

## **The Mortgage Society of Finland in brief**

The Mortgage Society of Finland specialises in financing residential property and other residence-related services nationwide. It is a well-known and established company and the only mutual company in the Finnish banking sector. This means that all the loan customers are the actual members of the society, having voting right for as long as their loan has balance with the society.

The core of the Mortgage Society Group comprises Finland's oldest and private credit institution, Finnish Mortgage Society, as well as the new deposit bank Suomen AsuntoHypoPankki Oy. AsuntoHypoPankki has expertise in Visa cards and so-called RS operations, offering safety and security to the Finnish home buyers during the construction phase of the house.

The Mortgage Society has approximately 10,000 members all over Finland and it serves its customers through Internet, telephone and postal services. The society has a tradition-rich but modern customer service office with approximately 30 experienced employees in the very heart of Helsinki.

The Mortgage Society's objective is to constantly create new and alternative ways of housing and residential property financing next to traditional services. The Mortgage Society provides its member customers with high-quality individual service and Finland's best expertise in residential financing. When choosing Mortgage Society as residential financier, our customers are still free to handle their everyday banking, mutual fund investments and insurance at the clearing bank of their choice.

Operational update programme that was initiated within the Group in 2002 has successfully reached its milestone target. The past two years have been busy in reach of strong operational growth and development. Society's visibility and recognition as an independent expert bank has increased. In terms of residential property financing, Mortgage Society now also offers more extensive service base than its competitors. The number of new members has also turned towards growth again.

The group's mission, vision and strategy have been thoroughly analysed during the year 2004 both internally and externally. Since Mortgage Society's long-term vision is to stabilise its privileged position in the housing loan market, the past three years have created a good foundation for enhancing operational targets in accordance with the operational update programme. Solvency is maintained and competitive operations to benefit our members are developed also in the future through the operating result.

The Mortgage Society's A+ credit rating was re-established on 25 November 2004. The group has financially maintained good operational preconditions. Both profitability and solvency have remained stable. Special attention has also been paid to risk management in order to achieve balanced growth. The Mortgage Society has additionally focused on increasing public awareness of its operations through active communications. The rules of the society have been revised and the roles of the administrative bodies have been specified.

The Mortgage Society's role as an active player in the housing finance sector has therefore strengthened.

## MANAGING DIRECTOR'S REVIEW 2004

For housing, on the resident's side

At the end of an extremely good and lively housing market year in 2004, it is time to stop for a while and reflect on the past as well as the future. In the Mortgage Society, the reflection focuses on housing, your home, as we are a banking group that specialises in residential property financing.

Could the constitution help?

The constitution contains many important principles that are intended to be long-lasting. According to the Constitution of Finland, everyone's right to housing and the independent acquisition of housing is considered so important that the government officials' task is to promote both issues.

Last year was positive in these terms in the Mortgage Society of Finland. Our clients have shown record activity in realising their right to their own housing and independently acquired housing for themselves and their families. The Mortgage Society's 144<sup>th</sup> year of activity is focused on this fundamental operation, which has also been defined as a cornerstone of our long-term strategy.

It is always nice to take a selective look back in history as well, when a suitable source is at hand. A statistic from the year in which I was born, 1949, shows that housing finance in the important post-war era was handled by cooperative loan funds, savings banks and the Mortgage Society. In accordance with the law on "funding the settlement of immigrants and front-line soldiers", the loans from financial institutions were divided between the three so that the biggest financier was the cooperative loan funds, but the society's share was also a record high, at approximately 16-17% of the loan amounts. The financing of commercial banks probably focused more on industrial reconstruction at the time.

Still work to be done in housing development

The cheapest housing loans in euros, together with versatile loan terms, enable Finns to catch-up in a European housing comparison and climb to higher rankings. A slight lead has been given to others. The most recent annals of construction and housing in 2004, published by Statistics Finland, offer a lot of information. Even though there is more than sufficient land area in Finland, our living conditions are still confined compared to others. Everybody has an average living area of approximately 37 m<sup>2</sup>. Of our approximate 2.3 million housing units, 12.4%, i.e. 268,000 housing units, constitute confined living. In the early 90's, Finland had a reputation as the model country for owner-occupied housing. That, if anything, is independent housing acquisition favoured by the constitution and on top of all always a sensible housing solution in the long run. At that time, 72% of Finns lived in owner-occupied housing. The deep recession regressed housing issues considerably and now owner-occupied housing represents 63%. In past years, the situation has again developed in a more positive direction.

The Mortgage Society's passion is housing finance

The society's strategic targets extend to 2010, when the Mortgage Society will have operated for 150 years in the world of housing finance. The society is not aiming at growing into a large bank; we are not part of the M&A activities in the sector and will remain an independent bank group that specialises in housing finance.

We want to be an alternative housing financier for a growing number of clients in need of housing finance services. As a special operator, we aim at offering a competitive price-quality ratio. We also offer customer-specific tailored financing solutions, which are not typical of large

banks. We take real interest in finding financing solutions for our clients' housing needs, which help to fulfil your housing dreams today and not someday. Since housing finance is our passion, our clients also notice this.

Matti Inha  
Managing Director

## **SUMMARY OF THE ANNUAL REPORT**

### **Operating environment**

The housing market was still lively during the 144<sup>th</sup> year of the Mortgage Society of Finland's operations. The growth in housing construction that began in 2003 continued. The number of construction licences granted for residential buildings decreased slightly. Almost every other household planned to renovate or make smaller repairs to their home within the next year. A lot of real estate deals were completed, especially in the Helsinki region, with slightly longer selling times. The escalation of prices of old residences slowed down slightly on the previous year; prices climbed 6.4% nationwide, 5.1% in the Helsinki region and 7.6% elsewhere in the country. The construction expenses index increased by 3.7%, while the change in the consumer price index was only 0.5%.

The 12 month Euribor did not change significantly last year after a four year decline. The average interest rate in January was 2.216%, in June 2.405% and in December 2.301%. Total deposits from private households increased by 0.9% to € 50.7 billion. The average interest rate of the deposit portfolio decreased slightly from 0.96% in January to 0.95% in November. The total volume of loans raised by households from banks was € 59.3 billion; the total volume of housing loans from banks increased by 15.1% to € 41.1 (36.1) billion (compared to 15.7% in 2003). A total of 72.8% (67.0%) of new housing loans were linked to Euribor rates, 19.9% (21.3%) to bank-specific prime rates and 7.3% (11.8%) to fixed rates.

