Alberta Capital Finance Authority

2004 ANNUAL REPORT

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DIRECTORS

BOARD OF DIRECTORS

Appointed
C.F. Barth
F.W. Clarke
L.R. Gordon
B.F. Manning
D.H. Bader

Elected
H.N. Johnsrude
- Representing Class B shareholders

E.A. Gibbons
- Representing Class C shareholders

S. Burford
- Representing Class D shareholders

D.O. Lussier
- Representing Class E shareholders

OFFICERS

D.O. Lussier
- Chair of the Board

H.N. Johnsrude
- Vice-Chair

T.S. Stroich
- President and Treasurer

L. Epp
- Vice-President

J. Hui
- Corporate Secretary and Assistant Treasurer

For more information, visit our website or contact
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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 Capital Finance Authority.

Authority

The Alberta Capital Finance Authority is a non-profit Authority established in 1956 under the authority of the *Alberta Capital Finance Authority Act*, Chapter A-14.5, Revised Statutes of Alberta 2000, as amended.

Shareholders

The authorized stock of the Authority 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 municipal authorities (defined as including improvement districts, metis settlements, municipal districts, counties, special areas, and specialized municipalities) and to regional authorities (includes drainage districts, irrigation districts, regional airport authorities and regional services commissions), and health authorities (includes approved hospitals, mental health hospitals, regional health authorities, and provincial health boards)
- 750 Class C, available only to cities
- 750 Class D, available only to towns and villages
- 500 Class E, available only to educational authorities (includes school districts and divisions, colleges, technical institutes, universities and Northland School Division)

The business of the Authority 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 Authority's resolution relating to the terms and conditions for lending money to shareholders.

Financing

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

Chair's Report

February 18, 2005

It is my privilege and pleasure to present the Annual Report of the Alberta Capital Finance Authority for the year ended December 31, 2004, and to review its activities over the past year.

This past year was again a year of change and growth for the Authority. This was the first year for advancing loans under the new lending policies and for the most part, the Authority was able to provide the continuing flexibility that borrowers demanded while advancing funds on a quarterly basis. The Board agreed that these lending policies would stay in effect for a two-year trial period and would be reviewed in 2006 to assess their continued applicability for borrowers while maintaining the financial viability of the Authority. Although there were issues with the change from annual to semi-annual loan repayment, during the borrowing for the last quarter in mid December, these issues were reduced significantly and did not cause any delays in required loan advances.

In September 2004, the Authority conducted a "Consultative Survey" to gauge the level of satisfaction with our current business practices. I would like to thank everyone who responded to the survey, as your comments are a key input into the development of the Authority's Three-Year Business Plan. While there has been some reduction in the overall levels of satisfaction, levels average above 75% for assistance in providing loans and timeliness of loan applications, both services considered high priority. The responses to the "usefulness of our website", has shown that this is an increasing priority and although satisfaction levels were high, an effort will be made to improve its functionality.

This past year was also busy for the Authority, which saw over $607 million in new loans issued, a significant increase over 2003. Included in the $607 million loans issued was $5 million in loans issued under the ME *first!* program, which provides interest free loans to municipalities for energy efficiency projects with the interest paid by the Department of Municipal Affairs. Interest rates on new loans remained relatively steady during the year with rates for the three-year term increasing by about 1% to June and then declining to near the same level as at the beginning of year. Long-term rates increased by about ½ of one percent by June and declined to below those rates at the beginning of the year.

The Authority was able to meet its long-term debt redemption of $361 million from the cash surplus and borrowed only $600 million to meet loan demand of $607 million.

During the year the Authority entered into interest rate swaps for risk management purposes which were used to manage exposure to fluctuations in interest rates in certain fixed rate loans and related debt.

The Authority had budgeted for a loss of $12.1 million for the year but with $1.6 million in unbudgeted prepayment fees and lower administration costs than budgeted, the loss was reduced to $9.7 million. In the Authority's 2005-2008 Business Plan, the Authority expected losses to be reduced to $3.0 million and $1.9 million in 2005 and 2006 respectively. Income should become positive in 2007 and beyond. Currently it is policy of the Authority to operate on a break-even basis with a minimum level of retained earnings.

The Board has also seen a number of changes in 2004. The Authority welcomed three new directors to the Board, Ed Gibbons, representing the Class "C" shareholders, Brian Manning, the new Deputy Minister of Finance and Dan Bader, the new Deputy Minister of Municipal Affairs. Our appreciation and thanks to former Chair, Garth Sherwin for his service as director since 1998 and as Chair for the past year and to Brad Pickering, former Deputy Minister of Municipal Affairs - 2002, and Peter Kruselnicki, former Deputy Minister of Finance - 1999.

