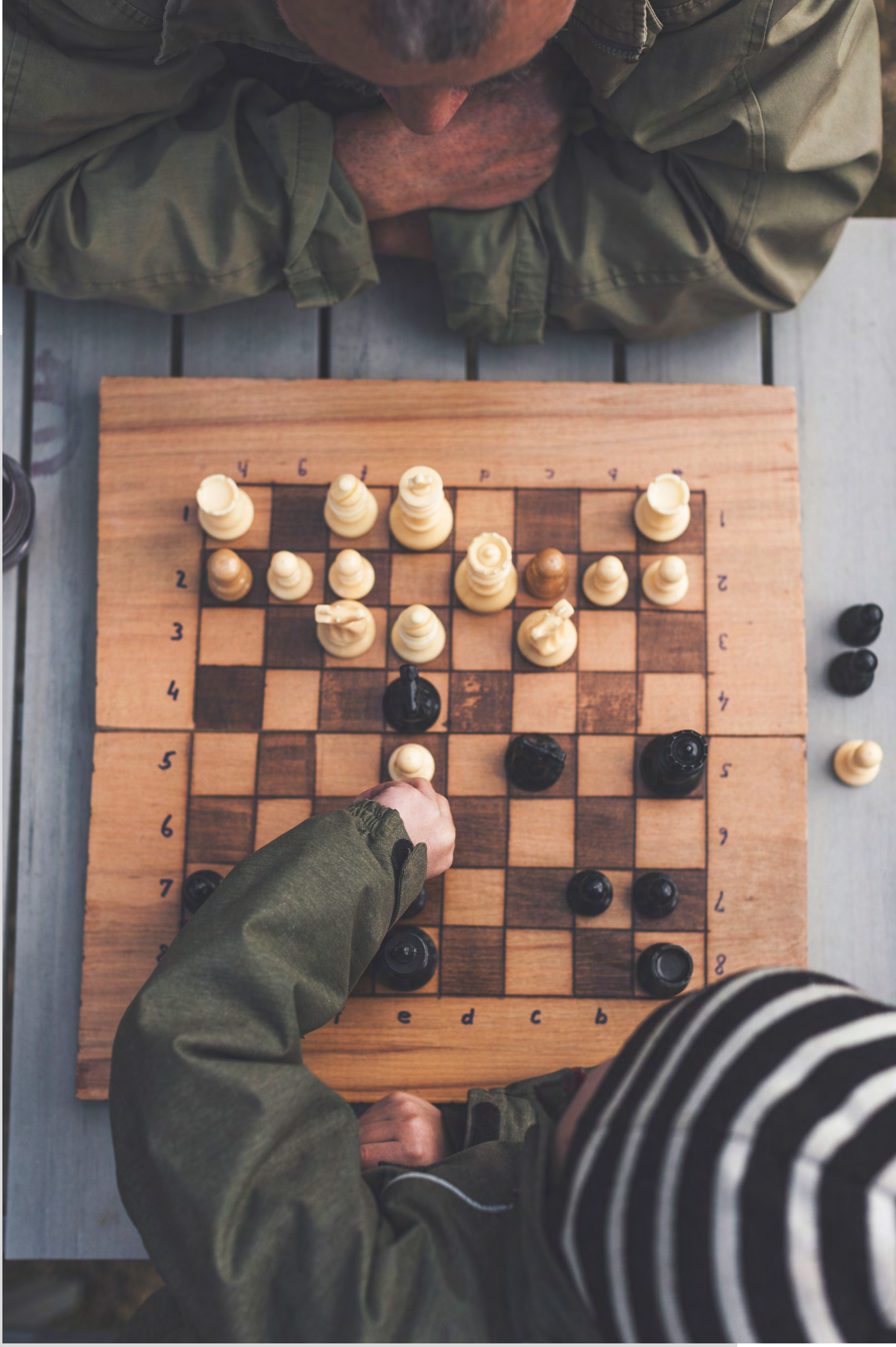

# Annual report 2016

KLP KOMMUNEKREDITT AS

# Contents

# Annual report for 2016

KLP Kommunekreditt AS is able to refer to good lending growth in 2016 and annual profits of NOK 53.2 million before tax. The Company is mainly financed by issuing covered bonds. The bonds have the highest possible rating (AAA).

KLP Kommunekreditt AS is a wholly owned subsidiary of KLP Banken AS. The Company is a credit enterprise mainly financed by the issuance of bonds secured in public lendings

KLP Banken AS is a commercial bank owned by Kommunal Landspensjonskasse gjensidig forsikringsselskap (KLP) through KLP Bankholding AS. KLP Banken AS also holds all the shares in KLP Boligkreditt AS, a subsidiary.

The overall business of KLP Banken AS and its subsidiaries are divided into the business areas of retail market and public sector loans. The business is nationwide and the companies' head office is in Trondheim.

KLP Kommunekreditt's presence in the public sector lending market helps the public sector get access to favourable long-term financing.

### FINANCIAL DEVELOPMENT 2016

Income statement

| NOK MILLIONS | 2016 | 2015 | Change |
|---|---|---|---|
| Pre-tax profit | 53.2 | 19.6 | 33.6 |
| Net interest income | 68.0 | 69.9 | -1.8 |
| Operating costs | -18.9 | -20.5 | 1.6 |

Financial position statement

| NOK BILLIONS | 2016 | 2015 | Change |
|---|---|---|---|
| New lending | 3.3 | 1.4 | 1.9 |
| Lending balance | 17.2 | 15.6 | 1.6 |
| Liquidity | 2.1 | 3.6 | -1.2 |

Figures for 2015 are shown in brackets below.

**Income statement**

The profit was NOK 53.2 million before tax and NOK 40.0 million after tax. That produced a return on owners' equity of 8.1 per cent as against 2.8 per cent in 2015.
As the only financial institution in Norway to do so, KLP Kommunekreditt AS has issued bonds secured in lending to municipalities, county administrations and enterprises with public guarantee since 2009.

The result for the year shows that net interest income is more or less maintained compared to 2015 whilst at the same time outstanding lending has increased. Current margins between lending and borrowing have fallen somewhat on average compared to the year before.

Net interest income from the lending and investment portfolios was NOK 68.0 million in 2016, as against NOK 69.9 million 2015, which is a reduction of 3 per cent. Gross interest income from lending and liquidity investments was reduced by 10 per cent on the preceding year, mainly as a result of falling interest rates.

In 2016 credit premiums in the securities market have come down somewhat compared to 2015. This has increased the value of the Company's securities investment by NOK 15.3 million for the full year. At the end of 2015 the income statement included a net loss of NOK 27.2 million in the value of securities

The Company regularly adjusts the terms of the borrowings in order to reduce liquidity risk and meet regulatory requirements for liquidity indicators and capital adequacy (Basel III and CRD IV). The refinancing of the borrowing side then creates a need for the repurchasing of own issuances. In 2016 the effect on profits due to the repurchasing of borrowings was NOK -13.1 million. The corresponding cost in 2015 was NOK 5.1. This is further described in "Liquidity" below.

Compared with issues of bonds covered by mortgages, KLP Kommunekreditt AS's issues are slightly lower priced, as the investment market considers the underlying risk posed by the municipal sector to be lower than for mortgages.

KLP Kommunekreditt AS's operating costs were NOK 18.9 million, a reduction of 8 per cent on 2015. The reasons for the cost reductions are the changeover from using two rating agencies to one, and reduced IT costs.

### LENDING

KLP Kommunekreditt AS's lending business is mainly based on the sale of new loans directly from the Company. The refinancing of loans at KLP in recent years has had no material significance for the development of lending operations.

Total lending amounted to NOK 17.2 billion at the end of 2016, which is a net growth in the lending volume of NOK 1.6 billion. 71 per cent of the lending volume is at floating interest rates. The proportion of lending at fixed interest rates has dropped from 32 per cent in 2015 to 29 per cent at the end of 2016.

In 2016 new loans have been paid out for NOK 3.3 billion, which is NOK 1.9 billion more than in 2015. The lending portfolio consists of direct loans to Norwegian municipalities and county administrations, or to companies that carry out official tasks and obtain guarantees from municipalities or county administrations. The risk involved in the lending portfolio is considered to be very low.

The credit risk associated with lending to municipal and county authorities in Norway is limited to the deferment of payment and not to the cessation of payment obligations. This is stipulated in the Local Government Act of 1992, which indemnifies the lender against losses if a local authority is unable to meet its payment obligations. In the event that payment is deferred, the same legislation provides for the lender to be compensated for loss of accrued interest, late payment interest and debt collection costs. KLP Kommunekreditt AS has not incurred any credit losses on loans to Norwegian municipal or county authorities. The Company has no loans in default at the end of 2016.

### BORROWING

KLP Kommunekreditt AS has established a programme for the issuance of covered bonds. In 2016 covered bonds equivalent to NOK 7.1 billion were issued in the Norwegian market. The corresponding figure for 2015 was NOK 2.9 billion.

In the Norwegian market the Company has covered bonds in loans to the local government sector outstanding, in the amount of NOK 17.3 (16.1) billion in 2016. There are currently no issuances abroad.

The bonds are issued with security in a portfolio of loans to municipalities, county administrations and enterprises carrying out tasks on behalf of the public sector and qualify for a guarantee. Loans to companies are to be guaranteed by municipalities or county administrations under the Local Government Act § 50, by the Norwegian State or a bank. Guarantees have to be framed as ordinary guarantees and cover both interest and instalments. The Company has achieved best rating on its covered bonds issuances.

### FINANCIAL POSITION AND SOLVENCY

Total assets amounted to NOK 19.5 billion at the end of 2016. Loans to public sector borrowers make up NOK 17.2 billion of that amount.

The Company's Tier 1 and Tier 2 capital, based on the Board's recommendation for the allocation of the profit, amounted to NOK 741.9 million at the end of 2016. Core capital is identical with Tier 1 and Tier 2 capital. This produces a capital adequacy ratio and a core capital adequacy ratio of 19.1 per cent. The equivalent figures for 2015 were NOK 687.5 million and 17.9 per cent respectively.

### LIQUIDITY

The year-end statement of cash flows shows that the liquidity situation is good. The holding of liquid assets is used to pay out new loans or redeem and repurchase loans coming in.

As new borrowings occur when the terms are considered favourable, there is sometimes a need to invest surplus liquidity. Such liquidity contributes to the earnings and provides flexibility to handle the demand for new lendings.

KLP Kommunekreditt AS is subject to strict rules for which assets the Company may invest in. The portfolio of liquidity placements is made up of safe securities and deposits in other banks. The securities are certificates and bonds with very good security, mainly covered bonds with AAA rating.

At the end of 2016 outstanding liquidity investments in the form of interest-bearing securities amounted to NOK 1.7 billion. Securities are booked at market value.

### ALLOCATION OF THE PROFITS FOR THE YEAR

The annual financial statements of KLP Kommunekreditt AS show total comprehensive income for 2016 of NOK 40.0 million after tax. The Board recommends that a Group contribution of NOK 40.8 million be paid to KLP. NOK 30.6 million is to be received from KLP as Group contribution with no tax effect. The profit after tax and Group contributions are transferred to other owners' equity.

### ABOUT THE FINANCIAL STATEMENTS

The Board believes the annual financial statements give a true and fair picture of the company's assets and liabilities, financial position and profits. The going concern assumption is appropriate and provides the basis for the annual financial statements.

KLP Kommunekreditt AS is presenting its financial statements in accordance with the international accounting standards IFRS, which is adopted by the EU with associated interpretations. Please see Note 2 for further information

## RATING

The rating agencies' assessment of KLP Kommunekreditt AS and the KLP Group is important for the Company's borrowing terms and conditions. The Company has engaged Moody's to credit rate the Company's bonds. All issuances of covered bonds have been AAA rated.

KLP Kommunekreditt AS terminated its agreement with Fitch in 2016 and asked Fitch to end its rating of the Company and the bonds. The termination was only based on a desire to lower the costs.

