Íbúðalánasjóður

Housing Financing Fund

Financial Statements 2007

Íbúðalánasjóður
Housing Financing Fund
Borgartún 21
105 Reykjavík

Reg. no. 661198-3629

Contents

Endorsement by the Board of Directors and the Managing Director

Operation of the year 2007

The Financial Statements of the Housing Financing Fund for the year 2007 have been prepared in accordance with International Financial Reporting Standards (IFRSs), as adopted by the EU. These are the Fund's first IFRS Financial Statements. The transition resulted in an increase of equity of ISK 1,286 million as at the transition date 1 January 2007. Further information regarding the impact of transition to IFRSs is provided in note no. 16 to the Financial Statements.

The Fund's operating profit amounted to ISK 2,528 million according to the income statement. Equity at year end amounted to ISK 20,189 million according to the balance sheet. The Fund's equity ratio, which is calculated on the basis of Regulation no. 544/2004 on the Housing Financing Fund, is 7,0%. The ratio is calculated on the basis of the same method as for financial companies. The Fund's long term goal is to have an equity ratio of over 5.0%.

At year end loans amounted to ISK 467,084 million and increased by ISK 60,535 million during the year. The Fund's borrowings amounted to ISK 583,185 million and increased by ISK 59,646 million during the year.

Governance

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

The Board of Directors of the Housing Financing Fund emphasizes on maintaining good governance. It hires a Managing Director, decides on his salaries and other employment benefits and establishes his job description. The Board of Directors also meets with the Fund's auditors on a regular basis. The Icelandic National Audit Office handles the Fund's internal audit. It supervises that all information required by law and regulations are remitted to the Ministry of Finance, the Icelandic Central Bank og other authorities at the appointed time. The Board of Directors also makes decisions regarding all extraordinary and substantial matters.

The Board of Directors has established extensive operating procedures, which define its competence. The Fund's operating procedures are published on the Fund's website; www.ils.is.

Statement of the Board of Directors and the Managing Director

The Financial Statements of the Housing Financing Fund for the year 2007 are prepared in accordance with International Financial Reporting Standards as adopted by the EU, and additional requirements on information providing of companies listed in an organized securities market.

According to our best knowledge, it is our opinion that the Financial Statements give a fair view of the Fund's operating profit for the year 2007, assets, liabilities and its financial standing as at 31 December 2007 and changes in cash and cash equivalents during the year 2007.

Furthermore, it is our opinion that the Financial Statements and the endorsement by the Board of Directors and the Managing Director include a fair overview on the Fund's operating development and results, its standing and describes the Fund's main risk exposures.

Endorsement by the Board of Directors and the Managing Director, cont.d.:

The Board of Directors and the Managing Director of the Housing Financing Fund have today discussed the Fund's Financial Statements for the year 2007 and hereby confirm them by means of their signatures.

Reykjavik, 1 February 2008

The Board of Directors of The Housing Financing Fund

Hákon Hákonarson
Chairman

Gunnar S. Björnsson

Kristján Pálsson

Elín R. Líndal

Jóhann Ársælsson

Managing Director

Guðmundur Bjarnason

Independent Auditor's Report

To the Board of Directors of the Housing Financing Fund.

We have audited the accompanying financial statements of the Housing Financing Fund, which comprise the balance sheet as at December 31, 2007, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the EU. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Housing Financing Fund as at December 31, 2007, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Reykjavik, 1 February 2008

KPMG hf.

Helgi F. Arnarson

Income Statement for the year 2007

	Notes	2007	2006
Net interest income:			
Interest income		62.582.683	56.548.118
Interest expenses		(59.071.587)	(53.046.373)
	6	3.511.096	3.501.745
Operating income:			
Service income		257.502	254.219
Total operating income		3.768.598	3.755.964
Operating expenses:			
Salaries and salary related expenses	7-9	399.423	353.971
Other administrative expenses	11	494.056	481.230
Other operating expenses	12	23.271	25.797
Depreciation and amortization	13,14	28.533	29.688
		945.283	890.686
Impairment of loans	4	(295.227)	(83.208)
Net profit for the year		2.528.088	2.782.070

Notes on page 10 to 26 are an integral part of these Financial Statements

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Balance Sheet 31 December 2007

	Notes	31.12.2007	1.1.2007
Assets			
Cash and cash equivalents		1.053.355	823.609
Market securities		39.949.986	35.833.702
Derivatives		1.026.850	1.282.974
Loans to banks		95.941.638	97.024.038
Loans to customers		467.084.491	406.549.623
Mortgages foreclosed		482.338	394.292
Fixed assets	13	59.695	72.093
Intangible assets	14	56.360	38.464
Other assets		202.810	115.375
Total assets		605.857.523	542.134.170
Liabilities			
Derivatives		2.176.754	825.133
Bond issues	15	578.747.759	513.310.594
Other borrowings		4.437.595	10.228.445
Other liabilities		306.642	109.313
Total liabilities		585.668.750	524.473.485
Equity			
Contributed capital		7.155.408	7.155.408
Retained earnings		13.033.365	10.505.277
Total equity		20.188.773	17.660.685
Total liabilities and equity		605.857.523	542.134.170

