Nordic Environment Finance Corporation

Annual Report 2013

NEFCO

Contents

This is a translation from the original Annual Report in Swedish. In the unlikely event of a disagreement in interpretation, meaning or otherwise, the original Swedish version shall prevail.

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Report of the Board of Directors 2013

The year was characterised by a flood of new projects and management mandates. What will affect NEFCO in the long term is the combination of the Nordic Project Fund (Nopef) and NEFCO. As a result, Nopef's activities will be integrated with NEFCO as of 2014. Nopef provides financing for promoting the internationalisation of Nordic companies. Since its establishment in 1982, it has been involved in a total of 4,800 projects. In future, Nopef will focus on green growth and its activities will be carried out through a separate fund under NEFCO's auspices and be financed by the Nordic Council of Ministers.

Political disagreement and the increasingly difficult economic situation in some of the target countries will pose challenges for NEFCO. This is reflected in delays in the planning and execution of projects in the face of growing uncertainty. For Ukraine where the problems are the gravest, this means waning private sector interest in projects at the same time as public projects are falling behind.

A large number of municipal projects have been identified and are being prepared in the district heating and water management sector in Ukraine and Russia. While municipal investments in the environment have always been an integral part of NEFCO's activities, there have been relatively few such projects in either country. A major change took place in this respect during 2013, partly as a result of the project subsidies offered in the context of the Nordic Dimension Environmental Partnership (NDEP) and the Eastern Europe Energy Efficiency and Environmental Partnership (E5P) in Ukraine.

Again, 2013 was a year of vigorous project activity. A total of 59 new projects were approved in 2013 by the various funds managed by NEFCO as compared to 65 the year before. The volume of new projects financed by the NEFCO Investment Fund increased substantially with new approved investments amounting to EUR 52 million as compared to EUR 5.7 million in 2012. Additionally, the value of provisionally approved projects reached EUR 37.9 million while the corresponding figure for 2012 was EUR 51.8 million. At the end of 2013, there were 54 active projects financed by NEFCO's principal fund, the NEFCO Investment Fund, with total investments amounting to EUR 144.1 million. As disbursements are made with a certain delay, a larger proportion of NEFCO's resources was actually allocated than indicated in the statement of financial position.

Two new funds were established and two dissolved during the reporting period: the *NEFCO Norwegian Carbon Procurement Facility* (NorCaP), a fund financed by Norway in order to purchase CERs equivalent to 30 million tonnes of carbon dioxide during the Kyoto Protocol's second commitment period (2013–2020); and a fund that disposes of the funding provided by the E5P for financing energy-efficient district heating demonstration projects in Ukraine.

At the end of the year, NEFCO had 28 funds (excluding the Investment Fund) with total assets of EUR 356 million under management. NEFCO renders separate accounts for all these funds. The funds are not included in NEFCO's statement of financial position.

The financial result was slightly better than expected mainly due a capital gain of EUR 2.4 million. Additionally, the result was affected by the political situation in Ukraine and consequently a provision was made for the outstanding loans in the country. In all other respects, the net balance between capital gains and losses provided no surprises.

As expected, environmental performance during the reporting period was also sound compared to previous years. A more detailed account of environmental performance is presented in the annex.

Negotiations on framework agreements were initiated with Moldova, Georgia and Armenia. The increase in the number of NEFCO's countries of operation was due to the fact that the E5P was extended to include the countries participating in the EU's eastern partnership programme. NEFCO plays an active role in E5P co-operation and the Nordic Dimension Environmental Partnership (NDEP) in Russia.

Assessment of the environmental impact of projects

In line with the procedures developed over time by NEFCO, each project is assessed in terms of its expected environmental impact before a decision on financing is made followed by a review of the actual effects upon completion of the project. The analysis of the projects launched under both the Investment Fund and the Environmental Development Fund (presented below in greater detail) indicates that on average, the positive environmental impacts are at the expected level. Of the 63 on-going projects assessed in terms of environmental impact, 19 were deemed to have exceeded expectations, eight were at the expected level and 14 failed to meet expectations. In 22 cases, no conclusions could yet be drawn. Of all the analysed projects, 175 have been completed. A summary of the assessment is provided in the annex.

NEFCO also systematically assesses the environmental cost-effectiveness of projects in relation to the cost of attaining comparable levels of emission reductions in the Nordic countries. On average, the costs of NEFCO's projects are roughly one eighth of the corresponding project costs in the Nordic countries.

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2013 was a year of vigorous project activity. A total of 59 projects were approved during the period by the various funds managed by NEFCO.

Investment Fund

During 2013, the Board of Directors approved 16 new investments. In addition, 15 'expressions of interest' were approved for further review.

NEFCO was able to complete four projects during the year. A loan programme for energy-efficiency projects was established in collaboration with a local bank in Ukraine and another project for harnessing biogas from landfills launched in Lithuania; two less successful projects, however, were terminated. By the end of 2013, NEFCO had completed 71 projects, to which it had contributed a total of EUR 80.5 million. Five projects were abandoned in 2009 as they were no longer deemed capable of being implemented as planned.

As a result, 54 active projects approved by the Board remain, with agreements signed on a total of 32. With regard to the outstanding 22 projects, negotiations and analyses are still underway. NEFCO's commitment to these 54 projects amounts to EUR 144.1 million with a total investment of approximately EUR 780 million, suggesting a major leverage effect. As a result, a larger share of NEFCO's resources is committed than the total investments of EUR 50.4 million (net after amortisation and depreciation) indicated in the statement of financial position, representing an increase on the 2012 figure of EUR 43.8 million.

NEFCO's investments in the 32 projects on which agreements have been signed amount to EUR 81.7 million while the total investments are roughly EUR 560 million.

NEFCO has made capital investments in 12 of these projects, two of which have also received loans from NEFCO. In 20 cases, NEFCO's funding consists exclusively of loans. On the whole, the 32 companies under contract with NEFCO are putting in a satisfactory performance. According to the 2012 financial statements of the respective companies, 15 projects had posted a profit, nine posted losses while eight companies had not yet commenced operations.

The new investments are spread widely across different sectors. Four of the new projects are related to a loan programme to be implemented in collaboration with local banks to promote various energy and process-efficiency projects; four projects concern the upgrading of municipal district heat distribution systems; one project is related to the production of biogas from waste; one addresses energy-saving measures at a pig farm; and one energy-saving measures in municipal buildings. Additionally, funding has been provided for investments in the production of construction and infrastructure materials and another investment in the transport sector. Funding has also been given to a loan programme to finance deliveries from Nordic countries and for a fund with a mission to facilitate the creation of new environmental technology. Of these projects, eight are located in Ukraine, four in Russia and two in Belarus; two further projects are expected to be implemented in all of these three countries.

Of the 15 approved expressions of interests, seven are located in Russia, five in Ukraine and two in Belarus; two further projects are expected to be implemented in all of these three countries.

MANAGEMENT MANDATES

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Nordic Environmental Development Fund

NEFCO has managed the Nordic Environmental Development Fund (NMF) on behalf of its member states since 1996. The NMF is financed with annual contributions from the Nordic countries and the Nordic Council of Ministers. At the end of the year, the NMF's total budget stood at EUR 71.5 million. NMF is administered by NEFCO whose Board of Directors also makes the final decisions on the financing to be extended by NMF. The Nordic Investment Bank (NIB) takes part in project evaluation. The current programme period expired during 2013 and the owner countries have committed to continue to provide funding.

Since 2010, revolving loans have been administered by NMF Credits, a special fund established with funding from the NMF. Separate accounts are rendered for the NMF and NMF Credits.

During 2013, the NMF and NMF Credits gave final approval for a total of 23 new projects including a supplemental investment in a project approved earlier. Of these, nine relate to the energy saving loan programme and 11 to the Cleaner Production programme.

All in all, 72 projects have received funding under NEFCO's energy saving loan programme to finance measures to save energy; moreover, 86 projects have been granted funding under the loan facility for Cleaner Production for projects in Russia, Ukraine, Belarus and the Baltics.

When all the individual projects financed by both funds are taken into account, the total number of projects approved, agreed upon and implemented came to 251 (including two expressions of interest). Of the current total budget, EUR 63.8 million was committed at the end of 2013.

Barents Hot Spots Facility

NEFCO has managed the *Barents Hot Spots Facility* (BHSF) since 2004. Financed by the Nordic countries and the funding provided by the Nordic Environmental Development Fund (NMF), the BHSF is primarily intended for project development purposes. The objective is to co-operate with the Russian authorities and project owners to continue to pursue high-priority environmental projects ('hot spots') in North-West Russia identified in a 2003 report issued by NEFCO in collaboration with the Arctic Monitoring and Assessment Programme (AMAP). Together with the supplemental funding provided by Norway during 2013, a total of EUR 6.7 million has been allocated to the fund to date. In total, 68 feasibility studies and pre-project measures have received BHSF financing. During 2013, the original report was revised and all the hot spots re-evaluated by the consultancy firm Akvaplan-niva. The findings were presented in a report entitled 'Assessment of the Barents Hot Spot Report - Describing the state of 42 original Barents environmental 'hot spots'. At the meeting of the environmental ministers in Inari in December 2013, it was established that some form of action had been taken in respect of all of the hot spots and so the overall objectives set in 2003 had been accomplished. Yet a great deal remains to be done and efforts continued based on the regional structures established in the Russian Barents regions. While three further hot spots were struck from the list during 2013, a total of 36 still remain from the original listing. In conjunction with the meeting of the environmental ministries, NEFCO presented a publication summarising the work on the hot spots during the preceding ten-year period – 'Hot Spots: Tackling environmental challenges in the Barents Region'. Among the projects and studies completed during 2013 is the programme for handling municipal waste and landfill deposits in the capital city of Syktyvkar and in two small municipalities in the Komi Republic where the proposed projects are based on a regional strategy previously co-financed by the BHSF.

Arctic Council Project Support Instrument

Since 2005, NEFCO has also managed the *Arctic Council Project Support Instrument* (PSI), a project preparation fund. NEFCO was part of the group of experts who were appointed by the Arctic Council to both develop and establish the fund. The PSI has been set up for project preparation, development and demonstration purposes, primarily in the context of the Arctic Council Action Plan (ACAP). The donors are Finland, Iceland, Norway, Russia, Sámi Parliament, Sweden and, as of 2012, the USA. While there has been a certain delay in the commencement of operations, the financiers have conducted preparatory discussions and now the fund is expected to become operational during 2014.

NEFCO Carbon Finance and Funds – CFF

Since 2003, NEFCO has managed the *Baltic Sea Region Testing Ground Facility (TGF)* carbon fund, which was established in conjunction with the Baltic Sea region's testing ground for Joint Implementation (JI), one of the mechanisms under the Kyoto Protocol. Its aim was to procure cost-effective Certified Emission Reductions for its investors from energy-related and other projects. At its highest, the fund's total capital was EUR 35 million. The fund terminated its investment phase in 2012 upon expiry of the Kyoto Protocol's commitment period and will be dissolved during 2014. Cumulatively, the fund delivered a total of 2.6 million CERs subsequently distributed to investors.

