KBN Kommunalbanken Norway

Interim financial statements January-March 2010

About KBN

Established by an act of Parliament in 1926 as a state administrative body called Norges Kommunalbank, Kommunalbanken AS (KBN) gained its current status and structure through a conversion act dated 1 November 1999. KBN's primary objectives are to promote competition in the market for municipal loans and provide low cost funding to Norwegian municipalities, counties, intermunicipal companies and other companies with a municipal guarantee that carry out tasks at a municipal level. KBN's financial objectives are to secure a satisfactory return to its owners and to strengthen its capital base so that it can maintain its lending activity.

Financial highlights

(Amounts in NOK 1 000 000)	**January-March 2010**	**January-March 2009**	**January—December 2009**
RESULTS			
Net interest income	247	239	1 053
Profit before tax	236	557	1 946
Profit for the period	170	401	1 399
Return on equity after tax*	19,08%	72,80%	63,45%
Return on assets after tax*	0,28%	0,75%	0,62%
LENDING			
New disbursements	11 862	11 247	43 160
Outstanding loans**	160 733	126 611	151 275
LIQUIDITY PORTFOLIO**	76 292	70 882	68 310
BORROWINGS			
New long-term borrowings	53 664	23 342	116 263
Repurchase of own debt	326	2 859	6 832
Redemptions	38 103	8 354	58 135
Total borrowings**	245 355	199 339	224 418
TOTAL ASSETS	253 413	214 310	231 932
EQUITY			
Equity	3 730	2 606	3 561
Core capital adequacy ratio	9,03%	7,06%	9,25%
Total capital adequacy ratio	10,69%	10,49%	11,05%

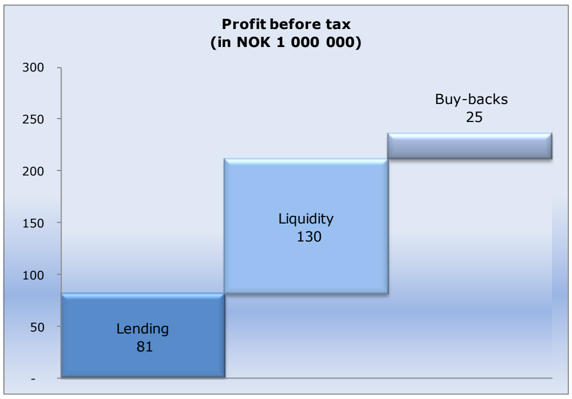
* Return on equity and return on assets are annualized

** Principal amounts

Results

KBN achieved good financial results in the first quarter of 2010. Profit for the first quarter of 2010 was NOK 170 million, compared with NOK 401 million for the same period in 2009. The decrease is due exclusively to the reduction in extraordinary gains on the buy-back of KBN's own debt.

Net interest income in the first quarter of 2010 was NOK 247 million, an increase of NOK 8 million compared with Q1 2009. The increase in interest income from lending operations is due to the strong growth in KBN's lending portfolio over the past year, whereas margins on lending rates are unchanged compared with the same period in 2009.



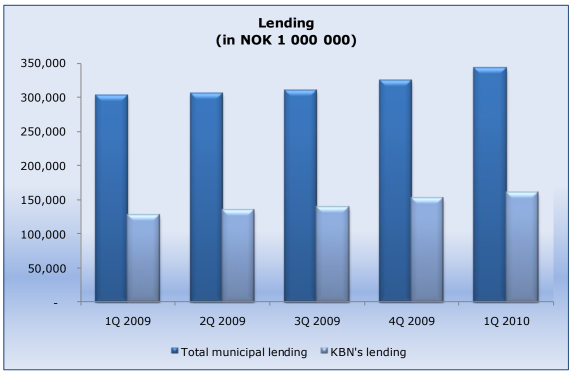
Pre-tax profit in Q1 2010 was NOK 236 million, compared with NOK 557 million in Q1 2009. Of the total pre-tax profit, NOK 81 million, or 35 per cent, is attributed to lending and NOK 130 million, or 55 per cent, to the management of surplus liquidity.

