Public Debt

[Annual Report 2008]

[French Community]

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Foreword

The year 2008 was marked by an unprecedented economic and financial crisis, the duration of which is still uncertain.

In this context, the role of the public authorities has been and is essential in supporting the economy and employment.

At present, this support is made possible thanks to:

- The budgetary efforts toward debt reduction carried out under this legislature. In fact, following the Saint-Polycarpe agreements in 2001, the special financing law was substantially modified, providing the French Community (rated Aa1 by Moody's) with the financial flows allowing it to reach budgetary equilibrium and to implement its debt reduction. As of 31/12/2008, moreover, the ratio of debt/revenue stood at 35.3%.

  In its report of July 2007, the High Council of Finance stated that "the French Community closed its accounts for each of the years 2003-2006 by attaining its annual objectives (…). The positive accrued margin compared to the objectives reached 35.0 million euro". In its report of May 2008, the Court of Accounts confirmed this trend for 2007: the French Community observed its objective with a positive margin of 32.0 million euro.

- An appropriate debt management policy, guided by the constant search for the optimal risk/yield ratio.

Finally, it seems evident that as concerns their financing, public bodies will have to take account of the profound changes and reorganisations that have taken place in banking circles in general, and those in Belgium in particular. It certainly presents a major challenge for the coming years.

The Vice-President of the Government
of the French Community,
Minister of the Budget, Finance,
Civil Service and Sports.

Foreword 3

[Section 1]

Institutional Framework of the French Community 6

A. | Belgium: a Federal State 7
B. | Explanation of the Concept of Community 7
C. | The French Community: "Geographical" Organisation, Institutions, Competences and Financing 8

C.1. | "Geographical" Organisation 8
C.2. | Institutions 8
C.3. | Additional Designation: the Wallonia-Brussels Community 9
C.4. | Competences 9
C.5. | Financing 10

D. | Rules Governing Indebtedness of Federated Bodies 11

D.1. | Judicial Basis 11
D.2. | Types of Loans 12

[Section 2]

Administrative and Technical Framework for Management of the Debt and the Community Treasury 14

A. | Administrative Framework 15
B. | Technical Framework 16

[Section 3]

Treasury and Community Indebtedness 17

A. | General Presentation 18

A.1. | Components of the Community Debt as of 31 December: Variation from 2004 to 2008 (in million €) 18
A.2. | Evolution and Distribution of the Long-term Non-consolidated Community Debt 20

B. | Breakdown of the Components of the Debt 22

B.1. | Direct Debt 22

B.1.1. | Standard and structured private loans 25

B.1.2. | Domestic commercial paper programmes – Short, medium and long term 26

B.1.3. | EMTN financing programme 27

B.2. | Indirect Debt 29

B.2.1. | The university debt 30

B.2.2. | The paracommunity debt 31

B.3. | Treasury 32

B.3.1. | Overall treasury balance 32

B.3.2. | Description of revenues and expenses 32

B.3.3. | Rate of revenue collection and disbursement of expenditures 33

C. | Principles of Debt Management 35

C.1. | Reminder of the Principles of Debt Management 35

C.1.1. | Harmonisation of financing and debt management procedures 35

C.1.2. | Optimal distribution of the fixed rate and floating rate portions of the debt as a function of variation of the yield curve 36

C.1.3. | Active utilisation of the most suitable financial instruments 37

C.1.4. | Development of financing programmes 38

C.1.5. | Synergy in the financing and investment transactions of the French Community and public bodies integrated into the ESA 39

C.2. | Application of Management Principles 39

C.2.1. | The debt 39

C.2.2. | The treasury 41

C.3. | Interest Rate Curve in 2008 45

C.4. | Debt Management Tools 47

C.5. | Timetable for Amortisations 49

Institutional Framework of the French Community

A. | Belgium: a Federal State

In 1993, Belgium officially became a Federal State composed of two types of federated bodies: the Regions and the Communities (Belgian Constitution[1] – Article 1). At present, the country includes three Regions (the Walloon Region, the Flemish Region and the Brussels-Capital Region) as well as three Communities (the French Community, Flemish Community and German-speaking Community). With the exception of Flanders, which merged its regional and community constituents into a single unit, each federated body exerts its powers and responsibilities sovereignly through its own parliamentary and governmental institutions.

B. | Explanation of the Concept of Community

The Communities group people together according to criteria of language and culture. The field of action of each Community is defined with respect to four linguistic regions: the "French-language region", the "Dutch-language region", the "bilingual Brussels-Capital region" and the "German-language region" (Constitution – Art. 4). The linguistic regions are simple territorial subdivisions having no political or administrative body and should not, consequently, be confused with the three large Walloon, Brussels and Flemish Regions (Constitution – Art. 3). Given the bilingual nature (French/Dutch) of the Brussels-Capital linguistic region, the two large Communities of the country (French and Flemish) are authorised to exercise their powers there within the limit of their competences. However, the absence of an official linguistic census making it impossible to differentiate people in this respect, the competence of the two Communities has been limited there to institutions having opted for one of the two linguistic adherences. This special feature implies that the Communities are human entities and not territorial entities in the standard sense of the term. As for the Regions, they are full-fledged territorial entities and exercise their competences in matters completely distinct from those of the Communities.

This two-level federalism results from the historical development of the reformation of the Belgian State.

[1] Constitution enacted on 17 February 1994.

c. | The French Community: "Geographical" Organisation, Institutions, Competences and Financing

c.1. | "Geographical" Organisation

The French Community is a federated body of the Belgian Federal State. Its legal existence is ensured by Articles 1 and 2 of the Constitution.

Its competences are exercised with regard to persons living in the territory of the "French-language region" (Wallonia, with the exception of the inhabitants of the German-speaking Community) and the monolingual Francophone institutions of the "bilingual Brussels-Capital Region".

c.2. | Institutions

The institutional organisation of the federal bodies is defined by the special law on institutional reforms (LSRI) of 8 August 1980, as modified in 1988 and 1993.

The Parliament[2] of the French Community is a monocameral assembly comprised of 94 indirectly elected members: the 75 Walloon regional representatives and 19 Brussels Francophone regional representatives. It exerts legislative power through decrees and in particular votes on the budget and the adoption of accounts.

The Government of the French Community presently includes seven members[3] and represents, since the regional and European elections of June 2004[4], a coalition of the Socialist Party and the Humanist Democratic Centre, who together make up 62.4% of the seats in the Parliament of the French Community. Charged with the exercise of executive power, the Government ensures, among other things, the execution of the decrees voted by Parliament through orders. The Government is politically accountable to the Parliament.

Legislative power being exerted collectively by the Parliament and the Government, the latter also has a power of legislative initiative.

[2] Designation definitively accepted by the revision of the Constitution of 25 February 2005 on modification of the terminology of the Constitution (entered into effect on 21 March 2005). Previously, the official designation was "Council of the French Community".

[3] Several Community Ministers are also Regional Ministers; thus, the Walloon Minister-President also became the Minister-President of the Government of the French Community on 20 March 2008. In line with this movement, a Brussels Francophone regional Minister participates in the meetings of the Government of the French Community, and joint meetings of the French Community/Walloon Region and French Community/French Community Commission of the Brussels-Capital Region Governments are regularly organised.

[4] The next regional and European elections will take place in June 2009.

c.3. | Additional Designation: the Wallonia-Brussels Community

In its general policy declaration of May 1999, the Community Government decided that the French Community of Belgium would also be called the "Wallonia-Brussels Community". This designation aims to further highlight the linking role played by the community institutions between the Francophones of Wallonia and of Brussels. However, to avoid any confusion on the part of the reader of the present report, it should be stated that only the designation "French Community" appears in the constitutional text.

c.4. | Competences

The powers and responsibilities of the French Community are determined by the Belgian Constitution as well as by the LSRI of 8 August 1980, as modified. The issues which are part of its sphere of responsibility can be divided into four aggregates:

- culture (fine arts, theatre arts, audiovisual and sport);
- education (from nursery school to higher education);
- social issues (youth assistance, early childhood, health promotion, social assistance to prisoners);
- use of languages (in administrative and social matters)[5].

In the various areas over which it has charge, the French Community is also competent in the sphere of national and international cooperation, as well as that of scientific research.

In 1993[6], the French Community transferred the exercise of certain of its responsibilities to the Walloon Region and the French Community Commission of the Brussels-Capital Region. This transfer concerned in particular school buildings, sport infrastructures, tourism, professional training, and continuing education as well as health and social assistance policies.

[5] For further details, see the chapter "Economic and financial report" of the 2008 General Report (pp. 95-102), available on the budget site of the Ministry of the French Community at the following address: http://www.budget.cfwb.be/page04.asp.

[6] See in particular Decree II of 19 July 1993 granting the exercise of certain competences of the French Community to the Walloon Region and to the French Community Commission (entered into effect on 1 January 1994)..

c.5. | Financing

Financing for the federated bodies (Communities and Regions) is governed by the special law of 16 January 1989 on financing the Communities and Regions (LSF), as modified in 1993 and 2001.

This law provides, in its Article 1, that financing for the Communities is ensured through:
- non-tax revenue;
- allocated portions of taxes;
- a compensatory allocation from the Radio and Television Licence Fee (RRTV);
- loans.

The non-tax revenue consists of various receipts coming, for example, from enrolment fees in establishments for artistic education, diploma equivalence fees, various registration fees, etc.
The allocated portions of taxes are made up of allocations historically called VAT (Value Added Tax) and IPP (Personal income tax, *Impôt des Personnes Physiques*). These are amounts allocated by the Federal State, as listed in the LSF, independently of the actual collection of these taxes and levies.
The RRTV compensatory allocation, calculated as a fixed amount and indexed to the general consumer price index, has replaced the RRTV resource, which has become a regional tax, since the 2002 financial year.

The year 2001 was marked by a significant reform in the method of financing the French Community.

The special law of 13 July 2001 on refinancing the Communities and extending the fiscal jurisdiction of the Regions modified the LSF of 16 January 1989. Starting from 2007, the allocation coming from the VAT, which was already indexed to inflation, is linked to economic growth[7].

The French Community should therefore collect an additional financial flow estimated at € 4 billion over the period 2002-2010.

