Municipality Credit Iceland

Interim financial statements
30 June , 2006

Index

Municipality Credit Iceland
Identity number 710169-4979
Borgartun 30, Post-box 8100, 128 Reykjavik

Report of the Board of Directors and the Managing Director

Lending and borrowings

Approved loans during the first six months 2006 amounted to 7,247.4 million ISK to 27 entities, but loan disbursements amounted to 3,045 million ISK, as compared to 3,104 million ISK in the first six months 2005.

Arrears are immaterial. MCI has never suffered a loan loss since it commenced operations in 1967 and does not make provisions for loan losses in its books.

Loans financed with equity capital are CPI indexed. The interest rates are variable and were raised from 4.0% to 4,4% at May 1, 2006, consistent with the general interest development. Borrowed money is re-lent on the same terms as the borrowings with a modest margin to cover running costs.

Bonds amounting to 2,220 million ISK were issued during the period to fund lending, as compared to 3,500 million ISK in the first six months of 2005. The bonds are listed on the Iceland Stock Exchange. Additionally, MCI borrowed 20 million EUR from the Council of Europe Development Bank.

Operating results and financial position

MCI's net financial result for the period was better than expected. The profit for the period amounted to 717.3 million ISK, as compared to 376.5 million ISK for the same period 2005. Price level increases positively influence the fund's net results as loans financed with equity capital are price indexed. In addition the return on current monetary assets during the period was satisfactory.

Total assets amounted to 28,850 million ISK in the period ending June 30, 2006, as compared to 23,927 million ISK at December 31, 2005 and have increased by 20.6% Due to increased activity the fund has for security reasons increased its current monetary assets to 2,185 million ISK at the end of the period compared to 1,329.3 million ISK at December 31, 2005.

The financial position of MCI is sound. Equity amounted to 11,455 million ISK at June 30, 2006, as compared to 10,738 million ISK at December 31, 2005, increasing by 6.7% over the period. Equity was 39.7% of total assets at June 30, 2006, as compared to 44.9% in the year end 2005, and the CAD-ratio was 206.6% at June 30, 2006, calculated according to FME rules on the capital requirement of financial undertakings. The minimum permitted CAD ratio is 8%.

MCI and other jointly administrated institutions are subject to pension fund obligations related to their employees that have and do participate in the B-department of the State Employees' Pension Fund. An actuarial calculation regarding the pension fund obligation is performed annually, but possible changes regarding the pension fund obligation in the first half of the year 2006 have not been taken into consideration in this interim financial statement.

Report of the Board of Directors and the Managing Director

MCI is now issuing its first interim financial statements. Comparatives have been calculated for the corresponding period in 2005.

The Board of Municipality Credit Iceland and the Managing Director hereby confirm the interim accounts for the period January 1 - June 30, 2006 with their signatures.

Reykjavik, August 23, 2006

Magnus B Jonsson
Chairman

Einar Njalsson

Kristinn Jonasson

Magnus Gunnarsson

Reinhard Reynisson

Thorsteinn Thorsteinsson
Managing Director

Auditor's report

To the Board of Directors' of Municipality Credit Iceland

We have reviewed the Interim financial statements of Municipality Credit Iceland (MCI) as of 30 June 2006. The financial statements consist of the Board of Directors' report, income statement, balance sheet as of June 30, cash flow statement, summary of accounting principles and notes 1 - 14. These financial statements are the responsibility of the MCI's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our review in accordance with the International Standards of review engagements 2400. This standard requiers that we plan and perform the review to obtain moderate assurance about whether the consolidated interim financial statements are free of material misstatement. A review is limited primarily to inquiries of company personel and analytical procedures applied to financial data and thus provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Based on our review, nothing has come to our attention that causes us to belive that the accompanying consolidated interim financial statements do not give a true and fair view in accordance with International Accounting Standard 34 "Interim financial Reporting".

Reykjavik, August 23, 2006

PricewaterhouseCoopers hf.

