



ANNUAL REPORT 2012

KUNTEN TAKAUSKESKUS | KOMMUNERNAS GARANTICENTRAL | MUNICIPAL GUARANTEE BOARD



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Managing Director's review

The global and European financial crisis occurring in different forms since 2008, has also tested the strength of the Finnish municipalities' joint funding system (i.e. the Municipal Guarantee Board "MGB" and Municipality Finance Plc) in several ways. The system has coped with the challenges it has faced by doing its core tasks; funding for municipalities and social housing production has been secured.

The legal foundations of the joint funding system, created amidst the crisis of the 1990s, have been sound and solid and the economic situation of the Finnish municipal finances has been robust. Supported by these two factors, Standard and Poor's and Moody's affirmed the highest possible credit ratings to MGB in their latest reports.

During the year 2012, the joint funding system continued preparation for a new banking regulation

that will be applied to all credit institutions in the eurozone. As preliminary measures the joint funding system accumulated capital and reserves and created new operating models for hedging operations and liquidity management.

The system also prepared for expected changes in market shares and operational methods within the Finnish banking industry. The Finnish banking industry will develop more in line with mainstream banking activities with the coming realization of the banking union and new regulations. This development is already incorporated into Municipality Finance Plc's capital structure.

In 2012, MGB found it necessary to expand its communications in Finland in order to increase awareness of the system and the economies of Finnish Municipalities.

HEIKKI NIEMELÄINEN
Managing Director



Annual report 2012

The purpose of the Municipal Guarantee Board (MGB) is to safeguard and develop the joint funding of Finnish municipalities.

The uncertainty in the international financial markets which has been on-going since 2008, is beginning to wane and regulations are being drafted, for example those related to credit institutions and the banking union. The joint municipal funding system, comprised of MGB and Municipality Finance Plc (Munifin), has prepared for these changes by developing its capital structure and studying the further developing needs of its operations.

The growth in Munifin's yearly results, in our view, strengthened Munifin's ability to meet its future obligations related to the amount and quality of its own capital.

MGB prepared for the future changes by studying the need for amending the Act on the Municipal Guarantee Board. The basic result of the survey was that the Act and the procedures of the joint municipal funding system should in all aspects comply with the competition legislation of the European Union and the procedures of the forthcoming banking union of the eurozone.

In addition to previous development measures targeting the future, the operations of the joint funding system were further enhanced during the year by adopting Munifin's repo operations in practice. Repo operations are transactions secured by a transfer of collateral provided by the repo counterparty. The transfer of collateral gives additional security to repo activities in possible disruptive situations and also offers benefits related to Munifin's liquidity management.

MGB continued its publication activities of previous years by producing a two-part report on the institutions and creditworthiness of Finnish municipality finances. An information session on related credit rating methods was arranged in connection with the publication of the said report. Due to the increasing publication activities and growing number of the joint system's funding arrangements, MGB hired a third employee with the title of Communications Specialist to take care of the various operative functions within MGB.

Standard & Poor's accredited MGB with the highest possible credit rating of AAA, but with a negative outlook, i.e. the same as the Republic of Finland's credit rating. According to S&P's credit rating system, the state's credit rating is also the upper limit for the local governments' credit ratings, and thus the limit for MGB's credit rating. Moody's maintained the highest possible credit rating of Aaa for MGB with a stable outlook.

The ability of the joint municipal funding system to secure and develop the necessary funding for municipalities and social housing production remained excellent, as has been the case during previous years. Munifin's new lending increased to approximately 15.42 billion euros, up by approximately 2.01 billion euros from the previous year.

At the end of the year under review, MGB's membership stood at 319. 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 MGB. The number of non-member municipalities remained at one.

MGB's social responsibility is a vital part of its purpose. The joint funding system, comprised of Munifin and MGB, is an integral part of the funding of the Finnish municipal sector and social housing production, and it has served its basic purpose without problems under all market conditions throughout its history. The joint funding system creates financial benefits based on the joint guarantee by municipalities through MGB, and transfers the benefits to the eligible borrowers in the form of loans with preferential terms in accordance with the Act on the Municipal Guarantee Board.

