Mortgage Agency Services Number Two Limited

Directors' report and financial statements

for the year ended 31 December 2006

Registered Number 2221553

Mortgage Agency Services Number Two Limited
Directors' report and financial statements
for the year ended 31 December 2006

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Mortgage Agency Services Number Two Limited

Directors and advisors

Directors
R S Green
G A Gregory
P A Lee
S Williams
M Lewis
D Tweedy
J Katovsky

Secretary
R S Green

Auditors
PricewaterhouseCoopers LLP
101 Barbirolli Square
Lower Mosley Street
Manchester
M2 3PW

Registered Office
Newton House
Leek
Staffordshire
ST13 5RG

Registered Number
2221553

Mortgage Agency Services Number Two Limited

Directors' report for the year ended 31 December 2006

The directors present their report and the audited financial statements of the company for the year ended 31 December 2006.

Principal activities
The company was incorporated in the United Kingdom. The principal activities of the company are investment in mortgage loans secured by first charges over residential properties within the United Kingdom and to receive deferred consideration for previously owned mortgage portfolios.

Review of business and future developments
During the year the residential mortgage assets and respective deemed loan liabilities have decreased in line with the residential mortgage portfolios they reflect, the decrease being due to the mortgage repayments received during the year. The residential mortgage interest, which is based on the outstanding capital, decreased in proportion to the mortgage portfolio; the interest receivable is in line with management's expectations.

Key performance indicators (KPI's)
Given the straightforward nature of the business, the company's directors are of the opinion that analysis using KPIs is not necessary for an understanding of the development, performance or position of the business.

Principal risks and uncertainties
The key business risks and uncertainties affecting the company are considered to relate to economic factors in the United Kingdom which could affect the ability of its customers to repay their loans. Further discussion of these risk and uncertainties, in the context of the group as a whole, is provided in the group's annual report which does not form part of this report.

As set out more fully in the Statement of accounting policies, these financial statements have been prepared under the current International Financial Reporting Standards (IFRS) framework. All financial information given in this Directors' report is taken solely from the statutory results prepared on the above basis.

Results and dividends
The profit for the year after tax amounted to £2,485k (2005: £5,916k). The net assets of the company at 31 December 2006 were £28,810k (2005:£32,241k). The directors propose a dividend for the year of £2,484,523 (2005: £5,915,939).

Directors and their interests
The directors who held office during the year are given below:

R S Green
G A Gregory
P A Lee
S Williams
M Lewis
D Tweedy
J Katovsky (appointed 1 February 2006)

No director had a beneficial interest in the share capital of the company or any other company in the group at any time during the period under review.

Directors' report for the year ended 31 December 2006 (continued)

Statement of directors' responsibilities
Company law requires the directors to prepare financial statements for each financial period that 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. The directors are required to prepare financial statements on the going concern basis, unless it is inappropriate to presume that the company will continue in business.

The directors confirm that suitable accounting policies have been used and applied consistently. They also confirm that reasonable and prudent judgements and estimates have been made in preparing the financial statements for the year ended 31 December 2006 and that applicable International Financial Reporting Standards have been followed.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and 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.

The directors are responsible for ensuring that reasonable care is taken to establish, maintain, document and review such systems and controls as are appropriate to the company in accordance with the rules made by the Financial Services Authority under the Financial Services and Markets Act 2000.

Disclosure of information to auditors
The directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the company's auditors are unaware; and each director has taken all the steps that they ought to have taken as directors to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

Financial risk management
The directors have considered the financial risks affecting the company and have disclosed the relevant policies in the Notes to the financial statements.

Auditors
The auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office, and a resolution concerning their reappointment will be proposed at the Annual General Meeting.

