

# KOMMUNINVEST 2006

Interim Report 1 January–30 June



- Six new members
- Balance sheet total SEK 105.9 billion
- New lending SEK 4.8 billion
- Operating profit SEK 14.9 million
- Positive financial development of municipalities and councils



KOMMUNINVEST

Interim Report for **Kommuninvest i Sverige AB (publ)**

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

1 January – 30 June 2006

**A local debt office for Sweden's municipalities and county councils**

Kommuninvest is owned and guaranteed by Swedish municipalities and county councils, and acts as a local debt office for its members. The primary aim of the business is to fulfil the needs of the local government sector regarding efficient financing, consultation and methods for functional financial management. Kommuninvest also acts as an interest organization for the municipal sector in financial issues. Today Kommuninvest is Sweden's largest inter-municipal cooperative society. The cooperation is voluntary, and is run on a commercial basis.

*Local government finances***Substantial share of public finances**

Sweden's municipal sector (290 municipalities and 20 county councils) represents a significant proportion of total public finances and the national economy in general. The municipalities and county councils account for over 70% of public services and approximately a quarter of the total number of people in work in Sweden.

**Strong public finances**

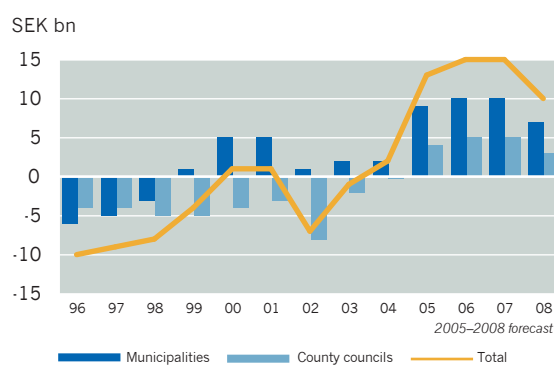
Public finances have continued to develop strongly in 2006. The financial savings surplus is expected to amount to 2.8% (2.7%) of GDP this year. The municipal sector is expected to contribute just over 0.5% to this surplus. The positive financial development of municipalities and county councils is a major factor in making the public sector surplus in Sweden today high by international standards.

**Municipal sector results continue to develop very strongly**

Kommuninvest's assessments indicate that the results of municipalities and county councils are continuing to develop very strongly. Results for 2006 are expected to total over SEK 15 (13) billion. The municipalities are expected to contribute SEK 10 billion to the results, and the county councils SEK 5 billion. The improved results are mainly the effect of positive development in the Swedish economy in general and rising employment in particular, which have a positive impact on the taxation base and tax income. The vigorous efforts of recent years to achieve financial balance have resulted in considerably tighter budget discipline, and the resulting cost control has helped the strong financial development to continue.

Over the past two years the municipal sector has made clear progress towards its goal of sound financial management both in the overall economy and its own operations.

The consolidated results for the municipal sector (including owned corporations and foundations) are also expected to strengthen this year, amounting to just

