

# REPORT

## 37th ICLC conference hosted by Dexia Bank Belgium in Brussels

The conference theme was "The impact of the financial crisis on the banks and their local partners".

During the time leading up to the conference there had been serious internal ICLC deliberations on what the impact of the crisis had been on the members and banks specialised in public finance.

In order to answer this question and to feed the debate, the Secretariat launched a survey, under the co-ordination of Marie-Alice Lallemand-Flucher. The ICLC members received the results – presented below – with great interest as it offered food for thought during the conference. It also provides valuable insights for the future work of the members.

The first session focused on the impact on the banks and was chaired by Pierre Mariani, ICLC General Secretary and Dexia CEO.

Rudolf Niessler, Director of Policy Coordination, Directorate General for Regional Policy of the European Union intervened as the first keynote speaker on the topic "EU Cohesion Policy: Investing in the real economy". Cohesion Policy aims at promoting overall harmonious development territorially balanced and sustainable development. It does so as a complement to member states policies. The Cohesion policy is composed of social and regional policy completed with contributions of other EU policies. Priorities and budget envelopes are agreed for a medium term perspective, currently 2007-2013.

Its three core objectives in this period are

- convergence: stimulate and support the catching up process of the least developed regions: 81,5% of the financial support; 170 m inhabitants (35% of EU27) in regions with a GDP per head below 75% of the EU average. Main focus: development and or improvement of infrastructure, modernisation of the economy, employment;
- regional competitiveness and employment of the other regions: 15,9%; 340 m inhabitants (65% of EU27). Main focus: innovation, protection of the environment, employment;
- territorial cooperation across borders: 2,5%.

In total the financial support represents 347 billion EUR. Countries receiving the highest support are currently: Poland (62bn), Spain (30bn), and Italy (25bn).

With 347bn EUR for the period 2007-2013 the Cohesion policy plays an important role in restoring confidence in the real economy by supporting investments in particular within infrastructure, productive capacities of business and human capital. These investments can boost short term internal demand while preserving a sustainable focus in the medium term. It is a powerful instrument of stability as it provides secure source of financing over the seven year programme period and it invests

in coherent strategies in the medium to long term upon which the regional and local partners can rely. 62% (230bn EUR) is allocated to priorities in the Lisbon agenda such as innovation and knowledge economy. A package of legislative proposals and non-legislative measures provides for rapid actions to address the immediate needs in economies.

The legislative package to mobilise the Cohesion policy resources is divided into four areas:

- increase in advances to programmes up to 6,25bn EUR in 2009 for public investments;
- accelerate immediate payments to major projects and state aid schemes. But also simplifying the treatment of advances, which could reach 100% of the aid as far as they are still subject to a bank guarantee and covered by expenditure paid by beneficiaries in project within the eligibility period and supported by accounting document;
- simplifying expenditure eligibility, which implies declaring overhead costs at a flat rate basis for all the funds.

Without a modification of the legislative framework four concrete actions are developed:

- the capacity increase of JASPERS (Joint Assistance in supporting Projects in European Regions) in order to accelerate implementation of major projects in the new Member States. More than 70 experts will assist Member States in the technical project preparation;
- promoting entrepreneurship and enhancing co-operation with the EIB and EIF in using and benefiting from the JEREMIE (Joint European Resources for Micro to Medium Enterprises) initiative for SME's, including guarantee, debt and equity instruments as well as the strengthening of the business environment for micro-credits.
- adapting priorities and objectives of existing programmes and an increased focus on smart investments;
- simplifying programme delivery mechanisms.

The financial engineering for the 2007-2013 period is characterised by the enlarged scope of JEREMIE and JESSICA, the emphasis on Holding Funds as a management tool (which can award tasks to the EIB and the EIF), the specific initiative for micro credit, energy efficiency and use of renewable energy in existing housing and buildings.

JEREMIE was launched late 2005. Its objective is to finance the expansion of SME's and creating new business. Special attention is given to start ups, new technologies, innovation and technology transfer. Commission partners are Member States, EIF, EIB and financial institutions. The networking platform started in March 2009. In 2006-2008 55 evaluations were completed in 21 member states. Current implementations via EIF and other financial institutions are done in 9 Member States and 14 regions. The so far signed holding fund agreements provide for a total amount of 3bn EUR (1 for EIF, 2 for the other financial institutions).

JESSICA was launched early 2006. Its objective is to promote partnerships and sustainable investment in Europe's urban areas. Commission partners are Member States, regions, cities, EIB, CEB and financial institutions. The network started in February 2009. 40 studies

have been launched of which 23 are finalised and 17 already completed and published. Agreements and memorandums of understanding have been signed with 7 Member States and 11 regions.

