Equity Release Funding (No. 1) plc

Directors' Report
and
Financial Statements

15 month period ended: 31 December 2001

Registered Number: 4074907

Contents

Directors and other information

Directors:

M McDermott
P Minoprio
SPV Management Limited

Secretary:

SPV Management Limited

Bankers:

Barclays Bank PLC
London Corporate Banking Centre
54 Lombard Street
London
EC3P 3AH

Solicitors:

Slaughter and May
35 Basinghall Street
London
EC2V 5DB

Auditors:

Ernst & Young LLP
Rolls House
7 Rolls Buildings
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LONDON
EC4A 1NH

Registered Office:

78 Cannon Street
London
EC4P 5LN

Registered in England No. 4074907

Directors' report

The directors present their first annual report and audited financial statements for the 15 month period ended 31 December 2001.

Principal activities, business and future developments

The company was incorporated on 20 September 2000 as Forecastgrowth plc, and on 19 October 2000 a special resolution was passed changing the company's name to Equity Release Funding (No1) plc.

On 30 March 2001, the company commenced its activity through the purchase of £218m of mortgage assets from Norwich Union Equity Release Limited, a wholly owned subsidiary of Norwich Union Life & Pensions Limited. These assets are a portfolio of UK Equity Release fixed rate residential mortgages, wholly secured on properties in the UK. In order to fund the purchase of these mortgage assets, the company issued a series of mortgage backed notes.

The principal activity of the company is the investment in Equity Release mortgage loans secured by first charges over properties within the United Kingdom and to raise/borrow money and to grant security over its assets. The directors do not anticipate any material changes to the nature or volume of the business in the foreseeable future.

The profit and loss account for the 15 month period to 31 December 2001 is set out on page 7 and in the related notes. The Directors do not recommend the payment of a dividend.

Directors and secretary and their interests

Directors who served during the period were as follows :-

M McDermott (Appointed 10 October 2000)
P Minoprio (Appointed 10 October 2000)
SPV Management Limited (Appointed 10 October 2000)
Swift Incorporations Limited (Deemed appointed 20 September 2000) (Resigned 10 October 2000)
Instant Companies Limited (Deemed appointed 20 September 2000) (Resigned 10 October 2000)

On 18 October 2000 Piers Minoprio and SPV Management each purchased one fully paid share in the company. On 14 February 2001 one share fully paid share in the company was transferred from Piers Minoprio to Piers Minoprio and Equity Release Holdings Ltd jointly, and on the same date another fully paid share in the company was transferred from SPV Management to Equity Release Holdings Ltd. During the period, the directors had no other interest in the share capital or loan stock of the company or group companies.

Statement of directors' responsibilities

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

- select suitable accounting policies and then apply them consistently
- make judgements and estimates that are reasonable and prudent
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts
- 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 books of account which disclose with reasonable accuracy at any time the financial position of the company and which enable them to ensure that the financial statements comply with the Companies Act 1985. They have a 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.

Policy on payment of creditors

The company is responsible for the agreement of terms and conditions under which business transactions with suppliers are conducted. It is the company's policy that payments to suppliers are made in accordance with these terms, normally between 30 and 60 days, provided that the supplier is also complying with all relevant terms and conditions. There were no trade creditors as at 31 December 2001.

Financial instruments

The company's financial instruments comprise mortgages, borrowings, cash and liquid resources and other sundry instruments such as debtors and creditors arising directly from the company's operations. The company also entered into an interest rate swap agreement for the purposes of managing the interest rate risk associated with the company's operations and to provide liquidity. No trading in financial instruments has been undertaken during the period. The main risks arising from the company's financial instruments held are credit risk, interest rate risk and liquidity/reinvestment risk. The company's management reviews and agrees policies for managing each of these risks and they are, broadly, as follows:

Credit Risk
Credit risk is the risk that borrowers or his/her estate will not be able to meet their obligations as they fall due. The lending criteria for the mortgages include low initial loan to value ratios reducing the risk of credit losses. The company also has the benefit of an insurance policy with Norwich Union Life & Pensions Ltd which insures any undischarged portion of a loan where a sale has occurred as a result of death or the need for long term care of the relevant borrower.

Interest rate risk
Interest rate risk exists when assets and liabilities attract interest rates set according to different bases or which are reset at different times. The company minimises its exposure to interest rate risk by ensuring that the interest rate characteristics of its assets and liabilities are similar. Where this is not possible, interest rate swaps are utilised to mitigate any residual interest rate risk.

