FIRST FLEXIBLE NO. 2 PLC

ANNUAL REPORT

FOR THE YEAR ENDED 30 SEPTEMBER 2004

Company number: 3952926

FIRST FLEXIBLE NO. 2 PLC

CONTENTS

	Page
Company information	1
Report of the directors	2 to 3
Independent auditors' report	4
Profit and loss account	5
Balance sheet	6
Notes to the financial statements	7 to 16

FIRST FLEXIBLE NO. 2 PLC

COMPANY INFORMATION

Directors	J P J Fairrie J G Gemmell SPV Management Limited M McDermott
Secretary	J G Gemmell
Company Number	3952926
Registered Office	St Catherine's Court Herbert Road Solihull West Midlands B91 3QE
Registered auditors	KPMG Audit Plc 1 Canada Square Canary Wharf London E14 5AG
Bankers	Barclays Bank PLC Financial Services and Structured Finance Team PO Box 544 54 Lombard Street London EC3P 3AH

FIRST FLEXIBLE NO. 2 PLC

REPORT OF THE DIRECTORS

FOR THE YEAR ENDED 30 SEPTEMBER 2004

The directors present their report on the affairs of the company, together with the audited financial statements of the company for the year ended 30 September 2004. The previous period is for the nine months ended 30 September 2003.

Principal activity and business review

The company was established for the sole purpose of issuing floating rate notes secured by pools of residential mortgages.

The principal activity during the year was the ownership of pools of residential mortgages.

The results for the year are set out in detail on page 5. No dividend was declared in the year (2003: £61k).

Directors and their interests

The directors who served during the year and up to the date of this report were as follows:

J P J Fairrie
J G Gemmell
A F Raikes (Resigned 24 August 2004)
SPV Management Limited
M McDermott

The company is a wholly owned subsidiary of Arianty Holdings Limited, of which J P J Fairrie, J G Gemmell and SPV Management Limited are directors.

According to the Register of Directors' Interests none of the directors had, at any time during the year, any interests in the share capital of the company or group. The shares in Arianty Holdings Limited are held by SPV Management Limited under a Declaration of Trust for charitable purposes.

None of the directors received any remuneration for their services to the company apart from SPV Management Limited. Under the terms of a Corporate Services Agreement as amended by side letters, SPV Management Limited is contracted to receive fees in the year of £12k (2003: £9k). J P J Fairrie and M McDermott are both directors of SPV Management Limited.

Creditor payment policy

The company's policy concerning the payment of its trade creditors is to pay in accordance with its contractual and other legal obligations.

Due to the nature of the business, the main creditors are the noteholders. Principal and interest is repaid monthly on the due date in accordance with the agreements in place. Other creditors are paid by the servicer (see note 1) which then recharges the company for the expense. The full balance due to the servicer is repaid monthly after the payment to the noteholders.

FIRST FLEXIBLE NO. 2 PLC

REPORT OF THE DIRECTORS (Continued)

FOR THE YEAR ENDED 30 SEPTEMBER 2004

Auditors

In accordance with Section 385 of the Companies Act, a resolution to reappoint KPMG Audit Plc as auditors will be proposed at the annual general meeting of the company.

Statement of directors' responsibilities

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

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

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

By order of the Board

J G Gemmell
Secretary
7 March 2005

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF

FIRST FLEXIBLE NO. 2 PLC

We have audited the financial statements on pages 5 to 16.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the directors' report and, as described on page 3, the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if 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 transactions with the company is not disclosed.

Basis of audit opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs as at 30 September 2004 and of the profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants
Registered Auditor
1 Canada Square
Canary Wharf
London
E14 5AG
11th March 2005

FIRST FLEXIBLE NO. 2 PLC

PROFIT AND LOSS ACCOUNT

FOR THE YEAR ENDED 30 SEPTEMBER 2004

	Notes	Year to 30 Sept 2004 £'000	9 months to 30 Sept 2003 £'000
Continuing operations			
Turnover	3	**13,940**	11,765
Cost of funding	4	**(11,230)**	(9,126)
Gross Profit		**2,710**	2,639
Administrative expenses		**(3,160)**	(2,935)
Operating loss		**(450)**	(296)
Other interest receivable and similar income	5	**478**	317
Profit on ordinary activities before taxation	6	**28**	21
Tax on profit on ordinary activities	7	**(8)**	(7)
Profit on ordinary activities after taxation		**20**	14
Dividends		**-**	(61)
Retained profit / (loss) for the financial year / period	11	**20**	(47)

The company has no recognised gains or losses other than those above and therefore no separate statement of total recognised gains and losses has been presented.

