

**MORTGAGE AND LAND BANK  
OF LATVIA**

**Interim Condensed Consolidated and Bank Financial  
Statements for the nine months period ended 30 September  
2008 (unaudited)**

*Mortgage and Land Bank of Latvia*  
*Interim Condensed Consolidated and Bank Financial Statements*  
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**INCOME STATEMENT**

(all amounts in thousands of Euro)

	9 months to 30 September 2008		9 months to 30 September 2007	
	Group	Bank	Group	Bank
Interest income	69,296	66,589	52,974	50,558
Interest expense	(47,394)	(46,556)	(29,646)	(29,535)
<b>Net interest income</b>	<b>21,902</b>	<b>20,033</b>	<b>23,328</b>	<b>21,023</b>
Fee and commission income	4,415	4,301	4,270	4,293
Fee and commission expense	(987)	(974)	(872)	(806)
<b>Net fee and commission income</b>	<b>3,428</b>	<b>3,327</b>	<b>3,398</b>	<b>3,487</b>
Dividend income	19	1,156	-	711
Net trading income	2,067	2,023	2,288	2,244
Other operating income	5,216	3,469	4,701	3,490
Staff costs	(11,012)	(9,853)	(10,395)	(9,521)
Administrative expenses	(9,589)	(8,234)	(8,567)	(7,784)
Depreciation and amortisation	(2,521)	(2,170)	(2,560)	(2,416)
Provision for impairment losses	(6,454)	(5,828)	(2,775)	(2,426)
<b>Profit before income tax</b>	<b>3,056</b>	<b>3,923</b>	<b>9,418</b>	<b>8,808</b>
Income tax expense	(883)	(807)	(1,705)	(1,507)
Minority interest	7	-	-	-
<b>Net profit for the period</b>	<b>2,180</b>	<b>3,116</b>	<b>7,713</b>	<b>7,301</b>

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**BALANCE SHEET**

(all amounts in thousands of Euro)

	30/09/08		31/12/07	
	Group	Bank	Group	Bank
<b><u>Assets</u></b>				
Cash and balances with Central Bank	66,462	66,462	94,287	94,287
Trading securities	6,212	6,212	4,651	4,651
Investment securities – held to maturity	21,316	21,316	18,583	18,583
Investment securities – available for sale	91,484	91,240	77,021	77,021
Due from credit institutions	127,206	126,644	149,218	148,921
Derivative financial instruments	202	202	120	120
Loans to customers	1,040,042	1,017,699	950,276	939,593
Investment properties	3,011	3,011	3,011	3,011
Investments in subsidiaries and associated undertakings	472	1,281	785	1,312
Intangible fixed assets	3,445	2,742	2,871	2,742
Property and equipment	12,551	11,150	12,770	11,308
Other assets	5,968	1,176	5,095	1,429
Deferred expenses and accrued income	1,144	862	1,154	980
<b>Total assets</b>	<b><u>1,379,515</u></b>	<b><u>1,349,997</u></b>	<b><u>1,319,842</u></b>	<b><u>1,303,958</u></b>
<b><u>Liabilities</u></b>				
Due to credit institutions	771,205	744,141	707,597	695,412
Due to customers	394,614	395,322	401,426	402,032
Derivative financial instruments	1,153	1,153	185	185
Transit funds	3,510	3,510	3,664	3,664
Issued debt securities	57,298	57,298	74,692	74,692
Other liabilities	15,370	14,466	17,023	15,952
Deferred income and accrued expenses	3,771	2,773	3,968	2,962
Current income tax liabilities	-	-	70	-
Deferred tax liabilities	1,370	1,332	1,370	1,332
Subordinated liabilities	44,883	44,883	18,927	18,927
<b>Total liabilities</b>	<b><u>1,293,174</u></b>	<b><u>1,264,878</u></b>	<b><u>1,228,922</u></b>	<b><u>1,215,158</u></b>
<b><u>Shareholder's equity</u></b>				
Share capital	69,028	69,028	69,028	69,028
Reserve capital	3,591	2,935	3,591	2,935
Minority interest	38	-	-	-
Revaluation deficit on available for sale investments	(6,628)	(6,628)	(2,191)	(2,191)
Retained earnings	20,312	19,784	20,492	19,028
<b>Total shareholder's equity</b>	<b><u>86,341</u></b>	<b><u>85,119</u></b>	<b><u>90,920</u></b>	<b><u>88,800</u></b>
<b>Total liabilities and shareholder's equity</b>	<b><u>1,379,515</u></b>	<b><u>1,349,997</u></b>	<b><u>1,319,842</u></b>	<b><u>1,303,958</u></b>
<b><u>Off balance sheet items</u></b>				
Contingent liabilities	31,554	31,554	16,300	16,300
Financial commitments	62,236	100,332	60,465	94,087

