ANNUAL REPORT 2005

MUNICIPALITY FINANCE PLC
ANNUAL REPORT 2005

Kuntarahoitus Oyj, PL 744, 00101 Helsinki, p. (09) 6803 5666, fax (09) 6803 5669, www.kuntarahoitus.fi

MANAGING DIRECTOR'S REVIEW

Municipality Finance Plc's financial year 2005 exceeded the budgeted targets and was good, measured by all yardsticks. The profit was much higher than last year's, and other key indicators were also good. The outlook for 2006 is promising.

The profit for the year reflects our sensible business operations based on avoiding risks and maintaining capital adequacy.

Steady growth targeted

The financial year's net operating profit came to EUR 5.6 million against EUR 3.4 million in 2004. The balance sheet grew by some 13% on the previous year. The loan portfolio grew by 14% in this financial year, exceeding the budgeted target even more clearly than the year before.

The company's long-term funding was acquired on international markets. In spite of the fierce competition in lending, the number of requests for tenders remained at the previous year's level. The company's market share of actual lending rose to 49%.
Both major credit rating institutions confirmed the best possible ratings for Municipality Finance. The company continues to be Finland's only credit institution that has the same best credit ratings from Standard & Poor's and Moody's as the State of Finland. The best credit ratings will strengthen the company's position on international capital financing markets and improve the competitiveness and profitability of its funding acquisition. Price-competitive acquisition of funds is of direct benefit to our own clientele.

Better customer service

The business strategy adopted in 2004 has met expectations. Inputs in customer service, more efficient organization and the improved readiness of our motivated personnel to react flexibly to customer needs and market requirements are evident in our good key indicators. Our active customer approach is evident in both funding acquisition and relations with the local government sector. Services were expanded further with the financial advisory service launched in 2004, which, according to experiences so far, has met a real need. There is a good demand for the service and the number of commissions is increasing steadily.

Improved funding acquisition targeted

The focus of the company's funding acquisition has for some time been on Japan in particular, and subsequently also on other Asian countries. The financial year now beginning will see us investigating new opportunities in countries such as Australia and Canada, although Asia will continue to be an important area in terms of funding acquisition.

Local government and service structure reform

The Government's local government and service structure project is looking for solutions to the economic problems of small and indebted municipalities in particular in order to be able to provide high-quality basic services cost-effectively for the entire population in the future. The goal of the reform is to create bigger and stronger units whose operations will rely on the taxations rights and autonomy of the municipalities.

Municipality Finance will keep an active eye on the situation and aims to improve its product range so that it can serve the special needs of the local government sector in the best possible way.

I give my heartfelt thanks to our clients, cooperation partners and personnel for this successful financial period.

Helsinki, February 14, 2006

Pekka Averio
Managing Director

Kuntarahoitus MUNICIPALITY FINANCE

CHAIRMAN OF THE BOARD'S REVIEW

Importance of Municipality Finance increasing in local government sector

Municipality Finance Plc's lending to municipalities increased in the past financial year, which is a favourable trend for the company and consolidates its status in the local government sector. It also shows that the company has been able to respond well to customer-oriented and market-based financing needs.

When the company's growth is looked at from the viewpoint of the municipalities themselves, we see an increasing need for borrowing and dark clouds accumulating on the local government horizon. Many municipalities will be in severe financial straits as revenues are not going to increase at the same rate as expenses. This trend, however, can be controlled with appropriate action.

Supported by strong general government finances

Finland has a long tradition of strong general government finances and strong local government finances. Finland is also characterized by a solid culture of survival, which, for instance, helped us in meeting the serious financial challenges the country had to face after the last recession. The same spirit and a firm belief in a better future will allow us to solve the municipalities' current financial difficulties, as long as action is taken at a sufficiently early stage.

Local government development and financing needs constitute a challenge

The current extent of our service structure makes it difficult to meet the often expressed requirement that all citizens should have an equal service level regardless of the size of the municipality and geographical realities. Nevertheless, if the municipality and service structure reform under preparation produces bigger and more efficient municipal entities, it will help municipalities to maintain an appropriate service level. Successful reform will also call for stable and well-organized relations between central and local government.

Apart from the local government reform, attention should be attached to the municipalities' own solutions, some of which have already been produced, while others are still under preparation. The client-supplier model is becoming more widespread, while the service structure is becoming more fragmented and beginning to network with the private sector.

Municipality Finance's role

As a company, Municipality Finance is part of the survival kit that municipalities will need in solving the equation of shrinking revenues and increasing expenses. The company must take into account in its own operations the challenges that already exist in the local government sector as well as those that will emerge with future changes.

There has already been a reaction to the challenges: the company's active customer work has been increased and supply of products has been complemented with advisory services to municipalities. The importance of municipally controlled corporations and companies as a customer group of their own will also increase.

Municipalities will in the future, too, need reliable cooperation partners who can and are willing to respond to the challenges of developing the service production. There will be an increasing demand in particular for new models that improve local government operations, construction and development.

On behalf of the entire Municipality Finance Board, I would like to thank the company owners and customers for the successful cooperation and their support for our common efforts. The purpose of the company will continue to be the advancement of the local government sector's own needs in a way that satisfies the owners.

Helsinki, February 14, 2006

Asko Koskinen
Chairman of the Board of Directors

BOARD OF DIRECTORS' REPORT

Balance sheet and operating result

The Municipality Finance balance sheet total on December 31, 2005 was EUR 6,050 million, compared with EUR 5,368 million at the end of the previous year, an increase of 12.7%. The company's long-term loan portfolio stood at EUR 4,594 million, up 14% on the 2004 year-end figure.

The trend in the operating result was better than expected. The profit for the financial year (January 1 – December 31, 2005) before appropriations and taxes was EUR 5.6 million (2004: EUR 3.4 million). Net income from financial operations totalled EUR 14.1 million (2004: EUR 11.8 million).

