



Credit Local

A Short History of Dexia's Long Journey from a Public Financial Institution to a Private Specialized Bank

*Financing Municipalities & Sub-National Governments
The Role of Specialized Local Funds and Financial Intermediaries*

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A Five Step Process

1. Post World War II Reconstruction
 - Weak local governments
 - Pressing needs for basic services
 2. The Pre-decentralization Period - Mid 60's to Late 70's
 - Erosion of the state controlled model
 - Rising tension between supply and demand
 3. The Decentralization Process: The 80's
 - Increasing maturity of local governments
 - Financial market reforms
 4. A Progressive Privatization and Consolidation Process: The 90's
 - There is room for a private specialized institution to intermediate for SNG's.
 5. A Quiet Revolution: Catching up with Financial Modernity to Reinforce our Core Mission
- Dexia Today

Post World War II Reconstruction

- French local governments have limited powers and even more limited capacity.
 - Access to basic services is low.
 - 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, the *Caisse des Dépôts et Consignations* (CDC), funded by the tax exempt savings of French households
 - This leads to discretionary and (somewhat) politicized resource allocation.
- **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.**

The Pre-decentralization Period – More of the Same

- Increasing civil society demand/pressure for more housing and better services.
 - Scarce budgetary resources to face increasing demand for L/T financing from the State.
 - CDC is asked by the Central Government to assign tax exempt savings to public housing in priority.
 - Rising gap between supply and demand of L/T funds.
 - Pressing needs for new financing instruments, but response limited by the (relative) inexistence of financial markets.
 - In 1966, CDC establishes *Caisse d'Aide à l'Équipement 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.
- **Lesson 2: A financial intermediary won't create a financial market where there is none!**

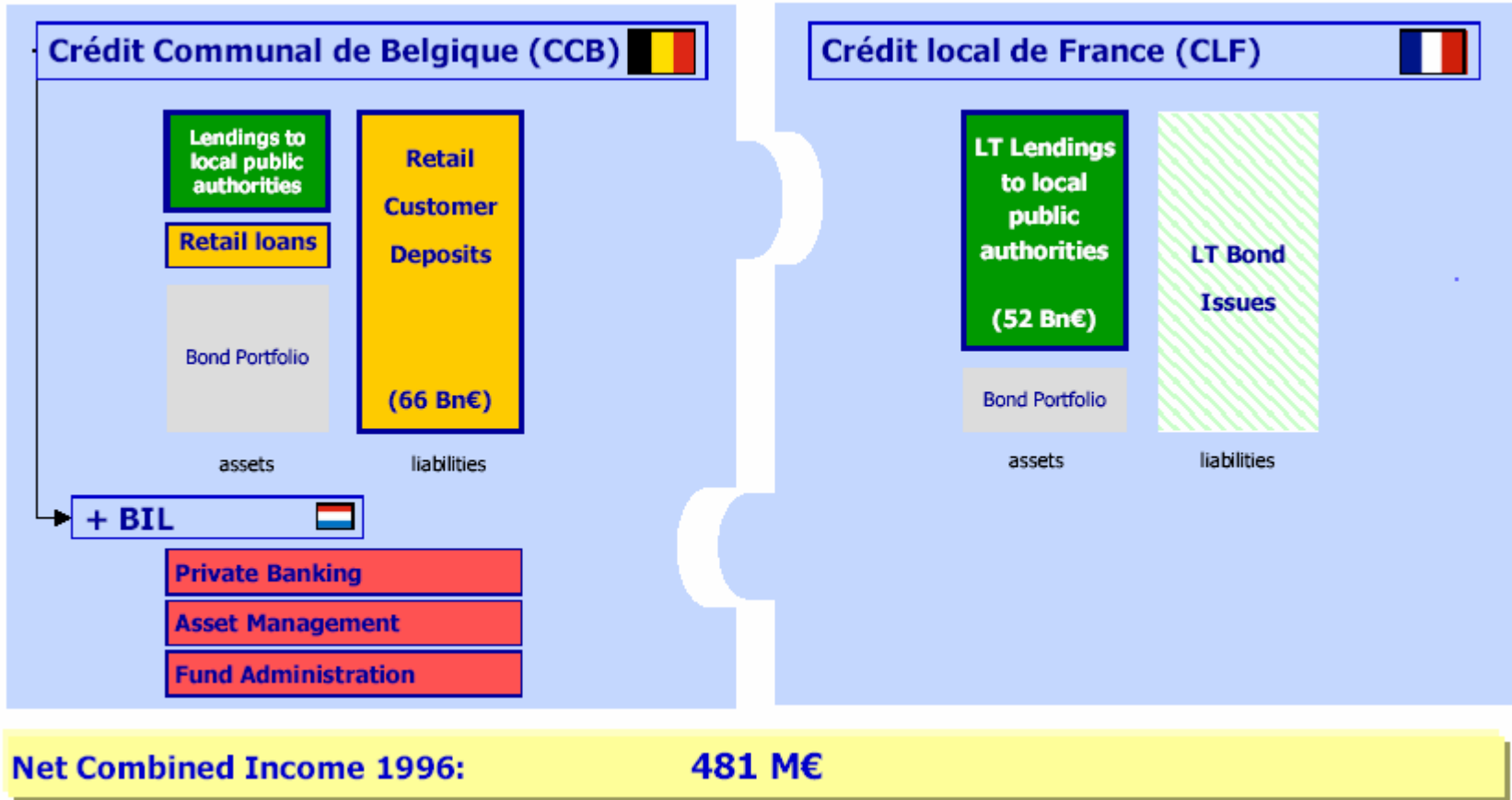
Decentralization, Yes but “à la Française”!

