

NEWS letter

Centre International
pour le Crédit Communal

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The Newsletter contains important information about the affiliated institutions. Among other items, Newsletter contains articles on interesting developments, new products, cooperative ventures and summaries of annual reports. Contributions to the Newsletter are very welcome and should be submitted on disk (preferably in Word for Windows), by e-mail or by fax. Please direct questions and comments regarding the Newsletter to the secretariat.

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In this edition of the Newsletter the Conference of the International Centre for Local Credit in Vienna on May 18-21 casts its shadows before.

Our host, Kommunalkredit Austria AG has made a lot of effort in collaboration with the Centre's secretariat to provide us with an interesting and attractive programme. When we look at the number of participants, we may conclude that they succeeded in doing so!

This Newsletter is partly dedicated to the forthcoming Conference.

Furthermore, the results of some of our member institutions are presented and our conference host unfolds its plans for the future. Also, a retrospective view on the Staff meeting in Frankfurt is given. This meeting was also a great success. We are DeKaBank grateful for the hospitality!

Pim Vermeulen, Secretary General

Conference host Kommunalkredit Austria expands business

For Kommunalkredit Austria, 2004 was an eventful year. After-tax profits and total assets grew the 10th time in a row. But above all, the decision was made to service the markets in Central, Eastern and South-Eastern Europe through the establishment of Dexia Kommunalkredit Bank.

The history of Kommunalkredit Austria starts in 1958 with the establishment of 'Österreichische Kommunalkredit Aktiengesellschaft zur Aufschließung von Industriegelände'.

Initiators had been Dr. Bruno Kreisky and Dr. Hermann Withalm. The underlying idea was the creation of a specialized bank supporting local authorities in Austria through the provision of long-term finance. From that idea, Kommunalkredit developed itself into an European specialist bank, providing finance for public investments projects as well as management services for public principals. Through its funding instruments – especially the AAA-rated Kommunalkredit Covered Bonds as well as environmental bonds – Kommunalkredit has a high reputation among sustainability oriented investors.

At present, the majority of the clients are local authorities, municipalities and municipal organisations, provinces, national governments and their administrative authorities, international financial institutions, institutional investors like banks, insurance companies and eco-funds.

The shareholders are Investkredit Bank AG, Dexia Crédit Local and the Austrian Association of Municipalities.

SOME HIGHLIGHTS OF ITS HISTORY

- In the mid seventies, a special financing scheme in support of investment projects with significant effects on the labour market was introduced. The special function of Kommunalkredit was underlined by the acquisition of a 15% share by the Republic of Austria.
- In the mid-eighties the Articles of Association were amended. Investkredit Bank AG took over the majority of Kommunalkredit shares. The name was changed into 'Österreichische Kommunalkredit Aktiengesellschaft'.
- In the years thereafter, support schemes in co-operation with the federal pro-



vinces were introduced: 'Structural Renewal Credit Scheme' for disadvantaged regions and 'One-Billion Leisure Industry Credit Scheme' in support of key projects in the field of tourism.

- In 1990 a decision of principle has been made: The activities of Kommunalkredit were focused on the financing and promotion of investment projects intended to improve the regional infrastructure and enhance the level of environmental protection.
- In the first half of the nineties Crédit Local de France (subsequently renamed Dexia Crédit Local) acquired 26% of the share capital. Kommunalkredit was given the mandate to administer the system of federal support to environmental programmes and manage the Environmental and Water Management Fund.
- From 1995 to 1997 Kommunalkredit launched and expanded its consultancy business in partnership with international organisations (World Bank, EBRD, EIB) and the European Commission. The implementation of the Maastricht Project on behalf of the Federal Government took place.
- In 1998/1999 the Debt Issuance Programme for Kommunalkredit bonds was introduced to facilitate access to attractive refinancing sources. The name was changed to 'Kommunalkredit Austria AG'.
- The first years of the 21st century saw a further expansion of international financing operations and – together with

Dexia Crédit Local – Kommunalkredit acquired a majority holding in Prvá Komunálna Banka. New shareholder structure: 51% Investkredit Bank AG, 49% Dexia Crédit Local.

