

INTERIM REPORT  
30 JUNE 2005



**KOMMUNINVEST**  
Svenska kommuner och landsting i samverkan

## INTERIM REPORT FOR

# KOMMUNINVEST I SVERIGE AB (PUBL)

Corporate Identity Number: 556281-4409. Registered office: Örebro, Sweden

1 JANUARY – 30 JUNE 2005

### **Kommuninvest – cooperating for better financing**

Kommuninvest i Sverige AB is a credit market company wholly-owned by Kommuninvest Cooperative Society. The members of the Society – municipalities, county councils and their companies – are able to utilise the credit market company's services.

The cooperation is voluntary, and is run on a commercial basis. The primary aim of the operation is to obtain effective financing solutions and favourable long-term conditions for members' borrowing – to act as a local debt office for Swedish municipalities and county councils.

Kommuninvest concerns itself primarily with loans for investment financing. It also offers added value in the form of advisory and training services.

### **The Municipal Sector's Finances**

#### *Improved results in 2004*

The financial results of Sweden's municipalities and county councils continued to improve in 2004, with profit before extraordinary items of SEK 2.2 (-0.8) billion. More municipalities and county councils also reported surpluses as regards profit before extraordinary items.

The economic conditions in 2004 were otherwise relatively disadvantageous. Compared to previous years, the taxation base developed less strongly, while income from the overestimated tax contributions and government grants of previous years was regulated in 2004. Although the positive result was in part an effect of one-off earnings and tax increases, a large proportion of the higher profit was due to moderated cost increases.

#### *Favourable conditions for 2005 and 2006*

The situation for 2005 and 2006 appears more favourable. An increased anticipated taxation base and general government contribution, along with the cost-cutting measures that have been implemented, lay the foundation for the best financial result since the early 1990s. At present, profit for the municipal sector in 2005 and 2006 is estimated at SEK 6-9 billion annually. Municipal economic conditions do, however, depend on how the Swedish economy develops in general. During the spring of 2005, reports showed the economy was growing less than had been expected. Later reports, however, point to a recovery. This could mean that the basic situation for municipalities and county councils is

adversely affected in relation to the original forecasts. In the run-up to 2005, the municipal financial equalisation system has been revised and updated with the aim of further ensuring equal conditions for all of Sweden's municipalities and county councils. Moreover, alterations in the Swedish Local Government Act highlight the requirements for sound public fund management. Altogether, this is expected to entail improved profits for more individual municipalities and county councils.

#### *Greater opportunities for improving financial readiness*

In 2004 the strong results, along with sales of assets and relatively restrained investment, have led to a better cash flow. Borrowing could thereby be reduced while liquidity and lending to municipal companies were able to increase. Improved conditions over the next few years are expected to entail continued scope to reduce borrowing, increase lending to municipal companies, or for external investments. This in turn means that municipalities' and county councils' ability to prepare for future financial strain is also expected to improve during the coming period. Examples of future financial strain include costs and payments for an ageing population, a higher maintenance requirement for fixed assets, development of medical treatments, and pensions.

#### *Municipal and county-owned enterprises constitute much of the municipal sector*

A considerable proportion of the municipal sector's activities are dealt with under a separate legal entity. Municipalities and county councils own approximately 1,500 companies, which jointly account for as large a balance sheet total as the municipalities and county councils themselves. The municipalities' capital-intensive ventures, such as housing and energy, are the main activities dealt with under a separate legal entity. Swedish legislation on financial reporting in local government requires that municipalities and county councils draw up consolidated accounts. In the past five years, the municipal sector has recorded consolidated profits of between SEK 2 billion and 14 billion. The vast majority of the municipal sector's borrowing is taken out by municipally owned companies. The municipal sector's consolidated borrowings amount to approximately SEK 360 billion. Even though a number of expansive



regions are set to increase their investment, primarily in housing, the consolidated borrowing is expected to remain unchanged in 2005 and 2006.

### **Most Swedish municipalities are members**

Kommuninvest is Sweden's largest inter-municipal cooperative society in the area of financing. Between 2000 and 2004, lending increased by 92% as membership rose by 45%.

The main reason for this rapid growth is the fact that the cooperative organisation has consistently been able to provide financing solutions with favourable terms. More and more municipalities and county councils are seeing the advantages of arranging their financing through Kommuninvest and are applying for membership in the cooperative society.

