Company Registration No: 04062132

ARIANTY HOLDINGS LIMITED

Report and Financial Statements

Year ended 30 September 2014

STRATEGIC REPORT

BUSINESS REVIEW AND PRINCIPAL ACTIVITIES

The principal activities of the Group during the year under review are the provision of first mortgage loans secured on residential properties.

Under the terms of the servicing agreement, Mortgage Trust Limited ("MTL") was appointed to service the mortgages. 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 has been the servicer.

Arianty Holdings Limited ('the Company') is a holding company and its main trading subsidiaries are Arianty No.1 plc ("ARI1"), First Flexible No.1 plc ("FFL1"), First Flexible No.2 plc ("FFL2"), First Flexible No.3 plc ("FFL3") First Flexible No.4 plc ("FFL4"), First Flexible No.5 plc ("FFL5") and Arianty Services Limited ("ARIS").

As shown in the Group's profit and loss account on page 6, the Group's net interest income decreased by 24% compared to the prior year (2013: 5% decrease). This was principally reflecting the reduction in the group's loan book reflecting the sale of FFL4 loan assets during the year. The result after tax has fallen from a retained profit of £763,000 to a retained loss of £35,000. This was principally due to a decrease in the net interest income and an decrease in fair value gain in the year.

The balance sheets on page 7 of the Financial Statements show the Group's and Company's financial position at the year end. In the Group's balance sheet, loans to customers have decreased by 52% due to its trading subsidiary customers redeeming their accounts during the year and the sale of the FF4L loan assets. As a result the floating rate loan notes have reduced by 51% during the year. This was due to FF4L using the proceeds to repay the asset backed loan notes. Details of amounts owed from and to other group companies are shown in notes 17 and 21.

No interim dividend was paid during the year (2013: £nil). No final dividend is proposed (2013: £nil).

The Group has entered into derivative contracts in order to provide an economic hedge against its exposure to fixed rate loans to customers. Although these instruments provide an economic hedge the prescriptive nature of the requirements of FRS 26 means that hedge accounting cannot always be achieved. This has led to the Group recognising a fair value net gain of £256,000, in the year (2013: £1,179,000). This represents a timing difference and cumulative gains and losses recognised will tend to zero over time.

The Paragon Group of Companies ('the Paragon Group') manages its operations on a centralised basis. For this reason, the Company's directors believe that further key performance indicators for the Company are not necessary or appropriate for an understanding of the development, performance or position of the business. The performance of the Paragon Group's mortgage lending operation, which includes the Company, is discussed in the Paragon Group's Annual Report, which does not form part of this Report.

PRINCIPAL RISKS AND UNCERTAINTIES

The Group comprises securitisation companies and has been structured so as to avoid, in as far as is possible all forms of financial risk with its outstanding loan notes match-funded to maturity. An analysis of the Company's exposure to risk, including financial risk, and the steps taken to mitigate these risks are set out in note 4, and a discussion of critical accounting estimates is set out in note 3.

After considering the above, the directors have a reasonable expectation that the Company will have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the Financial Statements.

ENVIRONMENT

The Paragon Group recognises the importance of its environmental responsibilities, monitors its impact on the environment, and designs and implements policies to reduce any damage that might be caused by the Paragon Group's activities. The Company operates in accordance with the Paragon Group policies, which are described in the Paragon Group's Annual Report, which does not form part of this Report.

STRATEGIC REPORT (CONTINUED)

EMPLOYEES

The Company has no employees. All operational services are provided by employees of the Paragon Group. The Paragon Group's employment policies are described in its Annual Report, which does not form part of this Report.

Approved by the Board of Directors

and signed on behalf of the Board

R J Woodman

Director

DIRECTORS' REPORT

The directors present their annual report and the audited Financial Statements for the Group of Arianty Holdings Limited, registration no: 04062132, for the year ended 30 September 2014.

DIRECTORS

The directors throughout the year and subsequently were:

N Keen (resigned 13 May 2014)

R D Shelton

J G Gemmell (resigned 30 June 2014)

R J Woodman (appointed 25 April 2014)

J Fairrie

D P Stolp (alternate to J Fairrie)

AUDITOR

The directors have taken all necessary steps to make themselves and the Company's auditor aware of any information needed in preparing the audit of the Annual Report and Financial Statements for the year, and, as far as each of the directors is aware, there is no relevant audit information of which the auditor are unaware.

No notice from members under section 488 of the Companies Act 2006 having been received, the directors intend that the auditor, Deloitte LLP, shall be deemed to be reappointed in accordance with section 487(2) of the Act.

INFORMATION PRESENTED IN OTHER SECTIONS

Certain information required to be included in a directors' report by Schedule 7 can be found in the other sections of the Annual Report, as described below. All of the information presented in these sections is incorporated by reference into this Directors' Report and is deemed to form part of this report.

A description of the Company's financial risk management objectives and policies, and its exposure to risks arising from its use of financial instruments are set out in note 4 to the accounts.