- 2002/2003: With two double-A ratings, Kommunalkredit was the best-rated Austrian bank not covered by a public guarantee. Kommunalkredit International Bank Ltd in Cyprus, Kommunalkredit Polska in Poland, as well as TrendMind as the Bank's IT subsidiary and Kommunalkreditleasing GmbH in Vienna were founded. Extension of asset management services for the public sector. A new product – the AAA-rated Kommunalkredit Covered Bond – was introduced with great success.

2004 – START OF A NEW ERA

2004 was another very successful year for Kommunalkredit: Total assets grew again by 45.2% to EUR 14.2 bln and after-tax profit for the year increased by 21.8% to EUR 32 mln, leading to a further consolidation of Kommunalkredit's position as the No. 1 provider of public finance in Austria. In 2004, the Austrian Association of Municipalities, holding 0.22%, became a new shareholder in Kommunalkredit. Four new subsidiaries were established (operating in the fields of custody business, asset management, e-government and public-private partnerships). Continued success with covered bonds.

But above all, 2004 marked the beginning of a new era for Kommunalkredit: The decision to service the markets of Central, Eastern and South-Eastern Europe from Vienna together with Dexia Crédit Local through the establishment of Dexia Kommunalkredit Bank is of far-reaching strategic importance. It provides the basis for an even more dynamic development of Kommunalkredit's business in the years to come.

The new bank services a market of 136 million inhabitants with an above average rate of economic growth and an estimated demand for public infrastructure investments worth more than EUR 200 billion over the coming fifteen years.

This is both a challenge and an opportunity, which Kommunalkredit is taking up in tandem with Dexia as a strong partner. Dexia Kommunalkredit Bank (Dexia-Kom), with 50.84% held by Dexia and 49.16% by Kommunalkredit, intends to be among the leading players in the field of public finance in these countries. Based at the Kommunalkredit headquarters in Vienna, the new bank draws on the staff resources of Kommunalkredit. Dexia-Kom has subsidiaries in the Czech Republic, Slovakia and Poland; currently a subsidiary in Bulgaria is being established. Local business units in Hungary and Romania will probably follow in the near future.

Important role for government guarantees in housing policy

In the wake of the reconstruction after World War II, guarantee systems for financing in the renting and owner-occupied housing sector have been developed in many countries. As a result of the political, cultural, economical and legal differences between the various countries, these systems have been crystallized in various manners.

Their common denominator lies in the public objectives

and the corresponding public involvement.

In order to learn more about the differences and characteristics of several guarantee systems in the world, Foundation Home-ownership Guarantee Fund, the Bank Nederlandse Gemeenten and the Foundation Social Housing Guarantee Fund took the initiative to have an inventory study done. The study dealt with the guarantee systems of countries within the Euro-

pean Union and outside the European Union, such as Canada, Japan and the United States. The study focused primarily on guarantee funds that receive government funding in whatever form. In addition the United Kingdom was also included in this study, although that country does not know a governmentally funded guarantee system.

The study was done by the Dutch research bureaus Onder-

zoeksinstituut OTB and RIGO Research & Advies. The study gives an overview of the manner in which the guarantee funds work in the various countries and in which historical and economical context this takes place. The publication shows that guarantee funds in which the government is involved are not an exceptional phenomenon and that their number is on the increase. There is also a growing interest in the European

Union, in particular from the newly entered countries in the Dutch system of government backed guarantee funds.

SOME INTERESTING CONCLUSIONS

Government guarantees are instruments for improving affordability and accessibility of good housing. This aim is shared by all countries in this study, but the guarantee is a particularly strong stimulus for investments in the USA, Canada and Lithuania. This guarantee takes different forms. In some countries there is a subsidized guarantee, that is fee-free for borrowers. Other countries have a cost-price-based government guarantee, which aims to operate under market conditions. The target group of the government guarantee is commonly defined by a maximum house price or maximum loan. In some countries however, this guarantee covers the whole market.

The guarantee offers better access for the borrowers to mortgage loans. In most countries a guarantee allows a loan-

to value ratio of 95-100 per cent.

As for the rental sector, the study concludes that there are large differences in size. The share of the social rental sector varies from 1 per cent in the US to 35 per cent in the Netherlands. The size of the private rental sector is the largest in Germany. In most countries the private rental sector is larger than the social rental sector, with exception of the United Kingdom and the Netherlands. Social rental sector covers various categories of landlords. In the Netherlands the social sector is entirely in hands of private non-profit organizations. In other countries, local government plays an important role. When a government (agency) owns social housing, this is financed via the public sector. Then guarantees are not a separate instrument in financing social housing.

