Housing Financing Fund

Financial Statements 2018

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 and CEO

The Housing Financing Fund ("the Fund") has its headquarters at Borgartún 21, Reykjavík and has 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 organization of housing affairs, an environment of security and equal rights in housing affairs for citizens. The main activities of the Fund are providing loans for the purchase and construction of housing, granting capital contributions for the purchase and construction of rental housing for low-income families and individuals, providing housing benefits to tenants, and collecting information, researching, and performing analyses of the housing market to support the government’s policy formulation in housing affairs. The Housing Financing Fund is an independent government-owned institution.

The Fund’s Financial Statements are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and additional disclosure requirements for companies that have their securities listed on the international securities market.

Results for the year 2018

The results of the Housing Financing Fund's operations according to the income statement were negative in the amount of ISK 313 million, compared to an operating surplus of ISK 1,426 million in 2017. Equity at year-end amounted to ISK 22,083 million. The Fund's equity ratio is 8.9%. The Fund's long-term objective is to maintain an equity ratio over 5% in accordance with the Regulation no. 544/2004 on the Finances and Risk Management of the Housing Financing Fund.

Operations in 2018

Net interest income during the year was negative by ISK 1,486 million compared to positive net interest income amounting to ISK 1,698 million during the year 2017. The turnaround of interest income between 2017 and 2018 is largely a result of increasing inflation as the Consumer Price Index rose by 1,73% in 2017 compared to 3,25% in 2018. Part of the explanation is also due to the loss of interest income resulting from the principal reduction of indexed mortgage loans, cf. Act no. 35/2014 as the Fund has been unable to reach an agreement with the Treasury to compensate for the loss of interest income due to the reduction on an annual basis. However, there is a letter from the Ministry of Welfare dated 19 December 2014, which states the common understanding of both the Minister of Social Affairs and the Minister of Finance that the Housing Financing Fund would be compensated for the negative impact the measures have had on the Fund. The Treasury has already contributed ISK 1.658 million to compensate for lost interest income resulting from the principal reduction, but further payments have not been made, however, due to the Fund's adequate equity and liquidity positions. The government has declared that it upholds previous statements regarding compensation, but that while the Fund's equity and liquidity is strong there is no need for further payments at this time.

Prepayment fees are included in interest income for the year. The significant number of prepayments in the year have a negative impact on the development of interest income and increase the Fund's reinvestment risk, however the Fund earns a considerable amount of income from prepayments fees, thereby mitigating the effects of prepayments. Operating expenses for the year amounted to ISK 1,935 million, increasing by 13% compared to the year 2017. Increased operating costs can be attributed to the fact that the Housing Financing Fund has enlisted 15 new employees following the take over of the operations of housing benefits on 1 January 2018. The operations of housing benefits are financed by the fiscal budget. During the year, the Housing Financing Fund made payments amounting to ISK 121 million for the operations of government agencies, the Debtor's Ombudsman, and the Financial Supervisory Authority or the equivalent of 15% of the other operating expenses of the Fund.

The interest income loss due to principal reductions of loans is calculated on a yearly basis as the difference between the expected interest income on loans that were adjusted and the real return on the Fund's liquid assets in the previous year. The calculations take into account that the relevant loans would have otherwise been subject to traditional subsidy payment processes, or would have been prepaid before the final maturity date. Accrued interest income not recognized as income amounts to ISK 1,137 million.

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

Operations in 2018, contd.

Arrears now amount to 1.8% of total loans, compared to 2.1% at year-end 2017. Leigufélagið Bríet ehf., established by the Fund during the year, purchased 251 appropriated properties from the Fund after the reporting date. Concurrent to the establishment of the rental company, the Fund reclassified these 251 appropriated properties to investment properties in its Financial Statements, a capital investment amounting to ISK 6,045 million. At the end of the year, capital invested by the Fund in appropriated properties is therefore ISK 431 million. The Fund owned 36 appropriated properties at the end of the year, of these 1 was a rental and 30 were for sale or unoccupied.

Operations and risk factors

Increased challenges exist in the Fund's operations as continuing prepayments of the Fund's loans have a major impact on net interest income. As the proportion of financial assets outside of the loan portfolio increases, the mismatch of the Fund's assets and liabilities increases which has a negative effect on the Fund's performance, as reflected in these financial statements. At the end of the year ISK 311 billion or 42% of the Fund's assets were outside of its loan portfolio (including liquid assets), which has a negative impact on the Fund's interest margin. However, the Fund has accumulated liquid assets in order to meet the outstanding cash flows of outstanding debt in the foreseeable future, in addition to which government authorities have declared that in the event that HFF's capital ratio becomes less than the statutory criteria, the government will contribute capital to the Fund. The current equity ratio is 8.9%.

As prepayments to the Fund have increased, the administration and investment on assets outside the loan portfolio has become a significant part of the Fund's activities and the Board's duties. The Board of Directors determines the Fund's investment policy and risk appetite in accordance with law and rules applicable to the Fund's activities. Risk management is an important and integral part of the Fund's operations, but while credit risk has diminished due to improved economic conditions, reduced defaults and loans, and improved collateral positions the projects of risk management and the risk committee of the Board have increasingly focused on financial management and the formulation of a responsible investment strategy with the aim of ensuring that the Fund is operational in the long term and able to meet its commitments in a changed business environment.

The Fund is not permitted to repay its debts (financing) before maturity and therefore has to reinvest funds received from prepayments of loans at lower interest rates. The Fund's debt is settled gradually according to terms but has a lifetime until 2044, which is the final maturity date of the debt. New lending is also insignificant as the Fund now only provides social loans. The Fund is therefore limited when it comes to lending and therefore almost all funds received due to prepayments are allocated to assets outside of the loan portfolio.

The objective of the strategy and asset management of assets outside the loan portfolio is to minimize the imbalance of assets and liabilities. The main challenges in managing assets outside of the loan portfolio are interest rate and inflation risk, as well as the extent and size of assets outside of the loan portfolio. Inflation risk arises from the fact that the Fund's debt is indexed, while a portion of the assets is non-indexed. The Fund's treasury policy is prudent which is reflected in the Fund's investments. Assets outside the loan portfolio have, among others, been invested in asset-backed indexed bonds with similar payment paths to increase the balance between the debt and assets of the Fund and thus reduce the loss due to prepayments.

Following the proposals of a working group appointed by the Minister of Social Affairs and Children on how the public sector can reduce the risk of the HFF's future operations due to the significant increase in prepayments of loans, it has been decided to legally separate the Housing Financing Fund's activities relating to policy formulation and implementation of housing affairs from the activities of the Fund relating to financial management of its financing and former lending. The decision on the appointment of the working group came after a legislative amendment by the newly-formed parliament where the Housing Financing Fund was changed to a government authority in the field of housing, a Nordic model of a housing agency. The working group was tasked with finding solutions to the problems that have arisen within the Housing Financing Fund due to a significant increase in prepayments in recent years.

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

Operations and risk factors, contd.:

The management and magnitude of funds as a result of prepayments of loans has become an extremely significant part of HFF's operations, and such administration is poorly suited to its current role as a constructor of housing affairs and a government control mechanism in housing policy formulation, analysis and management of public housing support. It is therefore important to separate the activities related to the management of funds from housing issues and to find the activities an acceptable path within the administrative system. The first step in this project was the decision taken by the Board of the Fund to separate the accounts and divide the activities of the Fund into two separate segments. In addition to the legal separation, it is proposed that the Board appoint an investment counsel with representatives from the Central Bank, the Ministry of Finance and Economic Affairs, the Housing Financing Fund, the Ministry of Social Affairs and thus ensure the involvement of the parties responsible for fiscal policy. In this way, it will be best ensured that the processing and management of risk will be effective, as the government has more resources to reduce its risk. When implementing legal separation, it is assumed that a new Housing Agency will be separated from the Housing Financing Fund so that the Fund's balance sheet will remain unchanged, except that social loans will be part of the Housing Agency which issues bonds to the Housing Financing Fund as compensation.

Housing Financing Fund becomes Housing Agency

In recent years, the Housing Financing Fund's activities have been evolving from being a traditional credit institution into being an authority in the field of housing affairs. This change in the role of the Fund was enacted in June 2018 by Act no. 65/2018. The role of the Housing Financing Fund is therefore comparable to the role of the Fund's sister institutions, Husbanken, in Norway and ARA in Finland. Following the changes, the Housing Financing Fund has become an authority that handles the implementation and coordination of housing issues throughout the country.

The role of the Housing Financing Fund as a housing institution will involve among other things:

- carrying out the implementation of public housing support: individuals' loans, loans to municipalities and non-profit rental companies, housing benefits and initial contributions, etc.
- managing municipal housing plans and assessing the need for housing development
- planning, researching and analysing housing affairs
- performing a coordinating role and cooperating with municipal governments on housing affairs
- managing housing information in a central housing base and communicating information to the public and other stakeholders

The government set up a task force in December of 2018 on increasing the supply of apartments and other measures to improve the situation in the housing market. The task force was part of the government's dialogue with confederate labor market organisations regarding wage agreements. The Housing Financing Fund played a significant role in this dialogue confirming its changed role. In addition to appointing a representative of the Housing Financing Fund, the terms of reference of one of the chairmen of the group implied that he would work with the Housing Financing Fund to prepare proposals for housing measures. The group submitted its proposals in January 2019 and there was a broad concensus on its conclusions.

The Housing Financing Fund also participated in a task force appointed by the Minister of Social Affairs and Children in 2018 on implementing specific measures to assist young and low-income people in buying private housing. The government's political agreement states that measures will be taken to assist young people and low-income individuals to enter the housing market. To this end, public sector support systems should be revised so that support is primarily benefits these groups. The task force worked with the Housing Financing Fund on the implementation of these measures, in addition to which the Fund had a representative in the group.

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

Governance

The Board of Directors of the Housing Financing Fund believes that good corporate governance is the basis for responsible and honest communications between the owner, the Board, management, employees, customers and other stakeholders, promoting trust, transparency and credibility in management of the Fund. In addition to abiding by legislation on housing and administrative procedures, the Fund operates partly under the provisions of Act no. 161/2002 on financial undertakings, rules and guidelines of the FSA, Central Bank and various other provisions on the financial markets. The Fund operates as according to an organizational structure and emphasis is placed on simplifying and clarifying the division of labor. Job descriptions are available for all job positions and employee communication channels are effective. The entire structure of the Fund, and its procedures, are designed to ensure the avoidance of conflicts of interests in its activities and ensure transparency and accountability in the management of the Fund.