Since 2008, NEFCO has also managed the global *NEFCO Carbon Fund (NeCF)*. Its mission is to finance environmental projects that meet the requirements of the Kyoto Protocol on *Joint Implementation* (JI) or the *Clean Development Mechanism* (CDM). The fund's investment activities declined drastically in 2012 as a result of the low demand for emission credits. Even if NeCF will continue to operate for years to come, investments in new purchase agreements will mostly likely be limited. Currently, the fund's total capital stands at EUR 105 million. At the end of 2013, NeCF had 15 active purchase agreements on CERs and during 2013 the fund was able to deliver 1.2 million credits distributed to its investors.

At the end of 2013, a total of 7.23 million CERs were distributed to investors by NEFCO's climate funds TGF and NeCF.

Established in 2009, the *Nordic Climate Facility (NCF)* is financed by the Nordic Development Fund and administrated jointly with NEFCO. The fund finances climate projects in the poorest countries in Africa, Asia and Latin America. It promotes innovative co-operation with Nordic organisations and companies engaged in climate-related fields. Operations have been successful and the fund has already been expanded three times. In the first call for tenders, financing was granted to 14 projects, in the second call to 12 and in the third call to 14 projects. The fourth call for tenders commenced in December 2013. A total of EUR 22 million has been allocated to the fund to date.

In an effort to develop the climate market, NEFCO coordinates an inter-Nordic project in collaboration with the Nordic Working Group for Global Climate Negotiations (NOAK) regarding Nationally Appropriate Mitigation Actions (NAMA) in the waste management sector in Peru. Part of a programme launched by the Nordic Partnership Initiative (NPI), the project is proceeding according to plan.

NEFCO Norwegian Carbon Procurement Facility (NorCaP) was established during 2013. Financed by Norway, the fund is tasked to purchase CERs during the Kyoto Protocol's second commitment period (2013–2020). The facility is to purchase up to 30 million CERs in UN-approved projects whose survival or continued emission reduction activity depend on a higher carbon price than achievable under current market conditions – or "vulnerable" projects. The first call for tenders commenced in November 2013.

Co-operation commenced in 2013 with the KfW Development Bank resulting in a series of workshops on the new market mechanisms for emission trading.

Other Management Mandates

In addition to the above funds, NEFCO also manages a number of other external funds. These are trust funds in which capital is injected for a specific purpose or project determined by the donor. NEFCO is responsible for the utilisation of this capital.

For analyses, preparation and monitoring of environmental projects, NEFCO manages contributions from Finland, Norway and Sweden. NEFCO is also managing Norwegian funds intended for water management in the Kenozero National Park in Russia; measures to clean up oil-contaminated waters in the Barents Region; and for co-financing project identification, development and monitoring efforts in collaboration with the Barents Hot Spots Facility. Swedish funds have been allocated for co-operation in district heating with the Ukrainian government; for the preparation of environmental projects given priority under the Baltic Sea Action Plan (BSAP) and/or NDEP; for environmental projects in the Solovki Islands in the Russian Barents region; and for environmental investments in Kaliningrad Oblast. Swedish funds have also been made available for projects designed to reduce (Short-Lived Climate Forcers) emissions, a district heating demonstration project in Ukraine and an inter-Nordic initiative for promoting an emissions reduction programme for developing countries. Finland and Sweden have also earmarked funds for an investment programme for small wastewater treatment plants in Kaliningrad. Additionally, Finland and Sweden have provided funding for the development and financing of a demonstration project for the disposal of substances harmful to the ozone layer through the market for voluntary carbon credits. Similarly, Finnish and Swedish funds have been allocated to administer a project development fund to support the implementation of the: BSAP together with NIB. Moreover, NEFCO has been commissioned to administer NDEP funding for three separate projects as well as E5P funds for three other projects. NEFCO renders separate accounts for all these funds.

To date, these funds have been allocated EUR 110.5 million by various donors, with contributions to concluded management mandates accounting for EUR 45.8 million of the total.

Personnel

At the end of 2013, NEFCO had 32 employees, three of whom were stationed in NEFCO's Representative Office in Kiev, Ukraine. NEFCO also retains experts on a consultancy basis.

Financial Result

The financial statements show a surplus of EUR 634,439.69. In accordance with previous practice, the Board of Directors proposes that the surplus be allocated to operations in the form of retained earnings.

Helsinki, 6 March 2014

John Kahn
Chairman

Danfríður Skarphéðinsdóttir
Deputy Chair

Harald Rensvik

Søren Bukh Svenningsen

Ann-Britt Ylinen

Magnus Rystedt
Managing Director

02

Environmental status report 2013

Figure 1
BOD Biochemical oxygen demand
CO_2 Carbon Dioxide
MWh Megawatt hours
Nox Nitrogen oxides
Ntot Nitrogen total
Ptot Phosphorus total
SO_2 Sulphur oxides
SS Suspended solids
VOC Volatile organic compounds
t/y Tonnes per year

NEFCO makes use of funding provided by a variety of donors. The present report addresses activities within the framework of the Investment Fund and the Nordic Environmental Development Fund. The Investment Fund, which has the larger resource base of the two, is divided into four environmental sectors: water and wastewater management, energy, industry, and waste. The environmental benefits of the credit facility for cleaner technology administered by the Nordic Environmental Development Fund are reported separately.

The fundamental goal of NEFCO's operations is the reduction of pollution originating in Eastern Europe. This means support for projects that, for example, reduce discharges into the catchment areas of the Baltic Sea and the Barents Sea or reduce transboundary airborne emissions of pollutants. As projects having a major impact on the Nordic region are given priority, the efforts focus on protecting water and air quality.

When NEFCO considers projects for support, it first assesses their expected environmental benefits to ensure that projects with direct and clear benefits to the environment are given priority. In principle, any measures that can help to reduce the burden on the environment, such as improved treatment capacity or advanced industrial processes, are eligible. NEFCO's evaluation is also based on an analysis of the relationship between the investment and its anticipated quantitative effects in order to identify the projects that are environmentally the most cost-effective.

Typical projects include:

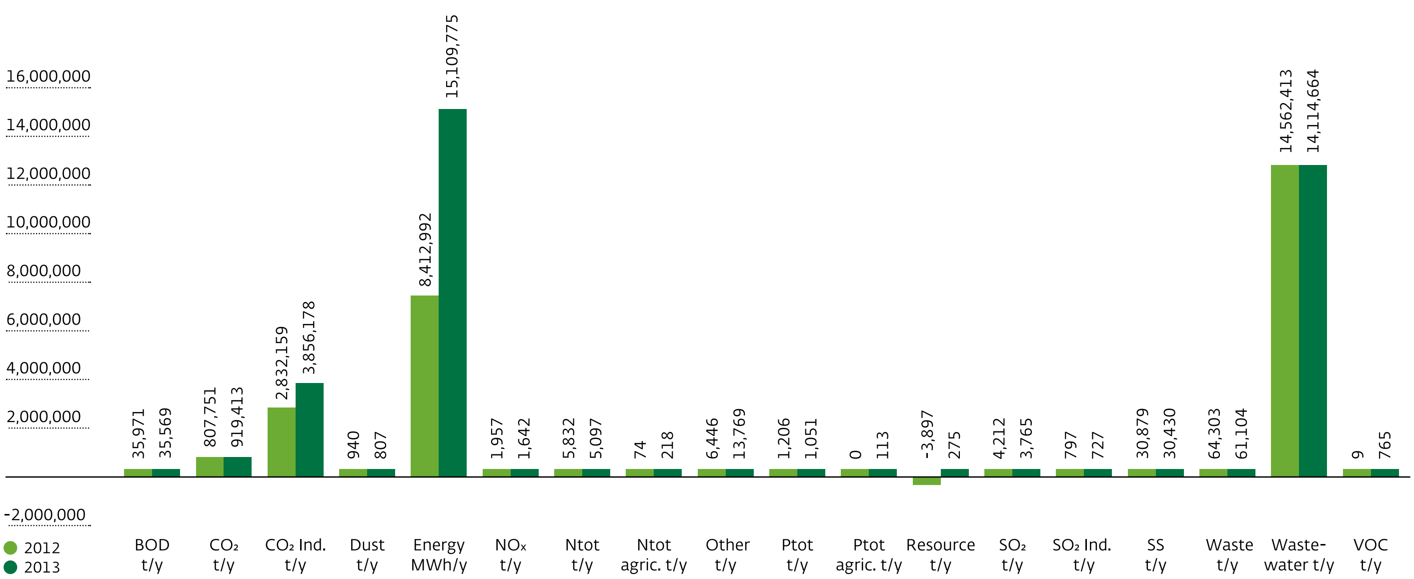
- Modernisation of industrial and power plants that will bring environmental benefits to the Nordic region and the surrounding seas;
- Partnerships with municipal and other authorities to deliver environmental services such as water treatment;
- Companies that manufacture environmental equipment (such as emission control equipment, measuring instruments and water treatment equipment) and equipment to increase energy efficiency; or companies that provide services in the environmental and energy fields and thereby contribute to creating a better basis for the implementation of environmental initiatives.

Over the past few years, attention has also been drawn to animal husbandry and agriculture since large animal populations create the need to handle manure in an environmentally sustainable manner, for example by constructing facilities for the production of biogas.

Environmental benefits gained in projects that have been completed or in which NEFCO's involvement has ceased are shown in Figure 1. For purposes of comparison, the data are shown as reductions or savings per annum.

NEFCO's environmental database also takes into account projects in which its involvement has ceased. The justification for including emission reductions from projects in which NEFCO is no longer involved is that

Figure 1 NEFCO: Total reductions



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Within the energy sector, the rate of reduction in carbon dioxide emissions clearly improved.

the relevant facilities have in post-evaluation been found to match or even significantly exceed expected reductions. The service life of an industrial facility is substantially longer than the repayment period of a loan, and as a result, the positive environmental effect of the facility will in all likelihood continue in a linear fashion for a long time into the future.

Even though the favourable effects of a project are felt for a number of years after the repayment of the loan, a reasonable technical depreciation period should be afforded for investments. In its environmental monitoring, NEFCO applies an annual depreciation rate of 5% on all actual reductions as of the beginning of the year following final repayment. This method was first applied in 2011. As a result, depreciation charges have accumulated for NEFCO's closed projects, decreasing reductions as of 2010.

The results achieved in 2013 for the determinant indicators of CO2 and energy improved slightly on 2013, which is due to one company selling bio-boilers equivalent to indirect CO2 reductions of some one million tonnes in terms of installed power (Figure 1). Substantial savings in energy consumption (fossil fuels) were also achieved in the same project.

The figures for nitrogen (N) and phosphorus (P) remain at the same level as in the preceding year. This is because data were not received on one project and the new wastewater treatment projects were not able to fully compensate for this. Additionally, depreciation on completed projects contributed to a weaker performance in 2013.

