



Municipality Credit Iceland

Strategic changes

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Mission

The principal objective of MCI is to provide financing at favorable terms to Icelandic municipalities and their fully owned enterprises for projects of general economic interest.

The condition for the granting of loans to municipally-owned enterprises is that such enterprises must be wholly owned by municipalities or jointly owned by municipalities and the State Treasury, which will act as guarantors for the loans.



Benefit for borrowers

All municipalities and municipal enterprises enjoy the same terms from MCI, which means that the smaller municipalities benefit relatively more from MCI than the bigger ones.

MCI access to municipality revenues at source in state treasury evens out credit quality differences.



General economic interest

MCI only finances projects of general economic interest and thereby avoids breaking competition rules, in spite of state aid in the form of being income tax exempt and having municipality revenues as collateral for loans.

Typical projects are:

Schools, kindergartens, sports facilities, land development, geothermal heating, harbor facilities, water supply, waste water and solid waste treatment and disposal.



Iceland Public Sector

- Two-tier system
 - Central government
 - Municipalities
- 79 municipalities, (down from 225 15 years ago)
- 35% of public spending
- 15% of GDP
- 300,000 inhabitants, 60% in the capital area



Debt and borrowing needs

- Icelandic municipalities (excl. Reykjavik City) total debt is EUR1.2 billion.
- Annual borrowing is EUR120 million.
- MCI covers 80-85% of new borrowing.
- MCI market share is expected to grow to 50-60% replacing more expensive bank financing.



History of MCI

- In operation from 1967 based on special law.
- Contributions from the Equalization Fund.
- Contributions from the Treasury.
- Limited borrowing, lending based on contributions.
- Run in co-operation with the Municipality Association.



Comparison to other Nordic municipal funding agencies

Year 2003	<u>MCI</u>	<u>Nordic agencies</u>
Loan portfolio	170 mEUR	6 bEUR
Market share	9%	40-70%
Productivity*	0.21%	0.07-0.13%
Equity ratio	71%	1.76%
Liquidity**	1.5%	16%
Rating	NR	AAA/Aaa

* operating exp./av. assets

** liquid assets/total assets



Strategic changes, 1st step 2004

- Direct contributions abolished
- Financial company
supervised by FSA
- Transfer of supreme power
from state to municipalities
- New strategy
Increased lending/borrowing/treasury activity



Strategic changes, 2nd step 2006

- Change to statutory limited liability company.
- Ownership of each municipality specified.
- Non-compete status.
 - Tax exempt & municipality revenue as collateral.
- Reduce capital by 3 billion ISK in 4 years.
- Limits on share transfer:
 - Only municipalities or their fully owned enterprises.
 - Voting right max. 15% per shareholder.



Possible funding strategies

- First step
Domestic bond market. Bilateral financing:
NIB, CEB, Depfa, Dexia, etc.
- Second step
Rating. International bond markets added.
Possibly EMTN.
- ?Third step?
Merger with a top rated public
(Nordic/European) financial institution.



Local Government Act

- Legal frame for the Icelandic municipalities.
- Provides collateral for MCI in municipality income.
- Limits issuance of guarantees by municipalities.
- Secures state supervision and support in case of financial problems.
- Prohibits bankruptcies of municipalities



Treasury policy

- Build up liquidity reserves
- Invest equity capital more in the market and less in lending.
- Strict investment criteria to control market and counterparty risks.



Operational risks

- Financial company under FSA supervision
- Monoline organisation
- Standardized documents and procedures
- Modern software systems
- Outsourcing



Key figures 2007

- New lending EUR108 m
- Total assets EUR457 m
- Market share 32%, (excl. Reykjavik City)
- Net profit EUR13 m
- Equity EUR110 m
- CAD ratio 112%
- Operating expenses 0.18% of assets
- Cost/income ratio 5.4%



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