At the end of June 2005, the organisation had 164 (151) members, of which 158 (146) were municipalities and 6 (5) were county councils.

The following became members during the first half of 2005:

- Municipality of Håbo
- Municipality of Gällivare
- Uppsala County Council
- Municipality of Kramfors
- Municipality of Haparanda
- Municipality of Krokom

In the period from the end of June to the date of this report, one more member has been added:

- Municipality of Arvidsjaur

### **Credit rating stable at top level, Aaa**

Kommuninvest's credit rating from Moody's Investors Service is Aaa, the same level as the Kingdom of Sweden. The credit rating has remained unchanged over the report period, and reflects the overall financial strength of Kommuninvest's members and the public sector as a whole.

### **Lending**

During the first half-year, Kommuninvest's lending increased by 8% (4%) to SEK 55.4 (51.4) billion at the end of the period. Net lending during the first half of 2005 was SEK 4.3 (2.0) billion. The increase in lending has thus doubled compared with the increase in the first half of 2004.

There has been great interest in lending to the municipal sector. The EU's new capital cover rules (EU Directive), with requirements for credit institutions to change the balance of their credit portfolios, have contributed to increased competition for lending to the municipal sector. There has been good access to capital on the market as a result of restrained investment and a high level of liquidity among large Swedish companies in the private sector. Many members – like the municipal sector in general – have also been restrained in new borrowing. The strong growth in membership of recent

years takes a while to impact on the company's lending figures, as it can take up to three years before the majority of the new members have renegotiated their borrowing requirements.

Owing to the prevailing low interest rates and the access to capital, the trend in recent years has been for borrowers to increasingly demand loans with variable interest rates, or relatively short credit periods and fixed interest terms.

Due to a combination of several new members with a higher total borrowing base and increased competition, Kommuninvest's share of its members' overall borrowing fell from approximately 44% at the end of 2003 to approximately 42% at the end of 2004.

### **Borrowing**

During the first six months of 2005, Kommuninvest has been highly active on the capital markets. Kommuninvest has conducted its second benchmark bond loan. The transaction amounted to USD 1 billion with a maturity of 5 years. Borrowing in the form of structured loans has remained an important source of financing, as it was throughout 2004. The conditions obtained have been, in the longer-term view, very favourable, and show the importance of Kommuninvest as a cooperative organisation. Total long-term borrowing, i.e. loans with a maturity of over one year, amounted to SEK 77.5 (59.4) billion at the end of the period.

### **Financial result**

Profit before tax and allocations for the first six months of the year was SEK 25.2 (6.6) million. The higher surplus is due to a combination of an increased return on investment liquid funds, as well as greater activity in buying back the company's own bonds.

Increased competition in municipal financing has helped reduce financial costs for Kommuninvest's members. However, for Kommuninvest itself, it has entailed a slight decrease in the margin between borrowing and lending. The lower margin has been made possible by growth in the balance sheet, which enables a lower administration cost: 6.9 (8.1) bps in relation to Kommuninvest's balance sheet.

### **Financial support – consultancy and training services**

The consultancy and training operations, directed at members and their companies, are based on Kommuninvest's models for financial analysis, financing policy and debt calculation for rationalising liability management. In its contacts with the Swedish municipal sector, Kommuninvest works in an organisation comprising three regions. Regional and customer managers have continued to endeavour to increase their collaboration with old and new members during the first half-year, in part through closer client contacts. Client contacts take place largely by telephone, but also



through individual or group visits to Kommuninvest. Furthermore, personnel within the region-based organisation travel all over Sweden to meet existing and prospective members. This is in addition to the regular regional and central meetings that focus on exchanging knowledge regarding developments on the capital market and in the municipal sector.

#### **Participation capital from new members becomes share capital in the company**

At the date of publication of this report, the Board, in accordance with the authority granted by the Annual General Meeting on 10 March 2005, has resolved to implement a new issue directed at the Parent Society, in order to increase share capital by SEK 11.2 million. This amount corresponds to the new share capital from new members in the Parent Society. The Society's Board is expected to take a decision on the offer during September.

#### **Executive Management Group**

The management group was unchanged and consists of Thomas Åkelius (President and CEO), Tomas Werngren (Executive Vice President and CFO), Malin Gillberg (HR Manager), Harriet Forsell Söderberg (Deputy CFO) and Maria Viimne (Funding and Investment Manager).