The Board of the Fund is composed of five members and an equal number of alternates as according to Article 7 of the Housing Act. The Board operates in accordance with rules of procedure which define its functions. The rules define its practices, qualifications, meetings and separation of duties between the Board and CEO. The rules are available on the Fund's website. There are no related interests between the Board and the Fund's major customers and board members submit information on related interests yearly. The Board has been involved in the making of a Rule Book containing all the rules that the Board is by law entrusted to set, and frames the powers and procedures of the Fund's operations. Furthermore, the Board has formulated the Fund's risk profile and treasury management strategy that establishes the risk appetite of the operations and control aspects of liquidity management.

The Board hires the CEO and appoints a Compliance Officer pursuant to the terms of reference. The CEO oversees the daily operations of the Fund and at least twice a year the Compliance Officer presents a report to the Board on the matters within the scope of his responsibilities. The Board meets regularly with the auditors of the Fund. The Board of Directors monitors that the reporting to the Financial Supervisory Authority, Central Bank and other regulatory authorities is as in accordance with laws and regulations. The Board also makes decisions regarding matters that are unusual and extraordinary.

The Executive Board is composed of six members in addition to the CEO. The Board deliberates on major decisions and makes recommendations on policy decisions to the Board of Directors. Six 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 recommends proposals to the Board regarding changes to the authorisation of treasury management. The Quality and Security Committee addresses quality systems and information security. The Fund has received ISO 27001 Information Security Standard verification four times since first implementing the standard in 2012. The Lending Committee discusses and makes decisions on lending, the Payment Difficulty Committee manages matters regarding payment difficulties. The Evaluation Committee on capital contributions evaluates capital contribution applications and the Allocation Committee makes decisions on allocation. The Fund has adopted policies on human resources, environmental, safety, archives, and quality assurance, a policy and program against bullying and sexual harassment as well as equal rights policies. In addition, the Fund has implemented a policy and action plan in gender equality issues and has received an equal pay certification.

Three committees operate under the mandate of the Board. The Audit Committee has the statutory monitoring role of the audit of the Fund, among other factors, such as the effectiveness of risk management. The committee 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, the CEO and Deputy CEO. The main objective of the committee is to develop and simplify the operations of the Fund. Then, acting on behalf of the Board is the Risk Committee, consisting of two Board members and one external expert. The committee addresses operational risks and risk management as well as other matters referred to it by the Board. The Board receives copies of the minutes of the meetings of the above-mentioned committees.

The Housing Financing Fund is committed to maintaining reliable financial accounts and has defined responsibilities emphasising the segregation of duties, regular reporting to the Board and transparency in carrying out duties. Monthly figures are reviewed by the Board and the Executive Committee which is an important control factor in the operations of the Fund.

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

Governance, contd.:
In 2018, the Board held 13 board meetings. The proportion of women on the Board of the Fund is 40% and the proportion of men is 60%. According to law, the Fund's Board is appointed by the Minister after each general election, for a term of four years. The Board of Directors and the Executive Board adhere to a certain policy on diversity with regards to factors such as age, sex and educational or professional background.

The Board of the Fund was appointed in September 2018. Haukur Ingibergsson was appointed chairman at the beginning of 2018, and at the same time Ásta Pálmadóttir was appointed as board member. Dírfa Snædal resigned as board memeber of the Housing Financing Fund during the year and was replaced by Elín Oddný Sigurðardóttir.

In 2018, the following persons were members of the Board of the Fund:
- Haukur Ingibergsson, from September 2013
- Dírfa Snædal, from January 2014 to September 2018
- G. Valdimar Valdemarsson, from October 2014
- Sigurbjörn Ingimundarson, from December 2015
- Ásta Björg Pálmadóttir, from January 2018
- Elín Oddný Sigurðardóttir, from September 2018

Statement by the Board of Directors and the CEO
The Financial Statements of the Housing Financing Fund for 2018 are prepared in accordance with International Financial Reporting Standards as adopted by the EU and additional disclosure requirements for companies that have securities listed on a regulated market.

According to the best of our knowledge, it is our opinion that the Financial Statements give a true and fair view of the financial performance of the Fund for the year 2018, its assets, liabilities, and financial position as at 31 December 2018 and changes in cash flows for the year 2018.

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 Financial Statements for the year 2018 and hereby confirm them by means of their signatures.

Reykjavik, 29 March, 2019.

Board of Directors:

Haukur Ingibergsson, Chairman of the Board

Elín Oddný Sigurðardóttir

Sigurbjörn Ingimundarson, Vice-President of the Board

Ásta Pálmadóttir

G. Valdimar Valdemarsson

CEO:

Hermann Jónasson

Independent Auditor's Report

To the Board of Housing Financing Fund

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of Housing Financing Fund (“the Fund”), which comprise the statement of financial position as at December 31, 2018, the statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Company as at December 31, 2018, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and additional disclosure requirements for listed companies in Iceland.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of financial statements in Iceland and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Matter

The financial statements of the Company as at and for the year ended December 31, 2017 were audited by another auditor who expressed an unmodified opinion on those statements on 19 March 2018.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key Audit Matters	How the matter was addressed in the audit
Impairment of loans and adoption of IFRS 9. On 1 January 2018 the fund implemented a new international financial statements standard no. 9, IFRS 9 - Financial Instruments. This standard replaces IAS 39. IFRS 9 sets out new requirements for recognising and measuring financial assets and financial liabilities. The standard also influence the selection of implementation methods. The adoption of IFRS 9 brings fundamental changes to the accounting for measure, presentation and disclosure relating to loans. The full impact of adopting the standard is set out by management in Note 3a. At year end the loans amounted to ISK 426,889 million or 57.3% of total Fund's assets. The impairment of loans at year end amounted to ISK 7,051 million.	We along with our valuation specialists audited the adoption of IFRS 9 and the calculation of impairment of loans in accordance with IFRS 9. This work included among other things: • We assessed if the appropriateness of accounting policies and disclosure du to adoption of IFRS9, valuation of loans at year end and the appropriateness of loans and its compliance with IFRS 9. • Management procedures for definition of contracts estimated based on new methods after the adoption of the standard and we obtained understanding of new and updated processes, systems and controls which management had implemented for the estimation of impairment. • We tested controls for assessment of impairment of loans among appropriated IT controls. • We assessed the appropriateness and assumptions for key decisions and management accounting estimates for the adoption and the assessment of impairment at year end.

Independent Auditor's Report, contd.

Key Audit Matters, contd.

Key Audit Matters	How the matter was addressed in the audit
Impairment of loans and adoption of IFRS 9, contd.:	
The Fund's accounting policies for impairment of loans are summarised by management in note 31e and the changes to impairment is disclosed in note 11. We identified impairment of loans as key audit matter in our audit because of adoption of IFRS 9 and as the underlying assumptions used for the estimate of impairment involves management judgement and are partly subjective. Main assumptions and risks related to the valuation are: • New approach for estimation of expected credit loss (ECL) and its measure. • New or updated processes, systems and controls which have not been tested before. • Modelling risk for ECL (for example inappropriate method or decisions). • Appropriateness and reliability of data used for the estimation of ECL. • Estimation uncertainty due to inappropriate management change to the model after initial setup.	• We estimated the completeness, accuracy and the appropriateness of the data used for recording of impairment and disclosure on the adoption and impairment at year end. • We reviewed and assessed the Funds' calculation for impairment of loans. We tested if the approaches used by the Found for valuation of impairment were in accordance with the requirements of IFRS 9. • We assessed if the accounting policies were in conformity with the requirements of IFRS 9 and our understanding of the Funds' operation. • We assessed if the mathematic models were appropriated and we tested their accuracy. • We reviewed if the information in the notes to the financial statements were in conformity to information required by applicable accounting policies.

Responsibilities of the Board of Directors and CEO for the Financial Statements

The Board of Directors and CEO are responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs as adopted by the European Union and additional disclosure requirements for listed companies in Iceland, and for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Board of Directors and CEO are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

The Board of Directors and CEO are responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Independent Auditor's Report, contd.

Auditor's Responsibilities for the Audit of the Financial Statements, contd.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Company’s internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management’s use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company’s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor’s report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor’s report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with The Board of Directors and audit committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide The Board of Directors and audit committee with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with The Board of Directors and audit committee, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor’s report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Other Legal and Regulatory Requirements

Pursuant to the legal requirement under Article 104, Paragraph 2 of the Icelandic Financial Statement Act No. 3/2006, we confirm that, to the best of our knowledge, the report of the Board of Directors and CEO accompanying the financial statements includes the information required by the Financial Statement Act if not disclosed elsewhere in the financial statements.

The engagement partner on the audit resulting in this independent auditor’s report is Helgi F. Arnarson.

Reykjavik, 29 March, 2019.

KPMG ehf.

Income Statement and Statement of Comprehensive Income for the year 2018

	Notes	2018	Restated 2017*
Interest income		53.285.808	46.753.817
Interest expense		(54.771.682)	(45.055.918)
Net interest (expense) income	20	(1.485.874)	1.697.899
Other income	21	432.848	203.976
Total operating income		(1.053.026)	1.901.875
Salaries and salary-related expenses	22	1.023.209	825.273
Other operating expenses	23	797.424	800.192
Depreciation and amortisation	25	114.013	80.490
Total operating expenses		1.934.646	1.705.955
Net income from appropriated properties	26	204.133	157.881
Net operating (expenses) income		(2.783.539)	353.801
Increase in value of loans, securities and appropriated properties	27	2.471.015	1.068.962
(Loss)/profit for the year and total comprehensive income		(312.524)	1.422.763

*Refer to note 3b.

The notes on pages 14 to 39 are an integral part of these Financial Statements.

Financial Statements of the Housing Financing Fund 2018 10 Amounts are in ISK thousand

Statement of Financial Position as at 31 December 2018

	Notes	2018	Restated 2017*
Assets			
Cash and cash equivalents	6	76.827.449	66.608.413
Claims on financial institutions	7	21.050.909	6.891.793
Marketable securities	8	0	11.249.780
Other securities	9	212.149.874	163.655.406
Receivable from State Treasury	10	1.330.355	6.107.495
Loans	11	426.888.831	499.989.109
Appropriated properties	12	431.091	6.631.138
Investment properties	13	6.044.575	0
Operating assets	14	150.405	150.269
Intangible assets	15	85.500	166.005
Other assets	16	691.566	477.339
Total assets		745.650.554	761.926.747
Liabilities			
Bond issues	17	722.915.782	737.182.714
Other borrowings	18	139.417	818.745
Other liabilities	19	512.076	317.178
Total liabilities		723.567.275	738.318.637
Equity			
Contributed capital		57.655.408	57.655.408
Accumulated deficit		(35.572.129)	(34.047.298)
Total equity		22.083.279	23.608.110
Total liabilities and equity		745.650.554	761.926.747

*Refer to note 3b.

