Housing Financing Fund

Financial Statements
for the year 2010

Housing Financing Fund
Borgartún 21
105 Reykjavík

Reg. nr. 661198-3629

Contents

Endorsement and Statement by the Board of Directors and the Managing Director

Operations in the year 2010

Operating results of the year 2010 are reflected by the economic situation and impairment loss on loans, as Government actions aimed at decreasing debt of over-pledged homes have had considerable effect. The Housing Financing Fund´s loss for the year amounted to ISK 34,513 million according to the income statement. Equity at year-end amounted to ISK 8,569 million according to the balance sheet, taking into account an ISK 33,000 million equity contribution by the Icelandic State, which was paid to the Fund in March 2011. The Fund´s equity ratio, which is calculated on the basis of regulation no. 544/2004 on the Housing Financing Fund, is 2.2%. The ratio is calculated on the basis of the same method as for financial institutions. The Fund´s long term goal is to maintain a equity ratio exceeding 5%. The Fund, in accordance with article 7 of the regulation mentioned above, notified the Minister of Welfare that the Fund’s equity ratio was heading under 4%. The Fund has raised the interest premium in three incremental steps from 0.45% to 0.90% í the year 2010.

At year-end, loans to customers amounted to ISK 751,280 million and decreased by ISK 5,354 million from the previous year. The Fund's borrowings amounted to ISK 826,976 million and increased by ISK 42,406 million during the year.

In the supplementary budget act for 2010 a contribution of ISK 33,000 million from the State Treasury to the Housing Financing Fund was approved, among others due to a pending write-down of individuals' loans down to 110% of the rateable value or value of the assets, and also to strengthen the Fund's equity ratio. The write-down is estimated to apply to around 9,400 homes and amount up to ISK 22,762 million. The calculation of the write-down is based on several premises, of which some are estimates. Therefore, a reservation is made with respect to that the final amount might change.

In December 2010 the lenders of real estate loans reached an agreement on adjustment of real estate loans for over-pledged homes and the Housing Financing Fund is part of this agreement. The Fund has already received 1,200 applications and has started processing the applications.

Difficulties have prevailed over financial markets since fall 2008 and the economic recession has had significant effect on the Housing Financial Fund. The Fund had approximately ISK 16,620 million in claims against Iceland’s three biggest banks by the time they collapsed in early October 2008, resulting from bonds and derivative contracts entered into with the banks. At the same time, the Fund owed these banks ISK 5,342 million due to derivatives and HFF bonds. ISK 1,987 million is recognised in the line item loans to banks in the balance sheet at year end 2010 (see note 8). In the financial statements it is presumed that the Fund has the right to off-set these balances. Uncertainty prevails regarding the settlement of claims and derivatives and the Fund’s right to off-set these balances. During the year 2010, the Fund reached an agreement with SPRON, but there is still a dispute with the Winding-Up Boards of Straumur-Burðarás Investment bank hf., Landsbanki Íslands hf. and Glitnir banki hf. The Fund´s actual loss may therefore differ when final settlement takes place.

Deteriorating economic conditions have significantly affected the operation of the Housing Financing Fund, which mainly manifests in a significant increase in appropriated assets and considerable increase in related management cost, in addition to increase in defaults. Increase in defaults may be attributed to unemployment, income loss and price level increase with consequential wage impairment. Renting associations face pressure to decrease rent but at the same time their loans have increased due to inflation.

Impairment of loans amounted to ISK 38,803 million at year-end 2010, an increase of ISK 35,359 million from the previous year. Impairment of the year is mainly due to write-down of real estate loans to individuals by ISK 22,762 million to 110% of market value of real estate and write-down of loans to legal entities by ISK 6,795 million. Default has increased from previous years but around 6.5% of the Fund’s borrowers have one or more payment past due at year-end 2010. Calculated balance of loans in default in excess of 90 days amounts to ISK 72,979 million at year end 2010.

During the year, the Fund repossessed 854 apartments on foreclosed mortgages and sold 132 apartments. At year-end 2010, the Fund owned 1,069 apartments, an increase of 722 from year-end 2009. At year end 2010, the Fund was renting out 346 apartments and rental income of the year amounted to ISK 202.4 million. Total cost due to repossession and management of apartments on foreclosed mortgages was ISK 81.5 million in excess of rental income on these assets. This is mainly explained by various cost related to repossessing the real estates on auction. Provisions of the Competition Act set restrictions to the Fund with respect to how many properties on foreclosed mortgages the Fund may rent out.

In 2009 around 50% of the Fund´s borrowers took advantage of their right to adjust their payments in accordance with the mortgage payment adjustment index rather than the consumer price index. This means that their payments decrease temporarily and the difference of payments goes into an adjustment account of the loan. The balance of the loan adjustment account at year end 2010 amounted to ISK 3,200 million. According to the newly adjusted law regarding adjustments of mortgage payments for individuals no. 63/1985, the repayment of the adjustment debt, after the original maturity period of the loan, shall not exceed 3 years. Any debt left on the adjustment account after those 3 years shall be written off. The Fund believes that the possible effects of these write-offs after the extended loan period are insubstantial.

The Fund's main risk factors are credit risk, liquidity risk, interest and inflation risk, duration mis-match of loans and financing, prepayment risk, refinancing risk and operational risk. In addition, the Fund faces counterparty and price risk. The State's equity contribution to the Fund in form of state bonds series RÍKH18 1009 causes increased imbalance between indexed liabilities and non-indexed assets and continued holding of this bond series may have considerable effect on net interest income.

The ESA (EFTA Surveillance Authority) has discussed and confirmed that the aforementioned ISK 33,000 million state aid is legal, though with the reservation that a draft of the reorganization of the Housing Financial Fund into a social and competitive operation shall be available by the end of September 2011.

Governance

The Board of Directors of the Housing Financing Fund is nominated by the Minister of Welfare for a four year period. The Board consists of five directors and five reserve directors and the Minister of Welfare nominates a Chairman and Reserve Chairman amongst Board members. A new Board of Directors was appointed at the beginning of year 2011. The Minister decides on the Board members' compensation.

The Board of Directors of the Housing Financing Fund emphasizes on maintaining good governance. The Board hires a Managing Director and establishes the job description. From the year 2010 Senior Civil Servants Salary Board determines the Managing Director´s salaries but previously Managing Director´s salaries were determined by the Board of Directors. The Board of Directors also meets with the Fund's auditors on a regular basis. The Icelandic National Audit Office handles the Fund's internal audit. The Board of Directors supervises that all information required by law and regulations are remitted to the Icelandic Financial Supervisory Authority, the Icelandic Central Bank and other authorities at the appointed time. The Board of Directors also makes decisions regarding all unusual and substantial matters.

The Board of Directors has established extensive operating procedures, which define its competence.