Liquidity risk
Liquidity risk is the risk that the company will encounter difficulty in raising funds to meet commitments associated with financial instruments, if the cashflows from the mortgages differs from that expected. This risk is managed by:

i) Cashflows have been modelled using multiple state modelling
ii) Liquidity is provided for through the facility agreement (see note 16) and the swap agreement (see note 14).

Auditors

The company appointed Ernst & Young LLP as auditors for the first year of trading. In accordance with section 385 of the Companies Act, 1985, Ernst & Young LLP have indicated their willingness to continue in office and the directors will place a resolution before the annual general meeting to re-appoint them as auditors for the ensuing year.

On behalf of the board

SPV Management Limited — 18 April 2002
Secretary

Auditor's report to the members of Equity Release Funding (No. 1) plc

Independent auditor's report to the members of Equity Release Funding (No.1) plc

We have audited the Company's financial statements for the 15 month period ended 31 December 2001 which comprise the profit and loss account, balance sheet and the related notes 1 to 17. These financial statements have been prepared on the basis of the accounting policies set out therein.

Respective responsibilities of directors and auditors

As described in the statement of directors' responsibilities the Company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

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.

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

Basis of audit opinion

We conducted our audit in accordance with United Kingdom 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 affairs of the Company as at 31 December 2001 and of its profit for the 15 month period then ended and have been properly prepared in accordance with the Companies Act 1985.

Ernst & Young LLP

Ernst & Young LLP
Registered Auditor
London

18 APR 2002

Profit and loss account
for the 15 month period ended 31 December 2001

	Note	15 Month Period ended 31 December 2001 £
Interest receivable and similar income	*2*	**15,880,323**
Interest payable and similar charges	*3*	**(12,185,690)**
Net income		**3,694,633**
Other operating expenses		**(3,693,264)**
Operating profit on ordinary activities before taxation	*4*	**1,369**
Tax on profit on ordinary activities	*6*	**(591)**
Profit for the financial period		**778**
Profit and loss account at beginning of period		**-**
Profit and loss account at end of year		**778**

The company had no recognised gains and losses in the financial year other than those presented above and accordingly, no statement of total recognised gains and losses has been presented.

Balance sheet
at 31 December 2001

	Note	£	As at 31 December 2001 £
Intangible fixed assets			
Unamortised premium	*8*		3,629,467
Current assets			
Mortgage advances	*7*	222,957,897	
Debtors	*9*	191,800	
Cash at bank and in hand		16,378,666	
			239,528,363
Creditors: amounts falling due within one year	*10*		(1,406,252)
Net current assets			238,122,111
Total assets less current liabilities			241,751,578
Creditors: amounts falling due after one year	*11*		(241,738,298)
Net Assets			13,280
Capital and reserves			
Called up share capital	*12*		12,502
Profit and loss account			778
Shareholders' funds – equity	*13*		13,280

The financial statements on pages 7 to 16 were approved by the Board on 18 April 2002 and were signed on its behalf by:

SPV Management Limited
Director

18 April 2002

1. Statement of accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the company's financial statements.

Basis of preparation

The financial statements have been prepared in accordance with generally accepted accounting principles under the historical cost convention and comply with financial reporting standards of the Accounting Standards Board. The financial statements are denominated in sterling.

Cash flow statement

The directors have availed of the exemption for any company whose ultimate parent undertaking prepares and files consolidated financial statements, incorporating the results of the company and including a consolidated cash flow statement in the required format. Accordingly no cash flow statement is presented.

Taxation

The charge for taxation is based on the profit for the year. The accounting treatment adopted provides for profit of 0.01% of interest accruing on the mortgages in each accounting period.

Interest rate swaps

The company hedges its exposure to gains and losses from interest rate movements by using interest rate swaps. The swaps are used for hedging and liquidity and are, therefore, not marked to market. Swaps are accounted for by reference to the aim of the arrangement. That element of the swap, which acts as a hedge, is accounted for on an accruals basis equivalent to that used for the underlying transaction. That element of the swap, which provides liquidity, is accounted for as a loan on an accruals basis. The interest on the loan is accrued based on the outstanding amount at a fixed interest rate. The fixed interest rate is the implied fixed rate cost calculated with reference to that element of the cash flow of the swaps, which represents a loan.