Net income from financial assets held for trading, totalling some EUR 0.5 million (2004: EUR 3.4 million), comprises sales profits from the sale of negotiable instruments. Assets from advance funding will be invested in these instruments until the money is granted as loans to customers.

Municipality Finance Plc	2005	2004	2003
Turnover, EURm	142.7	122.8	128.7
Net operating profit, EURm	5.6	3.4	4.0
% of turnover	3.9	2.8	3.1
Profit before appropriations and taxes, EURm	5.6	3.4	4.0
% of turnover	3.9	2.8	3,1
Return on equity (ROE), %	8.8	5.5	7.3
Return of assets (ROA), %	0.1	0.1	0.1
Equity ratio, %	1.1	1.2	1.3
Yield-expense ratio	1.6	1.4	1.5
Capital adequacy ratio, %	30.0	38.1	52.0
Head count, Dec 31	32	30	27

These key indicators are not directly comparable with those related to other credit institutions. The operating principle and objective of the company's operations is not to maximize profit but to lower municipalities' financial costs by providing a joint municipal funding system.

Total turnover comprises net income from interest, commissions, securities and foreign exchange transactions, financial assets held for trading and other operating income. Net operating profit and profit before appropriations and taxes are entered as in the profit and loss account.

$$\text{Return on equity ratio (ROE)} = \frac{\text{Net operating profit – taxes}}{\text{Equity + voluntary provisions - deferred tax liabilities (average of year beginning and year end)}} \times 100$$

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

$$\text{Equity ratio} = \frac{\text{Equity + voluntary provisions – deferred tax liabilities}}{\text{Balance sheet total}} \times 100$$

$$\text{Yield-expense ratio} = \frac{\text{Net financial income + dividends received + commission income + net income from securities and foreign exchange transactions + other operating income + net income from sale of financial assets held for trading}}{\text{Commission expenses + administrative expenses + depreciation + other operating expenses}}$$

$$\text{Capital adequacy ratio} = \frac{\text{Primary and secondary own funds}}{\text{Total risk-weighted claims, investments and off-balance-sheet commitments}} \times 100$$

Capital adequacy and own funds

	2005	**2004**
Primary own funds	65,868	62,798
of which capital loans	23,846	23,846
capital loans of primary own funds	36%	38%
Decrease in intangible assets	-698	-902
Total primary own funds	65,170	61,896
Total secondary own funds	33,819	33,819
Total own funds	**98,989**	**95,715**
Risk-weighted claims, investments and off-balance-sheet commitments	329,556	251,055
Capital adequacy ratio	30.04%	38.13%
Primary own funds in relation to risk-weighted assets, investments and off-balance-sheet commitments	19.78%	24.65%

The company has not had any non-performing assets or credit losses during its operations.

The company's share capital totalled EUR 16.5 million on December 31, 2005.

Credit rating

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

Moody's Investors Service	Aaa
Standard & Poor's	AAA

The credit ratings of the company's short-term funding have been verified as the best possible:

Moody's Investors Service	P1
Standard & Poor's	A-1+

Lending

Long-term lending

Municipality Finance's borrowers are municipalities and municipal federations, corporations owned or controlled by them, and non-profit housing corporations.

The company's loan products comprise loans to municipalities, municipal federations and municipal enterprises and housing loans for new production, renovation and acquisitions. Some Municipality Finance loans are refinanced by the European Investment Bank (EIB) or the Council of Europe Development Bank (CEB).

The company maintained its strong standing as a financier for municipalities and municipal federations in particular. It won agreements worth EUR 988 million in the competitive tendering it participated in, i.e. some 49%. Municipalities and municipal federations accounted for EUR 705 million of the competitive offers won, municipal enterprises for EUR 76 million and housing corporations for EUR 207 million. The number of offers won rose by some 30% from 2004 and the number of loans withdrawn by 36%.

The Municipality Finance loan portfolio totalled EUR 4,594 million at the end of 2005 (2004: EUR 4,030 million), a net increase of 14%. Altogether, EUR 967 million in loans were withdrawn (2004: EUR 709 million).

Municipality Finance's customers favoured short-term reference rates in 2005. Municipality Finance's own reference rate was the most popular. Customers were also interested in a more diverse variety of interest rate structures in 2005.

In State-subsidized housing production, the focus shifted towards interest-subsidy loans. State-subsidized construction began on some 4,065 housing units in 2005, slightly fewer than the previous year.

Short-term lending

In order to meet their short-term loan needs, municipalities and enterprises controlled by municipalities or municipal federations may issue municipal commercial papers via Municipality Finance.

At the end of 2005, municipal commercial paper programmes were being used by 301 municipalities, municipal federations and municipal enterprises. The programmes came to a total of EUR 1,257 million at the end of the year. Customers used municipal commercial papers to raise EUR 1,781 million in short-term funding, an increase of 39% (2004: EUR 1,280 million).

Funding

Municipality Finance acquired a total of EUR 1,093 million (2004: EUR 1,002 million) in long-term funding during the financial year. When the books were closed, the company's funding stood at a total of EUR 5,778 million (2004: EUR 5,054 million). Of this, 53% (2004: 59%) was denominated in euros and 47% (2004: 41%) in other currencies.

Modes of funding

Municipality Finance's funding relies on activity on several major capital markets. Most of it is acquired through the following debt programmes:

EMTN programme	EUR 5,000,000,000
Domestic debt programme	EUR 500,000,000
Treasury Bill Programme	EUR 500,000,000

The Euro Medium Term Note (EMTN) programme is an international debt programme for issuing financial instruments. In April, it was raised from EUR 3,000 million to EUR 5,000 million. It is listed on the London Stock Exchange.

Municipality Finance uses credit limits agreed with the European Investment Bank (EIB) and the Council of Europe Development Bank (CEB) as part of its refinancing.

Municipality Finance's debt programmes and funding outside the debt programmes are guaranteed by the Municipal Guarantee Board, so the debt instruments it issues are weighted as zero-risk under Finnish law for capital adequacy purposes. The same applies at least in Germany and France in Europe.

