Housing Financing Fund

Condensed Consolidated
Interim Financial Statements
June 30, 2014

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Endorsement and Statement by the Board of Directors and the CEO

The Condensed Consolidated Interim Financial Statements of the Housing Financing Fund for the period 1 January to 30 June 2014 have been prepared in accordance with the International Financial Reporting Standard IAS 34, Interim Financial Reporting.

Performance during the period

According to the income statement, the loss of the Fund amounted to ISK 1,308 million for the six months ended 30 June 2014. Equity at the end of June amounted to ISK 13,538 million according to the balance sheet.

The Fund´s equity ratio, calculated according to stipulations of the Rules of the Housing Financing Fund no. 544/2004 was 3.2% at the end of June 2014. The calculation of the ratio is equivalent to the calculation of the capital ratio of financial institutions. The long- term goal of the Fund is to maintain the ratio above 5% and not below 4% . The objective of communications between the Housing Financing Fund and the government is to achieve this equity ratio, however no time limits have been set.

Operations during the period

Operating costs increased slightly compared to the same period of the year 2013. The number of the Fund´s employees as at 30 June 2014 were 104 compared to 98 at the same time in 2013. The employees of Leigufélagið Klettur ehf. were 5 as at 30 June 2014.

On 30 June, the Fund´s loans amounted to ISK 754,455 million and decreased by ISK 14,026 million from the beginning of the year.

New loans by the Fund have decreased to some extent during the period corresponding to an increase in early settlement of loans and increased activity in the processing of mortgage loan assumptions. The Fund granted 246 general housing loans during the first 6 months of the year compared to 468 loans during the same period in the year 2013. Early prepayments of loans amounted to ISK 11,600 million during the period compared to ISK 8,300 million during the first six months of the year 2013. The Fund´s liquidity position is strong and has remained stable between the years despite the increase in prepayments.

The allowance for impairment of loans amounted to ISK 21,700 million at the end of the period and has decreased by ISK 700 million from the beginning of the year.

The adjusted outstanding balance of the Fund´s loans in default for more than 90 days amounted to ISK 88,200 million, or 12% of the Fund´s total loans, thereof loans in default amounted to ISK 7,700 million.

Since the beginning of the year, the Fund has repossessed 234 properties and sold 733 properties. The Fund owned 2,107 properties at the end of the period. Repossessed properties are recognised at the lower of cost on repossession or fair value. Thereof 928 of these properties are rentals or 44% of total properties held for sale owned by the Fund.

The Fund is undergoing changes in accounting policies that affect the classification and presentation of interest income and impairment without the change having an impact on the Fund´s comprehensive income or its equity, cf. Note 3.

The main risk factors of the Housing Financing Fund are credit risk, market risk, liquidity risk, interest rate and inflation risk, prepayment risk, political risk and operational risk. Counterparty and currency risk and the risk due to uncertainty about the number, timing and final sales value of repossessed properties held for sale are as well considered to be financial risks of the Fund.

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

The project committee on the future organization of housing affairs presented its proposals on the Fund´s prospects on 6 May 2014, According to the proposal the current activities of the Housing Financing Fund will be separated and the structure of its affairs changed. On 16 July, ESA (EFTA Surveillance Authority) presented its proposals recommending that the Fund´s operations be subject to certain restrictions and that it operate only in activities related to the public interest. The ministry is preparing further implementation of the proposals and it is expected that a bill amending the laws will be presented to the Althingi this winter.

The Condensed Consolidated Interim Financial Statements for the period 1 January to 30 June 2014 have been prepared in accordance with International Financial Reporting Standard, IAS 34, Interim Financial Reporting, and additional disclosure requirements for companies that have their securities listed on a regulated market. To the best of our knowledge, it is our opinion that the Condensed Consolidated Interim Financial Statements give a true and fair view of the comprehensive loss of the Fund for the period 1 January to 30 June 2014, its assets, liabilities and financial position of the Fund as at 30 June 2014 and its cash flows for the period.

Further, in our opinion the Condensed Consolidated Interim Financial Statements and the endorsement by the Board of Directors and the CEO give a fair view of the development and performance of the Fund´s operations and its financial position and fairly describes the principal risks and uncertainties faced by the Fund

The Board of Directors and the CEO of the Housing Financing Fund have today discussed the Fund's Condensed Consolidated Interim Financial Statements for the six-month period ended 30 June 2014 and confirm them by means of their signatures.

Reykjavik, 29 August 2014

The Board of Directors of the Housing Financial Fund

The CEO

Sigurður Erlingsson

Independent Auditors´ Review Report

To the Board of Directors of the Housing Financing Fund,

We have reviewed the accompanying Condensed Consolidated Interim Financial Statements of the Housing Financing Fund for the period of 1 January until 30 June 2014, which are comprised of the balance sheet, the income statement and statement of comprehensive income, the statement of changes in equity and statement of cash flows, and a summary of significant accounting policies 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 Consolidated 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 Consolidated Interim Financial Statements.

Conclusion

Based on our review, nothing has come to our attention that suggests otherwise, but that the accompanying Condensed Consolidated Interim Financial Statement give a true and fair view of the performance of the Fund for the period of 1 January to 30 June 2014, the financial position of the Fund as at 30 June, 2014, and its cash flow for the period 1 January to 30 June, in accordance with IAS 34 “Interim Financial Reporting”, as adopted by the European Union.

