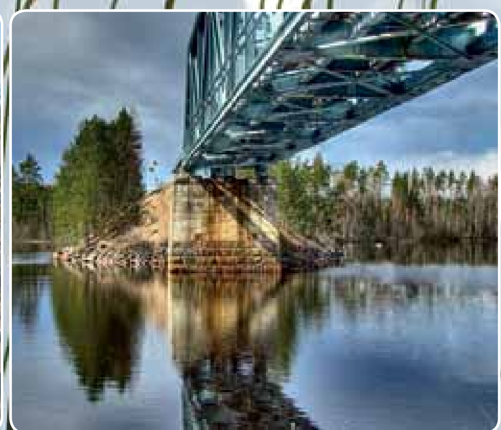
Kuntarahoitus
MUNICIPALITY FINANCE



Interim Report 2012

CEO'S REVIEW

The Nordic financing model secures competitive funding for municipalities

The international financial markets remained nervous in the first half of 2012, with investors sensitive to react to market changes. Measures taken by the European Central Bank gave rise to some hope of a turn for the better in February-March, but market sentiment became extremely cautious again around Easter. The reason behind this was the dragging on of the euro crisis and, in particular, the situation in Greece coming to a head. The problems were exacerbated in late spring due to increased speculation over Spain drifting deeper into difficulties arising from the debt crisis.

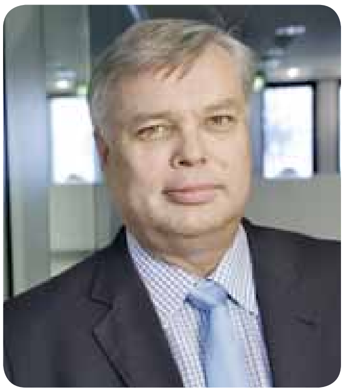
Municipality Finance's funding acquisition was active in the first half of the year in spite of the uncertainty in the markets. We acquired over 80% of our annual funding of nearly six billion euros by the end of June.

The two largest transactions were our inaugural Sterling benchmark issue of GBP 300 million, carried out in February, and the April issue of our second USD benchmark at USD 1 billion. The successful transactions helped Municipality Finance acquire significant new investors and increase its geographic diversification.

The high level of interest in our benchmark issues among central banks is a very positive sign. It is indicative of the confidence international investors have in Finland and the Finnish local government sector. Investor confidence in Finland has remained high despite the prevailing uncertainty over whether the eurozone can overcome the current crisis. Finland is increasingly perceived as a safe harbour in a nervous market.

Municipality Finance broke new ground in funding acquisition in April by issuing a new kind of targeted bond in the Finnish and Japanese markets. For the first time private investors around the world had the opportunity to invest safely in a specific Finnish environmental project, namely a Westenergy waste energy power plant in Mustasaari. The "clean energy bond" was so popular in Japan that Municipality Finance issued a total of three bonds, with the second issue following the first by just over a week. The clean energy bond is proof of Municipality Finance's ability to create innovative new investment products to further diversify the funding base of non-profit projects.

Municipality Finance does not anticipate major changes in the funding requirements of the Finnish local government sector in the near term. Lending volume in the first half of 2012 remained largely unchanged from the previous year, although the housing loan portfolio grew somewhat faster than in 2011. Lending for renovation projects and the level of refinancing of housing loans increased. Many of the refinancing transactions concerned old state-subsidised housing loans that were refinanced as market loans due to the historically low interest rates. The state's guarantee liabilities for the housing loans of municipalities and non-profit corporations are diminishing as the loans become guaranteed by the municipalities themselves.



Municipality Finance maintained its strong position as the largest lender for the Finnish local government sector. For our customers, we are clearly the most important channel for accessing the international financial markets. Our customers are also increasingly relying on us to anticipate market changes. Our active involvement in a variety of markets helps us keep our finger on the pulse of the development of the financial markets and anticipate market risks for the benefit of our customers, Finnish municipalities and non-profit operators engaged in state-subsidised housing construction.

The financial markets are going through major changes. One of the consequences of these changes is lenders focusing on operations that best match their risk and yield profiles. The forthcoming banking regulations and the current eurozone crisis have resulted in changes in the way many banks acquire funding and their capacity to offer loans for long-term investments. Banks are increasingly focusing on lending to the private sector, while Municipality Finance and similar financial institutions manage the funding of the local and regional government sectors in many European countries. Many of the countries that currently do not have a financial institution of this type are either in the process of establishing one or giving the matter serious consideration. It remains to be seen what other impacts the forthcoming regulations will have on the functioning of the financial markets.

The tighter market regulations stemming from the financial crisis will be an important factor in the future of Municipality Finance, as they will result in increasing costs and capital requirements for the banking sector as a whole, including Municipality Finance. In response to these developments, Municipality Finance is continuing to strengthen its balance sheet to ensure the availability of competitive funding to its customers in the future. Our primary method for strengthening the balance sheet is ensuring the profitability of our operations.