JASMINE (Joint Action to Support Micro-finance Institutions in Europe) was launched in September 2008. Its objective is supporting non-banking micro finance institutions to improve the quality of their operations, to expand and to become sustainable. The partners are EIB, micro finance institutions, financial institutions.

The debate following this presentation highlighted the strong efforts to refine the use of grants and subsidies and the re-inforced use of financial engineering and revolving instruments. Partnerships are needed. After a solid number of financial engineering actions being in place now the aim is on exchange of experience and further promotion of such measures. Also the question was raised how the Commission can control corruption with Structural Funds.

The Commission co-operates with Member States to ensure that they have efficient management and control systems in place. In case of irregularities or fraud the Commission can suspend payments and recover expenditure paid out already which is not in line with the rules. There are strong safeguards in place which ensure that the taxpayers money is spend according to agreed objectives and to the rules of sound financial management.

Anton Brender, Chief Economist of Dexia Asset Management, focused on the collapse of globalised finance. According to him vast transfers of savings through the financial globalisation are responsible for the crisis. Ever since the Asian countries came out of their crisis they have been the driving force behind our economies. Their economic growth reached 9% before the crisis. However, a global current account imbalance grew in parallel with that growth. Asia's high saving ratio helped to finance the deficit of the United States. This, in its turn, was possible thanks to the links between their currencies being tied US dollars. This means in practice that they were able to export large amounts of savings without any exchange risk. Emerging countries moved from undervalued currencies into overvalued,. However, Central and Eastern European countries faced an opposite evolution. This contrast is visible even for real exchange rates according to the purchasing power parity calculation.

The savings were exported mainly through reserve accumulation towards the US.

The crucial question: who takes the risk because there are various risks implied by those transfers of savings?

- the Chinese households have a surplus: a deposit in Yuan, they rely on short term Yuan interest rates;
- the US households have no savings but a mortgage loan, their interest rate is the mortgage rate in USD;
- the Chinese commercial banks use the Yuan deposits for investments in Chinese bank bills in Yuan for the same maturity, so no interest rate neither currency risk;

- the Chinese central bank pays short term interest rate in Yuan to the Chinese commercial bank. It accumulates the savings and build up reserves, which are invested in USD. The currency risk is a reality;
- the US commercial bank receives the deposits in USD from the Chinese central bank and finances the special purpose vehicle in USD which allows the SPV to set up a construction of mortgage backed securities (MBS). The SPV does have an interest rate risk.

That mechanism leads to an accumulation of risk, mainly in the less supervised part of the system, the so called shadow banking system: off balance sheet vehicles, government security enterprises such as Freddie Mac and Fannie May, hedge funds, investment banks, financial companies.

The rise in risk aversion triggered by the sub-prime shock has led to a painful deleveraging process. The sub-prime crisis provokes a rise in risk aversion, forcing a decline in the leverage, the risk takers are condemned to fire sales, falling asset prices erode risk taking capacities, borrowing by risk takers is restricted, risk takers have to reduce further their positions, etc. This infernal spiral has been stopped by the intervention of the central banks which occupy now the position of the private risk takers.

The major lessons of this analysis are:

- never leave finance on its own; regulation is necessary;
- public authorities have a major role to play in the design of flows; they must offer the tubes in order to be able to build the pipeline. They have not only the task to distribute money, but also to control risk and therefore a more pro active intervention is needed.

During the lively discussion it became clear that the US has a major macro economic responsibility due to its big current account deficit. But it is also clear that the US is giving the world a surplus which is translated into large volumes of reserves. The monetary policy developed by Alan Greenspan has been a major contribution to the financial crisis. Investment banks, not being controlled by the FED did not respect the leverage ratio. Hybrid organisations became a very serious problem. Risk management becomes crucial for all market participants. Chinese households should consume more and companies should invest more. The actual credit boom in China is certainly contributing to the reversal of recent evolutions. It would be better if some of those investments would favour local authorities.

The first round table was chaired by Thomas Werngren, President and CEO of Kommuninvest Sverige AB, Sweden. In his introductory remarks he underlined that the worst is perhaps behind us. The increase of interest rates will be a new phase in the actual crisis. New regulations will have a strong impact on future banking. His bank did not suffer so much thanks to taking over a portfolio of private bank. Being active only in the Swedish market the financing of very long term projects was easily achieved through short term means. A real leverage ratio could be a major challenge. Does a local authority invest in a capital increase of their specialised financial partner knowing that they also have to face the tremendous needs of an ageing population?