**Local government financial development 1996–2008**

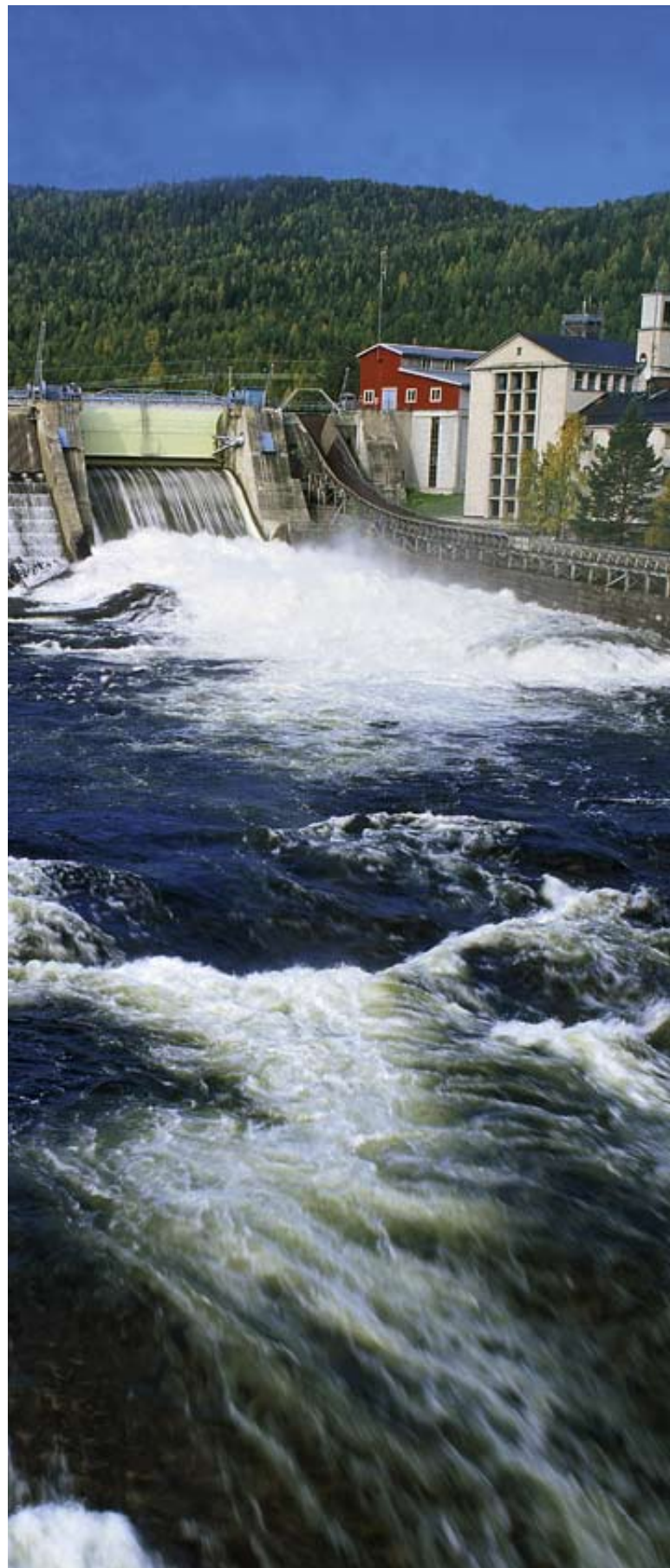
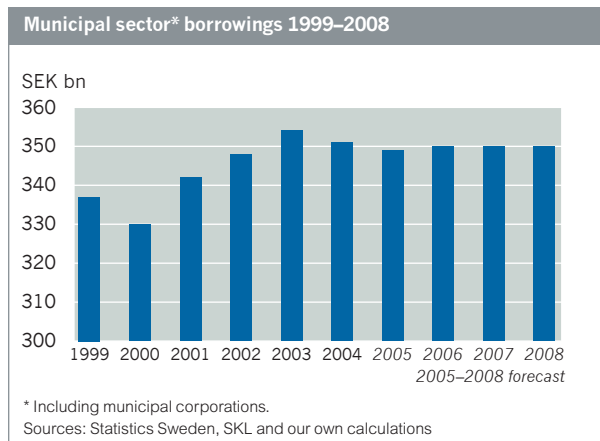
Source: Statistics Sweden, SKL and our own calculations

under SEK 20 billion. Municipal sector corporations comprise the municipality/county council itself and the controlled share of municipal enterprises. These enterprises mainly relate to capital-intensive operations such as housing and commercial premises. The enterprises are more sensitive to changes in capital-related expenditure than the municipalities and county councils. The recent rises in interest rates and energy costs will therefore have an adverse impact on these corporations' finances. Consequently the municipal sector's consolidated results will be affected negatively.

#### Increased investment but unchanged borrowing

Municipality and county council investments are expected to increase by just under 10% this year. The strong focus in recent years on creating a balanced operating economy has also led to a lower rate of investment. This is one reason why the municipal sector as a whole is considered to have a slightly neglected investment requirement. Strong financial development has now given rise to greater optimism and an opportunity for the sector to raise its investment volume without increasing the scope of external loan finance.