The policies relating to the rental sector varies widely as well. In some countries the rental sector has been strongly marginalized in recent years as

regards size and consideration in policy. At the other end, in the Netherlands, Denmark and Sweden the rental sector is in the focus of the public housing policy. Germany holds a special position. Rented housing there is built with government support. Once this support has been repaid, the rented housing is regarded to be in the private rental sector.

In many countries the role of the government is changing. Direct support, often in the form of subsidies, is under discussion or is being reduced. Forms of government support that are less demanding on the government's budget are being sought. In the countries studied, there are less active guarantee funds in the rental sector than in the owner-occupied sector. Some of that funds are operating in both the rental and the owner-occupied sector. Other countries have separate funds for the rental sector. With the exception of the Netherlands, all the guarantee funds belong to the (semi-)public sector. The government is directly

or indirectly involved in providing the guarantee. In the Netherlands, the guarantee fund covers the risks via contribution from the housing associations, partly as premiums to be paid for issuing the guarantee, partly as contingent liabilities. Central and local government act as the backstop only. When necessary, finances of housing associations are restructured by a separate public organization, the Central Fund for Social Housing. The resources needed for this are generated by the housing association themselves. Only when the restructuring by the Central Fund would be inadequate and next to this, the Social Housing Guarantee Fund would have insufficient resources to cover the guarantee liability, the backstop function of local and central government will be called on.

In the Centre Conference workshop 'Non accounted forms of funding', Johan Conijn will discuss the role of guarantee funds and focus on the context in which the two Dutch guarantee funds function.

Emissionszentrale Schweizer Gemeinden special guest at Centre conference

The Emissionszentrale der Schweizer Gemeinden (ESG) was founded in 1971, as an initiative of the Swiss Municipal Association. In the beginning of the seventies of the past century, Swiss municipalities faced large difficulties in meeting their demands for loans, as a result of the credit restrictions of the Swiss government during that booming period.

In this situation, possibilities were investigated to accommodate the access of municipalities to the capital market. The foundation of ESG as a co-operation of Swiss municipalities and cantons was the result. By issuing bond loans, ESG can

provide the members with long-term loans under favourable conditions. ESG issues bond loans under its own name, but on request and on the account of participating municipalities. Public loans are issued with the liability of the participating municipal entities for their respective share in it.

Participators stand as guarantors to the bondholder for the same amount. This additional pro rata guarantee could be fully or partially called on if another member were to default on its portion.

Since 2000, an extra security is provided as the insurance company obliges itself

to guarantee up to 10 percent of the original amount of an ESG issue, as soon as a delay in payment of one of the participants occur.

In 2001, a strategic cooperation agreement with Credit Suisse was signed, which enhances the resistance against delays in payment or insolvency of its debtors.

The guarantees provided, makes ESG an attractive issuer on the financial markets. ESG, that has applied for the membership of the International Centre for Local Credit, will be represented by Mr. Alexander Glatthart.

Palais Schwarzenberg has an eventful history



The gala dinner of the Conference on Friday takes place in palais Schwarzenberg, one of the many beautiful palaces that characterise Vienna. Situated in the heart of the city, its 18-acre private park forms an unique oasis in the busy city-centre. It is one of the last family-owned Palais in Vienna.

At the end of the 17th century, shortly after the second Turkish siege of Vienna, one of the most noteworthy of all the aristocratic palaces of the baroque period was commissioned. In 1697, Lukas von Hildebrandt received the assignment by Prince Heinrich von Mansfeld-Fondi to build a new palace with an orangerie and formal gardens.

Upon the death of Prince Heinrich Mansfeld-Fondi in 1715, the construction came to a halt and the Schwarzenberg family acquired the uncompleted work with all its surrounding grounds. Prince Adam Franz zu Schwarzenberg commissioned Johann Bernhard Fischer von Erlach – together with Lukas von Hildebrandt the most significant builder of European baroque – to complete the Palais and the gardens. But also Fischer von Erlach did not see his plans fully executed, since he passed away in 1723. It was his son Josef Emanuel who finally finished the Palais and gardens in 1732.

