Housing Financing Fund

Consolidated Financial Statements 2015

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

Housing Financing Fund
Borgartúni 21
105 Reykjavík

Reg.no. 661198-3629

Contents

Endorsement and Statement by the Board of Directors

The Housing Financing Fund ("the Fund") has its headquarters in Borgartún 21, Reykjavik and a branch in Sauðárkrókur. The Fund operates in accordance with the Housing Act no. 44/1998. The Act aims to promote, through the granting of loans and the organisation of housing affairs, the ability of citizens to live with security and equal rights in housing affairs.

The Consolidated Financial Statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the EU and additional disclosure requirements for companies that have their securities listed on a regulated market.

Performance in the year 2015

In 2015, the operating surplus from the Housing Financing Fund´s operations amounted to ISK 1,826 million compared to a profit of ISK 3,241 million in 2014. Equity at year-end amounted to ISK 19,838 million and the Fund´s equity ratio was 5.5% compared to 4.5% at the end of 2014. The Fund´s capital ratio exceeds for the first time since 2007 its long-term objective of an equity ratio of 5%, as according to Regulation no. 544/2004, and the Fund generates an operating surplus for the second year in a row.

Financing

At the end of 2015, loans amounted to ISK 647,969 million decreasing by ISK 80,112 million during the year, of which ISK 33,880 million was due to the government´s debt relief measures. The Fund´s debt burden amounted to ISK 784,435 million, decreasing by ISK 22,209 million during the year. Funds invested apart from the Fund´s loan portfolio amounted to ISK 126,691 million at the end of 2015, of which ISK 107,152 million were indexed bonds intended to be held to maturity countering the Fund´s debt. A portion of the bonds are structured covered bonds in the amount of ISK 69,967 million acquired in December 2015, which will immediately in 2016 substantially strengthen the return on the Fund´s investments excluding the Fund´s mortgage portfolio.

Development of arrears and quality of loan portfolio

The quality of the loan portfolio increased considerably due to a reduction in arrears and improved collateralisation of the loan portfolio, due to rising housing prices in real terms. At the end of 2015, 3.47% or a total of 1,547 of the Fund´s customers had loans in arrears, this ratio was more than 10% in mid-year 2012. The average LTV ratio of the Fund´s loan portfolio as a percentage of property values was well over 60% following the crash, now amounts to less than 46% of pledges and was 53.6% at the beginning of the year. Unprotected loan value exceeding 100% of the value of pledges is about 3.8% of the value of the portfolio. The same ratio was 5.4% at the beginning of the year. Recognised impairment against unprotected loan value amounted to 2.4% of the loan portfolio at the end of 2015.

Properties for sale and other assets for sale

Funds invested in appropriated properties decreased by ISK 7,849 million during the year, 898 properties were sold. The book value of appropriated properties at year end was on average 81% of the property value of the underlying portfolio. The book value of appropriated properties is therefore 1,822 million lower than the fair value of the same assets. The Fund´s appropriated properties decreased from 1,891 to 1,348 in 2015, as the Fund sold more properties than it redeemed. In total, the Fund repossessed 355 properties. The Fund´s plans assume high estate sales in 2016, which will lead to a reduction in capital tied in appropriated properties simultaneously strengthening the Fund´s interest margin.

The Fund has decided to sell its subsidiary Leigufélagið Klettur ehf. The financial services company Virðing has been entrusted with the sale of the company in an open sales process.

Endorsement and Statement by the Board of Directors contd.

Operations in the year 2015

Operating results for the year 2015 are affected by the strengthening of the loan portfolio due to a decrease in delinquency, reduction of costs, sales of appropriated properties, loss of interest income due to the government´s debt solutions, prepayments and a reduction in the granting of new loans. Equivalent positions were 88 in 2015. Equivalent positions have reduced by 6.5 over the year. Salary expenses decreased by 1% between years, despite the significant increase in wages in accordance with agreements with the trade unions, SFR and BHM. Other operating expenses decreased by 5% compared to the previous year and operating expenses as a percentage of total assets was 0.23%. Since 2013, the operating expenses of the Fund decreased by 13% and plans for 2016 assume an additional 9% decrease in operating expenses.

In 2015, the Board along with the CEO launched a strategic plan subsequently changing the focus of its operations. The main emphasis of the Fund´s operations aims to simplify services to existing customers with the objective of reducing prepayments and maximizing the value of the Fund´s portfolio. In order to implement the policies, changes were made to the structure of the Fund´s operations. Following the changes, the Fund´s operations are divided into four main areas: business, lending, finance and operations. In accordance with the changed focus of the Fund´s operations, the following business objectives have been approved by the Board for the year 2016:

1. To simplify services to existing customers in order to reduce prepayments by customers.
2. To maximise the value of the Fund´s loan portfolio with active surveillance and effective debt collecting.
3. To minimise the Fund´s operating costs with effective procedures, simplification of procedures, simplification of regulation and improvement of infrastructure.
4. To continue the systematic sale of the Fund´s appropriated properties.
5. To ensure refinancing and achieve acceptable returns on the investment of its liquid assets in accordance with the investment strategy.

Effect of the government´s debt solutions on the results of 2015

The government´s prepayments of the Fund´s mortgage loans, amounting to a total of ISK 33,800 million in 2015 had a negative impact on the Fund´s net interest income. In the fiscal budget for 2015 a contribution was allocated to the Fund for the loss of interest income suffered by the Fund as a result of the government´s debt measures. The calculation takes into account the terms by which the Fund invests its liquid assets. The difference between the returns and the interest income on the loans that the government prepaid is the basis of the contribution. The Fund´s investment in indexed covered bonds issued by Arion Bank hf. in December 2015 has largely countered the accumulated prepayments of the Fund´s loans. The investment resulted in an immediate increase of net interest income. The real return of invested funds excluding the Fund´s loan portfolio amounted to 2.72% in 2015. Sales of lower interest bearing assets such as shares in the subsidiary and sales of appropriated assets will strengthen the Fund´s net interest income considerably once proceeds have been reinvested in interest-bearing assets.

The Fund´s risk factors

The Fund faces various risks and risk management is an important and integral part of other activities of the Fund. Ultimately, the Fund´s Board is responsible for risk management. The Board determines the Fund´s acceptable risk in accordance with laws and regulations. Information on the framework of risk management is in Note 33.

Governance

The Fund operates in accordance with the Housing Act no. 44/1998, Act no. 161/2002 on financial undertakings and regulations and guidelines issued by the FSA as appropriate in each case.

The Board´s Rules of Procedures outline its practices, qualifications, meetings and the division of responsibilities between the Board and the CEO. The Rule Book contains all the rules that the Board pursuant to the law is abided to implement for the operations and frames the authorities and procedures of operations. Furthermore, the Board has formulated the Fund´s risk profile and investment strategy that establishes the risk appetite of the operations and control aspects of liquidity management.

Endorsement and Statement by the Board of Directors contd.

An organisational chart is implemented within the Fund and the division of labor is clear, job descriptions are available for all jobs and conflicts of interest in operations are prevented. In addition, the disclosure of information to employees is effective.

The Compliance Officer is appointed by the Board under the terms of reference and he presents to the Board a report on compliance semi-annually.

Board of Directors

The Board of Directors of the Housing Financing Fund emphasises maintaining good governance. The Board hires a CEO and finalises his terms of reference. The Board meets with the Fund's internal and external auditors on a regular basis. The Board ensures that all information submitted to supervisory bodies, the Icelandic Financial Supervisory Authority, the Icelandic Central Bank and other authorities is at all times in accordance with law and regulations. The Board also makes decisions regarding all unusual and substantial matters. In the year 2015, the Board of Directors held 32 board meetings

Three committees operate under the mandate of the Board. The Audit Committee has the statutory role of the audit of the Fund, it consists of two external experts and a board member. The Operational Development Committee also works on behalf of the Board and it consists of two Board members and the CEO. Its aim is to simplify the operations and organisation chart of the Fund and the main goal of the committee is to streamline operations. Then, acting on behalf of the board the Risk Committee addresses operational risks and risk management as well as other matters referred to it by the Board. The committee consists of two Board members and one external expert. Meetings are normally held monthly.

Of the five appointed Board members of the Fund, three members are male and two members are female.

The Fund´s Board of Directors was appointed in September 2013. In the year 2015 the following individuals have a seat on the Fund´s Board:

- Ingibjörg Ólöf Vilhjálmsdóttir, from September 2013
- Haukur Ingibergsson, from September 2013
- Drífa Snædal, from January 2014
- G.Valdimar Valdemarsson, from October 2014
- Þorsteinn Arnalds, to September 2015
- Sigurbjörn Ingimundarson, from December 2015

Executive Board

The CEO receives orders directly from the Housing Financing Fund´s Board and his performance in all matters and in regards to the operations of the Fund is according to the law. The CEO makes decisions about all the affairs of the Fund that are not entrusted to others by legislation, the Fund´s statutes or the Board's decision. The CEO shall initiate the Fund´s strategic policy and make recommendations thereon to the Board. The CEO attends most board meetings and has the right to deliberate and submit proposals.

The Executive Board is composed of, in addition to the CEO, four directors who make decisions regarding daily operations. The Executive Board focuses on major decisions and makes recommendations regarding strategic policy decisions to the Board. The financial and operational forecasts prepared by the Executive Committee are based on policies established and approved by the Board.

Endorsement and Statement by the Board of Directors contd.

Four committees operate under the authority of the CEO. The Financial Committee addresses and ensures an overview of the reporting to regulators and monitors the activities of the Treasury, ensures the follow up of treasury management authorisation and makes recommends proposals to the Board regarding authorization of treasury management. The Security Committee addresses information security. The Fund has received ISO 27001 verification three times since first implementing the standard in 2012. The Fund employs two credit committees, one for individual loans and the other for loans to legal entities. The Financial Difficulties Committee consists of three members which addresses all decisions regarding the granting of payment solutions.