In the context of this refinancing, the Parliament of the French Community adopted a decree on 20 June 2002 on creation of the "French Community Savings Fund [*Fonds Ecureuil*]" for which the

[7] Originally, the growth indicator was the gross national product (GNP). The authorities very quickly replaced the GNP by the gross national income (GNI), before favouring in 2005 the gross domestic product (GDP) given notably its lower relative volatility and its greater predictability.

investment of the reserves must[8] "take place in assets fulfilling the following criteria:
1. be constituted of interest rate products, including derivative instruments in the context of a financial hedging strategy; 2. as of 31 December of each year, be composed of debt certificates of the French Community"; in this latter respect, the Court of Accounts[9] states that "debts for which the corresponding claims are held by sub-sectors of the public authorities cannot be involved in calculation of the public debt". The *Fonds Ecureuil* has continued to evolve, due notably to the development of jurisprudence on the interpretation and application of the ESA95 rules; thus the decree-programme of 15 December 2006[10] redefines the aim of the Fund as follows: "[it] has the aim of constituting and managing the financial reserves allowing it to carry out, in the framework of mission delegation, all the missions of a financial nature entrusted to it by the French Community. [...] is empowered with the following missions: 1. collecting its revenues and managing its expenses; 2. managing its reserves; [...]; 4. granting advances of funds in cases determined by the Government [...]; 5. Taking investments or granting credits with the characteristics of the 'OCPP code 08' in the sense of ESA95, under conditions determined by the Government".

[8] See Article 2 of the decree-programme of 21 December 2004 on various measures concerning the Budgetary Fund, the *Fonds Écureuil* of the French Community and debt reduction, university institutions, the *hautes écoles*, boarding schools, psycho-medical-social centres, school buildings, teaching and the status of members of administrative personnel, supervisory personnel, tradespeople and service personnel in teaching establishments organised by the French Community (entry into effect of Article 2: 1 January 2005).

[9] See the *Informational Document on ESA Methodology*, Report adopted on 18 May 2005 by the General Assembly of the Court of Accounts, p. 34. The document is available on the site of the Court of Accounts at the following address: http://www.courdescomptes.be/FR/PublicationsAutre.htm.

[10] Decree-programme of 15 December 2006 on various measures concerning boarding schools, psycho-medical-social centres, school buildings, financing of universities and *hautes écoles*, social grants for the *hautes écoles* and higher schools of the arts, budgetary funds, the guarantee granted by the French Community to the financial products of the RTBF and the *Fonds Ecureuil* of the French Community (entry into effect of Chapter X devoted to the *Fonds Ecureuil*: 1 January 2006).

D | Rules Governing Indebtedness of Federated Bodies

D.1. | Judicial Basis

By virtue of Article 49, §1 of the LSF of 16 January 1989, the Communities and the Regions can contract loans. They do not benefit directly from the guarantee of the Federal State in application of Article 15 of the LSRI of 8 August 1980.

By means of certain provisions of the LSF, the federal authorities have ensured supervision of the borrowing capacity of the federated bodies. Two objectives are pursued in this: on the one hand, protection of the economic union and the monetary unit (at the European as well as internal level); on the other hand, prevention of structural deterioration of financing needs (Article 49, §6). To this end, a section "Financing requirements of the public authorities" was created within the High Council of Finance (CSF). This agency is made up of representatives of the federal and federated bodies. It is charged with issuing advice on their financing needs and the manner in which they have, in the past, implemented the previous debt standard or, since 2003, observed the cooperation agreements concluded between the different regional and community bodies of the Federal State. This section can also submit advice to the [federal] Minister of Finance aiming to limit the borrowing capacity of a federated body. The adoption of such a provision must nevertheless observe strict rules of consultation between the parties concerned. It should be noted that the advice and recommendations issued annually by the CSF have acquired a great influence on the debt policy of the federated bodies. Since 1 September 2006 there are two permanent sections ("Financing requirements of the public authorities" section and "Fiscal concerns and parafiscality" section) and a Study Committee on Ageing. Advice on the initiative of or at the request of the [federal] Minister of Finance is of course possible.

D.2. | Types of Loans

The special law of 13 July 2001 on refinancing the Communities and Regions also substantially modified the modalities for recourse to loans for these bodies. Article 49 of the LSF stipulates henceforth as follows:

"§1 The Communities and Regions can contract loans in euro or foreign currencies."

"§2 The planning of public loans [in the strict sense][11] is set by the [federal] Council of Ministers after consultation with the governments [community and regional]. The terms and issue timetable for any public loan are submitted for approval to the [federal] Minister of Finance. In the event that approval is denied by the [federal] Minister of Finance, the government [community or regional] concerned can demand that the matter be brought before the [federal] Council of Ministers for a decision."

"§3 The Communities and Regions can issue private loans as well as short-term securities after having informed the [federal] Minister of Finance. [...]."

[11] That is, loans addressed to private parties.

The entry of these provisions into effect was set for 1 January 2002. This means that since this date, only a procedure of informing the federal Minister must be observed before recourse to a loan. The methods of communication and the content of this information (notably, amount and duration of the loan, financial terms, and co-contracting party) were the subject of an agreement[12] between the [federal] Minister of Finance and the community and regional Governments.

Only loans which are to be carried out with private parties are subject to approval from the federal Minister of Finance; all other loans require only that he be informed. The French Community has never to the present day had recourse to financing from private parties.

It should also be noted that the repeal of the former §4 of Article 49 of the LSF caused any allusion to the limitation of the borrowing field of the French Community to either the former Belgian franc zone or the present euro zone to disappear.

12 Agreement of 29 April 1991 on Article 49 of the LSF.

Administrative and Technical Framework for Management of the Debt and the Community Treasury

A. | Administrative Framework

The finances of the French Community are managed by the community Minister having Budget and Finance under his responsibilities.

By virtue of Article 3 of the decree containing the Ways and Means Budget of the Community, the Minister is authorised to subscribe loans authorised by the Parliament and to conclude any financial management transaction dictated by the general interest of the Treasury. This authorisation is however renewed each year and is also subject to observance of the procedures decreed by the Government.

Ministerial orders relating to management of the debt and the treasury are carried out within the Administration by the Debt Service; they are however charged with day-to-day aspects of this management[13].

The activities of the Debt Service are divided into two distinct units: the Front and the Back/Middle Office. While the first is responsible for concluding financial transactions in the money markets and financial markets, the second provides administrative, budgetary and accounting follow-up. In this matter, the Debt Service is assisted by a consultancy office which issues advice on all the transactions carried out as well as on the financial strategy to be followed.
The management activities of the Debt Service are subject to various controls, internal as well as external to the Administration. There are essentially three of these: the Finance Inspectorate, the Court of Accounts and the prudential supervision carried out by a statutory auditor agreed upon by the Banking, Finance and Insurance Commission.

In order to optimise the management of regional and community finances, organisational synergies have been set up between the Walloon Region and the French Community, notably by the creation of a Joint Treasury Council[14] within which the strategic orientations of management of the debt and the treasury, the coordination of community and regional finance policies, the determination of joint principles of financial risk management and the intensification of synergies in the light of institutional frameworks are discussed. This consulting body is presided over by a representative chosen by joint agreement by the community and regional Ministers responsible for Budget and Finance, and is made up of representatives of the regional and community Minister-Presidents, Vice-Presidents and Administrations; the Finance Inspectorate, the Court of Accounts, the statutory auditors and external experts

[13] See on this subject the decree of the Government of the French Community of 19 January 2009 on delegations of competence and of signature to general public officials and to certain agents of the Services of the Government of the French Community – Ministry of the French Community – General Finance Service – Debt Service.

[14] Cooperation agreement of 10 December 2004 instituting a Joint Treasury Council for the Walloon Region and the French Community.

also take part in the meetings of the Council. The Joint Council contains a Community Treasury Council[15] and a Regional Treasury Council[16] charged with assisting their respective Governments in day-to-day management of the debt and the treasury and ensuring the implementation of strategic decisions proposed by the Joint Council and decided upon by the Minister concerned.

B. | Technical Framework

The Debt Service has available efficient computer tools for carrying out its tasks. Thus, the Front Office is equipped among other things with software allowing it to re-evaluate at any moment and in real time the financial instruments to which the French Community holds title or for which it is issuer. As for the Back/Middle Office, it has available various computer platforms and software intended for back-up of all transactions concluded and production of semi-automated reports.

A comparative study completed in May 2008 by the PricewaterhouseCoopers[17]company, shows that the organisational and administrative procedures set up for management of the debt and the treasury within the Debt Service (49 items selected and classed into seven categories: governance, management and performance, Front Office, Back Office, Middle Office, computer systems, reporting) are in line with good practices identified in bodies carrying out similar activities at the international level, even ahead by comparison with public sector bodies. By way of illustration, the competitive call practices, verification of market data and independent validation of products is in line with the best market practices; the financing products and hedging instruments utilised represent a diversified mix of products in line with good benchmarking practices; the processes for handing confirmations and labelling transactions are in line with the best practices of treasury management; the processes in place observe the principle of separation of function; the physical access security is in line with the best market practices; etc.

As for the statutory auditors in charge of prudential supervision, they note in their report of December 2007 that "the tools and procedures put in place by the Debt Service are such as to allow evaluation and management of the risks[18] inherent in management of the treasury and of the debt of the Community. These tools and procedures lead to publication of reports that faithfully reflect the actions in question as well as the situation of the treasury and the debt of the Community".

15 See also the decree of the Government of the French Community of 21 January 2005 repealing the decree of the Government of the French Community of 7 December 1998 instituting the Treasury Council.

16 See also the decree of the Walloon Government of 23 December 2004 repealing the decree of the Walloon Government of 10 July 1997 instituting a regional Treasury Commission (CORET).

17 Following a joint state contract for analysis of the financial management procedures in place at the Ministry of the Walloon Region and the Ministry of the French Community compared to an international benchmark representing the standard procedures followed at the international level by similar bodies.

18 The four essential risks identified by the auditors in their report of May 2004 being:
• the interest rate risk and in particular the interest rate yield curve risk;
• the operational risk;
• the liquidity risk;
• the counterparty risk
.

Treasury and Community Indebtedness

A. | General Presentation

A.1. | Components of the Community Debt as of 31 December: Variation from 2004 to 2008 (in million €)[19]

The various components of the community debt drawn up as of 31 December for the years 2004 to 2008 have developed as follows:

table 1

Amounts in millions of €	2004	2005	2006	2007	2008
Direct debt [1]	2,598.1	2,630.5	2,704.8	2,707.0	2,709.0
University debt [2]	286.5	259.5	183.6	181.3	179.0
Paracommunity debt [3]	0.0	0.0	0.0	0.0	0.0
Long-term community debt [4] = [1] + [2] + [3]	2,884.6	2,890.0	2,888.5	2,888.4	2,888.0
Outstanding treasury commercial paper [5]	0.0	0.0	0.0	29.8	88.2
Current account debit [6]	60.4	32.4	46.4	23.1	0.0
Current account credit [7]	0.0	0.0	0.0	0.0	17.3
Short-term community debt [8] = [5] + [6] – [7]	60.4	32.4	46.4	52.9	70.9
Community debt held by the *Fonds Ecureuil* [9]	18.7	70.9	72.8	75.7	79.2
Total consolidated community debt [10] = [4] + [8] – [9]	2,926.3	2,851.5	2,862.0	2,865.6	2,879.7

It should be noted that, for the first time in its history, the French Community saw its total consolidated debt[20] decrease by € 74.8 million in 2005 compared to 2004, while its long-term debt grew by € 5.4 million for the same period.

