ARTHUR ANDERSEN

ARTHUR ANDERSEN & CO. SC

THE MORTGAGE CORPORATION LIMITED

FINANCIAL STATEMENTS - 31 DECEMBER 1995

TOGETHER WITH DIRECTORS' AND AUDITORS' REPORTS

The company's registered number is: 1759546

THE MORTGAGE CORPORATION LIMITED

DIRECTORS' REPORT

FOR THE YEAR ENDED 31 DECEMBER 1995

The directors present their annual report on the affairs of the company, together with the financial statements and auditors' report for the year ended 31 December 1995.

PRINCIPAL ACTIVITIES AND BUSINESS REVIEW

The principal activities of the company throughout the year were the provision of mortgage loans secured on residential properties within England, Wales and Scotland and servicing mortgages for fellow subsidiary undertakings.

The company made a profit on ordinary activities after taxation of £6,175,342 for the year ended 31 December 1995 (1994 loss: £2,684,204).

The directors cannot recommend the payment of a dividend (1994 - £nil).

DIRECTORS AND THEIR INTERESTS

The following directors served from 1 January 1995:

P. J. McSloy	Chairman	(resigned 4 October 1995)
P. Middleton	Chairman	(appointed 10 January 1996)
N. Kheraj		
P. D. Mullen		
R. A. Nau		(resigned 24 April 1995)

The company is a wholly-owned subsidiary of Salomon Brothers Europe Limited of which P. Middleton is a director.

None of the directors had at any time during the year any interests in the shares or contracts of the company which are required to be disclosed under the terms of the Companies Act 1985.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

FIXED ASSETS

Information relating to changes in tangible fixed assets is given in note 7 to the financial statements.

EMPLOYEE CONSULTATION

The company places considerable value on the involvement of its employees and has kept them informed by formal and informal meetings on matters affecting them as employees and on the various factors affecting the company.

EMPLOYMENT OF DISABLED PEOPLE

In line with its general policy of equal opportunity in employment practice the company supports the employment of disabled persons wherever possible, by recruitment, by retention of those who become disabled during their employment and generally through training, career development and promotion.

LIABILITY INSURANCE FOR COMPANY OFFICERS

As permitted by the Companies Act 1985, the company maintains insurance cover for the directors against liabilities in relation to the company.

BY ORDER OF THE BOARD,

Victoria Plaza
111 Buckingham Palace Road
London
SW1W 0SR

18 March 1996

I. A. Pellow
Secretary

London

Auditors' report to the shareholders of THE MORTGAGE CORPORATION LIMITED:

We have audited the financial statements on pages 4 to 16 which have been prepared under the historical cost convention and the accounting policies set out on pages 6 to 8.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

As described on page 1 the company's directors are responsible for the preparation of the financial statements. It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion to you.

BASIS OF OPINION

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

OPINION

In our opinion the financial statements give a true and fair view of the company's state of affairs as at 31 December 1995 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Arthur Andersen

Arthur Andersen
Chartered Accountants and Registered Auditors
1 Surrey Street
London
WC2R 2PS

18 March 1996

THE MORTGAGE CORPORATION LIMITED

PROFIT AND LOSS ACCOUNT

FOR THE YEAR ENDED 31 DECEMBER 1995

	Notes	1995	1994
TURNOVER	1b & 2	34,792,334	41,220,284
Interest expense	3	(14,068,979)	(11,065,186)
Other operating expenses		(14,548,013)	(30,440,963)
PROFIT/(LOSS) ON ORDINARY ACTIVITIES BEFORE TAXATION		6,175,342	(285,865)
Tax on profit/(loss) on ordinary activities	6	-	(2,398,339)
PROFIT/(LOSS) ON ORDINARY ACTIVITIES AFTER TAXATION	14	£ 6,175,342	£ (2,684,204)

The accompanying notes are an integral part of this profit and loss account.

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

There were no other recognised gains or losses in the current year (1994 - £Nil).

