January 2014

Summary

- New mortgages for privately owned homes amounted to ISK 489 million
- Prepayments amounted to ISK 1.5 billion
- Privately owned homes in arrears decreased from last month
- 7.05% of homes are in default
- Total amount in default is ISK 8.0 billion, underlying loan amount equals 12.42% of loan portfolio
- HFF's appropriated properties numbered 2,117, whereof 871 apartment is rented

HFF Lending Rate

4.20% fixed rate

Market news

Total lending by the Housing Financing Fund (HFF) in January 2014 amounted to ISK 506m, whereof ISK 489m were mortgages for privately owned homes. In comparison, in January 2013, these loans amounted to ISK 854m. The average amount of mortgages for privately owned homes was ISK 9.2m.

A change was made to the HFF's board of directors in January where the Minister of Social Affairs and Housing appointed Drífa Snædal to the board replacing Stefán Ólafsson.

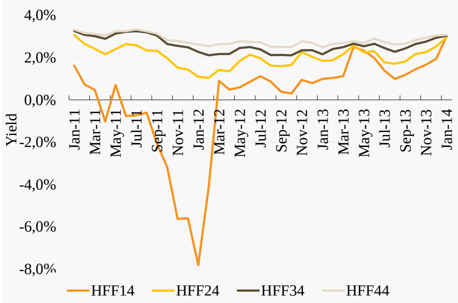
The yield of all classes of HFF bonds rose in January. The increase was 4–105 points. The yield of HFF14 rose by 1.05%, that of HFF24 by 0.43%, that of HFF34 by 0.10 and HFF44 by 0.04%. The total turnover of HFF bonds amounted to ISK 24bn this month, compared to ISK 27bn in December 2013. The HFF's payments due to HFF bonds and other liabilities amounted to ISK 3.9bn in January. Prepayments amounted to ISK 1.5bn.

Development of defaulted loans

The number of households in arrears continued to fall in January. Since last December, their number has decreased by nearly 2.5%, or 83 homes. The proportion of the underlying loan value of individuals in arrears has also continued to fall. By the end of January, the amount of defaulted loans to individuals amounted to ISK 4.3bn, with the underlying loan value amounting to ISK 66.6bn or approximately 10.27% of HFF's loan portfolio to privately owned homes, compared to 13.39% at the end of last year. There are 3,460 households currently in arrears, whereof 238 have had their loan payments deferred. A total of 7.05% of the households that have their property loans from HFF were in arrears with their loans at the end of the month, compared to 9.29% at the end of 2013. The amount of defaulted loans to legal entities was ISK 3.7bn with an underlying loan value of ISK 32.7bn. Thus 21.71% of the Fund's loans to legal entities are connected to defaults, which is a 0.67% decrease from the previous month. Defaults or loans with deferred payments are a total of 12.42% of the Fund's loan portfolio. The corresponding percentage in January 2013 was 14.99%.

Defaults are considered to be loans in arrears for longer than 90 days and loans where payments have been deferred.

Yield of HFF Bonds



Series	Nov 2013	Dec 2013	Jan 2014	Dur-ation	Face value	Outst.n. value
HFF14	1,66%	1,95%	3,00%	0,4	70,0	8,2
HFF24	2,26%	2,53%	2,96%	4,8	164,0	101,0
HFF34	2,76%	2,94%	3,04%	9,2	175,3	139,1
HFF44	2,94%	3,04%	3,08%	13,1	273,1	239,3

*Yield on the last trading day of each month
Duration (yrs) and class size (MISK) as of end of January ´14
Of the total issuance of the face value, ISK 9.6 bn in all HFF bonds directly belong to the lending facilitation for HFF bond market makers.

Outst. amount in the securities lending facility at the end of last month

Series	HFF14	HFF24	HFF34	HFF44
Outstanding amount (NV)	0,0	0,3	0,4	1,1

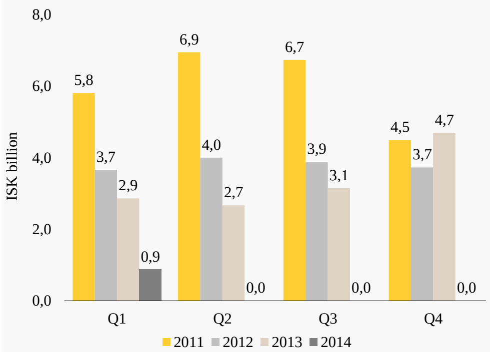
HFF Auctions, Lending and Payments

Actual figures 2014	Forecast 1Q	Actual 1Q	Actual Jan
HFF bond issuance (NV)	0	0	0,0
New HFF lending	0	0,9	0,9
HFF total payments	0	3,9	3,9

