Kuntarahoitus
MUNICIPALITY FINANCE

Interim Report 2011

CEO's Review

The financial markets have remained exceptionally nervous in 2011 with continued uncertainty regarding market conditions. The prevailing lack of confidence in the ability of countries to manage their debts has resulted in a situation where the eurozone is perceived as the region with the greatest financial risks. Europe is falling behind in terms of economic development, for reasons that are largely self-inflicted. The U.S. economy has taken a slight positive turn for the better, while Asia continues to rise.

The most significant new challenge in Europe this year is the increase in political uncertainty and the way it is reflected in the economy. In Municipality Finance's operations this prevailing uncertainty is evident in the fact that we need to strengthen international investors' confidence in the stability of Finland in practically all of our international funding meetings. We also need to constantly communicate to investors that decision makers are able to identify and implement appropriate financial solutions for both Finland and the EU.

The general uncertainty in the markets has not, however, had a negative impact on Municipality Finance's funding acquisition. Due to our solid reputation, we are offered more funding than we need. The fact that we acquired three quarters of our annual funding by the beginning of June is evidence of this. Finland continues to be ranked as a safe haven in the risk analyses conducted by international investors, and I hope it will remain one for a long time to come.

In recent years, the majority of our funding has been acquired from the capital markets of Japan, Taiwan and Switzerland. The natural disaster in Japan has not had a major impact on our funding acquisition.

In May 2011, we carried out our inaugural USD Benchmark issue, which saw us join the ranks of significant benchmark issuers. The transaction was highly successful, meeting all the goals we had set for it. Over 50% of the orderbook was sold to central banks and just over one third of the total was sold to Asia. Over 40 investors from all across the world participated in the issue.

With the inaugural USD Benchmark issue, we were able to bring in some of the largest and most significant investors. This further improves our position in terms of being able to provide our customers with the funding they need under all circumstances. At the same time, the issue raised Municipality Finance's profile on the international financial markets. As a AAA issuer, Municipality Finance is a highly competitive new entrant in this market where issuers are typically governments.

Municipality Finance's position in terms of lending to its customers has remained stable despite the aforementioned financial uncertainties and the questions around future regulation of financial institutions. We are the only lender on the market that has been able to consistently offer competitive financing to all its customer groups.

The future of the international financial markets does not look bright. If political decision makers are unable to reach compromises on stabilising the situation, we may face a new financial crisis that is more severe and uncontrollable than the previous one. The 2008 financial crisis was primarily felt in the banking sector. The current situation is more worrying, as now many countries are also facing dire circumstances.

There is growing fear that the eurozone debt crisis will only get worse, and decision makers in various countries are holding crisis meetings on a weekly basis to find a solution and calm the markets down. In many countries, taxpayers are critical of solutions that would use public money to bring the situation under control. The national debt crises are becoming a threat to economic growth and even to political unity in the EU.

The government programme of Finland's new government covers EU co-operation and participation in decision-making that has an impact on Finns. The government programme also comprises a number of policies that influence municipalities. The promotion of the restructuring of local government based on a strong primary municipality model and increasing the duties of local government, combined with planned cuts in state subsidies, will lead to changes in how municipal services are funded and how municipalities manage their finances in general.

It is worth noting that the new Finnish government programme specifically mentions Municipality Finance's role in providing funding for local government and state subsidised housing production. This reflects genuine concern over the need to ensure local government and social housing production under all circumstances and the importance of competitive local government funding.

Helsinki 23 August 2011

Pekka Averio
President and CEO

Interim Report 1 January - 30 June 2011[1)]

The first half of 2011 in brief

- The Group's net operating profit for the period was EUR 35.0 million (1 January - 30 June 2010: EUR 30.5 million). This represents a 15% increase on the previous year.
- Net interest income for January-June was EUR 41.0 million (1 January - 30 June 2010: EUR 38.1 million).
- The balance sheet total was EUR 20,088 million (31 December 2010: EUR 20,047 million).
- The Group's risk bearing capacity remained strong, with capital adequacy at 22.83% at the end of June (31 December 2010: 19.28%) and the capital adequacy ratio, Tier 1 capital at 16.90% (31 December 2010: 13.92%).
- Total funding acquisition for January-June amounted to EUR 5,124 million (1 January - 30 June 2010: EUR 3,155 million). The total amount of funding grew to EUR 17,652 million (31 December 2010: EUR 17,162 million).
- The Group's long-term loan portfolio grew to EUR 12,649 million (31 December 2010: EUR 11,698 million). Loans amounting to EUR 1,476 million were issued (1 January - 30 June 2010: EUR 1,410 million).
- The company has also continued to focus on and invest in the financial leasing operations launched in 2010.
- At the end of June, investments totaled EUR 4,721 million (31 December 2010: EUR 4,839 million).
- The turnover of Municipality Finance's subsidiary Inspira grew by 41%, reaching EUR 1.2 million (1 January - 30 June 2010: EUR 0.9 million). Inspira's net operating profit at the end of June was EUR 0.4 million (1 January - 30 June 2010: EUR 0.02 million).

Key figures, Group

	30 Jun 2011	30 Jun 2010	31 Dec 2010
Net interest income (EUR million)	41.0	38.1	78.7
Net operating profit (EUR million)	35.0	30.5	58.3
New loans issued (EUR million)	1,476	1,410	2,842
New funding acquisition (EUR million)	5,124	3,155	6,504
Balance sheet total (EUR million)	20,088	19,375	20,047
Own funds (EUR million)	273.9	199.9	245.9
Capital adequacy ratio for Tier 1 capital, %	16.90	10.54	13.92
Capital adequacy ratio, %	22.83	15.56	19.28
Return on equity (ROE), %	28.63	32.33	28.42
Cost-to-income ratio	0.21	0.22	0.23

The calculation formulas for the key figures are given on page 12.

