

# Semi-Annual Financial Report

# 2009

DEXIA KOMMUNALBANK  
DEUTSCHLAND AG

**DEXIA**



# Semi-Annual Financial Report

June 30, 2009

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# DEXIA KOMMUNALBANK DEUTSCHLAND AG AT A GLANCE

## KEY BALANCE SHEET FIGURES (IN EUR MILLION)

	Dec. 31, 2008	June 30, 2009
<b>Assets</b>		
Loans to the public sector	23.940,5	23.213,9
Other receivables due from banks and clients	5.184,7	4.657,7
Securities	19.339,0	17.686,5
<b>Liabilities</b>		
Pfandbriefe	37.306,2	36.401,0
Other liabilities due to banks and clients	10.776,6	8.841,9
Equity capital	290,5	330,9

## KEY INCOME STATEMENT FIGURES (IN EUR THOUSAND)

	June 30, 2008	June 30, 2009
Interest and commission income	32.949,1	35.119,6
Administrative expenses (incl. amortization)	11.243,4	9.644,6
Risk provisioning	20.454,1	24.977,0
Net income for the fiscal year	877,6	415,9

## OTHER DISCLOSURES

	Dec. 31, 2008	June 30, 2009
Employees (average)	110,0	105,9
Cost-income ratio	34,0 %	27,5 %



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# EXECUTIVE BODIES OF THE BANK

## Supervisory Board

### Stéphane Vermeire

*Head of PWB International*

*Member of the Management Board of Dexia Crédit Local*

*Dexia SA*

*Chairman*

### François Durollet

*(until February 17, 2009)*

*Deputy Executive Vice President Public Finance*

*Head of Public Finance Network & FSA Department*

*Dexia SA*

*Chairman*

### Claude Schon

*Head of Group Treasury*

*Member of the Treasury & Financial Markets Executive*

*Committee*

*Dexia SA*

*Deputy Chairman*

### Hans Handschuh

*Bank employee*

### Jean Le Naour

*Member of the Management Board of Dexia Crédit Local*

*Head of Finance, Operations and IT Department*

*Dexia Crédit Local*

### Sascha Riegenring

*Bank employee*

### Xavier Rojo

*Global Head of Innovation & Financial Engineering*

*Public and Wholesale Banking*

*Dexia Crédit Local*

## Management Board

### Giselbert Behr

*Chairman*

### Dr. Wolfgang Eickhoff

### Wilfried Wouters

## Trustees

### Josef Baiz

*Member of the Management Board (ret.)*

### Werner Graf

*Bundesbank Division Head (ret.)*

### Victor von Bothmer

*Attorney*

# INTERIM MANAGEMENT REPORT AS OF JUNE 30, 2009

## ■ GENERAL ECONOMIC CONDITIONS

The unprecedented and extensive steps taken by central banks and governments to implement a combination of traditional and innovative fiscal and monetary measures to overcome the financial crisis appear to have averted a worst case scenario.

Nonetheless, analyses of previous economic crises have shown that downturns resulting from financial market turmoil tend to be deeper and more pronounced. Moreover, a lasting economic recovery could take longer to achieve – and not be as strong – since appropriate measures must first be taken to ensure that capital flows back into the financial sector and to restore the sector's credibility.

If monetary and fiscal policy is eased in a concentrated, timely and internationally coordinated manner, this could help break or at least to soften the impact of the recessionary cycle and fortify an instable banking system.

In spite of a diverse combination of various stabilizing measures, which range from the zero-interest policies of certain central banks through an easing of fiscal policies to a relaxation of accounting standards, it is still too early to draw conclusions as to the long-term effectiveness of these measures. However, it is clear that analysts are taking a positive view to the upcoming discussions concerning potential exit strategies for government and central bank interventions in the economy.

### Development in the economic regions

In the US, real gross domestic product fell in the first quarter of 2009 by 5.7% year-on-year. Although this figure had already dropped by 6.3% in Q4 2008, a closer look reveals significant differences between the two quarters. The sharp decline in the fourth quarter of 2008 was due to a drop in consumer spending, which rebounded by 1.6% in Q1 2009. By contrast, capital expenditures by companies and private households continued to slide. Since many companies reduced inventories during the first quarter of 2009, their efforts to rebuild reserve stock could contribute to a positive development to US GDP in the months to come. However, this would also require a swift recovery of consumptive demand.

Traditionally, the US economy has been dependant for growth

on domestic consumption to surmount recessionary phases. It was precisely for that reason that the most recent labour market figures did not bode well: In spite of the decline in job losses observed between April and June 2009 (from 663,000 to 345,000), the unemployment rate is still expected to hover around 11% in 2010. Factoring in part-time workers, the unemployment rate is currently already 16.5%.

Compared with other economic phases, the 5% increase in the saving ratio points at a considerable shift in the savings behaviour of US households.

A similar picture is emerging in the EU as well, where gross domestic product fell by 9.5% year-on-year. The 15.5% decline in new industrial investment activities, the almost complete absence of new capital expenditures and a drop in exports were major factors in this development. With eurozone unemployment on the rise, efforts to shore up consumer confidence through consumption-boosting measures such as the used car „scrapping premium“ in Germany have taken on a significant role.

The situation in the exports sector has taken a dramatic turn, particularly in Germany: by January 2009, exports were down 7.4% year-on-year. This downturn was due in particular to the weak US dollar – which hovered around USD 1.40/EUR – as well as the collapse of demand from emerging economies such as China and India.

Over the course of the first half of 2009, clear differences emerged between sentiment and real economic data. Indicators of sentiment such as the ZEW Index and the ifo-Business Climate Index tended to rise. For example, the ZEW Index climbed from -31 in January to +45 points in June 2009. Yet this cautiously optimistic assessment has yet to be reflected by the real economy. In fact, as of April 2009, industrial output in Germany fell by 22.3% year-on-year. Following a brief recovery, the Purchasing Managers Index (PMI) has also remained below 50 points thus far, pointing towards a further economic contraction.

