Housing Financing Fund
Condensed Interim
Financial Statements
30 June 2018

These Financial Statements are translated from the original statements which are in Icelandic. Should there be discrepancies between the two versions, the Icelandic version shall prevail.

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Contents

Endorsement and Statement by the Board of Directors and CEO

The Condensed Interim Financial Statements of the Housing Financing Fund for the period 1 January to 30 June 2018 have been prepared in accordance with the International Financial Reporting Standard IAS 34, Interim Financial Statements, and additional disclosure requirements for companies whose securities are listed on a regulated market.

Results during the period

According to the income statement, the Housing Financing Fund's operating surplus in the first six months of 2018 amounted to ISK 1,474 million. Equity at the end of the period amounted to ISK 24,502 million, and the equity ratio is 9.11%. The equity ratio of the Housing Financing Fund has not been higher since the establishment of the Fund in 1999, and the Fund's long-term objective pertaining to the equity ratio is 5% as according to Regulation no. 544/2004 on the financial and risk management of the Housing Financing Fund.

Net interest income during the period was negative in the amount of ISK 109 million but was positive by ISK 532 million for the same period last year. Interest income contribution due from the Treasury, amounting to ISK 299 million, to compensate for the loss of interest income during the period as a result of the principal reduction of inflation-indexed housing mortgages, cf. Act no. 35/2014, has not been recognised in the Interim Financial Statements as an agreement has not yet been reached regarding the payments of the compensation. Net interest income is therefore lower by that amount. Prepayment fees are included in interest income within the period. The significant number of prepayments in the year affect the development of interest income and increase the Fund's reinvestment risk, however the Fund earns a considerable amount of income from prepayments fees, thereby mitigating the effects of prepayments. Operating expenses for the period amounted to ISK 958 million, increasing by 13.7% compared to the same period last year. Increased operating costs can be attributed to the fact that the Housing Financing Fund has enlisted 15 new employees following the take over of the operations of housing benefits on 1 January of this year. The operation of housing benefits is financed by the fiscal budget. During the period, the Housing Financing Fund made payments amounting to ISK 81 million for the operations of government agencies, the Debtor's Ombudsman, and the Financial Supervisory Authority or the equivalent of 17% of the other operating expenses of the Fund.

Regarding the principal reduction of inflation-indexed housing mortgages under Act no. 35/2014, a letter from the Ministry of Welfare dated 19 December 2014 stated that both the Minister of Social Affairs and Housing and the Minister of Finance were in agreement that the Housing Financing Fund would be compensated for the negative impact the measures have had on the Fund. Since then, the Fund has had discussions with the government about how the Fund would be compensated, as has been disclosed in previous annual and interim financial statements. The Housing Financing Fund has already received compensation for its losses in the amount of ISK 1,658 million from the Treasury. Further payments have not been made due to the adequate capital and liquidity positions of the Fund. The conclusions of the discussions with the government are that previous statements regarding compensation still stand, but at the present time further payments from the Treasury to the Housing Financing Fund are not justified given the Fund's current financial position.

Losses due to principal reductions of loans are calculated on a yearly basis as the difference between the expected interest income on loans that were adjusted and the real return on the Fund's liquid assets in the previous year. The calculations take into account that the relevant loans would have otherwise been subject to traditional subsidy payment processes, or been prepaid before the final maturity date. Accrued interest income not recognized as income amounts to ISK 760 million.

Arrears amount to 2.0% of total loans, but were 2.1% at the end of 2017. At the end of the period, funds invested in appropriated properties amounted to ISK 5,541 million, decreasing by ISK 1,090 million between periods. The Fund owned 333 properties at the end of the period. Of these, 208 were rentals and 125 were sold and empty.

Operations and risk factors

Increased challenges exist in the Fund's operations as continued prepayments of the Fund's loans affect net interest income. As the proportion of financial assets outside of the loan portfolio increases, the mismatch of the Fund's assets and liabilities increases which in the future has a negative effect on the Fund's performance. However, the Fund has accumulated liquid assets in order to meet the outstanding cash flows of outstanding debt in the foreseeable future.

Endorsement and Statement by the Board of Directors and CEO, contd.:

Operations and risk factors, contd.

The Housing Financing Fund is a non-profit organization and therefore has a low-risk appetite, the Fund's Board of Directors determining acceptable risks as permitted by law and regulations. The Housing Financing Fund faces various types of risks and risk management is an important and integral part of the Fund's operations. Due to improved economic conditions, the Fund's lending risk has decreased sharply as new lending and defaults on older lending decrease and collateral positions improve.

Increased prepayments have a negative impact on the Fund's interest rate margin, as the Fund is not permitted to pay its debt (funding) before maturity and has to reinvest funds received from the prepayment of loans at lower interest rates. New lending is also insignificant as the Fund now provides almost exclusively social loans. The Fund is therefore subject to tighter restrictions when it comes to lending, and almost all of the proceeds from prepayments are allocated towards assets outside of the loan portfolio.

The objective of the policy and management of assets outside the loan portfolio is to minimize the imbalance of assets and liabilities. The main challenges in managing assets outside of the loan portfolio are interest rate and inflation risk, as well as the extent and size of assets outside of the loan portfolio. The risk of inflation arises from the fact that the Fund's debt is indexed, while a portion of the assets is non-indexed. This entails greater challenges in the management of funds outside of the loan portfolio. The Fund's treasury policy is prudent which is reflected in the Fund's investments.

Assets outside of the loan portfolio at the end of the period amounted to 37% of the Fund's total assets or a total of ISK 275,790 million. Assets and liabilities are settled consistently under terms but have a maturity until 2044 which is the final maturity date of debt. Assets outside the loan portfolio have, among others, been invested in asset-backed indexed bonds with similar payment paths to increase the balance between the debt and assets of the Fund and thus reduce the loss due to prepayments.

