

# Credit Analysis

## Moody's International Public Finance Regional and Local Governments

May 2009

### Table of Contents:

Summary Rating Rationale	1
Rating Outlook	2
Issuer Overview	2
Key Rating Considerations	2
The Crisis of the 1990s	2
Financial Position and Performance	3
Debt Profile	5
Governance and Management Factors	6
Economic Fundamentals	9
Operating Environment	12
Institutional Framework	12
Rating History – Issuer rating	14
Appendix 1. Economic crisis of the 1990s	15
Appendix 2: The fishing industry today	16
Appendix 3: Division of responsibilities between the Faroe Islands and Denmark	18
Annual Statistics	19
Moody's Related Research	25

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## Faroe Islands

Denmark

### Summary Rating Rationale

The Aa2 issuer and foreign currency debt rating with stable outlook for the Faroe Islands reflects a Baseline Credit Assessment (BCA) of 5 (on a scale of 1 to 21, where 1 represents the lowest credit risk) and a high likelihood that the Kingdom of Denmark (Aaa, stable) would act to prevent a default by the Islands.

The Faroe Islands' BCA of 5 reflects a number of factors, including the strength and increasing diversification of the economy. The BCA also reflects the government's powers to raise revenues through taxation and fees and ability to control spending as shown by the strong financial results achieved since 1995. The Faroe Islands maintains ample reserves while the debt level interest burden are moderate.

The final rating takes into account the Islands' relationship with the Kingdom of Denmark and the funding it receives for "Joint Matters", which it administers in conjunction with the Kingdom of Denmark. The support (see below) also takes into account the settled relationship the Faroese have established with Denmark regarding further autonomy and potential independence.

This Credit Analysis provides an in-depth discussion of credit rating(s) for Faroe Islands and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on Moody's website. [Click here to link.](#)



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## Faroe Islands

## Rating Outlook

The outlook for the Faroe Islands' Aa2 rating is stable, reflecting its robust management of Home Rule responsibilities and the orderly process being conducted with Denmark vis-à-vis autonomy and potential independence.

## Issuer Overview

The Faroe Islands is a self-governing country within the Kingdom of Denmark. Located in the North Atlantic, its closest neighbours are the United Kingdom and Iceland. It consists of 18 islands and has a population of 48,350. The great distance to Denmark — 1,300 kilometres to Copenhagen — has allowed the Faroese to preserve their distinct language<sup>1</sup> and culture.

The long distance from Denmark has also influenced the political relationship between the two countries. The Faroe Islands has historically been a special jurisdiction within the Kingdom of Denmark. Since 1947, the potential for Faroese independence has been an important political issue in both Denmark and the Islands. In 1948, the Faroe Islands was granted Home Rule, which allows matters of common concern to be assigned wholly or partly to the Faroese government. In 2005, an act of the Danish Parliament<sup>2</sup> supplemented the Home Rule Act and granted the Faroe Islands the authority to take over all matters except those related to full independence.<sup>3</sup> In the Faroese elections of January 2008, independence received relatively little attention, indicating that the relationship with Denmark — including consideration of further steps towards independence — is in a period of stability.

The Faroe Islands is an independent area within the Kingdom of Denmark with regard to customs, excise duties and taxation. When Denmark entered the European Community in 1973, the Faroese Parliament (Løgting) voted unanimously against joining. The Faroe Islands has instead established a separate trade agreement with the EU and negotiated agreements with other countries for trade and fishing rights. The currency of the Faroe Islands is the Faroese króna, a version of the Danish krona issued by the Danish National Bank.<sup>4</sup>

## Key Rating Considerations

### The Crisis of the 1990s

The financial crisis of the 1990s and the response of the Faroese and Danish authorities provide the backdrop for the reforms that followed. The Faroese economy's dependence on fishing proved the need to balance commercial incentives for efficiency with greater diversification and tighter management of stocks. Indeed, the crisis prompted a drive for increased diversification in the economy as a whole as well as leading to the introduction of tighter fiscal controls on governmental spending and the establishment of substantial reserves.

Moral hazard within the Faroese economy and the national accounts has been substantially reduced by fixing the level of subsidies from Denmark. Further steps to autonomy are clearly linked to self-sufficiency. After more than a decade of prudent management, these measures have largely proven successful. The economy has stabilised and grown, with similar results for governmental finances. Further growth and stability, if not independence itself, depend on maintaining the fine balance of fiscal, commercial, political and environmental policies in the Parliaments of Tórshavn and Copenhagen.

<sup>1</sup> Faroese is a West Nordic language, closely related to Icelandic and Norwegian.

<sup>2</sup> Act No. 91/2004 and reflected by the Faroese parliament under *Acts of Assumption of Fields of Responsibility, Act 79 12 May 2005*.

<sup>3</sup> The following Joint Matters are inalienable to the Kingdom of Denmark and are excluded from the process of increasing autonomy and potential independence: the Danish Constitution, Danish internal affairs, the Danish Supreme Court, foreign affairs, security and defence policies, currency and monetary policy. The division of responsibilities under this 2005 agreement is discussed further under *Institutional Factors* and in Appendix 4, *Division of Responsibilities between the Faroe Islands and Denmark*.

<sup>4</sup> Faroese krona is issued in notes. Coins in circulation are Danish krona.

## Faroe Islands

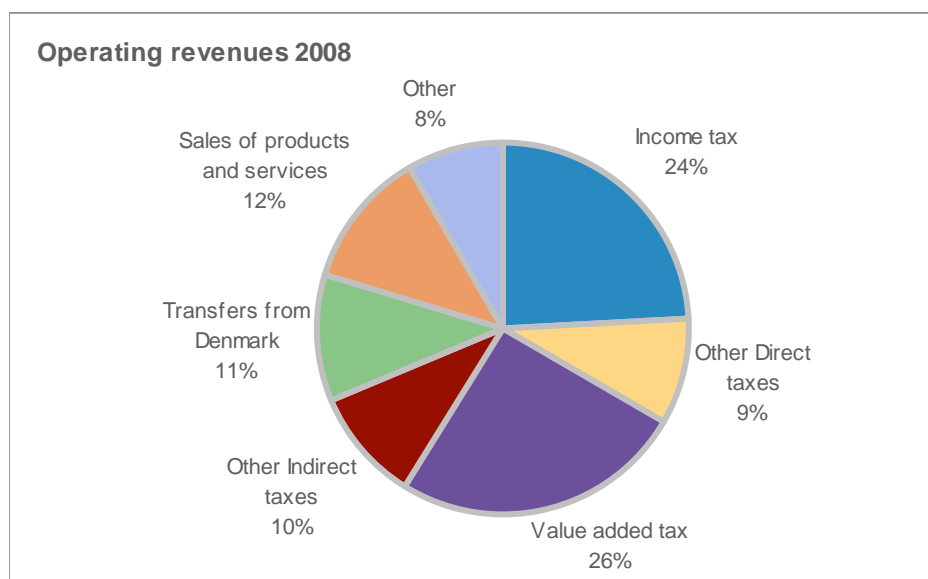
## Financial Position and Performance

### Revenues

The government finances of the Faroe Islands have benefited from the steadier economy and a stable regime for subsidies from Denmark. Between 2003 and 2005, operating income fell by 1-2% annually, but increased by 11% in 2006 and 7% in 2007. Growth slowed significantly in 2008 and operating income was the same as in 2007.

As shown in Figure 1, the DKK5.5 billion of operating income of the national government is widely distributed by source. The majority (89%) of operating revenues come from economically-driven taxes, which are under the control of the Faroese government. The remaining 11% are transfers from the Danish government, a distribution that has been stable for the past five years. In spite of this apparent diversity, revenues still depend on a variable economy (see Economic Fundamentals below, and Appendix 3, *The Fishing industry today*).