Emphasis of matter

Without qualifying our opinion we would like to draw attention to note 5 , regarding the uncertainty as to the operations of the Housing Financing Fund. Serious doubt exists as to the Fund´s future role and its potential existence and this volatile state has existed since the Minister of Social Affairs and Housing appointed a project committee on the future organization of housing policy on 9 September 2013 in accordance with the resolution on the action plan for household debt relief passsed by Parliament in the spring of 2013. Also it has been obvious for some time that the Fund´s interest rate margin has been insubstantial or only 0,30%, which is insufficient to cover the impairment comparable to the impairment resulting from the economic collapse.

Also we would like to draw attention to note 18 stating that the Fund´s equity ratio, calculated in accordance with the provisions of Regulation no. 544/2004, is 3.2% at the end of June 2014, however according to the article 7 of the Regulation, the Fund´s long term objective is to maintain an equity ratio over 5%. The Fund´s Board of Directors has as according to the said regulations communicated this to the Ministry of Social Affairs and Housing.

Reykjavik, 29 August 2014

Grant Thornton endurskoðun ehf

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Sturla Jónsson
State authorised public accountant

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Davíð Arnar Einarsson
State authorised public accountant

Consolidated Income Statement and Statement of Comprehensive Income from 1 January to 30 June 2014

	Notes	2014 1.1.-30.6.	2013 1.1.-30.6.
Interest income		27.481.585	38.853.062
Interest expense		(27.363.792)	(38.274.961)
Net interest income	7	117.793	578.101
Other income		62.613	81.037
Total operating income		180.406	659.138
Salaries and salary-related expenses		500.950	425.483
Other operating expenses		601.788	654.730
Depreciation and amortisation		25.275	31.346
Total operating expenses		1.128.014	1.111.559
Revenue in excess of expenses of properties held for sale	15	15.390	120.857
Revenue in excess of expenses of investment properties	14	611.244	0
Net operating income		(320.974)	(331.564)
Impairment		(986.770)	(2.646.953)
Loss for the year and comprehensive loss		(1.307.744)	(2.978.517)

The notes on pages 9 to 20 are an integral part of these Financial Statements.

Consolidated Balance Sheet as at 30 June 2014

	Notes	30.6.2014	2013
Assets			
Cash and cash equivalents	8	5.498.168	7.916.388
Loans to banks	9	13.016.043	11.478.270
Treasury securities	10	30.320.721	32.294.209
Receivable due from State Treasury	11	4.550.204	4.500.000
Loans	13	754.455.090	768.480.860
Properties held for sale	15	30.420.436	37.663.230
Investment properties	14	7.823.347	0
Investment in subsidiary	16	0	10.000
Operating assets		81.170	69.505
Claims on related parties		0	73.180
Intangible assets		180.490	151.428
Other assets		339.046	309.953
Total assets		846.684.715	862.947.023
Liabilities			
Bond issues		820.296.407	834.463.465
Other borrowings		4.104.036	4.273.495
Other liabilities		8.746.627	9.364.674
Total liabilities		833.147.070	848.101.634
Equity			
Contributed capital		57.655.408	57.655.408
Accumulated deficit		(44.117.763)	(42.810.019)
Total equity	18	13.537.645	14.845.389
Total liabilities and equity		846.684.715	862.947.023

The notes on pages 9 to 20 are an integral part of these Financial Statements.

Condensed Consolidated Statement of Changes in Equity from 1 January to 30 June 2014

Changes in equity from 1 January to 30 June 2014	Contributed **capital**	**Accumulated deficit**	**Total equity**
Equity as at 1 January 2014	57.655.408	(42.810.019)	14.845.389
Loss for the period and comprehensive loss	0	(1.307.744)	(1.307.744)
Equity as at 30 June 2014	57.655.408	(44.117.763)	13.537.645

Year 2013

Equity as at 1 January 2013	53.155.408	(38.456.036)	14.699.372
Increase in contribued capital	4.500.000	0	4.500.000
Loss for the year and comprehensive loss	0	(4.353.983)	(4.353.983)
Equity as at 31 December 2013	57.655.408	(42.810.019)	14.845.389

Changes in equity from 1 January to 30 June 2013

Equity as at 1 January 2013	53.155.408	(38.456.036)	14.699.372
Loss for the period and comprehensive loss	0	(2.978.517)	(2.978.517)
Equity as at 31 June 2013	53.155.408	(41.434.553)	11.720.855

The notes on pages 9 to 20 are an integral part of these Financial Statements.

Condensed Consolidated Statement of Cash Flows from 1 January to 30 June 2014

	2014 1.1.-30.6.	2013 1.1.-30.6.
Net cash provided by (used in) operating activities	20.954.308	12.700.897
Net cash provided by investing activities	1.331.955	3.928.580
Net cash used in financing activities	(24.704.483)	(21.118.200)
Net increase (decrease) in cash and cash equivalents	(2.418.220)	(4.488.723)
Cash and cash equivalents at the beginning of the year	7.916.388	10.766.771
Cash and cash equivalents at the end of the period	5.498.168	6.278.048

The notes on pages 9 to 20 are an integral part of these Financial Statements.