The notes on pages 14 to 39 are an integral part of these Financial Statements.

Financial Statements of the Housing Financing Fund 2018 11 Amounts are in ISK thousand

Statement of Changes in Equity for the year 2018

Year 2018	**Notes**	**Contributed capital**	**Accumulated deficit**	**Total Equity**
Equity as at 31 December 2017		57.655.408	(32.761.719)	24.893.689
Adjustment of bond issues*			(1.285.579)	(1.285.579)
Adjusted equity as at 31 December 2017		57.655.408	(34.047.298)	23.608.110
Impact of adopting IFRS 9 on 1 January 2018			(1.865.803)	(1.865.803)
Equity as at 1 January 2018		57.655.408	(35.913.101)	21.742.307
Reclassification of investment properties			653.496	653.496
Loss for the year and total comprehensive loss			(312.524)	(312.524)
Equity as at 31 December 2018		57.655.408	(35.572.129)	22.083.279

Year 2017	**Contributed capital**	**Accumulated deficit**	**Total Equity**
Restated*			
Equity as at 31 December 2016	57.655.408	(34.127.566)	23.527.842
Adjustment of bond issues		(1.342.495)	(1.342.495)
Equity as at 1 January 2017	57.655.408	(35.470.061)	22.185.347
Profit for the year and total comprehensive income	0	1.422.763	1.422.763
Equity as at 31 December 2017	57.655.408	(34.047.298)	23.608.110

*Refer to note 3b.

The notes on pages 14 to 39 are an integral part of these Financial Statements.

Amounts are in ISK thousand

Statement of Cash Flows for the year 2018

	2018	Restated 2017
Operating activities		
Profit/(loss) for the year and total comprehensive income	(312.524)	1.422.763
Adjusted for:		
Indexation on claims on financial institutions and loans	(21.751.036)	(12.221.927)
Indexation on borrowings	23.750.360	12.939.317
Depreciation and amortisation	114.013	80.490
Increase in value	(2.471.015)	(1.068.962)
Fair value changes of marketable securities	0	(409.356)
Changes in operating assets and liabilities:		
Loans	86.859.091	88.612.645
Appropriated properties	3.038.687	4.161.575
Receivable from State Treasury	4.898.047	513.975
Other assets	(255.352)	205.954
Other liabilities	194.897	(393.967)
Cash flows from operating activities	94.065.168	93.842.506
Investing activities		
Investment in shares of subsidiary	(500)	0
Claims on financial institutions, changes	(13.704.890)	(6.765.478)
Other securities, changes	(31.410.479)	(34.693.869)
Investment in operating assets and intangible assets	(33.643)	(80.490)
Investing activities	(45.149.512)	(41.539.837)
Financing activities		
Bond issues and other borrowings, repayments	(38.696.620)	(38.865.616)
Financing activities	(38.696.620)	(38.865.616)
Change in cash and cash equivalents	10.219.036	13.437.053
Cash and cash equivalents at the beginning of the year	66.608.413	53.171.360
Cash and cash equivalents at year end	76.827.449	66.608.413

The notes on pages 14 to 39 are an integral part of these Financial Statements.

Financial Statements of the Housing Financing Fund 2018 13 Amounts are in ISK thousand

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, Reykjavik. The Fund's objectives are to provide housing loans, loans for new constructions and property renovations in Iceland. The Fund is responsible for the allocation of government contributions for the development of public housing, housing policy planning, conducting housing market research and carrying out the implementation of housing benefits. The Housing Financing Fund is an independent institution owned by the State. The Fund operates under the Housing Act no. 44/1998, the Housing Compensation Act no. 75/2016, the Rent Act no. 36/1994 and the Act on Public Housing no. 52/2016, 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.

2. Basis of preparation

a. *Statement of Reporting Standards*

The Financial Statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union, as well as the relevant requirements of the Annual Accounts Act no. 3/2006.

The Board of Directors of the Housing Financing Fund approved the Financial Statements on 29 March 2019.

Information on the Fund's accounting policies can be found in note 32.

On January 1, 2018, the Fund adopted IFRS 9 - Financial Instruments and other accounting standards that came into effect during the year. Note 3a contains a more detailed description of the effects of IFRS 9 on the Fund's financial statements.

b. *Going concern*

The Fund's management has assessed the Fund's ability to continue as a going concern and has reasonable expectations that the Fund will have sufficient capacity to continue operations. The Financial Statements are therefore prepared on a going concern basis.

c. *Functional currency*

The 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.

d. *Use of estimates and judgements in the application of accounting policies*

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.

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, see note 11.
- Appropriated assets, see note 12.
- Investment properties, see note 13.
- Commitments and contingent liabilities due to litigation, see note 30.

3. Changes in accounting policies and other adjustments

a. Changes in accounting policies

IFRS 9 - Financial instruments

IFRS 9 was adopted as of January 1, 2018, resulting in changes in the classification and recognition of financial assets and financial liabilities. At the same time, the adoption involved the introduction of a new methodology for the measurement of impairment of financial assets that is based on expected losses. The new accounting policies under IFRS 9 have been applied retrospectively with the following exceptions:

3. Changes in accounting policies and other adjustments, contd.:

a. Changes in accounting policies, contd.:

IFRS 9 - Financial instruments, contd.:

- Comparative amounts have not been restated in accordance with the requirements of IFRS 9. Differences between the carrying amount of financial assets and financial liabilities due to the adoption of IFRS 9 are recognised in the accumulated deficit on 1 January 2018.

- When classifying financial assets under business models and designating financial assets and financial liabilities measured at fair value through profit or loss, consideration is given to prevailing circumstances at the beginning of adoption that may differ from the circumstances prevailing at initial recognition.

- Since credit risk is considered to be low at the beginning of adoption of IFRS 9, it is assumed that there is no significant increase in credit risk from the initial recognition.

As comparative figures are not fully comparable, the accounting policies of IAS 39 are specifically disclosed in cases where they differ from IFRS 9.

In general, there are three major changes resulting from IFRS 9. First, there are changes to the classification and measurement of financial assets and financial liabilities in financial statements, secondly, changes are made to impairment of financial assets and thirdly changes are made in hedge accounting. Below is a description of the major changes and their expected impact.

Classification and measurement

The new standard entails significant changes in the classification and measurement of financial assets. Financial assets should be classified into the following main categories according to IFRS 9:

(1) financial assets measured at amortised cost if the objective with the asset is to hold the financial asset to maturity and collect, on specified due dates, contractual payments consisting only of principal and interest payments.

(2) financial assets measured at fair value through other comprehensive income (FVOCI) if the objective with the asset is to hold the financial asset to maturity and collect, on specified due dates, contractual payments consisting only of principal and interest payments, as well as to sell the financial asset.

(3) financial assets measured at fair value through profit or loss which includes all other financial assets.

IFRS 9 establishes mainly the same requirements as IAS 39 for the classification of financial liabilities. Financial liabilities shall be divided into two categories: amortised cost and fair value through profit or loss.

The table below shows the original measurement categories according to IAS 39 and new measurement categories according to IFRS 9 for financial assets and liabilities as at 1 January 2018.

	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39	Carrying amount under IFRS 9
Financial assets:				
Cash and cash equivalents...............	Loans	Amortised cost	66.608.413	66.608.413
Claims on financial institutions..........	Loans	Amortised cost	6.891.793	6.891.793
Marketable securities.......................	Trading assets	Amortised cost	11.249.780	0
Other securities................................	Loans	Amortised cost	163.655.406	174.901.025
Receivable from State Treasury.......	Loans	Amortised cost	6.107.495	6.107.495
Loans..	Loans	Amortised cost	499.989.109	498.402.200
Other assets.....................................	Loans	Amortised cost	477.339	477.339
Total financial assets			754.979.335	753.388.265
Financial liabilities:				
Bond issues......................................	Liabilities at amortised cost	Amortised cost	737.182.714	737.182.714
Other borrowings..............................	Liabilities at amortised cost	Amortised cost	818.745	818.745
Other liabilities..................................	Liabilities at amortised cost	Amortised cost	195.661	195.661
Total financial liabilities			738.197.120	738.197.120

Financial Statements of the Housing Financing Fund 2018 15 Amounts are in ISK thousand

Notes, contd.:

3. Changes in accounting policies and other adjustments, contd.:

a. Changes in accounting policies , contd.:

IFRS 9 - Financial instruments, contd.

The Fund's financial assets are classified as financial assets at amortised cost, as the objective of the Fund is to hold the financial assets to maturity and collect contractual payments consisting of principal and interest payments.

Loans consist of loans to individuals and companies. The change in the carrying amount is explained by the change in the impairment provision of loans, as the assessment of the loan impairment provision is based on the expected loan loss according to IFRS 9, but was previously based on incurred loss according to IAS 39.

Market securities that were previously classified as financial assets held for trading and measured at fair value through profit or loss are measured at amortised cost according to IFRS 9.

The Fund classifies financial liabilities at amortised cost.

Impairment

The fundamental difference between the provisions of IAS 39 and IFRS 9 regarding impairment of financial assets is that impairment of financial assets according to IAS 39 is based on incurred loss while impairment of financial assets according to IFRS 9 is based on expected loss. The latter method implies that an impairment loss is recognised on the basis of future expectations and should therefore result in an increase in provisions for impairment losses sooner in the downturn, see note 32e(vi).

The table below shows the final balance of the provision for impairment of financial assets under IAS 39 and the impact of IFRS 9 on the opening balance of the provision as at January 1, 2018.

Provision for impairment of loans and other financial assets	**Impact of adopting IFRS 9 on 1 January 2018**
Balance as at 31 December 2017 under IAS 39	6.917.267
Change due to revaluation of impaired loans in accordance with IFRS 9	1.591.070
Impairment of other financial assets at amortised cost	4.162
Balance as at 1 January 2018 under IFRS 9	8.512.499

The table below reconciles the carrying amounts under IAS 39 to the carrying amounts under IFRS 9 on transition to IFRS 9 at 1 January 2018.