Approved by the Board of Directors

and signed on behalf of the Board

R J Woodman

Director

STATEMENT OF DIRECTORS' RESPONSIBILITIES
in relation to Financial Statements

The directors are responsible for preparing the Annual Report and the Financial Statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The financial statements are required by law to give a true and fair view of the state of affairs of the Company and the Group, and of the profit or loss of the Group for that period. In preparing these financial statements, the directors are required to:

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

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF ARIANTY HOLDINGS LIMITED

We have audited the Group and parent company Financial Statements of Arianty Holdings Limited for the year ended 30 September 2014 which comprise the consolidated profit and loss account, the Group and Company balance sheets, the consolidated cash flow statement and the related notes 1 to 26. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. 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 auditor
As explained more fully in the Statement of Directors' Responsibilities, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements
An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on Financial Statements
In our opinion the Financial Statements:

- give a true and fair view of the state of the Group's and Company's affairs as at 30 September 2014 and of the Group's loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006
In our opinion the information given in the Strategic Report and the Directors' Report for the financial year for which the Financial Statements are prepared is consistent with the Financial Statements.

Matters on which we are required to report by exception
We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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

K. J. Cooper

Kieren Cooper (Senior Statutory Auditor)

for and on behalf of Deloitte LLP

Chartered Accountants and Statutory Auditor

Birmingham, United Kingdom

23 January 2015

CONSOLIDATED PROFIT AND LOSS ACCOUNT

YEAR ENDED 30 SEPTEMBER 2014

	Note	2014 £000	2014 £000	2013 £000	2013 £000
Interest receivable					
Mortgages			2,411		3,411
Other	5		74		107
			2,485		3,518
Income from assets subject to non-recourse funding					
Income from funding vehicles		3,753		4,145	
Expense from funding vehicles		(3,380)		(3,782)	
			373		363
Interest payable and similar charges	6		(1,842)		(2,551)
Net interest income			1,016		1,330
Other operating income			-		-
Total operating income			1,016		1,330
Operating expenses			(1,285)		(1,677)
Provisions for losses	7		(13)		98
			(282)		(249)
Fair value net gain	8		256		1,179
Operating (loss) / profit, being (loss) / profit on ordinary activities before taxation	9		(26)		930
Tax on (loss) / profit on ordinary activities	10		(9)		(167)
(Loss) / profit on ordinary activities after taxation	19		(35)		763

All activities derive from continuing operations.

There are no recognised gains or losses, other than the loss for the current year and the profit for the preceding year, and consequently a separate statement of total recognised gains and losses has not been presented.

BALANCE SHEETS

30 SEPTEMBER 2014

	Note	Group 2014 £000	Group 2013 £000	Company 2014 £000	Company 2013 £000
ASSETS EMPLOYED					
FIXED ASSETS					
Assets subject to non-recourse funding	12	177,271	188,823	-	-
Non-recourse finance	12	(176,397)	(188,160)	-	-
		874	663	-	-
Investments	13	-	-	75	75
Financial assets	14	75,551	156,265	-	-
		76,425	156,928	75	75
CURRENT ASSETS					
Debtors					
Amounts falling due within one year	17	531	575	146	144
Investments		309	-	-	-
Cash at bank and in hand		9,433	17,095	1	1
		10,273	17,670	147	145
		86,698	174,598	222	220
FINANCED BY					
SHAREHOLDERS' FUNDS					
Called up share capital	18	-	-	-	-
Profit and loss account	19	1,626	1,661	37	54
		1,626	1,661	37	54
PROVISIONS FOR LIABILITIES	20	164	312	-	-
CREDITORS					
Amounts falling due within one year	21	549	2,166	185	166
Amount falling due after one year	21	84,359	170,459	-	-
		84,908	172,625	185	166
		86,698	174,598	222	220

These Financial Statements were approved by the Board of Directors on 23 January 2015.

Signed on behalf of the Board of Directors

D P Stolp
Director

CONSOLIDATED CASH FLOW STATEMENT

YEAR ENDED 30 SEPTEMBER 2014

	Note	2014 £000	2013 £000
Net cash (outflow) / inflow from operating activities	22	(11,280)	2,914
Corporation tax paid		-	-
Capital expenditure & financial investment			
Net decrease in loans to customers		80,701	4,657
Net decrease in assets subject to non-recourse finance		11,552	1,137
		92,253	5,794
Management of liquid resources			
Increase in investment deposits		(309)	-
Financing			
Decrease in non-recourse finance		(11,763)	(1,332)
Redemption of floating rate notes		(76,563)	(7,696)
		(88,326)	(9,028)
Decrease in net cash		(7,662)	(320)
Reconciliation of net cash flow to movement in net debt			
Decrease in net cash		(7,662)	(320)
Increase in investment deposits		309	-
Decrease in non-recourse finance		11,763	1,332
Redemption of floating rate notes		76,563	7,696
Change in net debt		80,973	8,708
Net debt at start of year		(321,812)	(330,520)
Net debt at end of year	23	(240,839)	(321,812)

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2014

1. RESTRICTION ON OPERATIONS

FFL1, FFL2, FFL3, FFL4 and FFL5, subsidiaries of Arianty Holdings Limited, were established for the sole purpose of issuing floating rate notes secured by pools of residential mortgages.