Only the equity markets have so far benefited from positive expectations. Although some market analysts were already

drawing parallels to the Great Depression of 1930, this scenario did not materialize. On the contrary, the markets were remarkably upbeat in the first half of 2009, and the DAX briefly climbed back above 5,000 points. This shift in the allocation of assets was also reflected in current bond yields: 10-year US Treasury note yields rose from the extremely low 2.2% as of December 31, 2008 to at times reach their present level just below 4.0%.

### Monetary policy of the European Central Bank

A typical feature of this crisis is the globally coordinated response to the recession. In that context, the European Central Bank (ECB) lowered its key rates a further 1.5% over the first half of 2009. Even so, the markets' reaction to the ECB's relatively cautious interest rate cuts by 25 basis points (bp) in April and in May 2009 was disappointing, as they had expected clearer signals. However, the ECB defended its stance by invoking the threats to money market mechanics inherent in a zero-interest policy.

It is expected that the ECB will maintain its benchmark interest rate at its present level of 1% through the end of the current year. By contrast, the fall in the EONIA and Euribor rates since June 2009 mirror market players' hopes for further interest rate cuts. Over the course of the year, the Harmonized Index of Consumer Prices fell from 1.6% to the present 0%. Given this significant drop in inflation, analysts have been emphasizing the possibility of further interest rate reductions. By contrast, the ECB remains convinced that the current key rate is sufficient to stimulate the economy over the medium term.

The ECB thus again confirmed that its primary focus does not only lie in establishing an interest rate policy that stimulates the economy, but rather on providing additional liquidity to banks. Moreover, the ECB's expansion of its bidding process and launch of a EUR 60 billion purchasing program for covered bank bonds underscores its willingness to secure market liquidity.

It is likely that the ECB will pursue a policy of price stability even in the event of negative inflation combined with near-zero economic growth. The ECB has repeatedly warned that oversized government bailout packages in conjunction with massive liquidity injections could quickly result in an inflationary bubble. At the same time, the ECB interprets the significant narrowing of the EONIA-Euribor-spreads as a normalization of the money market.

In the meantime, the debate has intensified as to the scenarios under which the central banks could roll back the support measures they initiated, once the economy recovers. An additional indication of this is offered by the balance sheets of the central banks, which have recently stabilized. However, the central banks' differing perceptions of the economic cycle are becoming apparent: while the Fed has significantly curbed its purchase of assets, the BoE continues to take market positions through buyback programs and the ECB has established only its first purchase program, to become effective in July 2009.

The ECB allocated a total amount of EUR 442 billion to the 1,121 participating banks at an interest rate of 1.0% in its first-ever one-year tender. This volume tender is now fully allocated and is unlikely to be rolled back in the near future along the lines of the usual rate tender methods with competitive bidding allocations. This highlights the different approaches of the ECB on the one side and the Fed and the BoE on the other: while the measures implemented by the ECB were aimed at eradicating the credit crunch, the other central banks were attempting to proactively bolster demand through measures to stimulate the economy and expand lending. However, the ECB has since received political backing to urge the banking sector to use the liquidity it was provided to foster lending within the economy.

### Development of the capital markets

The levels of key rates for the first half of 2009 were virtually unprecedented.

This is all the more noteworthy since the volume used to fund government economic stimulus packages and bailouts did not lead to the interest rates to rise which critics expected at the beginning of the year. Government offerings were fully absorbed by the market. However, the market did not take into account the future burdens to be borne by the banking sector: The International Monetary Fund estimates that European banks will be forced to write off some EUR 800 billion, of which only EUR 250 billion have been accounted for. According to IMF estimates, roughly EUR 430 billion in supplementary equity will be needed in order to realize these additional write-offs.

The high volume of government bond issues did not lead to an increase in interest rates. In both the US and in Europe, the move in the long end of the yield curve correlated with the considerable interest rate cuts – albeit to a markedly lesser degree – which caused the overall curve to steepen. At the end

of May, the spread between the 2-year and 10-year euro swap rates was over 200 bp. Furthermore, the decline in interest rates was fuelled by muted inflation expectations, which in turn were driven primarily by low prices for commodities, particularly oil.

Sales pressure on the bond markets rose against the backdrop of rebounding economic indicators. To the Fed's dismay, the resulting interest rate increases for long-term US Treasuries were also followed by an increase in mortgage rates. This development may give rise to additional difficulties, especially since the real estate market is still a long way off from a recovery. Moreover, rising interest rates could lead US households to save more, thus curbing consumption even further.

Looking towards a return to normality on the financial markets, a concrete timeline for interest rate increases is already being discussed. However, this seems to be highly premature. To date, the positive development on the capital markets is rooted less in an overall improvement in economic fundamentals than in an increase in investor propensity to take risks thanks to the more favourable terms and conditions for uncovered bank bond issues and new equity capital in the US.

#### Covered bonds

But for a few exceptions, such as Sweden and Ireland, government guarantees issued for banks do not extend to covered bonds. Lawmakers are firmly convinced that due to the underlying legal frameworks applicable to this asset class, the latter has proven its stability even in the face of the crisis. As a pure precaution, many countries – including Germany – signaled that they would back the ability of this market segment to function even in stress situations. Given this implicit support, many investors tend to prefer their respective domestic covered market. It is also worth noting that institutions that accepted government assistance generally found it easier to place their covered issues.

Some emerging trends from 2008 gained a firm foothold in the first half of 2009. For example, covered bond spreads varied significantly with regard to the underlying credit risk. In particular, this made it more difficult for issuers with lower credit ratings to obtain funding, leaving them to focus their efforts almost entirely on issuing government guaranteed bank bonds. The further evolution of the Pfandbrief banks' business models, the reduction of their total balance sheet and the necessity to bolster their equity have led to a noticeable reduction in issuing activities. At the same time, hardly any new

assets were generated that were eligible for the cover pool. The lack of a functioning secondary market led many investors to exit this market segment once their asset backed bonds had matured. At the same time, this asset class – particularly up to the five-year maturity range – has lost considerable market share to the government guaranteed segment.