**Figure 1**



### Block grant from Denmark remains a key source of funding

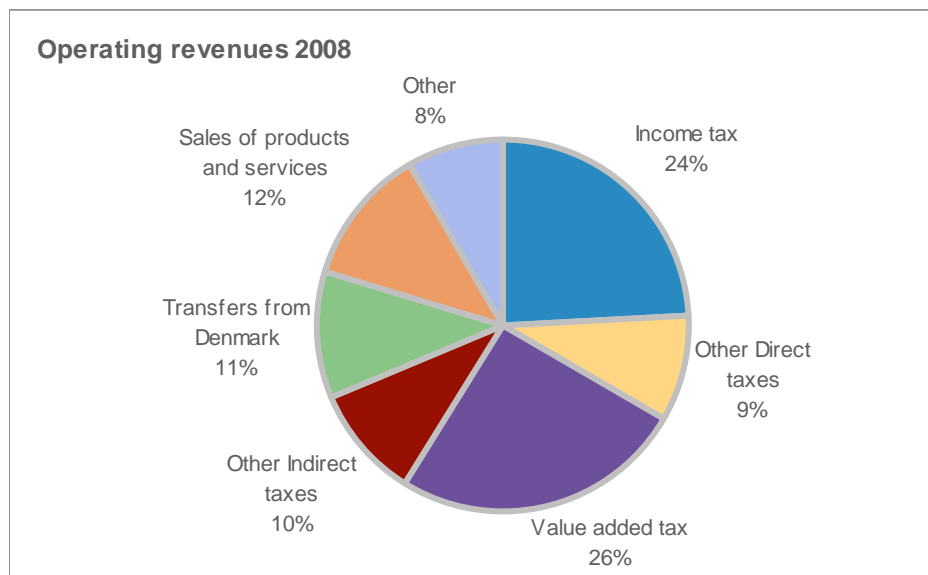
The annual block grant from Denmark was set in 2002 at DKK615.5 million. The Danish government spends another approximately DKK280 million in the Faroe Islands on matters under Danish control, such as public order and judicial administration. These amounts do not appear in the Faroese budgets. (See Institutional Factors (below) for the division of responsibilities between the Faroe Islands and Denmark.)

### Expenses

In 2008, operating expenditure was DKK5.6 billion, with the major components as shown in Figure 2. Between 2002 and 2006, operating expenses showed growth of 1.5-2.5% per year. However, in 2007 and 2008, the operating expenses grew very rapidly at 8.4% and 8.9%, respectively, which was substantially above the growth in operating income in 2008. However, the growth in expenses can partly be explained by the fact that the CPI increased 6.7% in 2008.

## Faroe Islands

Figure 2



### Gross operating balances have been volatile, but generally positive

Gross operating balances have fluctuated widely, due to the volatility of revenues. The surplus of 9.8% in 2002 gradually fell to a deficit of 0.5% in 2005, only to rise to 8.0% in 2006 and 6.9% in 2007. In 2008, there was a deficit of 1.2%, which was due to a conscious political decision to keep public spending up even as the economy slowed down. This policy will continue in 2009 and the budget indicates an operating deficit of approximately 5%. This is based on a small decrease, 0.8%, in operating expenses, but it is anticipated that revenues will fall by approximately 4.4%. (See Governance — Fiscal Management (below) for a discussion of budgeting practices, which contribute to balancing the budget across periods of economic volatility.)

The outlook for 2010 is even more challenging and it is anticipated that the deficit could increase. The government is considering proceeding with investment plans that could provide fiscal stimulus, and the Faroe Islands have ample reserves. However, such investments will draw down economic cushions within governmental finances, for which the longer-term benefits may not be clear. (See Economic Fundamentals (below) for further discussion.)

### Investments

To support the diversification of the economy, the Faroe Islands has emphasised investments in communications and transport. Direct government investment is expected to continue at a baseline of around DKK200 million per year, with planned amounts for 2009 and 2010 somewhat higher. Approved spending levels are generally inflexible, so projects must be frequently reprioritised to keep within this budget constraint.

For larger projects that would strain the annual budget process, the Faroese government also relies on alternative funding sources, such as the Faroese Infrastructure Investment Fund, which will be used for the airport runway extension. The government will also fund investments through special purpose corporations, with the Faroese government as shareholder and debt from private lenders.

Spending from the Investment Fund and special purpose corporations is accounted separately from the national government's budget.

## Faroe Islands

## Debt Profile

The debt burden of the Faroese government has fallen to moderate levels since the financial crisis. In 2006, net debt was reduced by almost 20%, to DKK3.5 billion, and has essentially stayed the same since then. As a result, net debt as a percentage of total revenues decreased at year-end 2008, to 65% of operating revenues, compared to 96% in 2005.

As a percentage of total revenues, net debt in 2008 was 59% of total revenues, which is remarkably lower than the level seen as a result of the financial crisis in the 1990s. Then, the cost of nationalising two of the Faroe Island's largest banks, funding reserves and managing structural deficits in the budget pushed debt as high as DKK7.3 billion in 1995 (263% of total revenues), of which the largest part was provided by the Danish government.<sup>5</sup>

By 1997, the debt to the Kingdom of Denmark was DKK5.8 billion. In 1998, Denmark and the Faroese government agreed to restructure these obligations. Short-term maturities were extended into approximately 20-year annuity repayments. The Danish government also forgave some DKK900 million and agreed to convert DKK500 million into a non-interest bearing, non-maturing loan, which the Faroese will repay with interest if oil is found within its economic zone before 2018.<sup>6</sup>

The Faroese government has since repaid all of its interest-bearing debt to the Danish state. The Faroese government now issues bonds on the Faroese securities market within OMX Nordic Exchange Iceland. Average debt maturity is approximately 3.5 years.

Municipalities are estimated to have DKK0.7 billion of debt outstanding as of 2007; this is not counted within the national government's accounts. The municipal debt burden varies widely, with some municipalities having a net debt of DKK60,000 per inhabitant while others have modest debt or no debt at all. For those with high debt burdens, interest and repayments comprise a large part of their municipal budgets (see *Institutional factors* below for further discussion).

## Liquidity

Landsbanki Føroya, which administers the loans and borrowings of the Treasury, maintains an overdraft facility of DKK440 million with Nordea (Aa1, stable), which can be used for short-term liquidity.<sup>7</sup> The Faroese government also has a repurchase facility, which can draw 90% (DKK0.6billion) against the security of Danish treasury bonds and Danish mortgage bonds, held in the DKK1.4 billion Liquidity Fund (see *Governance*). The Faroese government may tap this facility, equal to 29% of total annual expenses, within 24 hours.

## Guarantees

The financial crisis led the Faroese government to reform its economic policies by curtailing guarantees for industries and, for the past 15 years, offering no new guarantees. Today, the only outstanding guarantees are for debt of Faroese municipalities borrowed from the Danish specialised lender KommuneKredit (Aaa, stable) and which are matched with guarantees by the Kingdom of Denmark.

## Pensions

The Faroe Islands is following the lead of other Scandinavian countries by preparing for the future cost of supporting its gradually ageing population. As seen below, the proportion of elderly people within the population is expected to grow to 25.7% in 2050 from 13.6% in 2007. Over the same period, the proportion of working age people will decrease to 49.3% from 55.8%, while the proportion of young people will fall to 25.7% from 30.6%.

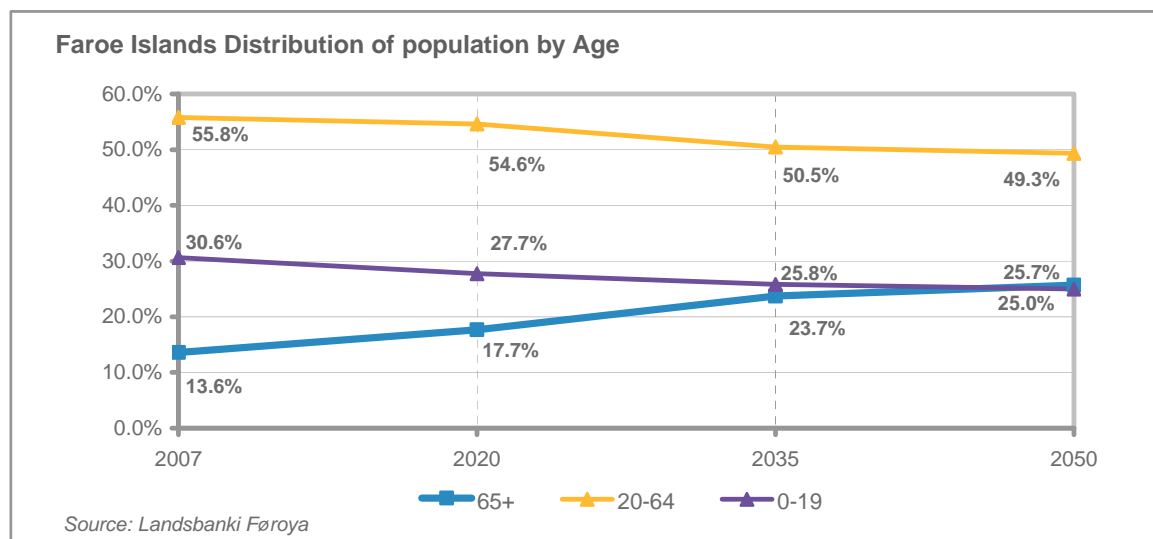
<sup>5</sup> Føroya Banki and Sjóvinnubankin.

<sup>6</sup> The DKK500 million loan will be written off after 2018, if no oil is found.

<sup>7</sup> There is no adverse change clause and the money is available instantaneously.

