Housing Financing Fund

Financial Statements for the year 2009

Housing Financing Fund
Borgartún 21
105 Reykjavík
Iceland

Reg. no. 661198-3629

Contents

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

Operations in the year 2009

The Housing Financing Fund´s loss for the year amounted to ISK 3,202 million according to the income statement. Equity at year-end amounted to ISK 10,083 million according to the balance sheet. The Fund´s solvency ratio, which is calculated on the basis of regulation no. 544/2004 for the Housing Financing Fund, is 3.0%. The ratio is calculated on the basis of the same method as for financial institutions. The Fund´s long term goal is to maintain an solvency ratio exceeding 5.0%. The Fund, in accordance with article 7 of the regulation mentioned above, notified the Minister of Social Affairs and Social Security that the Fund's solvency ratio was heading under 4%. The Fund's management is working on ways to improve the solvency ratio so as to reach the long term goal and have already raised the interest premium on new loans.

At year-end loans amounted to ISK 756,634 million and increased by ISK 76,228 million during the year. The Fund's borrowings amounted to ISK 784,570 million and increased by ISK 71,901 million during the year.

The Fund's operations were significantly adversely affected by the crisis in the financial market prevailing since the last several months 2008. 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 to these banks ISK 5,342 million due to derivatives and HFF bonds. In 2009, the Icelandic Financial Supervisory Authority suspended the Board of Directors of SPRON and Straumur-Burðarás Investment Bank hf. and appointed Resolution Committees for the banks. According to the decision of the Resolution Committees, the Fund´s deposits amounting to ISK 5,254 million were withheld in closed accounts.

During 2009 an impairment loss amounting to ISK 2,914 million was expensed in the income statement due to these claims. This impairment is an addition to the ISK 7,875 million recognised in the 2008 income statement as an estimate of the loss. A total of ISK 10,789 million has therefore been recognised as impairment relating to these claims. ISK 2,352 million is recgonised in the line item loans to banks in the balance sheet (see note 5). In the finanical 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. The Fund´s actual loss may therefore differ from this estimation.

Impairment of loans amounted to ISK 3,127 million at year-end 2009 an increase of ISK 1,462 million from the previous year. The number of loans where payments are past due has increased from the previous year and around 5.3% of the Fund's borrowers have one or more payment past due at year-end 2009.
During 2009 the Fund repossessed 251 apartments on foreclosed mortgages. At year-end 2009 the Fund owned 347 apartments, an increase of 151 from year-end 2008.

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. 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 has not evaluated possible effects of these write-offs after the extended loan period.

Governance

The Board of Directors of the Housing Financing Fund is nominated by the Minister of Social Affairs and Social Security for a four year period. The Board consists of five directors and five reserve directors and the Minister of Social Affairs nominates a Chairman and Reserve Chairman amongst Board members. The Minister decides on the Board members' compensation.

Endorsement and Statement, contd.:

The Board of Directors of the Housing Financing Fund emphasizes on maintaining good governance. The Board hires a Managing Director and establishes his job description. From the year 2010 Senior Civil Servants Salary Board determines the Managing Director´s salaries but previously his salaries were determined by the Board of Director. 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 Ministry of Finance, the Icelandic Central Bank, the Icelandic Financial Supervisory Authority 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. The Fund's operating procedures are published on the Fund's website; www.ils.is.

According to law no. 80/2008 the Fund’s management 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 the making 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 2009 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 2009, its assets, liabilities, and financial position as at 31 December 2009 and its cash flows for the year 2009.

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 2009 and hereby confirm them by means of their signatures.

Reykjavík, 15 April 2010.

The Board of Directors:

Hákon Hákonarson, Chairman
Gunnar S. Björnsson
Elín R. Líndal
Jóhann Ársælsson
Kristján Pálsson

The Managing Director:

Guðmundur Bjarnason

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, 2009, 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. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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 2009, 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 would like to draw attention to the fact that the Fund´s solvency ratio, which is calculated on the basis of regulation no. 544/2004, regarding the financial position and risk management of the Fund, is 3.0% at year end 2009. According to article 7 of the regulation the Fund´s long term goal shall be to maintain an solvency ratio exceeding 5.0%. In accordance with the regulation the Fund has informed the Minister of Social Affairs and Social Security of this fact.

Reykjavík, 15 April 2010.

KPMG hf.