In 2006, the total debt increased by € 10.4 million, exclusively due to the rise in current account debit of € 14.0 million as of 31 December compared to 31/12/2005; the nominal long-term community debt having, on its part, been reduced by € 1.5 million. The total debt as of 31 December 2006 remained below the total debt reported as of 31 December 2004 by 64.3 million. The total consolidated community debt was stabilised in 2007 compared to 2006: a slight increase of € 3.6 million (or a rise of 0.13%) is noted, due exclusively to a slight increase in the short-term indebtedness measured as of 31/12/2007 by comparison with that measured the preceding year; it remains less by € 60.7 million than that measured as of 31/12/2004. Despite the decision of the Government of the French Community to proceed with payment in December 2008 of the December 2008 wages[21] (payment of which was initially planned for the first days of January 2009), the

[19] The figures listed in the present report are in general expressed in millions of €; the underlying calculations being most often carried out to the cent, a difference due to automatic roundoffs can appear between a total and the sum of its constituent parts.

[20] The total non-consolidated nominal community debt (that is, essentially outside the *Fonds Ecureuil*) also decreased by € 22.6 million in 2005.

[21] See point B.3.3 of the present Report on the rate of collection of revenues and disbursement of expenses.

process of stabilisation of the consolidated community debt was sustained in 2008 compared to 2007: a modest rise of 0.49% (or € 14.1 million) was measured, also due to an increase of € 18.0 million in short-term indebtedness. In nominal terms, the consolidated debt as of 31/12/2008 remains lower by € 46.6 million than that reported on 31/12/2004.
It should be noted that the short-term debt [8] compared to the total consolidated debt [10] oscillates between 1.0% and 2.3% for the last six years and is very decisively less than 1% when compared to revenues.

The variation of the indebtedness over the last years can also be understood by analysis of the consolidated nominal debt stock for 2003-2008 in constant 2003 euro. It represents the variation of commitments toward external parties, where, in the interest of comparison, all the figures are presented in terms of 2003 value, based on inflation rates.

table 2

Amounts in million □	2003	2004	2005	2006	2007	2008
Debt stock in current □	2,908.3	2,926.3	2,851.5	2,862.0	2,865.6	2,879.7
Variation in debt		18.0	– 74.8	10.5	3.6	14.1
Inflation rate		2.10%	2.78%	1.79%	1.82%	4.49%
Debt in constant 2003 □	2,908.3	2,866.1	2,717.3	2,679.3	2,634.7	2,533.9
Variation in debt		– 42.2	– 148.8	– 38.0	– 44.6	– 100.8

The treasury of the French Community is comprised of financial accounts opened with its cashier[22]. All of these accounts together are subject to a merger of scale. The debit or credit balance of this merger is listed in the table above under headings [6] or [7].

The accounts with the cashier "outside merger" are presented separately as they are not included in the merger of scale of the accounts.

22 Designated in compliance with the provisions of the royal decree of 6 August 1990 setting the modalities for organisation of the treasury of the Communities, the Regions and the Joint Community Commission.

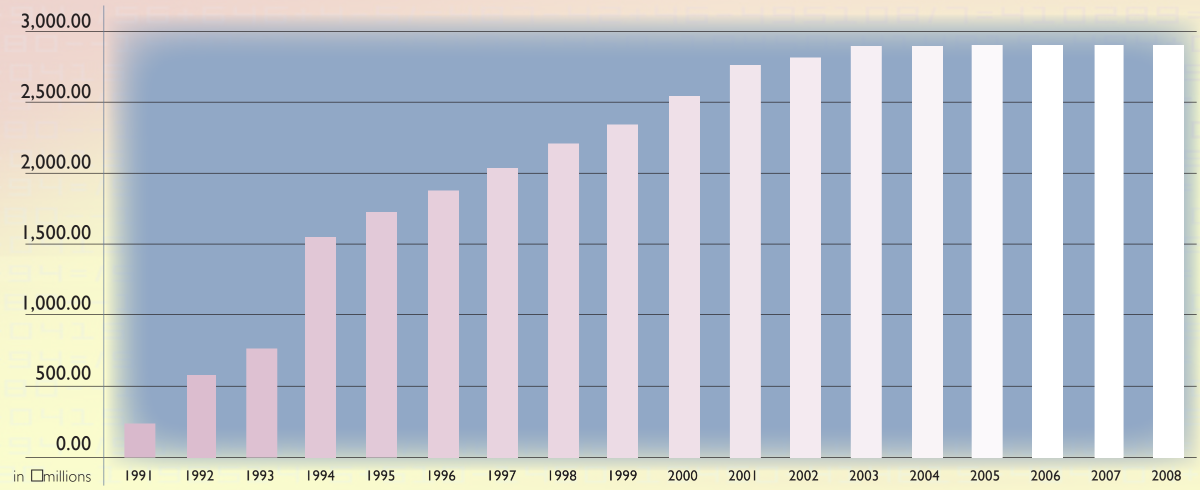
table 3

Amounts in million □ adopted as of 31 December	2004	2005	2006	2007	2008
Accounts of Community schools outside merger	43.6	43.3	39.5	40.1	40.9
Foreign currency provision accounts	0.1	0.1	0.1	0.1	0.1

A.2. | Evolution and Distribution of the Long-term Non-consolidated Community Debt

The variation from 1991 to 2008 of the total long-term community debt (heading [4] of the table above) looks as follows:

figure 1



The long-term community debt has thus been stabilised in nominal terms over the past six years. Its relative variation is shown in the table below:

table 4

Variation of the non-consolidated total long-term community debt

Year	Amount in million €	Variation in million €	Variation in %
1991	218.1		
1992	559.1	341.0	156.22
1993	744.9	185.8	33.23
1994	1,531.7	786.8	105.61
1995	1,707.2	175.5	11.46
1996	1,858.6	151.4	8.87
1997	2,022.9	164.3	8.84
1998	2,187.3	164.3	8.12
1999	2,328.5	141.2	6.46
2000	2,530.7	202.2	8.68
2001	2,741.5	210.8	8.33
2002	2,803.5	62.0	2.26
2003	2,884.6	81.1	2.89
2004	2,884.6	0.0	0.00
2005	2,890.0	5.4	0.19
2006	2,888.5	– 1.6	– 0.05
2007	2,888.4	– 0.1[23]	– 0.00
2008	2,888.0	– 0.4	– 0.01

[23] In reality, and by way of an aside, a reduction of the order of 0.09 million was measured, representing a relative decrease of 0.003%.

The distribution in 2007 and 2008 of the various components of the total long-term debt is as follows:

figure 2

Distribution of the outstanding amount of □2,888.38 million as of 31/12/2007

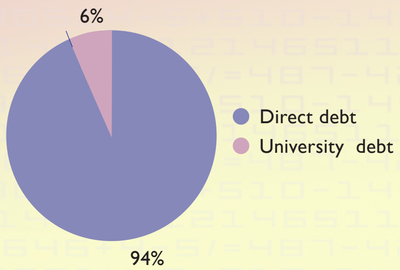
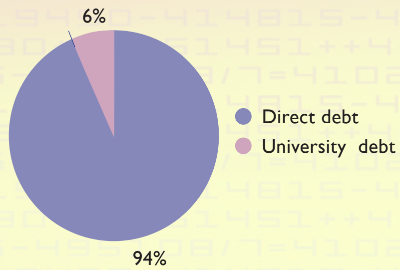


figure 3

Distribution of the outstanding amount of □2,888.02 million as of 31/12/2008



The relative share of the indirect debt thus continues to decrease, as the table below shows: the paracommunity debt is already totally extinguished (since the beginning of 2004); the university debt continues to decrease and will be completely amortised on 1 December 2037, if no early repayment is made from now to then.

table 5

Distribution of the long-term outstanding amounts as of 31 December

Year	Total debt in million □	Indirect debt in million □	Direct debt in million □	Direct debt in % of the total debt
1991	218.1	0.0	218.1	100.00
1992	559.1	0.0	559..1	100.00
1993	744.9	0.0	744.9	100.00
1994	1,531.7	591.9	939.8	61.35
1995	1,707.2	574.6	1,132.6	66.34
1996	1,858.6	564.9	1,293.8	69.61
1997	2,022.9	558.0	1,464.9	72.42
1998	2,187.3	563.4	1,623.9	74.24
1999	2,328.5	555.7	1,722.8	76.13
2000	2,530.7	547.9	1,982.8	78.35
2001	2,741.5	466.1	2,275.4	83.00
2002	2,803.5	441.7	2,361.8	84.25
2003	2,884.6	432.4	2,452.2	85.01
2004	2,884.6	286.5	2,598.1	90.07
2005	2,890.0	259.5	2,630.5	91.02
2006	2,888.5	183.6	2,704.8	93.64
2007	2,888.4	181.3	2,707.0	93.72
2008	2,888.0	179.0	2,709.0	93.80

B. | Breakdown of the Components of the Debt

The present Report deals only with the debt managed by the Debt Service of the French Community, that is, the so-called "direct" and "indirect" debts. Thus, the secured debt, as well as the debt intended to finance construction of cultural infrastructures, etc., are excluded.

B.1. | Direct Debt

Originally, the direct debt of the French Community consisted solely of loans contracted to satisfy its own needs. But since the mid-nineties, refinancing of amortisation of the indirect debt has been integrated into the direct debt. Consequently, the current variation of the outstanding amount of the direct debt includes re-borrowing of direct debt amortisations, but also of indirect debt amortisations.

According to the standards of public accounting, re-borrowing debt amortisations does not constitute an increase in its outstanding amount, insofar as this refinancing corresponds to the repayment of an equivalent amount.

In 2005, the outstanding amount of the direct debt increased by € 32.4 million, € 27.0 million of which relates to the amortisation of the university debt and € 5.4 million of which represent the consolidation of a portion of the short-term debt into long-term debt.

In 2006, the outstanding amount of the direct debt increased by € 74.3 million: this results from partial transfer to direct debt of the university debt amortised in 2006 in the amount of € 75.9 million; the difference of € 1.6 million represents reduction of the long-term community indebtedness.

The total amount in loans falling due in 2007 and capital repayments made during this same year comes to € 27.1 million, € 24.8 million of which comes under direct debt and € 2.3 million under university debt. A total amount of € 27.0 million was re-borrowed at the end of the 1st quarter of 2007 and classified as direct debt, which thus increases by € 2.2 million to reach € 2,707.0 million as of 31 December 2007: as for the long-term nominal community debt, it was reduced by a marginal amount of € 0.1 million compared to 31 December 2006.

In 2008, the total amount in amortisations was evaluated at € 255.4 million[24], € 255.0 million of which was refinanced into direct debt from the beginning of the year, bringing its outstanding amount to € 2,709.0 million as of 31/12/2008, thus reducing the total amount of the long-term nominal debt by € 0.4 million compared to that of the preceding year.

