

**MORTGAGE AND LAND BANK  
OF LATVIA**

**Interim Condensed Consolidated and  
Bank Financial Statements for the nine  
months period ended 30 September 2004**

*Mortgage and Land Bank of Latvia*  
*Interim Condensed Consolidated and Bank Financial Statements*  
*for the nine months period ended 30 September 2004*

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## MANAGEMENT REPORT

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### The nine months of 2004

The International Monetary Fund (IMF) forecasts that growth of the global economy will reach 5% this year that is the highest indicator during the last 30 years. It is anticipated that in the current year growth pace of economy will have increased in all major centres of the global economy disregarding the hindrance to development – rise of oil prices by 30% per annum. IMF indicates that the United States of America still remain the main driving force of development of the global economy where the gross domestic product (GDP) will increase by 4.3% this year. Out of the developed countries the most rapid increase is forecasted for Japan – by 4,4%. GDP growth for Eurozone countries is estimated at 2.2%, for the countries of Central and Eastern Europe – 5.5%, for Russia – 7.3%, for China - 9%. IMF indicates that rising income of the companies and distinct upsurge in housing market are at the core of growth of the economy. In the year 2003 the global economy increased by 3.9%.

In the year 2004 rapid economic growth has continued in Latvia. The present economic development is based on high domestic demand (private consumption and investments) and consistent measures for improvement of business environment that enhance the capability of the Latvian entrepreneurs to expand the market of export. The domestic demand is stable that has been ensured by mounting of income, stability of the financial system, expansion of creditworthiness, accession to NATO and European Union and positive visions for future. Also the international rating agencies have appraised the economic development of Latvia as favourable. The rating agencies *Moody's* and *Fitch Ratings* extended the ratings already granted to Latvia, but *Standard & Poor's* upgraded the rating for long-term foreign currency liabilities from BBB+ to A-.

During the first six months of the year 2004 GDP of Latvia has increased by 8.2% in comparison with the respective period of the last year (in the year 2003 GDP growth amounted to 7.5%). In the first half-year GDP growth was 9.8% in trade volume, 9.6% - transport and communications, 8.5% - processing industry, 12.5% - construction. According to statistical data both in the first and second quarters of the year economy of Latvia was the fastest in terms of growth surpassing Lithuania – the unchallenged leader of the last year in GDP increase. The Bank of Latvia, Ministry of Economy and Ministry of Finance estimate that GDP growth might attain 7.5% this year.

In the year 2004 the annual consumer price inflation grew rapidly in Latvia reaching 7.7% in September that was brought about by rise of administratively regulated prices, tax changes, global upsurge of oil prices, poor harvest and clamour related to accession to the European Union. The prices of food-stuffs having increased by 7.3% exerted the largest influence onto price rise during the period of nine months. In the year 2003 consumer price inflation was 2.9%. The Bank of Latvia forecasts that annual inflation will amount to 7%.

In the year 2004 unemployment rate remained high at 8.7% with an annual increase of 0.2%.

The volumes of external trade of Latvia continued to build up in the year 2004. In August comparing with the respective period of the last year export has increased by 38%, import by 21%, predominance of import over export amounted to 73%. The main trade partners of Latvia are EU member states whose share in the total turnover of the external trade is 74%.

In compliance with Maastricht criteria (3% of GDP) the budgetary deficit of this year is planned in the amount of 2% of GDP.

The banking system of Latvia continues to advance dynamically. In the year 2004 the number of the banks has not changed – there are 22 banks and one subsidiary of foreign bank operating in Latvia. During nine months the assets of the banks have increased by 29% amounting to 7,35 bln lats as at the end of September, deposits have accrued by 29%, volume of granted loans enlarged by 34%, but capital and reserves of the banks – by 18%. In nine months of the year 2004 unaudited profit of the banks accounted for 82,5 mln lats that was by 29,9 mln lats or 57% more than profit for the respective period in the year 2003.

## MANAGEMENT REPORT

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The banks are competing for acquisition of the customers fiercely by offering ever more advantageous settlement and lending services. During this year the banks have paid particular attention to advertising of mortgage loans providing special conditions and reduced interest rates. The rapid increase in loans granted to natural persons for acquisition of housing by 60.3% as well as upsurge of the total mortgage loans by 58.7% during nine months of this year confirm the trend.

To limit the rapid increase in lending and reduce macro-economic risks the Bank of Latvia raised the re-financing rate by 0.5% (to 3.5%) in March and enlarged the requirement of reserves for the banks and subsidiaries of foreign banks from 3% to 4% in July. These decisions affected average interest rates for loans (in lats) granted by the banks – for loans to natural persons the average interest rate has augmented from 6.9 % (in January) to 9.1% (in September), but for companies from 6.8% to 7.7%. The average interest rates have grown also for foreign currency loans: for companies from 4.9% (in January) to 5.2% (in September), but for natural persons from 5.3% to 5.4 % in the respective period.

During nine months of this year the average interest rates for LVL term deposits made by natural persons have increased by 0.1% reaching up to 3.5%; the interest rates for foreign currency deposits have remained at the level of 2.1%. Meanwhile the average interest rate for LVL term deposits made by companies has increased by 0.6% reaching up to 3.4%, but for foreign currency deposits - by 0.4% reaching up to 1.8%.

Also in the year 2004 Mortgage Bank continues to develop the main financial indices confirming the process. During 9 months of the year 2004 amount of gross assets of the Bank has augmented to 299 mln lats or by 27%, whereas the profit of the Bank reached 1 321 thousand lats that was by 150 thousand lats or 13% more than in the respective period last year.

