

Íbúðalánasjóður  
Housing Financing Fund  
Condensed  
Interim Accounts  
1 January - 30 June 2011

Íbúðalánasjóður  
Borgartúni 21  
105 Reykjavík

Reg. no. 661198-3629

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# Endorsement and Statement by the Board of Directors and the Managing Director

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The Condensed Interim Accounts of the Housing Financing Fund for the period January 1st to June 30th 2011 have been prepared in accordance with the International Financial Reporting Standard (IFRS) for interim accounts, IAS 34.

According to the income statement, the profit of the Fund amounted to ISK 1,562 million for the six months ended June 30th 2011. Equity amounted to ISK 10,131 million according to the balance sheet.

The Fund's equity ratio, calculated according to stipulations in the Rules on the Housing Financing Fund no. 544/2004, was 2.4% at the end of June 2011. The calculation of the ratio is equivalent to the calculation of the capital ratio of financial institutions. The long-term goal of the Fund is to keep the ratio above 5.0%

Operating expenses increased considerably compared to the same period of the year 2010, which is mainly caused by expenses due to appropriated assets and the Fund's increased activity related to execution and processing of payment resources for indebted homes and management of appropriated assets.

On 30 June, the Fund's loans amounted to ISK 779,807 million and increased by ISK 28,526 million from the beginning of the year. The Fund's borrowings amounted to ISK 837,891 million and increased by ISK 17,581 million during the period.

The allowance for impairment on loans amounted to ISK 34,026 million at the end of June 2011 and has decreased by ISK 4,778 million from the beginning of the year. Fair value changes of appropriated assets held for sale in the amount of ISK 2,058 million were recognised in the interim financial statements in addition to the ISK 2,002 million recognised due to impairment losses related to debt value in excess of property value upon repossession. This is done in order to compensate for the various conditions of properties repossessed by the Fund. On 30 June, the amount of ISK 1,080 million had been written off due to the 110% debt mitigation method. Applications for the 110% debt mitigation resulted to be around 5,000 instead of the estimated 9,400 homes entitled to receive such debt mitigation. A detailed analysis has been carried out on the balance of loans to legal entities on the basis of which impairment losses on loans to legal entities has been increased by in excess of ISK 4.0 billion.

From the beginning of the year, the Fund has repossessed 388 apartments on foreclosed mortgages and sold 80 properties. Apartments owned by the Fund numbered 1,377 at the end of the period. The apartments are recognised at estimated market value at the end of June. Of those assets 576 were rented or 42% of the Fund's properties held for sale.

Around 15.9% of the Fund's loans are in payment suspension or in default at the end of June compared to 15.6% at the beginning of the year. During the period, the ratio of those in payment suspension has decreased whereas loans in default have increased. Amounts in default on loans to individuals and legal entities have increased from 0.50% to 0.60% of the Fund's loans. Payments in default on loans to individuals have increased from 0.39% to 0.50% during the period. Defaults have increased during the period but around 7.8% of borrowers are in default with one or more maturities compared to 6.5% at the end of year 2010. Calculated outstanding balance of the Fund's loans in default for more than 90 days amounts to ISK 84.5 billion, thereof the defaulted amount is ISK 4.4 billion.

In the notes to the the Interim Accounts is a discussion on matters concerning ESA's observation regarding the Fund's operation and State Aid (see note 10).

# Endorsement and Statement by the Board of Directors and the Managing Director, contd.

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## **Statement by the Board of Directors and the Managing Director**

To the best of our knowledge the condensed interim financial accounts are in accordance with the International Financial Reporting Standard (IFRS) for interim accounts, IAS 34 and give a true and fair view of the financial performance of the Fund for the period January 1st to June 30th 2011, its assets, liabilities and financial position as at June 30th 2011 and its interim statement of cash flows for the period.

Further, in our opinion the condensed interim financial accounts and the endorsement by the Board of Directors and the Managing Director 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 Managing Director of the Housing Financing Fund have today discussed the Fund's financial statements for the six-month period ended June 30th 2011 and confirm them by means of their signatures.