## RISK MANAGEMENT

KLP Kommunekreditt AS is exposed to various types of risk. The Company has established a risk management framework whose purpose is to ensure that risks are identified, analysed and managed by means of policies, limits, routines and instructions. Risk policies have been drawn up to cover the most important individual risks (liquidity risk, credit risk, market risk, operational risk, and compliance risk), as well as an overarching risk policy that covers principles, organisation, limits, etc. for the bank's overall risk. The risk policies are adopted by the board of directors and are reviewed at least once a year. The policies are of an overarching nature and are complemented by routines, guidelines and instructions determined at the administrative level.

Stress testing is used as a method of risk assessment and as a tool for communication and the exchange of views concerning risk matters. In this context stress testing means both sensitivity analyses and scenario analyses.

The risk policies include risk tolerance for the individual risks and for the overall risk. The risk tolerances are defined based on various stress scenarios, and different forms of stress testing are conducted to measure that actual exposure is within predefined tolerances.

The Company is to have a prudent risk profile and earnings should largely be the result of borrowing and lending activity as well as liquidity management. This means that the Company is to have low market risk and that interest and foreign exchange risks arising in the borrowing and lending activity are to be reduced by using derivatives. The Company is to have responsible, long-term financing and limits have been established to ensure that this objective is reached. The credit risk in the Company is low, and the Company's lending is limited to loans with local government risk. Management of the Company's liquidity is conducted through investments in banks and in securities satisfying the requirement for credit quality in accordance with Board-approved credit lines. The Company's liquidity investments have high credit quality.

It is an objective that the Company is to have low operational risk and to maintain high professional competence, good procedures and efficient operation.

The Company is included in the KLP Banken Group's process for assessing and quantifying major risks and calculating the capital (Internal Capital Adequacy and Assessment Process - ICAAP). The capital requirement assessment is forward-looking and in addition to calculating the requirement based on current exposure (or limits) the requirement is assessed in the light of planned growth, strategic changes decided, etc. The Company's Board of Directors participates actively in these assessments and, in conjunction with the capital requirement assessment, the Board adopts a desired level of total capital. This level is known as the "target capital".

## THE LENDING ACTIVITY AND THE BANK'S ROLE

Lending to public sector borrowers and enterprises is provided by KLP and KLP Kommunekreditt AS. Cost-effective financing is to contribute to KLP Kommunekreditt offering loans on good terms and conditions.

Total lending managed by KLP Banken (the public sector market) amounted to NOK 57.4 (52.7) billion at the end of 2016, an increase of NOK 4.7 (4.4) billion on 2015, or 9 (9) per cent. Total payment of new loans during the year adds up to NOK 10.1 (8.5) billion.

In 2016 requests were received for new loans and refinancing in the amount of NOK 63 (45) billion from municipalities, county administrations and companies carrying out public-sector tasks. Loan agreements were entered into for NOK 10.3 (9.9) billion, the equivalent of 16 per cent of the applications volume. All in all KLP Banken is a major long-term lender for public-sector value creation and welfare.

## THE WORK OF THE BOARD OF DIRECTORS

The Board held seven Board meetings in 2016. Please see Note 16 in the annual financial statements for an overview of remuneration for Board members and senior management.

At the end of 2016 the Board is made up of two women and two men.

## CORPORATE GOVERNANCE

The Company's articles of association and applicable legislation provide the framework for corporate governance and a clear division of roles between the governing bodies and executive management.

In accordance with Article 3 of the articles of association the Board is to have between four and seven members. Board members are elected for a term of two years in such a way that half are up for election each year. The Chair and Deputy Chair of the Board of Directors are elected individually.

The Board does not have the authority to issue or buy back shares in the Company.

The Board lays down the guidelines for the Company's activities. Binding agreements can be signed by the Managing Director or the Chair of the Board of Directors alone.

The Managing Director carries out the day-to-day management of the Company in accordance with instructions laid down by the Board of Directors.

An account of the management of the bank is available at KLP's website, please go to https://www.klp.no/om-klp.

## WORKING ENVIRONMENT AND ORGANISATION

KLP Kommunekreditt AS had two employees at the end of 2016. These also had employment relationships with other companies in the KLP Banken Group. The newly-appointed head of Offentlig Marked (The Public-Sector Market) at KLP Banken AS, Mr Carl Steinar Lous, took up the position as Managing Director of KLP Kommunekreditt AS, thus replacing Christopher A. N. Steen, on 24 November 2016.

A management agreement has been entered into with KLP Banken AS, covering administration, IT operations, finance and risk management as well as borrowing and liquidity management.

As part of the KLP Group, KLP Kommunekreditt AS follows the Group's guidelines when it comes to equality and diversity, where goals, measures and activities take account of the discriminatory factors legislation describes. Separate targets for equality and diversity have been adopted in a central working group. In connection with recruitment, the company routinely states its desire to be contacted by all qualified job applicants irrespective of age, gender, disability, political opinions, sexual orientation or ethnic background.

The Board of Directors considers the working environment to be good.

## EXTERNAL ENVIRONMENT

By way of its social responsibility policy KLP has committed to have good procedures for measuring and reducing the companies' impact on the environment. As is the case with the KLP Group as such, KLP Kommunekreditt AS takes its environmental impact seriously. As an office Company it is first of all energy consumption, transport, waste and procurement that can be impacted. KLP Banken AS, the parent Company, is environmentally certified.

## CORPORATE SOCIAL RESPONSIBILITY

As part of the KLP Group, KLP Kommunekreditt AS is to contribute to sustainable investment and responsible business operations. This is materialized through actions associated with the Group's business activities. KLP has signed the UN Global Compact and is thereby committed to working for human rights, worker rights, the environment and anti-corruption. An in-depth description of the goals, measures and results are available at KLP's website (https://www.klp.no/om-klp/samfunnsansvar).

## FUTURE PROSPECTS

KLP Kommunekreditt AS exploits the high creditworthiness of its lending portfolios to achieve favourable borrowing terms. The authorities' regulation of banks and financial institutions mean that they must satisfy a number of regulatory requirements for capital and liquidity. This means they must have positive current earnings that make it possible to meet increased capital requirements.

The market for loans to the local government sector has enjoyed substantial growth for many years, but a large and increasing part of growth in recent years has been financed through the securities market rather than through the financial institutions. KLP Kommunekreditt AS is well capitalized and has the advantage of being a stable and long-term lender in the market. Developments in the company's lending activities will largely be determined by the extent to which it achieves sufficiently favourable borrowing terms to enable it to compete for public lending contracts.

Norwegian local authorities have developed good and extensive services to the population. The combination of increased longevity and population growth give reason to expect permanently high levels of investment in the public sector. The demand for loans in the local government sector and to projects with local government guarantees and local government ownership is therefore assumed to remain high in the years ahead, even if the local government structure and tasks change.

A large part of local government borrowings will likely continue to be obtained from the securities market in future. The board of directors nevertheless assumes that there will still be a need for a significant element of long-term financing over and above what the securities market can offer to public-sector borrowers.

KLP Kommunekreditt AS, together with KLP, is well-positioned in the market for public sector lending. Their presence is extremely popular with local government because it contributes to competition and to the public sector getting access to long-term financing at low cost. Its growth during 2016 has shown that it has maintained its market position.

KLP Kommunekreditt AS will continue to offer loans for investment purposes in the public sector and maintain its low risk profile. The Company's further development will mainly depend on it achieving sufficiently good borrowing conditions in the market to compete for public lendings.

Oslo, 10 March 2017
The Board of Directors of KLP Kommunekreditt AS

**Sverre Thornes**
Chair

**Aage E. Schaanning**
Deputy Chair

**Eva M. Salvesen**

**Toril Sigrid Lahnstein**

**Carl Steinar Lous**
CEO

The Board of Directors of KLP Kommunekreditt AS. Aage E. Schaanning, Eva M. Salvesen, Sverre Thornes and Toril Sigrid Lahnstein.

# Income statement

KLP KOMMUNEKREDITT AS

| NOTE | NOK THOUSANDS | 01.01.2016 -31.12.2016 | 01.01.2015 -31.12.2015 |
|---|---|---|---|
| | Interest income and similar income | 437 565 | 485 635 |
| | Cost of interest and similar costs | -369 530 | -415 784 |
| **10** | **Net interest income** | **68 035** | **69 850** |
| 5 | Net gain/(loss) on financial instruments | 4 070 | -29 742 |
| | **Total net value change and gain/loss on currency and securities held for trading** | **4 070** | **-29 742** |
| 25 | Other operating expenses | -18 906 | -20 502 |
| | **Total operating expenses** | **-18 906** | **-20 502** |
| | **Operating profit/loss before tax** | **53 198** | **19 606** |
| 21 | Tax on ordinary income | -13 245 | -5 433 |
| | **Income for the year** | **39 953** | **14 173** |
| | Other comprehensive income | 0 | 0 |
| | **Other comprehensive income for the year after tax** | **0** | **0** |
| | **COMPREHENSIVE INCOME FOR THE YEAR** | **39 953** | **14 173** |
| | | | |
| | **ALLOCATION OF INCOME** | | |
| | Allocated to/from retained earnings | -39 953 | -14 173 |
| | **TOTAL ALLOCATION OF INCOME** | **-39 953** | **-14 173** |
| | Total profit in% of total assets | 0.20 % | 0.07 % |

# Financial position statement

KLP KOMMUNEKREDITT AS

| NOTE | NOK THOUSANDS | 31.12.2016 | 31.12.2015 |
|---|---|---|---|
| | **ASSETS** | | |
| 11,28 | Loans to and receivables from credit institutions | 414 803 | 443 481 |
| 11 | Loans to and receivables from customers | 17 245 853 | 15 646 269 |
| 8 | Fixed-income securities | 1 723 589 | 3 133 684 |
| 21 | Deferred tax assets | 0 | 1 746 |
| 9 | Financial derivatives | 107 927 | 122 900 |
| 26 | Other assets | 24 060 | 1 251 |
| | **TOTAL ASSETS** | **19 516 233** | **19 349 331** |
| | **LIABILITIES AND OWNERS' EQUITY** | | |
| | **LIABILITIES** | | |
| 17 | Liabilities to credit institutions | 1 170 823 | 2 181 927 |
| 18 | Liabilities created on issuance of securities | 17 342 542 | 16 114 897 |
| 9 | Financial derivatives | 240 602 | 345 305 |
| 21 | Deferred tax | 11 499 | 12 695 |
| 23 | Other liabilities | 4 508 | 4 646 |
| 23 | Provisions for accrued costs and liabilities | 4 395 | 646 |
| | **TOTAL LIABILITIES** | **18 774 369** | **18 660 115** |
| | **OWNERS' EQUITY** | | |
| | Share capital | 362 500 | 362 500 |
| | Share premium | 312 500 | 312 500 |
| | Other owners' equity | 66 864 | 14 216 |
| | **TOTAL OWNERS' EQUITY** | **741 864** | **689 216** |
| | **TOTAL LIABILITIES AND OWNERS' EQUITY** | **19 516 233** | **19 349 331** |

Oslo, 10 March 2017
The Board of Directors of KLP Kommunekreditt AS

**Sverre Thornes**
Chair

**Aage E. Schaanning**
Deputy Chair

**Eva M. Salvesen**

**Toril Sigrid Lahnstein**

**Carl Steinar Lous**
CEO

# Statement of owners' equity

KLP KOMMUNEKREDITT AS

| 2016<br>NOK THOUSANDS | Share capital | Share premium | Other equity | Total owners' equity |
|---|---|---|---|---|
| Owners' equity 1 January 2016 | 362 500 | 312 500 | 14 216 | 689 216 |
| Income for the year | 0 | 0 | 39 953 | 39 953 |
| Other comprehensive income | 0 | 0 | 0 | 0 |
| **Comprehensive income for the year** | **0** | **0** | **39 953** | **39 953** |
| Group contribution received | 0 | 0 | 47 018 | 47 018 |
| Group contribution paid after tax | 0 | 0 | -34 323 | -34 323 |
| **Total transactions with the owners** | **0** | **0** | **12 695** | **12 695** |
| **Owners' equity 31 December 2016** | **362 500** | **312 500** | **66 864** | **741 864** |

| 2015<br>NOK THOUSANDS | Share capital | Share premium | Other equity | Total owners' equity |
|---|---|---|---|---|
| Owners' equity 1 January 2015 | 362 500 | 312 500 | 53 653 | 728 653 |
| Income for the year | 0 | 0 | 14 173 | 14 173 |
| Other comprehensive income | 0 | 0 | 0 | 0 |
| **Comprehensive income for the year** | **0** | **0** | **14 173** | **14 173** |
| Dividends paid | 0 | 0 | -28 300 | -28 300 |
| Group contribution received | 0 | 0 | 4 980 | 4 980 |
| Group contribution paid after tax | 0 | 0 | -30 290 | -30 290 |
| **Total transactions with the owners** | **0** | **0** | **-53 610** | **-53 610** |
| **Owners' equity 31 December 2015** | **362 500** | **312 500** | **14 216** | **689 216** |

| NOK THOUSANDS | Number of shares | Par value | Share capital | Share premium | Other equity | Total |
|---|---|---|---|---|---|---|
| Equity as at 1 January 2016 | 3 625 000 | 0.1 | 362 500 | 312 500 | 14 216 | 689 216 |
| Changes in the period 1 January - 31 December | - | - | 0 | 0 | 52 648 | 52 648 |
| **Equity as at 31 December 2016** | **3 625 000** | **0.1** | **362 500** | **312 500** | **66 864** | **741 864** |

There is one class of shares. All the shares are owned by KLP Banken AS.