Sigurdur B. Arnthorsson

Sigrun Gudmundsdottir

Income statement

	Notes	Six months ended 30 June 2006	2005
Interest income			
Interest on amounts due from credit institutions		49,457,890	2,769,427
Interest and indexation on loans		1,627,807,075	546,780,919
Interest on trading securities		1,710,800	0
		1,678,975,765	549,550,346
Interest expenses			
Interest and indexation on borrowings	2	977,086,053	169,536,615
Other interest expenses		0	127,747
		977,086,053	169,664,362
Net interest income		701,889,712	379,885,984
Other operating income			
Trading gains	3	37,965,061	17,997,412
Net operating income		739,854,773	397,883,396
Operating expenses			
Salaries and related expenses	4	8,915,255	8,589,698
Other expenses		13,057,187	12,183,635
Depreciation	9	597,814	597,814
		22,570,256	21,371,147
Net profit		717,284,517	376,512,249

Balance sheet

Assets	Notes	At 30 June 2006	2005
Cash and amounts due from credit institutions	6		
Amounts due from credit institutions		832,851,577	1,329,267,261
Loans			
Loans	7,8	26,607,393,492	22,539,857,237
Trading securities			
Securities with fixed income		82,186,700	0
Securities		1,269,990,057	0
		1,352,176,757	0
Property and equipment			
Property	9	56,792,304	57,390,118
Other assets			
Other assets		1,267,303	803,159
Total assets		28,850,481,433	23,927,317,775

Balance sheet

Equity and liabilities

	Notes	At 30 June 2006	2005
Borrowings	11		
Issued bonds		12,930,917,560	10,161,394,297
Amounts owed to credit institutions		4,426,976,410	2,988,363,179
		17,357,893,970	13,149,757,476
Other liabilities			
Other liabilities		1,577,968	3,264,409
Deferred liabilities			
Pension obligations	12	35,614,088	36,185,000
Total liabilities		17,395,086,026	13,189,206,885
Equity	13		
Retained earnings		11,455,395,407	10,738,110,890
Total equity and liabilities		28,850,481,433	23,927,317,775

Cash flow statement

	Six months ended 30 June 2006	2005
Cash flows from operating activities		
Net profit	717,284,517	376,512,249
Items not affecting cash:		
Depreciation	597,814	597,814
Indexation and exchange rate difference	(317,987,037)	11,391,681
Pension obligations, changes	(570,912)	(615,406)
Gain from sale of fixed assets	0	(1,361,656)
Other assets, decrease (increase)	(464,144)	480,066
Other liabilities, increase (decrease)	(1,686,441)	2,306,900
Net cash from operating activities	397,173,797	389,311,648
Cash flows from investing activities		
Amounts due from credit institutions, changes	592,684,779	(500,000,000)
Loans, changes	(3,343,126,041)	(2,557,572,052)
Sales of fixed assets	(1,352,176,757)	0
Sales value shares	0	1,752,217
	(4,102,618,019)	(2,555,819,835)
Cash flows from finance activities		
Borrowings, changes	3,801,713,317	3,224,294,988
	3,801,713,317	3,224,294,988
Increase in cash and cash equivalents	96,269,095	1057,786,801
Cash and cash equivalents at beginning of year	386,582,482	459,284,870
Cash and cash equivalents at end of period	482,851,577	1,517,071,671

Notes

1. Accounting policies

Basis of preparation

The financial statements are prepared in accordance with the Financial statements act and rules on the financial statements of credit institutions. The financial statements are based on historical cost accounting.

The principal accounting policies adopted in the preparation of these financial statements are described in this chapter and are mainly the same as last year except where stated below.

Changes in accounting policies

Loans and borrowings are recognised according to the method of effective rate of interest. Initially loans and borrowings are recorded at fair value, net of transaction costs incurred. They are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period to the loans and borrowings using the effective rate of interest method. The effect of these changes are recorded as an increase in retained earnings at the beginning of the year, according to note 13 and the comparative figuers have been changed to conformity.

