

LOCAL AUTHORITY CAPACITY BUILDING: BUDGETING AND GOOD GOVERNANCE FOR SUSTAINABLE DEVELOPMENT.

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FRENCH LOCAL GOVERNMENT AND DEXIA CREDIT LOCAL'S HISTORY :

**An example of close and effective interaction
between Local Governments and Financial
Institutions in the Capacity Building process.**

DEXIA – A STRONG FOCUS ON PUBLIC AND STRUCTURED FINANCE.

Dexia was born in 1996 of the union of two financial institutions, each leader on the Public Finance Market and with a long history in their respective countries.

Dexia is a world leader in public and project financial services to local governments.

- **17% market share in Europe**
- **25% market share in the USA**

DEXIA WORLD LEADER IN PUBLIC FINANCE

Balance Sheet

(13th ranking among European Banks)

► EUR 350 billion

Public Finance Outstanding (2003)

► EUR 150 billion

FSA Municipal Insured Portfolio

► USD 137.2 billion

Listed on the Euronext 100, CAC 40, BEL 20

RATINGS

Dexia Municipal Agency

AAA / Aaa / AAA

Financial Security Assurance

AAA / Aaa / AAA

Dexia Group

AA/Aa2/AA+



DEXIA – IN THE LOCAL PUBLIC FINANCE MARKET

Liability Driven

Asset Driven

Intermediated

Domestic Savings
Banks

Dexia Bank

L.T. lending
institutions

Dexia Crédit Local

Disintermediated

DEXIA

Dexia Public Capital Markets

Arrangers

Bond
Insurers

Investors



DEXIA

Dexia Municipal Agency
Dexia Hypothekbank Berlin
Dexia Crediop
...

DEXIA

1945 – MID 80'S: RECONSTRUCTION AND THE PRE-DECENTRALISATION PERIOD

- ❑ French local governments have limited powers and even more limited capacity.
 - ❑ Access to basic services is low and Increasing civil society demand/pressure for more housing and better services.
 - ❑ Local infrastructure is financed on a subsidized basis through State grants, Soft loans originated directly by the Ministry of Finance, Additionally, low rate/long term loans from a public financial institution (Caisse des Dépôts et Consignations)
 - ❑ This leads to discretionary and (somewhat) politicized resource allocation.
 - ❑ In 1966, CDC establishes Caisse d'Aide à l'Equipement des Collectivités Locale (CAECL), a public financial institution which raises funds in the financial market (with an implicit State guarantee) to on-lend to local governments. (Rate) subsidies remain.
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- Lesson 1: When local governments are weak, they don't (may not) ask for much. When local governments don't do much, they remain weak... Where do you break the cycle? Local Participation.
 - Lesson 2: A financial intermediary won't create a financial market where there is none!

DECENTRALISATION AND CONSOLIDATION PROCESS

- ❑ Local governments gain in institutional autonomy and taxation power with the 1982 decentralization reform. More targeted Central Grant system.
- ❑ Local governments become more efficient in service delivery and more mature in their investment choices.
- ❑ Central Government lending programs are outpaced by growing demand for L/T financing to meet new investments in decentralized sectors.
- ❑ In 1987, CAECL gives way to Credit Local de France (CLF), a private bank 51% owned by the State (through Min Fin and CDC).
- **Lesson 3: A public financial intermediary can turn very creative when it is at risk of becoming irrelevant.**
- ❑ Early 90's: Dynamism of the local sector's market and prospect of the Euro market attracts commercial banks, from France and other countries.
- ❑ A turmoil period reminds commercial banks of the specificity of LG financing this leads to a (relative) contraction of supply.
- ❑ However, the financial autonomy of local governments remains constrained by tax administration and cash management regulations.
- **Lesson 4: There is a role for a specialized private intermediary in reaching LG's small and large.**

FINANCING THE SUB SOVEREIGN LEVEL = RISK ASSESSMENT

Major obstacles in analyzing the risk on sub-sovereigns and of infrastructure projects at the sub sovereign level:

- Revenues predictability = fiscal allocation is not always in line with the decentralization of responsibilities. Local governments may rely on central government tax sharing and transfers. Revenues do not always have the long term predictability required for long term planning and commitment.
- Long term stability of the legal and administrative systems.
- Transparency = besides the accounts, budgets and financials of the local authority itself, a precise assessment of its commitments regarding satellites is also needed (guarantees provided to municipal companies for instance...).