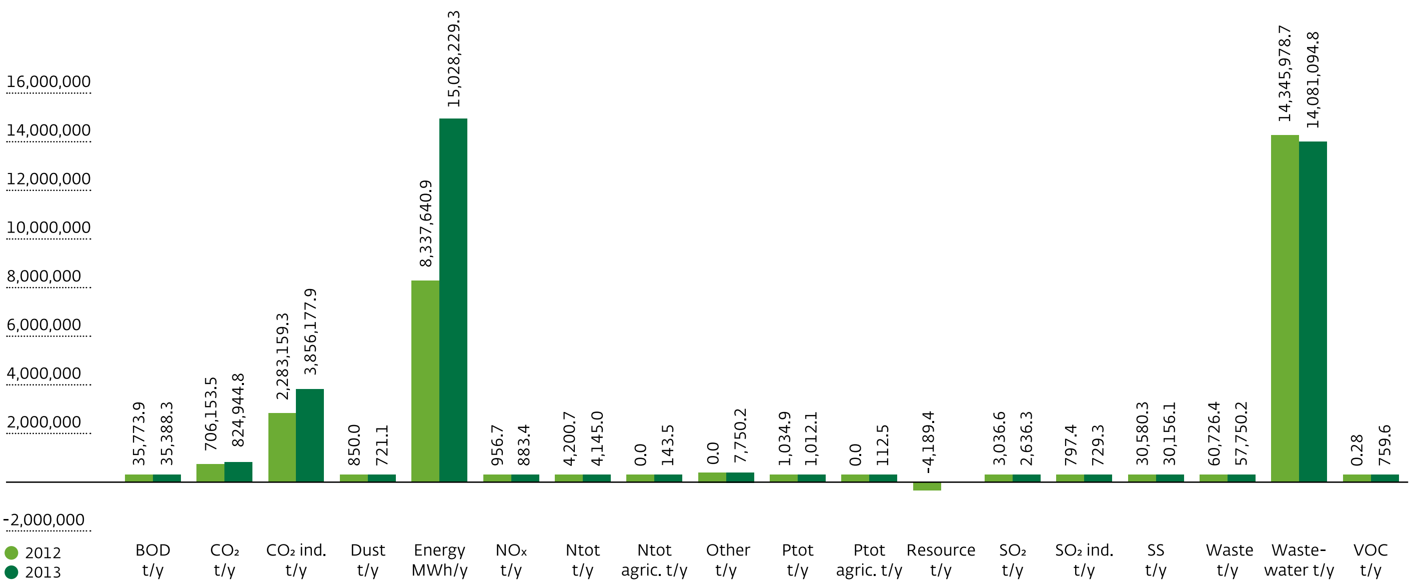
Performance in the water and waste management, energy, industrial, and waste sectors are shown in specific sections below. Emission reductions associated with the Nordic Environmental Development Fund and the Cleaner Production Facility are presented at the end of this environmental status report. Indirect CO2 reductions are shown as a separate bar.

WATER AND WASTEWATER MANAGEMENT

Most of the untreated municipal wastewater entering the Baltic Sea from the Baltic countries comes from small and medium-sized municipalities. At the time when the negotiations on accession to the EU were under way, the water and wastewater management sector had a high priority in the Baltics and systems have subsequently been upgraded to better meet the environmental criteria imposed by membership. With this work now completed, further efforts will be pursued to improve treatment capacity in northwest Russia.

While great importance is attached by NEFCO to benefits such as acceptable quality of drinking water and higher water connection rates, top priority is given to reduced BOD, phosphorus, and nitrogen emissions to

Figure 2 Investment Fund: Total reductions



water areas, especially the Baltic Sea. Work is continued along with the efforts to achieve further reductions under HELCOM's Baltic Sea Action Plan.

Figure 2 shows that there was a light improvement in performance in 2013 relative to 2012 with regard to phosphorus and nitrogen due to a number of new wastewater treatment plants going on stream in Russia. None of the other indicators follow the trend set by phosphorus and nitrogen as new wastewater project do not necessarily aim at achieving reductions in these other areas but focus on limiting emissions of phosphorus and nitrogen instead. As in the previous years, the impact of the Southwest Wastewater Treatment Plant in St Petersburg was excluded from the 2013 figures because of the dominant position of the facility in terms of the volume of wastewater treated (80 million m^3). Overall, the treated volumes vary considerably from one treatment plant to another, due to climatic and economic conditions, among others.

As in the past, the continued reduction in suspended solids (SS) was primarily due to the improved efficiency of the Southwest Wastewater Treatment Plant in St Petersburg.

Overall, the water sector continued to put in a good performance in 2013.

ENERGY

The combustion of fossil fuels produces acidifying emissions, CO_2 (which contributes to the greenhouse effect), and emissions of hydrocarbons, dust, and heavy metals, among others. With the appropriate technology and dimensioning, emissions can be reduced and efficiency increased substantially. More efficient energy production and conversion to less polluting fuels leads to reduced atmospheric emissions of sulphur dioxide (SO_2), nitrogen oxides (NO_x), CO_2, heavy metals, and dust from combustion processes.

All of NEFCO's energy projects aim at improving energy efficiency in order to generate positive effects for the environment. Typical goals for these projects include a general reduction in energy consumption, more efficient production and/or conversion to less polluting fuels.

Where quantitative targets have been set, reductions have been measured, as shown in Figure 3.

Within the energy sector, the rate of reduction in carbon dioxide emissions clearly improved compared to 2012. On the whole, the sector' performance in terms of CO_2 reductions was positive. The increased CO_2 reductions and substantial energy savings were due to a single energy producer in Russia, which achieved a considerable reduction in the use of natural gas by upgrading its facilities, and increased energy production by wind farms in the Baltics relative to 2012. Otherwise no major changes in reductions took place in 2013. The indicators are shown in Figure 2.

Figure 3 Investment Fund: Water and wastewater sector

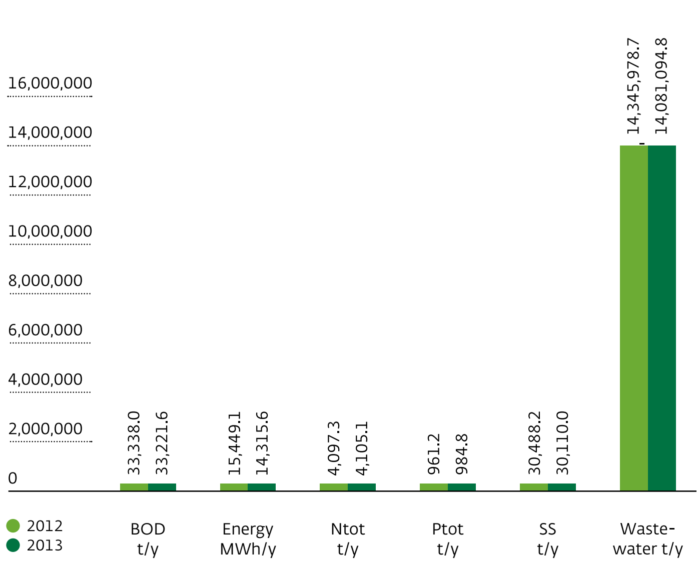
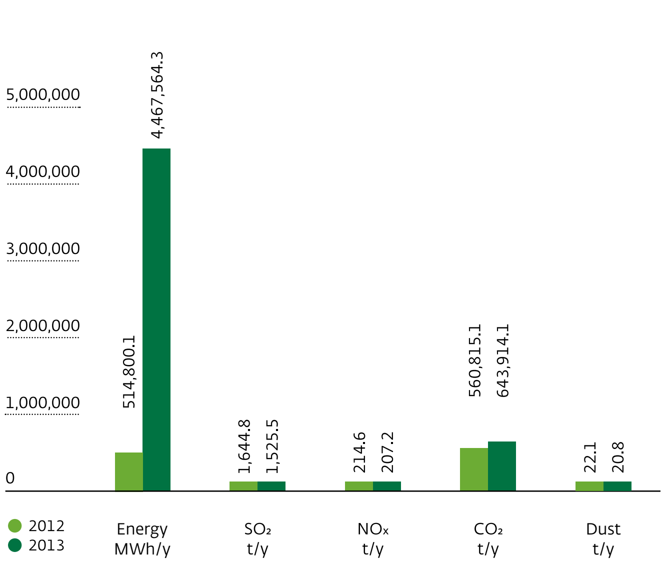


Figure 4 Investment Fund: Energy sector



In 2013 NEFCO introduced a sustainability policy capturing both the environmental and social aspects of sustainability.

INDUSTRY

Industrial activity impacts on the environment in a number of ways:

- The extraction of raw materials has a physical impact on the environment;
- Emissions affect air, land, and water;
- The manufacture of certain goods such as chemicals can be environmentally harmful;
- Landfill sites pollute groundwater through various types of leakages, and many end-products tend to burden landfill sites at the end of their lifecycle;
- Some industries cause odours and create noise; and
- Industrial buildings and roads have an impact on the landscape and plant and animal habitats.

NEFCO's industrial projects aim at improving resource efficiency in order to reduce emissions to air, soil and water. Environmental benefits can be achieved as a direct consequence of investments but also indirectly as NEFCO supports companies manufacturing environment-related products, such as water cleaning agents and insulation materials. In these cases, the benefits are only felt at the consumer level.

Compared with 2012, reductions in indirect CO_2 emissions clearly increased during 2013, which is explained by one of NEFCO's clients selling its bio-fuel boiler equipment. The fact that NOx and SO_2 emissions failed to decrease despite the deployment of the new bio-boilers is partly because the potential reductions and the impact of depreciation on completed projects were not factored in. The latter also applies to direct CO_2 reductions. That industrial projects lead to higher rates of reduction in wastes goes to show that industry in NEFCO's host countries is improving its performance in recovering and recycling resources in its processes, which is also indicated by the fall in the volume of wastes as shown in Figure 4.

WASTE

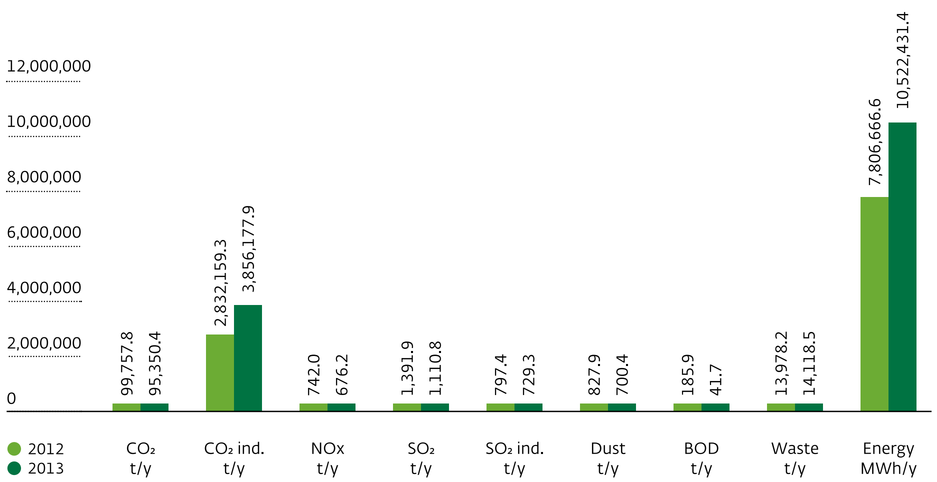
Waste causes a range of environmental problems:

- Toxins and other pollutants escape from landfill sites into air, soil, and water;
- Waste incineration causes air pollution;
- Waste management involves extensive transportation; and
- Waste depletes natural resources if not recycled.