The Minister of Social Affairs and Equal Opportunities has requested nominations and intends to appoint a working group to assist the government in reducing the Treasury's risk due to prepayments. The group will be assigned to find solutions to the problems caused by the prepayments. The decision on the appointment of the working group follows a legislative amendment by the newly convened parliament session, converting the Housing Financing Fund into a government control agency of housing affairs, a Nordic model of a housing agency. The amount of prepayments of the Fund's loans has continued to increase, and now it is estimated that prepayments in 2017 and 2018 will amount to up to ISK 150 billion. The government has focused on finding a solution that reduces its risk due to prepayments and is examining how to improve the management of the loan portfolio so as to reduce the imbalance of assets and liabilities of the Fund. Both the Financial Supervisory Authority and the Central Bank of Iceland have recently pointed out that the changed role of the Housing Financing Fund and its legislative changes call for the accounting separation of the new and older activities of the Fund.

Housing Financing Fund becomes Housing Agency Fund

The role of the Housing Financing Fund was changed by the newly convened parliament session under Act no. 65/2018. Following these changes, the Fund will be a government control mechanism in housing affairs. Also proposed is to change the name of the Fund in the near future to the Housing Agency Fund in line with its current role. In recent years, the Fund's activities have evolved from being a traditional credit institution to being a government agency focusing on policy formulation in housing affairs. The role of the Housing Financing Fund will now be comparable to the role of the sister institutions: Husbanken Fund in Norway and the ARA in Finland. These institutions are responsible for implementing government policies in housing affairs, planning and analysis as well as managing comprehensive housing support, including housing benefits, grants and loans to individuals, municipalities and companies.

Endorsement and Statement by the Board of Directors and CEO, contd.:

Housing Financing Fund becomes Housing Agency Fund, contd.:

The Minister of Social Affairs and Equal Opportunities has requested nominations and intends to appoint a task force to develop a comprehensive housing policy for Iceland and to change the name of the Housing Financing Fund to the Housing Agency Fund in accordance with the changed role of the Fund. The appointment of the working group is in line with the Government's objectives in housing affairs. The government's policy statement promotes the improvement of the public's access to secure housing by enhancing support systems, coordinating policies in the development of social housing and increasing transparency in the rental market. The threshold for young people and low income in the housing market will be reduced.

The working group is expected to focus on these goals, and to draft a housing policy for Iceland that may be the basis for a parliamentary resolution by the Minister. Such a proposal shall be submitted after the end of the housing session pursuant to the new legislation on housing. The Act states that the Minister proposes to Parliament, within a year of parliamentary elections, a proposal for a parliamentary resolution on housing policy for a period of four years at a time. The proposal should include, inter alia, information on housing issues collected by the Housing Financing Fund and municipal housing plans as well as information from the Housing Financing Fund on their progress. A parliamentary resolution on housing policy shall cover all projects aimed at ensuring safe housing for the citizens of the country.

Endorsement by the Board of Directors and CEO

To the best of our knowledge, it is our opinion that the Condensed Interim Financial Statements give a true and fair view of the Fund's comprehensive income, assets, liabilities and financial position on 30 June 2018, and changes in cash in the period 1 January to 30 June 2018. Further, in our opinion, the Fund's Condensed Interim Financial Statements and the report of the Board of Directors and CEO provide a clear overview of the development and performance of the Fund's operations, describing its position and the main risks and uncertainties of the Fund. The Board of Directors and CEO have today discussed the Condensed Interim Financial Statements of the Fund for the period 1 January to 30 June 2018 and hereby confirm them by means of their signature.

Reykjavik, 31 August, 2018

Board of Directors:

Haukur Ingibergsson
Chairman of the Board

G. Valdimar Valdemarsson

Ásta Pálmadóttir

Sigurbjörn Ingimundarson

CEO

Hermann Jónasson

Independent Auditors' Review Report

To the Board of Directors of the Housing Financing Fund,

We have reviewed the accompanying Condensed Interim Financial Statements of the Housing Financing Fund for the period of 1 January until 30 June 2018, which consist of the income statement and statement of comprehensive income, balance sheet,the statement of changes in equity, the statement of cash flows, and other explanatory notes. Management is responsible for the preparation and fair presentation of this interim financial information in accordance with IAS 34 "Interim Financial Reporting", as adopted by the European Union. Our responsibility is to express a conclusion on this Condensed Interim Financial Statement based on our review.

Scope of Review

We conducted our review in accordance with International Standard on Review Engagements 2410, on reviews of interim financial statements by independent auditors. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion on the Condensed Interim Financial Statements.

Conclusion

Based on our review, nothing has come to our attention that suggests otherwise, but that the accompanying Condensed Interim Financial Statement give a true and fair view of the performance of the Fund for the period of 1 January to 30 June 2018, the financial position of the Fund as at 30 June 2018, and its cash flow for the period 1 January to 30 June 2018, in accordance with IAS 34 “Interim Financial Reporting”, as adopted by the European Union.

Reykjavik, 31 August 2018

Grant Thornton endurskoðun ehf.

J. Sturla Jónsson

Sturla Jónsson
State authorised public accountant

Interim Income Statement and Statement of Comprehensive Income from 1 January to 30 June 2018

	Notes	2018 1.1.-30.6	2017 1.1.-30.6
Interest income		25.178.042	24.779.469
Interest expense		(25.287.291)	(24.247.182)
Net interest income	21	(109.249)	532.287
Other income	22	221.523	94.502
Total operating income		112.274	626.789
Salaries and salary-related expenses	23	507.044	415.075
Other operating expenses	24	410.038	389.067
Depreciation and amortisation	25	41.475	38.935
Total operating expenses		958.557	843.077
Net income of appropriated properties	26	92.356	83.260
Net operating income		(753.927)	(133.028)
Reversal of impairment of loans and appropriated assets	27	2.227.805	747.133
Profit for the year and comprehensive income		1.473.878	614.105

The notes on pages 11 to 24 are an integral part of these Interim Financial Statements.

