

**Caisse  
Française de  
Financement  
Local**

**Financial report**  
as of September 30, 2013  
**Caisse Française de Financement Local**  
Local public sector assets - *Obligations foncières*

# Financial Report

as of September 30, 2013

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**Management report**  
For the period January 1 to September 30, 2013

## 1. HIGHLIGHTS OF THE FIRST NINE MONTHS OF 2013

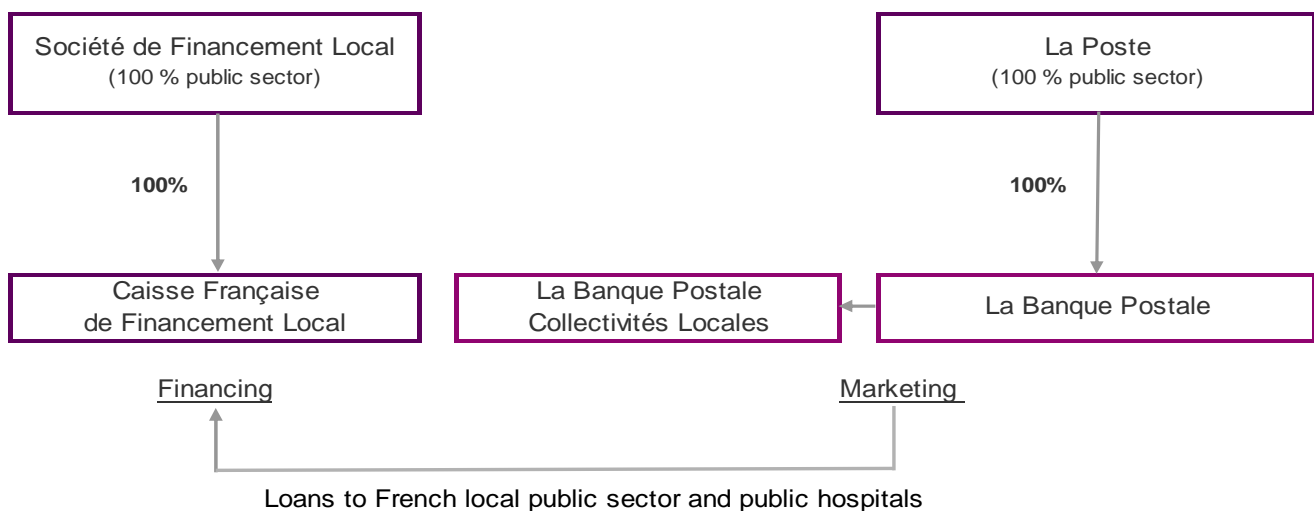
The third quarter marked a new step forward in the operational implementation of the system of local public sector financing in France in effect since February 1, 2013. Caisse Française de Financement Local conducted its first acquisition of assets originated by La Banque Postale, and completed its annual issuance program in the amount of EUR 3.1 billion in three months.

### 1.1 CHANGE IN THE SHAREHOLDING STRUCTURE OF CAISSE FRANÇAISE DE FINANCEMENT LOCAL

On January 31, 2013, Société de Financement Local (Sfil) acquired 100% of Dexia Municipal Agency, which took the name Caisse Française de Financement Local. Sfil is a credit institution approved by the Autorité de contrôle prudentiel.

Sfil's shareholders are the French State (75%), Caisse des Dépôts et Consignations (20%) and La Banque Postale (5%). The French State is the reference shareholder for the Autorité de contrôle prudentiel, underlining its commitment to ensure oversight and strategic decision-making, as well as its determination to ensure Sfil's ongoing financial transactions if so required.

#### New organization for the financing of the local public sector in France



The role of Société de Financement Local is to support the activities of Caisse Française de Financement Local as a servicer. This role is defined by the regulations that apply to *sociétés de crédit foncier*, in particular in the sense of article L.515-22 of the Monetary and Financial Code. Three main missions have been assigned to Sfil,

- Sfil is the servicer of Caisse Française de Financement Local, and in this role, manages the company and provides Caisse Française de Financement Local with the non-privileged funding its activity requires;
- Sfil also manages the operational reduction of the sensitivity of the sensitive structured loans on Caisse Française de Financement Local's balance sheet;
- Sfil likewise provides services for La Banque Postale and the joint venture La Banque Postale Collectivités Locales in the fields of commercial support, financial control, risk management and back office.