	Carrying amount under IAS 39 31.12.2017	**Re-classification**	**Re-measurement**	**Carrying amount under IFRS 9 1.1.2018**
Financial assets:				
Cash and cash equivalents	66.608.413			66.608.413
Claims on financial institutions	6.891.793			6.891.793
Marketable securities	11.249.780	(11.249.780)		0
Other securities	163.655.406	11.249.780	(270.571)	174.634.615
Receivable from State Treasury	6.107.495			6.107.495
Loans	499.989.109		(1.591.070)	498.398.039
Other assets	477.338		(4.162)	473.176
Total financial assets	754.979.334	0	(1.865.803)	753.113.531
Financial liabilities:				
Bond issues (restated)	737.182.714			737.182.714
Other borrowings	818.745			818.745
Other liabilities	195.661			195.661
Total financial liabilities	738.197.120	0	0	738.197.120

Effect on accumulated deficit

The table below shows the impact of adopting IFRS 9 on the accumulated deficit.

Accumulated deficit	**Impact of adopting IFRS 9 at 1 January 2018**
Balance as at 31 December 2017 under IAS 39 (restated)	(34.047.298)
Change due to reclassification of financial assets and financial liabilities	(274.733)
Change due to expected credit losses under IFRS 9	(1.591.070)
Balance as at 1 January 2018 under IFRS 9	(35.913.101)

Financial Statements of the Housing Financing Fund 2018 16 Amounts are in ISK thousand

3. Changes in accounting policies and other adjustments, contd.:

b. Other adjustments

In preparing for the transfer of the Fund's debt into a new system, discrepancies were found in calculations related to effective interest rates and the present value of debt. On the one hand, effective interest rates on initial bond auctions were underestimated, the result being that the effective interest rates on total debt is 4.34% instead of 4.31%. This does not change the carrying amount of these liabilities nor their future charges. On the other hand, effective interest rates that were too high have been used for the discounting of debt issued after initial bond auctions. This has resulted in an underestimation of the Fund's debt amounting to ISK 1,342,495 thousand at the beginning of 2017. An adjustment was made during the year and this amount is deducted from the Fund's equity. The reduction in equity will be realized in the form of lower interest expenses until the maturity of debt. Thus, interest expenses are therefore ISK 56,915 thousand lower in 2017 and ISK 57,102 thousand lower in 2018. Comparative figures have been restated accordingly.

This table shows the effect of adjustments on the balance sheet items on 1.1.2017 and the 2017 Financial Statements:

Income Statement and Statement of Comprehensive Income	**Previously published 2017**	**Adjustments 2017**	**Restated 2017**
Interest income	46.753.817		46.753.817
Interest expense	(45.112.834)	56.916	(45.055.918)
Net interest expense	1.640.983		1.697.899
Other income	203.976		203.976
Total operating income	1.844.959		1.901.875
Total operating expenses	1.705.955		1.705.955
Net income of appropriated properties	157.881		157.881
Net operating income	296.885		353.801
Reversal of impairment of loans, securities and appropriated properties	1.068.962		1.068.962
Profit for the year and comprehensive income	1.365.847	56.916	1.422.763

Statement of Financial Position	**Restated 1.1.2017**	**Previously published 2017**	**Adjustments**	**Restated 2017**
Assets:				
Total assets	786.634.645	761.926.747	0	761.926.747
Liabilities				
Bond issues	760.828.261	735.897.135	1.285.579	737.182.714
Other borrowings	3.153.172	818.745		818.745
Other liabilities	467.867	317.178		317.178
Total liabilities	764.449.300	737.033.058	1.285.579	738.318.637
Equity				
Contributed capital	57.655.408	57.655.408		57.655.408
Accumulated deficit	(35.470.061)	(32.731.719)	(1.285.579)	(34.047.298)
Total equity	22.185.347	24.923.689	(1.285.579)	23.608.110

Statement of Cash Flows	**Previously published 2017**	**Adjustments**	**Restated 2017**
Operating activities:			
Profit(loss) for the year and total comprehensive income	1.365.847	56.916	1.422.763
Non-cash items	(623.523)	(56.916)	(680.439)
Changes in operating assets and liabilities	93.100.182		93.100.182
Cash flows from operating activities:	93.842.506		93.842.506
Investing activities:	(41.539.837)		(41.539.837)
Financing activities:	(38.865.616)		(38.865.616)
Change in cash and cash equivalents	13.437.053		13.437.053
Cash and cash equivalents at beginning of year	53.171.360		53.171.360
Cash and cash equivalents at year end	66.608.413	0	66.608.413

Financial Statements of the Housing Financing Fund 2018 17 Amounts are in ISK thousand

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.

In 2018, the Fund separated its former lending and financial management activities from other activities undertaken in accordance with current legislation and regulations. The Fund is thus divided into two areas of activity, the Housing Agency and the former lending and financial management activities, named the HFF Fund. The Fund's leasing activities are performed by the HFF Fund and are considered to be a separate segment in 2018, cf. note 13. Until January 1, 2018, there was only one segment. Comparative amounts are not disclosed for 2017 as these are new segments.

Overhead costs have been distributed between segments as appropriate. The Fund's assets that belong to individual segments are financed through internal financing from the Fund. Equity is allocated to segments based on underlying risk factors and capital requirements. Excess capital belongs to the Fund.

The table below shows identifiable information about the Fund's lending activities on the one hand and other segments, respectively.

	HFF Fund		Housing Agency	
	Leasing activities	Former lending and financial management	Housing Agency Activities	Total
2018				
Net interest income	(302.229)	(3.527.615)	2.343.970	(1.485.874)
Other income	0	395.073	37.775	432.848
Total operating income	(302.229)	(3.132.542)	2.381.745	(1.053.026)
Total operating expenses	(91.007)	(604.936)	(1.238.703)	(1.934.646)
Net income of appropriated properties	204.133	0	0	204.133
Net operating income	(189.103)	(3.737.478)	1.143.042	(2.783.539)
Reversal of impairment of loans and appropriated assets	2.166.911	(60.961)	365.065	2.471.015
Profit for the year and comprehensive income	1.977.808	(3.798.439)	1.508.107	(312.524)
31 December 2018				
Total assets	6.867.534	596.780.260	142.002.760	745.650.554
Total liabilities	4.835.660	591.531.392	127.200.223	723.567.275
Share in equity	2.031.874	5.248.868	14.802.537	22.083.279

5. Financial assets and liabilities

Classification and measurement

The Fund has applied IFRS 9 from 1 January 2018. During the implementation, comparative figures were not restated in accordance with the standard, therefore comparative figures from 31 December 2017 are not fully comparable. The effect of the changes is explained in Note 3a.

The following table shows to which category financial assets and liabilities of the Fund pertain and their fair value:

	Amortised cost	Fair value through profit and loss Mandatory	Designated	Total carrying amount	Fair value
31 December 2018					
Assets:					
Cash and cash equivalents	76.827.449			76.827.449	76.827.449
Claims on financial institutions	21.050.909			21.050.909	21.050.909
Other securities	212.149.874			212.149.874	212.766.694
Receivable from State Treasury	1.330.355			1.330.355	1.330.355
Loans	426.888.831			426.888.831	505.141.489
Other assets	691.566			691.566	691.566
Total financial assets	738.938.984	0	0	738.938.984	817.808.462
Liabilities:					
Bond issues	722.915.782			722.915.782	876.174.600
Other borrowings	139.417			139.417	139.417
Other liabilities	340.084			340.084	340.084
Total financial liabilities	723.395.283	0	0	723.395.283	876.654.101

Financial Statements of the Housing Financing Fund 2018 18 Amounts are in ISK thousand

Notes, contd.:

5. Financial assets and liabilities, contd.

Classification and measurement, contd.

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 as according to IAS 39:

31 December 2017	Trading assets	Loans and receivables	Liabilities at amortised cost	Total carrying amount	Fair value
Assets:					
Cash and cash equivalents.....................		66.608.413		66.608.413	66.608.413
Claims on financial institutions................		6.891.793		6.891.793	6.891.793
Marketable securities..............................	11.249.780			11.249.780	11.249.780
Other securities.......................................		163.655.406		163.655.406	181.582.453
Receivable from State Treasury.............		6.107.495		6.107.495	6.107.495
Loans..		499.989.109		499.989.109	599.951.980
Other assets..		477.339		477.339	477.339
Total financial assets..............................	11.249.780	743.729.555	0	754.979.335	872.869.253
Liabilities:					
Bond issues...			737.182.714	737.182.714	869.286.412
Other borrowings.....................................			818.745	818.745	818.745
Other liabilities...			195.661	195.661	195.661
Total financial liabilities...........................	0	0	738.197.120	738.197.120	870.300.818

Fair value

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 . 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 under IAS 39 are now measured at amortised cost in accordance with IFRS 9. Fair value is based on quoted prices in active markets for identical assets.

The fair value of other securities measured at their yield at acquisition is the last quoted market price for the individual category.

6. Cash and cash equivalents

Cash and cash equivalents are specified as follows:	2018	2017
Cash in Central Bank	68.117.841	58.743.186
Cash in financial institutions	8.709.608	7.865.227
Cash and cash equivalents total	76.827.449	66.608.413

7. Claims on financial institutions

Claims on financial institutions are specified as follows:	2018	2017
Inter-bank loans	9.953.346	3.053.801
Other claims	14.623	691
Bank bills	11.082.939	3.837.300
Loans to financial institutions total	21.050.908	6.891.792

Financial Statements of the Housing Financing Fund 2018 19 Amounts are in ISK thousand

Notes, contd.:

8. Marketable securities

Marketable securities are specified as follows:

	2018	2017
Listed treasury bonds at fair value	0	11.249.780
Marketable securities total	0	11.249.780

See further information on reclassification of assets in note no. 3a.

9. Other securities

Other securities are specified as follows:

	2018	2017
Covered bonds measured at yield at acquisition	127.507.247	115.290.704
Municipal bonds	9.230.473	1.465.641
Treasury bonds measured at yield at acquisition	75.441.180	46.899.061
Provision for losses	(29.026)	0
Other securities total	212.149.874	163.655.406

10. Receivable from State Treasury

The receivable due from the State Treasury comprises a bond in the amount of ISK 1,240 million that is payable in one lump sum on 1 January 2021. The bond has a permanent prepayment privilege favourable to the Treasury, in part or in full. Only interest payments on the bond is collected during the loan period. The bond is not transferable by the Housing Financing Fund. The carrying amount of the bond at year-end 2018 is ISK 1,330 million.

11. Loans

Loans are specified as follows:

	2018	2017
Loans to individuals	282.208.426	365.061.806
Loans to legal entities	144.680.405	134.927.303
Loans total	426.888.831	499.989.109

Following the implementation of IFRS 9, the Fund has changed its impairment process in accordance with the provisions of the Standard. Further details of the changes resulting from the adoption of the standard are given in Note 3a.