Under the terms of the servicing agreement, MTL was appointed to service the mortgages. The business of MTL was transferred to MTS on 1 October 2003, under the novation agreement then dated, and consequently, since that date, MTS has been the servicer.

The ability of FFL1, FFL2, FFL3, FFL4 and FFL5 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 companies with, among others, The Bank of New York Mellon, in its capacity as Trustee for the note holders. Under the terms of the servicing agreement, FFL1, FFL2, FFL3, FFL4 and FFL5 and the Trustee each appointed MTS to service the mortgages under the floating rate notes. The assets of FFL1, FFL2, FFL3, FFL4 and FFL5 are subject to a fixed and floating charge in favour of the Trustee for the note holders.

2. ACCOUNTING POLICIES

The Financial Statements are prepared in accordance with applicable UK Accounting Standards. The particular accounting policies adopted are described below. They have been applied consistently throughout the current and preceding year. The Financial Statements have been prepared on a going concern basis as described in the Strategic Report.

Accounting convention

The Financial Statements are prepared under the historical cost convention, except as required in the valuation of certain financial instruments which are carried at fair value.

Basis of consolidation

The Group has complied with Financial Reporting Standard No. 5 "Reporting the Substance of Transactions" and having met the conditions laid down in the standard, has adopted "linked presentation" in respect of mortgage advances managed on behalf of other financial institutions. The consolidated financial statements incorporate the financial statements of the Company and all of its subsidiaries for the year then ended.

Loans to customers

Loans to customers are considered to be 'loans and receivables' as defined by Financial Reporting Standard 26 – 'Financial Instruments: Recognition and Measurement' (FRS 26). They are therefore accounted for on the amortised cost basis.

Such loans are valued at inception as amount of initial advance, which is the fair value at that time, inclusive of procuration fees paid to brokers or other business providers and less initial fees paid by the customer. Thereafter they are valued at this amount less the cumulative amortisation calculated using the Effective Interest Rate ('EIR') method. The loan balances are then reduced where necessary by a provision for balances which are considered to be impaired.

The EIR method spreads the expected net income arising from a loan over its expected life. The EIR is that rate of interest which, at inception, exactly discounts the expected future cash payments and receipts arising from the loan to the initial carrying amount.

The Group's policy is to hedge against any exposure to fixed rate loan assets (note 4).

Impairment of loans and receivables

Loans and receivables are reviewed for indications of possible impairment throughout the year and at each balance sheet date, in accordance with FRS 26. Where loans exhibit objective evidence of impairment, the carrying value of the loans is reduced to the net present value of their expected future cash flows, including the value of the potential realisation of any security, discounted at the original EIR. Loans are assessed collectively, compared by risk characteristics and account is taken of any impairment arising due to events which are believed to have taken place but have not been specifically identified at the balance sheet date.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2014

2. ACCOUNTING POLICIES (CONTINUED)

Fixed assets – investments in subsidiaries

The investment in the subsidiary companies is shown at cost less provision for impairment.

Current assets – short-term investments

Balances shown as current asset investments in the balance sheet comprise short-term deposits with banks with maturities of more than 7 days and not more than 90 days.

Current tax

Current tax, including UK corporation tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred taxation

Deferred taxation is provided in full on timing differences that result in an obligation at the balance sheet date to pay more tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the Financial Statements. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

Borrowings

Borrowings are carried in the balance sheet on the amortised cost basis. The initial value recognised includes the principal amount received less any discount on issue or costs of issuance.

Interest and all other costs of the funding are expensed to the profit and loss account as interest payable over the term of the borrowing on an Effective Interest Rate basis.

Revenue

The revenue of the Group comprises interest receivable and other income. The accounting policy for the recognition of each element of revenue is described separately within these accounting policies.

Fee and commission income

Other income includes administration fees charged to borrowers, which are credited to the profit and loss account when the related service is performed.

Servicing fees

Servicing fees are payable by ARI1, FFL1, FFL2, FFL3, FFL4 and FFL5 to MTS under the terms of a servicing agreement. The servicing fee is calculated on the outstanding mortgage portfolio as defined in the servicing agreement.

Derivative financial instruments

Derivative instruments utilised by the Group comprise interest rate swaps. All such instruments are used for hedging purposes to alter the risk profile of the existing underlying exposure of the Group in line with the Group's risk management policies (note 4).

The Group does not enter into speculative derivative contracts.