The municipal sector's borrowings (including municipal corporations) amount to SEK 350 billion. Municipalities and county councils account for just over SEK 150 billion and municipal corporations for SEK 200 billion. A high proportion of municipal borrowings are loaned to municipal corporations. Municipal lending to owned corporations is increasing in scope and amounts to just under SEK 130 billion. This is a result both of stronger control of the municipal corporations, and an improved cash flow in the municipalities which is increasing the scope to finance the investment requirement of owned corporations. The municipal sector's total volume of borrowing is expected to remain unchanged over the next three years. In addition to external borrowing, the municipal sector has SEK 300 billion in total pension liabilities, of which SEK 250 billion has been re-loaned to the operation.



### Better prepared for future economic challenges

The positive financial development also means greater financial strength overall. According to Kommuninvest's calculations, the annual cash flow will result in a decrease in net indebtedness of SEK 8-10 billion a year over the next three years. This increases financial preparedness and the scope for action in dealing with future challenges.

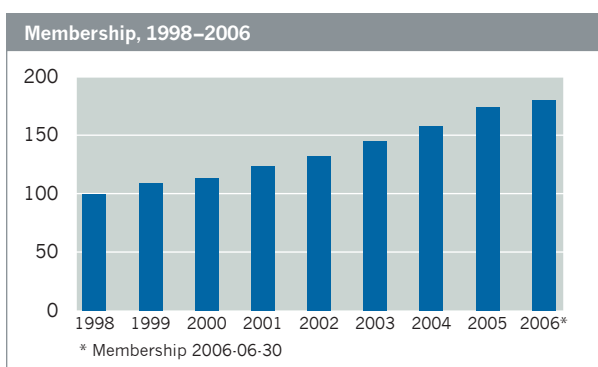
### Continued stable growth

Kommuninvest offers its members and their majority-owned corporations favourable conditions for financing important public investments for the long term. Lending is supplemented with advisory service and training programmes, and tools that help clients manage their credit portfolios as efficiently as possible. Kommuninvest, which is Sweden's largest inter-municipal cooperation within the finance sector, is showing continued stable growth.

At the end of June 2006, Kommuninvest had 180 (164) members, of which 174 (158) were municipalities and 6 (6) were county councils. The following became members during the first half of the year:

*The Municipality of Hallstahammar*  
*The Municipality of Avesta*  
*The Municipality of Trosa*  
*The Municipality of Lilla Edet*  
*The Municipality of Kiruna*  
*The Municipality of Skinnskatteberg*

The main reason for this stable growth is the fact that the cooperative society 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.



### Credit rating at top level

Two major independent credit rating institutions assign Kommuninvest the same credit rating as the Kingdom of Sweden. This reflects the overall financial strength of Kommuninvest's members and the public sector as a whole. When Kommuninvest was assigned a rating by Standard & Poor's for the first time in June, it was

given the highest possible rating of AAA.

Kommuninvest's credit rating from Moody's Investors Service is Aaa, which has remained unchanged during the report period.

### Increased market share

The municipal sector has strong finances. These strong finances have reduced the need for new borrowing while at the same time some units have been able to reduce existing debts. The municipal sector is facing major investments; these are partly self-financed but they also require external capital. Access to capital has remained good due to high liquidity in the private and banking sectors. The Basle II regulations favour the granting of credit based on a profitability perspective. In this climate, Kommuninvest has managed to increase its net lending by SEK 4.8 billion during the report period. A significant proportion of this increase can be attributed to the growing number of members. The effects of increased membership numbers come with a few years' delay, as it takes time for new members' borrowing requirements to be fully realized.

### Lending

All lending is carried out in Sweden and at present exclusively in Swedish kronor (SEK). As all lending is aimed at municipalities, county councils and majority-owned municipal corporations with indemnity from the owner, Kommuninvest has no impaired loans.

### Funding

During the first six months of 2006, Kommuninvest has been highly active on the capital markets. Kommuninvest has conducted its third benchmark bond loan. The transaction amounted to USD 1 billion with a maturity of five years. Funding in the form of structured loans has remained an important source of financing, as it was throughout 2005. The conditions obtained have been, in the longer-term view, very favourable, and show the importance of Kommuninvest as a cooperative society. Total long-term borrowing, i.e. loans with a maturity of over one year, amounted to SEK 100.6 (77.5) billion at the end of the period.