## Faroe Islands

Figure 3



Currently, there are unfunded pensions liabilities of approximately DKK2.0 billion; amounts to close this deficit are covered within the yearly budget. To fund future pension costs, the Faroese government is moving to pre-funding its public and private pension systems from a pay-as-you-go system.<sup>8</sup> Landsbanki Føroya has responsibility for the supplementary pension fund (or "AMG") established by law. As of 2008, this fund totalled DKK640 million in diversified investments, in line with the requirements of Danish law.

## Governance and Management Factors

As its autonomy has increased, the Faroe Islands has built up its institutions to manage the expanding range of revenue, spending, economic and risk-management decisions.

The Faroese Parliament, the *Løgting*, is the legislative assembly for Faroese affairs and consists of 33 MPs. It appoints the Prime Minister (*Løgmaður*), who, with his/her cabinet ministers, constitutes the Faroese government (*Landsstýri*). The most recent election took place on 19 January 2008; however, the coalition that took power imploded in September 2008. Still, it was possible to form a new coalition without a re-election, and on 26 September 2008, Kaj Leo Johannesen from the unionist party was appointed as the new Prime Minister.

In addition to electing the *Løgting*, the Faroes elect two representatives to the Danish Parliament. The Faroese head of state is Queen Margrethe II of Denmark.

Faroese internal politics has historically been stable and, in line with other Nordic countries, based on consensus. Most elections take place as planned, every four years. No party can achieve a political majority on its own. Coalition governments create a base for timely and orderly consideration of key national issues. Changes in economic policy are usually measured and specifically related to managing the fishing industry. Both governing and opposition parties broadly endorse the need for fiscal discipline, as a legacy of the 1990s. Moody's does not anticipate any significant weakening of fiscal or economic policies from the new coalition in power since September 2008.

<sup>8</sup> The private pension fund is being created with 15% of personal income (shared between employer and employee); this scheme was implemented in the public sector, which pays the whole 15% on behalf of their employees.

## Faroe Islands

### Fiscal management

One of the key results of the crisis of the 1990s is that the path for greater autonomy and potential independence has been aligned with prudent management of government finances. As agreed with Denmark, the Faroese government must finance any budget deficits from its own resources. Following the crisis, the Faroese government accepted restrictions on borrowing and on issuing guarantees; these restrictions continued until 1998. In general, the Faroese government's budget policy has limited spending to prudent increases over prior-year budgets, rather than being re-based to consume windfall revenues from boom years in the economy. In this way, periods of economic growth create multi-year surpluses, whilst government service and spending levels remain stable.

No formal targets for future surpluses have been established. Plans to build up the National Savings Fund (see below) will, however, require surpluses of approximately DKK100-200 million per year. Maintaining these and other reserves — and potentially increasing them — has broad consensus across the major political parties. Debate focuses largely on how much they should increase from their already healthy levels.

The Parliament is the central appropriation authority. The Minister of Finance presents the Government Budget Proposal for the next fiscal year to Parliament before October.<sup>9</sup> Parliament must then approve the budget before the beginning of the budget year.

The budget may be revised two to three times annually and is always revised in the early autumn, when the proposal for the following year's budget is presented.

### Role of liquidity fund within government finances

The 1995 Act on the Treasury's deposits and loans in the Landsbanki requires the government to maintain a liquidity reserve (often referred to as the "Liquidity Fund") of 15% of GDP, equal to DKK1.78 billion in 2009. These amounts are deposited with Landsbanki Føroya to meet immediate shortfalls, to provide liquidity for debt repayments and, if required, to serve as bridging funds to smooth deficits over a multi-year period. As of 31 March 2009, the total deposits with Landsbanki were DKK2.1 billion, equal to 37% of operating expenses.

### Other funds

The Danish authorities set up an Investment Fund in 1964, which has since come under Faroese control.<sup>10</sup> It currently holds almost DKK800 million of assets, of which approximately half represent infrastructure loans to national or municipal governments or companies contracted for capital works.<sup>11</sup> These loans may be long-term, and to date have always been repaid. The balance of liquid funds is deposited with Faroese banks.

The Faroese government is also building up an unemployment compensation fund, currently valued at approximately DKK670 million. These amounts are invested largely outside the Faroe Islands. Neither the Investment Fund nor the Unemployment Fund appears on the government's balance sheet, as these funds are not directly accessible by the government for spending within the national budget. They may, however, purchase government bonds or invest in Faroese bank deposits, therefore supporting broader liquidity within the budget and the banking system.

The pension fund has risen to approximately DKK640 million (see Pensions (above)).

Together, the funds totalled approximately DKK4.2 billion at 13 March 2009, equal to almost 35% of GDP or 67% of total costs (2008).

<sup>9</sup> The budget year follows the calendar year.

<sup>10</sup> The fund was originally capitalised by Denmark. The fund is now governed by a board appointed by the Minister of Finance of the Faroe Islands.

<sup>11</sup> The investment fund has loans to the undersea tunnel companies, the Faroese Telecom company and municipal electric companies.

## Faroe Islands

### Investment management

The Liquidity Fund is invested abroad to avoid risks correlated with Faroese banks. Investments of the Liquidity Fund are limited to highly-rated banks and to fixed-income securities with little market risk and access to T+1 liquidity. Due to their longer-term spending horizon, other funds, such as the planned National Savings Fund and the supplementary pension fund, may be invested in longer-term securities and up to 20% in shares. The Faroese government does not maintain strict rating thresholds (although it requires ratings for non-Faroese banks). Internal policies, not all of which are formalised in writing, limit counterparty exposures beyond government bonds and Danish mortgage bonds to a maximum of 20%.

### Debt management

As established by a 1978 Act of the Løgting, Landsbanki Føroya is the government's banker. It administers the loans and borrowings of the Treasury and provides economic and fiscal analysis to the government and Parliament.

Since 1994, the government has raised new debt denominated in Danish kroner through medium-term bonds. The relatively short tenors give the Faroese government the option to pay down frequently maturing principal with surpluses or reserves. The relatively short tenors, of course, also incur refinancing risk.

### Transparency and disclosure

The monitoring systems for governmental spending are good, with some improvements pending. However, the detail provided within the annual accounts has not reached the level of other Scandinavian countries. For example, the balance sheet of the national government only lists financial assets, liabilities and working capital, rather than presenting a full range of GAAP-standard accruals.

Nevertheless, the current system of managing against published budgets is a good foundation for improvement. Around 70% of central government spending is updated immediately from general ledger entries; the balance is updated monthly. Income tax receipts are reported as collected. Value Added Tax (VAT) collections are reported quarterly.

The national government is in the process of updating its online accounting systems to consolidate municipal accounts into the national totals every month. The separation of municipal and national accounts is frequently noted as a potential concern in overall economic and fiscal management, especially when more responsibilities and spending are being moved to the municipalities.

### Audits

The auditing system is good and tied to public scrutiny within the democratic process. The President of the Parliament appoints the Auditor General, who heads the National Audit Office (NAO). Each of the four largest parties in parliament chooses a representative for the Audit Committee, on which the Auditor General serves as secretary.

The NAO (or other authorised accountants) ensures that spending remains with budget directives, that there are proper accounting and control systems, and that sound economic management has been applied.

The Auditor General may audit the accounts of the government and entities owned by the government. It may also audit entities receiving any kind of financial support from the Faroese government and audit most public agencies, institutions and government foundations. The Auditor General conducts a performance audit of the results against planned goals. The Audit Committee may require the NAO to prepare reports on an extended performance audit on areas of special interest.

The Audit Committee has the final governmental authority to scrutinise the public accounts and to ensure their compliance with appropriation limits. Each April, the Minister of Finance presents the prior year's public accounts to the Audit Committee. Parliament then approves the accounts, based on the recommendation of the Audit Committee.