All derivatives are carried in the balance sheet at fair value, as assets where the value is positive or as liabilities where the value is negative. Fair value is based on market prices, where a market exists. If there is no active market, fair value is calculated using present value models which incorporate assumptions based on market conditions and are consistent with accepted economic methodologies for pricing financial instruments. Changes in the fair value of derivatives are recognised in the profit and loss account, except where such amounts are permitted to be taken to equity as part of the accounting for a cash flow hedge.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2014

2. ACCOUNTING POLICIES (CONTINUED)

Hedging

For all hedges, the Group documents, at inception, the relationship between the hedging instruments and the hedged items, as well as its risk management strategy and objectives for undertaking the transaction. The Group also documents its assessment, both at hedge inception and on an on-going basis, of whether the hedging arrangements put in place are considered to be 'highly effective' as defined by FRS 26.

For a fair value hedge, as long as the hedging relationship is deemed 'highly effective' and meets the hedging requirements of FRS 26, any gain or loss on the hedging instrument recognised in income can be offset against the fair value loss or gain arising from the hedged item for the hedged risk. For macro hedges (hedges of interest rate risk for a portfolio of loan assets) this fair value adjustment is disclosed in the balance sheet alongside the hedged item, for other hedges the adjustment is made to the carrying value of the hedged asset or liability. Only the net ineffectiveness of the hedge is charged or credited to income. Where a fair value hedge relationship is terminated, or deemed ineffective, the fair value adjustment is amortised over the remaining term of the underlying item.

Where a derivative is used to hedge the variability of cash flows of an asset or liability, it may be designated as a cash flow hedge so long as this relationship meets the hedging requirements of FRS 26. For such an instrument the effective portion of the change in the fair value of the derivative is taken initially to equity, with the ineffective part taken to profit or loss. The amount taken to equity is released to the profit and loss account at the same time as the hedged item affects the profit and loss account. Where a cash flow hedge relationship is terminated, or deemed ineffective, the amount taken to equity will remain there until the hedged transaction is recognised, or is no longer highly probable.

Related party disclosures

Under the provisions of Financial Reporting Standard No. 8 ("FRS 8"), the Group has taken advantage of the exemption provided (for subsidiary undertakings whose voting rights are 100% controlled within the Group) from disclosing Group related party transactions. The consolidated financial statements of The Paragon Group of Companies PLC, in which these results are included, are publicly available.

FRS 29 disclosure

The Company has taken advantage of the exemption granted by Financial Reporting Standard 29 - 'Financial Instruments: Disclosures' and does not therefore provide the disclosures required by the Standard as all voting rights are controlled by The Paragon Group of Companies PLC, the accounts of which are publicly available.

Deferred purchase consideration

Deferred purchase consideration is recognised in which it becomes payable and is paid when sufficient cash resources allow.

3. CRITICAL ACCOUNTING ESTIMATES

Certain balances reported in the financial statements are based wholly or in part on estimates or assumptions made by the directors. There is, therefore, a potential risk that they may be subject to change in future periods. The most significant of these are:

Impairment losses on loans to customers

Impairment losses on loans are calculated based on statistical models. The key assumptions revolve around estimates of future cash flows from customer's accounts, their timing and, for secured accounts, the expected proceeds from the realisation of the property. These key assumptions are based on observed data from historical patterns and are updated regularly based on new data as it becomes available.

In addition the directors consider how appropriate past trends and patterns might be in the current economic situation and make any adjustments they believe are necessary to reflect the current conditions.

The accuracy of the impairment calculations would therefore be affected by unexpected changes to the economic situation, variances between the models used and the actual results or assumptions which differ from the actual outcomes.

3. CRITICAL ACCOUNTING ESTIMATES (CONTINUED)

In particular, if the impact of economic factors such as employment levels on customers is worse than is implicit in the model then the number of accounts requiring provision might be greater than suggested by the model, while falls in house prices, over and above any assumed by the model might increase the provision required in respect of accounts currently provided.

Effective interest rates

In order to determine the effective interest rate applicable to loans an estimate must be made of the expected life of each loan and hence the cash flows relating thereto. These estimates are based on historical data and reviewed regularly. The accuracy of the effective interest rate applied would therefore be compromised by any differences between actual borrower behaviour and that predicted.

Fair values

Where financial assets and liabilities are carried at fair value, in the majority of cases this can be derived by reference to quoted market prices. Where such a quoted price is not available the valuation is based on cash flow models, based, where possible on independently sourced parameters. The accuracy of the calculation would therefore be affected by unexpected market movements or other variances in the operation of the models or the assumptions used.

4. FINANCIAL RISK MANAGEMENT

Market risk management

Market risk is managed by the Asset and Liability Committee ("ALCO") of MTS and the Paragon Group. 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 MTS and the Paragon Group.

Interest rate risk is the Group'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 Group. 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 Group uses interest rate derivatives to manage interest rate risk. The Group does not use derivatives for creating risk that does not arise in the underlying business and the Group does not trade in derivatives. Consequently all derivatives are classified as hedging contracts and accounted for using hedge accounting.

Liquidity management

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

Credit risk management

Credit risk during the year was monitored by the Credit Department of MTS and the Paragon Group, and arises from the Group's lending activities. MTS and the Paragon Group 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. MTS and the Paragon Group 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.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2014

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

Use of derivative financial instruments

The Group uses derivative financial instruments for risk management purposes. Such instruments are used only to limit the exposure of the Group to movements in market interest.

