February 14, 2013

# Municipality Finance Plc Financial Statements Bulletin 1 January-31 December 2012


## Summary of 2012

- The Group's net operating profit amounted to EUR 138.6 million (2011: EUR 65.3 million). The growth was 112% year-on-year.
- Net interest income grew by 51% compared with the previous year, totalling EUR 142.4 million (2011: EUR 94.2 million).
- Balance sheet total stood at EUR 25,560 million (2011: EUR 23,842 million). The balance sheet grew by 7% compared with the end of the previous year.
- The Group's risk-bearing capacity continued to be very strong, with capital adequacy ratio at 33.87% at year end (2011: 24.13%) and the capital adequacy ratio for Tier I capital at 26.22% (2011: 19.04%).
- Total funding acquisition for 2012 amounted to EUR 6,590 million (2011: EUR 6,673 million). The total amount of funding grew to EUR 22,036 million (2011: EUR 20,092 million).
- Lending increased to EUR 15,700 million (2011: EUR 13,625 million). In total, 17% more loans were withdrawn than in the previous year, amounting to EUR 3,254 million (2011: EUR 2,780 million).
- Focus on the development of financial leasing operations that started in 2010 continued strongly. The leasing portfolio stood at more than EUR 64 million at year end (2011: EUR 30 million).
- Investments totalled EUR 6,224 million at the end of 2012 (2011: EUR 5,640 million).
- The turnover of Municipality Finance's subsidiary, Inspira, stood at EUR 1.8 million (2011: EUR 2.2 million). Net operating profit at the end of 2012 totalled EUR 0.2 million (2011: EUR 0.4 million).


## Key figures (group):

| | 31 Dec 2012 | 31 Dec 2011 |
|---|---|---|
| Net interest income (EUR m) | 142.4 | 94.2 |
| Net operating profit (EUR m) | 138.6 | 65.3 |
| New loans issued (EUR m) | 3,254 | 2,780 |
| New funding acquisition (EUR m) | 6,590 | 6,673 |
| Balance sheet total (EUR m) | 25,560 | 23,842 |
| Own funds (EUR m) | 428.9 | 288.4 |
| Capital adequacy ratio for Tier 1 capital, % | 26.22 | 19.04 |
| Capital adequacy ratio, % | 33.87 | 24.13 |
| Return on equity (ROE), % | 38.04 | 27.08 |
| Cost-to-income ratio | 0.14 | 0.23 |

### CEO Pekka Averio's comments on the financial year:

"2012 was a successful year for Municipality Finance, and the company's financial performance was strong. The company remained the largest lender for its customer base, providing approximately 80% of municipal sector loans. The financing of state-subsidised housing production was in practice overall the responsibility of Municipality Finance. However, the construction industry's interest in state-subsidised new building production plummeted.

The company acquired funding in a front-loaded manner during the first half of the year. The availability of funds was very good throughout the year, and the costs of funding continued to be competitive. The situation reflects the confidence of international investors in the future of the Finnish municipal sector.

The development work on the regulation of the financial sector that started from the financial crisis continued during the year. A number of parallel projects are in progress, which tighten the liquidity and capital requirements for the entire banking sector and increase the costs of regulation and control. With these developments, customers' financing costs will rise.

During the year, measures were undertaken at Municipality Finance aiming at meeting the new capital requirements by means of profits made. The most significant changes were made to the pricing and funding strategies, in addition to which we focused on enhancing the efficiency of our own operations.

Municipality Finance forms a integral part of the basic financial structure of Finnish society. The company balances economic fluctuations of municipal finances and fundamentally supports the activities of municipalities. The company plays an extremely important role when it secures funding for the municipal sector in times of uncertainty as well.

Municipality Finance continues to develop its operations in order to ensure the best services to its customers and good financial performance in the future as well. The basic requirement is ensuring operational efficiency and the expertise of personnel."

### Credit ratings

Municipality Finance Plc's credit ratings

The credit ratings of the company's long-term funding are the best possible:

| Rating agency | Long-term funding | Outlook | Short-term funding | Outlook |
|---|---|---|---|---|
| Moody's Investors Service | Aaa | Stable | P-1 | Stable |
| Standard & Poor's | AAA | Stable | A-1+ | Stable |

In January 2013, Standard & Poor's confirmed Municipality Finance's AAA credit rating and, at the same time, changed the outlook from negative to stable.

