Municipality Finance Plc Financial Statements Bulletin
1 January–31 December 2014

Municipality Finance has strengthened its Tier 1 capital to more than EUR 500 million during the last four years

Summary of 2014:

- Net interest income grew by 7% compared with the previous year, totalling EUR 160.0 million (2013: EUR 149.5 million).
- The Group's net operating profit amounted to EUR 144.2 million (2013: EUR 141.3 million). The growth was 2% year-on-year.
- The balance sheet total stood at EUR 30,009 million (2013: EUR 26,156 million).
- The Group's capital adequacy remained strong, with the ratio of own funds to risk-weighted assets being 33.53% at the end of the year (2013: 32.52%) and the ratio of Tier 1 capital to risk-weighted assets being 29.98% (2013: 28.86%). The figures for the comparison year 2013 have been calculated in accordance with the EU Capital Requirements Regulation that entered into force on 1 January 2014.
- The leverage ratio at the end of 2014 was 1.8% (2013: 1.7%).
- Total funding acquisition for 2014 amounted to EUR 7,440 million (2013: EUR 10,695 million). The total amount of funding grew to EUR 26,616 million (2013: EUR 23,108 million).
- Lending increased to EUR 19,205 million (2013: EUR 17,801 million) and the amount of new loans withdrawn amounted to EUR 2,775 million (2013: EUR 3,537 million).
- The leasing portfolio stood at EUR 133 million at year end (2013: EUR 81 million).
- Investments totalled EUR 6,751 million at the end of 2014 (2013: EUR 5,671 million).
- The turnover of Municipality Finance's subsidiary, Inspira, stood at EUR 2.5 million (2013: EUR 1.7 million). Net operating profit at the end of 2014 totalled EUR 0.4 million (2013: EUR 0 million).

Key Figures (Group):	31 Dec 2014	31 Dec 2013
Net interest income (EUR million)	160.0	149.5
Net operating profit (EUR million)	144.2	141.3
New loans issued (EUR million)	2,775	3,537
New funding acquisition (EUR million)	7,440	10,695
Balance sheet total (EUR million)	30,009	26,156
Tier 1 capital (EUR million)	557.2	452.0
Total own funds (EUR million)	623.1	509.3
Ratio of Tier 1 capital to risk-weighted assets, %	29.98	28.86
Ratio of total own funds to risk-weighted assets, %	33.53	32.52
Leverage ratio, %	1.8	1.7
Return on equity (ROE), %	21.66	30.58
Cost-to-income ratio	0.15	0.15
Number of employees	90	83

Consolidated key figures for capital adequacy at 31 December 2013 have been calculated in accordance with the EU Capital Requirements Regulation (EU 575/2013) effective as of 1 January 2014.

CEO Pekka Averio's comments on the financial year:

"In 2014, Municipality Finance's operations developed as planned despite the challenging market situation, and the company achieved the highest net operating profit in its history, EUR 144.2 million. Municipality Finance continued to be the single most important financier for its customers, and the company's business volume grew as expected. There were no significant changes in the loan needs of the municipal sector, and the financing needs of central government subsidised housing production also developed as expected.

As far as the company's funding was concerned, the year was a successful one. Following our strategy, we managed to increase the diversification of funding, which further ensures the availability of funding over the long term.

The positive financial result allows the company to increase its own funds in line with its strategy, so that the tightening leverage ratio requirement of increased regulation will be met in the future. The company has managed to triple its Tier 1 capital to more than EUR 500 million during the last four years.

In 2015, there will be a significant change in the operating environment as the European crisis resolution regulation and banking union enter into force. The crisis resolution regulation includes the obligation for all credit institutions to contribute to the crisis resolution fund with annual payments. As a consequence, Municipality Finance's annual costs may increase, depending on the final allocation bases of the contributions.

During the year, Municipality Finance continued the development of its operations and focused especially on developing its customer relationship management and customer service. Related to this, we reorganised the Customer Finance function from the beginning of 2015, with the aim of meeting our customers' changing needs even better in the future."

