

MUNICIPAL GUARANTEE BOARD

ANNUAL REPORT 2006



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Managing Director's Review



The past year, 2006, marked ten years of activity for the Municipal Guarantee Board (MGB). During the past decade the MGB has consolidated its operations as a guarantor for the municipalities' joint funding system, increasing its guarantee activities to EUR 6.63 billion. Smooth guarantee operations have made it possible to increase the MGB's fund to about EUR 8.4 million at the same time.

The need for reform and change that has developed during the past ten years has given cause to update and reform the Act on the Municipal Guarantee Board. The reform was completed when Parliament approved a revised act unanimously in autumn 2006.

Another major event of significance in the past year was an addition to the MGB's credit rating, when Standard & Poor's classified the MGB's credit rating as the best possible to go alongside a similar one given earlier by Moody's.

As in previous years, the joint funding system for the municipalities continued its profitable growth at the same time as the costs for funding local government and social housing production remained economical. The prospects for the system are still good. The reformed legislation, strong credit ratings and increased capital and reserves will create the conditions for enlarging the system's market share, which is still much smaller than that of other Nordic municipal financing institutions in their own countries.

The development of the system in the past year was characterized by close cooperation among the various players such as the Ministry of the Interior, credit raters, municipality representatives and the media. I would like to express my gratitude to all those with whom we have cooperated and I look forward to further shared success in the years to come.

Heikki Niemeläinen
Managing Director



REPORT ON OPERATIONS 2006

During 2006 Parliament passed new legislation on the Municipal Guarantee Board (MGB), which celebrated its tenth anniversary. The amended Act increases the basic security of the municipalities' joint funding system and brings up to date the MGB's qualifications for managing its basic duties in safeguarding the competitive funding for the municipalities. Another major factor in the development of the funding was the highest possible credit rating, AAA, obtained by MGB from the credit rating institution Standard & Poor's. The MGB previously had an equivalent rating of Aaa from Moody's.

At its autumn meeting the MGB's Council approved a strategy for implementing the new legislation concerning the MGB. According to it, the duties in the municipalities' joint funding system include creating a financial benefit based on activities for which the municipalities are jointly responsible, attaching the benefit to the funding and financing products, and passing it on to borrowers in line the requirements of the Act on the Municipal Guarantee Board. With the new strategy the municipalities' joint funding system will play a stronger role in financing the municipalities and social housing production.

During the year under review, the membership of the MGB comprised 403 municipalities, representing around 98.7 per cent of the entire Finnish population. Membership decreased by one from 2005 because of a merger. The municipalities of the Åland Islands are not member organizations of the Guarantee Board.

The year under review was the best for the municipalities' joint funding system so far. The system's market share increased towards the end of the year, as did the financial result. At the same time the margins of the municipalities' borrowing remained at a historically low level. Successful operations are based on motivated personnel and advanced business methods. The system's funding was weighted towards structured arrangements, as in previous years.

Municipal Guarantee Board Legislation

The Act on the Municipal Guarantee Board (487/1996) was passed by Parliament on 18 June 1996 and entered into force on 1 July 1996. The Act states that the purpose of the Guarantee Board is to safeguard and develop the joint funding of Finnish municipalities. In order to fulfil this purpose, the Guarantee Board can grant guarantees for such funding by credit institutions directly or indirectly owned or controlled by municipalities which will be used for lending to municipalities and municipal federations, and to corporations which are wholly owned by municipalities or under their control. In 2006, the only credit institution to meet the criteria set out in the Act was Municipality Finance Plc.

An amendment to the Act, passed by the Finnish Parliament on 25 April 1997, entered into force on 1 May 1997. As a result of the amendment, MGB was able to grant guarantees for such funding of a credit institution as will be used for lending to corporations designated by government authorities and engaged in renting or producing and maintaining housing on social grounds or corporations controlled by them.

