Alberta Municipal Financing Corporation

2002 ANNUAL REPORT

Contents

Directors

BOARD OF DIRECTORS

Appointed
J.M. Drinkwater
P.A. Kruselnicki
A.J. McPherson
B. Pickering
R.A. Splane

Elected
H.N. Johnsrude
- Representing Class B shareholders
G.H. Sherwin
- Representing Class C shareholders
S. Burford
- Representing Class D shareholders
D.O. Lussier
- Representing Class E shareholders

OFFICERS

J.M. Drinkwater
- President & Chairman of the Board (to December 31, 2002)
G.H. Sherwin
- Vice-President & Vice-Chairman
T.S. Stroich
- General Manager & Treasurer
L. Epp
- Assistant General Manager
J. Hui
- Secretary & Assistant Treasurer

For more information, visit our website or contact
the Alberta Municipal Financing Corporation Office

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E-mail webamfc@gov.ab.ca

Organization

Mission

To provide local authorities within the Province with flexible funding for capital projects at the lowest possible cost, consistent with the viability of the Alberta Municipal Financing Corporation.

Authority

The Alberta Municipal Financing Corporation is a non-profit Corporation established in 1956 under the authority of the *Alberta Municipal Financing Corporation Act*, Chapter A-27, Revised Statutes of Alberta 2000, as amended.

Shareholders

The authorized stock of the Corporation consists of the following shares with a par value of $10 each:

- 4,500 Class A, available only to the Crown
- 1,000 Class B, available only to municipalities (defined as including municipal districts, counties, improvement districts and special areas) and to regional airport authorities, approved hospitals, hospital districts and regional health authorities
- 750 Class C, available only to cities
- 750 Class D, available only to towns and villages
- 500 Class E, available only to school districts and divisions, universities and colleges.

The business of the Corporation is administered by a Board of Directors. The Lieutenant Governor in Council appoints up to five directors to represent the Class A common shareholder. Each of the other four classes of shareholders elects one director to the Board.

Loans

Maximum terms of loans for various projects are prescribed in the Corporation's by-laws relating to the terms and conditions for lending money to shareholders.

Financing

The Corporation issues various debt obligations to obtain the funds necessary to finance loan requirements. These obligations of the Corporation carry the unconditional guarantee of the Province of Alberta.

Chairman's Report

February 14, 2003

It is my privilege and pleasure to present the Annual Report of the Alberta Municipal Financing Corporation for the year ended December 31, 2002, and to review the activities for the past year.

Firstly, I would like to recognize our former Chairman Jim Drinkwater who stepped down from the Board as of December 31, 2002. His leadership as Chairman over the past year and his long service and contributions to both the Corporation as acting General Manager from 1986-1989 and as board member since 1991, has served both the shareholders and Corporation well.

The past year has been a busy one for the Corporation. 2002 saw over $766 million in new loans issued, the most since 1981 and 1982 and the third highest on record and the first year since 1992 that the loan portfolio has increased. It is interesting to note that loans of $840 million in 1981 and $1.1 billion in 1982 were issued during the period when interest rates were at their highest, while in 2002, rates were at historical lows.

The large increase in new loans and maturing debt of over $454 million necessitated the Corporation borrow $740 million; $500 million for 10-years, $100 million for 20-years and $140 million for 3-years. Based on 2003 estimates on loan requirements from borrowers, maturing debt of over $666 million and the $100 million transfer, the Corporation is expecting to borrow over $800 million in 2003. Interest rates remained steady over the year with more volatility in rates for the shorter term.

In addition to the increased borrowing activity, the Corporation is working with the Departments of Finance and Justice to put forward amendments to the *Alberta Municipal Financing Corporation Act*, scheduled to be introduced in the Spring 2003 Legislature session. The Act is being modernized to provide the Corporation with natural person powers and a more efficient operating structure.

The Corporation will also be changing its location in 2003 and all shareholders will be notified in due course once plans are finalized.

The Annual Report provides details of other financial highlights and activities for 2002. The Corporation budgeted for a loss of $10.2 million in 2002 based on the difference between anticipated interest earned on loans and interest expense on debt, but because of the significant increase and timing of new loans, losses were reduced to $6.0 million.

On December 9, 2002 the Minister of Finance advised that further to the announcement in Budget 2002, the Corporation is to transfer $100 million of its retained earnings to the Province on March 28, 2003. This has been reflected in the financial statements for 2002. This transfer will have a major impact on the Corporation's lending policies and earnings in the future. In the Corporation's 2002-2005 Business Plan, losses for 2003 and 2004 were expected to be $6.9 and $7.3 million respectively with earnings becoming positive in 2005. With the transfer, it is estimated losses for 2003 through 2005 are expected to increase by approximately $24 million, with positive earning anticipated after 2006.