The total volume of euro-denominated debt instruments issued by Finnish credit institutions amounted to € 29.5 billion (€ 23.8 billion), of which institutions other than deposit banks made up € 2.9 billion (€ 2.7 billion).

Total deposits from private households did not cover the volume of housing loans and consumer credit during the year. The interest rate margin between housing loans and deposits from households at deposit banks decreased 0.13 percentage points compared to a 0.67 percentage point decrease in the year before.

Intense competition for housing loan customers continued, benefiting prospective home buyers. The average interest rate of new housing loans issued by banks decreased in January-December by 0.27 percentage points, while the 12 months Euribor increased by 0.085 percentage points in the corresponding period.

The Mortgage Society published its own quarterly housing market analysis. The purpose of this well-received analysis is to provide market participants with a simplified overview of the housing market and related changes, and of topical issues.

The Mortgage Society is a member of the following international housing finance associations: Nordisk Realkreditsamråd and Mortgage Bankers Association. Suomen AsuntoHypoPankki Oy is a member of the Finnish Bankers' Association, the Deposit Guarantee Fund and the credit card service company Luottokunta.

## **Operational update programme**

The operational update programme of the Mortgage Society continued in line with the group mission, vision and strategy defined in 2002. Housing loan operations were renewed and made more efficient by focusing on developing the know-how of housing loan experts. The Hypo Visa card was established as part of the group's customer service including deposit bank services. The first construction project within the scope of the so-called RS system was completed in Helsinki in Kulosaari.

In addition to housing loans, our private clients were particularly interested in the Mortgage Society's partial ownership solutions and our community clients were interested in the Mortgage Society's Land Ownership Concept. The Mortgage Society's Reverse Mortgage, which enables homeowners to release dormant equity in their homes for their own use through a tailored contractual arrangement and was introduced in the previous year, still interested senior customers.

## **The Mortgage Society group of companies**

The Mortgage Society Group's consolidated financial statements comprise the Mortgage Society of Finland, Suomen AsuntoHypoPankki Oy and Hypoteekkinotariaatti Oy. There is no material difference between the Mortgage Society Group's consolidated financial statements and the unconsolidated financial statements of the Mortgage Society of Finland. In the following, the information relates to the Mortgage Society unless otherwise specified in context.

## **Suomen AsuntoHypoPankki Oy**

Suomen AsuntoHypoPankki Oy is a deposit bank, whose parent company, Mortgage Society of Finland, as credit institution is not permitted to engage in deposit banking. Neither one is involved in payment transmission operations. AsuntoHypoPankki mainly offers deposit banking services to the Mortgage Society's client members <tätä oli aiemmin käytetty toisin päin member customers>. AsuntoHypoPankki is a member of the Deposit Guarantee Fund and the Finnish Bankers' Association. In addition, it owns a share in the credit card service cooperative Luottokunta.

Based on a deposit banking licence granted by the Ministry of Finance in 2002, AsuntoHypoPankki gradually started its operations in October 2003 in close cooperation with the Mortgage Society. In 2004, the bank's product and service portfolio was established as part of the group's daily operations. The bank's first construction project within the scope of the so-called RS system was completed in Helsinki in Kulosaari at Kyöstinkuja 1 in September 2004. The deposit portfolio amounted to € 10.3 million (€ 4.3 million in 2003) at the end of the year. On 31 December 2004, the bank had 868 customers. There were 401 Hypo Visa card customers and 467 deposit customers.

The net income from financial operations mainly originates in the equity investment; expenses originate in the start-up of the operations and in joining the Finnish Bankers' Association. The deposit system was completed and extensive implementation began in mid-2004, when system depreciation also started. The year's loss was 98,355.11 euro and the balance sheet total was 16,752,692.20 euro.

The Board of Directors, which comprises the same people as the Board of Directors of the Mortgage Society, convened eleven times.

## Hypoteekkinotariaatti Oy

Hypoteekkinotariaatti's, which is fully owned by the Mortgage Society, operations comprises the owning and leasing of apartments. The financial statements of Hypoteekkinotariaatti have been combined with the Mortgage Society Group's financial statement due to joint dividend distribution 326,478.87 € and sales gain from apartments 52,187.32 €. The profit for the period was 224,054.93 euro, which includes the returned excess contribution margin of the Mortgage Society's Pension fund 135,813.77 euro and the related avoir fiscal 55,473.23 euro. The balance sheet total was 520,803.16 euro.

### Membership benefits

The Mortgage Society Group provides its customer members with competitive housing loans and other credit, deposit services, the Hypo Visa credit card and the safekeeping of collateral documents free of charge, even after the mortgage period, as well as discounts on the services of its partners eQ Bank, Suomen SKV, ERA, Suomen Vuokranantajat and Forex. A special membership benefit is Garantia Insurance Company's favourable security, which makes it possible to take out a housing loan representing 100% of the deal price. Temporary residences to bridge the sale of an existing home and the purchase of a new one, and other rental housing services in the Helsinki region are available to our member customers.

### Lending

The Mortgage Society's total loan portfolio grew by 2.8% to € 374.4 million euro (€ 364.3 million) despite certain considerable one-time loan instalments in line with housing corporations' loan payment plan. Loans for households grew by 16.6% to € 256.8 million (€ 220.2 million). Customers of the Mortgage Society are able to choose the reference rate for their loan, which can be a Euribor rate, a fixed rate or a combination of these that balances the interest rate risk.

A total of € 113.3 million was drawn on new loans, which was slightly more than the year before (€ 112.6 million).

The Mortgage Society's loan portfolio at year-end, grouped by main categories:

<b>Loans outstanding</b>				
<b>€million</b>	<b>2004</b>	<b>2003</b>	<b>Change</b>	<b>Change %</b>
Housing loans for households	230.2	198.9	31.3	15.7
Consumer loans for households	26.6	21.3	5.3	24.9
Households total	256.8	220.2	36.6	16.6
Housing corporations and similar entities	97.8	107.2	-9.6	-9.0
Interest-subsidised housing corporation loans	19.1	36.0	-16.9	-46.9
Housing corporations total	116.9	143.2	-26.5	-18.5
Loans made from government funds	1.1	1.4	-0.3	-17.8
Total loans	374.5	364.7	9.6	2.8

The average loan amount remained unchanged (growth 13.4%).