Except where otherwise noted, the figures presented in this interim report are consolidated figures.

Credit ratings

Municipality Finance's credit ratings

The company has the best possible credit ratings for its long-term funding:

Moody's Investors Service	Aaa (stable)
Standard & Poor's	AAA (stable)

The best possible credit ratings have also been confirmed for the company's short term funding:

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

Municipal Guarantee Board's credit ratings

The Municipal Guarantee Board guaranteeing the company's funding has the best possible credit ratings for long-term funding:

Moody's Investors Service	Aaa (stable)
Standard & Poor's	AAA (stable)

1) This is a translation of the original Finnish interim report "Osavuosikatsaus 1.1.-30.6.2011". Should there be any discrepancies between this translation and the Finnish original, the latter shall prevail.

Development of business operations

Group structure

The Municipality Finance Group (hereinafter "the Group") consists of Municipality Finance Plc (hereinafter "Municipality Finance" or "the Company") and Financial Advisory Services Inspira Ltd (hereinafter "Inspira").

The role of Municipality Finance is to offer market-based funding to municipalities, municipal federations, municipality-controlled entities and non-profit corporations nominated by the Housing Finance and Development Centre of Finland (ARA) by acquiring funding from capital markets at competitive costs.

Inspira offers expert financial services to the public sector. Its services include the analysis and arrangement of various forms of funding for public sector investments. In addition, Inspira offers its services for different public sector ownership arrangements by planning them, making value assessments and assisting in contract negotiations. Inspira helps the public sector to arrange its services more effectively and invest more economically.

Operating result and balance sheet

The Group reached a good operating result. Business continued to grow and the net operating profit for the first half of 2011 before appropriations and taxes stood at EUR 35.0 million (1 January – 30 June 2010: EUR 30.5 million). The Group's net interest income in the first half of 2011 increased by 8% on the previous year, reaching EUR 41.0 million at the end of June 2011 (1 January – 30 June 2010: EUR 38.1 million). The net interest income includes EUR 1.4 million in profits from the repurchase of the company's own debt securities (1 January – 30 June 2010: EUR 7.3 million). The net income includes EUR 1.8 million in unrealised fair value changes (1 January – 30 June 2010: EUR 0.7 million). The business operations of Municipality Finance's subsidiary Inspira continued to grow, with the net operating profit for the period of 1 January – 30 June 2011 totalling EUR 0.4 million (1 January – 30 June 2010: EUR 0.02 million).

The Group's operating expenses grew moderately in the first half of the year, with a 3% year-on-year increase to EUR 7.6 million (1 January – 30 June 2010: EUR 7.4 million). The increase in expenses was primarily caused by growth in volume and personnel. Administrative expenses were EUR 5.4 million (1 January – 30 June 2010: EUR 5.0 million), of which personnel expenses were EUR 3.6 million (1 January – 30 June 2010: EUR 3.2 million). Depreciation of tangible and intangible assets totalled EUR 0.3 million (1 January – 30 June 2010: EUR 0.3 million). Other operating expenses were EUR 1.9 million (1 January – 30 June 2010: EUR 2.2 million).

The consolidated balance sheet total was EUR 20,088 million at the end of June 2011 (31 December 2010: EUR 20,047 million).

Capital adequacy

The Group calculates its capital adequacy based on the Basel II regulations. The capital adequacy requirement for credit risk is calculated using Pillar I and the standard method, and the capital adequacy requirement for operative risks using the basic method. As the Group has neither a trading book nor share or commodity positions, only currency risks are taken into account in the capital adequacy calculations for market risk. The credit ratings given by Standard & Poor's, Moody's Investor Service and Fitch Ratings are used for determining the risk factors used in the capital adequacy calculations. The aforementioned companies are credit rating institutions approved by the Finnish Financial Supervisory Authority for capital adequacy calculations. For capital adequacy calculations of the credit risk, Municipality Finance uses methods for reducing the credit risk such as guarantees provided by the municipalities as well as deficiency guarantees given by the state of Finland. For derivatives, netting agreements, additional guarantee agreements (ISDA/Credit Support Annex) and guarantees granted by the Municipal Guarantee Board are used for reducing the capital adequacy requirement related to the counterparty risk of derivative counterparties.

Municipality Finance Group's own funds totalled EUR 273.9 million at the end of June 2011 (31 December 2010: EUR 245.9 million). Tier 1 capital stood at EUR 202.8 million at the end of June 2011 (31 December 2010: EUR 177.5 million). Tier 1 capital includes the net profit for the period of 1 January – 30 June 2011, as the result for the period has been subject to a general review and can therefore be included in the company's own funds under the Act on Credit Institutions. Tier 1 capital at the end of June 2011 does not include a provision for dividend distribution, because according to the decision of the Shareholders' Meeting, the Board of Directors determines the dividend to be distributed annually and makes a dividend distribution proposal based on the company's financial situation and the regulations in force at the time, taking the company's ownership structure into consideration. Secondary own funds at the end of the period under review totalled EUR 71.1 million (31 December 2010: EUR 68.3 million).