Notes to the Condensed Consolidated 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 Housing Financing Fund is an independent institution owned by the State. The Fund operates in accordance with the Housing Act no. 44/1998 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. The Condensed Consolidated Interim Financial Statements of the Fund are comprised of the Interim Financial Statements of the Housing Financing Fund and its subsidiary Leigufélagið Klettur ehf., together referred to as the "Fund" or the "Housing Financing Fund."

2. Basis of preparation

a. Statement of compliance

The Condensed Consolidated 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 2013.

The Condensed Consolidated Interim Financial Statements of the Housing Financing Fund were approved by the Board of Directors on 29 August 2014.

b. Basis of measurement

The Condensed Consolidated Interim Financial Statements have been prepared on the historical cost basis except for the following items in the balance sheet: trading securities measured at fair value, properties held for sale which are recognised at the lower of cost or net fair value, and investment properties which are measured at fair value.

c. Functional currency

The Condensed Consolidated 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 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, see note 13.
- Receivable and payable to fallen credit institutions, see note 12.
- Properties held for sale, see note 15.
- Investment properties, see note 14.

e. New standards and interpretations

The Fund has adopted all International Financial Reporting Standards and interpretations applicable to the Fund's operation and which have been adopted by the EU and have entered into force as at 30 June 2014. The Fund has however not adopted standards and interpretations adopted by the EU but which will enter into force after that date. These standards and interpretations are not assumed to have a significant effect on the Fund's financial statements.

IFRS 10 Consolidated Financial Statements became effective 1 January 2014 and was applied in these Condensed Consolidated Interim Financial Statements. IFRS 10 outlines the requirements for the preparation and presentation of consolidated financial statements, when an entity controls one or more entities. The standard defines the principle of control and establishes control as the basis for consolidation. The adoption of the standard does not have a significant effect on the Fund´s financial statements.

3. Significant accounting policies

The accounting policies applied by the Fund in these financial statements are the same as those applied by the Fund in its Annual Financial Statements as at and for the year ended 31 December 2013 except that the requirements of IAS 39, namely article 63, are now fulfilled in respect of the realization of interest income on impaired loans. Consideration is now given to the impairment of loans in the calculation of interest income (net), however in the Fund´s previous financial statements interest income was calculated without accounting for the impairment of loans (gross). This change has no impact on the Fund´s net income, total assets or equity, cf. note 3.b. Comparative figures have been adjusted accordingly. Consolidated financial statements are prepared for the first time for the Fund and its subsidiary, Leigufélagið Klettur ehf. No revenues or expenses of the Fund are recognised directly in other comprehensive income and the result for the period is therefore equal to comprehensive (loss) income.

a. ***Basis of consolidation***

(i) Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the Consolidated Financial Statements from the date that control commences until the date that control ceases.

(ii) Intra-group transactions

All intra-group transactions, balances, income and expense are eliminated on consolidation. Unrealized losses are eliminated in the same way as unrealized gains, but only to the extent that there is no evidence of impairment.

b. *Interest income and interest expense*

Interest income and expense are recognised in the income statement using the effective interest method and consist of interest income on loans to customers, cash and cash equivalents, restricted cash, treasury securities and loans to banks, and interest expenses on borrowings. Interest income and expense includes the amortisation of discounts and premiums and other differences between initial book value of the financial instrument and amounts due on maturity, based on the effective interest method. Borrowing fee arising from loans granted as well as the Fund´s financing 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.

Effective interest is the imputed rate of interest used in determining the present value of estimated cash flow over the estimated useful life of a financial instrument or a shorter period if applicable, so that it equals the book value of the financial asset or liability in the balance sheet. When calculating the effective interest rate the Fund estimates future cash flows considering all contractual terms of the instrument but not future credit losses.

Indexation of inflation-indexed assets and liabilities are recognised in the income statement among interest income and expenses as they accrue and in the balance sheet as part of the carrying amount of assets and liabilities.

The requirements of the standard IAS 39.63 have been implemented as consideration is now given to the impairment of loans in the calculation of interest income (net), however in the Fund´s previous financial statements interest income was calculated without accounting for the impairment of loans (gross).

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 borrowing and lending rates each year (see note no. 7). The aforementioned loans to rental apartments are inflation-indexed on floating interests. No long term agreement has been made between the Fund and the State on subsidy of interests on these loans but the subsidy is determined on annual basis by the State and approved in the national budget. If the State's subsidy for the payment of the interests would no longer be granted, interests on the loans should be increased in order to secure the Fund's financial return and interest margin There are loan issues in the amount of approximately ISK 8,000 million granted in the years 2001-2009 for social benefits where State compensations do not apply.

c. *Investment property*

An investment property is a property held by the Fund for the purpose of generating rental income. Investment properties are initially measured at cost, including transaction costs, and are subsequently measured at fair value. Further discussion on the Fund´s measurment is provided in note 14.

Income and expenses from investment properties and changes in the value of investment properties are shown as revenue in excess of expenses of investment properties in the income statement. Investment properties are not depreciated.