The liquidity and credit crisis in the beginning of 2009 presented KBN the opportunity to realise large extraordinary gains on the buy-back of its own debt. Such opportunities will disappear as general access to credit and spreads improve. In the first quarter of 2010, KBN executed a small number of buy back transactions with a combined realised gain of NOK 25 million.

Net unrealised losses on financial instruments in the first quarter of 2010 amounted to NOK 11 million. The loss is primarily due to a reversal of earlier unrealised gains on KBN's own debt and movements in basis swap levels, which impact a significant proportion of KBN's derivative hedging portfolio.

Lending

In the first quarter of 2010 KBN's total lending portfolio increased by NOK 9.4 billion (6.23 per cent) to NOK 160.7 billion. Lending growth for the same period in 2009 was NOK 8.6 billion (7.30 per cent). A total of NOK 11.9 billion was disbursed in new loans in Q1 2010, compared with NOK 11.2 billion in the same period in 2009.



Loan demand in the first quarter of 2010 was high, while competition for new loans from other market participants was relatively low. The local government sector's gross debt levels increased by NOK 18.7 billion, or 5.78 per cent, in the first quarter of 2010. As of 31 March 2010, KBN's market share for the entire local government sector, including municipal companies, was 47 per cent.

Financing of environmentally-friendly projects

KBN wants to take an increased responsibility when it comes to reducing energy consumption and contributing to a better environment. As a result, KBN became the first Norwegian financial institution to offer a subsidised interest rate or "Green" lending rate to municipalities and counties that implement projects aimed at improving the environment. KBN finances projects that reduce energy consumption and climate gas emissions, waste processing plants, initiatives that promote nature and outdoor leisure pursuits and other initiatives that contribute to a better environment.

Financing of environmentally-friendly projects is done through KBN's own Green bond programme. International investors are beginning to show interest in bonds that are directly linked to environmentally friendly projects. A significant market for green bonds is the Japanese retail market where KBN is one of the largest non-Japanese issuers.

Liquidity management

KBN's surplus liquidity covers the institution's 12 month net debt requirement, in line with KBN's financial policies. As of 31 March 2010, KBN's liquidity portfolio stood at NOK 76.3 billion, an increase of NOK 8.0 billion since the beginning of 2010. The increase in the liquidity portfolio reflects KBN's good access to funding in the first quarter of 2010.

The liquidity portfolio is carefully placed in notes issued by governments, states, regions, supranationals and financial institutions with a high credit rating. Income from the management of surplus liquidity still contributes to a considerable amount of KBN's net interest income due to a considerable improvement in KBN's funding levels and low risk less volatile investments.

Funding

In the first quarter of 2010 KBN experienced good demand for its debt issuance across a variety of different markets. 2010's funding programme began with a successful three-year USD 1 billion benchmark issue. During the first quarter of 2010, KBN raised a total of NOK 53.7 billion, compared with NOK 23.3 billion in the same period in 2009.

Capital

As of 31 March 2010, KBN's total eligible capital amounted to NOK 4.1 billion, with core capital at NOK 3.5 billion. In Q1 2010, KBN's total assets increased by NOK 21.5 billion to NOK 253.4 billion.

As of 31 March 2010, KBN's core capital ratio was 9.03 per cent, compared with 7.06 per cent in the same period in 2009. The increase in KBN's core capital ratio reflects an increased solidity, based on good profitability and large extraordinary gains in 2009.

Future prospects

The competitive situation in the municipal lending market is still marked by a limited provision of long term financing. The market for short term commercial paper has meanwhile improved and KBN has experienced strong competition from the capital market itself. Regardless of the competitive situation, KBN's role is to offer the municipal sector continued access to cost efficient financing of public sector projects and to be there for all municipalities regardless of their size.

The financial crisis at the end of 2008 and the beginning of 2009 created unprecedented volatility in financial markets. Macroeconomic developments at the beginning of 2010 indicated a phase of improvement in the world economy however the sovereign debt crisis in the euro zone has increased insecurity in the financial markets. The general unrest and increased uncertainty linked to the credit markets could affect the market value of KBN's assets and debt, and have the potential for some impact on future results.

