1927-2010

Kommunalbanken Norway Annual Report 2010

KBN Kommunalbanken Norway

Miljøfyrtårn®

KBN's primary goal is to make real public sector projects pursuant to the institution's sector political function and to secure attractive loan terms for the municipal sector.

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Competition and communication make us a better institution

The time has come for us to present our results for 2010. Again, it is a solid set of results. While the results are good, I would characterise 2010 the results as “back to normal” both in terms of our operations and financials. To compare this year’s results with those of 2009 would be wrong. The market situation is different and incomparable.

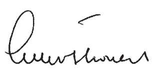
Our core mandate is to offer the municipal sector cost efficient financing. The role of being the most important supplier of credit to the sector has been maintained. When I look at our market share, it has increased from 46.7 in 2009, to 48.7 in 2010. If I interpret this correctly, it means that our clients are satisfied with our competitive pricing and that is why they choose us for their financing needs. Even though we have long history dating back to 1927, and a unique competence for municipal financing, we work hard every day to maintain our position. KBN has become a larger institution in many areas of our business, but still we compete every day with both new and established counterparties.

We have a close dialogue at all times with our customers. In order to be an even better partner, we have recently undertaken a customer survey. Feedback and communication are important to us so that our services and products can be even better. There can also be demand for other services, which may have a natural fit within our spectrum of services. I will see to it that what we can be better at, we will be better at. Competition is healthy and it ensures that we give our utmost at all times.

I notice that a considerably larger investor base is buying municipal debt. Previously, buyers of this issuance were banks and financial institutions, but that is not the case today. Market participants change over time and we have seen this change over the last few years. Funds and institutional investors are now active buyers in the short term and longer dated municipal bond market and have therefore taken over a proportion of municipal debt. For KBN, it means that we are able to free up resources to focus on longer dated financing.

KBN is a large and predictable provider of loans to the municipal sector. Even though we will soon celebrate our 85th anniversary, I would characterise KBN as being in very good health.

I defined 2010 as a ”return to normal”, and all signals point to 2011 also being a good year for us, and as a result, our customers.



Petter Skouen
President & CEO

2010 - The year in brief

KBN's importance to Norwegian public sector increased due to the effects of the financial crisis.

In a White Paper to the Norwegian parliament about the government's ownership policy, KBN is classified as 'an institution with important sector political functions'.

KBN achieved a profit for the year of NOK 741 million in 2010, compared with NOK 1 399 million in 2009.

Return on equity after tax decreased from 63.5 per cent in 2009 to 21.6 per cent in 2010.

Total return on assets after tax decreased from 0.62 per cent to 0.26 per cent.

The Board proposes to allocate NOK 165 million to payment of dividend. NOK 576 million will be retained as equity capital.

KBN's total lending portfolio increased by NOK 33 billion to NOK 184 billion.

KBN's market share of loans to the local government sector increased from 46.7 per cent to 48.7 per cent.

KBN advises its customers in connection with entering into ordinary banking agreements. In 2010, KBN assisted in 39 such agreements.

Total funding volume raised in 2010 was NOK 138 billion and KBN had access to funding markets throughout the year.

KBN was the first Norwegian financial institution to launch a "Green Lending Rate", whereby projects that promote a better environment qualify for an improved interest rate. KBN also launched a "Green" funding programme, focused predominantly on the Japanese retail market, whereby proceeds are earmarked for environmentally friendly projects in the municipal sector.

Summary financial figures

(Figures in NOK million)

	2010	2009
Net interest and commission income	1 178	1 033
Staff costs and other expenses	97	91
Profit before tax	1 034	1 946
Tax	293	547
Profit for the year	741	1 399
Total lending portfolio [1-2]	184	151
Average total assets [1]	285	224
Core capital ratio	9.15 %	9.25 %
Operating cost/total assets (%)	0.03 %	0.04 %

[1] Figures in NOK billion
[2] Principal

KBN facts

KBN was established by an act of Parliament in 1926 and reorganised pursuant to a conversion act in 1999 as a government funding agency.

KBN has an important public policy function of providing low cost loans to Norwegian municipalities and counties.

KBN is the largest lender to the local government sector in Norway with a market share of 49 per cent, including loans to municipally-owned companies.

KBN can only lend to municipalities and counties and to municipal enterprises and intermunicipal companies against a municipal guarantee.

KBN is 100 per cent owned by the central government. The state's ownership is managed by the Norwegian Ministry of Local Government and Regional Development.

KBN has been assigned the highest possible credit ratings, Aaa/AAA, by the credit rating agencies Moody's Investor Service and Standard and Poor's respectively.

KBN is regulated by the Financial Supervisory Authority of Norway (Finanstilsynet).

How KBN works

KBN uses its triple-A credit rating to raise funds by issuing bonds in international capital markets.

KBN follows a diversified funding strategy and annual issuance volumes are determined by its 12 months net cash requirement including forecasted lending growth. No currency or interest rate risks are allowed. Swap agreements are used to hedge against movements in interest rates as well as currency fluctuations. Currency proceeds are eventually swapped to floating rate and Norwegian kroner and matched against KBN's lending portfolio.

With continued access to stable financing from bond markets globally, KBN is able to provide loans at competitive terms to Norwegian municipalities and counties. Under normal conditions, Norwegian local governments select their loan providers through a tender process, and by participating in the process, KBN contributes to setting the benchmark for pricing to the sector.

KBN's excess liquidity reserves are invested in a portfolio of highly rated short dated assets. Revenue generated from the liquidity portfolio has been satisfactory under current market conditions.

KBN's cost effective organisational structure and conservative management means that operating costs are kept low. KBN's operating costs as a percentage of total assets were 0.03 per cent in 2010.

Key figures

(Figures in NOK million)	**2010**	**2009**
Total lending*	183 841	151 275
Lending		
The year's approbations	52 906	46 393
Unsettled allocations	7 353	4 660
Disbursements during the year	49 933	43 158
Principal payments on loans	17 380	9 900
Borrowings		
Borrowings*	290 231	224 418
Key figures		
Average total assets	285 483	224 084
Return on capital after tax	21.6%	63.5%
Dividend	165	267
Core capital ratio	9.15%	9.25%
As percentage of average total assets		
Interest income	1.76	2.16
- Interest costs	1.34	1.69
= Net interest income	0.42	0.47
- Commission costs and costs of banking services	0.01	0.01
+ Net unrealised gains/losses on financial instruments	(0.03)	0.10
+ Gain from repurchase of issued securities	0.01	0.35
- Staff costs	0.02	0.02
- Other expenses	0.01	0.02
= Operating profit	0.36	0.87
Profit analysis (Figures in NOK million)		
Interest income	5 034	4 847
- Interest expense	3 837	3 794
= Net interest income	1 197	1 053
-Commission costs and costs of banking services	18	19
+ Net gain/(loss) on financial instruments at fair value	(89)	222
+ Net gain/(loss) from repurchase of issued securities	41	781
- Staff costs	60	53
- Other expenses	38	38
= Profit before tax	1 034	1 946
Profit for the accounting period before tax	1 034	1 946

* Principal

An update on the Norwegian economy

The international recovery following the financial crisis is now picking up pace, supported by low interest rates, tax reductions and increased public spending.

The world economy has expanded at a faster pace than expected a few months ago, but is still faced with trade imbalances and large budget deficits in advanced economies. Unemployment rates are still high in many countries. Further problems in the Eurozone are still a possibility and continued budget cuts will quite possibly mean low interest rates in the leading industrial countries for some time to come. However, warnings of inflationary pressures are increasingly coming to light and with energy and food prices also rising there are still challenges ahead for the leading industrial economies.

However, despite the market shocks produced by Ireland's bail-out in the latter part of 2010 and the anaemic growth forecast from the peripheral European economies, 2011 opened with successful auctions and bond issues for Portugal, Spain and both the EU's bail out financing mechanisms, the European Financial Stabilization Mechanism (EFSM) and the European Financial Stability Facility (EFSF).

Compared to its peers in Europe, Norway was in a better position than most countries to counteract the effects of the economic slowdown. The current account balance and government finances are solid, and Norway is projected to post a budget surplus of 10 per cent of GDP in 2011. Furthermore, the Norwegian banking system is not large, and the financial position of Norwegian banks is sound.

The Norwegian government is a net creditor with substantial foreign assets and large fiscal surpluses, primarily originating from the oil and gas sector. The government's total net cash flow from the extraction of petroleum is transferred to the Government Pension Fund – Global, Norway's Sovereign Wealth Fund. This Fund is fully integrated into the National Budget which means the Government will cover the non-oil budget deficit by transfers from the fund according to the fiscal rule.

At the end of 2010, the Government Pension Fund – Global reached NOK 3 trillion in size, approximately USD 500 billion. The fund increased its share of equity investments to 60 percent from 40 percent between the summers of 2007 and 2009, reducing fixed-income investments to 40 percent. From March 2010, it also has a mandate on to invest as much as 5 per cent of its assets in real estate through a corresponding decrease in fixed-income investments.

According to Norges Bank, the Norwegian central bank, "the

The Norwegian local government sector - An asset class of exceptional quality

Norwegian local government rests on strong pillars. The high credit quality of the sector is largely derived from several factors; the economic and legislative framework that protect local authorities' status, responsibilities and finances, the strong equalisation system between municipalities that ensures minimum revenues, a high degree of central government transfers and a comprehensive system for meticulous central government supervision and control on the local government budgetary process.

The combined strengths of the system are fundamental to the low risk associated with Norwegian local governments as an asset class. Norwegian municipalities play a crucial role in providing vital services to the Norwegian public and a stable economic framework with access to low cost financing is considered important by the central government. The central government has a strong incentive to provide for a stable economic environment for local government financing, as volatility could lead to uncertainty, increase municipal borrowing expenses and prevent local governments delivering essential services to the population.

KBN's public mandate of offering the local government sector access to low cost financing contributes to protecting the stability of this system.

The Nordic model

The public sector in the Nordic region is effectively comprised of central and local governments. In Norway, Sweden and Denmark, the local government sector is made up of two tiers: counties and municipalities.

In Norway's case, the concept of municipal self-government is an important political principal, however in contrast to other Nordic and most European countries this self-government is not enshrined in the Norwegian constitution. The central government can at any time regulate the framework of municipal self-government and in principle this gives the national authorities great influence on the content of municipal activities.

The Norwegian local government sector has the responsibility for the provision of welfare state services. Municipalities' responsibilities cover education (primary schools), healthcare, care for the elderly, and the provision of drinking water and sewerage, while counties perform healthcare (county hospitals), secondary education, and some public transportation functions. The central government controls the transfer of funds through the public pension and social security system as well as controlling natural resources, defence, and the police.

Norway is divided into 19 counties and 430 municipalities, both having equal standing in terms of the formal framework for their responsibilities.

Supervision and control

Local governments hold an important position, being responsible for more than two thirds of public expenditure. The framework for the activities of the local government sector is laid down by Parliament through legislation and decisions regarding local government financing. Parliament determines the division of functions between the different levels of government, i.e. central government, counties and municipalities. The government can only assign new functions to local government by means of legislation or decisions made by Parliament.

Although the average population of a Norwegian local government is 10,000 operational target of monetary policy in Norway is low and stable inflation, with annual consumer price inflation of close to 2.5 per cent over time”. In recent years, inflation moved slightly above this target level and as such the key policy rate was raised accordingly. However, following the onset of the financial crisis, Norges Bank reduced the key policy rate considerably, continuing to cut further in 2009 to 1.25 per cent. With a bounce back in the economy from the second half of 2009, rates were increased steadily to the 2 per cent level by the end of 2010. Although projections for 2011 are uncertain, forecasts show a steady increase in rates going forward of up to and beyond 3 per cent by 2012. Inflation is also back under 2 per cent and expected to stay in a range between 2 and 2.5 per cent for the coming year.

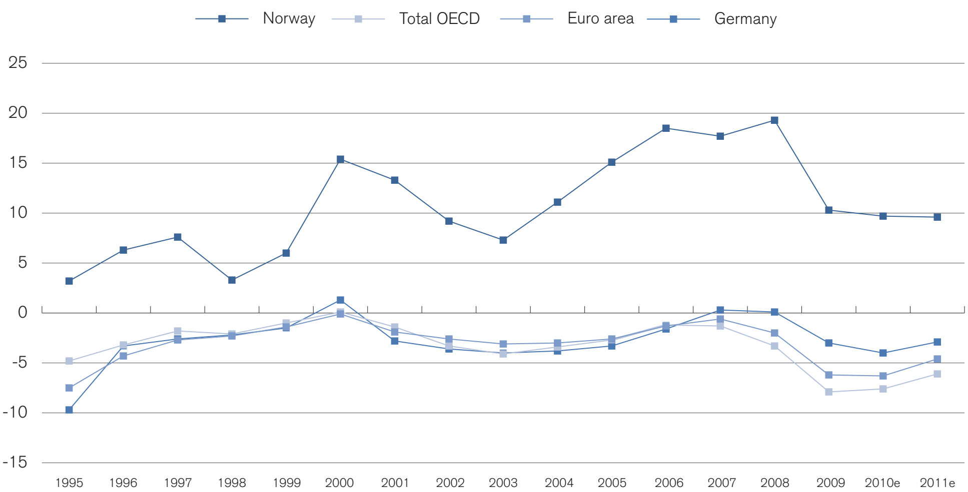
Norway has been through a period of high GDP growth in recent years, peaking at 6.1 per cent for the mainland economy in 2007. Although Norway experienced two quarters of negative GDP growth in 2009, the economy rebounded in H2 2009 and according to the Ministry of Finance, the mainland economy showed only mild negative growth of 1.4 percent for the whole of 2009.

In 2010, the economy continued to grow, with increased consumer confidence, low interest rates and low unemployment leading to higher private consumption. GDP growth for mainland Norway reached 1.7 per cent in 2010. With the improved outlook for Norway and its key trading partners, growth is expected to surpass 3 per cent in 2011.

Unemployment in Norway has not risen as sharply as in other developed countries. Projections from the Ministry of Finance point to a unemployment rate of 3.6 per cent in 2011, an increase of only 0.1 per cent compared with 2010. This is lower than the average of the past 20 years, approximately 4.25 per cent, and also very low compared with other developed economies.

According to the National Budget for 2010, fiscal policy will provide further stimulus to the economy in 2011.

General government financial balances (% of GDP)



(and Norway’s population is 4.9 million) and the difference in size of local governments is vast, there exists a comprehensive regional development policy which compensates for the economic disparities between local governments. It is an aim of the central government to offer citizens a high level of public services with equal standards, wherever they live in the country. Therefore there is a high degree of redistribution of income between municipalities and between counties. This is achieved through the General Purpose Grant Scheme. Redistribution of resources through the General Purpose Grant Scheme ensures both a fair distribution of income, and regional growth and development. This is essential to maintain an efficient and autonomous local government sector.

The local government sector relies on several sources of income, mainly taxes and central government transfers which account for 39 per cent and 42 per cent of revenues respectively. Municipalities collect most of their taxes from individual and corporate income and property tax. Counties on the other hand receive only income tax. The right of municipalities and counties to levy taxes is limited by maximum rates set annually by Parliament. Today, all municipalities and counties apply the maximum rate.

The legislative framework underlying the local government sector is laid out in the Local Government Act of 1992 which focuses on the key areas of monitoring and controlling local government budgets, regulating borrowing and the granting of guarantees, and provisions should a local government encounter financial difficulties.

Municipal budgets are regulated by the central government and each county or municipality’s annual budget must be presented to the Ministry for Local Government and Regional Development.

Local government borrowing and granting of guarantees are regulated under the Local Government Act of September 1992 and municipalities are only permitted to raise debt for primary municipal investments, to convert existing debt and for temporary liquidity purposes.