Within nine months the gross loan portfolio of the Bank has enlarged by 65,5 mln lats or 34% and reached 257,1 mln lats as at the end of September. This year at the end of September the Bank was in the 6<sup>th</sup> place among the commercial banks of Latvia by volume of the loan portfolio acquiring a market share of 6.4%. Mortgage loans account for the majority of the products offered by Bank (30.3%). As at the end of September Mortgage Bank was the 5<sup>th</sup> largest bank in Latvia by granted mortgage loans with a market share of 7 % and occupied the 4<sup>th</sup> place by volume of mortgage loans granted to natural persons with a market share of 9.6%. In spring (from 9 February till 30 April) Mortgage Bank implemented retail lending discount campaign for real estate loans – loans for acquisition, repairs and refurbishment of real estate. The aim of the campaign was to attract new customers and reduce the seasonal effect of real estate lending by promoting the activities of the customers exactly at the beginning of the year. Decreased interest rates and discounts on processing of the loans were offered to the natural persons when being granted real estate loans.

Within nine months the amount of deposits has increased in the Bank by 17% reaching 149,8 mln lats. Just as last year also this year (from 14 April till 30 June) the Bank implemented term deposit campaign ‘Ābele’ (‘Apple Tree’). During the campaign 20,62 mln lats were attracted to the resources of the term deposits. This is the sixth year when in autumn, continuing the successful tradition, Mortgage Bank has launched the special cash deposit ‘Ozols’ (‘Oak Tree’).

In nine months of the year 2004 the amount of the issued mortgage bonds increased by 6,85 mln lats or 17% attaining 30,5 mln lats. For the first time in Latvia the Bank issued mortgage bonds in US dollars – there were mortgage bonds issued for the face value of USD 10 million with a redemption maturity of 7 years. In the initial placement of these securities Mortgage Bank co-operated with ‘Latvijas Unibanka’ that acted as a general agent.

Alongside the development of the range of the services Mortgage Bank has prepared a co-operation start-up offer for the entrepreneurs providing a full set of the banking services that a company needs quickly and at a reasonable price. As from beginning of July till the year-end a company having paid one lat may open an unlimited number of demand deposit (settlement) accounts, register specimen card for the signature and seal, apply for the Internet bank ‘HipoNet’, obtain a debit card ‘Maestro’ and one cheque book.

## MANAGEMENT REPORT

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While proceeding with improvement of the services Mortgage Bank continues to implement various development programmes providing support to specific groups of entrepreneurs and population in line with the assignments of the government. The following programmes are implemented: the Small and Medium-sized Enterprises (SME) Programme offering SME framework and special programme loans (loans for rapidly developing SMEs, business start-ups, loans for women and SME loans in special support areas), Housing Development Lending Programme, Lending Programme for Long-term Investments in Agriculture, Lending Programme for Acquisition of Agricultural Use Land, loans from Energy Efficiency Fund and project 'Housing Improvement Initiative for Saving Energy'. Mortgage Bank pays particular attention to granting of micro-loans (up to EUR 25 000) and expansion of co-operation with the co-operative credit unions. On 24 February 2004 Mortgage Bank and 'Hansabanka' signed a loan agreement with the Nordic Investment Bank and Council of Europe Development Bank about opening of the credit line in the amount of EUR 2 mln of which Mortgage Bank would receive EUR 1 mln to be repaid after 5 years. The resources of the credit line will be used to implement the support programme for women entrepreneurs.

This year in April the state-owned JSC 'Mortgage and Land Bank of Latvia' and SIA 'Norway – Latvia Business Development Fund' acting jointly established a new venture capital fund 'Small and Medium-sized Enterprises Support Fund' (Support Fund) that would offer the small and medium-sized companies (SMC) registered in Latvia financing of venture capital. The Support Fund will function as a pilot project by testing adequacy of the ideas, principles and solutions within the framework of the respective state support programme. The aim of the programme elaborated by the Ministry of Economy is to develop venture capital sphere in Latvia by offering financing for setting up and development of SMC. It is planned that the Support Fund will work till the year 2014 and should have financed at least 40 projects by then.

To promote accessibility to finances and in particular accessibility to SME loan guaranties Loan Guaranty Programme was commenced in August 2004. Within the framework of the programme Mortgage Bank as a development bank will provide guaranties to the customers of other commercial banks of Latvia.

At the High Level Meeting of the Network of European Financial Institutions (NEFI) Mortgage Bank signed an accession treaty to the network on 26 April 2004 continuing to enhance international co-operation with foreign institutions. NEFI co-operates with the official institutions of the European Union i.e. consults these institutions, participates in the drafting of legislation, as well as promotes introduction of the appropriate financial instruments in the member states. As part of their daily activities the members of the organisation analyse the processes of economy, exchange experts and experience, devise new financial instruments.

Mortgage Bank proceeds with expansion and updating of its network of branches and settlement groups enabling its customers to receive the banking services more conveniently. Expanding its activities in Riga the Bank has opened two new branches this year.

In accordance with the order of the Minister for Finance an inter-ministerial working group was set up to draft proposals for transformation of the Mortgage Bank into a development bank. The working group has prepared for submission to the Cabinet of Ministers news report about execution of the concept 'On Development of the State-owned JSC 'Mortgage and Land Bank of Latvia' for the Years 1999 – 2005' and measures to be undertaken in future.