Between 1722 and 1726, Daniel Gran painted the magnificent frescos in the ceiling of the ‘Marmorsaal’ which over the

years have virtually remained unaffected. The frescos in the dome of the ‘Kuppelsaal’ were partly destroyed in an air-raid towards the end of the Second World-War. The „Marmorsaal“ contains the only original baroque picture gallery in Vienna; it holds works by Carree, Tamm, Hamilton, Horemans, Wouvermann, Lingelbach, Wyek and some unknown masters.

Two paintings of Peter Paul Rubens adorn the walls of the room which has been named after the artist ‘Rubensaal’, ‘Ganymede’ which without any doubt has been painted by the master himself, while ‘Romulus and Remus’, even though coming from the master’s atelier, might have been partly executed by the master’s students.

The Palais still contains other works of art: in the ‘Speisesaal’ the still-lives of Franz Werner Tamm (1658 to 1724) in the ‘Speisesaal’, a collection of early 18th century Meissen vases, various goblins as well as a collection of East Asian and Chinese artifacts are particularly noteworthy.

The vast gardens were planned by Jean Trehet and built by the younger Fischer von Erlach on four levels of terraces with various ponds. The painting ‘Vienna, View from the Belvedere’ by Bernardo Bellotto, known as ‘Canaletto’, which can be admired in the ‘Kunsthistorische Museum’, is a marvellous illustration of what the gardens must have looked like in the 18th century. The stone vases designed by Fischer von Erlach as well as the two groups of

sculptures ‘The Four Seasons’ and ‘The Rape of the Sabine Women’ by Lorenzo Mattielli can still be seen in the gardens today.

In more recent history, the staunch and fervent opposition of the Schwarzenberg family towards fascism and the Nazi-regime from the beginning – followed by the second great war itself, could not remain without consequence to their Palais and estate. The National-Socialist powers requisitioned the Palais in 1940, removed a substantial part of its art treasures and used the Palais for their party purposes. During the Allied bombings in 1945, the west-wing, the cupola and the gardens in particular were partly destroyed. One year later, in 1946, Prince Adolph zu Schwarzenberg took repossession of his Vienna Palais and began rebuilding, a task completed only by his heir Prince Heinrich zu Schwarzenberg in 1957.

In the early sixties, a hotel-pension was opened in the Palais and the state rooms were occasionally used for entertainment purposes and balls. In 1968, a bar and restaurant were added and a full service hotel operation started to develop.

Today the Hotel im Palais Schwarzenberg comprises 36 rooms and 8 suites, all individually furnished.

Five separate state baroque rooms and a spectacular entrance hall lend themselves for events of any kind. Austrian cuisine with a Mediterranean touch is served in the ‘Terrassenrestaurant’. Guests also have the exclusive right to use 18 acres of private park with resting lawn, jogging paths and five clay tennis courts beside the Belvedere castle.



Nederlandse Waterschapsbank N.V. enjoys a successful 50th anniversary year

Net profit rises 31.4%

The policy for 2004 was based on controlling costs, reinforcing the market position and an expected slight increase in profit.

New long-term loans granted of € 3.5 billion fell short of expectations, owing to lower funding requirements of local authorities. Market share was maintained in the various segments of the public sector market and increased in some. Interest income was markedly higher at € 112.0 million, up 24.9% on 2003. This can be attributed to an advantageous yield curve, favourable short-term financing opportunities and active asset and liability management.

Thanks to the joint efforts of all employees, not only did income increase significantly in 2004, but also expenses dropped 9.8% compared with 2003 to € 9.2 million.

On balance, this resulted in a 31.4% increase in net profit to € 102.9 million.

The past year was also dominated by preparations for the introduction of the new financial reporting standards (IFRS) in 2005, the application of the Dutch Corporate Governance Code, a further increase in the

scope and definition of the risk management activities and the continuing preparations for the Basel II accord on the capital adequacy requirements for banks. The Bank also celebrated its 50th anniversary in 2004. This milestone was marked with a festive reception for shareholders and clients in the Amsterdam Concertgebouw on 22 June 2004 and a donation of € 78,000 to a water project for orphans in Burundi made in consultation with H.R.H. Prince Willem-Alexander. Finally, the Bank was faced with the plans of the Minister for Finance to include the two public sector banks under the corporate income tax regime as from 1 January 2005. The legislative amendments to effect this have now been made.

A cash dividend of € 678.08 per share will be paid to shareholders (2003: € 508.50), representing a total dividend for 2004 of € 40.0 million, compared with € 30.0 million for 2003. This will raise the pay-out ratio from 38.3% to 38.9%.