# Statement of cash flows

KLP KOMMUNEKREDITT AS

| NOK THOUSANDS | 01.01.2016 -31.12.2016 | 01.01.2015 -31.12.2015 |
|---|---|---|
| **OPERATIONAL ACTIVITIES** | | |
| Payments received from customers – interest, commission & charges | 386 298 | 450 013 |
| Net disbursements on lending to customers | -1 841 054 | 505 434 |
| Disbursements on operations | -14 295 | -20 480 |
| Net receipts/payments on other operating activities | 4 214 | 3 046 |
| Net interest from investment accounts | 572 | 6 703 |
| Income tax paid | 0 | 0 |
| **Net cash flow from operating activities** | **-1 464 265** | **944 716** |
| **INVESTMENT ACTIVITIES** | | |
| Payments on purchase of securities | -1 754 141 | -2 355 043 |
| Receipts on sales of securities | 3 170 907 | 2 266 105 |
| Interest received from securities | 48 395 | 48 428 |
| **Net cash flow from investment activities** | **1 465 162** | **-40 510** |
| **FINANCING ACTIVITIES** | | |
| Net receipts on loans from credit institutions | 281 331 | -466 261 |
| Net payment of interest on loans | -310 334 | -370 876 |
| Dividends paid | 0 | -28 300 |
| Group contribution payment made | 0 | -36 513 |
| **Net cash flow from financing activities** | **-29 003** | **-901 950** |
| **Net cash flow during the period** | **-28 106** | **2 256** |
| Cash and cash equivalents at start of period | 430 916 | 428 660 |
| Cash and cash equivalents at end of period | 402 810 | 430 916 |
| **Net receipts/disbursements (-) of cash** | **-28 106** | **2 256** |

# Declaration

PURSUANT TO THE NORWEGIAN SECURITIES TRADING ACT, SECTION 5-5

We hereby declare that, to the best of our knowledge, the annual financial statements for the period from 1 January to 31 December 2016 have been prepared in accordance with applicable accounting standards, and that the information in the financial statements gives a true and fair view of the Company's assets, liabilities, financial position and overall profit or loss.

We also declare that the Directors' report provides a true and fair overview of the development, profit or loss and the financial position of the Company, together with a description of the most significant risk and uncertainty factors the Company faces.

Oslo, 10 March 2017
The Board of Directors of KLP Kommunekreditt AS

**Sverre Thornes**
Chair

**Aage E. Schaanning**
Deputy Chair

**Eva M. Salvesen**

**Toril Sigrid Lahnstein**

**Carl Steinar Lous**
CEO

# Notes to the Accounts

KLP KOMMUNEKREDITT AS

## NOTE 1 General information

KLP Kommunekreditt AS was formed on 25 August 2009. The Company is a credit enterprise whose object is to provide and acquire public sector loans that are guaranteed by the Norwegian state, Norwegian county administrations or Norwegian municipalities. Borrowers provide ordinary surety covering both repayments and interest.

The business is primarily financed by issuing covered bonds (obligasjoner med fortrinnsrett - OMF) with security in public sector guaranteed loans. Some of these are listed on Oslo Børs (Oslo Stock Exchange).

KLP Kommunekreditt AS is registered and domiciled in Norway. KLP Kommunekreditt AS has its head office at Beddingen 8 in Trondheim.

The Company is a wholly-owned subsidiary of KLP Banken AS, which is in turn wholly owned by Kommunal Landspensjonskasse (KLP) through the holding company, KLP Bankholding AS. KLP is a mutual insurance company.

The annual financial statements are available at www.klp.no.

## NOTE 2 Summary of the most important accounting principles

Below is a description of the most important accounting principles used in preparation of the financial statements for KLP Kommunekreditt AS. These principles are used in the same way in all periods presented unless otherwise indicated.

### 2.1 FUNDAMENTAL PRINCIPLES

The financial statements for KLP Kommunekreditt AS have been prepared in accordance with the international accounting standards (IFRS) and interpretations from the IFRS interpretations committee, as adopted by the EU. The Accounting Act contains certain supplementary information requirements not required in accordance with IFRS. These supplementary information requirements have been incorporated into the notes to the financial statements.

The annual accounts have been prepared based on the principle of historic cost, with the following exceptions:

— Financial assets and liabilities (including financial derivatives) are valued at fair value through profit or loss.
— Financial assets and liabilities are valued in accordance with the rules on fair value hedging.

To prepare the accounts in accordance with IFRS, management has to make accounting estimates and approximate valuations. This will affect the value of the Company's assets and liabilities, income and expenses recognized in the financial statements. Actual figures may deviate from estimates used. Areas in which discretionary valuations and estimates of material significance for the Company have been shown are described in Note 3.

All amounts are presented in NOK thousands without decimals unless otherwise stated.

The financial statements have been prepared in accordance with the going concern assumption.

#### 2.1.1. Changes in accounting principles and information

**a) New and changed standards adopted by the Company in 2016**

No standards, changes or interpretations that came into effect during 2016 have been adopted that have had significant effect on the Company's accounts.

**b) Standards, changes and interpretations of existing standards that have not come into effect and where the Company has not elected advanced application**

IFRS 9 *Financial Instruments* governs the classification, measurement and recognition of financial assets and financial liabilities, introduces new rules on hedge accounting and a new impairment model for financial assets. The Group will begin using the standard as of 2018. IFRS 9 replaces the classification and measurement models in IAS 39 with a single model which in principle only has two categories: amortized cost and fair value.

The classification of loans will be dependent on the entity's business model for the management of its financial assets and the characteristics of the cash flows of the financial assets. A debt instrument is measured at amortized cost if:

a) the business model is to hold the financial asset to collect the contractual cash flows, and
b) the instrument's contractual cash flows exclusively represent the payment of principal and interest.

All other debt and equity instruments, including investments in complex instruments, must be recognized at fair value through profit or loss. There is an exception for investments in equity instruments that are not held for trading. For such investments, the value changes are recognized through other comprehensive income, without subsequent recycling to profit or loss.

For financial liabilities that the entity has chosen to measure at fair value, the share of the value change that is due to a change in the entity's own credit risk must be recognized in other comprehensive income and not in profit or loss.

The new rules for hedge accounting mean that the recognition of hedging better reflects general practice for risk management in the companies. As a general rule, it will be easier to use hedge accounting in the future. The new standard also introduces extended disclosure requirements and changes in the rules on the presentation of hedging.

Other significant changes in classification and measurement include:
— a third measurement category (fair value through other comprehensive income) for certain financial assets that are debt instruments
— a new impairment model for losses on loans and receivables based on expected credit losses.

The model is based on three stages, depending on the change in credit quality. How the impairment loss is to be measured is laid down for each individual stage and the model uses the effective interest method. A simplified approximation is permitted for financial assets that do not have a significant financing component (e.g. trade receivables). On initial recognition, expected losses are included for the first 12 months (or credit losses over the whole lifetime for trade receivables), unless the assets have to be written down.

The KLP Banken Group has launched a project aimed at establishing a new loss provisioning model that complies with the rules in IFRS 9. In connection with this, since the autumn of 2016, the bank has started using a new risk classification system which, among other things, will be used to provide input for the model. Transfer between risk classes will form the basis for migration between the levels in the impairment model. In addition, the bank will work on developing models for probability of default (PD), loss given default (LGD) and exposure at default (ED).

The new rules for the classification of financial assets and debt are not expected to have significant consequences for the Company because the classification at fair value and amortized cost can largely be continued. The Company's hedge accounting is not expected to be affected by the changeover to the new standard.

IFRS 15 *Revenue from Contracts with Customers* deals with revenue recognition. The standard calls for a division of the customer contract into the individual performance obligations. A performance obligation may be a good or service. Income is recognized when a customer obtains control over a good or service, and thus has the ability to direct the use of and obtain the benefits from the good or service. The standard replaces IAS 18 *Revenue* and IAS 11 *Construction Contracts* and associated interpretations. The Group will begin applying the standard as of 2018. The changeover to IFRS 15 is not expected to have a significant impact on the Company's accounts.

IFRS 16 *Leases* will result in almost all leases being reported on the financial position statement, as the difference between operating and financial leases has been removed. Under the new standard, the right to use a leased item is an asset and the obligation to pay rent is a liability that must be reported on the financial position statement. The exceptions are short-term leases of low value. The accounting treatment for lessors will not be significantly changed. The Company will begin applying the standard as of 2019. The changeover to IFRS 16 is not expected to have a significant impact on the Company's accounts, as the Company does not have any significant leases, owing to the fact that only small assets are leased.

There are no other IFRS standards or IFRIC interpretations not yet in force that are expected to have a significant impact on the Company's financial statements.

## 2.2 TRANSLATION OF TRANSACTIONS IN FOREIGN CURRENCY

### 2.2.1 Functional currency and presentation currency

The accounts are presented in NOK, which is the functional and presentation currency of the Company.

### 2.2.2 Transactions and financial position statement items

Transactions in foreign currency are converted to the functional currency at the transaction rate of exchange. Foreign exchange gains or losses realized on settlement and conversion of money items in foreign currency at the exchange-rate at the end of the reporting period are taken to profit/loss. Foreign exchange gains and losses are presented net on the line "Net gain/loss on financial instruments".

Translation differences on non-monetary items (assets and liabilities) are included as a part of the assessment of fair value. Foreign currency differences associated with non-monetary items, such as shares at fair value through profit or loss, are included as an element of value change recognized through profit/loss.

## 2.3 FINANCIAL ASSETS

The Company's financial assets are divided into the following categories: financial assets measured at fair value through profit or loss and financial assets measured at amortized cost. In addition, hedge accounting is used in accordance with the rules on fair value hedging. The purpose of the asset determines the classification and management undertakes classification on acquisition of the financial asset.

### 2.3.1 Financial assets at fair value through profit or loss

This category is divided into two sub-categories: held for trading, and voluntarily categorized at fair value through profit or loss on acquisition in accordance with the fair value option.

a) Financial assets held for trading are assets acquired primarily with a view to providing a profit from short-term price fluctuations. The Company's derivatives are included in this category unless they are included as an element of accounting hedging in accordance with the rules on hedge accounting.

b) Financial assets voluntarily categorized at fair value through profit or loss on acquisition comprise financial assets managed as a group and where their earnings are valued and reported to management on the basis of fair value. The size of the portfolio is decided on the basis of the Company's desired risk exposure to the interest market.