4. *Segment information*

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 financial results of the segment and distributes funds specifically to the segment. Financial information of the segment must be separable for operational purposes in order to be identified as a segment. Financial information of the segment must be seperable fo operational purposes in order to be identified as a segment. The Fund identifies its operations as a single segment.

5. Uncertainty in the operations of the Housing Financing Fund and its ability to continue as a going concern

It has been obvious for quite some time that the Fund´s interest rate margin has been insubstantial or only 0.30% which is insufficient to cover the impairment comparable to the impairment resulting from the economic collapse. Therefore, the Fund for the time being has needed support from its owner to achieve once again financial strength.

Doubt exists as to the Fund's future role and its potential existence and this volatile state has existed first and foremost since the Social Affairs and Housing Minister appointed a project committee on the future organization of housing policy on 9 September 2013, in accordance with the resolution on the action plan for household debt relief passed by Parliament in the spring of 2013. The Project Committe on the Future Organization of housing policy has submitted to the Minister its proposals and he Ministry of Welfare is taking steps to devise a framework of laws and reulgations which hopefull will be completed as soon as possible. As a result, strategic decision-making in the immediate environment of the fund has been suspended, affecting the operations of the Fund in various ways.

The government announced plans at the end of November 2013 for principal reductions of mortgages. Indexed mortgage loans will be reduced and deductions will be made of earlier measures of reductions benefited by borrowers. It is clear that the laws on the adjustment of mortgage loans to individuals and the allocation of private pension savings to reduce loan principals will cause an increase of pre- and excess payments of the Fund´s loan portfolio which will have a negative impact on the Fund´s balance of assets and liabilities and thereby on the Fund´s net interest income. The Fund´s managers expect full compensation for the loans that are written down, however implementation of the compensation plan has not been finalized.

6. Financial assets and liabilities

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 and liabilities - are recognised at fair value.
- 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:

	Trading assets	Loans and receivables	Liabilities at amortised cost	Total carrying amount	Fair value
30 June 2014					
Assets:					
Cash and cash equivalents............	0	5.498.168	0	5.498.168	5.498.168
Due from State Treasury................	0	4.550.204	0	4.550.204	4.550.204
Treasury securities.........................	3.188.697	27.132.024	0	30.320.721	30.320.721
Loans to banks...............................	0	13.016.043	0	13.016.043	13.016.043
Loans...	0	754.455.090	0	754.455.090	768.794.304
Total financial assets.....................	3.188.697	804.651.529	0	807.840.226	822.179.440
Liabilities:					
Bond issues...................................	0	0	820.296.407	820.296.407	868.774.718
Other borrowings...........................	0	0	4.104.036	4.104.036	4.104.036
Other liabilities...............................	0	0	8.746.627	8.746.627	8.746.627
Total financial liabilities..................	0	0	833.147.070	833.147.070	881.625.381
31 December 2013					
Assets:					
Cash and cash equivalents............	0	7.916.388	0	7.916.388	7.916.388
Due from State Treasury................	0	4.500.000	0	4.500.000	4.500.000
Treasury securities.........................	2.095.623	30.198.585	0	32.294.209	32.294.209
Loans to banks...............................	0	11.478.270	0	11.478.270	11.478.270
Loans...	0	768.480.860	0	768.480.860	822.804.839
Total financial assets.....................	2.095.623	822.574.103	0	824.669.727	878.993.706

6. Financial assets and liabilities, contd.:

	Trading assets	Loans and receivables	Liabilities at amortised cost	Total carrying amount	Fair value
Liabilities:					
Bond issues..................................	0	0	834.463.465	834.463.465	915.228.318
Other borrowings...........................	0	0	4.273.495	4.273.495	4.397.956
Other liabilities...............................	0	0	9.364.674	9.364.674	9.364.674
Total financial liabilities..................	0	0	848.101.634	848.101.634	928.990.948

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 are measured at fair value. Fair value is based on quoted prices in active markets for identical assets. Other treasury securities are measured at their yield at acquisition.

Fair value Hierarchy

The following table shows the level in the hierarchy into which the fair value of financial assets and liabilities, carried at fair value in the Balance Sheet, are categorised as of 30 June 2014:

The levels are as follows:

Level 1: Valuation technique is based on quoted prices in active markets for assets and liabilities.
Level 2: Valuation technique is not based on quoted prices in active markets (level 1) but on information that is observable for the asset or liability directly (quoted price) or indirectly (adjusted quoted price),
Level 3: Valuation technique is based on significant information other than market information.

30 June 2014	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets:				
Treasury securities...	3.188.697	0	0	3.188.697
Investment properties...	0	0	7.823.347	7.823.347
Total financial assets..	3.188.697	0	7.823.347	11.012.044

31 December 2013	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets:				
Cash and cash equivalents..	0	0	0	0
Due from State Treasury..	2.095.623	0	2.095.623	2.095.623
Total financial assets..	2.095.623	0	2.095.623	2.095.623

The fair value of the Fund´s investment properties is based on the official property valuation of the registry in effect at year end 2013 and is increased by the consumer price index from February 2013. The fair value of trading securities is based on quoted prices in active markets.