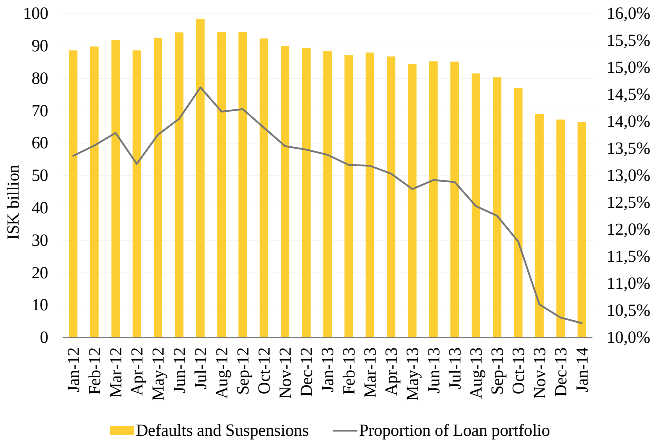
HFF bond holders 31.12.2013	HFF14	HFF24	HFF34	HFF44
Banks and Savings banks	15,5%	2,3%	0,3%	0,2%
Individuals	4,3%	2,8%	1,2%	0,9%
Foreign Investors	9,5%	1,6%	1,7%	0,4%
Other Corporations	13,1%	4,6%	3,3%	0,5%
Banks in liquidation	0,1%	0,0%	0,0%	0,0%
Credit Institutions	18,5%	5,9%	5,3%	3,1%
Pension Funds	4,8%	50,7%	69,6%	86,8%
Insurance Companies	5,1%	3,7%	1,8%	0,8%
Securities and Investm. Funds	28,0%	26,1%	16,1%	6,7%
Others	0,9%	2,1%	0,6%	0,6%
Nominal Value	70,0	164,0	175,3	273,1

Of the total issuance of the face value, ISK 9.6 bn in all HFF bonds directly belong to the lending facilitation for HFF bond market makers.
All figures are in ISK billion.

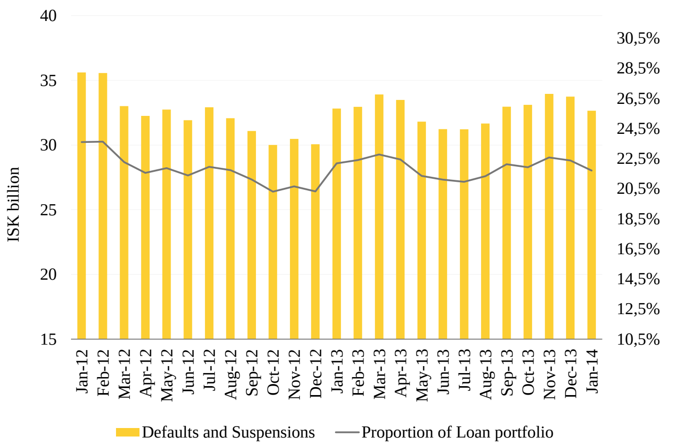
Total Lending by Quarter



Individuals - Defaults and Suspensions



Legal Entities - Defaults and Suspensions



HFF's Appropriated Property

Property portfolio

The HFF has currently sold 517 apartments, located throughout Iceland, to their subsidiary Klettur Ltd. Klettur is a rental company which main objective is to offer suitable residential rental housing with the intention of supporting long-term housing security.

Apart from the rental company´s properties, the HFF owned 2,117 appropriated assets by the end of January. Of this number, 871 apartments were rented (1,388 if the rental company's apartments are included). The vast majority were rented to families and individuals who resided in the properties when the HFF acquired them.

In January the HFF sold 27 properties, as well as the 517 already mentioned. As opposed to 9 properties in January 2013. Thus sales have tripled between years. In addition, purchase offers for 81 properties have been accepted. The HFF has sold 909 properties since the beginning of 2008, excluding the 517 sold to Klettur. Undergoing the sales process were 976 properties.