According to law no. 80/2008 the Fund’s Board has established an audit committee to carry out certain assignments which are a part of the Board´s responsibilities. The audit committee shall oversee the process of preparation of the financial statements in order to increase credibility of financial information.

Statement by the Board of Directors and the Managing Director

The financial statements of the Housing Financing Fund for the year 2010 are prepared in accordance with International Financial Reporting Standards, as adopted by the EU and additional Icelandic disclosure requirements for financial statements of companies with listed securities.

According to our best knowledge, it is our opinion that the financial statements give a true and fair view of the financial performance of the Fund for the year 2010, its assets, liabilities, and financial position as at 31 December 2010 and its cash flows for the year 2010.

Further, in our opinion the financial statements and the Endorsement by the Board of Directors and the Managing Director include a fair view on the Fund's operating development and results, its standing and describes the Fund's main risk exposures.

The Board of Directors and the Managing Director of the Housing Financing Fund have today discussed the Fund's Financial Statements for the year 2010 and hereby confirm them by means of their signatures.

Reykjavík, 31 March 2011.

Managing Director:

Board of Directors:

Framkvæmdastjóri:

Independent Auditor's Report

To the Board of Directors of the Housing Financing Fund.

We have audited the accompanying financial statements of the Housing Financing Fund, which comprise the balance sheet as at December 31, 2010, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the EU, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Housing Financing Fund as at December 31 2010, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Emphasis of Matter

Without qualifying our opinion we draw attention to the Fund´s equity ratio which is calculated on the basis of regulation no. 544/2004 on the finances and risk management of the Housing Financing Fund and is 2.2% at year end 2010. However according to article 7 of the regulation mentioned above the Fund´s long term goal is to maintain an equity ratio exceeding 5.0%. The Fund has in accordance to the aforementioned regulation notified the Minister of Welfare.

Report on the Board of Directors report

Pursuant to the legal requirement under Article 106, Paragraph 1, Item 5 of the Icelandic Financial Statement Act No. 3/2006, we confirm that, to the best of our knowledge, the report of the Board of Directors accompanying the financial statements includes the information required by the Financial Statement Act if not disclosed elsewhere in the Financial Statements.

Reykjavík, 31 March 2011.

KPMG ehf.

Margrét Guðjónsdóttir

Income Statement for the year 2010

	Notes	2010	2009
Interest income		57.789.240	97.115.897
Interest expense		(55.260.696)	(94.314.161)
Net interest income	10	2.528.544	2.801.736
Other income	11	418.376	236.952
Operating income		2.946.920	3.038.688
Salaries and salary-related expenses	12-14	487.624	462.022
Other administrative expenses	16	840.540	658.185
Other operating expenses	18	23.938	33.419
Depreciation and amortisation	19,20	55.173	52.108
Total operating expenses		1.407.275	1.205.734
Net operating income		1.539.645	1.832.954
Impairment of assets	5b, 8	(36.052.967)	(5.035.268)
Loss for the year		(34.513.322)	(3.202.314)

The notes on pages 11 to 28 are an integral part of these financial statements.

Financial Statements of the Housing Financing Fund for the year 2010 7 Amounts are in ISK thousands

Balance Sheet as at 31 December 2010

	Notes	2010	2009
Assets			
Cash and cash equivalents	6	23.826.463	20.602.063
Restricted cash	6	8.331.053	7.782.622
Receivable due from State Treasury	2	33.000.000	0
Loans to banks	7,8	4.036.715	6.634.118
Loans to customers	5b	751.280.719	756.634.191
Properties held for sale	17	15.029.172	2.852.925
Operating assets	19	54.743	58.023
Intangible assets	20	189.022	153.284
Other assets		215.954	130.099
Total assets		835.963.841	794.847.325
Liabilities			
Bond issued	21	820.310.099	775.447.922
Other borrowings		6.666.266	9.122.153
Other liabilities		418.202	194.654
Total liabilities		827.394.567	784.764.729
Equity			
Contributed capital	2	40.155.408	7.155.408
(Accumulated deficit) retained earnings		(31.586.134)	2.927.188
Total equity		8.569.274	10.082.596
Total liabilities and equity		835.963.841	794.847.325

The notes on pages 11 to 28 are an integral part of these financial statements.

Amounts are in ISK thousands

Statement of Changes in Equity for the year 2010

	Contributed capital	(Accumulated deficit) Retained earnings	Total equity
2009			
Equity as at 1 January 2009	7.155.408	6.129.502	13.284.910
Loss for the year		(3.202.314)	(3.202.314)
Equity as at 31 December 2009	7.155.408	2.927.188	10.082.596
2010			
Equity as at 1 January 2010	7.155.408	2.927.188	10.082.596
Increase in contributed capital	33.000.000		33.000.000
Loss for the year		(34.513.322)	(34.513.322)
Equity as at 31 December 2010	40.155.408	(31.586.134)	8.569.274

The notes on pages 11 to 28 are an integral part of these financial statements.

Financial Statements of the Housing Financing Fund for the year 2010 9 Amounts are in ISK thousands

Statement of Cash Flows for the year 2010

	Notes	2010	2009
Cash flows from operating activities			
Loss for the year		(34.513.322)	(3.202.314)
Operating items not affecting cash flows:			
Indexation on loans to banks, loans to customers and borrowings		1.213.552	1.019.050
Depreciation and amortisation		55.173	52.108
Provision for losses on loans		36.052.967	5.035.268
Changes in operating assets and liabilities:			
Loans to customers		(10.649.474)	(16.011.510)
Properties held for sale		(12.176.247)	(2.138.659)
Derivatives		0	1.360.915
Other assets		(85.855)	226.443
Other liabilities		223.548	(481.335)
Cash flows to operating activities		(19.879.658)	(14.140.034)
Cash flows from investing activities			
Loans to banks		2.371.705	21.790.324
Restricted cash		(548.431)	(7.782.622)
Operating assets and intangible assets		(87.631)	(70.887)
Investing activities		1.735.643	13.936.815
Cash flows from financing activities			
Bond issues and other borrowings, repayments		(43.250.611)	(16.763.666)
Bond issues and other borrowings, issues		64.619.026	24.053.442
Financing activities		21.368.415	7.289.776
Net increase in cash and cash equivalents		3.224.400	7.086.557
Cash and cash equivalents at 1 January		20.602.063	13.515.506
Cash and cash equivalents at 31 December		23.826.463	20.602.063
Investing and financing activities without cash flow effect:			
Receivable due from State Treasury		33.000.000	0
Increase in contributed capital		(33.000.000)	0

The notes on pages 11 to 28 are an integral part of these financial statements.