As a result of last year's financial crisis, the EU is considering a move to strengthen the capital buffers in place in the financial sector through an increase in capital requirements. Proposals with regard to the new framework include among other things suggested leverage ratios and new liquidity requirements. KBN is working to prepare itself for the consequences of any new requirements, but the early drafts point towards an increased capital requirement for KBN going forward.

The Board

INCOME STATEMENT

(Amounts in NOK 1 000 000)	Note	January—March 2010	January–March 2009	2009
Interest income		990	1 782	4 847
Interest expenses		743	1 543	3 794
Net interest income	**4**	**247**	**239**	**1 053**
Commission expenses and expenses of banking services		5	4	20
Net gain/(loss) on financial instruments at fair value	**3**	(11)	(16)	222
Net gain/(loss) from repurchase of issued securities	**3**	25	358	781
Other income		0	0	1
Total other operating income		**9**	**338**	**984**
Salaries and administrative expenses		15	15	68
Depreciation on fixed assets		1	1	5
Other expenses		4	3	18
Total operating expenses		**20**	**20**	**91**
Profit before tax		**236**	**557**	**1 946**
Income tax		66	156	547
Profit for the period		**170**	**401**	**1 399**

STATEMENT OF COMPREHENSIVE INCOME

(Amounts in NOK 1 000 000)	Note	January—March 2010	January– March 2009	2009
Profit for the period		170	401	1 399
Other comprehensive income		0	0	0
Total comprehensive income for the period		**170**	**401**	**1 399**

STATEMENT OF FINANCIAL POSITION

(Amounts in NOK 1 000 000)	Note	31 March 2010	31 March 2009	31 December 2009
ASSETS				
Deposits with credit institutions		3 665	6 321	988
Instalment loans	**1**	162 806	129 526	153 040
Notes, bonds and other interest-bearing securities	**5**	77 961	70 837	69 649
Financial derivatives		8 962	7 613	8 241
Deferred tax assets		0	1	0
Other assets		20	12	14
TOTAL ASSETS		**253 413**	**214 310**	**231 932**
LIABILITIES AND EQUITY				
Loans from credit institutions		1 018	1 776	1 051
Senior securities issued	**2**	245 310	199 882	223 566
Financial derivatives		1 829	8 250	2 206
Other liabilities		506	303	512
Deferred tax liabilities		60	0	60
Pension liabilities		24	20	24
Subordinated debt		655	1 169	667
Hubrid Tier 1 capital instruments		280	304	285
TOTAL LIABILITIES		**249 683**	**211 704**	**228 371**
Share capital		1 221	1 221	1 221
Retained earnings		2 340	984	2 340
Total comprehensive income for the period		170	401	
TOTAL EQUITY	**6,7**	**3 730**	**2 606**	**3 561**
TOTAL LIABILITIES AND EQUITY		**253 413**	**214 310**	**231 932**

STATEMENT OF CHANGES IN EQUITY

(Amounts in NOK 1 000 000)

	1 January — 31 March 2010		
	Share capital	**Retained earnings**	**Total equity**
Equity as of 1 January 2010	1 221	2 340	3 561
Total comprehensive income for the period	0	170	170
Issue of share capital	0	0	0
Dividends	0	0	0
Equity as of 31 March 2010	**1 221**	**2 510**	**3 730**

	1 January — 31 March 2009		
	Share capital	**Retained earnings**	**Total equity**
Equity as of 1 January 2009	1 221	984	2 205
Total comprehensive income for the period	0	401	401
Issue of share capital	0	0	0
Dividends	0	0	0
Equity as of 31 March 2009	**1 221**	**1 386**	**2 606**

	1 January — 31 December 2009		
	Share capital	**Retained earnings**	**Total equity**
Equity as of 1 January 2009	1 221	984	2 205
Total comprehensive income for the period	0	1 399	1 399
Issue of share capital	0	0	0
Dividends	0	(44)	(44)
Equity as of 31 December 2009	**1 221**	**2 340**	**3 561**