Parliament made considerable changes to the Act on the Municipal Guarantee Board a second time when the Act on amending the Act on the Municipal Guarantee Board was passed by Parliament on 18 October 2006. The amendment specifies the range of receivables for which a guarantee granted by the Guarantee Board can be used as security and opens up an opportunity for municipalities that have remained outside the MGB to apply to become a member. With the amendment the regulations controlling the operations of the MGB and confirmed by the Ministry of the Interior will be abandoned. At the same time some of the provisions included in the present regulations were transferred to the Act on the Municipal Guarantee Board as belonging to the legislative field, for instance regulations that apply to the qualifications for granting a guarantee and the relationship of a guarantee with the European Community's provisions on government support, the investment and use of funds transferred to the MGB's fund and the powers of the Guarantee Board Auditor.

Since the amendment to the Act, the MGB's fund can be used temporarily for arrangements that will prevent the MGB from being immediately threatened by the creation of an obligation. Municipalities that are not at this moment members of the Guarantee Board can now also become member organizations. The auditing corporation to be chosen to audit the MGB's administration and accounts and the Guarantee Board Auditor responsible for the supervision of the MGB can be chosen for longer than a year, but not more than four years. The amendment to the Act also specifies the right of municipalities that are member organizations of the MGB to apply for a change to the contributions collected from municipalities in order to cover guarantee liability.

Administration and Personnel

Under the Act, the Municipal Guarantee Board has a Council of 15 members, each of whom has a personal deputy. On 30 August 2005, the Ministry of the Interior appointed a Council for a term of office lasting from 1 October 2005 to 30 September 2009. From among its members, the Council elected **Mr Jari Blom**, Executive Director (Jyväskylä), as Chairperson and **Mr Mika Munkki**, Agrologist (Vehmaa) and **Ms Raija Rönkä-Nieminen**, Administration Manager (Lohja), as Deputy Chairpersons. The Council convened twice during the year under review.

Under the Act the MGB has a Board of Directors of 5-7 members who are responsible for MGB's administration, the granting of guarantees, and the preparation and execution of the decisions of the Council. The members of the Board of Directors in 2006 were as follows:

Mr Pekka Alanen, Director, Helsinki
Ms Maija-Liisa Havia, Director of Administration, Jyväskylä
Ms Sari Innonen, Lecturer, Kokkola
Ms Pirkko Janhunen, Finance Manager, Varkaus
Mr Janne Laine, City Manager, Savonlinna
Mr Markku Pietarila, Director of Town Structure, Kemi
Mr Markku Rahikkala, City Manager, Nokia

Mr Pekka Alanen served as Chairperson of the MGB Board of Directors, and **Ms Pirkko Jantunen** served as Deputy Chairperson. The Board convened eight times during the year under review.

Mr Heikki Niemeläinen was the Guarantee Board's Managing Director and **Mr Tuukka Salminen**, the Office Manager, was also the Managing Director's deputy. The number of employees during the year was two.

Auditing and Supervision

The Council appoints an auditing corporation authorized by the Central Chamber of Commerce or by the Board of Chartered Public Finance Auditors for a term of office of one calendar year at a time to audit the financial accounts and administration of the MGB. In 2006, the authorized auditing corporation was KPMG Oy Ab, who were also re-appointed by the MGB's Council for 2007.

The activities of the MGB are supervised by the Guarantee Board Auditor, who is appointed by the Ministry of the Interior on the proposal of the Board of Directors of the Guarantee Board. In 2006, the Guarantee Board Auditor was Deloitte Oy, whom the Ministry of the Interior also re-appointed for 2007.

Risk Management

Risks in guarantee operations

According to the Act on the Municipal Guarantee Board, the MGB may grant guarantees against adequate security. The amount of security during the past year was adequate. In the main, guarantee activities are arranged so that the MGB's Board of Directors grants guarantees for funding programmes, the most important of which is the EMTN programme. Within the programme the MGB's Managing Director decides on guarantees for individual issues. Of the guarantees granted by the MGB EUR 606.5 million were for use by the now-defunct Municipality Finance Plc, EUR 724.9 million by Municipal Housing Finance Plc and EUR 5,298.6 million by the current Municipality Finance Plc.

Funding carried out in 2006 with a guarantee from the MGB was divided according to the following currency denominations: Japanese yen 40%, euros 20%, Swiss franc 15%, US dollar 10% and other currencies 15%. Security items were denominated in euros.