Importantly, under the local government act, a local government cannot file for bankruptcy and cannot have bankruptcy proceedings filed against it.

If a local government does incur a budget deficit, the central government steps in to assure that the local government in question acts to provide a solution to correct its financial position. First, the local government is put on a publicly available ‘watch-list’. The central government must then approve each of the local government’s borrowings as well as a ‘financial plan’ for rectifying the problem within three years.

At all times the central government has the power to edit the budget and/or the ‘financial plan’ to ensure a timely recovery for the relevant municipality.

Should the extremely unlikely situation arise that a local government does experience financial difficulties the central government appoints a supervisory board for the relevant local government and the board then approves all payments and the order in which any claims shall be met. However, it is a testament to the high level of control and supervision of the municipal sector that this measure has never had to be implemented.

The Board of Director's Annual Report 2010

In 2010, Kommunalbanken Norway (KBN) delivered a set of good results, both in terms of operations and financial results. 2009 was on the other hand, an extraordinary year, with extraordinary results.

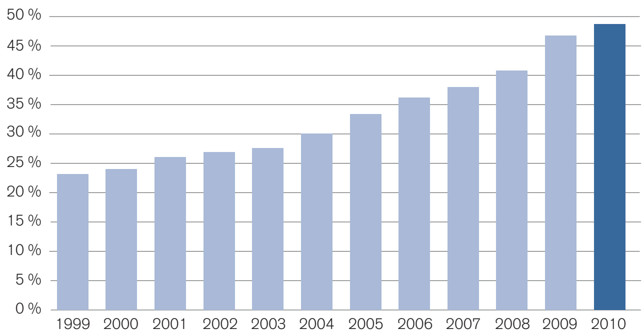
KBN's primary goal is to make real public sector projects pursuant to the institution's sector political function and to secure attractive loan terms for the municipal sector. This is achieved by passing through the advantages that KBN benefits from in international capital markets through its high creditworthiness and key competencies. At the same time, KBN should aim for a satisfactory return on equity, which is done under Norwegian law, KBN's Articles of Association and its ethical guidelines.

The situation in the municipal lending market is changing. KBN's role as the most important provider of financing to the local government sector has been maintained, but the domestic capital market has increased its proportion of municipal debt. Investment levels are high within most service areas and this is a result of the central government's efforts to secure good local public services. High investment levels over the last few years have meant that municipal debt levels have increased. At year-end 2010, municipalities and counties' gross debt stood at NOK 377 billion, compared with NOK 324 billion in 2009. This is an increase of 16.4 per cent.

KBN's total lending portfolio grew by NOK 33 billion, from NOK 151 billion at year end 2009, to NOK 184 billion at the end of 2010. During 2010, KBN placed new loans to the sum of NOK 50 billion during the year, compared with NOK 43 billion in 2009. KBN's market share for the entire municipal sector, including municipal companies, increased from 46.7 per cent to 48.7 per cent, and it is an important goal for KBN to offer the same loan terms to both small and large municipalities.

KBN achieved a pre-tax profit of NOK 1.034 billion in 2010, compared with NOK 1.946 billion in 2009. In 2009, close to half of KBN's income came from the buy-back of its own securities. Of KBN's earnings in 2010, NOK 1.197 billion came from net income interest, NOK 41 million from the buy-back of KBN's own securities, with an unrealised valuation change of NOK 89 million using the Fair Value Option for financial liabilities and assets. Total return on assets decreased from 0.62 per cent in 2009 to 0.26 per cent in 2010, while return on equity went from 63.5 per cent in 2009 to 21.6 per cent in 2010, after tax.

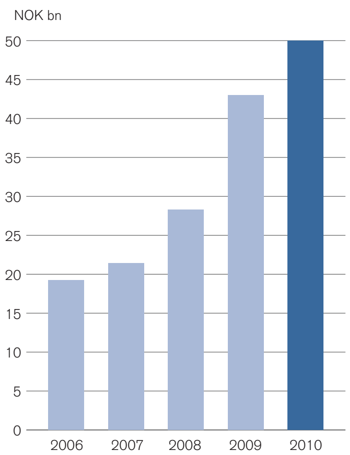
KBN's share of total market 1999-2010



Funding markets in 2010 were relatively stable, however funding costs for all financial institutions have settled at a higher level than where they were before the financial crisis. KBN had good access to liquidity throughout 2010 as a result of its diversified funding strategy, and the total issuance in 2010 of NOK 138 billion, raised across 14 different currencies, was its largest ever. 2009's total funding volume was NOK 116 billion.

KBN has a policy of maintaining net cash balances equivalent to a minimum of 12 months' net debt redemptions. KBN's increased funding volume in 2010 was due to a combination of lending growth and refinancing needs. The average maturity on KBN's outstanding debt has not increased materially. In 2011, priority will be given to extending the overall maturity on the funding portfolio. The liquidity portfolio of NOK 96 billion is carefully placed, adhering to a low-risk investment strategy. At year-end, notes issued by governments, states, regions and institutions with a government guarantee made up for 67 per cent of the portfolio. The majority of the liquidity portfolio has a maturity date of less than one year.

Loans granted 2006-2010



The Central Government, represented by the Ministry for Local Government and Regional Development, is the sole owner of KBN. KBN's registered office is in Oslo.

Annual accounts

The annual financial statements have been prepared on the basis of the going concern principle. It is the opinion of the Board that the Income Statement and Balance Sheet, with their associated notes, as at 31 December 2010 provide an adequate description of the institution's financial position at year end. The annual accounts have been prepared in accordance with IFRS.

KBN achieved a profit after tax of NOK 741 million, compared with NOK 1.399 billion in 2009. Strong lending and satisfactory gains on the management of surplus liquidity lead to a return on equity of 21.6 per cent in 2010, a considerable reduction compared with the return on equity of 63.5 per cent in 2009, which was the result of extraordinary gains on the buy-back of KBN's securities.

Net interest income amounted to NOK 1.197 billion in 2010, an increase of 13.7 per cent compared with 2009. The fact that interest income increased less than total assets is due to lower margins on the investments made with KBN's surplus liquidity. KBN had unhindered access to funding in 2010 and through a diversified funding strategy KBN's average cost of funds remained low. Furthermore, through favourable moves in basis swap levels, KBN was able to improve its funding cost in Norwegian kroner terms.

Pursuant to accounting rules, most lending, liquidity investments, funding and other financial instruments are recorded at fair value. Changes in unrealised value are recorded in the financial results and amounted to NOK 89 million in 2010. The value of the liquidity portfolio decreased by NOK 42 million, while the value of the lending portfolio at fair value was reduced by 112 million. The value of KBN's liabilities has been written down by NOK 65 million as a result of interest rate changes and

Key figures

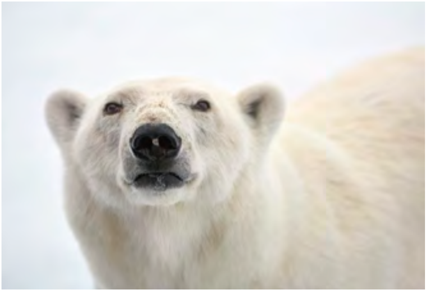
Figures in NOK 1 000 000	2010	2009
PROFIT		
Net interest income	1197	1 053
Pre-tax profit	1 034	1 946
Profit for the year	741	1 399
Return on equity after tax*	21.62 %	63.45 %
Total return on assets after tax*	0.26 %	0.62 %
LENDING		
The year's approbations	49 933	43 158
Total lending portfolio**	183 841	151 275
LIQUIDITY**	86 278	68 310
FUNDING		
Borrowings	138 231	116 263
Buy back of own securities	2 032	6 832
Redemptions	89 840	58 135
Total outstanding debt**	290 231	224 418
TOTAL ASSETS	307 666	231 932
EQUITY CAPITAL		
Equity capital	4 034	3 561
Core capital ratio	9.15 %	9.25 %
Total capital ratio	9.86 %	11.05 %

* Annualised return
** Principal

increased credit premiums on long dated funding.

Operating costs amounted to NOK 97 million in 2010, compared with NOK 91 million in 2009.

Total assets were NOK 308 billion at the end of 2010, compared with NOK 232 billion at the end of 2009. The growth in assets can be explained by a combination of lending growth of NOK 32 billion, an increase in liquidity of NOK 25 billion to meet future lending growth and debt redemptions, and an increase in value of hedging instruments of NOK 18 billion.

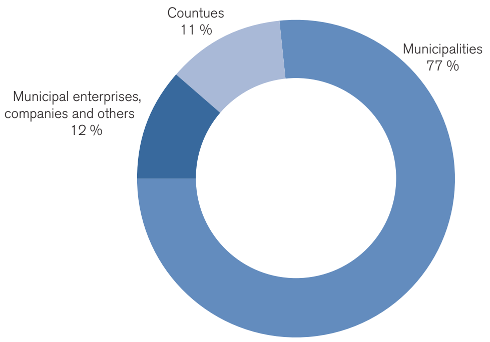

KBN's borrower closest to the North Pole lives at Svalbard where this photo was taken. Photo: Samfoto.

Total capital at year end amounted to NOK 4.630 billion, of which NOK 4.296 billion is core capital. The total capital ratio at year end was 9.86 per cent, and the core capital ratio was 9.15 per cent.

Lending

The total lending portfolio of NOK 184 billion is divided between NOK 141 billion for loans to municipalities, NOK 21 billion to counties and NOK 22 billion for loans to inter-municipal companies and other companies with municipal guarantees that perform primary municipal responsibilities. Of the total NOK 36 billion in new loan offerings, NOK 4 billion was offered to municipalities with less than 5,000 inhabitants, and KBN was able to win NOK 3 billion of these loans.

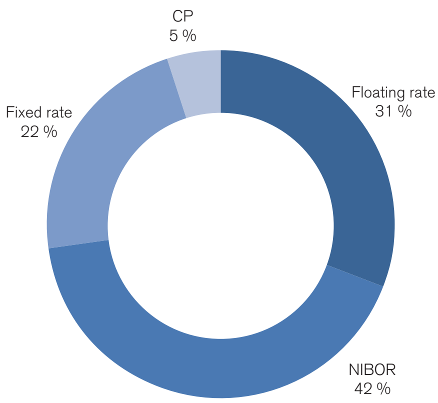
Loan volume by borrower as at year end 31.12.10



All counties have loans with KBN and 425 of the 430 municipalities in Norway have a loan with KBN. Furthermore, the majority of municipal and inter-municipal companies have loans with KBN. These types of loan always require a municipal or county guarantee.

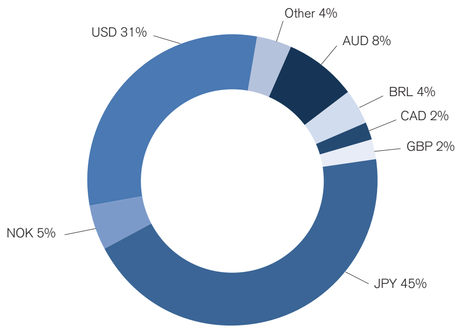
73 per cent of the loan portfolio is floating rate with fixed rate loans making up the remaining 27 per cent. The percentage of loans linked to Nibor increased from 39 to 42 per cent in 2010, while short term loans decreased from 7 to 5 per cent in the same period. The proportion of KBN's own floating rate product, or PT rate was reduced from 32 per cent in 2009 to 31 per cent in 2010, while fixed rate loans increased from 21 per cent in 2009 to 22 per cent in 2010. Competition for long term loans has been limited in 2010, whereas financing by the municipalities issuing short and longer term bonds direct to the market has been more pronounced.

Loan volume by interest rate product as at 31.12.10



As part of KBN's regular customer service, it advises customers on structuring their debt portfolios and their choice of interest rate products. Customers have direct access to online financial information and their own loan portfolio through the KBN website. In accordance with the law on public acquisitions, the municipalities have to set a tender on banking agreements. KBN advises municipalities on entering into banking agreements and can offer advice to its customers as this is an area in which KBN does not operate. In 2010, KBN assisted in the signing of 39 banking agreements, an increase

Funding currency split 2010



of 10 compared with 2009. KBN also arranges regional seminars which cover current topics in the municipal sector.

Large investments in the municipal sector must now be implemented to reach agreed local and national environmental targets. Together with the country's municipalities and counties, KBN wants to take on more responsibility to reduce energy consumption and climate gas emissions. As a result, in 2010, KBN was the first Norwegian financial institution to launch a "Green Lending Rate". KBN's "Green Lending Rate" is 0.10 per cent lower than its standard floating rate product. By offering a more competitive rate, KBN aims to be a key driver in implementing the municipal sector's climate and environment focussed projects. As of 31 December 2010, KBN had allocated a total of NOK 5.3 billion in "green lending".

Funding

KBN splits its funding activities across four areas: USD benchmark issuance, issuance in public niche markets, private placements to institutional investors and retail issuance. Focusing on a variety of funding markets, KBN has secured stable access to funding markets on favourable terms and at the same time increased the institution's investor base. Japan continues to be KBN's largest source of funds, while other key markets included the USA, Europe and the rest of Asia.

In recent years, KBN has seen a substantial increase in the volume of funding raised in the Japanese "Uridashi" market. Uridashi loans are primarily sold direct to retail investors in Japan, where under Japanese regulations KBN qualifies as a sovereign borrower. Increased demand for KBN's name has meant that annual volume continued to grow in 2010. KBN issued a total of 279 individual trades in Uridashi format in 2010, raising an equivalent of NOK 67 billion, approximately 50 per cent of KBN's total funding.

KBN issued three USD benchmark bonds in 2010. KBN also added SEC 144a documentation to its debt issuance programme during the course of the year, which meant that the institution can now sell its bonds to US "Qualified Institutional Buyers" or QIB's. Following an investor marketing exercise focused on this new investor base, KBN issued its first benchmark under this documentation in April. The issue was well received by the market and was heavily oversubscribed with an orderbook of over USD 3 billion. This resulted in the transaction being increased from USD 1 billion to 1.5 billion, with more than 40 per cent of the investors coming from the US. There has been continual demand

throughout the year from the US for exposure to KBN and the US market has become the largest pool of investors with regard to KBN's USD benchmark programme. Furthermore, throughout the year, KBN reduced its overall cost of funds when compared with its AAA-rated peer group.

With the introduction of KBN's "Green Lending Rate", the institution launched a "Green" funding programme, focussed predominantly on the Japanese retail market, whereby proceeds are earmarked for environmentally friendly projects in the municipal sector. The programme helps show the focus that KBN is placing on environmentally friendly projects.

Continued access to funding markets can be attributable to the desire for investors to invest in high quality government related credits. In this regard, the credit quality of Scandinavia stands out, but particularly Norway's strong economic situation compared with other European countries makes KBN an attractive investment from a diversification point of view. Norway has the tightest sovereign credit default swap (CDS) spreads in the market, which has also helped improve KBN's own funding costs. KBN's total outstanding debt portfolio, including bonds, commercial paper and other funding instruments, increased from NOK 224 billion to NOK 290 billion in 2010.

KBN's international loan programme "The Programme for the Issuance of Debt Instruments" is a standardised loan documentation that not only simplifies but provides security for both lender and borrower. From 2011 onwards, the Programme will have no maximum issuance limit.

Liquidity management
KBN has a policy of maintaining net cash balances equivalent to a minimum of 12 months' net debt redemptions. This means that in a given situation KBN can cover all its debt obligations for the next 12 months without additional borrowing. Surplus liquidity is managed using a low risk investment policy, both in terms of credit and market risk, through investing in liquid securities issued by governments and financial institutions with a high credit rating. The majority of the portfolio has a maturity of less than one year. KBN is not exposed to any material interest or currency risk, and the maturity profile of the liquidity portfolio is coordinated with underlying borrowing redemptions.