### Financial result

The prime indicator of the financial success of Kommuninvest's activities is the improvement in the results of the treasuries of Kommuninvest's members. This is achieved as a result of the favourable terms offered to the members collaborating through Kommuninvest and using the services of the company.

Operating profit for the first six months of the year before appropriations and tax was SEK 14.9 (25.2) million. The balance sheet total has increased to SEK 105,914 (83,321) million. Net interest income amounted to SEK 51.8 (38.8) million. Results from the buy-back of Kommuninvest's own issued bonds are reported under 'Net result of financial transactions', and

improved results by just over SEK 8.4 (15.7) million during the first half of the year.

The increase in net interest income is partly attributable to a higher margin on investing funds that have not yet been loaned on to Kommuninvest's borrowers. Kommuninvest's investment activities include investing in securities with a high credit rating, of which a significant proportion are investments in states and financial institutions guaranteed by states. On 30 June, SEK 41.6 (24.6) billion was invested in bonds and other interest-bearing securities prior to lending to members.

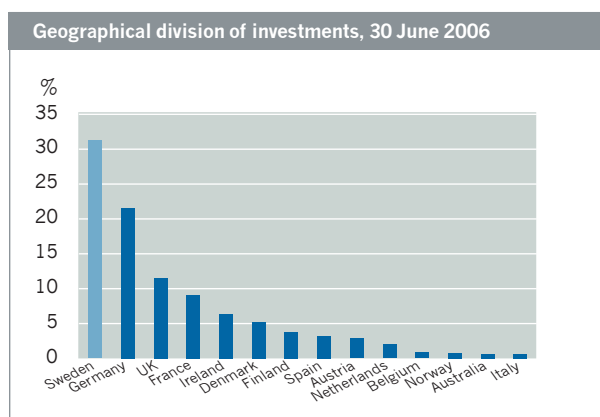
Expenditure has increased by approximately 35.9%, or by SEK 11.2 million, and amounted to SEK 42.4 (31.2) million. This increase in costs is mainly due to internal development work undertaken and adaptation to the new IAS/IFRS accounting rules. Work on these new accounting rules has meant continued analysis of the effects, the choices, and the legal requirements, as well as the implementation of hedge accounting and adaptations to the system.

#### 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 General Meeting on 23 March 2006, has resolved to implement a new issue directed at the Parent Society, in order to increase share capital by SEK 3.1 million to SEK 153.1 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.

#### Risk management

During the first half of 2006, a review of internal procedures was carried out to reduce operational risks. At the same time counterparty risks could be kept at a low level, primarily by investing with counterparties that have government guarantees for their obligations. It was also possible to reduce exposure to individual counterparties through security agreements related to derivatives contracts.



#### Market risks

As an intermediary on the financial credit market, Kommuninvest is exposed to financial risks. These financial risks can be divided into market risks and liquidity risks. Kommuninvest's policy is to keep financial risks as low as possible. All terms and conditions between borrowing and lending are secured through derivatives contracts. The scope of the business means that interest risks between borrowing and investment are limited at the portfolio level. Exchange risks are limited through the frequent exchange of returns on investment in foreign currencies into Swedish kronor.

#### Liquidity risks

Liquidity risk is the risk of Kommuninvest not being able to fulfil its payment commitments, or being forced to take extraordinary measures to do so. Liquidity risk can also be expressed as a shortage of funding.

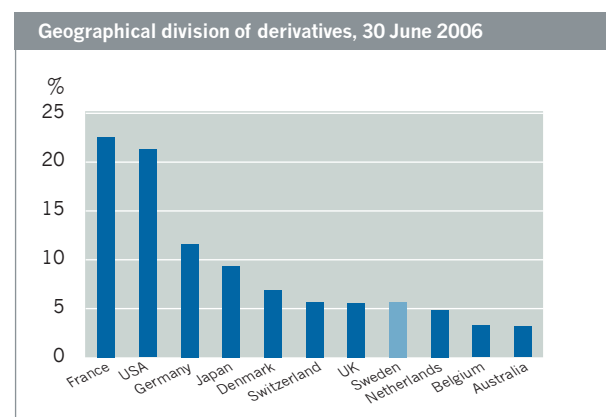
Consequently, the Board of Directors has resolved on a liquidity reserve, currently a minimum of SEK 4 billion and a maximum of SEK 6 billion, which can be utilized to fulfil its liquidity requirements at any time. Invested assets constituent to the company's prefunding can also be considered a form of liquidity reserve.