Risks in investment operations

The MGB's investment operations are controlled by a policy approved by its Board of Directors under which the MGB allocates 70% of its investments to normal debt instruments issued by government and banks and 30% to capital-secured debt instruments issued by banks, corporates and shares in condominiums. The minimum requirement in respect of credit-rated investments is that they are classified as investment grade (S&P BBB/Moody's Baa3).

Operational risks

MGB's operational risks are dealt with in the Regulations and in the Guarantee and Operations Policy approved by the Board of Directors in which the authority and rights of different MGB organs are defined. Operational risks have also been managed by outsourcing operations and creating deputy-person systems.

Finances

Income from regular operations consisted of guarantees granted, which produced in 2006 a total guarantee premium sum of EUR 1,750,000.00. Operating costs came to a total of EUR 738,675.45, comprising personnel costs of EUR 276,388.95, depreciation of EUR 10,927.70 and other costs of EUR 451,358.80. The result from regular operations in the financial year was EUR 1,011,324.55.

No claims on guarantees were paid in 2006 nor were there any recoveries, and the nature of MGB's activities makes it unlikely that any claims on guarantees will need to be paid, nor recoveries made in the foreseeable future.

Income from investments came to EUR 324,290.00 and costs to EUR 6,155.29. The result from investment activities was EUR 318,134.71, approximately 4.5% on the invested capital. MGB values its investments at fair value in the balance sheet. The change in the fund at fair value was EUR -48,467.04. The result from investments and adjustments to the value of the fund at fair value together were some 3.8% on the invested capital. The result for the financial year, i.e. the total from regular operations and investment totalled EUR 1,329,459.26 before transfer to the fund.

It is proposed that the result for the financial year be transferred in total to the fund, which thus amounts to EUR 8,355,090.71 on 31 December 2006.

The MGB has an ongoing agreement for safeguarding the Guarantee Board's cash position up to EUR 50 million.

Outlook

The municipalities' joint funding system made considerable advances in 2006. Legislation concerning the MGB was reformed, and the Council approved a new strategy. The MGB was given the best possible credit rating also by the credit institution Standard & Poor's, and Municipality Finance Plc made a successful share issue. During 2007 MGB will be reforming internal regulations and carrying out changes to the guarantee operations, as enabled by the legislative amendment. With the new development factors an even bigger role in the financing of municipalities and social housing production can be expected for the municipalities' joint funding system.

During the year Municipality Finance Plc arranged a targeted share issue, as a result of which the ownership structure came closer to the membership of the MGB. Some of the new owners are not members of the MGB, so one must expect these municipalities to make good use of the new legislation concerning the MGB and become members, at which point MGB will cover 100 per cent of the municipalities on mainland Finland.



Income Statement

	1.1.-31.12.2006	1.1.-31.12.2005
Ordinary operations		
Income		
Guarantee premiums	1 750 000,00	1 750 000,00
Expenses		
Staff expenses	-276 388,95	-227 795,40
Depreciation	-10 927,70	-14 041,18
Other expenses	-451 358,80	-383 345,72
Result from ordinary operations	1 011 324,55	1 124 817,70
Investment activities		
Income		
	324 290,00	319 737,08
Expenses		
	-6 155,29	-1 872,37
Result from investment activities	318 134,71	317 864,71
Result before transfer to fund	1 329 459,26	1 442 682,41
Transfer to fund	-1 329 459,26	-1 442 682,41
Result for the financial year	0,00	0,00

Balance Sheet

Assets

	31.12.2006	31.12.2005
Non-current assets		
Intangible assets	0,00	856,44
Tangible assets	27 870,86	64 362,10
Other shares and similar rights of ownership	523 956,65	21 713,55
Investments		
Other investments		
Shares and similar rights of ownership	662 757,00	119 380,00
Certificates of deposit	2 027 766,87	1 928 406,45
Debt securities	3 456 618,64	3 259 887,20
Other investments	1 159 818,06	1 183 252,00
Current assets		
Debtors		
Guarantee receivables	437 500,00	437 500,00
Receivables	73 901,17	33 230,05
Cash and bank accounts	87 360,70	102 271,26
Total assets	8 457 549,95	7 150 859,05