This transfer will necessitate a significant change in the Corporation's overall lending practices and interest rate policies. As an interim, the Board has approved a change in the interest rate policy from using the Province of Alberta's rate annualized and rounded down to the nearest one eighth of one percent, to rounding up to the nearest one eighth of one percent. This policy, announced to shareholders on January 9, 2003, raised rates by one eighth of one percent on average and came into effect on January 15, 2003.

The Corporation has in the past been able to provide shareholders with financing on very flexible terms and favourable rates through the establishment of a number of inter-related policies, including an equity policy of 3-1/2% of assets, designed to maintain the financial strength of the Corporation. With the transfer of retained earnings, the Corporation has no risk equity and must review all of its lending policies and incorporate changes aimed at reducing risk.

The Corporation will develop alternative lending policies which will be discussed with our shareholders to determine the most flexible way of providing financing on the best possible terms without impairing the financial health of the Corporation.

As I indicated earlier, 2002 was a very busy year for the Corporation and 2003 is shaping up to be even busier. I wish to thank our directors for their time and effort on your behalf and a very sincere appreciation to our staff for their effort and diligence in providing you, our shareholders, and the Board, with outstanding service and support in the past year.

[Original Signed]

Garth H. Sherwin, CA
Chairman of the Board

Management Discussion and Analysis

The following provides management's analysis of the financial position and results of operations of the Alberta Municipal Financing Corporation for the year ended December 31, 2002.

Loans

During 2002, the AMFC loan portfolio increased from $3,506 million to $3,854 million, an increase of $348 million. New loans issued during the year totalled $766 million, an increase of $403 million from new loans issued in 2001 and loan repayments totalled $418 million. The Corporation is forecasting that loan demand will be volatile over the next few years. Increasing demands by the educational sector coupled with the uncertainty in the municipal sector are likely to cause loan demand to exceed loan repayment. Included in this review is a Schedule of Loans Outstanding at December 31, 2002, Analysis of New loans Issued in 2002 by Jurisdiction and Purpose, and the Ten-Year Loan Review 1993-2002.

Annually, the Corporation requests the estimated borrowing requirements from each shareholder in order to help manage the Corporation’s own financing requirements. The 2003 Shareholders’ Forecast of Loan Requirements and actual borrowings are included for information.

Schedule of Loans Outstanding

as at December 31, 2002
(thousands of dollars)

	Principal Outstanding 31-Dec-01	2-Jan-02 to 31-Dec-02 New Loans Issued	Principal Repaid	Principal Outstanding 31-Dec-02
By Jurisdiction				
Cities	$ 2,236,681	$ 255,139	$ 274,427	$ 2,217,393
Specialized Municipalities	109,542	17,742	9,050	118,234
Towns	201,054	19,289	23,594	196,749
Villages	12,455	922	2,093	11,284
Counties	27,159	7,302	2,734	31,727
Municipal Districts	11,272	2,493	980	12,785
Irrigation & Water Services Commission	49,683	694	4,342	46,035
Regional Airport Authorities	–	370,000	–	370,000
Hospitals & Regional Health Authorities	9,440	–	363	9,077
Universities, Colleges & Technical Institutes	117,009	91,300	5,963	202,346
School Districts & Divisions	732,202	1,260	95,019	638,443
	$ 3,506,497	**$ 766,141**	**$ 418,565**	**$ 3,854,073**
By Purpose				
Municipal - General	$ 2,100,944	$ 294,581	$ 253,550	$ 2,141,975
Municipal - Utility	542,856	9,000	62,608	489,248
Airport Infrastructure	–	370,000	–	370,000
Hospital - Ancillary Operation	13,030	–	1,406	11,624
Student Residence, Parkade and Ancillary Operation	117,009	91,300	5,963	202,346
School - Core Operation	732,658	1,260	95,038	638,880
	$ 3,506,497	**$ 766,141**	**$ 418,565**	**$ 3,854,073**

Analysis of New Loans Issued

By jurisdiction and purpose for the year ended December 31, 2002
(thousands of dollars)

