

Registered number: 03331871

BOS (SHARED APPRECIATION MORTGAGES) NO.3 PLC

Annual report and financial statements
for the year ended 31 December 2017

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DIRECTORS AND COMPANY INFORMATION

Directors

Janet Turner
Emma Louise Lawrence

Company Secretary

David Dermot Hennessey

Registered Office

Trinity Road
Halifax
HX1 2RG

Independent Auditors

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
7 More London Riverside
London
SE1 2RT

Strategic Report

For the year ended 31 December 2017

The directors present their Strategic Report and the audited financial statements for BOS (Shared Appreciation Mortgages) No.3 plc ("the Company") for the year ended 31 December 2017.

Principal activities

The principal activity of the Company is to finance mortgage lending. In 1998 the Company issued £46,600,000 fixed rate notes (the "Notes"). The interest payable on the Notes is set at 4.50% per annum until February 2028. Thereafter, the interest rate applicable to the Notes will be 5.50% per annum until 2073 when the Notes become due. The Notes are secured on the mortgage portfolio. The capital appreciation arising on the sale of a mortgage holder's property is shared between the mortgage holder and the Company as set out in the original loan agreement. The Company pays its entire share of the appreciation to Note holders.

The activities of the Company are conducted primarily by reference to a series of transaction documents (the "Programme Documentation").

Movements in the mortgage book are disclosed in the notes to the financial statements.

Business structure

The Company is a subsidiary undertaking of Bank of Scotland plc ("BOS") and ultimately Lloyds Banking Group plc ("LBG").

Business review and performance

No new mortgages were acquired or originated by the Company in the year and no new Notes were issued.

The profit for the financial year amounted to £104,007 (2016: £107,211). Total equity as at 31 December 2017 amounted to £2,266,944 (2016: £2,162,937).

The principal asset in the Company is a mortgage portfolio which is subject to an annual impairment review. The mortgage portfolio is subject to the economic factors relating to the housing market (see "Credit Risk" below). However, these factors did not have any significant bearing on the Company's arrears levels (see note 14) and no impairment provision was deemed necessary as at 31 December 2017 or 31 December 2016.

The underlying profits are determined by a margin earned between the interest received on the mortgage portfolio and the interest paid to the Note holders.

Under International Financial Reporting Standards ("IFRSs") the mortgages and Notes are recognised initially at fair value with an appropriate effective yield adjustment recognised in the income statement. Subsequent measurement is at amortised cost with revenue being recognised using the effective interest method. The discount arising on initial recognition is being amortised over the expected life of the mortgages.

Key Performance Indicators

The Board is responsible for assessing the risk of irregularities, where caused by fraud or error in the financial reporting and ensuring that the processes are in place for the timely identification of internal and external matters with a potential effect on financial reporting.

The key performance indicator used by management in assessing the performance of the Company is the monitoring of actual cash flows against planned cash flows on the Notes.

In order to assist the directors to mitigate key risks, there is a Board meeting held quarterly with programme managers. This meeting analyses and discusses the trends for the quarter and identifies any issues or required changes. Any such issues are then reported, further discussed and collectively agreed. There were no significant issues impacting the Company in the current or previous year.

The Company has made all necessary payments on the Notes in accordance with the scheduled repayment dates for the year ended 31 December 2017.

Risk management

The majority of the Company's assets and liabilities have been classified as financial instruments in accordance with IAS 32 "Financial Instruments: Presentation". The Company's financial instruments comprise a mortgage portfolio, cash and liquid resources, and embedded derivative, interest-bearing loans and borrowings and various other receivables and payables that arise directly from its operations.

It is, and has been throughout the year under review, the Company's policy that no trading in financial instruments is undertaken.

The principal risks arising from the Company's financial instruments are credit risk and interest rate risk. These and other risks which may affect the Company's performance are detailed below. Further analysis of the risks facing the Company on its financial instruments is provided in note 14.

Credit Risk

Credit risk arises on the individual loans within the mortgage loan portfolio which are in turn secured on the underlying UK residential properties. The performance of these loans is therefore influenced by the economic background and the UK housing market. However, with a maximum loan-to-value of the original advances being 75% and with the mortgage portfolio having a weighted average current loan-to-value of 19.6% as at 31 December 2017, the credit exposure is low.

The extent to which the Company can meet its obligations to pay interest and ultimately repay the Notes will be dependent upon the receipt of funds earned on the mortgage portfolio and the Letter of Credit issued by BOS (see "Liquidity Risk" below). To the extent that this income does not provide sufficient funds to cover the interest due on the Notes or the repayment of the Notes, the Note holders have no claim on the assets of BOS.

The terms of the Mortgage Portfolio Agreement given by BOS in respect of the mortgages require BOS to repurchase any mortgage which is found to be in breach of warranty. BOS will repurchase any mortgages that are found or held not to be valid, binding and enforceable.

In such an event the total value of the outstanding loan and any accrued interest will be covered by BOS, the Note holder will not receive the benefit of any future payments of appreciation amounts or partial repayment of appreciation amounts in respect of the mortgages repurchased.

Strategic Report (continued)
For the year ended 31 December 2017

Risk management (continued)

Market risk

Market risk is the risk of financial losses to the Company in the event of movements in the prices of the market in which it operates. The Company's market is the UK residential housing market.

Under the terms of the Notes the Company is obligated to pay the Note holders the return on the shared appreciation that has accrued during the life of the mortgage loan at the rate implicit in the specific mortgage loan agreement as and when repaid by the mortgage loan customer. Shared appreciation is subject to the movement in the market value of the property which is dependent upon house price inflation, as measured by the Halifax House Price Index ("HPI").

However, the Company itself is not impacted by market risk as the risk of returns on the Notes being below initial expectations lies with the Note holder and there are no guarantees within the terms of the Notes for expected increases in value.

Interest rate risk

Interest rate risk exists where assets and liabilities have interest rates set under a different basis or which reset at a different time.

The Company minimises its exposure to interest rate risk by ensuring that the interest rate characteristics of assets and liabilities are similar.

Liquidity risk

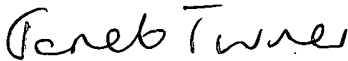
The Company holds a Reserve Account of £1,397,000 to assist the Company should it not be able to meet its obligations. The reliance on this facility is therefore dependent upon the creditworthiness of BOS. The rating requirement under the Programme Documentation for the Reserve Account to remain with BOS is a short term rating with Standard and Poor's (S&P) of A. As at 31 December 2017, BOS met this requirement with a short term rating of A (2016: S&P short term rating: A). The Company has not drawn on this facility since inception.

Operational risk

In accordance with the Programme Documentation the Company is bound to make payments to meet third party expenses. To mitigate this risk the directors hold quarterly board meetings to review the performance of the Company and ensure that the Company is in a position to meet all necessary payments.

BOS has been appointed to act as account bank and servicer of the mortgage book on behalf of the Company. The Company also uses the Bank of New York Mellon to provide all corporate services in respect of the Notes in issue.