[24] € 2.3 million in capital repayments of university loans and € 253.0 million in loans falling due and listed as direct debt.

The variation of the outstanding amount of the direct debt (in million €) as of 31 December for the years 1991 to 2008 can be charted as follows:

table 6

Year	Loans	Amortisa-tions	Re-borrowed from amorti-sations	Outstanding
1991	218.1	0.0	0.0	218.1
1992	345.8	4.8	0.0	559.1
1993	224.3	38.5	0.0	744.9
1994	179.2	57.8	73.5	939.8
1995	175.5	67.1	84.4	1,132.6
1996	151.4	70.2	79.9	1,293.8
1997	164.3	57.6	64.5	1,464.9
1998	151.8	46.6	53.7	1,623.9
1999	141.3	585.8	593.4	1,772.8
2000	202.1	433.5	441.4	1,982.8
2001	210.8	411.7	493.5	2,275.4
2002	62.0	189.6	214.0	2,361.8
2003	81.1	421.5	430.6	2,452.2
2004	0.0	518.1	664.0	2,598.1
2005	5.4	417.3	444.3	2,630.5
2006	0.0	120.7	195.0	2,704.8
2007	0.0	24.8	27.0	2,707.0
2008	0.0	253.0	255.0	2,709.0

It should be noted that starting from 2003, the methodology for determining the financing balance authorised for the French Community by the CSF and the budgetary objectives set in the Cooperation Agreements between the federal body and the federated bodies was modified substantially in application of the prescriptions of ESA95. The result is an expansion of the scope of community consolidation. Thus, since 2003, a series of corrections have been integrated into the calculation of the financing balance, with the consequence of better adaptation of the calculation of the budgetary result of the Community by comparison with the accounting guidelines of the European Commission. This has necessitated an adaptation of budgetary policy.

The table given below illustrates that the French Community has more than observed the objectives assigned to it (by joint agreement) with regard to the financing balance over the last seven years:

table 7

Financing balances achieved compared to objectives[25]

Year	Objective in million €	Financing balance achieved in million €	
2001	–79.0	–57.1	Financing balance better than objective by €21.9 million
2002	–99.0	–88.9	Financing balance better than objective by €10.1 million
2003	–28.7	–28.9	Near-attainment of objective: financing balance below objective by €0.2 million
2004	–40.5	–11.5	Financing balance better than objective by €29.0 million
2005	–6.5	–6.6	Near-attainment of objective: financing balance below objective by €0.1 million
2006	1.0	7.3	Financing capacity exceeding objective by €6.3 million
2007[26]	–40.2	–8.2	Financing balance better than objective by €32.0 million

As indicated in the section "Financing requirements of the public authorities" from the High Council of Finance in its report of July 2007, "the French Community closed its accounts each of the years 2003-2006 by observing its annual objectives. (…) The positive accrued margin compared to the objectives reached 35.0 million euro."[27] We note that the accrued margin made available by the Community during the period 2001-2006 comes to € 67.0 million and to € 99.0 million for the period 2001-2007 based on the figures of the Court.

At the end of June 2008, the aforementioned section of the CSF published a recommendation on "Evaluation of the 2007 and 2008 budgets and of the new 2008-2011 Stability Programme"[28] in which the results are expressed in % of the GDP and are not quoted for each individual body, but in overall terms.

25 High Council of Finance – Section "Financing requirements of the public authorities", *Evaluation of the implementation of the stability programme in 2006 and prospects for 2007-2011*, July 2007, pp. 95ff. The document is available on the site of the High Council of Finance at the following address: http://www.docufin.be/websedsdd/intersalgfr/hrfcsf/adviezen/PDF/rapport2007.pdf.

26 Figures taken from: Court of Accounts, *Projection of the results of implementation of the budget of the French Community for the year 2007*, Report adopted 30 May 2008 by the French Chamber of the Court of Accounts, Parliamentary Document 557 (2007-2008) No. 1, p. 50. The document can be consulted on the site of the French Community Parliament at the address: http://archive.pcf.be/100000001005094?action=browse.

27 High Council of Finance – Section "Financing requirements of the public authorities", op.cit., p. 103.

28 High Council of Finance – Section "Financing requirements of the public authorities", Evaluation of the 2007 and 2008 budgets and of the new 2008-2011 Stability Programme, 115 pp. The document is available at the following address: http://www.docufin.be/websedsdd/intersalgfr/hrfcsf/adviezen/PDF/ltfr2008_06.pdf.

The budgetary objectives (expressed in million €) assigned to the French Community after the Interministerial Finance and Budget Conference of 1 June 2005 and confirmed by the Consultation Committee on 8 June 2005 can be presented as follows:

table 8

Year	2005	2006	2007	2008	2009
Objective	–6.47	0.96	-1.67	8.40	8.40

The budgetary objectives for the years 2006 and 2007 were subject to the supplementary agreements of 6 July 2005 and 26 October 2005 within the aforementioned Committee.

In 2007, in the context of intra-Francophone cooperation, the Walloon Region carried out a "transfer of objective of € 38.5 million" to the French Community. Concretely, the Region revised its objective by the abovementioned sum so that the global Region & Community objective was achieved.

In 2008, the initial budget showed a financing balance which attained the objective set at € 8.4 million. Following a request from the Federal State in February 2008, the French Community and the Walloon Region agreed, based on a "best effort", to a joint supplementary contribution of € 90.0 million to the Stability Pact. During the 1st budgetary adjustment of the French Community, measures were taken so that the projected financing balance would be brought to slightly more than € 71.6 million, or more than € 63.0 million above the objective of the cooperation agreement.

B.1.1. | Standard and structured private loans

The French Community has contracted standard private loans since 1991 and structured private loans since 1995. These are concluded with financial institutions, the range of which has considerably expanded over time.

The structures backing the loans can be extremely varied (swaption, series of swaptions, cap, floor, options with activation or deactivation barrier, etc.). They are developed by the French Community itself or proposed by a counterpart concomitantly with an underlying loan. The decisions to proceed in the matter result essentially from the impact produced by the structured product with regard to financing cost, risk and duration objective.

B.1.2. | Domestic commercial paper programmes – Short, medium and long term

Until the end of 2003, the French Community had two domestic financing programmes available with Dexia Bank: one devoted to the short term, for a sum of € 1.1 billion, and the other long-term, for € 1.4 billion. Since then, these two programmes have been combined into one. This then allows it to issue commercial paper having a maturity of one day to thirty years for a total amount of € 2.5 billion.

Since its establishment at the end of 1994, the French Community has used its short-term commercial paper programme at the same time for management of its treasury (see item B.3) and that of its consolidated debt, whether for the floating portion of this latter (successive rollovers), or, for the fixed portion, underlying a derivative product.

Moreover, based on its former MTN (Medium Term Note) programme, the French Community has since December 1995 issued OLCos (Community linear bonds). The total outstanding amount of the OLCos as of 31/12/2008 is € 183.0 million; the weighted average yield is 5.2% and the weighted residual term is 2.1 years.

table 9

Outstanding amounts of OLCos as of 31/12/2008

Amount in	Issue date	Maturity date	Yield in %
18,000,000.00	14/11/2002	16/11/2009	4.4125
125,000,000.00	22/03/2002	22/03/2010	5.3275
25,000,000.00	19/03/2002	19/03/2012	5.5425
15,000,000.00	21/02/2003	21/02/2018	4.6000

Total amount in 183,000,000.00
Weighted average maturity: 8.75 years
Residual term in terms of liquidity: 2.11 years
Weighted average yield: 5.21%

In addition, it has available since 2000 a short-, medium- and long-term financing programme with Fortis Bank for an amount of € 750.0 million.

We emphasise that in the context of diversification of its types and sources of financing, the French Community has had the opportunity to use dematerialized issues similar to the German Schuldshein, and in doing so, has been able to take advantage of an advantageous financing cost compared to other proposals received.

B.1.3. | EMTN financing programme

The Aa1/P1 rating granted by the Moody's agency to the French Community, confirmed year after year[29], as well as the changes made in the special financing law regarding certain loan conditions for the federated bodies[30], have allowed the Community to pursue new diversification in its financing sources, by among other things the establishment of an EMTN (*Euro Medium Term Notes*) programme.

Following a market consultation, the French Community charged Deutsche Bank and Dexia Bank with setting up this programme. The dealers are, besides the two banking institutions cited above, CBC Banque – KBC Bank, Depfa Bank plc, Fortis Bank, HSBC and Calyon Crédit Agricole CIB.

This programme allows the Community to issue short-, medium- and long-term paper (from 30 days to 50 years) for a maximum amount of € 1,500.0 million (€ 2,500.0 million since its latest update at the beginning of January 2008); however, the Community has not, to the present, used the said programme for short-term issues. The issues can be public as well as private, using notably the reverse inquiry process.

The EMTN programme was activated in the amount of € 535.0 million in 2004 (four issues, with a weighted average maturity of 10.0 years and a weighted average rate on a possible covered basis of 4.00%) and for € 425.0 million in 2005 (seven issues, with a weighted average maturity of 19.7 years and a weighted average rate on a possible covered basis of 4.14%). In 2006, the aforementioned programme was activated four times in the total amount of € 195.0 million: the weighted average maturity of the issues was 15.2 years for a net weighted average rate of 3.71%. In 2007, as indicated above, a sum of € 27.0 million was issued by way of re-borrowing on amortisations; in this latter case also, the EMTN programme was used via an issue of 15.0 years maturity at a net rate after IRS of 4.318%. Only 11.8% of the amounts to be financed in 2008 were financed in the framework of the programme cited, via an issue at 15.0 years for an amount of € 30.0 million and at a net rate after IRS of 3.811%. As of 31/12/2008, the programme was activated in the amount of € 1,212.0 million – or 48.48% of the total amount authorised since the last revision – the residual term in terms of liquidity being 10.54 years and the net weighted average rate, 3.91%.

29 See on this topic the press releases, *Analysis* and *Credit Opinions* published regularly since 17 April 2003. The last updated *Credit Opinion* was published on 26 January 2009.

30 As a reminder, the most important change is that the federated bodies can from now on finance themselves on the international capital markets without special authorisation from the federal authority. Article 49, §3 of the LSF specifies however an obligation to inform the [federal] Minister of Finance.

Through the establishment of this financing programme, along with the achievement and confirmation from year to year of an Aa1/P1 rating, the French Community is seeking to ensure better visibility on the financial markets, which should allow it to facilitate all the more its access to financing and to optimise its financing costs.

During the revision of the programme finalised on 11 January 2008, while opting for a maximum maturity of issues at 50 years, it was decided in particular to resort to the clause for increasing the maximum volume of the programme, to bring it to € 2,500.0 million. It is of course understood that this does not constitute in any way a message of modification of the debt strategy of the Community, but of the desire for probably increased utilisation of a programme which has been proven in terms of soundness and flexibility of utilisation. The available balance activatable as of 31/12/2008 thus went from € 288.0 million to € 1,288.0 million, which can prove useful in dealing with the latest refinancing "peaks" of 2009 (€ 450.3 million) and of 2011 (€ 485.4 million).