Guido Ravoet, Secretary General of the European Banking Federation formulated a few major challenges: restoring trust and

confidence, reviewing business models, a level playing field environment, a balance between market rules and regulatory intervention, the new legislative framework and consistency in the implementation. He is in favour of broad based banks without a split up between retail and commercial banks and investment banks. Size does not matter. Focus must be set on complexity and on systemic risk. Financial innovation is still needed.

Laurent de Mautort, Director Lending Operations Western Europe of the European Investment Bank, started his intervention with listing priority lending activities. In 2008 57,6bn EUR has been lent and for 2009 the forecast is 70bn EUR. Cohesion and Convergence is the major activity, followed by innovation, trans-European networks, sustainable energy, environmental sustainability, SME's. The crisis impact on economies and funding conditions were a negative economic growth, sharp reduction in tax revenues, restrictive fiscal policies, unavailability of commercial bank LMT financing, in particular for PPP, unavailability of trade finance and performance bonds, sharp widening of risk margins.

The EIB response: increase of the lending volume by 30%, additional support to SME's, more direct support to public investment of local authorities, increase of support to public finance banks re-financing public investment, additional lending within the energy and climate change package. New instruments launched recently are JESSICA, JASPERS (joint Assistance to Support Projects in European Regions). Marguerite 20% European Fund for energy, climate change, infrastructure and EPEC (European PPP Expertise Centre).

The effects of the crisis on PPP's are numerous: reduced available funds, not operating in a syndicated loan market, increased banks' margins, reduced senior debt tenors, lack of consistency in terms and conditions, no viable capital market solution to replace the wrapped bond market. EIB base its approach on evolution of benefits, no favouring of any particular procurement method, expertise and financial resources for infrastructure investment. The measures introduced by the public sector are direct or indirect guarantee to the private sector, refinancing guarantee, public sector co-lending facilities. Of course there are differences between guarantees for poorly structured projects and guarantees which address reasonable lender risk on the largest deals.

Hans Leenaars, Board member of Bank of Nederlandse Gemeenten, considered 2008 and 2009 as good years for his bank. The Dutch banking sector is suffering a lot because legislation/regulation was inadequate and supervision did not work correctly for broad based banks. The request to have a higher Trier 1 but also an increase of lending is not realistic unless you accept a revitalisation of securitisation. The actual crisis is liquidity and not a solvency crisis, but the changes in regulation focus too much on solvency issues.

Pierre Mariani shortly described how the big Belgian banks and especially Dexia were rescued. The core business activity of financing the public sector is maintained while high risk activities have been reduced. The issue is to protect the core market and the basic activities. The launch of a new publicity campaign in Belgium "Banking for people - Banking for communities" highlights the key message: focussing on the "essential" for the customers.

During the discussion it was underlined that the new capital requirements are not suitable for lending capacity. The exclusion of hybrid capital from Tier 1, the leverage ratio as part of pillar 2, the capital needed for trading and securitisation, the greater transparency for derivatives are acceptable as far as everybody implementing those new rules. We know that the US is very reluctant. If Europe is too strict when setting in place new rules, we will be excluded from the global playing field. The European traditional banking model for financing the economy is a major handicap for the economy. But knowing that securitisation is now nearly impossible, the bank credit focus is perhaps at least for some time an advantage. Of course the pressure to deleverage the balance sheet neutralises that perspective.

In Japan securitisation still is big business. The crisis has had no impact on fund raising and credit business. Funding via institutional investors is still huge. Credibility is in place. In Russia the government banks and central bank rescued the local authorities. A reallocation of the capital use of the sovereign wealth funds took place.

Major lessons learnt from the crisis:

- the need of severe liquidity risk management;
- interest rate risk can be huge;
- lower mismatching must be the goal;
- we are moving to lesser prosperity and wealth;
- bank capital buffers must be higher;
- quality of risk management must be enhanced by a greater involvement of the top level and no outsourcing toward rating agencies;
- back to basics of normal banking practice;
- risk pricing must be reconsidered;
- the role of public banks and PPP must be reviewed.

The second session focusing on the local sector experience was chaired by Pascal Poupelle, CEO of Dexia Crédit Local.

Raphaël Alomar, Governor of the Council of Europe Development Bank was the keynote speaker on "Boosting local investments". His starting point was the key role of regional policies. Public spending is an effective tool to create jobs and provide foundation for economic recovery and sustained growth. However, it is not sufficient. Its impact increases where investments in human capital and innovation are present, recognising the need for integrated regional policies in shaping growth and economic recovery policies. In overcoming the crisis they allow the combination of different types of investment to maximise the impact on growth, they accelerate the implementation of public investment, they mobilise local competitive advantages, they provide clear roadmaps based on agreed policies and bring differentiated tools to address the challenges of regions and communities in need.