Notes on page 10 to 26 are an integral part of these Financial Statements

Amounts are in ISK thousand

Statement of changes in equity for the year 2007

	Notes	Contributed capital	Retained earning	Total equity
Changes in equity from 1 January to 31 December 2006:				
Equity as at 31 December 2005		7.155.408	6.739.006	13.894.414
Changes due to IFRSs			984.199	984.199
Equity as at 1 January 2006, IFRSs	16	7.155.408	7.723.205	14.878.615
Net profit for the year			2.782.070	2.782.070
Equity as at 31 December 2006, IFRSs		7.155.408	10.505.275	17.660.685
Changes in equity from 1 January to 31 December 2007:				
Equity as at 31 December 2006		7.155.408	9.219.156	16.374.564
Changes due to IFRSs			1.286.121	1.286.121
Equity as at 1 January 2007, IFRSs		7.155.408	10.505.277	17.660.685
Net profit for the year			2.528.088	2.528.088
Equity as at 31 December 2007, IFRSs		7.155.408	13.033.365	20.188.773

Notes on page 10 to 26 are an integral part of these Financial Statements

Amounts are stated in ISK thousand

Statement of Cash Flows for the year 2007

	2007	2006
Cash flows from operating activities:		
Profit for the year	2.528.088	2.782.070
Operating items not affecting cash flows:		
Indexation on loans and borrowings	1.175.702	1.058.322
Depreciation and amortization	28.533	29.688
Impairment on loans	295.227	83.208
Changes in operating assets and liabilities		
Loans to banks	6.736.541	(4.884.280)
Loans to customers	(35.231.500)	(1.875.606)
Mortgages foreclosed	(88.046)	(282.540)
Market securities	(4.116.284)	(8.153.562)
Derivatives	1.607.745	1.026.774
Other assets	(87.435)	10.146
Other liabilities	197.330	(187.356)
Cash flows from operating activities	(26.954.099)	(10.393.136)
Cash flows from investing activities:		
Fixed assets, change	(34.032)	(17.514)
Investing activities	(34.032)	(17.514)
Cash flows from financing activities:		
Borrowings, change	27.217.877	9.799.544
Financing activities	27.217.877	9.799.544
Cash and cash equivalents, increase (decrease)	229.746	(611.106)
Cash and cash equivalents at year beginning	823.609	1.434.715
Cash and cash equivalents at year end	1.053.355	823.609

Notes on page 10 to 26 are an integral part of these Financial Statements

Amounts are stated in ISK thousand

Notes to the Financial Statements

General information

1. Reporting entity

The Housing Financing Fund is domiciled in Iceland. The address of the Fund's registered office is Borgartún 21, Reykjavik. The Fund's objectives are to provide housing loans, loans for new constructions and property development in Iceland. The Housing Financing Fund is an independent institution owned by the State and appertains to a special management and the Minster of Social Affaires.

The Financial Statements of the Housing Financing Fund were approved by the Board of Directors and the Managing Director on 1 February 2008.

2. Basis of Preparation

a. ***Statement of Compliance***

The Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU. These are the Fund's first IFRS Financial Statements. IFRS 1, *First-time Adoption of International Financial Reporting Standards* has been applied.

An explanation on how the transition to IFRSs affected the reported financial position, financial performance and cash flows of the Fund is provided in note no. 16. This note includes reconciliations of equity and net profit for comparative periods reported under IS-GAAP for the year 2006 to those reported for those periods unders IFRSs.

b. ***Basis of Measurement***

The Financial Statements have been prepared on the historical cost basis except for derivatives, market securities and other financial assets and liabilities designated at fair value through profit and loss. Mortgages foreclosed are stated at the lower of the book value and the net fair value.

c. ***Presentation and Functional Currency***

The Financial Statements are prepared in Icelandic krona (ISK), which is the Fund's functional currency. All financial amounts presented have been rounded to the nearest thousand.

d. ***Use of estimates and judgements***

The preparation of the Financial Statements in conformity with IFRS requires management to make judgements, estimates and assumptions, which affect the application of accounting policies and the reported amount of assets and liabilities as well as income and expenses. The estimates and underlying assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying amounts of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revison and future periods if the revision affects both current and future periods.

2. Contd.:

(i) *Impairment on loans*

The Fund regularly reviews its loan portfolios to assess impairment. In determining whether an impairment loss sould be recorded in the income statement, the Fund makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from individual loans or from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there have been changes in the payment status of borrowers in a group or economic conditions. Management uses estimates based on historical loss experience for assets with similar credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss.