The Fund has established a personnel policy, strategy and program against bullying and sexual harassment as well as a policy to ensure equal rights. The directors of the Fund communicate regularly with the Ministry of Welfare.

Statement by the Board of Directors and the CEO

The Consolidated Financial Statements of the Housing Financing Fund for the year 2015 are prepared in accordance with International Financial Reporting Standards as adopted by the EU and additional Icelandic disclosure requirements for financial statements of companies with listed securities.

According to our best knowledge, it is our opinion that the Consolidated Financial Statements give a true and fair view of the financial performance of the Fund for the year 2015, its assets, liabilities, and financial position as at 31 December 2015 and changes in cash flows for the year 2015.

Further, in our opinion the financial statements and the Endorsement by the Board of Directors and the CEO include a fair view of the Fund's development and performance and its standing and describes the Fund's main risk exposures.

The Board of Directors and the CEO of the Housing Financing Fund have today discussed the Fund's Consolidated Financial Statements for the year 2015 and hereby confirm them by means of their signatures.

Reykjavik, 4 March 2016.

Board of Directors:

Ingibjörg Ólöf Vilhjálmsdóttir

Ingibjörg Ólöf Vilhjálmsdóttir, Chairman of the Board

Drífa Snædal

Sigurbjörn Ingimundarson

Drífa Snædal

Sigurbjörn Ingimundarson, Vice-President of the Board

Haukur Ingibergsson

G. Valdimar Valdimarsson

Haukur Ingibergsson

G. Valdimar Valdimarsson

CEO

Hermann Jónasson

Hermann Jónasson

Independent Auditors' Report

To the Board of Directors of the Housing Financing Fund,

We have audited the accompanying Consolidated Financial Statements of the Housing Financing Fund for the year 2015. The Consolidated Financial Statements comprise the consolidated statement of income and comprehensive income, the consolidated statement of financial position, the consolidated changes in equity, cash flow, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these Consolidated 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these Consolidated 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 Consolidated Financial Statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Consolidated Financial Statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the Consoldiated 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 Consolidated 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 Consolidated 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 Consolidated Financial Statements give a true and fair view of the financial position of the Housing Financing Fund as of 31 December 2015, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards, as adopted by the EU.

Emphasis of Matter

Without qualifying our opinion we draw attention to the discussion in Note 2.b. on the Fund's ability to continue as a going concern.

Verification of Directors´ Report

In accordance with the provisions of paragraph 2, Article 104 of the Icelandic Financial Statements Act No. 3/2006, we confirm that, to the best of our knowledge, the report of the Board of Directors accompanying the Consolidated Financial Statements includes the information required by the Financial Statements Act if not disclosed elsewhere in the Consolidated Financial Statements.

Reykjavik, 4 March 2016.
Grant Thornton endurskoðun ehf.

J. Sturla Jónsson

Sturla Jónsson
State Authorized Public Accountant

Davíð Arnar Einarsson
State Authorized Public Accountant

Consolidated Income Statement and Statement of Comprehensive Income

	Notes	2015	2014
Interest income		51,706,865	45,783,689
Interest expense		(50,074,104)	(43,995,208)
Net interest income	20	1,632,761	1,788,481
Other income	21	182,717	159,252
Total operating income		1,815,478	1,947,733
Salaries and salary-related expenses	22	920,164	927,151
Other operating expenses	23	900,688	947,648
Depreciation and amortisation	25	53,682	50,887
Total operating expenses		1,874,534	1,925,686
Net income of properties held for sale	26	162,717	194,901
Net operating income		103,661	216,948
Impairment of loans and properties held for sale	27	1,059,259	(1,538,170)
Impairment of securities	19	251,953	4,017,000
Profit (loss) from continuing operations		1,414,873	2,695,778
Profit from discontinued operations, net of tax	28	412,001	545,937
Profit for the year and comprehensive income		1,826,874	3,241,715

The notes on pages 11 to 36 are an integral part of these Consolidated Financial Statements.

Consolidated Statement of Financial Position as at 31 December 2015

	Notes	2015	2014
Assets			
Cash and cash equivalents	5	13,236,528	17,524,392
Loans to financial institutions	6	5,061,627	7,621,776
Marketable securities	7	4,898,018	3,232,477
Other securities	8	97,617,421	27,110,898
Receivable from State Treasury	9	5,877,687	4,546,964
Loans	10	647,969,024	728,081,166
Properties held for sale	11	20,021,499	27,870,768
Investment properties	12	0	8,063,973
Operating assets	13	99,578	105,964
Intangible assets	14	200,838	171,002
Other assets		344,543	326,696
Assets for sale	15	8,946,871	0
Total assets		804,273,634	824,656,077
Liabilities			
Bond issues	16	778,926,079	798,547,938
Other borrowings	17	3,631,603	3,871,068
Other liabilities	18	1,491,087	4,226,095
Liabilities associated with assets for sale	15	387,015	0
Total liabilities		784,435,784	806,645,101
Equity			
Contributed capital		57,655,408	57,655,408
Accumulated deficit		(37,817,558)	(39,644,432)
Total equity		19,837,850	18,010,976
Total liabilities and equity		804,273,634	824,656,077

The notes on pages 11 to 36 are an integral part of these Consolidated Financial Statements.

Consolidated Statement of Changes in Equity for the year 2015

Year 2015	Notes	Contributed capital	Accumulated deficit	Equity Total
Equity as at 1 January 2015		57,655,408	(39,644,432)	18,010,976
Profit for the year and comprehensive income		0	1,826,874	1,826,874
Equity as at 31 December 2015		57,655,408	(37,817,558)	19,837,850

Year 2014	Notes	Contributed capital	Accumulated deficit	Equity Total
Equity as at 1 January 2014		57,655,408	(42,810,019)	14,845,390
Recognition of obligation	18	0	(76,129)	(76,129)
Profit for the year and comprehensive income		0	3,241,715	3,241,715
Equity as at 31 December 2014		57,655,408	(39,644,432)	18,010,976

The notes on pages 11 to 36 are an integral part of these Consolidated Financial Statements.

Consolidated Statement of Cash Flows
for the year 2015

	2015	2014
Cash flows from operating activities		
Profit for the year and comprehensive income	1,826,874	3,241,715
Adjusted for:		
Indexation on loans to banks and loans to customers	(15,188,675)	(8,171,909)
Indexation on borrowings	15,955,208	8,467,687
Depreciation and amortisation	58,246	54,086
Impairment	(1,311,212)	(2,472,893)
Valuation adjustment of investment properties	(561,152)	(654,694)
Deferred tax liability	116,755	136,488
Changes in operating assets and liabilities:		
Loans	95,114,477	47,809,997
Properties held for sale	7,677,663	1,240,868
Receivable from State Treasury	(1,240,000)	0
Other assets	(72,213)	(22,202)
Other liabilities	(2,607,447)	(5,317,026)
Cash flows from (to) operating activities	99,768,524	44,312,117
Cash flows from investing activities		
Loans to (from) banks, changes	2,937,916	7,953,612
Marketable securities, changes	(1,665,541)	(1,109,362)
Other securities, changes	(69,262,202)	3,383,380
Capitalised investment properties	(58,511)	(50,062)
Investment in operating assets and intangible assets	(101,974)	(96,040)
Cash flows from (to) investing activities	(68,150,312)	10,081,528
Cash flows from financing activities		
Bond issues and other borrowings, repayments	(35,673,443)	(44,785,641)
Cash flows to financing activities	(35,673,443)	(44,785,641)
Net increase (decrease) in cash and cash equivalents	(4,055,231)	9,608,004
Cash and cash equivalents at the beginning of the year	17,524,392	7,916,388
Cash and cash equivalents at year end	13,469,161	17,524,392
Cash and cash equivalents at year end:		
Cash as according to the balance sheet	13,236,528	17,524,392
Cash included in the assets of the disposal group	232,633	0
	13,469,161	17,524,392

The notes on pages 11 to 36 are an integral part of these Consolidated Financial Statements.

Notes

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, Reykjavík. 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 by 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 Consolidated Financial Statements of the Fund are comprised of the 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 Consolidated Financial Statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union. Information as to the new IFRS accounting standards and amendments to standards can be found in note 34.v.

The Consolidated Financial Statements of the Housing Financing Fund were approved by the Board of Directors on 4 March 2016.

b. 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 margin has been insubstantial or only 0.28% which is insufficient to cover the impairment comparable to the impairment resulting from the economic collapse.

As uncertainty exists as to the Fund's future role, the strategic decision making of the Fund's immediate environment has been put on hold, having a negative effect on the Fund's operations.

A decrease in new lending and increased prepayments by customers have a negative effect on the Fund's interest rate margin as the Fund is not permitted to pay its debt before its maturity. Therefore, a larger proportion of funds is being invested excluding traditional mortgages for homes and rental companies, reducing the balance between the Fund's assets and liabilities.

The fiscal budget for 2015 authorises compensation to the Fund for the interest margin losses which the measures of the debt solution will have on the performance of the Fund. The decision is evident to compensate the Fund the negative effect on the interest margin of ISK 1,240 million in 2015. This is ensured by the transfer of an indexed claim on the State that is recognised as a receivable from the Treasury. The Fund has not been compensated for the discount that the government received resulting from the purchase of the loan portfolio. This loss is recognised as an impairment loss in the years 2013 to 2015 and is estimated to amount to ISK 1,362 million.

c. *Basis of measurement*

The Consolidated Financial Statements have been prepared on the historical cost basis except for the following: trading securities are measured at fair value, properties held for sale are measured at the lower of cost or net fair value, investment properties are measured at fair value and assets for sale are measured at the lower of cost or fair value less costs to sell.

d. *Functional currency*

The Consolidated 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.

e. *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.