It is, and has been throughout the year under review, the Group's policy that no trading in financial instruments shall be undertaken, and hence all of the Group's derivative financial instruments are for commercial hedging purposes. These are used to protect the Group from exposures principally arising from fixed rate lending. Hedge accounting is applied where appropriate, though it should be noted that some derivatives, while forming part of an economic hedge relationship, do not qualify for this accounting treatment under FRS 26 either because natural accounting offsets are expected, or obtaining hedge accounting would be especially onerous.

The Group has designated a number of derivatives as fair value hedges. In particular this treatment is used for hedging the interest rate risk of groups of fixed rate prepayable loan assets with interest rate derivatives on a portfolio basis. The Group believes this solution is the most appropriate as it is consistent with the economic hedging approach taken by the Group to these assets.

Fair values of financial assets and financial liabilities

Fair values have been determined for all derivatives, listed securities and any other financial assets and liabilities for which an active and liquid market exists. The fair values of cash at bank and in hand, bank loans and overdrafts and asset backed loan notes are not materially different from their book values because all the assets mature within one month of the year end and the interest rates charged on financial liabilities reset on a monthly basis.

Derivative financial instruments are stated at their fair values. The fair values of the interest rate swaps have been determined by reference to prices available from the markets on which these instruments are traded.

The fair value of loans to customers is considered to not be materially different to the amortised cost value at which they are disclosed.

Maturity profile

The maturity of the Group's financial liabilities, other than short term creditors such as other creditors, accruals and deferred income, were as follows:

	2014 £000	2013 £000
In one year or less or on demand	-	-
Over 1 year but less than five years	-	-
In more than five years	74,184	151,747
	74,184	151,747

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2014

5. INTEREST RECEIVABLE - OTHER

	Group 2014 £000	Group 2013 £000
Interest receivable from group companies	25	31
Bank interest	49	76
	74	107

Bank interest comprises interest earned on short term deposits

6. INTEREST PAYABLE AND SIMILAR CHARGES

	Group 2014 £000	Group 2013 £000
Mortgage backed bank loans	1,748	2,381
Interest rate swaps	67	110
Commitment fees	13	46
Interest payable to group companies	14	14
	1,842	2,551

7. PROVISIONS FOR LOSSES

	Group 2014 £000	Group 2013 £000
Impairment of financial assets / (Release of provision)		
First mortgage loans	13	(98)

8. FAIR VALUE NET GAIN

The fair value net gain of £256,000 (2013: £1,179,000) represents the accounting volatility on derivative instruments which are matching risk exposure on an economic basis. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting has not been adopted or is not achievable on certain items. The gain is primarily due to timing differences in income recognition between the derivative instruments and the economically hedged assets and liabilities.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2014

9. OPERATING (LOSS) / PROFIT, BEING (LOSS) / PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION

	Group 2014 £000	Group 2013 £000
Operating (loss) / profit is after charging:		
Administration and servicing fee	114	155
Corporate service fee – ATC Capital Markets (UK) Ltd	7	7
Auditor remuneration - audit services	27	35

The Group has no employees and the directors received no remuneration during the year apart from that disclosed above. The Group pays an administration charge to MTS, a related party, to provide daily services to the Group. Non audit fees provided to the Group are disclosed in the accounts of the parent company and the exemption from disclosure of fees payable to the Company's auditor in respect to non-audit services in these Financial Statements has been taken.

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

a) Tax charge for the year

	Group 2014 £000	Group 2013 £000
Current tax		
Corporation tax	157	(14)
	157	(14)
Deferred tax (note 20)		
Origination and reversal of timing differences	(148)	227
Rate change	-	(46)
	(148)	181
	9	167

b) Factors affecting the current tax charge

(Loss) / profit before tax	(26)	930
UK corporation tax at 22% (2013: 23.5%) based on the (loss) / profit for the year	(6)	218
Effects of:		
Movement on short term timing differences	163	(232)
	157	(14)

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2014

10. TAX ON (LOSS) / PROFIT ON ORDINARY ACTIVITIES (CONTINUED)

During the year ended 30 September 2012 the Government enacted provisions reducing the rate of corporation tax from 24.0% to 23.0% from 1 April 2014. During the year ended 30 September 2013 the Government enacted provisions further reducing the rate of corporation tax to 21.0% with effect from 1 April 2014 and 20.0% from 1 April 2015. Therefore the standard rate of corporation tax applicable to the Group for the year ended 30 September 2013 was 23.5%, the rate for the year ending 30 September 2014 was 22.0%, the rate for the year ending 30 September 2015 is expected to be 20.5% and the rate in subsequent years is expected to be 20.0%. The expected impact on deferred tax balances of the changes to 23.0% was accounted for in the year ended 30 September 2012 and the expected impact of the changes to 21.0% and 20.0% was accounted for in the year ended 30 September 2013.