STATEMENT OF CASH FLOWS

(Amounts in NOK 1 000 000)	**January-March 2010**	**January-March 2009**	**January-December 2009**
Cash flows from operating activities			
Interest received	1 035	2 312	5 754
Interest paid	(702)	(2 188)	(4 748)
Fees and commissions paid	(6)	(5)	(19)
Receipts from repurchase of issued securities	25	358	781
Other income	0	0	1
Cash payments to employees and suppliers	(20)	(18)	(69)
Income taxes paid	(77)	(56)	(201)
	255	**403**	**1 499**
Net disbursement of loans to customers	(9 424)	(8 578)	(33 217)
Net (increase)/decrease in deposits with credit institutions	(2 794)	(2 932)	2 375
Net (increase)/decrease in notes, bonds and other interest-bearing securities	(7 647)	(2 643)	(6 416)
Net (increase)/decrease in other assets	0	(1)	62
Net increase/(decrease) in other liabilities	4	23	(25)
Net cash flows from operating activities	**(19 606)**	**(13 728)**	**(35 723)**
Cash flows from investing activities			
Purchase of property and equipment	(3)	0	(8)
Net cash flows from investing activities	**(3)**	**0**	**(8)**
Cash flows from financing activities			
Net proceeds from issuance of debt securities	15 207	12 289	50 886
Net proceeds from other borrowed funds	0	0	(612)
Net proceeds from issuance of subordinated debt	0	0	0
Dividends paid	0	0	(44)
Issue of ordinary shares	0	0	0
Net cash flows from financing activities	**15 207**	**12 289**	**50 230**
Net change in cash and cash equivalents	**(4 402)**	**(1 439)**	**14 499**
Effects of foreign exchange differences	4 368	1 413	(14 476)
Cash and cash equivalents at 1 January	**63**	**40**	**40**
Net change in cash and cash equivalents	**(34)**	**(26)**	**23**
Cash and cash equivalents at end of period	**29**	**14**	**63**
Cash and deposits with central banks	*0*	*0*	*0*
Deposits with credit institutions without agreed period of notice	*29*	*14*	*63*

ACCOUNTING POLICIES

Basis for preparation

KBN prepares its financial statements in accordance with International Financial Reporting Standards (IFRS), as adopted by EU. Interim financial statements are prepared in accordance with IAS 34 Interim Financial Reporting, and follow the same accounting policies as annual financial statements for 2009.

Critical estimates and assumptions

Preparation of the financial statements in accordance with IFRS requires the management to make use of estimates and make assumptions which can affect carrying values of assets and liabilities, and revenues and costs. Estimates and assumptions are based on historical experience and expectations of future trends, and actual results may deviate from the estimates.

The fair value of financial instruments that are not traded in an active market, or do not have available quoted prices at Balance Sheet date, is determined using valuation techniques. The valuation requires the management to make assumptions and use estimates when considering credit risk and liquidity risk. Even if the assumptions and estimates are based to the greatest possible extent on actual market conditions prevailing at Balance Sheet date, actual results may differ from accounting estimates.

NOTE 1

Instalment loans

(Amounts in NOK 1 000 000)

	31 March 2010	31 March 2009	31 December 2009
Outstanding loans (principal amount)	160 733	126 661	151 315
Accrued interest	942	1 196	817
Adjustment for fair value	1 131	1 668	908
Total instalment loans	**162 806**	**129 526**	**153 040**

NOTE 2

Senior securities issued

(Amounts in NOK 1 000 000)

	31 March 2010	31 March 2009	31 December 2009
Securities issued (opening balance)	**224 418**	**202 197**	**202 197**
New issuance	53 664	23 342	116 263
Redemptions	(38 429)	(11 213)	(64 967)
Amortisation	(63)	37	(26)
Translation differences	5 766	(15 023)	(29 048)
Securities issued (closing balance)	**245 355**	**199 339**	**224 418**
Accrued interest	2 918	2 587	2 662
Adjustment for fair value	(2 963)	(2 044)	(3 514)
Total senior securities issued	**245 310**	**199 882**	**223 566**

NOTE 3

Net gain/(loss) on financial instruments

(Amounts in NOK 1 000 000)