2. Basis of preparation, contd.

e. Uses of estimates and judgements, contd.

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

- Impairment on loans, cf. note 27.
- Properties held for sale, cf. note 11.
- Investment properties, cf. note 12.
- Assets for sale, cf. note 15.

f. Changes in presentation

Comparative figures in the income statement and the statement of comprehensive income have been changed as the profit (loss) of discontinued operations is shown net of tax. The assets and liabilities of the subsidiary Leigufélagið Klettur ehf. are defined as discontinued operations, thereby the Fund is required to present in a single amount in the income statement and statement of comprehensive income the profit or loss from discontinued operations, net of tax.

3. 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. The Fund identifies its operations as a single segment.

4. 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:

31 December 2015	**Trading assets**	**Loans and receivables**	**Liabilities at amortised cost**	**Total carrying amount**	**Fair value**
Assets:					
Cash and cash equivalents.....................	0	13,236,528	0	13,236,528	13,236,528
Loans to financial institutions..................	0	5,061,627	0	5,061,627	5,061,627
Marketable securities..............................	4,898,018	0	0	4,898,018	4,898,018
Other securities.......................................	0	97,617,421	0	97,617,421	97,617,421
Receivable from State Treasury..............	0	5,877,687	0	5,877,687	5,877,687
Loans..	0	647,969,024	0	647,969,024	653,110,598
Total financial assets...............................	4,898,018	769,762,287	0	774,660,305	779,801,879
Liabilities:					
Bond issues...	0	0	778,926,079	778,926,079	892,112,593
Other borrowings.....................................	0	0	3,631,603	3,631,603	3,631,603
Other liabilities...	0	0	1,491,087	1,491,087	1,491,087
Total financial liabilities...........................	0	0	784,048,769	784,048,769	897,235,283

4. Financial assets and liabilities, contd.

31 December 2014	Trading assets	Loans and receivables	Liabilities at amortised cost	Total carrying amount	Fair value
Assets:					
Cash and cash equivalents......................	0	17,524,392	0	17,524,392	17,524,392
Loans to financial institutions..................	0	7,621,776	0	7,621,776	7,621,776
Marketable securities..............................	3,232,477	0	0	0	3,232,477
Other securities.......................................	0	27,110,898	0	27,110,898	27,110,898
Receivable from State Treasury...............	0	4,546,964	0	4,546,964	4,546,964
Loans...	0	728,081,166	0	728,081,166	759,072,947
Total financial assets...............................	3,232,477	784,885,196	0	784,885,196	819,109,454
Liabilities:					
Bond issues...	0	0	798,547,938	798,547,938	854,711,104
Other borrowings.....................................	0	0	3,871,068	3,871,068	3,871,068
Other liabilities...	0	0	4,226,095	4,226,095	4,226,095
Total financial liabilities...........................	0	0	806,645,101	806,645,101	862,808,268

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 year-end 2015. 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.

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.

31 December 2015	Level 1	Level 2	Level 3	Total
Assets:				
Treasury securities...	4,898,018	0	0	4,898,018

31 December 2014	Level 1	Level 2	Level 3	Total
Assets:				
Treasury securities...	3,232,477	0	0	3,232,477

5. Cash and cash equivalents and restricted cash

Cash and cash equivalents and restricted cash are specified as follows:	2015	2014
Unrestricted cash in Central Bank	13,151,849	17,064,614
Unrestricted cash in financial institutions	84,679	459,778
Cash and cash equivalents total	13,236,528	17,524,392

6. Loans to financial institutions

Loans to financial institutions are specified as follows:

	2015	2014
Inter-bank loans	5,007,313	7,508,083
Other claims	54,314	113,693
Loans to banks total	5,061,627	7,621,776

7. Marketable securities

Marketable securities are specified as follows:

	2015	2014
Listed treasury bonds at fair value	4,898,018	3,232,477
Marketable securities total	4,898,018	3,232,477

8. Other securities

Other securities are specified as follows:

	2015	2014
Covered bonds	69,967,066	0
Treasury bonds without active market capitalised based on amortised cost and initial rate of return	27,650,355	27,110,898
Treasury bonds total	97,617,421	27,110,898

9. Receivable from State Treasury

The receivable due from the State Treasury is comprised of two bonds, a bond amounting to ISK 4,637 million that is payable in one lump sum in the year 2018, and a bond in the amount of ISK 1,240 million that is due on 1 January 2021.The bonds have however a permanent prepayment privilege favorable to the Treasury, in part or in full. Only interest payments on the bonds are collected during the loan period. The bonds are not transferable by the Housing Financing Fund.

10. Loans:

Loans are specified as follows:

	2015	2014
Loans to individuals	518,189,581	599,033,780
Loans to legal entities	129,779,443	129,047,386
Loans total	647,969,024	728,081,166

Impairment on loans is specified as follows:

	2015	2014
Balance at the beginning of the year	21,127,603	22,438,473
Impairment loss (reversal)	(1,274,518)	311,339
Write-offs	(3,704,403)	(1,622,209)
Balance at year end	16,148,682	21,127,603

11. Properties held for sale

The Fund had repossessed 1,348 properties at year-end 2015 (2014: 1,891). Total number of properties held for sale managed by the Fund is specified as follows:

	2015	2014
Number of properties at the beginning of the year	1,891	2,606
Repossessed properties during the year	355	351
Properties sold during the year	(898)	(1,066)
Number of properties at year end	1,348	1,891

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

South and South West	427	780
Great Reykjavík area	217	340
South Iceland	174	218
West Iceland	141	201
East Iceland	234	193
North Iceland	99	109
Westfjords	56	50
Number of properties at year end	1,348	1,891

11. Properties held for sale, contd.:

At year-end 2015, 629 properties of the 1,348 properties owned by the fund are in the sales process. 610 properties were rentals (2014: 889) or 45.2% of the total properties owned by the Fund on 31 December 2015 (2014: 48%).

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

Year-end 2015	Number of properties	Official property value	Fair value	Book value
Rentals	610	12,291,088	11,820,409	10,673,140
In sales process	629	10,468,087	8,388,904	7,888,135
Empty	87	1,497,664	1,314,558	1,200,935
Other properties*	22	374,780	319,964	259,289
Total	1,348	24,631,619	21,843,836	20,021,499

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

Year-end 2014				
Rentals	889	17,416,631	16,901,886	15,556,879
In sales process	913	14,351,411	11,946,170	11,206,199
Empty	67	964,470	828,626	778,596
Non-habitable	2	29,950	56,876	35,303
Other properties*	20	393,790	351,103	293,792
Total	1,891	33,156,252	30,084,662	27,870,768

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

12. Investment properties

The Fund's investment properties are residential properties owned by Leigufélagið Klettur ehf. In 2015, the Fund's Board made the decision to sell the subsidiary and the assets of the company are reclassified in the balance sheet as assets held for sale in accordance with note 15.

Investment properties are specified as follows:

	Capital region	South and Southwest	West and Westfjords	North Iceland	East Iceland	Total
Cost						
Transferred 2014	2,770,908	2,263,718	835,993	968,745	519,853	7,359,217
Additions	11,297	9,075	2,921	3,275	2,573	29,142
Improvements	5,791	9,557	1,197	3,594	781	20,920
Balance 31.12.2014	2,787,997	2,282,351	840,111	975,614	523,207	7,409,280
Additions	18,899	11,362	9,924	12,998	5,328	58,511
Reclassified for sale	(2,806,896)	(2,293,713)	(850,035)	(988,612)	(528,535)	(7,467,791)
Balance 31.12.2015	0	0	0	0	0	0
Valuation adjustment						
Balance 1.1.2015	484,954	101,350	(37,499)	(18,878)	124,767	654,694
Valuation adjustment	366,071	111,283	(13,182)	59,481	37,499	561,152
Reclassified for sale	(851,025)	(212,633)	50,681	(40,603)	(162,266)	(1,215,846)
Balance 31.12.2015	0	0	0	0	0	0
Carrying amount						
Balance 31.12.2014	3,272,951	2,383,700	802,612	956,736	647,974	8,063,973
Balance 31.12.2015	0	0	0	0	0	0

Official property value and insurance value

The official property value of investment properties amounted to ISK 7,995 million at the end of the year. The insurance value of the Fund´s investment properties at the end of December 2015 mounted to ISK 10,629 million.

13. Operating assets:

Operating assets are specified as follows:

	Fixtures and equipment	Real estate	Total
Cost			
Balance at 1.1.2014	255,657	10,197	265,854
Additions during the year	29,495	20,529	50,024
Balance at 31.12.2014	285,152	30,726	315,878
Additions during the year	13,220	0	13,220
Reclassified as assets for sale	(4,931)	0	(4,931)
Balance at 31.12.2015	293,441	30,726	324,167
Depreciation			
Balance at 1.1.2014	190,382	5,967	196,349
Depreciation during the year	12,865	700	13,565
Balance at 31.12.2014	203,247	6,667	209,914
Depreciation during the year	14,481	1,027	15,508
Reclassified assets as for sale	(833)	0	(833)
Balance at 31.12.2015	216,895	7,694	224,589
Carrying amount			
Balance at 1.1.2014	65,275	4,230	69,505
Balance at 31.12.2014	81,905	24,059	105,964
Balance at 31.12.2015	76,546	23,032	99,578

Property value of real estate at year end 2015 amounted to ISK 9.0 million (2014: ISK 8.7 million) and insurance value amounted to ISK 22.2 million (2014: ISK 21.3 million).