Condensed Interim Financial Statements of the Housing Financing Fund 30 June 2018 7 Amounts in ISK thousand

Interim Balance Sheet as at 30 June 2018

	Notes	30.6.2018	31.12.2017
Assets			
Cash and cash equivalents	7	63.235.145	66.608.413
Loans to financial institutions	8	20.610.215	6.891.793
Marketable securities	9	0	11.249.780
Other securities	10	191.944.451	163.655.406
Receivable from State Treasury	11	6.186.191	6.107.495
Loans	12	462.521.863	499.989.109
Appropriated assets	13	5.541.412	6.631.138
Operating assets	14	142.368	150.269
Intangible assets	15	135.399	166.005
Other assets	16	1.002.479	477.339
Total assets		751.319.523	761.926.747
Liabilities			
Bond issues	17	725.654.013	735.897.135
Other borrowings	18	370.237	818.745
Other liabilities	19	793.509	317.178
Total liabilities		726.817.759	737.033.058
Equity			
Contributed capital		57.655.408	57.655.408
Accumulated deficit		(33.153.644)	(32.761.719)
Total equity	20	24.501.764	24.893.689
Total liabilities and equity		751.319.523	761.926.747

The notes on pages 11 to 24 are an integral part of these Interim Financial Statements.

Condensed Interim Financial Statements of the Housing Financing Fund 30 June 2018 8 Amounts in ISK thousand

Interim Statement of Changes in Equity from 1 January to 30 June 2018

Changes in equity from 1 January to 30 June 2018	**Contributed capital**	**Accumulated deficit**	**Equity Total**
Equity as at 1 January 2018	57.655.408	(32.761.719)	24.893.689
Impact of adopting IFRS 9	0	(1.865.803)	(1.865.803)
Profit for the period and comprehensive income	0	1.473.878	1.473.878
Equity as at 30 June 2018	57.655.408	(33.153.644)	24.501.764

Year 2017	**Contributed capital**	**Accumulated deficit**	**Equity Total**
Equity as at 1 January 2017	57.655.408	(34.127.566)	23.527.842
Profit for the year and comprehensive income	0	1.365.847	1.365.847
Equity as at 31 December 2017	57.655.408	(32.761.719)	24.893.689

The notes on pages 11 to 24 are an integral part of these Interim Financial Statements.

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Interim Statement of Cash Flows from 1 January to 30 June 2018

	2018 1.1.-30.6.	2017 1.1.-30.6.
Cash flows from operating activities		
Profit for the year and comprehensive income	1.473.878	614.105
Adjusted for:		
Indexation on loans to banks and loans to customers	(7.847.830)	(5.726.962)
Indexation on borrowings	9.511.091	6.418.122
Depreciation and amortisation	41.475	38.935
Impairment	(2.227.804)	(993.628)
Changes in operating assets and liabilities:		
Loans	43.196.323	39.793.469
Appropriated properties	2.261.630	3.959.411
Other assets	(532.409)	(91.067)
Other liabilities	477.572	(361.645)
Cash flows from operating activities	46.353.926	43.650.740
Cash flows from investing activities		
Marketable securities, change	0	(95.938)
Claims on financial institutions, change	(13.628.798)	41.099
Other securities, change	(15.892.709)	(9.449.897)
Investment in operating assets and intangible assets	(2.967)	(52.192)
Cash flows to investing activities	(29.524.474)	(9.556.928)
Cash flows from financing activities		
Bond issues and other borrowings, repayments	(20.202.721)	(19.646.455)
Cash flows to financing activities	(20.202.721)	(19.646.455)
Net increase in cash and cash equivalents	(3.373.269)	14.447.357
Cash and cash equivalents at the beginning of the year	66.608.413	53.171.360
Cash and cash equivalents at the end of the period	63.235.144	67.618.717

The notes on pages 11 to 24 are an integral part of these Interim Financial Statements.

Condensed Interim Financial Statements of the Housing Financing Fund 30 June 2018 10 Amounts in ISK thousand

Notes to the Interim Financial Statements

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 renovations in Iceland. The Fund is responsible for the allocation of government contributions for the development of public housing, housing policy planning, conducting housing market research and carrying out the implementation of housing benefits. The Housing Financing Fund is an independent institution owned by the State. The Fund operates under the Housing Act no. 44/1998, the Housing Compensation Act no. 75/2016, the Rent Act no. 36/1994 and the Act on Public Housing no. 52/2016, and appertains to a special management and the Minister of Welfare. The Housing Financing Fund is subject to supervision of the Financial Supervisory in Iceland in accordance with Act. 87/1998 on Official Supervision of Financial Activities. According to the law, the Icelandic State Treasury guaranties all of the Fund’s financial obligations.

2. Basis of preparation

a. *Statement of compliance*

The Condensed Interim Financial Statements have been prepared in accordance with IAS 34 Interim Financial Reporting. They do not include all of the information required for full annual financial statements and should be read in conjunction with the Financial Statements of the Fund as at and for the year ended 31 December 2017.

The Condensed Interim Financial Statements of the Housing Financing Fund were approved by the Board of Directors on 31 August 2018.

b. *Basis of measurement*

The Condensed Interim Financial Statements have been prepared on the historical cost basis except for the following: trading securities are measured at fair value, appropriated properties are measured at the lower of cost or net fair value.

c. *Functional currency*

The Condensed Interim 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. *Uses of estimates and judgements*

The preparation of interim financial statements in conformity with the IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. The estimates and underlying assumptions are based on historical experience and various other factors that are believed to be reasonable at the reporting date, 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.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised and the effect of the changes are entered in the periods that the changes are made and in subsequent periods if the change also affects those periods.

Information about significant areas of estimation uncertainty that have the most significant effect on the amounts recognised in the financial statements are described in the following notes:

- Impairment on loans, cf. note 12.
- Appropriated assets, cf. note 13.

3. Significant accounting policies

The accounting polices applied in the Condensed Interim Financial Statements are consistent with those applied in the Financial Statements for the year 2017, with the exception of the changes introduced by the adoption of the new standards, IFRS 9 and IFRS 15. Further information on the changes in accounting policies due to the implementation of the new standards are described in note 31. Revenues and expenses of the Fund are not recognised directly in other comprehensive income and the result for the year is therefore equal to comprehensive (loss) income.

Notes, contd.:

4. Classification of financial assets and financial liabilities under the implementation of IFRS 9

The table below shows the original measurement categories according to IAS 39 and new measurement categories according to IFRS 9 for financial assets and liabilities of the Fund on 1 January 2018.