## Investments

The Mortgage Society's assets were invested in three areas: lending, real estate and listed equities. The Society's return target on real estate investments is 5 to 7 per cent. The real estate investments are located in the key residential areas of the Helsinki region and include estates that are leased to housing corporations on a long-term basis and a fraction is intended for redemption, as well as part ownership apartments that are leased to the occupying tenant. Real estate property increased by 138.5% to € 39.5 million.

In addition to rents, income from real estate includes sales gains to the amount of € 1.2 million (2.8). The property at Piikkikuja 6 was formed into the housing corporation Asunto Oy Vantaan Piikkikuja 6, in 2003, which created sales gains of € 2.0 million in 2003. In connection with sales, a revaluation reserve of € 0.1 million (1.4) was dissolved.

The net yield on real estate investments was 4.9% (8.0%) based on book values. Monthly rental income from residential real estate averaged € 11.10 (€ 11.52) per square metre. The average book value of residential real estate was € 1,540 (€ 1,029) per square metre, while business premises in central Helsinki averaged € 2,908 (€ 2,748) per square metre. The book value of residential real estate, the majority of which is located in the Helsinki region, amounted to approximately 63% (46%) of average sales prices in the region.

The Mortgage Society's investments in listed equities are long-term holdings, and it does not actively trade in securities. Unrecognised gains on listed equities carried as current assets totalled € 3.1 million at the end of the year, compared to € 2.8 million a year earlier. Sales gains on equities and the cancellation of write-downs amounted to € 0.6 million (€ 0.4 million).

## Funding

Suomen Asiakastieto Oy renewed the Mortgage Society's long-term credit rating of A+ stable. More detailed information on the credit rating is available at [www.asiakastieto.fi](http://www.asiakastieto.fi).

Total borrowings stood at € 360.9 million at the end of the year (€ 342.0 million). Borrowed funds included € 15.7 million of the Mortgage Society's regulatory capital (€ 35.8 million). The Mortgage Society's drawn and undrawn credit facilities to cover housing loans with a loan period longer than ten years, with a similar loan period, amounted to € 88.4 million (€ 88.0 million), which is 24.3% (24.1%) of the loan portfolio.

## Bonds

The Mortgage Society's bonds are issued under a € 200 million face value bond programme set up in 2000 and increased in 2003, which was arranged by Sampo Bank Plc. The total book value of outstanding bonds and certificates of deposit was € 122.3 million (€ 97.4 million).

Two bonds were issued in 2004. The bond issue 1/2004 is a € 11.2 million face value equity index loan that will mature on 3 December 2014. The issue was arranged by Nordea Bank Finland Plc. The return of the equity index linked bond issue 1/2004 is an index bonus that is linked to the performance of the EURO STOXX 50 equity index. During the first two years of the loan period the index bonus is a fixed 4.5% of the nominal capital of the bond. In 2007 – 2014, the index bonus is calculated based on the annualised change of the reference index and is at least 0% and at most 7%.

A private placement type debenture loan 2/2004 was issued on 27 December 2004. The loan has less privilege than the issuer's other debentures. The debenture loan is included in secondary own capital in solvency calculations. The subscription period for the loan ends on 14 April 2004. By 31 December 2004, € 1.0 million had been subscribed. The issue will mature on

27.12.14 and its coupon rate is 6-month Euribor +0.20%. The issue was arranged by the Mortgage Society of Finland.

The first instalment of the 1/2003 bond issue, amounting to € 20 million, was issued on 2 June 2003. The issue will mature on 2 June 2008 and its coupon rate is 6-month Euribor + 0.15%. The issue was arranged by Sampo Bank Plc.

The outstanding amount of the series bond 1/2000 is € 55 million. The issue will mature on 2 November 2005 and its coupon rate is 6-month Euribor + 0.175%. The issue was arranged by Sampo Bank Plc.

A total of € 1.8 million of the bond issue 2/2000 remains outstanding, whose coupon rate is 12-month Euribor + 0.175%. These bonds mature on 2 November 2005. This bond issue was arranged by the Mortgage Society.

The bond issue 1/2001 is a € 9.3 million face value equity index loan that will mature on 2 January 2007. The return of the equity index linked bond issue 1/2001 is tied to an equity index basket: comprising 45% of EURO STOXX 50, 40% of Standard & Poors 500 and 15% of Nikkei 225. At least a 10% return will be paid upon maturity in addition to the principal amount of the bonds. The issue was arranged by Nordea Bank Finland Plc.

#### Interest rate derivatives

The Mortgage Society has hedged the interest rate and equity index risk through derivatives contracts so that the rate of interest payable is linked to the reference rate charged on its loan portfolio. The nominal value of interest rate swaps was € 102.6 million (€ 84.8 million). The index bonus on the equity index linked bonds has been converted into obligations based on either fixed interest or 12-month Euribor through interest rate swaps. The 6-month Euribor rate of the bond issues 1/2000 and 1/2003 has been contractually swapped for 12-month Euribor and 3- and 5-year fixed rates based on the loan portfolio's reference rates.

#### Certificates of deposit

The book value of the certificates of deposit belonging to the Mortgage Society's € 100 million CD programme was € 24.9 million (€ 10.8 million). The certificates of deposit will be issued through Sampo Bank Plc, Nordea Bank Finland Plc and Danske Bank A/S, Helsinki branch.

#### Other funding

The deposit portfolio of AsuntoHypoPankki, € 10.3 million (€ 4.3 million), constitutes a part of the Group's funding. The Mortgage Society's other fund raising is based on promissory notes issued to banks, insurance companies, and corporations in respect to personnel loans.

### **Risk management**

Risk management is used to ensure that all considerable risks, which may hinder the Mortgage Society from reaching its targets and realising its strategy are recognised, assessed and reported. The task of risk management is to support the Mortgage Society's undisturbed and stable operations and prevent the generation of risks and losses, which could considerably endanger the Mortgage Society's solvency or cause weakening to its reputation and regard. The risk management of the Mortgage Society is based on policies, guidelines and authorisation issued by the Board of Directors and monitored using risk and deviation reports. The Mortgage Society has arranged its risk management with respect to its organisational structure and the scope of its business operations.

Risk management covers the following risks associated with the Mortgage Society's operations, among others: credit risk, interest rate and funding risk, real estate and investment risk, operational risk and strategic risk.