Gundega Šulca  
Chairman of the Council

Inesis Feiferis  
Chairman of the Board

## SUPERVISORY COUNCIL AND THE BOARD OF DIRECTORS

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### Supervisory Council (at 30 September 2004)

Gundega Šulca	Chairman of the Council
Zaiga Liepiņa	Deputy Chairman of the Council
Uldis Apels	Member of the Council
Linda Kaņepe	Member of the Council
Vija Gēme	Member of the Council
Māris Klismets	Member of the Council
Laimdota Straujuma	Member of the Council

### Board of Directors (at 30 September 2004)

Inesis Feiferis	Chairman of the Board
Rolands Paņko	Deputy Chairman of the Board
Aija Laicāne	Member of the Board, Chief Accountant
Jēkabs Krieviņš	Member of the Board, Credit Director

There have been no changes among the members of the Board and Supervisory Council during the reporting period.

## **STATEMENT OF RESPONSIBILITY OF THE SUPERVISORY COUNCIL AND BOARD OF DIRECTORS**

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Riga

15 November 2004

Supervisory Council and the Board of Directors (Management) is responsible for preparing the interim financial statements from the books of prime entry of the Bank and the Group for each financial period that present fairly the state of affairs of the Bank and the Group as at the end of the financial period and the results of its operations and cash flows for that period according to the accounting principles set forth in International Financial Reporting Standards.

Management confirms that suitable accounting policies have been used and applied consistently and reasonable and prudent judgments and estimates have been made in the preparation of the interim condensed consolidated financial statements on pages 7 to 18 for the period ended 30 September 2004. Management also confirms that applicable International Financial Reporting Standards have been used in preparation of the financial statements and that these financial statements have been prepared on a going concern basis. Appropriate accounting policies have been applied on a consistent basis. Prudent and reasonable judgments and estimates have been made by the management in the preparation of the financial statements.

Management is responsible for keeping proper accounting records, for taking reasonable steps to safeguard the assets of the Bank and the Group and to prevent and detect fraud and other irregularities. They are also responsible for managing the Bank in compliance with the Law on Credit Institutions, regulations of the Bank of Latvia and the Financial and Capital Market Commission as well as other legislation of the Republic of Latvia.

On behalf of the management,

Gundega Šulca  
Chairman of the Council

Inesis Feiferis  
Chairman of the Board



## AUDITORS' REVIEW REPORT

**To the Board of Directors of Joint stock company “Mortgage and Land Bank of Latvia”**

We have reviewed the accompanying condensed consolidated and Bank interim balance sheets of the Mortgage and Land Bank of Latvia (the Bank) and its subsidiary (the Group) as of 30 September 2004 and the related condensed consolidated interim statements of income, changes in equity and cash flows for the nine months then ended set out on pages 7 to 18. This condensed consolidated interim financial information is the responsibility of the Bank's management, as referred to on page 5. Our responsibility is to issue a report on this condensed interim financial information based on our review.

We conducted our review in accordance with the International Standard on Auditing applicable to review engagements. This Standard requires that we plan and perform the review to obtain moderate assurance about whether the condensed interim financial information is free of material misstatement. A review is limited primarily to inquiries of Bank's personnel and analytical procedures applied to financial data and thus provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Based on our review, nothing has come to our attention that causes us to believe that the accompanying condensed interim financial information for the nine months ended 30 September 2004 has not been properly prepared, in all material respects, in accordance with International Accounting Standard No. 34 “Interim Financial Reporting”.

PricewaterhouseCoopers SIA  
Audit company licence No. 5

Juris Lapshe  
Personal ID: 250670-10408  
Certified auditor  
Certificate No. 116

Member of the Board

15 November 2004

*Mortgage and Land Bank of Latvia*  
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**STATEMENT OF INCOME**

(all amounts in thousands of Lats)

	Notes	9 months to 30 September 2004		9 months to 30 September 2003	
		Group	Bank	Group	Bank
Interest income		13,213	13,175	11,341	11,332
Interest expense		<u>(6,255)</u>	<u>(6,256)</u>	<u>(5,134)</u>	<u>(5,136)</u>
<b>Net interest income</b>		<b>6,958</b>	<b>6,919</b>	<b>6,207</b>	<b>6,196</b>
Fee and commission income		2,654	2,548	2,041	2,007
Fee and commission expense		<u>(281)</u>	<u>(281)</u>	<u>(169)</u>	<u>(169)</u>
<b>Net commission and fee income</b>		<b>2,373</b>	<b>2,267</b>	<b>1,872</b>	<b>1,838</b>
Result from dealing with securities and foreign exchange		589	566	513	509
Other operating income		<u>1,982</u>	<u>1,515</u>	<u>1,241</u>	<u>1,222</u>
<b>Operating income</b>		<b>11,902</b>	<b>11,267</b>	<b>9,833</b>	<b>9,765</b>
Staff costs		(3,956)	(3,862)	(3,442)	(3,388)
Administrative expenses		(3,705)	(3,567)	(3,051)	(3,026)
Depreciation and amortisation		(1,507)	(1,192)	(937)	(921)
Profit/(loss) from revaluation of long-term investments		<u>-</u>	<u>88</u>	<u>-</u>	<u>(54)</u>
<b>Operating expenses</b>		<b>(9,168)</b>	<b>(8,533)</b>	<b>(7,430)</b>	<b>(7,389)</b>
Provision for impairment losses	2	<u>(1,121)</u>	<u>(1,121)</u>	<u>(1,015)</u>	<u>(1,015)</u>
<b>Profit before income tax</b>		<b>1,613</b>	<b>1,613</b>	<b>1,388</b>	<b>1,361</b>
Income tax expense		(292)	(292)	(217)	(190)
<b>Net profit for the period</b>		<b><u>1,321</u></b>	<b><u>1,321</u></b>	<b><u>1,171</u></b>	<b><u>1,171</u></b>

The notes on pages 11 to 18 are an integral part of these financial statements.

