

# Housing Financing Fund

## Condensed Interim Financial Statements

### 30 June 2016

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 prevail.

Housing Financing Fund  
Borgartúni 21  
105 Reykjavík

Reg.no. 661198-3629

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# Endorsement and Statement by the Board of Directors and CEO

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The Condensed Interim Financial Statements of the Housing Financing Fund for the period 1 January to 30 June 2016 have been prepared in accordance with the International Financial Reporting Standard IAS 34, Interim Financial Reporting, and additional disclosure requirements for companies that have their securities listed on a regulated market.

## Results during the period

According to the income statement, the Fund's operating surplus amounted to ISK 2,510 million for the six months ended 30 June 2016. Equity at the end of June amounted to ISK 21,781 million according to the balance sheet.

The Fund's equity ratio was 6.45% at the end of June 2016, an increase of 1% over the period. The calculation of the ratio is equivalent to the calculation of the capital ratio of financial institutions. The long-term objective of the Fund is to maintain the ratio above 5% and not below 4%. The Fund's liquidity position is strong.

## Operations during the period

Net interest income for the period amounted to ISK 525 million including ISK 279 million in interest contributions from the Treasury, compensating the Fund for its loss of interest income as a result of the government's debt relief measures. The interest rate contribution is the difference between the interest on the loan portfolio and the return on the Fund's liquid funds during the period. Operating expenses for the period amounted to ISK 909 million, of that amount ISK 82 million is a one-time cost resulting from the Fund's streamlining measures and preparation due to the new Act no. 52/2016 on General Housing. Excluding one-time costs, operating expenses of the Fund decreased by 9.5% despite substantial increases in wages due to collective bargaining agreements. The Fund's budget assumes that the streamlining measures will have an effect to a certain degree in the second half of the year but will be fully implemented in the year 2017. Full-time equivalent positions were reduced by 10% from the previous year and were 85 in the first half of 2016 compared to 95 the same period of 2015. There were 87 employees on the Fund's payroll on June 30, 2016, of which 11 have completed their duties for the Fund and therefore full-time equivalent positions excluding those that have completed their duties are 76.

On 30 June 2016, the Fund's loans amounted to ISK 613,595 million, a decrease of ISK 34,373 million from the beginning of the year. The reduction in the loan portfolio is due to limited lending, the government's debt measures and prepayments. The issuance of bonds to raise capital was not necessary during the period. Assets excluding the loan portfolio including liquid assets increased between years and amounted to ISK 160,800 million. The increase is primarily due to positive results from sales of appropriated assets and prepayments of loans. The real return on assets outside the loan portfolio for the period was 3.39%.

Improved economic conditions have reduced the risk of the loan portfolio. Arrears have decreased significantly and collateral status improved significantly due to rising housing prices in excess of inflation. The Fund's customers in arrears have decreased and arrears are currently 4.8% of total loans compared to 8.6% in the same period 2015. Simplification of the billing processes including among other things, the Fund implementing a second phase in the process has had a positive impact on the development of delinquency. The adjusted balance of the total of the Fund's loans in arrears amounted to ISK 29,800 million of which arrears amounted to ISK 2,464 million. The provision for impairment of loans was ISK 8,033 million at the end of the period, a decrease of the provision by ISK 8,115 million since the beginning of the year. Approximately 10,612 households have taken advantage of the option to prepay their loans by allocating private pension savings towards their loans held by the Fund. Excess payments resulting from the allocation of customer's private pension savings amounted to ISK 6,882 million from the time the measures became effective until June 30, 2016, of which this amount was ISK 1,983 million in the year 2016.

During the first half of 2016, the subsidiary Leigufélagið Klettur ehf. was sold to the highest bidder in an open sales process. The Fund is awaiting the opinion of the Competition Authority on the sale. The Housing Financing Fund's profit from the sale of the company is ISK 1,427 million, incurred during the period. Year-to-date the Fund has sold 667 properties and repossessed 144 properties on foreclosed mortgages. Profits from sales of appropriated properties amounted to ISK 11,286 million, which is 5.5% more than the book value of the assets. The Fund owned 825 properties at the end of the period, of which 390 are rented, 342 in sales and 93 vacant. Sales of appropriated properties will have a positive impact on the Fund's net interest income in the future as cash tied up in real estate is transferred into interest-bearing assets.

## Endorsement and Statement by the Board of Directors and CEO, contd.:

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In July, the ratings agency S & P raised its long-term ratings on the HFF to BB with a stable outlook due to financial strength. S & P's rationale is that the improved economic situation in Iceland has had a more positive effect on the operations and finances of HFF than S & P had anticipated. It is also noted that the actions of the Fund to reduce its prepayment problems, increase interest-bearing assets and reduce operating costs has delivered results that have a positive impact on the Fund's performance. In this context, specific reference was made to the sale of Leigufélagið Klettur ehf. and appropriated assets and the Fund's purchase of Arion Bank's structured covered bonds.