The ECB's EUR 60 billion program to purchase covered bonds has been extremely helpful in overcoming this market standstill. Through this program, the ECB offers issuers the opportunity to increase the average duration of their liabilities, and hence to roll back their short-term funding via the central banks.

As a consequence, the spreads for covered bonds narrowed significantly, despite the debate over the (country-specific) volume of the buyback program. This facilitated access to the capital markets for some issuers – such as the Spanish Cedulas. The amount of covered bonds issued in Europe in 2009 thus far was roughly EUR 5 billion per month, or approximately EUR 30 billion in the first half of the year. A total issue volume of EUR 80 billion to EUR 100 billion is forecasted for the year overall.

#### The Pfandbrief market in 2009

As the Pfandbrief market reopened, following the Lehman crisis in Q4 2008, it quickly became clear that Pfandbrief spreads, too, were reaching new dimensions. Due to the increased focus on issuer creditworthiness, the market occasionally saw spreads of up to 100 bp for 10-year Pfandbriefe. The heterogeneous assessment of credit risk is thus responsible not only for differing spreads for the various bond types under various legislations, but also for different issuers albeit subject to identical statutory conditions.

In the same context, the rating agencies aim to expand the scope of their rating methodologies, which they have previously warned will result in substantial changes to the credit rating of many issuers. In particular, the link between an AAA-rating for Pfandbriefe and the rating of the underlying issuer is seen as critical.

Investors have been purchasing registered Pfandbriefe in particular since 2009 as these structures are not recognized as loans under IFRS and are thus not marked to market.

Issue spreads have narrowed ever since the ECB unveiled its EUR 60 billion purchase program in May 2009. Regular

investors responded this announcement, and some institutions were able to leverage the returning liquidity for themselves to issue jumbo Pfandbriefe. Dexia Kommunalbank Deutschland also seized this opportunity by launching a five-year, EUR 1 billion benchmark issue. It also increased the 10-year jumbo Pfandbrief it issued in 2008 by EUR 125 million.

In spite of the support offered by the ECB, there is still no liquid secondary market. In contrast to the previous year, this development is driven more by the lack of sufficient supply of Pfandbriefe in the wake of reduced issuing activity, thus also narrowing the spreads significantly.

Amid the euphoria caused by the ECB purchase program, the public barely noticed the taking effect of the improved German Pfandbrief Act on March 26, 2009. The amendments to this law focused on improving investor protections further and on solidifying the position of the Pfandbrief.

## ■ THE TRANSFORMATION PROCESS OF DEXIA KOMMUNALBANK

As a result of the Group-wide implementation of its transformation process, Dexia Kommunalbank Deutschland decided to discontinue its primary German municipal business and its semi-public enterprises segment. By contrast, the project finance segment will be continued in close cooperation with the Dexia Group. Against this backdrop, it was decided to close the Frankfurt office as of June 30, 2009. This office had been responsible for the Bank's direct lending business throughout Germany. The customer service will henceforth be handled out of Dexia Kommunalbank Deutschland's headquarters in Berlin. The transfer of the Frankfurt branch office's activities to Berlin was completed by the end of June 2009.

Going forward, Dexia Kommunalbank Deutschland will concentrate primarily on its municipal secondary market business in Germany and on the international cover pool eligible government financing business. The ongoing transfer of international assets eligible for the cover pool from other members of the Dexia Group will further solidify the role of Dexia Kommunalbank Deutschland as a specialist bank and Pfandbrief issuer in the future, and underscores its position as a long-term financier and strategic core entity of the Dexia Group. The Bank continues to pursue its aim of greater internationalization of its cover pool assets while maintaining a high German share. We expect the transfer of our international government financing business – which tends to offer higher margins than German municipal lending – to more than compensate

for the significant increase in our funding costs. On the whole, the factors described are expected to assist in further stabilizing Dexia Kommunalbank Deutschland's results of operations and financial position over the medium term.

## ■ NEW LENDING AND FUNDING

### New lending

In keeping with the transformation plan published by the Dexia Group in November 2008, Dexia Kommunalbank Deutschland discontinued its function as a primary municipal lender at the beginning of the 2009 fiscal year while maintaining its interest management business and secondary market business on the German market.

In order to internationalize its cover pool assets, Dexia Kommunalbank Deutschland acquired eligible assets from other Dexia Group companies. Initial transactions of EUR 0.1 billion had already been concluded by the end of H1 2009.

Along with its primary municipal lending business, Dexia Kommunalbank Deutschland also terminated its recently started lending business to finance semi-public enterprises. The project financing business will be continued in close cooperation with the Dexia Group.

### Pfandbriefe and other funding

For the purpose of long-term refinancing of the lending business, Dexia Kommunalbank Deutschland newly issued a total volume of EUR 2,612.0 million (June 30, 2008: EUR 5,967.7 million) in public Pfandbriefe in the first half of 2009. As liquidity partially returned to the Pfandbrief market thanks to the ECB's purchase program in the beginning of May, the Bank seized the opportunity to initiate a new jumbo issue and to increase an existing jumbo issue.

Traditional fixed- and variable-interest instruments accounted for approx. 84 % of total debt instruments placed. In addition to the jumbo issues, demand remained high for a large number of single transactions of up to EUR 50 million, which were particularly well-suited to meet the needs of investors for custom, secure investment forms.

All in all, the portfolio of public Pfandbriefe plus the uncovered other bonds and borrower's note loans decreased to EUR 38,061.8 million as of June 30, 2009 (December 31, 2008: EUR 38,902.9 million).

The Banks own debt securities acquired for market-regulating operations had a nominal value of EUR 8.9 million as of June 30, 2009.

A total of 37 issues in H1 2009 (June 30, 2008: 33) was launched on the Berlin Stock Exchange, where Dexia Kommunalbank Deutschland is one of the largest issuers, with a total volume of EUR 2,221.5 million (June 30, 2008: 7,677.8 million).

The AAA-rating for public Pfandbriefe awarded by Standard & Poor's in 1998 for the first time was, as in the previous years, reconfirmed in February 2009.