	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39	Carrying amount under IFRS 9
Financial assets:				
Cash and cash equivalents	Loans	Amortised cost	66.608.413	66.608.413
Loans to financial institutions	Loans	Amortised cost	6.891.793	6.891.793
Marketable securities	Trading assets	Amortised cost	11.249.780	0
Other securities	Loans	Amortised cost	163.655.406	174.901.025
Receivable from State Treasury	Loans	Amortised cost	6.107.495	6.107.495
Loans	Loans	Amortised cost	499.989.109	498.402.200
Total financial assets			754.501.996	752.910.926
Financial liabilities:				
Bond issues	Liabilities at amortised cost	Amortised cost	735.897.135	735.897.135
Other borrowings	Liabilities at amortised cost	Amortised cost	818.745	818.745
Other liabilities	Liabilities at amortised cost	Amortised cost	317.178	317.178
Total financial liabilities			737.033.058	737.033.058

The table below shows the impact of adopting IFRS 9 on the accumulated deficit.

Accumulated deficit	**Impact of adopting 2018**
Balance as of 31 December 2017 under IAS 39	(32.761.719)
Change due to reclassification of financial assets and financial liabilities	(274.733)
Change in expected loan losses under IFRS 9	(1.591.070)
Balance as of 1 January 2018 under IFRS 9	(34.627.522)

The table below shows the final balance of the provision for impairment of financial assets under IAS 39 and the impact of IFRS 9 on the opening balance of the provision on January 1, 2018.

Provision for impairment of loans and other financial assets	**Impact of adopting 2018**
Balance as of 31 December 2017 under IAS 39	6.917.267
Change due to revaluation of impaired loans in accordance with IFRS 9	1.591.070
Impairment of other financial assets at amortised cost	4.162
Balance as of 1 January 2018 under IFRS 9	8.512.499

5. Operating segments

A segment is a component of an entity that generates income and expenses that are directly attributable to the segment. Management assesses and evaluates the performance and operational results of the segment, and distributes funds specifically to the segment. Financial information of the segment must be separate for operational purposes in order to be identified as a segment. The Fund defines its activities as three segments, of which one segment, lending activity, is identified separately due to size. Other segments include payments for housing benefits and management of government contributions for the construction of public housing, cf. Act no. 52/2016. Up until 1 January 2018, only one segment was identified.

The table below shows identifiable information about the Fund's lending activities on the one hand and other segments, respectively.

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Notes, contd.:

5. Operating segments, contd.

1 January - 30 June 2018	Lending activities	Other segments	Total
Net interest income	(109.249)		(109.249)
Other income	103.123	118.400	221.523
Total operating income	(6.126)	118.400	112.274
Total operating expenses	806.070	152.487	958.557
Net income of appropriated assets	92.356		92.356
Net operating income	(719.840)	(34.087)	(753.927)
Reversal of impairment of loans and appropriated assets	2.227.805		2.227.805
Profit for the year and comprehensive income	1.507.965	(34.087)	1.473.878

30 June 2018			
Total assets	751.269.273	50.250	751.319.523
Total liabilities	726.733.425	84.334	726.817.759
Allocated equity	24.535.851	(34.087)	24.501.764

6. Financial assets and liabilities

The Fund has applied IFRS 9 from 1 January 2018. During the implementation, comparative figures were not restated in accordance with the standard, therefore comparative figures from 31 December 2017 are not fully comparable. The effect of the changes is explained in Note 4, in addition further clarification of the changes introduced by the standard can be found in Note 33.

The following table shows to which category financial assets and liabilities of the Fund pertain and their fair value:

	Amortised cost	Fair value through profit and loss		Total carrying amount	Fair value
30 June 2018		Mandatory	Designated		
Assets:					
Cash and cash equivalents	63.235.145			63.235.145	63.235.145
Loans to financial institutions	20.610.215			20.610.215	20.604.966
Other securities	191.944.451			191.944.451	197.220.468
Receivable from State Treasury	6.186.191			6.186.191	6.190.122
Loans	462.521.864			462.521.864	548.474.500
Total financial assets	744.497.866	0	0	744.497.866	835.725.201
Liabilities:					
Bond issues	(725.654.013)		0	(725.654.013)	846.181.570
Other borrowings	(370.237)		0	(370.237)	548.593
Other liabilities	(793.509)		0	(793.509)	846.182
Total financial liabilities	(726.817.759)	0	0	(726.817.759)	847.576.345

Condensed Interim Financial Statements of the Housing Financing Fund 30 June 2018 13 Amounts in ISK thousand

Notes, contd.:

6. Financial assets and liabilities, contd.

According to the International Financial Reporting Standard 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 - are recognised at fair value through profit and loss.
Loans and receivables - are recognised at amortised cost.
Other financial liabilities - are recognised at amortised cost.

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

31 December 2017	Trading assets	Loans and receivables	Liabilities at amortised cost	Total carrying amount	Fair value
Assets:					
Cash and cash equivalents		66.608.413		66.608.413	66.608.413
Loans to financial institutions		6.891.793		6.891.793	6.891.793
Marketable securities	11.249.780	0		11.249.780	11.249.780
Other securities		163.655.406		163.655.406	181.582.453
Receivable from State Treasury		6.107.495		6.107.495	6.107.495
Loans		499.989.109		499.989.109	599.951.980
Total financial assets	11.249.780	743.252.216	0	754.501.996	872.391.914
Liabilities:					
Bond issues			735.897.135	735.897.135	869.286.412
Other borrowings			818.745	818.745	818.745
Other liabilities			317.178	317.178	317.178
Total financial liabilities	0	0	737.033.058	737.033.058	870.422.335

The fair value of loans is estimated by discounting the cash flows of the loan portfolio by using the yield of HFF bonds plus 1.0% spread. The spread reflects the cost of operating the loan portfolio and the credit risk and prepayment risk in the case of loans which do not contain prepayment options.

The fair value of HFF bonds is based on their market price at the end of the period. The fair value of Housing bonds is measured by discounting the cash flows by using the HFF interest plus 0.5% spread due to lesser liquidity compared to HFF bonds. The fair value of Housing Authority bonds is measured by discounting at the interest of HFF bonds plus 1.0% spread due to liquidity and prepayment risk of those bonds.

Treasury securities that are classified as trading assets under IAS 39 are now measured at amortised cost in accordance with IFRS 9. Fair value is based on quoted prices in active markets for identical assets.