I wish to thank the Board of Directors for their dedication and support of the Authority's objectives and their skill in addressing the issues coming before them. Special thanks to our staff for their efforts and diligence in providing our shareholders with outstanding service and support over this year of changes.

It has been an honour and privilege to act as your Chair and I look forward to being able to continue our tradition of providing low cost flexible financing for our shareholders.

[Original Signed]

Don Lussier
Chair

Management Discussion and Analysis

The following provides management's analysis of the financial position and results of operations of the Alberta Capital Finance Authority for the year ended December 31, 2004.

Loans

During 2004, the Authority loan portfolio increased from $3,941 million to $4,150 million, an increase of $209 million. New loans issued during the year totalled $607 million, an increase of $110 million from new loans issued in 2003 and loan repayments totalled $398 million. The Authority is forecasting that loan demand will be volatile over the next few years, with increasing demands by the educational sector coupled with uncertainty in the municipal sector. Included in this review is a Schedule of Loans Outstanding at December 31, 2004, Analysis of New Loans Issued in 2004 by Jurisdiction and Purpose, and the Ten-Year Loan Review 1995-2004.

Annually, the Authority requests the estimated borrowing requirements from each shareholder in order to help manage the Authority's own financing requirements. The 2005 Shareholders' Forecast of Loan Requirements and actual borrowings are included for information.

Schedule of Loans Outstanding
as at December 31, 2004
(thousands of dollars)

	Principal Outstanding 31-Dec-03	2-Jan-04 to 31-Dec-04 New Loans Issued	2-Jan-04 to 31-Dec-04 Principal Repaid	Principal Outstanding 31-Dec-04
By Jurisdiction				
Cities	$ 2,321,196	$ 377,445	$ 261,101	$ 2,437,540
Specialized Municipalities	135,543	15,115	10,771	139,887
Towns	203,626	53,005	22,609	234,022
Villages	11,631	564	1,851	10,344
Counties	60,033	15,615	5,444	70,204
Municipal Districts	14,345	5,089	1,562	17,872
Irrigation Districts & Regional Services Commissions	47,723	22,838	3,363	67,198
Regional Airport Authorities	370,000	20,000	–	390,000
Health Authorities	8,691	19,000	605	27,086
Colleges , Technical Institutes & Universities	216,569	71,112	12,077	275,604
School Districts & Divisions	551,301	7,680	78,533	480,448
	$ 3,940,658	**$ 607,463**	**$ 397,916**	**$ 4,150,205**
By Purpose				
Municipal - General	$ 2,344,725	$ 363,716	$ 262,287	$ 2,446,154
Municipal - Utility	447,183	120,419	43,962	523,640
ME *first!*	–	5,536	–	5,536
Airport Infrastructure	370,000	20,000	–	390,000
Health - Ancillary Operation	10,460	19,000	1,036	28,424
Student Residence, Parkade and Ancillary Operation	216,569	71,112	12,077	275,604
School - Core Operation	551,721	7,680	78,554	480,847
	$ 3,940,658	**$ 607,463**	**$ 397,916**	**$ 4,150,205**

Analysis of New Loans Issued

By jurisdiction and purpose for the year ended December 31, 2004
(thousands of dollars)

	Cities	Towns	Villages	Other	Total
Sewer and water	$ 108,758	$ 14,696	$ 524	$ 45,080	$ 169,058
Electric utilities	120,419	–	–	–	120,419
Roads and sidewalks	90,833	5,666	–	2,175	98,674
Educational - core operation	–	–	–	43,557	43,557
Student residences	–	–	–	35,235	35,235
Parks and recreation	12,866	18,549	–	1,050	32,465
Equipment and machinery	15,674	1,570	–	3,419	20,663
Airport infrastructure	–	–	–	20,000	20,000
Health - ancilliary operation	–	–	–	19,000	19,000
Municipal buildings	9,065	6,354	–	2,775	18,194
Transit	12,255	–	–	1,065	13,320
ME *first!*	3,659	1,547	40	290	5,536
Senior citizen lodges	–	1,340	–	2,503	3,843
Land	–	3,283	–	–	3,283
Landfill development	2,500	–	–	300	2,800
Public housing	1,300	–	–	–	1,300
Irrigation	116	–	–	–	116
Total	**$ 377,445**	**$ 53,005**	**$ 564**	**$ 176,449**	**$ 607,463**