#### Counterparty risks

Credit-related counterparty risk can be defined as the risk of a counterparty not fulfilling its commitments to Kommuninvest at the contracted time. Kommuninvest minimizes counterparty risk in accordance with the Board's guidelines by only entering into contracts with highly credit-worthy counterparties and also by spreading contracts between various counterparties from different countries.

Since January, investments in German government-guaranteed securities have increased, and as a result Swedish and German counterparties are predominant. With regard to derivatives, counterparties from France and the USA dominate the geographical distribution for nominal amounts.

With regard to investments, counterparties in the most secure rating category, AAA, are predominant. For derivatives, over 90% are distributed among counterparties with a credit rating of at least AA.

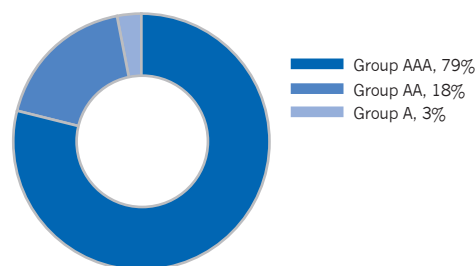




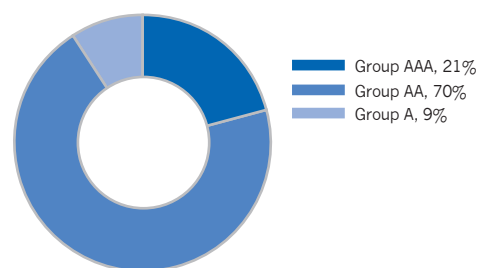
### Operational risks

Internal monitoring requires each employee to take responsibility. Activities to develop methods for identifying and valuing operational risks were intensified during the first half of the year. The company is currently enhancing its capital assessment process to comply with the new capital cover rules according to the EU directive (Basel II).

Invested assets by rating, 30 June 2006



Nominal amount on derivatives by rating, 30 June 2006



### Executive management

Tomas Werngren was appointed President and CEO on 19 April 2006. The executive management changed at the same time and now comprises Tomas Werngren, President and CEO, Harriet Forsell Söderberg, Executive Vice President, Maria Viimne, Head of Funding and Investment, Ulf Jivmark, Head of Legal, Johanna Larsson, Head of Administration.

### Prospects for the second half of 2006

The number of members in the cooperative society will continue to increase, although to a more limited extent. The explanation for a decreased level of activity lies in the general election in September this year, which usually reduces the number of applications of interest.

Membership growth in and before 2005, however, 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 during the rest of the year, as other factors also need to be considered, such as the level of the sector's new investment.

Growth in membership remains one of the most important fundamental factors in ensuring a future increase in lending, both in the second half of 2006 and in future years.

## INCOME STATEMENT

(in millions of SEK)	2006 Jan–Jun	2005 Jan–Jun	2005 Jan–Dec
Interest income	1 432.0	1 200.2	2 477.1
Interest expenses	-1 380.2	-1 161.4	-2 385.9
<b>NET INTEREST INCOME</b> (Note 1)	<b>51.8</b>	<b>38.8</b>	<b>91.2</b>
Commission expenses	-2.2	-2.0	-3.8
Net result of financial transactions	7.3	15.9	26.4
Other operating income	0.4	3.7	3.8
<b>TOTAL OPERATING INCOME</b>	<b>57.3</b>	<b>56.4</b>	<b>117.6</b>
General administration expenses	-39.7	-29.3	-57.6
Depreciation of tangible assets	-0.9	-0.8	-1.8
Other operating expenses	-1.8	-1.1	-2.2
<b>TOTAL EXPENSES</b>	<b>-42.4</b>	<b>-31.2</b>	<b>-61.6</b>
<b>OPERATING INCOME</b>	<b>14.9</b>	<b>25.2</b>	<b>56.0</b>
Appropriations	-2.7	-5.7	-11.6
<b>PROFIT BEFORE TAX</b>	<b>12.2</b>	<b>19.5</b>	<b>44.4</b>
Tax on profit for the period	-3.7	-5.7	-12.8
<b>PROFIT FOR THE PERIOD</b>	<b>8.5</b>	<b>13.8</b>	<b>31.6</b>