14. Intangible assets

Intangible assets are specified as follows:

	Software
Cost	
Balance at 1.1.2014	464,391
Additions during the year	60,095
Balance at 31.12.2014	524,486
Additions during the year	79,750
Reclassified as assets held for sale	(14,106)
Balance at 31.12.2015	590,130
Amortisation	
Balance at 1.1.2014	312,963
Amortisation during the year	40,521
Balance at 31.12.2014	353,484
Amortisation during the year	38,174
Reclassified as assets held for sale	(2,366)
Balance at 31.12.2015	389,292

Intangible assets are specified as follows:

Carrying amounts	
Balance at 1.1.2014	151,428
Balance at 31.12.2014	171,002
Balance at 31.12.2015	200,838

15. Assets for sale and liabilities associated with assets for sale

The Board decided this year to sell the subsidiary Leigufélagið Klettur ehf. The Board considers it likely that the sale will be complete in 2016. The assets and liabilities of the subsidiary are classified as held for sale and liabilities associated with assets for sale and are distinguished from other assets and liabilities in the balance sheet.

	2015
Assets for sale:	
Cash	232,633
Other receivables	3,270
Accounts receivable	7,054
Investment properties	8,683,636
Intangible assets	17,092
Property and equipment	3,186
Total assets	8,946,871
Liabilities associated with assets for sale:	
Accrued liabilites and expenses	122,553
Accounts payable	11,219
Deferred income tax liability	253,243
Total liabilities	387,015

16. Bond issues

The Fund issues housing bonds in three 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:	2015	2014
HFF24 bond	143,991,787	154,645,941
HFF34 bond	211,945,151	214,886,971
HFF44 bond	384,232,639	383,478,068
Housing bonds (final maturity 2040)	19,097,658	25,067,248
Housing Authority bonds (final maturity 2038)	19,658,844	20,469,710
Total bond issues	778,926,079	798,547,938

17. Other borrowings

Other borrowings are specified as follows:	2015	2014
Pension funds	873,090	1,332,339
Municipalities	0	442
Insurance fund	298,928	287,502
Callable bonds	157,744	95,605
Unpaid due to purchase of loan portfolios	2,301,841	2,155,179
Total other borrowings	3,631,603	3,871,068

18. Other liabilities

Other borrowings are specified as follows:	2015	2014
Treasury due to subsidized interest	207,699	177,487
Interbank borrowings	0	173,315
Income tax liability	0	136,488
Employee vacation obligation	75,875	76,129
Other liabilities	1,207,513	3,662,676
Total other liabilities	1,491,087	4,226,095

The deferred tax liability of the Fund is due to the taxable activities of its subsidiary Leigufélagið Klettur ehf. The liability arises when the book value of assets differs from their taxable base. The subsidiary´s liabilities are reclassified as liabilities associated with assets for sale in the Fund´s balance sheet, cf. note 15.

The employee vacation obligation had not been recognised in the financial statements until the year 2015. The initial balance has been recognised in equity in accordance with generally accepted accounting principles.

19. Impairment of claims on banks

At year-end 2015, one case involving the failed banks is unfinalised. An agreement has been reached as to the settlement of the claim and will be finalised in March 2016. The uncertainty regarding the outcome of the dispute has been eliminated. The change in the positon during the year results in a decrease of the total impairment of these claims amounting to ISK 252 million.

20. Net interest income

Interest income	2015	2014
Interest income on items not at fair value:		
Interest income from loans to customers	45,095,900	42,581,697
Interest income from covered bonds*	(42,359)	0
Interest income from other financial assets	4,499,420	2,595,466
Government contribution to subsidy interests**	630,788	606,526
Gov't contribution due to reduced interest margin related to debt solutions***	1,240,000	0
	51,423,749	45,783,689
Interest income on items at fair value:		
Interest income on market securities	283,116	0
	283,116	0
Total interest income	51,706,865	45,783,689

Interest income on the interest-bearing receivable due from the subsidiary Leigufélagið Klettur ehf. is recognised as interest income on the basis that the resources made available from the sale of Leigufélagið Klettur ehf. will be allocated to investments that will continue to generate interest income. Interest income fom the loan to the subsidiary amounted to ISK 299.7 million in 2015 (2014: ISK 244.6 million). See note 31.

Interest expenses	2015	2014
Interest expenses on items not at fair value:		
Interest expenses on bonds issued	49,852,346	43,759,174
Interest expenses on other borrowings	221,758	199,434
Interest expense on items at fair value:		
Interest expense on market securities	0	36,600
Total interest expenses	50,074,104	43,995,208
Net interest income	1,632,761	1,788,481

*The Fund purchased the bonds on 1 December 2015 and the price index decrease in Desember exceeded the interest income accured during the period.

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

***The government contribution due to the reduced interest margin and the loss or prepayment premiums related to debt solutions.

21. Other income

Other income is specified as follows:	2015	2014
Collection and service income	177,295	150,241
Other income	5,422	9,011
	182,717	159,252

22. Salaries and salary-related expenses

Salaries and salary related expenses are specified as follows:

	2015	2014
Salaries	663,470	682,333
Pension fund contributions	100,494	95,344
Tax on financial activity	44,108	43,659
Other salary related expenses	75,109	71,626
Other personnel expenses	36,983	34,189
Total salaries and salary related expenses	920,164	927,151

Number of employees of the Fund are specified as follows:

	2015	2014
Average number of employees during the year in full-time equivalent units	95	101
Number of employees at year-end	88	92

23. Other operating expenses

Other administrative expenses are specified as follows:

	2015	2014
Collection fees	219,421	201,126
Operating expenses of housing	125,826	124,063
Operating cost of IT systems	154,106	151,165
Audit and review of financial statements	23,746	15,313
Professional services	75,519	109,117
Price evaluation related to payment difficulty solutions	14,569	23,033
Advertising, promotional material and grants	34,475	14,526
Debtors' Ombudsman	113,735	165,168
Financial Supervisory Authority	52,164	53,814
Credit rating	18,875	16,614
Service fees	24,858	31,320
Other operating expenses	43,394	42,389
Total other administrative expenses	900,688	947,648

24. Auditors' fee

Remuneration to the auditors' are specified as follows:

	2015	2014
Audit of financial statements	12,134	8,182
Review of interim financial statements	2,722	2,519
Internal audit	8,890	4,612
Total auditors' fee	23,746	15,313

25. Depreciation and amortisation of the year:

Depreciation and amortisation is specified as follows:

	2015	2014
Depreciation of operating assets (cf. note 13)	15,508	12,732
Amortisation of intangible assets (cf. note 14)	38,174	38,155
Total depreciation and amortisation	53,682	50,887

26. Net income of properties held for sale

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

	2015	2014
Rental income from rented properties	1,074,225	1,232,477
Cost of properties held for sale	(911,508)	(1,037,576)
Net income of properties held for sale	162,717	194,901

The costs of real estate 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 187.6 million in 2015 compared to ISK 185.6 million in 2014. Revenues exceeded expenses of properties held for sale in the amount of ISK 24.9 million, if taken into account the costs of the asset division (2014: ISK 9.3 million).

27. Impairment

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

	2015	2014
Specific impairment loss of loans (reversal of impairment loss)	(739,351)	(434,440)
General impairment on loans	(535,167)	745,779
Impairment loss of loans (reversal of impairment loss)	(1,274,518)	311,339
Impairment on properties held for sale	171,605	1,192,377
Impairment on other receivables	43,654	34,454
Total expensed impairment	(1,059,259)	1,538,170

28. Profit (loss) of discontinued operations, net of tax

The assets and liabilities of the Fund´s subsidiary Leigufélagið Klettur ehf. are classified as assets for sale as according to note 15 and meet the definition of discontinued operations. The Fund presents the results of discontinued operation, net of tax, as a single amount in the income statement and the statement of comprehensive income.

Profit (loss) of discontinued operations net of tax is specified as follows:

	2015	2014
Rental income	617,071	574,351
Operating expenses of investment properties	(204,462)	(179,211)
Operating expenses	(153,644)	(130,436)
Valuation adjustment of investment properties	561,152	654,694
Net financial expenses	(291,361)	(236,973)
Income tax	(116,755)	(136,488)
Profit(loss) net of tax of subsidiary's operations	412,001	545,937
Profit of discontinued operations, net of tax and costs to sell	412,001	545,937

29. Rental agreements

The Fund has entered into a operating lease agreement on the property used in its operations. Minimum lease payments are specified as follows at year end:

	2015	2014
Payable within 1 year	112,195	114,293
Payable after 1 to 5 years	235,870	265,396
Later	0	9,695
Total	348,065	389,384

30. Investment in subsidiary

Leigufélagið Klettur ehf. was established on 23 January 2013. The Fund is the owner of 100% of the shares of the company. The operations of the subsidiary are independent and the company has been appointed a Board of Directors. There are two main objectives with establishing the company. On the one hand to release the Fund's ownership of the properties and separate the operations of the company from the operations of the Fund. On the other hand, to accommodate the will of the government to increase the supply of housing for lease. 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.

During the year the Fund's Board approved the decision to sell the subsidiary Leigufélagið Klettur ehf., cf. note 15.

31. Related parties and salaries of management

The Fund has a related party relationship with its owner, board members, executive officers and its subsidiary. The Housing Financing Fund is publically owned and administratively falls under the Ministry and Minister of Welfare. Government institutions and self-governing corporate entities that are financially dependent on the authorities are related parties of the Fund. Loans to related parties are granted on arms-length basis. The balance of mortgage loans to related parties amounted to ISK 0.7 million at year end 2015 (2014: ISK 12.5 million) and are recognized as loans in the balance sheet.