THE MORTGAGE CORPORATION LIMITED

BALANCE SHEET - 31 DECEMBER 1995

	Notes	1995	1994
FIXED ASSETS			
Tangible assets	7	£ 2,610,418	£ 2,607,866
Investments	1i	14,287,610	13,668,610
		16,898,028	16,276,476
MORTGAGE ADVANCES	8	193,762,319	63,387,580
ASSETS SECURITISED	9	1,127,332,353	1,550,226,381
CURRENT ASSETS			
Debtors	10	27,186,257	114,754,534
Cash at bank and in hand	11	10,577,258	18,976,041
		37,763,515	133,730,575
TOTAL ASSETS		£ 1,375,756,215	£ 1,763,621,012
CAPITAL AND RESERVES			
Called-up share capital	12	£ 67,500,100	£ 67,500,100
Share premium account	13	11,360,000	11,360,000
Profit and loss account		(67,337,932)	(73,513,274)
SHAREHOLDERS' FUNDS	14	11,522,168	5,346,826
PROVISION FOR LIABILITIES AND CHARGES	15	18,814,558	6,089,579
CREDITORS	16	1,345,419,489	1,752,184,607
		£ 1,375,756,215	£ 1,763,621,012

SIGNED ON BEHALF OF THE BOARD

P.D. Mullen

P.D. Mullen
Director

18 March 1996

The accompanying notes are an integral part of this balance sheet.

1. PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies, all of which have been applied consistently throughout the current year and the preceding year, are set out below.

(a) Basis of Accounting

The financial statements are prepared under the historical cost convention and are in accordance with applicable accounting standards.

Under the provisions of Financial Reporting Standard No. 1, the company has not prepared a cash flow statement because its parent undertaking, Salomon Brothers Europe Limited, which is incorporated in England and Wales, has prepared consolidated accounts which include the accounts of the company for the year and which contain a consolidated cash flow statement.

(b) Turnover

Turnover comprises interest, servicing fees, commissions and miscellaneous fee income recognised as it becomes receivable. Interest includes that which is recoverable from the Inland Revenue under MIRAS (mortgage interest relief at source).

(c) Interest Rate Hedges

Gains and losses arising from interest rate swaps and forward rate agreements ("FRAs") are taken to the profit and loss account in equal instalments over the period to which they relate. At year end, a provision is made for gains or losses on transactions where the notional values of the interest rate swaps or FRAs exceed the assets or liabilities being hedged.

(d) Depreciation

Depreciation is provided at rates calculated to write-off the cost of fixed assets on a straight-line basis over their expected useful life, as follows:

Leasehold improvements	Over the life of the lease to a maximum of 20 years
Fixtures, fittings and equipment	4 - 5 years
Computer equipment	3 - 5 years
Motor cars	3 years

The depreciation method for leasehold improvements was changed during the year to limit the depreciation period to a maximum of 20 years.

(e) Pension Costs

The company accounts for pension costs in accordance with Statement of Standard Accounting Practice 24. For the defined contribution scheme, the charge recorded in the profit and loss account is the amount of contribution payable in respect of the year, plus administration costs incurred by the fund.

Further information on pension costs is provided in note 17c.

(f) Leases

Rentals under operating leases are primarily charged on a straight-line basis to the profit and loss account over the term of the lease. Where the company has vacated or intends to vacate space a provision is established for the estimated net future liability of the space vacated.

1. **PRINCIPAL ACCOUNTING POLICIES (Continued)**

(g) **Taxation**

Corporation tax is provided on taxable profits at the current rate.

Deferred taxation is calculated on the liability method at the rate of tax at which the liability is likely to be paid. Deferred taxation is provided to take account of the difference in timing between certain items for financial statement purposes and taxation purposes. Deferred taxation is not provided on timing differences which, in the opinion of management, will not reverse.

(h) **Mortgage Advances**

Mortgage advances comprise loans which are secured by way of a mortgage over freehold and leasehold residential properties located in England, Wales and Scotland.

Mortgage advances include properties in possession and are stated after deducting a provision for loan losses. The provision is maintained at a level that is considered adequate by management to absorb losses inherent in the loan portfolio of the company. A judgement as to the adequacy of the provision is made at year end and includes anticipated recoveries under mortgage indemnity guarantees and other insurance policies. Should the provision be judged inadequate either because of reductions due to write-offs or because of changes to the size and characteristics of the portfolio, the provision is increased and charged to other operating expenses in the current year.

(i) **Investments**

Investments are recorded at cost less provisions for permanent diminution in value and represent properties which have been sold to non-group companies organised under a business expansion scheme ("BES"). As more fully described in note 16c, the company has granted an option which may require the company to repurchase these properties at a future date. Therefore, the company has not accounted for these transactions as a sale, and a corresponding liability is reported in creditors.

The liability is adjusted at each year end based on management's estimate of the future liability that may arise and is charged to the profit and loss account.

(j) **Securitisation of Mortgage Advances**

During the period 1987 through 1992, the company entered into a series of transactions under which it sold pools of residential mortgages to fellow subsidiaries (referred to as Special Purpose Vehicles - "SPVs") of its immediate parent. Each SPV issued debt, the proceeds of which were used to finance the purchase of mortgages from the company.

