# MORTGAGE AND LAND BANK
# OF LATVIA

## Interim Condensed Consolidated and Bank Financial Statements for the three months period ended 31 March 2008
## (unaudited)

## MANAGEMENT REPORT

### 3 months of 2008

The economy of Latvia has entered a new cycle of development. In the beginning of 2008, the rapid development pace of the national economy dropped some of its speed, but inflation still remained high. Decrease of the domestic demand reduced imports demand and advanced growth of exports. Changes in the national economy also affected the development of the commercial banking sector of Latvia.

Banking services in Latvia in 2008 are provided by 21 bank and three branches of foreign banks. Also, the Bank of Latvia has registered three electronic money institutions and three money market funds. In the 1st quarter of 2008, the assets of the banks have decreased by 3%, by the end of March reaching 21.3 bln lats, deposits (including the transit funds) decreased by 6%, whereas the volume of granted loans increased by 2%, and the capital and reserves of the banks increased by 3%.

Contrary to the banking sector tendency during the 1st quarter of this year, the volume of Mortgage Bank's gross assets has increased by 1.6 million lats, reaching 925.5 million lats. The Mortgage Bank ranked eighth among Latvian commercial banks by its asset volume (market share – 4.3%) by the end of March. The unaudited profit of the Bank reached 2.02 million lats during the first quarter, that is by 0.38 million lats or 23% more than the respective period of the previous year.

The gross loans' portfolio of the Mortgage Bank increased by 2.98 mln lats during the first three months of 2008 or by 23%, reaching 665.4 mln lats. The Mortgage Bank ranked seventh among Latvian commercial banks by its loans' portfolio volume with a market share of 4.4%. The Mortgage Bank was the eighth largest bank in Latvia by corporate loan volume (market share – 5%) and seventh by loan volume to natural persons (market share – 3.5%).

The volume of deposits with the Mortgage Bank has increased by 3.64 mln lats during the first quarter of 2008 or 1%, reaching 285.8 mln lats. The Mortgage Bank ranked tenth among Latvian commercial banks by its deposits volume (including the transit funds) (market share – 2.9%) by the end of March.

To furnish its clients an opportunity to conveniently place their money funds and accrue savings in pension funds, Mortgage Bank completed the procurement process of the Asset Management Company "Suprema Fondi" during the first quarter of 2008 and initiated client attraction to three 2nd pillar pension plans in all branch offices of the Bank.

In 2008 the Bank proceeds with implementation of various development programmes, within their framework support is provided to certain groups of entrepreneurs and population as tasked by the government – Small and Medium Enterprises lending programme, Housing guarantees programme, rural development programmes.

Implementation of the project, co-financed by the European Social fund, "Training, consultations and financial support to self-employment or entrepreneurship start-ups" continued during the first quarter of 2008. The first two phases of the project are fully completed: training of the business starters and presenting business plans to Mortgage Bank. 998 prospective entrepreneurs were trained under this project, and 600 financial support seekers presented their business plans. Processes of considering business plans, granting support and disbursement continued. By the 31st of March 2008, support in the form of grants and loans had been granted to 153 prospective entrepreneurs.

According to the execution agreement provisions, performance report of the Loan Fund, established under the project, was developed for the first time and approved by the supervisory institutions. Both the contributing parties, the Ministry of Economics and Mortgage bank, increased the fund by their profit shares.

In March, Mortgage bank signed cooperation agreements with all the leaders of regional funds established in Latvia and council of Limbaži region on organization of Mortgage bank's project competition The Bank will support the best projects submitted to the funds' competition, projects that enhance self-initiative and activity of local population in improvement of their surrounding environment.

**MANAGEMENT REPORT** (continued)

The quality of the services provided by our Bank has not gone unnoticed by our clients. The branch offices of Mortgage bank in March participated in a campaign “Praise good service”, organized by organization *Labsserviss.lv (Goodservice.lv)* (it involved 50 various Latvian companies with 800 customer service points), and Rēzekne branch office of the Bank managed top 10 of this contest.

Stability of the Mortgage Bank is characterized by ratings assigned by the credit rating agency *Moody’s Investors Service*: long-term foreign currency bank deposits – *A2*, short-term foreign currency bank deposits – *P1*, financial strength rating – *D-*, rating of mortgage bonds – *A1*.

In the 1$^{st}$ quarter of this year, the Mortgage Bank continued modernization and upgrade the network of its branches and subbranches. Balvi branch office started operation in new premises in January. The Bank has 29 branches, one in each district centre, and 8 subbranches in various regions of Latvia providing services to the customers in the whole territory of Latvia .