The overall aim of NEFCO's participation in waste projects is to minimise the amount of waste and to deal with the ever-increasing quantities of waste in improved ways, e.g. through sorting, re-use, and/or recycling. These projects target both household and industrial waste, which can include paper, plastics, chemicals, and heavy metals.

A new waste management project was launched in Belarus during 2012 to recover gas from landfills. Biogas production was

Figure 5 Investment Fund: Industrial sector



commenced as part of this project during 2013 but it has not yet reached full capacity.

The reduction in nitrogen emissions (Ntot) from the landfill in Sillamäe continues to play an important part in the efforts to manage nutrient levels in the Baltic Sea. Aside from nitrogen, the project has also helped to stop the entry of significant amounts of radioactive isotopes into the Gulf of Finland by stabilising and covering the landfill and isolating it from the sea. No other waste management projects were launched in Belarus during the reporting period in addition to the scheme to harness gas released from landfills.

Nordic Environmental Development Fund (NMF)

Financing from the Nordic Environmental Development Fund is used to support specific environmental projects in the regions neighbouring the Nordic countries. The goal is to attain environmental benefits by enhancing the potential profitability of high-priority environmental projects, facilitating financing with higher risk, advancing the completion of projects, or by attracting additional environmental investments. This support is intended to complement bilateral initiatives.

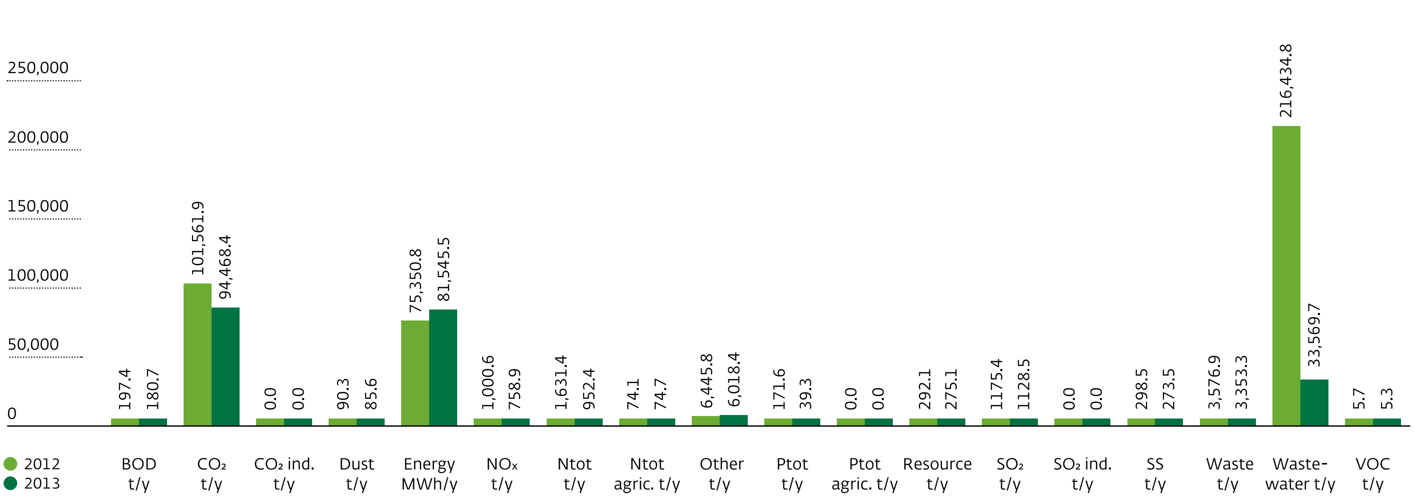
Compared with 2012, a fall in the rate of reduction in CO2 emissions can be noted (Figure 5). The same applies to atmospheric emissions of NOx. As far as the nutrients nitrogen and phosphorus are concerned, the statistics shows a substantial decrease in the rate of reduction relative to 2012, which is due to the fact that the figures from one project showing major reductions in nitrogen and phosphorus have not yet come in. Similarly, the drastic dip in wastewater performance is due to the same project. While some of the clients have failed to submit reports, it may be noted that performance in this respect has improved as a result of revised procedures. Further support is still needed by these borrowers to improve their performance and reporting. NEFCO is making continuous efforts to develop advice and consultancy services in the target countries.

CLEANER PRODUCTION

Cleaner production aims at reducing industrial pollution through improved resource and energy efficiency, process modifications, and reduced wastage. The overriding objective of this financing facility is to use a series of positive examples of 'win-win' projects to instil a mindset that is compatible with sustainable development in industry and other forms of production. The starting point for each project approved under the scheme is that it should bring about clear and measurable environmental benefits.

Investments in cleaner technology result in real reductions in emissions and/or waste. More environmentally friendly production and consumption are achieved through, for

Figure 6 NMF: Total



example, the use of less resource-intensive processes. Priority is given to projects that provide environmental benefits to the Nordic region, i.e. projects that will result in reduced emissions into the Baltic Sea or Barents Sea, or those resulting in reduced transboundary and global air pollution. In particular, small and medium-sized private companies have helped to reduce emissions to air and water by making investments in cleaner technology in their processes.

Selected parameters relevant to environmental benefits are presented in Figures 6a-b, where quantitative results have been reported. A number of positive differences in energy consumption relative to 2012 can be discerned (Figure 6a). In other respects, performance was weaker in most other indicators as compared to the previous year. One reason for this is that reporting is often not quite up to the required standard in this sector, particularly with regard to phosphorus and nitrogen. Another contributing factor is that this credit facility is used to finance private companies that sometimes have financial problems and may go bankrupt. It means that the long-term environmental benefit is not realised. As far as the types of project are concerned, it is noted that energy-saving projects dominate. No projects to reduce pollutant discharges to water were launched during 2013, which lead to a gradual deterioration of the water-related indicators BOD, SS, Ptot and Ntot (Figure 6b). With regard to the other air and energy-related indicators, performance in 2013 was by and large similar to 2012, allowing for the fact that a number of reports were not received on time.

Management of carbon credits by NEFCO

Aside from its own Investment Fund and the NMF that report on their performance on an annual basis, NEFCO also manages carbon credits. A brief summary of the carbon dioxide reductions managed by these two funds is given below. One of the funds – the Testing Ground Facility (TGF) - was dissolved in 2012 but it is still expected to generate approximately 302,580 tonnes of CO2 reductions per year after 2012. Here, deductions have been made for projects to which NEFCO has contributed loans or share capital. The other fund is NeCF (NEFCO Carbon Fund) where not all of the projects have been verified. According to preliminary figures, this fund achieved 365,505 tonnes worth of CO2 reductions. All in all, 668,000 tonnes of CO2 reductions were attained in addition to the statistics shown in Figure 1.

NEFCO 21.2.2014
Karl-Johan Lehtinen

Figure 7a NMF: CPF. Reduction of emissions to air

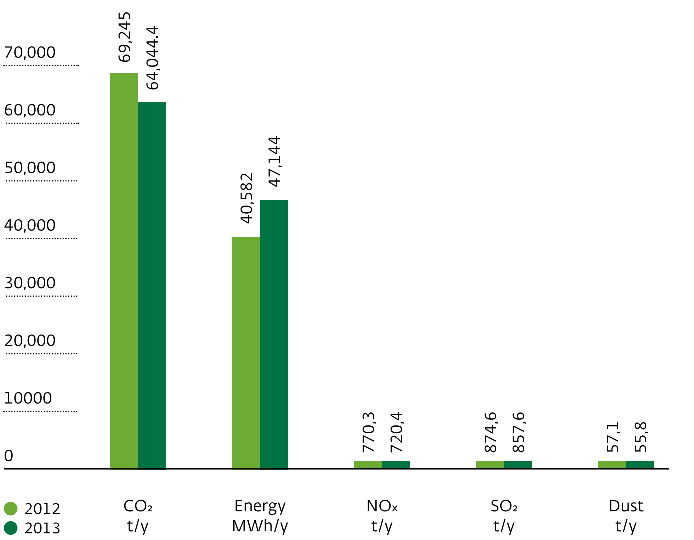
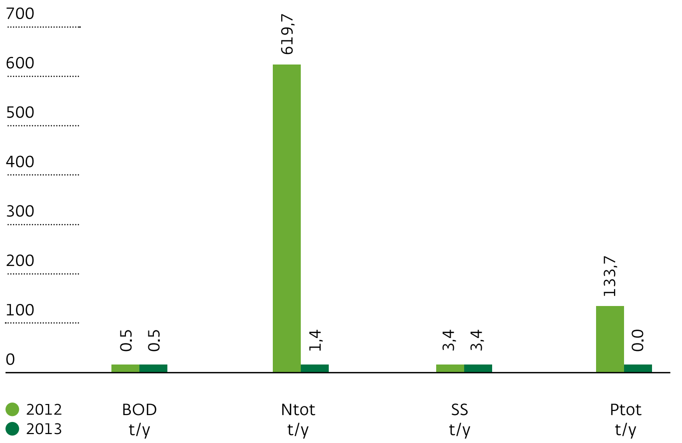


Figure 7b NMF: CPF. Reduction of emissions to water



Financial statement

Statement of comprehensive income

1 January — 31 December

(Amounts in EUR)	Note	2013	2012
Income			
Interest income, placements with credit institutions		824 015	878 243
Interest income, debt securities		9 673	-
Interest income, lending		1 686 751	1 446 568
Net result of financial operations	(1)	2 082 714	-1 606 654
Other income		3 594 306	4 795 214
Total income		**8 197 460**	**5 513 372**
Operating expenses			
Administrative expenses	(2) (3) (4)	5 260 943	5 465 878
Depreciation and write-down in value of tangible and intangible assets	(9)	19 642	23 047
Foreign exchange gains and losses		1 125 204	-33 493
Impairment of loans / reversals	(6)	1 157 231	30 441
Total operating expenses		**7 563 020**	**5 485 872**
RESULT FOR THE YEAR		**634 440**	**27 500**
TOTAL RESULT		**634 440**	**27 500**