The company does not hold any of the issued share capital of the SPVs but has entered into servicing agreements with the SPVs to administer their mortgage portfolios. For certain of these SPVs the company is required to provide liquidity support facilities and limited indemnities against shortfalls arising on the sale of repossessed properties.

Servicing fees are earned by the company from each SPV calculated on excess earnings as defined in the relevant servicing agreements.

1. PRINCIPAL ACCOUNTING POLICIES (Continued)

(k) Assets and Liabilities Recognised by the company

In order to comply with the requirements of Financial Reporting Standard No. 5 ("FRS No. 5"), the company has separately presented on its balance sheet assets securitised under the arrangements summarised in note 1 j). The corresponding financing obligations for these assets are classified as credit facilities and floating rate notes within creditors.

This treatment is deemed appropriate because the directors have concluded, on the basis of reasonable assumptions, that the company retains significant interest and control in the performance of assets sold to the SPVs for the purpose of securitisation.

2. TURNOVER

Turnover comprises:

		1995		1994
Servicing fees	£	18,362,782	£	29,573,291
Interest income		14,638,311		8,474,508
Commission income and miscellaneous fees		1,791,241		3,172,485
	£	34,792,334	£	41,220,284

All income and the profit/(loss) on ordinary activities is derived from the company's principal activities relating to mortgage advances offered in England, Wales and Scotland.

3. INTEREST EXPENSE

Interest expense comprises:

		1995		1994
Interest on intercompany borrowings	£	10,476,089	£	7,392,378
Interest on bank loans and other		2,196,018		2,686,840
Interest on subordinated loan		1,396,872		985,968
	£	14,068,979	£	11,065,186

With the exception of interest on subordinated loan, interest expense relates to short-term borrowings.

4. PROFIT/(LOSS) ON ORDINARY ACTIVITIES BEFORE TAXATION

Profit/(Loss) on ordinary activities before taxation is stated after charging:

		1995		1994
Provisions for loan losses	£	1,573,804	£	17,645,353
Staff costs (note 5)		5,123,073		5,391,394
Depreciation		603,498		797,104
Equipment rental		44,943		412,470
Auditors' remuneration - audit		37,492		42,000
Auditors' remuneration - non audit		3,500		3,000

5. STAFF COSTS

Particulars of employees including executive directors are shown below:

Employee costs during the year amounted to:

		1995		1994
Wages and salaries	£	4,472,982	£	4,702,419
Social security costs		363,389		381,880
Other pension costs (note 17c)		286,702		307,095
		5,123,073	£	5,391,394

The average weekly number of persons employed by the company during 1995 was 191 (1994 - 201).

Directors' remuneration in respect of directors of the company was as follows:

		1995		1994
Other emoluments (including pension contributions)	£	158,744	£	221,872

The directors' remuneration shown above (excluding pensions and pension contributions) included:

		1995		1994
Chairman	£	-	£	-
Highest paid director	£	158,744	£	159,598

NOTES TO THE FINANCIAL STATEMENTS (Continued)

5. STAFF COSTS (Continued)

Directors received emoluments (excluding pensions and pension contributions) in the following ranges:

	1995	1994
£ 0 - £ 5,000	3	3
£ 60,001 - £ 65,000	-	1
£ 155,001 - £160,000	1	1

6. TAX ON PROFIT/(LOSS) ON ORDINARY ACTIVITIES

The tax credit/(charge) is based on the profit/(loss) for the year and comprises:

	1995	1994
Corporation tax at 33%	£ -	£ (2,737,456)
Adjustment of current taxation in respect of prior years	-	339,117
	£ -	£ (2,398,339)

The tax losses for 1995 have been surrendered for group relief with zero value.

7. TANGIBLE FIXED ASSETS

The movement in the year was as follows:

	Computer Equipment	Motor Cars	Leasehold Improvements	Fixtures, Fittings & Equipment	Total
COST-					
Beginning of year	£ 3,275,813	£ 276,520	£ 2,209,025	£ 2,114,694	£ 7,876,052
Additions	55,117	28,151	474,106	100,120	657,494
Disposals	(71,490)	(99,977)	-	(79,099)	(250,566)
End of year	3,259,440	204,694	2,683,131	2,135,715	8,282,980
DEPRECIATION-					
Beginning of year	£ 2,637,257	£ 83,551	£ 516,872	£ 2,030,506	£ 5,268,186
Transfer	-	-	27,156	(27,156)	-
Charge	295,139	47,509	186,571	74,279	603,498
Disposals	(71,490)	(48,533)	-	(79,099)	(199,122)
End of year	2,860,906	82,527	730,599	1,998,530	5,672,562
NET BOOK VALUE					
Beginning of year	£ 638,556	£ 192,969	£ 1,692,153	£ 84,188	£ 2,607,866
End of year	£ 398,534	£ 122,167	£ 1,952,532	£ 137,185	£ 2,610,418

