

RatingsDirect Headline:

Icelandic Housing Financing Fund Outlook To Negative On Sovereign Outlook Change; Rtgs Afrmd

CreditWire Vendor Headline:

S&P Revises Icelandic Housing Finance Fund Outlook To Negative

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FRANKFURT (Standard & Poor's) Nov. 20, 2007--Standard & Poor's Ratings Services said today it revised its outlook on the sovereign credit ratings on Ibudalanasjodur, the Icelandic Housing Financing Fund (HFF), to negative from stable. At the same time, the 'A+/A-1' foreign currency and 'AA-/A-1+' local currency ratings were affirmed.

"The outlook revision reflects the corresponding change in outlook in the ratings on the Republic of Iceland (foreign currency A+/Negative/A-1+; local currency AA/Negative/A-1+), which reflects the increased risk of a hard landing for the Icelandic economy," said Standard & Poor's credit analyst Kai Stukenbrock.

The ratings on HFF continue to benefit from the support of the government, as indicated by the sovereign's ultimate (but not timely) guarantee. HFF is 100% state owned. The state maintains close supervision over the fund and includes its surplus in the government's consolidated accounts.

The government started considering reform of the HFF in February 2006, to take into account the structural change in the housing finance market, concerns about state aid potentially not being in line with EU/EFTA rules, and potential adverse implications that HFF's operations could have on the soundness of the financial sector and the economy as a whole. Initial reform efforts stalled, however, as the general elections in May 2007 approached. Reform discussions were revived after the elections, but contrary to initial expectations have not yet yielded results. A working group is expected to present a proposal within the coming weeks.

The negative outlook reflects that of the sovereign. We nevertheless expect HFF to maintain its good asset quality and moderate profitability, as the interest rate exposure risk has declined and the duration gap has closed. A cooling housing market could eventually put some pressure on asset quality, however.

Despite significant delays, we still expect the government to put forward a proposal for reforming HFF over the short term. Such a reform could preempt an upcoming ruling of the EFTA court on the permissibility of state support for HFF, following a complaint by the Icelandic banks. This ruling is expected in the first half of 2008.

"A reduction in government support to the fund, as well as a deterioration in the fund's risk profile, would put the ratings under further downward pressure," said Mr Stukenbrock. "Conversely, a significant strengthening of government support to HFF could lead to an upward revision of the ratings."