Interest income and exchange rate difference

Interest income and interest expense are recorded in the income statement when earned/incurred. Interest income is calculated on loans to credit insitutions and other loans. Interest expense is calculated on debt owed to credit institutions and borrowings.

Accrued foreign exchange rate differences and indexation are recorded in the income statement. Index linked assets and liabilities are stated using indexes that were effective at the beginning of the year 2006. Assets and liabilities in foreign currency are converted into Icelandic kronur at June 30 exchange rates.

Loans

Loans are recognised when they are disbursed to the debtor. Loans are capitalized with accrued interest, indexation and exchange rate difference at June 30, according to effective rate of interest. Indexed loans are entered based on indices effective at the beginning of 2006 and loans in foreign currency based on the exchange rate of the relevant currencies at June 30 2006.

According to act no. 136/2004 on Municipality Credit Iceland, the principal objective of MCI is to secure for the municipalities, its institutions and enterprises loan capital on favourable terms through loans or guarantees. The condition for the granting of loans or guarantees by MCI to municipally-owned enterprises and institutions is that such enterprises and institutions must be wholly owned by municipalities or jointly owned by municipalities and the State Treasury, which will act as guarantors for the loans.

According to paragraph 3 of article 73 of act no. 45/1998 (Local Government Act), municipalities may put up their revenues as security for loans they receive from the MCI and for guarantees they grant. The Minister of Social Affairs may make further provisions in regulations, regarding the MPI’s security in municipal revenues (regulation no. 123/2006). MCI's objective is to demand such liens as security for the loans.

Notes

Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method. Accrued interest are included in the loan amount.

Property and equipment

Property and equipment are capitalized at cost price less depreciation. Depreciation is calculated as a fixed annual percentage based on the estimated useful life of the property and equipment until scrap value is reached.

Pension obligations

MCI and other jointly administrated insitutions are subject to pension fund obligations related to their employees, that have and do participate in the B-department of the State Employees' Pension Fund. MCI's obligation is recorded as debt in the balance sheet in accordance to the calculations of an actuary.

Cash and cash equivalents

Cash and cash equivalents in the statement of cash flows consist of cash and demand deposits with credit institutions.

Notes

2. Interest expenses

Interests on borrowings are specified as follows:

	1/1 - 30/6 2006	1/1 - 30/6 2005
Interests on issued bonds	842,911,368	116,614,762
Interests on borrowings	134,174,685	52,921,853
	977,086,053	169,536,615

3. Trading gains (losses)

Trading gains (losses) are specified as follows:

	1/1 - 30/6 2006	1/1 - 30/6 2005
Securities trading	30,831,653	19,350,939
Foreign exchange	7,133,408	(1,353,527)
	37,965,061	17,997,412

4. Salaries and related expenses

At June 30 2006 the Managing Director is the only employee of Municipality Credit Iceland. MCI has entered into a service agreement with the Icelandic Association of Local Authorities regarding the purchase of administrative services and such expense is recorded in the other operational expenses item.

Salaries and related expenses are specified as follows:

	1/1 - 30/6 2006	1/1 - 30/6 2005
Salaries	7,718,934	7,372,894
Related expenses	1,196,321	1216,804
	8,915,255	8,589,698

Salaries and other fees to the Board of Directors and the Managing Director are specified as follows:

Thorsteinn Thorsteinsson, Managing Director	6,563,934
Magnus B Jonsson, Chairman	315,000
Einar Njalsson	210,000
Kristinn Jonasson	210,000
Magnus Gunnarsson	210,000
Reinhard Reynisson	210,000

5. Auditor's Fee

Remuneration to the MCI's auditor are specified as follows:

	1/1 - 30/6 2006	1/1 - 30/6 2005
Audit	2,263,800	1,386,900
Preparation of the financial statements	336,650	292,000
Other services	19,872	895,050
	2,620,322	2,573,950

Notes

6. Cash and amounts due from credit institutions

Cash and amounts due from credit institutions are specified as follows:	**30/6 2006**	**31/12 2005**
On demand	482,851,577	386,582,482
Up to 3 months	350,000,000	942,684,779
	832,851,577	1,329,267,261

