects risks that its external position could deteriorate further. However, we consider that our economic risk assessment already reflects a moderate vulnerability in terms of current account imbalances, which influence financial institutions. In addition, we consider Colombia's economic resilience (income levels, growth prospects, and economic diversity) should remain stable during the next 12 months. The higher economic risk score in Colombia's BICRA already captures a potential deterioration in credit risk, as a result of the increasing economic imbalances.

We continue to assess Findeter's business position as adequate, reflecting its leading position as a government agent in promoting sustainable infrastructure in Colombia. As of Dec. 31, 2015, Findeter was the largest development bank in the country in terms of total assets ($2.5 billion) and by total loans ($2.1 billion), representing market shares of 1.5% and 3.03%, respectively. Findeter is the 14th-largest financial institution in Colombia in terms of total assets. Its loan portfolio increased by 13.8% in 2015, with a CAGR of 4% for the past three years, and we expect a similar pace for the next two years. Findeter mainly lends to other Colombian financial institutions (mostly top commercial banks), which mitigate the risk of a narrower borrower base than those of other Colombian banks. Findeter's portfolio mainly consists of commercial loans granted to regulated financial institutions, which represent 86% of its total assets. We don't expect major changes in Findeter's portfolio mix during the next two years.

We revised our capital and earnings assessment on Findeter to strong from very strong, reflecting our average projected RAC ratio of 13.5%-14.5% during 2016 and 2017. Our financial forecasts for the next two years incorporate the following assumptions:

- Colombia's GDP growth is likely to be around 2.6% in 2016 and 3.3% in 2017;
- An average loan portfolio growth of 10% for 2016 and 2017 and our estimates of risk-weighted assets increasing at a similar rate;
- The bank's outstanding asset quality metrics to keep relieving pressure on its profitability and capitalization levels;
- Credit loss provisions would represent around 30% of operating revenues during the next two years;
- Return on assets of about 0.35% for the next two years; and
- By law, there are no dividend payments, so all net income will be capitalized.

Findeter's capital structure has remained stable during the past five years. Its equity mainly consists of paid-in capital and retained earnings. The bank doesn't have any hybrid instruments in its capital base. However, profitability levels are modest, limiting its internal capital generation.

We consider Findeter's risk position as adequate. This assessment reflects the bank's consistently healthy asset quality metrics with no nonperforming assets or charge-offs in 2015, and we expect this trend to continue during the next 12-18 months. The bank is exposed mainly to Colombian commercial banks, with a modest exposure to nonregulated entities. In our opinion, the bank's lending to regulated financial institutions mitigates the high risk of a concentrated loan portfolio. As of Dec. 31, 2015, the bank's top 20 loans represent 98% of its gross customer loans, similar to the 2014 level. In addition, this risk concentration is mitigated by the automatic charge mechanism to the financial institutions through the central bank, which has resulted in high quality of assets. If we consider Findeter's exposure to final beneficiaries, its concentration metric would drop to 18%. Its asset-liability management is adequately monitored and matched.

Findeter's overall funding and liquidity assessment is moderate, based on the bank's below-average funding and adequate liquidity. Even though the bank doesn't have a retail deposit base, we believe that its GRE status provides flexibility in terms of financing. This is reflected in the strong demand for Findeter's funding instruments--bond issuances, term deposits, and securitizations--its ability to rollover debt, and attractive and competitive interest rates. The bank's GRE status also gives access to long- and short-term credit facilities from various domestic and international multilateral banks including the Inter-American Development Bank (AAA/Stable/A-1+) and the Corporacion Andina de Fomento (AA-/Negative/A-1+). Findeter's funding structure consists of debt issuances (66%) in the local capital market, credit lines from multilateral agencies (20%), and international bond issuances (14%). As of December 2015, its stable funding ratio was 89.5% with a three-year average of 86.9%, which is slightly below the industry's average.

The bank is trying to increase the share of peso-denominated funding to keep its balance sheet hedged. Bond issuances also helped match its loan terms.

The bank has historically maintained prudent liquidity policies and adequate liquidity levels to meet its short-term obligations. As of December 2015, its broad liquid assets covered its short-term wholesale funding by 1.8x, and averaged 3.79x for the past three years. This ratio has been historically above 1x. The GRE status allows Findeter to roll-over its short-term obligations with lower refinancing risk than private commercial banks.

Outlook

The negative outlook on Findeter is based on our outlook on Colombia. Our ratings on the bank incorporate two notches of government support from its GRE status, which results in a very high likelihood of support given the bank's very important role and very strong link to the government. The combination of s bank's 'bb+' SACP and 'BBB+' local currency sovereign rating results in a 'BBB' credit rating on Findeter, a two-notch uplift from the SACP. We don't expect the bank's GRE status to change during the next two years.

Downside scenario

We could lower the ratings on Findeter following a similar rating action on Colombia's local currency rating, if the peace negotiations with the country's main guerilla group flounder or political developments weaken the government's ability to adjust fiscal policy via a combination of spending and revenue measures. If, contrary to our expectations, the peace process suffers marked setbacks, the government may find it more challenging to take timely and adequate fiscal steps, especially in a context of a decelerating economy. Under such a scenario, the government's debt burden would rise and would likely further erode Colombia's weakened external profile, resulting in a downgrade.

Upside scenario

An upgrade of Findeter is possible following a similar action on the sovereign if, in line with our base case, the peace process advances, facilitating the government's ability to bolster fiscal prospects with a combination of spending cuts and increased revenues. In addition, successful implementation of investment projects associated with the government's "4G" infrastructure program would help maintain GDP growth, partly compensating for the negative impact of low commodity prices, contributing to economic stability and fiscal revenues.

Ratings Score Snapshot

Issuer Credit Rating	BBB/Negative/A-2
SACP	bb+
Anchor	bb+
Business Position	Adequate (0)
Capital and Earnings	Strong (+1)
Risk Position	Adequate (0)
Funding and Liquidity	Below average and adequate (-1)
Support	0
GRE Support	2
Group Support	0
Sovereign Support	0
Additional Factors	0

Related Criteria And Research

Related Criteria

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

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Ratings Affirmed

Financiera de Desarrollo Territorial S.A. FINDETER	
Counterparty Credit Rating	BBB/Negative/A-2
Senior Unsecured	BBB

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. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.