As a result of the change to the policy for depreciation of leasehold improvements, the charge above is £31,702 greater than it would have been under the previous method of calculation.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

8. MORTGAGE ADVANCES

Mortgage advances comprise:

		1995		1994
Completed advances	£	197,587,983	£	64,897,735
Provisions for loan losses		(3,825,664)		(1,510,155)
	£	193,762,319	£	63,387,580

Mortgage advances are all due to be repaid after more than one year.

The movement in mortgage advances in the year was as follows:

		1995		1994
Beginning of year	£	63,387,580	£	37,851,936
Net purchases from group and fellow subsidiary undertakings		159,261,403		41,875,819
Advances made		181,000		48,000
Loans redeemed		(26,752,155)		(16,175,101)
Net change in provisions for loan losses		(2,315,509)		(213,074)
End of year	£	193,762,319	£	63,387,580

9. ASSETS SECURITISED

		1995		1994
Mortgage advances	£	1,082,948,652	£	1,518,702,041
Investments		44,383,701		31,524,340
	£	1,127,332,353	£	1,550,226,381

Investments represent redemption proceeds on mortgage advances. The total of mortgage advances and investments secure the credit facilities and floating rate notes reported in creditors (see note 16).

Other net assets of the SPVs, including capitalised issue costs of £4,752,820 (1994 - £6,189,399), from which the company will not obtain economic benefit, have been excluded from the financial statements of the company.

10. DEBTORS

The following are included in the net book value of debtors:

		1995		1994
Amounts falling due within one year:				
Due from other fellow subsidiary undertakings	£	9,195,800	£	50,157,677
Prepayments and accrued income		4,157,988		3,845,965
Other debtors (see (a) below)		2,598,311		3,529,813
		15,952,099		57,533,455
Amounts due after more than one year:				
Due from fellow subsidiary undertakings (see (b) below)		11,234,158		57,221,079
Total debtors	£	27,186,257	£	114,754,534

(a) Other debtors consist primarily of mortgage interest receivable and is stated net of provisions for uncollectable amounts.

(b) Amounts from fellow subsidiary undertakings due after more than one year are in respect of subordinated loans which are currently non-interest bearing. The loans may be repaid in whole or in part provided the subsidiaries have sufficient assets to meet their other obligations and liabilities. The balance shown is after a provision of £269,744 (1994 - £6,291,887) for uncollectable amounts.

11. CASH AT BANK AND IN HAND

Cash at bank and in hand at 31 December 1995 includes segregated funds of £10,245,426 (1994 - £18,701,652) which have been established to meet potential claims by fellow subsidiary companies for losses on repossessed properties (see note 15).

12. CALLED-UP SHARE CAPITAL

		1995		1994
Authorised:				
170,000,000 ordinary £1 shares	£	170,000,000	£	170,000,000
30,000,000 non-redeemable preference shares of £1 each		30,000,000		30,000,000
	£	200,000,000	£	200,000,000
Allotted, called-up and fully paid 67,500,100 ordinary £1 shares	£	67,500,100	£	67,500,100

13. SHARE PREMIUM ACCOUNT

		1995		1994
Beginning and end of year	£	11,360,000	£	11,360,000

14. RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

		1995		1994
Profit/(loss) for the year	£	6,175,342	£	(2,684,204)
Opening shareholders' funds		5,346,826		8,031,030
Closing shareholders' funds	£	11,522,168	£	5,346,826

Shareholders' funds comprise equity interests.

15. PROVISION FOR LIABILITIES AND CHARGES

The provision for liabilities and charges comprises:

		1995		1994
Provisions for mortgage related charges	£	17,538,776	£	4,166,778
Lease costs		1,275,782		1,922,801
	£	18,814,558	£	6,089,579

Provisions for mortgage related charges primarily consist of recoveries for shortfalls on the sale of repossessed properties and associated insurance claims by fellow subsidiary undertakings, as well as other liabilities relating to its fellow subsidiary undertakings.

Lease costs represent a provision for the estimated future payments on premises sublet by the company. The estimated future payments are net of income from sub-leasing the vacant space.