04

Statement of financial position

31 December

(Amounts in EUR)	**Note**	**2013**	**2012**
ASSETS			
Cash and cash equivalents	(5)	5 329 295	4 839 013
Placements with credit institutions	(5)	89 441 412	107 349 612
Total cash, cash equivalents and placements with credit institutions		**94 770 707**	**112 188 625**
Debt securities	(5)	10 042 267	-
Investment assets	(7)	16 448 817	16 453 827
Other placements	(8)	3 708 650	3 750 836
Loans outstanding	(6)	30 226 774	23 579 115
Other receivables	(6)	450 908	239 194
Accrued interest	(6)	568 944	865 992
Intangible assets	(9)	15 633	28 676
Tangible assets	(9)	9 089	6 226
TOTAL ASSETS		**156 241 789**	**157 112 491**
LIABILITIES AND EQUITY			
Liabilities			
Other liabilities		627 402	2 132 544
Equity			
Paid-in capital	(10)	113 406 560	113 406 560
Reserve for investment/credit losses		24 557 177	24 557 177
Operational fund		4 500 000	4 500 000
Retained earnings		12 516 210	12 488 711
Result for the year		634 440	27 500
Total equity		**155 614 387**	**154 979 947**
TOTAL LIABILITIES AND EQUITY		**156 241 789**	**157 112 491**

05

Changes in equity

(Amounts in EUR)	Paid-in capital	Reserve for investment/ credit losses	Operational fund	Retained earnings	Result for the year	Total
Equity as of 1 January 2012	113 406 560	24 557 177	4 500 000	11 656 838	831 872	154 952 447
Appropriation to the retained earnings				831 872	-831 872	-
Appropriation to the reserve for investment/credit losses		-				-
Appropriation to the Operational Fund			-			-
Paid-in capital	-					-
Result for the year					27 500	27 500
Equity as of 31 December 2012	**113 406 560**	**24 557 177**	**4 500 000**	**12 488 711**	**27 500**	**154 979 947**
Equity as of 1 January 2013	113 406 560	24 557 177	4 500 000	12 488 711	27 500	154 979 947
Appropriation to the retained earnings				27 500	-27 500	-
Appropriation to the reserve for investment/credit losses		-				-
Appropriation to the Operational Fund			-			-
Paid-in capital	-					-
Result for the year					634 440	634 440
Equity as of 31 December 2013	**113 406 560**	**24 557 177**	**4 500 000**	**12 516 210**	**634 440**	**155 614 387**

Proposed allocation of the year's result:	**2013**	**2012**
Appropriation to the retained earnings	634 440	27 500
RESULT FOR THE YEAR	**634 440**	**27 500**

06

Cash flow statement

1 January — 31 December

(Amounts in EUR 1,000)	2013	2012
Cash flow from operating activities		
Result for the year	634	27
Depreciation and write-down in value of tangible and intangible assets	20	23
Value adjustments, investment assets	350	-
Value adjustments, other placements	-7	1 683
Capital adjustments, other placements	267	185
Impairments, lending	1 157	-451
Change in accrued interests	297	-24
Lending		
Disbursements	-14 904	-11 924
Repayments	5 438	3 826
Premature repayments	737	2 919
Realised credit losses	-	333
Capitalisation of interest and loan receivables	-	-
Exchange rate adjustments	1 048	-41
Change in investment assets	-345	-700
Cash flow from operating activities	**-5 308**	**-4 143**
Cash flow from investing activities		
Change in placements with credit institutions	17 908	-28 602
Debt securities	-10 042	-
Change in other placements	-218	-1 697
Change in other receivables and liabilities, net	-1 841	1 370
Change in tangible and intangible assets	-9	-14
Net cash flow from investing activities	**5 798**	**-28 943**
Change in cash and cash equivalents	**490**	**-33 086**
Breakdown of cash and cash equivalents		
Cash and balances with banks	5 329	4 839
Placements with a maturity of less than six months	-	-
TOTAL CASH AND CASH EQUIVALENTS	**5 329**	**4 839**

i

The cash flow statement has been prepared using the indirect method and the cash flow items cannot be directly concluded from the statements of financial positions.

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Notes to the financial statement

GENERAL OPERATING PRINCIPLES

—

The operations of the Nordic Environment Finance Corporation (hereinafter the Corporation or NEFCO) are governed by an agreement that was made on 6 November 1998 between the governments of Denmark, Finland, Iceland, Norway and Sweden and related statutes, which replaced the previous agreement of 2 March 1990 regarding the formation of the Corporation on 9 October 1999. This agreement both strengthened the Corporation's status as a multilateral institution, as well as its legal position.

NEFCO's role is to promote investments of Nordic environmental interest in Eastern Europe by helping to finance companies in these countries.

The Corporation is an international legal person with full legal capacity and is exempt from payment restrictions and credit policy measures in the member countries. In addition, the 1998 agreement contains immunity provisions exempting the Corporation from all taxation.

The Corporation operates from the Nordic Investment Bank's premises at Fabianinkatu 34, Helsinki.

The Corporation also manages trust funds on behalf of various principals.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

—

Basis for preparing the financial statements

The Corporation's financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). The accounts of the Corporation are kept in euro.

The Corporation's financial statements are presented in euro. With the exceptions noted below they are based on historical cost.

Assessments made in preparing the financial statements

In preparing the financial statements, the management is called upon to make estimates that have an effect on the reported result, financial position and other disclosures. These assessments of impairment of loans and the fair value of the investments are based on the information available to the management (Notes 6–8). Actual outcomes may deviate from the assessments made, and these deviations may be significant in relation to financial statements.

Foreign currency translation

Monetary assets and liabilities in currencies other than the euro are converted at the exchange rates published by the European Central Bank at the balance sheet date (see Note 12). Realised and unrealised exchange gains/losses are recognised separately in the statement of comprehensive income under 'Foreign exchange gains and losses'. Non-monetary assets are converted at the exchange rate applied on the transaction date.

Cash and cash equivalents

Cash and cash equivalents comprise monetary assets and placements with an original maturity of up to six months.

Placements with credit institutions

NEFCO invests its short-term liquidity, which is primarily in euros, with credit institutions, preferably Nordic banks.

According to IAS 39, placements with credit institutions are classified as held-to-maturity financial assets and recognised at cost (normally nominal value) on the settlement date. These placements are carried at amortised cost in the annual financial statements. Accrued interest on these placements is recognised as 'Accrued interest' in the statement of financial position. Due to the short maturities of these placements, the difference between their fair value and book value including accrued interest is not significant.

Lending

Loan receivables are recognised in the statement of financial position on the transfer of funds to the borrower. Loans are initially recognised at historical cost as determined by NEFCO to reflect the fair value inclusive of any transaction cost. Loans outstanding are carried at amortised cost after deductions for any impairment losses.

Loans to public-sector borrowers are issued primarily against municipal risk, while loans to private-sector borrowers are generally secured by a lien on the company's assets or with a negative pledge clause and other financial covenants.

In the absence of a relevant market interest rate reflecting the loan terms, it has not been possible to calculate the fair value reliably for disclosure in the Notes. However, NEFCO is of the opinion that fair value is not lower than book value.

According to IAS 39, loans outstanding are classified as loan receivables.

Impairment of loans

Impairment is based on individual or collective assessment of outstanding loans. An impairment loss is booked if the management recognises a risk of the borrower not being able to meet his payment obligations. Impairment losses affect the result for the year and are recognised as a separate item in the statement of comprehensive income.

NEFCO has determined that a collective impairment loss is to be recognised in respect of a set of risk exposures in Ukraine where risks have increased as a result of political developments relative to the risk level prevailing at the time when the disbursements were made. NEFCO's loans extended to Ukrainian partners are subject to such impairment because of the current political instability (see Note 6).

Intangible assets

Intangible assets are primarily investments in software and licenses for the development of NEFCO's *Project Registration and Information System (formerly Project Management System)*. The investments are carried at historical cost and amortised over the assessed useful life of the assets estimated to be 3 to 5 years. The amortisations are made on a straight-line basis.

Tangible assets

Tangible assets include inventories. Tangible assets are recognised at historical cost less accumulated depreciation and impairment. Tangible assets are depreciated on a straight-line basis over their useful life of 3 to 5 years.

Write-downs and impairment of intangible and tangible assets

NEFCO's assets are reviewed annually for impairment. If there is any objective evidence of impairment, the impairment loss is determined based on the recoverable amount of the assets.

Financial assets

Measurement of financial assets at fair value is carried out according to the following hierarchy based on fair value:

Level 1: Market prices quoted on an active market for identical assets.

Level 2: Valuation model based on observable data either directly (i.e. prices) or indirectly (i.e. derived from prices). This category includes assets valued using quoted market prices in an active marketplace for similar assets; quoted prices for identical or similar assets in a less active market place or other valuation method, in which all significant data can be determined either directly or indirectly in the marketplace.

Level 3: Valuation method based on data not directly observable. This category includes all assets where the valuation method includes inputs not based on observable data and the unobservable inputs have a significant effect on the valuation. If there is any objective evidence of impairment, the impairment loss is determined based on the recoverable amount of the assets.

- *Investment assets*

NEFCO's investment assets include participating interests in a number of companies. NEFCO is regarded as an investor in companies with the aim of generating positive environmental impacts in accordance with the Corporation's mandate and statutes. The primary objective is to achieve environmental benefits, not to maximise profits. However, the statutes require that the companies in which NEFCO invests are financially profitable in order to ensure that the Corporation's paid-in authorised capital remains intact.

Aside from one exception, NEFCO is a minority shareholder in all the companies. A prerequisite for NEFCO's participation is that the majority (or other) shareholder assumes responsibility for the business operations. Each new investment always involves an exit agreement setting out the conditions for NEFCO's withdrawal from the company.

Even if NEFCO's participating interest exceeds 20%, NEFCO, as an investment company, recognises such investments as financial instruments instead of using the equity method. For the foregoing reasons, the Corporation's investment assets are carried at fair value in the statement of comprehensive income.

The Corporation regularly assesses its investment assets using its own valuation model. However, the assessed fair value is greatly affected by the market conditions in the individual countries and other circumstances beyond NEFCO's control. If fair value cannot be reliably determined, the assets are carried at cost.

NEFCO's investment assets fall in either Level 2 or Level 3 categories.

- *Other placements*

NEFCO's other placements include placements in the NEFCO Carbon Fund and the Nordic Environmental Development Fund as well as the emission reductions received. NEFCO's other placements are carried at fair value. Changes in fair value are recognised in the statement of comprehensive income. The Corporation regularly assesses its other placements using its own valuation model. However, the assessed fair value is greatly affected by market conditions and other circumstances beyond NEFCO's control. If fair value cannot be reliably determined, the assets are carried at cost.

Emission reductions are carried at market value.

NEFCO's other placements fall in either Level 1 or Level 3 categories.

For the breakdown of other placements, see Note 8.

Equity

Paid-in capital reached its full amount of EUR 113.4 million on 31 December 2007.

Additionally, the Corporation has built up a general reserve in equity to cover the risk of losses on loans outstanding and investment assets. This reserve is used to cover major investment or credit losses arising during the course of the Corporation's operations.