Shareholders' equity after taking account of the dividend payable grew 6.2% in 2004, from € 1,002 million to € 1,065 million. The return on average shareholders' equity was 9.6%, compared with 8.0% in 2003.

The capital ratio, the ratio of shareholders' equity (after accrual of dividends) to total assets, came to 3.8% (2003: 3.9%). The BIS ratio, the ratio of the capital base to risk-weighted assets, was 102% at year-end 2004 (2003: 88%).

The policy for 2005 is again aimed at maintaining the level of lending, controlling costs and

strengthening the market position. While conditions on the financial markets are expected to be less favourable and the impact of corporate income tax is anticipated, the effect of the application of IFRS on NWB's financial reporting is still uncertain. For this reason, the Managing Board does not wish to make a profit forecast for 2005.

Key Figures (in millions of euros)

	2004	2003
BALANCE SHEET		
Long-term loans and advances	24,074	21,999
Interest-bearing securities	2,106	2,236
Capital base after accrual of dividends	1,089	1,027
Total assets	27,975	25,729
RESULTS		
Income	112.0	89.7
Expenses	9.2	10.2
Addition to Fund for general banking risks	0.0	1.2
Net profit	102.9	78.3
Dividend per share in euros	678.08	508.50
RATIOS		
BIS ratio	102	88
Operating expenses/ total income ratio (%)	8.2	11.3

Bank Nederlandse Gemeenten: profit for 2004 remains high

BNG achieved a solid financial performance in 2004. With a Net Profit of EUR 301 million, the bank almost equalled its favourable result of 2003 (EUR 304 million). The interest result increased EUR 12 million to EUR 341 million. At EUR 9.0 billion, long-term lending was

below the historically high turnover levels of the previous years (2003: EUR 13.0 billion). BNG shares are 50% owned by municipalities, provinces and a Water Board; the remaining half is held by the State of the Netherlands.

The net profit of EUR 301

million was in line with the previously announced expectations. The EUR 3 million decline was the net effect of a fractionally higher total income and an increase of EUR 5 million in expenses. The interest result rose to EUR 341 million due to higher income from the

reinvestment of matured funds in the interest-bearing portfolio, new lending and the bank's asset and liability management.

The sharp fall in the demand for credit among municipalities and housing associations in 2004 was reflected in the lower

long-term lending turnover in these sectors. On the other hand, lending to healthcare institutions advanced strongly. In 2004, those institutions borrowed more than EUR 1 billion from BNG. Thanks to the Guarantee Fund for the Health Care Sector, BNG is able to provide this sector with long term loans under favourable conditions. BNG remains the foremost market leader in loans and advances to the public sector in the Netherlands.

In december 2004, a contract for the first public-private-partnership concerning the building of a school for secondary education was signed. BNG acts as financier on behalf of the private partners in this project.

In the beginning of 2005, BNG reached an interesting milestone. The bank administered its 100.000th loan in its history. A housing corporation borrowed an amount of EUR 3 million.

In february the BNG real estate development company BVG saw the light of day. The aim of BVG is the support of housing associations, care institutions and municipalities in the development and realisation of real estate plans, and contribute in that way to the feasibility of city restructuring plans.

The outlook for 2005 is surrounded by major uncertainties, particularly due to the introduction of IFRS. These new accounting standards may increase the volatility of results. In addition, the introduction of corporation tax and the ensuing first fiscal valuation of the bank will impact the result. In addition to these uncertainties, a lower result will be taken into account.

Balance Sheet as of December 31, 2004 after Proposed Profit Appropriation		
<i>In millions of euros</i>		
Assets	2004	2003
Cash and Cash Equivalents	344	200
Banks	8,394	6,939
Loans and Advances	62,836	61,152
Interest-Bearing Securities	12,793	11,472
Participating Interests	32	25
Property and Equipment	31	33
Other Assets	78	29
Prepayments and Accrued Income	4,078	4,055
<i>Total Assets</i>	<u>88,586</u>	<u>83,905</u>
Liabilities		
Banks	5,410	6,311
Funds Entrusted	5,355	6,281
Debt Securities	64,462	58,760
Other Liabilities	275	225
Accruals and Deferred Income	10,217	9,488
	85,719	81,065
Fund for General Banking Risks	102	102
Subordinated Loans	173	173
Equity	2,592	2,565
Liability Capital	2,867	2,840
<i>Total Liabilities</i>	<u>88,586</u>	<u>83,905</u>
Contingent Liabilities	851	849
Irrevocable Facilities	3,465	3,923