	Cities	Towns	Villages	Other	Total
Airport infrastructure	$ –	$ –	$ –	$ 370,000	$ 370,000
Student residences and parkades	–	–	–	91,300	91,300
Sewer and water	68,845	6,779	437	11,686	87,747
Roads and sidewalks	57,437	5,597	–	6,136	69,170
Parks and recreation	29,983	4,944	–	500	35,427
Transit	34,885	–	–	–	34,885
Land	26,668	1,271	200	920	29,059
Equipment and machinery	20,965	599	35	3,820	25,419
Electric utilities	9,000	–	–	–	9,000
Municipal buildings	4,856	100	250	3,573	8,779
Public housing	2,500	–	–	–	2,500
Senior citizen lodges	–	–	–	1,500	1,500
School core operation	–	–	–	1,260	1,260
Landfill development	–	–	–	95	95
Total	**$ 255,139**	**$ 19,290**	**$ 922**	**$ 490,790**	**$ 766,141**

Shareholders' Forecast of Loan Requirements
(thousands of dollars)

	2003 Estimated	2002 Estimated	2002 Actual Loans
By Jurisdiction			
Cities	$ 344,900	$ 204,100	$ 255,139
Specialized municipalities	33,400	20,600	17,742
Towns	40,500	29,800	19,289
Villages	3,200	1,700	922
Counties, municipal and other districts	27,800	20,600	10,489
Regional airport authorities	–	300,000	370,000
Hospitals and regional health authorities	56,300	–	–
Universities, colleges and technical institutes	40,400	104,400	91,300
School districts and divisions	1,500	–	1,260
Total	**$ 548,000**	**$ 681,200**	**$ 766,141**
By Purpose			
Municipal - General	$ 433,100	$ 273,800	$ 294,581
- Utility	16,700	3,000	9,000
Airport Infrastructure	–	300,000	370,000
Hospital - Ancillary Operation	56,300	–	–
Student Residence, Parkade and Ancillary Operation	40,400	104,400	91,300
School – Core Operation	1,500	–	1,260
Total	**$ 548,000**	**$ 681,200**	**$ 766,141**

Ten-Year Loan Review 1993-2002
(thousands of dollars)

	2002	2001	2000
New loans issued during the year:			
By jurisdiction:			
Cities	$ 255,139	$ 297,004	$ 226,820
Specialized municipalities	17,742	13,133	38,741
Towns and villages	20,211	25,657	29,726
Counties, municipal and other districts	10,489	9,449	2,815
Regional airport authorities	370,000	–	–
Hospitals and regional health authorities	–	–	–
Universities, colleges and technical institutes	91,300	17,825	66,300
School districts and divisions	1,260	271	5,033
Total	**$ 766,141**	**$ 363,339**	**$ 369,435**
Shareholders' Forecast of Loan Requirements	$ 681,200	$ 382,000	$ 343,000
By purpose:			
Municipal	$ 303,581	$ 345,243	$ 298,102
Airport Infrastructure	370,000	–	–
Hospital – Ancillary Operation	–	–	–
Student Residence, Parkade and Ancillary Operation	91,300	17,825	66,300
School – Core Operation	1,260	271	5,033
Total	**$ 766,141**	**$ 363,339**	**$ 369,435**
Loans repaid during year	418,565	456,062	427,095
New debt issues sold during year	2,280,000	725,000	592,367
Outstanding long-term debt at December 31	3,771,081	3,420,816	3,472,555
Sinking fund investments at December 31	–	–	–
Retained earnings at December 31	26,676	132,738	149,913
Lending rate at December 31 *(based on 20-year term)*	5-7/8%	6%	6-1/8%

1999	1998	1997	1996	1995	1994	1993
$ 157,516	$ 115,738	$ 137,631	$ 104,949	$ 49,156	$ 131,566	$ 248,746
20,226	10,233	5,906	1,376	1,596	–	–
24,044	16,268	15,025	11,486	12,169	12,844	15,117
14,431	2,785	3,816	898	4,027	24,071	75,603
–	–	–	–	–	–	–
–	10,000	–	–	–	258	–
17,975	–	–	–	–	–	8,300
2,294	5,080	2,246	1,400	45,192	117,604	161,218
$ 236,486	**$ 160,104**	**$ 164,624**	**$ 120,109**	**$ 112,140**	**$ 286,343**	**$ 508,984**
$ 280,000	$ 215,000	$ 185,000	$ 152,000	$ 190,000	$ 475,000	$ 600,000
$ 215,967	$ 144,774	$ 162,378	$ 118,709	$ 66,948	$ 147,066	$ 300,480
–	–	–	–	–	–	–
–	10,000	–	–	–	258	2,330
17,975	–	–	–	–	–	500
2,544	5,330	2,246	1,400	45,192	139,019	205,674
$ 236,486	**$ 160,104**	**$ 164,624**	**$ 120,109**	**$ 112,140**	**$ 286,343**	**$ 508,984**
422,002	562,723	495,961	447,310	413,596	413,614	553,782
–	–	–	–	–	20,000	113,000
3,882,555	4,176,761	4,403,406	4,578,863	4,785,548	5,023,242	5,201,560
450,153	417,639	385,304	345,764	312,091	277,421	242,328
275,656	318,602	333,505	312,211	343,125	280,340	510,721
6-1/2%	5-5/8%	6%	6-7/8%	8%	9-3/4%	8%