On 25 May, the Board approved a new organizational structure for the Fund following the policy formulation which focused on simplifying and customizing the operations of HFF to the changing position of the Fund in the credit market. An emphasis was made on customer service, simplifying procedures, shortening routes of communication and the introduction of a new credit system, with the aim of achieving the highest efficiency in its operations. A fundamental change in the organizational structure of the Fund was involved and now the Fund operates within a simple organizational chart, reflecting the focus of the Fund's operations. There are three divisions, two income divisions; finance which manages assets outside of the loan portfolio and lending which manages loans to individuals and legal entities. Operations is a support division, which is responsible for financial accounting, information technology and back office activities.

During the period a new credit system software was implemented providing an opportunity to change procedures, shorten processes and increase productivity in operations.

Concurrent to the implementation of a new organizational chart, the Fund's 5 year operating budget was revised. The Board approved the operating budget of the Fund for the years 2016 - 2020 in which the simplification of operations and streamlining measures undertaken in the years 2015-2016 will be fully implemented. The operating budget projects positive results in all years and therefore capital injections from the Treasury are not expected, and it is expected that the equity ratio will be about 8% at the end of the period. Reduction in operating expenses during the period is expected to be 22% in real terms.

With Act no. 52/2016 on General Housing, the Fund was entrusted a new and crucial role in the development of a new rental housing program designed for individuals and families below certain income and asset limits. The legislation is based on a Danish model and the Fund implements the Act in regards to the granting of the State's initial contributions and monitoring private housing. The role of the Fund in accordance to the Act is threefold. Its role is divided into the administration of the initial contributions, monitoring of private housing and the housing of non-profit organizations as well as the collection of repayments of the initial contributions. In addition, it is expected that the Fund undertake substantial analysis of the housing market. Operating expenses of the Fund will increase due to the implementation of the Act in the second half of this year as it is expected that additional full-time equivalent positions will be needed to perform the required tasks entailed by the Act. The cost of applying the Act is paid by the Treasury and therefore does not adversely affect the operations of the Fund. With reference to the above it can be stated that the uncertainty regarding the future role of the HFF has been reduced and therefore no longer the subject of a disclaimer in the notes to these financial statements. In addition to the above, a bill has been proposed in Parliament amending Act no. 44/1998 on Housing which assigns responsibility to the Housing Financing Fund for housing policy in line with practices in similar institutions in the Nordic countries, Husbanken in Norway and ARA in Finland.

HFF faces a number of risks and risk management is an important and integral part of other activities of the Fund. Ultimately the Board of the Funds is responsible for risk management. The Board determines the Fund's acceptable risk in accordance with laws and regulations.

# Endorsement and Statement by the Board of Directors and CEO, contd.:

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## **Endorsement by the Board of Directors and CEO**

To the best of our knowledge, it is our opinion that the Condensed Interim Financial Statements give a true and fair view of the comprehensive income of the Fund for the period 1 January to 30 June 2016, its assets, liabilities and financial position of the Fund as at 30 June 2016 and its cash flows for the period 1 January until 30 June 2016.

Further, in our opinion the Condensed Interim Financial Statements and the endorsement by the Board of Directors and the CEO give a fair view of the development and performance of the Fund's operations and its financial position and fairly describes the principal risks and uncertainties faced by the Fund.

The Board of Directors and the CEO of the Housing Financing Fund have today discussed the Fund's Condensed Interim Financial Statements for the six-month period ended 30 June 2016 and confirm them by means of their signatures.

Reykjavik, 31 August, 2016

## **Board of Directors:**

Ingibjörg Ólöf Vilhjálmsdóttir  
Chairman of the Board

Sigurbjörn Ingimundarson  
Vice-Chairman of the Board

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Drífa Snædal

Haukur Ingibergsson

G. Valdimar Valdimarsson

## **CEO**

Hermann Jónasson

# Independent Auditors' Review Report

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## To the Board of Directors of the Housing Financing Fund,

We have reviewed the accompanying Condensed Interim Financial Statements of the Housing Financing Fund for the period of 1 January until 30 June 2016, which are comprised of the balance sheet, the income statement and statement of comprehensive income, the statement of changes in equity, the statement of cash flows, and other explanatory notes. Management is responsible for the preparation and fair presentation of this interim financial information in accordance with IAS 34 "Interim Financial Reporting", as adopted by the European Union. Our responsibility is to express a conclusion on this Condensed Interim Financial Statement based on our review.

### Scope of Review

We conducted our review in accordance with International Standard on Review Engagements 2410, on reviews of interim financial statements by independent auditors. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion on the Condensed Interim Financial Statements.

### Conclusion

Based on our review, nothing has come to our attention that suggests otherwise, but that the accompanying Condensed Interim Financial Statement give a true and fair view of the performance of the Fund for the period of 1 January to 30 June 2016, the financial position of the Fund as at 30 June 2016, and its cash flow for the period 1 January to 30 June 2016, in accordance with IAS 34 "Interim Financial Reporting", as adopted by the European Union.