Margrét Guðjónsdóttir
Hildur Sigurðardóttir

Income Statement for the year 2009

	Notes	2009	2008
Interest income		97.115.897	137.322.166
Interest expense		(94.314.161)	(134.650.816)
Net interest income	8	2.801.736	2.671.350
Service income		236.952	184.186
Operating income		3.038.688	2.855.536
Salaries and salary-related expenses	9-11	462.022	445.927
Other administrative expenses	13	658.185	556.390
Other operating expenses	14	33.419	30.882
Depreciation and amortisation	15,16	52.108	43.361
Total operating expenses		1.205.734	1.076.560
Impairment	4b, 5	(5.035.268)	(8.682.839)
Loss for the year		(3.202.314)	(6.903.863)

The notes on pages 10 to 25 are an integral part of these financial statements.

Amounts are in ISK thousands

Balance Sheet as at 31 December 2009

	Notes	2009	2008
Assets			
Cash and cash equivalents	4b	28.384.685	13.515.506
Derivatives		0	1.360.915
Loans to banks	6	6.634.118	29.767.718
Loans to customers	4b	756.634.191	680.405.761
Non-current assets held for sale		2.852.925	1.031.257
Operating assets	15	58.023	67.164
Intangible assets	16	153.284	125.364
Other assets		19.118	245.561
Total assets		794.736.344	726.519.246
Liabilities			
Bond issues	17	775.447.922	708.496.649
Other borrowings		9.122.153	4.172.679
Other liabilities		83.673	565.008
Total liabilities		784.653.748	713.234.336
Equity			
Contributed capital		7.155.408	7.155.408
Retained earnings		2.927.188	6.129.502
Total equity		10.082.596	13.284.910
Total liabilities and equity		794.736.344	726.519.246

The notes on pages 10 to 25 are an integral part of these financial statements.

Amounts are in ISK thousands

Statement of Changes in Equity for the year 2009

	Contributed earnings	Retained earnings	Total equity
2008			
Equity as at 1 January 2008	7.155.408	13.033.365	20.188.773
Loss for the year		(6.903.863)	(6.903.863)
Equity as at 31 December 2008	7.155.408	6.129.502	13.284.910
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

The notes on pages 10 to 25 are an integral part of these financial statements.

Amounts are in ISK thousands

Statement of Cash Flows for the year 2009

	Notes	2009	2008
Cash flows to operating activities:			
Loss for the year		(3.202.314)	(6.903.863)
Operating items not affecting cash flows:			
Indexation on loans to banks, loans to customers and borrowings		1.019.050	1.853.087
Depreciation and amortization	15,16	52.108	43.361
Loss on sale of operating assets		0	579
Provision for impairment		5.035.268	8.682.839
Changes in operating assets and liabilities:			
Loans to banks		21.790.324	(24.045.254)
Loans to customers		(16.011.510)	(19.767.381)
Non-current assets held for sale		(2.138.659)	(548.919)
Market securities		0	32.074.558
Derivatives		1.360.915	(2.510.819)
Other assets		226.443	(42.751)
Other liabilites		(481.335)	258.366
Cash flows to operating activities		7.650.290	(10.906.197)
Cash flows to investing activities:			
Operating assets and intangible assets, change		(70.887)	(120.415)
Investing activities		(70.887)	(120.415)
Cash flows from financing activities:			
Borrowings, change		7.289.776	23.488.763
Financing activities		7.289.776	23.488.763
Net increase in cash and cash equivalents		14.869.179	12.462.151
Cash and cash equivalents at 1 January		13.515.506	1.053.355
Cash and cash equivalents at 31 December		28.384.685	13.515.506

The notes on pages 10 to 25 are an integral part of these financial statements.

Financial Statements of the Housing Financing Fund for the year 2009 9 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 Social Affairs and Social Security. According to the law, the Icelandic state treasury has unlimited responsibilities for all of the Fund’s financial obligations.

2. 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 15 April 2010.

b. Basis of measurement

The financial statements have been prepared on the historical cost basis except for derivatives. Furthermore non-current assets held for sale are recognised at the lower of the book value and the 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 of the revision and future periods if the revision affects both current and future periods.

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. 3.c.(iv) to 3.c.(vi).

e. Changes in accounting policies

At the beginning of the year, revised IAS 1 Presentation of Financial Statements (2007) became effective. According to the standard, an entity shall present a statement of comprehensive income. Comprehensive income consist of both revenue and expenses recognised in profit or loss as well as revenue and expenses recognised directly in equity. No revenue or expenses of the Fund are recognised directly in equity and the loss for the period is therefore equal to comprehensive loss. Therefore, the Fund only presents an income statement.

f. New standards and interpretations not yet adopted

A numer of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2009, and have not been applied in preparing these financial statements. None of these will have an effect on the financial statements of the Fund.