These interim financial statements on pages 7 to 18 have been accepted by the Board of Directors on 8 November 2004 and accepted by the Supervisory Council on 15 November 2004 and are signed by:

Gundega Šulca  
Chairman of the Council

Inesis Feiferis  
Chairman of the Board

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**BALANCE SHEET**

(all amounts in thousands of Lats)

	Notes	30/09/04		31/12/03	
		Group	Bank	Group	Bank
<b>Assets</b>					
Cash and balances with Central Bank		12,579	12,579	7,293	7,293
Fixed income securities		11,166	11,166	10,543	10,543
Due from credit institutions		5,369	5,325	15,289	15,274
Loans to customers	3	251,932	253,807	187,930	188,774
Equity securities available for sale		23	23	18	18
Investments in subsidiaries and associated entities	4	100	430	102	344
Intangible assets		1,302	1,283	927	909
Fixed assets		10,012	7,386	7,842	6,827
Other assets		785	725	901	638
Prepayments and accrued income		1,896	1,910	1,566	1,562
<b>Total assets</b>		<b>295,164</b>	<b>294,634</b>	<b>232,411</b>	<b>232,182</b>
<b>Liabilities</b>					
Due to Central Bank		3,293	3,293	-	-
Due to credit institutions	5	65,074	65,074	40,218	40,218
Customer deposits	6	149,761	149,778	128,330	128,363
Transit funds		3,489	3,489	4,158	4,158
Mortgage bonds	7	29,895	29,895	22,846	22,846
Other liabilities		704	531	1,364	1,259
Provisions and accrued expense		4,130	3,756	2,636	2,479
Deferred tax liabilities		563	563	500	500
Subordinated liabilities		13,300	13,300	8,300	8,300
<b>Total liabilities</b>		<b>270,209</b>	<b>269,679</b>	<b>208,352</b>	<b>208,123</b>
<b>Shareholder's equity</b>					
Share capital		22,820	22,820	20,058	20,058
Reserve capital		814	814	3,576	3,576
Retained earnings		1,321	1,321	425	425
<b>Total shareholder's equity</b>		<b>24,955</b>	<b>24,955</b>	<b>24,059</b>	<b>24,059</b>
<b>Total liabilities and shareholder's equity</b>		<b>295,164</b>	<b>294,634</b>	<b>232,411</b>	<b>232,182</b>
<b>Off balance sheet items</b>					
Contingent liabilities		2,022	2,022	1,180	1,180
Financial commitments		12,610	13,925	9,271	10,903

The notes on pages 11 to 18 are an integral part of these financial statements.

These interim financial statements on pages 7 to 18 have been accepted by the Board of Directors on 8 November 2004 and accepted by the Supervisory Council on 15 November 2004 and are signed by:

Gundega Šulca  
Chairman of the Council

Inesis Feiferis  
Chairman of the Board

*Mortgage and Land Bank of Latvia*  
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**STATEMENT OF CHANGES IN SHAREHOLDER'S EQUITY**

(all amounts in thousands of Lats)

	Share Capital	Reserve capital	Retained earnings	Total equity
<b>Balance as at 31 December 2002</b>	<b>17,858</b>	<b>4,627</b>	<b>328</b>	<b>22,813</b>
Distribution of profit	-	-	(328)	(328)
Capitalisation of reserves	2,200	(2,200)	-	-
Profit for the period	-	-	1,171	1,171
<b>Balance as at 30 September 2003</b>	<b>20,058</b>	<b>2,427</b>	<b>1,171</b>	<b>23,656</b>
Profit for the period	-	-	403	403
Transfer to reserves	-	1,149	(1,149)	-
<b>Balance as at 31 December 2003</b>	<b>20,058</b>	<b>3,576</b>	<b>425</b>	<b>24,059</b>
Distribution of profit	-	-	(425)	(425)
Capitalisation of reserves	2,762	(2,762)	-	-
Profit for the period	-	-	1,321	1,321
<b>Balance as at 30 September 2004</b>	<b>22,820</b>	<b>814</b>	<b>1,321</b>	<b>24,955</b>

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**CASH FLOW STATEMENT**

(all amounts in thousands of Lats)