NEFCO's equity includes a provision for an Operational Fund to secure resources for the Corporation's development and for preparation of projects.

Administrative expenses

NEFCO purchases administrative services from a related party, the Nordic Investment Bank (NIB). The cost of these services is shown under 'Administrative expenses'. The Corporation receives a host country reimbursement from the Finnish Government equal to the tax withheld from the salaries earned by its employees. The host country reimbursement is reported as a deduction from administrative expenses.

For the breakdown of this item, see Note 2.

Employee pensions and insurance

In accordance with the Headquarters Agreement between the Corporation and the Finnish Government, the Corporation is responsible for providing full pension security to its employees. NEFCO applies the Finnish state pension system in respect of its employees based in Helsinki. Pension contributions, which are paid to the Finnish State Pension Fund, are calculated as a percentage of the wagebill. The Finnish Ministry of Finance determines the basis for these contributions and the actual percentage of the contributions on the recommendation of Keva (formerly Municipal Pension Insurance).

At the end of 2013, the Corporation's pension obligations were fully covered. The normal retirement age under the Finnish pension system is currently between 63 and 68 years.

NEFCO has also a supplementary pension insurance scheme for its permanent employees based in Helsinki. This pension insurance is based on a defined contribution plan.

In addition to the applicable local social security system, NEFCO has also taken out comprehensive life, accident, health, disability and travel insurance for its employees based in Helsinki.

The Corporations has a Representative Office in Kiev, Ukraine, with three employees whose contract is based on the local terms of employment and health and safety regulations as defined in Ukrainian law.

STANDARDS, AMENDMENTS AND INTERPRETATIONS

—

As of 1 January 2013, NEFCO has applied the following revised standards that have come into effect. The standards do not have any significant impact on the Corporation's financial statements.

- *Annual Improvements to IFRS 2009–2011* (May 2012); effective for the financial year beginning on 1 January 2013 or later
- IFRS 7 *Financial Instruments: Disclosures* (revised); effective for the financial year beginning on 1 January 2013 or later
- IFRS 10 *Consolidated Financial Statements* and subsequent amendments; effective for the financial year beginning on 1 January 2013 or later
- IFRS 11 *Joint Arrangements* and subsequent amendments; effective for the financial year beginning on 1 January 2013 or later
- IFRS 12 *Disclosures of Interest in Other Entities*; effective for the financial year beginning on 1 January 2013 or later
- IFRS 13 *Fair Value Measurement*; effective for the financial year beginning on 1 January 2013 or later
- IAS 1 *Presentation of Financial Statements*; effective for the financial year beginning on 1 January 2013 or later

NEFCO has not opted for early application of the following standards, amendments and interpretations:

- IAS 32 *Financial Instruments*: *Presentation* (revised); effective for the financial year beginning on 1 January 2014 or later
- IFRS 9 *Financial Instruments* and subsequent amendments. This standard is not yet finished.
- *Annual improvements to IFRS 2011-2013 cycle and 2010-2012 cycle (December 2013)*; effective for the financial year beginning on 1 January 2014 or later

These standards and amendment are not expected to have any significant impact on NEFCO's financial statements.

MANAGEMENT OF FINANCIAL RISKS BY NEFCO

—

NEFCO has adopted a risk management policy that provides guidelines for reporting and monitoring the risks associated with its operations. In accordance with said guidelines, the risk management process includes an evaluation of the portfolio four times per year accompanied by country risk reports. The goal is to provide an objective on-going assessment of the portfolio risk.

The purpose of NEFCO's business is to provide risk capital and loans to finance investments in Eastern Europe that are of interest to the Nordic countries from the environmental point of view. The paid-in authorised capital—the Investment Fund—is used to finance NEFCO's investments. In addition, NEFCO has a risk reserve fund comprising approximately 21.7% of the authorised capital. The main financial risks – credit risk, foreign exchange rate risk, interest rate risk, price risk, liquidity risk and operational risk – are carefully managed and risk management procedures are closely integrated into NEFCO's business routines. NEFCO's financial investments cannot exceed the paid-in authorised capital.

Market risk

- *Foreign exchange rate risk*

Outstanding loans are denominated in euros, roubles and US dollars. Rouble-denominated lending accounts for 27.9 % and dollar-denominated lending for 3.6% of all outstanding loans four of which are in roubles and one in dollars. NEFCO is exposed to a currency risk in respect of the rouble and the dollar. Risks due to exchange rate fluctuations are not hedged. A guarantee facility for the rouble-denominated loans extended by the Investment Fund is available from the Nordic Environmental Development Fund (NMF) but it has not been used. The foreign exchange rate risk in respect of other activities is insignificant.

- *Interest rate risk*

Interest rate risk refers to the effect of market rate fluctuations on the Corporation's interest-bearing assets and related interest income.

Of the loans outstanding, 80.1 % are floating-rate and 19.9 % fixed-rate loans on which interest accrues up until the final repayment date. The distribution of loans outstanding according to the length of the interest rate fixing period is indicated in Note 11. The liquidity reserve of approximately EUR 95 million is primarily placed in one-year bank deposits. As the maturity dates are spread across the year, the interest rate risk is distributed in such a way that any change in interest rate levels resulting from a fall in market interest rates is not immediately fully reflected in the financial result. A 0.5% fall in the annual interest rate would result in a reduction in earnings of around EUR 0.47 million. Conversely, an increase in interest rates would have a positive impact on financial performance.

- *Price risk*

The price risk associated with NEFCO's equity investments is subjected to thorough examination before presentation to NEFCO's Board for an investment decision. The maximum price risk exposure at the balance sheet date consists of the investment assets totalling EUR 16.5 million as at 31 December 2013. The cumulative risk reserves protect the Corporation's authorised capital against losses. Equity investments account for 14.5% of the authorised capital.

An indirect price risk may be associated with placements in the NEFCO Carbon Fund (NeCF) and the emission rights received. During 2013, the market price fell marginally (EUR 0.32/CER and EUR 0.22/ERU as at 31 December 2013). The market price of emissions rights declined sharply during 2011 and 2012, and most of NeCF's agreements had been signed with the project developers before the fall in prices. As the prices specified in the agreements exceed the current market prices by a wide margin, NEFCO's investments in NeCF will be loss-making to the extent the funds have been invested in projects. NEFCO is involved in projects that delivered the last emission rights in 2013. NEFCO's investments generated a total of 84,372 emission rights. However, a substantial percentage of the fund's reserves remain unused.

Credit risk

The credit risk associated with NEFCO's lending is subjected to thorough examination before presentation to NEFCO's Board for a lending decision. The maximum credit risk exposure at the balance sheet date consists of the amounts outstanding for loans totalling EUR 30.2 million as at 31 December 2013. The cumulative risk reserves protect the Corporation's authorised capital against losses.

Credit risk is NEFCO's main financial risk. It involves the risk that the Corporation's borrowers or other counterparties fail to fulfil their contractual undertakings and that the collateral provided as security does not cover the Corporation's claims. In accordance with NEFCO's mandate, all of the Corporation's lending can be classified as high risk. The main risk consists of lending to companies in the target countries, which accounts for 26.7% of the paid-in authorised capital. Collateral for the loans consists of local authority guarantees (23.5%) or guarantees given by a parent company or bank (15.5%) while various types of liens and charges account for 23.7%. Negative pledge or other financial covenants represent 37.3% of the total.

Liquidity risk

The effective management of liquidity risk ensures that NEFCO can fulfil all its payment obligations as they mature. In total, 94.4% of the liquid funds and other placements with credit institutions (accounting for 83.6% of the authorised capital) consist of euro-denominated deposits with Nordic banks placed for a period of one year or less. The deposits mature at regular intervals, guaranteeing access to liquid funds when necessary. A small percentage of the liquid assets not to be used over the next few years have been invested in bonds with a maturity of five years. The intention is to hold the investment to maturity.

Status reports regarding the liquid funds are regularly presented to NEFCO's Board of Directors. NEFCO is not burdened by any substantial financial liabilities.

Operational risk

Operational risk is the risk of financial loss or loss of reputation through shortcomings or failings relating to technology, the Corporation's employees or physical circumstances. Legal risk is also considered an operational risk. NEFCO's management of operational risk focuses on proactive measures designed to ensure business continuity as well as the accuracy and appropriateness of internal and external information. The main responsibility of Internal Audit is to evaluate the in-house controls, risk management and governance processes in NEFCO. Internal Audit reports to NEFCO's Board of Directors while keeping the Managing Director informed of the developments on a regular basis. The annual internal audit activity plan is submitted to the Board of Directors for approval.

Capital management

NEFCO is not governed by any national or international regulations. The Corporation maintains an adequate capital base to cover the risks inherent in its lending and investment activities.

(1) NET RESULT OF FINANCIAL OPERATIONS

(Amounts in EUR 1,000)	**2013**	**2012**
Investment assets, realised gains and losses	2,400	-
Other placements, realised gains and losses	-	-1,513
Other realised gains and losses	2	1
Total realised gains and losses	**2,402**	**-1,512**
Investment assets, unrealised gains and losses	-350	-
Other placements, unrealised gains and losses	31	-95
Total unrealised gains and losses	**-319**	**-95**
Net result of financial operations	**2,083**	**-1,607**

(2) ADMINISTRATIVE EXPENSES

(Amounts in EUR 1,000)	**2013**	**2012**
Staff costs	3,175	3,019
Pension premiums in accordance with the Finnish state pension system	636	590
Other pension premiums	144	116
Office premises expenses	305	279
Other administrative expenses	1,829	2,172
Miscellaneous administrative income	-13	-6
Total administrative expenses[1)]	**6,077**	**6,169**
Host country reimbursement according to agreement with Finnish government	-816	-704
Net administrative expenses	**5,261**	**5,466**

1) The Corporation's administrative expenses include the administrative expenses for NeCF, TGF, NMF, NCF and NorCaP. Income from administration amounting to EUR 1,465,364 (2012: EUR 2,616,238) for NeCF; EUR 194,376 (2012: EUR 371,046) for TGF; EUR 893,165 (2012: EUR 846,659) for NMF; EUR 263,834 (2012: EUR 274,680) for NCF; and EUR 370,666 EUR (2012: EUR 0) for NorCaP are included in the statement of comprehensive income under 'Other income'.

In 2013 the average number of employees was 29 (29 in 2012).

NEFCO is renting an office with a floor area of 729.5 m^2 from NIB in Helsinki. Additionally, the Corporation is renting an 80.5 m^2 office in Kiev.

(3) COMPENSATIONS AND BENEFITS

Compensation paid to the Board of Directors, Control Committee and Managing Director
The compensation paid to the Board of Directors and the Control Committee is determined by the Nordic Council of Ministers. The members of the Board of Directors and Control Committee are also entitled to reimbursement of the cost of travel and accommodation and per diem in accordance with the Corporation's travel regulations. The compensation paid to the Managing Director of the Corporation as determined annually by the Board of Directors consists of a basic salary and regular taxable benefits.