As approved by the Board of Directors and signed by order of the Board:



Janet Turner
Director

Trinity Road
Halifax
HX1 2RG

DATE: 26 April 2018

Directors' Report

For the year ended 31 December 2017

The directors present their annual report and the audited financial statements for BOS (Shared Appreciation Mortgages) No.3 plc (the "Company") for the year ended 31 December 2017.

Directors

The directors of the Company during the year, and up to the date of signing the financial statements, were:

Emma Louise Lawrence
Janet Turner (appointed 21 December 2017)
Mark Stuart Dolman (resigned 4 July 2017)
Tracey Anne Hill (resigned 22 December 2017)

Statement of directors' responsibilities in respect of the Financial Statements

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulation.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they 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 the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; 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 adequate accounting records that are sufficient to show and explain the company's transactions and 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 2006.

The directors 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.

Disclosure of information to auditors

In accordance with Section 418 (2) of the Companies Act 2006, in the case of each director in office at the date the report is approved:

- so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- The director has taken all the steps that he or she ought to have taken as a director in order to make him or herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

Directors' indemnities

LBG has granted to the Directors of the Company, (including former directors who have resigned in the year), a deed of indemnity through deed poll which constituted 'qualifying third party indemnity provisions' for the purposes of the Companies Act 2006. The deed was in force during the whole of the financial year and at the date of approval of the financial statements or from the date of appointment in respect of the Directors who joined the Board of the Company during the financial year. Directors no longer in office but who served on the Board of the Company at any time in the financial year had the benefit of this contract of indemnity during that period of service. The indemnity remains in force for the duration of the Directors' period of office. The deed indemnifies the Directors to the maximum extent permitted by law. Directors no longer in office but who served on the Board of the Company at any time in the financial year had the benefit of this contract of indemnity during that period of service.

Future Developments

The Company's business will continue to unwind over the life of the mortgages issued as no further advances will be made. Cash is continuing to be collected. A review of the business can be found in the Strategic Report.

Dividends

The directors did not recommend the payment of a dividend during the year ended 31 December 2017 (2016: £Nil).

Corporate governance

The Directors have been charged with governance in accordance with the Programme Documentation describing the structure and operation of the transaction. The governance structure of the Company is such that the key policies have been predetermined at the time of issuance and the operational roles have been assigned with their roles strictly governed by the Programme Documentation.

The Programme Documentation provides for procedures that have been designed for safeguarding assets against unauthorised use or disposition; for maintaining proper accounting records; and for the reliability and usefulness of financial information used within the business or for publication. Such procedures are designed to manage rather than eliminate the risk of failure to achieve business objectives whilst enabling them to comply with the regulatory obligations.

Due to the nature of the securities which have been issued, the Company is largely exempt from the requirements of the Financial Conduct Authority pertaining to the Disclosure and Transparency Rules (DTR) as detailed in DTR 7.1 Audit Committees and 7.2 Corporate Governance statements (save for the rule DTR 7.2.5 requiring a description of the features of the internal control and risk management systems), which would otherwise require the Company respectively, to have an audit committee in place and include a corporate governance statement in the report of the directors. The directors are therefore satisfied that there is no requirement for an audit committee or a supervisory body entrusted to carry out the functions of an audit committee or to publish a corporate governance statement.

From the perspective of the Company, the daily operational internal controls and risk management systems are integrated with those of LBG, the Company's ultimate controlling party. Therefore additional information may be found in section "Internal Control" of the 2017 Annual Report of LBG, which does not form part of this report. Details of where to get access to the 2017 Annual Report of LBG can be found in note 18.

Directors' Report (continued)

For the year ended 31 December 2017

Risk Management

Further details on the risks facing the Company and how these risks are managed are detailed in the Strategic Report.

Employees

The Company had no employees during the year ended 31 December 2017 or the previous year.

None of the directors received any emoluments from the Company in the current or previous year.

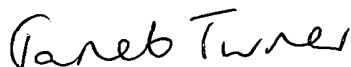
Independent auditors

The company regarded by the directors as the ultimate controlling party is Lloyds Banking Group plc ("LBG"). The Company's directors give the LBG Audit Committee the authority to appoint the auditors of the Company. At the 2018 LBG Annual General Meeting, a resolution will be proposed to re-appoint PricewaterhouseCoopers LLP as auditors of LBG, in turn re-appointing PricewaterhouseCoopers LLP as auditors of the Company.

Statement of going concern

The Company has continued to perform in line with the Programme Documentation. The directors are satisfied that the Company has adequate resources to continue to operate for the foreseeable future and is financially sound. For this reason, they continue to adopt the going concern basis in preparing these financial statements.

As approved by the Board of Directors and signed by order of the Board by:



Janet Turner
Director

Trinity Road
Halifax
HX1 2RG

DATE: 26 April 2018

Statement of comprehensive income

For the year ended 31 December 2017

	Note	2017 £	2016 £
Interest receivable and similar income	2	869,936	930,884
Interest payable and similar charges	3	(714,220)	(771,954)
Net interest income		155,716	158,930
Other operating income	5	215	300
Operating expenses	6	(27,129)	(31,878)
Profit before tax		128,802	127,352
Taxation	7	(24,795)	(20,141)
Profit for the financial year/ total comprehensive income attributable to owner		104,007	107,211

The profit shown above is derived from continuing operations. The Company operates in a single business segment and all of the Company's activities are in the UK.

The accompanying notes on pages 10 to 19 are an integral part of the financial statements.

Balance sheet
As at 31 December 2017

	Note	2017 £	2016 £
Assets			
Cash and cash equivalents	8	1,926,641	1,934,493
Mortgage portfolio	9	12,347,567	12,677,799
Shared appreciation rights receivable	10	30,511,652	30,129,189
Total assets		<u>44,785,860</u>	<u>44,741,481</u>
Equity and liabilities			
Bank overdraft	8	-	528
Interest-bearing loans and borrowings	11	11,909,932	12,234,346
Shared appreciation rights payable	10	30,511,652	30,129,189
Current tax liability	7	24,795	20,141
Trade and other payables	12	72,537	194,340
Total liabilities		<u>42,518,916</u>	<u>42,578,544</u>
Share capital	13	50,001	50,001
Retained earnings		2,216,943	2,112,936
Total equity		<u>2,266,944</u>	<u>2,162,937</u>
Total equity and liabilities		<u>44,785,860</u>	<u>44,741,481</u>

The financial statements on pages 6 to 19 were approved by the Board of Directors on 26 April 2018 and were signed on behalf of the Board by:

Janet Turner

Janet Turner
Director

The accompanying notes on pages 10 to 19 are an integral part of the financial statements

Statement of changes in equity
For the year ended 31 December 2017

	Share capital £	Retained earnings £	Total equity £
Balance at 1 January 2017	50,001	2,112,936	2,162,937
Profit for the financial year / total comprehensive income for the year	-	104,007	104,007
Balance at 31 December 2017	50,001	2,216,943	2,266,944

	Share capital £	Retained earnings £	Total equity £
Balance at 1 January 2016	50,001	2,005,725	2,055,726
Profit for the financial year / total comprehensive income for the year	-	107,211	107,211
Balance at 31 December 2016	50,001	2,112,936	2,162,937

The accompanying notes on pages 10 to 19 are an integral part of the financial statements.