The reduction of financing availability for infrastructure projects is all the more regrettable as Europe is facing significant social needs due to primarily three long term trends:

- rapidly ageing population (population aged over 65 will increase by more than 50% between 2000 and 2050 and reach 23% of the population.) Major investments in housing and healthcare infrastructure for the elderly are needed;
- increased energy cost, driven by increased energy consumption (+50% worldwide between now and 2030) while there is the need for more production of renewable energy to reduce the greenhouse gas emissions. Investments to improve of building and housing energy efficiency must be made;
- degradation of urban and rural environment as a result of rapid urbanisation and ageing and insufficient infrastructure. More investments in housing and local public infrastructure are needed.

The Council of Europe Development Bank (CEB) response to the crisis is based on its mandate to contribute to the financing of social development. Infrastructure projects in favour of social cohesion are essential. The scarcity of financing by the private sector is compensated. Appropriate expertise and financial conditions are attractive for borrowers. An increase in applications for CEB loans is expected especially in CEE countries because they are more affected by the decrease in available financing and the already mentioned three long term trends as their economic development is lower than that of other European countries. CEB is to place sustainable development requirements at the heart of projects and to set up enhanced cooperation with the CEE to co-finance EU operational programmes.

Via an enlarged and constant dialogue with IMF and other development banks and cooperation with the EU in focusing on CEE countries a greater synergy can be achieved. The CEB's support for national and or regional governmental sector programmes is done often in co-financing with other IFI's or the EU.

The CEB increases its efforts to improve the quality and focus of its operations towards the Target Group and within its priorities. The pace in approvals and disbursements will pick up due to increased demand from the CEB's member states that CEB participates in financing their social infrastructure and employment and SME support initiatives during these challenging economic times.

The short debate following this presentation highlighted the cash rich position of the bank, having no toxic products, able to cover 50% of all needs for the coming three years. CEB has no defaults thanks to its strong risk management and traditional financial activity.

Pascal Poupelle chaired the second round table.

Jeremy Smith, General Secretary of the Council of European Municipalities and Regions presented preliminary results of a survey how the financial crisis had impacted its members. A large majority still says the situation is worsening (71% for 2009 and 58% for 2010), while 10% and 14% forecast improvements, the other 19% and 27% see no change. The expected budget evolution of the members in 2010 shows an increased access to borrowing, a decrease of own resources, and a rise of expenditures and service. Due to the general deterioration of public finances (increasing deficit and debt) expectations for the near future are gloomy. In many countries, the public debt to GDP ratios were projected

to increase sharply to 2014, which means that there will be much pressure to reduce public expenditure – and local and regional governments are likely to be required to share the burden.

Ottar Gudjonsson, Managing Director of Municipality Credit Iceland, started his presentation by stressing that the Icelandic banks were small enough to fail, but were too big for Iceland to save. The default of most banks resulted in a spectacular decrease of the banking sector's total assets which at the end of 2008 were about 2% of those of mid-2008. That means that 98% of the system is in default. The exchange rate dropped from 90 to 180 Icelandic Krona for 1 EUR. Inflation jumped to 20%. The central bank base rate reached 18%. The economy contracted sharply, unemployment increased and so did bankruptcies.

With the help of the IMF, the government took initiatives to restore the banking system via recapitalisation of its biggest bank, to reopen the foreign exchange market (not yet the case) and to improve public finances over the medium term. The new government delayed the IMF plan with 6 months because the discussions on the deposit guarantee with by? the UK and the Netherlands are continuing.

The impact on the municipalities' finances was a 48% jump of debt levels in 2008 due to devaluation and inflation. Higher wages and interest payments pushed costs upwards. Tax revenues increased 2,5%. Capital expenditures were cut. For 2009 a break even is expected. There will be no default of municipalities.

The Municipal credit Institution faced an increased lending, a jump of 53% of the assets in refinancing. An asset growth of 7% is expected. No new hard currency loans are launched. By the way net profits stayed stable and no loan losses and arrears occurred.

Stéphane Rio, Head of Product and Portfolio Management, Deutsche Pfandbriefe AG, Member of Depfa Board considered the liquidity problems and the closure of the covered bond market as an immediate impact of the crisis. The restructuring of the HRE Group/Depfa is a good example of market changes: partial or full nationalisation, focus on historic markets and key clients, deleveraging balance sheets, conservative funding strategy. Liquidity solutions have been found thanks to the intervention of lenders of last recourse and the modification of regulatory framework.