The principles for calculating the fair value of the various instruments are described in Note 6.

Gains or losses from changes in fair value of assets classified as financial assets at fair value through profit or loss are included in the income statement in the period they arise. This is included in the line "Net unrealized gain/loss financial instruments".

Coupon interest is taken to income as it accrues and is included in the line "Interest income and similar income".

### 2.3.2 Loans and receivables at amortized cost

Loans and receivables, with the exception of derivatives, are financial assets with fixed or determinable payments that are not traded in an active market or which the Company intends to sell in the short-term or has earmarked at fair value through profit or loss.

Loans and receivables are initially recognized in the financial position statement at fair value. Subsequent measurement is at amortized cost using the effective interest rate method with write-down for credit losses if appropriate.

Effective interest on loans and receivables in the investment business is taken to income and included in the line "Interest income and similar income".

### 2.3.3 Derivatives and hedging

Financial derivatives are capitalized at fair value at the time the derivative contract is struck. On subsequent measurement the derivatives are recognized at fair value and are presented as an asset if the value is positive and a liability if the value is negative. Recognition of associated gains and losses depends on whether the derivative has been identified as an accounting hedge instrument and in which type of accounting hedge the derivative is included.

For derivatives not included in accounting hedge relationships, gains and losses are recognized through profit or loss as they arise in the line for "Net gain/(loss) on financial instruments". These fall into the category of financial assets at fair value reported through profit or loss.

The derivatives which are hedging instruments are used for hedging interest rate risk on fixed-interest borrowing and lending. In its hedging activity, the Company safeguards itself against movements in market interest rates. Changes in the credit spread are not taken into account in the hedging effectiveness. The Company uses the rules on fair value hedging, so that the book value of the hedged item (asset or liability) is corrected with the value development in the hedged risk. The value change is recognized in the income statement. On entry into a hedging contract, the connection between the hedging instrument and the hedging object is documented, in addition to the purpose of the risk management and the strategy behind the different hedging transactions. The hedging effectiveness is measured regularly to ensure the hedge is effective.

If the hedging no longer fulfils the criteria for hedge accounting, the recognized effect of the hedging for hedging objects recognized at amortized cost is amortized over the period up to the due date of the hedging instrument.

### 2.3.4 Accounting treatment of financial assets

Purchases and sales of financial assets are recognized on the trading date, i.e. when the Company has committed itself to buying or selling that financial asset. Financial assets are recognized at fair value. Direct costs of purchase are included in acquisition cost except for purchase costs associated with assets at fair value through profit or loss. For these assets purchase costs are taken to expenses directly. Financial assets cease to be recognized when the Company is no longer entitled to receive the cash flow from the asset or the Company has transferred all risk and entitlements associated with its ownership. Recognition of financial liabilities ceases when the underlying obligation in the contract has been met, been cancelled or expired.

### 2.3.5 Write down of financial assets valued at amortized cost

If there is objective proof of value impairment write-down is carried out. In assessing whether there is value impairment, weight is attached to whether the issuer/debtor has significant financial difficulties and whether there is breach of contract, including default. The write-down is calculated by comparing the new, anticipated cash flows with the original cash flows discounted by the original effective interest rate (assets with fixed interest) or by the effective interest rate at the time of measurement (assets with variable interest).

Loss assessment and loss write-down is carried out quarterly on individual loans where there is objective evidence of impairment. Lending is also assessed by group. If there is objective evidence of impairment in a group of loans, write-down is carried out. The write-down is reversed if after the date of write-down events occur that reduce the loss.

#### 2.3.6 Netting
Financial assets and liabilities are presented net in the statement of financial position when there is an unconditional offsetting entitlement that can be legally enforced and the intention is to settle net, or realize the asset and liability simultaneously.

### 2.4 CASH AND CASH EQUIVALENTS
Cash and cash equivalents are defined as receivables from credit institutions without termination date. The amount does not include receivables from credit institutions that are linked to purchase and sale of securities in the management of the securities portfolios. The statement of cash flows has been prepared in accordance with the direct method.

### 2.5 FINANCIAL LIABILITIES
The Company's financial liabilities comprise liabilities to credit institutions and covered bonds issued.

#### 2.5.1 Liabilities to credit institutions
Liabilities to credit institutions are capitalized at market value on take-up. As a rule, on subsequent measurement the liability is recognized at amortized cost in accordance with the effective interest rate method. The interest costs are included in the amortization and are shown in the line "Interest costs and similar costs" in the income statement.

#### 2.5.2 Covered bonds issued
In the first instance covered bonds issued are recognized at fair value on take-up adjusted for purchase costs, i.e. nominal adjusted for any premium/discount on issue. On subsequent valuation the bonds are valued at amortized cost by the effective interest method. The interest costs are shown in the line "Interest costs and similar costs" in the income statement. Bonds with fixed interest are recognized in accordance with the rules on fair value hedging in as much as they are hedged against change in interest rate level.

### 2.6 OWNERS' EQUITY
The owners' equity in the Company comprises owners' equity contributed and retained earnings.

#### 2.6.1 Owners' equity contributed
Owners' equity contributed comprises share capital, the share premium fund and other owners' equity contribute.

#### 2.6.2 Retained earnings
Retained earnings comprise other owners' equity. Ordinary company law rules apply for any allocation or use of the retained earnings.

### 2.7 PRESENTATION OF INCOME
Income on sale of goods and services is valued at fair value of the consideration, net of deductions for VAT and any discounts.

#### 2.7.1 Income from services
Fees for lending management are taken to income in proportion to the management carried out for the period up to the end of the reporting period. Other services are taken to income by straight line over the contract period.

#### 2.7.2 Interest income/expenses
Interest income and interest expenses associated with all interest-bearing financial instruments valued at amortized cost are taken to income using the effective interest rate method. Setting-up fees for lending are included in the amortization and taken to income over the loan's duration.

For interest-bearing financial investments measured at fair value, interest income is classified as "Interest income and similar income", whereas other value changes are classified as "Net gain or loss on financial investments".

### 2.8 TAX
Tax costs in the income statement comprise tax payable and changes in deferred tax. Tax is charged to the income statement, apart from tax relating to items reported under other comprehensive income. Deferred tax and tax assets are calculated as differences between the accounting and taxation value of assets and liabilities. Deferred tax assets are capitalized to the extent it can be shown probable that the Company will have sufficient taxable profit to exploit the tax asset in the future.

The Company is not covered by the new rules on capital activity tax.

## NOTE 3 Important accounting estimates and valuations

The Company's balance sheet principally comprises loans to local government and enterprises with local government guarantee, as well as covered bonds issued. These items are valued in the accounts at amortized cost, with the exception of borrowing and lending with fixed interest rates which are valued at fair value in accordance with the rules on fair value hedging. This means that the accounting value of the hedging object (fixed interest borrowing and lending) is changed when the market interest rate changes. The credit spread is locked at the commencement date, so the market's pricing of credit is not reflected in book value. This is because the credit element is not hedged.

The risk of credit loss is considered very low and there is very little probability credit loss will occur in the local government lending portfolio.

During the year the Company has invested surplus liquidity in fixed-income securities. These were initially recognized in the statement of financial position at fair value. The securities in the portfolio are classified in the category "financial assets at fair value through profit or loss" as they are managed, and their earnings are valued on the basis of fair value. The principles for calculating the fair value of the various instruments are described in Note 6.

## NOTE 4 Segment information

KLP Kommunekreditt has no division of its income by products or services. The Company has only the public sector market segment and offers only loans to its customers. The Company has only Norwegian customers. The Company has no external customers representing more than 10 per cent of the Company's total operating income.

## NOTE 5 Net gain/(loss) on financial instruments

| NOK THOUSANDS | 01.01.2016 -31.12.2016 | 01.01.2015 -31.12.2015 |
|---|---|---|
| Net gain/(loss) on fixed-income securities | 15 320 | -27 160 |
| Net gain/(loss) financial derivatives and realized amortization linked to lending | 1 867 | 2 470 |
| Net gain/(loss) financial derivatives and realized repurchase of own debt | -13 118 | -5 051 |
| **Total** | **4 070** | **-29 742** |

## **NOTE 6** Categories of financial instruments

| | 31.12.2016 | | 31.12.2015 | |
|---|---|---|---|---|
| NOK THOUSANDS | Book value | Fair value | Book value | Fair value |
| **FINANCIAL ASSETS AT FAIR VALUE HELD FOR TRADING** | | | | |
| Fixed-income securities | 1 723 589 | 1 723 589 | 3 133 684 | 3 133 684 |
| **Total financial assets at fair value held for trading** | **1 723 589** | **1 723 589** | **3 133 684** | **3 133 684** |
| **FINANCIAL ASSETS AT FAIR VALUE USED FOR HEDGING** | | | | |
| Financial derivatives | 107 927 | 107 927 | 122 900 | 122 900 |
| Lending to Norwegian municipalities | 5 164 845 | 5 186 458 | 5 558 168 | 5 526 008 |
| **Total financial assets at fair value used for hedging** | **5 272 772** | **5 294 385** | **5 681 068** | **5 648 908** |
| **FINANCIAL ASSETS AT AMORTIZED COST** | | | | |
| Loans to and receivables from credit institutions | 414 803 | 414 803 | 443 481 | 443 481 |
| Lending to Norwegian municipalities | 12 081 008 | 12 071 700 | 10 088 101 | 10 080 287 |
| **Total financial assets at amortized cost** | **12 495 811** | **12 486 503** | **10 531 582** | **10 523 768** |
| **Total financial assets** | **19 492 172** | **19 504 477** | **19 346 334** | **19 306 361** |
| **FINANCIAL LIABILITIES AT FAIR VALUE USED FOR HEDGING** | | | | |
| Covered bonds issued | 1 744 658 | 1 748 349 | 1 509 154 | 1 501 873 |
| Financial derivatives | 240 602 | 240 602 | 345 305 | 345 305 |
| **Total financial liabilities at fair value used for hedging** | **1 985 260** | **1 988 951** | **1 854 459** | **1 847 178** |
| **FINANCIAL LIABILITIES AT AMORTIZED COST** | | | | |
| Liabilities to credit institutions | 1 170 823 | 1 170 823 | 2 181 927 | 2 181 927 |
| Covered bonds issued | 15 597 884 | 15 980 849 | 14 605 743 | 14 549 701 |
| **Total financial liabilities at amortized cost** | **16 768 707** | **17 151 672** | **16 787 670** | **16 731 628** |
| **Total financial liabilities** | **18 753 967** | **19 140 623** | **18 642 128** | **18 578 805** |

Fair value should be a representative price based on what a corresponding asset or liability would have been traded for at normal market terms and conditions. A financial instrument is considered as listed in an active market if listed prices are simply and regularly available from a stock market, dealer, broker, industry group, price-setting service or regulatory authority, and these prices represent actual and regularly occurring transactions at arm's length. If the market for the security is not active, or the security is not listed on a stock market or similar, the Group uses valuation techniques to set fair value. These are based for example on information on recently completed transactions carried out on business terms and conditions, reference to trading in similar instruments and pricing using externally collected yield curves and yield spread curves. As far as possible the estimates are based on externally observable market data and rarely on company-specific information.

### THE DIFFERENT FINANCIAL INSTRUMENTS ARE THUS PRICED IN THE FOLLOWING WAY:

**Fixed-income securities - government**
Bloomberg is used as a source for pricing Norwegian government bonds. It is Oslo Børs (Oslo Stock Exchange) that provides the price (via Bloomberg). The prices are compared with the prices from Reuters to reveal any errors.