Profit and Loss Account as of December 31, 2004		
<i>In millions of euros</i>		
Income	2004	2003
Interest Income	2,939	3,103
Interest Expenses	2,598	2,774
Interest Result	341	329
Income from Securities and Participating Interests	8	22
Commission Income	11	10
Commission Expenses	5	5
	6	5
Results on Financial Transactions	1	(1)
Other Revenue	2	1
Other Income	17	27
<i>Total Income</i>	<u>358</u>	<u>356</u>
Expenses		
Administrative Expenses		
Staff Costs	37	35
Other Administrative Expenses	15	13
	52	48
Depreciation	4	4
Other Operating Expenses	0	0
Operating Expenses	56	52
Value Adjustments to Financial Fixed Assets	1	0
Total Expenses	57	52
<i>Net Profit</i>	<u>301</u>	<u>304</u>

Local public sector in EU maintains investment effort, preserves its financial equilibrium

At the end of 2004, Dexia published a study presenting the local public sector finance situation in the European Union. Using five indicators (expenditure, investment, taxation, budget balance and debt), this study gives an overview of the financial situation of the local public sector in the fifteen countries of the European Union. With the enlargement, it also includes a number of references to the local public sector in the 10 new member States.

The study shows that, in 2003, the local authorities in the fifteen countries of Europe actively took part in policies for controlling public debt and deficits, despite an unfavourable economic context. Indeed, at the same time they were successful in:

Containing the progression of their expenditure (1,165 billion* euros, +2.7% in volume)

Overall, local public expenditure in the Fifteen in the 1998-2003 period underwent strong annual growth (+4.2% in volume), following the various transfers of jurisdiction to local authorities in several European countries during this period. The particularly notable progression of local expenditure in 2002 (+5.8%), for example, can be explained by the transfer of health and education authority to the Spanish regions.

In 2003, the evolution (+2.7%) was lower than this average trend, despite the upward pressures of local social expenditure and the continued movement toward decentralisation.

Maintaining their investment effort: local investment outlays (141 billion euros; +0.5% in volume) remain high

Local investment outlays had an average annual growth of 3.5% between 1998 and 2003, with two major phases in their evolution: dynamic growth until 2001, then a slower evolution after that. This reversal of the trend was caused by the slowdown in the economies which, depending on the country, can be seen on the local level in an increase in local social expenditure, a less dynamic progression of local taxation and the implementation of measures designed to contain local debt and deficits within the

framework of domestic stability pacts. In this context, local investment was often used as an adjustment variable to avoid or limit local deficits. This was notably the case in Germany and Austria. The slower progression in local investment was also the consequence of a greater use of public-private partnerships in certain countries. In this type of setup, investment and debt no longer appear in the local public sector's accounts.

Local authorities in Europe nonetheless remain major investors: in 2003, they were at the origin of more than three-fifths of all public investment.

Preserving their financial equilibrium: local public deficits in the Fifteen countries of the European Union account for no more than 0.05% of the GDP

Throughout the 1998-2003 period, European local budgets remained in a close-to-balance position. In 2003, half of the countries even had local surpluses. These results are in contrast with those of public administrations in general, which had a net deficit (2.8% of GDP). The debt among local authorities (516 billion euros) remains under control. For 2004, the local public sector should continue to have a close-to-balance budgetary position.

The ten new member States of the European Union are characterised by growing decentralisation and major investment efforts made by the local authorities: local investment stands at 2.0% of GDP in the Ten compared to 1.5% in the Fifteen, proof of the active role now played by the local public sector in upgrading infrastructures in these countries.

One last point is common to most of the twenty five members of the European Union: local tax reform was undertaken in 2003 and 2004, as was the case in France. This often limits the margin of flexibility for local authorities concerning certain taxes or an increase in the share of State taxation redistributed to the local authorities. Reforms of the local taxes paid by business-

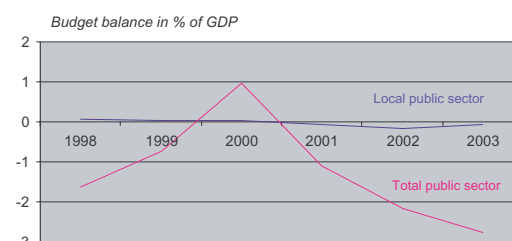
es have notably been undertaken in several countries.