### Emphasis of matter

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

Reykjavik, 31 August 2016

### **Grant Thornton endurskoðun ehf**

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Sturla Jónsson  
State authorised public accountant

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Davíð Arnar Einarsson  
State authorised public accountant

# Interim Income Statement and Statement of Comprehensive Income from 1 January to 30 June 2016

	Notes	2016 1.1.-30.6	2015 1.1.-30.6
Interest income .....		28.048.316	30.253.963
Interest expense .....		( 27.523.280)	( 30.727.371)
<b>Net interest income</b>	19	<u>525.036</u>	<u>( 473.408)</u>
Other income .....	20	<u>50.513</u>	<u>77.119</u>
<b>Total operating income</b>		575.549	( 396.289)
Salaries and salary-related expenses .....	21	533.352	461.308
Other operating expenses .....	22	345.004	419.871
Depreciation and amortisation .....	23	30.655	28.029
<b>Total operating expenses</b>		<u>909.011</u>	<u>909.208</u>
Net income of properties held for sale .....	24	46.809	106.064
<b>Net operating income</b>		<u>( 286.653)</u>	<u>( 1.199.433)</u>
Impairment of loans and properties held for sale .....	25	1.369.491	369.983
Profit (loss) from continuing operations .....		1.082.838	( 829.450)
Profit from discontinued operations, net of tax .....	26	<u>1.427.190</u>	<u>449.978</u>
<b>Profit (loss) for the year and comprehensive loss</b>		<u><u>2.510.028</u></u>	<u><u>( 379.472)</u></u>

The notes on pages 11 to 21 are an integral part of these Interim Financial Statements.

# Interim Balance Sheet as at 30 June 2016

	Notes	30.6.2016	31.12.2015
<b>Assets</b>			
Cash and cash equivalents .....	6	20.299.739	13.236.528
Loans to financial institutions .....	7	12.619.635	5.061.627
Marketable securities .....	8	9.978.346	4.898.018
Other securities .....	9	111.941.519	97.617.421
Receivable from State Treasury .....	10	5.961.185	5.877.687
Loans .....	11	613.595.245	647.969.024
Properties held for sale .....	12	12.290.316	20.021.499
Operating assets .....	13	92.330	99.578
Intangible assets .....	14	208.036	200.838
Other assets .....		858.383	344.543
Receivable from sale of subsidiary .....	26	10.101.000	0
Assets for sale .....	26	0	8.559.856
<b>Total assets</b>		<u>797.945.734</u>	<u>803.886.619</u>
<b>Liabilities</b>			
Bond issues .....	15	771.840.853	779.492.835
Other borrowings .....	16	3.356.207	3.631.603
Other liabilities .....	17	967.552	1.491.087
<b>Total liabilities</b>		<u>776.164.612</u>	<u>784.615.525</u>
<b>Equity</b>			
Contributed capital .....		57.655.408	57.655.408
Accumulated deficit .....		( 35.874.286)	( 38.384.314)
<b>Total equity</b>	18	<u>21.781.122</u>	<u>19.271.094</u>
<b>Total liabilities and equity</b>		<u>797.945.734</u>	<u>803.886.619</u>

The notes on pages 11 to 21 are an integral part of these Interim Financial Statements.



# Interim Statement of Changes in Equity from 1 January to 30 June 2016

<b>Changes in equity from 1 January to 30 June 2016</b>	<b>Contributed capital</b>	<b>Accumulated deficit</b>	<b>Equity Total</b>
Equity as at 1 January 2016 .....	57.655.408	( 38.384.314)	19.271.094
Loss for the year and comprehensive loss .....	0	2.510.028	2.510.028
Equity as at 30 June 2016 .....	57.655.408	( 35.874.286)	21.781.122
 <b>Year 2015</b>	 <b>Contributed capital</b>	 <b>Accumulated deficit</b>	 <b>Equity Total</b>
Equity as at 1 January 2015 .....	57.655.408	( 39.644.432)	18.010.976
Recognition of discounts, adjustment ..... 2.f.	0	( 582.569)	( 582.569)
Profit for the year and comprehensive income .....	0	1.842.687	1.842.687
Equity as at 31 December 2015 .....	57.655.408	( 38.384.314)	19.271.094
 <b>Changes in equity from 1 January to 30 June 2015</b>	 <b>Contributed capital</b>	 <b>Accumulated deficit</b>	 <b>Equity Total</b>
Equity as at 1 January 2015 .....	57.655.408	( 39.644.432)	18.010.976
Recognition of discounts, adjustment ..... 2.f.	0	( 582.569)	( 582.569)
Loss for the year and comprehensive loss .....	0	( 379.472)	( 379.472)
Equity as at 30 June 2015 .....	57.655.408	( 40.606.473)	17.048.935

The notes on pages 11 to 21 are an integral part of these Interim Financial Statements.