### Credit risk

The purpose of credit risk management is to keep the impact of customer liabilities on earnings and capital adequacy down to an acceptable conservative level. A credit risk is generated when the counterpart, usually the debtor, is unable to take responsibility for its obligations. The credit risk is realised as non-performing loans and credit losses. The focus of the Mortgage Society's lending is on housing loans granted to households and other closely related financing services against a residence as collateral. The taking of credit risk is limited to loans granted in accordance with the general terms and conditions for lending, confirmed by the Supervisory Board as required by the Society's rules. The fundamental principle is that lending is based on the customer's creditworthiness, an adequate ability to service the loan and sufficient security. Apart from public sector entities and certain entities under public control mentioned in the rules, loans cannot be granted without collateral unless the board gives unanimous consent. The credit decisions made by the management team are communicated monthly to the Board of Directors. The Board of Directors decides on granting loans of unusual size or with unusual collateral, as well as on loans to member of the Mortgage Society's institutions and its employees. The credit approval process pays specific attention to the sufficiency of the documentation serving as the basis of the credit decision, the separation of the process stages and the correctness of information.

The Mortgage Society only has small scale business funding. The amount of loans granted against mortgage security to corporate customers other than housing corporations was minor, € 9.7 million or 16.5% of regulatory capital. Housing production funding in accordance with the RS system is only executed in cooperation with the biggest builders. The Mortgage Society does not have any customer entities whose liabilities would exceed the limit specified in the Credit Institutions Act, 25% of regulatory capital. The amount of liabilities attributable to customer entities exceeding the 10% limit is € 19.9 million or 32.9% of regulatory capital, when the maximum limit specified in the Credit Institutions Act is 800%. The amount of loans granted to the Mortgage Society's subsidiaries is € 0.2 million or 0.3% of regulatory capital, while the maximum in accordance with the Credit Institutions Act is 20%.

In accordance with the loan terms and conditions, the borrower must take out an insurance policy covering the real estate mortgaged as collateral. The Mortgage Society has taken out a collective insurance policy for the real estate mortgaged as collateral to cover any failure to pay insurance premiums.

Unserviced credit is monitored regularly and collection actions are started immediately when even the slightest risk of credit loss is suspected to exist. A conservative lending policy and sufficient security have kept the Mortgage Society's credit losses to a minimum.

### Interest rate risk

Interest rate risk refers to the impact of changes in the interest rate level on earnings and capital adequacy. Interest rate risk is caused by differences in the reference rates of receivables and liabilities, as well as in their different rollover periods and maturity dates. Interest rate risk is the most significant of the market risks. Interest rate risk is controlled by matching borrowing with lending, keeping the reference rates and rollover periods in line with each other with respect to the money market situation. The group's credit risk at year end amounted to 7.2% of net income from financial operations and 0.4% of regulatory capital.

### Funding risk

Funding risk is a risk associated with the availability and price of funding, caused by different maturities of receivables and liabilities. Funding risk is also created if receivables, liabilities or derivatives contracts are dominated by single counterparties. The Mortgage Society raises most of its funding by means of long-term promissory notes and bonds, keeping the ratio between funding and lending at an adequate level and maintaining good liquidity. The maturity of the Mortgage Society's funding is significantly longer than what is generally applicable to deposit banks. The financing position remained good and stable throughout 2004.

### Real estate and equity risk

Real estate risk refers to the risk of loss of value, yield and damage on real estate assets. The real estate shares held by the Mortgage Society are located in the Helsinki region and mostly consist of residential units. The ratio between the book values and market values of shares in housing corporations is kept at a conservative level, eliminating any significant earning impacts from potential decreases in value. In the Group, the book value of real estate, € 39.5 million, amounts to 9.1% of the balance sheet total, while the maximum prescribed in the Credit Institutions Act is 13% of the balance sheet total.

Equity risk is realised through a decrease in price or yield, causing a negative effect on earnings. The Mortgage Society will be essentially reducing its equity risk in the upcoming years by divesting itself of equity investments.

At € 3.6 million, the book value of equity investments amounts to 6.1% of regulatory capital, while the maximum prescribed in the Credit Institutions Act is 60%.

### Operational risk

Operational risk refers to losses due to deficiencies in systems, processes and the actions of personnel, or losses due to external factors. The probability of a particular risk being realised and its effects are taken into account when assessing operational risks. Special attention has been paid to assessing the risks of a new product or services, creation of client identification and recognition systems, and the improvement of data security by arranging appropriate training and by developing and adding directions.

Crucial information systems have been outsourced or procured as software packages, and contingency plans have been made to cover risks caused by operational disturbances. Legal risks are managed by, e.g. means of standardised banking sector contract terms approved by the authorities.

### Strategic risk

The growth strategy of the Mortgage Society's business is based on conservative risk-taking so that the Mortgage Society's risk position is kept at a targeted level. The strategies chosen are dimensioned so that they are in correct proportion to the Mortgage Society's ability to bear risk, technical and human resources and the competence of the personnel. Strategic risks are managed by updating the strategies annually and by regularly monitoring the realisation of the annual plans.

### Internal audit

The reformed internal audit function performed extensive internal audits in accordance with an audit plan and participated in development and training operations.

A contract on internal auditing exists with Control Consulting CC Ltd Oy. The tasks have been performed by Eila Koivu, CIA, CCSA, CISA, CFE, Atte Holopainen, M.Sc., CISA, and Jani Hiekkala .MSc (Econ).

### **Non-performing and other non-interest bearing loans and the collection of receivables**

The amount of non-performing and other non-interest bearing loans increased by 25.7%, to € 2.7 million (€2.1 million). They accounted for 0.7% (0.6%) of the total loan portfolio.

### **Net income, balance sheet and profitability**

On 18 August 2004, the Mortgage Society published an interim report for the period 1 January to 30 June 2004.

Net interest income and loan portfolio growth remained below target due to tight competition resulting in lower interest margins, low interest levels and large one-time repayments by housing corporations. The group's net interest income decreased by 8.6% to € 3.3 million (compared to € 3.6 million the previous year). The Mortgage Society's net interest income declined by 8.1% to €3.2 million (€3.5 million).

The group's dividend income remained at €0.3 million. Net income from securities transactions amounted to €0.6 million (€-0.4 million), consisting of €0.4 million (€0.2 million) of sales gains and €0.2 million of cancelled write-downs (€0.2 million). Hypoteekkinotariaatti Oy's dividend payment to the Mortgage Society was €0.3 million (€0.0 million).