Results of Operations

The Corporation's interest expense on debt exceeded interest income on loans, including amortization and income from investments, by $6.2 million as the yield on the loan portfolio of 8.3% was lower than the cost of 8.9% on the debt. This net interest expense of $6.2 million was reduced by $.5 million in loan prepayment fees, and with other expenses of $.4 million, resulted in a loss of $6.1 million for 2002.

The Corporation's goals are to provide local authorities with flexible funding at the lowest possible cost and to maintain the lowest administrative and new loan costs compared to other municipal borrowing corporations. Included is a comparison of the Corporation's 2002 costs with the latest audited financial data of other provincial municipal borrowing corporations.

Municipal Financing Corporation Statistics - 2002

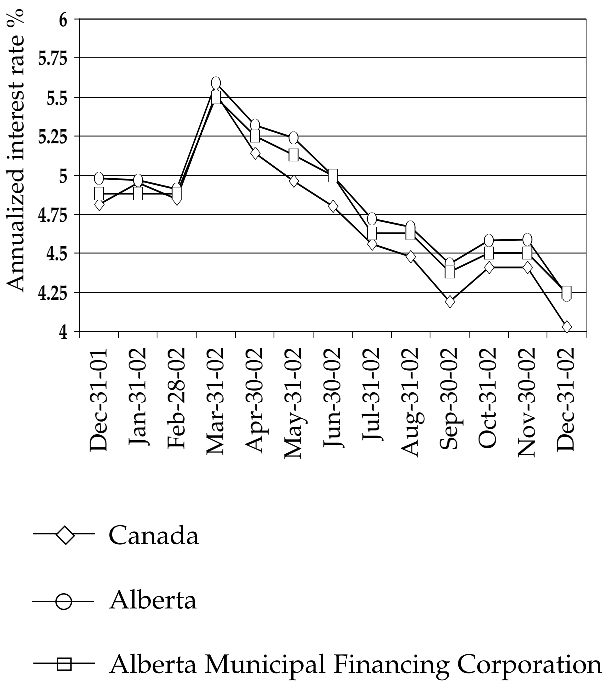
	Alberta	British Columbia	Nova Scotia	Newfoundland and Labrador
New loans to shareholders				
($ millions)	766.1	373.0	49.9	37.3
Total loans outstanding				
($ millions)	3,854	2,832	576.3	290.7
Administrative expense				
($ thousands)	342	941	272	359
($ per $ thousand of new loans)	0.45	2.52	5.45	9.62
($ per $ million of loans)	.09	.33	.47	1.23

Interest Rates

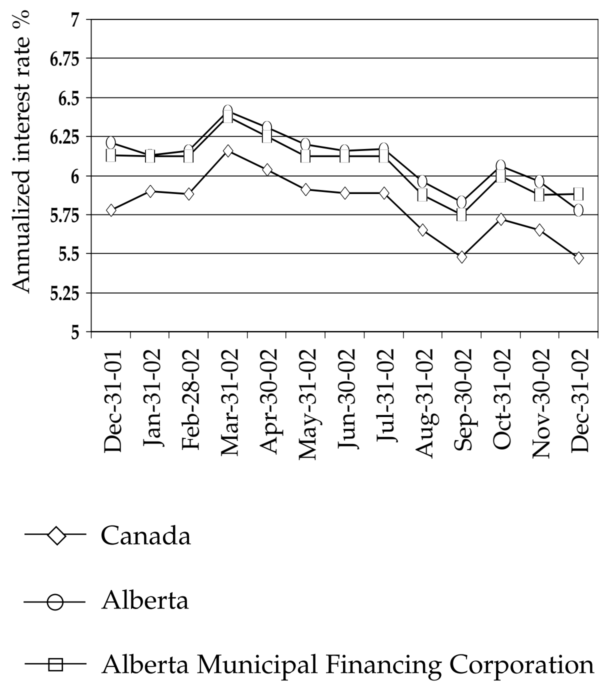
The Corporation's lending and interest rate policies provide shareholders with funds on a semi-monthly basis with interest rates set at the Province of Alberta's annualized average borrowing rate rounded down to the nearest 1/8%. Effective January 2003, the Board changed the method of the interest rate calculation by rounding up to the nearest eighth, rather than down. During 2002, interest rates showed a slight decline although there was more volatility in the shorter term 3 and 5-year rates which are now at historical lows.