Notes to the Condensed Consolidated Financial Statements contd.:

7. Net interest income

Interest income

Interest income on items not measured at fair value:	30.6.2014	30.6.2013
Interest income on loans to customers	25.890.915	35.979.166
Interest income on other financial assets	1.366.798	2.471.589
Government contribution to subsidy interests*	304.251	299.180
	27.561.964	38.749.935
Interest income on items measured at fair value:		
Interest income (expenses) on market securities	(80.379)	103.127
	(80.379)	103.127
Total interest income	27.481.585	38.853.062

Interest expenses

Interest expenses on items not measured at fair value:		
Interest expenses on bonds issued	27.239.881	38.074.826
Interest expenses on other borrowings	123.911	200.135
Total interest expenses	27.363.792	38.274.961
Net interest income	117.793	578.101

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

8. Cash and cash equivalents and restricted cash

	30.6.2014	31.12.2013
Unrestricted cash in Central Bank	5.265.969	7.855.259
Unrestricted cash in financial institutions	232.199	61.129
Cash and cash equivalents total	5.498.168	7.916.388

9. Loans to banks

Loans to banks are specified as follows:	30.6.2014	31.12.2013
Inter-bank loans	12.500.000	7.518.906
Other claims	480.043	423.364
Claims on collapsed banks	36.000	3.536.000
Loans to banks total	13.016.043	11.478.270

10. Treasury securities

Treasury bonds are specified as follows:	30.6.2014	31.12.2013
Listed treasury bonds at fair value	3.188.697	2.095.623
Treasury bonds without active market capitalised based on amortised cost and initial rate of return	27.132.024	30.198.585
Treasury bonds total	30.320.721	32.294.209

11. Receivable due from State Treasury

The receivable due from the State Treasury is a bond amounting to ISK 4,550 million, that the Fund received during the period and that is payable in one lump sum in the year 2018. The bond has however a permanent prepayment privilege favorable to the Treasury, in part or in full. Only interest payments on the bond are collected during the loan period. The bond is not transferable by the Housing Financing Fund.

12. Impairment of claims on banks

The Fund had approximately ISK 16,620 million outstanding claims on commercial banks that collapsed in October 2008, resulting from bonds and derivative contracts entered into with the banks. At the same time, the Fund owed to these banks ISK 5,342 million due to derivatives and HFF bonds. A total of ISK 12,628 million has been written down as impairment due to these claims. In the financial statements it is presumed that the Fund has among others the right to off-set these balances. Uncertainty prevails regarding the settlement of claims and derivatives and the Fund's right to off-set these balances. Therefore, the Fund's loss could be different when the final settlement occurs. In the first half of the year, one case ended with an agreement.

13. Loans, impairment and loan defaults

The following table shows an age analysis of total default on loans.

	Loans to individuals		Loans to legal entities		Total	
	30.6.2014	**31.12.2013**	**30.6.2014**	**31.12.2013**	**30.6.2014**	**31.12.2013**
Loans past due:						
31-60 days..............	475.087	467.095	181.265	214.321	656.351	681.416
61-90 days..............	338.858	336.555	72.122	98.704	410.981	435.259
Past due over 90 days	4.403.803	4.293.635	3.325.033	4.546.940	7.728.836	8.840.575
Total past due........	5.217.748	5.097.285	3.578.420	4.859.965	8.796.168	9.957.250

The following table shows the carrying amount of loans that are neither past due nor impaired, the carrying amount of loans that are past due and not impaired and the carrying amount of loans that are impaired.

	Loans to individuals		Loans to legal entities		Total	
	30.6.2014	**31.12.2013**	**30.6.2014**	**31.12.2013**	**30.6.2014**	**31.12.2013**
Neither past due nor impaired						
Total	527.525.566	541.066.469	86.108.619	80.556.629	613.634.185	621.623.098
General impairment.............	(469.171)	(533.317)	(109.487)	(82.275)	(578.658)	(615.592)
Carrying amount.....	527.056.395	540.533.153	85.999.132	80.474.354	613.055.527	621.007.507
Past due and not impaired						
31-60 days..............	17.577.963	16.211.140	688.620	144.671	18.266.583	16.355.811
61-90 days..............	6.934.318	11.581.469	716.741	145.336	7.651.059	11.726.805
Past due over 90 days..................	27.832.613	19.907.389	5.576.437	1.698.531	33.409.050	21.605.920
General impairment.............	(400.148)	(361.642)	(10.763)	(21.029)	(410.911)	(382.671)
Carrying amount.....	51.944.746	47.338.355	6.971.035	1.967.510	58.915.781	49.305.865
Impaired						
Total.......................	53.569.537	58.471.402	49.660.039	61.136.296	103.229.575	119.607.698
Specific................... impairment	(9.122.088)	(8.941.937)	(11.623.705)	(12.498.273)	(20.745.793)	(21.440.210)
Carrying amount.....	44.447.449	49.529.465	38.036.334	48.638.023	82.483.782	98.167.488
Loans total...........	623.448.590	637.400.973	131.006.501	131.079.887	754.455.090	768.480.860
Impairment as proportion of loans..................	1,58%	1,52%	8,23%	8,77%	2,80%	2,84%

13. Loans, contd.:

Write-off on loans

Loans are written off under the following two 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 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.