Other operating income, i.e. income from real estate investments, totalled €2.9 million (€4.5 million). This income includes €1.2 million (€2.8 million) in gains on the disposal of some residential real estate not integral to the Society's real estate investment strategy.

The group's administrative costs decreased by 32.2% to €2.7 million (€4.0 million) supported by reduction in personnel costs due to the returned excess contribution margin of the Mortgage Society's Pension fund and the related avoir fiscal. Comparable administrative expenses stood at €4.1 million, increasing by 3.6%.

Other operating expenses amounted to €0.8 million (€0.8 million). €).

Scheduled depreciation on real estate and equipment, and the amortisation of software licences, was based on the maximum amounts allowable under the Business Tax Act.

The total amount of realised credit losses €0.01 million (€0.01 million), returned credit losses €0.06 million (€0.03 million) and adjustment in specific credit loss provisions decreased the profit by €0.03 million (€0.07 million). Realised credit losses amounted to 0.002% of the loan portfolio (0.004%).

The consolidated operating profit exceeded the set target and totalled €3.7 million (€4.1 million). The group's operating profit excluding sales gains and the returned Pension Fund's excess margin grew by 14.1% to €1.0 million (€0.9 million). Due to the growth of the loan portfolio, the tax-deductible amount of the general loss provision booked earlier increased, which cut income taxes by €0.1 million (0.5). After direct taxes, the year's net income decreased by 18.6%, totalling €2.8 million (€3.4 million). The income/expense ratio was 2.0 (1.9). Expenses totalled 50.2% of income (54.1%). Balance sheet equity and reserves grew by €2.9 (1.9) million to €58.9 (56.0) million. The balance sheet total was €435.8 million (€403.4 million), growth 8.0%.

The Mortgage Society's operating profit increased by 3.7% and totalled € 3.9 million (€ 4.1 million). After direct taxes, the year's net income decreased by 14.0%, totalling € 2.9 million (€ 3.4 million). The income/expense ratio was 2.1 (1.9). Expenses totalled 48.6% of income (53.4%). Balance sheet equity and reserves grew by € 3.1 (1.9) million to € 58.8 (55.7) million. The balance sheet total was € 440.7 million (€ 404.7 million), growth 8.9%.

Contingent liabilities, which consist of interest rate swaps for hedging purposes, undrawn lending and buy-options related to partially owned housing, grew by 25.4% (33.0) and totalled € 121.3 million (€ 96.7 million). €).

## Capital adequacy

Based on applicable legislation on the capital adequacy of credit institutions, the equity and reserves (regulatory capital) of a credit institution must total at least 8% of its risk-weighted receivables, assets and contingent liabilities. The Mortgage Society's capital adequacy ratio was 20.7% (22.3%), consisting of:

### CAPITAL ADEQUACY

	Consolidated	Consolidated		Mortgage Society	Mortgage Society
million euro	31.12.2004	31.12.2003	Change %	31.12.2004	31.12.2003
Regulatory capital					
Tier 1 capital	48.3	45.2	6.9%	49.1	46.0
Tier 2 capital	10.7	9.8	9.7%	10.7	9.8
Total regulatory capital	59.1	55.0		59.9	55.7
Group I (public sector entities)	0.0	0.0	-	0.0	0.0
Group II (credit institutions)	2.6	3.4	-24.0%	2.6	2.7
Group III (home equity loans)	113.8	99.3	14.6%	113.8	99.3
Group IV (other loans and assets)	169.0	143.5	17.8%	174.9	149.1
Risk-weighted receivables, assets and contingent liabilities	285.4	246.2	15.9%	291.2	251.1
Ratio of Tier 1 capital to risk-weighted receivables, assets and contingent liabilities, %	16.9%	18.4%		16.9%	18.3%
Capital adequacy ratio %	20.7%	22.3%		20.5%	22.2%

## Future outlook

The year 2005 is likely to be an interesting year for the housing market. The outlook indicates that the exceptionally strong demand seen in the loan markets during the past few years has now calmed down and the market is returning to a more normal market situation.

The rise in housing prices that continued for a long time has stabilised and this offers opportunities for light and affordable financing resulting in an increased improvement of individuals' level of housing and not only in a rise in housing prices.

Low interest rate levels, together with the tight competition for housing loans between banks, are continued positive factors on our housing markets from the consumer's viewpoint.

It will also be interesting to see how far large finance houses are prepared to go in cross-subvention of housing loans, from which it may be extremely painful to recover, especially when the margin from other products decreases as well.

The Mortgage Society will continue to succeed in the price competition due to low costs. A special focus area for us is to continue our strategy as a specialised player in housing finance, which means that we offer special products that are well-suited to the prevailing market situation and that are tailored for our customers, which retail banks do not offer. As a specialised player we must also offer a higher level of professionalism and expertise in housing finance issues than our competitors.

The operational outlook for the Mortgage Society is favourable in 2005. There are no visible risks that would prevent the Mortgage Society from reaching its financial targets for the year. We aim for a stable loan portfolio and customer growth with strict risk management. A satisfied customer who's financing solutions related to housing have been successfully solved by us, is, however, the most important measure of our success.

## **Corporate Governance**

### **The Mortgage Society of Finland – member clients' mutual company**

Mortgage societies are, in accordance with applicable legislation, unique mutual companies. The highest authority is, in accordance with law, exercised by the members who have taken out a loan in the general meeting. A member has a voting right for as long as he/she has a loan with the society. The voting right ends when the loan is repaid, and no voting right exists if the member has payments that have fallen due to the society. In addition, it should be taken into account that clients with loans made from government funds have no voting right, because they are not, in accordance with law, members of the mortgage society. Members are not, based on express legal provisions, entitled to the mortgage society's property or profits. When the mortgage society ceases operating, any remaining property is used for the public good. Due to the company form based on mutuality, the Mortgage Society should, as closely as possible, follow from time to time valid principles for good methods of administration in organising its administration.

### **Administration and control systems in the Society**

New recommendations for listed companies administration published in December 2003 came into effect on 1 July 2004. Even though the Mortgage Society of Finland is not a listed company, it is, as an issuer of bonds, in many ways obliged to follow the regulations that apply to listed companies. Therefore, the Mortgage Society's Board of Directors subjected a number of revisions to the Society's rules and regulations in the spring of 2004 based on the recommendations for listed companies' administration, for approval by the general meeting and extraordinary meeting of the Society's members. The revisions were approved unanimously. The revisions clarified the interrelation between different institutions and founded e.g. appointment and bonus committees to support the work of different institutions.