The fair value of other securities measured at their yield at acquisition is the last quoted market price for the individual category.

7. Cash and cash equivalents and restricted cash

Cash and cash equivalents and restricted cash are specified as follows:

	30.6.2018	31.12.2017
Unrestricted cash in Central Bank	54.240.682	58.743.186
Unrestricted cash in financial institutions	8.994.462	7.865.227
Cash and cash equivalents total	63.235.144	66.608.413

8. Loans to financial institutions

Loans to financial institutions are specified as follows:

	30.6.2018	31.12.2017
Inter-bank loans	9.704.603	3.053.801
Other claims	49.229	691
Bank bills	10.856.383	3.837.300
Loans to financial institutions total	20.610.215	6.891.792

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Notes, contd.:

9. Marketable securities

Marketable securities are specified as follows:

	30.6.2018	31.12.2017
Listed treasury bonds at fair value	0	11.249.780
Marketable securities total	0	11.249.780

10. Other securities

Other securities are specified as follows:

	30.6.2018	31.12.2017
Covered bonds measured at yield at acquisition	120.978.618	115.290.704
Municipal bonds	5.141.960	1.465.641
Treasury securities measured at yield at acquisition	65.832.718	46.899.061
Impairment provision	(8.846)	0
Other securities total	191.944.451	163.655.406

11. Receivable due from State Treasury

The receivable due from the State Treasury is comprised of two bonds, a bond amounting to ISK 4,881 million that is payable in one lump sum at year end of 2018, and a bond in the amount of ISK 1,306 million that is due on 1 January 2021.The bonds have however a permanent prepayment privilege favorable to the Treasury, in part or in full. Only interest payments on the bonds are collected during the loan period. The bonds are not transferable by the Housing Financing Fund.

12. Loans:

Loans are specified as follows:

	30.6.2018	31.12.2017
Loans to individuals	329.532.230	365.061.806
Loans to legal entities	132.989.633	134.927.303
Total loans	462.521.863	499.989.109

As a result of the implementation of IFRS 9, the Fund has changed its impairment process in accordance with the provisions of the Standard. Further details of the changes resulting from the adoption of the standard are given in Note 33.

Restated balance of impairment provision of loans 1 January 2018:

Impairment provision of loans 31 December 2017 (under IAS 39)	6.917.267
Changes due to the adoption of IFRS 9	1.591.070
Restated balance of impairment provision of loans 1 January 2018 (under IFRS 9)	8.508.337

Changes in the provision during the period of 1.1.2018-30.6.2018:

	12-month ECL	Lifetime ECL		
	Stage 1	Stage 2	Stage 3	Total
Balance of provision 1 January 2018	1.533.357	2.163.342	4.811.638	8.508.337
Expected credit loss from new loans	22.304	438	0	22.742
Reversal of expected credit loss due to prepayments	(55.505)	(108.517)	(68.972)	(232.994)
Transfer to stage 1	1.001.640	(985.674)	(15.966)	0
Transfer to stage 2	(48.126)	312.528	(264.402)	0
Transfer to stage 3	(2.357)	(92.364)	94.721	0
Changes in model or risk factors	(959.197)	127.984	254.614	(576.599)
Contributions covering write-offs	(315)	(835)	(1.098.749)	(1.099.899)
Balance of provision 31 June 2018	1.491.801	1.416.902	3.712.884	6.621.587

Condensed Interim Financial Statements of the Housing Financing Fund 30 June 2018 15 Amounts in ISK thousand

Notes, contd.:

12. Loans, contd.

Quality of loans

The following table shows the gross carrying amount of loans by past due status and the carrying amount of loans.

30 June 2018	**Not past due**	**30-59 days past due**	**60-89 days past due**	**Over 90 days past due**	**Impairment provision**	**Carrying amount**
Loans to individuals.......	317.759.926	6.714.372	2.008.318	5.905.177	(2.855.563)	329.532.230
Loans to entities............	135.869.597	91.245	0	794.816	(3.766.024)	132.989.633
	453.629.523	6.805.617	2.008.318	6.699.993	(6.621.587)	462.521.864

31 December 2017	**Not past due**	**30-59 days past due**	**60-89 days past due**	**Over 90 days past due**	**Impairment provision**	**Carrying amount**
Loans to individuals.......	347.472.980	8.857.556	2.978.171	7.924.463	(2.171.364)	365.061.806
Loans to entities............	132.679.505	5.631.460	0	1.362.445	(4.746.107)	134.927.303
	480.152.485	14.489.016	2.978.171	9.286.908	(6.917.471)	499.989.109

The following table is an age analysis of the amounts past due.

	Loans to individuals		**Loans to legal entities**		**Total**	
	30.6.2018	**31.12.2017**	**30.6.2018**	**31.12.2017**	**30.6.2018**	**31.12.2017**
Amounts past due:						
Past due less than						
30-59 days....................	84.488	111.410	1.112	54.027	85.600	165.437
60-89 days....................	35.301	52.953	2.692	0	37.993	52.953
Past due over 90 days	766.100	1.040.630	1.156.636	1.710.532	1.922.736	2.751.162
Total past due..............	885.889	1.204.993	1.160.440	1.764.559	2.046.329	2.969.552

Write-off on loans:

Loans are written off under the following circumstances:

- Upon loss on the sale of apartments auctioned, when the sales value is lower than the valuation of the apartment, according to Article 57 of Act no. 90/1991 on forced sale.
- Upon the approval of the Board of Housing Financing Fund of the discontinuance of a claim of "lost pledge" in accordance with Regulation no. 359/2010, on the treatment of the Housing Financing Fund's claims for which pledges have been lost
- In compliance with Act no. 101/2010 cf. para. 3 article 47 of the Housing Act on write offs in accordance with agreement on debt mitigation.
- Upon the financial restructuring of legal entities according to agreement thereunder pursuant to Act no. 101/2010 cf. para. 6. article 47 of the Housing Act.
- On the basis of laws.