The Group's capital adequacy ratio stood at 22.83% at the end of June 2011, compared to 19.28% on 31 December 2010. The capital adequacy ratio, Tier 1 capital was 16.90% (31 December 2010: 13.92%). The Group's own funds at the end of June 2011 were EUR 273.9 million (31 December 2010: EUR 245.9 million) and the minimum requirement

Own funds, Group

EUR 1,000	30 Jun 2011	31 Dec 2010
Share capital	42,583	42,583
Minority interest	239	303
Reserve fund	277	277
Reserve for invested non-restricted equity	40,366	40,366
Retained profit	84,703	51,540
Profit for the financial year	25,681	42,929
./. Provision for dividend distribution	-	-10,006
Capital loans	11,009	11,009
Intangible assets	-2,102	-1,464
Total Tier 1 capital	**202,757**	**177,537**
Fair value reserve	-3,869	-6,653
Subordinated liabilities, included in upper secondary own funds	40,000	40,000
Subordinated liabilities, included in lower secondary own funds	35,000	35,000
Total secondary own funds	**71,131**	**68,347**
Total own funds	**273,888**	**245,884**

Risk weighted exposure, Group

EUR 1,000	30 Jun 2011	31 Dec 2010
Credit risk, standard method	**1,101,572**	**1,177,113**
Total minimum requirement for own funds Credit risk, standard method		
Claims on credit institutions and investment firms	43,980	53,240
Covered bonds	8,585	5,036
Securitised items	33,423	33,400
Other items	2,138	2,493
Total credit risk, standard method	88,126	94,169
Market risk	-	-
Operational risk, basic method	7,839	7,839
Total minimum requirement for own funds	**95,965**	**102,008**
Capital adequacy ratio, Tier 1 capital, %	16.90%	13.92%
Capital adequacy ratio, %	**22.83%**	**19.28%**

for own funds was EUR 96.0 million (31 December 2010: EUR 102.0 million). The capital adequacy requirement for credit risk tied up the largest amount of the Group's own funds at EUR 88.1 million (31 December 2010: EUR 94.2 million), the most significant items being claims from credit institutions and investment firms as well as securitised items.

Funding

Funding is based on reliability, speed, flexibility and operating in the major capital markets. The majority of funding is done as standardised issues under debt programmes. Municipality Finance uses the following debt programmes:

Euro Medium Term Note (EMTN) programme	22 000 mEUR
Domestic debt programme	800 mEUR
Treasury Bill programme	2 000 mEUR
AUD debt programme (Kangaroo)	2 000 mAUD

Municipality Finance's funding is guaranteed by the Municipal Guarantee Board, which also has a Aaa/AAA credit rating from the same rating agencies as Municipality Finance. The Municipal Guarantee Board has granted guarantees for the debt programmes and funding arrangements outside the programmes; as a result, debt instruments issued by Municipality Finance are classified as zero-risk in calculating the capital adequacy of credit institutions in Finland and several other European countries.

Municipality Finance is an active participant in the international bond markets and acquires a very significant portion of its funding from the international capital markets. Asian markets continued to play important roles in Municipality Finance's funding. The largest European market for funding acquisition was Switzerland, with Germany the largest in the eurozone. There has also been interest towards the company's bonds in the Nordic countries.

In January-June, EUR 5,124 million was acquired in long-term funding (1 January - 30 June 2010: EUR 3,155 million), of which Municipal Bonds issued under the domestic debt programme amounted to EUR 13.7 million (1 January - 30 June 2010: EUR 16.9 million). The company issued bonds denominated in 15 different currencies in the first half of 2011. A total of EUR 1,893 million was issued in short-term debt instruments under the Treasury Bill programme in January-June (1 January - 30 June, 2010: EUR 668 million). Total funding at the end of June 2011 amounted to EUR 17,652 million (31 December 2010: EUR 17,162 million). Of this total amount, 16% was denominated in euros (31 December 2010: 15%) and 84% in foreign currencies (31 December 2010: 85%).

Municipality Finance has acquired the majority of its funding for the year in the first half of 2011. A total of 132 arrangements were made in the international funding markets in the first half of the year (1 January - 30 June 2010: 118 arrangements). In May 2011, Municipality Finance successfully launched its inaugural USD 1.5 billion benchmark issue. The benchmark transaction allowed Municipality Finance to further diversify its funding sources and join the ranks of significant benchmark issuers. With the successful USD benchmark issue, Municipality Finance was able to bring in some of the world's largest and most significant investors. Over 50% of the orderbook was sold to central banks and just over one third of the total was sold to Asia.

The first half of 2011 was characterised by continued restlessness on the markets. Active investor cooperation has increased the company's good reputation in different markets and diversifying the sources of funding has proven to be a good strategy in the unstable market situation. The company has managed to keep funding costs at a competitive level despite the challenges it has faced in this aspect.

Customer Financing

Municipality Finance's customers consist of municipalities, municipal federations, municipality-controlled entities and non-profit corporations nominated by the Housing Finance and Development Centre of Finland (ARA). Over the years, the company has increased its importance as a financer to its customers and is clearly the largest single operator in its customer segment.

Long-term financing

Demand for loans in the municipal sector remained strong in the first half of 2011. Investments by municipalities and municipal corporations, and the resulting need for financing in the local government sector, have remained at a similar level compared to the same period last year. Lending for housing production was higher in the first half of 2011 than in the previous year. Funding in this area has been particularly focused on housing production for special groups and assisted-living homes.

In addition to loans, Municipality Finance also offers municipalities, municipal federations and municipal corporations derivative contracts tailored to their needs for the management of interest rate risks. Demand for derivative products was high in the first half of 2011. As long as the level of interest rates remains low, customers are likely to increase their hedging against any future increase in interest rates.

The total volume of requests for loan proposals received by Municipality Finance grew by 6% in January-June 2011, reaching EUR 2,308 million (1 January - 30 June 2010: EUR 2,185 million). The total amount of new loans granted in the first half of 2011 was slightly up from the corresponding period in the previous year at EUR 1,476 million (1 January - 30 June 2010: EUR 1,410 million). Municipality Finance's long-term loan portfolio at the end of June amounted to EUR 12,649 million (31 December 2010: EUR 11,698 million). This corresponds to an 8% increase in the loan portfolio from year's end 2010.

Municipality Finance's market share remains high. Due to the debt situation in European countries and uncertainty in the financial sector caused by the new bank regulations, the competitive situation is not expected to change significantly in the short term.

Leasing operations

Municipality Finance offers financial leasing services to municipalities, municipal federations and municipally-owned corporations. The leasing services were launched in early 2010 and their focus has thus far been on leasing movable tangible property.