Comparison of Rates

Canada, Alberta and AMFC rates in 2002
5-year term



Canada, Alberta and AMFC rates in 2002
25-year term



Debt

The gross debt of the Corporation increased by $350 million to $3,771 million. During the year, the Corporation received $418 million in loan repayments while issuing $766 million in new loans. The Corporation repaid $275 million to the Canada Pension Plan Investment Fund and $180 million under the Public Promissory Note Program. During the year the Corporation borrowed $140 million for three years, $500 million for ten years and $100 million for 20 years. In addition, to meet short-term cash requirements, the Corporation borrowed $1,540 million and repaid $1,475 million.

Sources of Capital

(thousands of dollars)

	Gross Outstanding December 31, 2002	Outstanding as a Percentage of Total
Canada Pension Plan Investment Fund	$ 2,706,081	71.8%
Public	1,065,000	28.2%
Total	$ 3,771,081	100.0%

Risk Management

Effective risk management is central to the ability to ensure a financially sound organization and includes identifying, assessing, managing and monitoring all forms of risk. The Corporation is primarily exposed to:

- Liquidity risk
- Market risk
- Operational risk and
- Credit risk

The General Manager of the Corporation is responsible for identifying risks and recommending the appropriate policies and framework. The Board of Directors reviews and approves the risk management policies and implements specific reporting procedures to enable them to monitor the adherence to these policies.

Liquidity Risk

Liquidity risk is the risk that the Corporation will not have sufficient cash to meet its obligations as they become due and also meet the loan requirements of our local authorities.

The Corporation manages its liquidity risk by monitoring its cash flows on a daily basis and providing updated cash flow reports to the Board as required. Surplus funds are invested in short-term investments or the Consolidated Cash Investment Trust Fund. When required, the Corporation raises funds under a five-year Promissory Note Program, by direct borrowing in the Canadian or European markets or by renewing borrowing from the Canada Pension Plan Investment Fund.

Market Risk

Market risk is the impact on the Corporation's income from changes in market factors such as interest rates and foreign exchange. The Corporation requires that all borrowing be done in Canadian dollars or that all borrowing in foreign currency be swapped into Canadian dollars. The primary source of interest rate risk is repricing risk which arises when there is a mismatch between the maturity and repricing of interest bearing assets and liabilities. This repricing risk also results from the Corporation's willingness to allow for some prepayments on existing loans.

The prepayment policy is structured to protect the Corporation from the significant losses that would occur in accepting additional prepayments of high interest rate loans and relending these funds at lower rates. The Corporation, on three separate occasions, has reduced the rates on higher interest rate loans to 12%. The Corporation does not have the ability to prepay or refinance its public debt and can only repay the Canada Pension Plan Investment Fund value at current market rates. The Corporation's prepayment policy is an integral part of its long-term financial planning.

The Corporation identifies and monitors interest rate risk by analyzing cash flows which are then reported to and reviewed by the Board of Directors.

Operational Risk

Operational risk is the risk associated with a breakdown in internal controls, systems or procedural failures, human errors or malfeasance. These risks can never be fully eliminated but are minimized by establishing appropriate policies and sound internal controls through an appropriate segregation of duties, accountability and reporting practices.

These controls and policies are established by management and reviewed by the Board in addition to the review done by the Auditor General during the year end audit.

Credit Risk

Credit risk is the risk of loss due to borrowers failing to meet their obligations to AMFC. Historically, the Corporation has not been required to record any provisions or allowances regarding credit losses nor has it suffered any such losses. The Corporation has established policies which provide for the approval and monitoring of all lending activity. These policies include establishing clear lines of authority for decision making and for accountability.

Financial Reporting Responsibility of Management

Management of AMFC prepared these financial statements and is responsible for their reliability, completeness and integrity. They conform in all material respects to Canadian generally accepted accounting principles and the requirements of the *Alberta Municipal Financing Corporation Act*.