# Interim Statement of Cash Flows from 1 January to 30 June 2016

	<b>2016</b>	<b>2015</b>
	<b>1.1.-30.6.</b>	<b>1.1.-30.6.</b>
<b>Cash flows from operating activities</b>		
Profit (loss) for the year and comprehensive income (loss) .....	2.510.028	( 379.472)
Adjusted for:		
Indexation on loans to banks and loans to customers .....	( 10.657.867)	( 12.890.835)
Indexation on borrowings .....	11.066.331	13.696.290
Depreciation and amortisation .....	30.655	28.029
Impairment .....	( 1.369.491)	( 369.983)
Profits from discontinued operations .....	( 1.427.190)	( 449.978)
Changes in operating assets and liabilities:		
Loans .....	44.112.153	49.081.917
Properties held for sale .....	8.342.643	5.632.620
Other assets .....	( 533.374)	( 145.497)
Other liabilities .....	( 523.535)	( 1.812.713)
Cash flows from (to) operating activities	51.550.353	52.390.378
<b>Cash flows from investing activities</b>		
Assets for sale, change .....	( 113.954)	102.534
Marketable securities, change .....	( 5.080.328)	0
Claims on financial institutions, change .....	( 7.432.931)	( 1.823.955)
Other securities, change .....	( 12.835.615)	( 272.293)
Investment in operating assets and intangible assets .....	( 30.605)	( 13.687)
Cash flows from (to) investing activities	( 25.493.433)	( 2.007.401)
<b>Cash flows from financing activities</b>		
Bond issues and other borrowings, repayments .....	( 18.993.709)	( 17.257.889)
Cash flows to financing activities	( 18.993.709)	( 17.257.889)
<b>Net increase (decrease) in cash and cash equivalents .....</b>	<b>7.063.211</b>	<b>33.125.088</b>
<b>Cash and cash equivalents at the beginning of the year .....</b>	<b>13.236.528</b>	<b>16.330.120</b>
<b>Cash and cash equivalents at the end of the period .....</b>	<b>20.299.739</b>	<b>49.455.208</b>
Sale of subsidiary .....	10.101.000	0
Receivable from sale of subsidiary .....	( 10.101.000)	0

The notes on pages 11 to 21 are an integral part of these Interim Financial Statements.

# Notes to the Interim Financial Statement

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## 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 of 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.

### 2. Basis of preparation

#### a. Statement of compliance

The Condensed Interim Financial Statements have been prepared in accordance with IAS 34 Interim Financial Reporting. They do not include all of the information required for full annual financial statements and should be read in conjunction with the Financial Statements of the Fund as at and for the year ended 31 December 2015.

The Condensed Interim Financial Statements of the Housing Financing Fund were approved by the Board of Directors on 31 August 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 rate margin has been insubstantial or only 0.28% which is insufficient to cover the impairment of loans comparable to the impairment resulting from the economic collapse. Efforts are underway to increase the Fund's interest income by improving the quality of the loan portfolio, by selling appropriated assets and utilizing the strong liquidity position to strengthen the Fund's financial position.

#### c. Basis of measurement

The Condensed Interim 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, and investment properties are measured at fair value.

#### d. Functional currency

The Condensed Interim 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 interim 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 11.
- Properties held for sale, cf. note 12.

#### 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.

The methodology on the recognition of discounts on a portion of the Fund's borrowing was changed. The beginning balance of borrowings and equity has been adjusted in accordance with generally accepted accounting principles and comparative figures have been adjusted accordingly. The effect of the change was a reduction in the interest expense of the Fund in the amount of ISK 428.6 from January to June 2015.

## Notes, contd.:

### 3. Significant accounting policies

The accounting policies set out below have been consistently applied to all periods presented in these Condensed Interim 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.

### 4. 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.

### 5. 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:

	Trading assets	Loans and receivables	Liabilities at amortised cost	Total carrying amount	Fair value
<b>30 June 2016</b>					
<b>Assets:</b>					
Cash and cash equivalents.....	0	20.299.739	0	20.299.739	20.299.739
Loans to financial institutions.....	0	12.619.635	0	12.619.635	12.619.635
Marketable securities.....	9.978.346	0	0	9.978.346	9.978.346
Other securities.....	0	111.941.519	0	111.941.519	111.941.519
Receivable from State Treasury.....	0	5.961.185	0	5.961.185	5.961.185
Loans .....		613.595.245		613.595.245	624.991.142
Total financial assets.....	9.978.346	764.417.323	0	774.395.669	785.791.566
<b>Liabilities:</b>					
Bond issues.....	0	0	771.840.853	771.840.853	827.506.938
Other borrowings.....	0	0	3.356.207	3.356.207	3.356.207
Other liabilities.....	0	0	967.552	967.552	967.552
Total financial liabilities.....	0	0	776.164.612	776.164.612	831.830.697
<b>31 December 2015</b>					
<b>Assets:</b>					
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.....		97.617.421		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
<b>Liabilities:</b>					
Bond issues.....	0	0	779.492.835	779.492.835	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	784.615.525	784.615.525	897.235.283

## Notes, contd.:

### 5. Financial assets and liabilities, contd.:

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 the end of the period. 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 similar 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.