FIRST FLEXIBLE NO. 2 PLC

BALANCE SHEET

AS AT 30 SEPTEMBER 2004

	Notes	2004 £'000	2003 £'000
ASSETS			
Mortgage advances			
Mortgage advances	8	**215,611**	266,002
Current assets			
Debtors	9	**459**	345
Cash at bank and in hand		**12,243**	15,094
		12,702	15,439
Total assets		**228,313**	281,441
LIABILITIES			
Capital and reserves			
Called up share capital	10	**12**	12
Profit and loss account	11	**26**	6
Equity shareholders' funds	12	**38**	18
Creditors			
Amounts falling due within one year	13	**1,003**	1,003
Amounts falling due after more than one year	14	**227,272**	280,420
Total liabilities and capital		**228,313**	281,441

The financial statements on pages 5 to 16 were approved by the Board on 7 March 2005 and signed on its behalf by:

For SPV Management Limited
Director

FIRST FLEXIBLE NO. 2 PLC

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 SEPTEMBER 2004

1. Restriction on operations

The company was established for the sole purpose of issuing floating rate notes secured by pools of residential mortgages.

The ability of the company to engage in any activity other than those associated with the purchase and servicing of the pool of mortgages is restricted by agreements entered into by the company with, among others, Mortgage Trust Limited (MTL) and Citicorp Trustee Company Limited in its capacity as Trustee for the noteholders.

Under the terms of the servicing agreement, the company and the Trustee each originally appointed MTL to service the mortgages under the floating rate notes. The business of MTL was transferred to Mortgage Trust Services Plc (MTS) on 1 October 2003, under the novation agreement then dated, and consequently, since that date, MTS have been the servicer.

The assets of the company are subject to a fixed and floating charge in favour of the Trustee for the noteholders.

2. Principal accounting policies

These financial statements have been prepared in accordance with applicable Accounting Standards in the United Kingdom. A summary of the more important accounting policies, which have been applied consistently, is set out below:

Basis of accounting
The financial statements are prepared in accordance with the historical cost convention.

Format of financial statements
The cost of funding heading within the profit and loss account has been adapted from that prescribed by Schedule 4 to the Companies Act 1985 in view of the nature of the business.

Turnover
Turnover represents interest receivable on mortgage loans.

Servicing fees
Servicing fees are payable by the company to the servicer under the terms of a servicing agreement. The servicing fee is calculated on the outstanding mortgage portfolio as defined in the servicing agreement. MTS is entitled to a deferred consideration based on the excess earnings as defined in the mortgage sale agreement.

Taxation
The charge for taxation is based on the profit for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred tax is recognised, without discounting, in respect of all material timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date, except as otherwise required by Financial Reporting Standard No. 19.

Cashflow statement
The company is a wholly owned subsidiary of Arianty Holdings Limited and the cashflows of the company are included in the consolidated group cashflow statement of Arianty Holdings Limited. Consequently the company is exempt under the terms of Financial Reporting Standard No. 1 ("FRS1") (Revised 1996) from publishing a cashflow statement.

2. Principal accounting policies (continued)

Related party disclosures

Under the provisions of Financial Reporting Standard No. 8 ("FRS8"), the company has taken advantage of the exemption provided (for subsidiary undertakings whose voting rights are more than 90% controlled within the group) from disclosing group related party transactions. The consolidated financial statements of Arianty Holdings Limited, in which these results are included, are publicly available.

Mortgage advances

Mortgage advances comprise loans that are secured by way of mortgages over freehold and leasehold residential properties located in England and Wales and assignment of the related life assurance policies. The mortgages over the properties and the related endowment life assurance policies are subject to a fixed charge in favour of the Trustee for the noteholders.

Losses arising from the possession and subsequent sale of properties are partly borne by third party insurers.

Mortgage advances have been presented separately on the face of the balance sheet rather than as part of current assets. In the opinion of the directors, this departure from the format of Schedule 4 of the Companies Act 1985 is required to give a true and fair view of the state of the company's affairs, since to present mortgage advances as part of current assets would not fairly reflect the liquidity of these assets.