(ii) *Fair value measurements of derivatives*

The fair value of financial instruments that are not quoted in active markets are determined by using valuation techniques which are reviewed regularly. All models that are used must be approved and calibrated to ensure that outputs reflect actual data.

3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these Financial Statements and in preparing an opening IFRS balance sheet at January 1 2006 for the purposes of the transition to IFRSs.

a. ***Interest income and interest expense***

Interest income and expenses are recognised in the income statement using the effective interest method. Interest income and expenses includes the amortization of discounts and premiums and other differences initially stated at the book value of the financial instrument and due amounts based on the effective interest method. Interest income is calculated on loans and market securities. Interest expenses are calculated on bond issues and other borrowings. Borrowing fee is recognised in the income statement in the same manner as interest income and expenses and those items are taken into account in the calculation of effective interest rates.

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.

The effective interest rate is the rate that exactly discounts the estimated future cash payment and receipts through the expected life of the financial asset or liability, or where appropriate, a shorter period, to the carrying amount of the financial asset or liability. The effective interest rate is established on initial recognition of the financial asset and liability and is not revised subsequently. Interest income in the income statement comprises of interest from loans to and receivables from credit institutions, loans to customers and market securities.

Interest income and interest expense presented in the income statement consist of:

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

b. ***Service income***

Service income consists of collection charges. Service income is recognised in the income statement when accrued. Borrowing charges are included in the calculation of effective interest rate and are therefore not included in service income.

3. Contd.:

c. ***Financial assets and financial liabilities***

(i) *Recognition and derecognition of financial assets and liabilities*

The Fund initially recognises financial assets and liabilities on the date that they are originated. Those assets and liabilities are initially recognised on the date at which the Fund becomes a party to the contractual provisions of the instrument, except for loans that are recognised when funds are transferred to borrowers. Financial assets are derecognised when the contractual rights to the cash flows from the asset expire, or when the Fund transfers the rights to receive the cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial assets are transferred.

The Fund derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

(ii) *Offsetting*

Financial assets and liabilities are set off and the net amount presented in the balance sheet when, and only when, the Fund has a legal right to set off the amounts and intends either to settle, on a net basis, or realise the asset and settle the liability simultaneously.

(iii) *Loans*

Loans and receivables are non-derivative financial assets with fixed or determinable payments thate are not quoted in an active market, except for those that the Fund designates as at fair value through profit and loss. Loans and receivables include loans to customers, loans which the Fund takes part in providing together with other credit institutions and acquired borrowings, which are unlisted and that the company has no intention to sell in the nearest future.

Loans and receivables are initially measured at fair value plus incemental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method. The book value of loans and receivables includes accrued interest and inflation adjustment.

(iv) *Amortised cost of financial assets and financial liabilities*

The amortised cost of a financial asset or financial liability is the amount at which the financial instrument is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

(v) *Market securities*

Market securities consist of bonds and unit shares in mutual funds. They are initially recognised and subsequently measured at fair value in the balance sheet. Fair value changes are recognised in the income statement.

(vi) *Fair value measurement*

The determination of fair value of financial assets and financial liabilities quoted in an active market is based on quoted prices. For all other financial instruments fair value is determined by using valuation techniques. A market is considered active if quoted prices are readily and regularly available and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Valuation techniques include recent arm's length transactions between knowledgeable, willing parties, if available, reference to the current fair value of other instruments that are substantially the same, the discounted cash flow analysis and option pricing models. Valuation techniques incorporate all factors that market participants would consider in setting a price and are consistent with accepted methodologies for pricing financial instruments. Periodically, the Fund calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument, without modification or repackaging, or based on any available observable market data.

3. Contd.:

(vii) *Impairment of financial assets*

The carrying amount of the Fund´s assets, other than trading assets and financial assets designated at fair value, is reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated.

An impairment is recognised in the income statement whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

Two methods are used to calculate impairment losses, one based on an assessment of individual loans and the other based on a collective assessment. Losses expected as a result of future events, no matter how likely, are not recognised.

Objective evidence of impairment includes information about the following events and conditions:

(i) significant financial difficulty of the borrower;
(ii) a breach of contract, such as a default on installments or on interest or principal payments;

Individually assessed loans

Impairment losses on individually assessed loans are determined by an evaluation of the exposures on a case-by-case basis. The Group assesses at each balance sheet date whether there is any objective evidence that individual loans are impaired.

Impairment losses are measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets´ original effective interest rate. Losses are recognised in profit or loss and reflected in an allowance account.

Collectively assessed loans

Where loans have been individually assessed and no evidence of loss has been identified, these loans are grouped together on the basis of similar credit risk characteristics for the purpose of calculating a collective impairment loss. This loss covers loans that are impaired at the balance sheet date but which will not be individually identified as such until some time in the future.

The collective impairment loss is determined after taking into account:
- future cash flows in a group of loans evaluated for impairment are estimated on the basis of the contractual cash flows of the
- historical loss experience in portfolios of similar risk characteristics (for example, by industry sector, loan grade or product);
- the estimated period between a loss occurring and that loss being identified and evidenced by the establishment of an allowance against the loss on an individual loan;
- management's experienced judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience.