Long-term funding

International funding
In 2005, total international funding stood at some EUR 1,028 million. Some 100 funding arrangements were made during the year. Loans continued to rely on a wider variety of structures than before, but loan periods were the same as in the previous year. New investors were acquired not only in Japan but also other Asian countries. Apart from the German 'schuldschein' arrangements, two yen loans were issued with Japanese investors and one Uridashi loan was targeted at private investors in Japan.

Domestic funding
Within the domestic debt programme, Municipality Finance issued nine Municipal Bonds in 2005, seven of them targeted at the general public and two index-linked loans for wholesale investors. The total subscription value was EUR 65 million.

Short-term funding

For short-term funding, the company has a Treasury Bill Programme. On December 31, 2005, issues of such funding totalled EUR 384 million (2004: EUR 274 million). Short-term funding is used to secure overall liquidity.

Risk management and internal control

The general principles of risk management at Municipality Finance are decided by the Board of Directors and implemented by the Managing Director assisted by the Board of Management. Practical risk management and related supervisory functions are separate. The company's risk standing is monitored regularly by the Board of Management and by the Board of Directors, on the basis of regular limit reports.

Credit risk

A credit risk means that the counterparty may not be able to answer for its commitment to the credit institution.

Loans can be granted directly to municipalities and municipal federations without separate collateral. For other loans, an absolute guarantee or deficiency guarantee issued by a municipality or a municipal federation, or a State deficiency guarantee, is acceptable. Because such security is required, the loans granted are calculated as zero-risk for the purpose of calculating the credit institution's capital adequacy.

Credit risks are also caused by financial and investment instruments, interest rate and currency futures and forwards, and interest rate and exchange rate swaps and other derivatives contracts. In terms of credit risk evaluation, principles and limits approved by the Board of Directors and based on external ratings are applied in the selection of counterparties. Counterparty risk is monitored according to the fair value method; an equivalent credit value is calculated for the instruments to act as a basis for monitoring the limits set.

Further measures to control higher credit risks include Credit Support Annexes with major derivatives counterparties. The company has currently 23 Credit Support Annexes in force.

Market and financial risk

A market risk means that the company suffers a loss, when the market price or its volatility follow a trend unfavourable to the company. Market risks include those related to interest rates, exchange rates, share prices and other prices.

For hedging against market risks, the company uses derivatives contracts, but never by increasing the existing risk position. The company hedges itself against all exchange rate risks.

A financial risk means the eventuality that the company cannot handle its payment obligations arising from implementation of derivatives or other financial operations.

The Municipality Finance Board of Directors has set limits on the following market risks:

- currency position
- refinancing/sustainability of financing
- refinancing gap
- interest rate risk based on duration
- minimum and maximum amounts of liquid assets
– value-at-risk

Apart from this, the management receives monthly interest rate sensitivity analyses and profit and loss figures.

The company has access altogether to EUR 140 million in liquidity back-up facilities in the form of credit limit arrangements.

Market liquidity risk

A market liquidity risk means that the company may not be able to realize or cover its position at the current market price, because there is not enough market depth or the market is not functioning because of market disruption.

The company monitors market and product liquidity on a continuous basis. Otherwise, the markets own standards are observed when derivatives contracts are concluded, e.g. in terms of maturity, contractual amount and interest rate calculation method. Structures in which the number of suitable market parties is limited will be avoided as far as possible.

Operational risk

An operational risk means risk of loss arising from insufficient or failed internal processes, personnel, systems or external factors.

Municipality Finance has dealt with operational risk management by separating trading, risk management, risk monitoring, back-office work, documentation and bookkeeping duties and by creating a system of staff substitution and by charting work duties and processes. The professional skill of the personnel is maintained through training.

The company's operational risks were charted in 2005.

Internal audit

Internal auditing has been outsourced, and these duties were carried out by Deloitte Oy in 2005.

Corporate Governance

The Board of Directors of Municipality Finance Plc prepared Corporate Governance on February 11, 2005, It complies with the Helsinki Stock Exchange Recommendation in all its material parts. The Recommendation is aimed at listed share issuers and does not therefore concern Municipality Finance directly, as it issues bonds. The Company shares are not subject to public trading and can be owned only by the parties referred to in the Articles of Association. Nevertheless, the Company wished to compile its own Corporate Governance rules based on the Stock Exchange Recommendation. The Board of Directors is responsible for compliance with Municipality Finance's Corporate Governance rules and committed to their further development.

The aim of the Corporate Governance is to create a framework for responsible operations that will produce value added for customers and owners and strengthen the confidence of all stakeholders (customers, owners, staff, financiers, etc.) in the management and the operating methods of the organization. The principles of Corporate Governance apply to the staff as a whole, not just to the highest level of management; similarly the staff as a whole is bound by the corporate values, principles and aims.

These Corporate Governance rules are accessible in full on the Company website (www.kuntarahoitus.fi). They deal with the following issues:

- organization (Shareholders' Meeting, Board of Directors, Managing Director and Board of Management)
- rewarding
- insider trading
- main operating principles (financial services policy, funding policy, investment policy, risk management policy, market risk, liquidity risk, operational risk management, internal auditing, risk management evaluation, reporting, information security and auditing)
- information dissemination.

In accordance with the Articles of Association, Municipality Finance's Board of Directors has nine members. The Board of Directors was elected for two year period at the Annual General Meeting March 11, 2005.

The Board members are (main job outside the company given in brackets):

- Asko Koskinen (Director, City of Tampere) as Chairman
- Timo Viherkenttä (Deputy Managing Director, Local Government Pensions Institution)
- Juhani Alanen (Deputy Mayor, City of Mikkeli)
- Esa Katajamäki (Director of Finance and Planning, City of Oulu)
- Tapio Korhonen (Finance Director, City of Helsinki)
- Jouko Lehmusto (Head of City Office, City of Turku)
- Eva Liljeblom (Professor, Swedish School of Economics and Business Administration, Helsinki)
- Kari Nars (D.Sc.(Econ & Bus.Adm.), Advisor to the Council of Europe Development Bank, Helsinki)
- Raija Peltonen (Municipal Manager, Municipality of Hartola)

Managing Director of the company is Pekka Averio and Deputy Managing Director is Director Jukka Reijonen.