	9 months to 30 September 2004		9 months to 30 September 2003	
	Group	Bank	Group	Bank
<b>Cash flow from operating activities</b>				
Operating profit	1,613	1,613	1,388	1,361
Depreciation and amortisation	1,507	1,192	937	921
Increase in provision for impairment losses	506	506	208	208
(Profit)/loss on dealing with securities and foreign exchange	124	148	(4)	1
(Profit)/loss from revaluation of long-term investments	-	(88)	-	54
(Profit)/loss on sale of fixed assets	(5)	(5)	17	17
Increase in provision and accrued expense	1,482	1,265	783	716
Increase in prepayments and accrued income	(302)	(320)	(212)	(213)
Increase in other assets	77	(126)	(409)	(99)
Increase/(decrease) in other liabilities	(660)	(728)	(304)	(332)
<b>Increase in cash and cash equivalents from operating activities before changes in assets and liabilities</b>	<b>4,342</b>	<b>3,457</b>	<b>2,404</b>	<b>2,634</b>
Increase in securities	(628)	(628)	(7,470)	(7,470)
Decrease in balances due from credit institutions	57	57	14	14
Increase in loans to customers	(64,498)	(65,529)	(48,221)	(48,694)
Increase in balances due to credit institutions	23,404	23,404	10,328	10,328
Increase in customer deposits	21,431	21,415	17,633	17,636
Decrease in transit funds	(669)	(669)	(349)	(349)
Increase in mortgage bonds issued	7,049	7,049	3,922	3,922
<b>Decrease in cash and cash equivalents from operating activities</b>	<b>(9,512)</b>	<b>(11,444)</b>	<b>(21,739)</b>	<b>(21,979)</b>
<b>Corporate income tax paid</b>	<b>(216)</b>	<b>(216)</b>	<b>(221)</b>	<b>(221)</b>
<b>Cash flow from investing activities</b>				
Purchases of fixed assets	(4,267)	(2,142)	(1,997)	(1,457)
Proceeds from fixed assets disposal	220	22	7	7
(Acquisition)/sale of investments in associated entities	2	2	-	(300)
	<b>(4,045)</b>	<b>(2,118)</b>	<b>(1,990)</b>	<b>(1,750)</b>
<b>Cash flow from financing activities</b>				
Proceeds from subordinated liabilities	5,000	5,000	-	-
Distribution of profit	(425)	(425)	(328)	(328)
	<b>4,575</b>	<b>4,575</b>	<b>(328)</b>	<b>(328)</b>
<b>Decrease in cash and cash equivalents</b>	<b>(9,198)</b>	<b>(9,203)</b>	<b>(24,278)</b>	<b>(24,278)</b>
Cash and cash equivalents at the beginning of the period	20,181	20,166	26,661	26,661
(Profit)/loss on dealing with securities and foreign exchange	(124)	(148)	4	(1)
<b>Cash and cash equivalents at the end of the period</b>	<b>10,859</b>	<b>10,815</b>	<b>2,387</b>	<b>2,382</b>

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*Mortgage and Land Bank of Latvia*  
*Interim Condensed Consolidated and Banks Financial Statements*  
*for the nine months period ended 30 September 2004*

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**NOTES TO THE FINANCIAL STATEMENTS**

**1 ACCOUNTING POLICIES**

**(1) Basis of preparation**

The Bank's accounting is carried out in accordance with the legislation of the Republic of Latvia, including procedures for the credit institutions of Latvia. These interim financial statements are prepared in accordance with IAS 34 "Interim Financial Reporting".

The accounting policies used in the preparation of the interim financial statements are consistent with those used in the audited annual financial statements for the year ended 31 December 2003.

These interim financial statements should be read in conjunction with the 2003 annual financial statements.

**(2) Consolidation**

Subsidiary undertakings, which are those companies and other entities in which the Bank, directly or indirectly, has power to exercise control over financial and operating policies and operating volumes are substantial, have been consolidated in these financial statements by adding together similar types of assets and liabilities as well as income and expenses.

For the purposes of consolidation, intra-group balances and intra-group transactions including interest income and expense as well as unrealised profits and loss resulting from intra-group transactions are eliminated in the Group's financial statements.

Investments in subsidiary undertakings in the Bank's individual financial statements are accounted for by the equity method of accounting. Under this method, the Bank's share of the post-acquisition profits or losses of subsidiaries is recognised in the income statement and the cost of the investment is adjusted by accumulated profit or loss.

**(3) Loans**

Loans originated by the Group by providing money directly to the borrower are categorised as loans originated by the Group and are carried at amortised cost. All loans are recognised when cash is advanced to borrowers.

Management of the Bank considers both specific and general risks for all loans to determine the balance of impairment provisions for possible losses.

Specific provisions for individual loan impairment are established if there is objective evidence that the Group will not be able to collect all amounts due according to the original contractual terms of loans. The amount of the provision is the difference between the carrying amount and the recoverable amount, being determined as the present value of expected cash flows, including amounts recoverable from guarantees and collateral.

In addition to specific provisions for individual loans the Group has created homogeneous groups of loans based on similarities of credit risk involved, loan size, quality and loan terms. The loan impairment provision for those loans included within homogeneous groups have been estimated based upon historical patterns of losses in each group, the historic pattern of timeliness of payments and reflecting the current economic climate in which the borrowers operate.

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**NOTES TO THE FINANCIAL STATEMENTS**

**(3) Loans (continued)**

General provision covers losses where there is objective evidence that probable losses are present in components of the loan portfolio at the balance sheet date. These are estimated based on the empiric experience of the Bank, taking into consideration the total tendencies of the development of national economy and actual figures, quality of the loans and its changing tendency.

**(4) Taxation**

Current and deferred income tax charge for the nine months period ended 30 September 2004 has been calculated based on the annual effective income tax rate which is then applied against the actual profit for the nine months period. The annual effective income tax rate is based on the budgeted results for the whole year. The effective income tax rate applied by the Bank for these financial statements is 18.1% (9 months ended 30 September 2003: 15.6%).

**(5) Comparative information**

International Accounting Standard 34 "Interim Financial Reporting" requires that comparative information is disclosed. Financial results for the period ended 30 September 2003 and the year ended 31 December 2003 balances have been used as comparatives in these financial statements.