Risk management
Risk management and risk exposure are subject to a strict internal regulation to ensure that KBN maintains its credit rating and thus is able to access the most attractive funding markets. Credit and liquidity risk are generally low. KBN is not positioned for interest and currency risk. All risk limits and trading in new financial instruments must be approved by the Board. The financial guidelines are approved by the Board on an annual basis.
Credit risk in the lending portfolio is confined to potential late payment of interest and instalments, not to potential failure of payment obligations. The provisions of the Local Government Act do not permit local and regional authorities to file for bankruptcy. There are also provisions in the Local Government Act relating to the procedures for late payment scenarios. According to these provisions, the state, in the form of the Ministry of Local Government and Regional Development, steps in to manage the financial

obligations of the municipality should it be unable to meet these obligations.

KBN has strict policies on entering into financial contracts arising from its liquidity management and hedging operations. For investments longer than one year, a minimum rating of A2/A from Moody's and Standard & Poor's is required. Short-dated investments (under one year) require a minimum short-term rating of P-1/A-1.

Trading in derivatives is subject to standard ISDA agreements, and additional collateral agreements (CSA's) are required for all new swap counterparties. Kommunalbanken had at year end 2010 entered into CSA's with 41 of 44 active derivative counterparties. Clear procedures and processes have been established for managing potential credit risk. All new lines of credit are established by the institution's finance committee and are reviewed regularly. Credit risk is managed on the basis of KBN's own credit risk models. The size of the credit limit is determined chiefly by available risk capital, the counterparty's rating, the type of financial instrument and its maturity.

Market risk consists mainly of interest and currency risk. KBN's financial policies only permit minimal exposure to interest rates and exchange rate risks. Interest rates and exchange rate risk is managed by ensuring that KBN's positions are hedged at all times.

Liquidity risk is minimised by ensuring that the liquidity portfolio is equivalent to a minimum of 12 months net debt redemptions. In addition, the liquidity portfolio is invested in liquid assets of high credit quality and short maturity.

Operational risk exists potentially throughout KBN's business. The institution seeks to minimise operational risk by focusing on good internal control, sound ethics and a high level of expertise among its employees. The Board of Directors is updated regularly with regard to KBN's operational risk.

Marketing, communication and corporate social responsibility
KBN collaborates with different organisations within the local government sector. The Board is focussed on maintaining regular contact with the government and other public authorities to, among other things, promote KBN's role.
The Board determines KBN's ethical standards for marketing communication and marketing activities. KBN's customers should feel safe in the knowledge that KBN has a proactive approach to ethical conduct.

Corporate governance
KBN complies with Norwegian recommendations for corporate governance. The purpose of the

recommendations is that companies must have corporate governance that clarifies the distribution of roles between shareholders, the Board and the management, in addition to that specified in the applicable legislation. The recommendation is intended to strengthen confidence in companies and contribute to the greatest possible wealth creation over time, to the benefit of shareholders, customers, employees and other interested parties.

KBN's central bodies are organised in accordance with the provisions of the Companies Act. KBN's bodies are: the General Assembly, the Supervisory Board, the Board of Directors, the Control Committee, internal and external auditors and the President & CEO. KBN is made up of three operating areas with staff and support functions.

The institution's internal audits are intended to ensure that risk analysis and monitoring is carried out, and that operations are conducted in accordance with approved policies and guidelines. Internal audits are also an integral part of the KBN's management and planning process. Risk analysis in the audit process is followed up at departmental level and is reported to the President & CEO and the Board of Directors.

At the General Assembly, Frode Berge, Nanna Egidius and Martha Takvam were re-elected as board members. As such, the Board is composed as follows: Else Bugge Fougner (Chairman of the Board), Kristin Marie Sørheim (Vice Chairman), Svein Blix, Åmund T. Lunde, Frode Berge, Nanna Egidius, Martha Takvam and Ellen E. Scavenius (employee representative). Steinar Mørch-Olsen is the alternate employee representative.

In 2010, the Board of Directors established an Audit Committee and Compensation Committee as internal bodies within the Board.

Organisation and skills development

At year end there were 48 employees, occupying 46.8 full time equivalent positions, compared with 44 employees occupying 42.5 full time employees in 2009. The increase in staff reflects a combination of KBN's growth and a strategy that focuses on strengthening KBN's competencies in topical areas in order to meet the growing complexity within the fields of regulation and financial framework. KBN's human resources plan has a three year time horizon and is evaluated annually. The plan ensures that KBN has sufficient personnel with the competence required for the tasks and ambitions established in KBN's planning and strategy policies.

Health, safety and diversity at KBN

KBN considers it of importance to recruit capable and proficient staff, including those with an international background and experience. This helps to give the institution greater competence in the areas that are central to KBN's business. 14.5 per cent of the employees are of a non-Nordic origin. Of this 14.5 per cent, 4 are women and 3 are men. They are also represented in senior management and at specialist levels.

In autumn 2010, a new working environment survey was undertaken. The survey shows that KBN offers for the most part, a good working environment, in line with the results of a similar survey in 2008. KBN will continue to work to improve KBN's core competencies but at the same time work on areas where an improvement is necessary.

Absence through illness in 2010 was 2.5 per cent, compared with 1.8 per cent in 2009, with 3.7 per cent among female staff and 1.2 per cent among male staff. No workplace injuries were reported in 2010. Six employees took parental leave, four women and two men. All employees benefit from an annual health check and optional occupational therapy advice.

KBN's headquarters are satisfactory. The building does not impact the external environment.

Social responsibility

Ethical guidelines have been adopted by the Board and apply to all employees and union officials. The guidelines are reviewed in an annual employee seminar, where working practices are also discussed. KBN emphasises communicating the content of the ethical guidelines to its customer groups.

The environment: KBN has been certified by the environmental management organisation The Eco-Lighthouse Foundation in connection with environmentally sustainable business practices, on the back of which guidelines for sorting of waste, waste reduction, and systems for reducing KBN's CO2 emissions, are already in place. KBN's new office building gives KBN the opportunity to make further energy saving measures.

Public policy function: KBN has a primary objective of being a predictable and reliable provider of credit. The institution must be a guarantor for competition in the loan market for the local government sector, so that counties and municipalities receive the best possible loan terms.

Equality of opportunity

KBN does not discriminate on the basis of gender in areas such as salary, career development and recruitment. KBN has flexible arrangements to make it easier for employees to manage their careers and family life. Of the institution's 48 employees, 25 are women and 23 are men.

The proportion of women on the Board is 62.5 per cent. The Chairman of the Board is a woman.

KBN's senior management consists of the President & CEO (male) and a Deputy CEO (female). Women comprise 33 per cent of the executive management level.

Through its salary and personnel policy, KBN strives to recruit and train highly qualified employees, based on its needs at any given time. The institution is strongly committed to the equal pay principal, which means equal pay for work of equal value.

Application of profits

The Board proposes that the profit of NOK 741 million be applied as follows:

NOK 165 million to be applied to payment of ordinary dividend.

NOK 576 million is to be transferred to other equity capital.

Changes in financial regulations

The authorities have announced changes to the requirement for increased solidity in credit institutions in accordance with Basel III. The increased requirements for risk-weighted capital ratios which will be gradually phased in during 2013-2017 will mean institutions such as KBN will have to build up capital. KBN should be able to meet the new requirements without needing a capital increase. This is based

KBN has provided loan to the Nordmøre Harbour Terminal in the town of Kristiansund.

(Photo: Lønnheim Entreprenør AS)

on the assumption that the state continues its current dividend policy.

Should Norwegian financial institutions like KBN be subject to leverage ratio requirements, there will be a significant need for an increase in equity capital. This means that in the coming years, KBN should build up capital in order to be better equipped should a requirement for leverage ratios be introduced at some stage in the future.

Future prospects

The global financial crisis is not over. The majority of Western economies are working to control their budget deficits, and certain countries have considerable challenges ahead due to high levels of government debt.

Norway is one of the few countries that have been only mildly affected by the financial crisis. Employment has remained at a high level, and both private and public sector investment levels look to also remain high. Norway has performed well, and the prognosis for the future is positive.

In the municipal sector, most economic indicators point to a high level of activity in 2011. There is still a considerable need for investments in, among other things, the health and welfare sector, and in infrastructure. Debt levels in the municipal sector are therefore expected to increase in the future as a result of planned central government policy. The 2011 National Budget plans for continued high activity in the municipal sector, and financing will be incentivised through various central government interest compensation schemes. It can therefore be expected that loan demand will grow in line with the overall growth in the municipalities' gross debt. The point of interest will be which opportunities the municipalities take advantage of to better prepare themselves for future cost increases. This relates to both operating expenses, which are a direct consequence of investments, and increased interest and pension charges. The servicing of future debt must be covered by an increase in revenues, and must therefore be seen in conjunction with the forthcoming years' National Budgets. There is reason to expect that lending growth will decline somewhat. It is difficult to say concretely how discernable that reduction will be.

Else Bugge Fougner

Kristin Marie Sørheim

Frode Berge

Svein Blix

Nanna Egidius

Åmund T. Lunde

Ellen Eskedal Scavenius

Martha Takvam

KBN plans to raise a considerable amount of funds in the international capital markets in 2011. The focus on increasing the average duration of the funding portfolio will continue. This will reduce the volume required for refinancing over the coming years. KBN will continue its diversified funding strategy as a means of securing the most cost efficient financing going forward. KBN has a deep and long-standing relationship with Japan and it is only natural that KBN follows the situation there after the recent earthquake, tsunami and the devastating after effects.

In order to improve the institution's regional visibility, KBN is now working with Husbanken (The State Housing Bank) so that KBN can make use of Husbanken's regional offices as a base for regional activities.

KBN has once again reached the end of another a year with a good set of results. Good results themselves are a precondition for KBN to fulfil its sector political function of financing local public sector development in a cost efficient way.

The Board of Directors would like to thank KBN's employees for a job well done.

Oslo, 31 December 2010
17 March 2011

The Board of Directors for KBN

Else Bugge Fougner Chairman of the Board	Kristin Marie Sørheim Vice Chairman	Frode Berge Board Member	Svein Blix Board Member
Nanna Egidius Board Member	Åmund T. Lunde Board Member	Ellen Eskedal Scavenius Board Member	Martha Takvam Board Member

Petter Skouen
President & CEO

INCOME STATEMENT

(Amounts in NOK 1 000 000)	**Note**	**2010**	**2009**
Interest income	**13**	5 034	4 847
Interest expenses	**13**	3 837	3 794
NET INTEREST INCOME		**1 197**	**1 053**
Commission expenses and expenses of banking services	**15**	18	19
Net gain/(loss) on financial instruments at fair value	**4,14**	(89)	222
Net gain/(loss) from repurchase of issued securities		41	781
TOTAL OTHER OPERATING INCOME		**(66)**	**984**
Salaries and administrative expenses	**16,17**	75	68
Depreciation of fixed assets		5	5
Other expenses		17	18
TOTAL OPERATING EXPENSES		**97**	**91**
PROFIT BEFORE TAX		**1 034**	**1 946**
Income tax	**18**	293	547
PROFIT FOR THE YEAR		**741**	**1 399**

STATEMENT OF COMPREHENSIVE INCOME

(Amounts in NOK 1 000 000)	**Note**	**2010**	**2009**
Profit for the year		741	1 399
Other comprehensive income		0	0
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**741**	**1 399**

STATEMENT OF FINANCIAL POSITION

(Amounts in NOK 1 000 000)	Note	2010	2009
ASSETS			
Deposits with credit institutions	**1,3,5**	6 857	988
Instalment loans	**1,2,3,6**	185 679	153 040
Notes, bonds and other interest-bearing securities	**1,2,3,12**	88 958	69 649
Financial derivatives	**1,3,9**	26 155	8 241
Other assets	**7**	17	14
TOTAL ASSETS		**307 666**	**231 932**
LIABILITIES AND EQUITY			
Loans from credit institutions	**1,3**	989	1 051
Senior securities issued	**1,2,3,8**	288 093	223 566
Financial derivatives	**1,3,9**	13 067	2 206
Other liabilities		37	23
Current tax liabilities	**18**	259	488
Deferred tax liabilities	**18**	182	60
Pension liabilities	**17**	25	24
Subordinated debt	**1,3,10**	306	667
Hybrid Tier 1 capital instruments	**1,3,10**	672	285
TOTAL LIABILITIES		**303 632**	**228 371**
Share capital	**11**	1 221	1 221
Retained earnings		2 814	2 340
TOTAL EQUITY		**4 034**	**3 561**
TOTAL LIABILITIES AND EQUITY		**307 666**	**231 932**

Statement from the Board of Directors

pursuant to § 5-5 of the Securities Trading Act

We confirm that the financial statements for 2010 is, to the best of our knowledge, prepared in accordance with International Financial Reporting Standards, IFRS, and that the information in the financial statements provides a true and fair view of the Company's assets, liabilities, financial position and profit or loss.

To the best of our knowledge, the financial statements provide a true and fair view of important events during the accounting period in question and their effects on the financial statements, and also the principal risks and uncertainties facing the Company in the next accounting period.

Oslo, 31 December 2010
17 March 2011
The Board of Directors
Kommunalbanken AS

Else Bugge Fougner
Chairman

Kristin Marie Sørheim
Vice Chairman

Frode Berge
Board Member

Svein Blix
Board Member

Nanna Egidius
Board Member

Åmund T. Lunde
Board Member

Ellen Eskedal Scavenius
Board Member

Martha Takvam
Board Member

Petter Skouen
President & CEO

STATEMENT OF CHANGES IN EQUITY

(Amounts in NOK 1 000 000)			2010	
	Note	**Share capital**	**Retained earnings**	**Total equity**
Equity as of 1 January 2010	11	1 221	2 340	3 561
Total comprehensive income for the year		0	741	741
Dividends		0	(267)	(267)
Equity as of 31 December 2010		**1 221**	**2 814**	**4 034**

			2009	
	Note	**Share capital**	**Retained earnings**	**Total equity**
Equity as of 1 January 2009	11	1 221	984	2 205
Total comprehensive income for the year		0	1 399	1 399
Dividends		0	(44)	(44)
Equity as of 31 December 2009		**1 221**	**2 340**	**3 561**

STATEMENT OF CASH FLOWS

(Amounts in NOK 1 000 000)	Note	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES			
Interest received		4 853	5 754
Interest paid		(3 846)	(4 748)
Fees and commissions paid		(18)	(19)
Receipts from repurchase of issued securities		41	781
Cash payments to employees and suppliers		(92)	(69)
Income taxes paid		(400)	(201)
		537	**1 499**
Net disbursement of loans to customers		(32 566)	(33 217)
Net (increase)/decrease in deposits with credit institutions		(6 049)	2 375
Net (increase)/decrease in notes, bonds and other interest-bearing securities		(17 760)	(6 416)
Net (increase)/decrease in other assets		(2)	62
Net increase/(decrease) in other liabilities		14	(25)
NET CASH FLOWS FROM OPERATING ACTIVITIES		**(55 825)**	**(35 723)**
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property and equipment		(7)	(8)
NET CASH FLOWS FROM INVESTING ACTIVITIES		**(7)**	**(8)**
CASH FLOWS FROM FINANCING ACTIVITIES			
Net proceeds from issuance of commercial papers		71	0
Net proceeds from issuance of debt securities		45 920	50 886
Proceeds from other borrowed funds		0	0
Repayment of other borrowed funds		0	(612)
Proceeds from issuance of subordinated debt		400	0
Repayment of subordinated debt		(351)	0
Dividends paid		(267)	(44)
NET CASH FLOWS FROM FINANCING ACTIVITIES		**45 773**	**50 230**
NET CHANGE IN CASH AND CASH EQUIVALENTS		**(10 059)**	**14 499**
Effects of foreign exchange differences		10 075	(14 476)
Cash and cash equivalents at 1 January		**63**	**40**
Net change in cash and cash equivalents		**15**	**23**
Cash and cash equivalents at 31 December		**78**	**63**
Deposits with credit institutions without agreed period of notice	**5**	*78*	*63*

Accounting Policies

REPORTING ENTITY

Kommunalbanken AS (”the Company”, or ”KBN”) is a limited company established for the purpose of providing loans to local authorities, regional authorities, inter-municipal companies and other companies that provide municipal services under a municipal guarantee or other security. The Company’s registered office is in Haakon VIIs gate 5B, Oslo.