30 June 2016	Level 1	Level 2	Level 3	Total
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#### Assets:

Treasury securities.....	9.978.346	0	0	9.978.346
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31 December 2015	Level 1	Level 2	Level 3	Total
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#### Assets:

Treasury securities.....	4.898.018	0	0	4.898.018
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### 6. Cash and cash equivalents and restricted cash

Cash and cash equivalents and restricted cash are specified as follows:

	30.6.2016	31.12.2015
Unrestricted cash in Central Bank .....	19.235.958	13.151.849
Unrestricted cash in financial institutions .....	1.063.781	84.679
Cash and cash equivalents total .....	<u>20.299.739</u>	<u>13.236.528</u>

### 7. Loans to financial institutions

Loans to financial institutions are specified as follows:

	30.6.2016	31.12.2015
Inter-bank loans .....	12.545.378	5.007.313
Other claims .....	74.257	54.314
Loans to financial institutions total .....	<u>12.619.635</u>	<u>5.061.627</u>

### 8. Marketable securities

Marketable securities are specified as follows:

	30.6.2016	31.12.2015
Listed treasury bonds at fair value .....	9.978.346	4.898.018
Marketable securities total .....	<u>9.978.346</u>	<u>4.898.018</u>

## Notes, contd.:

### 9. Other securities

Other securities are specified as follows:	<b>30.6.2016</b>	<b>31.12.2015</b>
Covered bonds .....	83.895.006	69.967.066
Treasury bonds without active market capitalised based on amortised cost and initial rate of return .....	28.046.513	27.650.355
Other securities total .....	<u>111.941.519</u>	<u>97.617.421</u>

### 10. Receivable due from State Treasury

The receivable due from the State Treasury is comprised of two bonds, a bond amounting to ISK 4,703 million that is payable in one lump sum in the year 2018, and a bond in the amount of ISK 1,258 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.

### 11. Loans:

Loans are specified as follows:	<b>30.6.2016</b>	<b>31.12.2015</b>
Loans to individuals .....	479.063.808	518.189.581
Loans to legal entities .....	134.531.437	129.779.443
Total loans .....	<u>613.595.245</u>	<u>647.969.024</u>
Impairment on loans is specified as follows:	<b>30.6.2016</b>	<b>31.12.2015</b>
Balance at the beginning of the year .....	16.148.682	21.127.603
Impairment loss (reversal) .....	(777.566)	(1.274.518)
Write-offs .....	(7.337.749)	(3.704.403)
Balance at the end of the period .....	<u>8.033.367</u>	<u>16.148.682</u>

#### 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	
	30.6.2016	31.12.2015	30.6.2016	31.12.2015	30.6.2016	31.12.2015
<b>Neither past due nor impaired</b>						
Total.....	429.922.340	451.922.023	87.599.108	101.722.474	517.521.448	553.644.497
General impairment.....	(714.589)	(726.347)	(105.199)	(126.347)	(819.788)	(852.694)
Carrying amount.....	<u>429.207.751</u>	<u>451.195.676</u>	<u>87.493.909</u>	<u>101.596.127</u>	<u>516.701.660</u>	<u>552.791.803</u>
<b>Past due and not impaired</b>						
31-60 days.....	16.993.206	15.423.452	249.830	917.852	17.243.036	16.341.304
61-90 days.....	7.179.043	7.390.499	62.424	18.480	7.241.467	7.408.979
Past due over 90 days	10.633.895	13.192.854	99.527	156.511	10.733.422	13.349.365
General impairment.....	(342.494)	(345.269)	(5.232)	(10.912)	(347.726)	(356.181)
Carrying amount.....	<u>34.463.650</u>	<u>35.661.536</u>	<u>406.549</u>	<u>1.081.931</u>	<u>34.870.199</u>	<u>36.743.467</u>
<b>Impaired</b>						
Total.....	18.696.586	38.107.102	50.192.653	35.266.459	68.889.239	73.373.561
Specific impairment.....	(3.304.179)	(6.774.733)	(3.561.674)	(8.165.074)	(6.865.853)	(14.939.807)
Carrying amount.....	<u>15.392.407</u>	<u>31.332.369</u>	<u>46.630.979</u>	<u>27.101.385</u>	<u>62.023.386</u>	<u>58.433.754</u>
<b>Total loans.....</b>	<u>479.063.808</u>	<u>518.189.581</u>	<u>134.531.437</u>	<u>129.779.443</u>	<u>613.595.245</u>	<u>647.969.024</u>
Impairment as proportion of loans.....	0,90%	1,49%	2,66%	6,01%	1,29%	2,43%

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

## Notes, contd.:

### 11. Loans:, contd.:

#### Quality of loans, contd.:

	Loans to individuals		Loans to legal entities		Total	
	30.6.2016	31.12.2015	30.6.2016	31.12.2015	30.6.2016	31.12.2015
<b>Loans past due:</b>						
31-60 days.....	295.886	308.253	20.758	120.177	316.644	428.430
61-90 days.....	196.718	182.686	4.268	35.243	200.986	217.929
Past due over 90 days....	1.908.984	2.762.694	555.112	3.017.233	2.464.096	5.779.927
Total past due.....	<u>2.401.588</u>	<u>3.253.633</u>	<u>580.138</u>	<u>3.172.653</u>	<u>2.981.726</u>	<u>6.426.286</u>