Shareholders' Forecast of Loan Requirements

(thousands of dollars)

	2005 Estimated	2004 Estimated	2004 Actual
By Jurisdiction			
Cities	$ 375,633	$ 345,500	$ 377,445
Specialized municipalities	33,152	17,700	15,115
Towns	37,606	34,800	53,005
Villages	1,464	1,800	564
Counties, municipal and irrigation districts, and regional services commissions	25,499	27,300	43,542
Regional airport authorities	75,000	20,000	20,000
Health authorities	24,000	28,400	19,000
Colleges, technical institutes and universities	32,503	63,200	71,112
School districts and divisions	–	1,300	7,680
Total	**$ 604,857**	**$ 540,000**	**$ 607,463**

Ten-Year Loan Review 1995-2004
(thousands of dollars)

	2004	2003	2002
New loans issued during the year:			
By jurisdiction:			
Cities	$ 377,445	$ 379,647	$ 255,139
Specialized municipalities	15,115	26,830	17,742
Towns and villages	53,569	31,122	20,211
Counties, municipal and irrigation districts, and regional services commissions	43,542	40,056	10,489
Regional airport authorities	20,000	–	370,000
Health authorities	19,000	–	–
Colleges, technical institutes and universities	71,112	19,302	91,300
School districts and divisions	7,680	–	1,260
Total	**$ 607,463**	**$ 496,957**	**$ 766,141**
Shareholders’ Forecast of Loan Requirements	$ 540,000	$ 548,000	$ 681,200
By purpose:			
Municipal	$ 484,135	$ 477,655	$ 303,581
ME *first!*	5,536	–	–
Airport Infrastructure	20,000	–	370,000
Health – Ancillary Operation	19,000	–	–
Student Residence, Parkade and Ancillary Operation	71,112	19,302	91,300
School – Core Operation	7,680	–	1,260
Total	**$ 607,463**	**$ 496,957**	**$ 766,141**
Loans repaid during year	397,916	410,372	418,565
Loans outstanding at December 31	4,150,205	3,940,658	3,854,073
New debt issued during year (at par)	714,500	3,137,000	2,280,000
Debt repaid during year	475,491	2,930,523	1,929,735
Debt outstanding at December 31	4,216,567	3,977,558	3,771,081
Sinking fund investments at December 31	–	–	–
Retained earnings at December 31	12,664	22,406	26,676
Lending rate at December 31 *(based on 20-year term)*	4.923%	5-5/8%	5-7/8%

2001	2000	1999	1998	1997	1996	1995
$ 297,004	$ 226,820	$ 157,516	$ 115,738	$ 137,631	$ 104,949	$ 49,156
13,133	38,741	20,226	10,233	5,906	1,376	1,596
25,657	29,726	24,044	16,268	15,025	11,486	12,169
9,449	2,815	14,431	2,785	3,816	898	4,027
–	–	–	–	–	–	–
–	–	–	10,000	–	–	–
17,825	66,300	17,975	–	–	–	–
271	5,033	2,294	5,080	2,246	1,400	45,192
$ 363,339	**$ 369,435**	**$ 236,486**	**$ 160,104**	**$ 164,624**	**$ 120,109**	**$ 112,140**
$ 382,000	$ 343,000	$ 280,000	$ 215,000	$ 185,000	$ 152,000	$ 190,000
$ 345,243	$ 298,102	$ 215,967	$ 144,774	$ 162,378	$ 118,709	$ 66,948
–	–	–	–	–	–	–
–	–	–	–	–	–	–
–	–	–	10,000	–	–	–
17,825	66,300	17,975	–	–	–	–
271	5,033	2,544	5,330	2,246	1,400	45,192
$ 363,339	**$ 369,435**	**$ 236,486**	**$ 160,104**	**$ 164,624**	**$ 120,109**	**$ 112,140**
456,062	427,095	422,002	562,723	495,961	447,310	413,596
3,506,497	3,599,220	3,656,880	3,842,396	4,245,015	4,576,352	4,903,553
725,000	592,367	–	–	–	60,000	210,000
776,739	1,002,367	294,206	226,645	175,457	266,685	447,694
3,420,816	3,472,555	3,882,555	4,176,761	4,403,406	4,578,863	4,785,548
–	–	450,153	417,639	385,304	345,764	312,091
132,738	149,913	275,656	318,602	333,505	312,211	343,125
6%	6-1/8%	6-1/2%	5-5/8%	6%	6-7/8%	8%

Results of Operations

The Authority's interest expense on debt exceeded interest income on loans, including amortization and income from investments, by $10.7 million as the yield on the loan portfolio of 7.2% was lower than the cost of 7.3% on the debt. This net interest expense of $10.7 million was reduced by $1.6 million in loan prepayment fees, and with other expenses of $.6 million, resulted in a loss of $9.7 million for 2004.