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**CONSOLIDATED STATEMENT OF CHANGES IN THE GROUP'S EQUITY**

(all amounts in thousands of Euro)

	Share Capital	Reserve capital	Minority interest	Revaluation deficit on available for sale investments	Retained earnings	Total equity
<b>Balance as at 31 December 2007</b>	<b>69,028</b>	<b>3,591</b>	-	<b>(2,191)</b>	<b>20,492</b>	<b>90,920</b>
Distribution of profit – payment for use of state capital	-	-	-	-	(2,361)	<b>(2,361)</b>
Net loss on available for sale investments	-	-	-	(4,437)	-	<b>(4,437)</b>
IPS „Hipo fondi” other minority shareholders	-	-	38	-	-	<b>38</b>
Profit for the period	-	-	-	-	2,180	<b>2,180</b>
<b>Balance as at 30 September 2008</b>	<b>69,028</b>	<b>3,591</b>	<b>38</b>	<b>(6,628)</b>	<b>20,311</b>	<b>86,340</b>

**STATEMENT OF CHANGES IN THE BANK'S SHAREHOLDER'S EQUITY**

(all amounts in thousands of Euro)

	Share Capital	Reserve capital	Revaluation deficit on available for sale investments	Retained earnings	Total equity
<b>Balance as at 31 December 2007</b>	<b>69,028</b>	<b>2,935</b>	<b>(2,191)</b>	<b>19,028</b>	<b>88,800</b>
Distribution of profit – payment for use of state capital	-	-	-	(2,361)	<b>(2,361)</b>
Net loss on available for sale investments	-	-	(4,437)	-	<b>(4,437)</b>
Profit for the period	-	-	-	3,116	<b>3,116</b>
<b>Balance as at 30 September 2008</b>	<b>69,028</b>	<b>2,935</b>	<b>(6,628)</b>	<b>19,783</b>	<b>85,118</b>

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**CASH FLOW STATEMENT**

(all amounts in thousands of Euro)

	9 months to 30 September 2008		9 months to 30 September 2007	
	Group	Bank	Group	Bank
<b>Cash flows from operating activities</b>				
Profit before taxation	3,056	3,923	9,418	8,808
Depreciation and amortisation	2,521	2,170	2,560	2,416
Increase / (decrease) in provision for impairment losses	4,539	3,920	1,047	699
(Profit) / loss from foreign exchange revaluation	(70)	(28)	-	43
(Profit) / loss from sale of property and equipment	(193)	(1)	(1)	(1)
Increase in deferred income and accrued expenses	(148)	(115)	1,531	1,329
(Increase) / decrease in deferred expenses and accrued income	10	118	(148)	(152)
(Increase) in other assets	(5,368)	(4,240)	(1,783)	(2,063)
Increase in other liabilities	(683)	(519)	9,254	8,966
<b>Increase in cash and cash equivalents from operating activities before changes in assets and liabilities</b>	<b>3,664</b>	<b>5,228</b>	<b>21,878</b>	<b>20,045</b>
Increase in balances due from credit institutions	(18,526)	(18,526)	(20,909)	(20,909)
Increase in loans to customers	(92,309)	(80,031)	(184,437)	(187,413)
Increase in trading securities	(1,561)	(1,561)	2,223	2,223
Increase in balances due to credit institutions	22,446	7,382	178,401	181,542
Increase in balances due to customers	(6,813)	(6,710)	12,541	13,211
Decrease in transit funds	(154)	(154)	(157)	(157)
Increase in debt securities issued	(17,394)	(17,395)	12,406	12,406
<b>Increase in cash and cash equivalents from operating activities</b>	<b>(110,647)</b>	<b>(111,767)</b>	<b>21,946</b>	<b>20,948</b>
<b>Corporate income tax</b>	<b>(959)</b>	<b>(881)</b>	<b>(2,486)</b>	<b>(1,992)</b>
<b>Cash flows from investing activities</b>				
Increase in investment securities	(19,215)	(18,971)	(3,693)	(3,694)
Purchases of property and equipment	(2,850)	(2,030)	(4,801)	(3,610)
Proceeds from property and equipment disposal	168	20	31	10
Acquisition of investments in associated entities	313	31	-	(711)
<b>Cash and cash equivalents used in investing activities</b>	<b>(21,584)</b>	<b>(20,950)</b>	<b>(8,463)</b>	<b>(8,005)</b>
<b>Cash flows from financing activities</b>				
Proceeds from subordinated debt	25,956	25,956	-	-
Dividend paid	(2,361)	(2,361)	(1,992)	(1,992)
<b>Cash and cash equivalents used in financing activities</b>	<b>23,595</b>	<b>23,595</b>	<b>(1,992)</b>	<b>(1,992)</b>
<b>Increase in cash and cash equivalents</b>	<b>(109,595)</b>	<b>(110,003)</b>	<b>9,005</b>	<b>8,959</b>
Cash and cash equivalents at the beginning of the period	187,728	187,616	172,730	172,626
Effect of exchange rates on cash and cash equivalents	70	28	-	(44)
<b>Cash and cash equivalents at the end of the period</b>	<b>78,203</b>	<b>77,641</b>	<b>181,735</b>	<b>181,541</b>