Estimates of changes in future cash flows for groups of assets are consistent with changes in observable data from period to period, for example changes in property prices, payment status, or other factors indicative of changes in the probability of losses on the group and their magnitude. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Fund to minimise any differences between loss estimates and actual losses.

Reversal of impairment

If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is recognised as revenue in the income statement.

3. Contd.:

Loan write-offs

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

Mortgages foreclosed

When the Fund has redeemed assets on foreclosed mortgages they are recognised at the lower of fair value less estimated cost of sale or book value of the loan net of impairment.

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

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

d. ***Cash and cash equivalents***

Cash and cash equivalents in the Statement of Cash Flows consist of demand deposits with credit institutions.

e, ***Fixed assets***

Recognition and measurement

Fixed assets are recognised at cost less accumulated depreciation and impairment.

Depreciation

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful life until residual value is reached. Estimated useful lives are specified as follows:

Real estate	25 years
Fixtures and equipment	5-10 years
Vehicle.	10 years

Residual value is reviewed annually unless it is immaterial.

f. ***Intangible assets.***

Intangible assets consist of software used in the Fund´s operations and its web site. Intangible assets are amortised on a straight-line basis over the estimated useful life, which is 5 years.

g. ***Other assets and liabilities***

Other assets and liabilities are measured at cost.

4. Financial risk management

a. ***overview of financial risk and risk management structure***

It is important for the Fund to maintain a balance in the composition of its borrowings and loans. Following are the risks the Fund is exposed to and that are of importance:

– Credit risk
– Liquidity risk
– Interest rate risk

Following is general information on the Fund's financial risk management, in addition to information on each of the aforementioned risk, objectives, policies and evaluation process and management of each risk. Furthermore information regarding the Fund's capital management is disclosed.

Risk management structure

The Housing Financing Fund is a non profit organization. Its financial and risk management takes note thereof. Its main objective is to continuously endeavour to keep low risk level in its financial operation and it aims at limiting financial risk and cost in accordance with its operating goals.

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

Hedging

It is important to maintain a certain balance in the Fund's combination of borrowings and loans. The Fund's financial and risk management rules stipulate that the Fund must limit its risks and manage interest rate and loan risk within a certain threshold. The fund uses both derivatives and other financial instruments in order to manage possible impacts of those risk factors on the Fund's return. Various types of derivative agreements and derivatives are used for that purpose, including interest rate swaps and options.

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

The Fund's Board of Directors

- Establishes the Fund's financial and risk management policy and reviews on a regular basis reports on the Fund's financial risk.
- Takes note of risk factors in the Fund's administration and organization.
- Nominates a financial committee.
- Remits reports to the Minister of Social Affairs.

Managing Director

- Responsible for reports on the Fund's risks.
- Responsible for the Fund's long term financing need being met.
- Divides responsibility of financial matters in accordance with financial and risk management policy between the financial committee and the financial department.

Financial Committee

- Brings proposals before the Board of Directors on new bond issuance.
- Brings proposals before the Board of Directors on interest levy on loan interests in accordance with the Fund's rules on loan interests.

4. Contd.:

Head of financial department

- Responsible for the implementation of risk management and risk analysis and ensures that all of the Fund's payments and financial agreements are within its financial and risk management policy.

- Directs the Fund's financial and risk management policy.
- Works on proposals on revision of the financial and risk management policy.

Risk management

- Takes care of daily risk management operation.
- Shares knowledge and risk awareness within the Fund.

Financial management

- Takes care of the Fund's financing and financial operations and ensures a safe and efficient handling of securities.

Credit risk management

All of the Fund´s loans are secured by real estate mortgages. The Fund limits its risk due to these loans in two ways, by setting a maximum individual credit amount and a maximum mortgage proportion. The Risk Management Division evaluates the credit risk on an ongoing basis and prices it when deciding the interest rates on loans, which represent a markup on the interest rates on the Fund´s liabilities.

Credit risk exposure

The book value of the Fund's financial assets equals maximum exposure to credit risk. The Fund's loans are specified as follows:

	Loans to individuals		Loans to others		Loans to banks	
	2007	2006	2007	2006	2007	2006
Book value.......................................	377.052.109	333.100.707	90.032.382	73.448.916	95.941.638	97.024.038
Defaults are specified as follows:						
Defaults incl. impairment.............	691.664	612.860	127.008	57.994		
Defaults excl. impairment						
30 - 60 days..................................	124.712	124.076	29.779	27.359		
60 - 90 days..................................	144.971	144.379	34.616	31.836		
Defaults over 90 days...................	184.642	182.730	44.089	40.292		
Total defaults................................	1.145.989	1.064.045	235.492	157.481		
Neither defaulted nor impaired						
Renegotiated loans.........................	1.034.700	977.956				
Other loans...................................	375.828.558	331.906.291	89.987.288	73.401.180	96.002.019	97.084.306
Total value....................................	378.009.247	333.948.292	90.222.780	73.558.661	98.082.224	99.190.889
Impaired financial assets						
Specific impairment......................	(691.664)	(612.860)	(127.008)	(57.994)		
General impairment......................	(265.474)	(234.725)	(63.390)	(51.751)	(60.381)	(60.268)
Total impairment..........................	(957.138)	(847.585)	(190.398)	(109.745)	(60.381)	(60.268)
Book value.......................................	377.052.109	333.100.707	90.032.382	73.448.916	95.941.638	97.024.038

Financial Statements of the Housing Financing Fund 2007 16 Amounts are stated in ISK thousand

4. Contd.:

Impairment on loans is specified as follows:

Year 2007	Specific impairment	General impairment	Total
Balance at the beginning of the year	670.854	346.750	1.017.604
Provision for impairment losses	183.498	111.730	295.227
Loans write off	(35.678)	(69.235)	(104.913)
Balance at year end	818.674	389.245	1.207.918
Impairment as a percentage of loans			0,21%

Year 2006	Specific impairment	General impairment	Total
Balance at the beginning of the year	693.811	375.208	1.069.019
Provision for impairment losses	27.260	55.948	83.208
Loans write off	(50.217)	(84.406)	(134.623)
Balance at year end	670.854	346.750	1.017.604
Impairment as a percentage of loans			0,18%

Write off

The Housing Financing Fund recognizes amounts as final depreciation of loans on the basis of two different conditions :

(i) Upon loss on the sale of appartments on auction when the sales value of the appartment results lower than its valuation according to Article 57 of law no. 90/1991, on forced sale. The loss on an appartment based on a valuation according to Article 57 of the law is entered as continued receivable under the item "lost pledge".

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

Quality of pledges

The Housing Financing Fund's loans are secured by pledges in real estates. Loans are granted to the maximum of 80% of the purchase value of a specific real estate, provided that there are no other restrictions of a maximum loan amount. Following the granting of a loan, pledges are not assessed specifically in terms of fair value unless in relation to the measurement of a possible impairment loss. Requirements for general housing loans are that a binding purchase offer has been made, which in general may be equaled to the fair value of the specific real estate on the date of purchase. The pledging ratio of the Fund's total loans on the rateable real estate value is specified as follows.

Pledging ratio under 30% of official tax valuation	19%
Pledging ratio of 31% - 60% of official tax valuation	33%
Pledging ratio of 61% - 80% of official tax valuation	28%
Pledging ratio of 81% - 100% of official tax valuation	20%
	100%

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

c. ***Liquidity risk***

Liquidity risk is the Fund's risk of not being able to meet its contractual payments of interests and principal on its borrowings. By effective control on liquidity balance the Fund endeavours to ensure that there are always sufficient funds in order to meet its obligations if a temporary imbalance arises between the payment flow of the Fund's loans and other financial assets on the one hand, and its borrowing on the other.

Financial Statements of the Housing Financing Fund 2007 17 Amounts are stated in ISK thousand

4. Contd.:

Liquidity risk management

The Fund's liquidity risk management comprises liquidity analysis, access to secured loan lines from banks and liquidity strategy. The Fund's liquidity strategy is determined one year a head in terms of operating and financial budget. Liquidity strategy is updated on a regular basis. On a daily basis a short term strategy is made for liquidity based on the estimation of the Fund's cash flow for the next 20 days.

Measurement of liquidity risk

A key issue in the Fund's liquidity management is to ensure that there is balance between payment flow of financial assets and liabilities. The following table shows the contractual payment flow of the Fund's financial assets and liabilities.

31 December 2007	0 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
Financial assets:					
Cash..	1.053.355				1.053.355
Market securities..	22.196.858	5.984.314	21.426.025		49.607.197
Derivatives	1.026.850				1.026.850
Loans..	8.522.584	25.737.048	166.100.220	764.947.668	965.307.520
Total financial assets:	32.799.647	31.721.362	187.526.245	764.947.668	1.016.994.922
Financial liabilities:					
Derivatives..	2.176.754				2.176.754
Borrowings and other liabilities............................	12.308.821	34.504.562	227.925.792	698.182.628	972.921.803
Total financial liabilities:	14.485.575	34.504.562	227.925.792	698.182.628	975.098.557
Net balance...	18.314.072	(2.783.200)	(40.399.547)	66.765.040	41.896.365

d. ***Interest rate risk***

Interest rate risk arises when there is a difference between the average useful lives of assets and liabilities. If a balance is not ensured interest rate changes affect the Fund's net interest income. The Fund's financial department is responsible for managing this risk and ensure that the difference stays within set limits according to the Fund's financial and risk management. The average useful life of financial assets and liabilities is the same, or 10 years.