Cash flow statement
For the year ended 31 December 2017

	Note	2017 £	2016 £
Operating Activities			
BOS administration fees paid		(18,946)	(19,822)
External audit fees paid		(1,200)	(1,200)
Administration expenses paid		(8,999)	(10,927)
Tax Paid		(20,141)	(42,334)
Net cash flows used in operating activities		(49,286)	(74,283)
Investing Activities			
Repayments on mortgage portfolio		456,184	429,261
Income earned on mortgage portfolio		741,800	769,230
Shared appreciation rights received		802,462	814,553
Bank interest received		2,399	4,976
Net cash flows generated from investing activities		2,002,845	2,018,020
Financing Activities			
Repayment of borrowings		(513,175)	(460,944)
Interest paid on borrowings		(570,246)	(592,198)
Shared appreciation rights paid to Note holders		(877,462)	(781,962)
Net cash flows used in investing financing activities		(1,960,883)	(1,835,104)
Net (decrease) / increase in cash and cash equivalents		(7,324)	108,633
Cash and cash equivalents at start of year		1,933,965	1,825,332
Cash and cash equivalents at end of year	8	1,926,641	1,933,965

The cash flow statement is presented using the direct method.

The accompanying notes on pages 10 to 19 are an integral part of the financial statements.

Notes to the financial statements

For the year ended 31 December 2017

1. Significant Accounting policies

BOS (Shared Appreciation Mortgages) No.3 plc is a public limited liability company domiciled in England and incorporated in England and Wales.

(a) Basis of preparation

The financial statements for the year ended 31 December 2017 have been prepared in accordance with EU adopted International Financial Reporting Standards (IFRSs) and interpretations issued by the IFRS Interpretations Committee (IFRS IC). The standards applied by the Company are those endorsed by the European Union and effective at the date the financial statements are approved by the Board. All accounting policies have been consistently applied in the financial statements.

There are no new or amended accounting standards that have required a change to accounting policies for the year.

The financial statements have been prepared in accordance with the Companies Act 2006 as applicable to companies using IFRSs.

The Company is reliant on funding provided by Bank of Scotland plc (BOS) which is a subsidiary of Lloyds Banking Group plc (LBG). LBG has provided letters of support dated 20 February 2018 stating that in its capacity as the indirect parent of BOS, it will continue to provide access to adequate liquidity and capital resources for the foreseeable future and, accordingly, the directors of the Company are satisfied that the financial statements have been prepared on a going concern basis.

The financial statements are presented in Sterling which is the Company's functional and presentation currency and have been prepared on the historical cost basis (except that derivative financial instruments are stated at fair value).

(b) Interest income and interest payable

Interest receivable and similar income and interest payable and similar charges have been calculated using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the expected life of the financial instrument. The effective interest rate is the rate that exactly discounts the 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 future cash flows are estimated after considering all the contractual terms of the instrument.

(c) Taxation

Tax expense comprises current and deferred tax. Current and deferred tax are charged or credited in the income statement except to the extent that the tax arises from a transaction or event which is recognised, in the same or a different period, outside the income statement (either in other comprehensive income, directly in equity, or through a business combination), in which case the tax appears in the same statement as the transaction that gave rise to it.

Current tax is the amount of corporate income taxes expected to be payable or recoverable based on the profit for the period as adjusted for items that are not taxable or not deductible, and is calculated using tax rates and laws that were enacted or substantively enacted at the balance sheet date.

Current tax includes amounts provided in respect of uncertain tax positions when management expects that, upon examination of the uncertainty by Her Majesty's Revenue and Customs (HMRC) or another tax authority, it is more likely than not that an economic outflow will occur. Provisions reflect management's best estimate of the ultimate liability based on their interpretation of tax law, precedent and guidance, informed by external tax advice as necessary. Changes in facts and circumstances underlying these provisions are reassessed at each balance sheet date, and the provisions are re-measured as required to reflect current information.

(d) Financial instruments

The Company's financial instruments comprise a mortgage portfolio, cash and liquid resources, an embedded derivative, interest-bearing loans and borrowings and various other receivables and payables that arise directly from its operations.

The main purpose of these financial instruments is to raise finance for the Company's operations. These financial instruments are classified in accordance with the principles of IAS 39 as described below.

(d)(i) Mortgage portfolio

The Company's mortgage portfolio comprises mortgage loans with no fixed maturity date. The individual mortgage loans terminate on the earlier of the date of sale of the property or the death of the mortgage account holder.

Under IAS 39, the mortgage portfolio is classified as "loans and receivables". The initial measurement is at fair value (excluding amounts for the shared appreciation referred to in (d)(iv) below). Subsequent measurement is at amortised cost with revenue being recognised using the effective interest method. The discount arising on initial recognition is being amortised over the expected life of the mortgages.

At each reporting period end, the Company assesses whether there is any objective evidence that mortgage loans within the portfolio are impaired. The directors do not consider that a provision for impaired assets is currently required.

(d)(ii) Cash and cash equivalents

The Company holds bank accounts with BOS, its parent undertaking. These accounts are held in the Company's name and meet the definition of cash and cash equivalents. The use of certain accounts is restricted by a detailed priority of payments set out in the Programme Documentation. As the cash can only be used to meet certain specific liabilities and is not available to be used with discretion, it is viewed as restricted cash.

These bank accounts are classified as "loans and receivables" in accordance with IAS 39 and income is being recognised using the effective interest method.

(d)(iii) Interest-bearing loans and borrowings

The Company's interest-bearing loans and borrowings comprise mortgage-backed fixed rate Notes that have been issued in the capital market.

Interest-bearing loans and borrowings are recognised initially at fair value less directly related incremental transaction costs. Subsequent to initial recognition, interest-bearing loans and borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

Notes to the financial statements (continued)

For the year ended 31 December 2017

1. Significant Accounting policies (continued)

(d) Financial instruments (continued)

(d)(iv) Embedded derivatives

Certain derivatives are embedded within other non-derivative host financial instruments to create a hybrid instrument. Where the economic characteristics and risks of the embedded derivatives are not closely related to the economic characteristics and risks of the host instrument, and where the hybrid instrument is not measured at fair value, the embedded derivative is separated from the host instrument with changes in fair value of the embedded derivative recognised in the income statement. Depending on the classification of the host instrument, it is then measured in accordance with IAS 39.

The capital appreciation arising on the sale of a mortgage holder's property is shared between the mortgage holder and the Company as set out in the original loan agreement. The Company pays its entire share of the appreciation to the Note holders.