The aim of Municipality Finance's leasing operations is to increase transparency and the range of alternatives available in the leasing market. The company has signed a number of framework agreements for leasing services and the prospects for expanding leasing operations are good, as financial leasing is increasingly seen as a viable alternative for procurement by municipally-owned corporations and hospital districts for example.

Short-term financing

Municipalities and municipal federations issue municipal papers to cover their short-term financing needs. Companies under the control of municipalities and municipal federations issue municipal company papers. At the end of June 2011, the total value of municipal paper and municipal commercial paper programmes concluded with Municipality Finance was EUR 2,776 million (31 December 2010: EUR 2,623 million). At the end of the reporting period, the company had EUR 492 million in municipal papers and municipal commercial papers in its balance sheet (31 December 2010: EUR 581 million). During the first six months of the year, the company's customers acquired financing through short-term programmes for a total of EUR 2,819 million (1 January - 30 June 2010: EUR 3,244 million).

Investment operations

Municipality Finance's investment operations comprise the investment of acquired funding in liquid deposits and financial sector debt securities with a good credit rating in order to ensure that the company can remain operational under all market conditions. According to the company's liquidity policy, the liquidity portfolio must be sufficient to continue operations for at least the six following months.

At the end of June 2011, the total amount of investment was EUR 4,721 million (31 December 2010: EUR 4,839 million), and the average credit rating of all investments was AA+ (31 December 2010: AA+). The duration of credit risk at the end of June 2011 was 1.46 years (31 December 2010: 2.38 years).

Liquidity continues to be good as a result of adequate funding acquisition. The main emphasis in the company's new investments has been on covered bonds, government and bank bonds as well as certificates of deposit with a maturity of less than one year.

The company does not have any direct investments in debt securities from southern European governments.

Inspira

Inspira continued to exhibit strong growth in the first half of 2011, meeting expectations in terms of both turnover and profitability. Turnover for January-June was EUR 1.2 million (1 January - 30 June 2010: EUR 0.9 million). This represents a 41% increase compared to the same period last year. Turnover comprised a wide range of assignments related to funding arrangements for public sector investments as well as ownership arrangements in the local government sector. Inspira's net profit for the first half of the year was EUR 0.3 million (1 January - 30 June 2010: EUR 0.01 million).

Governance

Corporate Governance

The Board has approved the company's Corporate Governance guidelines in compliance, where applicable, with the Finnish Securities Market Association Corporate Governance Code for listed companies in Finland. The Finnish Corporate Governance Code applies to listed share issuers and does not therefore concern Municipality Finance directly, as it issues bonds. Municipality Finance's shares are not subject to public trading and can only be owned by the parties mentioned in the Articles of Association. However, as an issuer of public bonds and an operator on the international capital market, the company wanted to prepare its own guidelines for corporate governance based on the recommendations for listed companies. The Board is responsible for making sure that Municipality Finance complies with the Corporate Governance rules and is committed to developing them further.

The Corporate Governance Policy is available on the company website (www.munifin.fi).

Annual General Meeting

Municipality Finance's Annual General Meeting was held on 23 March 2011. The Annual General Meeting confirmed the financial statements for 2010 and discharged the members of the Board of Directors, the Managing Director and the Deputy Managing Director from liability. In addition, it was decided that a dividend of EUR 0.25 per share, or a total of EUR 9.8 million, be paid from Municipality Finance's distributable own funds. The dividend was paid on 28 March 2011. The Annual General Meeting also decided on a change in dividend policy. Under the new policy, the Board of Directors determines the dividend to be distributed annually and makes a dividend distribution proposal based on the company's financial situation and the regulations in force at the time, taking the company's ownership structure into consideration.

The Annual General Meeting decided, based on a proposal by the Shareholders' Nomination Committee, to amend the Articles of Association to state that the company's Board of Directors shall have no fewer than five and no more than eight members and that the Board members' term of office ends at the conclusion of the Annual General Meeting following their election. On the period starting at 23 March 2011 the Board of Directors of Municipality Finance has eight members.

The Annual General Meeting also decided to establish the Shareholders' Nomination Committee as a permanent body. Members for the Shareholders' Nomination Committee are elected by three largest shareholders and the Association of Finnish Local and Regional Authorities. The Shareholders' Nomination Committee is charged with making a proposal to the Annual General Meeting each year on the members of the Board of Directors of Municipality Finance, the number of members and their remuneration.

The meeting also elected KPMG Oy Ab as the auditor of the company with Authorized Public Accountant Raija-Leena Hankonen as the accountable auditor.

Board of Directors

The Annual General Meeting of 2009 elected eleven members to the Board of Directors for a term of office concluding at the end of the second Annual General Meeting following their election. According to that decision, the term of office of that Board of Directors ended on 23 March 2011. The Members of the Board of Directors were: Markku Pohjola (Chairman), Sisko Seppä (Vice Chairman), Pekka Alanen, Tapio Korhonen, Eva Liljeblom, Liisa Linna-Angelvuo, Hannes Manninen, Mikko Pukkinen, Antti Rantakangas, Hanna Tainio and Pekka Timonen.

The Annual General Meeting of 23 March 2011 resolved to amend the company's Articles of Association as follows: According to the Articles of Association of Municipality Finance, the Board of Directors of the company shall have no fewer than five and no more than eight members. The Annual General Meeting elects the members of the Board and their term of office concludes at the end of the Annual General Meeting following their election. The eight members to the Board of Directors of Municipality Finance Plc are:

Eva Liljeblom, Chairman of the Board, on the Board of Directors since 2003

- Education: D.Sc. (Econ)
- Year of birth: 1958
- Primary occupation: Rector, Professor, Hanken School of Economics in Helsinki
- Independence: independent of the company and its significant shareholders

Fredrik Forssell, Vice Chairman, on the Board of Directors since 2011

- Education: M.Sc. (Econ)
- Year of birth: 1968
- Primary occupation: CIO, Internal equity & FI Management, Keva
- Independence: independent of the company

Teppo Koivisto, on the Board of Directors since 2011

- Education: M.A. (Pol. Sci.)
- Year of birth: 1966
- Primary occupation: Head of Division, State Treasury
- Independence: independent of the company

Tapio Korhonen, on the Board of Directors since 2005

- Education: Master of Laws, M.Sc. (Econ)
- Year of birth: 1949
- Primary occupation: Finance Director, City of Helsinki
- Independence: independent of the company.

