

2000
ANNUAL REPORT



KUNTARAOITUS
MUNICIPALITY FINANCE

*The Board of Directors**Simo Lämsä,*

Chairman, Managing Director,
Local Government Pensions Institution

Pekka Alanen,

Deputy Managing Director, Association
of Finnish Local Authorities

Ari Huotari,

Director of Investments, Local Government
Pensions Institution
(member until March 16th, 2000)

Tom Käla,

Director of Finance, Local Government
Pensions Institution
(member since April 25th, 2000)

Mika Mäkinen,

Director of Finance, City of Lahti

Raija Peltonen,

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

Leena Siikanen-Töivö,

City Manager, City of Toijala

*The Advisory Council**Aaro Honkola,*

Chairman, Director of Finance,
City of Seinäjoki

Maija-Liisa Havia,

Director of Finance, City of Jyväskylä

Hannu Horto,

Director of Finance, City of Kotka

Marjatta Keisu,

Municipal Manager, Municipality of Liminka

Tapio Korhonen,

Director of Finance, City of Helsinki

Martti Lipponen,

Deputy City Manager, City of Vantaa

Voitto Maksimainen,

Controller and Planning Director,
City of Joensuu

Vesa Matikainen,

Director of Finance, City of Lappeenranta

Simo Paassilta,

Municipal Manager, Municipality of Halikko

Matti Pelttari,

City Manager, City of Rovaniemi

Markku Rahikkala,

City Manager, City of Nokia

Kari Salmi,

City Manager, City of Lahti

Kristina Wikberg,

Director of Swedish Activities,
Association of Finnish Local Authorities

Aila Ylioja,

City Treasurer, City of Riihimäki

Stig Öst Dahl,

City Manager, City of Uusikaarlepyy

The auditors of the company are Arthur Andersen Oy,
Authorised Public Accountants.

MUNICIPALITY FINANCE PLC

Municipality Finance Plc, founded in 1989 and owned by the Local Government Pensions Institution, is a funding institution for the municipal sector. It represents the Finnish municipal sector in both domestic and international capital markets. The company's foremost objective is to channel competitive financing to Finnish municipalities, municipal federations and entities whose loans are guaranteed by municipalities.

The funding of Municipality Finance is guaranteed by the Municipal Guarantee Board, which has 417 member municipalities. Municipal Bonds are the company's most important form of domestic funding. The company engages in foreign funding mainly through a Medium Term Note Programme listed on the London Stock Exchange. The company also channels funds from the European Investment Bank and the Council of Europe Development Bank to the Finnish municipal sector.

In 2001, Municipality Finance Plc and Municipal Housing Finance Plc are merging their operations to a new company that will be named Municipality Finance Plc. The new company will combine the resources of both municipal funding institutions and aims to strengthen the municipal joint funding system.

REVIEW OF THE MANAGING DIRECTOR

Nicholas Anderson, Managing Director, Municipality Finance Plc

The year 2000 has been both a year of success and a year of change for Municipality Finance Plc. The sales of our Municipal Bonds have reached a record high and we have strengthened our name in the capital markets. During 2000 we decided to merge Municipality Finance Plc and Municipal Housing Plc into a new company, which will operate under the name of Municipality Finance Plc. The merger will take place in the spring of 2001.

This is a promising situation for the new company. We have built up the name recognition that Municipality Finance needs to operate in international capital markets. A good name and a good reputation are essential to the success of the company. Earning them has been a demanding task. It has been challenging for Municipality Finance to be heard in the midst of large, influential banks and borrowers.

High credit ratings are essential for Municipality Finance to obtain cost-effective funding. The primary pillar for the rating has been the joint guarantee system established by the Municipal Guarantee Board.

Municipal Bonds have been the most significant instrument of domestic funding for Municipality Finance. Just eight years ago, few thought that we would succeed in selling Municipal Bonds to private customers. Yet our decision has been validated because customer interest in our investment instrument has grown continuously, and in 2000 we sold about FIM 1 billion worth of Municipal Bonds. At the same time, the number of our Municipal Bond customers increased by several thousand.