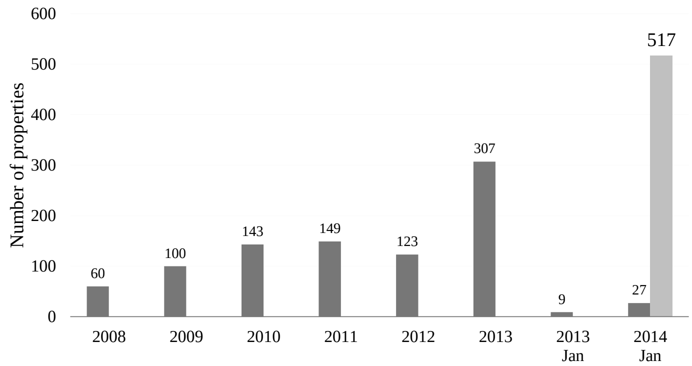
All estate agencies in Iceland may sell the HFF's properties. The HFF has a partnership agreement with the Association of Estate Agents (Félag fasteignasala) as regards the procedures that must be employed when selling properties owned by the Fund. The Fund's properties are rented at market price, taking into account comparable properties according to location, size, age, etc.

The table to the right contains an overview of the location of properties, categorized according to regions and their use/disposal. Of the 2,117 properties that the HFF owned at the end of January 2014, 1,900 properties have been rented or are undergoing the sales process or other procedures. A further 197 properties await assessment, most of which will go into sales process. As many as 146 auction deeds and certificates of title await processing by the District Commissioner. This has caused delays in the sales of the properties as these documents are essential for carrying out the sales procedure.

HFF's Property According to Regions and Status, 31.01.2014

	For sale	Rented	Empty	Uninhabit-able	In process	Total Jan'14	Total Dec´13
Capital Area	104	278	20	2	11	**415**	593
Sth. Peninsula	371	294	102	12	25	**804**	881
Western Region	131	64	37	2	3	**237**	285
Westfjords	52	9	7	0	2	**70**	73
Northw. Region	11	7	0	0	1	**19**	18
Northe. Region	50	43	3	0	5	**101**	155
Eastern Region	89	74	13	0	2	**178**	232
Southern Region	168	102	15	4	4	**293**	369
Total	**976**	**871**	**197**	**20**	**53**	**2.117**	**2.606**

Sold properties



Prepayments in the Housing Financing Fund's portfolio are within normal limits

The Housing Financing Fund's (HFF) prepayment problem has been regularly discussed in the public arena with the general tone in the debate being that the problem is continuously growing.

The said prepayment problem is in fact an issue of prepayment risk because the Fund cannot prepay its own debts to the same extent as the Fund's customers. This is because the Fund's financing bonds are non-callable and have been so since 2004. In the event of extensive prepayments, such as in 2004-2006, and rapidly declining interest rates, the Fund's losses could be considerable. The Fund's finance and risk management, however, has for the most part been able to maintain the interest rate spread between interest carrying assets and liabilities despite prepayments. Moreover, the Fund has laid the foundations for a change in the arrangements to its funding and risk management which is based on having callable bonds to meet customer prepayments. This will considerably reduce the Fund's risk level and create a balance in the Fund's financial position.

