

MUNICIPAL GUARANTEE BOARD

ANNUAL REPORT 2010

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Managing Director's Review

For the Finnish municipalities' joint funding system, the year 2010 was again a period of strong growth. The growth, which started with the 2008 financial crisis, is a result of a number of factors: the withdrawal of competing credit institutions from the financing of municipal and social housing production, the excellent credit rating of the municipalities' joint funding system and the ability of the system to raise funds at low funding cost on international markets.

The growth in the operations of the municipalities' joint funding system has been on a profitable basis. An indication of the profitability is the fact that Municipality Finance Plc was able to increase its profits from approximately EUR 34 million in 2009 to almost EUR 59 million in 2010. The relationship between growth and profitability will also be examined in the coming years. This is because tighter regulations of credit institutions' operations and capital adequacy will require more own funds from the institutions themselves.

During the year under review, the Municipal Guarantee Board paid particular attention to counterparty risks in money and capital markets in its guarantee operations. It tied the growth in its fund to counterparty risks. This procedure forms a basis for monitoring that will also in the future allow funding to be sought using low-risk counterparties and businesses.

The year 2009 was characterised by differences in credit ratings between public sector operators, such as governments and municipalities, across the euro area. This was a new phenomenon and a result of the exceptional measures that a number of euro area countries had to take on account of the high debts they had accumulated and the decrease in the valuation of their bonds. Credit rating agencies also introduced more detailed guidelines for the credit ratings of central and local government operators. As a result of these developments, the need arose for the Municipal Guarantee Board to produce information material about the finances of Finland's municipalities. The purpose of the material is to provide an overview of their financial basis and the nature of their operations and, consequently, to underline their independent status among other European central and local government operators.

The trust in the municipalities' joint funding system as a provider of funds for public sector operations in Finland increased during the year under review. A recognised position and smoothly working contacts with stakeholders in Finnish society allow us to successfully face the challenges that we are facing in money and capital markets and as credit institutions have to adjust their operations in accordance with changing capital adequacy requirements.

Heikki Niemeläinen
Managing Director

ANNUAL REPORT 2010

Like the year preceding it, the year 2010 was a time of growth for the joint municipal funding system. The general task of the Municipal Guarantee Board (MGB) is to safeguard and develop the joint funding of the municipalities. Municipality Finance Plc accounted for about 80% of the new loans for financing municipal and social housing production in Finland.

The fact that the MGB and Municipality Finance Plc have the highest possible credit ratings and the financial status of Finnish municipalities has remained good by international standards, provided a sound basis for fundraising by Municipality Finance Plc in the year under review. They enabled the company to attract capital to Finland, which could then be used to finance municipalities, municipal federations and social housing production. The rapid increase in Municipality Finance Plc's new lending, the acquisition of new loans for existing municipal and social housing production and measures taken to safeguard Municipality Finance Plc's liquidity led to an increase of about EUR 2.279 billion in funding guaranteed by the MGB in 2010.

During the year under review, the MGB deemed it necessary to clarify the basis for its funding so that it would be in accordance with the manner in which it provides guarantees. The guarantees for the benefit of Municipality Finance Plc, covering the counterparty risks of its hedging activities were under special scrutiny. According to the estimates of the MGB, the risk-based funding requirement resulting from these guarantees amounts to about EUR 20 million and the Municipal Guarantee Board aims to collect this sum during the next two operating and financial planning periods.

The Council of the Municipal Guarantee Board changed the MGB's strategy so that it would be in accordance with the new funding principles. In the same connection, the Council stated that the fund's growth should primarily be based on risk-based funding needs of hedging-related counterparty guarantees and interest and administrative expenses of short-term capitalisation.

In the future, the system for assessing counterparty risks drawn up by the MGB can be used for monitoring counterparty risks of Municipality Finance Plc. In its 2010 credit rating report, the credit rating agency Standard & Poor's stated that the system for monitoring counterparty risks is a major factor allowing the MGB to enjoy the highest possible credit rating.

It became clear during 2010, that the international regulations on credit institutions will be changed in a manner that will have a substantial impact on the operations of the joint municipal funding system and the system's ability to manage its basic task. Prompted by this, the MGB, together with Municipality Finance Plc, notified competent authorities of the matter and started the necessary cooperation with the authorities.

At the end of the year under review, after the municipalities of Oripää and Kuhmoinen had joined the MGB, the membership stood at 325. The total number of residents in the member municipalities constitutes about 99.95 per cent of Finland's population, excluding the municipalities of the Åland Islands. For constitutional reasons, the municipalities of the Åland Islands are not members of the MGB. The number of non-member municipalities thus fell to one.