During the first half of 2005, the management group has focused on updating the company's vision, goals and strategies.

#### **Prospects for the second half of 2005**

The number of members in the Cooperative Society is continuing to increase, and could reach 180 by the end of 2005. This would mean that 60% of the municipalities and 30% of the county councils in Sweden would be cooperating through Kommuninvest.

Experience shows that new members entail an increase in net lending as their existing loans are paid off and new financing is required. The considerable increase in membership in 2005 will therefore not fully impact on the company's figures until 2006 and beyond.

In the same way, membership growth in and before 2004 has an effect on this year's lending figures. It is difficult in the short term to determine the effect which the lending volume will have in the second half of 2005, as other factors also need to be considered, such as the level of the sector's new investment and which forms of financing will be used.

Nevertheless, growth in membership remains one of the most important fundamental factors in ensuring a future increase in lending, both in the second half of 2005 and in future years.

**INCOME STATEMENT (in millions of SEK)**

|                                      | 2005<br>1 January –<br>30 June | 2004<br>1 January –<br>31 December | 2004<br>1 January –<br>30 June |
|--------------------------------------|--------------------------------|------------------------------------|--------------------------------|
| Interest income                      | 1,200.2                        | 2,125.1                            | 1,084.6                        |
| Interest expenses                    | -1,145.7                       | -2,046.7                           | -1,048.8                       |
| <b>NET INTEREST INCOME</b>           | <b>54.5</b>                    | <b>78.4</b>                        | <b>35.8</b>                    |
| Commission expenses                  | -2.0                           | -2.7                               | -1.0                           |
| Net result of financial transactions | 0.2                            | -2.0                               | -1.3                           |
| Other operating income               | 3.7                            | 1.5                                | 0.8                            |
| <b>TOTAL OPERATING INCOME</b>        | <b>56.4</b>                    | <b>75.2</b>                        | <b>34.3</b>                    |
| General administration expenses      | -29.3                          | -49.4                              | -25.6                          |
| Depreciation of tangible assets      | -0.8                           | -1.6                               | -0.7                           |
| Other operating expenses             | -1.1                           | -2.4                               | -1.4                           |
| <b>TOTAL EXPENSES</b>                | <b>-31.2</b>                   | <b>-53.4</b>                       | <b>-27.7</b>                   |
| <b>OPERATING INCOME</b>              | <b>25.2</b>                    | <b>21.8</b>                        | <b>6.6</b>                     |
| Allocations                          | -5.7                           | -2.7                               | -0.9                           |
| Tax on profit for the period         | -5.7                           | -5.5                               | -1.7                           |
| <b>PROFIT FOR THE PERIOD</b>         | <b>13.8</b>                    | <b>13.6</b>                        | <b>4.0</b>                     |

**BALANCE SHEET (in millions of SEK)**

|   | 30 June 2005    | 31 December 2004 | 30 June 2004    |
|---|-----------------|------------------|-----------------|
| <b>ASSETS</b>                                     |                 |                  |                 |
| Cash  | 0.0             | 0.0              | 0.0             |
| State bonds eligible as collateral                | 2,412.0         | 5,175.6          | 2,848.0         |
| Lending to credit institutions                    | 3,338.5         | 1,705.4          | 2,222.7         |
| Lending   | 55,352.3        | 51,115.5         | 51,404.4        |
| Bonds and other interest-bearing securities       | 19,418.5        | 8,716.6          | 5,199.2         |
| Shares and participations in associated companies | 0.5             | 0.5              | 0.5             |
| Tangible assets equipment                         | 3.0             | 3.6              | 3.1             |
| Other assets                                      | 2,165.8         | 616.5            | 9.0             |
| Prepaid expenses and accrued income               | 630.4           | 650.3            | 686.3           |
| <b>TOTAL ASSETS</b>                               | <b>83,321.0</b> | <b>67,984.0</b>  | <b>62,373.2</b> |
| <b>LIABILITIES, ALLOCATIONS AND EQUITY</b>        |                 |                  |                 |
| Liabilities to credit institutions                | 2,653.3         | 1,800.5          | 2,049.2         |
| Securities issued                                 | 77,506.8        | 64,682.4         | 59,403.0        |
| Other liabilities                                 | 2,238.9         | 623.2            | 26.6            |
| Accrued expenses and prepaid income               | 666.7           | 652.5            | 681.9           |
| <b>Total liabilities</b>                          | <b>83,065.7</b> | <b>67,758.6</b>  | <b>62,160.7</b> |
| <b>Untaxed reserves</b>                           | <b>31.6</b>     | <b>25.9</b>      | <b>24.1</b>     |
| Share capital                                     | 138.8           | 128.5            | 123.5           |
| Statutory reserve                                 | 14.4            | 12.9             | 12.9            |
| Profit brought forward                            | 56.7            | 44.5             | 48.0            |
| Profit for the period                             | 13.8            | 13.6             | 4.0             |
| <b>Equity</b>                                     | <b>223.7</b>    | <b>199.5</b>     | <b>188.4</b>    |
| <b>TOTAL LIABILITIES, ALLOCATIONS AND EQUITY</b>  | <b>83,321.0</b> | <b>67,984.0</b>  | <b>62,373.2</b> |