The Municipal Guarantee Board's credit ratings

The Municipal Guarantee Board guaranteeing the company's funding has the best possible credit ratings for long-term funding:

| Rating agency | Long-term funding | Outlook | Short-term funding | Outlook |
|---|---|---|---|---|
| Moody's Investors Service | Aaa | Stable | P-1 | Stable |
| Standard & Poor's | AAA | Stable | A-1+ | Stable |

In January 2013, Standard & Poor's confirmed the Municipal Guarantee Board's AAA credit rating and, at the same time, changed the outlook from negative to stable.

### Operating environment in 2012

The uncertain conditions on the international financial markets calmed down somewhat towards the end of the year, despite the lengthening of the European sovereign debt crisis and the decline in the overall economic conditions in many countries. The strong intervention by the European Central Bank through increasing financing to the European banking sector had a significant soothing effect on the financial market.

During the year, companies in the financial and banking sector launched measures to adapt to the Basel III regulation in the future. The most important pressures for change are caused by the tightening requirements for the amount and quality of equity for operators in the industry and the increases in liquidity requirements.

In addition, the financial market tax being planned in a number of EU countries, the bank tax that will enter into force in Finland and the new requirements related to the supervision of banks will significantly increase the operating costs of the financial sector in the next few years. The changes require more efficient operations and may result in banks focusing on the most profitable business in the private sector.

Municipality Finance is an important part of the basic financial structure of Finnish society and the only financial institution exclusively specialising in the municipal sector in Finland. In 2012, Municipality Finance as the largest lender for the municipal sector ensured the availability of financing for its customers in the normal manner. Funding acquisition by Municipality Finance focused on the early part of the year and the company's liquidity was good throughout the year. The company's strong position and well-performing risk management are also reflected in its credit ratings, which are assessed by rating agencies as the highest possible.

### Group operating result and balance sheet

Considering the challenges in the international operating environment, the

Group's net operating profit was excellent. The growth of the business continued and net operating profit for the financial year before appropriations and taxes stood at EUR 138.6 million (2011: EUR 65.3 million). Net operating profit grew by 112% year-on-year. The Group's net interest income amounted to EUR 142.4 million (2011: EUR 94.2 million).

Municipality Finance's net operating profit stood at EUR 138.5 million (2011: EUR 65.0 million). Compared with the previous year, net operating profit was improved by the increase in business volume, the increase in the margins of new loans, excellently performing funding, successful balance sheet management and repurchases of the company's own bonds. Income from repurchased bonds totalled EUR 9.7 million in 2012 (2011: EUR 2.3 million), which is recognised under net interest income. The result includes EUR 15.8 million of unrealised fair value changes recorded based on valuations (2011: EUR -11.5 million).

The net operating profit of Municipality Finance's subsidiary, Inspira, was EUR 0.2 million in 2012 (2011: EUR 0.4 million).

The Group's commission expenses totalled EUR 3.2 million at the end of the year (2011: EUR 2.9 million). Operating expenses increased by 15% to EUR 19.4 million during 2012 (2011: EUR 16.9 million). The growth in expenses was mainly due to both an increase in personnel resulting from changes in business volume and in the company's operating environment and on-going system development projects.

Administrative expenses totalled EUR 13.5 million (2011: EUR 12.1 million), of which personnel expenses accounted for EUR 9.2 million (2011: EUR 8.3 million). Depreciation of tangible and intangible assets amounted to EUR 1.1 million (2011: EUR 0.8 million). Other operating expenses stood at EUR 4.9 million (2011: EUR 4.0 million).

The Group's balance sheet total was EUR 25,560 million at the end of 2012, compared to EUR 23,842 million at the end of the previous year. The majority of the balance sheet development was due to growth in business volume and changes in the valuation of balance sheet items.