#### Mortgage loans

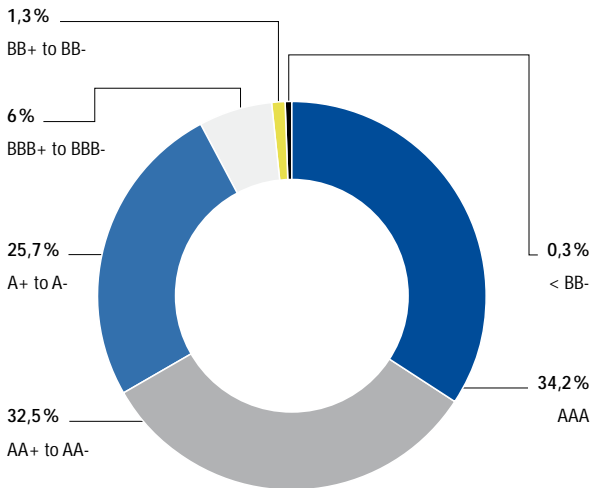
The portfolio of traditional mortgages was reduced further. Since December 31, 2008, it fell by EUR 2.6 million to a net EUR 10.1 million as of June 30, 2009.

#### Foreclosure measures

During the period under review, one foreclosure measures initiated during the prior years was still pending.



**INTERNAL RATING ACCORDING TO BASEL II (AIRBA\*)**



\*Advanced Internal Rating Based Approach

From a risk standpoint, Dexia Kommunalbank Deutschland continues to consider the above ratings structure as balanced. In H1 2009 the ratings spreads narrowed again for a few selected securities.

At no time has Dexia Kommunalbank Deutschland held positions, either directly or indirectly, in the sub-prime market through special purpose vehicles or structured investment vehicles.

The crisis of confidence on the global financial markets triggered by the sub-prime crisis early on in the second half of 2007 persisted in H1 2009. Last year, the Bank adjusted its earnings targets for the current year in line with the difficult market conditions, and met these targets in H1 2009 by posting a pre-tax operating profit.

**Net interest income and commission income**

At the end of H1 2009, net interest income was up by EUR 3.3 million year on year. On the one hand, this was based on the restructuring of loans and Pfandbriefe, which was undertaken during the first half of 2009 in order to improve margins. On the other hand, the cost of short-term funds decreased noticeably. However, this effect will be offset by an increase in the cost of long-term funds in H2 2009 due to a considerable widening of funding spreads.

Due to the realignment of our business strategy, no new lending was initiated in H1 2009 in the project financing or semi-public enterprises segments. This resulted in a EUR 1.1 million reduction in net commission income as compared to H1 2008.

**Administrative expenses**

Administrative expenses fell year on year as of H1 2009 by 14.2% to a total of EUR 9.6 million. This was due mainly to the restructuring efforts within the former business segments of primary municipal lending, semi-public enterprise financing and project financing, which went according to plan. A EUR 2.5 million provision was recognized as of December 31, 2008 for human resources and other expenses incurred in connection with the restructuring.

The cost of labour was reduced by more than 25% to EUR 3.9 million thanks to on-target staff reductions. Other administrative expenses plus depreciation, amortization and write-downs fell by EUR 0.2 million. These savings in other administrative expenses were the result of the restructuring measures as well as of consistent overall cost management. However, depreciation and amortization due to investments made in 2008 rose year on year.

**Level and development of risk provisioning**

Risk provisioning comprises all recognizable and pending risks in the lending business and in the securities of the liquidity reserve, as well as the gains and losses from cross compensation pursuant to Section 340 f (3) of the German Commercial Code (HGB). Net risk provisioning amounted to EUR 25.0 million (June 30, 2008: EUR 20.5 million). It primarily includes provisions made according to the lower of cost or market principle in the securities business, which were recognized in response to widening spreads. This also affected the portfolios of underlyings which are micro hedged against interest rate risks via in-



sheet date, the Bank's capital backing was significantly above the minimum requirement as defined under § 10 (1) sentence 9 of the German Solvency Regulation (Solvabilitätsverordnung, „SolvV“).

### Liquidity

The liquidity ratio as of June 30, 2009 was calculated on the basis of the German Liquidity Regulation (Liquiditätsverordnung, „LiqV“) pursuant to § 10 (1) sentence 9 KWG. This regulation states that the ratio of the cash available in the first maturity range (from daily up to 1 month) to the callable payment ob-

ligations during the same period may not fall below 1. Dexia Kommunalbank Deutschland's liquidity planning factored in the extent of expected cash inflows and outflows, an adequate liquidity supply in the form of highly liquid assets and available funding lines on the money market.

### Derivatives

The Bank used derivatives as auxiliary transactions in accordance with the German Pfandbrief Act (Pfandbriefgesetz, „PfandBG“) to hedge against interest rate and foreign exchange risks and to improve earnings.

DEVELOPMENT OF THE BANK'S EQUITY (IN EUR MILLION)					
	2005	2006	2007	2008	30.06.2009
Subscribed capital	162,5	162,5	162,5	162,5	182,5
Reserves	111,4	114,8	122,4	127,6	148,0
Deduction item acc. to §10 (2a) KWG	-2,0	-2,6	-5,3	-8,1	-7,0
Profit participation capital	126,1	125,5	140,6	140,6	126,3
Subordinated liabilities	135,3	136,0	126,7	115,4	115,4
Tier 3 capital	0,0	0,0	0,0	0,0	0,0
<b>TOTAL</b>	<b>533,2</b>	<b>536,2</b>	<b>546,9</b>	<b>538,0</b>	<b>565,3</b>

LIQUIDITY			
	Minimum	Maximum	Average
Liquidity ratio	1,07	1,2	1,12

DERIVATIVES IN EUR MILLION			
	31.12.2008	30.06.2009	
Interest rate and cross-currency swaps	109.380,4	96.967,6	
of which EONIA	20.000,0	6.500,0	
Options	481,0	398,0	

The volume of interest rate and cross-currency swaps and options developed as follows from December 31, 2008 to June 30, 2009:

**Subsequent events**

There were no notable subsequent events following the end of the first half of 2009.