Management maintains the necessary accounting and internal control systems designed to ensure the timely production of reliable and accurate financial information, the protection of assets (to a reasonable extent) against loss or unauthorized use and the promotion of operational efficiency. The Board of Directors oversees management's responsibilities for financial reporting and internal control systems.

The Auditor General of Alberta is designated as the external auditor in the *Alberta Municipal Financing Corporation Act*. The Board of Directors reviewed these financial statements with the external auditor in detail before their approval.

[Original Signed]

T. Stroich
FCA
General Manager/Treasurer

Edmonton, Alberta
January 31, 2003

Auditor's Report

To the Shareholders of the Alberta Municipal Financing Corporation

I have audited the balance sheet of the Alberta Municipal Financing Corporation as at December 31, 2002 and the statements of loss and retained earnings and cash flow for the year then ended. These financial statements are the responsibility of the Corporation's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2002 and the results of its operations and its cash flow for the year then ended in accordance with Canadian generally accepted accounting principles.

[Original Signed]

Fred J. Dunn
CA
Auditor General

Edmonton, Alberta
January 31, 2003

Balance Sheet

as at December 31, 2002
(thousands of dollars)

	2002 Budget	2002 Actual	2001 Actual
Assets:			
Cash (Note 3)	$ 19,812	$ 6,030	$ 30,917
Accrued interest receivable	133,078	135,649	128,422
Loans to local authorities (Note 4)	3,719,666	3,818,270	3,454,950
	$ 3,872,556	$ 3,959,949	$ 3,614,289
Liabilities and Shareholders' Equity:			
Liabilities:			
Accrued interest payable	$ 64,616	$ 59,035	$ 62,922
Due to the General Revenue Fund (Note 10)	–	100,000	–
Debt (Note 5 and Schedule 1)	3,685,343	3,774,174	3,418,565
	3,749,959	3,933,209	3,481,487
Shareholders' Equity:			
Share capital (Note 6):			
Authorized: 7,500 common shares, par value $10 per share			
Issued and fully paid:			
6,373 shares (2001 - 6,372)	64	64	64
Retained earnings	122,533	26,676	132,738
	122,597	26,740	132,802
	$ 3,872,556	$ 3,959,949	$ 3,614,289

The accompanying notes are part of these financial statements.

[Original Signed]

G.H. Sherwin, CA
Chairman of the Board

[Original Signed]

A.J. McPherson
Director

Statement of Loss and Retained Earnings

for the year ended December 31, 2002
(thousands of dollars)

	2002 Budget	2002 Actual	2001 Actual
Interest Income:			
Loans	$ 322,193	$ 323,829	$ 328,622
Amortization of loan discounts	15,744	15,744	19,872
Other	500	618	1,671
	338,437	340,191	350,165
Interest Expense:			
Debt	343,206	342,743	359,532
Amortization of net discounts on debt	6,037	3,687	7,633
	349,243	346,430	367,165
Net interest expense	(10,806)	(6,239)	(17,000)
Other Income:			
Loan prepayment fees	1,000	519	141
Net interest expense and other income	(9,806)	(5,720)	(16,859)
Non-Interest Expense:			
Administration and office expenses (Note 7)	399	342	316
Net loss	(10,205)	(6,062)	(17,175)
Retained earnings, beginning of year	132,738	132,738	149,913
	122,533	126,676	132,738
Transfer to the General Revenue Fund (Note 10)	–	(100,000)	–
Retained earnings, end of year	$ 122,533	$ 26,676	$ 132,738

Statement of Cash Flow

for the year ended December 31, 2002
(thousands of dollars)

	2002 Budget	2002 Actual	2001 Actual
Operating Activities:			
Interest received on loans	$ 317,537	$ 316,602	$ 339,038
Other interest	500	618	1,671
Loan prepayment fees	1,000	519	141
Administration and office expenses	(399)	(342)	(316)
Interest paid on debt	(341,512)	(346,630)	(370,394)
Cash flows used in operating activities	(22,874)	(29,233)	(29,860)
Investing Activities:			
Loan repayments	417,028	418,565	456,062
New loans issued	(666,000)	(766,141)	(363,339)
Cash flows (used in) from investing activities	(248,972)	(347,576)	92,723
Financing Activities:			
Debt issues	1,455,476	2,281,657	722,520
Debt redemptions	(1,194,735)	(1,929,735)	(776,739)
Cash flows from (used in) financing activities	260,741	351,922	(54,219)
Net (decrease) increase in cash	(11,105)	(24,887)	8,644
Cash, beginning of year	30,917	30,917	22,273
Cash, end of year	$ 19,812	$ 6,030	$ 30,917

1. Authority
The Alberta Municipal Financing Corporation operates under the authority of the *Alberta Municipal Financing Corporation Act*, Chapter A-27, Revised Statutes of Alberta 2000, as amended.

