Housing Financing Fund

Financial Statements
for the year 2008

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 2008

The Housing Financing Fund´s loss for the year amounted to ISK 6,904 million according to the income statement. Equity at year-end amounted to ISK 13,285 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 4.6**%**. 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%.

At year-end loans amounted to ISK 680,406 million and increased by ISK 117,379 million during the year. The Fund's borrowings amounted to ISK 708,497 million and increased by ISK 129,749 million during the year.

The Fund´s operations were significantly adversely affected by the crisis in the financial market prevailing during the last several months of the year 2008. The Fund had approximately ISK 16,620 million outstanding receivable from Iceland´s three biggest banks that collapsed in early October 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 housing bonds. In the financial statements it is presumed that the Fund has the right to offset these balances. An impairment amounting to ISK 7,875 million has been recognised in the income statement as an estimate of the loss. Uncertainty prevails regarding the settlement of derivatives and Fund's right to offset these balances. The Fund's actual loss may therefore differ from this estimation.

Governance

The Board of Directors of the Housing Financing Fund is nominated by the Minister of Social Affairs 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.

The Board of Directors of the Housing Financing Fund emphasizes on maintaining good governance. The Board hires a Managing Director, determines his salaries, other employment benefits and establishes his job description. 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 og 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.

Statement by the Board of Directors and the Managing Director

The financial statements of the Housing Financing Fund for the year 2008 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 2008, its assets, liabilities, and financial position as at 31 December 2008 and its cash flows for the financial year 2008.

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.

Endorsement and Statement, contd.:

The Board of Directors and the Managing Director of the Housing Financing Fund have today discussed the Fund's Financial Statements for the year 2008 and hereby confirm them by means of their signatures.

Reykjavík, 19 March 2009.

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, 2008, 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 2008, 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.

Reykjavík, 19 March 2009.

KPMG hf.

Helgi F. Arnarson
Margrét Guðjónsdóttir

Income Statement for the year 2008

	Notes	2008	2007
Interest income		137,322,166	62,582,683
Interest expense		(134,650,816)	(59,071,587)
Net interest income	8	2,671,350	3,511,096
Service income		184,186	257,502
Operating income		2,855,536	3,768,598
Salaries and salary-related expenses	9-11	445,927	399,423
Other administrative expenses	13	556,390	494,056
Other operating expenses	14	30,882	23,271
Depreciation and amortisation	15,16	43,361	28,533
Total operating expenses		1,076,560	945,283
Impairment	4b, 5	(8,682,839)	(295,227)
(Loss) profit for the year		(6,903,863)	2,528,088

The notes on pages 10 to 24 are an integral part of these financial statements.

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Balance Sheet as at 31 December 2008

	Notes	2008	2007
Assets			
Cash and cash equivalents		13,515,506	1,053,355
Market securities	4b, 5	0	39,949,986
Derivatives		1,360,915	1,026,850
Loans to banks	6	29,767,718	95,941,638
Loans to customers		680,405,761	467,084,491
Non-current assets held for sale		1,031,257	482,338
Operating assets	15	67,164	59,695
Intangible assets	16	125,364	56,360
Other assets		245,561	202,810
Total assets		726,519,246	605,857,523
Liabilities			
Derivatives		0	2,176,754
Bond issues	17	708,496,649	578,747,759
Other borrowings		4,172,679	4,437,595
Other liabilities		565,008	306,642
Total liabilities		713,234,336	585,668,750
Equity			
Contributed capital		7,155,408	7,155,408
Retained earnings		6,129,502	13,033,365
Total equity		13,284,910	20,188,773
Total liabilities and equity		726,519,246	605,857,523

The notes on pages 10 to 24 are an integral part of these financial statements.

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Statement of Changes in Equity for the year 2008

	Contributed earnings	Retained earnings	Total equity
2007			
Equity as at 1 January 2007	7,155,408	10,505,277	17,660,685
Profit for the year		2,528,088	2,528,088
Equity as at 31 December 2007	7,155,408	13,033,365	20,188,773
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

The notes on pages 10 to 24 are an integral part of these financial statements.

