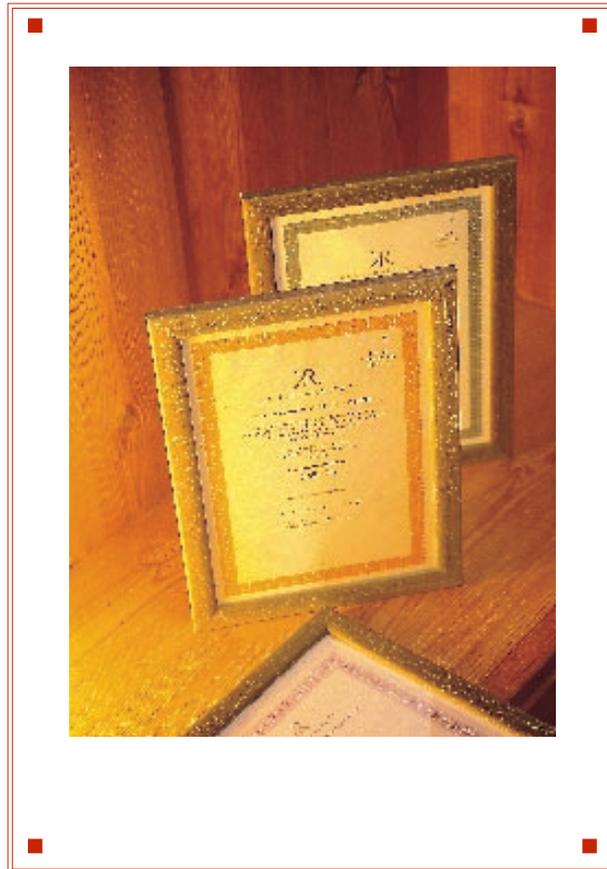


1998
ANNUAL REPORT



KUNTARAHOTUS
MUNICIPALITY FINANCE

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MUNICIPALITY FINANCE PLC.



Municipality Finance Plc., established in 1989, is a credit institution owned by the Local Government Pensions Institution. The company represents the Finnish municipal sector both on the domestic and international capital markets. The company's main objective is to provide cost-efficient finance for Finnish municipalities, municipal federations and municipality-controlled entities, whose loans are guaranteed by a municipality.

The funding of Municipality Finance is guaranteed by the Municipal Guarantee Board, a public organisation consisting of 421 member municipalities. Municipal Bonds and Municipal Notes are important forms of funding for the company on the domestic market. Funding on international capital markets is mainly raised under the EMTN programme listed on the London Stock Exchange. Municipality Finance is a non-profit making organisation.

Mr. Nicholas Anderson is the Chief Executive Officer and Managing Director of Municipality Finance and Mr. Juha Heinonen is the Deputy Managing Director of the company.

In the picture Municipality Finance's staff (from the left): Nicholas Anderson, Jukka Reijonen, Riikka Levenon, Riitta Jämsä, Anu Pääkkönen, Juha Heinonen, Leena Roininen-Himberg, Heli Iiskola, Katriina Hartikka, Marjo Tomminen, Toni Heikkilä, Jaana Palmroos, Anu Päivinen, Sari Ahonen, Maria Pöyhönen and Raija House.

REVIEW OF THE MANAGING DIRECTOR

Mr. Nicholas Anderson

As the Managing Director of Municipality Finance Plc., I am pleased to inform our clients that our most important objective – providing competitive funding for the Finnish municipal sector at the lowest possible cost – continued to be fulfilled with strength during the past year. In a year of great upheavals in the financial markets, we secured the largest share of new municipal loans; Municipality Finance provided over 50% of all municipal loans in 1998. We maintained our agreed margins over our cost of funding and did not resort to reducing loan margins or making unprofitable loans just to gain market share.

We were able to take advantage of our excellent ratings, AA+ and Aaa, in funding these municipal loans. As a result of successful operations both on the domestic and international capital markets, we have now seen our funding base develop quite considerably.

The year 1998 was successful in financial terms for Municipality Finance. The company's balance sheet increased significantly compared to the respective figure in 1997.

Breathtaking year for the financial markets

The year 1998 was an active and breathtaking year for the financial markets with booming markets in Europe and in the United States where share prices hit record levels and where European interest rates fell to very low levels. The sharp increase in asset values was accelerated by the official actions taken in response to the serious financial disturbances that started in 1997 and continued throughout 1998. Global infection spread from Russia to South America and to the Western hedge funds.

Unfortunately the size and losses of hedge funds went



beyond what was safe for the markets and the Federal Reserve intervened to stop more damage from spreading to existing financial structures.

Despite the rapid growth and reorganisation of financial institutions, financial supervisory boards have claimed that they can handle the process. Nevertheless, it is unrealistic to believe that multinational financial institutions can be effectively supervised from a single office. The failure of supervisors was proven in practice by the move by the Federal Reserve

to act as a mediator in saving the hedge fund called the Long Term Credit Management. The rescue came at the last minute. Why did they not take preventive action at an earlier time? It was known that some of the world's largest banks were involved in the activities of this fund.

The growth of investment markets is rapid and thus competition in international markets will accelerate and become fiercer. Many leading commentators are concerned about the growing asset bubble and the "too big to fail" question which remains just beyond the horizon. A bank that has grown too big cannot be allowed to file for bankruptcy. Action by the IMF and by various central banks to calm markets and lower interest rates may have inflated asset values and prolonged the bubble economy.

Competition for markets will intensify

When operating on the domestic and international capital markets, Municipality Finance's most important objective is to secure finance for Finnish municipalities and municipal federations at the lowest possible cost. This is also a great challenge for our company, since our loan volumes are small compared with

the current normal size of Eurobond issues offered by other credit institutions.

Municipality Finance is subject to fierce competition from many credit institutions on all the major capital markets. Some Finnish and Swedish banks offer loans at a price even below their own cost of funding. This kind of unprofitable activity cannot be long-standing and systematic. It distorts competition, which is not acceptable. Naturally this limits Municipality Finance's possibilities to act efficiently as the agency of the municipal sector.

In Finland laws and regulations give banks, insurance companies and investment funds many competitive advantages which are used in their marketing. For example banks can offer tax-free deposits to their clients. Both insurance companies and investment funds benefit from tax-advantaged pension accounts for private individuals who want to save for their own supplementary pensions.