- Local governments gain in institutional autonomy and taxation power with the 1982 decentralization reform.
 - Central Government grant system is made more explicit, more targeted.
 - Local governments become more efficient in service delivery and more mature in their investment choices.
 - A thorough reform of the banking sector facilitates direct access of local governments to saving & loans institutions – mostly S/T lending.
 - 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).
 - Increased leverage.
 - Subsidies disappear completely from loans.
 - More efficient management of funds.
- **Lesson 3: A public SN financial intermediary can turn very creative when it is at risk of becoming irrelevant.**

A Gradual Privatization and Consolidation Process

- Early 90's: The dynamism of the local sector's market attracts commercial banks, from France and other countries.
 - A turmoil period reminds commercial banks of the specificity of SNG financing – this leads to a (relative) contraction of supply.
 - The prospect, then the opening, of the Euro market boost cross border transactions within the Euro zone's local sector.
 - [However, the financial autonomy of local governments remains constrained by tax administration and cash management regulations.]
 - To keep pace with a changing world, CLF is privatized:
 - 1991: CLF listed on the Paris Stock Exchange
 - 1993: The State sells its majority interest.
 - 1996: CLF enters into a strategic alliance with its Belgian counterpart, Crédit Communal, and becomes Dexia.
 - 1996-2000: Implementation of an ambitious yet cautious/targeted external growth strategy.
- **Lesson 4: There is a role for a specialized private intermediary in reaching SNG's small and large.**

Dexia's Creation: The Birth of a Perfect Balance Sheet (!)