Sirpa Louhevirta, on the Board of Directors since 2011

- Education: M.Sc. (Econ)
- Year of birth: 1964
- Primary occupation: Group Treasurer, Sanoma Oyj
- Independence: independent of the company and its significant shareholders

Ossi Repo, on the Board of Directors since 2011

- Education: Bachelor of Social Services, L.Soc.Sc.
- Year of birth: 1948
- Primary occupation: Mayor, City of Kemi
- Independence: independent of the company and its significant shareholders

Asta Tolonen, on the Board of Directors since 2011

- Education: M.Sc. (Econ.)
- Year of birth: 1960
- Primary occupation: Financial Director, Kainuu Regional Council
- Independence: independent of the company and its significant shareholders

Juha Yli-Rajala, on the Board of Directors since 2011

- Education: M.A. (Adm.Sci.)
- Year of birth: 1964
- Primary occupation: Director, Group Administration, City of Tampere
- Independence: independent of the company and its significant shareholders

In order to organise its work as efficiently as possible, the Board of Municipality Finance has established an Audit Committee and a Remuneration Committee for the preparation of matters. The members of the Audit Committee are Tapio Korhonen (Chairman), Fredrik Forssell and Sirpa Louhevirta. The members of the Remuneration Committee are Eva Liljeblom (Chairman), Teppo Koivisto and Juha Yli-Rajala.

The work of the Board of Directors and its committees is described in more detail in the company's Corporate Governance Policy (www.munifin.fi).

Personnel

At the end of June 2011, Municipality Finance Group had 65 employees, of whom 55 are staff of the parent company. The President and CEO of Municipality Finance is Pekka Averio. Executive Vice President Esa Kallio acts as deputy to the CEO. In addition, the Board of Management of Municipality Finance includes Senior Vice President Toni Heikkilä and Senior Vice President Marjo Tomminen. Senior Vice President Jarkko Vuorenmaa's membership in the Board of Management ended 1 May 2011.

The CEO of Municipality Finance's subsidiary Inspira is Kimmo Lehto.

Internal audit

Internal auditing work has been outsourced to Deloitte & Touche Oy. The outsourced auditing is coordinated by the company's risk management function. Internal auditing tasks include monitoring the reliability and correctness of Municipality Finance's financial and other management information. The tasks also include making sure that the company has adequate and properly organised manual and IT systems for its operations and that the risks associated with the operations are being managed adequately. The internal audit reports to the Board of Directors and its audit committee.

Risk management

The business of Municipality Finance requires adequate risk management mechanisms in order to ensure that the risk position of the company stays within the limits specified by the Board. Municipality Finance applies very conservative principles to its risk management. The objective is to minimise open risk positions and maintain the overall risk position at a level that is low enough not to endanger the company's strong credit rating (Aaa/AAA).

The general principles, limits and benchmarks for risk management at Municipality Finance are decided by the Board of Directors of the company. The purpose of risk management is to ensure that the risks associated with lending, funding acquisition, investment and other business operations are in line with Municipality Finance's low risk profile.

There were no material changes in the company's risk standing in the period under review.

Strategic risks

Strategic risk means that the company would have chosen the wrong strategy for financially profitable operations or that the company would fail to adapt the chosen strategy to changes in the operating environment. The Group's management of strategic risks is based on continuous monitoring and analyses of the clients' needs, forecasts of market trends as well as changes in the competition and the operating environment. Risks and their significance are assessed annually when the business plan is drawn up. The Group's existing strategy plan extends to 2015.

Credit risk

Credit risk is the risk that the counterparty might default on its obligations to the company. Municipality Finance may only grant loans without a separate security directly to a municipality or municipal federation. For other loans, only an absolute guarantee or deficiency guarantee issued by a municipality or municipal federation, or a state deficiency guarantee serve as security. As such security is required to reduce the credit risk, all loans granted are classified as zero-risk in calculating capital adequacy. During its operation, Municipality Finance has not had any non-performing assets or credit losses from loans to its customers.

Municipality Finance is also exposed to credit risk from investments in advance funding acquisition and derivative instruments. In terms of credit risk assessment, the Board of Directors of the company approves the principles and limits, based on external credit rating, to be applied in the selection of counterparties. Credit risk is monitored with the nominal values of debt instruments and the conversion value for derivatives (the fair value method). Municipality Finance limits the credit risk with ISDA Credit Support Annexes in the case of major derivatives counterparties. In addition, the company has guarantees granted by the Municipal Guarantee Board for reducing the counterparty risks of certain derivative counterparties.

As of 30 June 2011, EUR 25 million of Municipality Finance's advance funding was invested in a bond issued by Caixa D'estalvis de Catalunya. This bond will mature on 29 October 2014 and it is guaranteed by the Spanish government. That bank did not pass the stress test coordinated by the European Banking Authority (EBA) in the summer of 2011. The company does not currently regard this investment as including any particular credit loss risks.

Market risk

Market risk means that the company would suffer a loss if the market price or its volatility undergo a change that is unfavourable to the company. Market risks include those related to interest rates, exchange rates, share prices and other prices.

Municipality Finance uses derivative agreements to hedge against long-term interest rate risks. The company hedges against exchange rate risks by translating all foreign-currency funding into euro with derivative contracts. Derivative contracts are also used to hedge against other price risks. Derivative contracts may only be made for hedging purposes.