During the year under review, the MGB deemed it necessary to publish a book on the development of the finances of Finnish municipalities. The book is intended for actors

on international financial and capital markets dealing with matters important to the MGB. The publication "Suomen kuntatalouden kehitys: miten tähän on tultu" (The history of Finland's municipal finances) came out in July 2010.

The success of the joint municipal funding system and its ability to react swiftly to changes in the operating environment are based on its motivated personnel, advanced business methods and stable, long-term partnerships, both in Finland and abroad. In the coming year the system has excellent prospects for carrying out the task set for it by the Act on the Municipal Guarantee Board, i.e. the safeguarding and development of municipal funding.

Legislation on the Municipal Guarantee Board

The Act on the Municipal Guarantee Board (487/1996) was passed by the Finnish Parliament on 18 June 1996 and entered into force on 1 July 1996. The Act states that the purpose of the Municipal 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 that is used for lending to municipalities and municipal federations, and to corporations wholly owned by municipalities or under their control. In 2010, one credit institution, Municipality Finance Plc, met the criteria set out in the Act.

The first 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, the MGB has also been able to grant guarantees for such funding of a credit institution that is 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.

The Parliament made further considerable changes to the Act on the Municipal Guarantee Board with another amendment to the Act passed on 18 October 2006, which entered into force on 1 January 2007. The amendment specified the range of receivables for which a guarantee granted by the MGB can be used as security. With the amendment, the Regulations controlling the operations of the MGB and approved by the Ministry of Finance were abandoned and some of the legal provisions included in the Regulations were transferred to the Act on the Municipal Guarantee Board. These include the requirements for granting of guarantees in accordance with European Community State Aid rules and their relationship with the rules, the investment and use of the MGB's fund, and the powers of the Guarantee Board Auditor.

Since the adoption of the amendment, it has also been possible to use the MGB's fund for interim arrangements in order to prevent a directly imminent payment obligation. Municipalities that are not members may also join the MGB. The auditing corporation appointed for the auditing of the MGB's administration and accounts and the Guarantee Board Auditor responsible for its supervision can be appointed for a term of between one and four years. The amendment to the Act also defines in more detail the right of a municipality that is a member organisation of the MGB to appeal for amendment of the contribution to be paid by the municipality for covering the 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. The Ministry of Finance has appointed a Council for the MGB for a term of office lasting from 1 October 2009 to 30 September 2013. Mr [Mika Munkki](#), Agrologist (Vehmaa) acts as Chairperson, and Mr [Reijo Vuorento](#), Planning Manager (Helsinki) and Mr [Matti Kankare](#), Project Director (Espoo) as Deputy Chairpersons. The Council convened twice during the year under review.

Under the Act on the Municipal Guarantee Board, the MGB has a Board of Directors of 5-7 members, which is responsible for the MGB's administration, the granting of guarantees and the preparation and execution of the decisions of the Council.

The Council chose the following persons as members of the Board of Directors starting its term of office on 1 January 2010:

Mr [Jari Blom](#), Executive Director, Jyväskylä
Ms [Maija-Liisa Havia](#), Permanent Undersecretary, Jyväskylä
Ms [Sari Innanen](#), Lecturer, Kokkola
Ms [Jaana Karrimaa](#), City Manager, Harjavalta
Ms [Leena Kuha](#), Secretary, Oulu
Mr [Janne Laine](#), City Manager, Savonlinna
Mr [Juha Yli-Rajala](#), Director, Tampere

The Board chose [Jari Blom](#) as its Chairperson and [Sari Innanen](#) as Deputy Chairperson.

Mr [Heikki Niemeläinen](#) was the Guarantee Board's Managing Director and Mr [Tuukka Salminen](#), Executive Director acted as deputy for the Managing Director. The number of employees during the year was two.

Auditing and Supervision

The Council appoints an auditing corporation authorised by the Central Chamber of Commerce or by the Board of Chartered Public Finance Auditors for a maximum period corresponding to its term of office, to audit the financial accounts and administration of the MGB. In 2010, the authorised auditing corporation was KPMG Oy Ab, which was, after competitive tendering, reappointed by the MGB's Council for the period 2011-2013.

The activities of the MGB are supervised by the Guarantee Board Auditor, who is appointed by the Ministry of Finance on the proposal of the Board of Directors of the Guarantee Board. In 2010, the Guarantee Board auditors were Deloitte & Touche Oy, whom the Ministry of Finance also reappointed for 2011.