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Statement of Cash Flows for the year 2008

	Notes	2008	2007
Cash flows to operating activities:			
(Loss) profit for the year		(6,903,863)	2,528,088
Operating items not affecting cash flows:			
Indexation on loans to banks, loans to customers and borrowings		1,853,087	1,175,702
Depreciation and amortization	15.16	43,361	28,533
Loss on sale of operating assets		579	0
Provision for impairment		8,682,839	295,227
Changes in operating assets and liabilities:			
Loans to banks		(24,045,254)	6,736,541
Loans to customers		(19,767,381)	(35,231,500)
Non-current assets held for sale		(548,919)	(88,046)
Market securities		32,074,558	(4,116,284)
Derivatives		(2,510,819)	1,607,745
Other assets		(42,751)	(87,435)
Other liabilites		258,366	197,330
Cash flows to operating activities		(10,906,197)	(26,954,099)
Cash flows to investing activities:			
Operating assets and intangible assets, change		(120,415)	(34,032)
Investing activities		(120,415)	(34,032)
Cash flows from financing activities:			
Borrowings, change		23,488,763	27,217,877
Financing activities		23,488,763	27,217,877
Net increase in cash and cash equivalents		12,462,151	229,746
Cash and cash equivalents at 1 January		1,053,355	823,609
Cash and cash equivalents at 31 December		13,515,506	1,053,355

The notes on pages 10 to 24 are an integral part of these financial statements.

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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.

The financial statements of the Housing Financing Fund were approved by the Board of Directors on 19 March 2009.

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.

b. *Basis of measurement*

The financial statements have been prepared on the historical cost basis except for derivatives, market securities and financial assets and liabilities designated at fair value through profit and loss. 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.(v) to 3.c.(vii).

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 amortization 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 and market securities. 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.

3. Significant accounting policies, contd.:

a. *Interest income and interest expense, contd.:*

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.
- Interest income on market securities using the effective interest method.
- Fair value changes of derivatives, including interest.
- Fair value changes of financial assets and liabilities designated at fair value though profit and loss, including interest.

b. *Service income*

Service income consists of collection charges. 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 and receivables 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.

(iii) Loans

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.

3. Significant accounting policies, contd.:

c. Financial assets and financial liabilities, contd.:

(iii) Loans, contd.;

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.

(iv) 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.

(v) 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.

(vi) 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 lenght 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 instuments, without modification or repackaging, or based on other available observable market data.

(vii) 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;

Individually assessed loans and receivables

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.

3. Significant accounting policies, contd.:

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

(vii) Impairment of financial assets, contd.:

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 and receivables

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.

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.

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.

3. Significant accounting policies, contd.:

d. *Cash and cash equivalents*

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

e. *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.

f. *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.

g. *Other assets and liabilities*

Other assets and liabilities are measured at cost.

h. *New standards and interpretations not yet adopted*

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2008, and have not been applied in preparing these financial statements. The amendments to the standards and interpretations are not expected to have a significant impact on the Fund´s financial statements when entering into force.

- *IFRS 8 Operating Segment,* applicable to periods starting 1 January 2009 and later.
- *IAS 1 Presentation of Financial Statements* , becomes mandatory for the Fund's 2009 financial statements.
- *IAS 23 Borrowing Costs* , becomes mandatory for the Fund's 2009 financial statements.
- *IFRS 3 Business Combinations* , becomes mandatory for the Fund's 2010 financial statements.
- *IFRS 2 Share-Based-Payment - Vesting Conditions and Cancellations* , becomes mandatory for the Fund's 2009 financial statements with retrospective application if it will be approved by the European Union.
- *IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements - Puttable Financial Instruments and Obligations Arising on Liquidation* becomes mandatory for the Fund's 2009 financial statements with retrospective application if it will be approved by the European Union.
- *IAS 39 Financial Instruments: Recognition and Measurement - Eligible Hedged Items* becomes mandatory for the Fund's 2010 financial statements with retrospective application if it will be approved by the European Union.
- *IFRIC 13 Customer Loyalty Programmes* becomes mandatory for the Fund's 2009 financial statements if it
- *IFRIC 15 Agreements for the Construction of Real Estate* becomes mandatory for the Fund's 2009 financial statements if it will be approved by the European Union.
- *IFRIC 17 Distribution of Non-cash Assets to Owners* becomes mandatory for the Fund's 2010 financial statements if it will be approved by the European Union.
- *IFRIC 12 Service Concession Arrangements* became effective for the year 2008 but has not been applied in the preparation of these financial statements as it has not yet been approved by the European Union.