Furthermore, Sfil has replaced Dexia Credit Local in all derivative transactions at the date of sale by Dexia Municipal Agency and Dexia Credit Local.

Caisse des Dépôts et Consignations (CDC) provides Sfil with the resources required to finance business existing prior to the date of transfer. It will contribute with La Banque Postale to meet the financing needs engendered by new business originated by La Banque Postale Collectivités Locales, a joint venture held by

CDC for 35% and La Banque Postale for 65%, or directly by La Banque Postale. All the financing provided by Caisse des Dépôts et Consignations will be capped at EUR 12.5 billion.

On January 31, 2013, Sfil signed a declaration of support for Caisse Française de Financement Local. This declaration is reproduced in the 2012 annual report - General information.

As of September 30, 2013, Sfil's long-term ratings were respectively:

- AA+ by Standard and Poor's (same rating as the French State),
- Aa2 by Moody's and AA by Fitch (one notch below the French State).

These ratings reflect the strategic character of the role the French State has assigned to Sfil and Caisse Française de Financement Local, and the French State's long-term commitment to assure them of its support if so required. These long-term ratings include an outlook negative, reflecting the current outlook of the rating of the French State.

On November 8, 2013, S&P lowered Sfil's rating to AA outlook stable following the downgrade of France's sovereign rating.

## 1.2 RATINGS OF CAISSE FRANÇAISE DE FINANCEMENT LOCAL

The issuance program of Caisse Française de Financement Local is rated by the three main rating agencies Standard & Poor's, Moody's and Fitch.

As of June 30, 2013, Caisse Française de Financement Local was rated:

- AAA by S&P,
- Aaa by Moody's,
- AAA by Fitch.

The S&P and Fitch ratings added an outlook negative which reflected the outlook negative of the sovereign rating as well as that of Société de Financement Local.

The rating of the *obligations foncières* (OF) of the Caisse Française de Financement Local was downgraded to AA+ (outlook stable) by Fitch and S&P, respectively on July 17 and November 15, 2013, following the downgrade of the rating of France from AAA (outlook negative) to AA+ (outlook stable) by Fitch and from AA+ (outlook negative) to AA (outlook stable) by S&P.

In fact, the agencies consider that there is a country ceiling, i.e. a ceiling for the rating of Caisse Française de Financement Local in relation to the sovereign rating).

Therefore, at the beginning of 2013, the rating of the *obligations foncières* (OF) of Caisse Française de Financement Local was as follows.

- AA+ by S&P,
- Aaa by Moody's,
- AA+ by Fitch.

These ratings were qualified as outlook stable.

## 1.3 THE COVERED BOND MARKET

In the first nine months of 2013, issues of euro-denominated benchmark covered bonds, totaling EUR 76.5 billion, contracted significantly in the primary market, compared with the same period in 2012 (- 17.3%). The third quarter was particularly active with EUR 21.5 billion in covered bond issues, representing almost 30% of total issues in the first nine months of 2013.

French issuers (20% of the market share) were less present than usual since the beginning of 2013, although they remained one of the most active market players, together with the Germans (18%) and the Scandinavians (20%).

At the same time, issuers from Southern European countries made a marked return in the primary market, particularly Spain (13%) and to a lesser extent Italy (7%).

Average spreads for covered bonds in all countries continued to narrow progressively through the first nine

months of 2013, as they demonstrated resistance to political and economic uncertainties in Europe.

The spread of the *obligations foncières* of Caisse Française de Financement Local in the secondary market narrowed significantly since the change in the shareholding structure at the beginning of the year 2013, returning to the level of the best French issuers.