**Fixed-income securities - other than government**
Norwegian fixed-income securities except government are generally priced using prices from Nordic Bond Pricing. Those securities that are not included in Nordic Bond Pricing are priced theoretically. In theoretical price is based on the assumed present value on the sale of the position. A zero-coupon curve is used for discounting. The zero-coupon curve is asjusted upwards by means of a credit spread, which is to take account of the risk the bond entails. The credit

## NOTE 6 Categories of financial instruments - continued

spread is calculated on the basis of a spread curve taking account of the duration of the bond. Nordic Bond Pricing is the mainsource of spread curves. They provide company-specific curves for Norwegian saving banks, municipalities and energy. Saving banks have various spread curves based on total assets. For companies where Nordic Bond Pricing do not deliver spread curves, the Group use spread curves from three Norwegian banks. When spread curves are available from more than one of these banks, an equal-weighted average is used.

### Financial derivatives

Interest rate swaps are valued based on the applicable swap curve at the time of valuation. Derivative contracts are to be used only to hedge balance amounts and to enable payments obligations to be met. Derivative contracts may be struck only with counterparties with high credit quality.

### Fair value of loans to Norwegian local government

Fair value of lending without fixed interest rates is considered virtually the same as book value since the contract terms are continuously changed in step with market interest rates. Fair value of fixedrate loans is calculated by discounting contracual cash flows by the marked rate including a relevant riskmargin on the reporting date.

### Fair value of liabilities to credit institutions

These transactions are valued using a valuation model, including relevant credit spread adjustments obtained from the market.

### Liabilities created on issuance of covered bonds

Fair value in this category is determined on the basis of internal valuation models based on external observable data.

## NOTE 7 Fair value hierarchy

| 31.12.2016<br>NOK THOUSANDS | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| ASSETS | | | | |
| FINANCIAL ASSETS RECOGNIZED AT FAIR VALUE | | | | |
| Fixed-income securities | 49 884 | 1 673 705 | 0 | 1 723 589 |
| Financial derivatives | 0 | 107 927 | 0 | 107 927 |
| **Total financial assets recognized at fair value** | **49 884** | **1 781 632** | **0** | **1 831 516** |
| Financial assets recognized at fair value in Note 6: | | | | |
| Lending to Norwegian municipalities | 0 | 5 186 458 | 0 | 5 186 458 |
| **Total financial assets at fair value used for hedging** | **0** | **5 186 458** | **0** | **5 186 458** |
| Loans to and receivables from credit institutions | 0 | 414 803 | 0 | 414 803 |
| Lending to Norwegian municipalities | 0 | 12 071 700 | 0 | 12 071 700 |
| **Total financial assets at amortized cost** | **0** | **12 486 503** | **0** | **12 486 503** |
| LIABILITIES | | | | |
| FINANCIAL LIABILITIES RECOGNIZED AT FAIR VALUE | | | | |
| Financial derivatives (liabilities) | 0 | 240 602 | 0 | 240 602 |
| **Total financial derivatives recognized at fair value** | **0** | **240 602** | **0** | **240 602** |
| Financial liabilities recognized at fair value in Note 6: | | | | |
| Covered bonds issued | 0 | 1 748 349 | 0 | 1 748 349 |
| **Total financial liabilities at fair value used for hedging** | **0** | **1 748 349** | **0** | **1 748 349** |
| Liabilities to credit institutions | 0 | 1 170 823 | 0 | 1 170 823 |
| Covered bonds issued | 0 | 15 980 849 | 0 | 15 980 849 |
| **Total financial liabilities at amortized cost** | **0** | **17 151 672** | **0** | **17 151 672** |

## **NOTE 7** Fair value hierarchy - continued

| 31.12.2015<br>NOK THOUSANDS | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| ASSETS | | | | |
| FINANCIAL ASSETS RECOGNIZED AT FAIR VALUE | | | | |
| Fixed-income securities | 0 | 3 133 684 | 0 | 3 133 684 |
| Financial derivatives | 0 | 122 900 | 0 | 122 900 |
| **Total financial assets recognized at fair value** | **0** | **3 256 584** | **0** | **3 256 584** |
| Financial assets recognized at fair value in Note 6: | | | | |
| Lending to Norwegian municipalities | 0 | 5 526 008 | 0 | 5 526 008 |
| **Total financial assets at fair value used for hedging** | **0** | **5 526 008** | **0** | **5 526 008** |
| Loans to and receivables from credit institutions | 0 | 443 481 | 0 | 443 481 |
| Lending to Norwegian municipalities | 0 | 10 080 287 | 0 | 10 080 287 |
| **Total financial assets at amortized cost** | **0** | **10 523 768** | **0** | **10 523 768** |
| LIABILITIES | | | | |
| FINANCIAL LIABILITIES RECOGNIZED AT FAIR VALUE | | | | |
| Financial derivatives (liabilities) | 0 | 345 305 | 0 | 345 305 |
| **Total financial derivatives recognized at fair value** | **0** | **345 305** | **0** | **345 305** |
| Financial liabilities recognized at fair value in Note 6: | | | | |
| Covered bonds issued | 0 | 1 501 873 | 0 | 1 501 873 |
| **Total financial liabilities at fair value used for hedging** | **0** | **1 501 873** | **0** | **1 501 873** |
| Liabilities to credit institutions | 0 | 2 181 927 | 0 | 2 181 927 |
| Covered bonds issued | 0 | 14 549 701 | 0 | 14 549 701 |
| **Total financial liabilities at amortized cost** | **0** | **16 731 628** | **0** | **16 731 628** |

Fair value should be a representative price based on what a corresponding asset or liability would have been traded for at normal market terms and conditions. Highest quality in regard to fair value is based on listed prices in an active market. A financial instrument is considered as listed in an active market if listed prices are simply and regularly available from a stock market, dealer, broker, industry group, price-setting service or regulatory authority, and these prices represent actual and regularly occurring transactions at arm's length.

**Level 1:**
Instruments in this level obtain fair value from listed prices in an active market for identical assets or liabilities that the entity has access to at the reporting date. Example instruments at Level 1 are stock market listed securities.

**Level 2:**
Instruments in this level obtain fair value from observable market data. This includes prices based on identical instruments, but where the instrument does not maintain a high enough trading frequency and is not therefore considered to be traded in an active market, as well as prices based on corresponding assets and price-leading indicators that can be confirmed from market information. Example instruments at Level 2 are fixed-income securities priced on the basis of interest rate paths.

**Level 3:**
Instruments at Level 3 contain non-observable market data or are traded in markets considered to be inactive. The price is based generally on discrete calculations where the actual fair value may deviate if the instrument were to be traded.

There has been no movement between the levels.

## NOTE 8 Fixed-income securities

| NOK THOUSANDS | | | | 31.12.2016 |
|---|---|---|---|---|
| **Debtor categories** | **Acquisition cost** | **Unreal. gain/loss** | **Accr. int. not due** | **Market value** |
| Government/social security administration | 49 883 | 1 | 0 | 49 884 |
| Credit enterprises | 1 561 494 | 3 285 | 3 020 | 1 567 799 |
| Local government administration | 98 050 | 7 427 | 429 | 105 906 |
| **Total** | **1 709 427** | **10 713** | **3 449** | **1 723 589** |

Effective interest rate: 1.45%

| NOK THOUSANDS | | | | 31.12.2015 |
|---|---|---|---|---|
| **Debtor categories** | **Acquisition cost** | **Unreal. gain/loss** | **Accr. int. not due** | **Market value** |
| Credit enterprises | 2 236 739 | -12 488 | 3 798 | 2 228 049 |
| Local government administration | 843 637 | 10 087 | 2 117 | 855 841 |
| Multilateral development banks (not banks) | 50 265 | -532 | 61 | 49 794 |
| **Total** | **3 130 641** | **-2 933** | **5 976** | **3 133 684** |

Effective interest rate: 1.72%

Effective interest is calculated as a yield-to-maturity, i.e. it is the constant interest rate level at which one may discount all the future cash flows from the securities to obtain the securities' total market value.

## NOTE 9 Financial derivatives

| | 31.12.2016 | | 31.12.2015 | |
|---|---|---|---|---|
| NOK THOUSANDS | Nominal amount | Fair value | Nominal amount | Fair value |
| Borrowing in NOK | 1 065 000 | 84 670 | 1 385 000 | 122 895 |
| Borrowing in currency | 0 | 0 | 0 | 0 |
| Lending | 1 292 583 | 23 257 | 100 000 | 5 |
| **Total assets** | **2 357 583** | **107 927** | **1 485 000** | **122 900** |
| Borrowing in NOK | 600 000 | -7 930 | 0 | 0 |
| Borrowing in currency | 0 | 0 | 0 | 0 |
| Lending | 3 901 602 | -227 265 | 4 992 761 | -336 553 |
| Investments | 100 000 | -5 408 | 100 000 | -8 752 |
| **Total liabilities** | **4 601 602** | **-240 602** | **5 092 761** | **-345 305** |

Interest rate agreements are used to correct for imbalances between the Company's lending and borrowing in regard to interest rate exposure. All the agreements entered into are hedging transactions. The value change from the effective part of the hedging instrument is compared with the value change for the hedged risk of the hedged objects.

Interest rate swaps are agreements on exchange of interest rate terms in a future period. They do not cover exchange of principal.

## NOTE 10 Net interest income

| NOK THOUSANDS | 01.01.2016 -31.12.2016 | 01.01.2015 -31.12.2015 |
|---|---|---|
| Interest on loans to and receivables from credit institutions | 4 214 | 6 702 |
| Interest on lending to customers | 387 482 | 430 665 |
| Interest on securities | 45 869 | 48 267 |
| **Total interest income** | **437 565** | **485 634** |
| Interest on debt to KLP Banken AS | -332 186 | -48 269 |
| Interest on debt to credit institutions | -37 215 | -368 152 |
| Amortization of premium/discount on covered bonds | -129 | 636 |
| **Total interest costs** | **-369 530** | **-415 784** |
| **Net interest income** | **68 035** | **69 850** |

## NOTE 11 Lending and receivables

| NOK THOUSANDS | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **LOANS TO AND RECEIVABLES FROM CREDIT INSTITUTIONS** | | |
| Bank deposits | 414 803 | 443 481 |
| **Loans to and receivables from credit institutions** | **414 803** | **443 481** |
| **LOANS TO AND RECEIVABLES FROM CUSTOMERS** | | |
| Principal on lending | 17 006 131 | 15 284 970 |
| Fair value hedging | 186 640 | 313 225 |
| Premium/discount | -19 032 | -22 857 |
| Accrued interest | 72 115 | 70 931 |
| **Loans to and receivables from customers** | **17 245 853** | **15 646 269** |

All lending comprises loans to, or loans guaranteed by, Norwegian municipalities and county administrations, including loans to local government enterprises and intermunicipal companies (public sector loans). Guarantees are of the ordinary guarantor type covering both repayments and interest.

## NOTE 12 Financial risk management

**Organisation of risk management**
KLP Kommunekreditt AS is a wholly owned subsidiary of KLP Banken AS. The Board of Directors has established a risk management framework aimed at ensuring that risks are identified, analysed and subjected to management using policies, limits, procedures and instructions. The Board has adopted risk policies covering the key individual risks as well as an overarching risk policy that covers principles, organisation, limits etc. for the bank's total risk. The risk policies are of an overarching nature and are complemented by procedures, guidelines and instructions laid down at the senior management level. The policies state which departments are responsible for handling the various risks and also cover the establishment of a separate risk control function. One purpose of the risk control function is to check that the risk policies and other guidelines for risk management are being followed. This function is carried out by the Risk Analysis and Control Department, which is responsible for preparing periodic risk reports to senior management and the Board as well is reporting in the event of breaches of policies or guidelines. The Department, which has an independent role in relation to other departments, also has other tasks associated with the Company's risk management. The responsibility for the operational direction of the Company's liquidity risk, exchange-rate risk and interest rate risk lies with the Finance Department. KLP Banken has established a risk committee, which is a sub-committee of the Board. The risk committee deals with matters specifically related to risk and has an advisory function to the Board.