Financial Statements of the Housing Financing Fund for the year 2010 10 Amounts are in ISK thousands

Notes

General information

1. Reporting entity

The Housing Financing Fund ("the Fund") is domiciled in Iceland. The address of the Fund's registered office is Borgartún 21, Reykjavik. The Fund's objectives are to provide housing loans, loans for new constructions and property development in Iceland. The Housing Financing Fund is an independent institution owned by the State and appertains to a special management and the Minister of Welfare. According to the law, the Icelandic State Treasury has unlimited and unambiguous responsibilities for all of the Fund’s financial obligations.

2. Receivable due from State Treasury

With the passing of the Supplementary Budget Act for 2010, the Minister of Finance was provided the permission to enhance the capital position of the Fund by means of capital injection amount up to ISK 33,000 million. This contribution was paid in in March 2011, paid in by means of government bonds in the series RÍKH18 1009.

3. Basis of preparation

a. *Statement of compliance*

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU.

The financial statements of the Housing Financing Fund were approved by the Board of Directors on 31 March 2011.

b. *Basis of measurement*

The financial statements have been prepared on the historical cost basis. However properties held for sale are recognised at the lower of cost or net fair value.

c. *Presentation and functional currency*

The financial statements are prepared and presented in Icelandic krona (ISK), which is the Fund's functional currency. All financial amounts presented have been rounded to the nearest thousand unless otherwise stated.

d. *Use of estimates and judgements*

The preparation of the financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions, which affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. The estimates and underlying assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying amounts of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.
The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period

Information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements are described in notes no. 4.c.(iv) to 4.c.(v).

e. *New standards and interpretations not yet adopted*

A few new standards, amendment to standards and interpretations have not taken effect by year-end 2010 and have not been applied in the preparation of the financial statements. It is not expected that those standards, amendments and interpretations will have significant effect on the Fund´s financial statements when they come into force, except for IFRS 9 *Financial Instruments*. IFRS 9 will be applicable from the beginning of 2013 if endorsed by the EU. The potential impact of IFRS 9 on the Fund´s operations has not been evaluated.

4. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements. No revenue or expenses of the Fund are recognised directly in equity and the loss for the year is therefore equal to comprehensive loss. Therefore, the Fund only presents an income statement.

a. *Interest income and interest expense*

Interest income and expense are recognised in the income statement using the effective interest method. Interest income and expense includes the amortisation of discounts and premiums and other differences between initial book value of the financial instrument and amounts due on maturity, based on the effective interest method. Interest income is calculated on loans. Interest expense are calculated on bond issues and other borrowings. Borrowing fee is recognised in the income statement in the same manner as interest income and expense and those items are taken into account in the calculation of effective interests.

Indexation of inflation-indexed assets and liabilities are recognised in full in the income statement as they accrue and are recognised as a part of book value.

The Fund has provided loans for rental apartments at a 3.5% and 4.5% interest rate. The State Treasury compensates the Fund the interest difference between those loans and loans taken by the Fund. The State Treasury's contribution is based on the difference between borrowings and lending rates each year.

The effective interest rate is the rate that exactly discounts the estimated future cash payment and receipts through the expected life of the financial asset or liability, or where appropriate, a shorter period, to the carrying amount of the financial asset or liability. The effective interest rate is established on initial recognition of the financial asset and liability and is not revised subsequently. When calculating the effective interest rate the Fund estimates future cash flows considering all contractual terms of the instrument but not future credit losses.

Interest income and interest expense in the income statement consist of:

- Interest income on loans to customers and interest expenses on borrowings using the effective interest method.
- Interest income on deposits and market securities using the effective interest method.

b. *Other income*

Other income consists of collection charges and rental income from repossessed apartments on mortgages foreclosed. Other income is recognised in the income statement when accrued. Borrowing charges are included in the calculation of effective interest rate and are not included in other income.

c. *Financial assets and financial liabilities*

(i) Recognition and derecognition of financial assets and liabilities

The Fund initially recognises financial assets and liabilities on the date that they are originated. Those assets and liabilities are initially recognised on the date at which the Fund becomes a party to the contractual provisions of the instrument, except for loans that are recognised when funds are transferred to borrowers. Financial assets are derecognised when the contractual rights to the cash flows from the asset expire, or when the Fund transfers the rights to receive the cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial assets are transferred.

Financial liabilities are recognised when the Fund becomes a party to the contractual provisions of the instrument. The Fund derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

(ii) Offsetting

Financial assets and liabilities are set off and the net amount presented in the balance sheet when, and only when, the Fund has a legal right to set off the amounts and intends either to settle on a net basis or realise the asset and settle the liability simultaneously.

4. Significant accounting policies, contd.:

c. Financial assets and financial liabilities, cont.:

(iii) Amortised cost of financial assets and liabilities

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

(iv) Fair value measurement

The determination of fair value of financial assets and financial liabilities quoted in an active market is based on quoted prices. For all other financial instruments fair value is determined by using valuation techniques. A market is considered active if quoted prices are readily and regularly available and those prices represent actual and regularly occurring market transactions on an arm's length basis.

(v) Impairment of financial assets

The carrying amount of the Fund´s financial assets is reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated.

An impairment is recognised in the income statement whenever the carrying amount of an asset exceeds its recoverable amount.

Two methods are used to calculate impairment losses, one based on an assessment of individual loans and the other based on a collective assessment. Losses expected as a result of future events, no matter how likely, are not recognised.

Objective evidence of impairment includes information about the following events and conditions:
(i) significant financial difficulty of the borrower.
(ii) economic conditions
(iii) a breach of contract, such as a default on installments or on interest or principal payments.

Individually assessed loans

Impairment losses on individually assessed loans are determined by the risk exposure on a case-by-case basis. The Fund assesses at each balance sheet date whether there is any objective evidence that individual loans are impaired.

Impairment losses are measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets´ original effective interest rate. Impairment losses are recognised in profit or loss and reflected in an allowance account.

Collectively assessed loans

Where loans have been individually assessed and no evidence of loss has been identified, these loans are grouped together on the basis of similar credit risk characteristics for the purpose of calculating a collective impairment loss. This loss covers loans that are impaired at the balance sheet date but which will not be individually identified as such until some time in the future.

The collective impairment loss is determined by taking into account:

- historical loss experience in portfolios of similar risk characteristics (for example, by industry sector, loan grade or product).
- the estimated period between a loss occurring and that loss being identified and recognised by the establishment of an allowance against the loss on an individual loan.
- management's experienced judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience.

4. Significant accounting policies, contd.:

c. Financial assets and financial liabilities, cont.:

(v) Impairment of financial assets

Estimates of changes in future cash flows for groups of assets are consistent with changes in observable data from period to period, for example changes in property prices, payment status, or other factors indicative of changes in the probability of losses on the group and their magnitude. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Fund to minimise any differences between loss estimates and actual losses.