Changes in the impairment provision during the year 2018 as according to IFRS 9:

	12 month ECL	Lifetime ECL		
	Stage 1	Stage 2	Stage 3	Total
Balance of provision 1 January 2018	(1.533.357)	(2.163.342)	(4.811.638)	(8.508.337)
Expected credit loss from new loans	35.298	30.552	3.218	69.068
Reversal of expected credit loss due to prepayments	109.279	217.182	112.170	438.631
Transfer to stage 1	(347.627)	303.836	43.791	0
Transfer to stage 2	321.322	(2.014.985)	1.693.663	0
Transfer to stage 3	3.130	74.197	(77.327)	0
Changes in model or underlying risk factors	311.608	821.999	(1.330.020)	(196.413)
Contributions covering write-offs	327	1.637	1.144.000	1.145.964
Balance of provision 31 December 2018	(1.100.020)	(2.728.924)	(3.222.143)	(7.051.087)

Changes in the impairment provision during the year 2017 as according to IAS 39:

Balance at the beginning of the year	7.480.198
Impairment loss on loans	(209.134)
Collected previously written off	429.407
Write-offs	(783.204)
Balance at year end	6.917.267

Financial Statements of the Housing Financing Fund 2018 20 Amounts are in ISK thousand

Notes, contd.:

12. Appropriated properties

At year-end 2018 there were 36 appropriated properties held by the Fund (2017: 419) that it had repossessed for satisfaction of claims. The change in the number of appropriated assets between years is mainly due to the reclassification of appropriated assets to investment properties, cf. Note 13. The total number of appropriated properties managed by the Fund is specified as follows:

	2018	2017
Number of properties at the beginning of the year	419	663
Appropriated properties during the year	23	53
Properties sold during the year	(155)	(297)
Reclassification to investment properties	(251)	0
Number of properties at year end	36	419

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

	2018	2017
South and South West	2	110
Capital region	8	71
South Iceland	10	76
West Iceland	2	45
East Iceland	8	55
North Iceland	4	38
Westfjords	2	24
Number of properties at year end	36	419

Of the 36 properties owned by the Fund at the end of the year, 20 real estate properties were listed for sale by real estate agents (end of 2017: 161). There was 1 real estate lease (year-end 2017: 231) or 2.8% of the total number of properties owned by the Fund on 31 December 2018 (year-end 2017: 55.1%).

Year-end 2018	Number of properties	Official property value	Fair value	Carrying amount
Rentals	1	49.100	37.902	29.491
In sales process	20	448.480	306.810	260.422
Empty	10	240.300	154.183	138.985
Other properties*	5	142.998	244.514	2.193
Total	36	880.878	743.409	431.091

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

Year-end 2017	Number of properties	Official property value	Fair value	Carrying amount
Rentals	231	5.175.440	4.569.214	4.074.698
In sales process	161	3.205.030	2.436.398	2.253.555
Empty	25	479.015	394.195	266.279
Other properties*	2	55.100	45.851	36.606
Total	419	8.914.585	7.445.658	6.631.138

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

Changes during the year:	2018	2017
Carrying amount 1.1	6.631.138	10.936.363
Repossessed for satisfaction of claims	361.423	1.104.072
Sold during the year	(3.400.110)	(6.022.584)
Reclassification of properties to investment properties	(4.586.637)	0
Recovered during the year	1.425.277	613.287
Carrying amount 31.12	431.091	6.631.138

Financial Statements of the Housing Financing Fund 2018 21 Amounts are in ISK thousand

Notes, contd.:

13. Investment properties

Investment properties are specified as follows:

	Number of properties	Carrying amount
Year-end 2018		
Southwest	77	1.909.062
Capital region	43	1.531.162
South Iceland	42	1.180.738
West Iceland	36	555.017
East Iceland	23	355.040
North Iceland	15	363.813
Westfjords	15	149.743
	251	6.044.575

During the year, 251 appropriated properties were reclassified as investment properties. The Fund's investment properties are residential properties that will be transferred to Leigufélagið Bríet, as a decision was made during the year that the leasing company is to take over the ownership and operations of the above-mentioned assets.

	2018
Changes during the year:	
Reclassification of properties during the year	4.586.637
Changes in valuation due to reclassification	1.457.938
Carrying amount 31.12	6.044.575

14. Operating assets

Operating assets are specified as follows:

	Fixtures and equipment	Real estate	Total
Cost			
Balance at 1.1.2017	229.994	30.727	260.721
Additions during the year	62.155	0	62.155
Balance at 31.12.2017	292.149	30.727	322.876
Additions during the year	30.674	0	30.674
Balance at 31.12.2018	322.823	30.727	353.550
Depreciation			
Balance at 1.1.2017	144.222	8.720	152.942
Depreciation during the year	18.638	1.027	19.665
Balance at 31.12.2017	162.860	9.747	172.607
Depreciation during the year	29.512	1.027	30.539
Balance at 31.12.2018	192.372	10.774	203.146
Carrying amount			
Balance at 1.1.2017	85.772	22.007	107.779
Balance at 31.12.2017	129.289	20.980	150.269
Balance at 31.12.2018	130.451	19.953	150.404

Property value of real estate at year-end 2018 amounted to ISK 25.3 million (2017: ISK 22.9 million) and insurance value amounted to ISK 25.9 million (2017: ISK 24.3 million).

15. Intangible assets

Intangible assets are specified as follows:

	Software
Cost	
Balance at 1.1.2017	658.623
Additions during the year	12.927
Balance at 31.12.2017	671.550
Additions during the year	2.969
Balance at 31.12.2018	674.519
Amortisation	
Balance at 1.1.2017	444.720
Amortisation during the year	60.825
Balance at 31.12.2017	505.545
Amortisation during the year	83.474
Balance at 31.12.2018	589.019

Financial Statements of the Housing Financing Fund 2018 22 Amounts are in ISK thousand

Notes, contd.:

15. Intangible assets, contd.:

	Software
Carrying amounts	
Balance at 1.1.2017	213.903
Balance at 31.12.2017	166.005
Balance at 31.12.2018	85.500

16. Other assets

	2018	2017
Eir bond securities	95.081	94.321
Other securities	141.166	0
Purchase contracts	155.913	269.215
Accounts receivable	288.389	71.721
Value added tax claim	11.017	42.082
Other assets total	691.566	477.339

17. 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. Housing bonds are inflation-indexed annuity bonds and are callable. Housing Authority bonds are inflation-indexed annuity bonds. The effective interest rate of the HFF bonds is 4.34%.

Bond issues are specified as follows:

	Final maturity	Number of yearly installments	Outstanding principal	Contractual interest rate	2018 Carrying amount
HFF24 bond	2024	2	56.524.778	Fixed 3.75%	106.251.839
HFF34 bond	2034	2	111.848.826	Fixed 3.75%	202.076.157
HFF44 bond	2044	2	213.230.708	Fixed 3.75%	388.953.137
Housing bonds	2040	Callable	1.381.293	4.75% - 6.00%	8.315.093
Housing Authority bonds	2020/2038	2	7.107.181	2.70% - 6.25%	17.319.556
Bond issues total			390.092.786		722.915.782

	Final maturity	Number of yearly installments	Outstanding principal	Contractual interest rate	2017 Carrying amount
HFF24 bond	2024	2	65.617.760	Fixed 3.75%	119.148.711
HFF34 bond	2034	2	117.087.538	Fixed 3.75%	204.310.425
HFF44 bond	2044	2	218.155.870	Fixed 3.75%	384.866.289
Housing bonds	2040	Callable	1.898.409	4.75% - 6.00%	10.836.443
Housing Authority bonds	2020/2038	2	7.744.843	2.70% - 6.25%	18.020.846
Bond issues total			410.504.420		737.182.714

Changes during the year:	2018
Balance 1.1.2018	737.182.714
Changes affecting cash flow:	
Repayments	(35.786.851)
Changes not affecting cash flow:	
Indexation	21.519.919
Balance 31.12.2018	722.915.782

Financial Statements of the Housing Financing Fund 2018 23 Amounts are in ISK thousand

Notes, contd.:

18. Other borrowings

Other borrowings are specified as follows:

	2018	2017
Pension funds	0	77.319
Insurance fund	7.395	191.225
Callable bonds	132.022	143.469
Unpaid due to purchase of loan portfolios	0	406.732
Total other borrowings	139.417	818.745

Changes during the year:	**2018**
Balance 1.1.2018	818.745
Changes affecting cash flow:	
Repayments	(599.433)
Changes not affecting cash flow:	
Indexation	(79.895)
Balance 31.12.2018	139.417

19. Other liabilities

Other borrowings are specified as follows:

	2018	2017
Salaries and related expenses	171.992	121.538
Surplus housing benefit contributions	192.100	0
Other liabilities	147.984	195.661
Total other liabilities	512.076	317.199

20. Net interest (expense) income

Interest income

Interest income on items not at fair value:

	2018	2017
Interest income on cash and cash equivalents	2.896.231	2.938.477
Interest income and indexation on loans	36.604.459	34.653.773
Interest income on receivable from the Treasury and claims on financial institutions	1.192.896	512.908
Interest interest on covered bonds	7.816.113	5.119.656
Interest income on government bonds	3.694.819	1.527.506
Interest income from other financial assets	431.675	18.830
Interest income from corporate bonds	0	294.840
	52.636.192	45.065.990
Gov't contribution due to reduced interest margin related to debt solutions*	649.616	857.886
	53.285.808	45.923.876
Interest income on items at fair value:		
Interest income on market securities	0	829.941
	0	829.941
Total interest income	53.285.808	46.753.817

*The government contribution due to social benefit loans to municipalities and organisations, such as student associations and organisations of disabled.

Interest expense	**2018**	**2017**
Interest expense on items not at fair value:		
Interest and indexation expense on bonds issued	54.760.669	44.891.921
Interest expense on other borrowings	11.013	163.997
Total interest expense	54.771.682	45.055.918
Net interest (expense) income	(1.485.874)	1.697.899

Financial Statements of the Housing Financing Fund 2018 24 Amounts are in ISK thousand

Notes, contd.:

21. Other income

Other income is specified as follows:

	2018	2017
Collection and service income	191.205	199.936
State contributions for administration of housing benefits	136.300	0
Other income	105.342	4.040
	432.848	203.976

22. Salaries and salary-related expenses

Salaries and salary related expenses are specified as follows:

	2018	2017
Salaries	748.746	615.756
Pension fund contributions	96.415	80.179
Tax on financial activity	32.742	34.548
Employee vacation obligation	18.364	(7.975)
Other salary related expenses	86.902	66.821
Other personnel expenses	40.040	35.944
Total salaries and salary related expenses	1.023.209	825.273
Average number of employees during the year in full-time equivalent units*	79	66

There were 82 employees on the Fund's payroll on 31 December 2018 (2017: 60).