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## **GENERAL INFORMATION**

The Mortgage and Land Bank of Latvia was established as a state-owned commercial bank on 19 March 1993 by the Government of Latvia based on the Decree No 140 adopted by the Cabinet of Ministers. The Bank was registered with the Register of Enterprises of the Republic of Latvia on 3 June 1993. According to the Commercial Law the Bank was registered in the Commercial Register on 14 July 2004.

The operations of the Bank are regulated by the law On Credit Institutions and other effective laws of the Republic of Latvia, the Statutes of the Bank, the instructions of the Bank of Latvia and Financial and Capital Market Commission, as well as the decrees and regulations of the Cabinet of Ministers of the Republic of Latvia. The Bank is under the jurisdiction of the Ministry of Finance of the Republic of Latvia that represents the interests of the shareholder on behalf of the Cabinet of Ministers and holds 100% of the Bank's shares.

## **RISK MANAGEMENT**

The Group and the Bank manages all the major risks affecting the operation of the Group and the Bank in accordance with the Risk Management Policy approved by the Council of the Bank. The Risk Management Policy stipulates and describes the aggregate of measures used to ensure that a possibility of suffering losses is minimised in the event the invested or receivable resources would not be repaid or recovered in due time or full amount or the Group or the Bank would suffer other losses or would not derive the planned profit.

The Group and the Bank abides by the following principles in its risk management:

- while assuming the risks the Group and the Bank shall be capable of implementing the aims and assignments defined in its development strategy in a longer run;
- the Group and the Bank shall operate by maintaining an optimum balance between profitability and safeguarding against the risks, i.e. the profitability must be as large as possible, however, the Group and the Bank shall not be exposed to the risks;
- risk assessment and management shall be an integral component of the every-day functions of the Group and the Bank;
- in accordance with their authority and competence the employees of the Group and the Bank shall know a customer and understand fully the nature of each transaction (operation) to be able to identify and assess the risks associated with the transaction (operation) and find the best solution both for the customer and the Group or the Bank;
- the Group and the Bank shall assess the probable losses that it might incur by assuming the risks and avoid extraordinary losses in its operation;
- the Group and the Bank shall identify and assess the probable risks before launching of new products or services or entering new markets;
- where necessary, the Group and the Bank shall reduce the risk limits, sell the assets subject to the risk or even leave the respective markets should these be assessed as excessively risky.

In managing the risks the Group and the Bank applies various methods for measuring the risks, sets the limits and maintains the appropriate controls. All risk policies are approved by the Council.

### ***Credit Risk***

The Group and the Bank is subject to the credit risk. The credit risk is the risk of the customer or co-operation partner not being able to or refusing to meet its liabilities towards the Group or the Bank in full amount and due time.

The Group and the Bank manages the credit risk according to the Credit Policy as well as internal regulations, procedures and instructions of credit operations.