Impairment on loans is specified as follows:

	Individuals		Legal entities		
	Specific impairment	General impairment	Specific impairment	General impairment	Total
30 June 2014					
Balance at the beginning of the year............	8.941.937	894.959	12.498.273	103.304	22.438.473
Impairment loss (reversal of impairment loss)......................	1.545.880	(25.640)	(1.491.636)	16.946	45.550
Write-off..	(1.365.729)	0	617.068		(748.661)
Balance at year end.......................	9.122.088	869.319	11.623.705	120.250	21.735.362

	Individuals		Legal entities		
	Specific impairment	General impairment	Specific impairment	General impairment	Total
31 December 2013					
Balance at the beginning of the year............	9.064.583	938.335	13.216.088	92.849	23.311.855
Impairment loss (reversal of impairment loss)......................	4.833.825	(43.376)	1.165.204	10.455	5.966.108
Write-off..	(4.956.471)	0	(1.883.019)	0	(6.839.490)
Balance at year end.......................	8.941.937	894.959	12.498.273	103.304	22.438.473

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

	30.6.2014	30.6.2013
Specific impairment loss of loans (reversal of impairment loss)...	54.244	2.682.632
General impairment on loans..	(8.694)	31.844
Impairment loss of loans (reversal of impairment loss)..	45.550	2.714.476
Impairment on properties held for sale...	923.063	(111.294)
Impairment on other receivables...	18.157	43.771
Total expensed impairment...	986.770	2.646.953

14. Investment properties

Investment properties are specified as follows:

	Reykjavík	Southern Iceland	Southern peninsula	Other areas	Total
Transferred properties...................	3.171.881	1.017.473	1.017.473	2.144.097	7.350.924
Additions.......................................	11.297	4.728	4.347	8.770	29.142
Balance 30 June............................	3.183.178	1.022.201	1.021.820	2.152.867	7.380.066
Value adjustment..........................	(130.282)	268.840	69.497	235.226	443.281
Balance 30 June............................	(130.282)	268.840	69.497	235.226	443.281
Carrying amount 30 June...............	3.052.897	1.291.041	1.091.317	2.388.093	7.823.347

14. Investment properties, contd.:

The Fund´s investment properties are residential properties owned by Leigufélagið Klettur ehf. that were previously accounted for as properties held for sale. Upon selling the assets the assets were transferred from property held for sale to investment properties in the consolidated statements. As at 30 June 2014, the total of investment properties amounted to 450 and the purchase price amounted to ISK 7.350 million.

Valuation of investment properties

The Fund relies on the official property valuation of the Icelandic Property Registry in the valuation of investment properties. The official property valuation according to the registry is defined as the fair value of the asset. The valuation is carried out in May of each year and is based on February prices. The property valuation includes the building and land, and is divided into the valuation of the building and land.

The valuation of the Fund´s investment properties is based on the official property valuation of the registry in effect at year end 2013 and is increased by the consumer price index from February 2013.

Official property value and insurance value

The official property value of invesment properties amounted to ISK 7,584 million at the end of June. The insurance value of the Fund´s investment properties at the end of June 2014 amounted to ISK 9,761 million.

Revenue in excess of expenses of investment properties are specified as follows:

	30.6.2014	30.6.2013
Rental income from investment properties	260.116	0
Expenses due to investment properties	(92.153)	0
Value adjustment	443.281	0
Income in excess of expenses from investment properties	611.244	0

15. Properties held for sale

The Fund had repossessed 2,107 properties as at 30 June 2014 (2013: 2,606). Total number of properties held for sale managed by the Fund is specified as follows:

	30.6.2014	31.12.2013
Number of properties at the beginning of the year	2.606	2.224
Repossessed properties during the year	234	689
Properties sold or transferred during the year	(733)	(307)
Number of properties at end of period	2.107	2.606

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

Southern Iceland	839	881
Great Reykjavík area	385	593
Southern peninsula	262	369
West Iceland	232	285
East Iceland	187	232
North Iceland	130	173
Westfjords	72	73
	2.107	2.606

Of the 2,107 properties owned by the Fund at the end of the period 2014, 1,032 are in the sales process. 928 are rentals (year-end 2013: 1,307) or 44% of the total number of properties owned by the Fund as at 30 June 2014 (year-end 2013: 50.1%). Revenue and expenses on properties held for sale are specified as follows:

	30.6.2014	31.12.2013
Rental income from rented properties	615.541	575.303
Cost of properties held for sale	(600.151)	(454.446)
Income in excess of expenses from properties held for sale	15.390	120.857

Notes to the Condensed Consolidated Financial Statements contd.:

15. Properties held for sale, contd.:

The costs of properties 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. If all costs of the reception, operations and enforcement of property sales are to be included then consideration needs to be given to the cost of operating the Fund´s asset division in addition to the division´s share of the Fund´s administrative costs. Operating expenses of the Fund´s asset division amounted to ISK 98 million in during the period compared to 176 million in the year 2013. Revenues exceeded expenses of properties held for sale in the amount of ISK 83 million, if taken into account the costs of the operations of the asset division (2013: ISK 214million, revenues exceeding expenses).