**Employees**

At the end of H1 2009, the Bank employed 98 people (December 31, 2008: 111).

**RISK REPORT**

**Risk environment**

The basic principles and the organization of Dexia Kommunalbank Deutschland's risk management system and overall bank management processes were adapted to fit the Bank's new business strategy. Please refer to the explanations of the methods applied for risk measurement and information on „Basel II“ contained in the Management Report as of December 31, 2008.

**Concept of risk-bearing capacity**

A top-down approach was still used as of June 30, 2009 to properly capture and map the quantifiable risks and interpret them in terms of the Bank's ability to carry and sustain risks. A loss ceiling is set by the Management Board for market, counterparty, liquidity and operational risks to be entered into. The individual risk categories are based on the following quantification methods:

The following presents the utilization of the ability to carry and sustain risks under the normal scenario during the first half of the year (average) and as of June 30, 2009:

CAPACITY TO CARRY AND SUSTAIN RISKS		Normal scenario	Extreme scenario
Market risk	Primarily write-downs of securities held as current assets plus risk of overnight deterioration (95% confidence level)	Primarily write-downs of securities held as current assets plus risk of overnight deterioration.	(2 x doubled max. swing of past 2 years)
Counterparty risk	„Credit Risk (Exposure x Probability of Default x Loss Given Default) factoring in a term component“	Credit risk (Ratings downgrade of entire portfolio by two notches)	
Liquidity risk	Due to high quality of assets not included in ability to carry and sustain risk; but included daily in the separate liquidity limits		See normal scenario
Operational risk		Not included	Standard Approach pursuant to Basel II

### Market risks

The market price risk inherent in volatile markets is one area on which risk management and monitoring focuses. In this context, interest rate risks are particularly relevant for Dexia Kommunalbank Deutschland. Foreign currency risks are generally eliminated by hedging.

Based on the method for quantifying risk laid out in the Management Report as of December 31, 2008, the positions as of June 31, 2009 were as follows:

Using back testing, Dexia Kommunalbank Deutschland performed a weekly review of the forecast quality of the VaR models for all sub-portfolios in the period under review. The changes in NPV that actually occurred were compared with the results of calculations based on the VaR model.

The three outliers established for the overall portfolio (= 1.2% of cases) are slightly higher than the anticipated value, hence constituting a very good result.

A Group-wide project has been launched to further improve the backtesting method used.

### Counterparty risks

In order to limit counterparty risks, the Management Board set specific credit lines and credit delegations for all counterparties in close cooperation with the Dexia Group.

Dexia Kommunalbank Deutschland has at its disposal a dynamic system for granting credit lines to public corporations and public law institutions for public sector lending. Per-capita debt and the ratio of the overall debt of the resp. public corporation to the average overall debt in the relevant category are

#### UTILIZATION OF OVERALL LIMIT

	Utilization of overall limit in %
Avg. 01-06/2009	54,0
30.06.2009	42,8

	Limit +/- 100 BPV in Mio. Euro	Limit VaR 99/10 in Mio. Euro
Cash Liquidity Management (CLM)	10	2

#### VALUE-AT-RISK/BPV

	-100 BPV (EUR million)	CLM +100 BPV (EUR million)	VaR (99%, 10 days)
Avg. 01-06/2009	0,6	-0,8	0,9
Min. 01-06/2009	-9,0	-8,6	0,0
Max. 01-06/2009	8,1	8,6	2,7
30.06.2009	-4,5	4,5	0,7

the key criteria for establishing the maximum credit line to be accepted by the Bank.

Detailed credit line utilization calculations are provided daily by Risk Management and are monitored by the back office. The Management Board is notified immediately if any credit line is exceeded, and a decision on the appropriate actions is made.

The organization and procedures established to manage credit risks comply qualitatively and quantitatively with the credit analysis as well as the credit processing requirements of these business segments. The documentation requirements set forth in MaRisk are complied with.

Dexia Kommunalbank Deutschland's semi-public enterprises and project financing portfolios are in reduction mode since March 3, 2009 in line with a specifically spelled-out reduction plan. The Bank applies the simplified procedures under MaRisk 1.2.5 relating to the preparation of credit votes independent of the front office.

Normal and extreme counterparty risk exposure is quantified against credit risk and – together with the relevant market and liquidity risks – is counted towards a maximum loss limit determined on the basis of the Bank's current profitability, its hidden reserves and its net equity.

In addition to measuring direct counterparty risks (credit risks), the Bank also assesses the risk of full or partial non-performance by the counterparty (replacement risk). After individual transaction risks are identified, all existing default risks are consolidated and measured based on counterparty or borrower.

In close cooperation with the Dexia Group, Dexia Kommunalbank Deutschland moved to accommodate the changes in underlying conditions as described above by first generally freezing lines of credit granted to banks and then subjecting all such portfolios to a more detailed critical review, among taking other measures. A new transaction-specific limit system has since gone into effect that defines terms and conditions for money market, repo and derivatives transactions.

### Liquidity risks

Liquidity risk is understood as the danger that the Bank will be unable to fulfill its current and future payment obligations in full or on time.

In view of the liquidity crisis on the international money markets resulting from the real estate crisis in the US, the Dexia Group has stepped up internal liquidity management. Dexia Kommunalbank Deutschland is fully integrated into this Group-system. Given the excellent quality of Dexia Kommunalbank Deutschland's assets, it always holds a large volume of ECB-eligible securities. As a result of that fact, coupled with the aforementioned concerted liquidity management system, Dexia Kommunalbank Deutschland was at no time exposed to any liquidity squeezes.

In order to guarantee liquidity at any time, a liquidity forecast is prepared daily containing an overview of maximum cash outflows for the next 90 days. Each day, Risk Management identifies the cumulative mismatched liquidity positions for one day, two days and one week, and matches them against defined limits. The Management Board receives daily updates on the utilization of this liquidity limit in a summary risk report. In addition, funding matrixes provide a medium and long-term view of the Bank's liquidity. In a special report, the mismatched medium-term liquidity positions (up to one year) are compared with the available liquidity reserves in the form of ECB-eligible securities. The ratio calculated in the first half of 2008 was well below 100%.