2. Significant Accounting Policies and Reporting Practices
These financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles and include the following significant accounting policies:

a) Debt
Debt premiums and discounts, including underwriting commission, arising on the issue of debt are deferred and amortized over the term of the debt.

Debt is recorded net of unamortized premiums or discounts.

Public debt issue expenses are charged against income as they are incurred.

b) Discounts on Loans to Local Authorities
Discounts are recorded for reductions of interest rates given on loans to local authorities with interest rates above a certain level and are amortized to income over the term of these loans. Annual amortization is the change in the present value of the remaining interest rate reduction.

c) Measurement Uncertainty
In preparing the financial statements, management must make estimates and assumptions concerning values of certain assets, liabilities, net income and related disclosures reported in these financial statements. Actual results could differ from these estimates.

d) Credit Risk
Credit risk is the risk of loss due to borrowers failing to meet their obligations to the Corporation. Historically, the Corporation has not needed to record any provisions or allowances regarding credit losses nor has it suffered any such losses. The Corporation has established policies which provide for the approval and monitoring of all lending activity. These policies include establishing clear lines of authority for decision making and for accountability.

3. Cash
Cash consists of deposits in the Consolidated Cash Investment Trust Fund (CCITF) of the Province of Alberta. CCITF is managed with the objective of providing competitive interest income to depositors while maintaining maximum security and liquidity of depositors' capital. The portfolio is comprised of high-quality short-term and mid-term fixed income securities with a maximum term to maturity of five years. Interest is earned on the Fund's daily cash balance at the average rate of interest earned by CCITF, which varies depending on prevailing market interest rates.

4. Loans to Local Authorities

	2002	**2001**
	(thousands of dollars)	
Loans to local authorities	$ 3,854,073	$ 3,506,497
Less: Unamortized discounts	35,803	51,547
	$ 3,818,270	$ 3,454,950

At the year-end, 2002 loan payments related to loans of $962,300 were in arrears. The book value for these loans has not been reduced as the Corporation expects the loans will be current in 2003.

5. Debt

a) The debt of the Corporation is fully guaranteed by the Province of Alberta.

b) Debt amounting to $2,706,081,000 (2001 - $2,880,816,000) held by the Canada Pension Plan Investment Fund (CPPIF) is redeemable at the option of the Minister of Finance of Canada by giving six months notice in writing and observing the other redemption provisions of the debt agreement.

The Corporation may prepay debt held by the CPPIF by providing 30 days notice prior to the proposed redemption date. The debt can be prepaid at market with the debt issued prior to January 1, 1998 discounted at the Government of Canada rate and debt issued after January 1, 1998 discounted at the Province's borrowing rate.

c) Debt redemption requirements, with the assumption of no early redemption during each of the next five years, are as follows:

	Debt Redemption (thousands of dollars)
2003	$ 666,023
2004	338,491
2005	423,604
2006	395,396
2007	335,383
	$ 2,158,897

6. Share Capital

Particulars of share capital are summarized hereunder:

		Number of Shares		
Class	**Restricted to**	**Authorized**	**Issued and Fully Paid**	**Total Dollar Amount**
A	Province of Alberta	4,500	4,500	$ 45,000
B	Municipalities, airport authorities and hospitals	1,000	854	8,540
C	Cities	750	582	5,820
D	Towns and villages	750	301	3,010
E	Schools, universities and colleges	500	136	1,360
		7,500	6,373	$ 63,730

During the year, two Class B shares were issued and one Class D share was cancelled at $10.00 each.

7. Directors' Fees and Related Party Transactions

Directors' fees paid by the Corporation are as follows:

	2002		2001	
	Number of Individuals	Total	Number of Individuals	Total
Chairman of the Board	1	$2,500	1	$2,100
Board members	6	$14,400	6	$11,100

There are two additional Board members who are employees of the Province of Alberta and do not receive compensation from the Corporation.

The Corporation has no employees. Included in administration and office expenses of $342,126 (2001 - $316,549) is the amount of $241,024 (2001 - $184,617) that was paid to the controlling shareholder, Province of Alberta, at prices which approximate market.