Equity and liabilities

Capital and reserves		
Fund	8 355 090,71	7 025 631,45
Fair value reserve	46 757,12	95 224,16
Creditors		
Current liabilities		
Trade creditors	10 987,05	2 850,94
Accruals and deferred income	26 741,86	18 398,87
Other current liabilities	17 973,21	8 753,63
Total equity and liabilities	8 457 549,95	7 150 859,05

Cash Flow Statement

	1.1.-31.12.2006	1.1.-31.12.2005
Cash flow from ordinary operations		
-operating income	1 750 000,00	1 777 669,00
-operating costs	699 113,03	636 662,17
Cash flow from ordinary operations	1 050 886,97	1 141 006,83
Cash flow from non-current assets	475 823,12	25 515,30
Cash flow from investments	589 974,41	1 104 141,64
Change in cash funds	-14 910,56	11 349,89
Cash funds at the beginning of financial period	102 271,26	90 921,37
Cash funds at the end of financial period	87 360,70	102 271,26

Notes to the Financial Statements

The Municipal Guarantee Board observes, where applicable, the Accounting Act and Decree in force.

Investments are valued in the balance sheet at fair value, so the unrealized differences between their book value and fair value have been recognized in the fair value reserve under capital and reserves.

Non-current assets have been valued at acquisition cost, on which planned depreciation is calculated.

Depreciation method:

- IT hardware and software, annual carrying value, 30%
- machinery and equipment, annual carrying value, 25%

Non-current assets

	2006	2005
Carrying value 1.1.	86 932,09	75 457,98
Increase	502 243,10	45 744,37
Decrease	-26 419,98	-20 229,09
Depreciation	-10 927,70	-14 041,17
Carrying value 1.1.	551 827,51	86 932,09

Intangible assets

IT software	0,00	856,45
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Tangible assets

IT hardware	6 052,81	8 646,89
Machinery and equipment	4 006,95	37 904,11
Other assets	17 811,10	17 811,10

Other shares and similar rights of ownership

Nurmijärvi Golf Club 1 share	21 713,55	21 713,55
As. Oy Topeliuksenkatu 15	502 243,10	0,00

Changes to capital and reserves

Fund 31.12.2005	7 025 631,45
Fund transfer 31.12.2006	1 329 459,26
Fund 31.12.2006	8 355 090,71

Fair value reserve 31.12.2005	95 224,16
Change in financial year	-48 467,04
Fair value reserve 31.12.2006	46 757,12

Guarantees and collateral

	31.12.2006	31.12.2005
Guarantee limits granted	13 088 864 315,60	12 790 000 000,00
Guarantees in use	6 629 971 187,49	5 698 755 457,68
Collateral received and items affecting collateral situation	7 000 257 457,11	6 008 181 970,88
Balance of collateral and guarantees	370 286 269,62	309 426 513,20

Signs

SIGNATURES OF THE ANNUAL REPORT OF ACTIVITIES AND THE FINANCIAL STATEMENTS

Helsinki, 1 February 2007

MUNICIPAL GUARANTEE BOARD

Mr Pekka Alanen
Chairman of the Board

Ms Pirkko Janhunen
Deputy Chairman of the Board

Ms Majja-Liisa Havia
Member of the Board

Ms Sari Innanen
Member of the Board

Mr Janne Laine
Member of the Board

Mr Markku Pietarila
Member of the Board

Mr Markku Rahikkala
Member of the Board

Mr Heikki Niemeläinen
Managing Director

Guarantees

Million euro

Municipality Finance Plc

	Guarantees	Funding	
			31.12.2006
Municipality Finance Plc (-30.4.2001)			
Domestic Debt Issuance Programme	800,0		5,9
EMTN	2 000,0		478,1
Other Guarantees	750,0		122,5
Total	3 550,0		606,5
Municipal Housing Finance Plc (-30.4.2001)			
EMTN	1 500,0		708,8
Other guarantees	400,0		16,1
Total	1 900,0		724,9
Total	5 450,0		1 331,4
Municipality Finance Plc (1.5.2001-)			
EMTN	5 000,0		3 697,8
Treasury Bill Programme	500,0		464,5
Domestic Debt Issuance Programme	500,0		387,8
AUD 500 Programme	0,0		0,0
Other foreign funding	298,9		551,5
Separate Decisions	1 200,0		197,0
Back up facility	140,0		0,0
Total	7 638,9		5 298,6
Total	13 088,9		6 630,0