During the past few years we have also channelled cost-effective loans to municipalities from two important multinational institutions, the European Investment Bank and the Council of Europe Development Bank. We also commenced co-operation with other Nordic



municipal funding agencies for road shows, funding, sharing of know-how and staff training. Even if the merged Municipality Finance will still be a rather small player in the markets, by taking appropriate measures we can seek out a strategic position that will benefit our customers in these volatile markets.

Risk management has been an essential factor of our success. Our company has established clear and straightforward risk management policies. This is an important pillar of our high credit rating. Maintaining

a high rating requires continuous work, adherence to principles and stainless risk management. Many companies in the capital markets have taken uncontrolled risks and lost assets together with their high ratings. High credit ratings are particularly important for public funding agencies that need to concentrate on their central objective, attaining the best funding price for the public sector, in a single-minded way. Since no compromises to risk management policies can be made, risks must be minimized by using top-class technology and reporting systems.

Municipality Finance Plc will remain a strong entity in the future. It is committed to its main purpose of channelling the most cost-effective funding possible to the municipalities. Success means satisfied customers, and as long as Finnish municipalities remain satisfied with the services of their own funding agency, they will give their continued support for the joint funding system.

My personal career at Municipality Finance is now coming to an end after ten years. I am able to leave the company with a peaceful mind, because Municipality Finance is now a strong and successful funding institution. It has been a great privilege to work with the professional staff of Municipality Finance during these years. Together we have made Municipality Finance what it is today.

MUNICIPALITY FINANCE AND MUNICIPAL HOUSING FINANCE WILL BECOME ONE COMPANY

Merger will strengthen the municipal funding system

Managing Director, Local Government Pensions Institution

Chairman of the Board of Directors, Municipality Finance Plc

Simo Lämsä

The year 2000 was the last year Municipality Finance operated in its present form. At the beginning of the year 2001, Municipality Finance and Municipal Housing Finance will merge through a combination merger. This is why we should briefly take a look back to the time when Municipality Finance was founded and the factors that led to its emergence at the time.

When the Local Government Pensions Institution began funding operations in 1988, its investment activity mainly consisted of lending money to member communities.

Loans were market priced, and since at the time interest rates were high, the Local Government Pensions Institution received good returns. The lending business brought municipalities a new funding alternative that both increased competition and eventually lowered financing costs for municipalities significantly. The purpose of the Local Government Pensions Institution was not to invest all funds into municipal loans, however, because it was important to the municipalities that the Institution be able to collect investment profits from outside the municipal sector.

After deregulation of the money markets the Local Government Pensions Institution saw an opportunity to establish a separate company to manage municipalities' funding, in addition to the already existing Pension Liability Fund. The Local Government Pensions Institution would then own the entire share capital of Municipality Finance and also guarantee its funding. Soon this plan was enhanced by applying for Moody's and Standard & Poor's credit rating for the funding of Municipality Finance. The established credit rating was



the same as the credit rating of the government of Finland.

Municipality Finance's business idea was to utilize the good credit rating from joint funding and in a competitive manner attain both foreign and domestic financing, thus transferring the benefits gained directly to the municipalities. A funding margin was determined so that Municipality Finance did not collect equity from municipalities, but rather the operations of the company were based on the good joint credit rating of the municipalities and the guarantee of the Municipal Guarantee

Board. The guarantee, then, was based on funds collected from municipalities into a Pension Liability Fund as well as on the fact that municipalities were jointly liable for the Local Governments Pensions Institution's commitments.

The system functioned well and was successful, and operations soon reached a larger than anticipated scope. Attention focused on the role of the Local Government Pensions Institution as a guarantor of such significant funding. It was considered that this should not belong to the role of the Local Government Pensions Institution, since it is a pension insurer.

Joint funding had, however, been so significant from the perspective of the municipalities that it was necessary to continue it. Thus the Municipal Guarantee Board was established as the municipalities' joint guarantee organization. In addition to Municipality Finance, it also provided guarantees for the funding of Municipal Housing Finance. Thus the guarantee liability of both companies was transferred to the same guarantor.