By order of the Board

PALee

P A Lee
Director
23 March 2007

Mortgage Agency Services Number Two Limited

Independent auditors' report to the members of Mortgage Agency Services Number Two Limited

We have audited the financial statements of Mortgage Agency Services Number Two Limited for the year ended 31 December 2006 which comprise the Income statement, the Balance sheet, the Cash flow statement, the Statement of recognised income and expenditure and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether, in our opinion, the information given in the Directors' report is consistent with the financial statements.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the Directors' report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) 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 judgments 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, in accordance with IFRSs as adopted by the European Union, of the state of the company's affairs as at 31 December 2006 and of its profit and cash flows for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' report is consistent with the financial statements.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Manchester
23 March 2007

Mortgage Agency Services Number Two Limited

Income statement for the year ended 31 December 2006

	Notes	2006 £000	2005 £000
Interest income	2	**19,576**	27,762
Interest expense	3	**(14,184)**	(19,211)
Net interest income		**5,392**	8,551
Fee and commission income	4	**842**	843
Net fee and commission income		**842**	843
Gains less losses from derivative financial instruments	5	**6**	82
Impairment losses on loans and advances	10	**(591)**	473
Other operating expenses		**(2,147)**	(1,705)
Profit before tax		**3,502**	8,244
Taxation	7	**(1,017)**	(2,328)
Net profit	16	**2,485**	5,916

The accounting policies and notes on pages 9 to 26 form part of these financial statements.

Mortgage Agency Services Number Two Limited

Balance sheet as at 31 December 2006

	Notes	2006 £000	2005 £000
Assets			
Derivative financial instruments	9	**3**	3
Loans and advances to customers	10	**244,630**	350,548
Deemed loans due from group undertakings	11	**1,673**	3,528
Current tax recoverable		**3**	-
Deferred tax asset	7	**503**	558
Other assets	12	**102**	85
Total assets		**246,914**	354,722
Liabilities			
Derivative financial instruments	9	**1,637**	-
Deemed loans due to group undertakings	13	**67,289**	86,540
Other liabilities	14	**149,178**	235,921
Current tax liabilities		**-**	20
Total liabilities		**218,104**	322,481
Equity			
Called up share capital	15	**-**	-
Retained earnings	16	**28,810**	32,241
Total equity and liabilities		**246,914**	354,722

The disclosure of deemed loans, deferred purchase consideration and group tax relief on the Balance sheet comparatives above has been amended to ensure presentation is consistent with other group companies.

The accounting policies and notes on pages 9 to 26 form part of these financial statements.

Approved by the Board of directors on 23 March 2007 and signed on its behalf by:

PAlee

PA Lee
Director

Mortgage Agency Services Number Two Limited

Statement of recognised income and expenditure for the year ended 31 December 2006

	Notes	2006 £000	2005 £000
Net profit for the year	16	**2,485**	5,916
Effect of changes in accounting policies:			
Changes in accounting policies on adoption of IAS 39		**-**	1,559
Tax on items through equity		**-**	(468)
Total recognised income and expenditure		**2,485**	7,007

Mortgage Agency Services Number Two Limited

Cash flow statement for the year ended 31 December 2006

	Notes	2006 £000	2005 £000
Cash flows from operating activities	17	**(14)**	(32)
Net decrease in cash and cash equivalents		**(14)**	(32)
Cash and cash equivalents at start of period		**(15)**	17
Cash and cash equivalents at end of period	8	**(29)**	(15)

The disclosure of taxation paid and the adoption of IAS 39 in the Cash flow statement comparatives above has been amended to ensure presentation is consistent with other group companies.

Statement of accounting policies for the year ended 31 December 2006

Basis of preparation

Mortgage Agency Services Number Two Limited is a company incorporated and domiciled in the United Kingdom. The accounts of the company are presented in £ Sterling unless otherwise stated.

From 1 January 2005, the company has chosen to prepare its annual financial statements in accordance with International Financial Reporting Standards (IFRS) and IFRIC interpretations as endorsed by the European Union (EU) and with those parts of the Companies Act 1985 applicable to companies reporting under IFRS.