Many financial institutions can benefit from certain advantages, which are not available to Municipality Finance. The German credit institutions KfW and DtA were given direct government guarantees and assigned permanent exclusion from the laws and regulations attached to normal credit institutions and banks. These credit institutions perform essential funding tasks for the sub-government sector inside Germany. They provide finance, for example, for infrastructure projects, social housing and environmental investments that are managed, among others, by municipalities and regional governments.

Strength from co-operation

It will be challenging to maintain our position in the current markets reaching beyond national boundaries. Therefore it is crucial for competitive reasons to co-operate with other similar credit institutions.

Municipality Finance has active co-operation with other Nordic credit institutions, e.g. with Kommuninvest in Sweden, Norges Kommunalbank in Norway and KommuneKredit in Denmark. The representatives of the companies meet regularly every year to discuss

common and topical issues. The exchange of experiences is important for each company in developing their business operations.

Diversity of funding

Municipality Finance succeeded in its funding operations both on the domestic and international capital markets in 1998. For example new Swiss bond issues were a resounding success. Bond issues in Japan were similarly successful. Municipal Bonds continued to sell well on the Finnish market, although low interest rates and a booming stock market have taken their toll.

The company's short-term Municipal Notes have sold well on the domestic market. As a result of entering the Notes into the electronic book-entry system, a wider investor interest was shown in Municipal Notes. Transferring to the electronic book-entry system was important for the company because in this way the company's short-term debt fulfils the requirements set for Tier 1 investment instruments given as security for repos by the European Central Bank.

Municipality Finance signed new loan agreements with the European Investment Bank and the Council of Europe Social Development Fund in 1998. Over FIM 1 billion of these loans have already been targeted to Finnish municipalities.

The strengthening of Municipality Finance's capital structure last year was an important event for our company. This was necessary due to tightening capital requirements.

Challenges for 1999

The introduction of the single European currency from the beginning of 1999 has brought only few and mostly positive changes to our company. We have not had to change our lending activities, operating procedures, or our risk management limits. The biggest change with the introduction of the euro has been the removal of the iron grip of the local banks on the pricing of domestic financial products. We have seen a dramatic fall in the dealing costs of these products.

In the light of the present outlook, I strongly believe

that Municipality Finance will be successful also on the Euro markets, although it is inevitable that competition will be intensified, as the number of new instruments and new issuers grows. Low cost of funding and excellent international credit ratings are our compa-

ny's permanent strengths, which are appreciated especially by investors and salesmen. Municipality Finance will provide a cost-efficient funding alternative for the Finnish municipal sector also in the Euro era.

KNOW-HOW AND STABILITY – FINLAND'S PRIME ASSETS

*Mr. Jussi-Pekka Alanen, Managing Director, Association of Finnish Local Authorities
Chairman of the Board, The Local Government Pensions Institution*

From a cultural viewpoint Finland is part of the Nordic countries. Our country's strengths are based on high technology, innovative thinking and general know-how combined with well-functioning basic social structures. It is our aim to maintain social stability, predictability and a safe operational environment also in conditions where uncertainty and competition will increase. Finland's membership in the EU and in the EMU emphasises these factors even further. Finland is not in competition with tax havens and countries with low labour costs. Instead, we can offer a basis for long-term operations. Our country forms a bridge between the East and West in the building process of the European Union's northern exposure.

Affluent society is a national value judgement in Finland. The majority of the population stands behind this value judgement regardless of political or social standing. Educational and cultural services as well as health care and social services belong to all people residing in Finland regardless of their domicile. The state and municipalities guarantee the availability of these services. These basic citizen rights are stated in provisions of the constitution of Finland.



Local governments, cities and municipalities bear the main responsibility for these services. In addition to providing educational, health care and social services, they are also responsible for providing general conditions for technical networks, land use and economic life in communities. Wide autonomy of inhabitants forms a basis for a democratic system.

Municipal finance as a whole is equal in size to the Finnish state budget. About 20% of the total work

force in Finland is employed by the municipal sector. The Local Government Pensions Institution, the sole owner of Municipality Finance and one of the largest pension funds in Finland, is responsible for the pension schemes of these people. Therefore, it is important that municipalities will receive cost-efficient finance for their infrastructure development projects. Municipality Finance has a significant role in this process as an agency of the municipal sector. The company offers a reliable and cost-efficient finance alternative for various development and investment projects in the municipal sector. It is in the interest of both municipalities and the whole of society that the operating conditions of Municipality Finance are secured.

REVIEW OF OPERATIONS IN 1998

The year 1998 was successful in financial terms for Municipality Finance Plc. At the end of the financial year the company's balance sheet stood at FIM 9,153 million, which was FIM 1,089 million more than the respective figure in 1997. The company's loan portfolio totalled FIM 7,921 million and long-term funding FIM 8,170 million at the end of 1998.

Since December 1996 all funding of Municipality Finance has been guaranteed by the Municipality Guarantee Board. The Act on the Municipal Guarantee Board came into force on 1 July 1996. According to section 1 of the Act, the Municipal Guarantee Board may grant guarantees for such funding of credit institutions owned or controlled by municipalities, which will be used for lending to the municipal sector. Since 2 December 1996 all funding has thus been guaranteed by the Municipal Guarantee Board. All funding guaranteed by the Local Government Pensions Institution ended on 2 December 1996 and guarantees will remain unchanged until the date of its final maturity.

The company's capital adequacy ratio was 84% at the end of 1998. The company's capital adequacy ratio has always been excellent and it improved even further through the strengthening of the company's capital structure in June 1998.

The company's capital adequacy ratios in the years 1994–1998 were as follows:

31.12.1994	35%	31.12.1997	24%
31.12.1995	45%	31.12.1998	84%
31.12.1996	44%		

There have not been any non-performing loans, nor credit losses in the company's history.

The company's capital structure was strengthened

Municipality Finance is a non-profit making organisation wholly owned by the Local Government Pensions Institution. The company's share capital stood at FIM 63 million. The share capital including Tier 1 capital stood at FIM 206 million at the end of 1998.

Municipality Finance strengthened its capital base by increasing the company's share capital and issuing a capital loan and a debenture. In an extraordinary shareholder's meeting of Municipality Finance on 16 June

1998, a decision was made to increase the company's share capital from FIM 38 million to FIM 63 million. An increase in share capital was achieved by issuing FIM 25 million of new equity, targeted solely at the company's owner, the Local Government Pensions Institution.