3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these Financial Statements.

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.

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 of borrowings using the effective interest method.
- Interest income on loans to banks using the effective interest method.
- Fair value changes of derivatives, including interest.

b. *Service income*

Service income consists of collection charges and rental income from repossessed apartments on mortgages foreclosed. Service 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 service 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.

3. Significant accounting policies, contd.:

c. *Financial assets and financial liabilities, contd.:*

(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.

(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) Fair value of derivatives

Fair value of financial instruments not quoted in an active market is established by using a valuation technique, regularly calibrated. All valuation models have to be approved and tested to ensure that they reflect the data used for the fair value measurement.

Valuation techniques include using recent arm´s length transactions between knowledgeable, willing parties, reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses or other pricing models. The chosen valuation technique incorporates all factors that market participants would consider in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments. The Fund calibrates valuation techniques and tests them for validity using prices form observable market transactions in the same instruments, without modification or repackaging, or based on other available observable market data.
The derivative contracts that were in place at year-end 2008 were all settled during 2009 and therefore no such contracts were in place at year-end 2009. In October 2008, when the Icelandic banks collapsed, the Fund had a claim of ISK 16,620 million owed by the banks resulting from bonds and derivative contracts entered into with the banks. At the same time the Fund owed the banks ISK 5,342 million for derivative contracts and housing bonds. These derivative contracts are now recognised within "loans to banks" in the balance sheet. The Fund presumes that it has the right to off-set these balances.

(vi) Impairment of financial assets

The carrying amount of the Fund´s assets, other than trading assets and financial assets designated at fair value, 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) a breach of contract, such as a default on installments or on interest or principal payments.

3. Significant accounting policies, contd.:

c. *Financial assets and financial liabilities, contd.:*

(vi) Impairment of financial assets, contd.:

Individually assessed loans

Impairment losses on individually assessed loans are determined by an evaluation of the exposures 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:

- future cash flows in a group of loans evaluated for impairment are estimated on the basis of the contractual cash flows of the assets.
- 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.

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.

Loan write-offs

Loans are written off, partially or in full, when there is no realistic prospect of recovery.

Designation of financial assets and liabilities at fair value through profit and loss

The Fund has made derivative contracts for hedging purposes in order to reduce interest risk. It has designated a part of its financial assets and liabilities at fair value through profit and loss in order to reduce accounting time difference, which otherwise would arise as the derivatives are recognised at fair value through profit and loss but those financial assets and liabilities being hedged would otherwise be recognised at amortized cost. The Fund does not apply hedge accounting.

d. *Cash and cash equivalents*

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

3. Significant accounting policies, contd.:

e. *Derivatives*

During the last few years the Fund has entered into derivative contracts in order to reduce its interest-rate risk. These contracts were recognised at fair value and changes in fair value recognised through profit or loss. The Fund had no derivative contracts at year-end 2009. The Fund does not apply hedge accounting.

f. *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 5).

g. *Loans to customers*

Loans are non-derivative financial assets with fixed or determinable payments thate are not quoted in an active market, except for those that the Fund designates as at fair value through profit and loss. Loans and receivables include loans to customers, loans,which the Fund takes part in providing together with other credit institutions and acquired borrowings, 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.

h. *Non-current assets held for sale*

When the Fund has redeemed assets on foreclosed mortgages they are classified as non-current assets held for sale and recognised at the lower of fair value less estimated cost of sale or book value of the loan net of impairment.

i. *Operating assets*

Recognition and measurement

Operating assets are recognised at cost less accumulated depreciation.

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
Vehicle	10 years

Residual value is reviewed annually unless it is immaterial.

j. *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.

k. *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.

l. *l. Other assets and liabilities*

Other assets and liabilities are measured at cost.

4. 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, 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.

Annually the Board of Directors authorizes the Fund's risk management policy after having sent it to the Financial Supervisory Authority of Iceland for review. In the policy the Board of Directors of the Fund grant the Risk Committe and Investment Management Division permission to uphold the policy. The Fund has both a risk management and a financial management division. Both appertain to the financial department. The head of the department presents on an annual basis, taking into account indications by the risk management division, proposals to the Board of Directors of changes in financial and risk management.