Floating rate notes

The floating rate notes' outstanding principal balance declines over time as the proceeds from redemptions on mortgage advances are used to repay noteholders, along with accrued interest, on each monthly interest payment date. Costs relating to the issue of the floating rate notes are deducted from the principal balance on the notes. These costs are charged to the profit and loss account in line with the expected redemptions of the underlying floating rate notes. Costs are fully amortised by the earliest date at which the option to redeem the floating rate notes may be exercised.

The floating rate notes fall due for repayment in full in June 2032 and comprised, at issue, of £276m Class A notes and £24m Class B notes. The Class A notes bear interest at a margin of 29 basis points over one month sterling LIBOR until June 2007 when the interest is adjusted to a margin of 58 basis points over one month sterling LIBOR. The Class B notes bear interest at a margin of 80 basis points over one month sterling LIBOR until June 2007 when the interest is adjusted to a margin of 160 basis points over one month sterling LIBOR. Interest is determined monthly on the first business day of each month in each year for the next succeeding month.

3. Turnover

Contributions to turnover and profit on ordinary activities before taxation were derived from the company's principal activity, which was carried out in England and Wales.

4. Cost of funding

	Year to 30 Sept 2004 £'000	9 months to 30 Sept 2003 £'000
Interest charged on floating rate notes	**11,018**	8,591
Amortisation of issue costs	**129**	133
Other costs	**83**	402
	11,230	9,126

5. Other interest receivable and similar income

Interest receivable comprises interest earned on short term deposits.

6. Profit on ordinary activities before taxation

	Year to 30 Sept 2004 £'000	9 months to 30 Sept 2003 £'000
Profit on ordinary activities before taxation is stated after charging:		
Servicing fees payable	**242**	210
Corporate service fee – SPV Management Limited	**12**	9
Auditors' remuneration – audit	**6**	6
Auditors' remuneration – other services	**3**	3

The company has no employees and, other than the fee noted above, the directors received no remuneration during the year.

FIRST FLEXIBLE NO. 2 PLC

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 SEPTEMBER 2004

7. Taxation on profit on ordinary activities

	Year to 30 Sept 2004 £'000	9 months to 30 Sept 2003 £'000
The tax charge is based on the profit for the year / period and comprises:		
UK Corporation tax at 30% (2003: 30%)	**8**	7

The current tax charge for the year is the same as (2003: same as) the standard rate of corporation tax in the UK (30%, 2003: 30%) which is explained below:

	£'000	£'000
Profit on ordinary activities before tax:	**28**	21
Profit on ordinary activities multiplied by standard rate tax of 30% (2003: 30%)	**8**	7
Total current tax charge	**8**	7

8. Mortgage advances

	2004 £'000	2003 £'000
The movement during the year was as follows:		
At start of year / period	**266,002**	277,798
Further acquisition during year / period	**-**	25,986
Net movements in loan provisions, redemptions, repayments and redraws during the year / period	**(50,391)**	(37,782)
Mortgage advances at end of year / period	**215,611**	266,002

Mortgage advances are all due to be repaid at various times before June 2032 and may be redeemed at any time at the option of the borrower.

9. Debtors

	2004 £'000	2003 £'000
Amounts falling due within one year		
Other debtors	**457**	303
Prepayments and accrued income	**2**	42
	459	345

10. Called up share capital

	2004 £'000	2003 £'000
Authorised		
Equity: 100,000 Ordinary shares of £1 each	**100**	100
Allotted, 25p called up and paid		
Equity: 50,000 Ordinary shares of £1 each	**12**	12

11. Profit and loss account

	2004 £'000	2003 £'000
At start of year / period	**6**	53
Retained profit / (loss) for the financial year / period	**20**	(47)
At end of year / period	**26**	6

12. Reconciliation of movements in equity shareholders' funds

	2004 £'000	2003 £'000
Opening equity shareholders' funds	**18**	65
Profit on ordinary activities after taxation	**20**	14
Dividends	**-**	(61)
Closing equity shareholders' funds	**38**	18

13. Creditors: amounts falling due within one year

	2004 £'000	2003 £'000
Corporation tax	**8**	6
Other creditors	**979**	970
Accruals and deferred income	**16**	27
	1,003	1,003