At the same time, we are also determined to develop our operations further and provide a broader range of services to our customers. Our highly popular financial leasing services are a good example of this. Real estate leasing, in particular, has a great deal of growth potential. We are also actively developing the financial advisory services of Inspira.

We contribute to the local government sector as a whole by funding investments in the maintenance of municipal infrastructure and public buildings. Many schools, hospitals, streets and water supply networks are badly in need of maintenance and renovation. Under the circumstances of uncertainty related to the local government reform and concern over the increasing indebtedness of municipalities, the burden of this maintenance backlog is being shifted to future generations. It would be sensible to proceed with maintenance and renovation investments during the current economic slowdown.

Helsinki 21 August 2012
Pekka Averio
President and CEO

Interim report 1 January – 30 June 2012

- The Group's net operating profit for the period was EUR 63.7 million (1 January – 30 June 2011: EUR 35.0 million). This represents an 82% increase on the previous year.
- Net interest income grew by 65% compared to the previous year, reaching EUR 67.9 million (1 January – 30 June 2011: EUR 41.0 million).
- The balance sheet total was EUR 27,141 million (31 December 2011: EUR 23,842 million). The balance sheet total increased by 14% from the end of the previous year.
- The Group's risk-bearing capacity remained very strong, with capital adequacy at 27.85% at the end of June (31 December 2011: 24.13%) and the capital adequacy ratio, Tier 1 capital at 21.66% (31 December 2011: 19.04%).
- Total funding acquisition for January-June amounted to EUR 4,930 million (1 January – 30 June 2011: EUR 5,124 million). The total amount of funding grew to EUR 22,820 million (31 December 2011: EUR 20,092 million).
- The long-term loan portfolio increased to EUR 14,680 million (31 December 2011: EUR 13,625 million). Loans amounting to EUR 1,582 million were issued (1 January – 30 June 2011: EUR 1,476 million).
- The company has also continued to focus on and invest in the financial leasing operations launched in 2010. The leasing portfolio stood at EUR 49 million at the end of June (31 December 2011: EUR 30 million).
- At the end of June, investments totaled EUR 5,662 million (31 December 2011: EUR 5,055 million).
- The turnover of Municipality Finance's subsidiary Inspira was EUR 0.9 million (1 January – 30 June 2011: EUR 1.2 million). Inspira's net operating profit at the end of June was EUR 0.1 million (1 January – 30 June 2011: EUR 0.4 million).

Key figures (Group)

	30 Jun 2012	30 Jun 2011	31 Dec 2011
Net interest income (EUR milllion)	67.9	41.0	94.2
Net operating profit (EUR million)	63.7	35.0	65.3
New loans issued (EUR million)	1,582	1,476	2,780
New funding acquisition (EUR million)	4,930	5,124	6,673
Balance sheet total (EUR million)	27,141	20,088	23,842
Own funds (EUR million)	354,0	273.9	288.4
Capital adequacy ratio of for Tier 1 capital, %	21.66	16.90	19.04
Capital adequacy ratio, %	27.85	22.83	24.13
Return on equity (ROE)	40.45	28.63	27.08
Cost-to-income ratio	0.15	0.21	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.
This is a translation of the original Finnish interim report "Osavuosikatsaus 1.1.-30.6.2012". Should there be any discrepancies between this translation and the Finnish original, the latter shall prevail.

Credit ratings

Municipality Finance's credit ratings

Rating agency	Long-term funding	Outlook	Short-term funding	Outlook
Moody's Investor Service	Aaa	Stable	P-1	Stable
Standard & Poor's	AAA	Negative	A-1+	Stable

Municipality Finance's funding is guaranteed by The Municipal Guarantee Board.

The Municipal Guarantee Board's credit ratings

Rating agency	Long-term funding	Outlook	Short-term funding	Outlook
Moody's Investor Service	Aaa	Stable	P-1	Stable
Standard & Poor's	AAA	Negative	A-1+	Stable

In January 2012, Standard & Poor's (S&P) confirmed the credit rating of the long-term funding of Municipality Finance and the Municipal Guarantee Board as AAA with a negative outlook. This credit rating is the same as that of the Finnish sovereign. S&P noted that no significant changes had taken place with regard to the company's financial position. However, according to S&P's rating methodology, the credit rating of Municipality Finance cannot be higher than the rating of the sovereign. At the same time, S&P confirmed its rating for the company's short-term funding as A-1+, the highest possible rating.

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 the services, 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

Taking the challenges of the international business environment into consideration, the Group's operating profit was excellent. Business continued to grow and the net operating profit for the first half of 2012 before appropriations and taxes stood at EUR 63.7 million (1 January – 30 June 2011: EUR 35.0 million). The Group's net interest income in the first half of 2012 increased by 65% on the previous year, reaching EUR 67.9 million at the end of June 2012 (1 January – 30 June 2011: EUR 41.0 million). The net interest income includes EUR 6.1 million in profits from the repurchase of the company's own debt securities (1 January – 30 June 2011: EUR 1.4 million). The net income includes EUR 7.2 million in unrealised fair value changes (1 January – 30 June 2011: EUR 1.8 million).