The financial statements for the year ended 31 December 2010 were approved by the Board of Directors on 17 March 2011.

BASIS FOR PREPARATION

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the EU. The Company presents its financial statements on a historical cost basis, except for:

- Financial instruments at fair value through profit or loss
- Financial instruments held for trading, which are measured at fair value
- Loans and receivables in fair value hedges, where hedged risk is measured at fair value.

FOREIGN CURRENCY TRANSLATION

The Company’s functional and presentation currency is the Norwegian kroner (NOK). Assets and liabilities denominated in a foreign currency are translated into NOK at the exchange rate on the reporting date. Revenues and expenses denominated in a foreign currency are translated into NOK at the exchange rate at the transaction date.

ESTIMATES AND CRITICAL ACCOUNTING JUDGEMENTS

Preparation of financial statements in accordance with IFRS requires management to exercise judgement and estimates which can affect carrying values of assets and liabilities, and revenues and expenses. Estimates and accounting judgements are based on historical experience and expectations of future trends. Actual results may deviate from those estimates.

Fair value of financial instruments

The fair value of financial instruments that are not traded in an active market, or do not have available quoted prices at the reporting date, is determined using valuation techniques. The valuation requires the management to make assumptions and use estimates when considering credit risk and liquidity risk. Even if the assumptions and estimates are based to the greatest possible extent on actual market conditions prevailing at the reporting date, they involve judgement and may add to the degree of uncertainty in valuations. Items in the financial statements that can be impacted by management’s assumptions include:

- Bonds and notes measured at fair value, where market quotes are not available and fair value needs to be established using valuation techniques
- Loans to customers measured at fair value
- Financial liabilities in the form of issued securities measured at fair value
- OTC-derivatives which do not have available market quotes and fair value needs to be established using valuation techniques.

Pension liabilities

The value of pension liabilities is determined using actuarial valuation, which involves assumptions about variables, which affect the defined benefit obligation, i.e. discount rates, expected return on plan assets, future salary increases, mortality rates and future pension increases. Changes in the estimates impact the value of pension liabilities and pension costs. The Company complies with the actuarial and economic estimates prepared and updated by the Norwegian Accounting Standards Board (Norsk Regnskapsstiftelse).

RECOGNITION AND DERECOGNITION

Recognition and derecognition of financial instruments in the Statement of Financial Position takes place at time of settlement. On initial recognition all financial assets and liabilities are measured at fair value. For financial assets that are not carried at fair value through profit or loss, the value at initial recognition includes transaction costs that are directly attributable to acquisition.

For regular way purchase of financial assets, the value changes of the asset to be received during the period between the trade date and settlement date are recognised in the same way as the asset acquired, i.e. the change in value is not recognised for financial assets carried at amortised cost, and it is recognised in profit or loss for assets carried at fair value or classified as held for trading.

Financial assets are derecognised when the contractual rights to the cash flows expire or are transferred. Repurchase agreements (repo) involve transfer of assets while the Company retains practically all risk and reward, and therefore does not qualify for derecognition. Securities sold subject to repurchase agreements ('repos') are not derecognised from the Statement of Financial Position, and a corresponding counterparty liability is recognised.

Financial liabilities are derecognised when the contractual obligation has been discharged, cancelled or expired. Repurchases of issued bond debt result in derecognition of financial liabilities. Any difference between settlement amount and carrying value of the liability is recognised in the income statement as gain or loss at the date of transaction.

FINANCIAL INSTRUMENTS - CLASSIFICATION AND MEASUREMENT

Classification of financial instruments takes place at initial recognition and determines the subsequent measurement according to IAS 39. Financial instruments are classified into the following categories (in accordance with IAS 39).

1. Financial assets designated at fair value through profit or loss (FVO)

Financial assets classified in this category include selected bonds and notes in the liquidity portfolio, fixed rate loans and NIBOR-indexed loans to customers, which are hedged with interest rate and/or cross-currency derivatives. Application of the Fair Value Option to these assets helps to achieve consistent treatment with associated derivatives or financial liabilities which are measured at fair value through profit or loss.

2. Financial assets held for trading

Included in this classification are bonds and notes in the trading portfolio. Financial derivatives, with the exception of contracts designated as hedging instruments, are classified as financial assets or liabilities held for trading. Debt certificates issued by municipalities with a maturity of less than 1 year and traded in an active market are classified as financial assets held for trading. Financial assets held for trading are measured at fair value through profit or loss.

3. Financial assets held to maturity

Financial assets in this category are primarily investments of equity capital in senior bonds, and asset-backed securities that have been acquired with the intention of being held to maturity and selected securities that became illiquid as a result of the financial crisis in 2008 and had been reclassified from "Held for trading" to "Held to maturity"-category as of 1 July 2008. Financial assets held to maturity are measured at amortised cost using the effective interest rate method.

4. Loans and receivables

Included in this category are loans and advances to customers, and bonds and notes not quoted in an active market. Financial assets classified as Loans and receivables are measured at amortised cost using the effective interest rate method.

Hedge accounting may apply to bonds and notes classified as Loans and receivables when interest rate and cross-currency swaps are used to manage corresponding risks in the hedged securities. When the criteria for fair value hedge are met, the change in the fair value that is attributable to the risk hedged is recorded as a part of carrying value under "Bonds, notes and other interest-bearing securities", and is also recognised in the income statement as "Net gain/(loss) on financial instruments at fair value".

5. Financial liabilities designated at fair value through profit or loss (FVO)

Fair Value Option is applied to the majority of issued debt, where market risk exposure is hedged with derivative contracts. The financial liabilities and corresponding derivative contracts are evaluated on a fair value basis and managed in accordance with the Company's risk management policy that allows only limited exposure to interest rate and FX-risk in liabilities.

6. Financial liabilities at amortised cost

Financial liabilities measured at amortised cost are public benchmark loans issued in the second quarter of 2009 and onwards that are designated as hedged items and meet criteria for fair value hedges. Changes in fair value of these loans that are attributable to the risk hedged are recorded as a part of the carrying value under "Senior securities issued" and are recognised in the income statement as "Net gain/(loss) on financial instruments at fair value".

FINANCIAL INSTRUMENTS - DETERMINATION OF FAIR VALUE

Level 1

Securities traded in an active market with frequent market observations are recorded at quoted prices in active markets at the reporting date. Quoted prices are provided by international vendors (Reuters/Bloomberg). Quoted prices provided by vendors are classified as Level 1-inputs when they represent actual market transactions. Basis swap prices on USD-NOK, EUR-NOK and EUR-USD basis swaps, that are quoted in an active market are classified as Level 1-inputs.

Level 2
Level 2 includes financial instruments that are not traded in an active market and where fair value can be determined using quoted prices on identical or similar instruments, or using valuation methods where significant inputs are based on observable market data. Level 2-inputs might include:

- Observable interest rate yield curves, FX-rates, equity indexes and commodity indexes
- Quoted prices and credit spreads at the reporting date for similar instruments issued by the same issuer but with a different tenor, so that an adjustment for maturity is necessary
- Quoted prices and credit spreads at the reporting date for similar instruments issued by the same issuer but denominated in a different currency, so that an adjustment for currency is necessary
- Actual market transactions in identical instruments before or after reporting date, so that an adjustment for events between the date of transaction and the reporting date is necessary
- More liquid instruments issued by the same issuer with identical maturity, but an adjustment for liquidity risk is necessary
- Prices on potential new issues in similar instruments from the same issuer.

Level 3
Level 3 includes financial instruments that are not traded in an active market. Fair value of these instruments is determined using valuation methods where significant inputs are not based on observable market data. Financial instruments classified as Level 3 include notes and bonds with low liquidity, fixed-rate loans to customers, issued bond debt not traded in an active market and most OTC-derivatives.

The same input might be used to determine fair value of notes and bonds classified as Level 2 and Level 3. In these cases classification depends on whether adjustments that are done to the observable market data are considered to be significant (Level 3) or not (Level 2). Other inputs used in determination of fair value might include:

- Indicative prices and estimates for similar instruments provided by other market participants
- Market indices, both bonds and credit default swap indices, for similar instruments
- Non-binding price quotes from different sources
- Historical or implied volatilities

OFFSETTING OF FINANCIAL ASSETS AND LIABILITIES
Financial assets and financial liabilities are offset and the net amount is presented in the Statement of Financial Position when the Company has a legally enforceable right to offset these items and intends to realise the asset and settle the liability simultaneously.

IMPAIRMENT OF FINANCIAL ASSETS
Financial instruments classified as Loans and receivables or Held to maturity are measured in accordance with IAS 39. When there is objective evidence of value loss, the assets are impaired.

Individual impairments
If there is objective evidence that a loss has been incurred, the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows. The loss is recognised in the income statement. When commitments are assessed for individual impairments, the following loss events may be taken into consideration:

- Significant financial difficulty of the issuer or obligor
- Payment default or breach of contract
- Delinquency in interest or principal payments or renegotiation of loan terms as a result of debtors' financial distress

Group impairments
Financial assets are tested for impairment at a group level, based on the division of the assets into groups with similar risk characteristics. Assets are impaired if the observable data indicates a reduction in future cash flows from the group as a result of negative changes to debtors' creditworthiness and/or changes in economic environment that correlate with defaults in the group. Loans to customers are assessed as a uniform group, based on the provisions of the Local Government Act that rates all Norwegian municipalities equally with regard to risk to the lender. Securities carried at amortised cost are split into groups according to the issuer's risk, underlying exposure and geographical spread. The impairment loss is calculated per risk group, based on expectations to the macroeconomic conditions that can impact on the counterparty's ability to pay, and the loss history for the various risk groups.

Under current legislation limiting the municipalities' possibility of going bankrupt, the Company does not expect any impairments on its instalment loans.

HEDGE ACCOUNTING

Interest rate swaps and cross currency swaps are used to manage market risk in the portfolio of notes and bonds classified as Loans and receivables and senior securities issued classified as Other liabilities. Hedge relationship between a bond and a swap is treated as fair value hedge. Hedge relationship is established and documented at a transaction level, and hedge effectiveness is measured on an on-going basis using Dollar-offset method. Ineffective part of hedge is recognised in the income statement.

Hedging instruments are measured at fair value through profit or loss, and carrying amounts are adjusted accordingly. Change in fair value on the hedged items, that is attributable to the risk hedged, is recorded as a part of carrying value of the item and is recognised in the income statement as “Net gain/(loss) on financial instruments at fair value”.

STATEMENT OF CASH FLOWS

Statement of Cash Flows is prepared using the direct method and presents cash flows classified by activity. Cash and cash equivalents include cash on hand, demand deposits and short-term deposits with credit institutions that are readily convertible to cash.

RECOGNITION OF INCOME AND EXPENSES

Interest and commissions are recognised in the income statement as they are earned or accrue. Unrealised gains and losses on financial instruments at fair value are recognised in the income statement under "Net gains/(losses) on financial instruments at fair value". Interest income for assets and liabilities carried at amortised cost is recognised in the income statement using the effective interest method.

Unrealised gains and losses on financial instruments at fair value and value changes on hedged items under hedge accounting are recognised in income statement under "Net gains/(losses) on financial instruments at fair value".

Commission costs on government guaranteed funding are accrued over the lifetime of the transaction. Other commission costs and charges are recognised as expenses in the period when the service is provided.

FIXED ASSETS

Fixed assets are carried at cost with the deduction of accumulated depreciation and write-downs. Ordinary depreciation, based on cost price, is calculated using a straight line method over the estimated useful life, and the disposal value of the assets is assumed to be zero.

INTANGIBLE ASSETS

A domain name is classified as an intangible fixed asset with an indefinite useful life and is not depreciated. Assets are tested for impairment annually. If there is an indication that the assets are impaired, the value of the assets is written down, and the difference between the carrying amount and the recoverable amount is recognised in profit or loss.

PENSIONS

The Company has an employee pension scheme. The pension scheme is treated as a defined benefit plan. A standard profile of benefits earned and expected final salary are used to determine entitlements. The net pension cost for the period is included in "Salaries and administrative expenses" and consists of the sum of the period's service costs, interest costs on the calculated liability and expected return on the pension assets.

The Company has pension commitments for salaries that exceed 12 times the National Insurance base amount, which is not administered through a life insurance company.

Value of net pension liabilities is calculated based on economic and actuarial assumptions. Actuarial gains and losses in excess of 10 % of the higher of gross pension liabilities and gross pension assets at the beginning of the year (the corridor) are recorded in the income statement.

TAXES

Taxes are recognised as they accrue, i.e. the income tax is based on the pre-tax accounting profit or loss. It is adjusted for temporary and permanent differences before the year's tax base for current taxes is calculated. Deferred tax and the deferred tax asset are calculated on the basis of temporary differences between the accounting and tax values at the financial year end. The nominal tax rate is used for this calculation. Tax increasing and tax-reducing differences within the same period are offset.

Income tax consists of current taxes (tax on the taxable profit or loss for the year), changes in net deferred tax and insufficient/excess provision for taxes recognised in previous years.

EQUITY
The Company's equity consists of share capital and retained earnings.

Dividends are classified as equity until approved by the Annual General Meeting.

SEGMENT INFORMATION
The Company has one operating segment: lending to the Norwegian municipalities and municipal companies. The Company does not provide separate segment reporting other than disclosures on the lending portfolio and the business as a whole.

NEW ACCOUNTING STANDARDS IN 2010
New accounting standards effective from 2010 has not resulted in any material change to the accounting policies of Kommunalbanken. The Company has particularly looked into the ammendments to IAS 32 and 39. New accounting standards not considered to be relevant for the Company are not accounted for in the following text.

Changes in IAS 39 *Financial instruments – recognition and measurement - Eligible Hedged Items*
Changes in IAS 39 aim to clarify what is a qualifying portion of fair value or cash flows. The amendments clarify application of hedge accounting to hedge of inflation risk and hedging with options. The amendments also make clear that hedged risk should be separately identifiable and reliably measurable to qualify for hedge accounting. The amendments are effective for annual periods beginning on and after 1 July 2009. The Company implemented the amendments from 1 January 2010 and did not experience any material impact on statement of financial position or income statement.

STANDARDS ISSUED, BUT NOT YET EFFECTIVE

IFRS 9 *Financial instruments*
IFRS 9 replaces classification and measurement rules in *IAS 39 - Financial instruments-Recognition and measurement.* In the new IFRS 9 financial instruments with basic loan features and managed on a contractual cash flow basis should be recorded at amortised cost, unless one opts to measure these assets at fair value. Other financial instruments should be measured at fair value. IFRS 9 is effective for annual periods beginning on or after 1 January 2013, but the standard is still not approved by the EU. The Company expects to implement the new standard from 1 January 2013. IFRS 9 is expected to affect the Company’s presentation of financial liabilities.

IASB’s annual improvement project 2010
Through its annual improvement project IASB has adopted amendments to several accounting standards. These amendments took effect from 1 July 2010 and onwards. The amendments are not approved by the EU. The Company expects to implement these changes from 1 January 2011.