Obligations not recognised in the balance sheet:	**30.6.2018**	**31.12.2017**
Binding loan commitments at year-end..	4.525.955	4.406.080

Condensed Interim Financial Statements of the Housing Financing Fund 30 June 2018 16 Amounts in ISK thousand

Notes, contd.:

13. Appropriated assets

The Fund owned 333 properties on 30 June 2018 (year-end 2017: 419) that the Fund had redeemed for the fulfillment of its claims. Total number of appropriated properties managed by the Fund is specified as follows:

	30.6.2018	31.12.2017
Number of properties at the beginning of the year	419	663
Repossessed properties during the period	13	53
Properties sold during the period	(99)	(297)
Number of properties at the end of the period	333	419

Properties owned by the Fund are divided as follows by geographical area:

	30.6.2018	Rentals 30.6.2018	31.12.2017
South and South West	88	70	110
Great Reykjavík area	62	34	71
South Iceland	57	36	76
West Iceland	40	31	45
East Iceland	38	14	55
North Iceland	30	13	38
Westfjords	18	10	24
Number of properties at the end of the period	333	208	419

At the end of the period, of the 333 properties owned by the Fund, 99 properties are in the sales process (2017: 161). 208 properties were rentals (2017; 231) or 62.5% of the total properties owned by the Fund on 30 June 2018 (2017: 55.1%).

Appropriated assets at the end of the period are measured at the lower of the cost or net fair value and are specified as follows:

30 June 2018	Number of properties	Official property value	Fair value	Carry amount
Rentals	208	5.198.110	4.387.520	3.766.282
In sales process	99	2.063.324	1.555.476	1.364.348
Empty	23	605.850	516.220	409.002
Other properties*	3	79.725	80.482	1.781
Total	333	7.947.009	6.539.698	5.541.413

* Abandoned, rent arrears or properties that have recently entered the portfolio and are being processed

31 December 2017				
Rentals	231	5.175.440	4.569.214	4.074.698
In sales process	161	3.205.030	2.436.398	2.253.555
Empty	25	479.015	394.195	266.279
Other properties*	2	55.100	45.851	36.606
Total	419	8.914.640	7.445.658	6.631.138

* Abandoned, rent arrears or properties that have recently entered the portfolio and are being processed

Condensed Interim Financial Statements of the Housing Financing Fund 30 June 2018 17 Amounts in ISK thousand

Notes, contd.:

14. Operating assets:

Operating assets are specified as follows:

	Fixtures and equipment	Real estate	Total
Total Cost			
Balance at 1.1.2017	229.994	30.727	260.721
Additions during the period	62.155	0	62.155
Balance at 31.12.2017	292.149	30.727	322.876
Additions during the period	2.667	0	2.667
Balance at 30.6.2018	294.816	30.727	325.543
Depreciation			
Balance at 1.1.2017	144.222	8.720	152.942
Depreciation during the period	18.638	1.027	19.665
Balance at 31.12.2017	162.860	9.747	172.607
Depreciation during the period	10.056	513	10.569
Balance at 30.06.2018	172.916	10.260	183.176

	Fixtures and equipment	Real estate	Total
Carrying amount			
Balance at 1.1.2017	85.772	22.007	107.779
Balance at 31.12.2017	129.289	20.980	150.269
Balance at 30.6.2018	121.901	20.467	142.368

Property value of real estate on 30 June 2018 amounted to ISK 22.9 million (2017: ISK 22.9 million) and insurance value amounted to ISK 24.9 million (2017: ISK 24.3 million).

15. Intangible assets

Intangible assets are specified as follows:

	Software
Total Cost	
Balance at 1.1.2017'	658.623
Additions during the period	12.927
Balance at 31.12.2017	671.550
Additions during the period	300
Balance at 30.6.2018	671.850
Amortisation	
Balance at 1.1.2017	444.720
Amortisation during the period	60.825
Balance at 31.12.2017	505.545
Amortisation during the period	30.906
Balance at 30.6.2018	536.451
Carrying amounts	
Balance at 1.1.2017	213.903
Balance at 31.12.2017	166.005
Balance at 30.6.2018	135.399

16. Other assets

Other assets are specified as follows:

	30.6.2018	31.12.2017
EIR 14 (bond)	94.430	94.321
Other bonds	135.543	0
Purchase contracts	253.380	269.215
Receivable from Treasury	363.439	0
Accounts receivable	144.412	71.721
Value added tax claim	11.275	42.082
Total other assets	1.002.479	477.339

Condensed Interim Financial Statements of the Housing Financing Fund 30 June 2018 18 Amounts in ISK thousand

17. Bond issues

The Fund issues housing bonds in four HFF series. The name of each series indicates the maturity year of the series. The bond issues are all inflation-indexed annuity bonds with semi-annual payments. All HFF series carry 3.75% nominal interests. Housing bonds are inflation-indexed annuity bonds with four annual instalments and carry 4.75% - 6.00% nominal interests. Housing bonds are redeemable. Housing authority bonds are inflation-indexed annuity bonds with semi-annual payments and carry 2.70%-6,25% nominal interests. The effective interest rate of the issued bonds is 4.31%.

Bond issues are specified as follows:	30.6.2018	31.12.2017
HFF24 bond	112.528.032	119.112.184
HFF34 bond	202.445.903	204.086.901
HFF44 bond	384.767.771	383.840.760
Housing bonds (final maturity 2040)	9.415.191	10.836.443
Housing Authority bonds (final maturity 2038)	16.497.116	18.020.846
Bond issues total	725.654.013	735.897.134

18. Other borrowings

Other borrowings are specified as follows:	30.6.2018	31.12.2017
Pension funds	0	77.319
Insurance fund	7.524	191.225
Redeemable bonds	130.708	143.469
Unpaid due to purchase of loan portfolios	232.005	406.732
Other borrowings total	370.237	818.745

19. Other liabilities

Other liabilities are specified as follows:	30.6.2018	31.12.2017
Employee vacation obligation	97.633	62.979
Other liabilities	695.877	254.199
Other liabilities total	793.509	317.178

20. Equity and capital management

The Fund's long-term objective is to maintain an equity ratio over 5.0%. The calculation of the equity ratio is in accordance with international standards (Basel II). If the Fund's equity ratio falls below 4.0% the Fund's Board of Directors shall notify the Minister of Welfare thereof. Furthermore, the Fund's Board of Directors shall propose solutions to reach the long term equity ratio goal.