11. PROFIT FOR THE YEAR

As permitted by section 408 of the Companies Act 2006, the parent company's profit and loss account has not been included in these financial statements. The parent company's loss for the financial year was £17,000 (2013: profit £13,000).

12. ASSETS SUBJECT TO NON-RECOURSE FUNDING / FINANCE

GROUP

	2014 £000	2013 £000
Securitised mortgage advances	171,469	175,218
Other related liabilities	5,802	13,605
	177,271	188,823
Non-recourse funding	(176,397)	(188,160)
	874	663

The Group obtains and administers mortgages for independent providers of finance, including First Flexible No. 6 PLC ("FFL6"), Paragon Mortgages No. 7 Plc ("PM7") and Paragon Mortgages No. 8 Plc ("PM8"), on terms which provide that the Group receives net income from the mortgages after the claims of providers of finance have been satisfied in full.

In accordance with Financial Reporting Standard Number 5 "Reporting the substance of transactions" these mortgages have been included in these accounts using linked presentation, whereby the non-recourse finance is shown deducted from the mortgage debtors.

The directors confirm that:

(a) The Group is not obliged to support any losses of its independent providers of finance, nor does it intend to do so; and

(b) The providers of finance have agreed in writing that they will only seek repayment of the finance, as to both principal and interest, to the extent sufficient funds are generated by or attached to the mortgages they have financed and they will not seek recourse in any other form.

The Group has no option or obligation to purchase the mortgages concerned.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2014

13. INVESTMENTS

	Company 2014 £000	Company 2013 £000
Balance at 1 October 2013	75	75
Disposals	-	-
Balance at 30 September 2014	75	75

Listed below are the subsidiary companies of the Group which are all incorporated in England and Wales:

Company	Principal activity	Description of shares held	Proportion of nominal value of issued shares held	Year end Status
Arianty No.1 PLC	Mortgage warehouse	Ordinary £1 shares	100%	Trading
Arianty Services Ltd	Leasing	Ordinary £1 shares	100%	Trading
First Flexible No.1 PLC	Mortgage securitisations	Ordinary £1 shares	100%	Trading
First Flexible No.2 PLC	Mortgage securitisations	Ordinary £1 shares	100%	Trading
First Flexible No.3 PLC	Mortgage securitisations	Ordinary £1 shares	100%	Trading
First Flexible No.4 PLC	Mortgage securitisations	Ordinary £1 shares	100%	Trading
First Flexible No.5 PLC	Mortgage securitisations	Ordinary £1 shares	100%	Trading

During the year ended 30 September 2014 the Company received £nil in dividend income from its subsidiaries (2013: £30,000).

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2014

14. FINANCIAL ASSETS

	Group 2014 £000	Group 2013 £000
Loans to customers (note 15)	75,551	156,102
Fair value adjustments from portfolio hedging	-	163
	75,551	156,265

15. LOANS TO CUSTOMERS

Loans to customers at 30 September 2014 and 30 September 2013, which are all denominated and payable in sterling, were first mortgages which are secured on residential property within the United Kingdom.

Mortgage loans have a contractual term of up to thirty years, the borrower is entitled to settle the loan at any point and in most cases such early settlement does take place. All borrowers are required to make monthly payments, except where an initial deferred period is included in the contractual terms.

All the mortgage loans are pledged as collateral for asset backed loan notes at 30 September 2014 and 30 September 2013.

	Group 2014 £000	Group 2013 £000
Balance at 1 October 2013	156,102	160,612
Additions	97	6,825
Securitisations and other sales	(70,114)	-
Other debits	2,512	3,708
Repayments and redemptions	(13,046)	(15,043)
Balance at 30 September 2014	75,551	156,102

Other debits include primarily interest charged to customers on loans outstanding, impairment movements on these loans and other changes in the amortised cost of the assets caused by the effective interest rate method.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2014

16. DERIVATIVE FINANCIAL ASSETS AND LIABILITIES

All of the Group's financial derivatives are held for economic hedging purposes, although not all may be designated for hedge accounting in accordance with the provisions of FRS 26. The analysis below therefore splits derivatives between those accounted for as hedges and those which, while representing an economic hedge do not qualify for this treatment.

	2014	2014	2014	2013	2013	2013
	Notional amount	Assets	Liabilities	Notional amount	Assets	Liabilities
	£000	£000	£000	£000	£000	£000
Derivatives in accounting hedge relationships	-	-	-	-	-	-
Other derivatives						
Interest rate swaps	64,000	-	(454)	137,400	163	(874)
Total recognised derivative assets / (liabilities)	64,000	-	(454)	137,400	163	(874)

17. DEBTORS

	Group		Company	
	2014	2013	2014	2013
	£000	£000	£000	£000
Amounts falling due within one year:				
Amounts owed by group undertakings	-	-	7	37
Corporation tax	-	102	5	5
Other debtors	524	463	133	101
Prepayments and accrued income	7	10	1	1
	531	575	146	144

The fair value of the above items are not considered to be materially different to their carrying values.