* On 1 January 2018, 15 full-time equivalent positions were transferred from the Directorate of Labor to the Housing Financing Fund in connection with the transfer of housing benefits to the Housing Financing Fund.

23. Other operating expenses

Other operating expenses are specified as follows:

	2018	2017
Collection fees	74.077	125.105
Operating expenses of housing	132.323	124.092
Operating cost of IT systems	209.856	147.261
Audit and review of financial statements (see note 24)	21.563	25.332
Professional services	85.955	72.986
Implementation of IFRS expenses	17.609	34.607
Real estate evaluations	7.708	6.615
Advertising, promotional material and grants	32.919	27.278
Debtors' Ombudsman	51.368	92.836
Financial Supervisory Authority	70.388	69.115
Credit rating	1.466	2.009
Custody and service fees	46.139	27.726
Other operating expenses	46.053	45.230
Total other operating expenses	797.424	800.192

24. Auditors' fee

Remuneration to the auditors' is specified as follows:

	2018	2017
Audit of financial statements	13.143	13.766
Review of interim financial statements	5.378	3.242
Internal audit	2.462	5.850
Other auditor-related services	580	2.474
Audit and review of financial statements total	21.563	25.332
Implementation of IFRS expenses	6.792	5.564
Total auditors' fee	28.355	30.896

25. Depreciation and amortisation of the year

Depreciation and amortisation is specified as follows:

	2018	2017
Depreciation of operating assets (see note 14)	30.539	19.665
Amortisation of intangible assets (see note 15)	83.474	60.825
Total depreciation and amortisation	114.013	80.490

Financial Statements of the Housing Financing Fund 2018 25 Amounts are in ISK thousand

Notes, contd.:

26. Net income of appropriated properties

Net income of appropriated properties is specified as follows:

	2018	2017
Rental income from rented properties	416.253	525.082
Expenses due to appropriated properties	(212.120)	(367.201)
Net income from appropriated properties	204.133	157.881

The expenses due to appropriated properties in the table above include only the direct incurred costs of the properties e.g. property taxes, insurance, maintenance, energy costs and commissions of administrators. If all expenses were included such as the operating expenses incurred by the Fund due to its management of the properties, the expenses would be significantly higher than stated in the breakdown above.

27. Impairment

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

	2018	2017
Reversal of impairment of loans	(345.728)	(209.134)
Impairment of other financial assets	29.026	0
Recoveries from appropriated assets	(1.362.469)	(900.450)
Reclassification of investment properties	(804.442)	0
Impairment of other receivables	12.598	40.623
Impairment recognised as income	(2.471.015)	(1.068.962)

28. Rental agreements

The Fund has entered into operating lease agreements on properties used in its operations. Minimum lease payments are specified as follows at year end:

	2018	2017
Payable within 1 year	125.100	112.094
Payable between 1 to 5 years	86.867	172.344
Total	211.967	284.438

29. Related parties and salaries of management

Related parties include the owner of the Fund, board members, executive officers and its subsidiary. The Housing Financing Fund is publicly 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. At year end 2018 there were no mortgage loans to related parties (2017: 0).

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

	2018	
	Salaries	Pension fund contributions
Hermann Jónasson, CEO	17.822	2.406
Haukur Ingibergsson, Chairman of the Board	3.241	65
Sigurbjörn Ingimundarson, Vice Chairman of the Board	2.132	170
Elín Oddný Sigurðardóttir, Board member	520	42
Valdimar Valdemarsson, Board member	2.515	201
Ásta Björg Pálmadóttir, Board member	1.613	186
Drífa Snædal, former Board member	1.229	98
Key personnel, (6)	95.549	12.211

	2017	
	Salaries	Pension fund contributions
Hermann Jónasson, CEO	17.822	2.406
Ingibjörg Ólöf Vilhjálmsdóttir, former Chairman of the Board	586	59
Sigurbjörn Ingimundarson, former Chairman of the Board/Board member	2.934	317
Haukur Ingibergsson, Board member	1.380	54
Drífa Snædal, Board member	1.420	114
Valdimar Valdemarsson, Board member	2.254	180
Key personnel, (7)	103.744	14.005

Former senior management received severance pay in 2017.

Financial Statements of the Housing Financing Fund 2018 26 Amounts are in ISK thousand

Notes, contd.:

30. Other matters

Leigufélagið Bríet ehf

Leigufélagið Bríet ehf was established on 12 December 2018. The initial capital was ISK 500 thousand and the Housing Financing Fund is the owner of 100% of the shares in the company. The subsidiary will assume ownership over most of the appropriated assets that are owned by the Fund on 31 December 2018 and operate a rental service with special emphasis in the rural areas. The Board of the Fund has decided that the amount of its equity investment in the subsidiary will be up to ISK 2,100 million, concurrent to the transfer of assets to the company. It is estimated that the company will take over the Fund's appropriated assets portfolio and commence formal operations in the first quarter of 2019.

The operations of the subsidiary Leigufélagið Bríetar ehf. will not begin until 1 March 2019 when the company takes over the ownership and operations of the above mentioned assets, and therefore its share in equity is not recognized in the Fund's Financial Statements of 2018. Likewise, the statements for the Housing Financing Fund and Leigufélagið Bríet ehf. are not consolidated in 2018.

Receivable from State Treasury

Regarding the principal reduction of inflation-indexed housing mortgages under Act no. 35/2014, a letter from the Ministry of Welfare dated 19 December 2014, announced that both the Minister of Social Affairs and Housing and the Minister of Finance were in agreement that the Housing Financing Fund would be compensated for the negative impact the measures have had on the Fund. The accumulated negative impact amounts to ISK 1,137 million and of that amount ISK 687 million is attributable to the year 2018.

Other matters

The Fund is a party to several disputes currently before the courts. These disputes are mainly related to damages due to forced sales and sales of appropriated assets and disputes regarding payments for construction work. It is the Fund's opinion however, that these cases, neither individually nor combined are likely to have a significant financial impact on the Fund.

31. Risk management

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

A key aspect 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 includes information on the organisation of the Fund's treasury and risk management, in addition to information on each of the aforementioned risks, including objectives, policies and processes for the evaluation and 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 treasury 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 costs 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 Audit Committee

- Monitors the design and functioning of the Fund's internal control, of the internal audit, if applicable, and of risk management.

31. Risk management, contd.:

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

Risk management structure, contd.:

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 to the Board and decides on further implementation.
- Monitors risk management.
- Directs the internal evaluation assessment of capital requirement.

CEO

- Recruits the risk manager and sets his terms of reference.

Risk manager

- Manages and is responsible for the risk management division.
- Has direct access to the Board.
- Responsible for the implementation of risk management including analysis, measurement, assessment, stress tests and the disclosure of information to the Board.
- Takes an active part in formulating risk management policies and addresses all important decisions related to risk management.

Financial Committee

- The CEO, CFO, COO, and Risk manager are members of the Financial Committee.
- Submits proposals to the Board on debt issuance and interest rate premiums and makes decisions on treasury management.
- Ensures that the disclosure of information to the Board is satisfactory and the policy of treasury and risk management is followed.
- Discusses key issues concerning the Fund's treasury and risk management.

Hedges

It is important to maintain a certain balance in the Fund's combination of borrowings and loans. The Fund's risk management rules stipulate that the Fund must limit its risks and manage interest rate and credit risk within a certain reference limits.

The Fund's treasury and risk management operates in accordance with the Fund's treasury and risk management rules. The rules define the risks and the margins of tolerance in the Fund's operation.

b. *Credit risk*

Credit risk is the risk of financial loss of the Fund if a customer or a counterparty to a financial instrument fails to meet its contractual obligations. As stated above it is the Fund’s main objective to maintain low risk level in its operations.

Maximum exposure to credit risk

The following table shows the maximum exposure credit risk of the Fund:

	2018	2017
Balance sheet credit risk:		
Cash and cash equivalents	76.827.449	66.608.413
Claims on financial institutions	21.050.909	6.891.791
Marketable securities	0	11.249.780
Other securities	212.149.874	163.655.406
Receivable from State Treasury	1.330.355	6.107.495
Loans	426.888.831	499.989.109
Other financial assets	680.549	435.257
Total balance sheet credit risk	738.927.967	754.937.251
Credit risk outside the balance sheet:		
Loaned own bonds, market value	0	75.129
Market value of pledges provided by market makers	0	79.083
Total credit risk outside the balance sheet	0	154.212
Maximum exposure to credit risk	738.927.967	755.091.463

Financial Statements of the Housing Financing Fund 2018 28 Amounts are in ISK thousand

31. *Risk management, contd.:*

b. *Credit risk, contd.*

Loans analysed by geographical areas

The following table shows the Fund's loans analysed by geographical areas:

Year-end 2018	Capital region	South and Southwest	West and Westfjords	North Iceland	East Iceland	Carrying Amount
Loans to individuals.....	185.073.771	60.561.025	18.484.885	29.036.229	11.683.827	304.839.737
Loans to entities...........	72.966.935	21.296.125	6.853.868	18.358.938	2.573.228	122.049.094
Total loans..................	258.040.706	81.857.150	25.338.753	47.395.167	14.257.055	426.888.831
Year-end 2017						
Loans to individuals.....	224.144.239	71.210.441	21.433.667	34.686.941	13.586.619	365.061.907
Loans to entities...........	79.873.603	24.340.163	7.678.196	20.169.363	2.865.978	134.927.303
Total loans..................	304.017.842	95.550.604	29.111.863	54.856.304	16.452.597	499.989.210

Quality of loans

The following table shows both the gross carrying amount of loans and the expected credit losses (ECL) and the classification into risk levels.

Year-end 2018	Loans to individuals	Loans to entities	Total
Stage 1			
Gross carrying amount..	248.358.735	122.972.484	371.331.219
12-month ECL..	(489.559)	(610.461)	(1.100.020)
Carrying amount..	247.869.176	122.362.023	370.231.199
Stage 2			
Gross carrying amount..	44.650.076	8.204.001	52.854.077
Lifetime ECL..	(1.584.706)	(1.144.219)	(2.728.925)
Carrying amount..	43.065.370	7.059.782	50.125.152
Stage 3			
Gross carrying amount..	6.339.555	3.415.067	9.754.622
Lifetime ECL..	(623.741)	(2.598.401)	(3.222.142)
Carrying amount..	5.715.814	816.666	6.532.480
Total carrying amount..	296.650.360	130.238.471	426.888.831

The following table shows the gross carrying amount of loans by past due status and the carrying amount of loans.