FINANCING TRENDS

- 1 - Evolution of the Loan Market**
- 2 - Access to Capital Markets products**
- 3 - Credit Enhancement**
- 4 - Mobilizing long term resources on Domestic Financial Markets**
- 5 - PF/ PFI / Public-Private-Partnerships (PPP)**

1) *INNOVATIVE LOANS LEADS TO ACTIVE DEBT MANAGEMENT: EXAMPLE WITHIN THE EU*

- ☐ **Before mid 90s, the loan market of EU public sector entities was an administrated market :**
 - fixed rates – standard maturities - plain vanilla loans
- ☐ **From mid 90s, new products have appeared in Western Europe:**
 - floating rates vs. fixed – longer maturities – revolving loans – structured products based on derivatives
- ☐ **And many local authorities have decided to manage their debt :**
 - Active debt management & debt restructuring
- ☐ **Same evolution is under way in Central and Eastern Europe, Asia still behind (except Japan)**

2) ***THE CAPITAL MARKETS OPTION***

❑ **International bond markets :**

○ **A deep market (2004, as of August, 31st) :**

- Sovereigns : 96 public bond issues / EUR 60 bn
- Sub-sovereigns : 32 public bond issues / EUR 6 bn

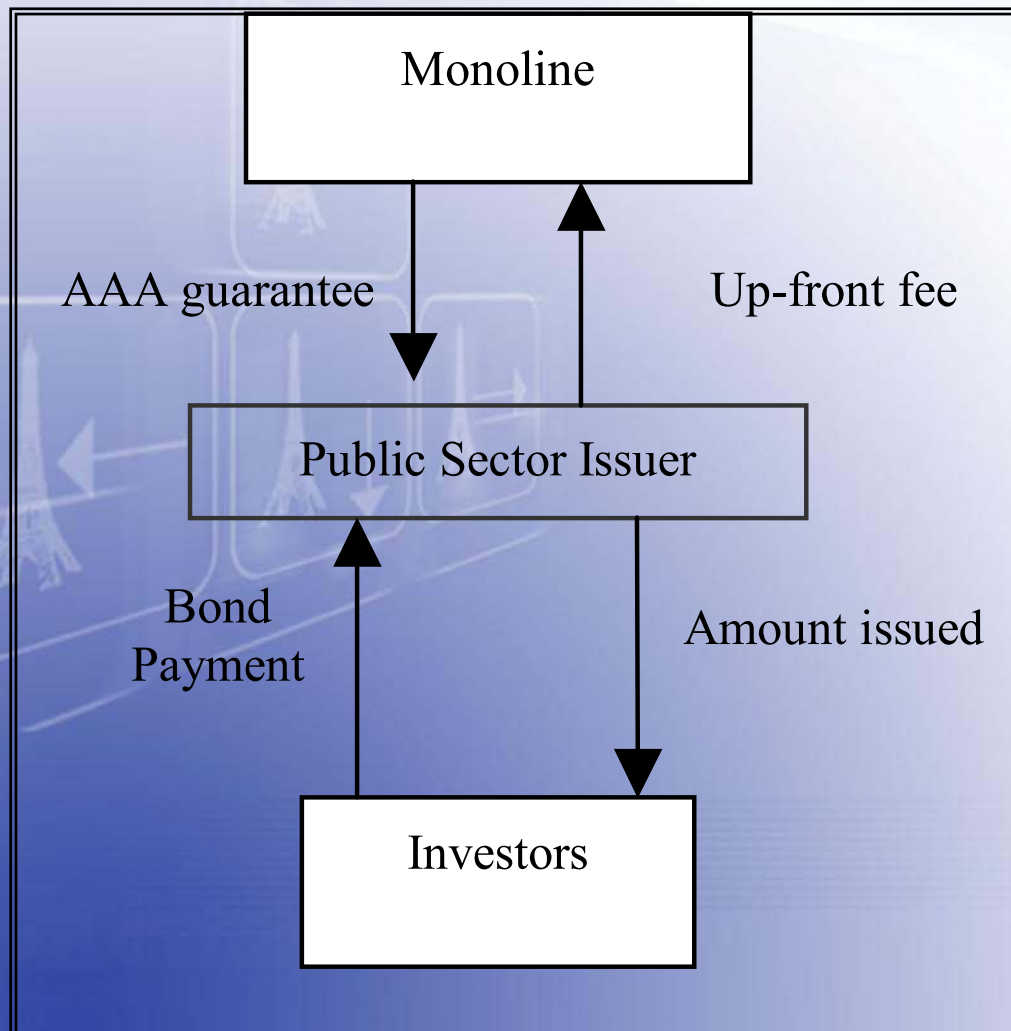
○ **With diversified products :**

- Public bond issues : plain vanilla / structured
- Euro Medium Term Notes programs
- Private placements – all currencies & maturities – fixed/floating rate

○ **Current trends:**

- Japan \approx €1,550Bn and USA \approx €1,350Bn
- Still only an option for major public issues in Europe

3) **CREDIT ENHANCEMENT PROVIDED BY A MONOLINE INSURANCE COMPANY ALLOWS PUBLIC SECTOR ISSUERS TO TAKE ADVANTAGE OF AN "AAA" RATING**