There are no significant uncertainties applied in the basis of preparing these financial statements. Key estimates applied are discussed below.

The company accounts have been prepared on a historical cost basis, except for derivative financial instruments that have been measured at fair value, as required by IAS 39.

Interest income and expense

Interest income and expense are recognised in the Income statement using the effective interest rate method.

Effective interest rate
The effective interest rate method is a method of calculating the amortised cost of a financial asset or a financial liability and allocating the interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the company estimates cash flows considering all contractual terms of the financial instrument. The calculation includes all amounts receivable or payable by the company that are an integral part of the overall return.

When a financial asset has been written down as a result of impairment or loss, subsequent interest income continues to be recognised using the original effective interest rate applied to the reduced carrying value of the financial instrument.

Deferred consideration payable
Deferred purchase consideration is deducted from interest income, since the company does not recognise income to which it is not beneficially entitled. Contingent deferred consideration arising in future periods is recorded in the Income statement in the period in which it arises.

Deferred consideration receivable
Deferred purchase consideration is deducted from interest expense, since the company does not recognise expenditure, which it has not incurred. Contingent deferred consideration arising in future periods is recorded in the Income statement in the period in which it arises.

Fee and commission income

Fee and commission income, other than that directly related to loans, is recognised over the period for which service has been provided or on completion of an act to which the fee relates.

Deferred tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is determined using tax rates that have been enacted or substantially enacted by the Balance sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax (continued)

Deferred tax assets are recognised only where it is probable that future taxable profits will be available against which the temporary differences can be utilised.

Tax payable on profits is recognised as an expense in the period in which profits arise. The tax effects of tax losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

Cash and cash equivalents

For the purposes of the Cash flow statement, cash and cash equivalents comprise balances with less than 3 months maturity from the date of acquisition.

Financial assets

The company classifies its financial assets into two categories: financial assets at fair value through profit or loss and loans and receivables.

Loans and advances to customers are classified as loans and receivables and are carried at amortised cost using the effective interest method with all movements being recognised in the Income statement.

The company's derivative instruments are classified as financial assets or liabilities at fair value through profit or loss. These derivatives are accounted for as set out in the 'derivative financial instruments and hedge accounting' accounting policy set out below.

Impairment of financial assets

Loans and advances to customers

The company assesses at each Balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. This arises if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset, or group of financial assets, that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the company about the following loss events:

(i) significant financial difficulty of the issuer or obligor;

(ii) a breach of contract, such as a default or delinquency in interest or principal payments;

(iii) the company granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the lender would not otherwise consider;

(iv) it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;

(v) the disappearance of an active market for that financial asset because of financial difficulties; or

(vi) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the company, including:
   - adverse changes in the payment status of borrowers in the portfolio; or
   - national or local economic conditions that correlate with defaults on the assets in the portfolio.

The company first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the company determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment.

Impairment of financial assets (continued)

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the Income statement. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from repossession less costs for obtaining and selling the collateral, whether or not repossession is probable.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the company's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors).

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the company and historical loss experience for assets with credit risk characteristics similar to those in the company. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

The methodology and assumptions used for estimating future cash flows are reviewed regularly by the company to reduce any differences between loss estimates and actual loss experience.

When a loan is uncollectible, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the Income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account in the Balance sheet. The amount of the reversal is recognised in the Income statement.

Derivative financial instruments and hedge accounting

The company undertakes transactions in derivative financial instruments to hedge its exposure to interest rate and foreign exchange risk arising from its activities. The company does not hold or issue derivative financial instruments for trading purposes.

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and options pricing models, as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The company designates certain derivatives as hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedge). Hedge accounting is used for derivatives designated in this way provided specified criteria are met.

Statement of accounting policies for the year ended 31 December 2006 (continued)

Derivative financial instruments and hedge accounting (continued)

Fair value hedge
Changes in the fair value of derivatives that are designated as fair value hedges are recorded in the Income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item necessary to remeasure it under the effective interest rate method is amortised to the Income statement over the period to maturity.