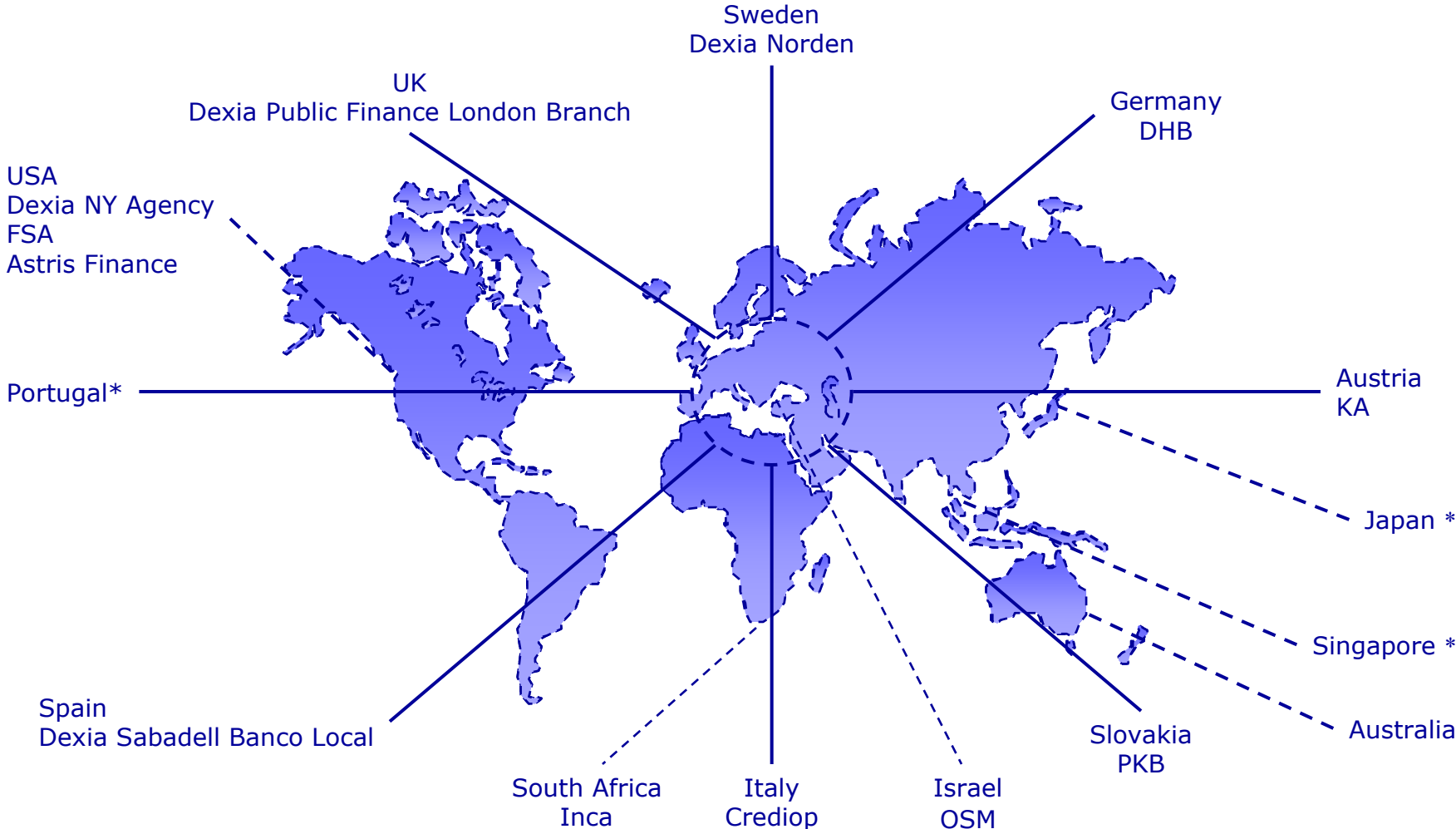


A Quiet Revolution

Acquiring a Worldwide Presence, Maintaining a Clear Focus

- 1990 New York Agency (USA)
- 1992 London Branch (UK)
- 1995 Dexia Hypothekenbank Berlin (Germany)
- 1996 Stockholm Branch (Sweden)
- 1997 Crediop (Italy)
- 1999 OSM (Israël)
- 2000 PKB (Slovakia)
- 2000 FSA (Monoline, USA) and Astris Finance (Advisory, LATAM)
- 2001 Sabadell Banco Local (Spain)

Dexia's Presence



*Rep Offices

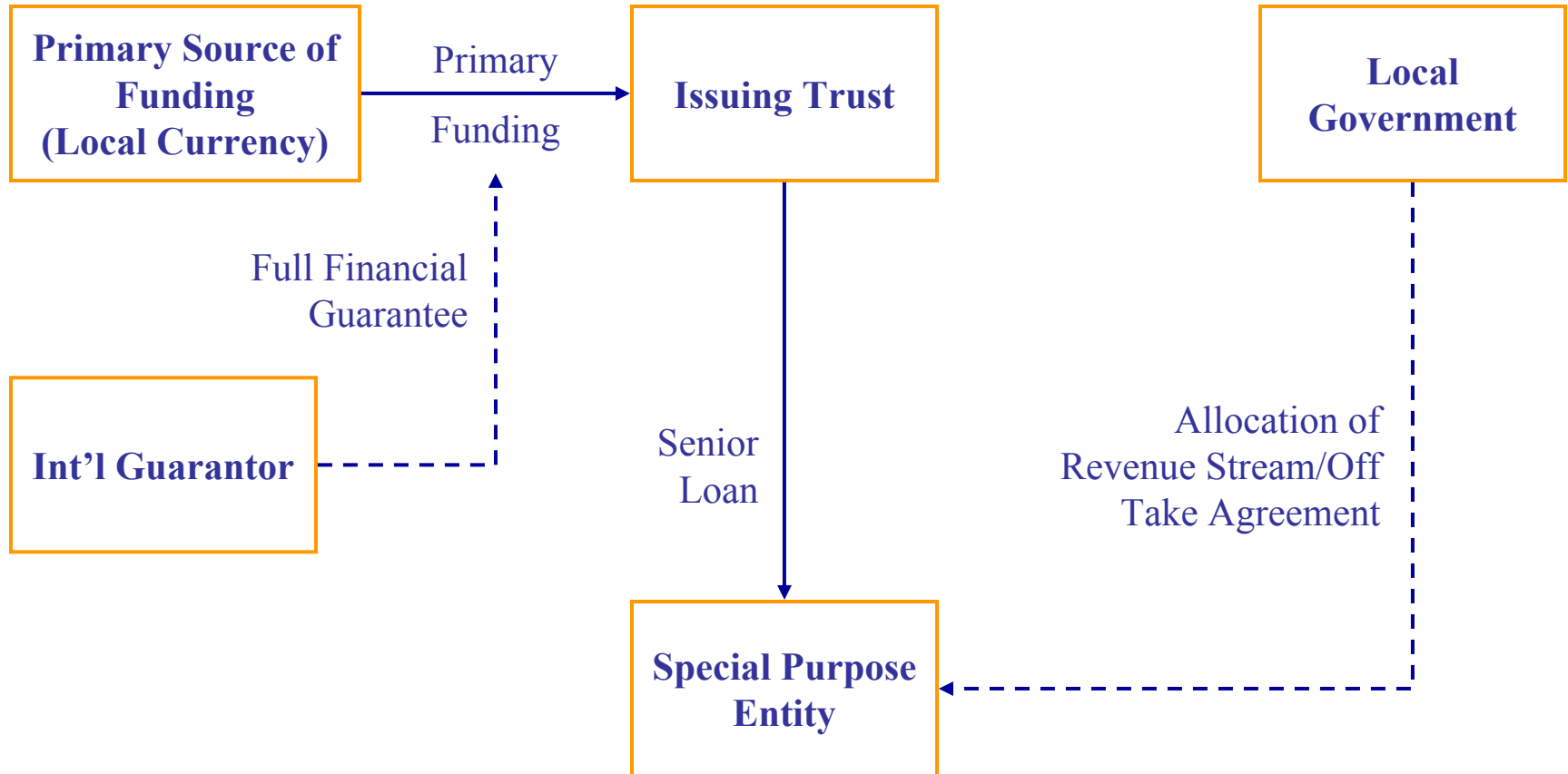
A Quiet Revolution: Catching up with Financial Modernity to Reinforce our Core Mission