Reversal of impairment

If, in a later period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is recognised as revenue in the income statement.

d. Cash and cash equivalents

Cash and cash equivalents consist of demand deposits with financial institutions.

e. Loans to banks

Loans to banks consist of government treasury bonds and unsettled claims on the Icelandic banks and other financial institutions connected to the Icelandic financial crisis (see note 8).

f. Loans to customers

Loans are financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables include loans to customers, loans, which the Fund takes part in providing together with other credit institutions and acquired loans, which are unlisted and that the Fund has no intention to sell in the nearest future.

Loans are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method. The book value of loans and receivables includes accrued interest and inflation adjustment.

g. Properties held for sale

When the Fund has redeemed propreties on foreclosed mortgages they are classified as properties held for sale and recognised at the lower of cost or net fair value.

h. Operating assets

Recognition and measurement

Operating assets are recognised at cost less accumulated depreciation.

4. Significant accounting policies, contd.:

h. Operating assets, contd.:

Depreciation

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful life until residual value is reached. Estimated useful lives are specified as follows:

Real estate	25 years
Fixtures and equipment	5-10 years
Vehicles	10 years

Residual value is reviewed annually unless it is immaterial.

i. Intangible assets

Intangible assets consist of software used in the Fund´s operations and its web site. Intangible assets are amortised on a straight-line basis over the estimated useful life, which is 5 years.

j. Issued bonds and other borrowings

Issued bonds and other borrowings are initially recognised at fair value, which is the amount borrowed including all costs associated with the transaction. After initial recognition they are measured at amortised cost, using the effective interest rate method. Accrued interest expense and indexation are recognised as part of the carrying amount.

k. Other assets and liabilities

Other assets and liabilities are measured at cost.

l. Equity

The Fund´s equity consists of contributed capital and retained earnings (accumulated deficit). Recognised in retained earnings (accumulated deficit) is the accumulated earnings or loss of the Fund from its establishment.

5. Financial Risk Management

a. Overview of financial risks and the risk management structure

It is important for the Fund to maintain a balance in the composition of its borrowings and loans. Following are the risks the Fund is exposed to and that are of importance:

- Credit risk
- Liquidity risk
- Interest rate risk
- Operational risk

Following is general information on the Fund's financial risk management, in addition to information on each of the aforementioned risks, goals, aim and evaluation process and management of each risk. Furthermore, information on the Fund's capital management is disclosed.

Risk management structure

The Housing Financing Fund is a non-profit organization. Its financial and risk management takes note thereof. Its main objective is to continuously Endeavour to keep low risk level in its financial operation and it aims at limiting financial risk and cost in accordance with its operating goals.

5. Financial Risk Management, contd.:

a. *Overview of financial risks and the risk management structure, contd.:*

Risk management

It is important to maintain a certain balance in the Fund's combination of borrowings and loans. The Fund's financial and risk management rules stipulate that the Fund must limit its risks and manage interest rate and credit risk within a certain threshold.

Following, the key role and responsibility of some parties for the Fund's financial and risk management are described according to the current risk management policy. A new risk management policy has been sent to the Icelandic Financial Supervisory Authority for evaluation and has therefore not been implemented. The main changes in the policy are regarding the Fund’s liquidity management.

The Fund's Board of Directors

- Establishes the Fund's financial and risk management policy and reviews on a regular basis reports on the Fund's financial risk.
- Takes note of risk factors in the Fund's administration and organization.
- Nominates a financial committee.
- Remits reports to the Minister of Welfare.

Managing Director

- Responsible for reports on the Fund's risks.
- Responsible for the Fund's long term financing need being met.
- Divides responsibility of financial matters in accordance with financial and risk management policy between the financial committee and the financial department.

Financial Committee

- Brings proposals before the Board of Directors on new bond issuance.
- Brings proposals before the Board of Directors on interest levy on loan interests in accordance with the Fund's rules on loan interests.

Head of financial department

- Responsible for the implementation of risk management and risk analysis and ensures that all of the Fund's payments and financial agreements are within its financial and risk management policy.
- Directs the Fund's financial and risk management policy.
- Works on proposals on revision of the financial and risk management policy.

Risk management

- Takes care of daily risk management operation.
- Shares knowledge and risk awareness within the Fund.

Financial management

- Takes care of the Fund's financing and financial operations and ensures a safe and efficient handling of securities.

b. *Credit risk*

Credit risk is the risk of financial loss if a customer or a counterparty to a financial instrument fails to meet its contractual obligations. The Fund´s credit risk arises from loans to customers, investments in market securities and loans to financial institutions. As stated before it is the Fund’s main objective to have low risk in its operations.

5. Financial Risk Management, contd.:

b. *Credit risk, contd.:*

Solutions for the Fund’s clients’ payment difficulties

The Housing Financing Fund offers various solutions aimed at solving its customers’ debt problems. Payment difficulty solutions may be applied in cases of payment difficulties, i.e. when salaries after deducting necessary cost of living do not suffice to cover the applicant´s obligations. The solutions shall be aimed at solving the problems and the Housing Financing Fund may set as condition that other creditors also apply payment difficulty solutions if necessary. The following resources can consist in forgiveness of a part of the Fund’s loans. In addition, this may cause an imbalance in its payment flow. Resources assuming for payment are more favorable for the Fund, rather than freezing of loans or extension of payment term where there will be no payment flow on the loans for up to 3 years. On the Fund’s website is a discussion on its payment difficulty solutions.

There is considerable uncertainty over the possible effect of the current economic situation on the recovery of the Fund’s loans. Impairment loss on loans recognized in the Fund’s financial statements reflects management’s best evaluation of the effect. It is hard to evaluate the possible effect of the measures that have already been carried out with respect to write-down of individuals’ real estate debts down to 110% of the ratable value of the real estate, recalculation of foreign car loans and reorganizing of other debts of both individuals and legal entities, as well as the effect of those measures on the Fund’s financial standing and quality of loans. Should the effect of these measures still cause significant default by individuals and if real estate prices continue to decrease the Fund will have to write-down its loan portfolio even further. International Financial Reporting Standards require that impairment of loans be recognized in the financial statements when the loss is incurred though the loss has not been fully realized on the reporting date. Therefore, the Fund may not wait until the loss has been directly incurred in form of final write-down of loans. This causes significant uncertainty over the evaluation of the Fund’s real loss following the financial crisis. Therefore, economic development in the next few years and government decisions will be decisive factors with respect to the Fund’s final loss and how useful the solutions offered to the Fund’s customers will be for borrowers.

Credit risk management

All of the Fund´s loans are secured by real estate mortgages. The Fund limits its risk due to these loans in two ways, by setting a maximum individual loan amount and a maximum pledge ratio. In addition, borrowers need to undergo a credit evaluation. The Risk Management Division evaluates the credit risk on an ongoing basis and prices it when deciding the interest rates on loans, which represent a markup on the interest rates on the Fund´s liabilities.