Salaries of the Board, Managing Director and key personnel is specified as follows:

31. Related parties and salaries of management, contd.

	2015		2014	
	Salaries	Pension fund contributions	Salaries	Pension fund contributions
Hermann Jónasson, CEO	7,338	955	0	0
Sigurður Erlingsson, former CEO	15,880	1,826	14,643	1,687
Ingibjörg Ólöf Vilhjálmsdóttir, Board Chairman,	2,849	269	2,369	249
Other Board Directors	6,951	594	5,716	503
Key personnel, (6)	88,302	11,572	81,821	11,897

The Board's salaries remained unchanged during the year. The increase in the remuneration of Board members is due to participation in committee activities related to the optimization of the Fund's activities.

Related party transactions:

	2015		2014	
	Interest income	Receivables	Interest income	Receivables
Leigufélagið Klettur ehf.	299,693	8,559,856	244,666	7,650,628

The receivable in the amount of ISK 8,559 million is due to the subsidiary's purchase of properties from the Fund in the year 2014, however the financing of the purchase under the agreement has not been finalised. The annual interest rate of the subsidiary's liabilities under the purchase agreement is 4.2% incl. indexation. The calculation of accrued interest in the financial statements is based on these terms. The Fund's interest bearing receivable amounted to ISK 4,882 million at the end of 2015. Upon the sale of the company, its debt will be refinanced in accordance with the provisions of the purchase agreement.

Related party transactions are made on terms equivalent to those that prevail in arm's length transactions.

32. Other matters

EFTA Surveillance Authority, SFF appeals

On 16 July 2014, 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 Fund in the form of a capital injection to maintain the Fund's equity. SFF has appealed the decision and ESA has agreed to the Icelandic government's request to intervene in the case. The outcome is awaited. The case was brought before the EFTA Court on 12 November 2015. If the case is lost, the ESA will resume its investigation of the Fund.

Future organization of housing policy

At the end of 2015, four bills related to housing affairs have been submitted to parliament. On the one hand, there are proposals amending the Rent Act and legislation on housing co-operatives. On the other hand, there are proposals for new legislation, ie general legislation on housing and housing allowances. The bill on general housing proposes that the Fund take on a new role which involves managing and monitoring subsidized funding for construction or the purchase of general housing for rental or low-income families and individuals.

Principal reduction of mortgages

Laws concerning the reduction of mortgage principals and the appropriation of private savings to reduce mortgage loans were passed in the spring of 2014. The legislation led to a reduction of the mortgage loans outstanding to individuals. The implementation of the measures by the Fund have been quite successful.

During the period the Fund has processed principal reductions of mortgages for 25,834 homes amounting to a total of ISK 34,440 million. As a result of the measurements the Fund's loan portfolio has decreased somewhat since the beginning of 2015 and cash equivalent increased accordingly or around 75% of the amount. The government will finalise the payment of the purchase price of the adjusted portion of the loan portfolio in January 2016 according to the terms of the agreement. Only a small portion of reductions remain unprocessed due to loans in dispute.

In the year 2015, 11,619 customers have taken advantage of the option to prepay loans by allocating private pension savings towards their loans held by the Fund. This measure was applied to 9,185 mortgages held by 8,984 residences. Excess prepayments resulting from this measure amounted to ISK 4,897 million during the year. The framework agreement on the reduction of mortgage principal assumes that credit institutions will be compensated for the losses that occur due to the solution and the Fund's management expects full compensation despite the fact that the implementation of the compensation has not been finalised.

33. Risk management

a. *Overview of financial risks and the risk management structure*

Principal reduction of mortgages, contd.:

Nonetheless, impairment in the amount of ISK 1,362 million has been recognised as an impairment loss at the end of the year, due to the difference between the book value of the prepaid portion of the loan portfolio and the expected purchase price from the government. Given that the Fund is not permitted to pay its debts until as according to the contractual maturities, early excess and prepayments as a result of both of the solutions will have a significant weakening effect on the Fund´s prerequisite for net interest income.

Other matters

The Fund is a party to several disputes currently before the courts. These disputes are mainly related to complaints due to the debt remedies, damages due to forced sales or sales of appropriated assets, complaints due to penalty charges, and disputes over the settlement of usufruct fees due to forced sales, among other disputes. It is the Fund's opinion however, that these cases, both individually and combined are not likely to have a significant financial impact on the Fund.

A key issue in the Fund's daily management is to reduce its risk exposure related to financial assets and liabilities. Following are the risks that the Fund is exposed to and which are of importance:

- Credit risk
- Liquidity risk
- Interest rate risk, prepayment risk and indexation risk
- Operational risk

The following include information on the Fund's financial risk management, in addition to information on each of the aforementioned risks, goals, aim and evaluation process along with management of each risk. Furthermore, information on the Fund's capital management is disclosed.

Risk management structure

The Housing Financing Fund is a non-profit organisation. Its financial and risk management takes note thereof. Its main objective is to continuously seek to keep a low risk level in its financial operations. Furthermore, the Fund aims at limiting financial risk and cost in accordance with its operating goals.

The Fund's Board of Directors

- Responsible for formulating and approving risk management strategy.
- Ensures that an effective risk management strategy is in place within the Fund, and its contents include effective processes and procedures.
- Recognises the risks involved in the operations of the Fund and sets acceptable risk limits.
- Receives statements and reports on the Fund's risk and implementation of risk management.
- Monitors risk management and assesses the effectiveness of current risk management strategy.
- Appoints the Board's Risk Committee.

The Board's Risk Committee

- Deliberates and makes decisions on the Board´s proposals regarding important issues in lending practices and the Fund's financial and risk management.
- Recognizes the risks involved in the Fund's operations and sets acceptable risk limits.
- Formulates proposals for risk appetite and risk profile iof the Board and decides on further implementation.
- Monitors risk management.
- Directs the internal evaluation assessment of captial requirement.

CEO

- Responsible for the implementation of risk management, including analysis, measurement and disclosure of information to the Board.
- Delegates responsibilty for the development and implementation of methods and systems to identify, measure, monitor, evaluate and manage the risks of the operations to the risk manager, who reports directly to the CEO.
- Maintains the organizational chart specifying clear responsibility, employee authorisations and the communication channels, ensures that responsibility is shared adequately, and that there is sufficient employee capacity and knowledge to meet the requirements of the risk management strategy.

33. Risk management, contd.:

a. ***Overview of financial risks and the risk management structure, contd.;***

Risk manager

- Performs daily risk monitoring, measurement and mandatory reporting to regulators.
- Is a member of the Financial Committee.
- Attends meetings of the Risk Committee.

Financial committee

- The CEO, CFO, and Risk manager are members of the Financial committee.
- Ensures that information to the Board is satisfactory and Treasury policy and risk management are followed.
- Discusses key issues concerning the Fund´s financial and risk management.

Hedges

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 credit risk within a certain threshold.

The Fund's financial and risk management operates in accordance with the Fund's financial and risk management rules. The rules define the risks and their margin of tolerance in the Fund's operation.

b. ***Credit risk***

Credit risk is the risk of financial loss if a customer or a counterparty to a financial instrument fails to meet its contractual obligations. The Fund's credit risk arises from loans to customers, investments in market securities and loans to banks. As stated before it is the Fund’s main objective to maintain low risk level in its operations.

Solutions for the payment difficulties of the Fund’s clients

In addition to general payment difficulty solutions, i.e. rescheduling of amounts in arrears and deferral of repayments due to temporary payment difficulties, the Housing Financing Fund participates in the payment difficulty solutions established on the one hand by the State and on the other hand, by joint effort of lenders in the housing market.

General solutions for payment difficulties, i.e. rescheduling of amount in arrears, deferral of repayments and term extensions, are mainly intended to meet temporary payment difficulties. These solutions are often used all together, i.e. amounts in arrears are rescheduled (changed to a new loan, a so-called reschedule loan), payment is suspended (interest suspension) and finally, the maturity of loans is extended by a period corresponding to at least the suspension period.

Specific solutions for payment difficulties, specific debt and payment adjustments for individuals have been established to meet payment difficulties of individuals.

Specific debt adjustment is based on an agreement between lenders on the housing loan market and is intended for those who have the ability to pay on their mortgage claims corresponding to the value of the property. A debtor pays on the claims, or contractual claims, for 3 years. If the debtor honors the agreement, claims in excess of the property value and contractual claims not paid during the period will be cancelled or written off. Time limit to apply for the specific debt adjustment expired at year-end 2012.

The Fund has also entered into agreements with customers to avoid the enforcement process, which includes restructuring and payment distribution of arrears for up to 18 months. A total of 508 homes had active contracts with the Fund for the payment of arrears for up to 18 months at the end of 2015.

33. Risk management, contd.:

b. *Credit risk, contd.:*

Solutions for the payment difficulties of the Fund's clients, contd:

Payment adjustments are intended to allow individuals with serious payment difficulties to reorganise their finances and establish balance between their debt and ability to pay so that they will have a realistic possibility to meet their obligations in the foreseeable future. The term of a debt adjustment lasts for 1-3 years during which the debtor pays on the claims corresponding to the value of the property. The debtor can then apply for a write-off of mortgage claims in excess of the market value of the property at the end of the period provided that legal conditions are met.

These solutions decrease considerably the cash payments towards the Fund. In addition, for specific debt and payment adjustments for individuals it is always assumed that claims in excess of the market value of properties will be written-off, should the applicant fulfil the contract.

Lifting of mortgage claims in excess of the sale price was established in order to facilitate sale of over-mortgaged properties where the owners are unable to pay on the loans in the future and can sell the property on a general market. Lifting of mortgage claims in excess of sale price is also applied on the basis of the Act on payment adjustment.

Payment detainment is a solution available to temporarily relieve the payment burden of loans by linking the loans to a so called Payment Detainment Index instead of the CPI. Approximately 23% of the value of the loans to individuals utilized this option at the end of 2015 and 49% of loans to individuals were linked to the PDI index.