The company's capital base was further strengthened through a capital loan of FIM 25 million and a debenture of FIM 100 million, both of

which were similarly targeted at the Local Government Pensions Institution. According to the regulations set by the Financial Supervision Authority, an increase in share capital, a capital loan and a debenture can be included in full in the company's equity base.

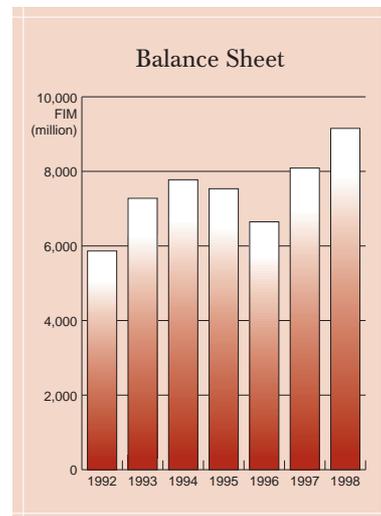
The company strengthened its capital base as a result of the tightening provisions on credit institutions.

International credit ratings were upgraded

To ensure cost-efficient funding it is important for the company to have a high credit standing. Both Standard & Poor's and Moody's Investors Service upgraded Municipality Finance's credit ratings in 1998. The high credit ratings will be increasingly important for Municipality Finance since the number of issuers will grow and competition for investors will become more fierce as a result of euro and the European Monetary Union.

In May 1998, Standard & Poor's upgraded Municipality Finance's credit rating for long-term funding to AA+, which is one notch higher than that of the Finnish Republic. Similarly, Moody's Investors Service upgraded Municipality Finance's credit rating for foreign funding to Aaa, which is their best credit standing. Regarding Municipality Finance's domestic funding, Moody's had already earlier upgraded the rating to Aaa.

Municipality Finance's upgraded credit ratings mean that the Finnish municipality sector's creditworthiness is excellent and its debt level is low.



Five years of Municipal Bonds™

The year 1998 was a jubilee year for Municipal Bonds, because it was five years since the first Municipal Bonds were issued. During the year 1998, Municipality Finance launched four new Municipal Bonds issues. The coupons of the issues varied between 3.15% to 4.20% and the terms to maturity between one to five years. The Municipal Bonds issues totalled FIM 210 million and all were denominated in Finnish markka.

In the jubilee year of Municipal Bonds, Municipality Finance improved its Internet services by introducing a Bond Calculator on the company's web-site.

Municipal Notes into the electronic book-entry system

The company's Municipal Notes issues were entered into the electronic book-entry system in May 1998. As a result of transferring to the electronic book-entry system Municipality Finance's short-term debt fulfils the requirements set for Tier 1 investment instruments given as security for repos by the European Central Bank. The ECB publishes two lists, Tier 1 and Tier 2, which include all those papers credit institutions can give as security when borrowing money from central banks. Since the beginning of 1999 Municipal Notes have been included in Tier 1 list.

Lending increased

Municipality Finance grants loans to the member municipalities and municipal federations of the Municipal Guarantee Board. If a municipality or a municipal federation acts as a guarantor, loans can also be granted to municipality-controlled entities. The amount of new borrowings by municipalities and municipal federations from Municipality Finance totalled FIM 2,307 million in 1998. All new loans were denominated in markka. The total amount of loans granted in 1997 was FIM 2,162 million.

Municipality Finance's loan portfolio totalled FIM 7,921 million in 1998. Loans granted to municipalities in recent years have mostly been denominated in markka. Of all loans granted, 94% were denominated in markka and 6% in foreign currencies.

The total of loans, which finally matured during the financial year totalled FIM 1,452 million.

The amount of municipal commercial paper programmes totalled FIM 2,855 million at the end of 1998. Trading in municipal paper totalled FIM 3,263 million during the financial year.

The book value of leased property stood at FIM 707,000 at the end of the year.

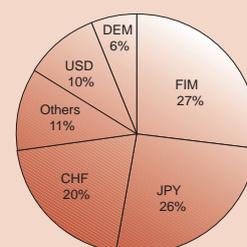
Funding from domestic and international markets

Municipality Finance raises funds by issuing bonds on the domestic and international capital markets. To raise domestic funding Municipality Finance launched a programme totalling FIM 4 billion for the issuance of bonds in 1998. Municipal Bonds and other bonds in the programme can total FIM 3 billion at the maximum, and the value of short-term Municipal Notes FIM 1 billion at the maximum.

Municipality Finance has a Medium Term Note Programme listed on the London Stock Exchange for foreign long-term funding. The company raised the limit of the programme from FIM 5 billion to FIM 8 billion in April 1998. During the year, the company launched bond issues especially in Japan and Switzerland.

Municipality Finance grants also such loans to the Finnish municipal sector that are funded by the European Investment Bank and the Council of Europe Social Development Fund. The company has a Global Loan Agreement with EIB for FIM 560 million. These credits granted by EIB are offered to the municipal sector for projects of infrastructure, environmental protection and energy production. Co-operation has recently been extended to cover health care projects and education. Municipality Finance and the Council of Europe Social Development Fund have signed a financing agreement for ECU 100 million corresponding to almost FIM 600 million. These credits can be offered to the municipal sector for projects of developing basic social infrastructure and modernising

Long-term Funding
by Currency



Others:
DKK 1%, GBP 2%, ITL 2%,
ECU 3%, AUD 3%

health care, environmental protection and community structures.

The amount of markka and foreign currency long-term funding totalled FIM 2,909 million in 1998. The respective amount of long-term funding a year earlier was FIM 2,986 million.

In 1998 the company raised short-term markka-denominated funding by issuing Municipal Notes totalling FIM 2,933 million. The amount of all short-term funding totalled FIM 578 million at the end of 1998.

Total funding at the end of the financial year was FIM 8,749 million of which 32% was denominated in markka and 68% in foreign currencies.

Operational result

Municipality Finance's operational result before provisions and taxes was FIM 13,4 million in 1998. The company's operational result improved in comparison with the respective figure in 1997 due to an increase in the balance sheet total. The company's net income from financial operations includes FIM 9 million income from changes in the loan portfolio.

The company's net income from securities transactions was FIM 3,6 million. Municipality Finance has made short-term investments in debt securities in case funds have not been immediately on-lent to municipalities. The profits gained from the sales of these debt securities have been entered under the item "Net income from securities transactions" in the profit and loss account.