Due to its unique company form and imperative legal provisions (Act on Mortgage Societies 8.12.1978/936), all recommendations, particularly those that have been drafted with limited companies in mind, could not be introduced in the Mortgage Society. The recommendations are based on the principle that if legislation or other compelling reasons prevent the introduction of a certain recommendation, it is allowed but the reason for deviation must be made public.

### **Main deviations from recommendations**

There are three main deviations. The reason behind the deviations is the imperative special legal provisions concerning mortgage societies. 1) The Board of Directors of the Mortgage Society is selected by the Supervisory Board instead of the General Member Meeting. 2) The Managing Director and Deputy Managing Director are selected by the Supervisory Board instead of the Board of Directors. 3) The Managing Director and the Deputy Managing Director are members of the Board of Directors. In terms of the last deviation, it should be pointed out that the new regulations expressly state that the Managing Director and the Deputy Managing Director cannot act as the Chairman or the Deputy Chairman of the Board. In addition, the regulations state that their role in the Board is to make preparatory work and present issues to the Board.

### **Corporate Governance Statement**

The Mortgage Society of Finland's Corporate Governance Statement has been published separately as a printable PDF document on the Mortgage Society's web page at [www.hypo.fi](http://www.hypo.fi). The information can also be ordered by e-mail from [hypo@hypo.fi](mailto:hypo@hypo.fi) or by phone from (09) 228 361.

### **Supervisory Board**

Lauri Koivusalo, Chairman, Senior Lawyer, Managing Director  
Vesa Majamaa, Deputy Chairman, LL.D. Professor  
Antti Aho, LL.M. Manager  
Antti Arjanne, LL.M. Managing Director  
Kyösti Ekdahl, LL.Lic. M.Sc. Econ. Senior Lawyer, Managing Director  
Mikael Englund, Graduate Engineer, MBA, Managing Director  
Juhani Erma, LL.Lic. Senior Lawyer, Attorney at Law  
Helena Jaatinen, LL.M. Managing Director  
Markku Koskela, Doctor of Economic Sciences, Professor  
Teemu Lehtinen, Dr.Pol.Sc. Graduate Engineer, Managing Director  
Kallepekka Osara, Degree in Agronomy, Farmer  
Elina Rantala, M.Sc. Lecturer  
Juhani Ruskeepää, M.Sc. Econ. Managing Director  
Jukka Räihä, Senior Lawyer  
Väinö Teperi, LL.M. Attorney at Law  
Terho Salo, Graduate Engineer, M.Sc. Econ. Managing Director  
Riitta Vahela-Kohonen, M.Sc. Trade Promoter

### **Board of Directors**

Professor Jarmo Leppiniemi, Chairman  
Managing Director Ukko Laurila, Vice-chairman  
Investment Director Jari Eklund  
Chief Executive Officer Ben Grass  
Chief Executive Officer Matti Inha  
Professor Hannu Kuusela  
Director General Jukka Tammi  
Executive Vice President Raimo Vaherno  
Managing Director Pentti Vartia

### **Auditors:**

Risto Mäkiö, APA  
SVH Pricewaterhouse Coopers Oy,  
Juha Wahlroos, APA  
Jukka Mynttinen, APA

# PROFIT AND LOSS STATEMENT 1.1. - 31.12.2004

	Note	Consolidate 200	Consolidate 200	Mortgage Society of 200	200
<b>Interest</b>	1, 53,	13 101	14 647	13 114	14 639
<b>Interest</b>	1	-9 789	-11 025	-9 901	-11 143
<b>NET INTEREST INCOME FROM FINANCIAL OPERATIONS</b>		<b>3 312</b>	<b>3 622</b>	<b>3 212</b>	<b>3 495</b>
<b>Income from equity</b>	1				
Group		0,0	0,0	326	23
Other		307	255	307	255
		<b>307</b>	<b>255</b>	<b>634</b>	<b>279</b>
<b>Commission</b>	1	330	299	309	298
<b>Commission</b>		-19	-47	-19	-47
<b>Net income from securities transactions and foreign exchange</b>					
Net income from securities	3,	564	432	564	432
<b>Other operating</b>	5, 12,	2 932	4 469	2 854	4 407
<b>Administrative</b>					
Personnel	5				
Salaries and		-1 711	-1 556	-1 691	-1 537
Indirect employee					
Pension	4	1 119	-248	928	-248
Other indirect employee		-90	-75	-89	-75
Other administrative		-2 009	-2 085	-1 915	-2 015
		<b>-2 690</b>	<b>-3 966</b>	<b>-2 768</b>	<b>-3 876</b>
<b>Depreciation, amortisation and write-downs on and intangible</b>	6	-223	-139	-123	-139
<b>Other operating</b>	5,	-803	-751	-774	-700
<b>Loan and guarantee</b>	7	32	-73	32	-73
<b>Write-downs on securities held fixed</b>	7	0,0	-1	0,0	-1
<b>PROFIT/LOS BEFORE APPROPRIATIONS AND TAXES</b>		<b>3 742</b>	<b>4 100</b>	<b>3 922</b>	<b>4 074</b>
<b>Income</b>	4	-983	-711	-1 003	-682
<b>PROFIT FOR THE YEAR</b>		<b>2 758</b>	<b>3 389</b>	<b>2 918</b>	<b>3 392</b>