In the first half of the year, the net operating profit of Municipality Finance's subsidiary Inspira was EUR 0.1 million (1 January – 30 June 2011: EUR 0.4 million).

The Group's operating expenses grew by 20% in the first six months of the year, reaching EUR 9.5 million (1 January - 30 June 2011: EUR 7.6 million). The increase in expenses was primarily the result of growth in personnel requirements due to the increase in business volume and changes in the company's operating environment, as well as currently ongoing system development projects. Administrative expenses for the period were EUR 6.5 million (1 January – 30 June 2011: EUR 5.4 million), of which personnel expenses were EUR 4.5 million (1 January – 30 June 2011: EUR 3.6 million). Depreciation of tangible and intangible assets amounted to EUR 0.5 million (1 January – 30 June 2011: EUR 0.3 million). Other operating expenses were EUR 2.4 million (1 January – 30 June 2011: EUR 1.9 million).

The consolidated balance sheet total was EUR 27,141 million at the end of June 2012 (31 December 2011: EUR 23,842 million). The majority of the balance sheet development was caused by increased operations as well as changes in the valuation of derivatives and debt, as other currencies strengthened against the euro.

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 for loans as well as deficiency guarantees given by the state of Finland. For derivatives, netting agreements, 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 354.0 million at the end of June 2012 (31 December 2011: EUR 288.4 million). Tier 1 capital stood at EUR 275.4 million at the end of June 2012 (31 December 2011: EUR 227.6 million). Tier 1 capital includes the net profit for the period of 1 January – 30 June 2012, as the result for the period has been subject to a general review by the auditors 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 2012 does not include a provision for dividend distribution. 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 to the Shareholders' Meeting based on the company's financial situation and the regulations in force at the time, taking also the company's ownership structure into consideration. Secondary own funds at the end of the period under review totalled EUR 78.7 million (31 December 2011: EUR 60.8 million).

Own funds, Group

(EUR 1,000)	30 Jun 2012	31 Dec 2011
Share capital	42,583	42,583
Minority interest	111	241
Reserve fund	277	277
Reserve for invested non-restricted equity	40,366	40,366
Retained profit	135,434	84,703
Profit for the financial year	48,007	50,731
Provision for dividend distribution	0	0
Capital loans	11,009	11,009
Intangible assets	-2,415	-2,273
TOTAL TIER 1 CAPITAL	**275,372**	**227,637**
Fair value reserve	3,658	-14,210
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	**78,658**	**60,790**
TOTAL OWN FUNDS	**354,030**	**288,427**

The Group's capital adequacy ratio has developed positively, reaching 27.85% at the end of June 2012, compared to 24.13% at the end of 2011. The capital adequacy ratio, Tier 1 capital, was 21.66% (31 December 2011: 19.04 %).

The minimum requirement for own funds, corresponding to the minimum capital adequacy ratio of 8% pursuant to the Act on Credit Institutions, was EUR 101.7 million (31 December 2011: EUR 95.6 million). The capital adequacy ratio for credit risk tied up the largest amount of the Group's own funds at EUR 91.4 million (31 December 2011: EUR 87.9 million), the most significant items being claims from credit institutions and investment firms as well as securitised items.

Risk-weighted exposure, Group

(EUR 1,000)	30 Jun 2012	31 Dec 2011
Credit risk, standard method	**1,142,472**	**1,098,808**
Total minimum requirement for own funds		
Credit risk, standard method		
Claims on credit institutions and investment firms	47,182	45,627
Covered bonds	12,758	9,797
Securitised items	28,945	29,619
Other items	2,512	2,861
Total credit risk, standard method	91,398	87,904
Market risk	0	0
Operational risk, basic method	10,270	7,722
TOTAL MINIMUM REQUIREMENT FOR OWN FUNDS	**101,668**	**95,626**
Capital adequacy ratio, Tier 1 capital, %	21.66%	19.04%
CAPITAL ADEQUACY RATIO, %	**27.85%**	**24.13%**

Funding

Municipality Finance's funding is based on reliability, speed and flexibility and on 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 has the same credit rating from Moody's and Standard & Poor's 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 when calculating the capital adequacy of credit institutions in Finland and several other European countries.

In January-June, EUR 4,930 million was acquired in long-term funding (1 January – 30 June 2011: EUR 5,124 million), of which Municipal Bonds issued under the domestic debt programme amounted to EUR 5.5 million (1 January – 30 June 2011: EUR 13.7 million). The company issued bonds denominated in 14 different currencies in the first half of 2012. A total of EUR 1,965 million was issued in short-term debt instruments under the Treasury Bill programme in January-June (1 January – 30 June 2011: EUR 1,893 million). Total funding at the end of June 2012 amounted to EUR 22,820 million (31 December 2011: EUR 20,092 million). Of this total amount, 15% was denominated in euros (31 December 2011: 16%) and 85% in foreign currencies (31 December 2011: 84%).