### Operational risks

The Bank defines operational risk as the risk of a direct or indirect loss caused by human conduct, procedural or control systems weaknesses, technical failures, catastrophes or external influences. These also include reputational and legal risks. The latter can arise from an unexpected change in legislation, unfavourable contractual terms or (potential) legal disputes with third parties. Measures such as the integration of customer complaint management, the implementation of an anti-corruption guideline and a specific code of conduct for both internal and external relationships contribute to a significant reduction in risks to the Bank's reputation. Controls are also in place at different levels to limit operational risks. Technical and organizational measures have been put in place in the area of IT infrastructure and organizational procedures in particular to limit and avoid risks. Emergency plans and a catalogue of measures have been drawn up; they are set out in a manual for emergencies that is available on the intranet.

In order to identify and assess operational risks, procedures were set in place at the end of 2007 to map operational risks as part of the Dexia Group's Risk & Control Self-Assessment Program (RCSA). These are currently being updated.

## ■ FORECAST

Now that the danger of a deep economic recession seems to have been averted with the help of government stimulus packages, the main question is whether the economic recovery can be expected to take a sharp V-shape or a slower W-shape. As an increasing number of signs are pointing to a return to normality in the financial and capital markets and some economic indicators are showing better-than-expected development, it is possible that the economy has hit bottom. Nonetheless, the majority of market observers are expecting the economy to first stagnate, and then make a slow recovery. Analysts recently have been revising upward the global growth expectations ..

At the same time, the effects and risks of the massive government interventions into the economy can only be gauged with great difficulty over the long term. In particular, the speed and timing of the reversal of government interventions will be especially critical with respect to the emergent dangers of an inflationary cycle, which could lead to premature key rate hikes.

Going forward, it can be expected that the need for mark-downs will shift from securities to lending positions due to cyclical factors. Since the banking sector remains heavily dependent on government assistance, it will not be possible to evaluate the success of these support measures until the state funding guarantees will expire. Once they have surmounted the financial market crisis, the well-positioned institutions will continue to stand out against the weaker ones. The banking sector can generally expect to see a wave of consolidation.

Some banks already withdrew from government aid programs early on, or opted not to take advantage of them. Among the reasons for this strategy are the high costs of the government guarantees. However, such a decision may prove premature if governments implement the likely capital requirements, and accounting and supervisory guidelines consistently. Moreover, the tendency of lending institutions to utilize equity to back an increasing amount of riskier asset allocation strategies jeopardizes their role as financial intermediaries within the economy.

The decline in industrial output and consumer spending are clear indications that Europe is still in the midst of a recession, despite a few positive signs of recovery. Falling consumer prices are not likely to lead to significant growth momentum since consumer spending by private households is on the

decline and the saving ratio is on the rise. Given this, it appears uncertain whether government support measures can be rolled back as early as 2009, or whether they will need to remain in place until 2010. It is equally likely that governments will extend the existing term of their funding guarantees.

Exploding deficits also represent a heavy burden, particularly for the weaker economies. In spite of extensive support from the IMF, the economies of eastern European EU member states in particular remain fragile since they rely to a great degree on the western EU states for lending.

Massive issuance of covered bonds will limit a further drop in issuance margins, as in the crisis, investors have introduced lower counterparty limits and lower credit product limits. Moreover, investor interest could decrease due to the rating downgrades of many Pfandbrief issuers as forecasted by S&P. If the crisis on the covered bond markets persists, the ECB can therefore be expected to expand its purchase program rather than continue to lower interest rates.

Dexia Kommunalbank Deutschland benefited from the strengthening of the Pfandbrief market and the significant narrowing of issuance spreads, and has already placed a considerable portion of the volume of planned funding for 2009. Going forward, Dexia Kommunalbank Deutschland's secured funding base will put it in a position – with support from the Dexia Group – to invest more heavily in its international public finance business, which tends to offer higher margins. This, too, will lead to the further diversification of the cover pool without eroding its extremely good quality.

Given the persistent market turmoil, the volatile market environment in which Dexia Kommunalbank Deutschland's currently operates and the uncertainty as to the future development of the economy, it is extremely difficult to provide an accurate earnings outlook for the 2009 fiscal year. Volatility risks are very real and must be taken into account, particularly in light of the enduring crisis on the financial and capital markets.

The 2009 fiscal year is expected to close with a net profit around the same level as the previous year. Moreover, the increase in funding costs and the planned reduction in total assets could result in opportunity costs on the earnings side in 2009 and 2010. The success of the transformation plan will be determined primarily by Dexia Kommunalbank Deutschland's future issuing success and hence by the ability to fund the intra-Group transfer of higher-margin assets eligible for the cover pool.

Administrative expenses are expected to decline at the end of the year due to changes in the organization of the Bank and the closing of the branch office in Frankfurt am Main. Naturally, the largest uncertainty revolves around the forecast for risk provisioning. At present, there are no apparent additional impairments in relation to special factors resulting from the failure of various banks, as was the case in 2008.

The measures taken by governments and central banks to stabilize and stimulate the economy are expected to provide positive results over the remaining course of the year, and particularly into 2010. Both Dexia Group and Dexia Kommunalbank Deutschland expect to benefit from the potential economic recovery that will follow. On the other hand, a global economic downturn or a deterioration of the situation on the financial markets could negatively affect Dexia Group or Dexia Kommunalbank Deutschland. It is currently not possible to accurately predict the extent of the impact of the recession or the recovery potential for subsequent years. However, it can be said with relative certainty that from an economic standpoint, 2009 will be one of the most difficult years since the Federal Republic of Germany was founded.

Thanks to the high quality of Dexia Kommunalbank Deutschland's cover pool- and ECB-eligible assets, its liquidity position will again remain stable this year. Furthermore, Dexia Kommunalbank Deutschland's liquidity position benefits from its close integration into Dexia Group's cash and liquidity management system, as well as from the providing of a liquidity support letter by Dexia Crédit Local, in which the parent company promises to cover potential liquidity squeezes.