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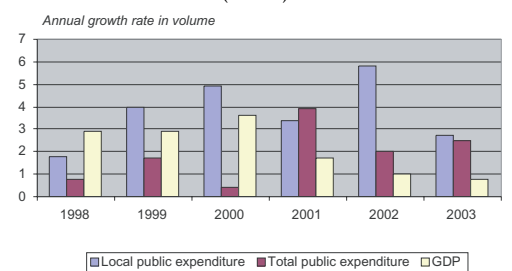
- Study of Local Finance in Europe, Dexia, November 2004 (available on-line at the www.dexia-creditlocal.fr site).
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- Hospitals in the 25 Countries of the European Union, a comparative table, March 2005.

* 1 billion = 1,000,000,000.

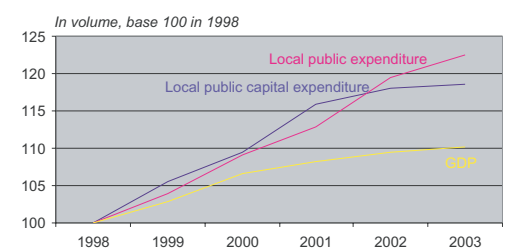
Local public governments do not generate public deficits (EU-15)



Local public expenditure contained in 2003 (EU-15)



Local public capital expenditure from 1998 to 2003 (EU-15)



Enlightening Centre staff meeting on Basel II

The staff meeting in Frankfurt early February, hosted by DekaBank, discussed the consequences of the Basel II banking accord for local authorities.

Like the present Basel accord, Basel II sets out a framework for assessing and managing banking risks. It deals especially with credit and operational risks and the amount of shareholders' equity that needs to be maintained to cope with them. However, Basel II is far more refined than the present version. The new accord is expected to take effect at the start of 2007, but all banks are already taking stock of its implications. Banks must make important decisions on how to adapt their organisations to benefit fully from the opportunities that Basel II offers. So the staff meeting, which addressed mainly credit risk issues, came at an opportune time, judging by the considerable interest among member banks. Fourteen banks were represented.

The staff meeting began with a representative of PricewaterhouseCoopers (PwC) examining choices and dilemmas for the banks. Should I opt for an advanced approach, enabling me to maintain less capital for the loans portfolio (which would be cheaper), but for which I will need to create an extensive control system (which

means more costs)? Or should I keep it simple (lower costs), which means I would need to maintain more shareholders' equity as and when necessary (more expensive)? The answer depends on factors like the type of customers a bank has. For a bank with mainly large customers with ratings from one of the rating agencies like S&P or Moody's, it may be more effective to choose the simple model. In other cases, where a bank's customers include numerous smaller companies without an external rating, the extra effort required for an advanced model for risk assessment and reporting will be rewarded by greater competitive strength. PwC provided numerous tips and identified matters participants will need to consider in their decision-making.

As the main purpose of staff meetings is to learn from each other, time was reserved for hearing about the experience of two members, Dexia Credit Local and DekaBank. Dexia Credit Local began making its preparations very early. When the outlines of Basel II became clear in 2001, Dexia made a strengths/weaknesses analysis of its principal subsidiaries. The findings of the analysis were used to produce an action plan designed to ensure Dexia is completely ready for Basel II when it comes into force. Dexia has clearly opted for the

extensive (advanced) model. In terms of credit risks, it will be necessary to establish for all types of counterparties an internal rating classification system. The bank will also have to make its own estimates of losses if a debtor ceases to be able to meet its obligations. This is an enormous job, because it involves sifting through a large volume of historical data. But it is the only way to gauge the likelihood of a certain customer ending up in payment difficulties and defaulting and to identify important indicators for this eventuality. It is all the more difficult because internationally few examples can be found in the public sector of default cases. DekaBank has decided to determine credit risks using a simpler approach, although it will still produce an internal rating model. To calculate the consequences of defaults, the bank has adopted the values and calculations prescribed by the regulator. DekaBank is working with a number of other German banks to set down the internal rating classification.

Both banks are busily adapting their internal organisations to the new regulations. Most of the changes are designed to provide a better insight into the risks in the conduct of business and to manage them more effectively.

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