Hedging

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 loan risk within a certain threshold. The fund uses both derivatives and other financial instruments in order to manage possible impacts of those risk factors on the Fund's return. Various types of derivatives are used for that purpose, including interest rate swaps and options. The Fund does not apply hedge accounting.

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

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 Social Affairs.

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.

4. Financial Risk Management, contd.:

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

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.

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. 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.

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:

4. Financial Risk Management, contd.:

b. *Credit risk, contd.:*

Credit risk exposure, contd.:

	Loans to individuals		Loans to others		Loans to banks	
	2009	**2008**	**2009**	**2008**	**2009**	**2008**
Book value...........	608.552.611	553.159.408	148.081.580	127.246.353	6.634.118	29.767.718
Past due and impared*	1.277.173	915.602	569.662	168.129		
Past due, not impaired**						
30 - 60 days	409.560	252.254	122.228	186.568		
61 - 90 days	559.465	320.101	256.843	213.204		
Over 90 days	1.529.224	334.869	658.459	235.793		
	2.498.249	907.224	1.037.530	635.565		
Loans past due total......................	3.775.422	1.822.826	1.607.192	803.694		
Loans neither past due nor impaired***	606.592.920	552.724.402	147.786.011	126.719.417	6.634.118	29.767.718
Gross carrying amount of loans	610.368.342	554.547.228	149.393.203	127.523.111	6.634.118	29.767.718
Impairment						
Specific impairment...........	(1.277.173)	(915.602)	(1.069.662)	(168.129)		
General impairment...........	(538.558)	(472.218)	(241.961)	(108.629)		
Impairment total...	(1.815.731)	(1.387.820)	(1.311.623)	(276.758)		
Book value...........	608.552.611	553.159.408	148.081.580	127.246.353	6.634.118	29.767.718

* Gross carrying amount of loans specifically impaired.
** Amounts past due.
*** Gross carrying amount of loans neither past due nor specifically impaired.

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.

Financial Statements of the Housing Financing Fund for the year 2009 17 Amounts are in ISK thousands

4. Financial Risk Management, contd.:

b. Credit risk, contd.:

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

ii) Upon the approval of the Housing Financing Fund of the discontinuance of claim of "lost pledge" in accordance with Regulation no. 119/2003, on the treatment of the Housing Financing Fund's receivables that have lost their pledges.

Impairment losses on loans, contd.:

Impairment on loans is specified as follows:

2009	Specific impairment	General impairment	Total 2008
Balance at the beginning of the year	1.083.730	580.990	1.664.720
Provision for impairment losses	1.368.130	436.008	1.804.138
Write-offs	(105.025)	(236.479)	(341.504)
Balance at year-end	2.346.835	780.519	3.127.354
Impairment on loans as a percentage of loans			0,41%

2008	Specific impairment	General impairment	Total 2007
Balance at the beginning of the year	818.673	389.245	1.207.918
Provision for impairment losses	422.958	384.453	807.411
Write-offs	(157.901)	(192.708)	(350.609)
Balance at year-end	1.083.730	580.990	1.664.720
Impairment on loans as a percentage of loans			0,23%

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

	2009	2008
Provision for impairment losses	1.804.138	807.411
Provision for assets held for sale	316.991	0
Impairment on receivables from banks (see note 5)	2.914.139	7.875.428
Total impairment	5.035.268	8.682.839

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.

Housing Financing Fund for the year 2009 18 Amounts are in ISK thousands

4. Financial Risk Management, contd.:

b. *Credit risk, contd.:*

	2009	2008
Pledging ratio under 30% of the rateable value	13%	13%
Pledging ratio of 31% - 60% of the rateable value	25%	25%
Pledging ratio of 61% - 80% of the rateable value	21%	38%
Pledging ratio of 81% - 100% of the rateable value	23%	13%
Pledging ratio of over 100% of the rateable value	18%	11%
	100%	100%

The weighted average pledging ratio of the Fund's total loans on the rateable value is approx. 48% (2008: 53%).

Cash and cash equivalents	2009	2008
Unrestricted cash in Central Bank	16.779.653	1.181.117
Unrestricted cash in other financial institutions	11.605.032	12.334.389
Cash and cash equivalents total	28.384.685	13.515.506

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 endeavours 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.

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 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.