The Authority'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 authorities. Included is a comparison of the Authority's 2004 costs with the latest audited financial data of other provincial municipal borrowing authorities.

Capital Finance Authority Statistics - 2004

	Alberta	British Columbia	Nova Scotia	Newfoundland and Labrador
New loans to shareholders				
($ millions)	607	490	73	20
Total loans outstanding				
($ millions)	4,150	3,191	493	258
Administrative expense				
($ thousands)	639	1,793	310	214
($ per $ thousand of new loans)	1.05	3.66	4.25	10.7
($ per $ million of loans)	.15	.56	.63	.83

Interest Rates

The Authority provides fixed rate semi-annual pay amortizing loans to its borrowers. Loan rates are based on actual rates for the interest rate swaps (or other floating rate instruments) executed to convert the loan to a floating rate to match the funding floating rate in order to reduce interest rate risk to the Authority. If a fixed rate instrument is used to fund the loan, then the loan rate will be based on the actual rate of the fixed rate instrument.

During the year a fee of 6 basis points was added to each loan rate, regardless of the duration of the loan to account for the following expenses:

- 2 basis points to cover the Authority's expenses to administer the loan program
- 4 basis points to recover financing commissions/fees; applied on a broad-basis to all loans, regardless of the loan term and funding decision employed on a particular borrowing date

Comparative Loan Spreads with Other Municipal Borrowers

In order to compare the Authority's loan rates provided to those of other municipal borrowers, actual issues of these borrowers were reviewed and compared to an estimated rate that the Authority would have achieved under similar terms and circumstances. The Authority's goal is to provide the lowest rate for Alberta borrowers.

	10 Year (10/04)	**20 Year (10/04)**
BCMFA	.436%	.488%
ACFA	.407%	.521%
	.029%	(.033%)

	10 Year (05/04)	**20 Year (10/04)**
Toronto	.613%	.547%
ACFA	.444%	.420%
	.169%	.127%

Debt

The gross debt of the Authority increased by $239 million to $4,217 million. During the year, the Authority received $398 million in loan repayments while issuing $607 million in new loans. The Authority repaid $338 million to the Canada Pension Plan Investment Fund and $23 million under the Public Promissory Note Program. During the year the Authority borrowed $600 million in medium and long-term debt for terms from 5 to 20-years and to meet short-term requirements, borrowed over $115 million all of which was repaid during the year.

Sources of Capital

(thousands of dollars)

	Gross Outstanding December 31, 2004	Outstanding as a Percentage of Total
Canada Pension Plan Investment Fund	$ 2,204,567	52.3%
Public	2,012,000	47.7%
Total	$ 4,216,567	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 Authority is primarily exposed to:

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

The President of the Authority 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.

Market Risk

Market risk is the impact on the Authority's income from changes in market factors such as interest rates and foreign exchange. The Authority requires that all borrowing be done in Canadian dollars or that 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 Authority's willingness to allow for some prepayments on existing loans.

The prepayment policy is structured to protect the Authority from the significant losses that would occur in accepting additional prepayments of high interest rate loans and relending these funds at lower rates. The Authority, on three separate occasions, has reduced the rates on higher interest rate loans to 12%. The Authority 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 Authority's prepayment policy is an integral part of its long-term financial planning.

Interest Rate Risk

The Authority uses mainly interest rate swaps for the purpose of managing its asset and liability position. The Authority's policy is to match the interest rate exposure on all new loans to the interest rate exposure of the debt used to fund these loans. In most cases, both interest on new loans and debt are swapped to floating.

The Board recognizes the unique risks associated with the use of derivative financial instruments and has established policies and procedures to monitor and minimize exposure to the Authority. These policies and procedures limit the type of derivative financial instruments and circumstances where they can be used, the authorities required to approve the transaction and the appropriate segregation of duties to reduce operational risk. All derivative financial instruments are reviewed and managed within policies approved by the Board and the Board reviews all derivative financial instruments made since the last meeting.

Credit risk on counterparty default arises with the use of derivatives. To control this risk, the Authority uses counterparty limits established for the Province and uses only counterparty believed to be credit worthy. The Authority is not exposed to credit risk for the full face value (notional amount) of the derivative contracts, but only to the potential replacement cost if the counterparty fails. This exposure is represented by the current replacement cost of all outstanding contracts in a favourable position. For additional information, see Note 8 in the Financial Statements.