- Diversification/globalization of instruments
 - Direct loans, credit commitments and acquisition of muni securities
 - Credit enhancing of municipal bonds (full wrap, L/C's, liquidity guarantee)
 - Structuring and Financing PPP's and Project Finance
 - Structuring and Purchasing/Enhancing ABS
 - Offering value added through financial advisory, asset management, debt management, insurance services
- The key to viability: maintaining very low funding costs – and a top rating.

	S&P	Moody's	Fitch
Dexia Crédit Local	AA	Aa2	AA+
Dexia Bank Belgium	AA	Aa2	AA+
Dexia BIL	AA	Aa2	AA+
Dexia Municipal Agency	AAA	Aaa	AAA
FSA	AAA	Aaa	AAA

An Example of Adaptive Solution

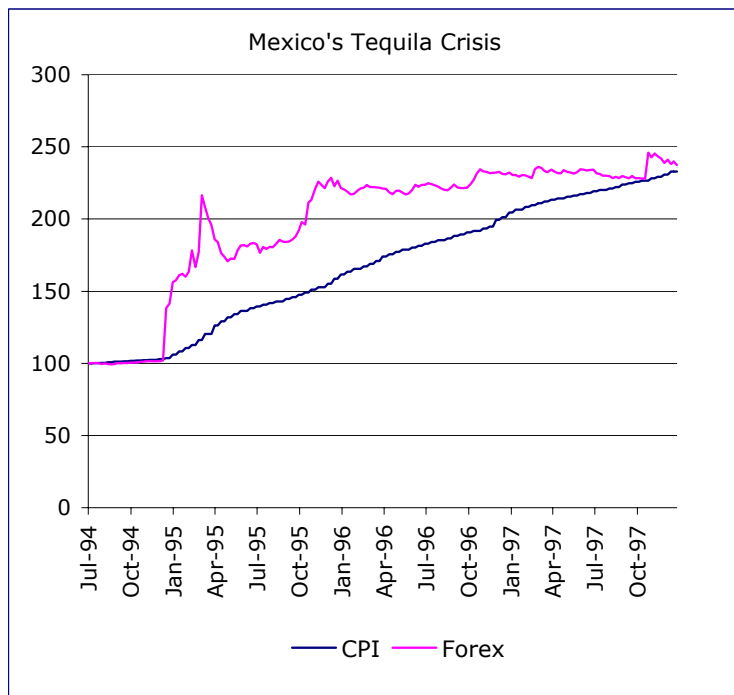
Cross-Border Enhancement of Local Currency Financing