Prepayment risk

Borowers have in some instances a permission to repay their loans without having to pay any special fee. Such permission is not available on the Fund's borrowings excluding the housing bonds. Therefore, the balance between the average useful life of financial assets and liabilities can be disrupted. This incurs refinancing risk, including interest rate risk.

Interest rate risk management

The financial committee evaluates the risk that the Fund is exposed to due to prepayment risk and rates it when the Fund's loan interests are determined. In order to further reduce this risk the Fund also offer loans with prepayment fee, carrying lower interests than those without such fee. On a monthly basis the real rate of prepayments is calculated and estimates are made on prepayments ratios. On the basis of estimated prepayments the Fund continuously reviews its financing when necessary aiming at limiting the interest sensitivity of its asset portfolio.

Financial Statements of the Housing Financing Fund 2007 18 Amounts are stated in ISK thousand

4. Contd.:

e. ***Equity and capital management***

The Fund's long term objective is to reach an equity ratio of over 5% as calculated according to rules on equity and equity ratio of financial companies. If the Fund's equity ratio is heading below 4% the Fund's Board of Directors shall notify the Minister of Finance thereof. Furthermore, the Fund's Board of Directors shall make proposals of ways to reach the long term equity ratio goal.

Equity ratio is specified as follows:

	2007	2006
Equity	20.188.895	17.660.685
Risk base	287.338.643	260.642.073
Equity ratio	7,0%	6,8%

Financial assets and liabilities

5. According to IAS 39 *Financial instruments: recognition and measurement,* financial assets and liabilities are divided into specific categories The classification effects how the relevant financial instrument is evaluated. 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 recognized at fair value through profit and loss.
- Financial assets and liabilities designated at fair value - are recognized at fair value through profit and loss.
- Loans and receivables - are recognized at the amortized cost.
- Other financial liabilities - are recognized at the amortized cost.

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

	Trading assets and liabilities	Designated at fair value	Loans and receivables	Other amortized cost	Book value	Fair value[1)]
31 December 2007						
Cash and cash equivalents			1.053.355		1.053.355	1.053.355
Market securities	39.949.986				39.949.986	39.949.986
Derivatives	1.026.850				1.026.850	1.026.850
Loans to banks		13.947.644	81.993.994		95.941.638	85.490.117
Loans to customers			467.084.491		467.084.491	404.736.694
	40.976.836	13.947.644	550.131.840	0	605.056.320	532.257.002
Derivatives	2.176.754				2.176.754	2.176.754
Bond issues		25.306.294		553.441.465	578.747.759	522.712.311
Other borrowings				4.437.595	4.437.595	4.283.393
	2.176.754	25.306.294	0	557.879.060	585.362.108	529.172.458

[1)] Fair value of loans is estimated on the basis of the Fund's current loan interests. Fair value of bond issuance and other borrowings is estimated on the basis of the yield of bond issues at year end.

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6. **Net interest income**

	2007	2006
Interest income		
Interest income on market securities	4.389.468	2.082.444
Interest income on derivatives	3.747.355	2.115.810
Interest income on loans to banks	9.591.668	10.397.979
Interest income on loans to customers	44.552.051	41.706.875
Government contribution to subsidy interests	302.142	245.009
Total interest income	62.582.683	56.548.118
Interest expenses		
Interest expenses on derivatives	3.134.851	43.618
Interest expenses on bond issues	45.648.765	47.102.896
Interest expenses on other borrowings	10.287.971	5.899.859
Total interest expenses	59.071.587	53.046.373
Net interest expenses	3.511.096	3.501.745

Salaries and salary related expenses

7. Salaries and salary related expenses are specified as

Salaries	312.686	281.252
Salary related expenses	72.119	59.855
Other personnel expenses	14.618	12.864
Total	399.423	353.971

8. The employees of the Fund number as follows:

Average number of full-time equivalent empoyees	63	63
Number of employees at year end	62	60

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

Guðmundur Bjarnason, Managing Director	17.460	16.253
Chairman of the Board	2.072	2.072
Other Board members total	4.145	4.380
Total	23.678	22.705

Auditors' fees

10. Auditors' fees are specified as follows:

Auditing of financial statements	5.711	5.805
Reviewing of interim financial statements	2.995	1.960
Other services	5.258	1.198
Total	13.964	8.963

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Administrative expenses and other operating expenses

11. Administrative expenses are specified as follows:

	2007	2006
Collection fees	167.052	166.058
Purchased professional services	101.421	84.547
Housing	69.388	70.893
Advertisments and promotions	25.945	36.614
Operating cost of IT systems	68.197	66.950
Other operating expenses	62.054	56.168
Total	494.056	481.230

12. Other operating expenses are specified as follows:

Grants due to technological advances	16.475	14.725
Homes' Advisory Office	6.031	5.260
Research center - Bifröst	0	2.137
Other grants	765	3.675
Total	23.271	25.797