The economic characteristics and risks of the shared appreciation rights receivable and payable are not viewed as being closely related to those arising on the mortgages and Notes, respectively. The shared appreciation rights receivable and payable have therefore been valued separately from the mortgages and Notes using current HPI at balance sheet date. There is uncertainty regarding the timing of any future shared appreciation. As a borrower could sell immediately the directors consider that spot price is the best estimate of shared appreciation and therefore current HPI is used.

The resulting fair value movements of these embedded derivatives are recorded in net fair value gains and losses on derivatives in the income statement and the embedded derivatives are shown separately on the face of the balance sheet. The host instruments are valued at amortised cost, as noted above in (d)(i) and (d)(iii).

(e) Critical accounting judgements and estimates

The preparation of the financial statements necessarily requires the exercise of judgement both in the application of accounting policies and in the selection of assumptions used in the calculation of estimates. These judgements are reviewed on an ongoing basis and are continually evaluated based on historical experience and other factors. The most significantly affected components of the financial statements and associated critical judgements are as follows:

Effective interest rate method

The effective interest rate is calculated on initial recognition of the financial asset or liability, estimating the future cash flows after considering all the contractual terms of the instrument. The calculation includes all amounts expected to be paid or received by the Company including expected early redemption fees and related penalties and premiums and discounts that are an integral part of the overall return. Direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument are also taken into account in the calculation. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

For the purpose of the effective yield calculation on the Notes, an average expected life has been calculated based on prepayment expectations for the mortgages. This is revised on a regular basis, considering actual redemption experience and actual contractual terms of Notes.

Fair value

Fair value is defined as the value at which assets, liabilities or positions could be closed out or sold in a transaction with a willing and knowledgeable counterparty.

The value of the embedded derivative has been calculated separately from the host contract using current HPI at balance sheet date. All inputs into the valuation models are obtained from observable market data. No assumption for future HPI has been included as the directors do not consider it is possible to make a reliable estimate on this basis. As a borrower could sell immediately, spot price is deemed more appropriate to use.

There are no other derivative financial instruments.

(f) Fees and commissions

Fees and commissions receivable for the continuing servicing of loans and receivables are recognised on the basis of services provided. Other fees are recognised when receivable.

(g) Dividends

Dividends on ordinary shares are recognised in equity in the year in which they are paid.

(h) Trade and other payables

Trade and other payables are stated at cost.

(i) Capital Management

The Company is not subject to externally imposed capital requirements in the current and prior year. The Company manages its ordinary share capital in order that there is sufficient capital, in the opinion of the directors, to support the transactions and level of business undertaken by the Company.

Notes to the financial statements (continued)
For the year ended 31 December 2017

2. Interest receivable and similar income

	2017 £	2016 £
Interest receivable on mortgage portfolio	867,537	925,908
Bank interest receivable	2,399	4,976
	<u>869,936</u>	<u>930,884</u>

3. Interest payable and similar charges

	2017 £	2016 £
Interest payable on notes	696,862	750,319
Amortisation of issue costs	17,358	21,635
	<u>714,220</u>	<u>771,954</u>

4. Net fair value gains and losses on derivatives

	2017 £	2016 £
Fair value movement on shared appreciation rights receivable	382,463	2,071,569
Fair value movement on shared appreciation rights payable	(382,463)	(2,071,569)
	<u>-</u>	<u>-</u>

5. Other operating income

	2017 £	2016 £
Fees and commissions receivable	215	300
Shared appreciation receivable	802,462	814,554
Shared appreciation payable	(802,462)	(814,554)
	<u>215</u>	<u>300</u>

6. Operating expenses

	2017 £	2016 £
Intercompany fees	16,930	19,750
Administration fees	8,999	10,928
Audit fees	1,200	1,200
	<u>27,129</u>	<u>31,878</u>

The Company has no employees (2016: nil) and none of the directors received any emoluments from the Company in the current or previous year.

Audit fees relate to the statutory audit. There are no fees payable to the auditors and their associates for services other than the statutory audit (2016: £nil).

The audit fee for the current year, net of VAT, was £1,000 (2016: £1,000).

Notes to the financial statements (continued)

For the year ended 31 December 2017

7. Taxation

	2017 £	2016 £
Current Tax		
Corporation tax charge for the year	24,795	25,470
Adjustments in respect of previous years	-	(5,329)
	<u>24,795</u>	<u>20,141</u>
Total tax charge for the year		
	<u>24,795</u>	<u>20,141</u>
Reconciliation of effective tax rate		
The tax assessed for the year is equal to (2016: lower than) the standard average rate of corporation tax in the UK of 19.25% (2016: 20.00%)		
Profit before tax	128,802	127,352
	<u>128,802</u>	<u>127,352</u>
Profit before tax multiplied by the standard rate of corporation tax in the UK of 19.25% (2016: 20%)	24,795	25,470
Effects of:		
Adjustments in respect of prior years	-	(5,329)
	<u>-</u>	<u>(5,329)</u>
Total tax charge in the Statement of Comprehensive Income	<u>24,795</u>	<u>20,141</u>

The current tax liability of £24,795 (2016: £20,141) represents the net amount of income tax payable in respect of the current year.

The Finance (No. 2) Act 2015 reduced the main rate of corporation tax to 19% with effect from 1 April 2017.

Finance Act 2016 further reduced the main rate of corporation tax to 17% with effect from 1 April 2020.

8. Cash and cash equivalents

	2017 £	2016 £
Bank accounts	1,926,641	1,934,493
Bank overdraft	-	(528)
	<u>1,926,641</u>	<u>1,933,965</u>
Cash and cash equivalents per the cash flow statement		
	<u>1,926,641</u>	<u>1,933,965</u>

The Company holds bank accounts with BOS. The use of the accounts is restricted by a detailed priority of payments set out in the Programme Documentation. As the cash can only be used to meet certain specific liabilities and is not available to be used with discretion, it is viewed as restricted cash. The accounts are held in the Company's name and meet the definition of cash and cash equivalents. The amounts are repayable on demand.

9. Mortgage portfolio

	2017 £	2016 £
At 1 January	12,677,799	12,956,304
Mortgage redemptions in the year	(456,184)	(435,482)
Amortisation of discount	125,952	156,977
	<u>12,347,567</u>	<u>12,677,799</u>
At 31 December		
	<u>12,347,567</u>	<u>12,677,799</u>

The mortgage loans advanced by the Company have no fixed maturity date but would terminate on the earlier of, the date of sale of the property, or the death of the mortgage account holder. All mortgage loans are considered to be non-current as maturity cannot be reasonably determined, with the exception of an amount of £95,206 (2016: £125,952) in respect of the discount amortisation due within 12 months.

Notes to the financial statements (continued)

For the year ended 31 December 2017

10. Shared appreciation rights receivable / payable

The Company is contractually obliged to pay to the Note holders any amounts received from mortgage customers for the shared appreciation. A corresponding embedded derivative liability has therefore been recognised in the balance sheet.

As the shared appreciation rights receivable are intrinsically linked to the maturity of the mortgage loans which have no fixed maturity, the balance is considered to be non-current (see note 9).