Liquidity Risk

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

The Authority 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 Authority raises funds under a five-year Promissory Note Program, by direct borrowing in the Canadian or European market or by renewing borrowing from the Canada Pension Plan Investment Fund.

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.

The examination of the financial statements was made in accordance with Canadian generally accepted auditing standards and, accordingly, included a review of certain of the systems of operating and financial controls and such tests that were considered necessary in the circumstances.

The objective of a financial statement audit is to obtain reasonable assurance whether the financial statements are free of material misstatement. Accordingly, an audit would not usually identify all such matters that may be of interest to management and the Board of Directors, however any weaknesses in internal controls or other non-trivial matters are communicated to management and the Board of Directors.

Credit Risk

Credit risk is the risk of loss due to a borrower failing to meet their obligations to the Authority. Historically, the Authority has not been required to record any provisions or allowances regarding credit losses nor has it suffered any such losses. The Authority 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 the Alberta Capital Finance Authority 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 Capital Finance Authority 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 Capital Finance Authority Act*. The Board of Directors reviewed these financial statements with the external auditor in detail before their approval.

[Original Signed]
T.S. Stroich

FCA
President

Edmonton, Alberta
January 28, 2005

Auditor's Report

To the Shareholders of the Alberta Capital Finance Authority.

I have audited the balance sheet of the Alberta Capital Finance Authority as at December 31, 2004 and the statements of loss and retained earnings and cash flow for the year then ended. These financial statements are the responsibility of the Authority'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 Authority as at December 31, 2004 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

[Original Signed]
Fred J. Dunn

FCA
Auditor General

Edmonton, Alberta
January 28, 2005

Balance Sheet

as at December 31, 2004
(thousands of dollars)

	2004 Budget	2004 Actual	2003 Actual
Assets:			
Cash (Note 3)	$ 7,264	$ 23,025	$ 2,308
Accrued interest receivable	117,963	121,988	128,189
Loans to local authorities (Note 4)	3,942,045	4,135,820	3,917,098
	$ 4,067,272	$ 4,280,833	$ 4,047,595
Liabilities and Shareholders' Equity:			
Liabilities:			
Accrued interest payable	$ 52,162	$ 56,329	$ 52,646
Debt (Note 5 and Schedule 1)	4,004,449	4,211,776	3,972,479
	4,056,611	4,268,105	4,025,125
Shareholders' Equity:			
Share capital (Note 6):			
Issued and fully paid:			
6,376 shares (2003 - 6,373)	64	64	64
Retained earnings	10,597	12,664	22,406
	10,661	12,728	22,470
	$ 4,067,272	$ 4,280,833	$ 4,047,595

The accompanying notes are part of these financial statements.

[Original Signed]

D.O. Lussier
Chair of the Board

[Original Signed]

T.S. Stroich, FCA
President

Statement of Loss and Retained Earnings

for the year ended December 31, 2004
(thousands of dollars)

	2004 Budget	2004 Actual	2003 Actual
Interest Income:			
Loans	$ 301,620	$ 298,412	$ 311,113
Amortization of loan discounts	9,175	9,175	12,243
Other	2,800	2,815	967
	313,595	310,402	324,323
Interest Expense:			
Debt	323,820	319,704	323,939
Amortization of net discounts on debt	979	1,378	4,642
	324,799	321,082	328,581
Net interest expense	(11,204)	(10,680)	(4,258)
Other Income:			
Loan prepayment fees	–	1,577	485
Net interest expense and other income	(11,204)	(9,103)	(3,773)
Non-Interest Expense:			
Administration and office expenses (Note 7)	875	639	497
Net loss	(12,079)	(9,742)	(4,270)
Retained earnings, beginning of year	22,676	22,406	26,676
Retained earnings, end of year	$ 10,597	$ 12,664	$ 22,406

Statement of Cash Flow

for the year ended December 31, 2004
(thousands of dollars)

	2004		2003
	Budget	Actual	Actual
Operating Activities:			
Interest received	$ 311,850	$ 304,613	$ 318,573
Other interest	2,800	2,815	967
Loan prepayment fees	–	1,577	485
Administration and office expenses	(875)	(639)	(497)
Interest paid	(323,655)	(316,021)	(330,328)
Cash flows used in operating activities	(9,880)	(7,655)	(10,800)
Investing Activities:			
Loan repayments	383,461	397,916	410,372
New loans issued	(400,000)	(607,463)	(496,957)
Cash flows used in investing activities	(16,539)	(209,547)	(86,585)
Financing Activities:			
Debt issues	459,899	713,410	3,124,186
Debt redemptions	(431,320)	(475,491)	(2,930,523)
Cash flows from financing activities	28,579	237,919	193,663
Payment of retained earnings to General Revenue Fund	–	–	(100,000)
Net increase (decrease) in cash	2,160	20,717	(3,722)
Cash, beginning of year	5,104	2,308	6,030
Cash, end of year	$ 7,264	$ 23,025	$ 2,308