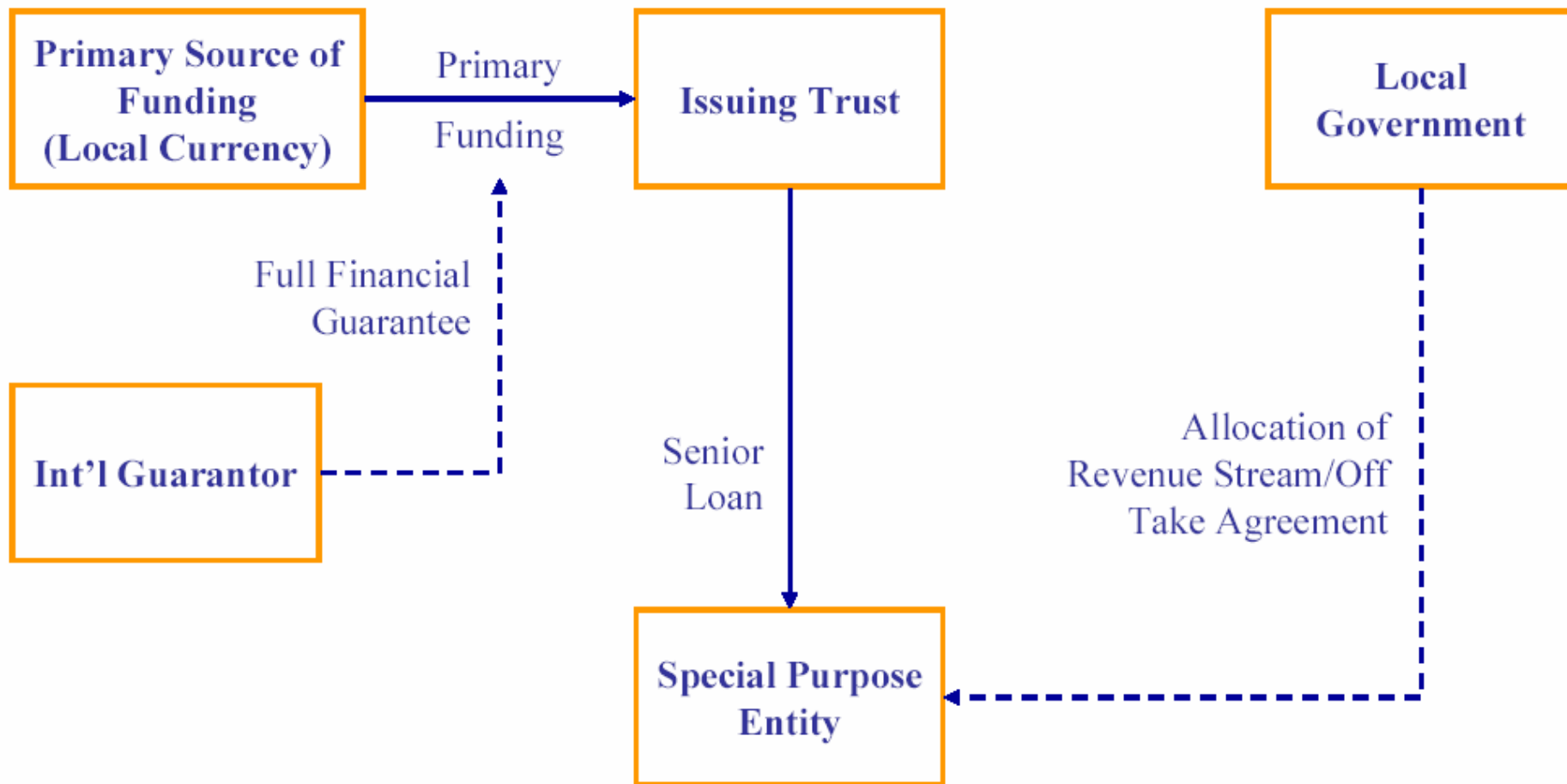


Advantages

- ⇒ Cost of funding optimisation
- ⇒ Sources of funding diversification due to new investor base

4) **MOBILIZING RESSOURCES ON DOMESTIC FINANCIAL MARKETS**

An Example of Adaptive Solution
Cross-Border Enhancement of Local Currency Financing



BENEFITS OF AN ENHANCED LOCAL CURRENCY FINANCING

- **Attract longer maturities in the local markets.**
- **Enhancement means low local funding margins (better than Sovereign?)**
- **Project risk and devaluation risk are de-linked.**
 - **Financing will not cause the project to fail.**
- **Guarantee is not exposed to devaluation risk:**
 - **if the project fails, the guarantee is exposed on a nominal amount denominated in local currency.**
- **On the macro-economic level: contributes to the development of a long term domestic Financial Market**

5) PF/PFI/PPP PROGRAMS HAVE SPREAD ACROSS THE WORLD OVER THE LAST YEARS.

- **Budgetary Constraints**
- **Optimisation of use of public funds: Value for Money**