Risk management

All of the risks of Municipality Finance have been minimised and the company is fully hedged against foreign currency risks. Similarly, the interest rate risk of markka is minute. Risks are hedged mainly with interest rate swaps, currency rate swaps and forward rate contracts. The company makes derivative contracts solely for hedging purposes. Risk management is improved further through standardising loan terms and dates when loans are drawn down.

The company uses risk management software for monitoring counterparty risks and market risks. Rating requirements and internal risk limits have been set

for counterparties. The counterparties of interest rate swaps denominated in domestic currency are required to have at least rating A. With other currencies the minimum rating requirement is AA-.

The company's portfolio of loans carries no real credit risks, as it lends exclusively to municipalities, municipality federations and municipality-controlled entities whose loans are guaranteed by a municipality.

The same prudent risk management policies are followed for investment activity. The majority of liquid assets is always invested in Finnish government treasury bills, bonds or bank CDs.

The Board of Directors of Municipality Finance is responsible for the company's risk management by setting general guidelines for risk management. The Managing Director together with the executive team is responsible for executing practical measures related to risk management. The company's risk position based on the given limits is regularly reviewed in the Board of Directors meetings as well as in the executive team meetings. The company reports regularly on its activities to the Bank of Finland and the Financial Supervision Authority.

Outlook for the years 1999 and 2000

From the beginning of 1999 Municipality Finance uses euro in all money market transactions. The company's Municipal Notes issues are denominated in euro and municipal commercial paper programmes have been converted into euro. New loan agreements will be made in euro. Funds will still be raised both in euro and foreign currencies depending on investors' interest.

Municipality Finance will convert the company's accounting into euro during the year 1999. Preparations have been made for the coming of euro by testing nec-



ecessary changes in the computer systems, as well as making required changes to new loan agreements and other documentation.

Municipality Finance will actively continue to provide both long and short-term funding for its municipal customers. In addition to its main business area the company aims at developing functional and competitive investment alternatives for both retail investors, as well as wholesale and institutional investors.

Since April 1998, the company has been studying the effects of the year 2000 on the company's operations. Being a small and young organisation with no decentralised operations, Municipality Finance will probably not be faced with any serious problems concerning the year 2000. Municipality Finance has asked for and received a written confirmation from the suppliers or manufacturers of the office equipment and main software used by the company, that all equipment and software will continue functioning without errors at the turn of the millennium. Computer programmes have been updated for the year 2000 as soon as various software manufacturers have made their updating programmes available. The company's year 2000 project has been scheduled so that all necessary changes will

have been made and all potential problems will have been solved by September 1999.

Personnel and administration

The company's personnel numbered seventeen at the end of 1998. According to the Articles of Association, the Board of Directors comprises at least four and at most six members. On 10 February 1998 the Annual General Meeting appointed a Company Board.

The company has a 12-member Advisory Council, the function of which is to supply advice and recommendations, and to guide and direct the company in matters connected with its operating conditions and their development. The council met twice during 1998.

An executive team was formed to assist the Managing Director in essential matters concerning the company's daily business operations, such as the implementation of new funding arrangements, questions related to risk management, lending prospects and issues of financial administration. The executive team consists of the Managing Director Nicholas Anderson, Deputy Managing Director Juha Heinonen, Finance Director Jukka Reijonen and Controller Marjo Tomminen.



In 1998 the meetings of the Board of Directors the following participated (from the left): Pekka Alanen, Raija Peltonen, advisor Erkki Pekkarinen, Simo Lämsä, Seppo Perttula, Marja Kauppila, Managing Director Nicholas Anderson and Leena Siikanen-Toivio.

The Board of Directors:*Mr. Simo Lämsä, Chairman*

Managing Director,
The Local Government Pensions Institution

Mr. Pekka Alanen

Deputy Managing Director, Association
of Finnish Local Authorities

Ms. Marja Kauppila

Lawyer
The Local Government Pensions Institution

Ms. Raija Peltonen

Chairman of the Municipal Council, Municipality of
Hartola, Director of Finance, Peltonen Ski Oy

Mr. Seppo Perttula

Deputy Managing Director,
The Local Government Pensions Institution

Ms. Leena Siikanen-Toivio

City Manager, City of Toijala

The Advisory Council:*Mr. Arto Laitinen, Chairman*

Manager, Municipal Finance
Association of Finnish Local Authorities

Ms. Christel von Martens, Deputy Chairman

Development Manager,
Association of Finnish Local Authorities

Mr. Håkan Fant

Auditor, Oy Audiator Ab

Ms. Riitta Hallberg

Municipal Secretary, City of Viitasaari

Ms. Maija-Liisa Havia

Finance Director, City of Jyväskylä

Mr. Aaro Honkola

City Treasurer, City of Seinäjoki

Mr. Hannu Horto

Finance Director, City of Kotka

Ms. Marjatta Keisu

Municipal Manager, Municipality of Liminka

Mr. Tapio Korhonen

Finance Director, City of Helsinki

Mr. Karl-Gustaf Lindström

Controller, Municipality of Kirkkonummi

Mr. Simo Paassilta

Municipal Manager, Municipality of Halikko

Mr. Matti Tölli

City Treasurer, City of Kemi

The auditors of the company are Arthur Andersen Oy, Authorised Public Accountants. *Mr. Erkki Mitro*, APA, as the auditor with the main responsibility and *Mr. Jaakko Pohtio*, APA, and as the deputy auditor *Mr. Eero Prepula*, APA, Chartered Public Finance Auditor.

Events in 1998:

10 February	Shareholders' meeting
9 March	Municipality Finance became a public limited company (plc)
17 March	Five years since the first Municipal Bonds were issued
25 March	Two Municipal Bonds were issued
6 May	Moody's Investors Service upgraded Municipality Finance's credit rating for long-term foreign funding to Aaa.
7 May	Standard & Poor's upgraded Municipality Finance's credit rating for long-term funding to AA+.
20 May	The company's Municipal Notes were entered into the electronic book-entry system.
4 June	Joint presentation with Kommuninvest i Sverige in Japan
10 June	Bond issue in Japan
16 June	Extraordinary shareholders' meeting, in which a decision was made to increase share capital by FIM 25 million.
30 June	The company's capital base was strengthened through a capital loan of FIM 25 million and a debenture of FIM 100 million.
17 August	Semi-annual report was published (1 January–30 June)
27 August	Bond issue in Japan
14 September	Municipal Bonds issue
16 September	Bond issue in Japan
18 September	Bond issue in Switzerland
17 November	Municipal Bonds issue
22 December	Bond issue in Switzerland

NORDIC CO-OPERATION

Municipality FinancePlc. is actively in contact with its Nordic co-operation partners, which is important for the company in order to develop its operations and to enhance competitiveness. During the year senior management and personnel met each other regularly.