The company's Board of Management includes

- Marjo Tomminen, Director
- Esa Kallio, Director
- Kimmo Lehto, Director

Company auditor is KPMG Ab, with Riitta Pyykkö, Authorized Public Accountant, as senior responsible auditor.

Other events in 2005

The key area in 2005 continued to be intensification of customer-targeted sales activities, a review of the processes of the organization reformed at the end of 2004 and underlining the importance of inter-departmental cooperation.

Operational risks were charted in 2005. On the basis of the charting, necessary changes were made in the company processes and methods were created to collect information on the potential loss involved.

In 2005 the entire corporate strategy was updated to range from 2010 to 2012. At the end of the year, a separate information management strategy up to 2012 was drawn up.

The Board was elected in March, with two new members: Tapio Korhonen (City of Helsinki) and Asko Koskinen (City of Tampere). Asko Koskinen (City of Tampere) was elected Chairman of the Board and Timo Viherkenttä (Local Government Pensions Institution) was elected Vice Chairman.

The financial advisory services for customers introduced in August 2004 developed well in 2005. The pressure of change on the local government sector has increased the demand for such services.

Prospects for 2006

According to estimates issued by the Association of Finnish Local and Regional Authorities, local government finances stabilized in 2005. The annual margin will improve but will still remain lower than depreciation. The Association of Finnish Local and Regional Authorities forecasts that the annual margin will continue to improve in 2006. The improvement will be due to increased tax revenues and higher central government transfers to local government.

Tough competition is expected to continue in the lending sector in 2006. Low interest rates will cause an increase in the number of different interest structures offered to municipalities. The number of requests for tenders coming to Municipality Finance is expected to remain at the 2005 level.

Increases in the volume of Municipality Finance operations are expected to require some 2-4 new employees in 2006, half of them in advisory services.

Demand for financial advisory services is expected to increase in 2006. The service is becoming better-known and the increased demand will call for more resources. The aim is an improved ability to offer a wide variety of advisory services.

Adoption of IFRS and transition schedule

Municipality Finance's original target was to move over to IFRS reporting as of January 1, 2005. Municipality Finance's principles for drawing up financial statements are affected most by Standard 39, Financial Instruments: Recognition and Measurement. Delayed adoption of the standard has caused the company to suspend transfer to IFRS reporting in financial statements until January 1, 2007. Under the current regulations, companies issuing bonds must start applying international accounting standards not later than January 1, 2007 or the financial period beginning after this date.

The company has had a project group since 2003, consisting of representatives from both financial administration and business units. Preparation for adoption of international accounting standards continued in 2005. Reporting and information systems have been developed to allow the application of IFRS accounting principles and production of necessary financial information. This work will continue in 2006.

New capital adequacy framework

The Basel Committee on Banking Supervision issued new capital adequacy recommendations for banks in June 2004. The reform will enter into force gradually, beginning December 31, 2006. The company has tested new accounting methods complying with the new framework. The new recommendations are not expected to cause major changes in the company's capital adequacy status, calculated with the risk-weighted claims in the current balance sheet.

Financial result for the year and distribution of profit

The company's financial statements show a profit of EUR 4,360.84. The Board proposes that the year's profit be carried over under the company's non-restricted equity and that no dividend be paid.

Kuntarahoitus MUNICIPALITY FINANCE

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BALANCE SHEET DEC 31, 2005

ASSETS		31.12.2005		31.12.2004
Liquid assets				
Cash		1,592.10		1,277.80
Liquid assets		3,251,294.09		3,997,083.11
Debt securities eligble for refinancing from central banks		835,050,650.92		588,846,522.22
Claims on credit institutions				
Repayable on demand	2,294,282.83		478,038.19	
Other	21,197,171.03	23,491,453.86	59,778,439.44	60,256,477.63
Claims on the public and public sector entities		4,593,604,437.23		4,029,574,609.44
Debt securities				
Public entities	250,850,837.21		195,645,149.46	
Other	205,403,186.40	456,254,023.61	389,939,339.30	585,584,488.76
Shares and participations		24,219.06		24,219.06
Derivatives contracts		44,415,407.28		15,035,316.12
Intangible assets		698,484.27		901,890.21
Tangible assets				
Other tangible assets		1,121,907.40		1,264,260.42
Accrued income and prepayments		92,323,642.90		82,070,418.51
TOTAL ASSETS		**6,050,237,112.72**		**5,367,556,563.28**

LIABILITIES		31.12.2005		31.12.2004
LIABILITIES				
Liabilities to credit institutions and central banks				
Credit institutions				
Other		421,512,441.84		452,247,106.73
Liabilities to public and public sector entities				
Other liabilities		440,350,366.82		311,929,783.28
Debt securities issued to the public				
Bonds	4,532,385,528.87		4,016,308,974.61	
Other	383,354,122.32	4,915,739,651.19	273,934,258.28	4,290,243,232.89
Derivatives contracts		55,125,934.82		115,340,711.06
Other liabilities		2,651,879.53		596,287.02
Accrued expenses and dereffed income		106,254,098.39		93,123,407.01
Subordinated liabilities		57,664,296.09		57,664,296.09
APPROPRIATIONS				
Voluntary provisions		34,290,000.00		28,688,000.00
EQUITY CAPITAL				
Share capital				
Share capital		16,522,000.00		16,522,000.00
Other restricted reserves				
Reserve fund		276,711.01		276,711.01
Non-restricted reserves				
Fair value reserve		-1,079,656.00		0.00
Retained profit	925,028.19		921,438.47	
Profit for the financial year	4,360.84	929,389.03	3,589.72	925,028.19
TOTAL LIABILITIES		**6,050,237,112.72**		**5,367,556,563.28**
OFF-BALANCE-SHEET COMMITMENTS				
Irrevocable commitments given in favour of a customer		282,941,981.00		246,197,466.00