11. Interest-bearing loans and borrowings

This note provides information about the contractual terms of the Company's interest-bearing loans and borrowings. For more information about the Company's exposure to interest rate risk and the fair value of its financial instruments, see note 14.

	2017 £	2016 £
Non-current liabilities		
Notes	11,916,620	12,256,603
Deferred issue costs	(40,631)	(53,752)
	<u>11,875,989</u>	<u>12,202,851</u>
Current liabilities		
Accrued interest payable to Note holders	47,064	48,854
Deferred issue costs	(13,121)	(17,359)
	<u>33,943</u>	<u>31,495</u>
At 31 December	<u>11,909,932</u>	<u>12,234,346</u>

The mortgage-backed fixed rate Notes are due to redeem in 2073. The interest rate payable on the Notes up to and including the interest period ending in the quarter to 28 February 2028 is 4.50% per annum. Thereafter, the interest rate payable on the Notes will be 5.50% per annum until 2073 when the Notes become due. At the end of the year the Notes, as rated by S&P, had a rating of A (2016: rating of A).

The Notes carry, in addition to interest, rights to receive certain amounts calculated by reference to the value of shared appreciation proceeds received from redeemed mortgages. The Notes are subject to mandatory part redemption from time to time based on the level of redeemed mortgages and can be redeemed in full, in certain circumstances, at the option of the Company. The Notes are secured on the mortgage portfolio, the bank accounts and certain other assets of the Company.

12. Trade and other payables

	2017 £	2016 £
Shared appreciation payable	-	75,000
Note redemptions payable	884	40,000
Accruals and deferred income	71,653	77,324
Amounts owed to BOS	-	2,016
	<u>72,537</u>	<u>194,340</u>

All amounts are due within 12 months of the balance sheet date.

Notes to the financial statements (continued)
For the year ended 31 December 2017

13. Share capital

	2017 £	2016 £
Authorised		
50,000 (2016: 50,000) ordinary shares of £1 each	<u>50,000</u>	<u>50,000</u>
1 (2016: 1) deferred share of £1	<u>1</u>	<u>1</u>
Allotted and paid up		
50,000 (2016: 50,000) ordinary shares of £1 each	<u>50,000</u>	<u>50,000</u>
1 (2016: 1) deferred share of £1	<u>1</u>	<u>1</u>

The Company is a directly held subsidiary undertaking of BOS.

The £1 deferred share is held by Deutsche Trustee Company Limited.

The holder of the ordinary shares is entitled to receive dividends as declared from time to time.

The deferred share carries no entitlement to any dividend or to any share in any surplus assets of the Company on a winding-up, other than the right to be repaid the amount of any paid-up share capital thereon. The right to be repaid any paid-up share capital in the deferred share shall be deferred until after all paid-up share capital has been first repaid on all other classes of issued share capital in the Company.

The deferred share carries the right to receive notice of all general meetings of the Company but does not carry the right to attend, speak or vote at a general meeting unless a resolution is to be proposed abrogating, varying or modifying any of the rights or privileges of the holder of the deferred share, or for the winding up or administration of the Company under the Insolvency Act 1986, or for the entry by the Company with any other party into a merger, reconstruction, scheme of arrangement or amalgamation of or affecting the Company, in any of which cases such holder shall have the right to attend such general meeting and shall be entitled to speak and vote. Whenever the holder of the deferred share is entitled to vote at a general meeting, such holder shall have one vote and on a poll such number of votes as is equal to 34% of the number of votes attached to all other issued shares of the Company.

14. Management of risk

The principal risks arising from the Company's financial instruments are credit risk and interest rate risk. However, considerable resource is given to maintaining effective controls to manage, measure and mitigate these risks. Further detailed analysis of the risks facing the Company in relation to its financial instruments is provided below.

The Company's exposure to risk on its financial instruments and the management of such risk is largely determined at the inception of the securitisation transaction. The Company's activities and the role of each party to the transaction are clearly defined and documented.

14(a). Credit risk

Credit risk is the risk of financial loss arising from a customer's failure to settle financial obligations as they fall due.

Credit risk arises on the individual loans within the mortgage portfolio which are in turn secured on the underlying UK residential properties. The performance of these loans is therefore influenced by the economic background and the UK housing market. Mortgage loans are no longer offered by the Company but the maximum loan-to-value of the original advances was 75% and the credit risk is considered to be low.

The ability of the Company to meet its obligations to repay the Notes is dependent upon the receipt of funds earned on the mortgage portfolio and the Letter of Credit issued by BOS (see "Liquidity Risk"). To the extent that this income does not provide sufficient funds to cover the interest due on the Notes or the repayment of the Notes, the Note holders have no claim on the assets of BOS.

The terms of the Mortgage Portfolio Agreement given by BOS in respect of the mortgages require BOS to repurchase any mortgage which is found to be in breach of warranty. BOS will repurchase any mortgages that are found or held not to be valid, binding and enforceable.

Although in such an event the total value of the outstanding loan and any accrued interest will be covered by BOS, the Note holder will not receive the benefit of any future payments of appreciation amounts or partial repayment of appreciation amounts in respect of the mortgages repurchased. In terms of the shared appreciation, in accordance with the Programme Documentation, amounts received by the Company from the borrower are required to be paid over to the Note holders.

In terms of arrears management, the Company has engaged BOS as servicer of the loans in the portfolio to help reduce the risk of loss. The servicer is required to monitor repayments on the mortgage loans in accordance with its usual credit policies.

Notes to the financial statements (continued)

For the year ended 31 December 2017

14. Management of risk (continued)

14(a). Credit risk (continued)

The mortgage balances are monitored as part of the LBG impairment process. At each reporting period end, the Company assesses whether there is any objective evidence that mortgage loans within the portfolio are impaired. All loans in the mortgage portfolio pay a fixed rate of interest of 5.75% or 5.95%.

The total value of interest arrears at 31 December 2017 was £121,473 (2016: £117,737). All accounts in the mortgage portfolio had a maximum loan-to-value of 75% and those accounts in interest arrears have a current loan-to-value ratio of less than 60% (2016: less than 60%). Credit risk is considered to be low. There are no properties in possession or bad debts within the Company (2016: nil). No impairment provision was deemed necessary at 31 December 2017 or 31 December 2016.

	2017 £	2016 £
Neither past due nor impaired	11,379,231	11,521,598
Past due but not impaired	595,485	779,635
Impaired	765,146	894,812
	<u>12,739,862</u>	<u>13,196,045</u>
Securitised loans and advances which are past due but not impaired:		
	2017 £	2016 £
Days past due		
0-30 days	312,120	453,153
30-60 days	137,098	130,836
60-90 days	146,267	195,646
90-180 days	-	-
	<u>595,485</u>	<u>779,635</u>

In respect of the Originator's secured mortgage portfolio, 'past due' is when a borrower has failed to make a payment when contractually due. The definition of impaired loans is those which are six months or more in arrears.