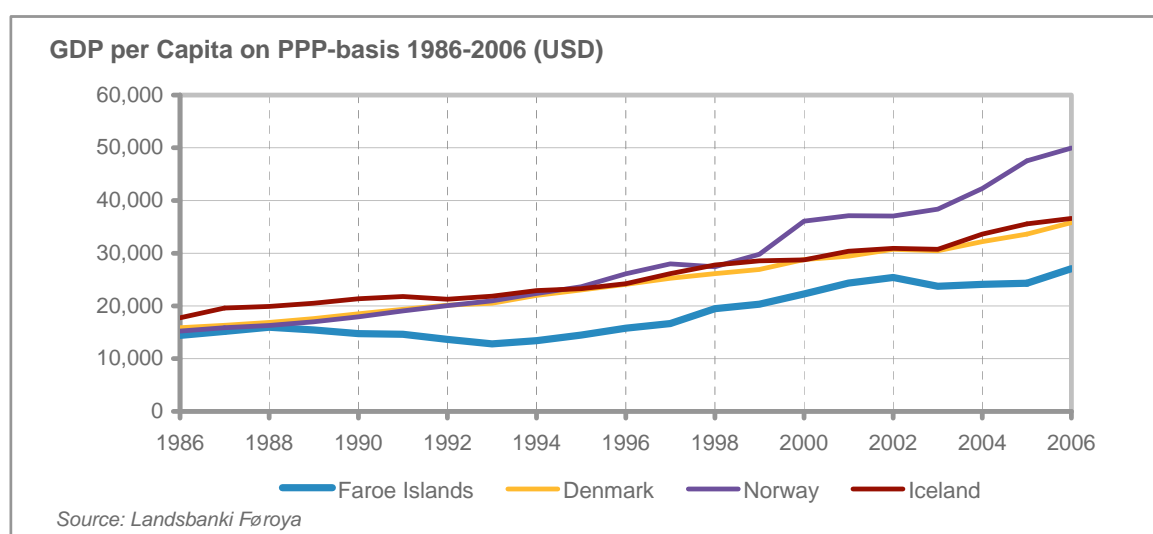
## Faroe Islands

## Economic Fundamentals

Since the crisis of the 1990s, the economy of the Faroe Islands has emerged as modern and market-based, with increasing diversification in its sectors. Economic output has stabilised, albeit at levels of volatility that remain high compared to those of OECD countries, due to the continuing influence of fishing and related industries. GDP per capita<sup>12</sup> for 2006 was US\$27,084, approximately 75% of the level for Denmark, with disposable income at US\$38,847, approximately 80% of Denmark's.<sup>13</sup> Total GDP is estimated at DKK11.9 billion for 2007.

Due to the large role of fishing, economic volatility has historically been higher in the Faroe Islands than in other Scandinavian countries. Since 1986, growth in GDP<sup>14</sup> has had a standard deviation of 6.7% compared to 1.9% for Denmark.<sup>15</sup> Moody's anticipates the continuing dominance of fishing-related industries in the economy will keep volatility relatively high.

Figure 4



The Faroe Islands have a high dependence on agriculture, fishing and quarrying, with fishing making up 14% of GDP. Finance and business activities and manufacturing compose a substantially smaller part of the Faroese economy than they do in Denmark.

Currently, the fishing fleet employs 9% of the workforce and the fish-processing industry 7%, with wages and salaries representing 15% and 6%, respectively, of the national total. Despite the sector's dominance of the economy, total employment in fishing and fish processing industries has registered annual declines since 2004.

The Faroese economy has so far been mostly indirectly affected by the global financial crisis. The economy relies on fish exports. In 2007, the volume and the value of the catch decreased, while volumes remained stable in 2008, but the value of the catch continued to decrease. Prices have declined, particularly for higher value catch, due to the economic downturn in the export markets; the lower volume may partly be due to high fishing volumes in the past years.

The decreasing revenues from fishing limit the room to manoeuvre in any fiscal stimulus plan. The Faroese reserves allow it to run a limited deficit, but the current situation could worsen and eventually increase the need for funds that would support longer-term re-adjustments in the economy and government finances.

<sup>12</sup> On an estimated PPP-basis.

<sup>13</sup> Income and GDP as a % of Denmark is an average of the past three years.

<sup>14</sup> Measured on a PPP basis, estimated by Landsbanki Føroya.

<sup>15</sup> Source: Landsbanki Føroya.

## Faroe Islands

Managing the fishing industry, the result of a fine balance of economic policies within a democratic-political framework, may be a particular challenge during the global crisis. No other Faroese industry has the scope to offset the loss income from fishing, at least for the foreseeable future. This makes the balance of income and jobs today versus a more secure long-term resource in the future even more critical. A deepening rift between industry quotas and sustainable fishery management can raise the risks factor for economic growth and could be a warning sign of future fragility for the economy and government finances.

### Trade

The dependence on fishing and fish farming is most visible in exports, with fish and fish products making up 94.3% of their total value in 2007.<sup>16</sup> (For further discussion of the management of the Faroese fishing industry, see Appendix 3, *The fishing industry today*.)

Historically, swings between trade deficits and surpluses begin with large imports of goods and equipment for investment. As this investment boosts production capacity, exports increase, thus rebalancing trade and driving surpluses. Given that the production of fishing-related industries may increasingly be constrained by the supply of fish, any self-correcting flows of imports and exports could depend on further progress in expanding other sectors of the national economy. Given the stagnation of exports since 2002 and the increasing trade deficit, a substantial decline in the value of fishing-related exports could have a significant impact on the economy.

**Figure 5**

Trade Balance: Faroe Islands									
(Million DKK)	2000	2001	2002	2003	2004	2005	2006	2007	2008
Export	3,857	4,294	4,235	3,913	3,689	3,587	3,869	4,057	4,318
Import	4,163	3,983	3,717	4,677	3,610	4,298	4,483	5,522	5,005
Trade Balance	-306	310	518	-765	79	-711	-614	-1,466	-687
Ships excluded	185	421	636	250	37	-178	-558		

Source: Faroese Statistical office

The exports of the Faroe Islands are geographically diversified, which limits the risk of a market collapse in one particular market. The key trading partners are shown in Figures 6 and 7.

<sup>16</sup> In comparison, Iceland had 42% of its export value from the fishing industry in 2007, a level that has been rapidly decreasing.

## Faroe Islands

Figure 6

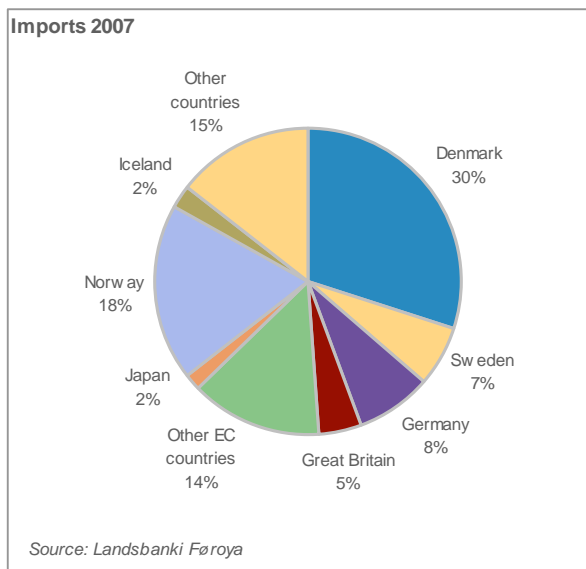
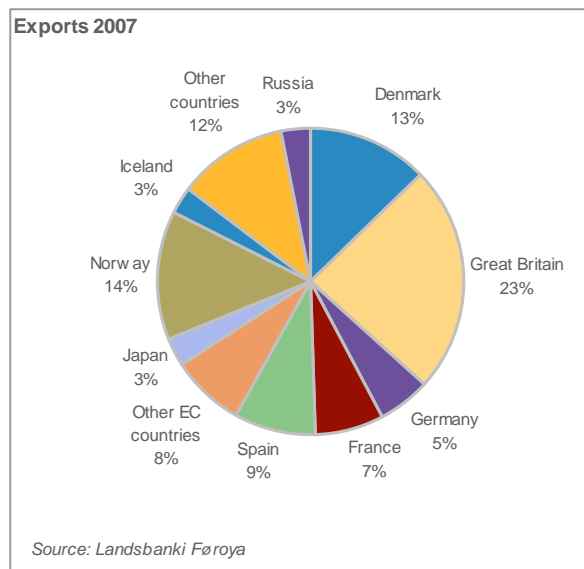


Figure 7



## Labour market

The labour market of the Faroe Islands is somewhat fluid, with shifts between self-employment, employment, unemployment and employment abroad across economic cycles. Employment regulations make it easier for Faroese workers to find work abroad in Nordic and EU countries than it is to attract workers from the more limited pool of Nordic countries alone, so boom times can lead to labour shortages and inflation pressure. As the economy has been buoyant until recently, unemployment stood at 1.1% as late as June 2008, well below the normal range of 2-5%. Since then, unemployment has increased rapidly, and reached almost 3% in February 2009; it is expected to be 4% at the end of the year.

## Oil

On 22 December 1992, the Danish government agreed to transfer mineral rights in the Faroe Islands' subsoil to the Faroese government. Oil reserves (Foinaven and Schiehallion) have been located in UK territory near the Faroese border. After some initial enthusiasm from these finds, accessible reserves within Faroese waters have not yet materialised. The outlook for future activity remains uncertain and the government does not include oil-related revenues, other than from current or planned exploration activity, in its economic and fiscal projections.

## Financial sector

Up until 2007, the major Faroese banks saw significant expansion on the back of the strengthening economy. Four banks — Eik Banki, Føroya Banki (A3/C-/P-2), Norðoya Sparikassi and Suðuroyar Sparikassi — service the financial market in the Faroe Islands. In mid-2007, Føroya Banki was privatised,<sup>17</sup> and Eik Banki (until 2006 Føroya Sparkassi) listed on the stock exchange. Employment in financial services grew by 8% in both 2006 and 2007.