PROFIT AND LOSS ACCOUNT DEC 31, 2005

		1.1. - 31.12.2005		1.1. - 31.12.2004
Interest income		142,004,562.84		122,669,072.90
Interest expenses		-127,919,620.65		-110,861,240.39
NET INCOME FROM FINANCIAL OPERATIONS		14,084,942.19		11,807,832.51
Commission expenses		-2,421,764.72		-2,383,824.15
Net income from securities and foreign exchange transactions				
Net income from foreign exchange transactions		3,843.71		207.83
Net income from financial assets held for trading		543,622.94		78,078.12
Other operating income		171,999.93		85,110.69
Administrative expenses				
Staff costs				
Salaries and fees	-2,165,167.98		-1,890,289.24	
Staff related costs				
Pension costs	-379,153.79		-319,421.01	
Other staff-related costs	-179,197.79		-153,543.21	
Other administrative costs	-1,643,509.65	-4,367,029.21	-1,693,947.22	-4,057,200.68
Depreciations and write-downs on tangible and intangible assets		-587,716.74		-535,192.54
Other operating expenses		-1,796,295.48		-1,573,889.30
NET OPERATING PROFIT		5,631,602.62		3,421,122.48
PROFIT BEFORE APPROPRIATIONS AND TAXES		5,631,602.62		3,421,122.48
Appropriations		-5,602,000.00		-3,389,455.10
Income taxes		-25,241.78		-28,077.66
PROFIT FOR THE FINANCIAL YEAR		4,360.84		3,589.72

FUNDS STATEMENT DEC 31,2005

eur	**1.1.-31.12.2005**	**1.1.-31.12.2004**
Cash flow from operations		
Net operating profit	5,631,602.62	3,421,122.48
Depreciation	587,716.74	535,192.54
Change in carried interest, assets	-7,750,116.32	-10,798,932.88
Change in carried interest, liabilities	10,478,811.85	6,709,593.82
Taxes	-25,241.78	-28,077.66
Cash flow from operations	**8,922,773.11**	**-161,101.70**
Cash flow from investments		
Change in claims of public	-564,029,827.79	-342,446,781.81
Change in debt securities	-57,570,976.58	-85,107,276.88
Change in tangible and intangible items	-241,957.78	-549,621.98
Cash flow from investments	**-621,842,762.15**	**-428,103,680.67**
Cash flow from funding		
Change in debt instruments issued	516,076,554.26	489,600,238.46
Change in liabilities to credit institutions	-30,734,664.89	27,627,484.45
Change in liabilites to public and public sector entities	128,420,583.54	124,601,220.90
Change in other liabilities	7,990,881.66	-5,214,459.89
Change in capital loans	0.00	0.00
Rate of exchange changes	-95,530,156.55	35,589,603.23
Cash flow from funding	**526,223,198.02**	**672,204,087.15**
Change in operating capital		
Cash and liquid assets	3,252,886.19	3,998,360.91
Claims on credit institutions	23,491,453.86	60,256,477.63
Other liquid assets	1,048,550,198.77	985,664,747.73
	1,075,294,538.82	**1,049,919,586.27**
Short term liabilities	386,006,001.85	273,934,258.28
Cash funds	**689,288,536.97**	**775,985,327.99**
Net change in cash funds	**-86,696,791.02**	**243,939,304.78**
Cash funds at beginning of financial year	**775,985,327.99**	**532,046,023.21**
Cash funds at end of financial year	**689,288,536.97**	**775,985,327.99**

Kuntarahoitus Oyj, PL 744, 00101 Helsinki, p. (09) 6803 5666, fax (09) 6803 5669, www.kuntarahoitus.fi

NOTES TO THE ACCOUNTS DEC 31, 2005

Notes to the accounts concerning the accounting principles applied

Municipality Finance Plc balances its accounts in compliance with the Act on Credit Institutions, the relevant Ministry of Finance Decree and the standard of Financial Supervision Authority that entered into force on December 1, 2005. The company reports regularly on its operations to the Financial Supervision Authority, the Bank of Finland, the European Central Bank, the Municipal Guarantee Board and Statistics Finland.

The company practice in making entries of commissions resulting from borrowing is as follows: If the amount of a loan on a subscription date is less or more than the amount the company is required to repay on the maturity date, the amount of debt on the subscription date, adjusted by direct commissions resulting from borrowing, is entered in the balance sheet. Differences between the issue price and nominal values are broken down on a time basis over the maturity of the debt.

Differences in the exchange rate valuations of derivatives contracts, the periodized differences between issue price and nominal value and management fees are entered in the balance sheet. The difference between annual interest income received and interest expenses paid on derivatives contracts is entered in the accounts as an adjustment to interest expenses arising from the hedged liability or to interest income from the hedged asset for the financial year in which it occurred.

As of January 1, 2005 the company has classified its debt securities, previously defined as current or non-current, in two categories: those held for trading and those to be kept up to maturity. The securities held for trading are valued at fair value and the value adjustment is entered in the fair value reserve set up under equity. The securities to be kept up to maturity are valued at periodized acquisition cost. The difference between acquisition price and nominal value is periodized under interest income.

Financial assets and liabilities are entered in the balance sheet in accordance with the settlement date practice.

All lending to enterprises, public-sector entities and non-profit organizations requires a guarantee or a deficiency guarantee from a municipality or a municipal federation or a State deficiency guarantee. There is no objective evidence of impairment of the value of loans and other claims, and therefore no write-downs have been made.