Increased imbalance at local and regional government levels are observed due to lower revenues mainly taxes, to higher expenses such as financial costs, social security expenses, rescue plans.

The crisis has shown the limits of disintermediation. Credit worthiness of lenders and local government has deteriorated and funding is now a scare and expensive resource. Local governments need to be able to rely on specialised lenders, which must have a profitability level that allows for sustainable business taking into account the various cost of business (cost of capital, credit risk, options, ...). PPP support is reinforced, including guarantee schemes to facilitate financing. Lenders controlled by states and regional governments may strengthen their market positions. All these observations underline the necessity to build up specialised lenders with a conservative strategy and ensure the new business models work through fair competition from commercial banks seeking to grow their credit portfolios.

Pascal Poupelle started his intervention by saying that Dexia Credit Local has a 40% market share of the loans to French municipalities. Bank loans are the funding instrument by excellence. In 2008 20bn EUR was financed this way and only 100 m EUR bond financing. The crisis hit hard, but DCL continued to lend. The borrowing conditions are now very competitive just as they were before the crisis. Loans on 25 or 30 years are actually given at Euribor +50bps. The funding (liquidity) cost is higher. The request of the French government to banks to increase credits to the economy was met by a higher volume of lending to the public sector which is of course less risky than to e.g. SME's.

The debate focused on the fact that new competitors such as insurance companies and pension funds are ready to lend money to local authorities. Municipalities are mainly looking for a sustainable low interest rate, which means that they are also interested in restructuring their debt volume and burden. Public banks must be long term providers of money to municipalities but must also offer rate management in a more transparent and easier way. This can structurally lower the debt burden. Raising money with a very long maturity is possible, but too expensive. This implies that most long term loans are financed with relatively short term finding. The refinancing risk is a serious threat if no derivatives are used.

In Turkey the financial crisis had no impact on the local authorities because their major revenue sources are government grants. The financial sector was not as hit by this crisis as compared to the hard crisis 2001. The economy suffered a lot, decrease in exports and imports, and higher unemployment, and lower GDP, lower income taxes - all which are endanger the municipalities' revenues. Banks active in municipality finances intervene in all kinds of projects, as well as provide technical support and consultancy.

The third session, focussing on the Belgian scope was chaired by Stefaan Decraene, CEO of Dexia Bank Belgium. He intervened on "Financial crisis and local investments: credit crunch?" The financial crisis has had a negative impact on the Belgian economy. Indirectly this is also negative for the finances of Belgian municipalities. The large budget deficit of all governments implies lower tax revenues for the municipalities 18 to 24 months from now. Meanwhile social assistance expenditures are soaring. The stock market crash (BEL20 -54% in 2008) forced Dexia to cancel its dividend. The Holding Communal, one of the institutional shareholders, also decided not to pay a dividend to its shareholders, which are the municipalities. The lack is approximately 100 m EUR or 0,7% of total revenues. The volatility of the inflation reached 6% by mid-2008 and caused a triple wage indexation for municipalities' employees. Higher energy prices (150 USD per barrel before dropping to 35 USD and a return to 80 USD) increased the overall energy bill. The only positive impact is the sharp drop of interest rates: short term -3,5% and long term -1,5%. The municipalities' debt burden also fell thanks to debt restructuring and a partial take over of the local debt (100 EUR per inhabitant) by the Flemish government. This last action must be compensated by a lower tax burden for companies settled within the borders of the Flemish municipalities. In Wallonia the government intervened to help the big cities via a reconversion of their loans, within the process of reform of the municipalities' fund.

Belgian municipalities' investments follow the 6 year election cycle. One or two years before municipal council elections investment activity accelerates. The huge increase forecasted for 2009 is exceptional and is probably linked to the public sector stimulation package to help the real economy. The most important areas in which investments are made are roads (27,7%), culture and leisure (18,4%) , waste management (16,4%). Future investments have to take into account major financial challenges such as ageing (rest homes, service flats, and hospitals), waste management, water distribution and purification of waste water, fire brigade zones, police zones .... Loans are still the most important financial instrument for investments (39,4% in Flanders, 45,0% in Wallonia), but auto-finance (37,4% and 19,8%) is quite strong. Subsidies and capital and the sale of property complete the basket of financing tools. The investments in percentage of real ordinary revenues (without subsidies for teachers) fluctuate sharply from year to year due to election cycle. But the investment ratio which gives the relationship between the investments and the impairments or amortisations of existing property is climbing. A ratio of more than 1 implies that investments are higher than the ageing of the property.