1. Authority

The Alberta Capital Finance Authority operates under the authority of the *Alberta Capital Finance Authority Act*, Chapter A-14.5, Revised Statutes of Alberta 2000, as amended.

2. Significant Accounting Policies and Reporting Practices

These financial statements have been prepared by management in accordance with Canadian Generally Accepted Accounting Principles (GAAP) 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

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the year. Actual results could differ from these estimates. Measurement uncertainty exists in the valuation of the loans to local authorities.

d) Credit Risk

Credit risk is the risk of loss due to borrowers failing to meet their obligations to the Authority. Historically, the Authority has not needed to record any provisions or allowances regarding credit losses nor has it suffered any such losses. The Authority 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.

e) Derivative Financial Instruments

Derivative financial instruments used by the Authority are interest rate contracts whose value is derived from interest rates and are used to accommodate the management of risk for asset/liability management purposes and to manage the Authority's interest rate exposure.

The Authority designates each derivative financial instrument as a hedge of identified assets or liabilities. In order to designate a derivative financial instrument as a hedge for accounting purposes, the criteria of Accounting Guideline 13, Hedging Relationships must be met. As a result, the Authority formally documents all relationships between hedging instruments and hedging items, as well as its risk management objectives and strategy for undertaking various hedge transactions. This process includes linking all derivative financial instruments to specific assets and liabilities. The Authority also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivative financial instruments that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

Derivative financial instruments are accounted for on an accrual basis. Income and expenses on derivative financial instruments designated and qualifying as hedges are recorded as an adjustment to the yield of the item being hedged over the term of the hedge contract in the Statement of Loss and Retained Earnings.

Accrued interest receivable and payable on these derivative financial instruments are recorded in accrued interest receivable and payable respectively, in the Balance Sheet.

If the hedge is no longer effective, the associated derivative financial instrument is subsequently carried at fair value on the Balance Sheet and the fair value and any subsequent changes to the fair value are recorded in the Statement of Loss and Retained Earnings in other income.

Derivative financial instruments that have been acquired for asset/liability management purposes that do not qualify for hedge accounting are carried at fair value on the Balance Sheet and the fair value and any subsequent changes in the fair value are recorded in the Statement of Loss and Retained Earnings in other income.

Accrued income and expenses and deferred gains and losses are included in other assets and other liabilities as appropriate in the Balance Sheet.

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 appropriate 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 three years.

4. Loans to Local Authorities

	2004	**2003**
Loans to local authorities	$ 4,150,205	$ 3,940,658
Less: Unamortized discounts	14,385	23,560
	$ 4,135,820	$ 3,917,098

5. Debt

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

b) Debt amounting to $2,204,567 (2003 - $2,465,058) 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.

c) Debt amounting to $302,000 (2003 - Nil) is comprised of a combination of various issues of step-up and accrual notes whereby the Authority has the option of extending or calling the debt, at predetermined extension or call dates. Principal is due upon termination of the debt, where debt is called or not extended by the Authority at the predetermined extension or call date, or upon final maturity of the debt (Schedule 1).

d) Debt redemption requirements, with the assumption that the step-up and accrual notes are redeemed at the first extendible date and all other debt at the maturity date, are as follows:

	Debt Redemption
2005	$ 725,604
2006	395,396
2007	335,383
2008	259,294
2009	330,523
	$ 2,046,200

6. **Share Capital**
Particulars of share capital are as follows:

Class	Restricted to	Number of Shares: Authorized	Number of Shares: Issued and Fully Paid	Total Dollar Amount
A	Province of Alberta	4,500	4,500	$ 45,000
B	Municipal authorities, airport and health authorities	1,000	859	8,590
C	Cities	750	582	5,820
D	Towns and villages	750	299	2,990
E	Educational authorities	500	136	1,360
		7,500	6,376	$ 63,760

During the year, four 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 Authority are as follows:

	2004		2003	
	Number of Individuals	Total	Number of Individuals	Total
Chair of the Board	1	$ 5	1	$ 7
Board members	6	$ 18	6	$ 19

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

The Authority has advanced loans to local authorities under the ME *first!* Municipal Energy Efficiency Assistance program (the "Program") on behalf of the Alberta Municipal Affairs and Alberta Environment. Under the Program, principal is advanced to qualifying municipalities by the Authority and repayments of principal are made by the municipality; however, the interest is paid by the Province of Alberta. Included in the balance of loans to local authorities at December 31, 2004 is principal of $5,536 (2003 - Nil), upon which, interest of $122 (2003 - Nil) has been recorded in interest income from loans.