## BALANCE SHEET

(in millions of SEK)	30 June 2006	30 June 2005	31 Dec 2005
<b>ASSETS</b>			
Cash	0.0	0.0	0.0
State bonds eligible as collateral	9 593.8	2 412.0	10 518.9
Lending to credit institutions	3 625.7	3 338.5	3 109.7
Lending	61 496.7	55 352.3	56 738.3
Bonds and other interest-bearing securities	29 334.0	19 418.5	18 116.5
Shares in associated companies	0.5	0.5	0.5
Tangible assets, equipment	4.0	3.0	3.1
Other assets	1 213.5	2 165.8	2 043.1
Prepaid expenses and accrued income	645.8	630.4	618.3
<b>TOTAL ASSETS</b>	<b>105 914.0</b>	<b>83 321.0</b>	<b>91 148.4</b>
<b>LIABILITIES, PROVISIONS AND EQUITY</b>			
Liabilities to credit institutions	3 124.0	2 653.3	3 424.6
Securities issued	100 597.8	77 506.8	84 738.3
Other liabilities	1 168.3	2 238.9	2 019.7
Accrued expenses and prepaid income	722.6	666.7	678.9
<b>Total liabilities</b>	<b>105 612.7</b>	<b>83 065.7</b>	<b>90 861.5</b>
<b>Untaxed reserves</b>	<b>40.2</b>	<b>31.6</b>	<b>37.4</b>
Share capital	153.1	138.8	150.0
Statutory reserve	17.5	14.4	14.4
Profit brought forward	82.0	56.7	53.5
Profit for the period	8.5	13.8	31.6
<b>Equity</b>	<b>261.1</b>	<b>223.7</b>	<b>249.5</b>
<b>TOTAL LIABILITIES, PROVISIONS AND EQUITY</b>	<b>105 914.0</b>	<b>83 321.0</b>	<b>91 148.4</b>

### Note 1

Last year's net interest income has been adjusted for the result from buying back own bonds, which, as recognised during 2006, is instead recognised under Net result of financial transactions.

## CASH FLOW STATEMENT

(in millions of SEK)

	30 June 2006	31 Dec 2005
<b>Liquid assets at the start of the accounting period</b>	<b>302.8</b>	<b>77.4</b>
<b>Operational activities</b>		
Operating profit	14.9	56.0
Adjustment for items not included in cash flow:	3.6	3.9
Income tax paid	-3.7	-5.4
<b>Cash flow from operational activities before the change in the assets and liabilities of operational activities</b>	<b>14.8</b>	<b>54.5</b>
Change in lending	-4 758.4	-5 622.8
Change in other assets	802.1	-1 394.6
Change in other liabilities	-807.8	1 415.5
<b>Cash flow from operational activities</b>	<b>-4 749.3</b>	<b>-5 547.4</b>
<b>Investment activities</b>		
Sale of tangible assets		
Acquisition of tangible assets	-1.8	-1.3
<b>Cash flow from investment activities</b>	<b>-1.8</b>	<b>-1.3</b>
<b>Financing activities</b>		
Change in securities issued	15 856.8	20 053.8
Change in liabilities to credit institutions	-300.6	1 624.0
Change in investments	-10 130.4	-15 922.0
<b>Cash flow from financing activities</b>	<b>5 425.8</b>	<b>5 755.8</b>
New share issue	3.1	21.5
Group contribution paid		-3.2
<b>Cash flow for the period</b>	<b>677.8</b>	<b>225.4</b>
<b>Liquid assets at the end of the accounting period</b>	<b>980.6</b>	<b>302.8</b>

The Cash Flow Statement is produced using the cash accounting method and based on the operating profit for the period and changes in the Balance Sheet's opening balances. Operating profit has been adjusted for changes not included in operational activities. The cash flow statement has been divided into inward and outward payments from operational activities, investment activities and financing activities. Liquid assets include cash, balances on current accounts and giro accounts.