## **RISK MANAGEMENT** (continued)

The Credit Policy of the Bank describes and defines the principles for the management of the credit risk and it relates to all activities of the Group and the Bank involving credit risk – lending, financial market transactions (operations), intermediary activities on behalf of the clients and issue of guarantees to third parties.

The Bank's Risk Management Committee monitors the credit risk, including credit risk concentrations, and the quality of the credit portfolio, whereas central, regional and branch credit committees are taking decisions on the credit risk within the approved limits. The Bank's Risk Management Department is responsible for analysis of the credit risk concentration, setting and controlling the limits as well as the evaluation of the quality of the credit portfolio, whereas the Bank's Loan Department and Treasury Department is responsible for daily credit risk management in lending operations and operations with financial instruments respectively.

The Group and the Bank monitors the credit risk by assessing the creditworthiness and adequacy of collateral of the customer or counterparty on a regular basis as well as controls the credit risk at the level of customer, related customers and sectors of economy according to the risk limits set at the Group and the Bank.

The Group and the Bank manages credit risk concentrations according to the Risk Exposures Controlling Policy that stipulates the methods of analysis of the credit risk concentrations and its controlling instruments including limits on credit risk concentrations. Credit risk concentrations is managed by measuring and setting limits on the following concentrations:

- ratio of large exposure concentration and own funds (internal limit - 400%, limit set by the Law on Credit Institutions – 800%), as of 30.09.2008. was 47% (as of 31.12.2007.-79%);
- ratio of single client's (related clients' group) large exposure and own funds, which can not exceed 25%, as of 30.09.2008. was 14.4% (as of 31.12.2007.-16.6%);
- proportion of risk concentration in single economic sector in the Bank's credit portfolio and own funds as of 30.09.2008. was 185.5% (as of 31.12.2007.-195.9%);
- ratio of risk exposures with persons related to the Bank and own funds, which can not exceed 15%, as of 30.09.2008. was 2.3% (as of 31.12.2007.-6.1%).

Since the Bank's strategy is not focused on servicing the non-residents business, the proportion of the Bank's total claims to non-residents was small and as of 30.09.2008. was 7.4% (as 31.12.2007.-7.7%) of the Bank's total assets. The Group and the Bank manages the country risk that results from the lending operations to non-residents according to the Country Risk Management Policy.

### ***Liquidity Risk***

The liquidity risk relates to the ability of the Group and the Bank to redeem the legally valid claims of its customers and other creditors in due time and secure that the increase of the anticipated claims presents reasonable costs. The Liquidity Risk Management Policy of the Bank stipulates the principles for management of liquidity risk. The Bank shall ensure that the liquid assets are not less than 30% (set by the FCMC) of its short-term liabilities at all times. The Assets and Liabilities Committee of the Bank stipulates the guidelines for liquidity risk management and controls compliance thereof, whereas the Treasury Department provides for daily management of the liquidity risk. To evaluate the liquidity risk, the Bank uses the GAP method. The Bank has set liquidity net position limit in each significant currency and total liquidity net position limit as well as maximum deposit amount from a single depositor to control the liquidity risk. Liquidity ratio (min – 30%) as of 30.09.2008. was 78.8% (as of 31.12.2007.-101.7%).

### ***Foreign Currency Risk***

The foreign currency risk occurs due to the differences between the asset and liability positions of foreign currencies that, as a result of the fluctuations of the exchange rates, affect the cash flow and financial results of the Group and the Bank. The Currency Risk Management Policy of the Bank stipulates the principles for the management of the foreign currency risk.

The Group and the Bank controls the foreign currency risk by imposing limits on the open currency positions for each currency and all currencies together consolidating in lats and by complying with the open currency position limits established in the law On Credit Institutions.

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**RISK MANAGEMENT** (continued)

The Assets and Liabilities Committee of the Bank stipulates the guidelines for foreign currency risk management and controls compliance thereof, whereas the Treasury Department provides for daily management of the foreign currency risk.

***Interest Rate Risk***

The interest rate risk is related to the influence of the fluctuations of the market rates onto the interest income and expenses of the Group and the Bank. To assess the interest rate risk the Bank analyses the maturity structure of the assets and liabilities sensitive to the changes in interest rates and susceptibility of the maturity structure to the potential fluctuations of the interest rates on a regular basis.