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NOTES TO THE FINANCIAL STATEMENTS

**2 PROVISION FOR IMPAIRMENT LOSSES**

	<b>9 months to 30 September 2004</b>		<b>9 months to 30 September 2003</b>	
	<b>Group</b>	<b>Bank</b>	<b>Group</b>	<b>Bank</b>
Provision expense:				
- specific provisions for loans	1,193	1,193	1,465	1,465
- specific provisions for other assets	65	65	37	37
- specific provisions for accrued interest income receivable	160	160	160	160
- specific provisions for off-balance sheet guarantees	-	-	22	22
- general provisions for bad loans	76	76	112	112
	<u>1,494</u>	<u>1,494</u>	<u>1,796</u>	<u>1,796</u>
Release of provisions for loans				
- specific provisions for loans	(172)	(172)	(196)	(196)
- specific provisions for accrued interest income receivable	(105)	(105)	(185)	(185)
- general provisions for bad loans	(96)	(96)	(400)	(400)
	<u>(373)</u>	<u>(373)</u>	<u>(781)</u>	<u>(781)</u>
<b>Total provision for impairment losses - expense</b>	<u><b>1,121</b></u>	<u><b>1,121</b></u>	<u><b>1,015</b></u>	<u><b>1,015</b></u>

**3 LOANS TO CUSTOMERS**

**(a) Loans from general funds**

	<b>30/09/04</b>		<b>31/12/03</b>	
	<b>Group</b>	<b>Bank</b>	<b>Group</b>	<b>Bank</b>
Local government	975	947	637	632
State owned companies	17	17	18	18
Private companies	148,153	151,297	117,981	119,288
Individuals	100,513	99,321	66,441	66,017
Management / staff	2,611	2,572	2,198	2,166
Public and religious institutions	259	249	160	158
	<u>252,528</u>	<u>254,403</u>	<u>187,435</u>	<u>188,279</u>
General provisions for loans impairment losses	(364)	(364)	(381)	(381)
Specific provisions for loans impairment losses	(2,918)	(2,918)	(2,419)	(2,419)
	<u>249,246</u>	<u>251,121</u>	<u>184,635</u>	<u>185,479</u>

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**3 LOANS TO CUSTOMERS (continued)**

<b>(b) Loans from transit funds</b>	<b>30/09/04</b>		<b>31/12/03</b>	
	<b>Group</b>	<b>Bank</b>	<b>Group</b>	<b>Bank</b>
Municipalities	-	-	236	236
Private companies	2,623	2,623	3,035	3,035
Individuals	102	102	49	49
	<u>2,725</u>	<u>2,725</u>	<u>3,320</u>	<u>3,320</u>
General provisions for loans impairment losses	(8)	(8)	(10)	(10)
Specific provisions for loans impairment losses	(31)	(31)	(15)	(15)
	<u>2,686</u>	<u>2,686</u>	<u>3,295</u>	<u>3,295</u>
<b>Total net loans</b>	<u><b>251,932</b></u>	<u><b>253,807</b></u>	<u><b>187,930</b></u>	<u><b>188,774</b></u>

Under the Subsidiary Loan agreement between the Bank and the Ministry of Finance, the Bank assumes credit risk related to transit loans disbursed. Therefore, special and general provisions are created for the transit loan portfolio by the Bank.

<b>(c) Analysis of movement in provisions for loan impairment losses</b>	<b>30/09/04</b>		<b>31/12/03</b>	
	<b>Group</b>	<b>Bank</b>	<b>Group</b>	<b>Bank</b>
As at beginning of the period	2,825	2,825	2,323	2,323
Increase of provisions	1,269	1,269	2,211	2,211
Release from provisions	(268)	(268)	(829)	(829)
Adjustment (foreign exchange fluctuation)	2	2	(26)	(26)
Write-off of loans	(507)	(507)	(854)	(854)
As at end of the period	<u>3,321</u>	<u>3,321</u>	<u>2,825</u>	<u>2,825</u>

<b>(d) Maturity profile</b>	<b>30/09/04</b>		<b>31/12/03</b>	
	<b>Group</b>	<b>Bank</b>	<b>Group</b>	<b>Bank</b>
Overdue	1,902	1,902	1,147	1,147
<b>Falling due within:</b>				
1 month	8,019	7,669	5,074	4,978
1 – 3 months	12,945	12,415	10,025	9,829
3 – 6 months	17,088	16,267	12,110	11,859
6 – 12 months	30,847	29,370	20,571	20,058
1 – 5 years	100,859	105,914	81,130	83,030
more than 5 years	83,593	83,591	60,698	60,698
<b>Total gross loans</b>	<u><b>255,253</b></u>	<u><b>257,128</b></u>	<u><b>190,755</b></u>	<u><b>191,599</b></u>
Less provision	<u>(3,321)</u>	<u>(3,321)</u>	<u>(2,825)</u>	<u>(2,825)</u>
<b>Total net loans to customers</b>	<u><b>251,932</b></u>	<u><b>253,807</b></u>	<u><b>187,930</b></u>	<u><b>188,774</b></u>

The average interest rate for the loan portfolio as at 30 September 2004 was 7.29% per annum (8.17 % at 31 December 2003).

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**NOTES TO THE FINANCIAL STATEMENTS**

**4 INVESTMENTS IN SUBSIDIARIES AND ASSOCIATED ENTITIES**

The Bank's investments in subsidiaries and associated entities are specified as follows:

	Share capital	Total equity	Bank's share (%)	Investment value 30/09/04	Investment value 31/12/03
SIA "Hipolīzings"	300	330	100%	330	242
SIA "Hipotēku bankas finansu konsultāciju centrs"	50	33	100%	50	50
SIA "Hipotēku bankas nekustamā īpašuma aģentūra"	50	113	100%	50	50
SIA "Skultes kokosta"	-	-	-	-	2
<b>Total</b>				<u><b>430</b></u>	<u><b>344</b></u>

SIA "Hipolīzings" was registered in the Enterprise Register of the Republic of Latvia on 22 January 2003. The primary business of the Company is leasing and factoring services.

SIA "Hipotēku bankas nekustamā īpašuma aģentūra" was registered in the Enterprise Register of Latvia on 14 January 1999. The primary business of the Company is related to real estate, i.e. administration, rent, lease, and other activities related to real estate.