In a concern for reducing liquidity and refinancing risk, lines of credit which can be drawn upon at any time, without reservation or non-utilisation fee, have moreover been opened since 1994.

As some of these lines expired on 31 December 2003, the French Community opened new ones in the context of the consultation on establishment of the EMTN programme.

Its financing capacity is thus ensured over both the short and long term on conditions determined in advance (compared to specific references) for a total amount of € 1,610.0 million as of 31 December 2008, against € 1,735.0 million as of 31/12/2007.

The following graphs specify, for the total debt, the proportion of the outstanding amount in different types of loans as of 31 December 2007 and as of 31 December 2008.

figure 4

Different types of total debt loans as of 31/12/2007

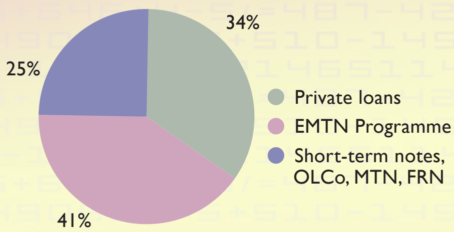
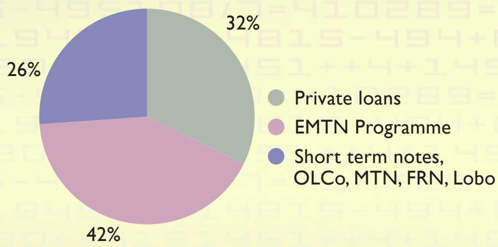


figure 5

Different types of total debt loans as of 31/12/2008



B.2. | Indirect Debt

The community debt includes the indirect debt. This, out of concern for consistency and rational management, is administratively grouped with the direct debt in the portion of the budget relating to the public debt (Chapter IV of the General Expenditures Budget).

The indirect debt corresponds to loans issued by third-party organisations to the French Community, for which the financial charges lie, in whole or in part, with the budget of the latter.

The principal characteristic of the indirect debt is that it is being eliminated. There are three reasons for this. On the one hand, this debt results from loans contracted in the past. On the other hand, financial solicitation of this type no longer occurs currently. Finally, the amortisations being refinanced via the direct debt, a shift in the outstanding amount is occurring between the two types of debt.

Moreover, until 2004, the indirect debt of the French Community was split into two parts according to the original issuers. These involved the universities and certain community organisations of public interest (the last tranche of the debt connected with these latter was repaid on 29 January 2004).

B.2.1. | The university debt

The university debt has been contracted by the universities to finance their real estate investments.

Two types of investments should be distinguished:
- the "academic" investments aimed essentially at construction of buildings intended for teaching (auditoria, etc.);
- the "social" investments aimed at construction of buildings intended to accommodate students outside courses (student homes, university restaurants, etc.).

The financial charges (interest and amortisation) for the "academic loans" are entirely assumed by the budget of the Community. On the other hand, only the part of the interest above 1.25% for the "social loans" is assumed by the Community. The balance of the interest as well as the amortisation of these loans is drawn from the budget of the universities themselves.

Following this distinction, only the academic debt of universities is considered an integral part of the debt of the French Community.

table 10

Evolution of the outstanding amount on the academic university debt, 1994 – 2008

Year	Outstanding as of 01/01	Amortisations as of 31/12	Outstanding as of 31/12
1994	543.4	12.7	530.7
1995	530.7	14.4	516.3
1996	516.3	6.7	509.6
1997	509.6	3.8	505.9
1998	505.9	4.0	514.5 [31]
1999	514.5	4.3	510.1
2000	510.1	4.5	505.7
2001	505.7	78.3	427.4
2002	427.4	5.1	422.3
2003	422.3	5.4	416.9
2004	416.9	130.4	286.5
2005	286.5	27.0	259.5
2006	259.5	75.9	183.6
2007	183.6	2.3	181.3
2008	181.3	2.3	179.0

Amounts in □million

[31] A technical correction was necessary in the outstanding amount as of 31/12/1998 in order to take account of a university loan (debt relating to the acquisition of grounds of the Plaine des Manœuvres in Etterbeek) which had not been incorporated into the oustanding indirect debt.

B.2.2. | The paracommunity debt

Only the loans taken out in 1992 and in 1993 by the four public interest institutions concerned (ONE, RTBF, CGRI[32] and the AIDS Prevention Agency[33]) of the French Community were involved in the outstanding amount of the so-called paracommunity debt; this therefore did not include all of the loans issued by the four aforementioned organisations. The Community budget supported all of the charges relating to these 1992 and 1993 loans in return for a decrease in the allocations paid to these institutions.

Starting from 1 January 1996, this outstanding amount has been directly managed by the Debt Service and its charges recorded in the part of the community budget devoted to the public debt.

As for the university debt, the outstanding amount of the paracommunity debt decreased year by year in the amount of the refinancing of amortisations by means of the direct debt. This debt was entirely eliminated in early 2004.

32 Birth and Childhood Office, Belgian Francophone Radio Television, General Commissariat for International Relations.

33 Dissolved by virtue of the decree of 22 December 1997.

table 11

Variation of the outstanding amount of the paracommunity debt as of 31 December, 1994 – 2004

Year	CGRI	ONE	RTBF	AIDS	Total
1994	3,7	24,3	32,5	0,8	61,2
1995	3,5	23,0	31,0	0,7	58,3
1996	3,3	21,8	29,4	0,7	55,3
1997	3,2	20,5	27,8	0,6	52,1
1998	3,0	19,2	26,2	0,6	48,9
1999	2,8	17,8	24,5	0,6	45,6
2000	2,6	16,4	22,7	0,5	42,2
2001	2,4	14,9	20,9	0,5	38,7
2002	1,2	7,4	10,5	0,3	19,4
2003	1,0	5,9	8,5	0,2	15,5
2004	0,0	0,0	0,0	0,0	0,0

Amounts in □million

B.3. | Treasury

B.3.1. | Overall treasury balance

The treasury of the French Community groups together all the financial accounts through which the revenues and expenses of the institution are handled. In this respect, the treasury flows reflect budgetary and extra-budgetary actions, such as third-party transactions and especially consolidated debt capital transactions (amortisations and re-borrowing).

All the accounts opened by the French Community with its cashier (currently, Dexia) have their consolidated balance examined daily in order to determine an overall treasury balance.

B.3.2. | Description of revenues and expenses

- Revenues

The revenue budget (ways and means) of the French Community is principally supplied by three types of resources.

The first two are, in decreasing order of importance, the portions of the VAT and IPP which are paid by the Federal State to the Community in application of the provisions of the LSF. The allocation paid by the federal authorities to finance foreign university students enrolled in the educational establishments of the French Community is added to these two transferred sources of revenue. These amounts are paid to the Community in the form of twelfths at the beginning of each month of the year.

The French Community had fiscal resources available through the RRTV. Beginning in 2002, after the revision of the previously cited financing law, the RRTV became a regional tax and was replaced by a compensatory allocation calculated as a fixed amount and indexed to the general consumer price index.

It should be noted that in ESA95, loans carried out are only subject to registration in accounts involved after calculation of the financing balance; they therefore have no impact on the realisation, or non-realisation, of the budgetary objectives assigned by the Cooperation Agreements.

figure 6

2008 Revenues excl. allocated revenues (Collections)

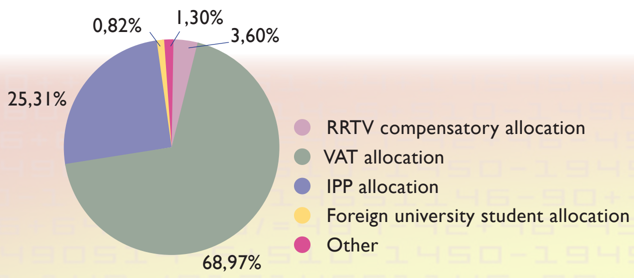


Figure 6 presents the distribution in relative value of the revenue of the French Community for 2008.

The substitution of a fixed-sum allocation for the RRTV community tax means that, since 2002, the resources of the French Community are approximately 98% constituted of allocations paid by the Federal State. This situation contributes to reinforcing the low volatility of the revenues of the French Community.

• Expenditures

A rough distribution of the expenditures of the French Community looks as follows:

• the Education, Research and Training sector represents slightly more than three quarters of the general expense budget of the French Community. For the Education area (from nursery school to the higher education level), a very significant part of the expenses is devoted to payment of teachers' salaries;

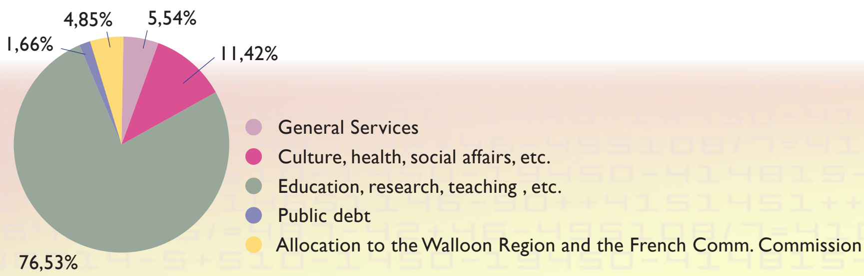
• the expenses of the second sector in order of significance (Health, Social Affairs, Culture, etc.) consist essentially of allocations or subsidies paid to the various agencies charged with implementation of these matters (RTBF, ONE, CGRI, etc.);

• the allocations paid annually by the French Community to the Walloon Region and the French Community Commission of the Brussels-Capital Region correspond to the amounts due by the Community in exchange for the transfer to these two bodies of the exercise of certain of its powers;

• as for the General Services sector, it covers expenses relating essentially to the operation of the institutions of the French Community.