5. Financial Risk Management, contd.:

b. Credit risk, contd.:

Credit risk exposure

The book value of the Fund´s financial assets equals maximum exposure to credit risk. The Fund´s loans are specified as follows:

	Loans to individuals		Loans to others		Total	
	2010	**2009**	**2010**	**2009**	**2010**	**2009**
Book value	606.688.606	608.552.611	144.592.113	148.081.580	751.280.719	756.634.191
Past due and impaired*						
Loans past due and impaired*	4.763.122	1.277.173	2.739.910	569.662	7.503.032	1.846.835
Past due, not impaired **						
30-60 days	355.263	409.560	195.841	122.228	551.104	531.788
60-90 days	270.690	559.465	78.631	256.843	349.321	816.308
Over 90 days	2.366.181	1.529.224	1.500.198	658.459	3.866.379	2.187.683
Total	2.992.134	2.498.249	1.774.670	1.037.530	4.766.804	3.535.779
Loans past due total	7.755.256	3.775.422	4.514.580	1.607.192	12.269.836	5.382.614
Loans neither past due nor impaired***	627.909.062	606.592.920	149.905.214	147.786.011	777.814.276	754.378.931
Total carrying amount of loans	635.664.318	610.368.342	154.419.794	149.393.203	790.084.112	759.761.545
Impairment						
Specific impairment	(27.620.223)	(1.277.173)	(9.531.367)	(1.069.662)	(37.151.590)	(2.346.835)
General impairment	(1.355.489)	(855.549)	(296.314)	(241.961)	(1.651.803)	(1.097.510)
Impairment total	(28.975.712)	(2.132.722)	(9.827.681)	(1.311.623)	(38.803.393)	(3.444.345)
Book value	606.688.606	608.235.620	144.592.113	148.081.580	751.280.719	756.317.200

* Gross carrying amount of loans specifically impaired.

** Total amount of payments past due on loans which are past due, but not specifically impaired.

*** Gross carrying amount of loans neither past due nor specifically impaired and the undue amounts of loans for which some payments are contractually past due.

Housing Financing Fund for the year 2010 18 Amounts are in ISK thousands

5. Financial Risk Management, contd.:

b. *Credit risk, contd.:*

Impairment losses on loans

The Fund regularly reviews its loan portfolios to assess impairment. Prior to determining whether an impairment loss should be recognised in the income statement, The Fund makes judgements as to whether there is any objective evidence indicating that there is a measurable decrease in the estimated future cash flows from individual loans or from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there have been changes in the payment status of borrowers in a group or economic conditions. Management uses estimates based on historical loss experience for assets with similar credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

In the second half of 2010 managers of the Fund have analysed loans to legal entities in light of increased defaults. A specific provision for impairment of loans to legal entities has been calculated and is based on the professional judgement of staff and managers of the Fund and has been recognised in the financial statements. As well a provision for general impairment has been calculated in accordance with loss experience.

The experts of the Fund have estimated the need for a provision on loans to individuals. In making this estimate an agreement from December 2010 on specific procedures for individuals was taken into account. Specific provision for impairment due to this has been recognised in the financial statements of the Fund.

As well a provision for general impairment has been calculated in accordance with loss experience.

Write-off

The Housing Financing Fund writes off loans on the basis of two different conditions:

i) Upon loss on the sale of apartments on auction when the sales value of the apartment results lower than its valuation according to Article 57 of law no. 90/1991, on forced sale. The loss on an apartment based on a valuation according to Article 57 of the law is entered as continued receivable under the item "lost pledge".

ii) Upon the approval of the Housing Financing Fund of the discontinuance of claim of "lost pledge" in accordance with Regulation no. 359/2010, on the treatment of the Housing Financing Fund's receivables that have lost

Impairment on loans is specified as follows:

	Specific impairment	General impairment	Total 2010
2010			
Balance at the beginning of the year	2.346.835	1.097.510	3.444.345
Provision for impairment losses	34.902.928	785.039	35.687.967
Write-offs	(98.173)	(230.746)	(328.919)
Balance at year-end	37.151.590	1.651.803	38.803.393

Impairment on loans as a percentage of loans 5,14%

Housing Financing Fund for the year 2010 19 Amounts are in ISK thousands

5. Financial Risk Management, contd.:

b. *Credit risk, contd.:*

Write-off, contd.:

	Specific impairment	General impairment	Total 2009
2009			
Balance at the beginning of the year	1.083.730	580.990	1.664.720
Provision for impairment losses	1.368.130	752.999	2.121.129
Write-offs	(105.025)	(236.479)	(341.504)
Balance at year-end	2.346.835	1.097.510	3.444.345
Impairment on loans as a percentage of loans			0,45%

Total impairment recognised in the income statement is specified as follows:

	2010	2009
Provision for impairment losses of loans to individuals	26.462.001	738.790
Provision for impairment losses of loans to legal entities	8.440.927	629.340
Provision for general impairment losses	785.039	752.999
Impairment on receivables from banks (see note 8)	365.000	2.914.139
Total impairment	36.052.967	5.035.268

Quality of pledges

The Housing Financing Fund's loans are secured by pledges in real estates. Loans are granted to the maximum of 80% of the purchase price, provided that there are no other restrictions of a maximum loan amount which is ISK 20 million. Following the granting of a loan, pledges are not assessed specifically in terms of fair value unless in relation to the valuation of a possible impairment loss. Requirements for general housing loans are that a binding purchase offer has been made, which in general may be equaled to the fair value of the specific real estate on the date of purchase. The pledging ratio of the Fund's total loans on the rateable real estate value is specified as follows.

The weighted average pledging ratio of the Fund's total loans on the rateable value is approx. 64% (2009: 48%).

c. *Liquidity risk*

Liquidity risk is the Fund's risk of not being able to meet its contractual payments of interests and principal on its borrowings. By effective control on liquidity balance the Fund endeavors to ensure that there are always sufficient funds in order to meet its obligations if a temporary imbalance arises between the payment flow on the Fund's loans and other financial assets on the one hand, and its borrowing on the other.

Financial Statements of the Housing Financing Fund for the year 2010 20 Amounts are in ISK thousands

5. Financial Risk Management, contd.:

c. Liquidity risk, contd.:

Liquidity risk management

The Fund's liquidity risk management comprises liquidity analysis, access to secured loan lines from banks and liquidity strategy. The Fund's liquidity strategy is determined one year a head in terms of operating and financial budget. Liquidity strategy is updated on a regular basis. On a daily basis a short term strategy is made for liquidity including the estimation of the Fund's cash flow for the next 20 working days.

Measurement of liquidity risk

A key issue in the Fund's liquidity management is to ensure that there is balance between payment flow on financial assets and financial liabilities. The following table shows the contractual payment flow of the Fund's financial assets and liabilities.