## Capital adequacy

The Group's capital adequacy developed favourably during the year. The capital adequacy ratio stood at 33.87% at the end of 2012, compared to 24.13% in 2011. The capital adequacy ratio for Tier 1 capital was 26.22% (2011: 19.04%).

The minimum requirement for own funds, corresponding to the minimum capital adequacy ratio of 8% pursuant to the Act on Credit Institutions, was EUR 101.3 million (2011: EUR 95.6 million). The capital adequacy requirement for credit risk tied up the largest amount of the Group's own funds at EUR 91.0 million (2011: EUR 87.9 million), the most significant items being claims on credit institutions and investment firms, as well as securitised items.

## Business operations

### Funding

Municipality Finance is an active participant in international bond markets and acquires a very significant portion of its funding from international capital markets. Asian markets continued to play an important role in Municipality Finance's funding. The largest European market for funding acquisition was Switzerland, with Germany the largest in the euro zone. There was also interest in the company's bonds in the Nordic countries.

The company concluded a total of 156 arrangements in international funding markets (2011: 222). In February 2012, Municipality Finance concluded its first inaugural arrangement in the pound market: GBP 300 million. In April 2012, a benchmark-sized bond of USD 1.0 billion was issued successfully. Through these funding arrangements Municipality Finance further diversified its sources of funding. Both issues were successful despite the challenging market conditions, allowing Municipality Finance to further expand its investor base.

The year 2012 was characterised by continued restlessness on the markets. As the European crisis continued, investors sought safe harbours for their assets. Supported by the stability and solid reputation of the Finnish local government sector, Municipality Finance was seen as a safe alternative by investors. Active work among investors has increased Municipality Finance's reputation in various markets, and diversifying the sources of funding has proven to be a good strategy in the unstable market situation. Despite the challenges, the company has managed to keep funding costs at the competitive level.

In 2012, EUR 6,590 million was acquired in long-term funding (2011: EUR 6,673 million), of which Municipal Bonds issued under the domestic debt programme amounted to EUR 8 million (2011: EUR 18 million). The company issued bonds denominated in 16 different currencies in 2012. A total of EUR 4,239 million was issued in short-term debt instruments under the Treasury Bill programme in 2012 (2011: EUR 3,168 million). Total funding at the end of the year amounted to EUR 22,036 million (2011: EUR 20,092 million). Of this total amount, 16% was denominated in euros (2011: 16%) and 84% was denominated in foreign currencies (2011: 84%).

### Customer financing

In 2012, investments by municipalities and municipal federations and the resulting funding requirements of the municipal sector remained at the previous year's level. The growth in housing loans was slightly higher than estimated at the beginning of the year. This increase in demand for housing financing is largely due to customers looking to refinance their old, expensive state-subsidised housing loans with new market-based loans.

The total number of tender requests received by Municipality Finance in 2012 increased by 13% compared with 2011. The total value of tender requests received was EUR 4,515 million (2011: EUR 3,988 million), of which it won EUR 3,284 million (2011: EUR 2,729 million). The market share was 80% of all competitive bidding for financing among Municipality Finance's customer base in 2012. Tenders worth EUR 1,822 million were won in the municipalities and municipal federations segment (2011: EUR 1,409 million), EUR 373 million in the municipal enterprises category (2011: EUR 433 million) and EUR 1,089 million in bids to housing corporations (2011: EUR 887 million). The company's long-term loan portfolio at the end of 2012 amounted to EUR 15,700 million (2011: EUR 13,625 million). This represents an increase of 15% on the previous year. New loans withdrawn amounted to 17% more than in 2011, or EUR 3,254 million (2011: EUR 2,780 million).

Municipality Finance offers financial leasing services to municipalities, municipal federations and municipally owned or controlled corporations. Leasing services were launched in 2010.

The aim of Municipality Finance's leasing operations is to increase transparency and the range of alternatives available in the leasing market. The company has concluded a number of facility agreements for leasing services and the prospects for expanding leasing operations are good, as financial leasing is increasingly seen as a viable alternative, particularly for procurement by municipal corporations engaging in municipal operations and hospital districts. Early in 2012, Municipality Finance also began offering financial real estate leasing services to municipalities as an alternative to traditional modes of financing.