Credit ratings

Municipality Finance's credit ratings

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

The Municipal Guarantee Board's credit ratings

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

The credit rating agency Standard & Poor's lowered the long-term funding credit rating of Municipality Finance and the Municipal Guarantee Board, the guarantor of Municipality Finance's funding, from AAA to AA+ in October 2014. The outlook of the rating is stable. The downgrade of the long-term funding rating of Municipality Finance and the Municipal Guarantee Board is a direct consequence of the equivalent change in the corresponding rating of the Republic of Finland. In accordance with the credit rating methodology of Standard & Poor's, the credit rating of Municipality Finance and the Municipal Guarantee Board cannot be higher than the rating of the sovereign.

Operating environment in 2014

In 2014, the European financial market was characterised by increasing uncertainty, resulting from both increasing tension in the international political situation and weaker-than-expected economic development especially in the eurozone. At the same time, the structural problems of several EU Member State economies remained unsolved.

The ECB's measures to turn around the trend of economic development in Europe significantly increased market liquidity during the year. As a result, the financial markets were excessively liquid, which led to a decline in risk margins and a decrease in margin differences between different credit risk categories. However, the increase of liquidity in the market did not significantly reverse the trend of economic development in Europe.

In Finland, the economic situation continued to decline in 2014. According to estimates, Finland's exports have already decreased by one fifth following the financial crisis. The situation is aggravated by the increase in public expenditure. Weak economic development was also reflected in Finland's credit rating during the year: Standard & Poor's lowered the country's credit rating to AA+ (stable). At the same time, Municipality Finance's credit rating also declined correspondingly. On the other hand, Moody's kept both ratings at the best possible level, Aaa.

Municipality Finance is an important part of the basic financial structure of Finnish society and the only credit institution in Finland exclusively specialising in financing the municipal sector and central government subsidised housing production. During the year, there were no significant changes in the financing needs of the Finnish municipal sector, and the demand for loans continued to grow at a conservative rate. Municipality Finance continued to be the single most important financier for its customers.

As far as the company's funding was concerned, the year was a successful one. The company continued to diversify funding, with the aim of ensuring the availability of funding over the long term.

The implementation of the common European crisis resolution framework will bring about significant additional costs to be paid by the financial sector starting from 2015. It is also likely that the contributions payable to the crisis resolution fund and expenses related to the administration of the system will also cause a significant increase in Municipality Finance's costs.

Group operating result and balance sheet

The Group's operations continued to be positive in 2014. The development of net interest income has remained good. Net interest income at the end of the year was EUR 160.0 million (2013: EUR 149.5 million). Net interest income includes EUR 1.5 million of commissions from the repurchase of own bonds (2013: EUR 10.4 million).

Net operating profit for the financial year before appropriations and taxes stood at EUR 144.2 million (2013: EUR 141.3 million). Municipality Finance's net operating profit stood at EUR 143.8 million (2013: EUR 141.3 million). The profit includes changes in IFRS fair valuation of financial items which are unrealised and change with the fluctuation of market interest rates. The impact of IFRS valuations on profit was EUR -2.1 million (2013: EUR 14.4 million).

The net operating profit of Municipality Finance's subsidiary, Inspira, was EUR 0.4 million in 2014 (2013: EUR 0.0 million).

The Group's commission expenses totalled EUR 3.8 million at the end of the year (2013: EUR 4.1 million). Operating expenses increased by 4% to EUR 21.7 million during 2014 (2013: EUR 20.9 million). The growth in expenses was mainly due to an increase in operating expenses resulting from changes in the company's operating environment as well as on-going IT system development projects.

Administrative expenses totalled EUR 14.7 million (2013: EUR 14.8 million), of which personnel expenses accounted for EUR 9.3 million (2013: EUR 10.4 million). Depreciation of tangible and intangible assets amounted to EUR 1.4 million (2013: EUR 1.2 million). Other operating expenses stood at EUR 5.5 million (2013: EUR 4.9 million).