Forex Risk

Benefits of an Enhanced Local Currency Financing

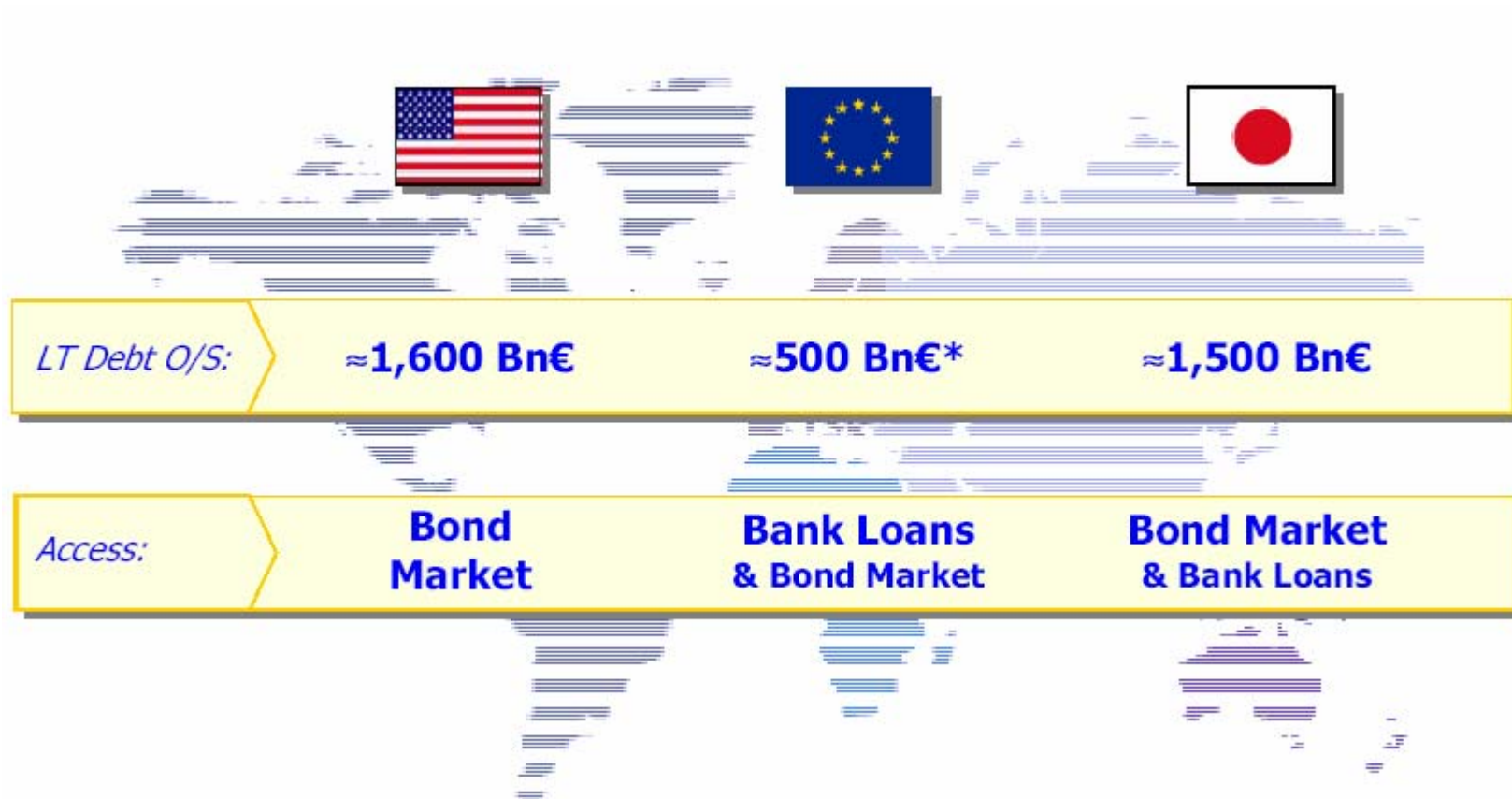
~> **Mexico:** Inflation/Forex lag



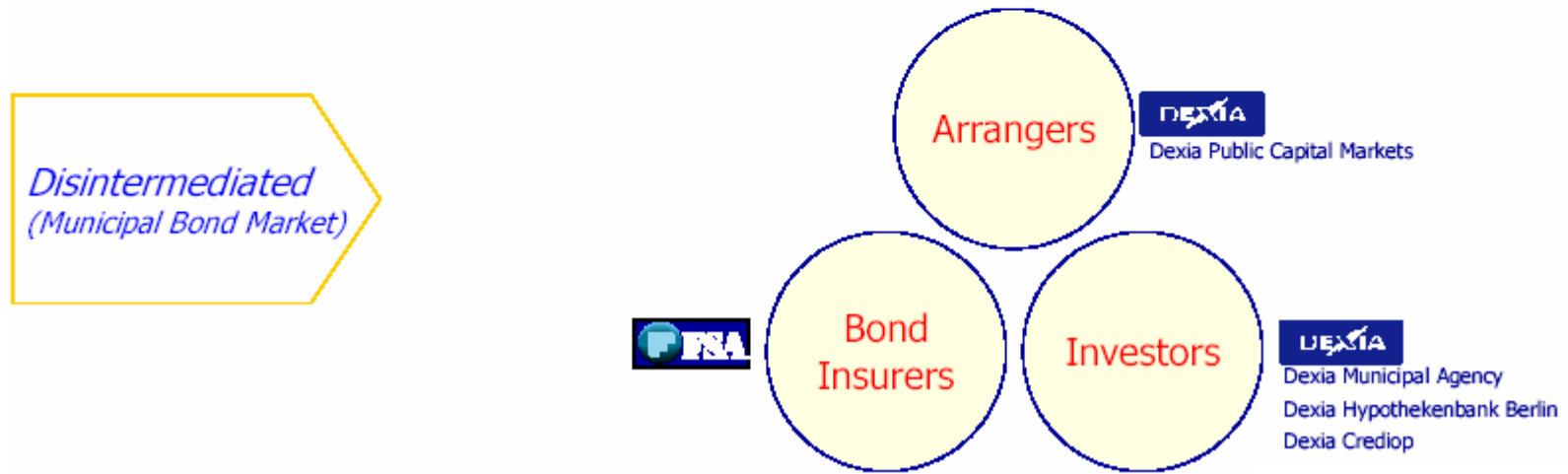
~> **Brazil:** The internal rate of return of a US\$ loan taken at Libor + 50 basis points in January 1999 would be **35% in Reais versus only 5.6% in US dollars** in December 2002 due to the devaluation of the Real...