Berlin, August 2009  
DEXIA KOMMUNALBANK DEUTSCHLAND AG

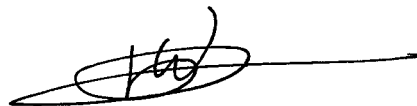
*The Management Board*



Behr



Dr. Eickhoff



Wouters

INTERIM FINANCIAL  
STATEMENTS  
AS OF JUNE 30, 2009



# CONDENSED BALANCE SHEET

*as of June 30, 2009*

CONDENSED BALANCE SHEET AS OF 30 JUNE 2009   ASSETS		Euro	Euro	Euro	31.12.2008 Euro thousand
<b>Cash reserve</b>					
a) Cash on hand		1.606,96			3
b) Balances with central banks including: with Deutsche Bundesbank		4.865.278,99			78.574
c) Postal bank balances		0,00		4.866.885,95	0
<b>Public debt issue and bills eligible for refinancing with central banks</b>					
a) Treasury bills and non-interest-bearing Treasury notes and similar public-sector debt instruments			0,00		0
including: refinancable with Deutsche Bundesbank	0,00				(0)
b) Bills of exchange			0,00	0,00	0
<b>Due from banks</b>					
a) Mortgage loans			0,00		0
b) Loans to the public sector		3.212.279.081,22			3.458.090
c) Other claims		4.262.776.547,82		7.475.055.629,04	4.694.485
<b>Due from customers</b>					
a) Mortgage loans			153.976.204,44		121.329
b) Loans to the public sector		20.001.643.526,08			20.482.411
c) Other claims		394.911.305,56		20.550.531.036,08	368.878
<b>Bonds and other fixed interest securities</b>					
a) Money market instruments					
aa) public-sector issuers	0,00				0
ab) other issuers	0,00				0
b) Bonds and notes					
ba) public-sector issuers	8.497.044.768,90				8.803.981
bb) other issuers	9.189.481.018,43	17.686.525.787,33			10.525.846
c) Own bonds		9.019.554,78		17.695.545.342,11	9.198
<b>Shares and other variable interest-bearing securities</b>					
				3.422.999,98	6.418
<b>Investments</b>					
				0,00	0
<b>Investments in affiliates</b>					
				0,00	0
<b>Trust assets</b>					
				0,00	0
<b>Compensation receivables from public bodies including bonds arising from their exchange</b>					
				0,00	0
<b>Intangible assets</b>					
				5.971.400,50	6.676
<b>Tangible assets</b>					
				10.693.035,76	10.867
<b>Subscribed capital unpaid</b>					
				0,00	0
<b>Own shares or capital</b>					
				0,00	0
<b>Other assets</b>					
				6.847.605,65	6.995
<b>Tax accruals</b>					
				15.075,72	30
<b>Accruals and deferrals</b>					
a) From new issues and lendings		231.471.553,64			270.907
b) Other		143.639.746,20		375.111.299,84	124.531
<b>Deficit not covered by equity</b>					
				0,00	0
<b>TOTAL ASSETS</b>				<b>46.128.060.310,63</b>	<b>48.969.218</b>

CONDENSED BALANCE SHEET AS OF 30 JUNE 2009   LIABILITIES		Euro	Euro	Euro	31.12.2008 Euro thousand
<b>Due to banks</b>					
a)	Registered mortgage Pfandbriefe		0,00		0
b)	Registered public Pfandbriefe	1.440.381.898,27			1.607.130
c)	Other liabilities	<u>6.924.839.237,69</u>		8.365.221.135,96	8.782.611
<b>Due to customers</b>					
a)	Registered mortgage Pfandbriefe		0,00		0
b)	Registered public Pfandbriefe	16.835.105.463,23			16.170.481
c)	Savings deposits				
ca)	terminable within three months	0,00			(0)
cb)	not terminable within three months	0,00	0,00		(0)
d)	Other liabilities	<u>1.917.073.220,01</u>		18.752.178.683,24	1.986.522
<b>Securitized liabilities</b>					
a)	Issued bonds				
aa)	Mortgage Pfandbriefe	0,00			0
ab)	Public Pfandbriefe	18.125.503.572,64			19.528.564
ac)	other	<u>60.211.951,40</u>	18.185.715.524,04		74.387
b)	Other securitized liabilities		<u>0,00</u>	18.185.715.524,04	0
<b>Trust liabilities</b>					
				0,00	0
<b>Other liabilities</b>					
				11.788.958,51	49.449
<b>Accruals and deferrals</b>					
a)	From new issues and lendings		23.094.179,13		18.545
b)	Other		<u>177.044.722,23</u>	200.138.901,36	151.613
<b>Provisions for liabilities</b>					
a)	Provisions for pensions and similar commitments		374.876,00		369
b)	Tax provisions		1.050.821,40		0
c)	Other provisions		6.883.345,82	8.309.043,22	7.427
<b>Special reserve item</b>					
				0,00	0
<b>Subordinated liabilities</b>					
				131.499.999,97	131.500
<b>Profit participation capital</b>					
				142.284.000,01	170.111
<b>Fund for general banking risks</b>					
				0,00	0
<b>Equity capital</b>					
a)	Subscribed capital		182.500.000,00		162.500
b)	Capital reserve		98.684.911,98		78.685
c)	Retained earnings				
ca)	Statutory reserve		0,00		0
cb)	Reserve for own shares		0,00		0
cc)	Reserves required by Articles of Incorporation		0,00		0
cd)	Other retained earnings	49.323.255,96	49.323.255,96		48.883
d)	Net income		<u>415.896,38</u>	330.924.064,32	440
<b>TOTAL LIABILITIES</b>				<b>46.128.060.310,63</b>	<b>48.969.218</b>
<b>Contingent liabilities</b>					
a)	Contingent liabilities from discounted bills of exchange		0,00		0
b)	Liabilities from guarantees and indemnity agreements		116.754.039,94		122.110
c)	Liability from assets pledged as collateral for third-party obligations		<u>0,00</u>	116.754.039,94	0
<b>Other commitments</b>					
a)	Repurchase obligations from reverse repurchase agreements		0,00		0
b)	Placement and underwriting commitments		0,00		0
c)	Irreversible loan commitments		<u>591.357.431,18</u>	591.357.431,18	693.706