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



Legislation on the Municipal Guarantee Board

The Act on the Municipal Guarantee Board (487/1996, “the Act”) 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 MGB is to safeguard and develop the joint funding of Finnish municipalities. In order to fulfil this purpose, MGB can grant guarantees for such funding by credit institutions directly or indirectly owned or controlled by municipalities where this funding is used for lending to municipalities and municipal federations, and to corporations wholly owned by municipalities or under their control. In 2012, one credit institution, Munifin, 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, MGB has also been able to grant guarantees for funding by 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 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 MGB can be used as security. With the amendment, the former Regulations controlling the operations of MGB and approved by the Ministry of Finance were abandoned and parts of the legal provisions included in the Regulations were transferred to the Act. These include the requirements for the granting of guarantees in accordance with European Community State Aid rules and their relationship with the said rules, the investment and use of monies transferred to MGB's fund and the powers of the Guarantee Board Auditor.

Since the adoption of the amendment, it has also been possible to use MGB's fund for interim arrangements in order to prevent a directly imminent MGB's payment obligation. Municipalities that are not members may also now join MGB. The auditing corporation appointed for the auditing of MGB's administration and accounts and the Guarantee Board Auditor responsible for MGB's 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, which is a member organisation of MGB, to appeal for an amendment of the contribution to be paid by the municipality to cover MGB's guarantee liabilities.

Administration and personnel

Under the Act, MGB has a Council of 15 members, each of whom has a personal deputy. The Ministry of Finance has appointed a Council for MGB for a term of office to run from 1 October 2009 to 30 September 2013. Mr Mika Munkki, Agrologist (Vehmaa), acts as Chairperson, and Mr Reijo Vuorento, Assistant Manager (Helsinki) and Mr Matti Kankare, Project Director (Espoo), act as Deputy Chairpersons. The Council convened twice during the year under review.



Under the Act, MGB has a Board of Directors of 5–7 members. The Board is responsible for 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 2012:

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 Kuba, Secretary, Oulu
Mr Janne Laine, City Manager, Savonlinna
Mr Pekka Alanen, Deputy Managing Director, Helsinki

The Board chose *Jari Blom* as its Chairperson and *Sari Innanen* as Deputy Chairperson. *Mr Heikki Niemeläinen* was MGB's Managing Director and *Mr Tuukka Salminen*, Executive Director, acted as a deputy to the Managing Director. The number of employees during the year increased to three.



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 MGB. In 2012, the authorised auditing corporation was KPMG Oy Ab, which was, after competitive tendering, reappointed by MGB's Council for 2013.

The activities of 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 MGB. In 2012, the Guarantee Board Auditor was Deloitte & Touche Oy, which the Ministry of Finance also reappointed for 2013.



Risk management

RISKS IN GUARANTEE OPERATIONS

Under the Act, MGB may grant guarantees against sufficient security. The level of security during the year under review was sufficient. Guarantee activities are mostly arranged in such a way that MGB's Board of Directors grants guarantees for Munifin's funding programmes, the most important of which is the MTN programme. Within the programmes, MGB's Managing Director or the Deputy to the Managing Director are authorized to grant guarantees for individual debt issues. Of the guarantees granted by MGB to Munifin, EUR 20,062,220,525.96 was in use at the end of 2012.

Under the Act, guarantees granted as security for Munifin's receivables may, at the time of granting the guarantee, amount to a maximum of four per cent of the total amount of MGB's guarantee liabilities. On 31 December 2012, these guarantee liabilities totalled EUR 53,859,581.00, or 0.27 per cent of all guarantee liabilities. The guarantee liabilities of MGB totalled EUR 20,116,080,376.96.

Funding guaranteed by MGB on 31 December 2012 was divided amongst the following currencies: Japanese yen 26%, US dollar 23%, euro 16%, Swiss franc 13%, Norwegian krone 6% and other currencies 16%. Collateral received by MGB from Munifin was denominated in euros. The currency risk is removed as a result of Munifin's hedging operations.

OPERATIVE RISKS

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 authorisations within MGB. MGB has a continuity plan, preparing for exceptional conditions so that MGB is able to continue its operations and prevent damages in different disruptive circumstances. Operative risks have been mitigated by outsourcing activities and by appointing deputies.

RISKS RELATED TO INVESTMENT OPERATIONS

MGB's liquidity is ensured through its fund and sufficient standby credit facilities. According to the strategy decided by the Council, increasing the fund must be based primarily on the risk-based funding need of counterparty guarantees in hedging operations or the interest and administration fees of temporary capitalisation.

The Board of Directors has decided on the investment of assets in its Guarantee and Operations Policy. According to the Policy, investments are allocated so that they support the operations of the municipal funding system. The aim of the investment activity is to obtain the maximum yield on the fund's assets while investing the assets safely; MGB invests only in liquid instruments that can be swiftly converted to cash based on MGB's liquidity needs. Derivatives are used only in special situations to hedge against risks.