The maximum exposure to credit risk arising on the Company's financial assets at the reporting date is disclosed in the table below.

	Note	Carrying amount 2017 £	Maximum Exposure 2017 £	Carrying amount 2016 £	Maximum Exposure 2016 £
Assets held at amortised cost:					
Cash and cash equivalents	8	1,926,641	1,926,641	1,934,493	1,934,493
Mortgage portfolio	9	12,347,567	12,737,584	12,677,799	13,193,768
Assets held at fair value					
Shared appreciation rights receivable	10	30,511,652	30,511,652	30,129,189	30,129,189
Total Assets		<u>44,785,860</u>	<u>45,175,877</u>	<u>44,741,481</u>	<u>45,257,450</u>

14(b). Market risk

Market risk is the risk of financial losses to the Company in the event of movements in the prices of the market in which it operates. The Company's market is the UK residential housing market.

Under the terms of the Notes the Company is obligated to pay the Note holders the return on the shared appreciation that has accrued during the life of the mortgage loan at the rate implicit in the specific mortgage loan agreement as and when repaid by the mortgage loan customer. Shared appreciation is subject to the movement in the market value of the property which is dependent upon house price inflation, as measured by the Halifax House Price Index ("HPI").

However, the Company itself is not impacted by market risk as the risk of returns on the Notes being below initial expectations lies with the Note holder and there are no guarantees within the terms of the Notes for expected increases in value.

14(c). Interest rate risk

Interest rate risk exists where assets and liabilities have interest rates set under a different basis or which reset at a different time.

The Company minimises its exposure to interest rate risk by ensuring that the interest rate characteristics of assets and liabilities are similar. Both the mortgage portfolio and the Notes issued by the Company are exposed to fair value interest rate risk as they carry fixed interest rates.

At 31 December 2017, if interest rates had been 100 basis points higher or lower with all other variables held constant, the net effect on the Company's income statement would be insignificant. All items remain unaffected by interest rate changes except for interest earned on bank accounts but a 100 basis points change would not give rise to a significant impact on bank interest.

Notes to the financial statements (continued)

For the year ended 31 December 2017

14(d). Liquidity risk

Liquidity risk is the risk that the Company is not able to meet its financial obligations as they fall due or can do so only at an unacceptably high cost.

The extent to which the Company can meet its obligations to pay interest and ultimately repay the Notes will be dependent upon the receipt of funds earned on the mortgage portfolio and the monies deposited in the Reserve Account with BOS.

The Company holds a Reserve Account of £1,396,800 to assist the Company should it not be able to meet its obligations. The reliance on this facility is therefore dependent upon the creditworthiness of BOS. The rating requirement under the Programme Documentation for the Reserve Account to remain with BOS is a short term rating with Standard and Poor's (S&P) of A. As at 31 December 2017, BOS met this requirement with a short term rating of A (2016: S&P short term rating: A). The Company has not drawn on this facility since inception.

The liquidity tables reflect the undiscounted cash payments which will fall due if the structure continues until the earliest contractual maturity date as set out in the Programme Documentation. The Note repayment profile mirrors the repayment of the mortgages, and based on current modelling assumptions, it is not anticipated that any mortgages will still be outstanding beyond the step-up date of February 2028.

	Carrying amount	Contractual repayment value	Not later than one month	Later than one month but not later than three months	Later than three months but not later than one year	Later than one year and not later than five years	Later than five years
2017	£	£	£	£	£	£	£
Principal							
Loans and borrowings (excluding deferred issue costs)	11,916,620	12,314,237	-	-	-	-	12,314,237
Shared appreciation payable	30,511,652	30,511,652	-	-	-	-	30,511,652
Trade and other payables	72,537	72,537	-	72,537	-	-	-
Bank overdraft	-	-	-	-	-	-	-
Interest payable							
Interest payable on Notes	47,064	5,775,208	-	136,637	417,503	2,218,081	3,002,987
	42,547,873	48,673,634	-	209,174	417,503	2,218,081	45,828,876
	Carrying amount	Contractual repayment value	Not later than one month	Later than one month but not later than three months	Later than three months but not later than one year	Later than one year and not later than five years	Later than five years
2016	£	£	£	£	£	£	£
Principal							
Loans and borrowings (excluding deferred issue costs)	12,256,602	12,782,625	-	-	-	-	12,782,625
Shared appreciation payable	30,129,189	30,129,189	-	-	-	-	30,129,189
Trade and other payables	194,340	194,340	-	194,340	-	-	-
Bank overdraft	528	528	528	-	-	-	-
Interest payable							
Interest payable on Notes	48,854	6,472,386	-	141,835	433,384	2,302,448	3,594,719
	42,629,513	49,579,068	528	336,175	433,384	2,302,448	46,506,533

Note – the shared appreciation payable in both tables is contractually due when the mortgage loan becomes due on either the date of sale of the property or on the death of the customer.

Notes to the financial statements (continued)

For the year ended 31 December 2017

14. Management of risk (continued)

14(e). Fair values

The financial instruments below are analysed by valuation method. The different levels are defined as follows:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1).
- Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2).
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

Financial assets and liabilities carried at fair value

	2017 £ Level 2	2016 £ Level 2
Shared appreciation rights receivable	30,511,652	30,129,189
Shared appreciation rights payable	(30,511,652)	(30,129,189)

Shared appreciation rights

The shared appreciation rights receivable and shared appreciation rights payable are measured at fair value. The fair value has been calculated by discounting expected cash flows at an appropriate market rate. All significant inputs into the valuation models are obtained from observable market data. For this reason, in accordance with "IFRS 7 Financial Instruments: Disclosures" ("IFRS 7"), the fair value measurement is considered to be Level 2 in the Fair Value Hierarchy.

Financial assets and liabilities carried at amortised cost

The table below analyses the fair values of the financial assets and liabilities of the Company which are carried at amortised cost.

	Note	Carrying amount 2017 £	Fair Value 2017 £	Carrying amount 2016 £	Fair Value 2016 £
Loans and receivables at amortised cost					
Mortgage portfolio	9	12,347,567	14,144,229	12,677,799	9,377,195
Financial liabilities at amortised cost					
Interest-bearing loans and borrowings	11	(11,909,932)	(13,056,678)	(12,234,346)	(9,728,931)

The fair value of the mortgage portfolio and loans and borrowings have been calculated by discounting future cash flows at an appropriate market rate and are considered to be Level 2 in the Fair Value Hierarchy in accordance with "IFRS 7 Financial Instruments: Disclosures".

Trade and other payables are recognised at cost. The fair value of these liabilities is considered to be a close approximation to cost due to the short term nature of these liabilities.

15. Related parties

The Company is a subsidiary undertaking of BOS and ultimately LBG.

The Company receives bank interest from BOS on its bank deposits. BOS administers the mortgage portfolio on behalf of the Company, for which quarterly service fees are paid. No dividend was paid during the year (2016: £nil).