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 euro zone. There was also interest in the company's bonds in the Nordic countries.

Municipality Finance has acquired the majority of its funding for the year in the first half of 2012. A total of 109 arrangements were made in the international funding markets in the first half of the year (1 January – 30 June 2011: 132 arrangements). In February 2012, Municipality Finance launched its inaugural Sterling benchmark issue worth GBP 300 million, and in April the company successfully made its second USD benchmark issue worth USD 1.0 billion. These funding arrangements help Municipality Finance increase the diversification of its funding sources. The two benchmark issues were successful despite the challenging market conditions, allowing Municipality Finance to further expand its investor base.

The first half of 2012 was characterised by continued restlessness in the markets. As the European crisis continued unabated, investors sought safe harbours for their assets. Supported by the stability and solid reputation of the Finnish local government sector, Municipality Finance was seen as a safe alternative by investors. Active investor cooperation has increased the company's 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 regard. The company managed to cover the vast majority of its full-year funding requirements during the first half and, as a result, had to restrict the number of new funding arrangements. Nevertheless, with some further funding still required, Municipality Finance will return to the international capital markets later in the year.

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 2012. 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. The rate of increase in lending for housing construction was higher than anticipated at the end of the previous year. This increase in demand for housing financing is largely due to customers looking to refinance their old state-subsidised housing loans with new market-based loans.

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 risk. Demand for derivative products was high in the first half of 2012. As interest rates remained low, customers increased their hedging against future increases in market rates.

The total volume of requests for loan proposals received by Municipality Finance in January-June was EUR 2,274 million (1 January – 30 June 2011: EUR 2,308 million). The total amount of new loans granted in the first half of 2012 was slightly up from the same period last year at EUR 1,582 million (1 January – 30 June: EUR 1,476 million). At the end of June 2012, Municipality Finance's long-term loan portfolio stood at EUR 14,680 million (31 December 2011: EUR 13,625 million). This corresponds to an 8% increase in the loan portfolio from year's end.

Municipality Finance's market share has remained 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.

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 e.g. municipally-owned corporations and hospital districts. Early in 2012, Municipality Finance also began offering real estate leasing services to municipalities as an alternative to traditional modes of financing.

Short-term financing

Municipalities and municipal federations issue municipal commercial papers to cover their short-term financing needs. Companies under the control of municipalities and municipal federations issue municipal company commercial papers.

With interest rates remaining low, customers continued to be active in using short-term financing. At the end of June 2012, the total value of municipal commercial paper programmes and municipal company commercial paper programmes concluded with Municipality Finance was EUR 2,934 million (31 December 2011: EUR 2,786 million). At the end of the reporting period, the company had EUR 533 million in municipal commercial papers and municipal company commercial papers in its balance sheet (31 December 2011: EUR 534 million). During the first six months of the year, the company's customers acquired financing through short-term programmes totalling of EUR 4,458 million (1 January – 30 June 2011: EUR 2,819 million).

Investment operations

Municipality Finance's investment operations comprise the investment of acquired funding in liquid deposits and financial sector 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 following six months.

At the end of June 2012, the total amount of investment was EUR 5,662 million (31 December 2011: EUR 5,055 million) and the average credit rating of all investments was AA (31 December 2011: AA+). The average remaining life of the portfolio stood at 2.85 years (31 December 2011: 2.72 years).

Thanks to ample funding, liquidity has remained good. New investments are mainly made in covered bonds, bonds issued by states and banks, certificates of deposit of less than one year and short-term central bank deposits.

The company has no investments in bonds issued by Southern European states or other significant investments in the region.

Inspira

Inspira's operations developed according to plan in the first half of 2012. Turnover for January-June was EUR 0.9 million (1 January – 30 June 2011: EUR 1.2 million). The net operating profit for the first half of the year was EUR 0.1 million (January 1 – June 30, 2011: EUR 0.4 million).

Turnover comprised a wide range of assignments related to funding arrangements for public sector investments as well as various ownership arrangements in the local government sector.

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. As Municipality Finance is solely an issuer of bonds and its shares are not subject to public trading, applying the Corporate Governance Code for Finnish listed companies directly in its entirety is not functional. Nevertheless, the company has decided to use the Corporate Governance Code as the basis for preparing its own Corporate Governance Policy. In addition to the Corporate Governance Code for Finnish listed companies, the Corporate Governance Policy of Municipality Finance has been prepared in compliance with Finnish Financial Supervisory Authority standard 1.3 on "Internal Governance and Organisation of Activities".