The Group's balance sheet total was EUR 30,009 million at the end of 2014, compared to EUR 26,156 million at the end of the previous year. Balance sheet growth is explained by the fact that liquidity has been kept at a high level in 2014 as the company prepared for refinancing needs in early 2015. Furthermore, received CSA collateral increased the balance sheet.

Capital adequacy

Municipality Finance Group's own funds totalled EUR 623.1 million at the end of 2014 (2013: EUR 511.5 million). Tier 1 capital amounted to EUR 557.2 million (2013: EUR 454.2 million). Tier 2 capital totalled EUR 65.9 million (2013: EUR 57.3 million), of which the fair value reserve accounted for EUR 30.9 million (2013: EUR 22.3 million).

The Group's capital adequacy has remained good, with the ratio of total own funds to risk-weighted assets being 33.53%. At the end of 2013, the ratio of total own funds to risk-weighted assets based on the new capital adequacy regulation was 32.52%. The capital adequacy ratio based on the capital adequacy regulations in force on 31 December 2013 was 39.88%. The decrease in the capital adequacy ratio since the end of 2013 is explainable by the changes in the capital adequacy regulation (the new Capital Requirements Directive and Regulation, CRD4/CRR), according to which, as of the beginning of 2014, risk-weighted assets for debt securities and derivatives are calculated on the basis of the counterparty credit ratings instead of using the credit rating of the country where the counterparty is located. The new regulation has increased the capital requirement for credit risk.

Business operations

Funding

In 2014, EUR 7,440 million was acquired in long-term funding (2013: EUR 10,695 million). The company issued bonds denominated in 15 different currencies in 2014 (2013: 14 currencies). A total of EUR 5,904 million was issued in short-term debt instruments under the Euro Commercial Paper programme in 2014 (2013: EUR 9,245 million), and total funding under the programme amounted to EUR 1,259 million at year end (2013: EUR 1,592 million). Total funding at the end of the year amounted to EUR 26,616 million (2013: EUR 23,108 million). Of this total amount, 18% was denominated in euros (2013: 15%) and 82% was denominated in foreign currencies (2013: 85%).

Municipality Finance is an active participant in international bond markets and acquires its funding almost exclusively from international capital markets. A total of 264 funding transactions were made in 2014 (2013: 240). The main focus of funding in 2014 was on public markets, which accounted for 43% of the total funding acquired during the year. During the year, Municipality Finance issued two U.S. dollar-denominated benchmark bonds. These issues were carried out under the EMTN programme which was updated to also fulfill the U.S. Rule 144A requirements. The public issues were successful despite the challenging market conditions, allowing Municipality Finance to further expand its investor base.

Active investor cooperation has increased the company's reputation in various markets, and diversifying the sources of funding has proven to be a successful strategy. The company diversifies its funding in three ways: geographically, by issuing bonds targeted at different investor groups, and by issuing bonds with different maturities.

Customer financing

The total volume of tender requests received by Municipality Finance in 2014 was EUR 4,387 million (2013: EUR 5,090 million), of which it won EUR 2,814 million (2013: EUR 3,442 million). The total amount of new loans withdrawn in 2014 was lower than in the previous year, EUR 2,775 million (2013: EUR 3,537 million). At the end of the year, the company's long-term loan portfolio stood at EUR 19,205 million (2013: EUR 17,801 million). This represents an increase of 8% on the previous year.

Municipality Finance offers financial leasing services to municipalities, municipal federations and municipally owned or controlled corporations. 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 concluded a number of facility agreements for leasing services and the prospects for expanding leasing operations are good, as financial leasing is seen as a viable alternative, particularly for procurement by municipalities, municipal corporations engaging in municipal operations and hospital districts. The leasing portfolio grew by 64% during the year and stood at EUR 133 million at year end (2013: EUR 81 million).