KommuneKredit

KommuneKredit was established in Denmark in 1899, and, as a credit institution, its task is to provide loans to Danish local authorities and to semimunicipal institutions backed by a 100% guarantee from a local authority. All Denmark's municipalities and 13 of the country's 14 county councils are members of KommuneKredit, sharing joint and several liability for the company's obligations including its borrowings. KommuneKredit's source of domestic funding consists of bonds issued in the Danish capital market and listed on the Copenhagen Stock Exchange.

Since 1987, when it was first allowed to raise loans abroad, KommuneKredit has developed and consolidated its position on the international capital market establishing its own ECP and EMTN programmes and funding itself on the international capital market via Euro bond issues, bank loans and private placements.

KommuneKredit's ratings at Moody's and Standard & Poor's are P-1/A-1+, Aa1/AA+ in foreign currency and Aaa/AAA in domestic currency, the same ratings as those enjoyed by the Kingdom of Denmark.

Kommuninvest i Sverige AB (publ)



Kommuninvest is a credit institution owned by Kommuninvest Cooperative Society. The society has currently 100 members, of which 98 are municipalities and 2 county councils. Co-operation started in 1986 and during the past few years the number of members and the company's loan portfolio have increased substantially.

Kommuninvest was established to secure that the members of the association together with the owners could get finance at the lowest possible cost. This will also enhance Swedish municipalities' common interests to lower their loan costs in the public sector.

The company raises funds mostly in the international capital markets. Since 1995 Kommuninvest has issued part of its bonds in the Swedish capital markets. The company has currently a loan portfolio of almost SEK 25 billion.

The members of Kommuninvest Cooperative Society are responsible both for their own and the company's liabilities. Due to the right of municipalities to collect taxes and the members' sound financial position, Moody's has granted a credit rating of Aa2 for the company's foreign funding, which is the same rating than that of the Kingdom of Sweden. Kommuninvest is a credit institution under the supervision of Swedish Financial Supervision Authority.

Norges Kommunalbank



Norges Kommunalbank is a municipal bank established by an act of Norwegian parliament in 1926 and is owned by the state. The funding of Kommunalbank is guaranteed by the state and the bank pays a guarantee commission for the state guarantee. The bank is the primary lender to the public sector in Norway. Norwegian authorities have introduced a law proposal, which will be handled in the parliament during the first half of 1999. The proposal contains a suggestion that the bank shall be turned into a limited company. As a result of this, state guarantees would cease to exist. The Norwegian government will give Norges Kommunalbank a greater freedom to operate so that the bank can better take into consideration the needs of municipalities.

Norges Kommunalbank has currently a loan portfolio of NOK 27 billion representing a market share of approximately 28%. The bank has currently the right to grant only Norwegian krona denominated loans. The bank covers its funding needs by issuing commercial papers and bonds to the Norwegian capital markets.

Norges Kommunalbank is one of the biggest issuers of interest rate papers in the Norwegian capital markets. If the bank becomes a limited company, it will be only natural that a larger share of the total loan portfolio will be acquired from international capital markets.

PROFIT AND LOSS ACCOUNT

(FIM 000's)	1 January– 31 December 1998	1 January– 31 December 1997
Interest income	542 249	450 514
Net income from leasing operations	33	73
Interest expenses	-512 897	-433 280
NET INCOME FROM FINANCIAL OPERATIONS	29 385	17 307
Commission income	13	116
Commission expenses	-5 014	-3 638
Net income from securities transactions and foreign exchange dealing		
Net income from securities transactions	3 595	-98
Net income from foreign exchange dealing	-134	134
	3 461	36
Other operating income	9	32
Administrative expenses		
Staff costs		
Salaries and fees	3 928	3 476
Staff-related costs		
Pension costs	697	606
Other staff-related costs	326	262
Other administrative expenses	4 963	4 851
	-9 914	-9 195
Depreciation and write-downs on tangible and intangible assets	-800	-705
Other operating expenses	-3 699	-3 225
NET OPERATING PROFIT	13 441	728
PROFIT BEFORE APPROPRIATIONS AND TAXES	13 441	728
Appropriations	-13 370	-680
Income taxes	-63	-36
PROFIT FOR THE FINANCIAL YEAR	<u>8</u>	<u>12</u>

BALANCE SHEET

(FIM 000's)

ASSETS	31 December 1998		31 December 1997	
Liquid assets		14		7
Debt securities eligible for refinancing with central banks		777 942		455 367
Claims on credit institutions				
Repayable on demand	942		1 172	
Other	<u>27 700</u>	28 642	<u>123 000</u>	124 172
Claims on the public and public sector entities		7 920 650		7 036 391
Leasing assets		707		718
Debt securities				
On public sector entities	249 378		199 922	
Other	<u>4 804</u>	254 182	<u>67 151</u>	267 073
Shares and participations		59		59
Intangible assets		1 100		1 559
Tangible assets				
Other tangible assets		1 728		1 660
Other assets		–		1
Accrued income and prepayments		168 124		176 786
TOTAL ASSETS		<u><u>9 153 148</u></u>		<u><u>8 063 793</u></u>

BALANCE SHEET

LIABILITIES	31 December 1998		31 December 1997	
LIABILITIES				
Liabilities to credit institutions and central banks				
Credit institutions				
Other		897 241		329 182
Debt securities issued to the public				
Bonds	7 273 082		7 064 740	
Other	<u>578 215</u>	7 851 297	<u>330 893</u>	7 395 633
Other liabilities		1 060		840
Accrued expenses and deferred income		189 324		287 290
Subordinated liabilities		100 000		–
APPROPRIATIONS				
Voluntary provisions		23 869		10 499
EQUITY CAPITAL				
Share capital		63 000		38 000
Other restricted reserves				
Reserve fund		2 335		2 335
Capital loans		25 000		–
Profit brought forward		14		2
Profit for the financial year		8 22		<u>12 14</u>
TOTAL LIABILITIES		<u>9 153 148</u>		<u>8 063 793</u>
OFF-BALANCE SHEET COMMITMENTS				
Irrevocable commitments given in a favour of a customer				
Other		444 401		251 450

NOTES TO THE ACCOUNTS ON 31 DECEMBER 1998

Notes to the accounts concerning the accounting principles applied

Municipality Finance Plc. has balanced the accounts in accordance with laws, following the decisions, rules and regulations given by the Ministry of Finance and the Financial Supervision Authority. The company reports regularly on its operations to the Financial Supervision Authority and the Bank of Finland. The profit and loss account and the balance sheet have been drawn up in accordance with the new regulations of 30 June 1998 set by the Financial Supervision Authority.