The Board is responsible for making sure that Municipality Finance complies with the Corporate Governance rules and is committed to developing them further.

Municipality Finance's Corporate Governance Policy is available in Finnish, English and Swedish on the company's website at www.munifin.fi.

Annual General Meeting

The Annual General Meeting of Municipality Finance was held on 27 March 2012. The Annual General Meeting confirmed the financial statements for 2011 and discharged the members of the Board of Directors, the CEO and the Deputy CEO from liability for the financial period of 2011. The Annual General Meeting adopted the proposal of the Board of Directors to not distribute a dividend and to retain the distributable funds of EUR 144,330.52 in equity.

Based on the proposal of the Shareholders' Nomination Committee, the Annual General Meeting decided that the Board of Directors shall have eight members during the 2012-2013 term of office and elected the members of the Board of Directors. The Annual General Meeting also adopted the proposal of the Shareholders' Nomination Committee on the remuneration of Board members.

The meeting also elected KPMG Oy Ab as the auditor of the company, with APA Marcus Tötterman as the accountable auditor.

Board of Directors

At the Annual General Meeting of 27 March 2012, the Shareholders' Nomination Committee proposed to the meeting that all of the current Board members be re-elected for the term beginning at the end of the Annual General Meeting of 2012 and concluding at the end of the following Annual General Meeting. The Annual General Meeting elected the following members to the Board of Directors:

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, 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: Municipality Director, Suomussalmi municipality
- 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 available online at www.munifin.fi.

Personnel

At the end of June 2012, Municipality Finance Group had 69 employees (31 December 2011: 67), of whom 59 were staff of the parent company (31 December 2011: 57). 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, Senior Vice President Marjo Tomminen and Senior Vice President Mari Tyster. Senior Vice President Mari Tyster was appointed as a member of the Board of Management effective 1 June 2012.

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

Internal audit

Internal auditing work has been outsourced to Deloitte & Touche Oy. The company's compliance unit is responsible for the coordination of the outsourced auditing. 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

Municipality Finance's operations depend on sufficient risk management mechanisms to ensure that the company's risk position remains within the limits confirmed by the Board of Directors. Municipality Finance applies very conservative principles to its risk management. The aim is to minimise open risk positions and keep the overall risk status at such a low level that the company's strong credit rating (Aaa/AAA) is not compromised.

Municipality Finance's general principles, limits and measurement methods used in risk management are determined by the Board of Directors. The purpose of risk management is to ensure that the risks associated with lending, funding acquisition, investment and other business operations remain in line with Municipality Finance's low risk profile. The risk position and limit utilisation are reported to the Board of Management and Board of Directors on a regular basis.

There were no material changes in the company's risk position during 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, and 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 extends to 2018.

Credit risk

Credit risk means the risk of a counterparty defaulting on its commitments to the company. Municipality Finance may only grant loans and leasing financing without a separate security directly to a municipality or municipal federation. For others, loans must be secured with an absolute guarantee or deficiency guarantee issued by a municipality or municipal federation, or a state deficiency guarantee. A primary pledge is required when the loan is given a deficiency guarantee by a municipality or a state. The amount of the primary pledge must equal 1.2 times the amount of the loan. Because such quarantee is required to reduce the credit risk, all loans granted are classified as zero-risk when calculating capital adequacy. The company does not bear the depreciation risk for the objects of its leasing services. Municipality Finance has not had any non-performing assets during its operations or credit losses in the financing of its customers.

Municipality Finance is also exposed to credit risk from its pre-funding investment portfolio and derivative instruments. In the assessment of credit risks, principles and limits that are based on external credit ratings and have been approved by the Board of Directors are applied to the selection of counterparties. Nominal values of debt securities and market values of derivatives (fair value method) are used in monitoring credit risk. Municipality Finance limits credit risk caused by derivative agreements with ISDA Credit Support Annexes in the case of derivatives counterparties. Additionally, the Municipal Guarantee Board's guarantees are used for reducing the counterparty risks related to the derivative contracts of certain counterparties.

Market risk

Market risk means the risk of the company incurring a loss as a result of an unfavourable change in market price or market price volatility. Market risks include interest rate, exchange rate, share prices and other price risks.

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

The Board of Directors of Municipality Finance has specified limits for currency position risk, interest rate risk based on duration and interest rate sensitivity, income risk and Value-at-Risk. In addition to these market risk parameters, management receives monthly the calculation of changes in the balance sheet market value.

Liquidity risk

Liquidity risk means the risk of the company not being able to perform on the due date its payment obligations arising from the implementation of funding agreements or other funding activities. The Board of Directors of Municipality Finance has set the following limits on liquidity risks:

- refinancing gap
- sufficiency of liquid assets measured as a minimum of time
- minimum amount of liquid assets

As back-up liquidity, Municipality Finance has access to a total of EUR 140 million in the form of back-up facility 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 monitors the liquidity of markets and products on a continuous basis. In addition, established market standards are observed when derivative contracts are made. The market values of almost all debt securities valued at fair value are calculated based on quotations received from the market. For the remaining debt securities, the market value is calculated using other market information.