figure 7

2008 Expenditures excl. debt amortisation (Disbursed)

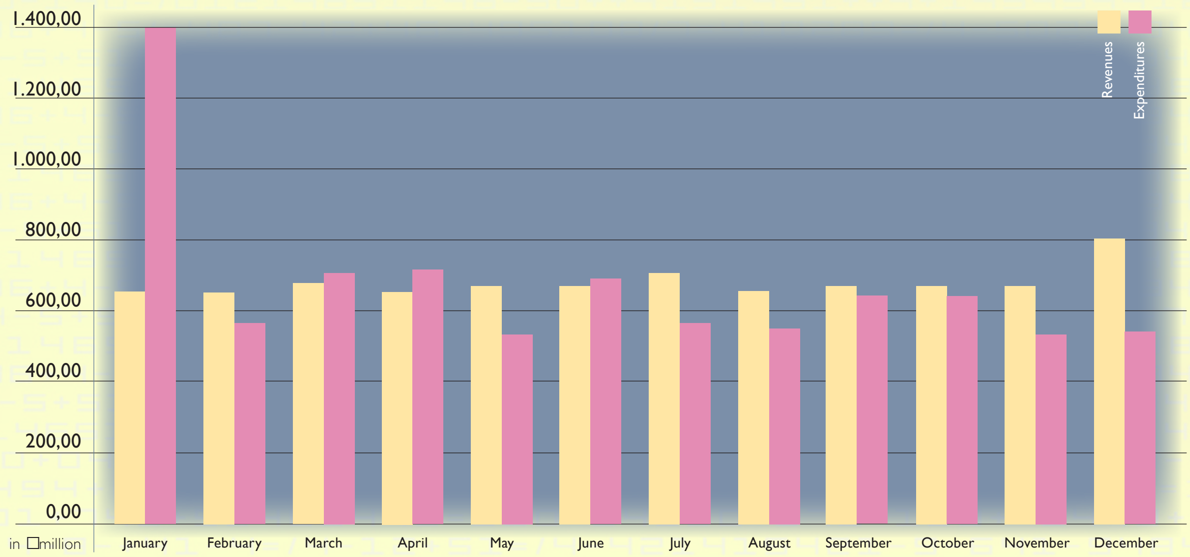


B.3.3. | Rate of revenue collection and disbursement of expenditures

The cycle of revenue collection and disbursement of expenditures of the French Community over the course of 2008 is illustrated by the following graph:

figure 8

Cycle of 2008 revenues and expenditures



The graph above shows that the French Community collects its revenues and pays its expenses at a relatively regular rate. Two factors explain this phenomenon:

• first, most of the revenues (a portion of the IPP and the VAT, the RRTV compensatory allocation and the allocation for foreign students) are paid to the Community by twelfths at the beginning of each month (the 1st working day of each month);

• second, a significant proportion of the expenses of the French Community is devoted to payment of salaries, distribution of which also occurs regularly throughout the year at the end of the month

(the last working day of each month). There is also the fact that the allocations paid to the Walloon Region and to the French Community Commission (see above) by the Community occur by transfer of twelfths on the 2nd working day of each month.
However, for a number of years, the disbursement of salary expenditures took place in an atypical way at the beginning and end of the year. This was due to the deferment, from 1984 to 2007, of payment processing from December to the beginning of the following year. Until 1999, the end-of-year bonus was also subject to the same deferment. As of 2000, this deferment no longer occurs.
In 2008, the Government of the French Community decided to end the procedure which delayed the payment of salary due for the month of December by several days for some 125,000 teachers, officials, and agents of the State. On 29 December 2008, the teachers and administrative personnel of the French Community received their salary for December 2008. The French Community thus paid 13 months of salaries in the course of 2008. It took the budgetary and financial measures needed to provide this payment.
The debt stock of the Community as of 31 December 2008, presented in item A.1. of Section 3 of this report, translates the 2008 budgetary result into financial terms, including the payment in December of the December salaries.

c. | Principles of Debt Management

c.1. | Reminder of the Principles of Debt Management

Five principles are observed constantly in managing the debt of the French Community. These principles are the following:

c.1.1. | Harmonisation of financing and debt management procedures.

All procedures relating to debt management, direct as well as indirect, are carried out by the Debt Service of the French Community. The other operational departments of the Administration do not intervene in any way in this matter. In addition, all the charges relating to these two types of debt are assembled in Chapter IV – entitled Public Debt of the French Community – of the general expense budget.

c.1.2. | Optimal distribution of the fixed rate and floating rate portions of the debt as a function of variation of the yield curve.

The yield curve is one of the principal items taken into consideration in managing the debt of the French Community. This indicator aids in determining a ratio for distribution of the outstanding debt between a fixed rate portion and another floating rate portion. The objective is to achieve an optimal risk/return ratio. For this reason, a significant change in the slope of the yield curve usually leads to repositioning the fixed rate/floating rate ratio independently of the maturity of the loan. Thus, in the case of a steeply sloped positive curve, the positioning of the debt ratio will be oriented more toward the floating rate. A highly arched yield curve makes utilisation of financial instruments – loans or derivative hedge products – listed as short term less expensive. On the other hand, in the case of a relatively flat yield curve, the return is relatively close for all maturities. In the case of this type of curve, the search for the best risk/return ratio would involve increasing the fixed rate portion of the ratio toward its maximum.

Before 2000, the fixed rate/floating rate distribution ratio was revised for any significant shift in the yield curve. Since then, this principle has been slightly modified, as it is no longer a matter of attaining, as of 30 June and 31 December, a set ratio precisely, but of varying in a range with fixed extremities. This capacity for rapid adaptation of the "fixed/floating" ratio to any shift in the yield curve allows the risk/return ratio most appropriate to the debt to be obtained at any time. This makes this ratio a basic tool in debt management for establishing an adequate balance between the debt cost and risks linked to interest rate volatility.

The limits set for the range of variation are fixed at 65% minimum and 75% maximum fixed rate, to observe the fixed rate and floating rate part of the debt, or an extent equal to 10% of the total outstanding community debt, which represents a nominal amount of € 288.8 million (as of 31/12/2008).

c.1.3. | Active utilisation of the most suitable financial instruments.

The French Community uses the financial instruments best suited to management of its debt. In this regard, any speculation is systematically excluded and each derivative product decided upon is attached to a component of the community debt.

Interest rate swaps maintain a place of choice in managing the yield rate, allowing easy transfer of a portion of the debt from fixed rate to floating rate, and vice versa. In 2002 and 2003, the French Community managed its debt in a way comparable to that of the preceding years. With a view toward keeping the minimum duration between 4.0 and 4.5 years and taking account of the behaviour of the interest rate curve, it has issued long term loans, in the form of issues of OLCos (at fixed rates), FRNs and fixed-rate swapped commercial paper. In addition, a series of basis swaps were concluded or renewed.
Starting from 2004, the French Community has opted for intensive utilisation, almost exclusive in 2005 and exclusive in 2006 and 2007, of its EMTN programme, via issues – accompanied or not by coverage making them ultimately equivalent to long-term fixed-rate issues (given in particular the historically low rate level). The upper bound of 75% for the fixed-rate portion has thus been temporarily exceeded since 2004, completely consistent with market reality. As of 31/12/2006, the fixed rate ratio was evaluated at 84.5%. Following the advice given by the [community] Treasury Council at its meeting of 30 April 2004, it was decided to include in the floating rate portion any loan with a maturity less than two years, regardless of its structure; this means notably that automatically, over time, the said ratio should decrease strongly given the significant amounts in loans[34] coming due in 2008 (€ 255.4 million) and 2009 (€ 450.3 million).

Thus, as of 1 January 2007, the fixed-rate portion went to 69.9%. During its meeting of 7 May 2007, the Community Treasury Council proposed to the Minister of Budget and Finance that, given a flat yield curve and taking account of assurances as to liquidity, especially in view of the Aa1 rating level of the Community, the fixed rate/floating rate ratio be repositioned by increasing by approximately 15% the fixed-rate portion to bring it to around 85%. To do this, the Community Treasury Council recommended utilisation of three deferred start swaps of € 100.0 million each Euribor floating rate receivers and IRS 20 years fixed-rate payers, each having a maturity of 20 years; and a structured coverage beginning in 2008, fixing a maximum rate close to the market level and having

[34] As a reminder, most are at fixed rate originally, or following a derivative transaction(s).

a maturity of 10 years: € 100.0 million for 10 years starting from 20 February 2008 (structured coverage); € 100.0 million for 20 years starting from 17 March 2008 (deferred start swap); € 100.0 million for 20 years starting from 19 February 2009 (deferred start swap); and € 100.0 million for 20 years starting from 12 March 2009 (deferred start swap). After appropriate competitive calls with a significant number of financial institutions, the aforementioned transactions were finally concluded with four different banks, one of them "national". By this means in particular, the fixed rate part of the debt was maintained at an elevated measured rate of 83.76% as of 31/12/2007.

Following the changes in the shape and levels of the yield curve, the Community Treasury Council proposed to the Minister of Budget and Finance positioning at the lowest possible point of the curve at the conclusion of the refinancing transactions decided upon at the beginning of 2008. Thus, even if the issues were concluded for maturities from 10 to 15 years when they were registered at variable rate, they were swapped for IRS 2 years, except for an issue of € 100.0 million at 10 years kept as underlying the anticipated structured coverage cited above and concluded in 2007. The other delayed start hedge swap against the rate rise also concluded in 2007 and beginning on 17 March 2008, having fulfilled its role, was settled in two stages after competitive calls from several banks: the notional was first brought to € 75.0 million on 21 February 2008[35] to make it coincide with the amount of the balance to be borrowed at that time, before being purely and simply settled on 6 March 2008[36], the concluding date of the last issue, carried out at fixed rate. The fixed-rate portion of the community debt thus went to 77.67% as of 31/12/2008.

c.1.4. | Development of financing programmes.

As a reminder, the financing programmes – such as EMTN – available to the French Community allow it to continuously fund its treasury and its consolidated debt.

Three great advantages result from the use of these programmes:
• a reduction in the financing cost compared with standard average short and long term conditions;
• a possibility for rapid reaction, allowing advantage to be taken of certain opportunities on the capital markets (the standard consultation procedures being slower);
• an expansion of the investor base.

[35] Following the decision of the Minister on 20 February 2008, following in this the advice of the Community Treasury Council of 19 February 2008.

[36] In accordance with the decision of the Minister of 5 March 2008, in response to the aforementioned advice of the Community Treasury Council and a memorandum from the Administration of 3 March 2008.

c.1.5. | Synergy in the financing and investment transactions of the French Community and public bodies integrated into the ESA.

Since 7 February 1995[37], the French Community[38] has been exempt from advance levy when it invests its treasury surpluses in dematerialised securities from public administrations (sector S13) listed in the consolidation of national accounts by the European authorities in application of the Maastricht treaty.

The approach of the investment policy has been sharply modified, insofar as the Community has since then exclusively acquired securities issued by the Federal State and the federated bodies.

c.2. | Application of Management Principles

c.2.1. | The debt

The total amount to be financed for the year 2005 came to € 444.3 million. An amount of € 24.7 million having been borrowed in the form of a direct credit taking effect on 15 January 2005, the French Community consulted the market on 1 March 2005 for a total amount of € 420.0 million in the legal framework of its EMTN programme. Firm offers for a total amount exceeding € 3,000.0 million were proposed by 16 banks from all quarters. Six issues of a total amount of € 415.0 million and an average weighted maturity of close to 20.0 years were carried out at once. Generally speaking, the French Community offered a funding cost below the level of the IRS of corresponding maturity. At the end of October 2005, a final especially significant issue was again carried out for an amount of € 10.0 million via the reverse inquiry procedure provided by the aforementioned programme.