Reykjavik, 31 August 2011

## **The Board of Directors of the Housing Financial Fund**

*Katrín Ólafsdóttir*  
*Elín R. Líndal*  
*Jóhann Ársælsson*  
*Lárus L. Blöndal*  
*Sjöfn Ingólfssdóttir*

## **The Managing Director**

*Sigurður Erlingsson*

# Independent Auditor's Review Report

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## **To the Board of Directors of the Housing Financing Fund.**

We have reviewed the accompanying condensed interim financial accounts of the Housing Financing Fund, which comprise the balance sheet as at June 30th, 2011 and the income statement, statement of changes in equity and statement of cash flows for the six-month period then ended, and a summary of significant accounting policies 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". Our responsibility is to express a conclusion on this interim financial information based on our review.

## **Scope of Review**

We conducted our review in accordance with International Standard on Review Engagements 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*. 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.

## **Conclusion**

Based on our review, nothing has come to our attention that causes us to believe that the accompanying condensed interim financial information is not prepared, in all material respects, in accordance with IAS 34 "Interim Financial Reporting".

## **Emphasis of matter**

Without qualifying our opinion, we would like to draw the attention to note no. 9, stating that the Fund's equity ratio, calculated according to provisions of the Rules on the Housing Financing Fund no. 544/2004, is 2.4% at the end of June 2011, but according to Article 7 of the Rules, the Fund shall set as a long-term goal to maintain its capital ratio over 5.0%. The Fund has in accordance with provisions of the aforementioned rules reported this fact to the Minister of Welfare.

Reykjavik, 31 August 2011

**KPMG ehf.**

*Margrét Guðjónsdóttir*

# Condensed Interim Income Statement for the Period from January 1st to June 30th 2011

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	Notes	2011 1.1.-30.6.	2010 1.1.-30.6.
Interest income .....		46.236.484	38.391.741
Interest expense .....		( 45.509.668)	( 38.103.387)
<b>Net interest income</b> .....	5	726.816	288.354
Other income .....	6	286.341	214.214
<b>Total operating income</b> .....		1.013.157	502.568
Salaries and salary-related expenses .....		304.041	235.143
General operating expenses .....		617.633	429.813
Depreciation and amortisation .....		32.721	25.810
<b>Total operating expenses</b> .....		954.395	690.766
<b>Net operating income</b> .....		58.762	( 188.198)
Impairment of assets .....	8	1.503.047	( 1.492.101)
<b>Net profit (loss) for the period</b> .....	9	1.561.809	( 1.680.299)

## Condensed Interim Balance Sheet as at June 30th 2011

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	Notes	30.6.2011	31.12.2010
<b>Assets</b>			
Cash and cash equivalents .....		6.574.667	23.826.463
Restricted cash .....		8.783.722	8.331.053
Receivable due from State Treasury .....		0	33.000.000
Market securities .....		38.437.266	0
Loans to banks .....		3.214.098	4.036.715
Loans to customers .....		779.806.687	751.280.719
Properties held for sale .....	7	17.319.785	15.029.172
Operating assets .....		50.490	54.743
Intangible assets .....		166.886	189.022
Other assets .....		273.257	215.954
<b>Total assets</b>		854.626.858	835.963.841
 <b>Liabilities</b>			
Bond issued .....		837.890.983	820.310.099
Other borrowings .....		6.320.337	6.666.266
Other liabilities .....		284.455	418.202
<b>Total liabilities</b>		844.495.775	827.394.567
 <b>Equity</b>			
Contributed capital .....		40.155.408	40.155.408
Accumulated deficit .....		( 30.024.325)	( 31.586.134)
<b>Total equity</b>	9	10.131.083	8.569.274
<b>Total liabilities and equity</b>		854.626.858	835.963.841