18. CALLED UP SHARE CAPITAL

	Company 2014	Company 2013
	£	£
Allotted:		
1 ordinary share of £1 (fully paid)	1	1

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2014

19. COMBINED STATEMENT OF MOVEMENT IN SHAREHOLDERS' FUNDS AND STATEMENT OF MOVEMENT ON RESERVES

	Group		Company	
	2014 £000	2013 £000	2014 £000	2013 £000
At start of year	1,661	898	54	41
Retained (loss) / profit for the year	(35)	763	(17)	13
At end of year	1,626	1,661	37	54

An interim dividend of £nil per share was paid during the year (2013: £nil per share). No final dividend is proposed (2013: £nil).

20. PROVISIONS FOR LIABILITIES

The movements in the net liability for deferred tax are as follows:

	Group 2014 £000	Group 2013 £000
Balance at 1 October 2013	312	131
Profit and loss charge (note 10)	(148)	227
Rate change (note 10)	-	(46)
Balance at 30 September 2014	164	312
The net deferred tax liability for which provision has been made is analysed as follows:		
Other timing differences	164	312

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2014

21. CREDITORS

	Group		Company	
	2014 £000	2013 £000	2014 £000	2013 £000
Amounts falling due within one year:				
Amounts owed by group undertakings	-	-	56	53
Other creditors	283	1,850	121	106
Corporation tax	55	-	-	-
Accruals and deferred income	211	316	8	7
	549	2,166	185	166
Amounts falling due after one year:				
Floating rate notes (note a)	74,184	150,747	-	-
Derivative financial liabilities (note 16)	454	874	-	-
Deferred purchase consideration (note b)	9,721	17,838	-	-
Redraw facility (note c)	-	1,000	-	-
	84,359	170,459	-	-

a) The floating rate notes for FFL4 was due for repayment in full in July 2036 and comprised, at issue, of £460m Class A notes, £35m Class M notes and £5m Class B notes. The Class A notes bear interest at a margin of 27 basis points over one month sterling LIBOR until July 2008 when the interest was adjusted to a margin of 54 basis points over one month sterling LIBOR. The Class M notes bear interest at a margin of 85 basis points over one month sterling LIBOR until July 2008 when the interest was adjusted to a margin of 170 basis points over one month sterling LIBOR. The Class B notes bear interest at a margin of 180 basis points over one month sterling LIBOR until July 2008 when the interest was adjusted to a margin of 280 basis points over one month sterling LIBOR. Interest is determined monthly on the first business day of each month in each period for the next succeeding month. All floating rate notes for FFL4 was repaid due to the loans being sold during the year.

The floating rate notes for FFL5 fall due for repayment in full in June 2034 and comprised, at issue, of £465m Class A notes, £22.5m Class M notes and £12.5m Class B notes. The Class A notes bear interest at a margin of 23 basis points over one month sterling LIBOR until July 2009 when the interest was adjusted to a margin of 46 basis points over one month sterling LIBOR. The Class M notes bear interest at a margin of 80 basis points over one month sterling LIBOR until July 2009 when the interest was adjusted to a margin of 160 basis points over one month sterling LIBOR. The Class B notes bear interest at a margin of 170 basis points over one month sterling LIBOR until July 2009 when the interest was adjusted to a margin of 270 basis points over one month sterling LIBOR. Interest is determined monthly on the first business day of each month in each period for the next succeeding month.

b) Under the mortgage sale agreements profits of FFL4, FFL5, FFL6, PM7 and PM8 are paid to the originator of the loans, ARI1 by way of deferred purchase consideration. In turn, profits of ARI1 are paid to MTS by way of deferred purchase consideration.

c) During the year the sterling revolving credit facilities in FFL4 and FFL5, which were part of their securitisation to fund, where necessary, the purchase of mortgage redraws, where FFL4 and FFL5 would otherwise have insufficient principal cash to meet these obligations, were cancelled. Interest on the loans was payable monthly, on the same day as the note payments, in sterling at 0.30% above LIBOR. The initial redraw facilities limit were £17.5m and £25m respectively although the limit may be varied in accordance with the securitisations agreements.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2014

22. RECONCILIATION OF OPERATING PROFIT TO NET CASH (OUTFLOW) / INFLOW FROM OPERATING ACTIVITIES

	Group 2014 £000	Group 2013 £000
Operating (loss) / profit	(26)	930
Provisions for losses impairment / (release)	13	(98)
(Increase) / decrease in debtors	(58)	315
(Decrease) / increase in creditors	(11,209)	1,767
Net cash outflow from operating activities	(11,280)	2,914

23. ANALYSIS OF CHANGES IN NET DEBT

Group	30 September 2012 £000	Cash flows £000	Non-cash changes £000	30 September 2013 £000	Cash flows £000	Non-cash changes £000	30 September 2014 £000
Cash in hand and at bank	17,415	(320)	-	17,095	(7,662)	-	9,433
Investment deposits	-	-	-	-	309	-	309
	17,415	(320)	-	17,095	(7,353)	-	9,742
Non-recourse finance	(189,492)	1,332	-	(188,160)	11,763	-	(176,397)
Debt falling due after one year							
Bank loan	-	-	-	-	-	-	-
Floating rate notes	(158,443)	7,696	-	(150,747)	76,563	-	(74,184)
	(330,520)	8,708	-	(321,812)	80,973	-	(240,839)

Non-cash changes relate to the amortised securitisation issue costs charged to the profit and loss account.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2014

24. RELATED PARTY TRANSACTIONS

The Group has identified the following transactions which are required to be disclosed under the terms of Financial Reporting Standard 8, "Related Party Disclosures" ("FRS8").