Receivables and liabilities denominated in foreign currencies have been converted into Finnish markkas at the Bank of Finland middle rate on the balance sheet date. The fixed and confirmed conversion rates of the Euro countries have been used for currency conversions. Exchange rate differences arising in the valuation process are included under the item "Net income from foreign exchange dealing" in the profit and loss account.

All of the company's debt securities are classified as "Current assets". Debt securities in transaction inventory have been entered in the accounts using the market value on the balance sheet date.

Machinery and equipment are depreciated according to a plan on the straight-line principle over five years, computer hardware and software straight-line over four years, and other long-term expenses straight-line over ten years. The planned depreciation was made on leased equipment, based on the length of the relevant leasing agreements. Derivative contracts are made solely for hedging purposes. The exchange rate valuations of the contracts are entered under "Accrued income" or "Accrued expenses" in the balance sheet. The difference between annual interest income received from and interest expenses paid for the derivative contracts is entered in the accounts to make an adjustment to the interest expenses of the hedged liability from the financial year from which the expenses have accrued.

The company has changed the practice of making entries of commissions resulting from borrowing. If the amount of a loan on a subscription date is smaller or bigger than the amount the company is obliged to pay back on a maturity date, the amount of debt on the subscription date is entered in the balance sheet, rectified with the direct commissions resulting from borrowing. According to the earlier practice all obtained or paid commissions resulting from borrowing were entered in accrued income or accrued expenses. The earlier balance sheet information has been reorganised to correspond to the present practice in order to make comparisons easier.

Notes to the profit and loss account

1.	Interest income, broken down as follows:	
	- Claims on credit institutions	1,023,624
	- Claims on the public and public sector entities	496,251,760
	- Debt securities	37,413,877
	- Other interest income	7,560,031

Interest expenses, broken down as follows:

	- Liabilities to credit institutions	33,002,555
	- Debt securities issued to the public	440,592,099
	- Subordinated liabilities	2,041,644
	- Capital loans	510,411
	- Other interest expenses	36,750,603

2.	Net income from leasing, broken down as follows:	
	- Rental income	239,357
	- Planned depreciation	-205,869
		33,488

3.	Net income from securities transactions, broken down as follows:	
	- Net income from transactions in debt securities	3,595,448

4. Total values of securities held as current assets purchased or sold during the financial year:
- | | |
|-----------------------------|---------------|
| - Debt securities purchased | 6,618,570,000 |
| - Debt securities sold | 2,687,734,626 |
5. Other operating income
- | | |
|---------------------------------------------------------------------|-------|
| - Other income from the ordinary business of the credit institution | 9,242 |
|---------------------------------------------------------------------|-------|
- Other operating expenses, broken down as follows:
- | | |
|-------------------------------------------------------------------------------|-----------|
| - Rental expenses | 829,538 |
| - Other expenses arising from the ordinary business of the credit institution | 2,869,954 |
6. The profit and loss account item "Depreciation and write-downs on tangible and intangible assets" consists of only planned depreciation.
7. Municipality Finance Plc. has not got any loan losses nor guarantee losses.
8. Municipality Finance Plc. has no extraordinary income, nor extraordinary expenses.
9. Appropriations, broken down as follows:
- | | |
|----------------------------------------|------------|
| - Change in other voluntary provisions | 13,370,000 |
|----------------------------------------|------------|
10. Municipality Finance Plc. has no obligatory provisions.
11. The company has not combined items in the profit and loss account in accordance with section 8, paragraph 4 of the Decision of the Ministry of Finance.
12. The business area of Municipality Finance Plc. is to operate as a credit institution. The company's market area is Finland.

Notes to the balance sheet

13. The balance sheet item "Debt securities eligible for refinancing with central banks", broken down as follows:
- | | |
|----------------------------------|-------------|
| - Government bonds | 110,569,667 |
| - Banks' certificates of deposit | 667,372,148 |
14. The balance sheet item "Claims on credit institutions" does not contain any claims on central banks.
15. The balance sheet item "Claims on the public and public sector entities" is broken down by sectors according to the official sector classification of Statistics Finland.
- | | |
|----------------------------|---------------|
| - Enterprises | 697,866,971 |
| - Public sector entities | 7,125,726,920 |
| - Non-profit organizations | 97,056,003 |
- All lending to enterprises, public sector entities and non-profit organizations is guaranteed by a municipality or a city. No specific loan loss provisions were made for claims on the public and public sector entities.
16. Municipality Finance Plc. does not have any non-performing nor other zero interest assets.
17. Municipality Finance Plc. has not acquired the ownership of assets, which were given as security for claims.

18. Municipality Finance Plc. has no debt securities, debentures, nor other subordinated claims to the debtor's other debts.
19. Leasing assets
- Machinery and equipment 706,768
20. The total book value of securities entered under the balance sheet items "Debt securities" and "Debt securities eligible for refinancing with central banks" is FIM 1,032,124,434.