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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

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.

Following, the key role and responsibility of some parties for the Fund's financial and risk management are described:

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.

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.

4. Financial Risk Management, contd.:

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

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 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:

	Loans to individuals		Loans to others		Loans to banks	
	2008	2007	2008	2007	2008	2007
Book value...........	553,159,408	377,052,109	127,246,353	90,032,382	29,767,718	95,941,638
Defaults are specified as follows:						
Defaults including impairment.........	915,602	691,664	168,129	127,008		
Defaults excluding impairment						
30 - 60 days..........	252,254	124,712	186,568	29,779		
60 - 90 days..........	320,101	144,971	213,204	34,616		
Defaults over 90 days..............	334,869	184,642	235,793	44,089		
Total defaults........	1,822,826	1,145,989	803,694	235,492		

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4. Financial Risk Management, contd.:

b. *Credit risk, contd.:*

Credit risk exposure, contd.:

	Loans to individuals		Loans to others		Loans to banks	
	2008	2007	2008	2007	2008	2007
Neither defaulted nor impaired						
Renegotiated loans	1,692,298	1,034,700	0	0	0	0
Other loans	551,032,104	375,828,558	126,719,417	89,987,288	29,767,718	96,002,019
Total	554,547,228	378,009,247	127,523,111	90,222,780	29,767,718	96,002,019
Impaired financial assets						
Specific impairment	(915,602)	(691,664)	(168,129)	(127,008)	0	0
General impairment	(472,218)	(265,474)	(108,629)	(63,390)	0	(60,381)
Total impairment	(1,387,820)	(957,138)	(276,758)	(190,398)	0	(60,381)
Book value	553,159,408	377,052,109	127,246,353	90,032,382	29,767,718	95,941,638

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.

Impairment on loans is specified as follows:

2008	Specific impairment	General impairment	Total 2008
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%

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4. Financial Risk Management, contd.:

b. *Credit risk, contd.:*

Impairment losses on loans, contd.:

2007	Specific impairment	General impairment	Total 2007
Balance at the beginning of the year	670,854	346,750	1,017,604
Provision for impairment losses	183,497	111,730	295,227
Write-offs	(35,678)	(69,235)	(104,913)
Balance at year-end	818,673	389,245	1,207,918
Impairment on loans as a percentage of loans			0.21%

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

	2008	2007
Provision for impairment losses	807,411	295,227
Impairment on market securities	7,875,428	0
Total impairment	8,682,839	295,227

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. 119/2003, on the treatment of the Housing Financing Fund's receivables that have lost their pledges.

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 rateable value of a specific real estate, provided that there are no other restrictions of a maximum loan amount. 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.

	2008	2007
Pledging ratio under 30% of the rateable value	13%	19%
Pledging ratio of 31% - 60% of the rateable value	25%	33%
Pledging ratio of 61% - 80% of the rateable value	38%	28%
Pledging ratio of 81% - 100% of the rateable value	24%	20%
	100%	100%

The weighted average pledging ratio of the Fund's total loans on the rateable value is approx. 53% (2007: 62%).

Financial Statements of the Housing Financing Fund for the year 2008 18 Amounts are in ISK thousands

4. Financial Risk Management, contd.:

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.

	0 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
31 Desember 2008					
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
31 Desember 2007					
Financial assets:					
Cash and cash equivalents...........	1,053,355	0	0	0	1,053,355
Market securities..........................	22,196,858	5,984,314	21,426,025	0	49,607,197
Derivatives....................................	1,026,850	0	0	0	1,026,850
Loans to customers and loans to banks............................	8,522,584	25,737,048	166,100,220	764,947,668	965,307,520
Total financial assets....................	32,799,647	31,721,362	187,526,245	764,947,668	1,016,994,922

Amounts are in ISK thousands

4. Financial Risk Management, contd.:

c. *Liquidity risk, contd.:*

Measurement of liquidity risk, contd.:

31 Desember 2007	0 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
Financial liabilities:					
Derivatives	2,176,754	0	0	0	2,176,754
Borrowings and other liabilities	12,308,821	34,504,562	227,925,792	698,182,628	972,921,803
Total financial liabilities	14,485,575	34,504,562	227,925,792	698,182,628	975,098,557
Net balance	18,314,072	(2,783,200)	(40,399,547)	66,765,040	41,896,365

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 the same, or 10 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. *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:	**2008**
Total equity	13,284,910
Credit risk	22,462,296
Market risk	1,307
Operational risk	498,718
Total capital requirements	22,962,321
Solvency ratio	4.6%

Financial Statements of the Housing Financing Fund for the year 2008 20 Amounts are in ISK thousands

5. Impairment of market securities

The Fund´s operations were significantly adversely affected by the crisis in the financial market prevailing during the last several months of the year 2008. The Fund owned approximately ISK 16,620 million in bonds and derivatives to Iceland´s three biggest banks that collapsed in early October. The Fund owed the banks ISK 5,342 million in derivatives and housing bonds at the same time. In the financial statements it is presumed that the Fund has the right to offset these balances. An impairment amounting to ISK 7,875 million has been recognised in the income statement as an estimate of the loss. Uncertainty prevails regarding the settlement of derivatives and Fund's right to offset these balances. The Fund's actual loss may therefore differ from this estimation.

6. Loans to banks

During the year terms of the Fund´s contracts with financial institutions were change in such a way that all risk and rewards relating to the underlying mortgage loans provided by the financial institutions, where transferred to the fund. As a result those instruments are now classified as loans to customers but were previously classified as loans to banks.

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.
- Financial assets and liabilities designated at fair value - are recognized at fair value.
- Loans and receivables - are recognized at the amortized cost value.
- Other financial liabilities - are recognized at the amortized cost value.

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

31 Desember 2008	Trading assets and liabilities	Financial assets and liabilities designated at fair value	Loans and receivables	Other at amortized cost value	Book value	Fair value[1)]
Assets:						
Cash and cash equivalents.........	0	0	13,515,506	0	13,515,506	13,515,506
Derivatives...........	1,360,915	0	0	0	1,360,915	1,360,915
Loans to banks.................	29,767,718	0	0	0	29,767,718	28,687,861
Loans to customers..........	0	0	680,405,761	0	680,405,761	647,260,273
Total financial assets................	31,128,633	0	693,921,267	0	725,049,900	690,824,555
Liabilities:						
Bond issues..........	0	0	0	708,496,649	708,496,649	701,383,888
Other borrowings..........	0	0	0	4,172,679	4,172,679	3,964,045
Total financial liabilities.............	0	0	0	712,669,328	712,669,328	705,347,933

Amounts are in ISK thousands

7. Financial assets and liabilities, contd.:

31 Desember 2007	Trading assets and liabilities	Financial assets and liabilities designated at fair value	Loans and receivables	Other at amortized cost value	Book value	Fair value[1)]
Assets:						
Cash and cash equivalents............	0	0	1,053,355	0	1,053,355	1,053,355
Market securities................	39,949,986	0	0	0	39,949,986	39,949,986
Derivatives..............	1,026,850	0	0	0	1,026,850	1,026,850
Loans to banks....................	0	13,947,644	81,993,994	0	95,941,638	85,490,117
Loans to customers................	0	0	467,084,491	0	467,084,491	404,736,694
Total financial assets....................	40,976,836	13,947,644	550,131,840	0	605,056,320	532,257,002
Liabilities:						
Derivatives..............	2,176,754	0	0	0	2,176,754	2,176,754
Bond issues............	0	25,306,294	0	553,441,465	578,747,759	522,712,311
Other borrowings............	0	0	0	4,437,595	4,437,595	4,283,393
Total financial liabilities................	2,176,754	25,306,294	0	557,879,060	585,362,108	529,172,458

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 2008 22 Amounts are in ISK thousands