Prepayments not a problem at present

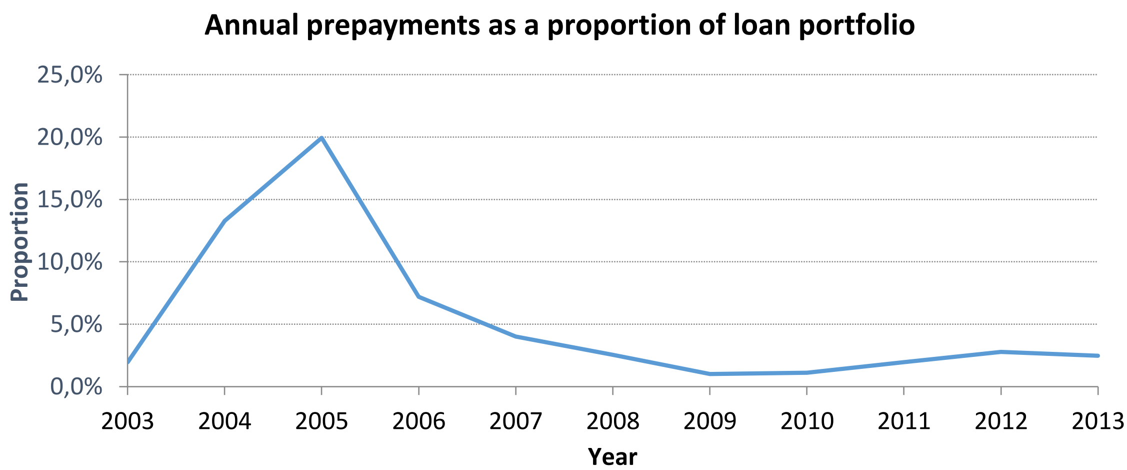
Due to continued discussions on the Fund's prepayment risk, many have reached the conclusion that prepayments are a significant problem for the Fund. The image drawn up is that prepayments are extensive and that this is evidence of customers' negative attitude toward the Fund. Extensive prepayments must mean dissatisfied borrowers. This begs the question as to whether the prepayments are as extensive as rumoured and do they provide an indication of borrowers' attitudes toward the Fund? The conclusion that this is a problem is based first and foremost on comparisons between new mortgages to customers and customer prepayments. If the prepayments, however, are compared to the Fund's overall position this shows that the actual prepayments do not pose large problems to the Fund.

Prepayments are a part of lending operations

One must always assume that there will be some prepayment of mortgages for privately owned homes. To think otherwise would be unrealistic. The main reasons for prepayments of mortgages for privately owned homes are events in the life of borrowers, such as change of residence, death, divorce, illness and other family circumstances. Better and more diverse financing terms in the market have an impact on prepayments and increased economic growth can lead to increases in the number of property transactions. Higher real property prices, moreover, encourage homeowners to redeem equity through the sale of properties. In addition, system changes in the bond market can affect prepayments.

The prepayment proportion has decreased between years

The figure below shows the development of prepayments at the HFF, as a proportion of the balance of the loan portfolio at year-end, from 2003 to 2013. The banks entered the mortgage market in 2004, after having been a peripheral figure. On their entry, the prepayment proportion rose steeply, or from 2.0% in 2003 to approximately 13.3% in 2004, and peaking at 19.9% in 2005.



Prepayments fell considerably in the following years and had fallen to 1.0% by 2009. In 2012, they rose again to approximately 2.8% and then fell again to around 2.5% in 2013. As of 2011-13, the annual prepayment proportion has been, on average, approximately 2.4% of the Fund's lending. This slight increase during 2011-12 can probably be traced to the non-indexed mortgages provided by the banks on generous interest terms. In comparison, it should be noted that in the US, annual prepayments are generally around 6-12% of the balance of mortgage portfolios.

The "big picture" is key

As previously stated, one must view the overall picture when assessing whether prepayments are a problem. Simply comparing prepayments with new mortgages is not sufficient. First, one must ask whether the Fund's prepayments are greater than may be considered normal for the portfolio over an extended period. In the case of the HFF, prepayments are within the normal range and much lower than is considered normal overseas. As a result, it may be assumed that the current prepayments are not really a problem.

Second, one must also take account of the total payment flow of the Fund's assets and liabilities, together with its liquidity position as current at any given time, in order to draw the correct conclusions about the problem. At present, the Fund's liabilities are being paid at a faster rate than the loan portfolio. As a result, the prepayments are useful to bridge the difference in cash flow between assets and liabilities. At the same time as the prepayments are occurring, the liquidity position is steadily decreasing.

The Housing Financing Fund remains active in the lending market

Prepayments in HFF's loan portfolio along with decreasing new lending reflect the fact that the Fund has not yet offered non-indexed mortgages. Moreover, they reflect the fact that, at present, the Fund is lending at slightly higher interest rates than the banks, something that can be traced to methodologies on interest determinations which are governed by the regulatory framework in force. The Fund determines lending rates on the basis of bond issues, the most recent of which was in January 2012. As the Fund has not issued bonds for the past two years, its interest rates have remained unchanged.

It should be noted that although the HFF's lending has decreased in comparison to earlier years, this does in no way suggest that the Fund is no longer an active participant in the housing market. By taking takeovers and transfers of previously issued mortgages into account, it is clear that the fund is financing a considerably larger proportion of the market then figures on new lending exclusively imply.