#### 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 Board of 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

Impairment on loans is specified as follows:

	Individuals		Legal entities		Total 30.6.2015
	Specific impairment	General impairment	Specific impairment	General impairment	
<b>30 June 2016</b>					
Balance at					
the beginning of the year.....	6.774.733	1.071.616	8.165.074	137.259	16.148.682
Impairment loss (reversal of impairment loss).....	(80.797)	(14.533)	(655.408)	(26.828)	(777.566)
Write-off.....	<u>(3.389.757)</u>	<u>0</u>	<u>(3.947.992)</u>	<u>0</u>	<u>(7.337.749)</u>
Balance at year end.....	<u>3.304.179</u>	<u>1.057.083</u>	<u>3.561.674</u>	<u>110.431</u>	<u>8.033.367</u>

	Individuals		Legal entities		Total 31.12.2014
	Specific impairment	General impairment	Specific impairment	General impairment	
<b>31 December 2015</b>					
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.....	<u>(1.941.488)</u>	<u>0</u>	<u>(1.762.915)</u>	<u>0</u>	<u>(3.704.403)</u>
Balance at year end.....	<u>6.774.733</u>	<u>1.071.616</u>	<u>8.165.074</u>	<u>137.259</u>	<u>16.148.682</u>

Obligations not recognised in the balance sheet: **30.6.2016** **31.12.2015**

Binding loan commitments at year-end..... 7.093.248 4.589.200

### 12. Properties held for sale

The Fund owned 825 properties on 30 June 2016 (year-end 2015: 1.348). Total number of properties held for sale managed by the Fund is specified as follows:

	30.6.2016	31.12.2015
Number of properties at the beginning of the year .....	1.348	1.891
Repossessed properties during the period .....	144	355
Properties sold during the period .....	<u>( 667)</u>	<u>( 898)</u>
Number of properties at the end of the period .....	<u>825</u>	<u>1.348</u>

## Notes, contd.:

### 12. Properties held for sale, contd.:

Properties owned by the Fund are divided as follows by geographical area:	30.6.2016	31.12.2015
South and South West .....	211	427
Great Reykjavík area .....	133	217
South Iceland .....	147	174
West Iceland .....	116	141
East Iceland .....	91	234
North Iceland .....	73	99
Westfjords .....	54	56
Number of properties at the end of the period .....	<u>825</u>	<u>1.348</u>

At the end of the period, 342 properties of the 825 properties owned by the fund are in the sales process (2015: 629). 390 properties were rentals (2015: 610) or 47.2% of the total properties owned by the Fund on 30 June 2016 (2015: 45.2%).

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

30 June 2016	Number of properties	Official property value	Fair value	Carry amount
Rentals.....	390	8.297.448	7.365.902	6.790.753
In sales process.....	342	5.644.391	4.405.870	4.105.906
Empty.....	54	1.075.380	956.921	846.867
Other properties*.....	39	712.514	615.668	546.790
Total.....	<u>825</u>	<u>15.729.733</u>	<u>13.344.361</u>	<u>12.290.316</u>

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

#### 31 December 2015

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.....	<u>1.348</u>	<u>24.631.619</u>	<u>21.843.835</u>	<u>20.021.499</u>

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

### 13. Operating assets:

Operating assets are specified as follows:

	Fixtures and equipment	Real estate	Total
<b>Total Cost</b>			
Balance at 1.1.2015 .....	280.221	30.726	310.947
Additions during the period .....	13.220	0	13.220
Balance at 30.6.2016 .....	<u>293.441</u>	<u>30.726</u>	<u>324.167</u>
<b>Depreciation</b>			
Balance at 1.1.2015 .....	202.414	6.667	209.081
Depreciation during the period .....	14.481	1.027	15.508
Balance at 31.12.2015 .....	<u>216.895</u>	<u>7.694</u>	<u>224.589</u>
Depreciation during the period .....	7.248	0	7.248
Balance at 30.06.2016 .....	<u>224.143</u>	<u>7.694</u>	<u>231.837</u>



## Notes, contd.:

### 13. Operating assets, contd.:

	Fixtures and equipment	Real estate	Total
<b>Carrying amount</b>			
Balance at 1.1.2015 .....	77.807	24.059	101.866
Balance at 31.12.2015 .....	76.546	23.032	99.578
Balance at 30.6.2016 .....	69.298	23.032	92.330

Property value of real estate on 30 June 2016 amounted to ISK 9 million (2015: ISK 9 million) and insurance value amounted to ISK 22.6 million (2014: ISK 22.2 million).