## Condensed Interim Statement of Changes in Equity for the Period from January 1st to June 30th 2011

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	<b>Contributed capital</b>	<b>Retained earnings (accumulated deficit)</b>	<b>Total equity</b>
<b>Changes in equity from January 1st to June 30th 2010:</b>			
Equity as at January 1st 2010 .....	7.155.408	2.927.188	10.082.596
Net loss for the period .....		( 1.680.299 )	( 1.680.299 )
Equity as at June 30th 2010 .....	7.155.408	1.246.889	8.402.297
<b>Changes in equity from January 1st to June 30th 2011:</b>			
Equity as at January 1st 2011 .....	40.155.408	( 31.586.134 )	8.569.274
Net profit for the period .....		1.561.809	1.561.809
Equity as at June 30th 2011 .....	40.155.408	( 30.024.325 )	10.131.083



## Condensed Interim Statement of Cash Flows for the Period from January 1st to June 30th 2011

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	<b>Notes</b>	<b>2011</b>	<b>2010</b>
		<b>1.1.-30.6.</b>	<b>1.1.-30.6.</b>
<b>Net cash used in operating activities</b> .....	(	7.307.773)	( 13.238.081)
<b>Net cash provided by (used in) investing activities</b> .....		483.636	( 49.513)
<b>Net cash (used in) provided by financing activities</b> .....	(	10.427.659)	19.070.993
<b>Net (decrease) increase in cash and cash equivalents</b> .....	(	17.251.796)	5.783.399
<b>Cash and cash equivalents at the beginning of the year</b> .....		23.826.463	28.384.685
<b>Cash and cash equivalents at the end of the period</b> .....		<u>6.574.667</u>	<u>34.168.084</u>

# Notes to the Condensed Interim Accounts

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## **1. Reporting entity**

The Housing Financing Fund ("the Fund") is domiciled in Iceland. The address of the Fund's registered office is Borgartún 21, Reykjavik. The Fund's objectives are to provide housing loans, loans for new constructions and property development in Iceland. The Housing Financing Fund is an independent institution owned by the State operating under the Housing Fund Act no. 44/1998, and appertains to a special management and the Minister of Welfare. According to the law, the Icelandic State Treasury has unlimited and unambiguous responsibilities for all of the Fund's financial obligations.

The condensed interim accounts of the Housing Financing Fund were approved by the Board of Directors on August 31st 2011.

## **2. Statement of compliance**

The condensed interim accounts 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 December 31st 2010.

## **3. Significant accounting policies**

The accounting policies applied by the Fund in these condensed interim accounts are the same as those applied by the Fund in its annual financial statements as at and for the year ended December 31st 2010. The financial statements are available on the Fund's homepage; [www.ils.is](http://www.ils.is) as well as on the Icelandic stock exchange's homepage; [www.omxnordicexchange.com](http://www.omxnordicexchange.com).

The condensed interim accounts are presented in Icelandic Krona (ISK) which is the Fund's functional currency. All amounts are rounded to the nearest thousand unless otherwise stated. They have been prepared on historical cost basis except that assets held for sale are recognised at the lower of book value or net fair value.

## **4. Use of estimates and judgements**

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

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

## Notes, contd.:

### 5. Net interest income

	<b>2011</b>	<b>2010</b>
	<b>1.1.-30.6.</b>	<b>1.1.-30.6.</b>
<b>Interest income</b>		
Interest income on deposits .....	767.732	1.240.262
Interest income on loans to customers .....	44.473.982	36.830.030
Government contribution to subsidy interests .....	279.845	249.672
Interest income on market securities .....	714.925	71.777
Total interest income .....	<u>46.236.484</u>	<u>38.391.741</u>
<b>Interest expenses</b>		
Interest expenses on bond issue .....	44.998.417	37.482.053
Interest expenses on other borrowings .....	511.251	621.334
Total interest expenses .....	<u>45.509.668</u>	<u>38.103.387</u>
<b>Net interest income</b> .....	<u>726.816</u>	<u>288.354</u>