- Attract longer maturities in the local markets.
- Overkill of enhancement means very low local funding margins (better than Sovereign?)
- Project risk and devaluation risk are de-linked.
- Guarantee is not exposed to devaluation risk:
 - Financing won't cause project to fail.
 - When project fails, guarantee is exposed on a nominal amount denominated in local currency.

Main Markets of Local Public Finance



Main Players



Market Constituents – Clients' Expectations - Products

Market constituents

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

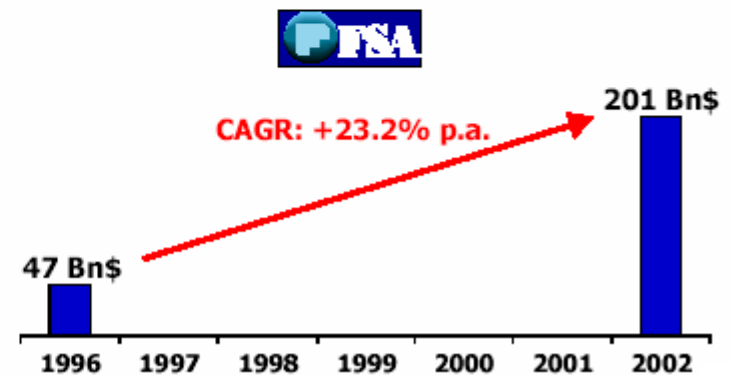
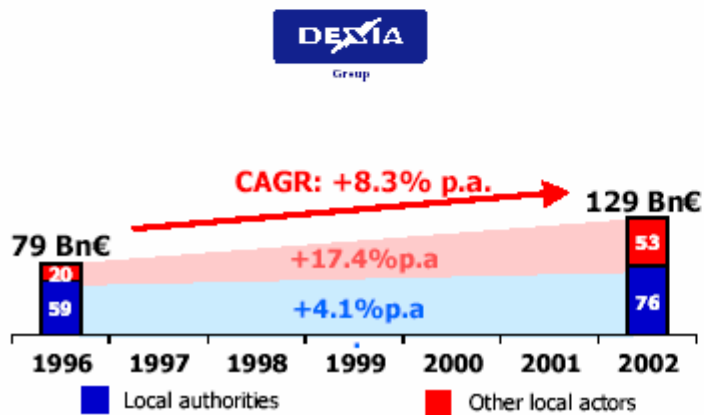
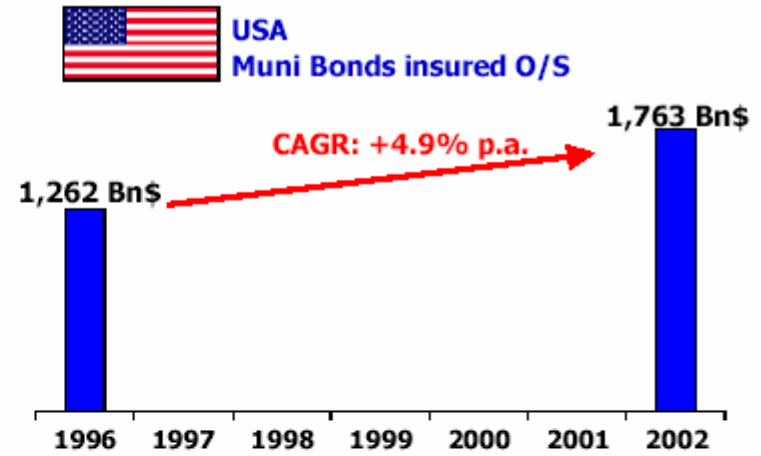
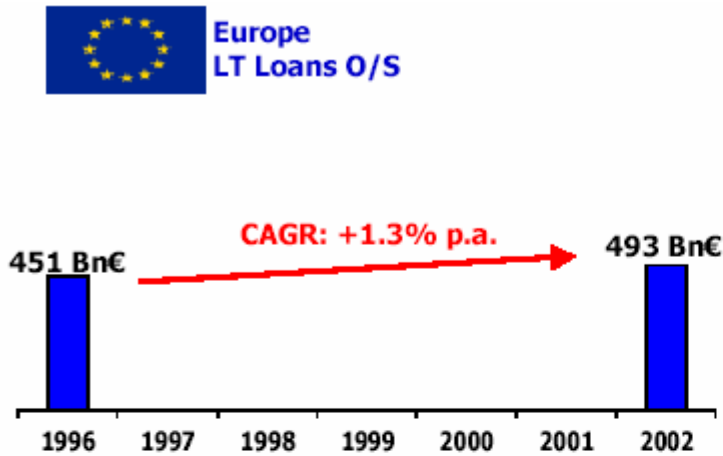
Clients' expectations