Risk Management

Risks in guarantee operations

Under the Act on the Municipal Guarantee Board, the MGB may grant guarantees against sufficient security. The amount of security during the year under review was sufficient. Guarantee activities are mostly arranged in such a way that the MGB's Board of Directors grants guarantees for funding programmes, the most important of which is the MTN programme. Within the programmes, the MGB's Managing Director decides on guarantees for individual debt issues. Of the guarantees granted by the MGB to Municipality Finance Plc, EUR 15,478,450,730.81 was in use at the end of 2010.

Under the Act on the Municipal Guarantee Board, guarantees granted as security for Municipality Finance Plc's receivables may at the time of granting the guarantee amount to a maximum of four per cent of the total amount of the MGB's guarantee liabilities. On 31 December 2010, these guarantee liabilities totalled EUR 130,166,329, or 0.832 per cent of all guarantee liabilities. Guarantee liabilities of the Municipal Guarantee Board totalled EUR 15,608,617,059.

As a result of fundraising in 2010, funding guaranteed by the MGB on 31 December 2010 was divided among the following currencies: US dollar 22.2%, euro 6.9%, Japanese yen 46.8%, Swiss franc 6.8%, Swedish krona 5.3% and other currencies 12%. Security items were denominated in euros. The currency position thus formed is closed by the MGB's hedging operations.

Risks in investment operations

The MGB has an investment policy approved by its Board of Directors. Under this policy, the MGB allocates 50% of its investments to conventional debt instruments issued by governments and banks (credit rating requirement S&P BBB / Moody's Baa3) and 50% to capital protected debt instruments issued by banks and debt instruments issued by corporations, shares of companies listed on the Helsinki stock exchange, equity investment funds and housing and real estate companies. The range is +/- 10 percentage points. Any greater deviation must be specifically justified.

Operative risks

The MGB's operative risks are dealt with in the Standing Orders and in the Guarantee and Operations Policy approved by the Board of Directors, which stipulates the authority and rights within the MGB. Operative risks have been mitigated by outsourcing activities and by nominating deputies.

Finances

Income from regular operations consisted of guarantees granted, which produced a total guarantee premium sum of EUR 1,500,000.00. Operating costs totalled EUR 1,202,677.93, comprising personnel costs of EUR 446,401.72, depreciation amounting to EUR 21,042.21 and other costs of EUR 735,234.00. A prime factor in the increase in other costs were the credit-rating costs which, as a result of a substantial increase in the balance sheet of Municipality Finance Plc, were higher than those budgeted. The result from ordinary activities was EUR 297,322.07.

In 2010 no claims on guarantees were made or paid, nor were there any recovery claims. The nature of the MGB's activities makes it unlikely that any claims on guarantees will be made or paid, or that recoveries will be made in the future.

Income from investments came to EUR 388,065.28 and costs to EUR 15,104.39, giving a result from investment activities of EUR 372,960.89. The MGB values its investments at fair value in its balance sheet. The fair value fund stood at EUR 649,324.82, and the revaluation on the previous year was EUR 387,485.15. The result of investment activities and revaluations of the fair value fund gave a total return of 8.53% on invested capital. Of this total, shares accounted for 5.72%, listed shares 31.05% and bonds 3.16%.

The result for the financial year, i.e. the total from ordinary activities and investment was EUR 670,282.96 before transfer to the fund. The result for the financial year is proposed to be transferred to the fund in its entirety. The fund will thus total EUR 11,958,065.82 on 31 December 2010, and the total amount of the equity will be EUR 12,607,390.64.

The MGB has ongoing stand-by credit facilities for safeguarding its cash position up to EUR 150 million.

Outlook

The outlook for the joint municipal funding system is positive as far as fundraising, creditworthiness of Finnish municipalities and municipal finances are concerned. Uncertainties may arise as the result of the new Basel III financial regulatory framework will be applied to the public sector's internal financing arrangements. This is also the sector where the system consist of he Municipal Guarantee Board and Municipality Financing Plc operates.

The solid support given by all players of Finnish society, resulting from the strong performance of the joint municipal funding system, will also provide a sound basis for operations in changing circumstances.