The current crisis has impacted the financial sector, most significantly through higher costs of financing. The banks also have liabilities abroad and have to pay a fee for participation in the Danish public bank packages. As a consequence, margins increased and there was no growth in lending activity in 2008, which will have a lacklustre effect on the rest of the economy. Still, liquidity for the banks is good and Moody's does not anticipate any systemic problems.

<sup>17</sup> Føroya Banki is the result of the 1994 merger of Føroya Banki and Sjøvinnubankin, and has been owned by the Financing Fund of 1992. Since 1998, the Financing Fund has been controlled by the Faroe Islands.

## Faroe Islands

### Population

The Faroe Islands is thought to have been originally settled by persons of both Scandinavian and Irish descent. The last two centuries have seen the population increase to almost 50,000 today from around 5,000 inhabitants in 1801, with the increase attributed to the larger economic base generated by the fishing industry. The net balance of in- and out-migration generally varies with the strength of the domestic economy. This was particularly visible during the crisis of the 1990s when the population decreased substantially, predominantly amongst the working-age segment. In recent years, high growth has seen net in-migration, due to increased consumption and investment in the islands.

The population has been increasingly urbanised due to infrastructure expansion and changes in government policy designed to support regional development over that of the villages. Tórshavn, the capital, has 18,000 inhabitants.

Due to its lack of higher education facilities, the Faroe Islands loses a significant portion of the population aged 20-29 to higher education and job training abroad.

### Connections

There are regular scheduled connections from the Faroe Islands for maritime trade to Denmark and Iceland. The Islands have modern infrastructure with good roads and many tunnels, which have helped integrate and urbanise the population centres under the regional development policy. Inter-island ferries operate on all major routes. The only airport on the Islands, Vagar Airport, reports over 200,000 passengers per year. At four times the national population, this figure underscores the good international connections of the Faroese people and their participation in the international economy.

### Operating Environment

The World Bank does not evaluate the Faroe Islands in its Government Effectiveness Index. Moody's believes that the governmental effectiveness of the Faroe Islands, its promotion of the rule of law, resistance to corruption and respect for governmental institutions owe much to the cultural, institutional, and historical ties to Denmark<sup>18</sup> and its North Atlantic neighbours, with levels comparable to those in OECD countries.

### Institutional Framework

Under the Home Rule agreements with the Kingdom of Denmark, the Faroese government enjoys broad latitude in raising revenues and setting spending. The Faroe Islands has two seats in the Danish Parliament. This has arguably contributed to a more active consideration of the Islands' interests — sometimes with considerable benefit — within the political dialogue of the Kingdom than its small size might suggest.

### Revenue flexibility

There are few legal limits on the Faroese government's ability to generate revenues. It can set its own rates for personal income taxes, VAT, import duties, corporate tax rates and other charges. These make up 87% of governmental revenues. The Faroes Islands may set fees for services as it sees fit. Current policy, like that of other Nordic countries, is to keep fees either to costs or to subsidised levels to meet policy goals, as determined by the democratic process.

One source of revenues with essentially no flexibility — other than downwards — is the annual subsidies from Denmark for "Joint Matters" (see below) that have not been transferred to Faroese control. As these subsidies make up a relatively small portion of governmental revenues (12.9%), revenue flexibility for the Faroese government is relatively high for a sub-sovereign entity. In Moody's view, the fixing of subsidies promotes financial discipline and removes what otherwise would be a constant point of friction in Faroese-Danish relations.

<sup>18</sup> Most civil servants are educated in Denmark and there are obviously intense commercial, cultural and political ties within the Kingdom.

## Faroe Islands

### Expense flexibility

The Faroe Islands has constitutional powers to set costs and to negotiate wages without the need for approval or to follow precedents from Denmark. This flexibility was borne out in the crisis of the 1990s, when the Faroese government cut spending by 5% in 1992 and 10% the following year. However, in the long run, due to expectations of the Faroese as citizens of the Kingdom and due to the need for Faroese businesses to keep workers from migrating to neighbouring countries, wages and standards – which are two large determinants of costs – tend to follow developments in Denmark, albeit at a lower level.

### Flexibility of borrowing

In the 1990s, the Faroese government borrowed — largely from the Kingdom of Denmark under distressed conditions – to fund the nationalisation of Føroya Banki and Sjóvinnubankin and to bridge the government's financial plan from deficits to structural stability. As its finances stabilised in the following years, the Faroese government showed that it can use its powers effectively, by reducing debt even in times of slow growth, such as in 2004 and 2005, and by borrowing without guarantees to repay Denmark.

### Municipal governments have substantial powers

The Faroe Islands is divided into 33 municipalities, with populations ranging between 40 and 19,680 inhabitants. The municipalities have substantial powers with regard to spending and infrastructure investments.<sup>19</sup> In addition, under an agreement with the Faroese national government, they have accepted responsibility for providing children's day care. Faroese municipalities have the right to borrow independently and to maintain debts of up to one year of operating income.

The structure of the municipalities has provoked various calls for reforms. A report published by a parliamentary committee in 1998 suggested there should be seven to nine municipalities, with clearer distinctions between their powers and the role of national government. Since then, the question of merging municipalities — and more tightly controlling their spending — has remained controversial. However, the current government has committed to progress with the mergers, initially voluntarily, but eventually on a compulsory basis.

### Predictability and responsiveness

The current division of responsibilities between the Faroe Islands and the Kingdom of Denmark is stable, with the parties committed to change within a well-defined process. Act No. 91/2004 of the Danish Parliament grants the Faroe Islands the authority to take over all matters, except those related to full independence, without approval from the Danish authorities.

Matters under Faroese control are deemed “Special Matters”. These include finance and the economy, industry, foreign trade and mineral rights, and, since 2002, the educational system. The Faroese Parliament has legislative authority over these issues and the government has full executive power in its administration. Direct taxes and other revenues of the Faroese government fund these responsibilities.

“Joint Matters” are administered by the Danish government according to the laws of the Kingdom of Denmark. Whilst certain Joint Matters are inalienable to the Kingdom of Denmark,<sup>20</sup> some may be wholly or partly assigned to the Faroe Islands, or undertaken by Danish and Faroese authorities jointly. For example, social welfare and health services are administered by the Faroes, while the legislative authority for these matters remains with the Danish government. The full division of responsibilities between the Faroe Islands and the Kingdom of Denmark is shown in Appendix 3.

<sup>19</sup> In 2006, operating expenditure is estimated to have been DKK0.9 billion and investments DKK0.3 billion.

<sup>20</sup> The following Joint Matters are inalienable to the Kingdom of Denmark and are excluded from the process of increasing autonomy and potential independence: the Danish Constitution, Danish internal affairs, the Danish Supreme Court, foreign affairs, security and defence policies, currency and monetary policy.

## Faroe Islands

### Potential independence

Moody's does not see the current path towards potential independence as problematic to the credit. The 2005 agreement with Denmark, which essentially leaves the country's final relationship in the hands of the Faroese, has reduced friction and may have muted the immediate calls for independence. Independence was not a major issue in the recent elections and recent governing coalitions have combined pro-union and pro-independence parties.

Consensus in both the Faroe Islands and Denmark has formed around maintaining an orderly political process with a solid financial foundation. Amongst the Faroese, most views suggest that final steps toward independence, were they to occur, could take about 15 years, as the Islands would gradually assume all of the remaining permitted Joint Matters.

It is not obvious what form final independence would take. Some form of continuing confederation with Denmark has been discussed and it currently appears unlikely that the historically strong political, economic and cultural ties would be cast aside lightly.

Secession of the Faroe Islands from Denmark would require a referendum.