The return of Caisse Française de Financement Local to the euro benchmark market at the beginning of July 2013 was heralded by a successful issue of EUR 1 billion with maturity of 7 years. This inaugural issue was followed by a second public issue at the end of September in the amount of EUR 500 million with a maturity of 15 years. It was the first issue with this maturity in the *obligations foncières* market in three years.

#### 1.4 STRUCTURED LOANS

In line with the French government announcements of June 18 and July 16, 2013, articles 23 and 60 of the finance bill for 2014 include provisions for a comprehensive, long-lasting solution to the problem of the most sensitive structured loans contracted by local governments and for guarantees to cover agreements currently in effect.

A complete discussion of structured loans and litigation is presented in part 3.3.d – Structured loans.

#### 1.5 FIRST APPLICATION OF IFRS 13 FAIR VALUE MEASUREMENT

Since January 1, 2013, Caisse Française de Financement Local reports a credit value adjustment (CVA) and a debit value adjustment (DVA) in the context of the first application of IFRS 13. The impact of the initial application of the standard was a loss of EUR - 19 million for the CVA and a profit of EUR + 118 million for the DVA, as of September 30, 2013. These amounts include the overall effects of the first application of this standard and changes in the period.

Such CVA/DVA represents an adjustment of the fair value of the portfolio of derivatives contracted by Caisse Française de Financement Local with other banks. These adjustments represent the measurement of counterparty risk on derivative instruments, whether this risk is borne by Caisse Française de Financement Local or its counterparties. Thus the CVA measures the losses that Caisse Française de Financement Local would assume in the event of the default of a swap counterparty. The measurement of this risk takes into account the cash collateral received for these operations.

The DVA represents an evaluation of the losses that the counterparties would assume in the event of the default of Caisse Française de Financement Local.

The absence of any payment of cash collateral by Caisse Française de Financement Local explains why the amount of DVA is high despite Caisse Française de Financement Local's very good rating. The DVA is sensitive to changes in Caisse Française de Financement Local's own credit risk.

The obligation to report these adjustments, in effect since the beginning of 2013 can be a source of volatility in net banking income in the future. This will depend among other items on the spreads of Caisse Française de Financement Local and its counterparties.

Caisse Française de Financement Local also modified the method it uses to value collateralized derivatives to account for changes in market practices. It opted for a valuation against Eonia for its derivatives subject to the payment of collateral to its benefit. The derivatives for which no payment is made to the benefit of the counterparties remain valued against Euribor. Whereas the valuation of the items hedged was not modified, this change in the valuation of hedging derivatives introduced an element of inefficiency in hedging relations. The impact of this change totaled EUR +20 million.

## 2. CHANGES IN MAIN BALANCE SHEET ITEMS

| EUR billions - value after swaps                           | 12/31/2011  | 12/31/2012  | 9/30/2013   | Change Sept. 2013 / Dec. 2012 |
|------------------------------------------------------------|-------------|-------------|-------------|-------------------------------|
| <b>Cover pool</b>                                          | <b>76.0</b> | <b>69.2</b> | <b>64.4</b> | <b>(7.0)%</b>                 |
| Central bank                                               | 2.2         | 2.4         | 1.2         | (50.8)%                       |
| Loans                                                      | 54.9        | 51.7        | 57.0        | 10.2%                         |
| Securities                                                 | 18.9        | 15.1        | 6.2         | (58.9)%                       |
| <b>Assets assigned in guarantee to Banque de France</b>    | <b>3.2</b>  | <b>-</b>    | <b>-</b>    | <b>-</b>                      |
| <b>Privileged debt</b>                                     | <b>65.6</b> | <b>59.7</b> | <b>55.8</b> | <b>(6.5)%</b>                 |
| <i>Obligations foncières</i> *                             | 63.1        | 56.2        | 53.3        | (5.1)%                        |
| Cash collateral received                                   | 2.5         | 3.5         | 2.5         | (28.7)%                       |
| <b>Non-privileged debt</b>                                 | <b>12.2</b> | <b>7.6</b>  | <b>6.8</b>  | <b>(10.3)%</b>                |
| Parent company                                             | 9.5         | 7.6         | 6.8         | (10.3)%                       |
| Banque de France                                           | 2.7         | -           | -           | -                             |
| <b>Equity IFRS (excluding unrealized gains and losses)</b> | <b>1.3</b>  | <b>1.5</b>  | <b>1.5</b>  | <b>0.0%</b>                   |