The total amount in loans falling due in 2006 was evaluated at 196.6 million. Very attractive spontaneous offers, again through the reverse inquiry procedure included in the EMTN programme, allowed the Community to raise almost all its financing needs (in terms of re-borrowing amortisations) from 15/02/2006; the programme was activated a last time in September 2006 to attain a total annual amount of € 195.0 million with an average weighted maturity of 15.2 years. These issues sometimes had complex structures which were not retained by the Community thanks to the utilisation of mirror swaps leading ultimately to a payer rate under the Euribor; a standard Euribor flat receiver and fixed rate payer

37 Royal decree of 23 January 1995 modifying the royal decree of 26 May 1994 on collection and rebate of the advance levy in compliance with Chapter I of the law of 6 August 1993 regarding transactions on certain securities (went into effect upon publication of the Official Gazette, 7 February1995).

38 This provision holds for all the public bodies consolidated in the ESA.

swap was systematically attached in view of the appearance and level of the yield curve.
Still in this same context, at the end of the 1st quarter 2007 an issue of € 27.0 million with a maturity of 15.0 years with a structure indexed to the Belgian health index was carried out – a non-conserved structure via a mirror swap finally generating a payer rate well under the Euribor; here also, a standard Euribor flat receiver and fixed rate payer swap was systematically attached.

In 2008, re-borrowing of debt amortisations was halted at € 255.0 million[39] and completely finalised from 6 March 2008. After various spontaneous offers from various banks, the Community carried out the following transactions:

table 12

Amount in €	Start	Contractual rate	Duration
75,000,000.00	17/03/2008	3.62%	5.0 years extendable until 2058
100,000,000.00	20/02/2008	Euribor 1 month – 7 bp	10.0 years
30,000,000.00	18/02/2008	Euribor 6 month – 7 bp	15.0 years
50,000,000.00	01/02/2008	Euribor 1 month – 7 bp	10.0 years

The transaction of € 75.0 million – so-called Lobo (*Lender's Option Borrower's Option*)[40] – of duration between 5.0 and 50.0 years (at the choice of the Community) was carried out based on specific documentation and after appropriate call to competition from several banks, despite the specificity of the product. The investor has the option of revising the rate once after 5 years, 7 years and every year thereafter; the Community has the option of accepting continuation or not of this transaction at the revised rate.
The two transactions at 10 years (€ 50.0 million and € 100.0 million) were carried out in the framework of a local commercial paper programme. This involved rollover issues placed on the market, but for which the bank committed itself to buying the paper with a minimum margin of – 4 bp for 10.0 years. In practice, during 2008, the issues were all acquired by investors with a margin more advantageous for the Community than that guaranteed by the bank.
As a reminder, the transaction of € 50.0 million at 10.0 years was subject to a fixed rate margin for the first two years and the transaction of € 100.0 million at 10.0 years constitutes the underlying instrument of one of the anticipated hedges concluded in 2007.

[39] Which represents a reduction in the long-term nominal indebtedness of the order of € 0.4 million.

[40] The Federal State, notably, carried out an analogous issue. For further details, see the 2007 Annual Report on the debt of the Federal State (page 33). The document is available on the site of the [federal] Debt Agency at the following address: http://www.debtagency.be/Pdf/rpt2007fr.pdf.

The transaction of € 30.0 million at 15.0 years is a structured issue on the EMTN programme, to which is attached a mirror swap to the Euribor. It was also subject to a fixed rate margin for the first two years.

c.2.2. | The treasury

The interest rate conditions applied to the current account of the French Community by its cashier are based on the Euribor 1 month (base 365) corrected by an upward spread for the lending rate and a downward spread for the borrowing rate. These rates are subject to a quarterly arithmetic averaging and are compared, with a view to arbitrage, with those of investments or issues on the cash market.

As for management of deficits and surpluses, this is carried out, for the first, by means of short-term commercial paper programmes and for the second, through investments in government bills; these latter being, as a reminder, not subject to withholding.

The management of spreads between commercial paper rates, borrowing and lending rates of the current account and investment rates in treasury certificates of the Federal State or the federated bodies has allowed the cost of treasury financing to be markedly reduced.

• deficit management

The French Community profits, for issues carried out on commercial paper programmes, from terms allowing it to finance itself, from the day to the year, some 3 to 7 basis points (bp) below the interbank rate (Euribor). This explains why it is in general more advantageous for the Community to finance itself in the short term by commercial paper issues than by a debit from the current account.

In 2005, a total amount of € 1.67 billion was borrowed via thirty-eight issues of commercial paper for an average amount of € 44.05 million, at an average weighted rate of 2.05% and with an average weighted maturity of 14.2 days.

Eighty-four issues of an average amount of € 30.62 million were carried out in 2006 to attain a total volume of € 2.57 billion, at an average weighted rate of 2.74% and with an average weighted maturity of 14.6 days.

During 2007, eighty-six issues of an average amount of 39.54 million (the total amount of the short-term loans thus reached € 3.40 billion) were carried out principally during the first three quarters, at an average weighted rate of 3.88% and an average weighted term of 13.2 days.

figure 9

Monthly issues of commercial paper in 2007 (in %)

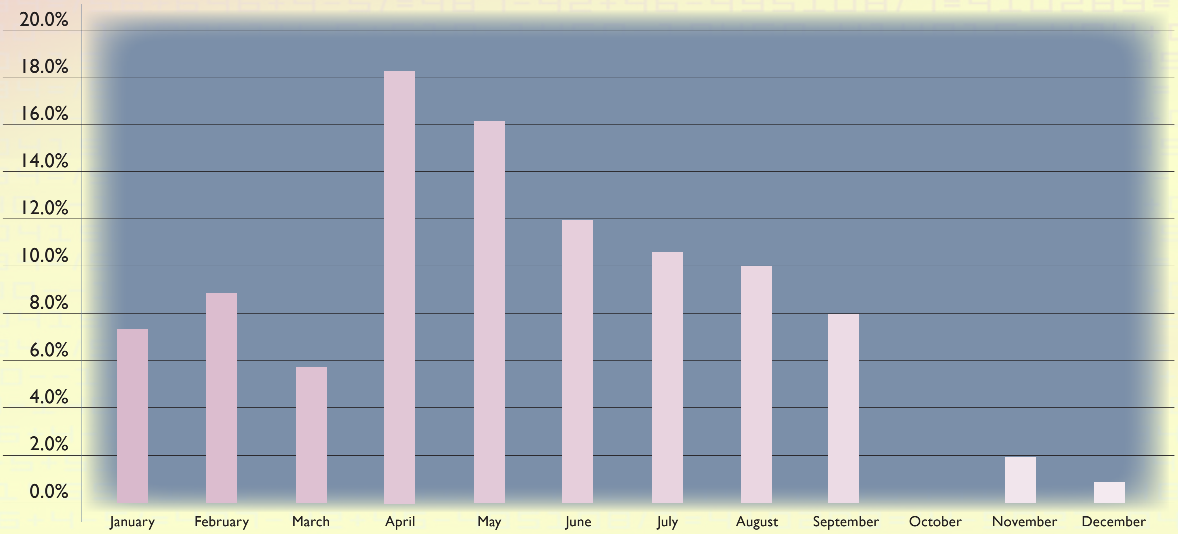
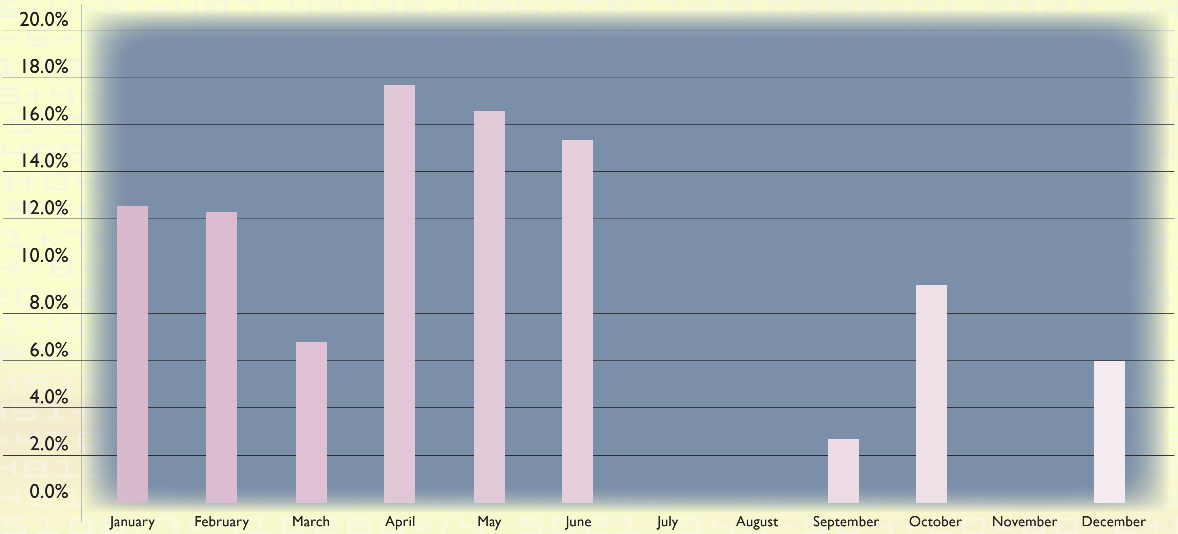


figure 10

Monthly issues of commercial paper in 2008 (in %)



In 2008, the total short-term amount borrowed reached € 3.16 billion via eighty-one issues at an average weighted rate of 4.04% and an average maturity of 10.1 days. Most of the issues having been carried out during the first two quarters of the year, the short-term financing cost was very little affected by the variations in short-term rates (rising until 8 October 2008, then falling).
The cycle of revenue collection and expense disbursement presented above explains the lesser need in general for commercial paper issues during the second semester. This being the case, the issues carried out at the end of 2008 were not carried out only to deal with the needs of the treasury, but also to allow the Fonds Ecureuil to observe its legal obligations to invest all its assets in community paper.

• surplus management

Benefitting, as explained above, from the exemption from the advance levy on revenues from investments in treasury certificates of the Federal State or Belgian federated bodies, The French Community invested in these various papers according to its available treasury funds.

Contrary to the interest paid by the paper of public bodies, the quarterly balance of the current account, when it is a credit balance, is subject to an advance levy of 15%. Thus, any credit balance is systematically invested in the product without advance levy when the interest rate which can be obtained by such an investment is not lower than the current account rate.

In 2005, thirty-five investments – for an average amount of € 100.5 million – were carried out during the second semester for a total amount of € 3.52 billion at the average weighted rate of 2.0% and for an average weighted maturity of 5.0 days.

In 2006, on the other hand, a total amount of € 589.6 million was placed in six investments – principally made during the first quarter of the year – at an average weighted rate of 2.4%, for an average weighted duration of 4.4 days and an average amount of € 98.3 million.