	0 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
December 31, 2010					
Financial assets:					
Cash and cash equivalents	23.826.463	0	0	0	23.826.463
Restricted cash..........................	0	0	8.331.053	0	8.331.053
Loans to customers and loans to banks	12.416.440	37.695.226	297.891.420	1.210.520.562	1.558.523.648
Total financial assets.................	36.242.903	37.695.226	306.222.473	1.210.520.562	1.590.681.164
	0 - 3 months	**3 - 12 months**	**1 - 5 years**	**Over 5 years**	**Total**
Financial liabilities:					
Borrowings and other liabilities..........................	18.937.947	55.753.323	324.148.823	930.980.568	1.329.820.661
Total financial liabilities..............	18.937.947	55.753.323	324.148.823	930.980.568	1.329.820.661
Net balance	17.304.956	(18.058.097)	(17.926.350)	279.539.994	260.860.503
December 31, 2010					
Financial assets:					
Cash and cash equivalents	20.602.063	0	0	0	20.602.063
Restricted cash..........................	0	0	7.782.622		7.782.622
Loans to customers and loans to banks..........................	13.424.232	35.745.214	268.874.412	1.216.887.812	1.534.931.670
Total financial assets.................	34.026.295	35.745.214	276.657.034	1.216.887.812	1.563.316.355
Financial liabilities:					
Borrowings and other liabilities..........................	16.226.031	48.338.858	332.054.657	972.451.010	1.369.070.556
Total financial liabilities..............	16.226.031	48.338.858	332.054.657	972.451.010	1.369.070.556
Net balance	17.800.264	(12.593.644)	(55.397.623)	244.436.802	194.245.799

The table above shows the agreed upon cash flow of loans and borrowings of the Fund and includes both payments and agreed upon interests but not budgeted future inflation. Cash and cash equivalents of the Fund, that can be used to meet temporary unbalance in cash flows of financial assets and liabilities are in the first time column of the table. If an unbalance would be between the cash flows of financial assets and liabilities the Fund would meet that with issuing of HFF bonds or sales of short term securities.

Financial Statements of the Housing Financing Fund for the year 2010 21 Amounts are in ISK thousands

5. Financial Risk Management, contd.:

d. Interest rate risk, contd.:

Interest rate risk arises when there is a difference between the average duration of financial assets and financial liabilities. If a balance is not ensured interest rate changes affect the Fund's net interest income. The Fund's financial department is responsible for managing this risk and ensure that the difference stays within set limits according to the Fund's financial and risk management. The average duration of financial assets and financial liabilities is 10.2 years and of financial liabilities is 9.9 years with a difference of 0.3 years. According to the Fund's financial- and risk management the maximum difference allowed is 0.9 years.

Interest rate risk management

The financial committee evaluates the risk that the Fund is exposed to due to prepayment risk and rates it when the Fund's loan interests are determined. In order to further reduce this risk the Fund also offer loans with prepayment fee, carrying lower interests than those without such fee. On a monthly basis the real rate of prepayment is calculated and estimates are made on prepayment ratios. On the basis of estimated prepayments the Fund continuously reviews its financing when necessary aiming at limiting the interest sensitivity of its asset portfolio.

Weighted average interest on the Fund´s borrowings at year-end 2010 was 4.34%, however the weighted average interest on loans was 4.62% and thus the interest-rate differential on borrowings and loans is 0.28%. Due to increase in the Fund´s loan defaults since the financial crash in autumn 2008 the Fund has raised the interest premium, i.e. the difference between interest on loans and interest on borrowings.

Non-interest bearing assets

When the Fund repossesses an apartment on mortgage foreclosed the loan ceases, from the date of claim, to be interest bearing. At year-end 2010, the Fund owned 1,069 apartments for sale at book value ISK 15,029 million. At year-end 2009 the apartments for sale were 347 and book value amounted to ISK 2,852 million. The Fund´s claims on the Icelandic banks and other financial institutions, related to the financial crisis, amounted to ISK 1,987 million at year-end 2010. Non-interest bearing assets amount to 17,016 million at year-end 2010 (year-end 2009: 5,215 million).

Borrowers have in some instances a permission to repay their loans without having to pay any special fee. Such permission is not available on the Fund's borrowings except for housing bonds. Therefore, the balance between the average duration of financial assets and financial liabilities can be disrupted. This incurs refinancing risk, and therefore interest rate risk.

Indexation risk

Indexation risk is the risk of changes in fair value and cash flows of indexed financial assets and liabilities due to fluctuations in the consumer price index (CPI). Most of the Fund´s loans are indexed and funded by issuance of indexed bonds. For the most part indexation risk arises from cash and cash equivalent financial assets that the Fund is required to hold in accordance with its financial- and risk management policy. Indexation risk is monitored by calculating the sensitivity of indexed financial assets and liabilities to changes in CPI.

	2010	2009
Financial assets:		
Loans	751.280.719	756.634.192
Other assets	14.122.444	9.624.827
Financial assets total	765.403.163	766.259.019
Financial liabilities:		
Bond issues	820.310.099	775.447.922
Other borrowings	6.687.668	6.751.943
Financial liabilities total	826.997.767	782.199.865
Total indexation balance	61.594.604	15.940.846

Non-indexed assets in excess of non-indexed liabilities at year-end 2010 amounted to ISK 61.6 billion (2009: 15.9 billion). Based on year-end position and assuming that all other variables remain constant a five percent inflation calculated over a period one year would have adverse impact on the Fund´s results amounting to ISK 1,283 million (2009: 62.6 million).

Financial Statements of the Housing Financing Fund for the year 2010 22 Amounts are in ISK thousands

5. Financial Risk Management, contd.:

e. *Operational risk*

Operational risk is the risk of loss as a result of insufficient internal processes, people and systems, or because of external events, including legal risk. The Fund uses both preventive and supervisory methods to minimize its business risk. The preventive methods include clear and documented procedures regarding all the Fund´s major operations, training of employees, data back-up, access control, and so on. Head of departments are responsible for the management of operational risk of their department and monitor the operational risk as well as their staff.

f. *Equity and capital management*

The Fund's long term objective is to maintain an solvency ratio over 5%. The calculation of solvency ratio is in accordance to international rules (Basel II). If the Fund's solvency ratio falls below 4% the Fund's Board of Directors shall notify the Minister of Welfare thereof. Furthermore, the Fund's Board of Directors shall make proposals of ways to reach the long term solvency ratio goal. In December 2010 with the passing of the Supplementary Budget Act for 2010 the Minister of Finance was provided the permission to enhance the capital position of the Fund by means of capital injection amount up to ISK 33 billion. The Ministry of Finance has confirmed that this permission will be utilised in full.