The balance of the payment detainment account was ISK 5,381 million at the end of the year 2015. Payment detainment involves accounting for the proportion of indexation consistent with the change in payment detainment index and the consumer price index in the payment detainment account. At the end of 2015 payments into the account began due to the development of the payment detainment index.

Information on possible solutions for payment difficulties can be found on the Fund's website. The following table shows the extent of these solutions based on the prepayment value of loans in the relevant solution category.

Solutions for the payment difficulties of the Fund's clients, contd.:	**2015**	**2014**
Payment suspension	2,692,833	1,866,221
Rescheduled loans	3,223,414	2,549,316
Extending the maturity of loans	7,542,736	8,475,917
Specific solutions		
- Specific debt adjustments	5,422,934	7,764,872
- Payment adjustments	4,244,073	7,869,245
- Lifting of mortgage claims in excess of sale price- outstanding amount of loans	4,479,133	4,736,807
Credit risk management		
Outstanding amount of loans with write-off in excess of 110% of loan-to-value	47,634,617	52,722,134

More than one solution in the table here above may have been applied to the same loan.

33. Risk management, contd.:

b. Credit risk, contd.:

Credit risk management, contd.:

All of the Fund's loans to customers are secured by real estate mortgages. The Fund limits its risk due to these loans in two ways: by setting a maximum individual loan amount and a maximum pledge ratio. In addition, borrowers need to undergo a credit evaluation. The finance committee evaluates the Fund's credit risk on an ongoing basis and determines the price thereof as part of the spread on the Fund's borrowing rates on loans when lending interest rates are determined.

As insurance for securities loaned to market makers with the Fund's bonds, the Fund holds pledges in the form of cash or securities. Pledgeable securities are issued securities with market makers, issued by the Government Debt Management and also the Fund's own bonds. The Fund's coverage ratio is invariably well over 100% in these transactions.

Maximum credit risk exposure as according to geographical areas

The following table shows the maximum credit risk exposure as according to geographical areas.

Year-end 2015	Capital region	South and Southwest	West and Westfjords	North Iceland	East Iceland	Total
Loans to individuals......	332,448,951	90,470,702	28,511,698	49,792,196	16,966,034	518,189,581
Loans to entities...........	77,833,745	22,348,036	8,758,338	19,140,664	1,698,659	129,779,443
Total loans..................	410,282,697	112,818,738	37,270,036	68,932,860	18,664,693	647,969,024

Year-end 2014	Capital region	South and Southwest	West and Westfjords	North Iceland	East Iceland	Total
Loans to individuals......	403,839,208	93,736,929	29,508,424	54,665,427	17,283,791	599,033,780
Loans to entities...........	79,400,901	20,417,662	7,943,763	18,902,211	2,382,850	129,047,386
Total loans..................	483,240,109	114,154,592	37,452,186	73,567,638	19,666,641	728,081,166

Quality of loans

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	
	2015	2014	2015	2014	2015	2014
Neither past due nor impaired						
Total............................	451,922,023	521,216,159	101,722,474	91,796,523	553,644,497	613,012,682
General impairment.....	(726,347)	(625,972)	(126,347)	(151,200)	(852,694)	(777,172)
Carrying amount..........	451,195,676	520,590,187	101,596,127	91,645,323	552,791,803	612,235,510
Past due and not impaired						
31-60 days....................	15,423,452	19,508,784	917,852	896,243	16,341,304	20,405,028
61-90 days....................	7,390,499	6,582,464	18,480	552,880	7,408,979	7,135,344
Past due over 90 days	13,192,854	21,765,945	156,511	7,205,498	13,349,365	28,971,443
General impairment.....	(345,269)	(812,243)	(10,912)	(154,628)	(356,181)	(966,870)
Carrying amount..........	35,661,536	47,044,951	1,081,931	8,499,993	36,743,467	55,544,944
Impaired						
Total.............................	38,107,102	39,747,137	35,266,459	39,937,137	73,373,561	79,684,274
Specific impairment.....	(6,774,733)	(8,348,495)	(8,165,074)	(11,035,066)	(14,939,807)	(19,383,561)
Carrying amount..........	31,332,369	31,398,642	27,101,385	28,902,070	58,433,754	60,300,713
Loans total.................	518,189,581	599,033,780	129,779,443	129,047,386	647,969,024	728,081,166
Impairment as proportion of loans........	1.49%	1.61%	6.01%	8.08%	2.43%	2.82%

33. Risk management, contd.:

b. *Credit risk, contd.:*

Quality of loans, contd.:

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

	Loans to individuals		Loans to legal entities		Total	
	2015	**2014**	**2015**	**2014**	**2015**	**2014**
Loans past due:						
31-60 days....................	308,253	386,358	120,177	190,458	428,430	576,816
61-90 days....................	182,686	266,251	35,243	85,701	217,929	351,952
Past due over 90 days..	2,762,694	3,949,753	3,017,233	3,783,456	5,779,927	7,733,209
Total past due...............	3,253,633	4,602,362	3,172,653	4,059,615	6,426,286	8,661,977

Obligations not recognised in the balance sheet:	**2015**	**2014**
Binding loan commitments at year-end...	4,589,200	2,051,900

The Fund regularly reviews its loan portfolio to assess impairment. Prior to determining whether an impairment loss should be recognised in the income statement, the Fund makes judgements as to whether there is any objective evidence 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 experience.

A specific provision for impairment of loans to legal entities has been calculated on the basis of the professional judgement of employees and management of the Fund and recognised in the financial statements. The specific provision is based on official information, solvency of the legal entity, condition of underlying assets, information on the standing of the debtors, marketability of the assets and value of pledges.

The experts of the Fund have estimated the need for a provision on loans to individuals. In making this estimate the balance of loans in arrears and the value of collaterals for the loans was taken into account. Specific provision for impairment due to this has been recognised in the financial statements of the Fund.

The value of pledges is based on the current real estate value at each given time.

General impairment is also recognized in the income statement. See in addition note 34.f.(v) regarding the estimation of general provisions required for impairment.

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

33. Risk management, contd.:

b. *Credit risk, contd.:*

Write-off on loans, contd.;

Impairment on loans is specified as follows:

	Individuals		Legal entities		
	Specific impairment	General impairment	Specific impairment	General impairment	Total
Year 2015					
Balance at the beginning of the year	8,348,495	1,438,214	11,035,066	305,828	21,127,603
Impairment loss (reversal of impairment loss)	367,726	(366,598)	(1,107,077)	(168,569)	(1,274,518)
Write-off	(1,941,488)	0	(1,762,915)	0	(3,704,403)
Balance at year end	6,774,733	1,071,616	8,165,074	137,259	16,148,682

	Individuals		Legal entities		
	Specific impairment	General impairment	Specific impairment	General impairment	Total
Year 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)	2,293,521	543,255	(2,727,961)	202,524	311,339
Write-off	(2,886,963)	0	1,264,754	0	(1,622,209)
Balance at year end	8,348,495	1,438,214	11,035,066	103,304	21,127,603

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 price, provided that there are no other restrictions of a maximum loan amount, which is ISK 24 million for individuals. The maximum official property value of the assets may not be over ISK 40 million. Following the granting of a loan, pledges are not assessed specifically in terms of fair value unless in relation to the evaluation of possible impairment losses. Requirements for general housing loans are that a binding purchase offer has been made, which in general may be equal to the fair value of the specific real estate on the date of purchase.

The weighted average pledging ratio of the Fund's total loans on the official property value is approx. 45.8% at year end 2015 compared to 53.6% at year end 2014. The majority of the Fund's loans have first pledge right. The pledging ratios, i.e. calculated remaining balance on loans without specific impairment as proportion of the official property value, are specified as follows at year end:

Quality of pledges, contd.:	2015	2014
Proportion of the total loans under 50% of the official property value	71.3%	66.9%
Proportion of the total loans from 51 - 70% of the official property value	14.7%	15.3%
Proportion of the total loans from 71 - 90% of the official property value	8.2%	9.5%
Proportion of the total loans from 91 - 100% of the official property value	2.0%	2.9%
Proportion of the total loans from 101 - 110% of the official property value	1.2%	1.8%
Proportion of the total loans over 110% of the official property value	2.6%	3.6%
	100%	100%

33. Risk management, contd.:

b. Credit risk, contd.:

Counterparty risk related to securities transactions

The Fund's own bonds, which it has lent to market makers, and underlying pledges are specified as follows at year end:

	2015	2014
Loaned own bonds, market value	2,891,160	2,536,537
Market value of pledges provided by counterparties	3,245,499	2,808,760

Other counterparty risk

Securities holdings and money market funds without government guarantee:

	2015	2014
Structured covered bonds Arion Bank	69,967,066	0
Money market funds	5,007,313	7,508,083

c. *Liquidity risk*

Liquid risk management

Liquidity risk is the Fund's risk of not being able to meet its contractual interest and principal payments 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 on the Fund's loans and other financial assets on the one hand, and its borrowing on the other.

The Fund's liquidity risk management includes liquidity analysis, access to secured loan lines from banks and liquidity plan. The Fund's liquidity plan is determined one year a head in terms of operating and financial budget. The liquidity plan is updated on a regular basis. A short-term plan is concluded daily for liquidity, including the estimation of the Fund's cash flow for the next 20 working days.