# CONDENSED INCOME STATEMENT

*for the period from January 1 to June 30, 2009*

<b>INCOME STATEMENT FOR THE PERIOD FROM JANUARY 1 TO JUNE 30, 2009   EXPENSES</b>		Euro	Euro	01.01.–30.06.2009 Euro	01.01.–30.06.2008 Euro thousand
Interest expenses				1.721.086.244,74	2.886.860
Commission expenses				1.679.394,60	2.302
Net expenses from financial operations				0,00	0
<b>General administrative expenses</b>					
a) Personnel expenses					
aa) Wages and salaries	3.274.022,87				4.534
ab) Social security and other employee benefits	<u>581.844,75</u>	3.855.867,62			672
b) Other administrative expenses		<u>4.479.939,72</u>		8.335.807,34	5.197
Depreciation and write-downs of intangible and tangible assets				1.308.745,64	841
Other operating expenses				81.059,75	180
Depreciation and write-downs of claims and certain securities, allocation to provisions for possible loan losses				24.977.019,50	20.454
Depreciation and write-downs of participations, interests in affiliates and securities treated as fixed assets				0,00	254
Expenses from underwriting losses				0,00	0
Transfer special reserve item				0,00	0
Extraordinary expenses				0,00	0
Income Taxes				79.896,39	149
Other taxes not reported under 'Other operating expenses'				5.442,77	9
Profits transferred on the basis of profit pooling, under a profit and loss transfer agreement or an agreement to transfer a portion of the profit/loss				0,00	0
Net income				415.896,38	878
<b>TOTAL EXPENDITURE</b>				<b>1.757.969.507,11</b>	<b>2.922.330</b>

<b>CONDENSED PROFIT AND LOSS ACCOUNT AS OF 30 JUNE 2009   INCOME</b>		01.01.–30.06.2009	01.01.–30.06.2008
	Euro	Euro	Euro thousand
<b>Interest income from</b>			
a) Lending and money market transactions	1.464.072.722,43		2.456.041
b) Fixed-interest securities and Debt Register claims	293.095.463,88	1.757.168.186,31	463.633
<b>Current income from</b>			
a) Shares and other non-fixed income	0,00		0
b) Participations	0,00		0
c) Investments in affiliated companies	0,00	0,00	0
<b>Profits transferred on the basis of profit pooling, under a profit and loss transfer agreement or an agreement to transfer a portion of the profit/loss</b>		0,00	0
<b>Commission income</b>		717.072,38	2.438
<b>Net income from financial operations</b>		6.000,00	0
<b>Income from write-ups of claims and certain securities, reversal of provisions for possible loan losses</b>		0,00	0
<b>Income from write-ups to participations, investments in affiliates and securities treated as fixed assets</b>		7.821,77	0
<b>Other operating income</b>		70.426,65	219
<b>Income from retransfer from special reserve item</b>		0,00	0
<b>Extraordinary income</b>		0,00	0
<b>Income from underwriting of losses</b>		0,00	0
<b>Net loss for the year</b>		0,00	0
<b>TOTAL INCOME</b>		<b>1.757.969.507,11</b>	<b>2.922.330</b>

# CONDENSED NOTES TO THE INTERIM FINANCIAL STATEMENTS

The Interim Report as of June 30, 2009 was prepared in accordance with the same accounting policies applied in the preparation of the annual financial statements as of December 31, 2008.

The interim management report provides an explanation of the material changes in the amounts reported in the condensed balance sheet and the condensed income statement as compared to the prior-period figures, as well as of developments having taken place during the reporting period.

We have calculated our income tax burden on the basis of our current expectations for overall net profit for the year 2009. We based this on the current tax rates and brackets, factoring in the expected differences between the financial accounts and tax accounts. This tax rate was applied to the pre-tax profit recorded in the interim financial statements.

The interim financial statements as of June 30, 2009 were neither audited in accordance with § 317 HGB nor reviewed by an auditor.



## Supervisory Board

### Stéphane Vermeire

(since February 17, 2009)

*Head of PWB International*

*Member of the Management Board of Dexia Crédit Local*

*Dexia SA*

*Chairman*

### François Durolet

(until February 17, 2009)

*Deputy Executive Vice President Public Finance*

*Head of Public Finance Network & FSA Department*

*Dexia SA*

*Chairman*

### Claude Schon

*Head of Group Treasury*

*Member of the Treasury & Financial Markets*

*Executive Committee*

*Dexia SA*

*Deputy Chairman*

### Hans Handschuh

*Bank employee*

### Jean Le Naour

*Member of the Management Board of Dexia Crédit Local*

*Head of Finance, Operations and IT Department*

*Dexia Crédit Local*

### Sascha Riegenring

*Bank employee*

### Xavier Rojo

*Global Head of Innovation & Financial Engineering*

*Public and Wholesale Banking*

*Dexia Crédit Local*

## Management Board

### Giselbert Behr

*Chairman*

**Dr. Wolfgang Eickhoff**

**Wilfried Wouters**



# RESPONSIBILITY STATEMENT

To the best of our knowledge, and in accordance with the applicable reporting principles for interim financial reporting, the interim financial statements give a true and fair view of the results of operations and financial position of the Company, and the interim management report includes a fair review of the development and performance of the business and the position of the Company, together with a description of the principal opportunities and risks associated with the expected development of the Company for the remaining months of the financial year.

Berlin, August 2009  
DEXIA KOMMUNALBANK DEUTSCHLAND AG

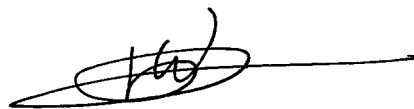
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Dr. Eickhoff



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