IFRS 7 ***Financial instruments – presentation*** *:* The standard is amended to reflect the interaction of quantitative and qualitative information and the type and extent of financial risk related to financial instruments. Further changes include amendments to the required quantitative and qualitative information about credit risk in the notes to the financial statements. These amendments are not expected to materially affect the Company’s financial statements.

IAS 34 ***Interim Financial Reporting****:* Guidance is presented about required information in IAS 34, and further requirements for information about circumstances that will affect the fair value of financial instruments and their classification, migration between different categories of financial instruments in the fair value hierarchy, changes in the classification of financial assets and changes to contingent liabilities and assets. The amendments can affect some interim financial reports going forward.

NOTE 1 Classification of financial instruments

(Amounts in NOK 1 000 000)

2010	Total	At fair value through profit or loss			Held to maturity	Loans and receivables	Other liabilites
		FVO	Held for trading	Fair value hedge			
Deposits with credit institutions	**6 857**	6 779	0	0	0	78	0
Instalment loans	**185 679**	103 879	8 375	0	0	73 424	0
Notes, bonds and other interest-bearing securities	**88 958**	52 200	24 562	0	3 155	9 041	0
Financial derivatives	**26 155**	0	25 096	1 059	0	0	0
Total financial assets	**307 648**	**162 858**	**58 032**	**1 059**	**3 155**	**82 544**	**0**
Loans from credit institutions	**989**	989	0	0	0	0	0
Senior securities issued	**288 093**	252 697	0	0	0	0	35 396
Financial derivatives	**13 067**	0	11 121	1 947	0	0	0
Subordinated debt	**306**	306	0	0	0	0	0
Hybrid Tier 1 capital instruments	**672**	672	0	0	0	0	0
Total financial liabilities	**303 128**	**254 665**	**11 121**	**1 947**	**0**	**0**	**35 396**

2009	Total	At fair value through profit or loss			Held to maturity	Loans and receivables	Other liabilites
		FVO	Held for trading	Fair value hedge			
Deposits with credit institutions	**988**	925	0	0	0	63	0
Instalment loans	**153 040**	78 862	11 162	0	0	63 017	0
Notes, bonds and other interest-bearing securities	**69 649**	34 595	16 140	0	1 481	17 432	0
Financial derivatives	**8 241**	0	8 195	46	0	0	0
Total financial assets	**231 918**	**114 382**	**35 497**	**46**	**1 481**	**80 512**	**0**
Loans from credit institutions	**1 051**	1 051	0	0	0	0	0
Senior securities issued	**223 566**	215 520	0	0	0	0	8 046
Financial derivatives	**2 206**	0	201	2 005	0	0	0
Subordinated debt	**667**	667	0	0	0	0	0
Hybrid Tier 1 capital instruments	**285**	285	0	0	0	0	0
Total financial liabilities	**227 775**	**217 523**	**201**	**2 005**	**0**	**0**	**8 046**

NOTE 2 Financial instruments measured at amortised cost

(Amounts in NOK 1 000 000)

2010	Carrying amount	Fair value
Instalment loans	73 425	73 346
Notes, bonds and other interest-bearing securities classified as loans and receivables	9 041	9 157
Notes, bonds and other interest-bearing securities classified as held to maturity	3 155	3 131
Total financial assets at amortised cost	**85 621**	**85 634**
Senior securities issued	35 396	35 446
Total financial liabilites at amortised cost	**35 396**	**35 446**

2009	Carrying amount	Fair value
Instalment loans	63 017	62 979
Notes, bonds and other interest-bearing securities classified as loans and receivables	17 432	17 555
Notes, bonds and other interest-bearing securities classified as held to maturity	1 481	1 461
Total financial assets at amortised cost	81 930	81 995
Senior securities issued	8 046	8 061
Total financial liabilites at amortised cost	**8 046**	**8 061**

Fair value of financial instruments recorded at amortised cost is determined using the same principles, as financial instruments carried at fair value. Calculation of fair value is based on the same market rates, estimates and assumptions, and uses the same valuation techniques for all financial instruments, regardless of classification.

NOTE 3 Fair value of financial instruments

(Amounts in NOK 1 000 000)

2010	Level 1	Level 2	Level 3	Total
Deposits with credit institutions	0	6 779	0	**6 779**
Instalment loans	0	70 690	41 564	**112 255**
Notes, bonds and other interest-bearing securities	3 836	56 800	16 126	**76 762**
Financial derivatives	784	19 315	6 056	**26 155**
Total financial assets at fair value	**4 620**	**153 584**	**63 746**	**221 950**
Loans from credit institutions	0	989	0	**989**
Senior securities issued	24 520	0	228 177	**252 697**
Financial derivatives	2 699	7 802	2 566	**13 067**
Subordinated debt	0	0	306	**306**
Hybrid Tier 1 capital instruments	0	0	672	**672**
Total financial liabilities at fair value	**27 219**	**8 792**	**231 722**	**267 732**

2009	Level 1	Level 2	Level 3	Total
Deposits with credit institutions	0	925	0	**925**
Instalment loans	0	56 427	33 596	**90 023**
Notes, bonds and other interest-bearing securities	4 463	30 467	15 806	**50 736**
Financial derivatives	865	6 782	594	**8 241**
Total financial assets at fair value	**5 328**	**94 601**	**49 996**	**149 925**
Loans from credit institutions	0	1 051	0	**1 051**
Senior securities issued	30 649	19 342	165 529	**215 520**
Financial derivatives	65	1 400	741	**2 206**
Subordinated debt	0	0	667	**667**
Hybrid Tier 1 capital instruments	0	0	285	**285**
Total financial liabilities at fair value	**30 714**	**21 793**	**167 222**	**219 729**

Certain financial instruments have been transferred from one level to another during 2010. The transfers are primarily a result of improved liquidity in the credit markets.

Reconciliation of movements in Level 3

	2009	Purchase	Sale	Gain/(loss)*	Transfers	2010
Instalment loans	33 596	13 070	(4 496)	0	(605)	41 564
Notes, bonds and other interest-bearing securities	15 806	9 164	(6 809)	309	(2 345)	16 126
Financial derivatives	594	3 326	(557)	2 679	14	6 056
Total financial assets in level 3	**49 996**	**25 560**	**(11 862)**	**2 989**	**(2 937)**	**63 746**
Loans from credit institutions	0	0	0	0	0	0
Senior securities issued	165 529	108 574	(70 749)	8 893	15 930	228 177
Financial derivatives	741	1 765	(41)	99	2	2 566
Subordinated debt	667	0	(389)	28	0	306
Hybrid Tier 1 capital instruments	285	402	0	(15)	0	672
Total financial liabilities in level 3	**167 222**	**110 742**	**(71 179)**	**9 004**	**15 932**	**231 722**

* The gain/(loss) is recognised in the income statement as Net gain/(loss) on financial instruments at fair value.

Reconciliation of movements in Level 3

	2008	Purchase	Sale	Gain/ (loss)*	Transfers	2009
Instalment loans	63 797	4 195	(8 255)	43	(26 184)	33 596
Notes, bonds and other interest-bearing securities	9 808	9 807	(908)	(30)	(2 871)	15 806
Financial derivatives	0	425	0	48	121	594
Total financial assets in level 3	**73 605**	**14 427**	**(9 163)**	**61**	**(28 934)**	**49 996**
Loans from credit institutions	1 922	0	(1 922)	0	0	0
Senior securities issued	200 087	67 723	(36 304)	1 017	(66 994)	165 529
Financial derivatives	0	45	0	1	695	741
Subordinated debt	1 253	0	(605)	19	0	667
Hybrid Tier 1 capital instruments	329	0	(58)	14	0	285
Total financial liabilities in level 3	**203 592**	**67 768**	**(38 889)**	**1 051**	**(66 299)**	**167 222**

* The gain/(loss) is recognised in the income statement as Net gain/(loss) on financial instruments at fair value.

Fair value of financial instruments

Determination of fair value at level 1 requires use of quoted market prices. The criteria for level 1 inputs are described in "Accounting policies."

Fair value of financial instruments in level 2 and 3 is determined mainly using discounted cash flow method, where future cash-flows are discounted with relevant money market interest rates plus an adjustment for credit and liquidity risk. Financial instruments with embedded option elements are valued using option pricing models that use both inputs observable in the market and estimated inputs as parameters. All changes in fair value are recorded as part of carrying value of assets and liabilities, and recognised in the income statement.

Deposits with credit institutions

Deposits with credit institutions that are carried at fair value include cash time deposits with other credit institutions. Because of their short-term nature the fair value of these instruments is approximately equal to the notional amount.

Instalment loans

Level 2 includes short-term debt certificates issued by municipalities and loans with floating Nibor-indexed interest rate. The customers have more flexibility in refinancing these types of loans with other lenders should market conditions change. As a result, these types of loans are subject to greater competition from lenders and have observable prices that can be used as Level 2 input when the fair value is determined.

Level 3 includes fixed rate loans to customers that are not traded in an active market and do not have observable market prices after initial recognition. A significant valuation input for fixed rate loans is credit value adjustment, that is estimated at each reporting date. Credit risk is considered to be the same for all municipalities. As observable market data for credit risk is not available, the management has to make assumptions and estimate relevant adjustments for credit risk based on current lending levels and any additional loan security.

Notes and bonds

The best estimate of fair value is price quotations in an active market with many willing buyers and sellers at the reporting date. Level 1 inputs for notes and bonds include quoted prices provided by international vendors (Reuters/Bloomberg). The price quotes used in valuation represent actual transactions in an active market.

Fair value of notes and bonds that do not have available market quotes at the reporting date is calculated using the discounted cashflow method, where discount rates are derived from current interest rate yield curves. Discount rates are adjusted for credit risk and liquidity risk of the issuer, based on observable market data. When applying credit/liquidity value adjustments to discount rates, the assets are grouped based on the issuer's credit rating, currency, time to maturity, underlying exposure and geographic position. For more detailed description of inputs in fair value determination, see "Accounting policies."

Senior securities issued

The funding portfolio is split into four main groups, based on the funding product and loan documentation used. The four main categories are benchmark loans, loans in public niche markets, private placements and retail loans. The two first groups are characterised by public syndicated loans in various currencies, where the size of the loan forms the primary difference between the two groups. Fair value of these loans is based on quoted prices of existing issues, prices on new issues and price information obtained from different sources. When those prices represent actual market transactions sufficiently close to the reporting date, they will be classified as Level 1 input in fair value hierarchy.

Group three is private placements and is characterised by non-public loans where the loan terms are specially adapted for a single investor. The final main group is retail loans, i.e. loans sold to retail investors. These loans are normally not traded in the secondary market and do not have available price quotes. The portfolio is therefore classified as Level 3 in fair value hierarchy. The choice of valuation models and input depends on the structure of each loan. The fair value of the bonds without embedded options is determined using the discounted cashflow method with inputs based on current interest rate yield curves and credit spreads estimated from prices on new issues. The fair value of structured bonds with option elements is calculated using option pricing models that use both interest rates, FX-rates and historical volatilities as parameters.

Financial derivatives

All financial derivatives are OTC-contracts used only in financial hedges. Basis swaps (USD-NOK, USD-EUR and EUR-NOK) are recorded at market prices quoted in an active market. The fair value of plain vanilla interest rate– and cross currency swaps is determined using the discounted cashflow method with discount rates derived from observable swap interest rates. Equity and commodity linked derivatives with embedded options are valued using the same valuation models as corresponding loans and are classified as Level 3.

The table below shows impact of 10 basis point change in estimated credit spreads on fair value of financial instruments at Level 3.

	10 bp change in credit spread
Instalment loans	(121)
Notes, bonds and other interest-bearing securities	(12)
Financial derivatives	(375)
Senior securities issued	332
Subordinated debt and Hybrid Tier 1 capital instruments	1
Total	**(175)**

NOTE 4 Hedge accounting

(Amounts in NOK 1 000 000)

Fair value hedge is applied to transactions used to manage exposures to interest rates and FX-rates in assets and liabilities.

Exposure to interest rate risk and FX-risk in notes and bonds classified as Loans and receivables is hedged with interest rate swaps and cross currency swaps. Hedge relationship is established at transaction level and hedge effectiveness is measured using Dollar-Offset method on a regular basis. Fair value hedge is also used for selected issued bonds. The risks hedged in liabilities include interest rate risk and FX-risk, and are hedged with interest rate swaps and cross currency swaps.

	2010	2009
Net gain/(loss) on financial derivatives in fair value hedges	507	(273)
Net gain/(loss) on notes and bonds in fair value hedges	166	346
Net gain/(loss) on issued bonds in fair value hedges	(670)	(104)
Net gain/(loss) on fair value hedges recognised in income statement	**3**	**(31)**

NOTE 5 Deposits with credit institutions

(Amounts in NOK 1 000 000)	2010	2009
Deposits with credit institutions without agreed lifetime	78	63
Deposits with credit institutions with agreed lifetime	6 779	925
Total Deposits with credit institutions	6 857	988

NOTE 6 Instalment loans

(Amounts in NOK 1 000 000)	**2010**	**2009**
Principal amount	183 841	151 275
Accrued interest	1 076	817
Adjustment for fair value*	722	908
Loans to customers	**185 639**	**153 000**
Other loans	40	40
Total instalment loans	**185 679**	**153 040**

*Changes in fair value attributable to changes in credit risk of the instalment loans are close to zero.

Geographic distribution	**2010**	**2009**
Østfold	11 199	8 623
Akershus	19 934	17 622
Oslo	4 224	1 364
Hedmark	6 684	6 198
Oppland	6 000	5 233
Buskerud	11 864	8 924
Vestfold	6 889	6 134
Telemark	7 163	6 170
Aust-Agder	5 220	4 277
Vest-Agder	9 581	7 796
Rogaland	12 508	10 824
Hordaland	19 011	14 707
Sogn og Fjordane	5 884	5 120
Møre og Romsdal	12 882	10 718
Sør-Trøndelag	10 996	9 889
Nord-Trøndelag	8 525	5 783
Nordland	11 645	9 774
Troms	8 636	8 038
Finnmark	4 956	4 037
Svalbard	42	45
Total loans to customers	**183 841**	**151 275**

Past due interest and instalment payments amount to NOK 51.3 million at 31 December 2010, and NOK 21.7 million at 31 December 2009.

NOTE 7 Other assets

(Amounts in NOK 1 000 000)

Other assets	**2010**	**2009**
Intangible assets	1	1
Fixed assets	14	12
Other assets	1	1
Prepaid, non-accrued expenses and accrued income	2	1
Total other assets	**17**	**14**

NOTE 8 Senior securities issued

(Amounts in NOK 1 000 000)

	2010	2009
Senior securities issued (nominal amounts) at 1 January	224 418	202 197
New issuance	138 231	116 263
Redemptions	(91 872)	(64 967)
Amortisation	(374)	(26)
Translation differences	19 828	(29 048)
Senior securities issued (nominal amounts) at 31 December	290 231	224 418
Accrued interest	2 746	2 662
Adjustment for fair value	(4 884)	(3 514)
Total senior securities issued	**288 093**	**223 566**
Gain from adjustment for fair value as a result of change in credit risk	*302*	*350*

Change in fair value attributable to changes in credit risk is calculated as a difference between market value and net present value of the portfolio based on risk-free interest rates.

There is no breach of debt covenants as at 31 December 2010.

Adjustments to fair value as a result of the Company's credit risk is a part of the change in fair value not attributable to changes in parameters associated with market risk. It is assumed that the market risk in senior securities issued is limited to changes in observable money market interest rates. Changes in fair value attributable to changes in credit risk in senior securities issued are calculated as the difference between the discounted value applying:

a) Relevant money market interest rates at the reporting date adjusted for the credit risk at time of recognition; and

b) Relevant money market interest rates at the reporting date adjusted for the credit risk at the reporting date.

