

KMIIF

Financial Statements 2008

KMIIF
Borgartun 19
105 Reykjavik

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Endorsement and Signatures of the Board of Directors and the Managing Director

The Financial Statements of Kaupthing Mortgages Institutional Investor Fund pertain to part B of the Financial Statements of Kaupthing Bank hf.'s management company, which includes the Financial Statements of Verdbrefasjodir Kaupthing Bank, Fjarfestingarsjodir Kaupthing Bank and Fagfjarfestasjodir Kaupthing Bank. They are prepared according to the same accounting methods as the previous year. The presentation of these Financial Statements is in accordance with the Financial Supervisory Authority's regulations on financial statements of management companies for mutual funds.

Net earnings, according to the Income Statement, amounted to ISK 3,732 million during the year and the profit is stated as increase of units in the company's books. According to the Balance Sheet, the fund's equity at the end of the period amounted to ISK 17,544 million.

The fall of the commercial banks at the beginning of October 2008 considerably affected the operation of Rekstrarfélag Kaupthings banka hf., as well as single funds in the Company's operation. With law no. 125/2008 (Emergency Law) on 6 October 2008 premises for the evaluation of bonds issued by the banks changed. Following the enactment of the emergency law, claims in relation to deposits were made priority claims upon bankruptcy of a financial company, and at the same time, claims in relation to bonds were put further behind other claimants. This led to a decrease in the price of bonds issued by financial companies.

At year end, considerable uncertainty prevails over the real value of several financial instruments held by funds within Rekstrarfélag Kaupthing Banka hf. and assistance was sought from independent parties in reassessing their value. The reassessment does not take into account events after year end 2008. Funds that have been released but not yet liquidated are measured at the release value.

The Board of Directors and the Managing Director of Rekstrarfélag Kaupthing Bank hf.'s hereby confirm the Financial Statements of the fund for the year 2008 by means of their signatures.

Reykjavik, March 31, 2009.

Board of Directors:

Managing Director:

Independent Auditor's Report

To the unit holder of Kaupthing Mortgages Institutional Investor Fund.

We have audited the accompanying financial statements of KMIIF, which comprise the balance sheet as at December 31, 2008 and the income statement, statement of changes in net assets and investment statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the Icelandic Financial Statement Acts. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the fund as at December 31, 2008, and the results of its financial performance and its changes in net assets and investment statement for the year then ended in accordance with the Icelandic Financial Statements Act.

Reykjavik, March 31, 2009.

KPMG hf.

Income Statement for the Year 2008

	Notes	2008	2007
Financial income and (expenses)			
	2-4		
Interests, indexation, dividends, translation difference		23.575	8.258
Interest expense		(19.821)	(7.373)
Net financial income		3.754	885
Operating expenses			
Administration fee	5	116	86
Other operating expenses		(94)	86
		22	86
Profit for the year moved to units		3.732	799

Balance Sheet at 31 December 2008

	Notes	2008	2007
Assets			
Securities			
Securities with fixed income		116.888	81.902
Total securities	6	116.888	81.902
Cash		17.032	6.471
Total other assets		17.032	6.471
Total assets		133.920	88.373
Liabilities			
Liabilities with management- og custody companies		(1.473)	(10)
Other liabilities		0	(7)
Subordinated liabilities		(114.903)	(80.549)
Total liabilities		(116.376)	(80.566)
Total net assets		17.544	7.807
Equity			
Units	8	17.544	7.807
Net assets		17.544	7.807
Number of units		9.637	5.611
Exchange rate of units at the end of the year		1,82	1,39

Statement of Changes in Net Assets for the year 2008

	Notes	2008	2007
Operating activities			
Profit for the year moved to units		3.732	799
Financing activities			
Units sold		6.005	0
Redeemed units		0	0
		6.005	0
Changes in net assets		9.737	799
Net assets at the beginning of the year		7.807	7.008
Net assets at the end of the year		17.544	7.807

Investment Statement 31 December 2008

KMIIF

	Market value	% of assets
Icelandic bonds		
Kaupthing hf., property loans	116.888	100,0%
Total assets	116.888	100,0%
Subordinated liabilities	(114.903)	(98,3%)
Other assets	17.032	14,6%
Other liabilities	(1.473)	(1,3%)
Total net assets	<u>17.544</u>	

Notes to the Financial Statements

Accounting methods

1. Basis of preparation

The Financial Statements of Fagfjarfestasjodur Rekstrarfelag Kaupthing Bank hf. are prepared in accordance with the Financial Statements Act and regulations on financial statements for management companies of mutual funds. They are prepared on the historical cost basis except that securities are generally stated at market value. The Financial Statements are prepared in accordance with the same accounting methods as the previous year. The Financial Statements have been prepared in Icelandic currency and amounts are presented in millions of Icelandic kronas. The fund is a part of Rekstrarfelag Kaupthing hf., which is Kaupthing Bank hf.'s subsidiary. Due to the nature of its operation, the Financial Statements of the fund are not included in the Financial Statements of the bank.