INCOME STATEMENT

	1.1.-31.12.2010	1.1.-31.12.2009
Ordinary operations		
Income		
Guarantee premiums	1 500 000,00	1 500 000,00
Other income	0,00	1 900,00
Expenses		
Staff expenses	-446 401,72	-394 527,26
Depreciation	-21 042,21	-9 449,55
Other expenses	-735 234,00	-592 821,42
Result from ordinary operations	297 322,07	505 101,77
Investment activities		
Income	388 065,28	407 981,07
Expenses	-15 104,39	-174 678,94
Result from investment activities	372 960,89	233 302,13
Result before transfer to fund	670 282,96	738 403,90
Transfer to fund	-670 282,96	-738 403,90
Result for the financial year	0,00	0,00

BALANCE SHEET

Assets

	31.12.2010	31.12.2009
Non-current assets		
Tangible assets	165 015,04	184 757,95
Other shares and similar rights of ownership	2 048 629,78	2 002 909,78
Investments		
Other investments		
Shares and similar rights of ownership	3 713 973,50	2 553 335,39
Debt securities	6 170 755,45	6 297 415,60
Other investments	0,00	0,00
Current assets		
Debtors		
Guarantee receivables	375 000,00	375 000,00
Receivables	155 377,62	143 828,22
Cash and bank accounts	114 032,73	50 352,88
Total assets	12 742 784,12	11 607 599,82

Equity and liabilities

Equity		
Fund	11 958 065,82	11 287 782,86
Fair value reserve	649 324,82	261 839,67
Liabilities		
Current liabilities		
Trade creditors	22 057,90	3 284,48
Accruals and deferred income	113 084,38	41 004,17
Other current liabilities	251,20	13 688,64
Total equity and liabilities	12 742 784,12	11 607 599,82

CASH FLOW STATEMENT

	1.1.-31.12.2010	1.1.-31.12.2009
Cash flow from ordinary operations		
- operating income	1 500 000,00	1 501 900,00
- operating costs	1 105 257,25	986 975,05
Cash flow from ordinary operations	394 742,75	514 924,95
Cash flow from non-current assets	47 019,30	1 638 408,02
Cash flow from investments	284 043,60	-1 074 771,58
Change in cash funds	63 679,85	-48 711,49
Cash funds at the beginning of financial period	50 352,88	99 064,29
Cash funds at the end of financial period	114 032,73	50 352,88

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.

Investments are adhered to by using the FIFO-principle.

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

Depreciation method:

- Machinery and equipment equal depreciation, 3 years
- Before 1.1.2009 purchased machinery and equipment equal depreciation, 3 years
- Equipment equal depreciation, 5 years
- Equipment of the MGB premises equal depreciation, 10 years

Staff expenses

1.1.-31.12.2010	Salaries and fees	Pension expenses	Other personnel-related expenses
Board of Directors	94 253,69	12 674,02	1 283,39
Managing Director and Deputy MD	220 470,58	36 917,96	8 541,75
Others	62 104,16	8 697,94	1 458,23
Total	376 828,43	58 289,92	11 283,37

Non-current assets

	2010	2009
Tangible assets		
Acquisition cost 1.1.	194 207,50	32 752,61
Increase	1 299,30	161 454,89
Acquisition cost 31.12.	195 506,80	194 207,50
Accrued depreciation 1.1.	-9 449,55	0,00
Accounting period depreciation	-21 042,21	-9 449,55
Accrued depreciation 31.12.	-30 491,76	-9 449,55
Book value 31.12.	165 015,04	184 757,95
Other shares and similar rights of ownership		
Nurmijärven Golf Club one share	21 713,55	21 713,55
As. Oy Topeliuksenkatu 15	504 243,10	504 243,10
Koy Yrjönkatu 11	1 476 953,13	1 476 953,13
As Oy Helsingin Eino Leinon katu 7	45 720,00	0,00
Total	2 048 629,78	2 002 909,78

Changes to capital and reserves

	2010	2009
Fund 1.1.	11 287 782,86	10 549 378,96
Fund transfer 31.12.	670 282,96	738 403,90
Fund 31.12.	11 958 065,82	11 287 782,86
Fair value reserve 1.1.	261 839,67	-544 711,23
Change in financial year	387 485,15	806 550,90
Fair value reserve 31.12.	649 324,82	261 839,67

Guarantees and collateral

	31.12.2010	31.12.2009
Guarantee limits granted	29 969 168 896,70	24 814 687 656,17
Guarantees in use	15 478 450 730,90	13 199 588 971,26
Collateral received and items affecting collateral situation	16 723 342 684,95	13 470 527 648,60
Balance of collateral and guarantees	1 244 891 954,05	270 938 677,34
Receivables of Municipality Finance Plc derivatives guaranteed by the Municipal Guarantee Board from counterparties, net.	130 166 329,00	85 980 283,00

Signatures

SIGNATURES OF THE REPORT OF THE BOARD OF DIRECTORS AND THE FINANCIAL STATEMENTS

Helsinki, 9th February 2011

MUNICIPAL GUARANTEE BOARD

Jari Blom
Chairperson of the Board

Sari Innanen
Deputy Chairman of the Board

Maija-Liisa Havia
Member of the Board

Jaana Karrimaa
Member of the Board

Leena Kuha
Member of the Board

Janne Laine
Member of the Board

Juha Yli-Rajala
Member of the Board

Heikki Niemeläinen
Managing Director

AUDITORS SIGN

Our auditors' report has been issued today.