7. Loans

Loans are specified as follows:		
Foreign currency loans	3,123,263,895	1,806,163,825
Indexed loans	23,484,129,597	20,733,693,412
	26,607,393,492	22,539,857,237

Loans are specified as follows by maturity:		
On demand	31,223,497	2,103,461
Up to 3 months	1,219,002,633	481,391,490
After 3 months and up to 1 year	1,721,025,573	2,062,224,033
After 1 year and up to 5 years	12,050,518,482	8,568,132,913
After 5 years	11,585,623,307	11,426,005,340
	26,607,393,492	22,539,857,237

8. Default

Loan defaults on loans provided by MCI amounted to 31.2 million ISK at 30 June 2006, but at year-end 2005 loan defaults amounted to 2.1 million ISK.

Overdue, installments	25,357,670	1,397,156
Overdue, interest	5,778,118	670,975
Overdue, late payment finance charge	87,709	35,330
	31,223,497	2,103,461

9. Property

Property is specified as follows:	**Real estate Building and land**	
	30/6 2006	**31/12 2005**
Total value 1.1.	59,781,371	59,781,371
Total value 30.06.	59,781,371	59,781,371
Previously depreciated	2,391,253	1,129,049
Depreciated during the period	597,814	1,262,204
Total depreciation 30.06.	2,989,067	2,391,253
Book value 30.06.	56,792,304	57,390,118
Depreciation ratios	2%	2%

The official real estate value at 31.12.2005 is ISK 38.5 million. The fire insurance value of the real estate is ISK 44.2 million at 31.12.2005.

Notes

10. Assets and liabilities inflation-indexed or subject to currency-rate fluctuations

The total indexed linked assets amounted to ISK 23,566 million at 30 June 2006, and the total amount of indexed liabilities amounted to ISK 14,129 million.

The total amount of assets in foreign currencies amounted to ISK 3,226 million at 30 June 2006 and the total foreign currency liabilities amounted to ISK 3,229 million at that time.

11. Borrowings

	30/6 2006	31/12 2005
Borrowings are specified as follows by maturity:		
Up to 3 months	403,523,412	325,935,153
After 3 months and up to 1 year	379,951,794	429,309,804
After 1 year and up to 5 years	8,701,279,372	4,861,230,085
After 5 years	7,873,139,392	7,533,282,434
	17,357,893,970	13,149,757,476

12. Deferred liabilities

MCI and other jointly administrated insitutions are subject to pension fund obligations related to their employees, that have and do participate in the B-department of the State Employees' Pension Fund. An actuaral calculation regarding the pension fund obligation has been performed and the obligation has been included in the annual financial statements based on an annual interest rate of 2%.

13. Equity

Balance 01.01	10,561,819,767
Adjustments due to changes in accounting policies	176,291,123
Adjusted balance 01.01	10,738,110,890
Net profit of the period	717,284,517
Balance 30.06	11,455,395,407

Equity at 30 June 2006 amounted to ISK 11,455 million or 39.7% of total assets. Capital adequacy ratio calculated according to article 84 regarding financial companies is 206.6% but the ratio may not fall below 8.0%.

The ratio is calculated as follows (in thousand ISK):	Book value	Weighted value 30/6 2006	Weighted value 31/12 2005
Risk base:			
Assets recorded in the financial statements	27,498,303	5,544,841	4,831,215
Risk base total	27,498,303	5,544,841	4,831,215
Capital:			
Recorded equity		11,455,395	10,738,111
Capital total		11,455,395	10,738,111
Capital adequacy ratio		206.6%	222.3%

Notes

14. Taxes

According to act no. 90/2003 regarding income tax, MCI is exempt from income tax.

According to act no. 94/1996 regarding finance tax, MCI is exempt from paying this tax.

According to act on MCI no. 136/2004 bonds related to loans taken and granted by MCI are exempt from stamp duty.