NOTE 9 Financial derivatives

(Amounts in NOK 1 000 000)

The Company uses financial derivatives to hedge against interest and currency risks that arise as a result of the Company's activities. The Company enters into swap contracts with counterparties which have high credit ratings and all derivative exposure is subject to risk limits set by the Board. The Company's funding in foreign currency is hedged by interest rate and currency derivatives, so that it only has exposure to changes in 3-month money market interest rates in NOK, USD and EUR.

Funding in foreign currency is converted to NOK using basis swaps (mostly USD-NOK), where the Company receives interest payments in foreign currency and pays interest in NOK.

Interest rate risk arising from fixed rate lending is hedged by interest rate swaps and FRAs. Interest rate and currency swaps are also used to hedge against market risk in the liquidity portfolio.

The Company has no credit derivatives in its portfolio.

Interest rate derivatives:

- Interest rate swaps, with exchange of interest terms for an agreed amount over an agreed period.
- Forward rate agreements (FRA), that fix the interest rate for a nominal amount for a future period.

Currency derivatives:

- Cross currency swaps, with exchange of currency amounts at an agreed rate over an agreed period.
- FX-forwards, which are purchase and sales of a currency amount at a fixed rate at a future point of time.

Equity-related derivatives:

- Derivatives that have equity instruments as underlying instruments, or that are related to the price of specific equity instruments or equity indexes.

Commodity-related derivatives:

- Derivatives with commodity indexes as underlying instruments.

Counterparty risk arising from derivatives is monitored continuously. Counterparty risk is mitigated by using standard ISDA-agreements that give the right to offset liabilities and assets in the case of default. In addition the Company enters into collateral agreements with most swap counterparties. The agreements require collateral in form of cash to be posted for all net exposures over a predefined threshold.

	2010			2009		
	Nominal value*	Assets	Liabilities	Nominal value*	Assets	Liabilities
Held for trading:						
Interest rate derivatives	119 755	1 708	1 515	123 092	1 014	111
Currency derivatives	351 936	13 356	9 454	286 626	5 218	624
Equity-related derivatives	67 862	9 951	150	49 872	1 946	(542)
Commodity-related derivatives	2 417	81	3	2 710	17	7
	541 971	**25 096**	**11 121**	**462 299**	**8 195**	**200**
Fair value hedges:						
Interest rate derivatives	26 720	808	156	3 696	50	(3)
Currency derivatives	7 010	251	1 790	1 838	(4)	2 009
	33 731	**1 059**	**1 947**	**5 534**	**46**	**2 006**
Total financial derivatives	**575 702**	**26 155**	**13 067**	**467 833**	**8 241**	**2 206**

* Nominal value reported in the capital adequacy statement

Pursuant to the requirements in the Company's financial policy, all derivative contracts can be used in financial hedges only. Most of the derivatives are classified as Held for trading, with the exception of derivatives designated as hedging instruments in fair value hedges. All financial derivatives are recorded at fair value through profit or loss.

NOTE 10 Subordinated debt

(Amounts in NOK 1 000 000)

Subordinated debt (nominal amount)	Redemption right	Interest	2010	2009
Perpetual subordinated loan capital (NOK 400 mill) (Interest rate is adjusted every 3 months)*	2020	4.87%	400	0
Perpetual subordinated loan capital (NOK 102 mill) (Interest rate is adjusted every 3 months)*	2019	3.59%	102	102
Perpetual subordinated loan capital (EUR 20 mill) *	2012	6.29%	156	166
Perpetual subordinated loan capital (NOK 7.5 mill) (Interest rate is adjusted every 3 months)		3.66%	8	8
Perpetual subordinated loan capital (EUR 45 mill)		6.95%	0	373
Perpetual subordinated loan capital (JPY 3 bn)	2012	1.61%	215	186
Ordinary subordinated loan capital (NOK 80 mill) (Interest rate is adjusted every 3 months)	2017	2.74%	80	80
Total subordinated debt			**961**	**915**

*Hybrid Tier 1 Capital instruments are capital instruments approved as an element in the core capital within a limit of 15 per cent of total Tier 1 capital.

NOTE 11 Share capital

	2010		2009	
	Number of shares	Share in %	Number of shares	Share in %
The Kingdom of Norway	1 220 625	100 %	1 220 625	100 %
Total	**1 220 625**		**1 220 625**	

KBN's share capital amounts to NOK 1 220 625 000 as of 31 December 2010. Share capital is divided into 1 220 625 shares of NOK 1 000. A dividend of NOK 164.7 million (NOK 134,90 per share) has been proposed for 2010. Dividend paid for the fiscal year 2009 amounted to NOK 267.2 million (NOK 219,00 per share).

The earnings per share is calculated as follows (amounts in NOK):

	2010	2009
Profit for the year	740 995 490	1 399 169 358
Number of shares	1 220 625	1 220 625
Earnings per share	**607**	**1 146**

NOTE 12 Collateral

(Amounts in NOK 1 000 000)

	2010	2009
Cash collateral received	7 368	2 836
Cash collateral posted	(716)	(1 733)
Total cash collateral	**6 653**	**1 104**

Kommunalbanken has entered into collateral agreements with most of its swap counterparties. These agreements will provide additional security against loss in case of a default of a counterparty. Kommunalbanken will not enter into any new ISDA agreements or approve any new credit lines for swap counterparties without also entering into a collateral agreement. Kommunalbanken's collateral agreements are based on standard terms and conditions only allowing cash collateral (USD and EUR). Received collateral is included as an asset with a corresponding liability towards the swap counterparty posting the collateral. Pledged collateral is deducted with a corresponding claim against the swap counterparty receiving the collateral.

NOTE 13 Net interest income

(Amounts in NOK 1 000 000)

	2010						
	Total	At fair value through profit or loss			Held to maturity	Loans and recei-vables	Other liabili-ties
		FVO	Held for trading	Fair value hedge			
Interest income from deposits with credit institutions	28	28	0	0	0	0	0
Interest income from instalment loans	4 910	2 933	316	0	0	1 662	0
Interest income from notes, bonds and other interest -bearing securities	2 481	1 128	437	0	53	863	0
Interest income from financial derivatives	(2 385)	0	(1 634)	(751)	0	1	0
Other interest income	0	0	0	0	0	0	0
Total interest income	5 034	4 088	(881)	(751)	53	2 526	0
Interest expenses on loans from credit institutions	13	13	0	0	0	0	0
Interest expenses on senior securities issued	9 395	8 623	0	0	0	0	772
Interest expenses on subordinated debt	19	19	0	0	0	0	0
Interest expenses on financial derivatives	(5 589)	0	(5 033)	(571)	0	15	0
Other interest expenses	0	0	0	0	0	0	0
Total interest expenses	3 837	8 655	(5 033)	(571)	0	15	772

	2009						
	Total	At fair value through profit or loss			Held to maturity	Loans and recei-vables	Other liabili-ties
		FVO	Held for trading	Fair value hedge			
Interest income from deposits with credit institutions	33	32	0.1	0	0	0.3	0
Interest income from instalment loans	4 398	2 543	173	0	0	1 681	0
Interest income from notes, bonds and other interest -bearing securities	2 613	668	767	0	25	1 153	0
Interest income from financial derivatives	(2 197)	0	(999)	(1 198)	0	0	0
Other interest income	1	0	0	0	0	1	0
Total interest income	4 847	3 243	(60)	(1 198)	25	2 836	0
Interest expenses on loans from credit institutions	24	24	0	0	0	0	0
Interest expenses on senior securities issued	7 609	7 449	0	0	0	0	160
Interest expenses on subordinated debt	37	37	0	0	0	0	0
Interest expenses on financial derivatives	(3 867)	0	(3 668)	(199)	0	0	0
Other interest expenses	(9)	0	0	0	0	0	(9)
Total interest expenses	3 794	7 510	(3 668)	(199)	0	0	151

NOTE 14 Net gain/(loss) on financial instruments at fair value

(Amounts in NOK 1 000 000)

Unrealised gain/(loss) on financial instruments at fair value	2010					
	Total	At fair value through profit or loss			Loans and receivables	Other liabilities
		FVO	Held for trading	Fair value hedge		
Instalment loans	**(186)**	(187)	0	0	0	0
Notes, bonds and other interest-bearing securities*	**174**	29	(21)	0	166	0
Financial derivatives	**(1 468)**	0	(1 975)	507	0	0
Loans from credit institutions	**1**	1	0	0	0	0
Senior securities issued*	**1 370**	2 040	0	0	0	(670)
Subordinated debt and Hybrid Tier 1 capital instruments	**21**	21	0	0	0	0
Net unrealised gain/(loss) on financial instruments at fair value	**(89)**	**1 905**	**(1 995)**	**507**	**166**	**(670)**

*Financial derivatives in fair value hedges are measured at fair value through profit or loss. Hedged items in fair value hedges include NOK 8.4 billion in notes and bonds, and NOK 34.3 billion in senior securities issued, that are measured at amortised cost. Changes in fair value of hedged items that are attributable to hedged risk are recorded as a part of carrying value of corresponding assets and liabilities, and are recognised in the income statement as "Net unrealised gain/(loss) on financial instruments at fair value". The effect of fair value hedges on the income statement is described in Note 4.

Unrealised gain/(loss) on financial instruments at fair value	2009					
	Total	At fair value through profit or loss			Loans and receivables	Other liabilities
		FVO	Held for trading	Fair value hedge		
Instalment loans	**(552)**	(536)	(16)	0	0	0
Notes, bonds and other interest-bearing securities	**385**	46	(7)	0	346	0
Financial derivatives	**1 875**	0	2 148	(273)	0	0
Loans from credit institutions	**10**	10	0	0	0	0
Senior securities issued	**(1 529)**	(1 425)	0	0	0	(104)
Subordinated debt and Hybrid Tier 1 capital instruments	**33**	33	0	0	0	0
Net unrealised gain/(loss) on financial instruments at fair value	**222**	**(1 872)**	**2 125**	**(273)**	**346**	**(104)**

NOTE 15 Commission expenses and expenses of banking services

(Amounts in NOK 1 000 000)

	2010	2009
Guarantee fee to the State of Norway	0	1
Expenses of banking services	12	11
Other transaction costs	8	8
Other income	1	1
Total commission expenses and expenses of banking services	**18**	**19**

NOTE 16 Salaries and other remuneration

(Amounts in NOK 1 000)

Salaries	2010	2009
Salaries	46 085	38 786
Employer's contributions	7 448	5 102
Pension costs	4 686	7 854
Other benefits	1 423	1 197
Total salaries	**59 642**	**52 939**

Average labour years	44,7	43,5

		2010	
Compensation for senior employees	Salaries	Remuneration/Bonus	Pension costs
President & CEO	1 940	560	436
Deputy CEO	1 479	357	292

		2009	
Compensation for senior employees	Salaries	Remuneration/Bonus	Pension costs
President & CEO	1 792	567	473
Deputy CEO	1 247	286	311

The President & CEO has termination benefit agreement of one year salary following termination of employment. Other senior management have a period of notice of three months and no termination benefit following termination. The pension scheme for the President & CEO is the same as for the other employees with a benefit level of 66 per cent without a limitation to 12 x National Insurance Base amount. Pension costs include pension costs in the collective pension scheme and provisions for contributions covering salary over 12 base amounts.

The Company has an incentive programme for the employees. The incentive programme is re-evaluated and approved by the Board annually. The programme includes all employees, regardless of position and area of responsibility. The incentive programme is aiming at stimulating better performance and long-term profit-making, and supports the company's ability to attract and develop motivated and competent employees. The remuneration approach is based on a set of quantitative criteria and reflects goal achievement in the areas critical for the Company's long-term value creation and sustainability.

Allotment from the incentive programme, including vacation pay, can not exceed three month salary for any employee. Based on the results for 2010, the employees were allotted on average 2.2 months salary, in total NOK 8.0 millions included vacation pay and employer's contribution, under the current incentive scheme. Of any incentives earned during 2010, half will be disbursed and disbursed in 2011 and the other half evenly distributed over a period of three years. Any allotted, not disbursed, incentives may be reduced or cancelled if future results for Kommunalbanken require this.

Based on the extraordinary results achieved by the Company in 2009, the Board approved in 2010 a separate incentive payment to a few employees, who had a particular influence on the goal achievement in 2009. This incentive payment was distributed over two year, with half being paid in 2010 and half in 2011.

For 2009, the President & CEO was awarded an incentive payment of NOK 547 480 and Deputy CEO was awarded NOK 376 319. Approved incentive payment for 2010 is NOK 450 000 for the President & CEO, and NOK 372 357 for the Deputy CEO.

In addition to the incentive programme the Company in 2008 has offered a one-time compensation to four employees who were identified as essential to the future development of the Company. The agreement matures in 2011 and requires continuous employment through the period of agreement.

Remuneration to the Board of Directors, Control Committee and Supervisory Board

Board of Directors	**2010**	**2009**
Chairman Else Bugge Fougner 1)	215	190
Vice Chairman Per N. Hagen	0	48
Vice Chairman Kristin Marie Sørheim 1)	122	50
Board member Frode Berge	92	45
Board member Svein Blix	92	90
Board member Nanna Egidius 2)	116	90
Board member Åmund T. Lunde 1, 2)	155	45
Board member Martha Takvam 2)	116	90
Board member Sverre Thornes	0	43
Board member, employee representative Ellen Eskedal Scavenius	47	0
Board member, employee representative Martin Spillum	45	90
Total Board of Directors	**1 000**	**780**

1) Member of Compensation Committee

2) Member of Audit Committee

Control Committee	2010	2009
Chairman Britt Lund	49	47
Committee member Kristine Stray Ryssdal	15	30
Committee member Kjell Inge Skaldebø	31	30
Committee member Anne-Ma Tostrup Smith	15	0
Committee member Roy Jevard	13	12
Total Control Committee	123	118

The remuneration to the alternate member is NOK 3 400 per appearance.

Supervisory Board	2010	2009
Chairman Elin Eidsvik	19	11
Chairman Oddvar Flæte	0	9
Members	47	57
Total Supervisory Board	**66**	**77**

Loans to employees	2010	2009
Short-term loans to senior employees	125	25
Short-term loans to other employees	594	570
Residential mortgages to senior employees	2 900	3 120
Residential mortgages to other employees	32 963	32 571
Total loans to employees	**36 582**	**36 286**
Interest subsidies in the period	83	434

The President & CEO's mortgage had a balance of NOK 2.283 million with an interest rate of 2.75 per cent as of 31 December 2010. The mortgage repayment period is 20 years.

Fees to the statutory auditor	2010	2009
Statutory audit fees	701	630
Other financial audit and attestation services	854	945
Tax services	0	0
Other services not related to audit	53	146
Total fees excl. VAT	**1 607**	**1 721**

NOTE 17 Pensions

(Amounts in NOK 1 000)

The Company has a defined benefit plan for all employees administrated through Kommunal Landspensjonskasse (KLP). The pension benefits include retirement pension, disability pension, spouse and child pension, and are coordinated with the National Insurance Scheme. The defined benefit plan complies with the requirements of the Norwegian Mandatory Service Pension Act.

Full pension benefit requires a service period of 30 years and gives the right to a retirement pension of 66 per cent of salary, including the National Insurance Scheme. KBN also has a scheme linked to the contractually agreed early retirement pension scheme (AFP). The scheme is included in the calculation of pension liabilities. Pension commitment for salaries over 12 x Base amount is expensed when incurred.

Pension costs and commitments recognised in the income statement include employer's contributions.

The defined benefit plan is administrated through a public sector occupational pension scheme and asset composition cannot be specified.