The Authority has no employees. Included in administration and office expenses of $638 (2003 - $497) is the amount of $331 (2003 - $287) that was paid to the controlling shareholder, Province of Alberta for goods and services at prices which approximate market.

8. **Derivative Financial Instruments**
Derivative financial instruments used by the Authority include all interest rate swaps and forward rate agreements. The Authority enters into derivative financial instruments for risk management purposes and does not act as an intermediary in this market.

The interest rate contracts are used to manage exposure to fluctuations in interest rates in certain fixed rate loans and related debt made after January 1, 2004.

Notional amounts represent the amount to which a rate is applied in order to calculate the exchange of cash flows. The notional amounts are not recorded in the Balance Sheet. They represent the volume of outstanding transactions and do not represent the potential gain or loss associated with the market risk or credit risk of such instruments.

The notional amounts of derivative financial instruments are summarized as follows:

As at December 31, 2004

Maturities	Within 1 Year	1 to 2 Years	3 to 5 Years	6 to 10 Years	Over 10 Years	Total
Interest rate contracts						
Interest rate swaps	$ 302,000	$ –	$ 46,713	$ 162,251	$ 647,196	$ 1,158,160

The cost of replacing the remaining cash flows of the derivative financial instruments at the prevailing prices and market rates are summarized as follows:

As at December 31, 2004

			Current Replacement Cost	
Maturities	Notional Outstanding	Net Fair Value	Favourable Position	Unfavourable Position
Interest rate contracts				
Interest rate swaps	$ 1,158,160	$ (3,595)	$ 12,308	$ (15,903)

Fair values are determined using pricing models which take into account current market and contractual prices of the underlying instruments, as well as time value and yield curve or volatility factors underlying the positions. Fair values have been segregated between those contracts which are in a favourable position (positive fair value) and those contracts which are in an unfavourable position (negative fair value).

Current credit exposure is limited to the amount of loss that the Authority would suffer if every counterparty to which the Authority was exposed were to default at once and is represented by the current replacement cost of all outstanding contracts in a favourable position. The Authority actively monitors their exposure and minimizes credit risk by only dealing with counterparties believed to be credit worthy.

9. Interest Rate Risk

Interest rate risk refers to the potential impact of changes in interest rates on the Authority's earnings when maturities of its financial assets are not matched with the maturities of its financial debt. The following table summarizes the carrying amounts of the Authority's interest sensitive assets and liabilities based on the earlier of contractual repricing or maturity date:

As at December 31, 2004

Maturities	Within 1 Year	1 to 2 Years	3 to 5 Years	6 to 10 Years	Over 10 Years	2004 Total	2003 Total
Assets							
Cash	$ 23,025	$ –	$ –	$ –	$ –	$ 23,025	$ 2,308
Accrued Interest Receivable	121,988	–	–	–	–	121,988	128,189
Loans	492,157	365,899	1,134,089	1,054,102	1,103,958	4,150,205(i)	3,940,658(i)
Effective Rate	6.5%	10.5%	9.1%	7.5%	6.2%	7.2%	7.8%
Total	$ 637,170	$ 365,899	$ 1,134,089	$ 1,054,102	$ 1,103,958	$ 4,295,218	$ 4,071,155
Liabilities							
Accrued Interest Payable	$ 56,329	$ –	$ –	$ –	$ –	$ 56,329	$ 52,646
Debt	725,502	395,396	925,200	1,246,795	918,883	4,211,776	3,972,479
Effective Rate	7.2%	9.9%	9.9%	5.6%	5.7%	7.3%	8.1%
Total	$ 781,831	$ 395,396	$ 925,200	$ 1,246,795	$ 918,883	$ 4,268,105	$ 4,025,125
Net Gap	$ (144,661)	$ (29,497)	$ 208,889	$ (192,693)	$ 185,075	$ 27,113	$ 46,030

(i) This total is not reduced by unamortized discount of $14,385 (2003 - $23,560).