## NOTE 13 Credit risk

Credit risk is understood here to mean the risk of loss associated with loan customers, counterparties in derivatives, issuers of securities and other counterparties being unable or unwilling to settle at the agreed time and in accordance with written contracts, and the securities established not covering the outstanding demand.

KLP Kommunekreditt AS provides loans to, or loans guaranteed by, Norwegian municipalities and county authorities, including loans to local government enterprises and inter-authority companies (public sector loans). Guarantees are payable on demand.

**13.1 Control and limitation of credit risk**
The Board has determined a credit policy that contains overarching guidelines, requirements and limits associated with credit risk. The policy lays down that the bank is to have a low credit risk profile and includes limits on types of lending and principles for organisation and operation of the Company's lending activity. The policy also includes an overall mandate structure for lending and other counterparty exposure. The mandates are linked to Board-determined limits for a large number of the Company's individual borrowers and these limits derive from a risk classification in which the individual borrowers are assigned a risk class based on a set of fixed criteria. Furthermore requirements are set for reporting to the Board on usage of the limits.

Credit risk associated with issuers of securities, derivative counterparties and other counterparties in the financial area is also limited by Board-determined limits on individual counterparties. These limits are based on the counterparty's

## NOTE 13 Credit risk - continued

solvency and other assessments of the counterparties' creditworthiness.

In processing all new loan applications checks are made on whether the customer's credit limits are larger than the total of the loan amounts applied for and current lending. In the credit policy described above, requirements are set for reporting to the Board on usage of the limits. Any exceeding of the limits is to be reported to the Company's Board regardless.

### 13.2 Loans according to type of security/exposure (principal)

| NOK THOUSANDS | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Lending to municipalities and county administrations | 14 637 875 | 13 274 548 |
| Lending with municipal/county administration guarantee | 2 368 255 | 2 010 422 |
| **Total** | **17 006 131** | **15 284 970** |
| Sums falling due more than 12 months after the end of the reporting period | 16 092 557 | 14 422 372 |

The Company also invests in securities issued by municipalities and county administrations and will in addition have credit risk exposure in the form of "additional collateral". In accordance with the Company's internal guidelines the additional collateral may be in the form of deposits in banks satisfying minimum rating requirements as well as covered bonds issued by Norwegian credit enterprises.

### Credit quality of securities, bank, deposits and derivates

Securities with external credit rating (Moody's)

| NOK THOUSANDS | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **AAA** | **1 709 000** | **2 379 000** |

Securities without external credit assessment

| NOK THOUSANDS | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **Securities issued by Norwegian municipalities/county administrations** | **0** | **745 445** |

Deposits in banks grouped by external credit assessment (Moody's)

| NOK THOUSANDS | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Aa1-Aa3 | 197 806 | 229 481 |
| A1-A3 | 216 997 | 214 000 |
| Baa1 | - | - |
| **Total** | **414 803** | **443 481** |

## NOTE 13 Credit risk - continued

The Company may also be exposed to credit risk as a result of derivative agreements struck. The purpose of such agreements is to reduce risks arising as a result of the Company's borrowing and lending activities. The Company's internal guidelines specify creditworthiness requirements for derivative counterparties. All derivative agreements are entered into with counterparties with a minimum A1 rating (Moody's).

### 13.3 Maximum exposure to credit risk

KLP Kommunekreditt AS measures maximum exposure as principal and accrued interest. Security in cash or securities is not exchanged, nor are other credit improvements carried out. The table below shows the maximum exposure for KLP Kommunekreditt AS.

Maximum exposure to credit risk

| NOK THOUSANDS | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Loans to and receivables from credit institutions | 414 803 | 443 481 |
| Loans to and receivables from customers | 17 078 246 | 15 355 901 |
| Fixed-income securities | 1 723 589 | 3 136 616 |
| Financial derivatives | 107 927 | 122 900 |
| **TOTAL** | **19 324 565** | **19 058 898** |

### 13.4 Loans fallen due or written down

The Company has not incurred losses on lending. The company considers all receivables to be satisfactorily secured.

Loans fallen due or written down

| NOK THOUSANDS | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Principal on loans with payments with 7-30 days' default | 28 331 | 287 199 |
| Principal on loans with payments with 31-90 days' default | 49 391 | 0 |
| Principal on loans with payments with more than 90 days' default | 0 | 0 |
| **Total loans fallen due** | **77 722** | **287 199** |
| Relevant security or guarantees | 77 722 | 287 199 |
| Lending that has been written down | - | - |

### 13.5 Concentration of credit risk

The Company's lending is in its entirety linked to public sector financing and the portfolio thus has high concentration against one single sector. The underlying credit risk against this sector is however so low that it is hardly possible to reduce this concentration without increasing total risk in the portfolio. The concentration against the Norwegian public sector is thus considered not to be a risk challenge.

The concentration against individual borrowers is limited by individual Board-set limits. KLP Kommunekreditt AS's largest exposure as at 31 December 2016 was about 3.6 per cent of the Company's total lending.

## NOTE 14 Market risk

Market risk is understood here as the risk of reduced fair value of the Company's owners' equity as a result of fluctuations in market prices for the Company's assets and liabilities. Changes in credit margins are however excluded since this comes under the term credit risk.

KLP Kommunekreditt AS is exposed to market risk as a result of the Company's borrowing and lending activity and management of the Company's liquidity. The exposure is however limited to interest rate risk and exchange rate risk. Interest rate risk arises as a result of differences in timing of interest rate adjustment for the Company's assets and liabilities. The risk associated with such imbalances is reduced by using derivative contracts. All borrowing is in Norwegian kroner. The whole of the lending portfolio comprises loans in NOK.

### Note 14.1 Measurement of market risk

Interest rate risk is measured as change in value on a one percentage point change in all interest rates. Exchange rate risk is measured as change in value on 10% unfavourable exchange rate change in all currencies.

### Note 14.2 Interest rate risk

The market risk policy is the Company's overarching guidelines, requirements and limits associated with market risk. The policy dictates that the market risk should be minimized so that the total market risk is low. It further states that the Company should not actively take positions that expose the Company to market risk. The policy also sets limits for interest rate risk both for the total interest rate risk for the infinite future and for rolling 12-month periods. The limits are set in relation to the Company's Tier 1 and 2 capital and the level of the limits should ensure that the low market risk profile policy is complied with. The operational responsibility for managing the Company's market risk lies with the Finance Department. The Risk Analysis and Control Department reports the Company's actual exposure in relation to limits in accordance with guidelines set by the Board.

Interest rate risk arises because the fixed interest periods for assets and liabilities are not the same. The gap in the table below shows the difference between assets and liabilities that can be interest-adjusted within the given time intervals. The repricing date shows the time to the next agreed interest adjustment date. Floating-rate loans and cash, and receivables from credit institutions, fall into the time interval up to one month, while fixed-interest loans, securities and debt fall into the time interval for which interest adjustment has been agreed.

### Interest-rate risk KLP Kommunekreditt AS

Repricing dates for interest-bearing assets and liabilities as at 31 December 2016

| NOK THOUSANDS | Total Principal | Up to 1 month | From 1 mth to 3 mths | From 3 mths to 12 mths | From 1 year to 5 years | Over 5 years |
|---|---|---|---|---|---|---|
| Lending | 17 006 131 | 12 201 466 | 75 847 | 704 917 | 3 071 540 | 952 361 |
| Securities | 1 709 000 | 394 000 | 1 165 000 | 50 000 | 100 000 | 0 |
| Cash and receivables from credit institutions | 414 803 | 414 803 | 0 | 0 | 0 | 0 |
| **Total** | **19 129 934** | **13 010 269** | **1 240 847** | **754 917** | **3 171 540** | **952 361** |
| Liabilities created on issuance of securities | 17 230 000 | 4 000 000 | 11 565 000 | 315 000 | 1 350 000 | 0 |
| Liabilities to financial institutions | 1 170 000 | 1 170 000 | 0 | 0 | 0 | 0 |
| **Total** | **18 400 000** | **5 170 000** | **11 565 000** | **315 000** | **1 350 000** | **0** |
| **Gap** | **729 934** | **7 840 269** | **-10 324 153** | **439 917** | **1 821 540** | **952 361** |
| Financial derivatives | 0 | 191 365 | 3 227 053 | -439 770 | -1 748 843 | -1 229 806 |
| **Net gap** | **729 934** | **8 031 635** | **-7 097 100** | **147** | **72 697** | **-277 445** |

## NOTE 14 Market risk - continued

Repricing dates for interest-bearing assets and liabilities as at 31 December 2015

| NOK THOUSANDS | Total Principal | Up to 1 month | From 1 mth to 3 mths | From 3 mths to 12 mths | From 1 year to 5 years | Over 5 years |
|---|---|---|---|---|---|---|
| Lending | 15 284 970 | 10 607 278 | 37 356 | 850 527 | 2 403 725 | 1 386 084 |
| Securities | 3 124 445 | 300 000 | 1 979 000 | 745 445 | 100 000 | 0 |
| Cash and receivables from credit institutions | 443 481 | 443 481 | 0 | 0 | 0 | 0 |
| **Total** | **18 852 896** | **11 350 759** | **2 016 356** | **1 595 972** | **2 503 725** | **1 386 084** |
| Liabilities created on issuance of securities | 16 055 000 | 170 000 | 14 500 000 | 0 | 1 385 000 | 0 |
| Liabilities to financial institutions | 2 180 000 | 2 180 000 | 0 | 0 | 0 | 0 |
| **Total** | **18 235 000** | **2 350 000** | **14 500 000** | **0** | **1 385 000** | **0** |
| **Gap** | **617 896** | **9 000 759** | **-12 483 644** | **1 595 972** | **1 118 725** | **1 386 084** |
| Financial derivatives | 0 | 542 547 | 2 807 984 | -756 818 | -889 212 | -1 704 501 |
| **Net gap** | **617 896** | **9 543 306** | **-9 675 660** | **839 154** | **229 513** | **-318 417** |

The Company's interest rate sensitivity as at 31 December 2016, measured as value change in the event of one percentage point change in all interest rates, was NOK 6.3 million.

### 14.3 Exchange rate risk

As at 31 December 2016 the Company had no borrowing in foreign currency.

## NOTE 15 Liquidity risk

Liquidity risk means the risk that the Company does not manage to meet its obligations and/or finance increases in its assets without substantial additional costs arising in the form of price falls in assets that must be realized, or in the form of more costly financing.

### Note 15.1 Management of liquidity risk

The management of KLP Kommunekreditt's liquidity risk must be viewed in the context of the management of the liquidity risk in the KLP Banken Group. A liquidity policy is established for the Group containing principles, guidelines, requirements and limits that apply to the management of the liquidity risk. The policy states that the Group is to have a moderate liquidity risk profile and various requirements and limits have been set to achieve this, including targets for deposit cover, limits for refinancing requirements for various time periods and requirements for liquidity buffers. The Board has further adopted an emergency plan for liquidity crises as part of the liquidity policy. In addition to the requirements at Group level, separate specific requirements have been established for KLP Kommunekreditt AS, including requirements for continually positive cash flows, limits for refinancing requirements and requirements for liquidity reserves and drawing rights. The operational responsibility for managing the Company's liquidity risk lies with the Finance Department. The Risk Analysis and Control Department reports the Company's actual exposure in relation to limits in accordance with guidelines set by the Board.

## NOTE 15 Liquidity risk - continued

**Note 15.2 Maturity analysis**

The tables below show the maturity analysis of the Company's assets and liabilities including stipulated interest rates.