Properties held for sale at the end of June 2014 are measured at the lower of the cost or net fair value and are specified as follows:

30 June 2014	Number	Official property value	Net Fair value	Carrying amount
Rented...	928	17.198.342	17.105.303	15.968.159
In sales process..	1.032	16.050.745	13.645.083	12.686.101
Empty..	116	1.625.450	1.471.198	1.411.404
Non-habitable..	15	228.250	210.212	180.415
Other assets*..	16	275.510	231.307	174.358
Total..	2.107	35.378.297	32.663.104	30.420.437

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

Year-end 2013				
Rented-out..	1.307	23.288.027	22.738.370	21.730.526
In sales process..	986	15.074.292	12.694.121	11.752.978
Empty..	243	3.616.160	3.331.767	3.259.473
Non-habitable..	21	288.600	268.682	237.981
Other assets*	49	893.953	893.953	682.271
Total..	2.606	43.161.032	39.926.893	37.663.230

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

16. Investment in subsidiary

Leigufélagið Klettur ehf. was established during a Board meeting on 23 January 2013. The initial capital amounted to ISK 10 million and the Fund is the owner of 100% of the shares.

Initially, the subsidiary was to purchase 517 properties from the Housing Financing Fund at the beginning of the year 2014, however the final amount of purchased properties was 450. The actual operations of Leigufélagið Klettur ehf. commenced in the beginning of the year 2014 when the company acquired the said properties and therefore the subsidiary´s share of equity is accounted for in the reviewed interim financial statements 2014.

Financing of the subsidiary´s purchase of the 450 properties has not been finalized and focus is on completing the equity and loan financing the purchased properties by the subsidiary as soon as possible. The purchase agreement between the Housing Financing Fund and its subsidiary indicates that the Fund will contribute equity amounting to 35.6% of the total financing of the properties and the total purchase price of the properties amounts to ISK 7,350 million.

The operations of Leigufélagið Klettur ehf. are independent and the company has been appointed a Board of Directors. There are two main objectives for establishing the company: to release the Fund´s ownership of the properties and separate the operations of the properties from the operations of the Fund. The main purpose of Leigufélagið Klettur ehf. is to provide suitable residential accommodation for rent throughout the country, with long-term housing security in mind. The Articles of Association states that the purpose of the company 's operations is the operating and leasing of housing, building, buying and selling residential property to maintain and expand the company, as well as administrating, trading and renovating properties along with lending and other activities related to the operations of the Company. The main purpose of the company´s sale of assets shall be to restructure or streamline its asset portfolio, finance other real estate properties or to strengthen liquidity.

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 callable. 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:

	30.6.2014	**2013**
HFF14 bond	6.425.911	12.587.562
HFF24 bond	161.282.656	165.839.992
HFF34 bond	218.470.729	219.404.366
HFF44 bond	387.031.358	385.983.495
Housing bonds (final maturity 2040)	26.620.131	29.090.763
Housing Authority bonds (final maturity 2038)	20.465.622	21.557.286
Total bond issues	820.296.407	834.463.465

18. Equity and capital management

The Fund's long-term objective is to maintain a 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:	**30.6.2014**	**31.12.2013**
Total equity according to the financial statements	13.537.645	14.845.388
Intangible assets	(180.490)	(151.428)
Equity base	13.357.155	14.693.960

Total equity requirement is specified as follows:

Credit risk	33.209.548	33.927.452
Market risk	103.633	68.108
Operational risk	460.228	460.228
Total capital requirements	33.773.409	34.455.788
Equity ratio	3.2%	3.4%

19. Related parties and salaries of management

The Fund has a related party relationship with its owner, board members and executive officers and its subsidiary. The Housing Financing Fund is publically owned and administratively falls under the Ministry 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. The balance of mortgage loans to related parties as at June 2014 amount to ISK 40.05 million (year-end 2013: ISK 46,5 million) and are accounted for as loans in the Fund´s consolidated balance sheet.

A claim on the Fund´s subsidiary Leigufélagið Klettur amounted to ISK 223,944 thous. at 30 June 2014.

20. Other matters:

Investigation of the Housing Financing Fund-Parliament´s Constitutional and Supervisory Committee

The investigation of the Housing Financing Fund, established by the Congressional resolution approved 17 December 2010, ended in June 2013. Significant findings were made on various aspects of the Fund's operations. The most serious findings involved the changes made to the financing of the Fund in 2004 with the introduction of non-callable HFF bonds instead of extendable housing bonds. Parliament´s Constitutional and Supervisory Committee received the report for substantive treatment, interviewed the CEO and CFO of the Fund and in addition obtained data from the Fund for further information on specific aspects of the report. The Constitutional and Supervisory Committee submitted its conclusion on 18 March 2014. The conclusion of the majority of the Committee entails serious allegations regarding the Investigation Committee´s methodology and approach and the committee has deemed it impossible to accept the allegations made. The individuals that were subjects of the investigation have not been granted the right of protest and the examination of all data was insufficient. Furthermore, the Committee believes that given the documents concerning the case, the Fund´s loss is approximately ISK 64 billion consistent with the data and assertions presented by the Board and not ISK 270 billion as projected by the Investigation Committee.

Parliament´s investigation of the Fund´s affairs is thereby formally concluded.