### Rating History – Issuer rating

Faroe Islands		
Date	Rating	Action
12-Feb-08	Aa2	Rating assigned

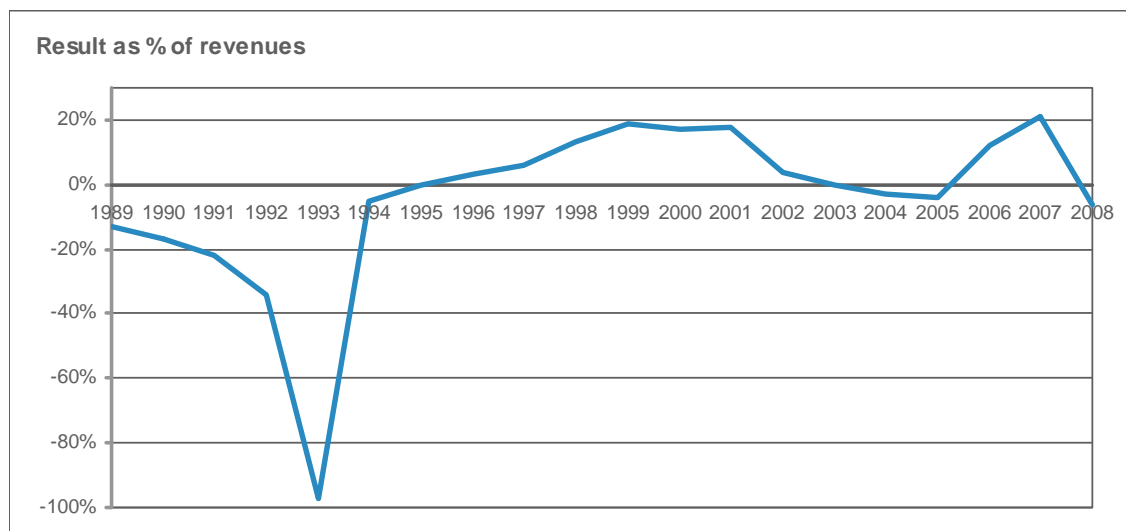
## Faroe Islands

## Appendix 1. Economic crisis of the 1990s

The financial crisis of the 1990s has its roots in the 1970s, with other nations' extension of their national Economic Exploitation Zones. This forced the Faroese fleet out of many of its previous fishing grounds and back to its home waters, as boat owners sought to preserve their capital, fishermen their livelihood and the government the employment of the fleet. In a pattern that has played out in other regions, the forcing of over-capacity into a zone of finite resources resulted in over-fishing, a crash in stocks and the eventual failure of the industry's finances.

In 1992, reforms in fishing practices and the removal of government subsidies promoting over-capacity were carried out. The economy began to stabilise and the government's budget was expected to return to balance. However, by late 1992, the accumulated losses in fishing and its related industries — mainly the shipyards, transport companies and fish farms — drove widespread bankruptcies. The Faroese banks, which had funded previous expansions, were forced to write off huge amounts of loans and were on the brink of failure.<sup>21</sup> The near-collapse of the banking system forced a DKK2.7 billion government bailout through privatisation. In 1993, the national budget recorded a deficit before financing of DKK2.5 billion — 97% of total cash revenues — and unemployment hit 25%.

**Figure 8**



### Legacy of the crisis: reform, accountability and management of scarce resources

The economic crisis in the 1990s led to seven economic agreements between Denmark and the Faroe Islands. These were mostly related to ensuring the survival of two of the largest Faroese banks and to the accumulation of liquidity for the Faroese Treasury. The agreements also required the Faroese government to accept temporary restrictions on its borrowing and on its ability to extend loan guarantees.

The crisis forced a reduction in the Faroese fishing fleet by one-third. Previously, the government had supported the fishing industry, partly to subsidise employment. After this had contributed to over-capacity and inefficiency in the industry — not to mention cost to the government — the Faroese government decided to minimise its involvement in private commercial enterprises. It sharply reduced subsidies and guarantees and, by 1998, subsidies to businesses had been removed altogether. This rebalanced fishing capacity reduced the pressure on fish populations and allowed the recovery of the fish stocks in Faroese waters. Subsequent higher catches and prices for fish restored profits to the industry and growth in the wider economy. In turn, government finances recovered with the resurgence in the large share of economically-sensitive taxes.

<sup>21</sup> Fosbankin, a relatively small bank, was allowed to fail, as it was deemed by the Faroese government that this particular bank would not have a significant impact on the banking system or the economy as a whole. Savings banks, which largely did mortgage lending, weathered the crisis.

## Faroe Islands

## Appendix 2: The fishing industry today

One of the most important results of the financial crisis of the 1990s has been the recognition that the management of the structure of the Faroese fishing infrastructure, and the fishing stocks in home waters, are essential to the long-term viability of the national economy. The crisis forced greater diversification within the industry. A wider range of target species from national, foreign and international fishing grounds has made the total value of the catch less variable. Despite the success of diversification, volumes and price by individual species remain volatile. Additional international cooperation and agreements could further diversify the industry.

Today, the fishing-related industries are diversified in the following way:

### 1. Fishing and fish farming:

- **Fishing in other territorial waters**, based on bilateral agreements between the Faroese government and other governments or agreements with individual fishing companies and countries providing licences.
- **Local ground fishing** on the continental shelf regulated by the Faroese government, undertaken via the method of licences for fishing days.
- **Pelagic fishing** with a relatively new system of quotas based on international quota agreements.
- **Fish farming**, covering seven operators in a licensing system. Fish farming had been a small but growing sector of the fishing industry, but collapsed earlier in the decade due to epidemics in the stock. Production in 2006 stood at less than a third of its 2003 level. Since then the industry has recovered and in 2008, production again approached the levels seen in 2003. The projection for 2009 is that production levels will stay similar as in 2008.

2. **Processing.** Approximately 85% of the catch is caught close to shore and processed on the Faroe Islands. Some production is also conducted directly on bigger Faroese ships. Other elements of the fishing-related industries include machinery and equipment for fishing and fish farming, and computer systems for monitoring fish processing.

The catch does not depend on local waters alone. Some 35% to 40% of the total value of the catch comes from fishing in foreign waters and on the high seas. Most of the fishing in foreign waters involves granting reciprocal rights to foreign countries in the Faroese Exclusive Economic Zone.

At present, the fishing industry relies very little on subsidies, although some indirect measures, e.g. tax breaks for fishermen, have been implemented instead. The goal is profit maximisation and consequently a lower proportion of the population is active in both the fleet and the processing industry.

### Diversification of species within the catch

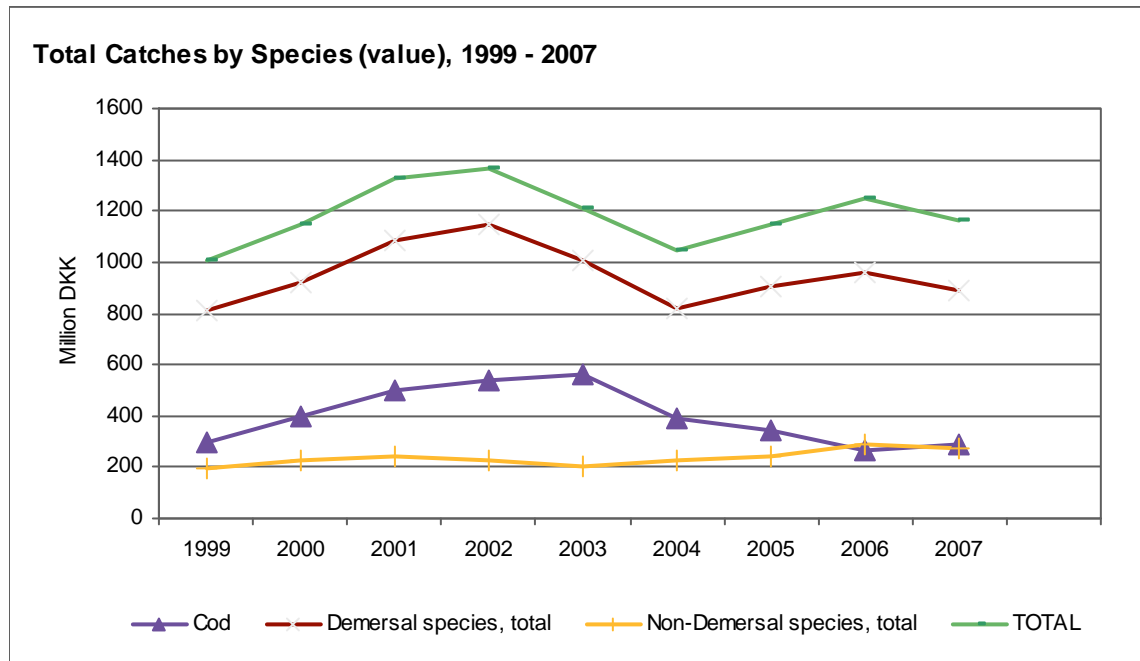
As can be seen in the chart below, up to 2006, in spite of the decline of cod, the total value of the catch has increased in the last two years. The catches of saithe (*Pollachius Virens*) and other demersal species have more than compensated for the decline. Other species, such as monkfish and pelagic fishes, used for fishmeal and oil, have helped spread risk within the Faroese fleet and related industries. However, in 2007 this trend was reversed as the total value of the catch declined. If this was a temporarily setback or a change in the trend remains to be seen.

The economics of even a diversified fishing industry remain challenging. Fish prices have risen in real terms for the past two decades, despite rolling waves of over-fishing in waters around the world and with many grounds being pushed to the barest levels of sustainability or being closed. The total volume of the catch from Faroese waters is expected to decline from current levels, and the total volume of free-catch (non-farmed fish) has been stable globally for many years. In the past inelastic prices for fish over the past two decades – spurred by demand from the expanding Asian economies and shortages of key species – have compensated, and in some cases over-compensated, for declining or vulnerable supplies. However, the current crisis has pushed down prices and economic incentives, even on well-managed fishing grounds, tend to push stocks to stressed levels. This, many scientists believe, makes them much more vulnerable to environmental factors that would normally have modest impacts on fish health levels.