Machinery and equipment are depreciated according to plan on a straight-line basis over five years. Capitalized IT equipment and software are depreciated primarily on a straight-line basis over four years. The IT software developed for the management of the lending procedure and CRM is depreciated over a period of seven years. Office renovation costs are entered under ‘Other long-term expenses’ and depreciated straight-line until the lease expires. Real estate is depreciated on a straight-line basis over 25 years.

The company’s accounts have been drawn up in euros. Claims and liabilities in foreign currencies have been converted into euros at the middle rate quoted by the European Central Bank on the balance sheet date. Exchange rate differences arising in the valuation process are included under the item ‘Net income from foreign exchange transactions’.

Notes to the balance sheet	**December 31, 2005**

The company has not combined any items in the balance sheet under chapter 2, section 8(4) of the Ministry of Finance Decree.

1. The balance sheet item “Claims on credit institutions” does not include any claims on central banks or foreign credit intitutions.

Payable on demand	2,294,283
Other than payable on demand	21,197,171
Total	23,491,454

2. The balance sheet item ‘Claims on the public and public sector entities’, broken down into sectors according to the official Statistics Finland classification system:

Enterprises and housing corporations	2,145,046,586
Public-sector entities	2,362,727,968
Non-profit organizations	85,829,883
Total	4,593,604,437

3. Debt securities

	Quoted	Other	Total
Issued by public sector entities	39,112,918	250,850,837	289,963,755
To be held up to maturity	20,362,523	6,088,403	26,450,926
Government bonds	20,362,523	0	20,362,523
Other bonds	0	6,088,403	6,088,403
Held for trading	18,750,395	244,762,434	263,512,829
Municipal commercial papers	0	244,762,434	244,762,434
Government bonds	18,750,395	0	18,750,395
Issued by other than public sector entities	0	1,001,340,919	1,001,340,919
To be held up to maturity	0	14,996,790	14,996,790
Bank bonds	0	8,996,790	8,996,790
Other debt securities	0	6,000,000	6,000,000
Held for trading	0	986,344,129	986,344,129
Banks’ certificates of deposit	0	13,519,644	13,519,644
Commercial papers	0	1,574,806	1,574,806
Bank bonds	0	864,657,679	864,657,679
Other debt securities	0	106,592,000	106,592,000
Total debt securities	39,112,918	1,252,191,756	1,291,304,674
Eligible for central bank refinancing	39,112,918	795,937,733	835,050,651
Total non-interest bearing	0	6,046,830	6,046,830

4. Shares and participations

	Quoted	Other	Of which in credit institutions
Held for trading	0	24,219	0

5. Derivatives contracts

Including periodized differences between issue price and nominal prices and arrangement fees EUR 44,415,407.

6. Intangible assets

IT costs	579,589
Other intangible assets	118,895
Total	698,484

7. Tangible assets

Real estate	
Buildings	247,303
Land	134,550
Real estate corporation shares	299,000
Other tangible assets	441,054
Total	1,121,907

8. Changes in intangible and tangible assets during the financial year

	Intangible assets	Tangible assets		
		Other real estate and real estate corporation shares	Other tangible assets	Total
Acquisition cost 1.1.	1,639,936	715,482	1,275,154	1,990,636
Increase during financial year	151,397	25,052	174,647	199,699
Decrease during Financial year	29,075	0	282,565	282,565
Acquisition cost 31.12.	1,762,258	740,534	1,167,236	1,907,770
Accumulated depreciation 1.1.	738,046	47,248	679,128	726,376
Accumulated depreciation on decreases	29,075	0	173,426	173,426
Depreciation for financial year	354,803	12,433	220,480	232,913
Accumulated depreciation 31.12.	1,063,774	59,681	726,182	785,863
Book value 31.12.	698,484	680,853	441,054	1,121,907

9. Accrued income and prepayments

Interest	89,820,535
Other	2,503,108
Total	92,323,643

10. Deferred tax assets and liabilities

The fair value reserve is negative and no deferred tax assets have been entered. Voluntary provisions include EUR 8,915,400 in non-recorded deferred tax liabilities.

11. Debt securities issued to the public

	Book value	Nominal value
Bonds	4,532,385,529	5,609,842,951
Other	383,354,122	384,400,000
Total	4 ,915,739,651	5,994,242,951

12. Derivatives contracts

Including derivatives contract exchange rate difference valuations worth EUR 55,125,935.

13. Other liabilities

Payment transfer	2,063,629
Other	588,251
Total	2,651,880

14. Accrued expenses and deferred income

Interest	105,883,347
Other	370,751
Total	106,254,098

15. Subordinated liabilities

	Currency	Nominal value	Book value	Interest-tied	Earliest repayment
Debenture loans					
1) Debenture loan 1/98	EUR	17,000,000	17,000,000	Euribor 6 months	18.5.2006
2) Debenture loan 1/99	EUR	16,818,793	16,818,793	Euribor 6 months	
Capital loans					
3) Capital loan 1/00	EUR	12,500,000	12,500,000	Euribor 6 months	12.10.2007
4) Capital loan 1/03	EUR	10,000,000	10,000,000	Euribor 6 months	10.12.2010
5) Capital investments	EUR	1,345,503	1,345,503	Euribor 12 months	
Total		57,664,296	57,664,296		

Debenture loans

Loans 1) and 2) have no maturity dates. In enforcement and dissolution procedures affecting the issuer, the loan principal and unpaid interest are subordinated to commitments affected by no such priority condition. The debentures cannot be converted into shares. The principal of both loans can be repaid only if the Financial Supervision Authority grants permission following an application from Municipality Finance.

Capital loans

Loans 3) and 4) do not have maturity dates. The company has agreed to pay interest only if the sum to be paid is distributable according to the balance sheet approved for the company's previous financial year. The loans involve no cumulative right to interest. The loans can be repaid on condition that the restricted capital and other non-distributable assets in the approved balance sheet for the company's previous financial year provide full coverage and that the Financial Supervision Authority grants permission to repay the loans. Interest accumulated by the end of the financial year is booked as interest expenses in the accounts.