The Board of Directors of Municipality Finance has specified limits for currency position risk, interest rate risk based on duration and Value-at-Risk. In addition to the above benchmarks, monthly reports are issued to the management on the parent company's sensitivity to interest rates and calculations concerning changes in the balance sheet market value.

Liquidity risks

Liquidity risk refers to the risk that the company would be unable to handle its payment obligations, arising from the implementation of funding agreements or other funding arrangements, on the due date. Loans that may be called in prematurely are classified in the maturity class corresponding to the first possible call option date. Municipality Finance estimates that 35–45% of debt containing a a call option will be prematurely redeemed during 2011. In the first half of 2011, the company called in 44% of its loans.

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

- refinancing/sustainability of financing,
- refinancing gap,
- minimum and maximum amounts of liquid assets and
- minimum time with the adequacy of liquid funds.

For securing liquidity, Municipality Finance has access to a total of EUR 140 million in the form of credit limit arrangements from other banks.

Market liquidity risk

Market liquidity risk means that the company would fail to realise or cover its position at the market price, because the market lacks depth or is not functioning due to disruption.

The company constantly monitors market and product liquidity. In addition, established market standards are observed when derivative contracts are made. The market values of almost all debt instruments valued at fair value are calculated based on quotations received from the market. For the remaining debt instruments, the market value is calculated using other market information.

Operational risks

Operational risk means the risk of loss due to insufficient or failed internal processes, personnel, systems, or external factors. Operational risks also include the compliance risk caused by non-compliance of internal and external regulation, legal risk and reputational risk. Operational risks may be realised as expenses, compensations, loss of reputation, incorrect position risk and result information or interruption of operations, for example.

Operational risks of the company's operations and processes have been identified. Operations/departments are responsible for the management of operational risks. In addition, the company's compliance department supports the operations/departments in this work and coordinates the management of operational risks at the company level.

Municipality Finance uses various methods for managing operational risks. The company has internal operational guidelines that are updated regularly and monitored for compliance. Key duties and processes have been charted and described. Internal guidelines and processes are updated on a regular basis. The tasks of trading, risk control, back office functions, documentation and bookkeeping are separated. The company has adequate substitution systems ensuring the continuity of key functions. The expertise of the personnel is maintained and improved through regular development discussions and training plans. Municipality Finance maintains sufficient insurance coverage and the level of coverage is evaluated on a regular basis. Municipality Finance has a contingency plan for situations where business operations are interrupted. The plan will help the company to continue functioning and limit its losses in different disruptive scenarios. Municipality Finance's compliance function continuously monitors the development of legislation and regulations issued by authorities relevant to the company's operations and ensures that any regulatory changes receive an appropriate response.

The realisation of operational risks is monitored with systematic damage reporting, which is used to change operating principles or implement other measures to reduce operational risks where necessary. The Board of Management and the Board of Directors are kept up-to-date on the damage reports. No material losses were incurred as a result of operational risks in the first half of 2011.

Prospects for the second half of 2011

The first half of the year has gone according to plan and the Group's profitability is expected to remain at the current strong level throughout the remainder of 2011.

The company expects that the demand for financing in the local government sector will remain at a similar level compared to 2010. The volume of financing for housing production is also expected to be largely the same as last year. However, in the longer term, the company expects that rental housing production will decline significantly unless the state implements a clear shift in housing policy to respond to the rising demand for rental housing in the Helsinki metropolitan area and other urban growth centres. No significant changes are expected in the competitive situation of customer financing in the second half of 2011.

The eurozone debt crisis and the deceleration of the economic growth have weakened the balance of global economy and brought uncertainty to the market stability. Due to the company's excellent credit rating, the good economic situation in the Finnish public sector and the company's advantageous funding position, no problems are expected in securing funding for Municipality Finance.

The upcoming changes in regulations concerning capital adequacy are likely to affect the company's operations in many ways. Municipality Finance actively monitors the progress of the regulatory work while promoting measures to ensure the company's operating conditions after the implementation of the new Capital Requirements Directive.

Municipality Finance began implementing an action plan based on the company's IT strategy in the first half of 2011. Under the IT plan, the company will initiate significant system development projects in the second half of the year.

Inspira's operations are expected to grow as planned in the second half of 2011. The changes in the operating environment and service structure of municipalities and the public sector result in increased demand for Inspira's services.

Helsinki 23 August 2011
Municipality Finance Plc
Board of Directors

Further information:
Pekka Averio, President and CEO, tel. +358 500 406 856
Esa Kallio, Executive Vice President, Deputy to CEO,
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The Group's development (key figures)

Municipality Finance Group: key financial indicators

	30 Jun 2011	30 Jun 2010	31 Dec 2010
Turnover (EUR million)	143.2	92.2	198.9
Net interest income (EUR million)	41.0	38.1	78.7
as percentage of turnover	28.65%	41.33%	39.60%
Net operating profit (EUR million)	35.0	30.5	58.3
as percentage of turnover	24.42%	33.07%	29.32%
Cost-to-income ratio	0.21	0.22	0.23
Loan portfolio (EUR million)	12,649	10,815	11,698
Funding portfolio (EUR million)	17,652	16,438	17,162
Balance sheet total (EUR million)	20,088	19,375	20,047
Return on equity, % (ROE)	28.63%	32.33%	28.42%
Return on assets, % (ROA)	0.44%	0.45%	0.42%
Equity ratio, %	0.95%	0.76%	0.85%
Own funds (EUR million)	273.9	199.9	245.9
Capital adequacy ratio for Tier 1 capital, %	16.90%	10.54%	13.92%
Capital adequacy ratio, %	22.83%	15.56%	19.28%

Calculation of key figures

Turnover

Interest income + commission income + net income from securities and foreign exchange transactions + net income from available-for-sale financial assets + net income from hedge accounting + other operating income