## THE SUPERVISORY COUNCIL AND BOARD OF DIRECTORS OF THE BANK

### Supervisory Council (at 31 March 2008)

| | |
|---|---|
| Gundega Šulca | Chairman of the Council |
| Andris Liepiņš | Deputy Chairman of the Council |
| Vija Gēme | Member of the Council |
| Jānis Šnore | Member of the Council |
| Baiba Bāne | Member of the Council |
| Baiba Paševica | Member of the Council |
| Dace Ratniece | Member of the Council |
| Iveta Strautiņa | Member of the Council |

### Board of Directors (at 31 March 2008)

| | |
|---|---|
| Inesis Feiferis | Chairman of the Board |
| Rolands Paņko | Deputy Chairman of the Board |
| Aija Laicāne | Member of the Board |
| Jēkabs Krieviņš | Member of the Board, Credit Director |
| Andris Riekstiņš | Member of the Board |

## INCOME STATEMENT

(all amounts in thousands of Lats)

| | 3 months to 31 March 2008 | | 3 months to 31 March 2007 | |
|---|---|---|---|---|
| | **Group** | **Bank** | **Group** | **Bank** |
| Interest income | 15,373 | 14,949 | 10,787 | 10,418 |
| Interest expense | (10,529) | (10,402) | (6,124) | (5,993) |
| **Net interest income** | **4,844** | **4,547** | **4,663** | **4,425** |
| Fee and commission income | 1,113 | 977 | 1,016 | 921 |
| Fee and commission expense | (205) | (191) | (174) | (161) |
| **Net fee and commission income** | **908** | **786** | **842** | **760** |
| Dividend income | 1 | 801 | - | - |
| Net trading income | 373 | 350 | 425 | 423 |
| Other operating income | 1,175 | 811 | 1,211 | 948 |
| Staff costs | (2,413) | (2,188) | (2,196) | (2,034) |
| Administrative expenses | (2,027) | (1,782) | (1,719) | (1,606) |
| Depreciation and amortisation | (669) | (605) | (557) | (545) |
| Provision for impairment losses | (595) | (451) | (401) | (401) |
| **Profit before income tax** | **1,597** | **2,269** | **2,268** | **1,970** |
| Income tax expense | (276) | (248) | (364) | (328) |
| **Net profit for the period** | **1,321** | **2,021** | **1,904** | **1,642** |

**BALANCE SHEET**
(all amounts in thousands of Lats)

| | 31/03/08 | | 31/12/07 | |
|---|---|---|---|---|
| | **Group** | **Bank** | **Group** | **Bank** |
| **Assets** | | | | |
| Cash and balances with Central Bank | 63,819 | 63,819 | 66,265 | 66,265 |
| Trading securities | 4,863 | 4,863 | 3,269 | 3,269 |
| Investment securities – held to maturity | 14,122 | 14,122 | 13,060 | 13,060 |
| Investment securities – available for sale | 62,857 | 62,857 | 54,131 | 54,131 |
| Due from credit institutions | 92,973 | 92,610 | 104,871 | 104,662 |
| Derivative financial instruments | 851 | 851 | 84 | 84 |
| Loans to customers | 681,117 | 663,453 | 667,858 | 660,350 |
| Investment properties | 2,116 | 2,116 | 2,116 | 2,116 |
| Investments in subsidiaries and associated undertakings | 360 | 915 | 552 | 922 |
| Intangible fixed assets | 2,309 | 1,896 | 2,018 | 1,927 |
| Property and equipment | 8,870 | 7,716 | 8,975 | 7,947 |
| Other assets | 3,620 | 942 | 3,580 | 1,005 |
| Deferred expenses and accrued income | 1,905 | 1,778 | 811 | 689 |
| **Total assets** | **939,782** | **917,938** | **927,590** | **916,427** |
| | | | | |
| **Liabilities** | | | | |
| Due to credit institutions | 511,919 | 492,898 | 497,302 | 488,738 |
| Due to customers | 281,124 | 281,193 | 282,124 | 282,550 |
| Derivative financial instruments | 50 | 50 | 130 | 130 |
| Transit funds | 2,614 | 2,614 | 2,575 | 2,575 |
| Issued debt securities | 51,754 | 51,754 | 52,494 | 52,494 |
| Other liabilities | 12,061 | 10,714 | 11,963 | 11,211 |
| Deferred income and accrued expenses | 2,226 | 1,571 | 2,789 | 2,082 |
| Current income tax liabilities | 46 | - | 49 | - |
| Deferred tax liabilities | 963 | 936 | 963 | 936 |
| Subordinated liabilities | 13,498 | 13,498 | 13,302 | 13,302 |
| **Total liabilities** | **876,255** | **855,228** | **863,691** | **854,018** |
| | | | | |
| **Shareholder's equity** | | | | |
| Share capital | 48,513 | 48,513 | 48,513 | 48,513 |
| Reserve capital | 2,524 | 2,063 | 2,524 | 2,063 |
| Minority interest | 27 | - | - | - |
| Revaluation deficit on available for sale investments | (1,600) | (1,600) | (1,540) | (1,540) |
| Retained earnings | 14,063 | 13,734 | 14,402 | 13,373 |
| **Total shareholder's equity** | **63,527** | **62,710** | **63,899** | **62,409** |
| | | | | |
| **Total liabilities and shareholder's equity** | **939,782** | **917,938** | **927,590** | **916,427** |
| | | | | |
| **Off balance sheet items** | | | | |
| Contingent liabilities | 11,206 | 11,206 | 11,456 | 11,456 |
| Financial commitments | 54,102 | 86,051 | 42,495 | 66,125 |