Measurement of liquidity risk

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

Remaining balance of financial assets and liabilities:

	0 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
31 December 2015					
Financial assets:					
Cash and cash equivalents	13,236,528				13,236,528
Marketable securities	4,898,018				4,898,018
Other securities	1,071,045	6,437,150	13,851,371	170,682,010	192,041,575
Receivable from State Treasury		152,820	6,183,327		6,336,147
Loans to customers and banks	11,593,954	37,754,195	169,303,324	969,566,020	1,188,217,493
Total financial assets	30,799,545	44,344,164	189,338,022	1,140,248,030	1,404,729,761
Financial liabilities:					
Borrowings and other liabilities	14,291,552	54,890,950	267,088,345	893,789,329	1,230,060,175
Binding loan commitment	11,473	4,577,727			4,589,200
Total financial liabilities	14,303,025	59,468,677	267,088,345	893,789,329	1,234,649,375
Net balance	16,496,521	(15,124,512)	(77,750,323)	246,458,701	170,080,387

33. Risk management, contd.:

c. *Liquidity risk, contd.;*

Measurement of liquidity risk, contd.:

31 December 2014	0 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
Financial assets:					
Cash and cash equivalents......................	17,524,392				17,524,392
Marketable securities...............................	3,232,477				3,232,477
Other securities..	407,892	418,408	3,305,199	36,783,458	40,914,957
Receivable from State Treasury...............		118,221	4,901,628		5,019,849
Treasury securities..................................					
Loans to customers and banks................	12,975,867	38,644,260	199,427,647	1,152,818,234	1,403,866,009
Total financial assets................................	34,140,628	39,180,890	207,634,474	1,189,601,691	1,470,557,683
Financial liabilities:					
Borrowings and other liabilities.................	13,320,962	52,964,969	258,265,533	924,544,567	1,249,096,031
Binding loan commitment.........................	5,130	2,046,770	0		2,051,900
Total financial liabilities............................	13,326,092	55,011,739	258,265,533	924,544,567	1,251,147,931
Net balance...	20,814,536	(15,830,849)	(50,631,059)	265,057,124	219,409,752

The table above shows contractual cash flow of loans and borrowings of the Fund, including both payments and contractual interests but not estimated future inflation. Cash and cash equivalents of the Fund, which can be used to meet temporary imbalance in cash flows of financial assets and liabilities, is stated in the first column of the table. If an imbalance would occur between the cash flows of financial assets and liabilities, the Fund would response by issuing HFF bonds or selling short term securities.

d. *Interest risk*

Interest rate risk is defined as the risk of fluctuation in fair value or future cash flow due to changes in market interests. The Fund recognises neither financial liabilities nor financial assets at fair value, except for treasury bonds which are listed on an active market (see note 7) and fair value risk due to interest rate changes is therefore limited. Around 90.7% of the Fund's financial assets (2014: 90.7%) and 99.5% (2014: 99.5%) of its financial liabilities have fixed interest rates and therefore the effect of interest changes is insubstantial. Decisions on changing interests on loans with floating interests is entirely in the hand of the Fund. However, the difference between the duration of assets and liabilities causes risk exposure for the Fund as interest rate changes can affect its net interest income. The Fund's financial division manages this risk and shall ensure that the difference is within limits established by the Fund's financial and risk management's policy. The duration of the Fund's financial assets at year end 2015 is 9.52 years (2014: 9 years) and of financial liabilities 9.6 years (2014: 9.67 years). According to the Fund's financial and risk management policy this difference may be up to 0.9 years.

Weighted average effective interest on the Fund's borrowings excluding equity was 4.31% at year-end 2015 (2014: 4.31%), but weighted average effective interest on loans at the same time was 4.59% (2014: 4.59%). The interest margin on loans and the Fund´s borrowings is therefore 0.28%.

Prepayment risk

The financial committee assesses the Fund's prepayment risk and other factors related to interest rate risk and prices it when the Fund's loan interests are decided. In order to reduce even further this risk the Fund also offers loans with prepayment fee but lower interests than loans without such fee. On monthly basis the real proportion of prepayments is measured and estimates for future prepayment proportions are made. On the basis of estimated prepayments the Fund regularly reviews its financing in order to limit the sensitivity of its loan portfolio with regards to interest rates. As according to an amendment to the law on consumer credit in November 2013 new loans to individuals bear 1% prepayment fee, however the borrower may pay an excess payment of up to ISK 1 million on its loan per year, without prepayment fee.

Borrowers may in many cases prepay their loans with the Fund without paying a specific prepayment fee. However, the Fund's issued bonds do not include prepayment options, with the exception of house bonds. Therefore, an imbalance between the duration of financial asset and liabilities can arise, which would lead to reinvestment risk for the Fund and thereby interest rate risk.

Around ISK 253 billion of the Fund's loans (2014: ISK 287 billion) is hedged with prepayment fee in part of entirely and prepayable house bonds would the borrower choose to prepay its loan before the end of the loan term. Interest rate and reinvestment risk related to this is considered to be considerable, especially while market interests remain low. The Fund is working on limiting this risk.

33. Risk management, contd.:

d. *Interest risk, contd.:*

CPI-indexation risk

CPI-indexation risk is the risk of fluctuations in the consumer price index (CPI) affecting the fair value and cash flow of indexed financial instruments. The majority of the Fund's loans are indexed, financed with indexed bonds. The indexation risk is mainly due to necessary liquidity according to the Fund's financial and risk management policy. Indexation risk is managed by calculating the sensitivity of the Fund's total balance in indexed assets and liabilities with respect to changes in the consumer price index.

	2015	2014
CPI-indexed financial assets:		
Loans	641,646,252	724,997,783
Treasury securities and other assets	108,485,821	34,913,934
Total financial assets	750,132,073	759,911,717
CPI-indexed financial liabilities:		
Bond issue	778,926,079	798,547,938
Other borrowings	3,603,972	3,775,459
Total financial liabilities	782,530,051	802,323,397
Total CPI-indexation balance	(32,397,978)	(42,411,680)

Indexed liabilities were around ISK 32.4 billion in excess of indexed assets at year end 2015 (2014: ISK 42.4 billion). Based on year-end position and assuming that all other variables remain constant a 1% inflation calculated over a period of one year would have adverse impact on the Fund´s results amounting to ISK 324 million (2014: ISK 424 million).

Interest-free assets

When the Fund redeems appropriated assets the loan becomes interest-free. At year end 2015, the Fund held 1,348 properties for sale (2014: 1,891 properties) recognised at the value of ISK 20,021 million. (2014: ISK 27,871 million).

e. *Operational risk*

Operational risk is the risk of loss as a result of insufficient internal processes, people and systems, or because of external events, including legal risk. The Fund uses both preventive and supervisory methods to minimise its operational risk. The preventive methods include clear and documented procedures regarding all the Fund's major factors of operations, training of employees, data back-up, access control and other procedures. The Fund is ISO 27001 certified for information security, a written security policy as well as having a Risk Committee and Security manager who administer various aspects of operational risk. Head of departments are responsible for management of operational risk in their departments and monitor the operational risk as well as their employees.

f. *Equity and capital management*

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

Equity ratio is specified as follows:	2015	2014
Total equity according to the financial statements	19,837,850	18,010,976
Intangible assets	(200,838)	(171,002)
Equity base	19,637,012	17,839,974
Total equity requirement is specified as follows:		
Credit risk	28,397,602	31,456,893
Market risk	134,695	105,056
Operational risk	257,480	287,674
Total capital requirements	28,789,777	31,849,622
Equity ratio	5.46%	4.50%

34. Significant accounting policies

The accounting policies set out below have been consistently applied to all periods presented in these Consolidated Financial Statements. Revenues and expenses of the Fund are not recognised directly in other comprehensive income and the result for the year is therefore equal to comprehensive (loss) income.

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. The financial statements of the subsidiary are included in the Consolidated Financial Statements, combining together the same kind of assets, liabilities, equity, income and expenses, and applied the methods of consolidation.

(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 fees 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 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. 20). 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. *Other income*

Other income consists of collection charges. Other income is recognised in the income statement when accrued. Borrowing fees are included in the calculation of effective interest rate. They are included in interest income and not other income.

d. *Other operating expenses*

Other operating expenses consist of housing costs, operation of IT systems, collection expenses, purchased expert services, contribution to the operation of the Debtors' Ombudsman and other general operating expenses, cf. note 23. Operating expenses are recognised as they are incurred.

e. *Net operating income of properties held for sale*

Net operating income of properties held for sale consist of rental income and expenses of properties held for sale, cf. note 26.

34. Significant accounting policies, contd.:

f. Financial assets and liabilities

(i) Recognition and derecognition of financial assets and liabilities

Purchase and sale of financial assets is recognised at the date of transaction. Those assets and liabilities are recognised on the date on which the Fund commits to purchasing or selling the asset, 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.

Financial liabilities are recognised when the Fund becomes a party to the contractual provisions of the instrument. The Fund derecognises a financial liability when its contractual obligations are discharged, cancelled or expire.

To ensure efficient price determination of its issued bonds the Fund has entered into agreements with market makers on a short term securities loans, where the Fund lends to the market maker its own bonds against collateral security for a maximum of 28 days. The bonds lent are not recognised in the balance sheet. The collaterals are not capitalised in the balance sheet as the risks and rewards remain with the Fund's counterparty. At the end of the agreement term, the Fund receives the bonds lent and returns the collaterals to the market maker.

(ii) Offsetting

Financial assets and liabilities are set off and the net amount is recognised in the balance sheet when, and only when, the Fund has the 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) Amortised cost of financial assets and liabilities

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured upon initial recognition, minus principal repayments, taking into account the cumulative amortisation of premiums and discounts using the effective interest method. Discounts and premium constitute the difference between the initial book value of the financial instrument on the one hand, and its nominal value on the other. In calculating the amortised cost of financial assets impairment is also taken into account, if any.