Auditors' Report

To the Council of the Municipal Guarantee Board

We have audited the accounting records, the report of the Board of Directors, the financial statements and the administration of the Municipal Guarantee Board for the year 2006. The Board of Directors and the Managing Director have prepared the Report of the Board of Directors and the financial statements, which include the balance sheet, income statement, cash flow statement and notes to the financial statements. Based on our audit we express an opinion on these financial statements, as well as on the report of the Board of Directors and on administration.

We have conducted the audit in accordance with Finnish Standards on Auditing. Those standards require that we perform the audit to obtain reasonable assurance about whether the report of the Board of Directors and 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 administration is to examine that the members of the Board of Directors and the Managing Director have complied with the rules of the Act on the Municipal Guarantee Board.

In our opinion, the report of the Board of Directors and the financial statements have been prepared in accordance with the Accounting Act to the appropriate extent. The report of the Board of Directors and the financial statements give a true and fair view, as defined in the Accounting Act, of the institution's result of operations as well as of the financial position. The report of the Board of Directors is consistent with the financial statements. The financial statements can be adopted and the members of the Board of Directors and the Managing Director can be discharged from liability for the year audited by us.

Helsinki, 1 February 2007

KPMG OY AB

Riitta Pyykkö
Authorized Public Accountant

Board of Directors



Chairperson

Mr. Pekka Alanen
Director
Helsinki

Deputy chairperson

Ms. Pirkko Janhunen
Finance Manager
Varkaus

Other members

Mr. Markku Pietarila
Director of Town Structure
Kemi

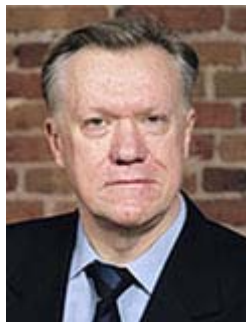
Ms. Maija-Liisa Havia
Director of Administration
Jyväskylä

Ms. Sari Innanen
Lecturer
Kokkola

Mr. Janne Laine
Mayor
Ikaalinen

Mr. Markku Rahikkala
Mayor
Nokia

Council



Jari Blom
Chairperson
Jyväskylä



Mika Munkki
Deputy Chairperson
Vehmaa



Raija Rönkä-Nieminen
Deputy Chairperson
Lohja

Personal Deputy Member:
Liisa Ruokoselkä
Pieksänmaa

Personal Deputy Member:
Leena Koponen
Muurame

Personal Deputy Member:
Pekka Heikkinen
Tuusula

Other members:

Pirkko Miikkulainen,
Helsinki

Markku Pohjonen,
Kokkola

Päivi Yli-Kauhaluoma-Nurmi,
Pori

Hilkka Hiltunen,
Ilomantsi

Asko Meski,
Orimattila

Mirja Okkonen,
Sotkamo

Aimo Ahti,
Kouvola

Kimmo Behm,
Nurmijärvi

Sari Hyytiäinen,
Hollola

Marjo Matikainen-Kallström,
Espoo

Leena Kuha,
Oulu

Torsten Widén,
Kauniainen

Personal deputy members:

Raimo Korjus,
Kotka

Annina Lehtiö-Vainio,
Turku

Markku Harju,
Kemijärvi

Kari Heikkilä,
Miehikkälä

Jouko Luukkonen,
Haapavesi

Sinikka Kangas,
Salla

Olli Viitasaari,
Lempäälä

Jukka Vilén,
Kemi

Päivi Norhio,
Kotka

Armi Salo-Oksa,
Mikkeli

Flemming Bergh,
Kirkkonummi

Gun Kapténs,
Luoto

Information about the Annual Report

Funding guaranteed by the Municipal Guarantee Board is channelled in the form of loans for upgrading the operations and infrastructure of municipalities and for housing production on social grounds.

An example is the Wee-Gee House, which these days is owned by the City of Espoo. Formerly a printing plant, it has been converted into a centre for museums, exhibitions, art and other events.

Municipal Guarantee Board

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