During 2007, only four investments were made for an amount of € 203.0 million at an average weighted rate of 3.95% and for an average weighted maturity of 6.1 days.

Twelve investments for a total amount of € 640.0 million were made in 2008 at an average weighted rate of 4.22% and for an average weighted term of 8.6 days. If the market conditions had been different (less deteriorated), other investments could have been made during the second semester of the year, but the current account credit conditions constituted a more advantageous alternative for the Community.

• treasury cycle

In the framework of active treasury management, it is interesting to isolate its annual cycle. This allows analysis of the development of the overall daily status of all the accounts integrated into the whole and determination of discrepancies in the rates of revenue collection and expense disbursement.

The general appearance of the treasury curve comes from the fact that the significant expenditures of the French Community occur mostly at the end of a month, while most of the revenues are collected at the beginning of the corresponding period.

The following graph shows for 2008, on the one hand, under the name of "overall status", the situation of the treasury resulting from combining all the accounts of the French Community, including the various management transactions (treasury investments and loans); on the other hand, under the name of "current situation", the treasury cycle corrected for very short term investments and loans.

figure 11

Treasury cycle for 2008

Examination of this graph reveals regular fluctuations, nonetheless more volatile in the first semester, while the fluctuations in the second semester show a more regular appearance. This distortion arises essentially from the lag between the time when debt amortisations are paid and the time at which they are re-borrowed.

In 2005, repayment and refinancing of amortisations were practically concluded as of the month of May; in 2006, while 91% of the amortisations took place during the 1st semester, their refinancing occurred from mid-February to an 87% extent. The volatility of the treasury fluctuations was thus less in the second semester of the years 2005 and 2006. Refinancing of 2007 amortisations, given their relatively modest amount, had no significant influence on the general appearance of the graph. In 2008, refinancing having been carried out very early in the year, volatility of the treasury fluctuations was consequently reduced.

c.3. | Interest Rate Curve in 2008

Over the major part of 2008, as in 2007, the slope of the yield curve remained relatively flat, with nonetheless relatively significant parallel displacements on the 2 years – 10 years maturities. The 2 years and 10 years spread was set at approximately (– 15 bp) at the beginning of July 2008, as against (+ 10 bp) at the end of 2007. The end of 2008 was marked by a sharp drop in the rates accompanied by an increased slope in the curve, with the 2 years and 10 years IRS spread set around 90 bp as of 31 December 2008.

During the first semester of 2008, money market rates increased; taking account of the inflation levels observed in the Euro zone, the ECB continued its policy of increasing lending rates undertaken in 2007, bringing its prime rate to 4.25% as of July versus 4.00% previously.
However, during the second semester, the ECB undertook three sharp successive rate reductions, of 50bp in October and November, then 75bp in December, thus bringing its prime rate to 2.50% at the end of December 2008.

As of 31 December 2008, the Euribor 3 month rate was set at a level close to 2.95% as against 4.70% in December 2007.

In the past, the Report on the Debt of the French Community was limited to an analysis of the yield curve based on the variation of the Euribor and IRS. This analysis allowed the variation of the rates that were then the references for community financing to be understood. Today, the variation of the OLO – IRS spread is such that an analysis of the yield curve allowing a decision to be made on debt positioning in terms of the fixed rate/floating rate ratio or duration is also tied to the variation of a Euribor – OLO curve.

figure 12

Variation of the Euribor and IRS yield curves in 2008

Thus, in focussing on the OLO curve, the increased slope is still more obvious. Given the weak slope of this curve at the beginning of 2008, the fixed rate part of the fixed rate/floating rate ratio – which, as a reminder, serves as a tool for measuring and managing the overall rate risk exposure – was maintained at an elevated level, above 77% of the total indebtedness at the end of 2008. This positioning falls within the framework of exemption from the principle of maintaining the fixed-rate part within the range 65% to 75%%[41], achieved in 2005 and repeated in 2006, 2007 and 2008.

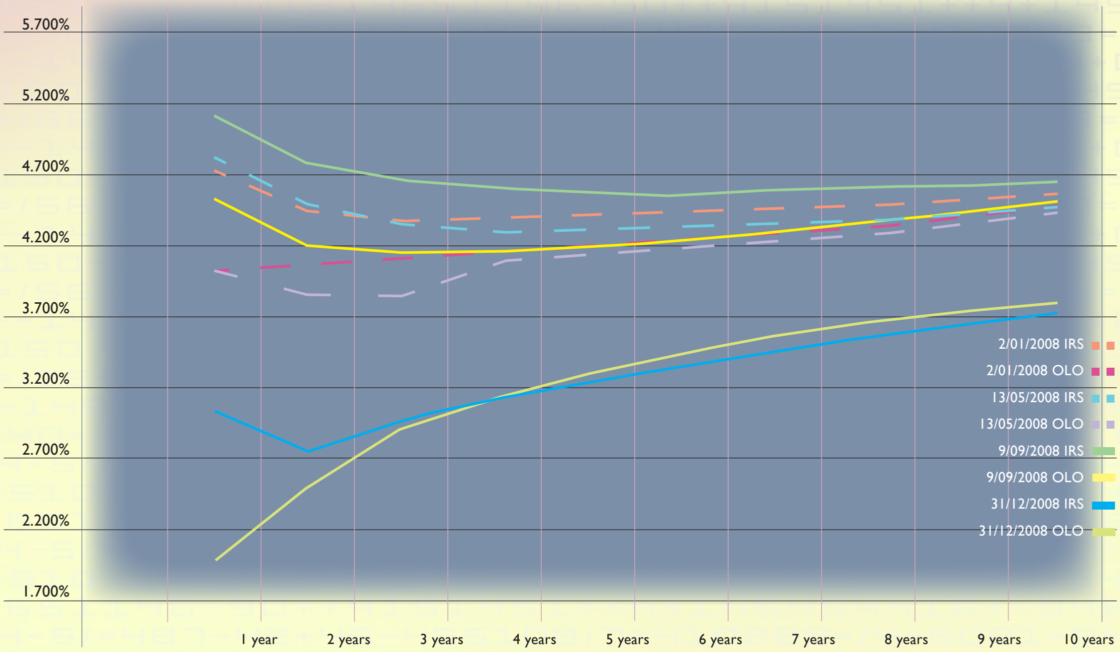
Finally, as a reminder, taking account of the assessment rules of the French Community – which stipulate that a loan due within two years must be considered a variable rate loan, regardless of the coupon, in order to take into account the rate risk on the amounts to re-borrow – and significant amortisations in 2008

41 See Principles of debt management

and 2009 (more than € 700 million), delayed start swaps (fixed rate payer) were concluded in 2007 for maturities running from 10 to 20 years so as to maintain a significant fixed-rate portion in the ratio, the rate risk on the covered refinancing portion having been eliminated.

figure 13

Variation of the IRS and OLO yield curves in 2008



Nonetheless, the portion of the refinancing loans not subject to anticipated hedge was borrowed long term at a floating rate, but swapped for 2 years in order to achieve positioning at the lowest point of the curve, to avoid elevated Euribor rates, while being considered floating rate debt in the context of the aforementioned ratio.

c.4. | Debt Management Tools

The Debt Service uses several measurement instruments intended to assess the risk level of its debt portfolio.

Since 2000, the usual parameters of "average life"[42] and "implied rate" have been supplemented by those of “duration” and "internal rate of return".

The results as of 31 December 2007 and 2008 are as follows:

[42] More precisely, the indicators “residual maturity in terms of liquidity” and “residual maturity in terms of rates” are used.

• in terms of maturities

• "residual maturity in terms of liquidity": 7.1 years/6.6 years
• "residual maturity in terms of rates": 8.4 years/7.0 years
• "duration": 5.3 years/5.1 years

• in terms of rates

• the variation of the "implied rate" (the amount of interest paid annually compared to the corresponding debt stock) for the period from 1995 to 2008 is described in the following tables and graphs:

table 13

Year	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Implied rate	6.4%	6.0%	4.7%	3.7%	4.3%	4.0%	4.6%	4.9%	4.9%	4.1%	4.4%	4.3%	4.4%	4.4%

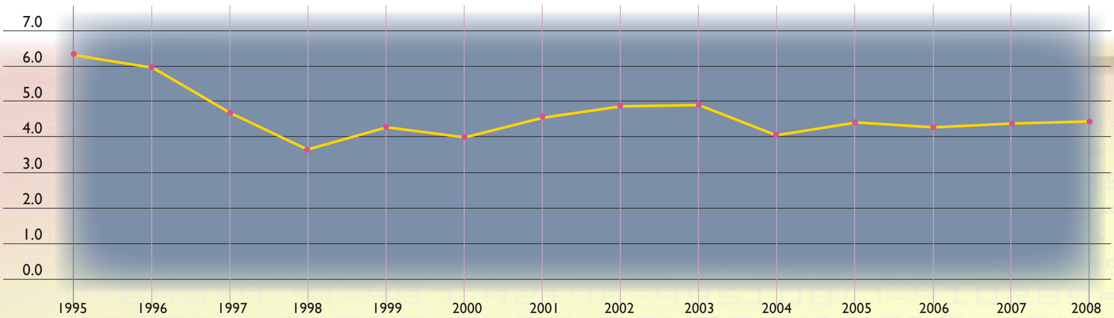
Debt management conducted through stable positioning of the fixed rate/floating rate ratio and through the consolidation of the objective of duration generated a total implied rate of 4.34% in 2006, 4.41% for 2007 and 4.43% for 2008 for the French Community. The variation of the implied rate from one year to another results in part from the level of interest rates and in part from fluctuations of the yield curve allowing dynamic management of the debt. Most of the new issues of the French Community being ultimately expressed in terms of fixed rate, the implied rate measured during the budgetary year (n) refers, insofar as they are concerned, to the transactions concluded during the financial year (n – 1). Thus the implied rate of 2008 was not affected by the issues concluded in 2008, but was by those carried out in 2007 for an amount of € 27.0 million.

These results in terms of rates are to be put in perspective with the considerable increase in the duration and the average term reducing the risk of liquidity and refinancing, as well as with the decision to position the fixed/floating ratio temporarily outside the maximum fixed rate range, so that the debt of the French Community is not only low-cost, but in particular low-risk in terms of both rates and refinancing terms.

The "internal rate of return" corresponds approximately to the implied rate.

figure 14

Variation of the implied rate 1995 – 2008 (in %)



c.5. | Timetable for Amortisations

Another objective of the French Community as regards debt is to "smooth out" the amortisations as much as possible in order to obviate any deficiencies in market liquidity; this is in particular a matter of avoiding refinancing peaks. As the graph below tends to show, the timetable of amortisations would eventually not display peaks like those of 2009 and 2011. It should be noted that, in the representation below, in order not to overburden the graph, it is assumed that the Lobo falls due in 2013, while the possible years due are 2013, 2015, 2016, etc., or 2058.

figure 15

Amortisations on 31/12/2008