Derivatives that do not qualify for hedge accounting
Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in the Income statement.

Deemed loans due from group undertakings

The beneficial ownership of the loans and advances to customers sold to the company by the originator fail the derecognition criteria of IAS 39 and, therefore, these loans remain on the Balance sheet of the originator. IAS 39, therefore, requires the seller to recognise a "deemed loan" financial liability on its Balance sheet and the resulting "deemed loan" asset is held on the company's Balance sheet.

This deemed loan initially represents the consideration paid by the company in respect of the acquisition of the beneficial ownership of the securitised loans and advances to customers and is subsequently adjusted due to repayments made by the originator to the company.

The deemed loan is carried at amortised cost using the effective interest rate method with all movements being recognised in the Income statement.

Management do not expect the amount of incurred credit losses on the originator's securitised loans and advances to customers to exceed the amount of credit enhancement supplied by Britannia Building Society. Therefore, in accordance with IAS 39, there is no requirement to recognise any impairment loss against this deemed loan.

Deferred consideration payable
Deferred purchase consideration payable is netted off against the deemed loans since they are due to and from the same counterparty.

Deemed loans due to group undertakings and securitisation transactions

The company has entered into various securitisation transactions in which it sells mortgages to special purpose entities (SPEs). Management considers that the company retains substantially all the risks and rewards of ownership of the securitised assets. The company, therefore, continues to recognise these assets as loans and advances to customers and recognises a financial liability for consideration received. This financial liability is termed a deemed loan.

In subsequent periods, income from the securitised mortgages is recognised by the company in the normal manner using the effective interest rate method. Amounts payable to the SPE, together with the expenses of the securitisation, are accrued as an expense on the financial liability.

The deemed loan is carried at amortised cost using the effective interest rate method with all movements being recognised in the Income statement.

Where, as part of the securitisation, the company enters into a derivative with the SPE, the company's rights and obligations are reflected in the expense accrued on the financial liability and the derivative is not accounted for separately.

Deemed loans due to group undertakings and securitisation transactions (continued)

Deferred consideration receivable
Deferred purchase consideration receivable is netted off against the deemed loans since they are due to and from the same counterparty.

Critical accounting estimates and judgements in applying accounting policies

The group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

a. Impairment losses on loans and advances
In accordance with the accounting policy on pages 10 and 11 the methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. To the extent that the net present value of estimated cash flows differs by 10%, the provision would change by an estimated £96k (2005: £68k).

b. Effective interest rate
The calculation of an effective interest rate requires the group to make assumptions around the expected lives of mortgages and the likely levels of early repayment fees (ERFs) to be received. The most critical assumption is on the level of future ERFs.

Were the ERF assumptions to change by 10% there would be an adjustment to profit of an estimated £96k (2005: £75k).

Dividends

Dividends are only recognised in the financial statements by the company once they have been approved by the shareholders.

Segmental reporting

Mortgage Agency Services Number Two Limited operates in one business segment and all business is conducted in the UK, therefore, no segmental information is presented.

Mortgage Agency Services Number Two Limited

Notes to the financial statements for the year ended 31 December 2006

1 Profit before tax

Profit before tax is stated after charging:

	2006 £000	2005 £000
Auditors' remuneration	**9**	9

2 Interest income

	2006 £000	2005 £000
Loans and advances	**19,220**	27,246
Deemed loan interest receivable	**485**	669
Deferred purchase consideration payable	**(129)**	(157)
Other	**-**	4
	19,576	27,762

There is £13k interest receivable accrued on impaired financial assets (2005: £15k).