	January-March 2010	January–March 2009	January-December 2009
Unrealised gain/(loss) on financial instruments at fair value			
Instalment loans	223	208	(552)
Notes, bonds and other interest-bearing securities	125	244	385
Financial derivatives	186	2 511	1 875
Loans from credit institutions	0	9	10
Senior securities issued	(551)	(2 998)	(1 529)
Subordinated debt and Hybrid Tier 1 Capital instruments	6	11	33
Net unrealised gain/(loss) on financial instruments at fair value	**(11)**	**(16)**	**222**
Net gain/(loss) from repurchase of issued securities	25	358	781
Net gain/(loss) on financial instruments	**13**	**342**	**1 003**

NOTE 4

Net interest income

(Amounts in NOK 1 000 000)

	January-March 2010	January–March 2009	January-December 2009
Interest income from deposits with credit institutions	6	17	33
Interest income from instalment loans	1 050	1 376	4 398
Interest income from notes, bonds and other interest-bearing securities	598	688	2 613
Other interest income	(664)	(299)	(2 197)
Total interest income	**990**	**1 782**	**4 847**
Interest expenses on loans from credit institutions	4	11	24
Interest expenses on senior securities issued	2 470	2 112	7 609
Interest expenses on subordinated debt	4	14	37
Other interest expenses	(1 735)	(594)	(3 876)
Total interest expenses	**743**	**1 543**	**3 794**
Net interest income	**247**	**239**	**1 053**

NOTE 5

Notes and bonds

(Amounts in NOK 1 000 000)

Exposure as at 31 March 2010

Maturity	**< 1 year**			**> 1 year**					**Total**
Risk class	**A-2**	**A-1/ A-1+**	**Not rated**	**A-**	**A/A+**	**AA**	**AAA**	**Not rated**	
Sovereigns and central banks	0	11 988	0	0	0	1 536	2 249	0	15 774
Multilateral development banks	0	7 769	0	0	0	0	10 234	0	18 002
Regional authorities	0	11 175	0	0	278	12 612	7 107	2 002	33 173
Financial institutions	119	5 674	0	223	1 979	2 040	506	0	10 541
Securitisation	0	171	0	0	0	0	301	0	472
Total	**119**	**36 777**	**0**	**223**	**2 257**	**16 188**	**20 395**	**2 002**	**77 961**

NOTE 6

Equity and subordinated loan capital

(Amounts in NOK 1 000 000)

Supplementary capital cannot exceed 100 per cent of Tier 1 capital. KBN's capital satisfies the capital adequacy requirements. KBN's capital comprises the following elements:

	31 March 2010
Tier 1 capital	
Share capital	1 221
Retained earnings	2 340
Total equity	**3 561**
Hybrid Tier 1 capital instruments	280
Pre-tax profit for the period (reduced by 50 %)	118
Deferred tax asset	0
Goodwill	(1)
Allocated to dividend	(267)
Unrealised gains on issued debt attributed to changes in own credit risk	(216)
Total Tier 1 capital	**3 474**
Supplementary capital	
Subordinated debt	80
Perpetual subordinated debt	560
Total supplementary capital	**640**
Total capital	**4 114**

Subordinated capital has been calculated pursuant to The Regulation governing calculation of subordinated capital for financial institutions.

NOTE 7

Capital adequacy

(Amounts in NOK 1 000 000)

	31 March 2010		
	Book value	Risk-weighted assets	Minimum capital requirement
Credit risk			
Sovereigns and central banks	6 036	0	0
Regional governments and local authorities	181 364	30 168	2 413
Of which are Norwegian municipalities	*153 963*	*30 168*	*2 413*
Public sector entities	3 033	0	0
Multilateral development banks	17 914	0	0
Financial institutions	20 377	4 075	326
Of which counterparty exposure on derivatives	*18 456*	*3 691*	*295*
Corporates	472	94	8
Claims secured by residential property	1 572	571	46
Covered bonds	409	41	3
Other assets	14	14	1
Total credit risk	**231 191**	**34 963**	**2 797**
Market risk	**32 558**	**2 395**	**192**
Operational risk—Basic Indicator Approach		**1 132**	**91**
Minimum capital requirements		**38 491**	**3 079**
Capital adequacy ratio		**10,69 %**	
Core capital adequacy ratio		**9,03 %**	