- × 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

Dexia's Volume Growth Outperforms the Market



Key Business Model Features

✓ Solvency of borrowers

- ↳ Low risk asset weighting
- ↳ Narrow margins
- ↳ Low cost of risk

✓ Long Term

- ↳ Annuity building business
- ↳ Low revenue volatility

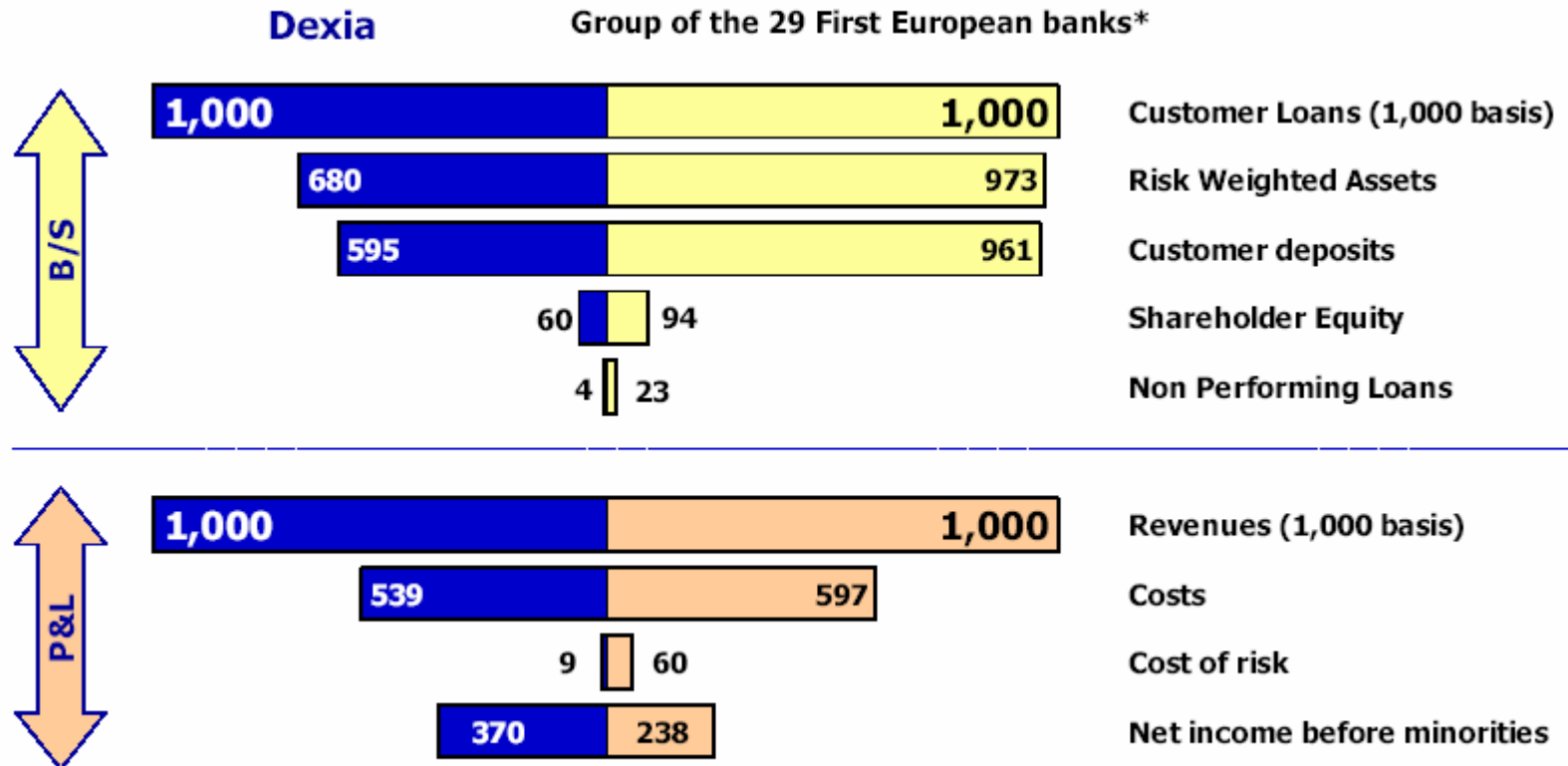
✓ Importance of Funding

- ↳ High credit ratings needed

✓ Differential advantages

- ↳ A "volume" business
- ↳ Innovation: new products successfully marketed in a country can be exported to others