The Managing Director's pension benefits are based on the terms of the Finnish state pension with certain supplements.

The remuneration of the Board of Directors, Control Committee and Managing Director was as follows:

(Amounts in EUR)	**2013 Compensation/ taxable income**	**2012 Compensation/ taxable income**
Chairman of the Board	3,364	3,364
Other Directors and Alternates	16,264	17,498
Managing Director	293,841	296,756
Control Committee	1,500	4,241

Pension obligations
NEFCO is responsible for providing pension security for its employees. The current pension arrangement consists of pensions based on the Finnish state pension system (VaEL Pension) as the basis for the pension benefits. The VaEL Pension is calculated on the basis of the employee's annual taxable income and the applicable age-linked pension accrual rate.

In 2013 the employer's pension contribution was 18.55% of the income used as a basis for determining the amount of pension. The employee's pension contribution in 2013 was either 5.15% or 6.5%, depending on the employee's age. This contribution paid by NEFCO for the permanent staff based in Helsinki is a taxable benefit for the employees.

In addition to the VaEL Pension, the Corporation has taken out a supplementary group pension insurance policy for its permanent staff and the Managing Director. This pension insurance is based on a defined contribution plan. The insurance premium (6.5%) is calculated on the basis of the employee's taxable income and paid by NEFCO until the employee reaches the age of 63.

In 2013 NEFCO paid a total of EUR 99,658 (EUR 98,270 in 2012) in pension insurance premiums for the Managing Director.

Staff loans
Staff loans can be granted on the Corporation's recommendation to permanent staff members based in Helsinki who have been employed by NEFCO for a minimum period of one year. The Managing Director is extended staff loans subject to a recommendation from NEFCO's Board. Staff loans are granted by a commercial bank.

The total amount of loans may not exceed EUR 200,000. The employee pays interest on the loan in accordance with the official base rate established by the Ministry of Finance of Finland (0.5% in July–December 2013). The same interest rates, terms and conditions are applied to all permanent staff members of the Corporation, including the Managing Director. The total amount of staff loans extended to employees in key positions was EUR 0 (EUR 62,365 in 2012).

Additional benefits to expatriates
Professional staff (including the Managing Director) who move to Finland for the sole purpose of taking up employment with the Corporation are entitled to certain expatriate benefits, such as an expatriate allowance and a spouse allowance. In addition, NEFCO assists the expatriates in finding a residence and with other practical arrangements. Such staff members are required to pay the Corporation the part of the rent equivalent to the minimum tax value of the accommodation benefit received. The tax value is determined annually by the Finnish tax authorities.

(4) RELATED PARTY DISCLOSURES

The Nordic Investment Bank (NIB), which has for the most part the same owners as NEFCO, is considered a related party of NEFCO. NEFCO acquires services from and enters into transactions with NIB. The table below shows the outstanding balance of NEFCO's receivables from and amounts owed to NIB and the amount of interest received during the year. The interest received is equal to normal commercial rates. NEFCO's key individuals are also considered related parties. Information regarding key individuals is presented in Note 3.

(Amounts in EUR 1,000)	Interest income	Amounts owed by NEFCO to NIB	Amounts owed by NIB to NEFCO	Rents paid to NIB
2013	-	53	-	234
2012	317	17	-	209

(5) CASH AND CASH EQUIVALENTS, PLACEMENTS WITH CREDIT INSTITUTIONS AND DEBT SECURITIES

(Amounts in EUR 1,000)			**2013**			**2012**
	Book value	**Fair value**	**Differ-ence**	**Book value**	**Fair value**	**Differ-ence**
Cash and cash equivalents						
Cash and balances with banks	5,329	5,329	-	4,839	4,839	-
Placements with credit institutions, held-to-maturity	-	-	-	-	-	-
Total cash and cash equivalents	**5,329**	**5,329**	**-**	**4,839**	**4,839**	**-**
Placements with credit institutions						
Placements with credit institutions, held-to-maturity	89,441	89,441	-	107,350	107,350	-
Total placements with credit institutions	**89,441**	**89,441**	-	**107,350**	**107,350**	-
Total cash and cash equivalents and placements with credit institutions	**94,771**	**94,771**	-	**112,189**	**112,189**	-

The remaining maturity of cash and cash equivalents and placements, counted from the balance sheet date to maturity, is as follows:

Maturity (Amounts in EUR 1,000)	**2013**	**2012**
Up to and including 3 months	14,329	24,838
3–6 months	16,838	22,000
6–12 months	63,254	65,000
Undefined	350	350
Total cash and cash equivalents and placements with credit institutions	**94,771**	**112,189**

DEBT SECURITIES

(Amounts in EUR 1,000)			2013			2012
	Book value	**Fair value**	**Differ-ence**	**Book value**	**Fair value**	**Differ-ence**
Debt securities with credit institutions, held-to-maturity	10,042	9,766	-276	-	-	-
Total debt securities	**10,042**	**9,766**	**-276**	**-**	**-**	**-**

The remaining maturity of debt securities, counted from the balance sheet date to maturity, is as follows:

Maturity (Amounts in EUR 1,000)	**2013**	**2012**
1–5 years	10,042	-
Total debt securities	**10,042**	**-**

The investment in debt securities falls in the Level 2 category in the fair value hierarchy.

(6) LENDING

Impairment of loans/reversals in the statement of comprehensive income (Amounts in EUR 1,000)	**2013**	**2012**
Realised credits losses	-	481
Individual impairment losses, net	23	-451
Collective impairment losses, net	1,134	-
Total impairment of loans/reversals	**1,157**	**30**

No realised credit losses were recognised in 2013 (EUR 481,127 in 2012).

Impairment of loans, accrued interest on loans and other loan receivables
NEFCO's loans outstanding, accrued interest and other loan receivables under 'Other receivables' have been reduced by a total of EUR 2.47 million (EUR 1.31 million in 2012) in impairment losses. The following changes were recognised in the statement of financial position in respect of impairment losses.

Impairment, loans outstanding (Amounts in EUR 1,000)	**2013**	**2012**
Impairment losses January 1	1,131	1,528
Impairment losses recognised during the year	1,134	-
Reversals of previously recognised impairment losses	-101	-396
Impairment losses December 31	**2,165**	**1,131**

Impairment, accrued interest (Amounts in EUR 1,000)	2013	2012
Impairment losses January 1	1	5
Impairment losses recognised during the year	-	-
Reversals of previously recognised impairment losses	-	-4
Impairment losses December 31	**1**	**1**

Impairment, other receivables (Amounts in EUR 1,000)	**2013**	**2012**
Impairment losses January 1	176	227
Impairment losses recognised during the year	124	88
Reversals of previously recognised impairment losses	-	-139
Impairment losses December 31	**300**	**176**

Of the impairment on outstanding loans in 2013, EUR 1,133,900 is related to the collective impairment of loans to Ukrainian borrowers as a result of the risk of political instability in the country (EUR 0 in 2012).

Non-performing loans as at 31 December 2013 amounted to EUR 1,331,801 (EUR 1,308,469 in 2012).

NEFCO finds that loan terms can be adjusted if the counterparty cannot meet their contractual obligations due to financial difficulties. Adjustments of loan terms can, for example, include rescheduling due dates for repayments and interest payments, which affect future cash flow. An adjustment of loan terms may be made in order to avoid an impending bankruptcy of the counterparty and to secure NEFCO's access to the cash flow foreseen in the loan contract. As at 31 December 2013, the total amount of outstanding loans subject to such adjustment was EUR 1,030,809 (EUR 1,131,386) before impairment. After impairment, the equivalent amount as at 31 December was EUR 0 (EUR 0 in 2012). Also interest on these loans was written off completely.

The following tables show net lending after deductions for impairment losses totalling EUR 2,164,719 (EUR 1,131,386 in 2012).

Lending by country as at 31 December:

Country (Amounts in EUR 1,000)	**2013**	**2012**
Estonia	409	546
Finland	2,438	2,892
Latvia	2,883	3,306
Lithuania	-	737
Russia	11,697	10,029
Ukraine	10,205	6,069
Belarus	2,595	-
Total loans outstanding	**30,227**	**23,579**

As at 31 December 2013, the loans signed but not yet disbursed totalled EUR 15.36 million (EUR 18.39 million in 2012).

The following table provides a summary of signed but non-disbursed loans according to the foreseen date of disbursement. In principle, all borrowers could request disbursement within three months but NEFCO does not disburse loans until the specified conditions precedent are met.

(Amounts in EUR 1,000)	**2013**	**2012**
Up to and including 3 months	15,362	18,387
Total loans signed but not yet disbursed	**15,362**	**18,387**

The maturity profile for loans outstanding as at 31 December:

Maturity (Amounts in EUR 1,000)	**2013**	**2012**
Up to and including 3 months	843	573
3–6 months	1,144	758
6–12 months	2,010	3,912
1–2 years	3,983	4,055
2–3 years	3,241	3,725
3–4 years	3,187	2,655
4–5 years	11,401	2,518
5–10 years	4,418	5,383
Total loans outstanding	**30,227**	**23,579**

Lending by currency:

Currency (Amounts in EUR 1,000)	**2013**	**2012**
EUR	20,714	15,376
RUB	8,418	8,203
USD	1,095	-
Total loans outstanding	**30,227**	**23,579**

As at 31 December, the guarantee commitments with a maturity of less than 1 year totalled EUR 678,999 (EUR 773,196 in 2012). Any extensions to the commitments are approved annually for 1 year ahead.

Loans outstanding by type of security:

As at December 31, 2013 (Amounts in EUR 1,000)	**Amount**	**Total amount**	**Share %**
Loans to or guaranteed by local authorities		7 095	23.5
Loans guaranteed by banks		591	2.0
Other loans		22,541	74.6
with mortgage on immovable property	4,205		
with pledge on shares	2,538		
with floating charge	409		
with a guarantee from the parent company	4,102		
with a negative pledge clause and other covenants	11,287		
Total loans outstanding		**30,227**	**100.0**

As at December 31, 2012 (Amounts in EUR 1,000)	**Amount**	**Total amount**	**Share %**
Loans to or guaranteed by local authorities		6,617	28.1
Loans guaranteed by banks		682	2.9
Other loans		16,280	69.0
with mortgage on immovable property	4,220		
with pledge on shares	1,500		
with floating charge	546		
with a guarantee from the parent company	4,741		
with a negative pledge clause and other covenants	5,273		
Total loans outstanding		**23,579**	**100.0**

The maturities of the loans extended by the Corporation vary from 2 to 11 years. Of all outstanding loans, 68.5% are denominated in euros, 27.9% in roubles and 3.6% in US dollars. Of the total of 20 loans, 15 are floating-rate loans. Such loans account for 80.1% of the total. The other 5 loans accounting for 19.9% of the total have fixed interest rates.