3 Interest expense

	2006 £000	2005 £000
Deemed loan interest payable	**5,354**	9,454
Deferred purchase consideration receivable	**(581)**	(2,522)
Interest and similar charges payable to group undertakings	**9,411**	12,279
	14,184	19,211

4 Fee and commission income

	2006 £000	2005 £000
Intercompany fees receivable	**64**	113
Other fees	**778**	730
	842	843

Notes to the financial statements for the year ended 31 December 2006 (continued)

5 Gains less losses from derivative financial instruments

	2006 £000	2005 £000
Fair value hedging of mortgage assets	6	82
	6	82

6 Directors' emoluments and employees

The directors receive emoluments from Britannia Building Society group companies for services rendered to all companies in the group. However, these are not apportioned to the individual companies.

Six directors have benefits accruing under the Britannia Building Society Pension scheme (2005: five). Particulars of the latest actuarial valuation of the group pension scheme are disclosed in the accounts of Britannia Building Society.

The company had no employees during the current or prior period.

7 Taxation

	2006 £000	2005 £000
UK tax at 30% (2005: 30%)		
Corporation tax		
Current	980	2,463
Adjustments in respect of prior periods	(18)	(135)
Total corporation tax	962	2,328
Deferred tax		
Current	65	-
Adjustments in respect of prior periods	(10)	-
	1,017	2,328

Notes to the financial statements for the year ended 31 December 2006 (continued)

7 Taxation (continued)

Factors affecting tax charge for the year
The average effective rate of corporation tax assessed for the period is lower than the standard rate of corporation tax in the UK (30%). The differences are explained below:

	2006	2005
	£000	£000
Profit on ordinary activities before tax	3,502	8,244
Profit before tax multiplied by standard rate of tax	1,050	2,473
Effects of:		
Non taxable income	(43)	(57)
Expenses not deductible for tax purposes	39	47
Adjustments in respect of prior periods	(28)	(135)
Change in rate	(1)	-
	1,017	2,328

The recognised deferred tax asset includes the following amounts:

	2006	2005
	£000	£000
Accelerated capital allowances	1	-
Short term timing differences	502	558
	503	558

As at 31 December 2006, there are no tax-related contingent assets or contingent liabilities in accordance with International Accounting Standard No. 37 'Provisions, Contingent Liabilities and Contingent Assets (IAS37)'.

The reconciliation of the opening and closing deferred tax asset is shown below:

	2006	2005
	£000	£000
Deferred tax asset at start of period	558	558
Deferred tax provided during the year	(55)	-
Deferred tax asset at end of period	503	558

8 Cash and cash equivalents

	2006 £000	2005 £000
Bank overdrafts	(29)	(15)
	(29)	(15)

9 Financial instruments

A financial instrument is a contract that gives rise to a financial asset of one entity and a financial liability of another entity. The company's financial instruments comprise principally of loans and advances to customers, deemed loans, amounts owed to group undertakings and cash and cash equivalents.

As a subsidiary of Britannia Building Society, the company applies the Society's formal structure for managing risk, including established risk limits, reporting lines, mandates and other control procedures. This structure is reviewed regularly by the Assets and Liabilities Committee (ALCO), which is charged with the responsibility for managing and controlling the Balance sheet exposures of the Society. The minutes of ALCO are presented to the Board of the Society.

Instruments used for risk management purposes include derivative financial instruments (derivatives), which are contracts or agreements whose value is derived from one or more underlying price, rate or index inherent in the contract or agreement, such as interest rates.

Derivatives are not used in trading activity or for speculative purposes.

Numerical financial instruments disclosures are set out below:

	Assets 2006 £000	Liabilities 2006 £000
Interest rate swaps	3	1,637

	Assets 2005 £000	Liabilities 2005 £000
Interest rate swaps	3	-

9 Financial instruments (continued)

Net fair values of derivative financial instruments

The net fair values of derivative financial instruments designated as fair value hedges at the Balance sheet date were:

	2006 £000	2005 £000
Contracts with positive fair values:		
Interest rate swaps	**3**	3
Contracts with negative fair values:		
Interest rate swaps	**1,637**	-

Interest rate swaps

The notional principal amount of the outstanding interest rate swap contracts at 31 December 2006 was £59,555k (2005: £72,247k).