31 Desember 2009	0 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
Financial assets:					
Cash and cash equivalents	28.384.685	0	0	0	28.384.685
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	41.808.917	35.745.214	268.874.412	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	25.582.886	(12.593.644)	(63.180.245)	244.436.802	194.245.799

Financial Statements of the Housing Financing Fund for the year 2009 19 Amounts are in ISK thousands

4. Financial Risk Management, contd.:

c. *Liquidity risk, contd.:*

Measurement of liquidity risk, contd.:

31 Desember 2008	0 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
Financial assets:					
Cash and cash equivalents...........	13.515.506	0	0	0	13.515.506
Derivatives..................................	930.352	430.563	0	0	1.360.915
Loans to customers and loans to banks...........................	16.322.515	41.433.352	255.123.650	1.012.543.711	1.325.423.228
Total financial assets....................	30.768.373	41.863.915	255.123.650	1.012.543.711	1.340.299.649
Financial liabilities:					
Borrowings and other liabilities...........................	17.079.050	46.032.125	319.204.488	891.855.073	1.274.170.736
Total financial liabilities................	17.079.050	46.032.125	319.204.488	891.855.073	1.274.170.736
Net balance.................................	13.689.323	(4.168.210)	(64.080.838)	120.688.638	66.128.913

d. *Interest rate risk*

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.

Prepayment risk

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.

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.

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. In addition, internal audit also has surveillance over the Fund’s operational risk.

Amounts are in ISK thousands

4. Financial Risk Management, contd.:

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 Finance thereof. Furthermore, the Fund's Board of Directors shall make proposals of ways to reach the long term solvency ratio goal.

Solvency ratio is specified as follows:	**2009**	**2008**
Total equity	10.082.596	13.284.910
Credit risk	26.245.612	22.462.296
Market risk	91	1.307
Operational risk	483.141	498.718
Total capital requirements	26.728.844	22.962.321
Solvency ratio	3,0%	4,6%

5. 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 management 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. During 2009 an impairment of ISK 2,914 million was expensed in the income statement. This impairment is an addition to the ISK 7,875 million recognised in the 2008 income statement as an estimate of the loss. A total of ISK 10,789 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. 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. The Fund´s actual loss may therefore differ from this estimation.

6. Loans to banks

Loans to banks are specified as follows:	**2009**	**2008**
Government bonds	2.831.193	0
Money market loans	0	6.029.574
Claim on SPRON	1.440.644	0
Claims on banks related to the financial collapse	2.362.281	23.738.144
Loans to banks total	6.634.118	29.767.718

7. 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.

Housing Financing Fund for the year 2009 21 Amounts are in ISK thousands

7. Financial assets and liabilities, contd.:

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

31 Desember 2009	Trading assets and liabilities	Loans and receivables	Other at amortized cost value	Book value	Fair value[1)]
Assets:					
Cash and cash equivalents..........		28.384.685		28.384.685	28.384.685
Loans to banks...........................		6.634.118		6.634.118	6.634.118
Loans to customers....................		756.634.191		756.634.191	751.766.420
Total financial assets..	0	791.652.994	0	791.652.994	786.785.223
Liabilities:					
Bond issues.................................			775.447.922	775.447.922	828.654.287
Other borrowings.......................			9.122.153	9.122.153	5.661.901
Total financial liabilities....................................	0	0	784.570.075	784.570.075	834.316.188
31 Desember 2008					
Assets:					
Cash and cash equivalents...........		13.515.506		13.515.506	13.515.506
Derivatives..................................	1.360.915	0		1.360.915	1.360.915
Loans to banks............................		29.767.718		29.767.718	28.687.861
Loans to customers.....................		680.405.761		680.405.761	647.260.273
Total financial assets..	1.360.915	723.688.985	0	725.049.900	690.824.555
Liabilities:					
Bond issues.................................			708.496.649	708.496.649	701.383.888
Other borrowings........................			4.172.679	4.172.679	3.964.045
Total financial liabilities....................................	0	0	712.669.328	712.669.328	705.347.933

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.