MGB allocates 50% of its investments to plain vanilla 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 on a case by case basis.

Finances

Income from operations consisted of fees related to guarantees granted, which produced a total guarantee premium of EUR 2,000,000.00. Operating costs totalled EUR 1,313,868.85, comprising of personnel costs of EUR 547,327.82, depreciation amounting to EUR 27,728.91 and other costs of EUR 738,812.12. Prime factors in the increase in other costs were the credit rating costs resulting from the municipal funding system's substantial funding acquisition. The result from MGB's operations was EUR 686,131.15.

In 2012 no claims on MGB's guarantees were made or paid, nor were there any recovery claims. Taking into consideration the nature of the municipal funding system's and MGB's activities makes it unlikely that any claims on guarantees will be made, or that recovery claims will be made in the future.

Income from investments came to EUR 290,686.93 and costs to EUR 10,370.99, giving a result from investment activities of EUR 280,315.94. MGB values its investments at fair value on its balance sheet. The fair value reserve stood at EUR 101,924.45 and the increase in fair value compared to the previous year was EUR 281,173.21. The result of investment activities and the change of the fair value reserve gave a total return of 5.3% on invested capital.

The result for the financial year, i.e. the total from MGB's activities and investments, was EUR 966,447.09 before transfer to MGB's fund. The result for the financial year is proposed to be transferred to the fund in its entirety. The fund will thus total EUR 14,071,405.06 on 31 December 2012, and the total amount of the equity will be EUR 14,173,329.51.

MGB has on-going credit facilities for safeguarding its cash position up to EUR 150 million.



Outlook



The outlook for the joint municipal funding system is fairly positive as far as funding acquisition, the creditworthiness of Finnish municipalities and municipal finances are concerned. Uncertainties may arise depending on how the new Basel III financial regulatory framework will be applied to the public sector's internal financing arrangements. This is also the sector in which MGB and Munifin operate. The solid result of Munifin for 2012 proves that the joint municipal funding system can operate successfully in a changing operating environment and ensure the sufficiency of own funds which are required for its operations.

The support to the joint municipal funding system provided by the main players in the Finnish public sector and the strong performance of the joint municipal funding system will provide a sound basis for the system's future operations.

Income statement

	<i>1.1.-31.12.2012</i>	<i>1.1.-31.12.2011</i>
Ordinary operations		
Income		
Guarantee premium	2 000 000,00	2 000 000,00
Expenses		
Staff expenses	-547 327,82	-467 534,33
Depreciation	-27 728,91	-25 032,38
Other expenses	-738 812,12	-707 211,85
Result from ordinary operation	686 131,15	800 221,44
Investment activities		
Income	290 686,93	360 112,19
Expenses	-10 370,99	-13 441,48
Result of investment activities	280 315,94	346 670,71
Result before transfer to fund	966 447,09	1 146 892,15
Transfer to fund	-966 447,09	-1 146 892,15
Result for the financial year	0,00	0,00

Balance sheet

	<i>1.1.-31.12.2012</i>	<i>1.1.-31.12.2011</i>
Assets		
Non-current assets		
Tangible assets	165 115,44	169 728,18
Other shares and similar rights of ownership	2 265 974,03	2 143 562,88
Investments		
Other investments		
Shares and similar rights of ownership	4 679 591,62	3 650 630,76
Debt securities	6 559 924,00	6 416 804,50
Current assets		
Debtors		
Guarantee debtors	500 000,00	500 000,00
Receivables	94 829,90	109 211,88
Cash and bank accounts	126 485,93	93 640,92
Total assets	14 391 920,92	13 083 579,12
Equity and liabilities		
Equity		
Fund	14 071 405,06	13 104 957,97
Fair value reserve	101 924,45	-179 248,76
Liabilities		
Current liabilities		
Trade creditors	59 085,05	29 175,70
Accruals and deferred income	157 691,36	128 664,21
Other current liabilities	1 815,00	30,00
Total equity and liabilities	14 391 920,92	13 083 579,12



Cash flow statement

	<i>1.1.-31.12.2012</i>	<i>1.1.-31.12.2011</i>
Cash flow from ordinary operations		
-operating income	2 000 000,00	1 875 000,00
-operating costs	-1 237 961,81	-1 153 139,33
Cash flow from ordinary operations	762 038,19	721 860,67
Cash flow from non-current assets	-145 527,32	-124 678,62
Cash flow from investments	-583 665,86	-617 573,86
Change in cash funds	32 845,01	-20 391,81
Cash funds at the beginning of financial period	93 640,92	114 032,73
Cash funds at the end of financial period	126 485,93	93 640,92