	Quoted	Others
Debt securities		
- Securities held as current assets	0	1,032,124,434
- Other	0	0

The total amount of the difference between the market value and the lower book value of securities, which are hold as current assets and which are entered under the balance sheet items "Debt securities" and "Debt securities eligible for refinancing with central banks" is FIM 206,815. The total amount of the book values of assets recorded in the balance sheet as "Debt securities" and "Debt securities eligible for refinancing with central banks", broken down as follows:

- Municipal commercial papers	241,632,552
- Certificates of deposit	667,372,148
- Other bonds	123,119,734

21. Municipality Finance Plc. has 11 certificates of participation in Helsingin Puhelin Oyj. The book value of the certificates of participation is FIM 58,900.
22. The balance sheet item "Tangible assets"
Machinery and equipment, computer hardware and capitalized computer software
- | | |
|-------------------------------------------------------------------|------------------|
| Purchase price at the beginning of the financial year | 3,696,584 |
| + increases during the financial year | 796,021 |
| - transfers between groups | 724,731 |
| - planned depreciation during the financial year | 727,863 |
| + accumulated depreciation in respect of transfers | 72,009 |
| - accumulated depreciation at the beginning of the financial year | 1,384,334 |
| Book value at the end of the financial year | <u>1,727,686</u> |
23. The item "Intangible assets" consists of other long-term expenditure.
24. No land and water areas, buildings nor shares and participations in real estate corporations were entered under the balance sheet item "Tangible assets".
25. Municipality Finance Plc. does not own any of its own shares nor the shares in the parent company.
26. No entries were made under the balance sheet item "Other assets"
27. The item "Accrued income and prepayments", broken down as follows:
- | | |
|------------|-------------|
| - Interest | 167,947,202 |
| - Other | 176,878 |

28. The company has not combined items in the balance sheet in accordance with section 8, paragraph 4 of the Decision of the Ministry of Finance.
29. The total amount of the difference between the nominal value and the lower book value of liabilities:
- | | |
|---------|------------|
| - Bonds | 37,794,188 |
| - Other | 5,515,629 |
- The total amount of the difference between the book value and the lower nominal value of liabilities:
- | | |
|---------|------------|
| - Bonds | 24,027,962 |
| - Other | 0 |
30. The total amounts of the book values of liabilities recorded in the balance sheet under the item “Debt securities issued to the public”, broken down as follows:
- | | |
|---------|---------------|
| - Bonds | 7,273,082,475 |
| - Other | 578,215,109 |
31. Other liabilities, broken down as follows:
- | | |
|-------------------------------------------|-----------|
| - Cash items in the process of collection | 3,992 |
| - Other | 1,055,702 |
32. Accrued expenses and deferred income, broken down as follows:
- | | |
|------------|-------------|
| - Interest | 162,294,377 |
| - Other | 27,029,933 |
33. Municipality Finance Plc. has no obligatory provisions.
34. Subordinated liabilities
The company has issued a debenture of FIM 100 million. The nominal interest rate of the loan is based on 6 months HELIBOR rate. The loan has no maturity date and the principal can be paid back only if the Financial Supervision Authority grants permission based on a written application submitted by Municipality Finance.
35. Changes in various items under “Equity capital” during the financial year.
- | | Share capital | Reserve fund | Capital loans |
|---------------------------------------------------|---------------|--------------|---------------|
| Book value at the beginning of the financial year | 38,000,000 | 2,334,600 | 0 |
| + increases for the financial year | 25,000,000 | 0 | 25,000,000 |
| Book value at the end of the financial year | 63,000,000 | 2,334,600 | 25,000,000 |
36. The shares of Municipality Finance Plc. have not been divided into various types of shares.
37. There are not any non-distributable items in non-restricted equity.
38. In an extraordinary shareholders meeting of Municipality Finance Plc. on 16 June 1998, a decision was made to increase the company’s share capital by issuing FIM 25 million of new equity; 5000 new shares at a nominal value of FIM 5,000 per share. The shares were targeted solely at the company’s owner, the Local Government Pensions Institution. The price was FIM 5,000 per share. The new shares had to be subscribed by 31 August 1998 and paid for on 30 September 1998 at the latest.

39. The Local Government Pensions Institution has a 100% holding in Municipality Finance Plc.
40. The company has raised a capital loan of FIM 25 million. The interest rate of the loan is based on 6 months HELIBOR rate. The company has agreed to pay interest only if the sum to be paid can be used for profit distribution in accordance with the balance sheet of the company's previously confirmed financial year. The loan contains no cumulative right to the interest. The loan has no maturity date and it can be paid back only on the condition that the restricted capital and other non-distributable assets in the balance sheet of the company's previously confirmed financial year have a full coverage. It is also required that the Financial Supervision Authority has granted permission for paying back the loan. Accrued interest at the end of the financial year has been entered under "Interest expenses" in the balance sheet.
41. The company has not combined asset items in the balance sheet in accordance with section 8, paragraph 4 of the Decision of the Ministry of Finance.
42. Maturity breakdown of claims and liabilities on the basis of remaining maturity
- | | 0–3 months | 3–12 months | 1–5 years | over 5 years |
|-------------------------------------------------------------|-------------|---------------|---------------|---------------|
| Debt securities eligible for refinancing with central banks | 496,187,615 | 180,365,010 | 73,273,520 | 28,115,670 |
| Claims on credit institutions | 28,641,623 | – | – | – |
| Claims on the public and public sector entities | 144,581,226 | 1,074,983,757 | 4,832,175,420 | 1,868,909,491 |
| Debt securities | 164,283,696 | 78,064,740 | 11,834,183 | – |
| Liabilities to credit institutions | 1,187,500 | 76,973,283 | 409,855,263 | 409,224,560 |
| Debt securities issued to the public | 485,321,905 | 645,937,473 | 4,757,167,365 | 1,962,870,841 |
- Municipality Finance Plc. has no other deposits than fixed term deposits.
43. Assets and liabilities broken down into items denominated in domestic and foreign currency.
- | | FIM | Foreign currency |
|-------------------------------------------------------------|---------------|------------------|
| Debt securities eligible for refinancing with central banks | 777,941,815 | – |
| Claims on credit institutions | 28,567,982 | 73,641 |
| Claims on the public and public sector entities | 7,443,010,997 | 477,638,897 |
| Debt securities | 254,182,619 | – |
| Liabilities to credit institutions | 155,632,500 | 741,608,106 |
| Debt securities issued to the public | 2,618,319,956 | 5,232,977,628 |
| Subordinated liabilities | 100,000,000 | – |

Notes to the accounts concerning income taxation

44. The company's voluntary provisions include deferred tax liabilities totalling FIM 6,683,432. Income taxes arise solely from the company's ordinary business operations. The company has no revaluations having an effect on income taxation.