With interest rates remaining low, customers continued to be active in using short-term financing. At the end of 2014, the total value of municipal paper and municipal commercial paper programmes concluded with Municipality Finance was EUR 3,787 million (2013: EUR 3,265 million). At the end of the year, the company had EUR 845 million in municipal papers and municipal commercial papers on its balance sheet (2013: EUR 704 million) and during the entire year, customers acquired EUR 9,638 million in financing under short-term programmes (2013: EUR 8,993 million).

In addition to loans, Municipality Finance offers municipalities, municipal federations and municipal enterprises derivative contracts tailored to their needs for the management of interest rate risk. Demand for derivative products was high in 2014. As interest rates remained low, customers hedged their loans against future increases in market rates.

Investments

Municipality Finance's investment operations comprise the investment of acquired funding. The funds are invested in highly liquid and rated financial instruments to ensure the company's operations in all market conditions. According to the Company's liquidity policy, its liquidity must be sufficient to cover the needs of continued undisturbed operations (including new net lending) for at least the following six months. The company invests cash collateral received on the basis of derivative collateral agreements in short-term money market investments.

At the end of 2014, investments in securities totalled EUR 5,581 million (2013: EUR 5,292 million) and their average credit rating was AA (2013: AA). The average maturity of the security portfolio stood at 2.3 years at the end of 2014 (2013: 3.5 years). In addition, the company had EUR 1,170 million in other investments (2013: EUR 379 million), of which EUR 593 million were in central bank deposits (2013: EUR 354 million), EUR 27 million in money market deposits in credit institutions (2013: EUR 25 million) and EUR 550 million in repurchase agreements (2013: EUR - million).

Liquidity remained good throughout 2014. New investments were made in covered bonds and bonds issued by public sector entities and banks based in strong countries in the eurozone.

Financial Advisory Services Inspira Ltd

Inspira's turnover in 2014 was EUR 2.5 million (2013: EUR 1.7 million). Net operating profit for the period totalled EUR 0.4 million (2013: EUR 0.0 million).

Risk management

There were no material changes in the company's risk position in 2014. Risks remained within the set limits and, based on the company's assessment, risk management met the requirements established for it.

Prospects for 2015

At the beginning of 2015, there are no signs of significant improvement in the general weak economic situation in Europe. In the eurozone, the fear of descending into deflation has further increased and the weakening of the euro in relation to other key currencies of the world has also continued. In January, the European Central Bank announced a bond purchase programme with which it will support the eurozone markets. In the international political situation, there are no factors visible yet that would support the acceleration of economic growth in Europe. In the financial market, the impact of weak economic development and the tense international political situation can be seen as nervousness, which may even lead to fast overreactions when new negative news emerge.

In Finland, there are no clear indications of improvement of the economy and forecasts predict that economic growth will remain weak. The Finnish government has launched an extensive reform in which the structures of social welfare, health care and the municipal sector will be changed thoroughly. However, the reform is still in its early stages and the final implementation method and structure are still unknown. Consequently, its impact on the overall costs of the public sector cannot be estimated precisely.

In 2015, there will be a significant change in the operating environment as the European crisis resolution regulation and banking union enter into force. The crisis resolution regulation includes the obligation for all credit institutions to contribute to the crisis resolution fund with annual fees. As a consequence, Municipality Finance's annual costs may increase, depending on the final contribution allocation bases. Furthermore, it is possible that Municipality Finance will be transferred, in line with regulation on the banking union, under the direct supervision of the European Central Bank as the company's balance sheet exceeds EUR 30 billion.

Municipality Finance continues to develop its operations systematically with the aim of meeting the changing financing needs of its customers in the best possible way. In 2015, the main focus areas will be customer relationship management and customer service. The company will also continue the ongoing system projects in order to improve the efficiency of its operations even further.

The profitability of Municipality Finance's operations is expected to remain at a strong level in 2015. Profitability may be affected by the new mandatory costs brought on by EU regulation which may increase the company's operating expenses significantly.

The Board's proposal for the distribution of profit for the 2014 financial year

Municipality Finance Plc's distributable funds total EUR 53,158,350.27, of which profit for the financial year is EUR 10,925,810.54. The Board of Directors proposes to the Annual General Meeting that no dividend be distributed and that the distributable funds of EUR 53,158,350.27 be retained in equity.