As the interest level stayed low throughout 2012, customers continued to actively use short-term financing. At the end of 2012, the total value of municipal paper and municipal commercial paper programmes concluded with Municipality Finance was EUR 3,054 million (2011: EUR 2,786 million). At the end of the year, the company had EUR 753 million in municipal papers and municipal commercial papers issued by municipalities and municipal corporations on its balance sheet (2011: EUR 534 million), and, during the entire year, customers acquired EUR 9,109 million in financing through short-term programmes (2011: EUR 5,758 million).

### Investment operations

Municipality Finance's investment operations comprise the investment of funds acquired in advance in liquid financial instruments with a good credit rating in order to ensure that the company can remain operational under all market conditions. According to the company's liquidity policy, the liquidity portfolio must be sufficient to cover the liquidity needs of continued undisturbed operations for at least the six following months. The company invests cash collateral received on the basis of derivative collateral agreements in short-term money market investments. In addition, the company has other investments that are not included in liquidity.

At the end of 2012, security investments totalled EUR 5,895 million (2011: EUR 5,055 million) and their average credit rating was AA (2011: AA+). The average repayment period of the security portfolio stood at 2.97 years at the end of 2012 (2011: 2.72 years). In addition to this, the company had EUR 329 million in other investments (2011: EUR 585 million), of which EUR 228 million were in central bank deposits (2011: EUR 556 million), EUR 51 million in money market deposits in credit institutions (2011: EUR 29 million) and EUR 50 million in repurchase agreements (2011: -).

### Financial Advisory Services Inspira Ltd

In 2012, Inspira's turnover was EUR 1.8 million (2011: EUR 2.2 million). Net operating profit for the period totalled EUR 0.2 million (2011: EUR 0.4 million).

## Risk management

There were no material changes in the company's risk standing in 2012. Risks remained within the set limits and, based on the company's assessment, risk management met the requirements established for it.

## Prospects for 2013

The uncertainty in the international financial market will continue in 2013. However, on the basis of the autumn of 2012, the worst market fluctuations are expected to have calmed down, but the continuing sovereign debt crisis and the declining economic trend in Europe may cause new disturbances.

Interest rates are expected to remain low, even though a slight rise can be seen at the beginning of 2013.

Despite the weakened economic conditions, the Republic of Finland and the Finnish municipal sector are one of four euro zone countries to have retained the highest credit rating, so material changes in the availability of financing are not expected.

The investment requirements of the municipal sector are increasing in the long term. However, new investment projects initiated by municipalities are expected to remain stable or decrease slightly as general economic uncertainty increases. The on-going, still unfinished municipal reform may also postpone municipalities' investment decisions in the next few years.

The primary financing needs in the municipal corporations segment are likely to be seen in energy companies and water management projects. State-subsidised housing production will probably remain at an extremely low level without any new subsidy schemes intended to launch production.

Municipality Finance will continue to develop its own operations in a systematic manner, investing in developing services that our customers need, in adjusting to changes in the operating environment and regulatory environment, in renewing information systems and in refining our processes, in particular. With regard to services, we will focus on developing our own financing products, particularly leasing services and Inspira's advisory services.

The profitability of Municipality Finance's operations is expected to remain at a strong level in 2013.

## The Board's proposal for the distribution of profit for the 2012 financial year

Municipality Finance Plc's distributable funds total EUR 21,641,120.68, of which profit for the financial year is EUR 21,496,790.16. The Board of Directors will propose to the Annual General Meeting that no dividend be distributed and that the distributable funds of EUR 21,641,120.68 be retained in equity.

The Board considers it reasonable to leave the profits for the financial year to the company. The company must prepare for tighter requirements regarding its own funds by growing its Tier 1 capital considerably through profits, in the event that the requirement included in credit institution regulation regarding the leverage ratio, which is currently under preparation, comes into force in the form that is forecasted at the moment.

Financial statements for 2012 will be available on the company's website (www.munifin.fi) as of 5 March 2013.