Helsinki 9th February 2011

KPMG OY AB

Marcus Tötterman
Authorized Public Accountant

This document is an English translation of the Finnish auditor's report. Only the Finnish version of the report is legally binding.

AUDITOR'S REPORT

To the Council of the Municipal Guarantee Board

We have audited the accounting records, the financial statements, the report of the Board of Directors, and the administration of the Municipal Guarantee Board for the year ended 31 December, 2010. The financial statements comprise the balance sheet, the income statement, the cash flow statement and notes to the financial statements.

Responsibility of the Board of Directors and the Managing Director

The Board of Directors and the Managing Director are responsible for the preparation of financial statements and report of the Board of Directors that give a true and fair view in accordance with the laws and regulations governing the preparation of the financial statements and the report of the Board of Directors in Finland. The Board of Directors is responsible for the appropriate arrangement of the control of the Guarantee Board's accounts and finances, and the Managing Director shall see to it that the accounts of the Guarantee Board are in compliance with the law and that its financial affairs have been arranged in a reliable manner.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial statements and on the report of the Board of Directors based on our audit. The Auditing Act requires that we comply with the requirements of professional ethics. We conducted our audit in accordance with good auditing practice in Finland. Good auditing practice requires that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and the report of the Board of Directors are free from material misstatement, and whether the members of the Board of Directors and the Managing Director are guilty of an act or negligence which may result in liability in damages towards the Guarantee Board or have violated the Act on the Municipal Guarantee Board.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements and the report of the Board of Directors. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements and report of the Board of Directors that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Guarantee Board's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements and the report of the Board of Directors.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements and the report of the Board of Directors give a true and fair view of the financial performance and financial position of the Guarantee Board in accordance with the laws and regulations governing the preparation of the financial statements and the report of the Board of Directors in Finland. The information in the report of the Board of Directors is consistent with the information in the financial statements.

Helsinki, 9 February 2011
KPMG OY AB

[signed]
Marcus Tötterman
Authorized Public Accountant in Finland

GUARANTEES

Million euro

Municipality Finance Plc

	Guarantees	Funding
		31.12.2010
Municipal Housing Finance Plc (-30.4.2001)		
MTN-EMTN Programme	1 500,00	98,6
Total	1 500,00	98,6
Municipality Finance Plc (1.5.2001-)		
MTN-EMTN Programme	20 000,0	12 508,7
AUD 1 billion Programme (Kangaroo)	1 529,2	365,1
Treasury Bill Programme	2 000,0	161,5
Domestic Debt Issuance Programme	800,00	170,0
Other domestic and foreign funding	4 000,0	2 114,6
Separate Decisions		60,0
Back up facilities	140,0	0,0
Total	28 469,2	15 379,9
Total	29 969,2	15 478,5
Receivables of Municipality Finance Plc derivatives guaranteed by the Municipal Guarantee Board from counterparties, net.		130,2
	Max 4%	0,8 %
Total		15 608,62

Administration



From left to right:

Juha Yli-Rajala (Member of the Board),

Mika Munkki (Chairperson of the Council),

Heikki Niemeläinen (Managing Director),

Jaana Karrimaa (Member of the Board),

Jari Blom (Chairperson of the Board),

Sari Innanen (Deputy Chairperson of the Board),

Reijo Vuorento (Deputy Chairperson of the Council),

Leena Kuha (Member of the Board),

Tuukka Salminen (Executive Director, Deputy for the Managing Director),

Maija-Liisa Havia (Member of the Board) and

Matti Kankare (Deputy Chairperson of the Council).

Janne Laine (Member of the Board) is not featured in the picture.

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.

One example is the Municipality of Eura, where the Municipal Guarantee Board has indirectly participated in financing investments of the City. The illustrations in this annual report are based on photographs taken at sheltered accommodation of Rantaniitty.



Municipal Guarantee Board

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