Municipalities' debt represent 4,5% of the total public debt. In 2007 this was equal to 14,7 and 327bn EUR respectively. The debt per inhabitant slowly increased to reach 1370 EUR in 2007. The debt assets ratio decreased modestly to 0,26%. The debt in number of years necessary to reimburse, the debt taking into account the theoretical hypothesis that all revenues can be spend for the reimbursement, shortens from 2004 to reach only 1,12 year in 2007. The outstanding bank credit to local authorities was about 15,9bn EUR mid 2009, 68% of the total bank credit to the whole public sector. It increases continuously from 2004. We observed a sharp drop of the credit for regions and communities due to the policy of the Flemish government to reimburse its debt. Alternative forms of financing investments are PPP, sale of real estate property, leasing, co-financing with EIB and European funds.

The debate focused on the non credit linked services offered to the municipalities. They already represent 50% of the revenues. In 2008 less aggressive competitors were observed, but now they are back. The credit margins which increased very nicely in recent months have reached a maximum. Some decrease is expected. Structures for debt rescheduling have been offered and sold, but they are followed pro actively on a monthly basis. The structures focus on long term financing and are very classical ones.

Belgian Prime Minister, Herman Van Rompuy presented the view of its government how the Belgian financial sector and the real economy had been impacted by the crisis. Belgium was hit hard because the big Belgian banks had total assets which were many times higher than the Belgian GDP. Capital injections and capital-equivalent loans for a total amount of 20,7bn EUR have been used by the federal and the regional governments to bail out 3 banks and 1 insurance company. The immediate result was an increased national debt with 6% of GDP. In addition state guarantees of 125bn EUR were provided, plus the savings guarantee which was raised from 20 000 tot 100 000 EUR. This help is no free lunch. The revenues for the government are estimated at 1,029bn EUR in 2010 and 1,391bn EUR in 2011. Amounts that considerably exceed the Belgian Treasuries' financing cost. Local authorities, and shareholders of Municipal Holding,

one of the institutional shareholders of Dexia, suffer from the crisis because no dividend has been paid.

Meanwhile, there are signs of hope. The economy is recovering. The stress test organized by CEBS recently showed that European banks in general are sufficiently capitalised. But a return to business as usual is not possible. The financial system needs to be reformed. Focus will be given to macro and micro prudential supervision. Thanks to the excellent report of the working group Lamfalussy, the Belgian government decided to implement the Twin Peaks model: the macro and micro prudential supervision is brought together within the central bank. Consumer protection is attributed to the Banking, Finance and Insurance Commission. Belgium follows the initiatives taken by its neighbours and recommended by the European Commission. Harmonisation at European and world level is necessary in order to create a level playing field taking into account the globalisation of real financial economy.

Concerning corporate governance and bonuses the government formulated proposals to adapt the Belgian law in line with the European recommendations. The so called golden parachutes are curbed to 12 month salary. The bonuses are definitively acquired 3 years after being allocated. Only half of variable pay can relate to performance in a single year. At least a quarter must relate to performance over a three year period.

The government has chosen to embark on the road to fiscal balance while taking into account the still fragile economic situation in 2010 and 2011. Restoring the health of the public finances is the primary task.

Frank Lierman, Chief Economist of Dexia Bank presented the financial situation of the Belgian Municipalities. His starting point was an overview of the "web" of the numerous local authorities which exist and of which the municipalities are the driving force. Municipalities are often also shareholders of a variety of public companies. In 1977 an important merger took place reducing the number of municipalities from 2359 to 589. The importance of the public local expenditures in percentage of GDP is relatively low in Belgium: 7%, while in the Nordic countries 20 to more than 30% is seen. Constitutional changes have provided regional governments with the management of the local authorities (supervision, financing, accounting rules, territorial public services ...). Via the constitution local taxes are still a privilege for municipalities and provinces. Regional autonomy results in an increased differentiation which becomes a real handicap for comparisons.

The main revenues are taxes (50%), funds and subsidies (37,5%) and own resources (12,5%). The split of expenditures is 57,5% for personnel and functioning, 30% for transfers to social agencies, police zones and other local authorities, 12,5% for debt (interest charges and reimbursement of loans with a maturity lesser than 1 year).