### Liquidity risk KLP Kommunekreditt AS

Maturity analysis for assets and liabilities as at 31 December 2016

| NOK THOUSANDS | Total | Undefined | Up to 1 mth | From 1 mth to 3 mths | From 3 mths to 12 mths | From 1 year to 5 years | Over 5 years |
|---|---|---|---|---|---|---|---|
| Lending | 21 648 076 | 0 | 55 400 | 282 615 | 878 208 | 4 661 789 | 15 770 064 |
| Securities | 1 772 455 | 0 | 1 465 | 4 815 | 402 821 | 1 363 355 | 0 |
| Receivables from credit institutions | 414 803 | 0 | 414 803 | 0 | 0 | 0 | 0 |
| **Total** | **23 835 334** | **0** | **471 668** | **287 430** | **1 281 029** | **6 025 144** | **15 770 064** |
| Liabilities created on issuance of securities | 18 152 471 | 0 | 26 847 | 31 800 | 1 138 949 | 16 954 875 | 0 |
| Financial derivatives | 171 265 | 0 | 3 363 | 11 630 | 33 554 | 109 040 | 13 677 |
| Liabilities to credit institutions | 1 205 980 | 0 | 1 598 | 2 809 | 14 673 | 1 186 900 | 0 |
| **Total** | **19 529 716** | **0** | **31 808** | **46 239** | **1 187 176** | **18 250 816** | **13 677** |
| **Net cash flow** | **4 305 618** | **0** | **439 860** | **241 191** | **93 853** | **-12 225 672** | **15 756 387** |

Maturity analysis for assets and liabilities as at 31 December 2015

| NOK THOUSANDS | Total | Undefined | Up to 1 mth | From 1 mth to 3 mths | From 3 mths to 12 mths | From 1 year to 5 years | Over 5 years |
|---|---|---|---|---|---|---|---|
| Lending | 19 755 998 | 0 | 57 181 | 184 518 | 1 004 673 | 4 354 051 | 14 155 575 |
| Securities | 3 262 393 | 0 | 1 104 | 8 475 | 936 873 | 2 265 216 | 50 725 |
| Receivables from credit institutions | 443 481 | 0 | 443 481 | 0 | 0 | 0 | 0 |
| **Total** | **23 461 872** | **0** | **501 766** | **192 993** | **1 941 546** | **6 619 267** | **14 206 300** |
| Liabilities created on issuance of securities | 16 719 110 | 0 | 656 | 51 991 | 2 327 383 | 14 339 080 | 0 |
| Financial derivatives | 224 794 | 0 | 5 200 | 14 081 | 48 730 | 115 604 | 41 179 |
| Liabilities to credit institutions | 2 190 558 | 0 | 3 653 | 2 186 905 | 0 | 0 | 0 |
| **Total** | **19 134 462** | **0** | **9 509** | **2 252 977** | **2 376 113** | **14 454 684** | **41 179** |
| **Net cash flow** | **4 327 410** | **0** | **492 257** | **-2 059 984** | **-434 567** | **-7 835 417** | **14 165 121** |

A 15-month internal loan of NOK 1,170,000 has been provided from KLP Banken AS to KLP Kommunekreditt AS, which is defined as "Liabilities to credit institutions". This loan is rolled over currently every third month and the interest rate is set each month.

## **NOTE 16** Salary and obligations to senior management

| 2016 NOK THOUSANDS | Paid from KLP Kommunekreditt AS | | | | Paid from another company in the same group | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Salaries, fees etc. | Other benefits | Annual pension accumulation | Loans | Salaries, fees etc. | Other benefits | Annual pension accumulation | Loans | Interest rate as at 31.12.2016 | Repayment plan[1] |
| **Senior employees** | | | | | | | | | | |
| Christopher A. Steen, Managing Director to Noveber 24th[2,4] | - | - | - | - | 886 | 17 | 159 | 2 899 | 1.95-2.20 | A31/42 |
| Carl Steinar Lous, Managing Director from November 24th[4] | - | - | - | - | 354 | 103 | 90 | 2 535 | 1.95 | A31 |
| **Board of Directors** | | | | | | | | | | |
| Sverre Thornes, Chair | - | - | - | - | 3 807 | 206 | 1 413 | 11 840 | 1.95-2.35 | A46 |
| Aage E. Schaanning | - | - | - | - | 3 338 | 164 | 1 193 | 5 680 | 1.95 | HC |
| Toril Lahnstein | 72 | - | - | - | - | - | - | - | - | - |
| Eva M. Salvesen | 22 | - | - | - | 130 | - | - | - | - | - |
| **Employees** | | | | | | | | | | |
| Total loans to employees of KLP Kommunekreditt | | | | | | | | 5 434 | - | - |

| 2015 NOK THOUSANDS | Paid from KLP Kommunekreditt AS | | | | Paid from another company in the same group | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Salaries, fees etc. | Other benefits | Annual pension accumulation | Loans | Salaries, fees etc. | Other benefits | Annual pension accumulation | Loans | Interest rate as at 31.12.2015 | Repayment plan[1] |
| **Senior employees** | | | | | | | | | | |
| Arnulf Arnøy, Managing Director to mid-October[2,3] | - | - | - | - | 1 161 | 86 | 430 | 919 | 2.25 | A28 |
| Christopher A. Steen, Managing Director from mid-October[3] | - | - | - | - | 237 | 5 | 52 | 2 939 | 2.25-2.45 | A34/A42 |
| **Board of Directors** | | | | | | | | | | |
| Sverre Thornes, Chair | - | - | - | - | 3 694 | 167 | 1 509 | 10 017 | 2.25 | A45 |
| Aage E. Schaanning | - | - | - | - | 3 264 | 150 | 1 301 | 3 127 | 2.25-2.45 | A22/A23 |
| Toril Lahnstein | 70 | - | - | - | - | - | - | - | - | - |
| Eva M. Salvesen | 21 | - | - | - | 137 | - | - | - | - | - |
| **Employees** | | | | | | | | | | |
| Total loans to employees of KLP Kommunekreditt | | | | | | | | 3 858 | - | - |

1) S= Serial loan, A= Annuity loan, last payment, HC=Home Credit.
2) The individual has stepped down from the appointment during the year.
3) Benefits are shown for the period in which each person held the position of Managing Director of KLP Kommunekreditt.
4) Benefits are shown for the period in which Mr Carl Steinar Lous was employed as Department Manager public market in the KLP Banken, 1 October .

The KLP Board of Directors has laid down principles and guide-lines for remuneration that apply for the entire Group and set up a remuneration committee as a subcommittee of the Board. The committee reports on and carries out checks that the remuneration schemes in the Group are in line with the Board's principles and guidelines.

Managing director is a contracted-in function from the parent company, KLP Banken AS, and the individual receives no benefits directly from KLP Kommunekreditt AS for the appointment (this applies to both the old and new Managing Directors). KLP Kommunekreditt AS refunds that part of the benefits associated with the role as managing director. The Managing Director has no agreement on performance pay (bonus) or guaranteed salary on termination. He is pensionable aged 70.

There are no obligations to provide the Chair of the Board of Directors special consideration or other benefits on termination or change in employment contract or appointment.

Directors' fees are set by the General Assembly. Board members employed in the KLP Group, not having been elected by and from the employees, do not receive a fee for the Board appointment. Benefits in addition to Directors' fees for Board members employed in the KLP Group are stated only if they are included in the senior management group employed in the KLP Group. This also applies to any loans they may have with the Group.

All benefits are shown without the addition of social security costs.

Attention is drawn otherwise to the description of the main principles on determination of remuneration in the KLP Group that may be found at www.klp.no.

## NOTE 17 Liabilities to credit institutions

| 31.12.2016 NOK THOUSANDS | Currency | Interest | Due date | Nominal | Accrued interest | Book value |
|---|---|---|---|---|---|---|
| Debt to KLP Banken AS | NOK | Fixed | 15.03.2018 | 1 170 000 | 824 | 1 170 823 |
| **Total liabilities to credit institutions** | | | | **1 170 000** | **824** | **1 170 823** |
| **Interest rate on debt to credit institutions at the reporting date** | | | | | | **1.49 %** |

The interest rate is calculated as a weighted average of the act/360 basis.

| 31.12.2015 NOK THOUSANDS | Currency | Interest | Due date | Nominal | Accrued interest | Book value |
|---|---|---|---|---|---|---|
| Debt to KLP Banken AS | NOK | Fixed | 16.03.2016 | 2 180 000 | 1 927 | 2 181 927 |
| **Total liabilities to credit institutions** | | | | **2 180 000** | **1 927** | **2 181 927** |
| **Interest rate on debt to credit institutions at the reporting date** | | | | | | **1.90 %** |

The interest rate is calculated as a weighted average of the act/360 basis.

## NOTE 18 Securities liabilities - stock exchange listed covered bonds

| NOK THOUSANDS | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Bonds, nominal value | 19 985 000 | 16 055 000 |
| Revaluations | 67 646 | 106 565 |
| Accrued interest | 44 896 | 33 332 |
| Own funds, nominal value | -2 755 000 | -80 000 |
| **Total liabilities created on issuance of securities** | **17 342 542** | **16 114 897** |
| **Interest rate on borrowings through the issuance of securities at the reporting date.** | **1.52 %** | **1.45 %** |

The interest rate is calculated as a weighted average of the act/360 basis. It includes interest rate hedges and amortization costs.

| NOK THOUSANDS | Balance 31.12.2016 | Issued | Fallen due/ redeemed Repurchased | Others changes | Balance 31.12.2015 |
|---|---|---|---|---|---|
| **CHANGE IN LIABILITIES CREATED ON ISSUANCE OF SECURITIES** | | | | | |
| Bonds, nominal value | 19 985 000 | 7 100 000 | -3 170 000 | 0 | 16 055 000 |
| Revaluations | 67 646 | 0 | 0 | -38 919 | 106 565 |
| Accrued interest | 44 896 | 0 | 0 | 11 564 | 33 332 |
| Own funds, nominal value | -2 755 000 | 0 | -2 675 000 | 0 | -80 000 |
| **Total liabilities created on issuance of securities** | **17 342 542** | **7 100 000** | **-5 845 000** | **-27 355** | **16 114 897** |

## NOTE 19 Presentation of assets and liabilities subject to net settlement

| 31.12.2016 | | | | Related sums that are not presented net | | |
|---|---|---|---|---|---|---|
| **NOK THOUSANDS** | **Gross financial assets/liabilities** | **Gross assets/liabilities presented net** | **Book value** | **Financial instruments** | **Security in cash** | **Net value** |
| **ASSETS** | | | | | | |
| Financial derivatives | 107 927 | 0 | 107 927 | -107 927 | 0 | 0 |
| **Total** | **107 927** | **0** | **107 927** | **-107 927** | **0** | **0** |
| **LIABILITIES** | | | | | | |
| Financial derivatives | 240 602 | 0 | 240 602 | -107 927 | 0 | 132 675 |
| **Total** | **240 602** | **0** | **240 602** | **-107 927** | **0** | **132 675** |

| 31.12.2016 | | | | Related sums that are not presented net | | |
|---|---|---|---|---|---|---|
| **NOK THOUSANDS** | **Gross financial assets/liabilities** | **Gross assets/liabilities presented net** | **Book value** | **Financial instruments** | **Security in cash** | **Net value** |
| **ASSETS** | | | | | | |
| Financial derivatives | 122 900 | 0 | 122 900 | -122 900 | 0 | 0 |
| **Total** | **122 900** | **0** | **122 900** | **-122 900** | **0** | **0** |
| **LIABILITIES** | | | | | | |
| Financial derivatives | 345 305 | 0 | 345 305 | -122 900 | 0 | 222 405 |
| **Total** | **345 305** | **0** | **345 305** | **-122 900** | **0** | **222 405** |

The purpose of this note is to show the potential effect of netting agreements on KLP Kommunekreditt AS. The note shows the derivative positions in the financial position statement.