Communications with ESA

On 16 July, the ESA reached its decision to close its investigation of the Fund´s activities. The ESA was investigating both the state aid received by the Fund in the form of a government guarantee on its funding and also the relief aid to the HFF in the form of a capital injection to maintain the Fund´s equity. Although the decisions of the ESA may be appealed, it is unclear as to whether this decision will be appealed. The findings of the ESA are outlined in a legal letter by Bjarnveig Eiríksdóttir in European Law, dated 14 August of this year.

Project on future organization of housing policy

In September, the Minister of Social Affairs and Housing appointed a project committee on the future organization of housing policy in accordance with the Congressional resolution on the government action plan for household debt relief passed by Parliament last spring. The committee submitted its findings to the government in early May. The committee proposes the adoption of a new mortgage credit system in which specialized mortgage lending companies administer lending throughout the country. The framework of all mortgage loans is modeled on the Danish system and is based on the balance between lending and financing loans. According to the proposal the Fund´s operations will be divided into two parts: a new public housing agency will be established and it is expected that many of the Fund´s current services will be administered by public authorities. The Fund´s current loan portfolio will be allowed to expire according to the proposal. The committee is currently working on the implementation of the proposal and Gunnhildur Gunnarsdóttir, the Director of the Fund´s legal department is assisting in the preparation of structural changes. It is unclear as to the outcome of the implementation and the laws on housing are not on the schedule of the Althingi´s fall session.

Dispute on validity of Eir´s hypothecation

A claim was made for the rectification of the property registry relating to alleged errors of the property registry director´s official recording of mortgage bonds secured against 116 properties owned by Eir, thereby releasing the mortgage bonds from the properties. The claim was based on the lack of the approval of the competent authorities for pledging, thereby the registry director was obligated to dismiss the registration of the mortgage bonds. The case has been brought before the court and the Supreme Court released its decision in a judgment of 20 February 2014 in case no. 99/2014. The result was in favor of the Fund as the claim for rectification was denied. The Supreme Court´s ruling was based on the lack of the plaintiffs´ legal standing to claim rectification.

The Supreme Court´s ruling however strongly implied in the terms of the judgment that the registration entailed an error. Therefore as a result of the judgment permission was sought of competent authorities for the pledging of Eir´s assets as collateral for the Fund´s mortgage loans. The permission was granted and the mortgage loans in question are now secured by Eir´s assets as initially planned. The mortgage loans owed by Eir amount to about ISK 3 billion.

Legal action due to indexed loans

The Fund was cited for violation of the Act on Consumer Credit, challenging the legality of indexed loans in the fall of 2013. The lawsuit was filed in November 2013. The main cause of the action pertains to the Fund not having the authority to collect the costs entailed by the CPI-indexation of the loan as total borrowing costs of the loan were not identified in the initial loan process. The Fund requested a motion for dismissal on the grounds of failure to state a valid claim and is currently awaiting the outcome of the District Court dismissal case. Further information on the case may be found in Landslög ´s lawyer´s letter dated 18 August 2014.

The discussion about the legality of indexation of loans in respect to consumers is prominent and the demand requiring adjustments is considerable. Clearly, if the provisions of the Act on Consumer Credit as to the granting of indexed loans to individuals are ruled illegal, this would lead to enormous losses for the Fund since its assets are essentially all indexed.

The EFTA Court published an advisory opinion on August 28 on the case of a individual against Íslandsbanki. The opinion of the Court maintains the unequivocal conclusion that indexation of mortgage loans does not conflict with the rules of the European Economic Union and it is the Icelandic courts jurisdiction to assess the validity of contractual terms at each given time.

Prepayment fee law-suit

Judgement was reached in June in a customer´s case against the Fund for the collection of a prepayment fee. The customer claimed the charge had not been adequately specified in the loan agreement that he signed. The conclusion reached was that the collection of the fee was in accordance with the law. Gizur Bergsteinsson, a Supreme Court attorney represented the Fund in this case.

There are quite a number of inquiries and objections from customers regarding the prepayment fee and fee for excess payments. With amendments to the Housing Act no.120/2004 the Fund was granted the authority to offer to its customers loans with lower interest rates, provided that they relinquish their right to prepay the loan. A customer of the Fund argued that the prepayment fee has not been sufficiently explained during the loan process and therefore is illegal. If the fees are deemed to be illegal due to lack of information to customers, the Fund is exposed to prepayments as the Fund does not have the authority to cover its own borrowings against prepayments. The Fund´s loans containing a prepayment clause amounted to ISK 137.1 on 30 June 2014(year-end 2013: 141 billion).

Principal Reduction of Mortgages

Laws concerning the reduction of mortgage principal and the allocation of private pension funds to decrease mortgages were approved in the spring session. A reduction in loans taken for the purpose of obtaining residential property for own use is expected. Households that paid indexed loans during the period 2008-2010 may receive a maximum reduction of their debt by ISK 4 million. Furthermore, individuals may allocate ISK 500 thousand of their contribution to private retirement accounts to reduce their mortgage per year and couples up to ISK 750 thousand. This action is intended to be implemented this fall. It is expected that defaults will decline somewhat when the action occurs, but it is clear that this will also result in increased prepayment risk for the Fund. The allocation of private pension savings to decrease loans is specifically exempt from prepayment fees by transitional provisions in the Housing Act. There are no agreements for compensation from the government for the principal reduction.