## CONSOLIDATED STATEMENT OF CHANGES IN THE GROUP'S EQUITY
(all amounts in thousands of Lats)

| | Share Capital | Reserve capital | Minority interest | Revaluation deficit on available for sale investments | Retained earnings | Total equity |
|---|---|---|---|---|---|---|
| **Balance as at 31 December 2007** | **48,513** | **2,524** | **-** | **(1,540)** | **14,402** | **63,899** |
| Distribution of profit – payment for use of state capital | - | - | - | - | (1,660) | **(1,660)** |
| Net loss on available for sale investments | - | - | - | (60) | - | **(60)** |
| IPS „Suprema fondi" other minority shareholders | - | - | 27 | - | - | **27** |
| Profit for the period | - | - | | - | 1,321 | **1,321** |
| **Balance as at 31 March 2008** | **48,513** | **2,524** | **27** | **(1,600)** | **14,063** | **63,527** |

## STATEMENT OF CHANGES IN THE BANK'S SHAREHOLDER'S EQUITY
(all amounts in thousands of Lats)

| | Share Capital | Reserve capital | Revaluation deficit on available for sale investments | Retained earnings | Total equity |
|---|---|---|---|---|---|
| **Balance as at 31 December 2007** | **48,513** | **2,063** | **(1,540)** | **13,373** | **62,409** |
| Distribution of profit – payment for use of state capital | - | - | - | (1,660) | **(1,660)** |
| Net loss on available for sale investments | - | - | (60) | - | **(60)** |
| Profit for the period | - | - | - | 2,021 | **2,021** |
| **Balance as at 31 March 2008** | **48,513** | **2,063** | **(1,600)** | **13,734** | **62,710** |

## 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 31.03.2008. was 75% (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 31.03.2008. was 15.6% (as of 31.12.2007. -16.6%);
- proportion of risk concentration in single economic sector in the Bank's credit portfolio as of 31.03.2008. was 23.8% (as of 31.12.2007. -25.1%);
- ratio of risk exposures with persons related to the Bank and own funds, which can not exceed 15%, as of 31.03.2008. was 3.5% (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 31.03.2008. was 8.8% (as 31.12.2007.–8.8%) 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 31.03.2008. was 88.8% (as of 31.12.2007.-99.4%).

### *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.

**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 intere st 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 31.03.2008. were 9.97% (as of 31.12.2007. - 7.96%) and 1.83% (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 31 March 2008 the capital adequacy ratio of the Bank calculated according to the regulations of the Financial and Capital Market Commission were 8.8% (as of 31.12.2007. -9.9%) which exceeded the minimum of 8%.

| **1. Capital requirements** | **31/03/2008** | **31/12/2007** |
|---|---:|---:|
| Credit risk capital requirement | 55,284 | 56,746 |
| Market risk capital requirement | 108 | - |
| Operational risk capital requirement | 3,539 | - |
| **2. Capital adequacy** | | |
| Total capital requirements (CR+MR+OR) | 58,931 | 56,743 |
| Own funds | 65,056 | 70,482 |
| Surplus of own funds | 6,125 | 13,739 |
| **Capital adequacy** | **8.8%** | **9.9%** |

## THE PERFORMANCE RATIOS OF THE BANK

| Items | Accounting period | Previous accounting year |
|---|---|---|
| Return on equity (ROE) (%) | 12.76% | 10.58% |
| Return on assets (ROA) (%) | 0.87% | 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 „Suprema fondi” | LV – Latvija 40003403040 | ISA | 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 |

* BNK – bank, APS – insurance company, ISA – investment company, PFO – pension fund,
CFI – other financial institution, FPS – finance management company, CKS – other commercial company.
** MS – subsidiary; KS – joint venture; MAS – parent company.

## RATINGS ASSIGNED TO BANK BY RATING AGENCY MOODY`S INVESTORS SERVICE

| Rating type | Ratings | Rating Approval date | Rating forecast | Previous rating |
|---|---|---|---|---|
| For long-term foreign currency bank deposits | A2 | 21.12.2006. | Stable | A2 |
| For short-term foreign currency deposits | P1 | 21.12.2006. | Stable | P1 |
| The financial strength rating | D- | 21.12.2006. | Stable | D- |
| The rating of mortgage bonds issued | A1 | 05.03.2007. | Positive | A1 |

Moody`s Investors Service reports of the Bank may be found at: *www.hipo.lv*
Additional information on the ratings assigned (incl. Legend of ratings) may be found at: *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