Establishing the Municipal Guarantee Board required plenty of innovation and hard work. Municipality Finance made a significant contribution in this matter as well. The project would not have succeeded, however, if the Association of Finnish Local and Regional Authorities – the representative of all Finnish municipalities – had not taken on the responsibilities of the project leader and if the largest cities in Finland had not supported the project as unreservedly as they did.

When we evaluate Municipality Finance's operations, we not only evaluate the operations of a single company but the emergence and development of all municipalities' joint funding system. I am convinced that none of us who were involved in creating these operations had the boldness to estimate that the growth and significance of these operations for the municipalities would be quite as essential and quite as extensive in volume as they are presently.

I present thanks for this success primarily to the customers of Municipality Finance. Customers' trust is a prerequisite for the operations of the company, and it is this very trust that the company has built its role on and created its success upon.

The second most important contribution has been made by the personnel of Municipality Finance. Mr Nicholas Anderson has been the Managing Director of Municipality Finance during its entire operational period. When we started the company he brought in his extensive and in-depth expertise about international financing markets. His expertise has been the cornerstone in building Municipality Finance's foreign and domestic funding and the credit rating they are based on. Municipality Finance has been fortunate to have an excellent and knowledgeable personnel that has committed itself to the company and its operational principles. This has created a unique and indispensable resource for the funding of the municipal sector.

From the owner's – the Local Government Pensions Institution's – perspective, Municipality Finance has performed the task it was given very well. The Local Government Pensions Institution's main goal has been to serve its member communities so that the solid economic foundation of Finnish municipalities can be utilized most effectively.

European integration has opened up and developed financial markets at an accelerating pace. Competition gets tighter and volumes increase. Succeeding in this environment requires centralization of efforts and familiarity with and expertise in international financing markets.

To answer these new challenges, the owners of Municipality Finance and Municipal Housing Finance have decided to merge the companies' operations. This allows better utilization of available resources as well as strengthening municipalities' joint funding services. The ownership base of the new company will be divided so that the Local Government Pensions Institution will own 42.5 percent and the partner municipalities of the Municipal Housing Finance will own a total of 57.5 percent.

The Local Government Pensions Institution intends to gradually withdraw from ownership and other liabilities in the new company. From the perspective of municipalities, the purpose of a pension insurance institution is to manage the security and financing of municipalities' employee pensions. This provides grounds for the Local Government Pensions Institution to refocus its role with respect to the ongoing merger.

The new Municipality Finance will continue the operations of both companies and also improve and strengthen municipalities' financing services from the perspective of the municipalities' needs and objectives.

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The year 2000 was financially favourable for Municipality Finance Plc. The company's balance sheet at the closing of accounts for the year 2000 stood at EUR 2,190 million (*FIM 13,021 million*), which is EUR 177 million (*FIM 1,052 million*) more than the respective figure in 1999. The company's amount of lending grew to EUR 1,711 million (*FIM 10,173 million*), and the amount of long-term funding was EUR 2,019 million (*FIM 12,004 million*) at the closing of accounts.

Since December 1996 all funding by Municipality Finance has been guaranteed by the Municipal Guarantee Board. The Act on the Municipal Guarantee Board was put into force on July 1st, 1996. According to section 1 of the Act, the Municipal Guarantee Board can grant guarantees to such funding of the municipal sector's own credit institutions as will be used for lending to the municipal sector or to organizations engaged in renting out, construction or maintenance of social housing.

Capital adequacy and own funds

The company's capital adequacy is excellent. At the end of 2000 the company's capital adequacy ratio was 38 %.

Capital adequacy in 1996–2000:

31.12.1996	44 %	31.12.1999	45 %
31.12.1997	24 %	31.12.2000	38 %
31.12.1998	84 %		

During its operations the company has not had any non-performing loans or credit losses.

Municipality Finance is wholly owned by the Local Government Pensions Institution. At the end of 2000 the company's share capital stood at EUR 10.6 million (*FIM 63 million*). The company's own funds totalled EUR 35.3 million (*FIM 209.9 million*).

Lending

Municipality Finance grants loans for different types of investment needs to member municipalities of the Municipal Guarantee Board and municipal federations and such companies and communities guaranteed by municipalities, which are wholly owned or under the control of municipalities. For example, real estate and housing companies, energy, garbage disposal and water supply management companies owned by municipalities can apply for loans from Municipality Finance.