The Assets and Liabilities Management Committee monitors the interest rate risk, whereas the Treasury Department is responsible for the daily management of the interest rate risk. The Bank has set limit on changes in economic value of the Bank at 10% of own funds and limit on changes in net interest income at 2% of own funds which as of 30.09.2008. were 9.8% (as of 31.12.2007.-7.96%) and 1.54% (as of 31.12.2007.-0.93%) respectively.

***Operational risk***

The operational risk results from intentional or unintentional deviations from the standards adopted in daily operation of the Group and the Bank, for example human mistake or fraud, disturbances in the operation of the information systems, insufficient control procedures or their ignorance. The Group and the Bank manages operational risk according to the Operational Risk Management Policy. The Internal Control System provides for management and control of the operational risk in the Group and the Bank. The Group and the Bank uses self-assessment method to measure the operational risk, whereas the Bank's operational risk information system is used to identify, analyse and control the operational risk. The structural units of the Group and the Bank are responsible for the management of the operational risk in the daily operations, but the Risk Management Committee monitor the operational risk. The Risk Management Department is responsible for the implementation of operational risk management in the Group and the Bank.

The Bank has implemented Business continuity plan that includes guidelines on actions to be taken by the Bank, its structural units and employees at occurrence of risks that can have substantial negative effect on the Bank's operations.

***Capital Adequacy***

Capital adequacy shows those capital resources of the Group and the Bank needed to cover the credit and market risks arising from asset-side and off-balance sheet positions.

As at 30 September 2008 the capital adequacy ratio of the Bank calculated according to the regulations of the Financial and Capital Market Commission were 9.2% (as of 31.12.2007.-9.9%) which exceeded the minimum of 8%.

<b>1. Capital requirements</b>	<b>30/09/2008</b>	<b>31/12/2007</b>
Credit risk capital requirement	93,151	80,742
Market risk capital requirement	-	-
Operational risk capital requirement	5,036	-
<b>2. Capital adequacy</b>		
Total capital requirements (CR+MR+OR)	98,187	80,738
Own funds	113,034	100,287
Surplus of own funds	14,848	19,549
<b>Capital adequacy</b>	<b>9.2%</b>	<b>9.9%</b>



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**THE PERFORMANCE RATIOS OF THE BANK**

Items	Accounting period	Previous accounting year
Return on equity (ROE) (%)	4.66%	10.58%
Return on assets (ROA) (%)	0.31%	0.78%

**CONSOLIDATION GROUP**

No	Name of commercial company	Code of place of registration, address of registration	Type of activity of commercial company *	Share of fixed capital (%)	Voting rights in commercial company (%)	Justification for including in the Group**
1.	SIA „Hipotēku bankas nekustamā īpašuma aģentūra”	LV –Latvija 40003426895	CKS	100	100	MS
2.	SIA „Rapsis”	LV – Latvija 50003614071	CKS	100	100	MS
3.	SIA „Hipolīzings”	LV – Latvija 40003616329	CFI	100	100	MS
4.	SIA „Risku investīciju sabiedrība”	LV – Latvija 40003952445	CFI	100	100	MS
5.	IPS „Hipo fondi”	LV – Latvija 40003403040	IPS	83	83	MS
6.	SIA „Rīgas Centra namu pārvalde”	LV – Latvija 40003266805	CKS	100	100	MS
7.	KS "Mazo un vidējo komersantu atbalsta fonds"	LV – Latvija 40003681329	CFI	47.62	47.62	KS

\* IPS – investment management company, CFI – other financial institution, CKS – other commercial company.

\*\* MS – subsidiary; KS – joint venture.

**RATINGS ASSIGNED TO BANK BY RATING AGENCY MOODY'S INVESTORS SERVICE**

Rating type	Ratings	Rating Approval date	Previous rating
For long-term foreign currency bank deposits	A2	10.07.2008.	A2
For short-term foreign currency deposits	P1	10.07.2008.	P1
The financial strength rating	D-	10.07.2008.	D-
The rating of mortgage bonds issued	A1	10.07.2008.	A1

Moody`s Investors Service reports of the Bank may be found at: [www.hipo.lv](http://www.hipo.lv)

Additional information on the ratings assigned (incl. Legend of ratings) may be found at: [www.moodys.com](http://www.moodys.com)

These interim financial reports are to be viewed along with the Bank`s Annual Report for 2007.

Inesis Feiferis  
Chairman of the Board

Uvis Zemītis  
Chief Accountant