8. Net interest income

	2008	2007
Interest income		
Interest income on items not at fair value:		
Interest income on loans to banks	19,509,075	9,591,668
Interest income on loans to customers	101,773,662	44,552,051
Government contribution to subsidy interests	435,401	302,141
	121,718,138	54,445,860
Interest income on items at fair value:		
Interest income on market securities	6,237,873	4,389,468
Interest income on derivatives	9,366,155	3,747,355
	15,604,028	8,136,823
Total interest income	137,322,166	62,582,683
Interest expenses		
Interest expenses on items not at fair value:		
Interest expenses on bond issues	128,612,077	45,648,765
Interest expenses on other borrowings	1,579,202	10,287,971
	130,191,279	55,936,736
Interest expense on items at fair value:		
Interest expenses on derivatives	4,459,537	3,134,851
Total interest expenses	134,650,816	59,071,587
Net interest income	2,671,350	3,511,096

9. Salaries and salary-related expenses

Salaries and salary-related expenses are specified as follows:

Salaries	351,871	312,686
Salary-related expenses	81,487	72,119
Other personnel expenses	12,569	14,618
Total salaries and salary-related expenses	445,927	399,423

10. Number of workers

The employees of the Fund number as follows:

Average number of full-time equivalent units	67	63
Number of employees at year-end	66	62

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	17,913	17,460
Chairman of the Board	2,072	2,072
Total other Board members	4,144	4,146
Total salaries of the Board of Directors and the Managing Director	24,129	23,678

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12. Auditor's fee

Remuneration to the auditor are specified as follows:

	2008	2007
Audit of Financial Statements	11,191	5,711
Review of Interim Financial Statements	4,530	2,995
Other services	7,795	5,258
Total auditor's fee	23,516	13,964

13. Other administrative expenses

Other administrative expenses are specified as follows:

	2008	2007
Collection fees	183,737	167,052
Purchased professional services	100,683	101,421
Housing operating expenses	72,025	69,388
Advertisments and promotions	41,886	25,945
Operating cost of IT systems	101,789	68,197
Other operating expenses	56,270	62,053
Total other administrative expenses	556,390	494,056

14. Other operating expenses

Other operating expenses are specified as follows:

	2008	2007
Grants due to technological advances	22,075	16,475
Homes' Advisory Office	6,407	6,031
Other grants	2,400	765
Total other operating expenses	30,882	23,271

15. Operating assets

Operating assets are specified as follows:

	Vehicle	Fixtures and equipment	Real estate	Total
Total value				
Total value as at 1.1.2007	3,735	172,789	6,071	182,595
Additions during the year	0	2,813	0	2,813
Total value as at 31.12.2007	3,735	175,602	6,071	185,408
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
Depreciation				
Depreciation as at 1.1.2007	779	105,246	4,477	110,502
Depreciation during the year	374	14,594	243	15,211
Depreciation as at 31.12.2007	1,153	119,840	4,720	125,713
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

Financial Statements of the Housing Financing Fund for the year 2008 24 Amounts are in ISK thousands

15. Operating assets, contd.:

	Vehicle	Fixtures and equipment	Real estate	Total
Book value				
Book value as at 1.1.2007	2,956	67,543	1,594	72,093
Book value as at 31.12.2007	2,582	55,762	1,351	59,695
Book value as at 31.12.2008	0	61,905	5,259	67,164

16. Intangible assets

Intangible assets are specified as follows:

	Software and webpage
Total value	
Total value as at 1.1.2007	65,057
Additions during the year	31,219
Total value as at 31.12.2007	96,276
Total value as at 1.1.2008	96,276
Additions during the year	96,774
Total value as at 31.12.2008	193,050
Depreciation	
Depreciation as at 1.1.2007	26,594
Depreciation during the year	13,322
Depreciation as at 31.12.2007	39,916
Depreciation as at 1.1.2008	39,916
Depreciation during the year	27,770
Depreciation as at 31.12.2008	67,686
Book value	
Book value as at 1.1.2007	38,463
Book value as at 31.12.2007	56,360
Book value as at 31.12.2008	125,364

17. Bond issues

Bond issues are specified as follows:	2008	2007
HFF bonds	636,731,426	510,792,546
Housing bonds	45,642,588	43,623,200
Housing Authority bonds	26,122,635	24,332,013
Total bond issues	708,496,649	578,747,759

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