The cash flow statement for 31 December 2005 has been adjusted compared to the annual report for 2005.



### Obligations not on the balance sheet on 30 June 2006

<b>Contracts with positive market value SEK</b>		<b>Nominal amount</b>	<b>Market value</b>
Interest contracts counterparty with	AAA	7 035 516	590 063
	AA	13 886 769	344 981
	A	1 950 326	42 756
		<b>22 872 611</b>	<b>977 800</b>
Currency and interest-based contracts counterparty with	AAA	2 801 348	274 479
	AA	20 853 836	3 342 261
	A	2 040 347	282 023
		<b>25 695 531</b>	<b>3 898 763</b>
Share contracts counterparty with	AAA	949 696	219 695
	AA	7 749 619	1 440 070
	A	571 071	235 890
		<b>9 270 386</b>	<b>1 895 655</b>
Raw materials contracts counterparty with	AAA		
	AA	256 810	367 294
	A		
		<b>256 810</b>	<b>367 294</b>
<b>Total</b>		<b>58 095 338</b>	<b>7 139 512</b>
<b>Contracts with negative market value SEK</b>		<b>Nominal amount</b>	<b>Market value</b>
Interest contracts counterparty with	AAA	10 425 987	-455 736
	AA	20 828 566	-1 341 989
	A	2 660 189	-87 560
		<b>33 914 742</b>	<b>-1 885 285</b>
Currency and interest-based contracts counterparty with	AAA	12 572 726	-2 742 018
	AA	45 240 968	-3 268 166
	A	3 741 717	-290 340
		<b>61 555 411</b>	<b>-6 300 524</b>
Share contracts counterparty with	AAA	1 921 300	-69 767
	AA	9 933 393	-762 518
	A	3 954 205	-302 092
		<b>15 808 898</b>	<b>-1 134 377</b>
Raw materials contracts counterparty with	AAA		
	AA	133 700	-12 401
	A		
		<b>133 700</b>	<b>-12 401</b>
<b>Total</b>		<b>111 412 751</b>	<b>-9 332 587</b>
<b>TOTAL</b>		<b>169 508 089</b>	<b>-2 193 075</b>

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 indicated a claim on the counterparty are entered under the heading 'positive market value'. 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, Kommuninvest insists on reserving the right to terminate a contract prematurely if the counterparty's rating falls below a certain level.



**Capital cover**

Capital cover amounts to 16.49% (15.04%).

**Accounting principles**

The accounting principles and calculation methods used in this interim report are identical to those used in the annual report for 2005.

A transfer has taken place between “net interest income” and “net result of financial transactions” in the income statement, as a result of buying back the company’s own bonds.

Örebro, 22 August 2006

Tomas Werngren  
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

## Introduction

We have reviewed the interim report for the period 1 January – 30 June 2006. The company management is responsible for preparing and presenting this interim report in accordance with the Annual Accounts Act for Credit Institutions and Securities Companies.

Our responsibility is to express a conclusion on this interim report based on our review.

## Focus and scope of the review

We have carried out our review in accordance with the Standard on Review Engagements SÖG 2410, Review of Interim Financial Information Performed by the Independent Auditor of the Entity issued by FAR.

A review consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review has a different focus and is substantially narrower in scope than an audit conducted in accordance with Standards on Auditing in Sweden RS and other generally accepted auditing practices. The procedures performed in a review do not enable us to obtain a level of assurance that would make us aware of all significant matters that might be identified in an audit. Therefore, the conclusion expressed based on a review does not give the same level of assurance as a conclusion expressed based on an audit.

## Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the interim financial report has not, in substance, been prepared in accordance with the Annual Accounts Act for Credit Institutions and securities Companies.

*Örebro, 22 August 2006*

Ernst&Young AB

Lars Bonnevier  
*Authorized Public Accountant*

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



**KOMMUNINVEST**

*Svenska kommuner och landsting i samarbete*

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