## NOTE 20 Capital adequacy

| NOK THOUSANDS | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Share capital and share premium fund | 675 000 | 675 000 |
| Other owners' equity | 66 864 | 14 216 |
| **Total owners' equity** | **741 864** | **689 216** |
| Deduction goodwill and other intangible assets | 0 | 0 |
| Deferred tax assets | 0 | -1 746 |
| **Core capital/Tier 1 capital** | **741 864** | **687 470** |
| Supplementary capital/Tier 2 capital | 0 | 0 |
| **Supplementary capital/Tier 2 capital** | **0** | **0** |
| Total own funds (eligible Tier 1 and Tier 2 capital) | 741 864 | 687 470 |
| Capital requirement | 310 430 | 306 812 |
| **Surplus of own funds (eligible Tier 1 and Tier 2 capital)** | **431 434** | **380 658** |
| Calculation basis credit risk | | |
| Institutions | 117 712 | 122 521 |
| Local and regional authorities | 3 491 045 | 3 320 023 |
| Covered bonds | 156 780 | 227 784 |
| **Calculation basis credit risk** | **3 765 537** | **3 670 328** |
| Credit risk | 301 243 | 293 626 |
| Operational risk | 9 045 | 13 186 |
| Credit valuation adjustment | 142 | 0 |
| **Total capital requirement assets** | **310 430** | **306 812** |
| Core capital adequacy ratio | 19.1 % | 17.9 % |
| Supplementary capital ratio | 0.0 % | 0.0 % |
| **Capital adequacy ratio** | **19.1 %** | **17.9 %** |
| **Unweighted capital adequacy** | **3.8 %** | **3.5 %** |

| CAPITAL REQUIREMENT AS AT 31.12.2016 | Core capital/ Tier 1 capital | Supplementary capital/ Tier 2 capital | Own funds |
|---|---|---|---|
| Minimum requirement without buffers | 4.5 % | 3.5 % | 8.0 % |
| Protective buffers | 2.5 % | 0.0 % | 2.5 % |
| System risk buffers | 3.0 % | 0.0 % | 3.0 % |
| Counter-cyclical buffers | 1.5 % | 0.0 % | 1.5 % |
| **Applicable capital requirements including buffers** | **11.5 %** | **3.5 %** | **15.0 %** |

## NOTE 21 Tax

| NOK THOUSANDS | 2016 | 2015 |
|---|---|---|
| Accounting income before taxes | 53 198 | 19 606 |
| Differences between accounting and tax income: | | |
| Reversal of value increase financial assets | -13 645 | 31 743 |
| Other permanent differences | 0 | -143 |
| Change in differences affecting relationship between book and taxable income | 1 201 | -4 189 |
| **Taxable income** | **40 754** | **47 017** |
| **Reconciliation of deferred tax/tax assets** | | |
| **Deferred tax asset linked to:** | | |
| Financial instruments | -24 688 | -45 699 |
| Hedging of borrowing | -18 923 | -30 736 |
| Securities | 0 | -733 |
| Premium/discount on borrowing | -720 | -230 |
| **Total deferred tax assets** | **-44 331** | **-77 398** |
| **Deferred tax linked to:** | | |
| Securities | 2 571 | 0 |
| Lending to customers and credit enterprises | 43 069 | 75 652 |
| **Total deferred tax** | **45 641** | **75 652** |
| **Net deferred tax/tax assets** | **1 310** | **-1 746** |
| Deferred tax assets | 0 | -1 746 |
| **Capitalized deferred tax asset** | **0** | **-1 746** |
| Deferred tax | 1 310 | 0 |
| Tax effect of group contribution | 10 188 | 12 695 |
| **Capitalized deferred tax** | **11 499** | **12 695** |
| Summary of tax expense for the year: | | |
| Tax charged to the income statement for previous years | 0 | 38 |
| Change in deferred tax taken to income | 3 056 | -7 300 |
| Capitalized tax from Group contribution | 10 188 | 12 695 |
| **Total tax costs** | **13 245** | **5 433** |
| Effective tax rate | 24.9 % | 27.7 % |
| **Reconciliation of tax rate:** | | |
| Accounting income before taxes | 53 198 | 19 606 |
| Income taxs expense, nominal tax rate | 13 300 | 5 294 |
| Income tax expense, effective tax rate | 13 245 | 5 433 |
| **Difference between effective and nominal tax rate** | **55** | **-139** |
| Recognised tax relating to previous years | 0 | -38 |
| Tax effects of permanent differences | 0 | 39 |
| Effect of change in tax rate on deferred tax | 55 | -140 |
| **Total** | **55** | **-139** |

## NOTE 22 Number of FTEs and employees

KLP Kommunekreditt AS has 2 employees, but they do not receive any remuneration or other benefits from the Company. KLP Kommunekreditt AS buys personnel services from other companies in the KLP Group.

## NOTE 23 Other liabilities and provision for accrued costs and liabilities

| NOK THOUSANDS | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Receivables between companies in the same Group | 4 110 | 4 573 |
| Creditors | 394 | 69 |
| Other liabilities | 4 | 4 |
| **Total other liabilities** | **4 508** | **4 646** |
| Value-added tax | 264 | 69 |
| Provisioned costs | 4 131 | 577 |
| **Total accrued costs and liabilities** | **4 395** | **646** |

## NOTE 24 Transactions with related parties

| NOK THOUSANDS | 01.01.2016 -31.12.2016 | 01.01.2015 -31.12.2015 |
|---|---|---|
| **INCOME STATEMENT ITEMS** | | |
| KLP Banken AS, interest on borrowing | -37 215 | -48 269 |
| KLP Banken AS, administrative services (at cost) | -12 830 | -14 168 |
| KLP Kapitalforvaltning AS, fees for services provided | -341 | -321 |
| **Total** | **-50 386** | **-62 758** |

| NOK THOUSANDS | 31.12.2016 | 31.12.2015 |
|---|---|---|
| **FINANCIAL POSITION STATEMENT ITEMS** | | |
| KLP Banken AS, debt to credit institutions | -1 170 823 | -2 181 927 |
| KLP Banken AS, loan settlement | 24 060 | 302 |
| **NET OUTSTANDING ACCOUNTS TO:** | | |
| KLP Banken AS | -4 018 | -4 494 |
| KLP Kapitalforvaltning AS | -92 | -79 |
| **Total** | **-1 150 873** | **-2 186 198** |

There are no direct salary costs in KLP Kommunekreditt AS. Personnel costs (administrative services) are allocated from KLP Banken AS.

Transactions with related parties are carried out on general market terms, with the exception of the Company's share of common functions, which is allocated at cost. Allocation is based on actual use. All internal receivables are settled as they arise.

## NOTE 25 Auditor's fee

| NOK THOUSANDS | 01.01.2016 -31.12.2016 | 01.01.2015 -31.12.2015 |
|---|---|---|
| Ordinary audit | 273 | 428 |
| Certification services | 182 | 86 |
| Tax advisory services | 0 | 0 |
| **Total auditor's fee** | **455** | **514** |

The sums above include VAT.

## NOTE 26 Other assets

| NOK THOUSANDS | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Receivables between Group companies | 24 060 | 302 |
| Prepaid expenses | 0 | 949 |
| **Total** | **24 060** | **1 251** |

## NOTE 27 Contingent liabilities

| NOK THOUSANDS | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Promised loans | 206 936 | 196 015 |
| **Total contingent liabilities** | **206 936** | **196 015** |

These are contractual payments to borrowers that are highly likely to be paid out.

## NOTE 28 Cash and cash equivalents and other loans and receivables from credit institutions

| NOK THOUSANDS | 31.12.2016 | 31.12.2015 |
|---|---|---|
| Bank deposits operations | 402 810 | 430 916 |
| Cash | 0 | 0 |
| **Total cash and cash equivalents (liquidity)** | **402 810** | **430 916** |
| Bank accounts to be used for the purchase and sale of securities | 11 993 | 12 565 |
| **Loans and receivables from credit institutions** | **414 803** | **443 481** |

To the General Meeting of KLP Kommunekreditt AS

# *Independent Auditor's Report*

## *Report on the Audit of the Financial Statements*

### *Opinion*

We have audited the financial statements of KLP Kommunekreditt AS which comprise the balance sheet as at 31 December 2016, income statement, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements are prepared in accordance with law and regulations and present fairly, in all material respects, the financial position of the Company as at 31 December 2016, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by EU.

### *Basis for Opinion*

We conducted our audit in accordance with laws, regulations, and auditing standards and practices generally accepted in Norway, included International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company as required by laws and regulations, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### *Key Audit Matters*

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

| Key Audit Matter | How our audit addressed the Key Audit Matter |
|---|---|
| *Risk of credit losses in loans to customers* | |
| The company has NOK 17.2 bn in loans to municipalities and counties and companies with public guarantees. The Local Government Act ensures credit losses will not occur on such loans when the Local Government Act's regulations for raising loans are fulfilled. We refer to | To ensure the company's loans are protected against credit losses based on the regulations in the Local Government Act the company has established a process and controls directed at ensuring a review of the applications for loans and associated documentation to ensure compliance with the regulations in the Local Government Act at the time of granting the loan. The |

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*State authorised public accountants, members of The Norwegian Institute of Public Accountants, and authorised accounting firm*

| | |
|---|---|
| the Board of Directors' report for further information.<br><br>We have focused our attention on the company's controls aimed at compliance with the requirements of the law at the time the loans are granted. This is a fundamental presumption in order for there not to be a loss potential in the portfolio, which may affect profit and loss. | process includes formal controls and division of responsibilities, which are directed at ensuring that the process has been carried out prior to granting or transfer of loans from the parent bank to the company.<br><br>Our audit was conducted by obtaining documentation and examining whether the process was conducted appropriately and timely. This included assessing if the underlying documentation that the company has collected supported the conclusions drawn by the company that the requirements in the Local Government Act was met. Our examinations did not reveal any differences of significance. |
| *IT systems supporting processes over financial reporting*<br>Weaknesses in automated processes and controls can potentially lead to a significant risk in the daily operations and risk of misstatements. We have focused on this area because it is important for the company's financial reporting systems, and their business model is dependent on complex IT systems. | The company uses external service providers to operate some of the important IT systems. The auditor at the relevant service organisation evaluates the design and efficiency of the established control systems, and tests the controls designed to ensure the integrity of the IT system that are relevant to financial reporting. We examined the reports and evaluated possible misstatement and improvements. Furthermore, we have tested IT general controls where necessary for our audit. Our work gave us sufficient evidence to enable us to rely on the operation of the company's IT systems relevant for our audit. |

## Other information

Management is responsible for the other information. The other information comprises the Board of Directors' report, statements on Corporate Governance and Corporate Social Responsibility, but does not include the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

## *Responsiblities of The Board of Directors and the Managing Director for the Financial Statements*

The Board of Directors and the Managing Director (management) are responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards as adopted by the EU, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

## *Auditor's Responsibilities for the Audit of the Financial Statements*

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with laws, regulations, and auditing standards and practices generally accepted in Norway, including ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with laws, regulations, and auditing standards and practices generally accepted in Norway, included International Standards on Auditing (ISAs), we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error. We design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the

audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Board of Directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit

We also provide the Board of Directors with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Board of Directors, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

## *Report on Other Legal and Regulatory Requirements*

### *Opinion on the Board of Directors' report*

Based on our audit of the financial statements as described above, it is our opinion that the information presented in the Board of Directors' report and statements on Corporate Governance and Corporate Social Responsibility concerning the financial statements, the going concern assumption, and the proposal for the allocation of the profit is consistent with the financial statements and complies with the law and regulations.

Auditor's Report - 10 March 2017 - KLP Kommunekreditt AS

## *Opinion on Registration and Documentation*

Based on our audit of the financial statements as described above, and control procedures we have considered necessary in accordance with the International Standard on Assurance Engagements *(ISAE) 3000, Assurance Engagements Other than Audits or Reviews of Historical Financial Information*, it is our opinion that management has fulfilled its duty to produce a proper and clearly set out registration and documentation of the company's accounting information in accordance with the law and bookkeeping standards and practices generally accepted in Norway.

Trondheim, 10 March 2017
**PricewaterhouseCoopers AS**

Rune Kenneth S. Lædre
State Authorised Public Accountant

Note: This translation from Norwegian has been prepared for information purposes only.

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