Operating assets

13. Operating assets are specified as follows:

Total value	Vehicle	Furnishings and equipm.	Real estate	Total
Total value as at 1.1. 2006	3.735	161.662	6.071	171.468
Additions during the year		11.127		11.127
Total value as at 31.12.2006	3.735	172.789	6.071	182.595
Total value as at 1.1.2007	3.735	172.789	6.071	182.595
Additons during the year		2.813		2.813
Total value as at 31.12.2007	3.735	175.602	6.071	185.408
Depreciation 1.1.2006	405	90.885	4.234	95.524
Depreciated during the year	374	14.361	243	14.978
Depreciation 31.12.2006	779	105.246	4.477	110.502
Depreciation 1.1.2007	779	105.246	4.477	110.502
Depreciated during the year	374	14.594	243	15.211
Depreciation 31.12.2007	1.153	119.840	4.720	125.713
Book value				
Book value as at 1.1. 2006	3.330	70.777	1.837	75.944
Book value as at 31.12.2006	2.956	67.543	1.594	72.093
Book value as at 31.12.2007	2.582	55.762	1.351	59.695

Amounts are stated in ISK thousand

Intangible assets

14. Intangible assets are specified as follows:

	Software and webpage
Total value:	
Total value as at 1.1. 2006	58.670
Additions during the year	6.387
Total value as at 31.12.2006	65.057
Total value as at 1.1.2007	65.056
Additions during the year	31.219
Total value as at 31.12.2007	96.275
Depreciation:	
Depreciation as at 1.1.2006	16.901
Depreciated during the year	9.691
Depreciation as at 31.12.2006	26.592
Depreciation as at 1.1.2007	26.593
Depreciated during the year	13.323
Depreciation as at 31.12.2007	39.916
Book value:	
Book value as at 1.1. 2006	41.768
Book value as at 31.12.2006	38.464
Book value as at 31.12.2007	56.360

Bond issue

15. Bond issue is specified as follows:	2007	2006
HFF bonds	510.792.547	445.523.798
Housing bonds	43.623.200	43.122.717
Housing Authority bonds	24.332.013	24.664.079
	578.747.759	513.310.594

Amounts are stated in ISK thousand

Changes to accounting policies in accordance with International Financial Reporting Standards (IFRSs)

17. As stated in note 2, these are the Fund's first annual financial statements prepared in accordance with IFRSs, as adopted by the EU.

    The Fund´s Financial Statements are prepared in accordance with the accounting policies specified in the notes on significant accounting policies. This also applies to comparative information for the year 2006 and the preparation of an opening IFRS balance sheet at 1 January 2006 (the Fund´s date of transition).

    Amounts in the opening Balance Sheet of 1 January 2006 have been changed in accordance with IFRS, but were previously presented in accordance with the Annual Accounts Act and the Regulation on the Presentation and Contents of the Annual Accounts of Commerial Banks, Savings Banks and Other Financial Institutions (referred to as IS-GAAP). The following tables and notes show the effects the transition from IS-GAAP to IFRS has had on the financial position of the Fund and its financial results There are no significant changes to the cash flows summary according to IFRS compared with how it was previously under IS-GAAP.

Changes in equity from IS-GAAP to IFRSs:

Equity according to IS-GAAP at 31 December 2006	16.374.564
Equity according to IFRSs at 1 January 2007	17.660.683
Changes in equity from IS-GAAP to IFRSs	1.286.119

Adjustments at the beginning of the year 2006:

Loans to banks	IAS 39	(163.527)
Loans to customers	IAS 39	558.991
Bond issues	IAS 39	2.127.343
Other liabilities	IAS 39	(1.538.607)
		984.200

Changes during the year 2006

Net interest income	IAS 39	(107.773)
Depreciation of fixed assets	IAS 16	(4.852)
Provision for impairment losses on loans	IAS 39	414.544
		301.919

Total effect of transition from IS-GAAP to IFRSs	1.286.119

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17. Contd.:

The total effect of the transition to IFRSs is an increase in equity amounting to 1,286 million. Following is an explanation of the the effect of transition on the income statement and balance sheet.

Derivatives

In accordance to IFRSs all derivative assets and liabilities are measured at fair value. Previously some of these financial assets and liabilities were measured at cost. The total effect of the change in measurement basis is an decrease in equity amounting to ISK 2,214 million.

Borrowing charges

n accordance with IFRSs borrowing charges are an integral part of the interest income of loans and recognised over the expected life of the loan. Previously borrowing charges were recognised in the income statement on grant date of loans. The total effect of this change in the accounting policy is a decrease in equity amounting to 2,425 million.

Impairment on loans

In accordance with the requirements of IAS 39 the Fund has made impairment test on its loans and receivables. As a result of that test equity increased by 3,193 million.

IAS 39 requires the Fund to reassess all its loans as to judge if there are objective evidence of impairment, effecting the estimated future cash flows of the loans. If objective evidence indicate that an impairment loss has occured the book value of the loan will be reduced to its estimated discounted cash flow.