The Board considers it reasonable to retain the profit of the financial year in the company. The company must prepare for higher own fund requirements by increasing its Tier 1 capital through profits.

The Financial Statements for 2014 will be available on the company's website (www.munifin.fi) as of 5 March 2015.

Municipality Finance Plc

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Municipality Finance Group

Consolidated statement of financial position

(EUR 1,000)	31 Dec 2014	31 Dec 2013
ASSETS		
Cash and cash equivalents	592,907	354,232
Loans and advances to credit institutions	1,072,099	589,144
Loans and advances to the public and public sector entities	19,337,730	17,882,282
Debt securities	6,416,586	5,985,644
Shares and participations	9,789	10,050
Derivative contracts	2,321,699	1,094,150
Intangible assets	4,757	4,740
Tangible assets	2,465	2,525
Other assets	2,196	1,977
Accrued income and prepayments	249,032	231,656
TOTAL ASSETS	**30,009,259**	**26,156,402**
LIABILITIES AND EQUITY		
LIABILITIES		
Liabilities to credit institutions	3,882,771	2,264,386
Liabilities to the public and public sector entities	963,662	929,209
Debt securities issued	23,230,298	20,269,298
Derivative contracts	934,399	1,818,359
Other liabilities	2,056	1,395
Accrued expenses and deferred income	249,902	268,590
Subordinated liabilities	37,943	48,974
Deferred tax liabilities	114,124	85,967
TOTAL LIABILITIES	**29,415,155**	**25,686,178**
EQUITY AND NON-CONTROLLING INTEREST		
Share capital	42,583	42,583
Reserve fund	277	277
Fair value reserve	30,914	22,285
Reserve for invested non-restricted equity	40,366	40,366
Retained earnings	479,686	364,641
Total equity attributable to parent company equity holders	**593,825**	**470,153**
Non-controlling interest	**279**	**71**
TOTAL EQUITY AND NON-CONTROLLING INTEREST	**594,104**	**470,224**
TOTAL LIABILITIES AND EQUITY	**30,009,259**	**26,156,402**

Municipality Finance Group

Consolidated income statement

(EUR 1,000)	1 Jan–31 Dec 2014	1 Jan–31 Dec 2013
Interest income	212,351	180,014
Interest expenses	–52,343	–30,524
NET INTEREST INCOME	**160,008**	**149,490**
Commission income	5,047	1,933
Commission expenses	–3,834	–4,135
Net income from securities and foreign exchange transactions	–5,711	5,023
Net income from available-for-sale financial assets	6,629	214
Net income from hedge accounting	3,693	9,617
Other operating income	11	5
Administrative expenses	–14,721	–14,802
Depreciation and impairment on tangible and intangible assets	–1,442	–1,196
Other operating expenses	–5,521	–4,937
Impairment losses on other financial assets	-	54
NET OPERATING PROFIT	**144,160**	**141,266**
Income tax expense	–28,908	–16,567
PROFIT FOR THE PERIOD	**115,252**	**124,699**
Profit attributable to:		
Equity holders of the parent company	115,044	124,697
Non-controlling interest	207	1

Statement of comprehensive income

(EUR 1,000)	1 Jan–31 Dec 2014	1 Jan–31 Dec 2013
Profit for the period	115,252	124,699
Components of other comprehensive income		
Items to be reclassified to profit or loss in subsequent periods		
Available-for-sale financial assets (fair value reserve):		
Net change in fair value	14,462	1,004
Net amount transferred to profit or loss	–3,769	–2,356
IAS 39 reclassification adjustment	92	167
Taxes related to components of other comprehensive income	–2,157	290
Change in corporate tax rate	-	1,254
TOTAL COMPREHENSIVE INCOME FOR THE PERIOD	**123,880**	**125,057**
Total comprehensive income attributable to:		
Equity holders of the parent company	123,673	125,056
Non-controlling interest	207	1