8. Interest Rate Risk

Interest rate risk refers to the potential impact of changes in interest rates on the Corporation's earnings and the fair value of the financial instruments when maturities of its financial assets are not matched with the maturities of its financial debt. The following table shows the maturities and effective rates of the Corporation's financial assets and liabilities:

As at December 31, 2002
(thousands of dollars)

Maturities	Within 1 Year	1 to 2 Years	3 to 5 Years	6 to 10 Years	Over 10 Years	2002 Total	2001 Total
Assets							
Cash	$ 6,030	$ –	$ –	$ –	$ –	$ 6,030	$ 30,917
Accrued Interest Receivable	135,649	–	–	–	–	135,649	128,422
Loans	67,660	89,750	801,041	1,246,809	1,648,813	3,854,073(i)	3,506,497 (i)
Effective Rate	9.1%	10.3%	9.2%	9.2%	7.0%	8.3%	9.0%
Total	$ 209,339	$ 89,750	$ 801,041	$ 1,246,809	$ 1,648,813	$ 3,995,752	$ 3,665,836
Liabilities							
Accrued Interest Payable	$ 59,035	$ –	$ –	$ –	$ –	$ 59,035	$ 62,922
Debt	665,573	338,491	1,153,791	1,293,952	322,367	3,774,174	3,418,565
Effective Rate	9.6%	13.3%	9.7%	7.4%	6.2%	8.9%	10.2%
Total	$ 724,608	$ 338,491	$ 1,153,791	$ 1,293,952	$ 322,367	$ 3,833,209	$ 3,481,487
Net Gap	$ (515,269)	$(248,741)	$ (352,750)	$ (47,143)	$ 1,326,446	$ 162,543	$ 184,349

(i) This total is not reduced by unamortized discount of $35,803 (2001 - $51,547).

The Corporation manages on a continuous basis its interest rate risk by matching its debt maturity profile to the forecast cash flows and their effect on the Corporation's surplus position.

9. Fair Value of Financial Instruments

The amounts set out in the table represent the fair value of the Corporation's financial instruments based on the following assumptions and valuation methods.

Fair value represents the Corporation's estimate of amounts for loans and debt that could be exchanged with unrelated parties who are interested in acquiring these instruments. For loans and debt, fair value is calculated using net present value techniques where the Corporation's future cash flows are discounted at the Corporation's cost of funds.

Changes in interest rates are the main cause of changes in the fair value of the Corporation's financial instruments.

The fair value of cash approximates its carrying value.

The following table presents the financial instruments with a carrying value different from the recorded value at December 31:

	2002		2001	
	Fair Value	**Book Value**	**Fair Value**	**Book Value**
	(thousands of dollars)			
Loans, including accrued interest receivable	$ 4,530,131	$ 3,953,919	$ 4,133,534	$ 3,583,372
Debt, including accrued interest payable	$ 4,404,516	$ 3,833,209	$ 4,063,567	$ 3,481,487

10. Transfer of Retained Earnings to the General Revenue Fund

On December 9, 2002, the Minister of Finance directed the transfer of $100 million of the Corporation's retained earnings to the General Revenue Fund. This transfer was made in accordance with Section 33 of the *Financial Administration Act*.

11. Budget

The 2002 budget was approved by the Board of Directors on March 20, 2002.

Schedule of Debt

As at December 31, 2002 Schedule 1

(thousands of dollars)

Maturity Date	Interest Rate	Principal Outstanding
Canada Pension Plan Investment Fund (Note 5(b))		
Apr 05, 2003	13.82	$ 209,284
Dec 01, 2003	11.50	231,739
Dec 03, 2004	13.25	338,491
Nov 01, 2005	11.66	283,604
Nov 03, 2006	9.85	395,396
Nov 02, 2007	9.66	335,383
Oct 03, 2008	10.04	259,294
Oct 02, 2009	9.99	291,414
Nov 01, 2009	9.62	32,457
Dec 01, 2009	9.26	6,652
Oct 01, 2020	6.28	222,367
Jun 01, 2022	6.06	100,000
Total		2,706,081
Public		
Apr 03, 2003	2.74	32,500
Apr 03, 2003	2.74	32,500
Aug 01, 2003	4.91	160,000
Jun 01, 2005	4.60	140,000
Sep 01, 2011	5.70	200,000
Jun 01, 2012	5.85	500,000
Total		1,065,000
		3,771,081
Net unamortized premium		3,093
Total debt 2002		$ 3,774,174
Total debt 2001		$ 3,418,565