Liabilities designated at fair value.

The Fund has applied the fair value option of IAS 39 and designated a portion of its liabilities as liabilities at fair value through profit and loss. The objective is to decrease an accounting mismatch that would otherwise arise since derivative contracts used for heding those liabilities are measured at fair value through profit and loss. The effect of this is an increase in equity amounting to 2,272 million.

Financial assets at fair value

In accordance with IAS 39 the Fund has designated a portion of the loans to banks as at fair value through profit and loss. The objective is to decrease an accounting mismatch that would otherwise arise since derivatives used for hedging those financial assets are measured at fair value through profit and loss. The effect of this is an decrease in equity amounting to 58 million.

Funding costs

The Fund´s borrowing costs, i.e. cost of issuing debt, is capitalised and expensed over the estimated life of the liability as an intergral part of effective interest rate. Previously these costs were expensed when incurred. The effect of this is an increase in equity amounting to 523 million.

Expensed assets

On the IFRS implementation date the amount of ISK 4.8 million was expensed due to previous capitalized cost of construction of the Fund´s webpage. This was done as the expense did not meet with requirements on capitalization of intangible assets according to IAS 38.

Notes, contd.:

From IS-GAAP to IFRSs

The following tables provide an overview of the effect of the transition to IFRSs by valuation and presentation.

Income Statement for the year 2006, change from IS-GAAP to IFRSs

According to IS-GAAP		Change in valuation	Change in presentation		IFRSs
Net interest income....................	3.223.463	(107.771)	386.053	3.501.745	Net interest income
Service income...........................	680.391		(426.172)	254.219	Service income
Service expense..........................	(21.744)		21.744	0	
Exchange difference....................	(18.375)		18.375	0	
Salaries and related exp..............	(353.971)			(353.971)	Salaries and salary rel.exp.
Other operating expenses............	(481.230)			(481.230)	Other operating expenses
Other expense............................	(25.797)			(25.797)	Other expenses
Depreciation...............................	(24.836)	(4.852)		(29.688)	Depreciation
Provision for impairment............	(497.752)	414.544		(83.208)	Impariment of loans
Net profit for the year	2.480.149	301.921	0	2.782.070	**Net profit for the year**

Balance sheet, change from IS-GAAP to IFRSs

According to IS-GAAP 31 December 2006		Change in valuation	Change in presentation		IFRSs 1 January 2007
			823.609	823.609	Cash and cash equivalents
			1.282.974	1.282.974	Derivatives
			35.833.702	35.833.702	Market securities
Receivables from credit inst........	99.029.788	(476.907)	(1.528.843)	97.024.038	Loans to banks
Loans to customers.....................	405.721.030	828.593		406.549.623	Loans to customers
Mortgages foreclosed.................	394.292			394.292	Mortgages foreclosed
Market securities.........................	36.411.442		(36.411.442)		
Fixed assets................................	115.409	(4.852)	(38.464)	72.093	Fixed assets
			38.464	38.464	Intangible assets
Other assets................................	28.579		86796	115.375	Other assets
Accrued income..........................	86.796		(86.796)		
Total assets	541.787.336	346.834	0	542.134.170	**Total assets**
			825.133	825.133	Derivatives
Bond issues................................	515.062.428	(1.751.834)		513.310.594	Bond issues
Other borrowings........................	10.228.445			10.228.445	Other borrowings
Other liabilities...........................	121.899	812.547	(825.133)	109.313	Other liabilities
Equity...	16.374.564	1.286.121		17.660.685	Equity
Total equity and liabilities	541.787.336	346.834	0	542.134.170	**Total equity and liabilities**

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Unaudited notes

Fair value of derivatives as at 30. June 2007 was overestimated by ISK 911 million in the fund's interim financial statements. Due to this mistatement, net profit for the period was overestimated by the same amount. The following table specifies the fund's net profit by periods after the relevant corrections have been made.

Income Statement for the year

	Jan. - June 2007	July. - Dec. 2007	Jan. - Dec. 2007
Net interest income:			
Interest income	27.410.603	35.172.080	62.582.683
Interest expenses	(25.048.536)	(34.023.051)	(59.071.587)
	2.362.067	1.149.029	3.511.096
Operating income:			
Service income	119.081	138.421	257.502
Total operating income	2.481.148	1.287.450	3.768.598
Operating expenses:			
Salaries and salary related expenses	195.229	204.194	399.423
Other administrative expenses	235.693	258.363	494.056
Other operating expenses	13.546	9.725	23.271
Depreciation and amortization	13.635	14.898	28.533
	458.103	487.180	945.283
Impairment of loans and receivables	(117.882)	(177.345)	(295.227)
Net profit for the year.	1.905.163	622.925	2.528.088

Financial Statements of the Housing Financing Fund 2007 26 Amounts are stated in ISK thousand