The Company's transactions with related parties are summarised below:

	Parent and subsidiary undertakings 2017 £	Parent and subsidiary undertakings 2016 £
Statement of Comprehensive Income		
Interest receivable and similar income	2,399	4,976
Operating expenses	(16,930)	(10,123)
Balance Sheet		
Assets		
Cash and cash equivalents	1,926,641	1,934,493
Liabilities		
Bank overdraft	-	(528)
Other payables	(2,016)	(2,016)

Notes to the financial statements (continued)

For the year ended 31 December 2017

16. Future Accounting Pronouncements

The following pronouncements are not applicable for the year ended 31 December 2017 and have not been applied in preparing these financial statements. Save for IFRS 9 'Financial Instruments', the impact of these accounting changes is still being assessed by the Company and reliable estimates cannot be made at this stage.

With the exception of certain other minor amendments, as at 26th April 2018 these pronouncements have been endorsed by the EU.

IFRS 9 Financial Instruments

IFRS 9 replaces IAS 39 'Financial Instruments: Recognition and Measurement' and is effective for annual periods beginning on or after 1 January 2018. The Company has chosen 1 January 2018 as its initial application date of IFRS 9 and will not restate comparative periods.

Classification and measurement

IFRS 9 requires financial assets to be classified into one of three measurement categories, fair value through profit or loss, fair value through other comprehensive income or amortised cost. Financial assets will be measured at amortised cost if they are held within a business model the objective of which is to hold financial assets in order to collect contractual cash flows, and their contractual cash flows represent solely payments of principal and interest. Financial assets will be measured at fair value through other comprehensive income if they are held within a business model the objective of which is achieved by both collecting contractual cash flows and selling financial assets and their contractual cash flows represent solely payments of principal and interest. Financial assets not meeting either of these two business models; and all equity instruments (unless designated at inception to fair value through other comprehensive income); and all derivatives are measured at fair value through profit or loss. An entity may, at initial recognition, designate a financial asset as measured at fair value through profit or loss if doing so eliminates or significantly reduces an accounting mismatch.

Impairment

IFRS 9 replaces the existing 'incurred loss' impairment approach with an expected credit loss ('ECL') model resulting in earlier recognition of credit losses compared with IAS 39. The ECL model has three stages. Entities are required to recognise a 12 month expected loss allowance on initial recognition (stage 1) and a lifetime expected loss allowance when there has been a significant increase in credit risk since initial recognition (stage 2). Stage 3 requires objective evidence that an asset is credit-impaired, which is similar to the guidance on incurred losses in IAS 39.

Impacts

The Company has considered the application of IFRS 9. The Company has financial assets in the form of mortgage loans, with the capital appreciation arising on the sale of a mortgage holder's property being shared between the mortgage holder and the Company. The contractual cash flows of the mortgage loans and shared appreciation receivable do not represent solely payments of principal and interest. Therefore, under IFRS 9, the mortgage loans and shared appreciation receivable are to be presented as a single item (as they are a contractually linked financial instrument) and measured at fair value with all changes recorded through profit or loss.

The fair value of the mortgage loans will be calculated by discounting back to present value the expected future interest cash flows against market interest cash flows. The fair value of the shared appreciation receivable will be unchanged under IFRS 9, calculated using HPI at the balance sheet date.

Under IFRS 9, where to address an accounting mismatch, the Company can elect to measure its financial liabilities at fair value with all changes recorded through profit or loss. The Company has elected to apply this to its interest-bearing loans and borrowings.

The fair value of the interest-bearing loans and borrowings, will be calculated by discounting back to present value the expected future interest cash flows against market interest cash flows.

The re-classification and measurement of financial assets and liabilities under IFRS 9 results in an increase to the carrying value of financial assets of approximately £1.8m and an increase to the carrying value of financial liabilities of approximately £1.1m. This is mainly as a result of a reduction in market interest rates since the mortgages and notes were written. The pre tax impact on shareholders' equity is an increase of approximately £0.7m.

Minor amendments to other accounting standards

The IASB has issued a number of minor amendments to IFRSs effective 1 January 2018 (including IFRS 2 Share-based Payment) and effective 1 January 2019 (including IAS 12 Income Taxes and IFRIC 23 Uncertainty over Income Tax Treatments). These revised requirements are not expected to have a significant impact on the Company.

17. Contingent liabilities

The Group provides for potential tax liabilities that may arise on the basis of the amounts expected to be paid to tax authorities. This includes open matters where Her Majesty's Revenue and Customs (HMRC) adopt a different interpretation and application of tax law which might lead to additional tax. The Group has an open matter in relation to a claim for group relief of losses incurred in its former Irish banking subsidiary, which ceased trading on 31 December 2010. In 2013 HMRC informed the Group that their interpretation of the UK rules, permitting the offset of such losses, denies the claim; if HMRC's position is found to be correct management estimate that this would result in an increase in current tax liabilities for the company of approximately £113K (including interest). The Group does not agree with HMRC's position and, having taken appropriate advice, does not consider that this is a case where additional tax will ultimately fall due.

In addition, during the ordinary course of business the Company is subject to other complaints and threatened or actual legal proceedings (including class or group action claims) brought by or on behalf customers as well as legal and regulatory reviews, challenges, investigations and enforcement actions. All such material matters are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of the Company incurring a liability. In those instances where it is concluded that it is more likely than not that a payment will be made, a provision is established to management's best estimate of the amount required at the relevant balance sheet date. In some cases it will not be possible to form a view, for example because the facts are unclear or because further time is needed properly to assess the merits of the case, and no provisions are held in relation to such matters. In these circumstances, specific disclosure in relation to a contingent liability will be made where material. However the Company does not currently expect the final outcome of any such case to have a material adverse effect on its financial position, operations or cash flows.

18. Parent undertaking and controlling party

The Company's immediate parent company is Bank of Scotland plc. The company regarded by the directors as the ultimate controlling party is Lloyds Banking Group plc, a limited liability company incorporated and domiciled in Scotland, which is also the parent undertaking of the largest group of undertakings for which group financial statements are drawn up and of which the Company is a member. Bank of Scotland plc is the parent undertaking of the smallest such group of undertakings. Copies of the group financial statements of both companies may be obtained from Group Secretariat, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN or downloaded via www.lloydsbankinggroup.com.

Independent auditors' report to the members of BOS (Shared Appreciation Mortgages) No. 3 plc

Report on the audit of the financial statements

Opinion

In our opinion, BOS (Shared Appreciation Mortgages) No. 3 plc's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2017 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report and Financial Statements (the "Annual Report"), which comprise: the balance sheet as at 31 December 2017; the statement of comprehensive income, the cash flow statement, and the statement of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to those charged with governance.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

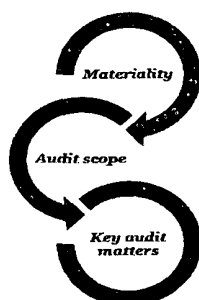
We remained independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the company.

We have provided no non-audit services to the company in the period from 1 January 2017 to 31 December 2017.