Transactions with the Mortgage Trust Group

Under the terms of the servicing agreements, MTL was appointed to service the mortgages. The business of MTL was transferred to MTS on 1 October 2003, under the novation agreement then dated, and consequently, since that date, MTS has been the servicer.

Under an agreement entered into on 28 December 2000 with MTS and subsequently amended, a group under common control as defined by FRS 8, ARI1 bought mortgages intraday which are originated by MTS at net book value. MTS also provides credit and threshold margin support for these mortgages.

At the balance sheet date the Company was owed £133,000 (2013: £101,000) by MTS in relation to monies owed to the Company, which is included in other debtors.

At the balance sheet date ARI1 had bought £2,641m (2013: £2,641m) of mortgages from MTL and owed £nil (2013: £nil) in relation to credit and threshold margin support provided by MTS. ARI1 also owed £9,722,000 (2013: £17,838,000) to MTS at the balance sheet date in relation to deferred purchase consideration. During the year ARI1 paid £9,172,000 (2013: £759,000) in relation to deferred purchase consideration. As at the balance sheet date ARI1 owed £nil (2013: £nil) to MTS in relation to servicing fees, which is included in other creditors.

At the balance sheet date ARIS was owed £55,000 (2013: £52,000) by MTS which is included in other debtors.

At the balance sheet date FFL1 was owed £52,000 (2013: £56,000) by MTS, which is included in other debtors.

At the balance sheet date FFL2 was owed £19,000 (2013: £20,000) by MTS, which is included in other debtors.

At the balance sheet date FFL3 was owed £154,000 (2013: £195,000) by MTS, which is included in other debtors.

At the balance sheet date MTS was owed £nil (2013: £17,000) for mortgage fees and insurance by FFL4, which is included in other creditors. During the year MTS earned £36,000 (2013: £73,000) in relation to servicing fees. At the balance sheet date FFL4 owed £nil (2013: £6,000) to MTS in relation to servicing fees, which is included in other creditors. FFL4 was owed £72,000 (2013: £36,000) by MTS relating to monies collected by MTS, that are yet to be passed on to FFL4, which is included in other debtors.

At the balance sheet date MTS was owed £4,000 (2013: £19,000) for mortgage fees and insurances by FFL5, which is included in other creditors. During the year MTS earned £77,000 (2013: £80,000) in relation to servicing fees. At the balance sheet date FFL5 owed £6,000 (2013: £7,000) to MTS in relation to servicing fees, which is included in other creditors. FFL5 was owed £48,000 (2013: owed £123,000) from MTS relating to monies received by MTS, that are yet to be passed on from MTS, which is included in other debtors.

On 2 October 2000 a Corporate Services Agreement was entered into and subsequently amended by three side letters, to provide Corporate Services to the Arianty Group of Companies between MTS, a group under common control as defined by FRS 8, Arianty Holdings Limited and Wilmington Trust SP Services (London) Limited. MTS is remunerated for its services on an invoice basis. On 10 October 2008 ATC Capital Markets (UK) Limited replaced Wilmington Trust SP Services (London) Limited.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2014

25. RELATED PARTY TRANSACTIONS (CONTINUED)

Transactions with Paragon Finance PLC (PF)

At the balance sheet date PF, a Company under common control as defined by FRS8, was owed £121,000 (2013: £105,000) by the Company in relation to payments made on behalf of the Company, which is included in other creditors.

At the balance sheet date PF was owed £21,000 (2013: £20,000) by ARIS in relation to payments made on behalf of the Company, which is included in other creditors.

At the balance sheet date PF was owed £nil (2013: £2,000) by FFL4 in relation to payments made on behalf of the Company, which is included in other creditors.

At the balance sheet date PF was owed £140,000 (2013: £1,550,000) by FFL5 in relation to payments made on behalf of the Company, which is included in other creditors.

26. ULTIMATE PARENT UNDERTAKING

On 10 October 2008 ATC Capital Markets (UK) Limited replaced Wilmington Trust SP Services (London) Limited as trustees under a declaration of trust for charitable purposes. The directors regard The Paragon Group of Companies PLC as the ultimate controlling party.

The smallest and largest group in which the Company is consolidated is that of the Paragon Group of Companies PLC.

Copies of the consolidated financial statements may be obtained from the Secretary, 51 Homer Road, Solihull, West Midlands, B91 3QJ.