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
- Equipment, 5 years
- Equipment of the MGB premises, 10 years

Staff expenses

<i>1.1.-31.12.2012</i>	Salaries and fees	Pension expenses	Other personnel-related expenses
Board of Directors	84 379,78	9 945,76	1 274,75
Managing Director and Deputy MD	265 2298,99	51 906,43	9 784,18
Others	98 165,35	14 603,09	2 793,01
Total	447 844,12	76 455,28	13 851,94

Non-current assets

Tangible assets	<i>2012</i>	<i>2011</i>
Acquisition cost 1.1.	225 252,32	195 506,80
Disposals	-31 168,45	0,00
Increase	23 116,18	29 745,52
Acquisition cost 31.12.	217 200,05	225 252,32

Accrued depreciation 1.1.	-55 524,14	-30 491,76
Accrued depreciation on disposals	31 168,45	0,00
Accounting period depreciation	-27 728,91	-25 032,38
Accrued depreciation 31.12.	-52 084,61	-55 524,14
Book value 31.12.	165 115,44	169 728,18

Other shares and similar rights of ownership	<i>2012</i>	<i>2011</i>
Koy Yrjönkatu 11	1 476 953,13	1 476 953,13
Nurmijärven Golf Club one share	21 713,55	21 713,55
As Oy Helsingin Eino Leinon katu 7	45 720,00	45 720,00
As Oy Topeliuksenkatu 15	721 587,35	599 176,20
Total	2 265 974,03	2 143 562,88



Changes to capital and reserves	2012	2011
Fund 1.1.	13 104 957,97	11 958 065,82
Fund transfer 31.12.	966 447,09	1 146 892,15
Fund 31.12.	14 071 405,06	13 104 957,97
Fair value reserve 1.1.	-179 248,76	649 324,82
Change in financial year	281 173,21	-828 573,58
Fair value reserve 31.12.	101 924,45	-179 248,76
Guarantees and collateral	31.12.2012	31.12.2011
Guarantee limits granted	34 515 795 776,87	34 583 912 599,23
Guarantees in use	20 062 220 525,96	17 459 460 423,62
Collateral received and items affecting collateral situation	22 812 393 842,88	18 919 899 154,37
Balance of collateral and guarantees	2 750 173 316,92	1 460 438 730,75
Receivables of Municipality Finance Plc derivatives guaranteed by the Municipal Guarantee Board from counterparties, net.	53 859 581,00	351 625 700,00

Signs

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

Helsinki, 13th February 2013

MUNICIPAL GUARANTEE BOARD

Jari Blom

Chairperson of the Board

Sari Innanen

Deputy Chairperson of the Board

Pekka Alanen

Member of the Board

Maija-Liisa Havia

Member of the Board

Jaana Karrimaa

Member of the Board

Leena Kuba

Member of the Board

Janne Laine

Member of the Board

Heikki Niemeläinen

Managing Director

AUDITOR 'S NOTE

Our auditors' report has been issued today.

Helsinki 13th February 2013

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, 2012. 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, 13 February 2013

Marcus Tötterman

Authorized Public Accountant in Finland

Guarantees

Million euro

Municipality Finance Plc	Guarantees	Funding 31.12.2012
Municipal Housing Finance Plc (-30.4.2001)		
EMTN Programme	1 500,0	98,6
Total	1 500,0	98,6
Municipality Finance Plc (1.5.2001-)		
EMTN Programme	22 000,0	15 649,2
AUD 1 billion Programme (Kangaroo)	1 575,8	43,7
Treasury Bill Programme	2 000,0	1 377,1
Domestic Debt Issuance Programme	800,0	111,0
Other domestic and foreign funding	6 500,0	2 757,6
Separate Decisions		25,0
Back up facilities	140,0	0,0
Total	33 015,8	19 963,6
Total	34 515,8	20 062,2
Receivables of Municipality Finance Plc derivatives guaranteed by the Municipal Guarantee Board from counterparties, net	Max 4 %	53,9 0,3 %
Total		20 116,08



Information about the Annual report

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

One example is the town of Ylöjärvi, where the Municipal Guarantee Board has indirectly participated in financing investments for the town. The illustrations in this annual report are based on photographs taken at the training center Valo.



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