(7) INVESTMENT ASSETS

The Corporation's portfolio comprised the following holdings as at 31 December 2013:

Holding	Country/region	% of total capital
Vardar Eurus AS	Baltics	10.0
Rindibel JC JSC	Belarus	35.0
4E Biofond OÜ	Estonia	30.1
International Pork Investments AS	Latvia	3.4
DGE Baltic Soil & Environment UAB	Lithuania	34.5
Biopal Sp. zo.o	Poland	35.0
Foster Wheeler Energy Fakop Sp. zo.o	Poland	21.3
Rindipol S.A.	Poland	35.0
Ekovod LLC	Russia	22.0
LTM OOO	Russia	22.8
Dolle Ukraine ApS	Ukraine	33.3
Eskaro Ukraine AS	Ukraine	20.0
Halychyna-Zahid LLC	Ukraine	5.6

The acquisition cost of the investment assets was EUR 20,252,447 (EUR 19,907,394 in 2012) while the fair value was EUR 16,448,817 (EUR 16,453,827 in 2012).

As at 31 December 2013, the signed but not yet acquired holdings totalled EUR 11,642 (EUR 35,642 in 2012).

Fair value of investment assets as at year end
The following table provides an analysis of the fair value of investment assets at the end of the year broken down by the applicable Level in the fair value hierarchy.

(Amounts in EUR 1,000)	2013	2012
Level 1	-	-
Level 2	1,769	1,769
Level 3	14,680	14,685
Total	**16,449**	**16,454**

Level 1 refers to market prices quoted in an active marketplace.
Level 2 refers to observable data other than Level 1 market prices.
Level 3 refers to information not based on observable data.

The following table provides an analysis of the change in the fair value of Level 3 investment assets.

(Amounts in EUR 1,000)	2013	2012
January 1	**14,685**	**13,985**
Investments during 2013	345	700
Divestments during 2013	-	-
Change in value	-350	-
Reassignment from Level 2	-	-
December 31	**14,680**	**14,685**

Sensitivity analysis
In the assessment of NEFCO's Level 3 assets, due consideration must be given to the inherent nature of the investments and the form of NEFCO's involvement. Initially, the investments – normally made in recently established entities – are assessed at acquisition cost if there is no indication of lower value. NEFCO pursues an exit strategy requiring that the invested capital is recovered in its entirety at a reasonable interest. Today exit agreements are made in respect of all investments. At a later stage, the companies are evaluated in terms of their financial performance in accordance with the exit agreement when exit is impending.

In case of new issues, this value is applied to previously acquired shares as well. A sensitivity analysis is difficult to carry out because normally there is no market for the shares. As an aid in establishing the potentially highest or lowest value, the historical return on the portfolio may be used. The average historical rate of return on completed projects is around 55%. It should be pointed out that losses have been posted for around 36% of the investments. A 55% increase in the value of the existing portfolio would add EUR 8.1 million to the financial result whereas a loss of 36% would have a negative impact of EUR 5.3 million.

A sensitivity analysis of Level 3 investment assets is provided below:

(Amounts in EUR 1,000)		Impact on financial result in 2013	
	Fair value	**Positive impact**	**Negative impact**
Investment assets	14,680	8,074	-5,285

(8) OTHER PLACEMENTS

The following table provides an overview of other placements measured at fair value at the end of the year.

(Amounts in EUR 1,000)	**2013**	**2012**
NEFCO Carbon Fund	3,687	3,742
Emission reductions	22	9
NMF	-	-
Total	**3,709**	**3,751**

NEFCO's share of NeCF's authorised capital is 4.8% (2.7% in 2012).

The following table provides an analysis of other placements according to the fair value hierarchy.

(Amounts in EUR 1,000)	**2013**	**2012**
Level 1	22	9
Level 2	-	-
Level 3	3,687	3,742
Total	**3,709**	**3,751**

Level 1 refers to market prices quoted in an active marketplace.
Level 2 refers to observable data other than Level 1 market prices.
Level 3 refers to information not based on observable data.

NEFCO Carbon Fund and emission reductions
NEFCO has invested EUR 5 million in the NEFCO Carbon Fund (NeCF). 5% of the Investment is earmarked as 'Technical Assistance Provision' of which half is committed. The third and fourth delivery of emission reductions by the fund took place during 2013 when NEFCO received reductions worth EUR 217,768 (accrued value EUR 1,020,126). The management fee for NEFCO's investments is paid out of interest income and through reduction in capital. In the valuation of the investment in NeCF, due consideration is also given to the indirect price risk. The investment in NeCF falls in the Level 3 category in the fair value hierarchy. The change in fair value is due to the valuation of the investment in NeCF and the emission reductions received by NEFCO in 2013.

The investment in NeCF has generated 84,372 emission reductions (CER and ERU) with a total value of EUR 21,999 based on the market price (67,523 emission reductions to a total value of EUR 9,154 as at 31 December 2012). The investment in emission reductions falls in the Level 1 category in the fair value hierarchy.

Nordic Environmental Development Fund

During 2011–2013, NEFCO invested a total of EUR 5,346,308 in the Nordic Environmental Development Fund (NMF). While the investment in NMF does not yield any financial profit, it contributes to NEFCO's investment activities. The investment in NMF falls in the Level 3 category in the fair value hierarchy.

(9) INTANGIBLE AND TANGIBLE ASSETS

(Amounts in EUR)	2013	2012
Intangible assets	**Computer software, development costs**	**Computer software, development costs**
Acquisition value January 1	104,804	93,503
Acquisitions during the year	1,766	11,301
Acquisition value December 31	106,570	104,804
Accumulated amortisation January 1	76,128	63,492
Amortisation according to plan	14,808	12,637
Accumulated amortisation December 31	90,936	76,128
Net book value	**15,633**	**28,676**
Tangible assets	**Office inventories**	**Office inventories**
Acquisition value January 1	50,842	48,019
Acquisitions during the year	7,697	2,823
Acquisition value December 31	58,539	50,842
Accumulated depreciation January 1	44,616	34,206
Depreciation according to plan	4,834	10,410
Accumulated depreciation December 31	49,450	44,616
Net book value	**9,089**	**6,226**

(10) EQUITY

NEFCO's paid-in authorised capital reached its full amount of EUR 113,406,560 in 2007. The breakdown of the authorised capital is as follows:

(Amounts in EUR)		Share %
Denmark	21,561,320	19.0
Finland	22,264,600	19.6
Iceland	1,319,560	1.2
Norway	24,191,560	21.3
Sweden	44,069,520	38.9
Total authorised capital	**113,406,560**	**100.0**

(11) INTEREST RATE RISK

Interest rate risk describes how the fluctuations in market interest rates affect the value of NEFCO's interest-bearing assets and liabilities, as well as interest income and expenses. The table below shows the interest rate profile for loans outstanding. Loans outstanding are broken down by maturity or interest adjustment date.

Loans outstanding (Amounts in EUR 1,000)	**2013**	**2012**
Up to and including 3 months	10,852	10,735
3–6 months	13,761	10,992
6–12 months	-	-
1–5 years	5,605	546
5–10 years	9	1,306
Total loans outstanding	**30,227**	**23,579**

(12) EXCHANGE RATES

The following exchange rates were used to convert monetary assets and liabilities into foreign currency:

		EUR rate 31.12.2013	**EUR rate 30.12.2012**
DKK	Danish krone	7.45930	7.46100
GBP	British pound	0.83370	0.81610
NOK	Norwegian krone	8.36300	7.34830
PLN	Polish zloty	4.15430	4.07400
RUB	Russian rouble	45.32460	40.32950
SEK	Swedish krona	8.85910	8.58200
UAH	Ukrainian hryvnia [1)]	11.04153	10.53717
USD	US dollar	1.37910	1.31940

1) National Bank of Ukraine

Independent Auditors' Report

To the Control Committee of the Nordic Environment Finance Corporation. Independent Auditors' report on the financial statement.

In our capacity as auditors appointed by the Control Committee of the Nordic Environment Finance Corporation we have audited the accompanying financial statements of the Corporation, which comprise the statement of financial position as at 31 December 2013, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

The Board of Directors' and the Managing Director's responsibility for the financial statements

The Board of Directors and the Managing Director are responsible for the preparation of the financial statements that give a true and fair view in accordance with International Financial Reporting Standards, and for such internal control as they 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 International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance 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 give a true and fair view of the financial position of the Nordic Environment Finance Corporation as of 31 December 2013, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Report on the other requirements

In accordance with the Terms of Engagement our audit also included a review of whether the Board of Directors' and the Managing Director's administration have complied with the Statutes of the Corporation. It is our opinion that the administration of the Board of Directors and the Managing Director complied with the Statutes of the Corporation.

Helsinki, 6 March 2014

Sixten Nyman
Authorised Public Accountant
KPMG Oy Ab

Per Gunslev
State Authorised Public Accountant
KPMG, Statsautoriseret
Revisionspartnerselskab

This document is an English translation of the auditors' report in Swedish. Only the Swedish version of the report is legally binding.

09

Statement by the Control Committee

To the Nordic Council of Ministers. Statement by the Control Committee of the Nordic Environment Finance Corporation on the audit of the administration and accounts of the Corporation.

In accordance with section 9 of the statutes of the Nordic Environment Finance Corporation, we have been appointed to ensure that the operations of the Corporation are conducted in accordance with the Statutes and to bear responsibility for the audit of the Corporation. Having completed our assignment for the year 2013, we hereby submit the following report.

The Control Committee met during the financial year as well as after the Corporation's financial statements had been prepared, whereupon the necessary control and examination measures were performed. The Corporation's Annual Report was examined at a meeting in Helsinki on 6 March 2014, at which time we also received the Auditor's Report submitted on 6 March 2014 by the authorised public accountants appointed by the Control Committee.

Following the audit performed,
we note that:

- the Corporation's operations during the financial year have been conducted in accordance with the Statutes, and that
- the financial statements give a true and fair view of the financial position of the Corporation as at 31 December 2013 and of its results and cash flows for the year then ended. The Statement of Comprehensive Income shows a profit of EUR 634 439,69.

We recommend to the Nordic Council
of Ministers that:

- the profit for the financial year be treated as proposed by the Board of Directors,
- the Statement of Comprehensive Income and the Statement of Financial Position be adopted, and
- the Board of Directors and Managing Director be discharged from liability for the administration of the Corporation's operations during the accounting period examined by us.

Helsinki, 6 March 2014

Bill Fransson
Thomas Jensen
Hans Frode Kielland Asmyhr
Åsa Torstensson
Tuula Peltonen
Ragnheiður Rikhardsdóttir

NORDIC ENVIRONMENT FINANCE CORPORATION
Street address: Fabianinkatu 34
Postal address: P. O. Box 249
FI-00171 Helsinki, Finland
tel: +358 10 618 003
fax: +358 9 630 976
www.nefco.org / info@nefco.fi
twitter.com/NefcoNordic

Design:
Nimiö (www.nimio.fi)
Cover photograph:
Jonas Häggblom