### 14. Intangible assets

Intangible assets are specified as follows:

	Software
<b>Total Cost</b>	
Balance at 1.1.2015 .....	510.380
Additions during the period .....	79.750
Balance at 31.12.2015 .....	590.130
Additions during the period .....	30.605
Balance at 30.6.2016 .....	620.735
<b>Amortisation</b>	
Balance at 1.1.2015 .....	351.118
Amortisation during the period .....	38.174
Balance at 31.12.2015 .....	389.292
Amortisation during the period .....	23.407
Balance at 30.6.2016 .....	412.699
<b>Carrying amounts</b>	
Balance at 1.1.2015 .....	159.262
Balance at 31.12.2015 .....	200.838
Balance at 30.6.2016 .....	208.036

### 15. Bond issues

The Fund issues housing bonds in four 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 redeemable. 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:

	30.6.2016	31.12.2015
HFF24 bond .....	138.842.447	143.991.787
HFF34 bond .....	211.166.602	211.945.151
HFF44 bond .....	386.083.810	384.232.639
Housing bonds (final maturity 2040) .....	16.962.559	19.097.658
Housing Authority bonds (final maturity 2038) .....	18.785.435	20.225.600
Bond issues total .....	771.840.853	779.492.835

The methodology on the recognition of discounts on a portion of the Fund's borrowing was changed. The beginning balance of borrowings and equity has been adjusted in accordance with generally accepted accounting principles.

## Notes, contd.:

### 16. Other borrowings

Other borrowings are specified as follows:	30.6.2016	31.12.2015
Pension funds .....	639.604	873.090
Insurance fund .....	187.962	298.928
Redeemable .....	140.000	157.744
Unpaid due to purchase of loan portfolios .....	2.388.641	2.301.841
Other borrowings total .....	<u>3.356.207</u>	<u>3.631.603</u>

### 17. Other liabilities

Other liabilities are specified as follows:	30.6.2016	31.12.2015
Treasury due to subsidized interest .....	225.048	207.699
Employee vacation obligation .....	92.378	75.875
Other liabilities .....	650.126	1.207.513
Other liabilities total .....	<u>967.552</u>	<u>1.491.087</u>

### 18. 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:	30.6.2016	31.12.2015
Total equity according to the financial statements .....	21.781.122	19.271.094
Intangible assets .....	(208.036)	(200.838)
Equity base .....	<u>21.573.086</u>	<u>19.070.256</u>

Total equity requirement is specified as follows:

Credit risk .....	26.274.862	28.397.602
Market risk .....	274.405	134.695
Operational risk .....	216.938	257.480
Total capital requirements .....	<u>26.766.205</u>	<u>28.789.777</u>

Equity ratio .....	6,45%	5,46%
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### 19. Net interest income

Interest income	30.6.2016	30.6.2015
Interest income on items not at fair value:		
Interest income and indexation on loans to customers .....	22.841.965	27.555.430
Interest income from covered bonds .....	2.655.503	0
Interest income from other financial assets .....	1.828.211	2.190.998
Government contribution to subsidy interests* .....	315.567	310.428
Gov't contribution due to reduced interest margin related to debt solutions** .....	279.676	0
	<u>27.920.922</u>	<u>30.056.856</u>
Interest income on items at fair value:		
Interest income (expenses) on market securities .....	127.394	197.107
	<u>127.394</u>	<u>197.107</u>
<b>Total interest income .....</b>	<u><b>28.048.316</b></u>	<u><b>30.253.963</b></u>

## Notes, contd.:

### 19. Net interest income, contd.:

#### Interest income, contd.:

	30.6.2016	30.6.2015
Interest expense on items not at fair value:		
Interest expense and indexation on bonds issued .....	27.524.144	30.587.732
Interest expense on other borrowings .....	108.654	139.639
Other interest expense .....	(109.518)	0
<b>Total interest expenses</b> .....	<u>27.523.280</u>	<u>30.727.371</u>
<b>Net interest income (expenses)</b> .....	<u>525.036</u>	<u>(473.408)</u>

\*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.

### 20. Other income

	30.6.2016	30.6.2015
Other income is specified as follows:		
Collection and service income* .....	45.111	76.678
Other income .....	5.402	441
	<u>50.513</u>	<u>77.119</u>

\* During the period, a new loan servicing software for the Fund's interest-bearing assets was adopted. The new software accrues revenue later than the discontinued software leading to a reduction in recognised income for the period of ISK 45 million.

### 21. Salaries and salary-related expenses

	30.6.2016	30.6.2015
Salaries and salary-related expenses are specified as follows:		
Salaries .....	380.933	337.074
Pension fund contributions .....	50.043	50.478
Tax on financial activity .....	21.058	20.220
Other salary-related expenses .....	64.314	37.978
Other personnel expenses .....	17.004	15.558
<b>Total salaries and salary-related expenses</b> .....	<u>533.352</u>	<u>461.308</u>

Number of employees at the Fund are specified as follows: 85                      95

On June 30, 2016, there were 87 employees on the Fund's payroll of which 11 employees have completed their duties for the Fund. A specific expense amounting to ISK 58.6 million was recognised due to those employees who have completed their duties in the period.