In dissolution procedures and bankruptcy, capital loan principals and their accumulated interest are subordinated to all other debts. The company's capital loans have the same priority status as any capital loans and equivalent commitments potentially issued in the future. The loans have priority over corporate shares.

5) The capital loans (worth EUR 1,345,503.44) cannot be recalled, but the company may repay them with permission from the Financial Supervision Authority on condition that the company's own funds do not fall below the minimum level. Interest can be paid insofar as the credit company's profit distribution allows and distributable funds are adequate, and the Board of Directors of the credit company so decides. Entitlement to pay interest is not carried over to future financial periods if no interest is paid on earlier periods. The Board of Directors has decided that no interest will be paid for 2005.

16. Maturity breakdown of financial assets and liabilities

	0-3 months	3-12 months	1-5 years	5-10 years	over 10 years
Debt securities eligible for refinancing with central banks	41,319,253	152,175,660	601,343,036	31,215,202	8,997,500
Claims on credit institutions	17,491,454	6,000,000			
Claims on the public and public sector entities	57,473,613	309,036,423	1,581,205,056	1,324,210,830	1,321,678,516
Debt securities	204,738,817	71,123,868	169,471,722	10,919,617	
Total	321,023,137	538,335,951	2,352,019,814	1,366,345,649	1,330,676,016
Liabilities to credit institutions	57,126,203	13,011,974	230,526,591	120,847,674	
Liabilities to the public	0	0	142,359,006	10,000,000	287,991,361
Debt instruments issued to the public	708,986,948	830,201,163	2,458,123,317	685,576,927	232,851,296
Subordinated liabilities	0	0	22,500,000	0	35,164,296
Total	766,113,150	843,213,136	2,853,508,914	816,424,601	556,006,953

17. Breakdown of balance sheet items in terms of denomination

	Domestic Currency	Foreign currency	Total
Debt securities eligible for central bank refinancing	835,050,651	0	835,050,651
Claims on credit institutions	23,469,467	21,987	23,491,454
Claims on the public and public sector entities	4,593,604,437	0	4,593,604,437
Debt securities	442,734,379	13,519,644	456,254,024
Derivatives contracts	44,415,408	0	44,415,408
Other assets, incl. "Liquid assets"	97,421,140	0	97,421,140
Total	6,036,695,482	13,541,631	6,050,237,113
Liabilities to credit institutions	329,815,081	91,697,361	421,512,442
Liabilities to the public and public sector entities	296,361,886	143,988,481	440,350,367
Debt securities issued to the public	2,436,679,242	2,479,060,409	4,915,739,651
Derivatives contracts	55,125,935	0	55,125,935
Subordinated liabilities	57,664,296	0	57,664,296
Other liabilities	159,844,422	0	159,844,422
Total	3,335,490,862	2,714,746,251	6,050,237,113

18. Equity capital

	Share capital	Reserve fund	Fair value reserve
Book value at beginning of year 1.1.2005	16,522,000	276,711 0	0
+ increase	0	0	0
- decrease	0	0	1,079,656
Book value 31.12.2005	16,522,000	276,711	- 1,079,656

19. Share capital

The shares of Municipality Finance Plc have not been divided into different types. The nominal value of the shares is one euro and their total number is 16,522,000. Each share carries one vote, but no-one is allowed to exercise more than fifteen (15) per cent of the votes represented at a shareholders' meeting. Acquisition of shares is restricted through the consent and redemption clauses in the Article of Association.

20. Largest shareholders

The ten largest shareholders in terms of voting rights and the number of shares held, their proportions of all Municipality Finance shares and of all votes attached to them, and the total number of shareholders.

	Number	percentage
1 Local Government Pensions Institution	7,021,850	42.50
2 City Of Helsinki	1,925,000	11.65
3 City of Espoo	651,750	3.94
4 City of Turku	440,000	2.66
5 VAV Asunnot Oy, Vantaa	412,500	2.50
6 City of Oulu	385,000	2.33
7 City of Tampere	343,750	2.08
8 City of Joensuu	272,250	1.65
9 City of Kuopio	228,250	1.38
10 The Association of Finnish Local and Regional Authorities	202,125	1.22

The total number of shareholders on December 31, 2005 was 253.

Notes on the profit and loss account

	Jan 1, - Dec 31, 2005

The company has not combined any items in the profit and loss account under section 8 (4) of the Ministry of Finance Decree.

21. Breakdown of interest income

Claims on credit institutions and central banks	1,284,678
Claims on the public and public sector entities	147,038,398
Debt certificates	32,321,123
Derivatives contracts	-42,241,708
Other interest income	3,602,072
Total	142,004,563

Breakdown of interest expenses

Liabilities to the public	11,319,772
Liabilities to credit institutions and central banks	13,233,680
Debt securities issued to the public	190,720,207
Derivatives contracts	-89,288,619
Subordinated liabilities	1,910,923
Other interest expenses	23,658
Total	127,919,621

22. Commission expenses

Commission fees paid	60,138
Other	2,361,627
Total	2,421,765

23. Net income from securities and exchange rate transactions

Net income from exchange rate transactions	3,844

24. Net income from sale of financial assets held for trading

On surrender of financial assets	543,623

25. Other operating income

Profit on the sale of fixed assets	7,174
Income from advisory services	142,160
Other income from actual credit institution operations	22,666
Total	172,000

26. Other operating expenses

Renting expenses	612,421
Other expenses from actual credit institution operations	1,183,874
Total	1,796,295

27. “Depreciation and write-downs on tangible and intangible assets” consists of planned depreciation.

28. Municipality Finance Plc operates as a credit institution. Its market area is Finland. Operations in the new operating area, financial advisory services, are still in their initial stages; division by business area is therefore not yet relevant.

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

29. Collateral given

On own liabilities Balance sheet item	Pledges
Liabilities to credit institutions	371,212,442
Liabilities to the public and public sector entities	440,350,363
Debt securities issued to the public	4,532,385,529
Total given on own liabilities	5,343,948,334

The collateral given is presented in accordance with the figures on December 31, 2005.