16. CREDITORS

The following are included in creditors:

		1995		1994
Amounts falling due within one year:				
Due to group and fellow subsidiary undertakings (see (a) below)	£	178,265,179	£	157,923,932
Credit facilities (see (b) below)		-		83,000,000
Other creditors and accruals		5,700,328		8,727,613
Group relief		-		2,737,456
Overdrafts		402,923		759,646
PAYE and NIC		360,498		252,262
		184,728,928		253,400,909
Amounts falling due after more than one year:				
Floating rate notes (see (b) below)	£	1,111,332,353	£	1,445,726,381
Credit facilities (see (b) below)		16,000,000		21,500,000
Other (see (c) below)		18,358,208		16,557,317
Due to parent company (see (d) below)		-		15,000,000
Due to group undertaking (see (d) below)		15,000,000		-
		1,160,690,561		1,498,783,698
	£	1,345,419,489	£	1,752,184,607

(a) The balance due to group and fellow subsidiary undertakings includes outstanding loans maturing within 12 months but capable of being rolled over at maturity. Interest is payable at market rates.

The company has granted a floating charge on its mortgage advances to secure certain amounts due to the group and fellow subsidiary undertakings.

(b) Credit facilities and floating rate notes represent the financing obligations of fellow subsidiaries whose securitised assets have been separately presented on the balance sheet of the company.

(c) Other represents amounts provided through a business expansion scheme ("BES"). Under the terms of the transaction, the company has sold repossessed properties to three BES companies, who in turn market them as rental properties. In connection with the sale, the company has granted an option to each of the BES companies. The option, if exercised, would require the company to repurchase the properties at such a price that will enable the BES companies to make a distribution of £1.37 for each £1 invested by their shareholders. Therefore, the company has not accounted for the transaction as a sale. The option may be exercised at any time between 1 June 1997 and 10 July 1997.

Due to the number of economic factors affecting the future operating performance of the BES companies, it is uncertain as to whether or not the option will be exercised.

(d) The amount due to a group undertaking (1994 - parent company) falling due after one year is a subordinated loan. The loan matures on 31 December 2000 and bears interest at a margin of 137.5 basis points over one year London Interbank Offer Rate ("LIBOR") as determined on the last business day in December.

17. GUARANTEES AND OTHER FINANCIAL COMMITMENTS

(a) Contingent Liabilities

The company has entered into interest rate swap contracts, under which it pays a weighted average fixed interest rate of 10.69% on notional borrowings of £9.25 million with a weighted average term to maturity of 4 months.

The company has entered into forward rate agreements with a weighted average interest rate of 6.16% on notional amounts of £720m, all expiring within 1996.

(b) Lease Commitments

The company has entered into operating leases in respect of equipment, the payments for which extend over a period not exceeding 3 years. The total annual rental for 1995 was £44,943 (1994 - £412,470).

In addition, the company leases certain land and buildings on short and long term leases. The annual rental on these leases for 1995 was £1,501,128 (1994 - £1,501,128). The rents payable under these leases are subject to re-negotiation at various intervals specified in the leases. The leases also require the company to pay insurance, maintenance and repairs of the properties.

The minimum annual rentals under the foregoing leases are as follows:

	1995		1994	
	Property	Equipment	Property	Equipment
Operating Leases which expire:-				
within 1 year	£ -	£ -	£ -	£ 45,454
within 2 - 5 years	-	11,652	-	-
after 5 years	1,501,128	-	1,501,128	-
	£ 1,501,128	£ 11,652	£ 1,501,128	£ 45,454

The minimum annual rental payment of £1,501,128 will be reduced by £543,426 through the sub letting of vacated space in 1996. Further annual rental of £70,000 becomes payable at the end of 1996 in relation to additional office space leased.

(c) Pension Arrangements

Eligible employees of the company participate in The Mortgage Corporation Pension Plan ("the Plan"). The Plan is a funded pension scheme providing defined contribution benefits and insured death benefits.

The assets of the Plan are held separately from those of the company and are administered by a trustee.

Total costs relating to the Plan for 1995 were £286,702 (1994 - £307,095).

18. ULTIMATE PARENT COMPANY

The company is a wholly-owned subsidiary of Salomon Brothers Europe Limited, incorporated in England and Wales, and its ultimate parent company is Salomon Inc, incorporated in the State of Delaware, U.S.A.

The largest group in which the results of the company are consolidated is that headed by Salomon Inc. The smallest group in which they are consolidated is that headed by Salomon Brothers Europe Limited.

The consolidated financial statements of Salomon Inc are available to the public from its office at 7 World Trade Center, New York, New York 10048, and those of Salomon Brothers Europe Limited may be obtained from the Company's Registered Office at 111 Buckingham Palace Road, London SW1W OSR.