### 22. Other operating expenses

	30.6.2016	30.6.2015
Other operating expenses are specified as follows:		
Collection fees .....	90.335	92.709
Operating expenses of housing .....	60.283	66.019
Operating cost of IT systems .....	99.124	68.808
Audit and review of financial statements .....	14.288	16.798
Professional services .....	41.914	24.836
Real estate valuation .....	5.472	7.328
Advertising, promotional material and grants .....	18.879	683
Debtors' Ombudsman* .....	(52.345)	75.823
Financial Supervisory Authority .....	36.560	34.776
Credit rating .....	0	1.069
Service fees .....	14.312	12.233
Other operating expenses .....	16.182	18.789
<b>Total other operating expenses</b> .....	<u>345.004</u>	<u>419.871</u>

\* The Fund received a refund from the DO of overpaid fees for the years 2010 - 2011 which has been recognized to the extent that it will not increase costs in the year 2017. The amount recognised as income due to the reimbursement is ISK 106.6 million.

## Notes, contd.:

### 23. Depreciation and amortisation during the period:

Depreciation and amortisation is specified as follows:	30.6.2016	30.6.2015
Depreciation of operating assets (cf. note 13) .....	7.248	7.611
Amortisation of intangible assets (cf. note 14) .....	23.407	20.418
Total depreciation and amortisation .....	30.655	28.029

### 24. Net income of properties held for sale

Net income of properties held for sale is specified as follows:	30.6.2016	30.06.2015
Rental income from rented properties .....	436.350	578.723
Cost of properties held for sale .....	(389.541)	(472.659)
Net income of properties held for sale .....	46.809	106.064

The costs of real estate held 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 116.4 million during the period compared to ISK 94 million in 2015. Revenues exceeded expenses of properties held for sale in the amount of ISK (69.6) million, if taken into account the costs of the asset division (2015: ISK 12 million).

### 25. Impairment

Total impairment recognised in the income statement is specified as follows:	30.6.2016	30.6.2015
Specific impairment loss on loans (reversal of impairment loss).....	(736.205)	(199.873)
General impairment loss on loans (reversal of impairment loss).....	(41.361)	(369.646)
Impairment loss on loans (reversal of impairment loss).....	(777.566)	(569.519)
Impairment loss on properties held for sale (reversal of impairment).....	(611.460)	204.118
Impairment on other receivables (reversal of impairment loss).....	19.535	(4.582)
Total impairment cost (reversal of impairment cost).....	(1.369.491)	(369.983)

### 26. Profit (loss) of discontinued operations, net of tax

On June 26, 2016 a purchase agreement was signed for the sale of 100% of the shares of the subsidiary Leigufélagið Klettur. The agreement was subject to approval by the Competition Authority. The selling price amounted to ISK 10,101 million and covers both debt settlement with the Fund and consideration for the shares. Proceeds from the sale are recognised as a separate item on the balance sheet. The subsidiary was classified as assets held for sale and discontinued operations in the financial statements of the Fund at the end of 2015. Profit from the sale amounted to 831.7 million, when taken into account the operations of the subsidiary until May 2016 and is recognized in other comprehensive income.

Profit (loss) of discontinued operations, net of tax is as follows:	30.6.2016	30.6.2015
Rental income.....	274.310	304.456
Operating expenses of investment properties.....	(100.774)	(106.357)
Operating expenses .....	(40.970)	(50.189)
Valuation adjustment of investment properties.....	741.257	594.092
Net financial expenses.....	(129.419)	(179.526)
Income tax.....	(148.881)	(112.495)
Profit(loss) net of tax of subsidiary's operations.....	595.523	449.981
Gains from sale of rental company.....	831.667	0
Profit(loss) of discontinued operations, net of tax and cost of sale.....	1.427.190	449.981

\*Operations of Leigufélagið Klettur ehf. are included in the interim financial statements until the end of May 2016.

## Notes, contd.:

### 27. Rental agreements

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

	30.6.2016	31.12.2015
Payable within 1 year.....	112.429	112.195
Payable after 1 to 5 years .....	183.319	235.870
Total.....	295.748	348.065

### 28. Related parties

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 0.5 million on 30 June 2016 (2015: ISK 0.7 million) and are recognized as loans in the balance sheet.

Related party transactions:

	30.6.2016 Interest income	30.6.2016 Claims	30.6.2015 Interest income	31.12.2015 Claims
Leigufélagið Klettur ehf. ....	134.684	0	182.433	8.559.856

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

### 29. Other matters

#### SFF has filed a complaint against the ESA due to the decision to close the investigation of the Fund's operations

On 16 July 2014 EFTA Surveillance Authority ("ESA") made the decision to close its investigation of the Fund's operations. ESA was investigating the state aid benefitting the fund in the form of government guarantees on its funding and also the relief aid provided by the government to the Fund in the form of a capital injection to maintain the Fund's equity. The Icelandic Financial Services Association ("SFF") appealed this decision of ESA and the case was tried before the EFTA Court on 12 November 2015. The outcome reached in March 2016 resulted in the EFTA Court dismissing the appeal from the court and SFF standing by its decision from 16 July 2014 to close the investigation into the activities of the Fund.

#### Other matters

The Fund is a party to several disputes that are currently before the courts. The disputes vary in nature, such as appeals related to debt remedies, damages due to forced sales and sales of appropriated assets, disputes regarding penalty interests, disputes on the settlements of forced sales due to usufruct fees, etc. 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.