Notes to the accounts concerning collateral, contingent liabilities and derivative contracts

45. Liabilities and collateral
- | | |
|----------------------------------------------------------------------|---------------|
| Pledged bonds to the Local Government Pensions Institution | 3,050,057,052 |
| Pledged debt securities to the Local Government Pensions Institution | 6,125,000 |
| Pledged bonds to the Municipal Guarantee Board | 4,773,850,729 |
| Pledged debt securities to the Municipal Guarantee Board | 433,313,480 |
| Pledged debt securities to Hex Ltd. | 8,000,000 |

46. The company is subject to the Local Government Officials' and Municipal Employees' Pensions Act.
47. Municipality Finance Plc. had no leasing payments. The company has not sold any assets nor leased them back.
48. Off-balance sheet commitments
- Binding stand-by facilities 444,400,700
49. The total values and the equivalent credit values of the underlying instruments pertaining to interest rate and currency derivative commitments and other derivatives outstanding on the balance sheet date.

Values of underlying instruments
For hedging purposes

<hr/>	
Interest rate derivatives	
Written options	150,000,000
Interest rate swaps	2,050,669,360
Currency derivatives	
Interest rate and currency swaps	6,757,966,476
Credit value of contracts	
<hr/>	
Interest rate derivative contracts	72,317,000
Currency derivative contracts	591,022,000

50. Municipality Finance Plc. has no sales receivables arising from the selling of assets on behalf of customers, nor accounts payable arising from the purchasing of assets on behalf of customers.
51. Municipality Finance Plc. has not given any other contingent liabilities.

Notes to the accounts concerning the staff and members of governing and supervisory bodies

52. Municipality Finance Plc. had 17 full-time employees during the financial year. The amount of salaries, fees, pension costs and other staff-related costs in respect of the managing director, deputy managing director and the members of the board of directors totalled FIM 1,428,722 during the financial year.

Salaries and fees were not paid on the basis of the company's financial performance.

The company has not granted any loans, nor guarantees to the members of the board of directors, the managing director, deputy managing director, auditors and their deputies.

Holdings in other undertakings

53. Municipality Finance Plc. has 11 certificates of participation in Helsingin Puhelin Oyj.
The book value of the certificates of participation is FIM 58,900.

Other notes to the accounts

54. Asset management services offered by Municipality Finance Plc.
Municipality Finance Plc. provides its Municipal Bond customers with free safe custody, which includes the custody of the physical securities by the company and payment of interest and principal directly to customers' accounts.
55. Municipality Finance Plc. is not part of any consolidated corporation, nor does it have any affiliate companies.

KEY INDICATORS DESCRIBING THE FINANCIAL DEVELOPMENT OF MUNICIPALITY FINANCE PLC.

	1998	1997	1996	1995	1994
Turnover, FIM million	546	451	562	672	647
Net operating profit	13.4	0.7	2.5	1.2	0.2
% of turnover	2.5	0.2	0.5	0.2	–
Profit before appropriations and taxes	13.4	0.7	2.5	1.2	0.2
% of turnover	2.5	0.2	0.5	0.2	–
Return on equity % (ROE)	17.2	1.4	4.8	2.5	–
Return on assets % (ROA)	0.2	–	–	–	–
Equity ratio %	1.2	0.6	0.7	0.6	0.6
Earnings to operating costs	1.7	1.0	1.2	1.1	1.0

The key indicators of Municipality Finance Plc. are not directly comparable to the corresponding figures of other credit institutions. The company's operational objective is not to maximise profits but to lower municipalities' finance costs through a joint municipal funding system.

Turn over consists of both income from interests, leasing operations, commissions, securities transactions, foreign exchange dealing and other operating income.

Net operating profit can directly be seen in the profit and loss account.

Return on equity ratio (ROE) is calculated as follows:

$$\frac{\text{Net operating profit – taxes}}{\text{Equity capital + voluntary provisions less deferred taxes due (average of year beginning and year end)}} \times 100$$

Equity ratio is calculated as follows:

$$\frac{\text{Equity capital + voluntary provisions less deferred taxes due}}{\text{Balance sheet total}} \times 100$$

Earnings to operating costs are calculated as follows:

$$\frac{\text{Net income from financial operations + commission income + net income from securities transactions and foreign exchange dealing + other operating income}}{\text{Commission expenses + administrative expenses + depreciation + other operating expenses}}$$

RESULT FOR THE ACCOUNTING PERIOD AND DISTRIBUTION OF PROFIT

The financial statements show a profit of FIM 8,192.33.

The Board of Directors proposes that the profit of the year be retained under non-restricted equity capital and that no dividend be distributed.

Helsinki, 5 February 1999

MUNICIPALITY FINANCE PLC.

<i>Mr. Simo Lämsä</i>	<i>Mr. Pekka Alanen</i>	<i>Ms. Marja Kauppila</i>
Chairman of the Board	Member of the Board	Member of the Board
<i>Ms. Raija Peltonen</i>	<i>Mr. Seppo Perttula</i>	<i>Ms. Leena Siikanen-Toivio</i>
Member of the Board	Member of the Board	Member of the Board
	<i>Mr. Nicholas Anderson</i>	
	Managing Director	

AUDITORS' REPORT

To the shareholders of Municipality Finance Plc.

We have audited the accounting, the financial statements and the corporate governance of Municipality Finance Plc. for the period 1 January – 31 December 1998. The financial statements, which include the report of the Board of Directors, income statement, balance sheet and notes to the accounts have been prepared by the Board of Directors and the Managing Director. Based on our audit we express an opinion on these financial statements and on corporate governance.

We have conducted the audit in accordance with the Finnish Standards on Auditing. Those standards require that we perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining on a test basis evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by the management as well as evaluating the overall financial statement presentation. The purpose of our audit of corporate governance is to examine that the members of the Board of Directors, the Managing Director and the Deputy Managing Director have legally complied with the rules of the Companies' Act.

In our opinion the financial statements have been prepared in accordance with the Accounting Act and other rules and regulations governing the preparation of financial statements. The financial statements give a true and fair view, as defined in the Accounting Act, of the company's result of operations as well as of the financial position. The financial statements can be adopted and the members of the Board of Directors, the Managing Director and the Deputy Managing Director can be discharged from liability for the period audited by us. The proposal by the Board of Directors regarding the distribution of retained earnings is in compliance with the Companies' Act.

We have read through the company's semi-annual report published during the financial year. In our opinion the report has been prepared in accordance with all rules and regulations governing the preparation of interim reports.

Helsinki, 15 February 1999

ARTHUR ANDERSEN OY,
Authorised Public Accountants
Mr. Erkki Mitro
Authorised Public Accountant

Mr. Jaakko Pohtio
Authorised Public Accountant

MUNICIPALITY FINANCE PLC.

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