Equity ratio is specified as follows:	30.6.2018	31.12.2017
Total equity according to the financial statements	24.501.764	24.893.689
Intangible assets	(135.399)	(166.005)
Equity base	24.366.365	24.727.684
Total equity requirement is specified as follows:		
Credit risk	21.117.449	20.805.595
Market risk	0	2.238.629
Operational risk	281.885	281.885
Total capital requirements	21.399.334	23.326.109
Equity ratio	9,11%	8,48%

Condensed Interim Financial Statements of the Housing Financing Fund 30 June 2018 19 Amounts in ISK thousand

Notes, contd.:

21. Net interest income

Interest income

	30.6.2018	30.6.2017
Interest income on items not at fair value:		
Interest income and indexation on loans to customers	17.710.340	18.831.092
Interest income from covered bonds	3.477.282	2.760.931
Interest income from other financial assets	3.677.480	2.458.767
Government contribution to subsidy interests*	312.939	396.277
	25.178.041	24.447.067
Interest income on items at fair value:		
Interest income (expenses) on market securities	0	332.402
	0	332.402
Total interest income	25.178.041	24.779.469

Interest expense

Interest expense on items not at fair value:	30.6.2018	30.6.2017
Interest expense and indexation on bonds issued	25.277.852	24.234.443
Interest expense on other borrowings	0	10.595
Other interest expense	9.439	2.144
Total interest expenses	25.287.290	24.247.182
Net interest income (expenses)	(109.249)	532.287

*Subsidy on interests on loans is due to social benefit loans to municipalities and organisations, such as student associations and organisations of disabled.

22. Other income

Other income is specified as follows:	30.6.2018	30.6.2017
Collection and service income*	221.266	93.866
Other income	257	636
	221.523	94.502

* New service income amounting to ISK 118,400 thous. explains the sharp rise in other income and is due to the Fund's new services for housing benefits and management of government contributions, etc.

23. Salaries and salary-related expenses

Salaries and salary-related expenses are specified as follows:	30.6.2018	30.6.2017
Salaries	348.137	321.083
Pension fund contributions	46.682	41.768
Tax on financial activity	16.104	19.693
Other salary-related expenses	59.084	37.239
Other personnel expenses	22.475	0
Reimbursed salary expenses	14.562	18.000
Capitalised salary expenses	0	(22.708)
Total salaries and salary-related expenses	507.044	415.075
Average number of employees of the Fund are specified as follows:	78	69

86 employees were on the Fund's payroll on 30 June 2018.

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Notes, contd.:

24. Other operating expenses

Other operating expenses are specified as follows:

	30.6.2018	30.6.2017
Collection fees	51.924	46.301
Operating expenses of housing	67.318	61.210
Operating cost of IT systems	110.676	85.479
Audit and review of financial statements	9.779	11.754
Professional services	26.580	31.156
Cost due to implementation of IFRS 9	17.515	18.871
Real estate valuation	3.468	2.882
Advertising, promotional material and grants	8.626	11.326
Debtors' Ombudsman	34.245	27.331
Financial Supervisory Authority	34.979	46.107
Service fees	23.140	13.012
Other operating expenses	21.789	33.638
Total other operating expenses	410.039	389.067

25. Depreciation and amortisation during the period:

Depreciation and amortisation is specified as follows:

	30.6.2018	30.6.2017
Depreciation of operating assets (cf. note 14)	10.569	9.210
Amortisation of intangible assets (cf. note 15)	30.906	29.725
Total depreciation and amortisation	41.475	38.935

26. Net income of properties held for sale

Net income of properties held for sale is specified as follows:

	30.6.2018	30.06.2017
Rental income from rented properties	216.248	283.050
Cost of properties held for sale	(123.891)	(199.790)
Net income of properties held for sale	92.357	83.260

The costs of real estate held for sale in the table above include only the direct incurred costs of the properties cf. property taxes, insurance, maintenance, energy costs and commissions of administrators but exclude indirect operating costs such as salaries and other administrative expenses.

27. Impairment

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

	30.6.2018	30.6.2017
Impairment loss (reversal of impairment loss) on loans	(1.072.014)	(339.763)
Impairment loss (reversal of impairment loss) on other financial assets	8.846	0
Impairment loss (reversal of impairment loss) on appropriated properties	(1.171.904)	(436.547)
Impairment loss (reversal of impairment) on other claims	7.268	29.177
Total impairment cost (reversal of impairment cost)	(2.227.805)	(747.133)

28. Rental agreements

The Fund has entered into an operating lease agreements on the property used in its operations. Minimum lease payments are specified as follows at the end of the period:

	30.6.2018	30.6.2017
Payable within 1 year	108.010	108.493
Payable after 1 to 5 years	94.561	232.499
Total	202.571	340.992

29. Related parties

The Fund has a related party relationship with its owner, board members and executive officers. The Housing Financing Fund is publicly owned and administratively falls under the Ministry and Minister of Welfare. Government institutions and self-governing corporate entities that are financially dependent on the authorities are related parties of the Fund. Loans to related parties are granted on arms-length basis. There were no mortgage loans to related parties outstanding on 30 June 2018 (2017: ISK 0 million).

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30. Other matters

The Fund is a party to several disputes that are currently before the courts. The disputes vary in nature, such as appeals related to debt remedies, damages due to forced sales and sales of appropriated assets, disputes regarding penalty interests, disputes on the settlements of forced sales due to usufruct fees, etc. It is the Fund's opinion however, that these cases, both individually and combined are not likely to have a significant financial impact on the Fund.

31. Changes in accounting policies due to the implementation of new standards

IFRS 9 - Financial instruments

IFRS 9 was implemented as of January 1, 2018, resulting in significant changes in the classification and recognition of financial assets and financial liabilities. At the same time, the implementation involved the introduction of a new methodology for assessing impairment of financial assets that is based on expected losses. The new accounting policies under IFRS have been applied retroactively, with the following exceptions:

- Comparative amounts have not been restated in accordance with the requirements of IFRS 9. Differences between the carrying amount of financial assets and financial liabilities due to the implementation of IFRS 9 are recognised in the accumulated deficit on 1 January 2018.
- When classifying financial assets under business models and designating financial assets and financial liabilities measured at fair value through profit or loss, consideration is given to prevailing circumstances at the beginning of implementation that may differ from the circumstances prevailing during initial recognition.
- Since credit risk is considered to be low at the initial stage of the implementation of IFRS 9, it is assumed that there is no significant increase in credit risk from the initial recognition.