The company has been approved as a counterparty of financial policy of the Bank of Finland.

Operational risks

Operational risk means the risk of loss due to insufficient or failed internal processe mapping, personnel, systems, or external factors. Operational risks also include risks arising from failure to comply with internal and external regulation (compliance risk), legal risks and reputational risk. Operational risks may result in expenses, payable compensation, loss of reputation, false information on position, risk and results or the interruption of operations.

Operational risks are recognised as part of the company's operations and processes. This has been implemented with an annual mapping of operational risk at a unit and company-specific level. The management of operational risks is the responsibility of each function/department. In addition, the company's middle office department, legal affairs and compliance department support functions/departments in this work. The middle office department is responsible for coordinating 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 instructions and processes are revised on a regular basis. The tasks of trading, risk control, back office functions, documentation and bookkeeping are separated. The company has adequate substitution systems to ensure the continuity of key functions. The expertise of the personnel is maintained and improved through regular development discussions and training plans. Municipality Finance maintains adequate insurance cover and assesses the level of insurance cover on a regular basis. Municipality Finance has a contingency plan for situations where business operations are interrupted. The plan is designed to help company continue functioning and limit its losses in different disruptive scenarios. The annual mapping of operational risks and the operational risk report procedure for operational risk events are used as inputs in the company's continuity planning.

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 are appropriately responded to. The company currently has significant ongoing information system projects aimed at improving the efficiency of operations. The operational risks involved with these projects have been minimised by developing procedures for project management and monitoring, including regular reporting.

The realisation of operational risks is monitored with systematic operational risk 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 operational risk reports. No material losses were incurred as a result of operational risks in the first half of 2012.

Prospects for the second half of 2012

It appears unlikely that the extended uncertainty in the international financial markets will be resolved in the near term. Interest rates are expected to remain low throughout the rest of the year. Despite the uncertainty in the financial markets and the problems of several eurozone economies, it is expected that Municipality Finance will maintain its strong position and capacity to serve the financing needs of the local government sector.

On the strength of successful funding acquisition during the first half of the year, Municipality Finance has ensured the availability of competitive financing for its customer base in the second half of the year regardless of the potential exacerbation of the euro crisis.

The local government sector financing needs are not expected to increase significantly in the second half of the year. The uncertainties surrounding local government reform may result in some municipal projects becoming postponed.

The company is actively monitoring the developments regarding future changes to capital adequacy requirements and other regulations while also proceeding with measures to ensure the continuity of its operations going forward.

Municipality Finance is continuing to develop its operations according to plans, with a particular focus on the information system renewal project launched in late 2011. On the service front, the company is focused on developing its financial products, leasing services and the advisory services of its subsidiary Inspira.

The company expects that pressures to improve public sector efficiency will continue to increase, which will be particularly reflected in the reorganisation of activities in the local government sector. The changes in the operating environment and service structure of municipalities and the public sector result in increased demand for Inspira's services.

The Group's profitability is expected to remain at the current strong level in the second half of 2012.

Helsinki 21 August 2012
Municipality Finance Plc
Board of Directors

Further information:
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The Group's development (key figures)

Municipality Finance Group: key financial indicators

	30 Jun 2012	30 Jun 2011	31 Dec 2011
Turnover (EUR million)	172.8	143.2	319.0
Net interest income (EUR million)	67.9	41.0	94.2
as percentage of turnover	39.27%	28.65%	29.53%
Net operating profit (EUR million)	63.7	35.0	65.3
as percentage of turnover	36.85%	24.42%	20.45%
Cost-to-income ratio	0.15	0.21	0.23
Loan portfolio (EUR million)	14,680	12,649	13,625
Funding portfolio (EUR million)	22,820	17,652	20,092
Balance sheet total (EUR million)	27,141	20,088	23,842
Return on equity, % (ROE)	40.45%	28.63%	27.08%
Return on assets, % (ROA)	0.38%	0.44%	0.23%
Equity ratio, %	1.00%	0.95%	0.86%
Own funds (EUR million)	354.0	273.9	288.4
Capital adequacy ratio for Tier 1 capital, %	21.66%	16.90%	19.04%
Capital adequacy ratio, %	27.85%	22.83%	24.13%