But

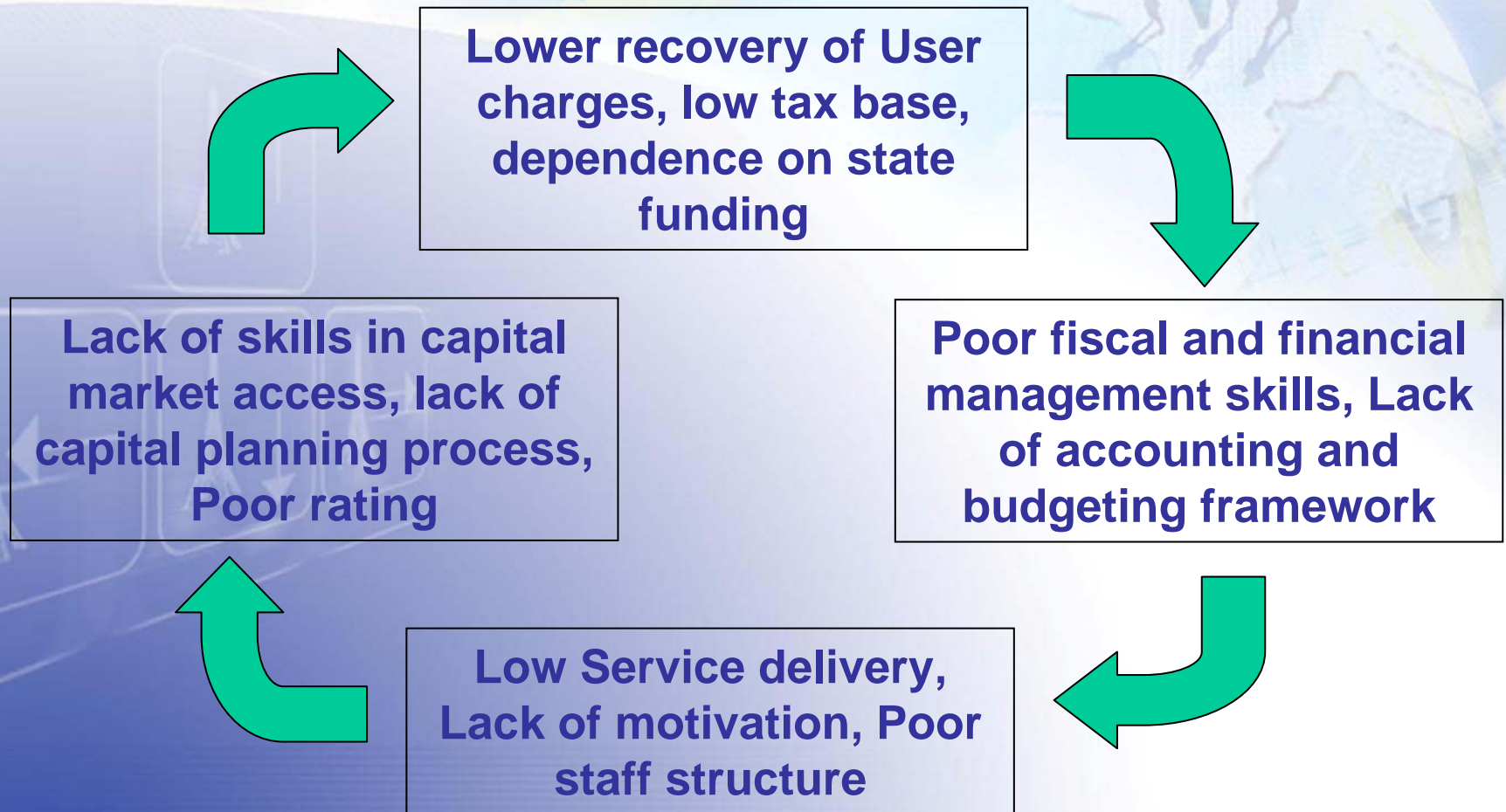
- **Slow and sometime painful learning curve for both the public and the private sectors**

The background is a light blue and white collage. It features a line graph with a green peak, a blue flag with a white 'E' symbol, a silhouette of a person holding a flag, and three small icons of the Eiffel Tower with arrows pointing left, down, and right respectively. The text 'CAPACITY BUILDING, LOCAL GOVERNANCE AND SUSTAINABLE DEVELOPMENT' is written in bold, yellow, italicized capital letters.

CAPACITY BUILDING, LOCAL GOVERNANCE AND SUSTAINABLE DEVELOPMENT

CONCLUSION.....

A VICIOUS CIRCLE TO BREAK ...



... BY ADDRESSING A LONG LIST OF ISSUES ...

- **Fiscal and Financial Reforms**
- **Municipal Financial Management**
- **Financial Control and Audit**
- **User Charges**
- **Capital Planning Process**
- **Debt Management Policy**
- **Human Resource Planning**
- **Training and Development**
- **Wider Information Dissemination**

Municipal Bond Issuance Process

- **Project Feasibility study**
- **Capital planning process**
- **Prepare for disclosure**
- **Decision to issue**
- **Credit Rating**
- **Formation of Bond Parties (Underwriter, Trustee, State government guarantee)**
- **Information Memorandum**
- **Approvals**
- **Issuance of bonds**
- **Listing**
- **Use of Funds and Follow Up**

... FOR A LARGE PANEL OF CLIENTS.

Market constituents

- × Municipalities
- × Regions
- × Social Housing Institutions
- × Health care institutions
- × Schools / universities
- × Charities

Clients' expectations

- × Funding
- × Long lasting relationship
- × Assistance to Financial/Budget management
- × Access to capital markets solutions
- × Optimisation of debt, and cost of debt
- × Public/Private partnership

Products

- × Long term Loans and Bonds
- × Short term facilities
- × Payment services
- × Asset management
- × Insurance services
- × Financial engineering/advisory services

THIS CAN ONLY BE A LONG TERM PROCESS

Capacity Building is a long term process that requires the support and the co-operation of:

- Central Governments**
- Multilateral Agencies**
- Commercial Financial Institutions**

Thank you and wishing you a Merry Xmas