In general, there are three major changes resulting from the adoption of IFRS 9. First, there are changes in the classification and measurement of financial assets and financial liabilities in the financial statements, secondly, changes are made to the impairment of financial assets and thirdly changes are made in hedge accounting. Below is an account of the major changes and their expected impact.

Classification and measurement

The new standard entails significant changes in the classification and measurement of financial assets. Financial assets should be classified into the following main categories according to IFRS 9:

(1) financial assets measured at amortised cost if the objective with the asset is to hold the financial asset to maturity and collect, on specified due dates, contractual payments consisting only of principal and interest payments.

(2) financial assets measured at fair value through other comprehensive income (FVOCI) if the objective with the asset is to hold the financial asset to maturity and collect, on specified due dates, contractual payments consisting only of principal and interest payments, as well as to sell the financial assets.

(3) financial assets measured at fair value through profit or loss which includes all other financial assets.

IFRS 9 mainly complies with IAS 39 on the classification of financial liabilities. Financial liabilities shall be divided into two categories: amortised cost and fair value through profit or loss.

The impact of the implementation of IFRS 9 on the classification of financial assets and financial liabilities of the Fund can be found in Note 4.

Impairment

The fundamental difference between the provisions of IAS 39 and IFRS 9 regarding impairment of financial assets is that impairment of financial assets according to IAS 39 is based on incurred loss while impairment of financial assets as according to IFRS 9 is based on expected loss. The latter method implies that an impairment loss is recognised on the basis of future expectations and should therefore result in an increase in provisions for impairment losses sooner in the downturn.

During the implementation, the Fund has had to develop extensive models to assess the expected credit loss of financial assets. Furthermore, the credit risk of each individual loan had to be defined based on historical data. The standard also sets out requirements for defining various terms, selecting the approach that is considered the most appropriate for the Fund, the application of various assumptions of expected credit loss and the use of external information.

The Fund decided to develop new methodologies and calculation models to calculate expected credit losses in accordance with IFRS 9. Expected credit loss may be expressed as probability of default, loss given default and exposure at default.

The calculation of impairment under IFRS 9 is based on a three-stage impairment model, which is intended to reflect the deterioration in credit quality of financial assets. The objective of the standard is that impairment should increase when credit risk increases and credit quality has deteriorated from initial recognition.

• Stage 1 - Credit risk has not increased significantly since the initial recognition of financial assets or credit risk is considered to be insignificant. For first-stage assets, impairment losses are based on 12-month expected credit losses.

• Stage 2 - Credit risk has risen sharply since initial recognition but there is no objective evidence of a credit loss event. For assets at the second level, lifetime expected credit losses are recognised.

• Stage 3 - Objective evidence of impairment exists at the reporting date and the financial asset is considered to be in default. The third level is largely comparable to the specific and general impairment of financial assets in accordance with IAS 39. At the third level lifetime expected credit losses are recognised, as in the second stage.

Risk management is responsible for calculating impairment of loans and ensuring compliance with IFRS 9 requirements. A special financial committee composed of the CEO, the Managing Director of the Operations Division and the Treasury, and the Risk Manager are responsible for reviewing and approving the conclusions.

Significant increase in credit risk and definition of default
According to IFRS 9, the estimate of changes in credit risk is based on the risk of default over the expected lifetime of financial assets. In assessing a significant increase in credit risk, quantitative and qualitative information are used and analyses are derived from historical data.

A significant increase in credit risk (SICR) is assessed on the basis of the following criteria:

• Loans in a higher risk category based on estimated assumptions from the initial date of commitment - The current risk category is calculated for each loan and compared to the expectations of the expected risk group from the initial date of commitment. If the risk has risen considerably based on the original assumptions then there is considered to be an increase in credit risk.

• Additional information on credit ratings are also used in assessing credit risk, such as warning signs and credit watch lists.

• Loans in arrears for more than 30 days.

Loans are considered to be in default if loans are more than 90 days past due, if customers show severe signs of financial difficulties, or indications exist that the loans are managed differently.

If the increase in credit risk has decreased or is no longer present then assets may be reclassified from stage two back to stage one. However, the loan remains in the second stage for at least three months. Similarly, the loan is no longer deemed to be in default if the indicators that resulted in default have not been present for the past three months, and then the loan reverts from stage three to stage two. Loans that were in stage three remain in stage two for at least nine months, i.e. in total, the loan is managed separately for at least one year from the date of default.

Economic forecasts
IFRS 9 requires that calculations of expected credit losses take into account probability forecasts of future economic conditions. The Fund also takes into account forecasts of whether credit risk has increased significantly since the initial date of the loan commitment. The Fund relies on statistical analysis based on historical data in assessing the relationships between economic variables, credit risk and expected credit losses. The Housing Financing Fund's Planning and Analysis Division will set-up scenarios, on the one hand the baseline forecast that reflects the most likely outcome, as well as setting a positive and negative scenario that reflects statistically probable deviations from the baseline forecast. All prerequisites for the calculations are presented to the Finance Committee that either approves the prerequisites or proposes remedies.

Hedge accounting
IFRS 9 introduces new rules for hedge accounting designed to harmonize hedge accounting and risk management. The standard allows entities to postpone the adoption of hedge accounting under IFRS 9 and to continue the application of the hedge accounting requirements in IAS 39. The Fund has not applied the provisions of IAS 39 on hedge accounting in its financial statements.

Notes, contd.:

IFRS 15 - Revenue from Contracts with Customers'

The standard IFRS 15 was implemented when it came into force on 1 January 2018. The standard replaces IAS 18 'Revenue', IAS 11 'Construction Contracts', and several revenue-related Interpretations. The new standard establishes a contract-based revenue recognition model. Revenue is recognised as the amount that reflects the consideration to which the entity expects to be entitled in exchange for transferring goods or services to customers. The impact of the standard on the Fund is insignificant.