SIA "Hipotēku bankas finansu konsultāciju centrs" was registered in the Enterprise Register of Latvia on 24 January 2002. The primary business of the Company is consulting services relating to the Bank's services, market investigation and professional training.

The Bank sold SIA "Skultes kokosta" shares in the reporting period.

**5 DUE TO CREDIT INSTITUTIONS**

	30/09/04		31/12/03	
	Group	Bank	Group	Bank
On demand	3,522	3,522	2,032	2,032
Short term	2,751	2,751	780	780
Long term	58,801	58,801	37,406	37,406
	<u><b>65,074</b></u>	<u><b>65,074</b></u>	<u><b>40,218</b></u>	<u><b>40,218</b></u>

Due to credit institutions include long-term loan from foreign banks for realisation of credit for Small and Medium Size Enterprise Development Program and Housing Development Program. As at 30 September 2004 long-term liabilities to credit institutions included borrowings from German Development Bank (Kreditanstalt für Wiederaufbau) in amount of EUR 27,041 thousand (LVL 18,144 thousand), Council of Europe Development Bank in amount of USD 9,592 thousand (LVL 5,218 thousand) and EUR 7,519 thousand (LVL 5,045 thousand), Nordic Investment Bank in amount of USD 9,592 thousand (LVL 5,218 thousand) and EUR 17,519 thousand (LVL 11,756 thousand), and European Investment Bank in amount of EUR 20,000 thousand (LVL 13,420 thousand).

The average interest rate payable on long - term borrowings from foreign credit institutions, as at 30 September 2004 was 2.67% per annum (as at 31 December 2003 – 2.78%).

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NOTES TO THE FINANCIAL STATEMENTS

6 CUSTOMER DEPOSITS

	30/09/04		31/12/03	
	Group	Bank	Group	Bank
<u>Demand deposits:</u>				
Central government	2	2	2	2
Local government	1,854	1,854	1,284	1,284
State owned companies	814	814	584	584
Private financial institutions	82	99	49	82
Private companies	10,942	10,942	10,080	10,080
Individuals	19,103	19,103	14,604	14,604
Public and religious organisations	336	336	347	347
	<b>33,133</b>	<b>33,150</b>	<b>26,950</b>	<b>26,983</b>
<u>Term deposits:</u>				
Local government	2,112	2,112	1,811	1,811
State owned companies	4,717	4,717	4,536	4,536
Private financial institutions	10,482	10,482	7,239	7,239
Private companies	10,846	10,846	8,165	8,165
Individuals	87,576	87,576	78,582	78,582
Public and religious organisations	895	895	1,047	1,047
	<b>116,628</b>	<b>116,628</b>	<b>101,380</b>	<b>101,380</b>
<b>Total deposits</b>	<b>149,761</b>	<b>149,778</b>	<b>128,330</b>	<b>128,363</b>

99.6% of the deposits with the Bank are the Bank's liabilities to residents of Latvia, 0.3% are liabilities to OECD residents, and the remaining 0.1% of the deposits are liabilities to non-OECD residents.

The average interest rate for demand deposits at 30 September 2004 was 0.8% (0.8% at 31 December 2003), for term deposits – 4.3% (4.5% at 31 December 2003).

**Maturity profile**

	30/09/04		31/12/03	
	Group	Bank	Group	Bank
<b>Total demand deposits</b>	<b>33,133</b>	<b>33,150</b>	<b>26,950</b>	<b>26,983</b>
<b>Term deposits due:</b>				
- up to 1 month	21,374	21,374	9,668	9,668
- from 1 to 3 months	33,956	33,956	9,218	9,218
- from 3 to 6 months	12,133	12,133	14,343	14,343
- from 6 to 12 months	25,283	25,283	47,123	47,123
- from 1 to 5 years	23,881	23,881	21,027	21,027
- more than 5 years	1	1	1	1
<b>Total term deposits</b>	<b>116,628</b>	<b>116,628</b>	<b>101,380</b>	<b>101,380</b>
<b>Total deposits</b>	<b>149,761</b>	<b>149,778</b>	<b>128,330</b>	<b>128,363</b>

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**NOTES TO THE FINANCIAL STATEMENTS**

**7 MORTGAGE BONDS**

Total amount of the debt securities issued by the Bank as at 30 September 2004 consists of mortgage bonds in circulation with a total nominal value of LVL 30,452 thousand (as of 31 December 2003: LVL 23,605 thousand). As at 30 September 2004, mortgage bonds for the total purchase price of LVL 589 thousand with nominal value LVL 580 thousand (as at 31 December 2003: LVL 814 thousand) were repurchased by the Bank. Mortgage bonds are shown net of repurchases with a nominal value of LVL 29,872 thousand and a book value of LVL 29,895 thousand (as of 31 December 2003: LVL 22,846 thousand).

The purpose of issuing was to attract financial resources for refinancing of the long-term mortgage loans. The average yield to maturity of the mortgage bonds denominated in lats fluctuated from 3.85% up to 5.60% per annum depending on the maturity of mortgage bonds. The average yield to maturity of the mortgage bonds denominated in US dollars was 2.67% per annum.

All mortgage bonds issued by the Bank are assigned A1 rating by Moody's Investors Service and are quoted on the Official List of the Riga Stock Exchange.

During the first nine months of 2004, the Bank issued mortgage bonds for the total amount of LVL 7,698 thousand, including LVL 2,258 thousand of AM series and LVL 5,440 thousand (USD 10,000 thousand) of BA series mortgage bonds, but redeemed LVL 850 thousand of AH series mortgage bonds.