The company is exposed to movements in interest rates and manages this exposure using derivatives. Interest rate risk arises on the mortgages of the company which contain both fixed and variable loans. The funding for these is variable based on LIBOR. This risk is managed on a continuous basis through the use of appropriate financial instruments, including derivatives. The group monitors risk daily using a risk management system and operates *within limits set down by* ALCO.

After taking into consideration the company's derivative instruments, the directors do not believe that the company has any *significant interest rate* re-pricing exposure.

9 Financial instruments (continued)

Fair values of financial instruments

Set out in the tables below are a comparison of book and fair values of some of the company's financial instruments by category. Where available, market values have been used to determine fair values.

	Book Value 2006 £000	Fair Value 2006 £000
Loans and advances to customers	**244,630**	**244,630**
Deemed loans due from group undertakings	**1,673**	**1,673**
Other assets	**102**	**102**
Deemed loans due to group undertakings	**(67,289)**	**(67,289)**
Bank overdraft	**(29)**	**(29)**
Other liabilities	**(149,178)**	**(149,178)**

	Book Value 2005 £000	Fair Value 2005 £000
Loans and advances to customers	350,548	350,548
Deemed loans due from group undertakings	3,528	3,528
Other assets	85	85
Deemed loans due to group undertakings	(86,540)	(86,540)
Bank overdraft	(15)	(15)
Other liabilities	(235,921)	(235,921)

Derivatives are excluded from the table above as they are already recorded at fair value.

Credit risk

Loans and advances to customers

Credit risk is the risk that a customer or counterparty will not be able to meet its obligations to us as they become due.

Credit risk in respect of the company's residential mortgage assets is managed as follows:

- Original due diligence on any acquisitions is undertaken by both Britannia personnel and external experts.
- Credit management is conducted in accordance with the service contract & service specifications with Western Mortgage Services Limited (WMS).
- Arrears, possessions and redemptions statistics are reported to BTS Mortgage Performance Committee (MPC), and subsequently to BTS Credit Committee which reports to group Credit Committee on asset performance.
- MPC maintains limits and recommends policy. BTS Credit Committee sets policy, subject to Group Credit Committee approval.

9 Financial instruments (continued)

Deemed loans

Credit risk on deemed loans is considered to be minimal because management do not expected the amount of incurred credit losses on the originator's securitised loans and advances to customers to exceed the amount of credit enhancement supplied by Britannia Building Society.

Derivatives

The company maintains strict limits on the exposure of derivatives with banks. At any one time, the amount subject to credit risk is limited to the current fair value of instruments that are favourable to the company, (ie assets where their fair value is positive), which in relation to derivatives is only a small fraction of the contract, or notional values used to express the volume of instruments outstanding. The credit risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market movements. Collateral or other security is not usually obtained for credit risk exposures on these instruments, except where the company requires margin deposits from counterparties.

Effective interest rates

The effective interest rates of those monetary financial instruments not carried at fair value through income and expense as at 31 December 2006 were as follows:

Loans and advances to customers	6.44% (2005: 8.17%)
Amounts owed to group undertakings	1 month LIBOR plus 21 basis points

No interest was received or paid on the company's bank account due to group bank accounts being pooled on a daily basis.

10 Loans and advances to customers

	2006 £000	2005 £000
Loans to individuals:		
Mortgages	**246,087**	351,586
Less: allowance for losses on loans and advances (below)	**(1,457)**	(1,038)
	244,630	350,548
Allowance for losses on loans and advances:		
Balance at 1 January	**(1,038)**	(3,536)
Provision for loan impairment	**(591)**	473
Loans written off during the year as uncollectible	**172**	2,025
	(1,457)	(1,038)

During the year the company recovered £2k (2005: £nil) against amounts previously written off.