Solvency ratio is specified as follows:	2010	2009
Total equity	8.569.274	10.082.596
Credit risk	30.226.785	26.245.612
Market risk	71	91
Operational risk	446.646	483.141
Total capital requirements	30.673.502	26.728.844
Solvency ratio	2,2%	3,0%

6. Cash and cash equivalents

	2010	2009
Unrestricted cash in Central Bank	20.157.095	16.779.653
Unrestricted cash in other financial institutions	3.669.368	3.822.410
Cash and cash equivalents total	23.826.463	20.602.063
Restricted cash in Íslandsbanki hf.	8.331.053	7.782.622
Restricted cash total	8.331.053	7.782.622

Restricted cash is available for payment in January 2012.

7. Loans to banks

Loans to banks are specified as follows:	2010	2009
Government bonds	844.405	2.831.193
Money market loans	1.205.188	0
Claim on SPRON	0	1.440.644
Claims on banks related to the financial collapse	1.987.122	2.362.281
Loans to banks total	4.036.715	6.634.118

Housing Financing Fund for the year 2010 23 Amounts are in ISK thousands

8. Impairment on claims on banks

The Fund had approximately ISK 16,620 million outstanding receivable from Iceland's three biggest banks that collapsed in early October 2008, resulting from bonds and derivative contracts entered into with the banks. At the same time, the Fund owed to these banks ISK 5,342 million due to derivatives and HFF bonds. During 2009, the Financial Supervisory Authority suspended the Boards of SPRON and Straumur-Burðaráss Investment Bank and appointed Resolution Committees for the banks. According to the decision of the Resolution Committees, deposits of ISK 5,254 million where withheld in closed accounts. A total of ISK 11,154 million has been impaired due to these claims. In the financial statements it is presumed that the Fund has the right to off-set these balances. Uncertainty prevails regarding the settlement of claims and derivatives and the Fund's right to off-set these balances. During the year 2010 the Fund reached an agreement with SPRON, but there is still a dispute regarding the Fund´s deposits in Straumur-Burðarás Investment bank hf. amounting to ISK 1,293 million. According to a letter from Glitnir hf.´s Resolution Committee received by the Fund in 2010 a claim is for the payment of ISK 5,776 million, however the book value of the Fund´s position with Glitnir hf. is debt amounting to ISK 1,300 million. The Fund´s Board has entirely rejected the claim of Glitnir hf. The Fund´s actual loss may therefore differ when final settlement takes place.

9. Financial assets and liabilities

According to the IFRS, IAS 39 Financial instruments: recognition and measurement, financial assets and liabilities are divided into specific categories. The classification affects how the relevant financial instrument is measured. Those categories to which the Fund's financial assets and liabilities pertain and their basis of measurement are specified as follows:

- Trading assets and liabilities - are recognised at fair value.
- Loans and receivables - are recognised at the amortized cost value.
- Other financial liabilities - are recognised at the amortized cost value.

The following table shows to which group financial assets and liabilities pertain and their fair value:

	Trading assets and liabilities	Loans and receivables	Other at amortised cost value	Book value	Fair value [1)]
December 31, 2010					
Assets:					
Cash and cash equivalents.......		23.826.463		23.826.463	23.826.463
Restricted cash..........................		8.331.053		8.331.053	8.331.053
Due from State Treasury...........		33.000.000		33.000.000	33.000.000
Loans to banks	2.049.593	1.987.122		4.036.715	4.036.715
Loans to customers..................		751.280.719		751.280.719	799.464.447
Total financial assets	2.049.593	818.425.357	0	820.474.950	868.658.678
Liabilities:					
Bond issues..............................			820.310.099	820.310.099	969.366.425
Other borrowings.....................			6.666.266	6.666.266	5.641.633
Total financial liabilities	0	0	826.976.365	826.976.365	975.008.058
December 31, 2009					
Assets:					
Cash and cash equivalents.......		20.602.063		20.602.063	20.602.063
Restricted cash..........................		7.782.622		7.782.622	7.782.622
Loans to banks	2.831.193	3.802.925		6.634.118	6.634.118
Loans to customers..................		756.634.191		756.634.191	776.136.792
Total financial assets	2.831.193	788.821.801	0	791.652.994	811.155.595
Liabilities:					
Bond issues..............................			775.447.922	775.447.922	932.314.946
Other borrowings.....................			9.122.153	9.122.153	5.661.901
Total financial liabilities	0	0	784.570.075	784.570.075	937.976.847

1) Fair value of loans is estimated on the basis of the Fund´s current loan interests. Fair value of bond issuance and other borrowings is estimated on the basis of the yield of bond issues at year end.

Financial Statements of the Housing Financing Fund for the year 2010 24 Amounts are in ISK thousands

10. Net interest income

	2010	2009
Interest income		
Interest income on items not at fair value:		
Interest income on deposits	1.966.855	1.983.565
Interest income on loans to customers	55.188.814	90.669.047
Government contribution to subsidy interests	492.142	514.395
	57.647.811	93.167.007
Interest income on items at fair value:		
Interest income on market securities	141.429	3.948.890
	141.429	3.948.890
Total interest income	57.789.240	97.115.897
Interest expenses		
Interest expenses on items not at fair value:		
Interest expenses on bonds issued	54.541.071	92.911.346
Interest expenses on other borrowings	719.625	1.329.427
	55.260.696	94.240.773
Interest expense on items at fair value:		
Interest expenses on derivatives	0	73.388
Total interest expenses	55.260.696	94.314.161
Net interest income	2.528.544	2.801.736

11. Other operating income

	2010	2009
Collection fee	215.912	205.146
Rental income from properties for sale	202.464	31.806
Total other operating income	418.376	236.952

12. Salaries and salary-related expenses

Salaries and salary-related expenses are specified as follows:

	2010	2009
Salaries	376.956	365.105
Salary-related expenses	96.167	85.506
Other personnel expenses	14.501	11.411
Total salaries and salary-related expenses	487.624	462.022

13. Number of employees

Number of employees of the Fund are specified as follows:

	2010	2009
Average number of full-time equivalent units	67	65
Number of employees at year-end	69	64

14. Salaries of the Board of Directors and the Managing Director

Salaries of the Board of Directors and the Managing Director are specified as follows:

	2010	2009
Sigurður Erlingsson, Managing Director	2.006	0
Guðmundur Bjarnason, former Managing Director	8.821	15.680
Chairman of the Board	2.072	2.072
Other Board members total	4.145	4.145
Total salaries of the Board of Directors and the Managing Director	17.044	21.897

Financial Statements of the Housing Financing Fund for the year 2010 25 Amounts are in ISK thousands

15. Auditor's fee

Remuneration to the auditor´s are specified as follows:

	2010	2009
Audit of Financial Statements	15.012	16.487
Review of Interim Financial Statements	4.471	3.753
Other services	7.480	6.647
Total auditor's fee	26.963	26.887