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 2012	31 Dec 2011
ASSETS		
Liquid assets	13,526,351.24	26,507,291.80
Loans and advances to credit institutions	2,138,130,608.95	562,006,830.73
Loans and advances to the public and public sector entities	14,729,738,132.70	13,654,934,443.96
Debt securities	6,195,453,539.95	5,588,958,735.18
Shares and participations	27,219.06	27,219.06
Derivative contracts	3,835,585,509.11	3,750,333,786.73
Intangible assets	2,415,371.25	2,273,072.18
Tangible assets	2,372,106.96	2,460,149.10
Other assets	2,559,920.05	1,742,655.66
Accrued income and prepayments	221,229,007.21	247,761,352.13
Deferred tax assets	22,403.39	4,611,171.00
TOTAL ASSETS	**27,141,060,169.87**	**23,841,616,707.53**
LIABILITIES AND EQUITY		
LIABILITIES		
Liabilities to credit institutions	4,377,028,836.59	3,533,230,091.21
Liabilities to the public and public sector entities	1,083,237,439.72	1,176,752,432.59
Debt securities issued	19,736,725,446.02	17,187,942,326.47
Derivative contracts	1,255,717,683.51	1,253,255,710.82
Other liabilities	514,698.08	2,529,600.82
Accrued expenses and deferred income	266,878,486.41	349,695,135.86
Subordinated liabilities	90,176,104.70	89,915,861.74
Deferred tax liabilities	60,345,149.59	43,605,100.00
TOTAL LIABILITIES	**26,870,623,844.62**	**23,636,926,259.51**
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	3,658,117.59	-14,209,934.69
Reserve for invested non-restricted equity	40,366,099.60	40,366,099.60
Retained earnings	183,440,852.40	135,433,584.54
Total equity attributable to parent company equity holders	**270,324,976.09**	**204,449,655.95**
Non-controlling interest	**111,349.16**	**240,792.07**
TOTAL EQUITY AND NON-CONTROLLING INTEREST	**270,436,325.25**	**204,690,448.02**
TOTAL LIABILITIES AND EQUITY	**27,141,060,169.87**	**23,841,616,707.53**

Consolidated Income Statement

Group, EUR	1 Jan – 30 Jun 2012	1 Jan – 30 Jun 2011
Interest income	165,932,626.72	140,119,149.06
Interest expense	-98,081,041.13	-99,092,384.47
NET INTEREST INCOME	**67,851,585.59**	**41,026,764.59**
Commission income	926,679.69	1,237,554.98
Commission expense	-1,582,941.04	-1,488,896.38
Net income from securities and foreign exchange transactions	3,229,487.71	2,592,456.56
Net income from available-for-sale financial assets	-529,140.03	-186,079.21
Net income from hedge accounting	3,242,666.11	-589,784.57
Other operating income	-20,543.91	6,279.11
Administrative expenses	-6,506,015.48	-5,409,432.35
Depreciation and impairment on tangible and intangible assets	-525,783.72	-332,393.42
Other operating expenses	-2,418,947.34	-1,890,467.34
OPERATING PROFIT	**63,667,047.58**	**34,966,001.97**
Income taxes	-15,616,222.63	-9,108,266.55
PROFIT FOR THE PERIOD	**48,050,824.95**	**25,857,735.42**
Profit attributable to:		
Equity holders of the parent company	48,007,267.86	25,681,397.97
Non-controlling interest	43,557.09	176,337.45

STATEMENT OF COMPREHENSIVE INCOME

Group, EUR	1 Jan – 30 Jun 2012	1 Jan – 30 Jun 2011
Profit for the financial period	48,050,824.95	25,857,735.42
Available-for-sale financial assets (fair value reserve):		
Net change in fair value	22,807,679.89	3,424,271.39
Net amount transferred to profit or loss	710,390.39	2,747.40
IAS39 reclassification adjustment	148,233.00	335,422.00
Taxes relating to other components of comprehensive income	-5,798,244.30	-978,234.61
TOTAL COMPREHENSIVE INCOME	**65,918,883.93**	**28,641,941.60**
Total comprehensive income attributable to:		
Equity holders of the parent company	65,875,326.84	28,465,604.15
Non-controlling interest	43,557.09	176,337.45

Consolidated Statement Of Cash Flows

Group, EUR	1 Jan – 30 Jun 2012	1 Jan – 30 Jun 2011
CASH FLOW FROM OPERATING ACTIVITIES	**771,095,356.93**	**–768,575,117.85**
Change in long-term funding	2,269,264,162.90	1,110,513,476.25
Change in short-term funding	244,499,664.52	144,827,396.49
Change in long-term loans	-1,044,658,712.55	-1,021,638,840.10
Change in short-term loans	393,466.18	89,437,014.14
Change in investments	-1,325,276,073.78	-773,863,127.94
Change in collaterals	569,430,000.00	-346,940,000.00
Interest paid	-119,399,465.68	-87,250,047.05
Interest received	184,368,213.85	126,913,610.03
Other income	3,239,669.24	1,807,134.31
Payments of operating expenses	-10,679,921.32	-10,569,805.68
Taxes paid	-85,646.43	-1,811,928.30
CASH FLOW FROM INVESTING ACTIVITIES	**-634,205.78**	**-850,319.07**
Acquisition of tangible items	-164,559.29	-55,571.40
Acquisition of intangible items	-469,646.49	-794,747.67
CASH FLOW FROM FINANCING ACTIVITIES	**-173,000.00**	**-10,005,949.50**
Dividends paid	-173,000.00	-10,005,949.50
NET INCREASE IN CASH FUNDS	**770,288,151.15**	**–779,431,386.42**
CASH FUNDS AT 1 JANUARY	**2,475,444,173.53**	**2,214,237,323.84**
CASH FUNDS AT 30 JUNE	**3,245,732,324.68**	**1,434,805,937.42**