14. Creditors: amounts falling due after more than one year

	2004 £'000	2003 £'000
Floating rate notes due 2032 (see note (a) below)	**219,379**	272,798
Deferred purchase consideration	**7,893**	7,596
Deferred income hedge reserve	**-**	26
	227,272	280,420
(a) Floating rate notes comprise:		
Principal balance outstanding	**219,457**	273,003
Unamortised issue costs	**(78)**	(205)
	219,379	272,798

The movement on floating rate notes during the year was:

	2004	2003
As at start of the year / period	**272,798**	285,707
Principal repaid during the year / period	**(53,546)**	(13,042)
Additional issue costs in the year / period	**(2)**	-
Issue costs charged to the profit and loss account	**129**	133
As at end of the year / period	**219,379**	272,798

15. Related Party Transactions

The company has identified the following transactions which are required to be disclosed under the terms of FRS8.

Transactions with MTL group

At the balance sheet date MTS, a company under common control as defined by FRS8, was owed £7.9m (2003: £7.6m) by the company in relation to deferred purchase consideration. During the year the MTS group earned £2.9m (2003: £2.7m) in relation to deferred purchase consideration. MTS acted as servicer of the mortgages for the company and earned £243k during the year (2003: £69k) in servicing fees. At the balance sheet date the company owed £20k (2003: £22k) to MTS in relation to servicing fees plus £24k (2003: £38k) for mortgage fees and insurance. The company was owed £424k (2003: £303k) by MTS relating to monies collected by the servicer, that are yet to be passed onto the company.

Transactions with The Mortgage Corporation ("TMC")

During the year, TMC, a former servicer of the company earned £nil (2003: £141k) in servicing fees from the company. At the balance sheet date the company owed £nil (2003: £nil) to TMC

16. Financial Instruments

Market Risk Management

Market risk is managed by the Asset and Liability Committee ("ALCO") of The Paragon Group of Companies Plc (Paragon), MTL's ultimate parent undertaking. The ALCO is composed of senior management and meets regularly to review performance, positions and market conditions and to make strategic decisions regarding interest rate risk, liquidity and capital management. The policy is implemented by the Treasury Department of Paragon.

Interest rate risk is the company's most significant market risk and arises from mismatches between the repricing profiles of assets and liabilities. Interest rate risk is quantified, and limits set, based on the effect that a given movement in interest rates may have on the profitability of the company. Overall planning in relation to interest rate risk is performed using a risk management system, which allows gap analysis reports to be produced on a regular basis together with sensitivity of the net exposure to a shift in interest rates. The company uses interest rate derivatives to manage interest rate risk. The company does not use derivatives for creating risk that does not arise in the underlying business and the company does not trade in derivatives. Consequently all derivatives are classified as hedging contracts and accounted for using hedge accounting.

Credit Risk Management

Credit risk during the year was monitored by the Credit Department of Paragon, and arises from the company's lending activities. Paragon are committed to maintaining a consistent credit culture based on sound lending principles because this is the best safeguard against any decline in the property market in particular or the economy as a whole.

The approval process for secured loans takes into account the ratio of the loan amount to the value of the mortgaged property. Paragon operate comprehensive monitoring systems that assist management in identifying any deterioration in loan quality. The quality of the loan book is reviewed on a regular basis.

Liquidity Management

It is the company's policy to ensure that adequate resources are available at all times to provide for the day to day activities of the company and to meet regulatory requirements. Management consider the year end position satisfactorily reflects the policies and objectives set out above.

16. Financial Instruments (continued)

Interest rate risk profile

The table below gives an indication of the interest rate risk profile of the company. Items are included in various time bands based on the earlier of the repricing or maturity date.