Municipality Finance's loan selection covers long-term variable rate and fixed-interest loans, single-installment loans and loans with an instalment program. In addition, the company grants loans that are funded through the European Investment Bank and the Council of Europe Development Bank. These loans are offered to the municipal sector for development projects on municipalities' general infrastructure, education, health care, environmental protection and energy supply.

New loans granted by Municipality Finance to member municipalities of the Municipal Guarantee Board, municipal federations and municipality-controlled entities totalled EUR 446 million (*FIM 2,652 million*) in 2000. Respectively, in 1999 the total amount of loans granted was EUR 479 million (*FIM 2,848 million*). Loans granted to municipalities have been denominated in the Euro for the past two years. Municipality Finance's loan portfolio totalled EUR 1,711 million (*FIM 10,173 million*) in 2000. The total of loans that matured during the financial year totalled EUR 282 million (*FIM 1,677 million*).

The amount of municipal commercial paper programmes totalled EUR 621 million (*FIM 3,692 million*) at the end of 2000. Trading in municipal commercial paper totalled EUR 642 million (*FIM 3,817 million*) during the financial year.

The book value of leased property stood at EUR 43,000 (*FIM 256,000*) at the end of the financial year.

Funding

Municipality Finance raises funds on the domestic and international capital markets. To raise domestic funding, Municipality Finance has a programme totalling EUR 800 million for the issuance of bonds and short-term debt instruments. It is possible to issue bonds with various maturity dates under this programme. Municipal Bonds and other bonds in the programme can total EUR 500 million at maximum, and the value of short-term debt instruments (KVS or Treasury Bills) can be EUR 300 million at maximum. The programme is called the Treasury Bill Programme. The main organizers of the T-Bill Programme are Nordea and Barclays Capital. T-Bills are also offered through Deutsche Bank, Aktia Savings Bank and Municipality Finance.

Municipal Bonds

Municipal Bonds form a significant part of Municipality Finance's domestic funding. Sales of Municipal Bonds in 2000 have been record high. In 2000, Municipality Finance issued nine Municipal Bonds. Municipal Bonds are still a paper-based investment instrument and as such investing in them does not require a book-entry account. They can be deposited at Municipality Finance free of charge. Municipal Bonds can also be subscribed through the Internet. The company will also buy back Municipal Bonds during the investment period for the market price of the day.

In April Municipality Finance issued a Stock Market Bond, a stock index loan with profits that are tied to the development of the European stock market.

Altogether, Municipality Finance has issued 32 Municipal Bonds since 1993.

Municipal Bonds issued under the Municipal Bonds Programme in 2000:

Issue date	Maturity date	Nominal value (EUR)	Coupon
7.2.2000	7.2.2003	20,000,000	4.40 %
7.2.2000	7.2.2005	17,970,000	5.00 %
29.3.2000	29.3.2004	26,323,000	4.70 %
5.5.2000	7.11.2005	12,501,000	tied to share index
15.5.2000	15.5.2003	32,135,000	4.45 %
30.8.2000	30.8.2002	21,842,000	4.60 %
30.8.2000	30.8.2004	11,459,000	5.00 %
9.10.2000	9.10.2006	7,609,000	5.25 %
10.11.2000	10.11.2003	7,784,000	4.90 %

Foreign funding

Municipality Finance has a Medium Term Note Programme listed on the London Stock Exchange for international long-term funding. The limit of the programme is EUR 2 billion.

Municipality Finance has a Global Loan Agreement with the European Investment Bank for EUR 194 million (*FIM 1,153 million*) and with the Council of Europe Development Bank for a total of EUR 200 million (*FIM 1,189 million*).

The amount of long-term funding totalled EUR 651 million (*FIM 3,871 million*) in 2000. The respective

amount of long-term funding in 1999 was EUR 429 million (*FIM 2,551 million*).