Cost/income ratio

$$\frac{\text{Commission expenses + administrative expenses + depreciations + other operating expenses}}{\text{Net interest income + commission income + net income from securities and foreign exchange transactions + net income from available-for-sale financial assets + net income from hedge accounting + other operating income}} \times 100$$

Return on equity (%) (ROE)

$$\frac{\text{Net operating profit - taxes}}{\text{Equity and non-controlling interest (average of values at the beginning and end of the reporting period)}} \times 100$$

Return on assets (%) (ROA)

$$\frac{\text{Net operating profit - taxes}}{\text{Average balance sheet total (average of values at the beginning and end of the reporting period)}} \times 100$$

Equity ratio (%)

$$\frac{\text{Equity and non-controlling interest + appropriations less deferred tax liabilities}}{\text{Balance sheet total}} \times 100$$

Capital adequacy ratio, Tier 1 capital (%)

$$\frac{\text{Tier 1 capital total}}{\text{Minimum requirement of own funds total}} \times 8$$

Capital adequacy ratio (%)

$$\frac{\text{Own funds total}}{\text{Minimum requirement of own funds total}} \times 8$$

Consolidated Statement of Financial Position

GROUP EUR	30 Jun 2011	31 Dec 2010
ASSETS		
Liquid assets	36,480,491.37	35,502,783.31
Loans and advances to credit institutions	152,719,393.06	36,053,182.53
Loans and advances to the public and public-sector entities	12,661,432,637.69	11,706,412,906.27
Debt securities	5,212,280,805.84	5,420,237,793.92
Shares and participations	27,219.06	27,219.06
Derivative contracts	1,826,757,606.12	2,634,014,984.96
Intangible assets	2,101,792.36	1,464,145.81
Tangible assets	1,365,741.57	1,485,462.47
Other assets	1,215,724.93	1,984,763.93
Accrued income and prepayments	192,385,936.78	207,555,556.99
Deferred tax assets	1,359,315.00	2,337,550.00
TOTAL ASSETS	**20,088,126,663.78**	**20,047,076,349.25**
LIABILITIES AND EQUITY		
LIABILITIES		
Liabilities to credit institutions	2,500,443,619.76	2,613,258,982.50
Liabilities to the public and public-sector entities	1,052,964,369.89	984,601,185.13
Debt securities issued	15,066,982,091.54	14,879,260,808.75
Derivative contracts	839,154,422.53	916,708,857.67
Other liabilities	97,124.48	1,223,063.43
Accrued expenses and deferred income	313,414,258.27	362,293,397.17
Subordinated liabilities	88,340,682.33	88,971,777.74
Deferred tax liabilities	36,749,626.41	29,413,800.00
TOTAL LIABILITIES	**19,898,146,195.21**	**19,875,731,872.39**
EQUITY AND NON-CONTROLLING INTEREST		
Share capital	42,583,195.49	42,583,195.49
Reserve fund	276,711.01	276,711.01
Fair value reserve	-3,868,819.39	-6,653,025.18
Reserve for invested non-restricted equity	40,366,099.60	40,366,099.60
Retained earnings	110,384,047.71	94,468,599.24
Total equity attributable to parent company equity holders	**189,741,234.42**	**171,041,580.16**
Non-controlling interest	**239,234.15**	**302,896.70**
TOTAL EQUITY AND NON-CONTROLLING INTEREST	**189,980,468.57**	**171,344,476.86**
TOTAL LIABILITIES AND EQUITY	**20,088,126,663.78**	**20,047,076,349.25**

Consolidated Income Statement

GROUP EUR	1 Jan – 30 Jun 2011	1 Jan – 30 Jun 2010
Interest income	140,119,149.06	90,460,190.91
Interest expense	-99,092,384.47	-52,352,726.28
NET INTEREST INCOME	**41,026,764.59**	**38,107,464.63**
Commission income	1,237,554.98	875,447.81
Commission expense	-1,488,896.38	-1,115,877.82
Net income from securities and foreign exchange transactions	2,592,456.56	-2,116,968.45
Net income from available-for-sale financial assets	-186,079.21	308,785.46
Net income from hedge accounting	-589,784.57	2,645,541.98
Other operating income	6,279.11	28,471.50
Administrative expenses	-5,409,432.35	-5,022,177.35
Depreciation and impairment on tangible and intangible assets	-332,393.42	-267,053.91
Other operating expenses	-1,890,467.34	-2,155,586.01
Impairment losses on other financial assets	0.00	-800,000.00
OPERATING PROFIT	**34,966,001.97**	**30,488,047.84**
Income taxes	-9,108,266.55	-7,943,751.46
PROFIT FOR THE PERIOD	**25,857,735.42**	**22,544,296.38**
Profit attributable to:		
Equity holders of the parent company	25,681,397.97	22,542,797.10
Non-controlling interest	176,337.45	1,499.28

Statement of Comprehensive Income

GROUP EUR	1 Jan – 30 Jun 2011	1 Jan – 30 Jun 2010
Profit for the financial period	25,857,735.42	22,544,296.38
Available-for-sale financial assets (fair value reserve):		
Net change in fair value	3,424,271.39	2,857,195.36
Net amount transferred to profit or loss	2,747.40	-366,018.94
IAS39 reclassification adjustment	335,422.00	437,544.00
Taxes relating to other components of comprehensive income	-978,234.61	-761,467.31
TOTAL COMPREHENSIVE INCOME	**28,641,941.60**	**24,711,549.49**
Total comprehensive income attributable to:		
Equity holders of the parent company	28,465,604.15	24,710,050.21
Non-controlling interest	176,337.45	1,499.28