Municipality Finance Group

Capital adequacy

Consolidated own funds

(EUR 1,000)	31 Dec 2014	31 Dec 2013*	31 Dec 2013
Common Equity Tier 1 before adjustments	561,112	447,925	447,939
Adjustments to Common Equity Tier 1	−4,757	−4,740	−4,740
COMMON EQUITY TIER 1 (CET1)	**556,354**	**443,185**	**443,199**
Additional Tier 1 capital before adjustments	807	8,807	11,009
Adjustments to Additional Tier 1 capital	-	-	-
ADDITIONAL TIER 1 CAPITAL (AT1)	**807**	**8,807**	**11,009**
TIER 1 CAPITAL (T1)	**557,162**	**451,992**	**454,208**
Tier 2 capital before adjustments	65,914	57,285	57,285
Adjustment to Tier 2 capital	-	-	-
TIER 2 CAPITAL (T2)	**65,914**	**57,285**	**57,285**
TOTAL OWN FUNDS	**623,075**	**509,277**	**511,493**

*Own funds at 31 December 2013 taking into account the changes pursuant to the EU Capital Requirements Regulation (EU 575/2013) effective as of 1 January 2014.

Risk-weighted assets

(EUR 1,000)	31 Dec 2014	
	Capital requirement	Risk-weighted assets
Credit and counterparty risk, standard method	**128,664**	**1,608,297**
Claims on credit institutions and investment firms	80,793	1,009,912
Covered bonds	15,258	190,731
Securitised items	27,028	337,851
Shares in investment funds	101	1,258
Other items	5,484	68,545
Market risk	**6**	73
Operational risk, basic method	**19,994**	**249,928**
TOTAL	**148,664**	**1,858,298**
Ratio of Tier 1 capital (T1) to risk-weighted assets, %	**29.98 %**	
Ratio of total own funds to risk-weighted assets, %	**33.53 %**	

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Municipality Finance Group

(EUR 1,000)	31 Dec 2013*		31 Dec 2013	
	Capital requirement	Risk-weighted assets	Capital requirement	Risk-weighted assets
Credit and counterparty risk, standard method	**109,667**	**1,370,836**	**86,991**	**1,087,383**
Claims on credit institutions and investment firms	60,869	760,858	38,233	477,916
Covered bonds	16,733	209,159	16,733	209,159
Securitised items	29,129	364,112	29,129	364,112
Shares in investment funds	132	1,651	132	1,651
Other items	2,804	35,056	2,764	34,546
Market risk	**0**		**0**	
Operational risk, basic method	**15,609**	**195,117**	**15,609**	**195,117**
TOTAL	**125,276**	**1,565,953**	**102,600**	**1,282,500**
Ratio of Tier 1 capital (T1) to risk-weighted assets, %	**28.86 %**		**35.42 %**	
Ratio of total own funds to risk-weighted assets, %	**32.52 %**		**39.88 %**	

*Capital requirement and risk-weighted assets at 31 December 2013 taking into account the changes pursuant to the EU Capital Requirements Regulation (EU 575/2013) effective as of 1 January 2014.

Municipality Finance Plc is one of Finland's largest financial institutions. It is owned by municipalities, Keva and the Republic of Finland. The company is an essential part of the basic financial structure of Finnish society.

Municipality Finance's balance sheet is over EUR 30 billion. The company acquires funding mainly from international capital markets. Municipality Finance's funding is guaranteed by the Municipal Guarantee Board.

Municipality Finance's task is to ensure competitive financing for municipal investments and central government subsidised social housing production under all market conditions. The company's customers are Finland's municipalities, municipal federations, municipally controlled companies and non-profit housing corporations. Our customers use financing solutions provided by Municipality Finance to finance social and non-profit entities such as day care centres, schools, housing facilities and hospitals, as well as other municipal investments.

The Municipality Finance Group also includes the subsidiary company Financial Advisory Services Inspira Ltd.

Read more: www.munifin.fi

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