The Authority 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 Authority's surplus position. For loans made after January 1, 2004, the Authority uses financial derivative financial instruments to swap fixed rate loans interest to floating, and swap corresponding debt from fixed rate to floating and use forward rate contracts to minimize the exposure related to the mismatch of reset dates of the loan and debt swaps.

10. Fair Value of Financial Instruments

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

Fair value represents the estimated consideration that would be agreed upon in a current transaction between knowledgeable, willing parties who are under no compulsion to act. For loans and debt, fair value is calculated using net present value techniques where the Authority's future cash flows are discounted at the Authority's current cost of funds.

Changes in interest rates are the main cause of changes in the fair value of the Authority'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:

	2004		2003	
	Fair Value	Book Value	Fair Value	Book Value
Loans, including accrued interest receivable	$ 4,737,552	$ 4,257,808	$ 4,571,827	$ 4,045,287
Debt, including accrued interest payable	$ 4,704,483	$ 4,268,105	$ 4,505,138	$ 4,025,125

Fair value of derivative financial instruments is provided in Note 8.

11. Commitments

Lease
The Authority has obligations under an operating lease for the rental of premises at an annual minimum amount of $25, expiring in July 2008.

Credit Commitments
In the normal course of business, the Authority enters into loan commitments to provide customers with sources of credit.

Commitments to extend credit represent undertakings to make credit available in the form of loans for specific amounts and maturities, subject to certain conditions and are recently authorized loans not yet drawn down.

These loan arrangements are subject to the Authority's normal credit standards and collateral is obtained where appropriate. The loan amounts represent the maximum credit risk exposure to the Authority should the loans be fully drawn. These arrangements will most likely be drawn upon; the loan amounts represent future cash requirements. Loan commitments as at December 31 were:

	2004	2003
Loan commitments as at December 31	$ 28,600	$ –

12. Budget

The 2004 budget was approved by the Board of Directors on November 24, 2003.

Schedule of Debt

As at December 31, 2004 — Schedule 1

(thousands of dollars)

Maturity Date	First Extendible Date	Interest Rate	Principal Outstanding	
Canada Pension Plan Investment Fund (Note 5(b))				
Nov 01, 2005		11.660	$ 283,604	
Nov 03, 2006		9.850	395,396	
Nov 02, 2007		9.660	335,383	
Oct 03, 2008		10.040	259,294	
Oct 02, 2009		9.990	291,414	
Nov 01, 2009		9.620	32,457	
Dec 01, 2009		9.260	6,652	
Oct 01, 2020		6.280	222,367	
Jun 01, 2022		6.060	100,000	
Apr 05, 2023		5.890	50,000	
Dec 01, 2023		5.500	150,000	
Dec 03, 2024		5.180	78,000	
Total			2,204,567	
Public				
Jun 01, 2005		4.600	140,000	
Jun 15, 2009	Jun 15, 2005	4.000	40,000	(i)
Jun 21, 2009	Jun 21, 2005	4.000	40,000	(i)
Sep 15, 2009	Sep 15, 2005	3.000	10,000	(i)
Mar 01, 2010		4.550	50,000	
Jun 15, 2010	Jun 15, 2005	4.550	10,000	(ii)
Jun 15, 2010	Jun 15, 2005	3.500	15,000	(i)
Jun 23, 2010	Jun 23, 2005	4.000	30,000	(i)
Aug 20, 2010		4.500	150,000	
Jun 21, 2011	Jun 21, 2005	4.300	22,000	(i)
Sep 01, 2011		5.700	200,000	
Dec 15, 2011		4.435	50,000	
Jun 01, 2012		5.850	500,000	
Jun 23, 2012	Jun 23, 2005	4.000	40,000	(i)
Dec 02, 2013		5.000	300,000	
Sep 15, 2014	Sep 15, 2005	4.050	15,000	(i)
Dec 15, 2014	Dec 15, 2005	4.000	25,000	(i)
Dec 15, 2014	Dec 15, 2005	4.300	30,000	(i)
Jun 01, 2015		4.900	200,000	
Jun 01, 2018		5.150	100,000	
Jun 23, 2019	Jun 23, 2005	6.000	25,000	(ii)
Dec 01, 2023		5.100	20,000	
Total			2,012,000	
			4,216,567	
Net unamortized discount			4,791	
Total debt 2004			$ 4,211,776	
Total debt 2003			$ 3,972,479	

(i) These are step-up notes extendible at the Authority's option which pay interest periodically at a predetermined rate with principal paid on termination.

(ii) These are accrual notes extendible or callable at the Authority's option which accrue interest semi-annually and pay interest and principal on termination.