## Undertakings not on the balance sheet

Refers to undertakings as at 30 June 2005 and 31 December 2004 (in millions of SEK).

|                | Interest related |         |                |         | Exchange rate based |         |                |         | Share related |         |                |         | Commodity related |         |                |         |
|----------------|------------------|---------|----------------|---------|---------------------|---------|----------------|---------|---------------|---------|----------------|---------|-------------------|---------|----------------|---------|
|                | Market value     |         | Nominal amount |         | Market value        |         | Nominal amount |         | Market value  |         | Nominal amount |         | Market value      |         | Nominal amount |         |
|                | 2005.06          | 2004.12 | 2005.06        | 2004.12 | 2005.06             | 2004.12 | 2005.06        | 2004.12 | 2005.06       | 2004.12 | 2005.06        | 2004.12 | 2005.06           | 2004.12 | 2005.06        | 2004.12 |
| Positive value | 1,173            | 414     | 19,432         | 9,991   | 3,671               | 1,963   | 48,292         | 15,158  | 2,249         | 1,016   | 15,212         | 12,548  | 72                | 6       | 321            | 111     |
| Negative value | -2,345           | -1,751  | 36,154         | 32,708  | -2,982              | -5,628  | 23,404         | 42,527  | -176          | -409    | 3,850          | 8,705   | -1                | -       | 50             | -       |

Note: When calculating market value, based on a fictitious expiry date, all contracts are calculated using the present value method with current market rates for interest, currency conversion and share prices. Those contracts which indicate a claim on the counterparty are entered under the heading 'positive value'. For counterparties with which Kommuninvest has signed ISDA contracts, the net market value is calculated in accordance with the Swedish Financial Supervisory Authority's instruction 2003:10.

Under the Articles of Association, derivative instruments may be used only with the aim of eliminating risks in borrowing and lending operations. Kommuninvest accepts only the best players as counterparties in swaps. At present, the majority of our contracts have been entered into with counterparties rated AA by at least one of the recognised US rating institutions. When signing ISDA contracts with a counterparty, Kommuninvest insists on reserving the right to terminate a contract prematurely if the counterparty's rating falls below a certain level. No counterparty currently has a rating below A2 and/or A. Kommuninvest's Board has issued regulations limiting the extent of exposure to any single counterparty.

### Capital cover

Capital cover amounts to 15.04% (16.76%).

### Accounting principles

The accounting principles and calculation methods used in this interim report are identical to those used in the annual report for 2004.

Örebro, 16 August 2005

Thomas Åkelius  
*President*

The interim report has been reviewed by the auditors of the corporation.

### Review report for Kommuninvest i Sverige AB

Corporate Identity Number: 556281-4409

We have carefully reviewed this interim report for the period 1 January 2005 – 30 June 2005, and in doing so have followed the recommendations issued by the Swedish Institute of Authorized Public Accountants.

A review is considerably more limited than an audit.

Nothing has emerged to suggest that the interim report does not fulfil the requirements for interim reports laid down in the Annual Accounts for Credit Institutions and Securities Companies Act.

Örebro, 16 August 2005

*Ernst & Young AB*

Lars Bonnevier  
*Authorised Public Accountant*

Margareta Edin  
*Authorised Public Accountant*  
Öhrlings Pricewaterhouse Coopers  
Appointed by the Financial Supervisory Authority



## **KOMMUNINVEST**

*The Swedish Local Government Funding Agency*

Kommuninvest i Sverige AB (publ)

Corporate Identity Number: 556281-4409

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