## Faroe Islands

Figure 9



Another significant factor beyond the control of the Faroese is the impact of global warming. Biologically, the phenomenon could affect domestic stocks as well as the key international and foreign catches. Preliminary research on the impacts of a shift south in the Gulf Stream, which now warms Faroese waters, offers mixed implications. Whilst some stocks may suffer, cold-water fish such as cod could benefit.

Global warming may also open northern transport lanes hitherto blocked by Arctic ice. This would bring more ships through the Faroese waters, bringing with them the possibility of accidents and environmental damage — with potentially dramatic impacts on stressed fish populations.

## Faroe Islands

## Appendix 3: Division of responsibilities between the Faroe Islands and Denmark

Figure 14:

### Faroe Islands, division of responsibilities

	Faroese Municipalities	Central Government of Faroe Islands	Danish Government
Childcare	X		
Water & Sewage	X		
Waste management	X		
Planning and zoning	X		
School buildings (maintenance)	X		
Road Maintenance	X	X	
Healthcare		X	
Public Transport		X	
Education		X	
Elderly Care		X	
Social Security		X	
Police Force			X
Judicial system			X
Banking supervision			X

Source: Landsbanki Føroya

## Faroe Islands

## Annual Statistics

## Financial Indicators

DKK million	2003 realized	%	2004 realized	%	2005 realized	%	2006 realized	%	2007 realized	%	2008 realized	%	2009 budgeted	%	2010 budgeted	%
Total revenues [1]	4,810		4,690		4,740		5,750		6,870		5,987		5,369		5,499	
Total expenses [2]	4,790		4,844		4,951		5,075		5,428		6,337		6,171		6,158	
<b>OPERATING REVENUES</b>																
Taxes	3,064	64.6	3,021	65.0	3,047	66.0	3,482	68.1	3,799	69.4	3,759	68.6	3,612	68.9	3,612	68.5
Direct tax	1,577	33.2	1,534	33.0	1,503	32.6	1,676	32.8	1,786	32.6	1,826	33.3	1,805	34.4	1,805	34.2
Indirect tax	1,487	31.4	1,486	32.0	1,543	33.5	1,806	35.3	2,013	36.8	1,934	35.3	1,807	34.5	1,807	34.3
Intergovernmental revenues	810	17.1	804	17.3	793	17.2	781	15.3	814	14.9	816	14.9	789	15.0	792	15.0
From the State (general grants)	659	13.9	673	14.5	661	14.3	658	12.9	668	12.2	652	11.9	672	12.8	672	12.7
From Municipalities and Governmental institutions	152	3.2	131	2.8	132	2.9	123	2.4	145	2.7	164	3.0	117	2.2	120	2.3
Other [3]	868	18.3	826	17.8	774	16.8	850	16.6	862	15.7	908	16.6	841	16.0	866	16.4
<b>Total operating revenues</b>	<b>4,743</b>	<b>100.0</b>	<b>4,650</b>	<b>100.0</b>	<b>4,613</b>	<b>100.0</b>	<b>5,113</b>	<b>100.0</b>	<b>5,475</b>	<b>100.0</b>	<b>5,483</b>	<b>100.0</b>	<b>5,241</b>	<b>100.0</b>	<b>5,270</b>	<b>100.0</b>
<b>OPERATING EXPENSES</b>																
Administrative & Personnel costs	1,632	36.5	1,748	38.2	1,743	37.6	1,775	37.7	1,893	37.1	2,036	36.7	2,170	39.4	2,235	39.4
General expenses	2,654	59.3	2,677	58.5	2,755	59.4	2,878	61.2	3,125	61.3	3,407	61.4	3,220	58.5	3,316	58.5
Interest expenses	191	4.3	151	3.3	138	3.0	51	1.1	81	1.6	109	2.0	118	2.1	122	2.1
<b>Total operating expenses</b>	<b>4,477</b>	<b>100.0</b>	<b>4,577</b>	<b>100.0</b>	<b>4,635</b>	<b>100.0</b>	<b>4,704</b>	<b>100.0</b>	<b>5,100</b>	<b>100.0</b>	<b>5,551</b>	<b>100.0</b>	<b>5,508</b>	<b>100.0</b>	<b>5,673</b>	<b>100.0</b>
Primary Operating Balance	457		225		116		461		456		41		-149		-282	
Gross Operating Balance	266		74		-22		409		375		-68		-267		-403	
Net Operating Balance	-181		-753		-453		-436		327		-1,091		-1,113		-837	

## Faroe Islands

NOK millions	2003	%	2004	%	2005	%	2006	%	2007	%	2008	%	2009	%	2010	%
	realized		realized		realized		realized		realized		realized		budgeted		budgeted	
Gross Operating Balance	266		74		-22		409		375		-68		-267		-403	
<b>CAPITAL REVENUES</b>																
Asset sales	0	0.6	4	10.2	2	1.8	0	0.0	42	3.0	0	0.0	0	0.0	0	0.0
Repayments	66	99.4	36	89.8	124	98.2	636	100.0	1,353	97.0	504	100.0	128	100.0	229	100.0
Interest income	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
Total capital revenues	67	100.0	40	100.0	127	100.0	636	100.0	1,395	100.0	503	100.0	128	100.0	229	100.0
<b>CAPITAL EXPENSES</b>																
Investments	260	83.0	208	77.8	170	53.9	227	61.2	270	82.3	217	27.6	198	25.2	255	52.6
Asset purchases	53	17.0	59	22.2	145	46.1	144	38.8	58	17.7	569	72.4	465	59.1	230	47.4
Other	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0
Total capital expenses	313	100.0	268	100.0	315	100.0	372	100.0	328	100.0	786	100.0	663	100.0	485	100.0
Gross Capital Balance (before Reserve Transfers)	-246		-228		-189		265		1,068		-282		-535		-256	
FINANCING DEFICIT/SURPLUS	20		-154		-211		674		1,443		-350		-802		-660	

## Faroe Islands

## DEBT INDICATORS

DEBT MOVEMENTS	2003	%	2004	%	2005	%	2006	%	2007	%	2008	%	2009	%	2010	%
	realized		realized		realized		realized		realized		realized		budgeted		budgeted	
Gross new borrowings	1,495		750		1,924		0		0		1,023		1,474		424	
Debt repayment	2,201		827		2,001		977		48		1,023		728		434	
Mandatory	448		827		431		846		48		1,023		846		434	
Early	1,753		0		1,571		131		0		0		-117		0	
Change in debt	-706		-77		-77		-977		-47		0		746		-9	
<b>TOTAL BUDGET BALANCE</b>	<b>-686</b>		<b>-231</b>		<b>-288</b>		<b>-303</b>		<b>1,395</b>		<b>-350</b>		<b>-56</b>		<b>-669</b>	

## DEBT STOCK

Direct debt	4,383	65.1	4,136	64.3	4,209	56.7	3,316	54.0	3,368	54.8	3,327	54.2	3,827	--	3,827	--
Short-term	683	10.1	483	7.5	584	7.9	592	9.6	718	11.7	718	11.7	718	--	718	--
Long-term	3,701	55.0	3,653	56.8	3,625	48.8	2,725	44.4	2,649	43.1	2,609	42.5	3,109	--	3,109	--
Guaranteed debt	1,288	19.1	1,488	23.1	1,590	21.4	1,686	27.4	1,797	29.2	59	1.0	59	--	59	--
Indirect debt	1,057	15.7	811	12.6	1,623	21.9	1,141	18.6	1,655	26.9	155	2.5	--	--	--	--
Other	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	--	--	--	--
<b>Total debt</b>	<b>6,728</b>	<b>100.0</b>	<b>6,435</b>	<b>100.0</b>	<b>7,422</b>	<b>100.0</b>	<b>6,143</b>	<b>100.0</b>	<b>6,819</b>	<b>111.0</b>	<b>3,540</b>	<b>57.6</b>	<b>--</b>	<b>--</b>	<b>--</b>	<b>--</b>
of which net debt	4,506		4,233		4,409		3,530		3,578		3,540		3,886		3,886	

## DEBT SERVICE

Interest expenses	191	8.0	151	15.5	138	6.4	51	5.0	81	63.1	109	9.6	118	13.9	122	21.9
Debt repayment	2,201	92.0	827	84.5	2,001	93.6	977	95.0	48	36.9	1,023	90.4	728	86.1	434	78.1
<b>Total debt service</b>	<b>2,392</b>	<b>100.0</b>	<b>978</b>	<b>100.0</b>	<b>2,139</b>	<b>100.0</b>	<b>1,029</b>	<b>100.0</b>	<b>129</b>	<b>100.0</b>	<b>1,132</b>	<b>100.0</b>	<b>846</b>	<b>100.0</b>	<b>555</b>	<b>100.0</b>