**Statement on Mortgage bond coverage as at 30 September 2004**

**(a) Issued mortgage bonds**

ISIN	Security class	Number of mortgage bonds	Face value	Registered volume	Coupon rate, %	Maturity date	Outstanding volume, LVL	Book value LVL
LV0000800076	AF	10,000	100 LVL	1,000,000 LVL	8.5%	15.02.2005.	991,200	991,647
LV0000800126	AD	30,000	100 LVL	3,000,000 LVL	6.5%	15.08.2006.	2,984,000	3,011,988
LV0000800092	AG	30,000	100 LVL	3,000,000 LVL	7.5%	15.08.2007.	2,876,200	2,871,930
LV0000800118	AI	20,000	100 LVL	2,000,000 LVL	7.0%	15.08.2008.	1,977,600	2,042,635
LV0000800167	AJ	30,000	100 LVL	3,000,000 LVL	4.5%*	15.08.2008.	2,995,000	2,990,073
LV0000800183	AK	30,000	100 LVL	3,000,000 LVL	4.5%*	15.08.2009.	2,910,600	2,907,665
LV0000800100	AH	20,000	100 LVL	2,000,000 LVL	7.5%	15.08.2011.	1,129,200	1,124,263
LV0000800217	BA	100,000	100 USD	10,000,000 USD	2.625%**	15.08.2011.	5,440,000	5,424,165
LV0000800142	AL	50,000	100 LVL	5,000,000 LVL	6.0%	15.08.2012.	4,960,000	4,946,784
LV0000800159	AM	70,000	100 LVL	7,000,000 LVL	5.25%	15.08.2013.	3,609,000	3,583,998
<b>Total</b>							<b>29,872,800</b>	<b>29,895,148</b>

\* floating coupon rate (6 month RIGIBOR plus 0.5%) that are revised twice every year on 15<sup>th</sup> February and 15<sup>th</sup> August

\*\* floating coupon rate (6 month LIBOR plus 0.8%) that are revised twice every year on 15<sup>th</sup> February and 15<sup>th</sup> August

**(b) Structure of Mortgage bond coverage**

Mortgage bonds in circulation are secured by assets included in the Mortgage Bond Cover Register which as of 30 September 2004 amounted LVL 48,230 thousand (as at 31 December 2003: LVL 34,095 thousand). Assets included in the Mortgage Bond Cover Register consisted of mortgage loans (ordinary cover) in the amount of LVL 48,230 thousand (as at 31 December 2003: LVL 33,808 thousand).

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**7 MORTGAGE BONDS (continued)**

As at 30 September 2004, a ratio of substitute cover against amount of mortgage bonds in circulation (maximum statutory allowed – 20%) was 0% (as at 31 December 2003: 1.2%), while the amount of assets included in the Mortgage Bond Cover Register exceeds the amount of mortgage bonds in circulation by 43.0% (as at 31 December 2003: 30.8%) of the amount of weighted assets included in the Mortgage Bond Cover Register (minimum statutory requirement: 10%).

**(c) Sufficiency Calculation of Cover of Mortgage Bonds in Circulation**

M-Bonds Redemption and Coupon Payment Dates	Mortgage Bond Cover Sufficiency on the last Payment Date*	Mortgage Payments receivable		Payments of Mortgage Bonds in Circulation		Substitute Cover	Mortgage Bond Cover Sufficiency
A	1	Principal Payments	Interest Payments	Redemption Payments	Coupon Payments	6	(1+2+3-4-5+6) 7
15.02.2005	0	1,670	1,258	(1,000)	(813)	-	1,115
15.08.2005	670	2,274	1,607	-	(771)	-	3,780
15.02.2006	2,944	2,146	1,519	-	(771)	-	5,838
15.08.2006	5,090	2,194	1,437	(3,000)	(771)	-	4,950
15.02.2007	4,284	2,107	1,353	-	(673)	-	7,071
15.08.2007	6,391	2,082	1,272	(3,000)	(673)	-	6,072
15.02.2008	5,473	2,061	1,192	-	(561)	-	8,165
15.08.2008	7,534	2,021	1,114	(5,000)	(561)	-	5,108
15.02.2009	4,555	2,020	1,038	-	(423)	-	7,190
15.08.2009	6,575	2,423	960	(3,000)	(423)	-	6,535
15.02.2010	5,998	1,884	882	-	(356)	-	8,408
15.08.2010	7,882	1,917	811	-	(356)	-	10,254
15.02.2011	9,799	1,992	734	-	(356)	-	12,169
15.08.2011	11,791	2,974	654	(6,590)	(356)	-	8,473
15.02.2012	8,175	1,634	555	-	(251)	-	10,113
15.08.2012	9,809	3,723	493	(5,000)	(251)	-	8,774
15.02.2013	8,532	2,093	381	-	(101)	-	10,905
15.08.2013	10,625	5,503	364	(3,862)	(101)	-	12,529
15.02.2014	12,266	5,512	263	-	-	-	18,041
<b>Total</b>	<b>X</b>	<b>48,230</b>	<b>17,887</b>	<b>(30,452)</b>	<b>(8,568)</b>	<b>-</b>	<b>X</b>

\* mortgage Bond Cover sufficiency on the last Payment Date is calculated: figures showed in Column 7 – (Column 3 – Column 5) on the last Payment Date

**(d) Analysis of mortgage loans included in Mortgage bond coverage by type of real estate**

	<b>30/09/04 Bank</b>	<b>31/12/03 Bank</b>
Residential mortgage loans	22,930	16,856
Commercial mortgage loans	25,300	16,952
	<b>48,230</b>	<b>33,808</b>