31 December 2018	Not past due	30-59 days past due	60-89 days past due	Over 90 days past due	Impairment provision	Carrying amount
Loans to individuals....	284.330.546	6.153.595	1.727.523	4.106.830	(2.698.006)	296.318.494
Loans to entities..........	128.093.415	1.123.208	0	1.353.714	(4.353.081)	130.570.337
	412.423.961	7.276.803	1.727.523	5.460.544	(7.051.087)	426.888.831

31 December 2017	Not past due	30-59 days past due	60-89 days past due	Over 90 days past due	Impairment provision	Carrying amount
Loans to individuals....	347.472.980	8.857.556	2.978.171	7.924.463	(2.171.364)	365.061.806
Loans to entities..........	132.679.505	5.631.460	0	1.362.445	(4.746.107)	134.927.303
	480.152.485	14.489.016	2.978.171	9.286.908	(6.917.471)	499.989.109

Financial Statements of the Housing Financing Fund 2018 29 Amounts are in ISK thousand

Notes, contd.:

31. 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	
	2018	2017	2018	2017	2018	2017
Loans past due:						
Arrears less then						
30-59 days..................	75.040	111.410	255.019	54.027	330.059	165.437
60-89 days..................	30.838	52.953	0	0	30.838	52.953
Past due over 90 days.....	489.534	1.040.630	1.276.706	1.710.532	1.766.240	2.751.162
Total past due.............	595.412	1.204.993	1.531.725	1.764.559	2.127.137	2.969.552

To maximize loan recovery, loan terms may change. Changes of terms have not resulted in the transfer of loans between stages, which means that the expected credit losses that were previously based on life-time expected losses are based on 12-month expected credit losses.

Write-off of loans

Loans are written off under the following circumstances:

- Upon loss on the sale of property 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 the Housing Financing Fund on the discontinuance of a claim in accordance with Regulation no. 359/2010, on the treatment of the Housing Financing Fund's claims effected by collateral loss.
- Abiding by Act no. 101/2010 as according to the Act on Housing par. 3 Art. 47 on write-offs as according to agreement on debt mitigation.
- Upon the financial restructuring of legal entities under agreement pursuant to Act no. 101/2010 as according to the Housing Act par. 6 Art. 47.
- On a legal basis.

Binding loan commitments

Obligations not recognised in the balance sheet:	2018	2017
Binding loan commitments at year-end	4.581.075	4.406.080

Quality of pledges

The Housing Financing Fund's loans are secured by real estate collateral. Loans granted are the maximum of 80% of the purchase price, provided that there are no other restrictions of a maximum loan amount, which is ISK 30 million for individuals. The maximum official property value of the assets may not be over ISK 50 million. Following the granting of a loan, individual mortgages 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 ratio of the Fund's loans to the official property valuation is approx. 34.2% at year end 2018 compared to 38.4% at year end 2017. The majority of the Fund's loans have first pledge right. Loan-to-value ratios, i.e. the calculated remaining balance of loans excluding specific impairment as a proportion of the official property value, are specified as follows at year end:

	2018	2017
Proportion of the total loans under 50% of the official property value	85,3%	80,3%
Proportion of the total loans from 51 - 70% of the official property value...	10,4%	12,3%
Proportion of the total loans from 71 - 90% of the official property value	2,8%	4,7%
Proportion of the total loans from 91 - 100% of the official property value	0,5%	0,8%
Proportion of the total loans from 101 - 110% of the official property value	0,3%	0,4%
Proportion of the total loans over 110% of the official property value	0,8%	1,5%
	100%	100%

Financial Statements of the Housing Financing Fund 2018 30 Amounts are in ISK thousand

Notes, contd.:

31. Risk management, contd.:

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 of its 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 treasury management includes liquidity analysis and liquidity management. The Fund's liquidity plan is organized in advance with reference to the operational and financial budget. The liquidity budget is updated on a regular basis.

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:

31 December 2018	0 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
Financial assets:					
Cash and cash equivalents.....................	76.827.449	0	0	0	76.827.449
Other securities.......................................	15.241.323	6.153.522	67.416.633	183.493.737	272.305.215
Receivable from State Treasury.............	16.919	16.643	1.341.446	0	1.375.008
Loans to customers.................................	7.469.878	23.015.668	114.801.207	646.694.654	791.981.407
Claims on financial institutions...............	16.089.786	5.100.000	0	0	21.189.786
Other assets..	1.348	4.045	21.123	111.007	137.523
Total financial assets..............................	115.646.703	34.289.878	183.580.409	830.299.398	1.163.816.388
Financial liabilities:					
Borrowings and other liabilities...	13.524.187	54.807.697	253.719.251	749.114.265	1.071.165.400
Binding loan commitment.......................	0	4.581.075	0	0	4.581.075
Total financial liabilities...........................	13.524.187	59.388.772	253.719.251	749.114.265	1.075.746.475
Net balance...	102.122.516	(25.098.894)	(70.138.842)	81.185.133	88.069.913

31 December 2017	0 - 3 months	3-12 months	1 - 5 years	Over 5 years	Total
Financial assets:					
Cash and cash equivalents.....................	66.608.413	0	0	0	66.608.413
Marketable securities..............................	11.249.780	0	0	0	11.249.780
Other securities.......................................	6.345.354	9.177.439	52.633.610	173.871.257	242.027.660
Receivable from State Treasury.............	16.882	79.055	6.252.045	0	6.347.982
Loans to customers.................................	8.559.084	25.299.932	131.032.481	749.581.099	914.472.596
Claims on financial institutions...............	3.706.488	3.240.000	0	0	6.946.488
Other assets..	1.306	3.917	20.458	112.735	138.416
Total financial assets..............................	96.487.307	37.800.343	189.938.594	923.565.091	1.247.791.335
Financial liabilities:					
Borrowings and other liabilities................	13.122.104	53.534.285	248.056.285	791.158.654	1.105.871.328
Binding loan commitment.......................		4.406.080			4.406.080
Total financial liabilities...........................	13.122.104	57.940.365	248.056.285	791.158.654	1.110.277.408
Net balance...	83.365.203	(20.140.022)	(58.117.691)	132.406.437	137.513.927

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 meet the imbalance by expending cash, selling securities or issuing HFF bonds, as necessary.

Financial Statements of the Housing Financing Fund 2018 31 Amounts are in ISK thousand

31. Risk management, contd.:

d. *Interest risk*

Interest rate risk is defined as the risk that the future cash flows of financial instruments will fluctuate due to changes in market interest rates. The Fund recognises neither financial liabilities nor financial assets at fair value, and fair value risk due to interest rate changes is therefore limited. Around 89.6% of the Fund's financial assets (2017: 89.8%) and 99.9% (2017: 99.8%) of its financial liabilities have fixed interest rates and therefore the effect of interest rate changes on payment flows is insubstantial. Decisions on changing the interest rates on loans with floating interest rates is entirely in the hands of the Fund. However, the difference between the duration of assets and liabilities causes risk exposure for the Fund as if a balance is not maintained changes in interest rates may affect its net interest income. The duration of the Fund's financial assets at year end 2018 is 12.29 years (2017: 11.91 years) and of financial liabilities 9.42 years (2017: 9.55 years). According to the Fund's risk management policy this difference may be up to 0.9 years.

The weighted average effective interest rate on the Fund's non-equity borrowings was 4.34% at year-end 2018 (2017: 4.34%), and the weighted average effective interest rate on loans at the same time was 4.46% (2017: 4.49%). The interest margin on the Fund's loan portfolio and its borrowings is therefore positive by 0.12%.

The risk committee assesses the Fund's prepayment risk and other factors related to interest rate risk and assesses this risk when the interest rates on the Fund's loans are decided. In order to reduce even further this risk the Fund also offers loans with prepayment fees that bear lower interest rates than loans without such a fee. On a monthly basis the real proportion of prepayments is measured and estimates for future prepayment ratios are calculated. On the basis of estimated prepayments the Fund regularly reviews its funding in order to limit the sensitivity of its loan portfolio with regards to interest rates.

Prepayment risk

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

Around ISK 141 billion of the Fund's loans (2017: ISK 174 billion) are hedged with prepayment fees in part or entirely and prepayable housing bonds should the borrower choose to prepay its loan before the end of the loan term. Related interest rate and reinvestment risk is considered to be considerable, especially while market interest rates remain low. The Fund is working on limiting this risk.

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 largely explained by the fact that not all financial assets are indexed, but the Fund's liabilities are all indexed. 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.

	2018	2017
CPI-indexed financial assets:		
Loans	426.454.111	499.989.109
Treasury securities and other financial assets	191.260.184	166.977.131
Total financial assets	617.714.295	666.966.240
CPI-indexed financial liabilities:		
Bond issue	722.915.782	737.182.714
Other borrowings	139.417	818.745
Total financial liabilities	723.055.199	738.001.459
Total CPI-indexation balance	(105.340.904)	(71.035.219)

Indexed liabilities amounted to approx. ISK 105.3 billion in excess of indexed assets at year end 2018 (2017: ISK 71 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 1,053 million (2017: ISK 710 million).

Financial Statements of the Housing Financing Fund 2018 32 Amounts are in ISK thousand

Notes, contd.:

31. Risk management, contd.:

e. *Operational risk*

Operational risk is the risk of loss as a result of insufficient internal processes, employees 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 manage various aspects of operational risk. Heads of divisions are responsible for the management of operational risk in their divisions 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 Social Affairs and Equality 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:	**2018**	**2017**
Total equity according to the Financial Statements	22.083.279	23.608.110
Intangible assets	(85.500)	(166.005)
Equity base	21.997.779	23.442.105
Risk exposure is specified as follows:		
Credit risk	242.631.000	260.069.938
Market risk	0	27.982.863
Operational risk	3.583.338	3.523.563
Total risk exposure amount	246.214.338	291.576.364
Equity ratio	8.93%	8.04%

32. Significant accounting policies

With the exception of the changes accompanying the introduction of new standards and that are specifically explained, the accounting policies set out below have been applied consistently to all periods presented in the Financial Statements. To increase the informational value of the Financial Statements, information is disclosed on the basis of how relevant and significant it is to the reader. Revenues and expenses of the Fund are not recognised directly in other comprehensive (loss) income and the result for the year is therefore equal to comprehensive (loss) income.

a. *Interest income and interest expense*

Interest income and expense are recognised in the income statement based on the effective interest method and consist of interest income on loans, cash and cash equivalents, securities, receivable from State Treasury, and claims on financial institutions, and interest expenses on borrowings. Interest income and interest 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 rate 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 interest rates.