As at 30 September 2004	Less than 3 months	Between 3-6 months	Between 6-12 months	Over 1 year but not more than 5 years	More than Five years	Non Interest Bearing	Total
	£'000	£'000	£'000	£'000	£'000	£'000	**£'000**
Assets							
Mortgage advances	196,900	12,632	5,161	918	-	-	**215,611**
Other assets	12,243	-	-	-	-	459	**12,702**
	209,143	12,632	5,161	918	-	459	**228,313**
Liabilities							
Floating rate notes	(219,457)	-	-	-	-	78	**(219,379)**
Other liabilities	-	-	-	-	-	(8,896)	**(8,896)**
Shareholders' funds	-	-	-	-	-	(38)	**(38)**
	(219,457)	-	-	-	-	(8,856)	**(228,313)**
Off Balance sheet items	14,700	(13,100)	(700)	(800)	(100)	-	-
Interest rate risk profile	4,386	(468)	4,461	118	(100)	(8,397)	-

The other liabilities are made up of deferred purchase consideration of £7.9m (2003: £7.6m) which is repayable to MTS as and when cash is available and therefore falls due in more than 1 year. Other liabilities of £1m (2003: £1m) fall due within one year. See note 2 for the maturity profile of the floating rate notes.

As at 30 September 2003	Less than 3 months	Between 3-6 months	Between 6-12 months	Over 1 year but not more than 5 years	More than Five years	Non Interest Bearing	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Assets							
Mortgage advances	231,865	11,715	2,702	19,750	-	(30)	266,002
Other assets	15,094	-	-	-	-	345	15,439
	246,959	11,715	2,702	19,750	-	315	281,441
Liabilities							
Floating rate notes	(273,003)	-	-	-	-	205	(272,798)
Other liabilities	-	-	-	-	-	(8,625)	(8,625)
Shareholders' funds	-	-	-	-	-	(18)	(18)
	(273,003)	-	-	-	-	(8,438)	(281,441)
Off Balance sheet items	20,888	-	(2,708)	(18,033)	(147)	-	-
Interest rate risk profile	(5,156)	11,715	(6)	1,717	(147)	(8,123)	-

16. Financial Instruments (continued)

Fair value of financial instruments

The table below shows the estimated fair value and the carrying value for each major category of assets and liabilities in the balance sheet at the balance sheet date. The fair value of a financial instrument is the amount at which it could be exchanged in an arm's length transaction between informed and willing parties, other than in a forced or liquidation sale. Where external or quoted market prices were not available the fair values were estimated using discounted cash flow techniques based on interest rates prevailing at the balance sheet date. Financial instruments with short term maturities or near term re-pricing are assumed to have fair values equal to their carrying amounts.

The table excludes certain financial assets and liabilities which are not listed or publicly traded, or for which a liquid and active market does not exist. Thus it excludes mortgages and other balance sheet items whose book and fair values differ at the balance sheet date.

As at 30 September	**Carrying Amount 30 Sep 2004 £'000**	**Fair Value 30 Sep 2004 £'000**	Carrying Amount 30 Sep 2003 £'000	Fair Value 30 Sep 2003 £'000
On balance sheet instruments				
Floating rate notes	**(219,379)**	**(219,379)**	(272,798)	(272,798)
Off balance sheet instruments				
Derivatives	-	**13**	-	28

At the balance sheet date the company had interest and base rate swaps in place with a notional value of £163.1million (2003: £186.9million) with a fair value of £13k (2003: £28k).

16. Financial Instruments (continued)

Gains and losses on hedges

All derivative contracts are accounted for as hedges. Changes in the fair value of instuments used as hedges are not recognised in the financial statements until the hedge position matures. Set out below is an analysis of these unrecognised gains and losses.

	Gains £'000	(Losses) £'000	Total net gains/(losses) £'000
Unrecognised gains and losses at 1 October 2003	70	(42)	28
Gains and losses arising in previous years that were recognised in the year	-	-	-
Gains and losses arising before 1 October 2003 that were not recognised in the year	70	(42)	28
Gains and losses arising in the year that were not recognised in the year	19	(34)	(15)
Unrecognised gains and losses on hedges at 30 September 2004	89	(76)	13
Of which:			
Gains and losses expected to be recognised in the year to 30 September 2005	86	(27)	59
Gains and losses expected to be recognised in the year to 30 September 2006	3	(49)	(46)

17. Ultimate parent undertaking

The immediate parent undertaking is Arianty Holdings Limited.

The smallest and largest group into which the company is consolidated is that of Arianty Holdings Limited, registered in England and Wales.

The shares in Arianty Holdings Limited are held by SPV Management Limited under a declaration of trust for charitable purposes. The directors regard Arianty Holdings Limited as the ultimate parent and controlling undertaking.

Copies of the consolidated financial statements may be obtained from the Company Secretary, St Catherine's Court, Herbert Road, Solihull, West Midlands, B91 3QE.