\*Including registered covered bonds

As of September 30, 2013, Caisse Française de Financement Local's cover pool, composed of loans and debt securities, totaled EUR 64.4 billion, excluding accrued interest not yet due. As of December 31, 2012, the total pool was EUR 69.2 billion; the decrease was therefore EUR 4.8 billion (- 7.0%).

As of September 30, 2013, no asset had been assigned in guarantee to the Banque de France.

Outstanding debt benefiting from the legal privilege was EUR 55.8 billion, including cash collateral received, down 6.5% from December 2012.

Debt vis-à-vis the parent company totaled EUR 6.8 billion. This amount corresponds to the financing of structural over-collateralization (commitment of Caisse Française de Financement Local and requirements of the rating agencies) or on a temporary basis (assets waiting to be refinanced by *obligations foncières*), which does not benefit from the legal privilege.

Equity, according to IFRS, but excluding reserves for unrealized gains and losses, totaled EUR 1.5 billion at the end of September 2013.

### 3. CHANGE IN ASSETS IN THE FIRST NINE MONTHS OF 2013

#### 3.1 NEW ASSETS

The net change in the cover pool as of September 30, 2013, was a decrease of assets of EUR 4.8 billion. The change can be analyzed as follows.

| EUR billions                          | 3Q 2013     |
|---------------------------------------|-------------|
| <b>Beginning of the year</b>          | <b>69.2</b> |
| New assets                            |             |
| <i>Loans to French public sector</i>  | 0.7         |
| <i>Replacement assets</i>             | 7.8         |
| Variation of Banque de France account | -1.2        |
| Amortization                          | -4.3        |
| Early reimbursements                  | -0.1        |
| Divestments                           | -7.8        |
| Changes in provisions                 | 0.0         |
| <b>End of the period</b>              | <b>64.4</b> |

The increase of gross assets on the balance sheet as of September 30, 2013, totaled EUR 8.5 billion and corresponds to:

- the acquisition for EUR 0.5 billion of loans to the French local public sector originated by La Banque Postale, with residual maturity of 15 years;
- the payment of EUR 0.2 billion from loan agreements signed previously and recorded on the balance sheet of Caisse Française de Financement Local, and EUR 0.1 billion for new commitments linked to operations to reduce the sensitivity of structured loans;
- the acquisition of replacement assets corresponding to loans for an outstanding total of EUR 7.6 billion to Société de Financement Local, the parent company of Caisse Française de Financement Local (cf. 3.3.c).

The decrease in assets mainly corresponds to the natural amortization of the portfolio of loans and securities, in particular EUR 0.5 billion in *cedulas territoriales* at the beginning of January 2013, as well as to the reduction of the balance of the Banque de France account for EUR 1.2 billion. Divestments represent the sale of all the internal and external ABS, which were reported on the balance sheet in the amount of EUR 7.8 billion.

#### 3.2 OUTSTANDING ASSETS AS OF SEPTEMBER 30, 2013

##### a. Geographic breakdown of the cover pool (excluding replacement assets and cash accounts)

French assets were predominant in the cover pool, and the geographical diversification was significant. The decline in the proportion related to Belgium and Italy in the cover pool was due to the sale of the securitization vehicles DSFB 2 and 4 and DCC 1 to DCC 3, which had been made up of exposures on the Belgian and Italian local public sector. In addition, Caisse Française de Financement Local committed to buy back the assets underlying the Italian securitization vehicles before the end of 2013. At the end of December 2013, the relative proportion in the cover pool will be similar to the one posted at the end of 2012.

The trend in the relative proportion of assets by country can be analyzed as follows.







































































































