In 2000 the company raised short-term domestic funding by issuing Treasury Bills totalling EUR 517 million (*FIM 3,074 million*). At the end of 2000 the amount of all short-term funding totalled EUR 101 million (*FIM 601 million*). Respectively, at the end of 1999 the amount of all short-term funding totalled EUR 106 million (*FIM 630 million*).

Total funding on the balance sheet at the end of the fiscal year was EUR 2,120 million (*FIM 12,605 million*), of which 55 % was denominated in domestic currencies (i.e. in markka and other euro area currencies) and 45 % in other currencies. Respectively, in 1999, total funding on the balance sheet at the end of the fiscal year was EUR 1,941 million (*FIM 11,541 million*), of which 35 % was denominated in domestic currencies and 65 % in foreign currencies.

Credit rating

Municipality Finance's long-term funding, which is guaranteed by the Municipality Guarantee Board, has received credit ratings from the most internationally well-known credit rating institutions.

The effective credit ratings for long-term funding are:

Moody's Investors Service Aaa

(last confirmed February 23, 2000)

Standard & Poor's AA+ (CreditWatch Negative)

(last confirmed October 25, 2000)

On October 25, 2000, Standard & Poor's placed the AA+ credit rating of Municipality Finance's long-term funding on the CreditWatch Negative list. Standard & Poor's maintained the A-1+ credit rating for Municipality Finance's short-term funding.

According to Standard & Poor's, the placement of Municipality Finance on the CreditWatch Negative list is due to Municipality Finance's announcement to merge with Municipal Housing Finance, for which Standard & Poor's has not confirmed a credit rating. Standard & Poor's intends to clarify if further procedures are required concerning the CreditWatch after receiving additional information concerning the merger.

Operational result

Municipality Finance's operational result before appropriations and taxes was EUR 254,000 (*FIM 1,51 mil-*

lion) in 2000. Net income from financial operations was EUR 5.1 million (*FIM 30.32 million*). The company's result from securities transactions and foreign currency operations was negative by EUR 438,000 (*FIM 2.60 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 or losses incurred from the sales of these debt securities have been entered under profit from securities transactions. Thus, the rise of interest rates, which was seen as a negative factor in terms of its effect on the profit of securities transactions and foreign currency operations, had a positive effect on interest rate profit of loans funded by these debt securities.

Risk management

All the risks of Municipality Finance have been minimized and the company is fully hedged against foreign currency risks. The company is subject to only minute interest rate risks in domestic currency. Risks are hedged mainly with interest rate swaps, currency rate swaps and forward rate contracts. The company makes derivative contracts solely for hedging purposes.

The company uses risk management software for monitoring counterparty and market risks. Credit rating requirements and internal risk limits have been set for contract counterparties. The counterparties of interest rate swaps denominated in domestic currencies are required to have at least rating A-. With other currencies the minimum rating requirement is AA-.

The company's loan portfolio carries no real credit risks as it lends exclusively to Finnish municipalities, municipality federations and municipality-controlled entities whose loans are guaranteed by the 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 in CDs and bonds of insurance companies and banks with high credit rating.

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

Outlook for the year 2001

The year 2001 will be challenging for Municipality Finance. Municipality Finance and Municipal Housing Finance Plc, which specializes in municipal housing funding, have agreed to merge operations through a combination merger. The merger will create an even stronger finance company for the municipal sector that is committed to developing financial services of municipalities. The new company's mission is to ensure the joint competitiveness of the funding for the entire municipal sector and the maintenance of the company's own cost-effective funding channel. The new company's business operations will cover all the sectors that the present companies have operated in before merger. The new company's trade name will be Municipality Finance Plc.

Personnel and administration

The company's personnel numbered 17 at the end of 2000.

The managing director of Municipality Finance Mr Nicholas Anderson's employment relationship will end on 7th March 2001. The board of directors has decided on 31st January 2001 to appoint Mr Juha Heinonen as managing director starting on 7th March 2001. He will continue to this position until the new company starts its operations.

According to the Articles of Association, the Board of Directors comprises at least four and at most six members. On March 7th, 2000, the Annual General Meeting appointed a Company Board. A total of 16 Board meetings were held in 2000.

The company has a 15-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 2000.