	Liabilities and collateral
Debt securities pledged to the Local Government Pensions Institution	40,118,850
Debt securities pledged to the Municipal Guarantee Board	4,550,694,343
Debt securities pledged to the Municipal Guarantee Board	1,044,010,064

30. The company's pension cover is arranged via an outside employment pension insurance company.

31. Leasing and other rental liabilities

Municipality Finance Plc has a total of EUR 242,965 in leasing payments payable in the following financial year.

32. Off-balance-sheet commitments

Binding credit commitments	282,941,981

The total values of the underlying instruments pertaining to derivatives contracts outstanding on the balance sheet date

	Values of underlying instruments For hedging purposes
Interest rate derivatives	
Interest rate swaps	6,877,907,173
Currency derivatives	
Interest rate and currency swaps	3,120,314,865
Equity derivatives	
Equity-linked contracts	57,480,000
Other derivatives	
Contracts linked to other assets	4,500,000

Total
10,060,202,038

Breakdown of derivatives contracts by counterparty credit rating

	Nominal value	Credit countervalue
AAA	2,282,828,517	16,865,150
AA	6,623,305,575	125,557,445
A	1,050,972,114	13,453,671
Finnish municipalities	103,095,832	2,928,980
Total	10,060,202,038	158,805,246

Notes on personnel and management

33. Municipality Finance Plc staff

	Average	End of financial year
Permanent full-time	29	30
Permanent part-time	1	2
Total	30	32

Salaries and remuneration paid to the management in 2005

Managing director	222,095
Managing director's substitute	134,451

The members of the Board receive an annual remuneration and remuneration for each meeting. The annual remuneration paid to the Chairman of the Board is EUR 12,500, and the remuneration paid to the other mebers of the Board is EUR 7,000. The remuneration for each meeting is EUR 250.

Auditing and other fees paid to auditing corporations

Oy KPMG Ab	54,403
Deloitte Oy	69,823

Other notes to the accounts

34. Asset management services offered by Municipality Finance Plc

Municipality Finance Plc provides its Municipal Bond customers with free safe custody, which includes the safekeeping of securities issued in paper form and payment of interest and principal directly into customers' accounts.

KEY FIGURES

Municipality Finance Plc	2005	2004	2003
Turnover, EURm	142.7	122.8	128.7
Net operating profit, EURm	5.6	3.4	4.0
% of turnover	3.9	2.8	3.1
Profit before appropriations and taxes, EURm	5.6	3.4	4.0
% of turnover	3.9	2.8	3,1
Return on equity (ROE), %	8.8	5.5	7.3
Return of assets (ROA), %	0.1	0.1	0.1
Equity ratio, %	1.1	1.2	1.3
Yield-expense ratio	1.6	1.4	1.5
Capital adequacy ratio, %	30.0	38.1	52.0
Head count, Dec 31	32	30	29

These key indicators are not directly comparable with those related to other credit institutions. The operating principle and objective of the company's operations is not to maximize profit but to lower municipalities' financial costs by providing a joint municipal funding system.

Total turnover comprises net income from interest, commissions, securities and foreign exchange transactions, financial assets held for trading and other operating income. Net operating profit and profit before appropriations and taxes are entered as in the profit and loss account.

Return on equity ratio (ROE) =

Net operating profit – taxes
--- x 100
Equity + voluntary provisions - deferred tax liabilities (average of year beginning and year end)

Return on assets ratio (ROA) =

Net operating profit - taxes
-- x 100
Balance sheet total (average of year beginning and year end)

Equity ratio =

Equity + voluntary provisions – deferred tax liabilities
-- x 100
Balance sheet total

Yield-expense ratio =

Net financial income + dividends received + commission income + net income from securities and foreign exchange transactions + other operating income + net income from sale of financial assets held for trading
----
Commission expenses + administrative expenses + depreciation + other operating expenses

Capital adequacy ratio =

Own funds

Risk-weighted assets and off-balance-sheet items

FINANCIAL RESULT FOR THE YEAR AND DISTRIBUTION OF PROFIT

The company's financial statements show a profit of EUR 4,360.84. The Board proposes that the year's profit be carried over under the company's non-restricted equity and that no dividend be paid.

Helsinki, February 14, 2006

MUNICIPALITY FINANCE PLC

Asko Koskinen
Chairman of the Board

Timo Viherkenttä
Vice Chairman of the Board

Juhani Alanen
Member

Esa Katajamäki
Member

Tapio Korhonen
Member

Jouko Lehmusto
Member

Eva Liljeblom
Member

Kari Nars
Member

Raija Peltonen
Member

Pekka Averio
Managing Director

AUDITORS' REPORT

To the shareholders of Municipality Finance Plc

We have audited the accounting, the financial statements and the administration of Municipality Finance Plc for the period January 1 – December 31, 2005. The financial statements prepared by the Board of Directors and the Managing Director comprise the report of the Board of Directors, the profit and loss statement, the balance sheet and notes to the financial statements. Based on our audit, we express our opinion on these financial statements and the administration.

We have conducted our audit in accordance with generally accepted auditing standards in Finland. Those standards require that we perform the audit to obtain reasonable assurance about whether the financial statements are free from 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 statements presentation. The purpose of our audit of the administration is to examine that the members of the Board of Directors, the Managing Director and the Deputy Managing Director have legally complied with the provisions of the Finnish Companies' Act and the Finnish Act on Credit Institutions.

In our opinion, the financial statements have been prepared in accordance with the Finnish Accounting Act and other rules and regulations regarding the preparation of financial statements. The financial statements give a true and fair view, as defined in the Accounting Act, of the company's performance and 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 Board of Directors' proposal regarding the result complies with the Companies Act.

Helsinki, February 14, 2006

KPMG OY AB

Riitta Pyykkö
Authorized Public Accountant