Our audit approach

Overview



- Overall materiality: £447,796 (2016: £447,892), based on 1% of total assets.

- The Company is a special purpose vehicle that forms part of a securitisation structure, established primarily as a means of raising wholesale funding for Bank of Scotland plc ("BOS") and subsequently Lloyds Banking Group plc ("LBG") the ultimate parent undertaking. LBG manages the securitisation transaction in its role as administrator, servicer of the underlying mortgage loans and cash manager. The capital appreciation realised on the sale of a mortgage holder's property is shared between the mortgage holder and the Company. This appreciation is passed on in full to note holders.
- The activities of the Company are conducted primarily by reference to a series of transaction documents (the "Programme Documentation"). We tailored the scope of our audit to ensure that we performed sufficient work to enable us to opine on the annual report and financial statements, ensuring audit procedures were performed in respect of every material financial statements line item.
- In establishing the overall approach to the audit, we determined the type of work that needed to be performed by us taking into account the accounting processes and controls in place at LBG as administrator and servicer, and the industry in which the Company operates.
- We obtained an understanding of the control environment in place at the administrator and adopted a controls and substantive testing approach.

Our key audit matters which involved the greatest allocation of our resources' effort comprise:

- The risk of errors in the priority or payments (the "Waterfalls") due to a lack of understanding of the transaction.
- The risk of misstatement in the valuation of shared appreciation rights receivable and payable.

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

We gained an understanding of the legal and regulatory framework applicable to the company and the industry in which it operates, and considered the risk of acts by the company which were contrary to applicable laws and regulations, including fraud. We designed audit procedures to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. We focused on laws and regulations that could give rise to a material misstatement in the company's financial statements, including, but not limited to, the Companies Act 2006 and the underlying legal documents and agreements governing this securitisation transaction. Our tests included, but were not limited to, management inquiries, review of board meeting minutes, and review and testing where applicable of the transaction documents. There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

Independent auditors' report to the members of BOS (Shared Appreciation Mortgages) No. 3 plc (continued)

Report on the audit of the financial statements (continued)

Our audit approach

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, 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. This is not a complete list of all risks identified by our audit.

Key audit matter

Errors in the priority or payments (the "Waterfalls") due to a lack of understanding of the transaction

Due to the complexity of the securitisation structure contractual terms and the special purpose nature of the entity, the Waterfalls present a pervasive risk to the overall accounting for the entity.

If the Waterfalls are incorrectly processed, there is a risk that interest expense and principal balances payable to investors are not appropriately calculated and settled, and the cash flows returned to the seller as excess spread are incorrect.

While the entity is well-established with management who are experienced in calculating Waterfalls, there is also an independent 3rd party paying agent who calculates the expected payments in parallel.

Due to the complexity and pervasive nature of the Waterfalls, this was an area of focus in our audit.

How our audit addressed the key audit matter

We understood the design of the securitisation structure through discussions with management and review of primary contractual programme documentation.

We tested the design and operating effectiveness of management's Waterfalls calculation and preparation control through:

- Discussion with management and by review of Waterfalls working papers for consistency with the base prospectus; and

- Inspection of supporting documentation and recalculation of relevant data points for a sample of Waterfalls in the year.

We performed substantive testing over this sample of Waterfalls to ensure no errors were made in Waterfalls preparation, including agreeing cash balances and transactions to cash account records, and agreeing cash collections balances agreed to system reports.

We additionally tested key system reports to validate that pool assets were completely and accurately identified in source system to support the cash collections as presented in the Waterfalls working papers.

We performed an independent recalculation of the year end shared appreciation rights for all securitised mortgages. As part of this we independently obtained regional HPI data from an external provider covering the period from origination to the balance sheet date, and agreed the shared appreciation percentages on a mortgage by mortgage basis to management's mortgage schedule.

Management's mortgage schedule has been separately validated through agreement to the origination documentation on a sample basis in prior years. As no new mortgages have been written, this audited schedule has been validated year on year to identify any inappropriate changes.

Valuation of shared appreciation rights receivable and payable

The shared appreciation mortgages include terms that entitle the Company to a share of the capital appreciation of the property on which the mortgage is secured as realised on the eventual sale of the property. The value of the Company's interest on this appreciation is calculated by reference to the sale proceeds and a formula established and agreed at the origination of the mortgage, including the loan to value ratio on the original advance.

The loan notes in issue are secured on the mortgage portfolio. The Company pays its entire share of the appreciation to the note holders as agreed within the terms on the notes.

As this shared appreciation entitlement is dependent on economic characteristics and risks not closely related the basic lending arrangement within the mortgage agreement, the overall contract is considered a hybrid instrument and the expected shared appreciation on all outstanding mortgages is recognised separately in the balance sheet as an embedded derivative measured at fair value.

Due to the pass through nature of the entity, a separate shared appreciation item is recognised in both assets (as receivable from mortgage holders, and in liabilities (as payable to note holders).

Management's fair value estimate of both the asset and liability is based on the shared appreciation percentage as agreed in the original loan agreement, and changes in the regional House Price Index ("HPI") between the origination date and the balance sheet date.

These items are disclosed as a 'shared appreciation rights receivable' asset, and a 'shared appreciation rights payable' liability on the balance sheet.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the company, the accounting processes and controls, and the industry in which it operates.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall materiality	£447,796 (2016: £447,892).
How we determined it	1% of total assets.
Rationale for benchmark applied	The entity is a not-for-profit whose main priority is to remit the cash received in respect of its assets so as to repay its liabilities. As such total assets is considered an appropriate benchmark. Where total assets is used, if the company is a public interest entity, a rule of thumb of up to 1% can be applied. We have deemed this to be a public interest entity and have therefore applied 1% due to the fact the entity has listed debt.

We agreed with those charged with governance that we would report to them misstatements identified during our audit above £22,390 (2016: £22,395) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Independent auditors' report to the members of BOS (Shared Appreciation Mortgages) No. 3 plc (continued)

Report on the audit of the financial statements (continued)

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which ISAs (UK) require us to report to you when:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company's ability to continue as a going concern.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, ISAs (UK) require us also to report certain opinions and matters as described below.

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2017 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of directors' responsibilities in respect of the Financial Statements set out on page 4, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible 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 directors 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 the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditors' 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 auditors' 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 (UK) 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.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, 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.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Independent auditors' report to the members of BOS (Shared Appreciation Mortgages) No. 3 plc (continued)

Report on the audit of the financial statements (continued)

Appointment

Following the recommendation of the Lloyds Banking Group Audit Committee, we were appointed by the directors on 31 March 2009 to audit the financial statements for the year ended 31 December 2009 and subsequent financial periods. The period of total uninterrupted engagement is 9 years, covering the years ended 31 December 2009 to 31 December 2017.

The audit of Lloyds Banking Group and its subsidiaries was tendered in 2014 and we were re-appointed with effect from 1 January 2016. There will be a mandatory rotation of Lloyds Banking Group for the 2021 audit.



Jessica Miller (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
26 April 2018