2. Foreign currencies

Assets and liabilities in foreign currencies are translated into Icelandic kronas at the foreign exchange rate ruling at the end of the year 2008. Operating income and expenses in foreign currencies are translated at the foreign exchange rate ruling at the transaction date.

3. Interest income and expenses

Interest income and expenses are recognised in the income statement as they incur, based on effective interest.

4. Dividends

Dividends are capitalized when there is demand of redemption, i.e. the date dividends are paid out.

5. Administration fee

KMIIF fagfjarfestasjodur pays to Rekstrarfelag Kaupthing Bank hf. an asset management fee which among other things includes the following operating cost for the fund: salaries of the management company's employee and market and administration cost. Furthermore, the fund pays to Arion hf. a security custody fee.

	Asset manage- ment fee	Administration fee
KMIIF	0,47%	0,03%

In addition to the aforementioned, the fund also pays audit expenses.

6. Investments

a. Bonds

Bonds listed on a public securities market are stated at market value at year end. In the assessment of those assets a reduction, which takes note of general risk in relation to the operation and market condition at year end, is calculated. The debtors' going concern is evaluated as companies under moratorium and companies with revalued negative value of equity are considered to be inoperative. For inoperative debtors the write down is measured on the basis of recoverable proportion of the bonds. Priority claims are taken into account. For operative companies the write down is measured on the basis of imputed rate of interest.

Notes, contd.:

b. Securities

Securities listed on a public securities market are stated at market value at the end of the year. Unlisted shares are stated at the last known transaction value or at the estimated market value, whichever is lower.

c. Collective funds

Collective fund units are stated according to the bid price ruling on the market at year end.

Funds closed down at year end are recognised at the revalued intrinsic value based on the write-down of the underlying assets. The exchange rate of funds that held a share in the relevant funds is upgraded accordingly.

d. Deposits with credit institution

Restricted deposits with credit institution are updated in accordance with accrued interests, indexation and translation difference at the end of the year.

e. Derivatives

Derivatives are financial agreements where agreement or nominal value amounts are not recognised in the funds' balance sheet, either because rights and duties arise from the one and same agreement, the agreements do not become effective until year 2008 or the nominal value amounts are only used as variables in the calculation of other measures. Nominal value amounts of derivative agreements do not necessarily indicate thereto related payment amounts or risks. As examples of derivative agreements, there are forward currency agreements, option agreements, swap agreements, future agreements and forward rate agreements. Their value can for example be based on interest ratios and prices of currencies, goods, bonds and shares.

The funds' derivative agreements are stated at market value. The agreements are used to protect the funds against interest and exchange rate risks of securities. The funds' derivative agreements are intended to reduce their interest and exchange rate risks. Profit from derivative agreements is recognised in the income statement and the balance sheet.

Derivative agreements market risk arises due to price changes of the elements on which the agreements are based, such as interest rate changes or price changes of currencies and listed securities.

7. Tax

Mutual funds do not pay income tax but their profits or losses are taxed with the unit holders. Individuals pay capital gains tax on the profits of their securities when they are redeemed. Profits and losses on units number among taxable income or expenses with companies, independent of redemption.

The funds are exempt from capital gains tax in Iceland but not in countries where capital gains tax is imposed on foreign parties' income and in cases where no Double Taxation Convention is in vigor between Iceland and the country in question stating that such income is taxable in Iceland.

Notes, contd.:

8. Units

Real return of the mutual fund of Rekstrarfelag Kaupthing Bank as of 31 December 2008.

		Last 3 months	Last 6 months	Last 12 months
KMIIF	(1,3%)	7,98%	10,76%

9. Statement of book value and exchange rate of units.

	Book value		Exchange rate	
	2008	2007	2008	2007
KMIIF	17.544	7.807	1,82	1,39

10. Statement of proportional division of assets and investment policy.

	Assets 2008	Assets 2007	Change	Investment policy	
	%	%		Minimum	Maximum
Other financial instruments	100	100	0	0	100

11. Segmentation of investments and proportional division:

	State, municipality or intern. inst.		Shares		Other		Total	
	ISK	%	ISK	%	ISK	%	ISK	%
	Other financial instruments	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>116.888</u>	<u>100</u>	<u>116.888</u>
	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>116.888</u>	<u>100</u>	<u>116.888</u>	<u>100</u>