There is a structural shift of revenues. Since 2001 the revenues has risen with a yearly average of 3,6%, but taxes went up 3,8%. The federal tax reduction in favour of households affecting the basic level on which additional tax of municipalities is calculated, has been partially compensated by a rapid increase of that additional tax especially after the municipal council elections of 2000. Those additions represent 37% of total municipal tax revenues. The tax rate is different in the three regions

(7,67% in Wallonia, 7,38% in Flanders and 6,63% in Brussels in 2009) and even within the social economic clusters of similar municipalities. But also the local additional part on withholding tax on property (44% of total) is increasing, not to compensate federal initiatives but regional government decisions. The local additional parts vary between 2501 in Wallonia over 2594 in Flanders and 2721 in Brussels. There are big differences in local taxes (19% of total) and often out dated or a handicap for companies having plants in different municipalities. In order to limit that upward movement regional fiscal pacts have been negotiated fixing maximum levels which were compensated by a change in the structure of municipalities' fund or restructuring of debt.

The sharp 4,5% increase of funds and subsidies illustrates how the municipalities were recapitalised by the regional governments in order to solve structural deficits. Within the basket of own revenues the dividends suffered from the European liberalisation of the energy market and the split of production and distribution of energy, knowing that most municipalities are shareholders of energy linked inter-communal companies. The non payment of a dividend in 2009 by the Municipal Holding intervenes also. The remuneration of services sold to the inhabitants and some compensation for the lack of energy dividends resulted in a sharp jump of the achievements linked revenues.

Since expenditures has increased with 3,4% on average. Personnel and maintenance, representing 57,5% of the total expenditures, went up 4,1% during the same period. The volatility of the inflation and the surge up to 6% in 2008 is not neutral for the wages due to automatic indexation. But also more contributions to pension schemes and attractive social agreements pushed up expenditures. Maintenance costs are increasing due to more expensive energy. Transfers were up with 4,1%. Social agencies and police zones receive each about one third of those transfers. The other third goes to a broad variety of local authorities. The creation of police zones in 2002 was quite expensive for rural municipalities. Social agencies are faced with an extension of their tasks often as a result of decisions of the federal government. The economic crisis is of course also a source of more expenditures. The debt costs decreased 0,7% thanks to the downward trend of interest rates, some structural interventions by regional governments and better debt management.

Looking to the financial equilibrium we must make a distinction between the balance of our own financial year and the global financial year which takes into account the balance of former years and general withdrawals.

In Flanders the municipalities budgets still show a deficit for the own financial year, while the global financial year is characterised by a rapid increase of the surplus thanks to exceptional revenues linked to financial operations of companies in which they are shareholders, such as Dexia, Telenet, Suez, SPE, Publigaz, ... 57% of the municipalities are facing a deficit.

Walloon municipalities have for the past years showed a balanced own financial year thanks to an important financial help from the Walloon government. The global financial year result is positive, but with a declining trend. The number of municipalities with a deficit is 42% and rising.

The Brussels municipalities received substantial support by the Brussels regional government. They were able to show a small surplus after huge deficits for the own financial year. The global financial year balance was very weak, except the last 2 years. 4 of the 19 municipalities are still in deficit.

On the positive side is a strong increase of tax revenues, financial help offered by the regions, decreasing debt level and burden, a nice surplus in the balance of global financial year. On the negative side we see an increased impact of the crisis on future revenues (lower dividend, lower additional on personal tax, temporarily effect of regional help) and expenditures (higher transfers to social agencies, strong growth of personnel costs, high number of municipalities with deficit).

The major challenges for the coming year are pensions (higher contributions, second pillar for contracted personnel), deterioration of public finances (less support), reform of fire services (financing uncertain, quid rapid implementation).

The discussion focused on the complex institutional structure of the federated state of Belgium, the impact of local taxes, the persistent balance problems, the fiscal implications and the indexation of the salaries.

The final round table was asked whether PPP is still a solution for public sector investments. Dirk Gyselinck, Member of the Management Board of Dexia Bank.

Bob Martens, Legal Advisor of DLA Piper presented the "datio in solutum" between sale and PPP as a new legal instrument for local government. "Datio in solutum" is an established legal concept that has gradually slipped into disuse. It could have a renewed relevance as a tool for the debt payback of local governments and for the realisation of new projects. The definition is that it is the act by which a debtor transfers something to the creditor in lieu of payment. It is already possible to pay succession taxes by especially valuable works of art. The fundamental characteristics are:

- the existence of a debt, which can be a pure monetary claim;
- the transfer of a good other than the good that was initially due;
- the consent of the creditor;
- the goal should be to settle the debt.