Economic estimates used in calculation of pension costs and commitments:

	2010	2009
Discount rate	4,00%	4,50%
Estimated wage growth	4,00%	4,50%
Expected growth in Base amount	3,75%	4,25%
Expected growth in benefit levels	3,00%	3,00%
Expected return on assets	5,40%	5,70%

Collective scheme		Pension commitment	Salaries over 12xBase amount	
2010	**2009**		**2010**	**2009**
53 173	46 803	Defined benefit obligation	10 184	6 347
32 224	25 856	Plan assets	0	0
(2 368)	(1 578)	Unrecognised actuarial gains/(losses)	(4 069)	(1 572)
18 581	**19 368**	**Net pension commitment**	**6 115**	**4 775**

Collective scheme		Pension costs	Salaries over 12xBase amount	
2010	**2009**		**2010**	**2009**
6 221	5 553	Fair value of pension earnings for the year	944	1 065
2 241	1 775	Interest costs on pension commitment	329	277
(1 599)	(1 195)	Expected return on plan assets	0	0
233	273	Service costs	0	0
(3 180)	0	(Gains)/losses of change in pension scheme recognised in income*	0	0
0	129	Actuarial gains/losses recognised in income	68	472
3 916	**6 536**	**Net pension costs**	**1 340**	**1 814**

* A new pension scheme was passed by Stortinget 17 June 2010.

Changes in pension commitment

	Collective scheme	Salaries over 12X Base amount
Pension commitment at 1 January	19 368	4 775
Net pension costs	3 916	1 340
Contribution to the pension scheme	(4 703)	0
Pension commitment at 31 December	18 581	6 115

NOTE 18 Tax

(Amounts in NOK 1 000 000)

	2010	2009
Current taxes	257	486
Changes in deferred tax	36	61
Total income tax	**293**	**547**

Current tax payable	257	486
Withholding tax	0	0
Total current taxes	**257**	**486**

Reconciliation of effective income tax rate	2010	2009
Profit before tax	1 034	1 946
Calculated income tax (28 %)	290	545
Non-deductible expenses	12	8
Non-taxable revenue	0	0
Tax expense	**293**	**547**
Effective income tax rate	28.3 %	28.1%

Deferred tax liability/(asset)	2010	2009
Deferred tax liability/(asset) at 1 January	146	(1)
Change in deferred tax	36	61
Deferred tax liability/(asset) at 31 December	**182**	**60**

Temporary differences	2010	2009
Fixed assets	0	(1)
Pension liabilities	(25)	(24)
Provisions	(1)	(1)
Financial derivatives	526	0
Fair value changes	152	241
Total	**652**	**215**

Deferred tax liability/(asset) 28%	**182**	**60**

NOTE 19 Risk management

KBN has AAA/Aaa rating from S&P and Moody's, which requires the Company to adhere to a low risk profile. The Company's risk limits are set so that the Company has a 0.01 percent (or lower) probability of bankruptcy. This is implicitly presumed by the company's AAA-rating. The Company's risk is managed according to its overall goal of achieving stable and predictable results and a return required by its shareholders. KBN follows a conservative investment policy.

All interest, currency risk and structured risk in assets and liabilities is hedged on an ongoing basis using derivative contracts. The Company's financial policy permits derivatives only to be used for hedging purposes.

Risk associated with the Company's assets is low. Its client base is the local government sector, which has high credit-worthiness with a good geographic diversification. The liquidity portfolio consists of bonds issued by sovereigns, regional authorities, supranational agencies (0 % risk weighting) and highly rated financial institutions (20 % risk weighting).

Lending to the local and regional authorities, inter-municipal companies and other companies with a municipal guarantee carries a very low level of risk. The Local Government Act states that a municipality cannot go bankrupt. Should a municipality face payment difficulties, the central government would assume control of the municipality until it is able to meet its payment obligations. On no occasion has the government had to apply Sections 56-58 of the Local Government Act to take over management of a municipality. The lender is protected against loss of principal and interest.

Management of the Company's liquidity portfolio is subject to conservative guidelines. At the end of 2010, the liquidity portfolio was 31 per cent of total assets., compared with 30 per cent at the end of 2009. In connection with large funding inflow in the third quarter, the liquidity portfolio peaked at 37 per cent of total assets for a short period. All liquidity exceeding 25 per cent of total assets must be invested in 0 per cent risk weighted assets.

The guidelines for the liquidity portfolio combine the requirement for high credit quality and a short maturity profile, which contributes to lowering the default risk in the portfolio.

NOTE 20 Credit risk

(Amounts in NOK 1 000 000)

The Company has exposure to the municipal sector, as well as financial institutions and sovereigns within the OECD. Loans given to municipalities may have maturities of up to 50 years, and the credit limits are regulated by Large Exposure regulation. Credit exposures on financials must have a rating of A/A-1 or above.

General limits for credit risk are set by the Board and evaluated at least annually.

KBN grants loans to public sector entities that carry out work for local and regional authorities. The conditions for such loans are that local or regional authorities provide guarantees that have been approved by the government, represented by the County Governor or the Ministry of Local Government and Regional Development. In addition, the loans are secured by collateral in the entities' assets.

Amounts in the table below represent actual credit exposure

	2010									
Maturity	**< 1 year**			**> 1 year**						
Risk class	**A-2**	**A-1/A-1+**	**Not rated**	**BBB-**	**A-**	**A**	**AA**	**AAA**	**Not rated**	**Total**
Sovereigns and central banks	0	5 665	0	0	0	0	1 471	4 046	0	**11 183**
Regional authorities*	0	12 132	15 407	0	0	523	18 860	13 352	167 272	**227 547**
Multilateral development banks	0	5 057	0	0	0	0	0	9 942	0	**15 000**
Financial institutions	234	18 284	0	50	38	1 795	188	632	192	**21 413**
Securitisation	0	4 839	0	0	0	0	0	1 514	0	**6 352**
Total	**234**	**45 977**	**15 407**	**50**	**38**	**2 318**	**20 520**	**29 485**	**167 465**	**281 494**

*Including loans to municipal sector of NOK 185.7 billion.

Credit risk by country

	2010									
Maturity	< 1 year			> 1 year						
Risk class	A-2	A-1/A-1+	Not rated	BBB-	A-	A	AA	AAA	Not rated	Total
Australia	0	2 863	0	0	0	0	130	0	0	2 993
Belgium	0	1 460	0	0	0	0	833	0	0	2 294
Canada	0	1 965	0	0	0	610	39	0	0	2 615
Denmark	0	6 827	0	0	0	75	0	3 035	0	9 937
Finland	0	586	0	0	0	0	0	147	0	732
France	0	4 520	0	0	0	0	58	698	0	5 277
Ireland	0	0	0	50	0	0	0	0	0	50
Japan	0	469	0	0	0	0	0	0	0	469
Netherlands	0	1 712	0	0	0	0	0	687	0	2 398
New Zealand	0	0	0	0	0	0	0	0	0	0
Norway	0	2 803	15 407	0	0	1 135	0	3 000	167 465	189 809
Spain	234	2 224	0	0	38	0	1 151	0	0	3 647
United Kingdom	0	3 188	0	0	0	420	0	504	0	4 112
Supranational	0	5 057	0	0	0	0	0	9 942	0	15 000
Switzerland	0	908	0	0	0	78	0	0	0	986
Sweden	0	1 731	0	0	0	0	0	1 673	0	3 405
Germany	0	7 270	0	0	0	0	18 308	9 546	0	35 125
USA	0	586	0	0	0	0	0	0	0	586
Austria	0	1 806	0	0	0	0	0	253	0	2 060
Total	234	45 977	15 407	50	38	2 318	20 520	29 485	167 465	281 494

NOTE 21 Interest rate risk

(Amounts in NOK 1 000 000)

Interest rate risk occurs as a result of the differences in the interest rate periods for assets and liabilities, and the fact that incoming and outgoing payments are due at different times. As part of interest risk management, the Company actively buys and sells securities issued by financial institutions and sovereigns and enters into derivative contracts.

The Company has maintained its strategy of adapting funding activities to the various types of loans it offers, which has resulted in its funding and lending activities having approximately identical interest periods. Interest risk is managed by matching duration of the funding portfolios with that of the loan portfolios. Maturity differences are monitored on a continuous basis.

The Company's assets and liabilities are denominated in several currencies, but all interest risk is hedged perfectly at a transaction level for all currencies except NOK, USD and EUR. The interest risk in these three currencies is hedged using interest rate swaps, so that the company only has exposure to changes in 3 month money market interest rates.

Interest rate sensitivity is measured as a change in fair value of assets and liabilities with 100 basis points change in interest rates (parallel shift).

Interest rate sensitivity in NOK depends on the opportunity to adjust floating interest rates on the lending portfolio. The Board has adopted a total limit for interest rate risk of NOK 24 million. The interest rate sensitivity is measured assuming 50 days to an adjustment of the floating rate on the lending portfolio, and the lowest value is reported. The interest rate sensitivity in the main currencies is shown in the table below:

	100 bp change in interest rate
NOK	4.8
USD	(4.6)
EUR	(3.6)
Total	**(3.4)**

Interest rate sensitivity can affect the income statement during the next three month period.

The calculation is based on total assets and liabilities at 31 December 2010.

NOTE 22 Currency risk

(Amounts in NOK 1 000 000)

Currency risk is defined as the risk of loss in market value as a result of fluctuations in FX-rates. The currency risk occurs as a result of the Company's funding mainly being in foreign currency, while lending is provided in NOK. The Company's risk policy requires hedging of all currency risk in the assets and liabilities. However, short-term net positions in the P/L items may occur in EUR and USD. The currency risk is hedged both at transaction level and portfolio level. The limit for currency risk is set to NOK 6 million for a 10 per cent absolute change in all currencies.

	2010		2009	
Currency	**Net position**	**10%-change in FX-rate**	**Net position**	**10%-change in FX-rate**
USD	(90)	9	(35)	4
EUR	3	0	3	0
Other currencies	4	0	3	1
Total	**(84)**	**10**	**(30)**	**4**

The table above shows an absolute effect on the income statement of a 10 per cent change in FX—rates relative to NOK. The amount is calculated based on assets and liabilities denominated in foreign currencies at 31 December 2010. Sensitivity analysis does not take into account correlation between FX-rates and other market risk factors.

NOTE 23 Liquidity risk

(Amounts in NOK 1 000 000)

Liquidity risk is defined as a risk for the Company not being able to meet its commitments and/or finance lending demand without significant extra costs being incurred in the form of value loss in assets that have to be sold, or in the form of more expensive funding.

Liquidity risk is monitored and managed through internal control and financial policy. KBN's financial policy requires to maintain net cash balances equivalent to a minimum 12 months' net debt redemptions. This means that in any given situation the Company can cover all its debt obligations for the next 12 months without new borrowing.

The liquidity portfolio is managed using a conservative investment policy to keep both credit risk and market risk low. Surplus liquidity is invested in notes and bonds issued by sovereigns, sub-sovereigns, regional authorities, multilateral development banks and financials with a high credit rating. Most of the portfolio matures within 12 months. Liquidity risk is further reduced by matching maturities on assets and liabilities. The Company also has a short-term funding programme and a credit line with DnB NOR to manage short-term liquidity.

Principal amounts split by tenor	Total principal	< 1 month	1-3 months	3-12 months	1-5 years	>5 years	Without maturity
Deposits with credit institutions	6 857	6 779					78
Instalment loans	183 789	963	3 260	5 347	16 048	158 172	
Notes, bonds and other interest-bearing securities	88 828		11 427	28 877	44 401	4 123	
Total assets	**279 474**	**7 742**	**14 687**	**34 224**	**60 449**	**162 295**	**78**
Loans from credit institutions	987	480			507		
Senior securities issued	291 375	6 014	12 613	50 786	158 408	63 554	
Other liabilities	321	22	10	264			25
Subordinated debt	303					80	223
Hybrid Tier 1 capital instruments	658						658
Total liabilities	**293 643**	**6 516**	**12 623**	**51 050**	**158 915**	**63 634**	**906**
Financial derivatives	19 849	(62)	170	1 004	6 774	11 963	
Net liquidity exposure		1 163	2 234	(15 822)	(91 692)	110 624	(828)

Principal amounts split by interest rate reset	Total principal	< 1 month	1-3 months	3-12 months	1-5 years	>5 years	Without maturity
Deposits with credit institutions	6 857	6 857					
Instalment loans	183 789	15 300	123 451	13 062	24 179	7 798	
Notes, bonds and other interest-bearing securities	88 828	161	28 344	23 124	33 550	3 650	
Total assets	**279 475**	**22 318**	**151 795**	**36 186**	**57 729**	**11 448**	
Loans from credit institutions	987	480	507				
Senior securities issued	291 375	24 850	75 410	72 880	100 729	17 506	
Other liabilities	321	22	10	264			25
Subordinated debt	303	80	8		215		
Hybrid Tier 1 capital instruments	658	102	400		156		
Total liabilities	**293 643**	**25 534**	**76 335**	**73 144**	**101 100**	**17 506**	**25**
Financial derivatives	**19 849**	**(8 031)**	**(73 491)**	**47 582**	**46 537**	**7 251**	
Net liquidity exposure		**(11 247)**	**1 970**	**10 624**	**3 166**	**1 193**	**(25)**

NOTE 24 Capital adequacy and capital management

(Amounts in NOK 1 000 000)

The Company's capital consists of share capital, retained earnings, Hybrid Tier 1 capital and subordinated capital. A healthy capital level is regarded as essential to maintain the company's AAA rating and ensure efficient market competition. The Board assesses the capital situation on an ongoing basis and approves KBN's principles for capital management.

The Company is subject to Capital Adequacy Requirements and shall have a sufficient capital level for its risk profile and current market situation. Capital level is measured as core capital ratio and total capital ratio relative to the risk-weighted assets. KBN's capital situation is assessed in relation to risk in day-to-day market conditions and through stress tests.

In order to maintain a sufficient capital level the Company can, depending on the market situation, reduce or increase its total assets or enter into a dialog with the shareholder to change the Company's capital structure through dividend policy or share capital.

	2010			2009		
	Book value	**Risk-weighted assets**	**Minimum capital requirement**	**Book value**	**Risk-weighted assets**	**Minimum capital requirement**
Credit risk						
Sovereigns and central banks	7 652	0	0	7 582	0	0
Regional governments and local authorities	219 264	35 523	2 842	167 916	28 322	2 266
Of which are Norwegian municipalities	*175 414*	*35 083*	*2 807*	*145 150*	*28 312*	*2 265*
Public sector entities	3 601	0	0	3 371	0	0
Multilateral development banks	15 000	0	0	16 651	0	0
Financial institutions	32 060	6 412	513	19 525	3 401	272
Of which counterparty exposure on derivatives	*26 580*	*5 316*	*425*	*19 328*	*3 362*	*267*
Corporates	415	83	7	496	99	8
Claims secured by residential property	1 514	549	44	1 584	575	46
Covered bonds	4 217	422	34	400	40	3
Other assets	14	14	1	12	12	1
Total credit risk	**268 738**	**43 002**	**3 440**	**217 536**	**32 449**	**2 596**
Market risk	**32 883**	**2 799**	**224**	**27 471**	**2 388**	**191**
Operational risk—Basic Indicator Approach		**1 132**	**91**		**1 132**	**91**
Minimum Capital requirement		**46 934**	**3 755**		**35 970**	**2 878**
Total capital ratio			**9.86%**			**11.05%**
Core capital ratio			**9.15%**			**9.25%**

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

	2010	2009
Core capital:		
Share capital	1 221	1 221
Retained earnings	2 813	2 340
Total equity	**4 034**	**3 561**
Hybrid Tier 1 capital instruments	644	285
Deferred tax asset	0	0
Goodwill	(1)	(1)
Allocated to dividend	(165)	(267)
Unrealised gains on issued debt attributable to changes in credit risk	(217)	(252)
Total Tier 1 capital	**4 296**	**3 326**
Supplementary capital:		
Subordinated debt	80	80
Perpetual subordinated debt	254	567
Total supplementary capital	**334**	**647**
Total capital	**4 630**	**3 973**

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

To the Annual Shareholders' Meeting in Kommunalbanken AS

AUDITOR'S REPORT

Report on the financial statements
We have audited the accompanying financial statements of Kommunalbanken AS, which comprise the statement of financial position as at 31 December 2010, the statements of income and comprehensive income, cash flows and changes in equity for the year then ended, and a summary of significant accounting policies and other explanatory information.