Municipality Finance Plc

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## Municipality Finance Group

# Consolidated Statement of Financial Position

| € | 31 Dec 2012 | 31 Dec 2011 |
|---|---|---|
| ASSETS | | |
| Cash and cash equivalents | 228,187,577.63 | 26,507,291.80 |
| Loans and advances to credit institutions | 106,827,960.79 | 562,006,830.73 |
| Loans and advances to the public and public sector entities | 15,764,231,632.51 | 13,654,934,443.96 |
| Debt securities | 6,637,830,750.68 | 5,588,958,735.18 |
| Shares and participations | 10,035,087.37 | 27,219.06 |
| Derivative contracts | 2,551,682,689.75 | 3,750,333,786.73 |
| Intangible assets | 2,399,027.80 | 2,273,072.18 |
| Tangible assets | 2,341,475.06 | 2,460,149.10 |
| Other assets | 2,410,053.48 | 1,742,655.66 |
| Accrued income and prepayments | 254,213,722.25 | 247,761,352.13 |
| Deferred tax assets | 0.00 | 4,611,171.00 |
| **TOTAL ASSETS** | **25,560,159,977.32** | **23,841,616,707.53** |
| LIABILITIES AND EQUITY | | |
| LIABILITIES | | |
| Liabilities to credit institutions | 3,961,730,190.03 | 3,533,230,091.21 |
| Liabilities to the public and public sector entities | 1,049,476,634.38 | 1,176,752,432.59 |
| Debt securities issued | 18,798,374,704.55 | 17,187,942,326.47 |
| Derivative contracts | 937,983,299.37 | 1,253,255,710.82 |
| Other liabilities | 1,306,287.44 | 2,529,600.82 |
| Accrued expenses and deferred income | 297,999,204.21 | 349,695,135.86 |
| Subordinated liabilities | 90,354,746.57 | 89,915,861.74 |
| Deferred tax liabilities | 77,670,361.00 | 43,605,100.00 |
| **TOTAL LIABILITIES** | **25,214,895,427.55** | **23,636,926,259.51** |
| EQUITY AND NON-CONTROLLING INTEREST | | |
| Share capital | 42,583,195.49 | 42,583,195.49 |
| Reserve fund | 276,711.01 | 276,711.01 |
| Fair value reserve | 21,926,619.09 | -14,209,934.69 |
| Reserve for invested non-restricted equity | 40,366,099.60 | 40,366,099.60 |
| Retained earnings | 239,943,960.64 | 135,433,584.54 |
| **Total equity attributable to parent company equity holders** | **345,096,585.83** | **204,449,655.95** |
| **Non-controlling interest** | **167,963.94** | **240,792.07** |
| **TOTAL EQUITY AND NON-CONTROLLING INTEREST** | **345,264,549.77** | **204,690,448.02** |
| **TOTAL LIABILITIES AND EQUITY** | **25,560,159,977.32** | **23,841,616,707.53** |

## Municipality Finance Group

# Consolidated Income Statement

| € | 1 Jan – 31 Dec 2012 | 1 Jan – 31 Dec 2011 |
|---|---:|---:|
| Interest income | 275,660,476.90 | 328,299,977.25 |
| Interest expenses | -133,258,921.71 | -234,051,397.85 |
| **NET INTEREST INCOME** | **142,401,555.19** | **94,248,579.40** |
| Commission income | 1,729,821.41 | 2,184,693.73 |
| Commission expenses | -3,225,035.25 | -2,864,764.97 |
| Net income from securities and foreign exchange transactions | 14,340,421.93 | -7,982,924.96 |
| Net income from available-for-sale financial assets | 404,887.74 | -216,237.02 |
| Net income from hedge accounting | 339,555.75 | -3,348,590.28 |
| Other operating income | 25,628.54 | 103,697.49 |
| Administrative expenses | -13,494,661.05 | -12,123,380.20 |
| Depreciation and impairment on tangible and intangible assets | -1,066,883.77 | -765,234.52 |
| Other operating expenses | -4,874,168.23 | -3,983,360.62 |
| Impairment losses on other financial assets | 2,020,000.00 | 0.00 |
| **NET OPERATING PROFIT** | **138,601,122.26** | **65,252,478.05** |
| Income tax expense | -33,990,574.29 | -14,343,647.88 |
| **PROFIT FOR THE PERIOD** | **104,610,547.97** | **50,908,830.17** |
| Profit attributable to: | | |
| Equity holders of the parent company | 104,510,376.10 | 50,730,934.80 |
| Non-controlling interest | 100,171.87 | 177,895.37 |