# BALANCE SHEET 31.12.2004

	Liitetieto	Konserni 2004	Konserni 2003	Suomen Hypoteekkiyhdistys 2004	2003
<b>VASTAAVAA</b>					
<b>Käteiset varat</b>		3 609,45	4 027,85	3 609,45	4 027,85
<b>Saamiset luottolaitoksilta</b>	14, 42				
Vaadittaessa maksettavat		8 085 595,62	14 249 145,34	7 457 798,09	10 569 941,89
Muut		2 320 978,34	498 902,05	2 320 978,34	498 902,05
		<u>10 406 573,96</u>	<u>14 748 047,39</u>	<u>9 778 776,43</u>	<u>11 068 843,94</u>
<b>Saamiset yleisöltä ja julkisyhteisöiltä</b>	15, 16, 42, 52, 53	374 404 469,66	364 264 693,51	374 529 728,66	364 749 693,51
<b>Saamistodistukset</b>	20, 42				
Julkisyhteisöiltä		0,00	208 320,45	0,00	208 320,45
Muilta		5 287 084,75	0,00	5 296 538,98	0,00
		<u>5 287 084,75</u>	<u>208 320,45</u>	<u>5 296 538,98</u>	<u>208 320,45</u>
<b>Osakkeet ja osuudet</b>	21	3 618 589,30	4 093 124,93	3 509 767,22	3 984 302,85
<b>Osakkeet ja osuudet tytäryrityksissä</b>	21, 22, 53	0,00	0,00	6 187 674,01	6 187 674,01
<b>Aineettomat hyödykkeet</b>	23	840 522,18	733 849,72	24 498,81	38 022,50
<b>Aineelliset hyödykkeet</b>	17, 22, 24, 53				
Kiinteistöt sekä kiinteistöyhteisöjen osakkeet ja osuudet		39 509 064,70	17 083 564,86	39 178 778,40	16 195 843,98
Muut aineelliset hyödykkeet		407 533,14	466 228,53	379 174,14	428 416,53
		<u>39 916 597,84</u>	<u>17 549 793,39</u>	<u>39 557 952,54</u>	<u>16 624 260,51</u>
<b>Muut varat</b>	26	45 894,02	113 548,21	518 907,68	113 548,21
<b>Siirtosaamiset ja maksetut ennakot</b>	27, 53	1 277 222,96	1 715 078,30	1 277 198,29	1 714 864,22
		<u>435 800 564,12</u>	<u>403 430 483,75</u>	<u>440 684 652,07</u>	<u>404 693 558,05</u>
<b>VASTATTAVAA</b>					
<b>VIERAS PÄÄOMA</b>	29, 42				
<b>Velat luottolaitoksille ja keskuspankeille</b>					
Luottolaitoksille					
Muut kuin vaadittaessa maksettavat		190 194 445,57	197 362 612,63	190 194 445,57	197 362 612,63
<b>Velat yleisölle ja julkisyhteisöille</b>					
Talletukset					
Vaadittaessa maksettavat		3 717 351,82	4 326 604,17	0,00	0,00
Muut kuin vaadittaessa maksettavat		6 620 524,99	0,00	0,00	0,00
		<u>10 337 876,81</u>	<u>4 326 604,17</u>	<u>0,00</u>	<u>0,00</u>
Muut velat		51 784 350,84	48 747 043,31	51 784 350,84	48 747 043,31
		<u>62 122 227,65</u>	<u>53 073 647,48</u>	<u>51 784 350,84</u>	<u>48 747 043,31</u>
<b>Yleiseen liikkeeseen lasketut velkakirjat</b>	30, 56				
Joukkovelkakirjalainat		96 300 000,00	86 573 392,73	97 444 679,69	86 573 392,73
Muut /sijoitustodistukset		11 193 483,97	4 981 985,08	24 892 153,60	10 791 461,89
		<u>107 493 483,97</u>	<u>91 555 377,81</u>	<u>122 336 833,29</u>	<u>97 364 854,62</u>
<b>Muut velat</b>	31	12 502 355,68	1 815 422,38	12 931 466,13	1 786 035,18
<b>Siirtovelat ja saadut ennakot</b>	32	3 581 017,97	3 673 681,78	3 549 346,24	3 661 985,42
<b>Velat, joilla on huonompi etuoikeus kuin muilla veloilla</b>	34	1 050 000,00	0,00	1 050 000,00	0,00
<b>TILINPÄÄTÖSSIIRTOJEN KERTYMÄ</b>					
<b>Vapaaehtoiset varaukset</b>	44	13 118 658,26	13 118 658,26	13 118 658,26	13 118 658,26
<b>OMA PÄÄOMA</b>	35				
<b>Peruspääoma ja osakepääoma</b>	36	5 000 000,00	5 000 000,00	5 000 000,00	5 000 000,00
<b>Arvonkorotusraho</b>		9 695 914,24	9 782 699,20	9 695 914,24	9 782 699,20
<b>Muut sidotut rahastot</b>					
Vararahasto		21 475 571,96	19 531 766,47	21 475 571,96	19 531 766,47
<b>Vapaat rahastot</b>	37				
Käyttöraho		6 600 000,00	4 925 818,95	6 600 000,00	4 925 818,95
<b>Edellisten tilikausien voitto</b>		208 117,74	201 584,52	29 402,96	19 343,90
<b>Tilikauden voitto</b>		2 758 771,08	3 389 214,27	2 918 662,58	3 392 740,11
		<u>45 738 375,02</u>	<u>42 831 083,41</u>	<u>45 719 551,74</u>	<u>42 652 368,63</u>
		<u>435 800 564,12</u>	<u>403 430 483,75</u>	<u>440 684 652,07</u>	<u>404 693 558,05</u>
<b>TASEEN ULKOPUOLISET SITOUKUKSET</b>					
<b>Asiakkaan puolesta kolmannen hyväksi annetut sitoumukset</b>	48, 49	50 000,00	0,00	0,00	0,00
<b>Asiakkaan hyväksi annetut peruuttamattomat sitoumukset</b>		18 691 508,82	11 898 871,86	18 691 508,82	11 898 871,86
<b>Johdannaissopimukset / koronvaihtosopimukset</b>		102 580 000,00	84 840 000,00	102 580 000,00	84 840 000,00
<b>Yhteensä</b>		<u>121 321 508,82</u>	<u>96 738 871,86</u>	<u>121 271 508,82</u>	<u>96 738 871,86</u>

## FINANCIAL INDICATORS 2000-2004 (€1000)

Financial indicators for 2000-2001 are presented for the parent company, from 2002 onwards also at the consolidated level.