Consolidated Statement of Cash Flows

GROUP EUR	1 Jan – 30 Jun 2011	1 Jan – 30 Jun 2010
CASH FLOW FROM OPERATING ACTIVITIES	**-768,575,117.85**	**-111,671,708.76**
Change in long-term funding	1,110,513,476.25	1,440,729,097.29
Change in short-term funding	144,827,396.49	-74,188,493.04
Change in long-term loans	-1,021,638,840.10	-1,008,984,110.00
Change in short-term loans	89,437,014.14	-172,166,231.78
Change in investments	-773,863,127.94	-1,607,107,940.07
Change in deposited guarantees	-346,940,000.00	1,281,110,000.00
Interest paid	-87,250,047.05	-55,531,949.32
Interest received	126,913,610.03	94,326,744.24
Other income	1,807,134.31	1,250,572.23
Payments of operating expenses	-10,569,805.68	-8,530,521.26
Taxes paid	-1,811,928.30	-2,578,877.05
CASH FLOW FROM INVESTMENT ACTIVITIES	**-850,319.07**	**-1,107,026.20**
Acquisition of tangible assets	-4,132.80	-258,931.95
Acquisition of intangible assets	-846,186.27	-848,094.25
CASH FLOW FROM FINANCING ACTIVITIES	**-10,005,949.50**	**-9,990,737.43**
Change in capital loans	0.00	-168,187.93
Dividends paid	-10,005,949.50	-9,822,549.50
NET INCREASE IN CASH FUNDS	**-779,431,386.42**	**-122,769,472.39**
CASH FUNDS AT 1 JANUARY	**2,214,237,323.84**	**1,322,885,948.86**
CASH FUNDS AT 30 JUNE	**1,434,805,937.42**	**1,200,116,476.47**

Cash funds include the following balance sheet items:
Liquid assets, loans and advances to credit institutions, and debt securities maturing within three months.

Cash Funds

GROUP EUR	30 Jun 2011	30 Jun 2010
Liquid assets	36,480,491.37	34,643,329.82
Loans and advances to credit institutions	152,719,393.06	290,969,691.61
Debt securities maturing within three months	1,245,606,052.99	874,503,455.04
TOTAL	**1,434,805,937.42**	**1,200,116,476.47**

Consolidated Statement of Changes In Equity

GROUP EUR 1,000	Attributable to equity holders of the parent company: Share capital	Reserve fund	Fair value reserve	Reserve for invested non-restricted equity	Retained earnings	Total	Non-controlling interest	Total equity
Equity at 31 December 2009	**42,583**	**277**	**-12,698**	**40,366**	**61,306**	**131,834**	**178**	**132,012**
Dividends paid for 2009	-	-	-	-	-9,766	-9,766	-57	-9,823
Comprehensive income for the period	-	-	6,045	-	42,929	48,974	182	49,156
Equity at 31 December 2010	**42,583**	**277**	**-6,653**	**40,366**	**94,469**	**171,042**	**303**	**171,345**
Dividends paid for 2010	-	-	-	-	-9,766	-9,766	-240	-10,006
Comprehensive income for the period	-	-	2,784	-	25,681	28,465	176	28,641
Equity at 30 June 2011	**42,583**	**277**	**-3,869**	**40,366**	**110,384**	**189,741**	**239**	**189,980**

Notes to Interim Financial Statements

1. Principles for preparing the financial accounts

The interim report has been prepared in accordance with the same International Financial Reporting Standards (IFRS) as the annual report of 31 December 2010. The accounting principles are described in the notes to the financial statements in the annual report of 31 December 2010.

This interim report observes the EU-approved IAS 34 Standard on Interim Financial Reporting. Reference figures have been calculated according to the same principles.

The figures in the notes to the financial statements are presented in thousands of euros. This interim report has not been audited.

2. Derivative contracts

30 Jun 2011 EUR 1,000	Nominal value of underlying instrument	Fair value Positive	 Negative
Contracts made for other than hedging purposes (IFRS classification)			
Interest rate swaps	5,029,410	20,415	18,801
Interest rate and currency swaps	72,695	282	524
Equity derivatives	2,577,898	196,603	196,603
Other derivatives	303,980	44,322	43,545
Total	**7,983,983**	**261,622**	**259,473**
Contracts made for hedging purposes (IFRS classification)			
Interest rate swaps	15,382,365	108,637	118,532
Interest rate and currency swaps	13,210,090	1,456,499	461,149
Total	**28,592,455**	**1,565,136**	**579,681**
All total	**36,576,438**	**1,826,758**	**839,154**

31 Dec 2010 EUR 1,000	Nominal value of underlying instrument	Fair value Positive	 Negative
Contracts made for other than hedging purposes (IFRS classification)			
Interest rate swaps	3,576,740	16,931	21,551
Interest rate and currency swaps	81,054	419	403
Equity derivatives	2,076,108	158,179	158,179
Other derivatives	328,945	44,983	44,159
Total	**6,062,847**	**220,512**	**224,293**
Contracts made for hedging purposes (IFRS classification)			
Interest rate swaps	15,670,461	121,267	164,934
Interest rate and currency swaps	13,042,902	2 292,236	527,482
Total	**28,713,363**	**2 413,503**	**692,416**
All total	**34,776,210**	**2 634,015**	**916,709**

3. Liabilities and collateral

EUR 1,000	30 Jun 2011	31 Dec 2010
Liabilities and collateral		
Bonds pledged to the Municipal Guarantee Board	11,754,027	11,557,902
Debt securities pledged to the Municipal Guarantee Board	4,730,471	4,852,991
Bonds pledged to the central bank	820,523	-
Total	**17,305,021**	**16,410,893**
Off-balance-sheet commitments		
Binding credit commitments	1,497,674	1,115,431
Total	**1,497,674**	**1,115,431**

4. Related parties

Any business transactions carried out with a related party are governed by the same principles as Municipality Finance's other business transactions. There were no significant changes with regard to related parties in the first half of the 2011 financial year.

Kuntarahoitus
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