16. Other administrative expenses

Other administrative expenses are specified as follows:

Collection fees	390.737	269.282
Professional services	144.066	113.942
Operating expenses of housing	94.029	80.560
Advertising and promotions	22.660	26.334
Operating cost of IT systems	124.773	118.395
Other operating expenses	64.275	49.672
Total other administrative expenses	840.540	658.185

17. Properties held for sale

At the beginning of 2010 there were 347 properties owned by the Fund. During the year 2010 the Fund repossessed 854 properties and sold 132 properties. Thus 1,069 properties are owned by the Fund at year end 2010. Thereof 346 properties are rented out or 31.8% of total properties owned by the Fund. Income and expenses during the year 2010 in relation to properties held for sale are specified as follows:

Rental income (from rented properties)	(202.464)	(31.806)
Services and other expenses (due to all properties for sale)	283.987	144.846
Expenses in excess of income from properties held for sale	81.523	113.040

18. Other operating expenses

Other operating expenses are specified as follows:

	2010	2009
Grants due to technical innovation	12.875	20.525
Homes' Advisory Office	5.153	8.544
Other grants	5.910	4.350
Total other operating expenses	23.938	33.419

19. Operating assets

Operating assets are specified as follows:

	Fixtures and equipment	Buildings	Total
Cost			
Balance at 1 January 2009	196.993	10.197	207.190
Additions during the year	3.128	0	3.128
Sold during the year	0	0	0
Balance at 31 December 2009	200.121	10.197	210.318
Balance at 1 January 2010	200.121	10.197	210.318
Additions during the year	5.723	0	5.723
Balance at 31 December 2010	205.844	10.197	216.041
Depreciation			
Balance at 1 January 2009	135.088	4.938	140.026
Depreciation for the year	12.063	206	12.269
Balance at 31 December 2009	147.151	5.144	152.295
Balance at 1 January 2010	147.151	5.144	152.295
Depreciation for the year	8.797	206	9.003
Balance at 31 December 2010	155.948	5.350	161.298

Financial Statements of the Housing Financing Fund for the year 2010 26 Amounts are in ISK thousands

19. Operating assets, contd.:

	Fixtures and equipment	Buildings	Total
Carrying amounts			
Balance at 1 January 2009	61.905	5.259	67.164
Balance at 31 December 2009	52.970	5.053	58.023
Balance at 31 December 2010	49.896	4.847	54.743

Official assessment value at year end 2010 amounted to ISK 6.4 million and insurance value amounted to ISK 17.9 million.

20. Intangible assets

Intangible assets are specified as follows:

	Software and webpage
Cost	
Balance at 1 January 2009	193.050
Additions during the year	67.759
Balance at 31 December 2009	260.809
Balance at 1 January 2010	260.809
Additions during the year	81.908
Balance at 31 December 2010	342.717
Amortisation	
Balance at 1 January 2009	67.686
Amortisation for the year	39.839
Balance at 31 December 2009	107.525
Balance at 1 January 2010	107.525
Amortisation for the year	46.170
Balance at 31 December 2010	153.695
Carrying amounts	
Balance at 1 January 2009	125.364
Balance at 31 December 2009	153.284
Balance at 31 December 2010	189.022

21. Bond issues

The Fund issues housing bonds in four series. The name of each series indicates the maturity year of the series. The bond issues are all inflation-indexed annuity bonds with semi-annual payments.

Bond issues are specified as follows:	2010	2009
HFF14 bond	42.133.702	50.361.720
HFF24 bond	176.563.541	167.069.024
HFF34 bond	201.681.934	184.565.819
HFF44 bond	338.237.691	301.007.833
Housing bonds	37.144.937	46.480.763
Housing Authority bonds	24.548.295	25.962.764
Total bond issues	820.310.100	775.447.923

Financial Statements of the Housing Financing Fund for the year 2010 27 Amounts are in ISK thousands

22. Related parties

The Fund has a related party relationship with owners, board members and executive officers. The Housing Financing Fund is publically owned and administratively falls under the Ministry and Minister of Social Affairs and Social Security which as of beginning of 2011 is called Ministry of Welfare. Government institutions and self-governing corporate entities that are financially dependant on the authorities are related parties of the Fund.

Other matters

23. Housing Affairs Complaint Committee

The Housing Affairs Complaint Committee has during the year 2010 ruled in two cases where the conclusion is that the Housing Financing Fund´s Board of Directors was not authorised to insist upon a letter of credit for loans to contractors during a period when a clause regarding loans to contractors and letters of credit in the regulation on housing bonds and housing bond transactions had been suspended. The period in question is from February 21, 2008 to April 24, 2009, during which the Board of Directors´ work procedures were in effect regarding evaluation of debtor´s ability to pay and mortgage eligibility, wherein a requirement was made for a letter of credit for loans to contractors. The rules were published on the website of the Fund along with other rules of procedures regarding pledgeablility and credit evaluation, which the Board is to establish according to the Housing Act. If the verdict is unfavourable for the Fund it is likely that it will have to repay all contractors' cost from letters of credit. Repayments could amount to approximately ISK 200 - 300 million.

24. Investigation of Housing Financing Fund

On December 17, 2010 the Icelandic parliament approved a proposed parliamentary resolution on an investigation on the Housing Financing Fund, in which the Parliament concludes that an independent investigation be carried out on the operations of the Housing Financing Fund. The investigation will concern the operations of the Fund from the events leading up to changes of financing and credit rules implemented from the year 2004 and until end of 2010. The aim with the investigation will first of all be to evaluate the effect of these changes, policy of the Fund and individual decisions during this period on the financial position of the Fund and real-estate market in whole; secondly to evaluate the effect of the operations of the Housing Financing Fund on economic management; and thirdly to evaluate how well the Fund has managed to attend its statutory role during this time. Following the investigation, there will be a comprehensive revision of the policy and operations of the Fund as well as the financing of the housing credit system in Iceland. The investigation shall be carried out in accordance with provisions of a bill to law about investigative committees submitted by the Prime Minister´s committee, but the bill has not been passed.

25. ESA

In June 2008, the ESA (EFTA Surveillance Authority) announced to the Icelandic authorities that the operation of The Housing Financing Fund consists in a State aid, which is not in conformity with the rules on State aids of the EEA Agreement and that the Icelandic government was obliged to adapt the operation of the Fund to those rules. The State aid to the Fund is considered to consist in unlimited state guarantee, exemption from taxation and that the state, as the Fund's owner, has not set requirements on the Funds operating return. This conclusion is based on the fact that the Fund operates on an open market and that its loans are not limited to a specific social role. The Government is now comprehensively reviewing its housing policy and has expressed that in that review the ESA comments will be taken into consideration when defining the role for the Housing Financing Fund. The extent of the Fund's public role is still under observation by the ESA.