The Board of Directors' and President & Chief Executive Officer's responsibility for the financial statements
The Board of Directors and President & Chief Executive Officer are responsible for the preparation and fair presentation of these financial statements in accordance with the International Financial Reporting Standards as adopted by the EU, and for such internal control as the Board of Directors and President & Chief Executive Officer determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with laws, regulations, and auditing standards and practices generally accepted in Norway, including International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the financial statements of Kommunalbanken AS have been prepared in accordance with laws and regulations and present fairly, in all material respects, the financial position of the Company as of 31 December 2010 and its financial performance and its cash flows for the year then ended in accordance with the International Financial Reporting Standards as adopted by the EU.

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 Directors' report concerning the financial statements, the going concern assumption and the proposal for the allocation of the result is consistent with the financial statements and complies with the law and regulations.

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 the Board of Directors and President & Chief Executive Officer have fulfilled their duty to properly record and document the Company's accounting information as required by law and generally accepted bookkeeping practice in Norway.

Oslo, 17 March 2011
ERNST & YOUNG AS

Eirik Tandrevold
State Authorised Public Accountant (Norway)
(sign)

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

Control Committee's statement

The Control Committee has examined Kommunalbanken AS' annual report and accounts as well as the Auditor's report for 2010.

The Control Committee recommends that the annual report and accounts presented be approved as Kommunalbanken's accounts for 2010 and that the application of profits is adopted by the Annual Shareholder's Meeting in accordance with the Board's proposals.

Oslo, 22 March 2011
Control Committee for Kommunalbanken AS

Britt Lund
Chairman

Anne-Ma Tostrup Smith

Kjell Inge Skaldebø
Vice Chairman

Supervisory Board's statement

To the Annual Shareholder's Meeting of Kommunalbanken AS.

In accordance with § 15 in Kommunalbanken's Articles of Association, the annual accounts and report for 2010 have been examined by the Supervisory Board.

The Supervisory Board recommends that the Board of Director's proposals for the operating statement and balance sheet as well as the application of profit, NOK 741 000 000, is adopted by the Annual Shareholder's Meeting.

Oslo, 7 April 2011
Supervisory Board for Kommunalbanken AS

Elin Eidsvik
Chairman

Articles of Association of Kommunalbanken AS

Chapter I - Company, objectives, registered office

§ 1 The Company's name is Kommunalbanken AS.

§ 2 The Company is a direct continuation of the enterprise carried out by the government administrative body, Norges Kommunalbank.

§ 3 The Company's objectives are to provide loans to local governments, counties, intermunicipal companies and other companies that carry out local government tasks against either a municipal guarantee, government guarantee, or other satisfactory security.

The Company can also undertake other tasks appropriate to the Company's business.

§ 4 The Company's registered office is to be situated in Oslo.

Chapter II - Equity and subordinated loan capital – shares

§ 5 The Company's share capital is NOK 1,220,625,000 (one billion, two hundred and twenty million, six hundred and twenty five thousand Norwegian kroner) divided into 1,220,625 shares of NOK 1,000 (one thousand Norwegian kroner) each.

§ 6 The acquisition of shares is conditional on the consent of the Company's Board of Directors. Consent can only be withheld on grounds of fact.

§ 7 Pre-emption rights given to shareholders under section 4-19 of the Norwegian Companies Act can also be claimed for shares which have changed owner.

Chapter III - Board of Directors

§ 8 The Company's Board of Directors shall comprise of between five (5) and eight (8) members. One (1) of the elected members of the Board shall be elected by and from amongst the Company's employees. For this member one (1) personal deputy shall be elected with the right to be present and to speak at board meetings.

The other members shall be elected by the Annual General Meeting for two-year terms, so that at least two (2) shall be elected annually, but no more than three (3) of the elected members. At least half the elected members shall retire at the end of the first year after the drawing of lots, and the remaining members shall retire at the end of the second year.

The Annual General Meeting shall elect the chairman and vice-chairman of the Board of Directors.

§ 9 The chairman of the Board shall ensure that the Board holds meetings as often as the Company's business necessitates, or when a member calls for a meeting to be held.

The Board constitutes a quorum if more than half the members are present. Valid resolutions are those for which the majority of the members present have voted, although a proposal which implies an alteration or amendment requires more than one-third of all board members. If the votes on each side are equal, the chairman of the meeting shall have the casting vote.

§ 10 The Board is responsible for managing the Company's business and shall therefore inter alia:

1. Lay down guidelines for the conduct of the Company's business and check that they are followed
2. Grant loans and delegate authority
3. Make decisions and grant authority for new loans raised
4. Grant special powers and authorisation to sign on behalf of the company per procurationem
5. Present the annual accounts and directors' report to the Annual General Meeting
6. Make recommendations to the Annual General Meeting with respect to alterations to the Articles of Association
7. Appoint the managing director
8. Fix the managing director's salary

§ 11 The chairman of the Board, the managing director or two members of the Board jointly shall sign for the Company.

§ 12 The managing director shall be responsible for the day-to-day management of the Company and its business in accordance with the instructions laid down by the Board and approved by the Supervisory Board.

Chapter IV - Supervisory Board

§ 13 The Supervisory Board shall consist of twelve members and four deputy members. The Supervisory Board should be composed of as broad a range of members as possible, so as to ensure that the various districts and interest groups affected by the Company's business are fairly represented. A member of the Board of Directors cannot also be member of the Supervisory Board.

One (1) of the members of the Supervisory Board shall be elected by and from amongst the Company's employees. For this member shall be elected one (1) personal deputy. The remaining members and deputy members shall be elected by the Annual General Meeting.

The members of the Supervisory Board shall be elected for two-year terms. One third of the members shall retire each year. Members elected by the shareholders shall be elected for two years. A minimum of one third of the members shall be elected annually. Following the first year one third of the members shall be up for election by drawing lots. The Supervisory Board shall elect a chairman and vice-chairman from amongst its members to serve for a term of one year.

§ 14 The Supervisory Board shall be convened by the chairman and meet at least once a year or as often as the chairman finds necessary or when called for by the Board of Directors, the Control Committee or at least two of the members of the Supervisory Board. The notice of the meeting shall set out the business to be considered.

The Board of Directors, the Control Committee and the Company's auditor shall be called to attend the meetings of the Supervisory Board. Unless otherwise determined by the Supervisory Board in individual instances, the Board of Directors and members of the Control Committee are entitled to be present at the meetings of the Supervisory Board with the right to speak and the right of initiative. The Ministry of Local Government and Regional Development can participate in the Supervisory Board meeting with up to two observers.

The Supervisory Board constitutes a quorum when at least 2/3 of its members or deputy members are present. If the requisite number of members is not present, a new meeting of the Supervisory Board shall be called. The new meeting will constitute a quorum if more than half the members are present.

Valid resolutions of the Supervisory Board are those for which the majority of the members present have voted, although a resolution can only be passed if voted for by more than one third of all members. If the votes on each side are equal, the chairman of the meeting shall have the casting vote.

§ 15 The Supervisory Board shall supervise the Company's business to ensure that the Company's objectives are being promoted in accordance with law, regulation, memorandum and articles of association, and the resolutions of the Annual General Meeting and the Supervisory Board.

The Supervisory Board shall:

1. Approve the instructions for the managing director as laid down by the Board
2. Elect a state-authorised public accountant to act as auditor
3. Provide a statement to the Annual General Meeting in respect of the Board of Directors' proposals for the income statement and balance sheet, including any consolidated income statement and consolidated balance sheet, and the Board's proposals for the application of profit or covering of loss for the year
4. Scrutinise the directors' report, the auditor's report and the Control Committee's report
5. Adopt instructions for the Control Committee
6. Give an opinion on matters concerning the Company which are brought before the Supervisory Board by the Board of Directors or Control Committee.

Chapter V - Annual General Meeting

§ 16 The ordinary Annual General Meeting shall be held before the end of June.

An extraordinary General Meeting shall be held if called for by shareholders representing minimum a tenth of the share capital, two members of the Supervisory Board, the Board of Directors, the Control Committee or the Company's auditor.

The Ministry of Local Government and Regional Development shall call the Annual General Meeting.

The Annual General Meeting shall transact the following business:

1. The consideration and adoption of the Company's annual report and accounts, including the application of profit or covering of loss for the year, and the declaration of dividend
2. The fixing of remuneration of the members of the Supervisory Board and the Board of Directors, the members of the Control Committee and the auditor
3. Elections of members and deputy members of the Control Committee in accordance with § 17 of the Articles of Association
4. Other business referred to in the notice of the meeting or which by law or Articles of Association falls under the Annual General Meeting.

Chapter VI - Control Committee

§ 17 The Control Committee shall consist of three members and one deputy member who shall be elected by the Annual General Meeting. One member shall satisfy the requirements to be fulfilled by judges under section 54, second subsection of the Norwegian Courts of Justice Act of 13 August 1915. The election of this member must be approved by the Financial Supervisory Authority of Norway.

No member or deputy member of the Board of Directors, auditor or employee of the Company can be elected as a member or deputy member of the Control Committee. Nor can any person become a member who is under a legal disability or in a relationship of collaboration, subordinacy or dependency to, or married to, or related by marriage or blood in the direct ascending or descending line or the first collateral line to a member of the Board of Directors, auditor or officer of the Company. No person may be elected as a member whose estate is in bankruptcy, under debt settlement proceedings or private administration. Should circumstances arise which render a person no longer eligible for election, he shall retire from the Control Committee.

Members of the Control Committee shall be elected for two-year terms. The Control Committee shall elect a chairman and vice chairman from amongst its members.

The Control Committee shall supervise the business of the Company, including the transactions of the Board of Directors, and ensure inter alia that the business is run in accordance with law and the Articles of Association.

The Control Committee shall meet as often as may be considered necessary in order to ensure effective supervision. It shall keep such a record of its proceedings as is authorised by the Financial Supervisory Authority of Norway, and shall annually deliver a report on its work to the Supervisory Board, the Annual General Meeting and the Financial Supervisory Authority of Norway.

Chapter VII - Auditor

§ 18 The Company's auditor shall be a state-authorised public accountant and shall be elected by the Supervisory Board.

The auditor's report shall be delivered at least two weeks prior to the meeting of the Supervisory Board which shall consider the accounts.

Chapter VIII

§ 19 The Company shall raise funds for lending by issuing bonds, certificates or other form of loan notes or by entering into loan agreements.

§ 20 Loans can only be granted to municipalities, counties, inter-municipal companies and other companies which carry out local government tasks against either a municipal guarantee, government guarantee or other satisfactory security. The Company can also undertake other tasks appropriate to the Company's business.

§ 21 The Board of Directors shall fix all lending terms and conditions as may be in force at any time.

§ 22 The Company's capitalisation and financial administration shall be satisfactory in relation to the Company's business and consistent with the Company's aims of maintaining highest possible creditworthiness.

Chapter IX - Annual Report and Accounts

§ 23 The Company's financial year shall follow the calendar year.

The Board of Directors shall deliver annual accounts and an annual report for each financial year.

The annual accounts shall be placed at the disposal of the auditor at least one month prior to the ordinary Annual General Meeting. The audited annual report and accounts shall be scrutinised by the Control Committee and Supervisory Board before being laid before the Annual General Meeting.

The Annual General Meeting shall adopt the annual report and accounts no later than the end of June.

The Board of Directors shall publish the annual report and accounts no later than one week after they have been adopted by the Annual General Meeting.

Chapter X - Age of retirement

§ 24 The age of retirement for the Company's Managing Director is 67 years.

Chapter XI - Entry into force

§ 25 These Articles of Association shall enter into force on the day on which they are Approved by the King.

Chapter XII - Alterations to the Articles of Association

§ 26 The Articles of Association cannot be altered save with the approval of the King.

The Articles of Association were last changed 24 June 2010.

Governing bodies

The Board of Directors
Else Bugge Fougner, Chairman, Barrister-at-law (Supreme Court)
Kristin Marie Sørheim, CEO, Bioforsk Organic Food and Farming, Vice Chairman
Frode Berge, Head, Stavanger Regional Business Development
Svein Blix, CEO, Bodø municipality
Nanna Egidius, Director of Strategic Planning, Lillehammer municipality
Åmund T. Lunde, CEO, Oslo Municipality Pension Fund
Martha Takvam, CEO, Telenor Real Estate
Ellen E. Scavenius, employee representative, Portfolio Manager

Alternate to the Employee Representative
Steinar Mørch-Olsen, Loan Manager

Supervisory Board
Elin Eidsvik, CEO, Hamarøy municipality, Chairman
Bjørn Arild Gram, Mayor, Steinkjer municipality, Vice Chairman
Svein Ludvigsen, County Governor, Troms
Hanne Braathen, Mayor, Storfjord municipality
Svein Skaaraas, CEO, Hamar municipality
Tore Sirnes, CEO, Sandnes municipality
Berit Flåmo, Head of Strategic Development, Trondheim Harbour
Karen Marie Hjelmeseter, County Chairman of the Centre Party, Sogn og Fjordane county
Knut Wille, CEO, Skien municipality
Anita Orlund, Mayor, Skedsmo municipality
Arne Johansen, CEO, Harstad municipality
Christin H. Kanden, Loan Manager, employee representative

Alternates to the supervisory board
Berit Koht, Chief Accountant, Troms county
Nils R. Sandal, CEO, Sogn og Fjordane county
Mona Skanke, Mayor, Porsanger municipality
Rune Øygard, Mayor, Vågå municipality

Alternate to the employee representative
Bjørn Ove Nyvik, Chief Accountant

Observers to the supervisory board
Anne Nafstad Lyftingsmo, Deputy Secretary, Ministry of Local Government and Regional Development
Thor Bernstrøm, Assistant Director General, Ministry of Local Government and Regional Development

Control Committee
Britt Lund, Chairman
Kjell Inge Skaldebø, CEO, Åfjord municipality, Vice Chairman
Anne-Ma Tostrup Smith, lawyer, Statoil ASA

Deputy member
Roy Jevard, CEO, Melhus municipality

Auditor
Ernst & Young AS
Eirik Tandrevold, State Authorised Public Accountant

Internal auditor
KPMG AS
Are Jansrud, State Authorised Public Accountant

Management

Directors

Petter Skouen
President & CEO

Siv F. Galligani
Deputy CEO

Section heads

Anette Berg, Lending

Thomas Møller, Funding

Kjell Pettersen, Corporate Communications & Organization

Karina Folvik, Accounting

Knut Andresen, Middle Office & IT

Annette Nielsen, Back Office

Martin Spillum, Treasury

Frank Øvrebø, Credit Analysis

The Ski Flying Hill in Vikersund. (Photo: vikersund.no.)

Photos:
The annual report contains photos of projects financed by KBN.

Page 13: City tram i Bergen. Foto: Jan Walbeck.
Page 14: Gurisenteret, Smøla. Foto: Wigdis Wollan.
Page 15: Margarinfabrikken barnehage, Oslo. Architect: NAV AS. Photo: Kim Müller.
Page 17: Nordmøre Harbour Terminal, Kristiansund. Photo: Lønnheim Entreprenør AS.
Side 59: Ski Flying Hill in Vikersund. Photo: vikersund.no.

Pages 2 and 4: Jan Walbeck.
Pages 1, 5 and 18: Kommunalbanken.

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