Amounts are in ISK thousands

8. Net interest income

	2009	2008
Interest income		
Interest income on items not at fair value:		
Interest income on loans to banks	13.117.116	19.509.075
Interest income on loans to customers	81.079.469	101.773.662
Government contribution to subsidy interests	514.395	435.401
	94.710.980	121.718.138
Interest income on items at fair value:		
Interest income on market securities	2.404.917	6.237.873
Interest income on derivatives	0	9.366.155
	2.404.917	15.604.028
Total interest income	97.115.897	137.322.166
Interest expenses		
Interest expenses on items not at fair value:		
Interest expenses on bond issues	92.911.346	128.612.077
Interest expenses on other borrowings	1.329.427	1.579.202
	94.240.773	130.191.279
Interest expense on items at fair value:		
Interest expenses on derivatives	73.388	4.459.537
Total interest expenses	94.314.161	134.650.816
Net interest income	2.801.736	2.671.350

9. Salaries and salary-related expenses

Salaries and salary-related expenses are specified as follows:

Salaries	365.105	351.871
Salary-related expenses	85.506	81.487
Other personnel expenses	11.411	12.569
Total salaries and salary-related expenses	462.022	445.927

10. Number of workers

The employees of the Fund number as follows:

Average number of full-time equivalent units	65	67
Number of employees at year-end	64	66

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

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

Guðmundur Bjarnason, the Managing Director	15.680	17.913
Chairman of the Board	2.072	2.072
Total other Board members	4.145	4.144
Total salaries of the Board of Directors and the Managing Director	21.897	24.129

Financial Statements of the Housing Financing Fund for the year 2009 23 Amounts are in ISK thousands

12. Auditor's fee

Remuneration to the auditor are specified as follows:

	2009	2008
Audit of Financial Statements	16.487	11.191
Review of Interim Financial Statements	3.753	4.530
Other services	6.647	7.795
Total auditor's fee	26.887	23.516

13. Other administrative expenses

Other administrative expenses are specified as follows:

Collection fees	269.282	183.737
Purchased professional services	113.942	100.683
Housing operating expenses	80.560	72.025
Advertisments and promotions	26.334	41.886
Operating cost of IT systems	118.395	101.789
Other operating expenses	49.672	56.270
Total other administrative expenses	658.185	556.390

14. Other operating expenses

Other operating expenses are specified as follows:

Grants due to technological advances	20.525	22.075
Homes' Advisory Office	8.544	6.407
Other grants	4.350	2.400
Total other operating expenses	33.419	30.882

15. Operating assets

Operating assets are specified as follows:

	Vehicle	Fixtures and equipment	Real estate	Total
Total value				
Total value as at 1.1.2008	3.735	175.602	6.071	185.408
Additions during the year	0	21.391	4.126	25.517
Sold during the year	(3.735)	0	0	(3.735)
Total value as at 31.12.2008	0	196.993	10.197	207.190
Total value as at 1.1.2009	0	196.993	10.197	207.190
Additions during the year	0	3.128	0	3.128
Total value as at 31.12.2009	0	200.121	10.197	210.318
Depreciation				
Depreciation as at 1.1.2008	1.153	119.840	4.720	125.713
Depreciation during the year	125	15.248	218	15.591
Sold during the year	(1.278)	0	0	(1.278)
Depreciation as at 31.12.2008	0	135.088	4.938	140.026
Depreciation as at 1.1.2009	0	135.088	4.938	140.026
Depreciation during the year	0	12.063	206	12.269
Depreciation as at 31.12.2009	0	147.151	5.144	152.295

Amounts are in ISK thousands

15. Operating assets, contd.:

	Vehicle	Fixtures and equipment	Real estate	Total
Book value				
Book value as at 1.1.2008	2.582	55.762	1.351	59.695
Book value as at 31.12.2008	0	61.905	5.259	67.164
Book value as at 31.12.2009	0	52.970	5.053	58.023

16. Intangible assets

Intangible assets are specified as follows:

	Software and webpage
Total value	
Total value as at 1.1.2008	96.276
Additions during the year	96.774
Total value as at 31.12.2008	193.050
Total value as at 1.1.2009	193.050
Additions during the year	67.759
Total value as at 31.12.2009	260.809
Depreciation	
Depreciation as at 1.1.2008	39.916
Depreciation during the year	27.770
Depreciation as at 31.12.2008	67.686
Depreciation as at 1.1.2009	67.686
Depreciation during the year	39.839
Depreciation as at 31.12.2009	107.525
Book value	
Book value as at 1.1.2008	56.360
Book value as at 31.12.2008	125.364
Book value as at 31.12.2009	153.284

17. Bond issues

Bond issues are specified as follows:	2009	2008
HFF bonds	703.004.395	636.731.426
Housing bonds	46.480.763	45.642.588
Housing Authority bonds	25.962.764	26.122.635
Total bond issues	775.447.922	708.496.649

Financial Statements of the Housing Financing Fund for the year 2009 25 Amounts are in ISK thousands