A board of management assists the Managing Director in 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 board of management has comprised the following members: Managing Director Nicholas Anderson, Deputy Managing Director Juha Heinonen, Director of Finance Jukka Reijonen and Director of Financial Administration Marjo Tomminen.

PROFIT AND LOSS ACCOUNT

	1 January– 31 December 2000	1 January– 31 December 1999
1 EUR = 5.94573 FIM	thousand EUR	thousand EUR
Interest income	105,204	81,518
Net income from leasing operations	4	6
Interest expenses	-100,113	-77,435
NET INCOME FROM FINANCIAL OPERATIONS	5,095	4,089
Dividends income	0	1
Commission income	21	0
Commission expenses	-992	-749
Net income from securities transactions and foreign exchange dealing		
Net income from securities transactions	-335	-60
Net income from foreign exchange dealing	<u>-103</u>	<u>13</u>
	-438	-47
Other operating income	5	4
Administrative expenses		
Staff costs		
Salaries and fees	1,182	789
Staff-related costs		
Pension costs	157	136
Other staff-related costs	91	52
Other administrative expenses	<u>983</u>	<u>687</u>
	-2,413	-1,664
Depreciation and write-downs on tangible and intangible assets	-153	-142
Other operating expenses	-871	-773
NET OPERATING PROFIT	254	719
PROFIT BEFORE APPROPRIATIONS AND TAXES	254	719
Appropriations	-244	-704
Income taxes	-9	-14
PROFIT FOR THE FINANCIAL YEAR	<u><u>1</u></u>	<u><u>1</u></u>

BALANCE SHEET

ASSETS	31 December 2000	31 December 1999
	thousand EUR	thousand EUR
1 EUR = 5.94573 FIM		
Liquid assets	2	1
Debt securities eligible for refinancing with central banks	200,407	203,547
Claims on credit institutions		
Repayable on demand	282	736
Other	4,900	15,720
Claims on the public and public sector entities	1,710,520	1,546,495
Leasing assets	43	71
Debt securities		
On public sector entities	51,679	49,285
Other	90,001	24,567
Shares and participations	1,063	10
Intangible assets	201	140
Tangible assets		
Other tangible assets	259	359
Accrued income and prepayments	130,520	172,430
TOTAL ASSETS	<u>2,189,877</u>	<u>2,013,361</u>

BALANCE SHEET

LIABILITIES	31 December 2000	31 December 1999
	thousand EUR	thousand EUR
LIABILITIES		
Liabilities to credit institutions and central banks		
Credit institutions		
Other	288,408	234,352
Debt securities issued to the public		
Bonds	1,730,612	1,600,782
Other	101,135	105,851
Other liabilities	287	7,207
Accrued expenses and deferred income	32,454	28,432
Subordinated liabilities	16,819	16,819
APPROPRIATIONS		
Voluntary provisions	4,962	4,719
EQUITY CAPITAL		
Share capital	10,596	10,596
Other restricted reserves		
Reserve fund	393	393
Capital loans	4,205	4,205
Profit brought forward	5	4
Profit for the financial year	1	1
TOTAL LIABILITIES	<u>2,189,877</u>	<u>2,013,361</u>
OFF-BALANCE SHEET COMMITMENTS		
Irrevocable commitments given in a favour of a customer		
Other	41,505	66,376

NOTES TO THE ACCOUNTS ON 31 DECEMBER 2000

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 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". Machinery and equipment are depreciated according to a plan on the straightline principle over five years, computer hardware and software straightline over four years, and other longterm expenses straightline 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 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. Differences between issue price and nominal values are broken down on a time-basis for the maturity of debt.