# Statement of Comprehensive Income

| € | 1 Jan – 31 Dec 2012 | 1 Jan – 31 Dec 2011 |
|---|---:|---:|
| Profit for the period | 104,610,547.97 | 50,908,830.17 |
| Available-for-sale financial assets (fair value reserve): | | |
| Net change in fair value | 47,307,526.77 | -10,554,141.21 |
| Net amount transferred to profit or loss | 283,126.83 | 71,903.70 |
| Net impact of IAS 39 classification | 272,335.00 | 651,707.00 |
| Taxes relating to other components of comprehensive income | -11,726,432.21 | 2,273,620.97 |
| **TOTAL COMPREHENSIVE INCOME FOR THE PERIOD** | **140,747,104.36** | **43,351,920.63** |
| Total comprehensive income attributable to: | | |
| Equity holders of the parent company | 140,646,932.49 | 43,174,025.26 |
| Non-controlling interest | 100,171.87 | 177,895.37 |

## Municipality Finance Group

# Capital Adequacy

### Own funds

| €1,000 | 31 Dec 2012 | 31 Dec 2011 |
|---|---|---|
| Share capital | 42,583 | 42,583 |
| Minority interest | 168 | 241 |
| Reserve fund | 277 | 277 |
| Reserve for invested non-restricted equity | 40,366 | 40,366 |
| Retained profit | 135,434 | 84,703 |
| Profit for the period | 104,510 | 50,731 |
| Capital loans | 11,009 | 11,009 |
| Intangible assets | -2,399 | -2,273 |
| **TOTAL TIER 1 CAPITAL** | **331,948** | **227,637** |
| Fair value reserve | 21,927 | -14,210 |
| Subordinated liabilities included in upper Tier 2 capital | 40,000 | 40,000 |
| Subordinated liabilities included in lower Tier 2 capital | 35,000 | 35,000 |
| **TOTAL TIER 2 CAPITAL** | **96,927** | **60,790** |
| **TOTAL OWN FUNDS** | **428,875** | **288,427** |

### Risk-weighted assets

| €1,000 | 31 Dec 2012 | 31 Dec 2011 |
|---|---|---|
| **Credit risk, standard method** | **1,137,809** | **1,098,808** |
| **Minimum requirement for own funds** | | |
| Credit risk, standard method | | |
| Claims on credit institutions and investment firms | 45,549 | 45,627 |
| Covered bonds | 13,528 | 9,797 |
| Securitised items | 28,755 | 29,619 |
| Other items | 3,192 | 2,861 |
| Total credit risk, standard method | 91,024 | 87,904 |
| Market risk | 0 | 0 |
| Operational risk, standard method | 10,270 | 7,722 |
| **TOTAL MINIMUM REQUIREMENT FOR OWN FUNDS** | **101,294** | **95,627** |
| **CAPITAL ADEQUACY RATIO FOR TIER 1 CAPITAL** | **26.22%** | **19.04%** |
| **CAPITAL ADEQUACY RATIO** | **33.87%** | **24.13%** |

Municipality Finance Plc is the credit institution of the public sector, which is owned by municipalities, Keva and the State of Finland. The company is part of the basic economic structure of Finnish society. Its task is to ensure as competitive financing as possible for municipal investments and state-subsidised social housing production under all market conditions. The Municipality Finance Group also includes the subsidiary company Financial Advisory Services Inspira Ltd.

The company's customers are Finland's municipalities, municipal federations, municipally controlled companies and non-profit housing corporations. Our customers use financing solutions provided by Municipality Finance to finance social and non-profit entities such as day care centres, schools, housing facilities and hospitals, as well as other municipal investments.

Municipality Finance has the highest possible credit rating and its funding is guaranteed by the Municipal Guarantee Board. The company acquires funding in a market-based manner, mainly from international capital markets. The Group's balance sheet is over EUR 25 billion.

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