Local authorities often have large debts but also extensive real estate which has lost its original functions and efficiency. Traditional sale being a one-off activity is not well-suited for implementing the specific projects the private sector wants. PPP is linked to public procurement contract and is often complex, subject to profitability risks for which the local authorities do not have the know-how.

The city of Ostend paid off of its loans by transferring real estate to the lender under conditions same as earlier realisation of planning and permitting conditions required for the project. This can settle a specific debt, a part of it or a combination of debts. There is a specific contract authority-lender. An optional clause is possible: surplus values realised by the lender in the exploitation of the project can lead to an additional settlement of debt by the authority. Of course the valuation of both real estate and outstanding debt is key. For real estate official purchase

committees are consulted, for outstanding debt the market conditions are taken into account.

It will only work if the 'datio' is conceptualised as a "modality of payment" to a prior loan contract concluded pursuant to Public Procurement Act. This implies that the realisation of the real estate project cannot be seen to be pushed by the local authority: no specifications for the realisation of the project beyond the requirements it sets for all constructions as the competent authority for town planning, environment and no treatment of the project differently from other projects. The authority can be financially involved in the project, but cannot steer the project.

Luc Asselman, Chairman of the public centre for social help of Merchtem and chairman of the board of directions of the Flemish Company for water supply, presented its experience of PPP for the building of senior housing. Merchtem has a senior housing infrastructure of 2 times 24 service flats and 92 rooms with residential care. Due to an ageing population there is a waiting list of 50 persons for service flats and 30 persons for residential care. Between 1991 and 2024 the 65+ population increased from 1 700 to 3 000. The financial plan for the realisation of the new buildings is a function of investment cost, revenues and operational costs of existing buildings and of future revenues and operational costs of the new buildings. Cash flow calculations for the period 2007 – 2033 resulted in a positive outcome. The first project launched in 1997 was already a PPP but the structure was unclear due to lacking legislation. In 2005 a second project lender procedure was set up for architecture, engineering, loan, general contractor. It became clear that the outcome was very expensive and demanded 4 to 5 years before starting. Therefore a new PPP was set up as this resulted in a serious gain of time. Dexia Bank became the only partner. Finance, design and building are closely linked. The budget was quite limited. The rent to pay started only 6 months after the first use of the building. The municipality was involved in all parts of the project. And cash flow was positive from the start.

Damien Legrand, Head of Guaranteed PPP of Deutsche Pfandbriefbank tried to answer the question: is PPP still a solution for public sector investments? The credit crunch had a serious impact on the PPP market. Shortening maturities due to liquidity risk aversion created a conflict with PPP contracts which are long by nature. The refinancing risk has to be shared between private and public sector. Closure of syndication and securitization and scarcity of bank capital resulted in lower underwriting tickets. Club deals are still necessary but the transactions delivery time is increasing. In order to reduce capital consumption and to deepen liquidity, public sector guarantees and or partial acceptance of PPP receivables assignment were set up. Nevertheless PPP is still a solution. It enables the public sector to deliver projects from their stimulus plans in a swift and efficient manner. The PPP margins have increased to 1,5 – 2,5% per annum but the premium compared to direct public finance is rather stable at around 1% per annum. Banks are back in the market thanks to credit quality and relative isolation from economic crisis. However PPP requires stronger expertise from the public sector side which excludes smaller projects.

According to Steven Benoît, Head of Public Real Estate of Dexia Bank underlined that PPP is still in a learning phase within the public sector. Funding is not obvious and pricing is quite difficult due to a changed market environment. An appropriate risk/price balance must be the goal. Banks must advise its clients and not only sell specific products. As bank professionals it our task to be close to the market and our clients to develop our plus value.

The debate focused on the fiscal aspects of the "datio", as a way to escape from the tender procedure, on the merits of a sale and lease back solution, on the possible reclassification risk of the real estate. The accounting implications of PPP, the debudgetting effect of investments, fiscal optimisation, project outsourcing, and the implied discipline were addressed. It is clear that PPP still has a great opportunity to be a valid solution for local investments.

In his concluding remarks Stefaan Decraene stressed the interesting and fruitful exchange of views during the conference. Dexia and Depfa have been hit by the crisis differently than other banks due to their financing scheme. There are a lot of European initiatives which must be explored to activate local authority project financing. Of course liquidity is still crucial. New regulation must be incorporated in a move to an adapted business model. Leverage ratio, maturity gap, liquidity ratio will have an impact. Prudent innovation is a necessity. Securitisation will not disappear but some constraints could be launched by the new regulation. Could the "public banking" banks prepare a white paper or memorandum to explain their specificity compared to other traditional commercial banks in order reinforce the service to the local authorities?