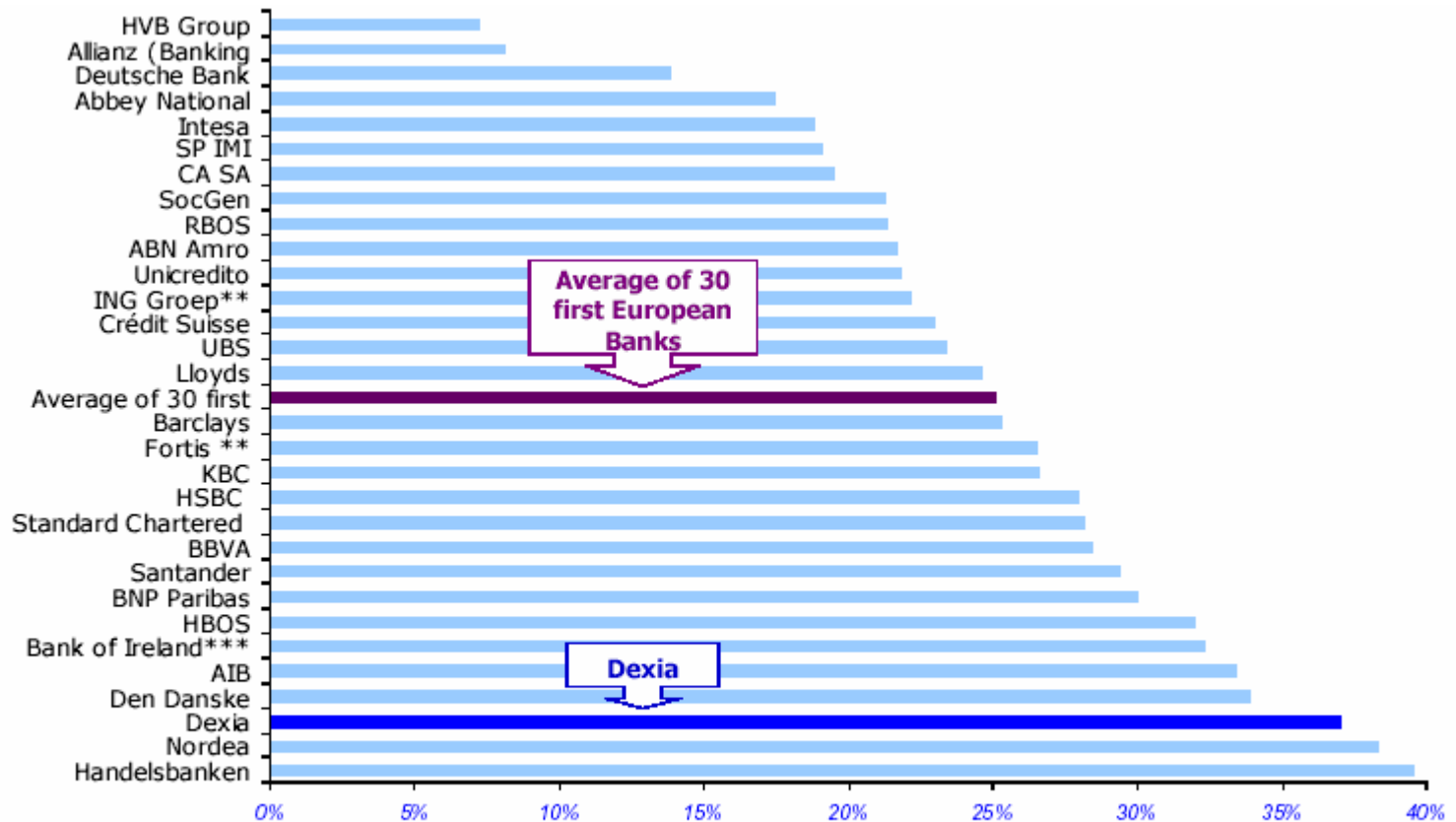
A Different Business Model



Data: H1 2004 Results

Profit Margin

Ranking in Terms of Capitalization as of Sep. 17th, 2004



* Profit Marging: Net Income before minority interests/Total revenue
 ** Banking Activities
 *** as of March 31st, 2004

Conclusion

- A gradual transformation following the evolution of, and adjustment to, the needs of local government clients.
- A key factor of success: stay 100% focused on core mission of helping SNG develop and access capital markets.
 - Diversity of instruments
 - Rigorous municipal credit analysis
 - Low cost of funding

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