### 6. Other income

Service fee income .....	83.405	135.587
Rental income on apartments repossessed .....	202.936	78.627
Total service fee income .....	<u>286.341</u>	<u>214.214</u>

### 7. Properties held for sale

At the beginning of 2011 there were 1,069 properties owned by the Fund. During the first six months of the year 2011 the Fund repossessed 388 properties and sold 80 properties. Thus 1,377 properties are owned by the Fund at 30 June 2011. Thereof 576 properties are rented out or 42% of total properties owned by the Fund. Income and expenses during the period in relation to properties held for sale are specified as follows:

Rental income (from rented properties) .....	(202.936)	(78.627)
Services and other expenses (due to all properties for sale ) .....	266.797	99.648
Expenses in excess of income from properties held for sale .....	<u>63.861</u>	<u>21.021</u>

### 8. Loans

Impairment losses on loans during the period are specified as follows:

	<b>Specific impairment</b>	<b>General impairment</b>	<b>Total</b>
<b>1.1. - 30.6. 2011</b>			
Balance at the beginning of the year.....	37.151.590	1.651.803	38.803.393
Decrease in provision for impairment losses.....	(3.479.069)	(82.174)	(3.561.243)
Loans write off.....	( 1.142.320)	( 74.282)	( 1.216.602)
Balance at 30.6.2011.....	<u>32.530.201</u>	<u>1.495.347</u>	<u>34.025.548</u>
Allowance account as percentage of loans.....			4,18%

## Notes, contd.:

### 8. Loans, contd.

	Specific impairment	General impairment	Total
<b>1.1. - 30.6. 2010</b>			
Balance at the beginning of the year.....	2.346.835	1.097.510	3.444.345
Provision for impairment losses.....	569.177	104.311	673.488
Loans write off.....	( 50.843)	( 51.030)	( 101.873)
Balance at 30.6.2010.....	<u>2.865.169</u>	<u>1.150.791</u>	<u>4.015.960</u>

Allowance account as percentage of loans..... 0,51%

Total impairment in the Interim Income Statement is as follows:

	<b>2011</b>	<b>2010</b>
	<b>1.1.-30.6.</b>	<b>1.1.-30.6.</b>
Reversal of provision for impairment losses on loans to individuals.....	10.698.731	0
Provision for impairment losses on loans to legal entities.....	(4.000.884)	0
Decrease (increase) in provision for general impairment losses.....	82.174	(673.488)
Provision due to properties held for sale.....	(2.002.178)	(716.740)
Write off due to the 110% debt mitigation and loans written off.....	(1.216.602)	(101.873)
Fair value changes of properties held for sale.....	(2.058.194)	0
Total impairment during the period.....	<u>1.503.047</u>	<u>(1.492.101)</u>

In the year 2010, a provision was recognised due to write down of loans to customers to 110% of the rateable value or the evaluation of the properties. As stated in the financial statements of the Fund for the year 2010, it was assumed that the write down would involve around 9,400 homes and could amount to up to ISK 22,762 million. Furthermore, it was stated that calculation of the write down was based on various assumptions, some of which were evaluated and a reservation made regarding the final amount. The time limit to apply for a 110% debt mitigation expired on 30 June 2011. Around 5,000 applications were received or around 4,400 fewer than what had been assumed. In addition, the average write down amount for each application was quite lower than expected. Finally, fewer applications met with the conditions for debt mitigation than expected.

Previously recognised provision due to impairment losses on loans to customers has been reversed in the interim financial statements based on changed assumptions on the effect of the 110% debt mitigation method. Reversed previous provision amounts to ISK 10,699 million.

### 9. Equity

The Fund's long term objective is to maintain a capital ratio over 5.0%. The calculation of the capital ratio is in accordance with international rules (Basel II). If the Fund's capital 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 make proposals of ways to reach the long term capital ratio goal.