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, EUR	30 Jun 2012	30 Jun 2011
Liquid assets	13,526,351.24	36,480,491.37
Loans and advances to credit institutions	2,135,130,609.95	152,719,393.06
Debt securities maturing within three months	1,097,075,363.49	1,245,606,052.99
Total cash funds	**3,245,732,324.68**	**1,434,805,937.42**

Consolidated statement of changes in equity

Group, EUR 1,000	Share capital	Reserve fund	Fair value reserve	Reserve for invested non-restricted equity	Retained earnings	Total	Non-controlling interest	Total equity
	Attributable to equity holders of the parent company							
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	-	-	-7,557	-	50,731	43,174	178	43,352
Equity at 31 December 2011	**42,583**	**277**	**-14,210**	**40,366**	**135,434**	**204,450**	**241**	**204,691**
Dividends paid for 2011	-	-	-	-	-	0	-173	-173
Comprehensive income for the period	-	-	17,868	-	48,007	65,875	43	65,918
Equity at 30 June 2012	**42,583**	**277**	**3,658**	**40,366**	**183,441**	**270,325**	**111**	**270,436**

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 2011. The accounting principles are described in the notes to the financial statements in the annual report of 31 December 2011.

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 2012	Nominal value of underlying instrument	Fair value Positive	Fair value Negative
Contracts made for other than hedging purposes (IFRS classification)			
Interest rate derivatives			
Interest rate swaps	5,961,100	40,642	79,287
Currency derivatives			
Interest rate and currency swaps	63,551	453	461
Forward exchange contracts	166,799	0	6,084
Equity derivatives	4,051,262	335,771	335,771
Other derivatives	261,511	43,041	42,388
Total	**10,504,223**	**419,907**	**463,991**
Contracts made for hedging purposes (IFRS classification)			
Interest rate derivatives			
Interest rate swaps	17,820,232	320,553	289,835
Currency derivatives			
Interest rate and currency swaps	15,929,165	3,095,125	501,892
Total	**33,749,396**	**3,415,678**	**791,727**
All total	**44,253,620**	**3,835,585**	**1,255,718**

31 Dec 2011	Nominal value of underlying instrument	Fair value Positive	Fair value Negative
Contracts made for other than hedging purposes (IFRS classification)			
Interest rate derivatives			
Interest rate swaps	5,462,807	27,513	55,088
Currency derivatives			
Interest rate and currency swaps	78,342	466	456
Equity derivatives	3,113,313	375,534	375,534
Other derivatives	306,721	46,952	46,229
Total	**8,961,183**	**450,465**	**477,307**
Contracts made for hedging purposes (IFRS classification)			
Interest rate derivatives			
Interest rate swaps	16,309,222	308,436	221,969
Currency derivatives			
Interest rate and currency swaps	14,636,337	2,991,433	553,979
Total	**30,945,559**	**3,299,869**	**775,948**
All total	**39,906,742**	**3,750,334**	**1,253,256**

3. Liabilities and collateral

Liabilities and collateral	30 Jun 2012	31 Dec 2011
Loans pledged to the central bank	2,128,693	1,119,103
Loans pledged to the Municipal Guarantee Board	12,306,059	12,292,246
Debt securities pledged to the Municipal Guarantee Board	5,579,382	5,044,995
Total	**20,014,134**	**18,456,344**

Off-balance-sheet commitments	30 Jun 2012	31 Dec 2011
Binding credit commitments	1,403,012	1,375,718
Total	**1,403,012**	**1,375,718**

4. Related-party transactions

Municipality Finance's related parties are shareholders whose ownership and corresponding voting rights in the company exceed 20%, the CEO, the Deputy to the CEO, members of the Board of Directors, the responsible auditor, the spouses and underaged children of these persons and corporations controlled by them. Municipality Finance's operations are restricted by the Act on the Municipal Guarantee Board and the framework agreement concluded between the company and the Municipal Guarantee Board, pursuant to which the company may only grant loans to parties stipulated by law (municipalities, municipal federations, corporations that are wholly owned by municipalities or under their control and corporations designated by government authorities and engaged in the renting or production and maintenance of housing on social grounds). Municipality Finance has not carried out any business transactions with related parties with the exception of employment-based remuneration. Municipality Finance does not have loan or financial receivables from related parties.

Municipality Finance's related parties also include its subsidiary Inspira. Transactions with Inspira comprise fees related to administrative services.

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