(iv) Fair value measurement

Fair value is the price received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The best measurement of the fair value of financial instruments is based on the quoted price in an active market and is used when readily available. For other financial instruments fair value is determined by using valuation techniques. A financial asset or liability is considered to be listed on an active market if the official price can be obtained from a stock exchange or another independent party and the price reflects actual and regular market transactions between unrelated parties.

(v) Impairment of financial assets

The carrying amount of the Fund's financial assets is reviewed at each reporting 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 exceeds its recoverable amount. An impairment loss is expensed in the income statement.

Two methods are used to calculate impairment losses on loans; one based on assessment of individual loans and the other based on collective assessment. Estimated loss as a result of future events, irrespective of the probability thereof, is not recognised.

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

(i) significant financial difficulty of the borrower,
(ii) deteriorating economic conditions,
(iii) a breach of contract, such as a arrears on installments or on interest or principal payments.

34. Significant accounting policies, contd.:
Financial assets and financial liabilities, contd.:
(v) Impairment of financial assets, contd.:

Individually assessed loans
Impairment losses on individually assessed loans are determined by the risk exposure on a case-by-case basis. The Fund assesses at each reporting 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 future cash flows discounted with the assets' original effective interest rate. Impairment losses are recognised in profit or loss and reflected in an allowance account as deduction in their carrying amount.

Collectively assessed loans
Where loans have been individually assessed and no evidence of loss has been identified, these loans are grouped in loan portfolios on the basis of similar credit risk characteristics for the purpose of calculating a collective impairment loss.

The collective impairment loss is determined by taking into account:
- historical loss experience in portfolios of similar risk characteristics,
- the estimated period from when a loss has occurred and until that loss is identified and recognised by contribution to an allowance account
- 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.

Changes in impairment on loan portfolios 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 impairment are reviewed regularly by the Fund to minimise any differences between loss estimates and actual losses.

Reversal of impairment
If, in a later 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 reversed in the income statement.

g. *Impairment loss of assets other than financial assets*
At each balance sheet date, the carrying amount of assets is reviewed to determine whether there is any indication that there has been an impairment loss. If evidence of impairment exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. If it is not possible to estimate the recoverable amount of an individual asset, the Fund estimates the recoverable amount of the cash-generating unit to which the asset belongs.The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted. If it is not possible to estimate the recoverable amount of an individual asset, the Fund estimates the recoverable amount of the cash-generating unit to which the asset belongs. If the recoverable amount of an asset or cash-generating units is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Impairment of cash-generating units are deducted from the carrying amount of the assets of the unit. An impairment loss is recognized in the income statement.

h. *Discontinued operations*
A discontinued operation is a component of an entity that either has been disposed of or classified as held for sale and either (1) represents a major line of business, (2) is part of a single co-ordinated plan to dispose of a separate major line of business, or (3) is a subsidiary acquired exclusively with a view to resell.

Profit of loss from discontinued operations is presented as a single amount in the income statement or statement of comprehensive income and consists of (1) the profit or loss after tax from the operations of the discontinued operation, (2) the profit or loss after tax arising from the fair value assessment less sales costs, (3) gains or losses from the sale or disposal of the discontinued operations.

Comparative figures of discontinued operations are restated in the income statement and statement of comprehensive income.

i. *Cash and cash equivalents*
Cash and cash equivalents consist of demand deposits with financial institutions.

34. Significant accounting policies, contd.:
Financial assets and financial liabilities, contd.:

j. ***Loans to banks***
Loans to banks consist of interbank loans and unsettled claims on the Icelandic banks.

k. ***Marketable securities***
Marketable securities are securities listed on an active market and are stated at fair value.

l. ***Other securities***
Other securities consist of covered bonds issued by Arion Bank secured by the bank´s mortgages and government treasury bonds. Initially, the covered bonds are recognized at fair value in the Fund´s financial statements and subsequently measured at amortized cost using the effective interest method. The interest revenue and impairment is recognized in the income statement. Treasury bonds are divided into securities listed on an active market and securities (RIKS30 and RIKS 33) listed on the stock exchange but without an active market, which are capitalised based on amortised cost and initial rate of return (note no 8).

m. ***Loans***
Loans are financial instruments with fixed or determinable payments that are not quoted in an active market. Loans and receivables include loans granted by the Fund to its customers and acquired loans, which are unlisted and will not be sold in the nearest future.

The loans are initially measured at fair value which represents the loan amount plus all direct transaction costs. The loans are then measured at their amortised cost using the effective interest method. The book value of loans and receivables includes accrued interest and inflation adjustments.

n. ***Properties held for sale***
When the Fund redeems properties on foreclosed mortgages they are recognised as properties held for sale in the balance sheet. Redeemed properties are recognised at the lower of cost or net fair value. The fair value is determined as the market value of the property. The fair value is measured on the basis of a realtor's evaluation, if available, or price information from a list for real transactions with similar properties. In some cases evaluations of the asset management division of the Fund are used.

If the net fair value of a property held for sale decreases after its initial recognition the fair value decrease is expensed as impairment loss. If the net fair value increases in the future the previously recognised impairment loss is reversed but only to the extent that the carrying amount does not exceed the initial cost value. The reversal is recognised as a reduction to the previously charged impairment.

o. ***Investment property***
Investment property is 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. 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 to be expected if the property is traded. The valuation is carried out in May of each year and is based on February prices. The valuation adjusted for the new prices is effective at the end of the year. 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 2015 and is increased by the consumer price index from February 2015. Income and expenses of investment property are recognized as net income of investment property in the Fund´s income statement. Investment property is not depreciated.

p. ***Operating assets***
Operating assets are recognised at cost less accumulated depreciation.
Depreciation

Depreciation is recognised in the income statement on a straight-line basis over the estimated useful lives of operating assets.

Estimated useful life is specified as follows:

Real estate	25 years
Fixtures and equipment	5-10 years

Residual value is reviewed annually unless it is immaterial.

34. Significant accounting policies, contd.:

Financial assets and financial liabilities, contd.:

q. *Intangible assets*

Intangible assets consist of software used in the Fund's operations. Intangible assets are amortised on a straight-line basis over the estimated useful life, which is 3 - 5 years.

r. *Assets for sale and liabilites associated with assets for sale*

Assets and disposal groups together with the related liabilities are classified as held for sale and liabilites associated with assets held for sale if their carrying amount is recovered through a sale transaction rather than through continuing use. Assets and liabilities classified as held for sale are measured at the lower of the carrying amount or fair value less costs to sell. Assets held for sale and liabilities associated with assets for sale are distinguished from other assets and liabilities in the balance sheet. Assets classified as held for sale are not depreciated.

s. *Issued bonds and other borrowings*

Issued bonds and other borrowings are initially recognised at fair value, which is the loan amount in addition to all costs associated with the transaction. After initial recognition they are measured at amortised cost using the effective interest rate method. Accrued interest expense and indexation are recognised as a part of the carrying amount.

t. *Equity*

The Fund's equity consists of contributed capital on the one hand and accumulated deficit on the other. The accumulated income or loss of the Fund from its establishment is recognised in accumulated deficit.

u. *Taxation*

Income tax of the taxable operations of the subsidiary, Leigufélagið Klettur ehf. is calculated and recognised in the financial statements. Calculations are based on the profit before tax, taking into account permanent differences between taxable income and income as according to the financial statements. The income tax rate is 20%. Deferred tax liabilities arises from the difference between the balance sheet items in the tax returns and financial statements. The difference stems from the fact that tax assessment is based on premises other than the financial statements.

v. *New standards and interpretations adopted*

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 at year end 2015.

New standards and interpretations not yet adopted

The IASB has published new standards and amendments to existing standards that have not become effective and have not been adopted early by the Fund. Information on those standards that are expected to be relevant to the Fund’s financial statements is provided below.

IFRS 9 ‘Financial Instruments’ (2014) supersedes the current guidance on financial instruments in accordance with IAS 39. The new standard introduces changes to IAS 39’s guidance on the classification and measurement of financial assets and introduces a new ‘expected credit loss’ model for the impairment of financial assets. IFRS 9 also provides new guidance on the application of hedge accounting. Management has started to assess the impact of IFRS 9 but is not yet in a position to provide quantified information. In view of the nature of the Fund´s operations, the main area of expected impact is the recognition of an expected credit loss-based impairment on the Fund’s loans.

IFRS 9 will be mandatory for annual reporting periods beginning on or after 1 January 2018 if endorsed by the EU.

IFRS 15 ‘Revenue from Contracts with Customers’ provides a comprehensive framework for the accounting treatment of income. The standard replaces IAS 18 ‘Revenue’, IAS 11 ‘Construction Contracts’, and several revenue-related Interpretations. The new standard establishes a control-based revenue recognition model. Revenue is recognised as the amount that reflects the consideration to which the entity expects to be entitled in exchange for transferring goods or services to customers. IFRS 16 is effective for annual reporting periods beginning on or after 1 January 2018, if endorsed by the EU. Management has started to assess the impact of IFRS 15 but is not yet in a position to provide quantified information.

34. Significant accounting policies, contd.:

v. Financial assets and financial liabilities, contd.:

IFRS 16 'Leases' replaces IAS 17 'Leases' and other related interpretations. The standard establishes guidelines for the recognition, measurement, presentation and disclosure of leases. The standard´s objective is to ensure that lessors and lessees provide information that represents the financial transactions. IFRS 16 is expected to change the balance sheet, income statement, and cash flow statement for companies with material off balance sheet leases. The requirements for lessor however are substantially unchanged. IFRS 16 is effective for annual reporting periods beginning on or after 1 January 2019, if endorsed by the EU. Management has started to assess the impact of IFRS 15 but is not yet in a position to provide quantified information

New standards and interpretations not yet adopted, contd.:

New standards, interpretations and amendments not either adopted or listed above are not expected to have a material impact on the Fund's financial statements.