11 Deemed loans due from group undertakings

	2006	2005
	£000	£000
Deemed loans recoverable	**6,404**	8,130
Deferred purchase consideration payable	**(4,731)**	(4,602)
	1,673	3,528

The effective interest rate on the deemed loan during the year was 6.67% (2005: 6.90%)

The deemed loans recoverable are repaid as and when the cash is received by the originator from the customers towards principal repayments of the loans and advances. Consequently, a proportion of the deemed loan recoverable will be repaid within 12 months, although the amount cannot be quantified.

Deferred purchase consideration payable

Deferred consideration is payable to Mortgage Agency Services Number One Limited dependent on the extent to which the surplus income generated by the mortgage book, purchased by Mortgage Agency Services Number Two Limited from Mortgage Agency Services Number One Limited, exceeds the administration costs of the mortgage book. The surplus income generated during the year ended 31 December 2006 amounted to £129k (2005: £157k). The deferred consideration is payable as follows:

	2006	2005
	£000	£000
Amounts owed to Mortgage Agency Services Number One Limited	**4,731**	4,602
	4,731	4,602

The movements in deferred consideration are as follows:

	2006	2005
	£000	£000
At start of period	**4,602**	4,445
Additional consideration payable	**129**	157
At end of period	**4,731**	4,602

Notes to the financial statements
for the year ended 31 December 2006 (continued)

12 Other assets

	2006	2005
	£000	£000
Amounts owed by group undertakings	**80**	60
Prepayments and accrued income	**16**	24
Other	**6**	1
	102	85

The above amounts owed by group undertakings are expected to be settled within 12 months of the Balance sheet date. No interest is payable on these intercompany balances.

13 Deemed loans due to group undertakings

	2006	2005
	£000	£000
Deemed loan repayable	**69,830**	89,812
Deferred purchase consideration receivable	**(2,541)**	(3,272)
	67,289	86,540

The effective interest rate on the deemed loan during the year was 6.67% (2005: 7.70%)

The deemed loan repayable is repaid as and when the cash is received by the originator from the customers towards principal repayments of the loans and advances. Consequently, a proportion of the deemed loan repayable will be repaid within 12 months although the amount cannot be quantified.

Deferred purchase consideration receivable

	2006	2005
	£000	£000
Amounts owed by Mortgage Agency Services Number One Limited	**1,040**	896
Amounts owed by Leek Finance Number One PLC	**1,170**	1,752
Amounts owed by Leek Finance Number Two PLC	**331**	624
	2,541	3,272

Notes to the financial statements for the year ended 31 December 2006 (continued)

13 Deemed loans due to group undertakings (continued)

It is anticipated that the majority of the above deferred consideration will be receivable within one year. However, an amount of the above balance will only become receivable after that time. Repayments of deferred consideration are dependent on market conditions, amongst other factors, and, therefore, the directors are unable to reliably estimate the amount that will fall to be receivable after one year.

	2006 £000	2005 £000
At start of period	**3,272**	4,682
Additional consideration receivable	**581**	2,522
Amounts received during the year	**(1,312)**	(3,932)
At end of period	**2,541**	3,272

14 Other liabilities

	2006 £000	2005 £000
Bank overdraft	**29**	15
Amounts owed to group undertakings	**145,660**	230,868
Group relief payable	**3,363**	4,851
Accruals and deferred income	**19**	3
Other	**107**	184
	149,178	235,921

The above amounts owed to group undertakings are expected to be settled more than 12 months after the Balance sheet date. These represent amounts due to Britannia Building Society. There is no formal repayment schedule for these monies, which are repayable on demand.

The effective interest rate on the above amounts owed to group undertakings is 1 month LIBOR plus 21 basis points.