Notes to the profit and loss account

All amounts in euros

1.	Interest income, broken down as follows:	
	- Claims on credit institutions	441,719
	- Claims on the public and public sector entities	87,364,198
	- Debt securities	17,157,471
	- Other interest income	240,073
	Interest expenses, broken down as follows:	
	- Liabilities to credit institutions	13,035,095
	- Debt securities issued to the public	79,810,672
	- Subordinated liabilities	749,881
	- Capital loans	187,470
	- Other interest expenses	6,329,964
2.	Net income from leasing, broken down as follows:	
	- Rental income	32,070
	- Planned depreciation	-27,776
		4,294

3. Net income from securities transactions, broken down as follows:
- | | |
|---|----------|
| - Net income from transactions in debt securities | -436,109 |
| - Net income from transactions in shares and participations | 101,136 |
4. Total values of securities held as current assets purchased or sold during the financial year:
- | | |
|-----------------------------|---------------|
| - Debt securities purchased | 1,493,089,307 |
| - Debt securities sold | 809,560,000 |
5. Other operating income
- | | |
|---|-------|
| - Other income from the ordinary business of the credit institution | 5,472 |
|---|-------|
- Other operating expenses, broken down as follows:
- | | |
|---|---------|
| - Rental expenses | 175,501 |
| - Other expenses arising from the ordinary business of the credit institution | 695,941 |
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 | 243,500 |
|--|---------|
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 | 39,145,375 |
| - Banks' certificates of deposit | 161,261,751 |
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 | 198,992,413 |
| - Public sector entities | 1,426,894,395 |
| - Non-profit organizations | 84,632,912 |

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 43,381
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 EUR 342,087,058.

	Quoted	Others
Debt securities		
- Securities held as current assets	0	342,087,058
- 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 EUR 1,709,997.

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	50,472,670
- Certificates of deposit	201,173,795
- Other bonds	90,440,593

- | | Quoted | Others |
|-------------------------------|--------|-----------|
| 21. Shares and participations | | |
| Shares held as current assets | 0 | 1,063,314 |
| Others | 0 | 0 |

22. The balance sheet item "Tangible assets" consists of machinery and equipment, computer hardware and capitalized computer software

Purchase price at the beginning of the financial year	459,963
+ increases during the financial year	123,351
- planned depreciation during the financial year	116,178
- accumulated depreciation at the beginning of the financial year	207,813
Book value at the end of the financial year	259,323

23. The item "Intangible assets" broken down as follows:
-Intangible assets 106,517
- Other long term expenditure 94,450
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 | 27,568,718 |
| - Other | 102,951,181 |
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 | 1,404,826 |
| - Other | 724,999 |
- The total amount of the difference between the book value and the lower nominal value of liabilities:
- | | |
|---------|---------|
| - Bonds | 117,064 |
| - 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 | 1,730,612,264 |
| - Other | 101,135,001 |
31. Other liabilities, broken down as follows:
- | | |
|---|---------|
| - Cash items in the process of collection | 104 |
| - Other | 286,859 |
32. Accrued expenses and deferred income, broken down as follows:
- | | |
|------------|------------|
| - Interest | 31,469,470 |
| - Other | 985,228 |
33. Municipality Finance Plc has no obligatory provisions.
34. Subordinated liabilities
The company has issued a debenture of EUR 16,818,792.65. The nominal interest rate of the loan is based on 6 months euribor 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 | 10,595,839 | 392,652 | 4,204,698 |
| + increases for the financial year | 0 | 0 | 0 |
| Book value at the end of the financial year | 10,595,839 | 392,652 | 4,204,698 |
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. The company did not launch any share issues or issues of options and convertible bonds during the financial year.
39. The Local Government Pensions Institution has a 100% holding in Municipality Finance Plc.

40. The company has a capital loan of EUR 4,204,698.16. The interest rate of the loan is based on 6 months euribor 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	108,632,890	52,628,860	35,357,996	3,787,379
Claims on credit institutions	5,181,513	0	0	0
Claims on the public and public sector entities	28,402,386	225,301,130	919,753,706	537,062,497
Debt securities	84,128,030	8,360,061	49,191,841	0
	0-3 months	3-12 months	1-5 years	over 5 years
Liabilities to credit institutions	0	0	125,917,369	162,490,430
Debt securities issued to the public	80,922,139	112,620,195	937,815,901	700,389,030

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.