Capital ratio is specified as follows:	<b>30.6.2011</b>	<b>31.12.2010</b>
Total equity .....	<u>9.964.193</u>	<u>8.380.252</u>
Total capital ratio is as follows:		
Credit risk .....	32.506.863	30.226.708
Market risk .....	82	77
Operational risk .....	442.057	446.646
Total capital requirements .....	<u>32.949.002</u>	<u>30.673.431</u>
Capital ratio .....	2,4%	2,2%

## Notes, contd.:

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### 10. Other matters

#### **Housing Affairs Complaint Committee**

In the year 2010, the Housing Affairs Complaint Committee ruled in two cases where the conclusion is that the Housing Financing Fund's Board of Directors was not authorised to insist upon a letter of credit for loans to contractors during a period when a clause regarding loans to contractors and letters of credit in the regulation on housing bonds and housing bond transactions had been suspended. The period in question is from February 21, 2008 to April 24, 2009, during which the Board of Directors' work procedures were in effect regarding evaluation of debtor's ability to pay and mortgage eligibility, wherein a requirement was made for a letter of credit for loans to contractors. The rules were published on the website of the Fund along with other rules of procedures regarding pledgeability and credit evaluation, which the Board is to establish according to the Housing Act. The District Court of Reykjavik ruled in one such case on 8 June 2011 in case no. E 5841/2010. The ruling confirms the ruling of the Housing Affairs Complaint Committee. However, in the ruling it is specifically stated that this does not affect the validity of the guarantees. The ruling will be appealed to the Supreme Court but the Fund's interests based on the conclusion are considered to be material. If the verdict is unfavourable for the Fund it is likely that it will have to repay all contractors' cost from letters of credit. Repayments could amount to approximately ISK 200 - 300 million.

#### **Investigation of Housing Financing Fund**

On December 17, 2010 the Icelandic parliament approved a proposed parliamentary resolution on an investigation on the Housing Financing Fund, in which the Parliament concludes that an independent investigation be carried out on the operations of the Housing Financing Fund. The investigation will concern the operations of the Fund from the events leading up to changes of financing and credit rules implemented from the year 2004 and until end of 2010. The aim with the investigation will first of all be to evaluate the effect of these changes, policy of the Fund and individual decisions during this period on the financial position of the Fund and real-estate market in whole; secondly to evaluate the effect of the operations of the Housing Financing Fund on economic management; and thirdly to evaluate how well the Fund has managed to attend its statutory role during this time. Following the investigation, there will be a comprehensive revision of the policy and operations of the Fund as well as the financing of the housing credit system in Iceland. The investigation shall be carried out in accordance with provisions of a bill to law about investigative committees submitted by the Prime Minister's committee, but the bill has not been passed.

#### **ESA**

In June 2008, the ESA (EFTA Surveillance Authority) announced to the Icelandic authorities that the operation of The Housing Financing Fund consists in a State aid, which is not in conformity with the rules on State aids of the EEA Agreement and that the Icelandic government was obliged to adapt the operation of the Fund to those rules. The State aid to the Fund is considered to consist in unlimited state guarantee, exemption from taxation and that the state, as the Fund's owner, has not set requirements on the Fund's operating return. This conclusion is based on the fact that the Fund operates on an open market and that its loans are not limited to a specific social role. The Government is now comprehensively reviewing its housing policy and has expressed that in that review the ESA comments will be taken into consideration when defining the role for the Housing Financing Fund. The Fund is working on the implementation of changes and has requested to extend the deadline until the end of September when the Fund will deliver results regarding the financial restructuring due to capital contribution.

Furthermore, ESA has recently reached the conclusion that provisions of the Emergency Act on the Fund's acquisition of financial institutions' bond portfolios is to be considered as government subsidy as it is not guaranteed that the portfolios were acquired on market value. ESA invited the Icelandic authorities to demonstrate that the acquisition of every single portfolio was made on market condition, or else redeem possible government subsidies. The Fund is preparing a memorandum to ESA on an analysis of the value of loan portfolios