

ISSUER COMMENT

Iceland's Housing Financing Fund's Sale of Property Management Unit Is Credit Positive

 From [Credit Outlook](#)
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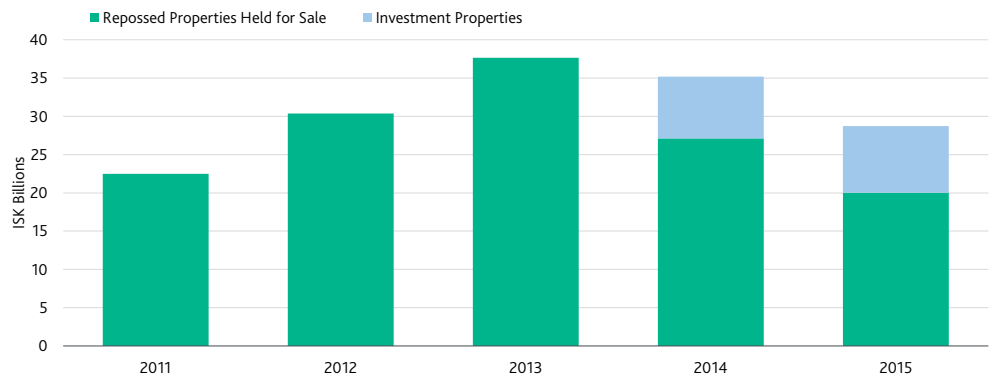
Last Monday, Iceland's government-owned [Housing Financing Fund](#) (HFF, Baa3 stable) announced the sale of its property management subsidiary Klettur Property Management ehf. (unrated). The sale is credit positive for HFF because at ISK10.1 billion, the sale price is ISK1.5 billion above book value, producing a one-off gain of about 2.4x HFF's 2015 net operating income (earnings before impairment provisions). The sale will lead to a material reduction of the repossessed properties portfolio on HFF's balance sheet, freeing up capital and reducing costs. Additionally, the sale will simplify the company's structure and allow management to focus on HFF's core operations.

Klettur was set up in 2013 with a mandate to manage and rent out some of the properties that HFF had repossessed from its customers after Iceland's 2008 economic collapse (see Exhibit 1). About 30% of all repossessed properties on HFF's balance sheet were held in Klettur as of year-end 2015. More than half of the 30% are located outside the capital region, making them less attractive to rent out and, as a result, less profitable to operate. Despite Klettur's total assets comprising only about 1.1% of HFF's total balance sheet as of year-end 2015, we expect that the Klettur sale proceeds will be invested in interest-yielding assets, which should help strengthen the earnings of the fund beyond 2016.

EXHIBIT 1

Housing Financing Fund's Repossessed Properties and Properties Held and Managed by Klettur

Sale of Klettur reduces HFF's stock of repossessed properties approximately 30%.

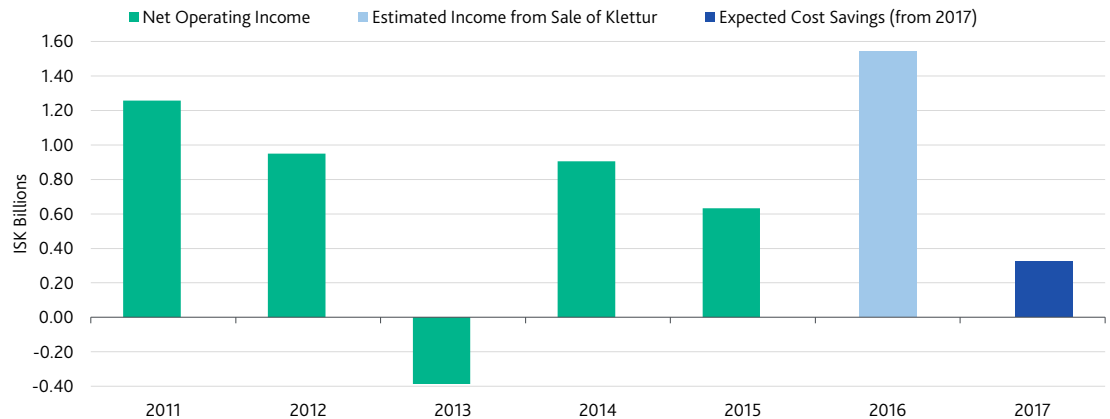

 Sources: *Housing Financing Fund and Moody's Investors Service*
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HFF also announced a new organizational structure to streamline its operations, allowing it to refocus on its social role in the Icelandic economy, namely lending for construction or purchase of residential housing when commercial banks are not fulfilling this role. The fund expects the change to result in an approximately ISK324 million reduction in operating costs by 2017, about 17% of HFF's total reported operating expenses in 2015. These are credit-positive developments, particularly in light of HFF's limited profitability (see Exhibit 2) and weak capital adequacy: return on tangible banking assets was 0.23% in 2015, while HFF's capital ratio was 5.5%, including capital injections from the government.

EXHIBIT 2

Housing Financing Fund's Historical Profitability



Note: For 2015 the net operating income includes the profit from discontinued operations.

Sources: Housing Financing Fund and Moody's Investors Service

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