	In-currencies	Foreign currency
Debt securities eligible for refinancing with central banks	200,407,125	0
Claims on credit institutions	5,148,574	32,938
Claims on the public and public sector entities	1,710,519,720	0
Debt securities	90,001,003	0
Liabilities to credit institutions	228,225,102	60,182,697
Debt securities issued to the public	946,485,156	885,262,109
Subordinated liabilities	16,818,793	0

Notes to the accounts concerning income taxation

44. The company's voluntary provisions include deferred tax liabilities totalling EUR 1,438,993. 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	235,172,348
Pledged debt securities to the Local Government Pensions Institution	2,815,352
Pledged bonds to the Municipal Guarantee Board	1,459,753,843
Pledged debt securities to the Municipal Guarantee Board	260,700,000

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 41,504,669
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

Interest rate derivatives	
Futures and forwards	10,000,000
Written options	25,228,189
Interest rate swaps	1,050,294,095
Currency derivatives	
Interest rate and currency swaps	1,029,183,189
Share derivatives	47,064,333
Credit value of contracts	
<hr/>	
Interest rate derivative contracts	26,425,000
Currency derivative contracts	150,748,000
Share derivatives	13,003,000

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 fulltime and 4 part-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 EUR 314,240 during the financial year. The managing director has a managerial agreement. The managerial agreement does not include any additional pension benefits.
Salaries and fees were not paid on the basis of the company's financial performance.
The company has not granted any loans or guarantees to the members of the board of directors, the managing director, deputy managing director, auditors and their deputies.
The company did not make any pension commitments in respect of members of the board, managing director, deputy managing director, auditor or his deputy.

Holdings in other undertakings

53. Municipality Finance Plc has no holdings in other undertakings.

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 a public listed company.
56. 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

	2000	1999	1998	1997	1996
Turnover, EUR million	105	82	92	76	95
Net operating profit, EUR million	0,3	0,7	2,3	0,1	0,4
% of turnover	0,3	0,9	2,5	0,2	0,5
Profit before appropriations and taxes, EUR million	0,3	0,7	2,3	0,1	0,4
% of turnover	0,3	0,9	2,5	0,2	0,5
Return on equity % (ROE)	1,3	3,8	17,2	1,4	4,8
Return on assets % (ROA)	-	-	0,2	-	-
Equity ration %	0,9	0,9	1,2	0,6	0,7
Yield-expense ratio	1,1	1,2	1,7	1,0	1,2
Capital adequacy ratio	38	45	84	24	44
Headcount	17	17	17	14	14

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 maximize profits but to lower municipalities' finance costs through a joint municipal funding system.

Turnover consists of both net income from interests, leasing operations, dividends income, commissions, securities transactions, foreign exchange dealing and of the total value of 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:

$$\frac{\text{Net operating profit} - \text{taxes}}{\text{Equity capital} + \text{voluntary provisions minus deferred tax liabilities} \text{ (average of year beginning and year end)}} \times 100$$

Return on assets ratio (ROA) is calculated as follows:

$$\frac{\text{Net operating profit} - \text{taxes}}{\text{Balance sheet total} \text{ (average of year beginning and year end)}} \times 100$$

Equity ratio is calculated as follows:

$$\frac{\text{Equity capital} + \text{voluntary provisions minus deferred tax liabilities}}{\text{Balance sheet total}} \times 100$$

Yield-expense ratio:

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

Capital adequacy ration is calculated as follows:

$$\frac{\text{Own funds}}{\text{Risk weighted assets and off-balance sheet items}} \times 100$$

RESULT FOR THE ACCOUNTING PERIOD AND DISTRIBUTION OF PROFIT

The financial statement shows a profit of EUR 1.330,25 (*FIM 7.909,31*).

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

Helsinki, January 31st, 2001

MUNICIPALITY FINANCE PLC

<i>Simo Lämsä</i> Chairman of the Board	<i>Pekka Alanen</i> Member of the Board	<i>Tom Kåla</i> Member of the Board
<i>Mika Mäkinen</i> Member of the Board	<i>Raija Peltonen</i> Member of the Board	<i>Leena Siikanen-Toivio</i> Member of the Board
<i>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 2000. 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 and the Act on credit institutions.

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.

Helsinki, 5 February 2001

ARTHUR ANDERSEN OY,
Authorised Public Accountants
Mr. Jarmo Lohi, Authorised Public Accountant

Kunta- obligaatiot

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