## Faroe Islands

## Key Ratios and Indicators

	2003 realized	2004 realized	2005 realized	2006 realized	2007 realized	2008 realized	2009 budgeted	2010 budgeted
<b>TOTAL ACCOUNTS</b>								
Population ( millions )	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Total revenue growth rate [1] (%)	-1.56	-2.49	1.06	21.30	19.49	-12.86	-10.32	2.41
Total expense growth rate [2] (%)	1.96	1.14	2.20	2.52	6.94	16.76	-2.63	-0.20
Total revenues per capita (DKK)	101,052	97,510	98,139	119,533	142,241	123,698	110,930	113,607
Total expenses per capita (DKK)	100,624	100,709	102,498	105,517	112,374	130,934	127,496	127,236
Total tax revenues/ total revenues (%)	63.71	64.41	64.28	60.56	55.30	62.79	67.27	65.69
Total intergovernmental revenues/total revenues (%)	16.85	17.14	16.73	13.58	11.85	13.64	14.69	14.40
Financing deficit/surplus as % of total revenues (%)	0.42	-3.28	-4.44	11.73	21.00	-5.85	-14.93	-12.00
<b>OPERATING ACCOUNTS</b>								
Operating revenues/total revenues (%)	98.61	99.15	97.33	88.93	79.69	91.59	97.61	95.84
Operating expenses/total expenses (%)	93.47	94.48	93.63	92.68	93.96	87.60	89.26	92.12
Tax revenues/operating revenues (%)	64.61	64.96	66.04	68.10	69.39	68.56	68.92	68.54
Intergovernmental revenues (op. related) /operating revenues (%)	17.09	17.29	17.19	15.27	14.87	14.89	15.05	15.03
Primary operating balance/operating revenues (%)	9.64	4.84	2.51	9.01	8.33	0.74	-2.84	-5.35
Gross operating balance/operating revenues (%)	5.62	1.59	-0.48	8.01	6.85	-1.24	-5.09	-7.66
Net operating balance/operating revenues [3] (%)	-3.83	-16.19	-9.81	-8.53	5.98	-19.89	-21.23	-15.89
Financing (deficit/surplus)/operating revenues (%)	0.43	-3.31	-4.56	13.19	26.35	-6.39	-15.30	-12.52
Tax revenues/operating expenses (%)	68.45	66.01	65.73	74.03	74.49	67.72	65.58	63.67
<b>CAPITAL ACCOUNTS</b>								
Capital revenues/total revenues (%)	1.39	0.85	2.67	11.07	20.31	8.41	2.39	4.16
Capital expenses/total expenses (%)	6.53	5.52	6.37	7.32	6.04	12.40	10.74	7.88
Net operating balance/capital expenses (%)	-57.98	-281.48	-143.58	-117.38	99.88	-138.81	-167.85	-172.58

## Faroe Islands

## Key Ratios and Indicators

	2003 realized	2004 realized	2005 realized	2006 realized	2007 realized	2008 realized	2009 budgeted	2010 budgeted
<b>DEBT</b>								
Total debt growth rate (%)	--	-4.35	15.33	-17.23	11.01	-48.08	—	—
Total debt per capita (DKK)	141,340	133,786	153,661	127,718	141,187	73,149	—	—
Total debt /total revenues (%)	139.87	137.20	156.58	106.85	99.26	59.14	—	—
Total debt in yrs of gross operating balance (yrs)	25.25	87.25	-337.83	15.00	18.19	-52.19	-14.56	-9.63
Debt [4] growth rate (%)	--	-5.64	1.77	-21.21	1.55	-1.21	15.03	0.00
Debt per capita	92,082	85,982	87,143	68,946	69,727	68,742	79,072	79,072
Direct Debt/total revenues (%)	91.12	88.18	88.80	57.68	49.02	55.57	71.28	69.60
Total Debt/operating revenues (%)	141.84	138.38	160.87	120.15	124.56	64.57	—	—
Net Debt/Operating Revenues	94.99	91.02	95.56	69.03	65.36	64.57	74.14	73.74
Net Debt/Total Revenues (%)	93.67	90.24	93.01	61.39	52.09	59.14	72.38	70.67
Direct Debt in yrs of gross operating balance (yrs)	16.45	56.07	-191.59	8.10	8.98	-49.05	-14.34	-9.49
Short-term debt/direct debt (%)	15.57	11.68	13.88	17.84	21.33	21.59	18.77	18.77
Interest expense growth rate (%)	-2.50	-20.75	-8.80	-62.73	58.01	33.73	8.64	3.00
Interest expenses/total revenues (%)	3.97	3.23	2.91	0.89	1.18	1.81	2.20	2.21
Interest expenses/operating revenues (%)	4.02	3.25	2.99	1.01	1.48	1.98	2.25	2.31
Debt service growth rate (%)	-0.24	-59.11	118.71	-51.91	-87.48	779.05	-25.21	-34.39
Debt service/total revenues (%)	49.73	20.85	45.13	17.89	1.87	18.90	15.76	10.10
Gross new borrowings/debt (%)	34.11	18.13	45.71	0.00	0.00	30.75	38.51	11.09
Gross new borrowings/debt repayment (%)	333.81	90.70	446.75	0.00	0.18	100.00	174.27	97.84
Gross new borrowings/capital expenses (%)	477.75	280.31	610.32	0.00	0.03	130.17	222.34	87.47
Debt repayment/gross operating balance (%)	168.10	1121.01	-1960.35	206.57	12.67	-1508.14	-316.84	-107.50
<b>BCA SCORECARD RATIOS</b>								
Interest Payments/Operating Revenue (%)	4.02	3.25	2.99	1.01	1.48	1.98	2.25	2.31
Accrual Financing Surplus (Requirement)/Total Revenue (%)	0.42	-3.28	-4.44	11.73	21.00	-5.85	-14.93	-12.00
Gross Operating Balance/Operating Revenue (%)	5.62	1.59	-0.48	8.01	6.85	-1.24	-5.09	-7.66
Net Working Capital/Total Expenditures (%)	15.8	18.8	6.3	16.7	18.9	--	--	--
Net Direct and Indirect debt / Operating Revenue	95.0	91.0	95.6	69.0	65.4	64.6	74.1	73.7
Short-term Gross Direct Debt/Gross Direct Debt (%)	10.1	7.5	7.9	9.6	10.5	20.3	—	—
Net Debt/Operating revenue Trend (05-08)	--	--	1.22	-8.79	-0.15	-8.09	2.11	-0.44
Intergovernmental Transfers / Operating Revenues	13.89	14.47	14.33	12.86	12.21	11.89	12.82	12.75
Real GDP Growth								

## Faroe Islands

Additional Information						
	2003	2004	2005	2006	2007	2008
<b>BALANCE SHEET</b>						
<u>ASSETS</u>						
Current Assets:	2,260	1,824	1,697	1,485	2,765	--
Fixed Assets:	2,643	2,839	2,418	2,474	1,987	--
<b>Total Assets</b>	<b>4,903</b>	<b>4,663</b>	<b>4,115</b>	<b>3,959</b>	<b>4,753</b>	<b>--</b>
<u>LIABILITIES:</u>						
Current Liabilities:	1,502	913	1,384	639	1,742	--
Long-term Liabilities:	2,881	3,223	2,825	2,677	1,626	--
<b>Total Liabilities</b>	<b>4,383</b>	<b>4,136</b>	<b>4,209</b>	<b>3,316</b>	<b>3,368</b>	<b>--</b>
<u>EQUITY:</u>	520	527	-94	643	1,385	--
<b>Total Liabilities and Equity</b>	<b>4,903</b>	<b>4,663</b>	<b>4,115</b>	<b>3,959</b>	<b>4,753</b>	<b>--</b>
<b>RATIOS</b>						
Current assets/total assets (%)	46.09	39.12	41.25	37.52	58.19	--
Liquid assets/short term debt (%)	331.10	377.68	290.55	251.14	384.93	--
Equity/ total assets (%)	10.61	11.31	-2.28	16.23	29.14	--
Equity/total debt	0.00	0.00	0.00	0.00	0.00	--
Equity/debt	11.87	12.75	-2.23	19.38	41.12	--



## Faroe Islands

## Moody's Related Research

### Statistical Handbook

- Non-U.S. Regional and Local Governments, December 2008 (113620)

### Special Comments

- The Application of Joint Default Analysis to Regional and Local Governments, October 2006 (99025)
- Non-US Sub sovereign Cases of Default: Despite Various Potential Default Triggers, Overall Credit Quality Is Solid Albeit Not Risk-Free, December 2002 (76759)

### Rating Methodology

- Local and Regional Governments Outside the US, May 2008 (107844)

*To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.*



**Moody's Investors Service**

## Faroe Islands

Report Number: 117165

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