Mortgage Agency Services Number Two Limited

Notes to the financial statements for the year ended 31 December 2006 (continued)

15 Called up share capital

	2006 £	2005 £
Authorised		
50,000 ordinary shares of £1 each	**50,000**	50,000
Issued and fully paid		
2 ordinary shares of £1 each	**2**	2

16 Retained earnings

Movements in Retained earnings were as follows:

	2006 £000	2005 £000
Balance at start of period	**32,241**	29,006
Profit for the period	**2,485**	5,916
Dividends	**(5,916)**	(2,681)
At 31 December	**28,810**	32,241

17 Reconciliation of operating profit to net cash flows from operating activities

	2006 £000	2005 £000
Profit before tax	**3,502**	8,244
Decrease / (increase) in prepayments	**8**	(4)
Increase / (decrease) in accruals	**16**	(14)
Net movement in provisions	**(591)**	473
Cash flows from operating profits before changes in operating assets and liabilities	**2,935**	8,699
Net decrease in loans and advances to customers	**106,509**	110,921
Net decrease in deemed loans due from group undertakings	**1,856**	3,285
Net decrease in deemed loans due to group undertakings	**(19,251)**	(64,417)
Net (increase) / decrease in other assets and amounts due from group undertakings	**(93,688)**	12
Net increase / (decrease) in other liabilities and amounts due to group undertakings	**1,627**	(56,936)
Taxation	**(2)**	(1,596)
Net cash flows from operating activities	**(14)**	(32)

Notes to the financial statements for the year ended 31 December 2006 (continued)

18 Ultimate parent undertaking and controlling entity

The company's immediate parent undertaking is Britannia Treasury Services Limited, a company registered in England.

Britannia Treasury Services Limited is wholly owned by Britannia Building Society, a body corporate registered in England. Copies of the financial statements of Britannia Building Society may be obtained from:

Britannia House, Leek, Staffordshire, ST13 5RG.

The Society, the ultimate controlling entity of this company, is a mutual organisation owned by its members and consequently has no controlling body.

19 Related party disclosures

Although retaining legal title to the mortgages held by subsidiaries of Britannia Building Society, beneficial ownership has been assigned to Mortgage Agency Services Number One Limited, Leek Finance Number One PLC and Leek Finance Number Two PLC.

Transactions with other companies within the group are detailed as follows:

Year ended 31 December 2006	**Fees and other income £000**	**Fees and other expense £000**	**Balance due to/(by) MAS2 £000**
Britannia Building Society	1,436	10,500	(145,541)
Mortgage Agency Services Number One Limited	477	628	(1,554)
Mortgage Agency Services Number Four Limited	-	-	(1)
Western Mortgage Services Limited	-	775	(118)
Leek Finance Number One PLC	201	4,210	(54,923)
Leek Finance Number Two PLC	235	800	(13,814)
Leek Finance Number Three PLC	-	-	11,874
Leek Finance Number Eleven PLC	51	-	20
Leek Finance Number Twelve PLC	9	-	4

Year ended 31 December 2005	Fees and other income £000	Fees and other expense £000	Balance due to/(by) MAS2 £000
Britannia Building Society	-	12,976	(230,807)
Mortgage Agency Services Number One Limited	865	619	(1,313)
Mortgage Agency Services Number Three Limited	-	-	(1)
Western Mortgage Services Limited	-	1,988	(60)
Leek Finance Number One PLC	768	5,496	(71,983)
Leek Finance Number Two PLC	320	1,059	(12,067)
Leek Finance Number Three PLC	1,271	2,436	-
Leek Finance Number Eleven PLC	69	-	23
Leek Finance Number Twelve PLC	12	-	3

Notes to the financial statements for the year ended 31 December 2006 (continued)

20 Dividends per share

Final dividends are not accounted for until they have been ratified at the Annual General Meeting. At the Annual General Meeting a dividend in respect of 2006 of £1,242,262 per share (2005: actual dividend £2,957,972 per share) amounting to a total of £2,484,523 (2005: actual £5,915,939) is to be proposed. The financial statements for the year ended 31 December 2006 do not reflect this resolution, which will be accounted for in shareholders' equity as an appropriation of retained profits in the year ending 31 December 2007.