Effective interest rate 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 carrying amount 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 does not take into account future credit losses.

Indexation of inflation-indexed assets and liabilities are recognised in the income statement among interest income and expense as they accrue and in the balance sheet as part of the carrying amount of assets and liabilities.

The Fund has granted loans for rental housing at a 3.5% and 4.2% interest rate. The State Treasury compensates the Fund the interest differential 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 (cf. note 18). The aforementioned rental housing loans are inflation-indexed at fixed interest rates. There is no long-term agreement between the Fund and the State on the subsidy of interests on these loans but the subsidy is determined on an annual basis by the State and approved in the national budget. In the event that the State's subsidy does not apply, interests on the loans should be increased in order to ensure the Fund's financial performance and its interest margin There are loans in the amount of approximately ISK 8 billion due to social assistance granted in the years 2001-2009, where the contribution from the State does not apply.

Financial Statements of the Housing Financing Fund 2018 33 Amounts are in ISK thousand

32. Significant accounting policies, contd.:

b. ***Other income***

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

c. ***Other operating expenses***

Other operating expenses consist of housing costs, operation of IT systems, collection expenses, purchased professional services, contributions to the operation of the Debtors' Ombudsman, FME supervision fees and other general operating expenses, see note 23. Operating expenses are recognised as they are incurred.

d. ***Net operating income of appropriated properties***

Net operating income of appropriated properties consist of rental income and expenses of appropriated properties, cf. note 26.

e. ***Financial assets and liabilities***

IFRS 9 Financial instruments: Effective after 1 January 2018

(i) Recognition and derecognition of financial assets and liabilities

Purchases and sales of financial assets are recognised at the date of transaction. The transactions 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 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) Classification and measurement

The Fund classifies financial assets on the basis of a business model in managing financial assets and the characteristics of the contractual cash flow of the asset.

(1) financial assets measured at amortised cost if the objective with the asset is to hold the financial asset to maturity and collect, on specified due dates, contractual payments consisting only of principal and interest payments.

(2) financial assets measured at fair value through other comprehensive income (FVOCI) if the objective with the asset is to hold the financial asset to maturity and collect, on specified due dates, contractual payments consisting only of principal and interest payments, as well as to sell the financial assets.

(3) financial assets measured at fair value through profit or loss which includes all other financial assets.

The Fund classifies financial liabilities at amortized cost.

(iii) 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.

(iv) 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 premiums 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.

32. Significant accounting policies, contd.

(v) 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.

(vi) Impairment of financial assets

Governance

Risk management is responsible for calculating impairment of loans and ensuring compliance with IFRS 9 requirements. A special financial committee composed of the CEO, the Managing Director of the Operations Division and the Treasury, and the Risk Manager are responsible for reviewing and approving the conclusions.

During the implementation, the Fund has had to develop extensive models to assess the expected credit loss of financial assets. Furthermore, the credit risk of each individual loan had to be defined based on historical data. The standard also sets out requirements for defining various terms, selecting the approach that is considered the most appropriate for the Fund, the application of various assumptions of expected credit loss and the use of external information.

The Fund decided to develop new methodologies and calculation models to calculate expected credit losses in accordance with IFRS 9. Expected credit loss may be expressed as probability of default, loss given default and exposure at default.

Impairment model

The calculation of impairment under IFRS 9 is based on a three-stage impairment model, which is intended to reflect the deterioration in credit quality of financial assets. The objective of the standard is that impairment should increase when credit risk increases and credit quality has deteriorated from initial recognition.

• Stage 1 - Credit risk has not increased significantly since the initial recognition of financial assets or credit risk is considered to be insignificant. For first-stage assets, impairment losses are based on 12-month expected credit losses.

• Stage 2 - Credit risk has risen sharply since initial recognition but there is no objective evidence of a credit loss event. For assets at the second level, lifetime expected credit losses are recognised.

• Stage 3 - Objective evidence of impairment exists at the reporting date and the financial asset is considered to be in default. The third level is largely comparable to the specific and general impairment of financial assets in accordance with IAS 39. At the third level lifetime expected credit losses are recognised, as in the second stage.

Expected credit losses

Credit losses are the difference between all the contractual cash flows that are due to an entity and the cash flows that it actually expects to receive. This difference is discounted at the original effective interest rate. Expected credit loss is determined by a probability weighted estimate of credit losses over the expected lifetime of the financial instrument.

12- month expected credit losses

12-month expected credit losses are a portion of the lifetime expected credit losses. They are calculated by multiplying the probability of a default occuring on the instrument in the next 12 months by the total (lifetime) expected credit losses that would result from that default.

Lifetime expected credit losses

Lifetime expected credit losses are the expected shortfalls in contractual cash flows, taking into account the potential for default at any point during the life of the financial instrument.

Significant increase in credit risk and definition of default

According to IFRS 9, the estimate of changes in credit risk is based on the risk of default over the expected lifetime of financial assets. In assessing a significant increase in credit risk, quantitative and qualitative information are used and analyses are derived from historical data.

A significant increase in credit risk (SICR) is assessed on the basis of the following criteria:

32. Significant accounting policies, contd.

(vi) Impairment of financial assets,contd.

• Loans in a higher risk category based on estimated assumptions from the initial date of commitment - The current risk category is calculated for each loan and compared to the expectations of the expected risk group from the initial date of commitment. If the risk has risen considerably based on the original assumptions then there is considered to be an increase in credit risk.

• Additional information on credit ratings are also used in assessing credit risk, such as warning signs and credit watch lists.

• Loans in arrears for more than 30 days.

Loans are considered to be in default if loans are more than 90 days past due, if customers show severe signs of financial difficulties, or indications exist that the loans are managed differently.

If the increase in credit risk has decreased or is no longer present then assets may be reclassified from stage two back to stage one. However, the loan remains in the second stage for at least three months. Similarly, the loan is no longer deemed to be in default if the indicators that resulted in default have not been present for the past three months, and then the loan reverts from stage three to stage two. Loans that were in stage three remain in stage two for at least nine months, i.e. in total, the loan is managed separately for at least one year from the date of default.

Initial recognition

The model requires that the financial risk of financial assets be defined at initial recognition, which will then be used as a reference point at each reporting date in the future. If credit risk has increased, then it must be assessed whether the increase is significant or not.

Credit risk rate classification

The Fund classifies each borrower into a risk category that is intended to reflect credit risk. The assessment is based on various input variables for default; default information, borrower's financial information and mortgage loan ratio. In the risk assessment, borrowers are classified according to whether they are individuals, legal entities or municipalities. In addition, individuals are divided in two groups based on their financial history with the Fund, customers who have less than 12 months of transactions with the Fund are identified separately from other customers. The default ratio of each class is calculated based on historical data but adjusted to take into account the current economic situation and expectations of the Fund's economic situation during the life of the loan portfolio.

Economic forecasts

IFRS 9 requires that calculations of expected credit losses take into account probability forecasts of future economic conditions. The Fund also takes into account forecasts of whether credit risk has increased significantly since the initial date of the loan commitment. The Fund relies on statistical analysis based on historical data in assessing the relationships between economic variables, credit risk and expected credit losses. The Housing Financing Fund's Planning and Analysis Division will set-up scenarios, on the one hand the baseline forecast that reflects the most likely outcome, as well as setting a positive and negative scenario that reflects statistically probable deviations from the baseline forecast. All prerequisites for the calculations are presented to the Finance Committee that either approves the prerequisites or proposes remedies.

IAS 39 Financial Instruments:Recognition and Measurement: Effective before 1 January 2018

(i) Recognition and derecognition of financial assets and liabilities

Purchases and sales of financial assets are recognised at the date of transaction. The transactions 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 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.

Notes, contd.:

32. Significant accounting policies, contd.

IAS 39 Financial Instruments:Recognition and Measurement: Effective before 1 January 2018, contd.

(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 arrears on installments or on interest or principal payments.

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.

32. Significant accounting policies, contd.

(v) Impairment of financial assets, contd.

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 in the loan portfolio 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.

f. *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. 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. Impairment losses are recognized in the income statement.

g. *Cash and cash equivalents*

Cash and cash equivalents include funds, deposits with the Central Bank and deposits with other financial institutions.

h. *Claims on financial institutions*

Claims on financial institutions consist of interbank loans and unsettled claims on the Icelandic banks.

i. *Marketable securities*

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

j. *Other securities and Receivable from Treasury*

Other securities consist of government treasury bonds, structured covered bonds issued by Arion Bank secured by the bank's mortgages and covered bonds issued by Landsbankinn, Arion bank and Islandsbanki, secured by mortgages. Initially, the covered bonds are recognized at fair value in the Fund's financial statements including direct transaction costs and subsequently measured at amortized cost using the effective interest method. The interest revenue and impairment is recognized in the income statement.

k. *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.

l. *Appropriated properties*

When the Fund redeems properties on foreclosed mortgages they are recognised as appropriated properties in the balance sheet. Appropriated 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 an appropriated property 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.

Notes, contd.:

32. Significant accounting policies, contd.

m. *Investment properties*

Investment properties are real estate properties owned by the Fund for the purpose of earning rental income. Initially, investment assets are measured at cost, including transaction costs. Investment assets are subsequently recognized at fair value on the reporting date, fair value being based on the official property valuation of the National Registry of Property Registers Iceland. The property valuation is defined as the estimated market value for which a property is expected to have in a sales or purchase transaction. The assessment is carried out in May each year and is based on February prices. Evaluation according to the new price level takes effect at the end of the year. Real estate valuation property covers both buildings and land and is divided into building and land valuations. Investment properties are not depreciated.

n. *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.

o. *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.

p. *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.

q. *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.

r. *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 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. The Fund has applied IFRS 16 as of 1 January 2019 the effective date, using a retroactive approach. The Fund's management has assessed the impact of the implementation of IFRS 16 on the Financial Statements, based on its leases, lease terms and market rates. The Fund will recognise new assets and liabilities for its leases of office space. The conclusion of the assessment is lease liabilities amounting to ISK 209 million, and right-of-use-assets being equal to lease liabilities on January 1, 2019.

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.

Financial Statements of the Housing Financing Fund 2018 39 Amounts are in ISK thousand