	Parent	Parent	Consolidated	Consolidated	Consolidated
	2000	2001	2002	2003	2004
Net revenue	17 578	19 230	18 087	20 106	17 236
Change %	5.7	9.4	-5.9	11.2	-14.3
Net income from financial operations	3 749	3 819	3 792	3 623	3 313
% of net revenue	21,3	19.9	21.0	18.0	19.2
Profit/loss before appropriations and taxes	2 508	2 722	2 513	4 101	3 743
% of net revenue	14,3	14.2	13.9	20.4	21.7
Depreciation, amortisation and increase in voluntary appropriations	412	-9	87	140	224
Loan loss items, (-) entry as income	83	-9	-89	73	-33
Loans outstanding on-performing and other non-interest bearing receivables	280 854	296 002	328 028	364 265	374 404
% of loans outstanding	0,9	0.9	0.8	0.6	0.7
Funding	272 367	279 517	310 751	341 992	360 860
Equity capital and voluntary provisions	49 080	51 397	53 794	55 950	58 857
Total assets	327 541	336 491	370 058	403 430	435 801
Return on equity % (ROE)	3,7	4,3	4.3	6.2	4.9
Return on assets % (ROA)	0,56	0,64	0.62	0.88	0.66
Equity ratio %	15,0	15.2	14.5	13.9	13.5
Capital adequacy ratio %	25,4	24.6	22.9	22.4	20.7
Net interest income margin %	1,3	1,3	1.2	1.0	0.9
Income/expense ratio	1,8	1.9	1.6	1.9	2.0
Expense/income %	56,6	53.5	61.3	54.0	50.2

## FORMULAS FOR CALCULATING FINANCIAL INDICATORS

<b>Net revenue</b>	interest income + income from equity investments + commission income + net income from securities transactions and foreign exchange dealing + other operating income
<b>Funding</b>	liabilities to credit institutions and central banks + liabilities to the public and public sector entities + debt securities issued to the public + liabilities with less privilege than other liabilities
<b>Return on equity % (ROE)</b>	$\frac{\text{operating profit} - \text{income taxes}}{\text{equity capital} + \text{voluntary provisions} - \text{intangible assets (average at beginning and end of year)}} \times 100$
<b>Return on assets % (ROA)</b>	$\frac{\text{operating profit} - \text{income taxes}}{\text{total assets (average at beginning and end of year)}} \times 100$
<b>Equity ratio %</b>	$\frac{\text{equity capital} + \text{voluntary provisions}}{\text{total assets}} \times 100$
<b>Capital adequacy ratio %</b>	$\frac{\text{equity capital} + \text{voluntary provisions} + \text{liabilities with less privilege than other liabilities} - \text{intangible assets}}{\text{total risk-weighted receivables, investments and contingent liabilities}} \times 100$
<b>Net interest income margin %</b>	$\frac{\text{net interest income}}{\text{average interest bearing receivables (average at beginning and end of year)}} \times 100$
<b>Income/expense ratio</b>	$\frac{\text{net interest income} + \text{income from equity investments} + \text{commission income} + \text{net income from securities transactions and foreign exchange dealing} + \text{other operating income}}{\text{commission expenses} + \text{administrative costs} + \text{depreciation} + \text{other operating costs}}$
<b>Expense/income %</b>	$\frac{1}{\text{income/expense ratio}} \times 100$

## 145 YEARS OF THE MORTGAGE SOCIETY OF FINLAND

From imperial proclamation towards a € 400 million loan portfolio

A new stage has been initiated through the operational update programme. Targets grow. The loan portfolio is € 374,000,000 and the deposit portfolio is € 10,000,000.

- 21.12.1858 The senate's decision to proclaim the founding of a Mortgage Society.
- 25.5.1859 His Imperial Majesty's Gracious Proclamation on the terms and general principles of the Mortgage Society of Finland
- 4.7.1860 Decision on the establishment of the Mortgage Society of Finland in Hamina in connection with a general agricultural meeting
- 24.10.1860 Senate ratifies the rules of the Mortgage Society of Finland
- II/1862 Lending operations start with funds received from the Bank of Finland and the Mortgage Society's own bonds. Loans are repayable over 55 years in level annuity instalments.
- 1862 Finland's first private bond issue.
- XII/1864 First foreign loan from M. A. V. Rothschild & Söhne stockbrokers, Frankfurt am Main. 3 million Prussian thaler/FIM 8,998,300 after 19% issue discount.
- 1865 The Finnish Markka is tied to a silver standard backed by a FIM 8 million currency reserve deposited at the Bank of Finland by the Mortgage Society.
- [1865-1915] Freedom fighter, Lieutenant and Knight of Danneborg, Herman Liikanen, serves the Mortgage Society of Finland as an accountant for nearly 50 years. 1890s
- The 1890s Economic growth. The Mortgage Society's loan portfolio totalled FIM 22 million in 1890 and FIM 73 million in 1913.
- 1914-1918 World War I. Based on the guarantee of the Grand Duchy, the government of Finland, the Republic of Finland paid off bonds issued before the war in the 1920s as creditors demanded payment on four currency-denominated loans in the currency least affected by inflation, the Swedish Krona.
- [1913-1917] The Mortgage Society finances AB Brändö Villastad, the garden suburb of Kulosaari in Helsinki.
- [1927-1979] The Housing Mortgage Bank of Finland. An 18% market share of all loans made on urban real estate in the late 1920s. Slightly less than 70% of these loans went to Helsinki. The bank was toppled by foreign exchange losses.
- 1929 The Great Depression starts.
- 1937 Head office, which now houses the Ministry of Transportation, was taken over by the government as old bonds and related agricultural loans were assumed by the state.
- 1939-1945 War years.

- 1945-1959 Post-war relocation activity. In addition to land loans, government funds also used for condominium association and association member loans, or home mortgage banking. Kansallis-Osake-Pankki and Pohjoismaiden Yhdyspankki, for example, served as agents. Subsequently also Postisäästöpankki.
- 1960-1980 Loan portfolio grows slowly. Farm loans from government funds.
- 1980-1997 Lending expands to home building and the purchase of condominium shares, and to condominium association repairs and new construction. Positive net income even during banking crisis.
- 1999 Funding raised in euro. Total loan portfolio € 277 million.
- 2000 Y2K preparations. Total loan portfolio € 280 million.
- 2002 The operational update programme of the Mortgage Society of Finland approved. Total loan portfolio € 330 million. Establishment of a deposit taking bank called Suomen Asuntohypopankki Oy. Bank's equity € 6 million.
- 2003 The operational update programme helps turn the number of customer members to a new growth. Total loan portfolio € 365 million. Deposit portfolio € 4.3 million. Customer members are offered e.g. Hypo Visa card, reverse mortgage deals and loans, versatile deposit products and ASP loans.
- 2004 Starts to grant student loans. The Mortgage Society offers a unique partial ownership solution for its members. New products and services generated through the operational update programme are established as part of the Mortgage Society's customer services.
- 2005 The second stage of the operational update programme starts. Target-orientation increases. The Society's organisation prepares for the retirement of certain key employees.