Income and expense recognition

Interest income and expenses are recognised on an accruals basis. Expenses are, in general, charged to the profit and loss account as accrued. However, initial costs incurred in arranging funding facilities are amortised over the expected life of the underlying security based on the expected repayment profile of the security. Unamortised initial costs are deducted from the associated liability in accordance with Financial Reporting Standard No. 4 ('Capital Instruments') and costs amortised in the period are included in interest payable.

Deferred consideration

Under the terms of the agreement for the purchase of the mortgage loans the company has a liability to pay deferred consideration when surplus funds become available under the priority of payments. Provision has been made to pay deferred consideration in any period, in which surplus income accrues, which will ultimately be paid out by way of deferred consideration.

Premium and Discount

Premium or discount on the purchase of mortgage advances or issue of loan notes are written off or accrued based on the expected repayment profile of the underlying transaction.

Notes to the accounts

		15 Month Period Ended 31 December 2001
		£
2	**Interest receivable and similar income**	
	Mortgage interest receivable	**13,789,490**
	On interest rate swaps (see note 14)	**1,342,523**
	Bank interest receivable	**670,836**
	Other income	**77,474**
		15,880,323

All of the company's revenues arose in the United Kingdom.

3	**Interest payable and similar charges**	
	On mortgage backed loan notes	**10,746,382**
	On interest rate swaps	**1,417,147**
	On interest rate swaps (loan element)	**20,024**
	On start up loan (see note 11)	**2,137**
		12,185,690

4	**Operating profit on ordinary activities**	
	Profit on ordinary activities is stated after charging	
	Auditors' remuneration – audit fee	**8,500**
	Deferred consideration	**2,373,072**
	Amortisation of initial funding costs	**151,844**

The company has no employees and services required are contracted from third parties.

5 Directors Emoluments

SPV Management received fees of £31,682 including VAT during the 15 month period to 31 December 2001, in respect of structuring and management services.

Notes to the accounts

	15 Month Period Ended 31 December 2001
	£

6 Tax on profit on ordinary activities

Corporation tax at 30%	591

The structure of the priority of payments is such that income is only retained by the company to the extent necessary to meet its obligations, and to provide a profit of 0.01% of the interest accruing on the outstanding balance of the mortgages.

7 Mortgage advances

On 30 March 2001, the company purchased £218m of mortgage assets from Norwich Union Equity Release Limited, a wholly owned subsidiary of Norwich Union Life & Pensions Limited. These assets are a portfolio of UK Equity Release fixed rate residential mortgages, wholly secured on properties in the UK. In order to fund the purchase of these mortgage assets, the company issued a series of mortgage backed notes. Under the terms of this arrangement, the rights of the providers of the finance for this transaction are limited to the mortgage assets purchased and any related income generated by the portfolio, and are without recourse to Norwich Union Equity Release Limited.

Norwich Union Equity Release Limited is not obliged to support any losses, which may arise in respect of the mortgage assets. During the term of this transaction, any amounts realised from the mortgage portfolio in excess of that due to the providers of the funding, less any related administrative costs, will be payable to Norwich Union Equity Release Limited as deferred consideration.

Norwich Union Equity Release Limited administers the mortgage portfolio.

	2001 Mortgage Advances
	£
On purchase	214,253,566
Loan substitution – net effect	(12,898)
Amounts redeemed	(5,072,261)
Interest	13,789,490
At end of year	222,957,897

Notes to the accounts

		2001
8	**Unamortised premium**	**£**
	Mortgage premium	
	On purchase	**3,839,135**
	Amortisation in period	**(209,668)**
	At end of period	**3,629,467**

The difference in value between the market price of mortgages paid for on purchase and their face value is amortised over the expected life of the mortgages based on their expected repayment profile.

9	**Debtors**	
	Interest Receivable	**187,825**
	Prepayments	**3,975**
		191,800

All amounts fall due within one year.

10	**Creditors: amounts falling due within one year**	
	Accruals and deferred income	**20,247**
	Corporation tax	**591**
	Interest payable	**1,385,414**
		1,406,252

11	**Creditors: amounts falling due after one year**	
	Deferred consideration	**2,373,072**
	Mortgage backed loan notes	**241,876,356**
	Less: unamortised element of initial funding costs	**(3,693,901)**
	Swap – loan element	**1,130,634**
	Start up loan	**52,137**
		241,738,298

Notes to the accounts

11 Creditors: amounts falling due after one year (continued)

On 30 March 2001, the company issued £244.5m of mortgage backed loan notes in order to fund the purchase of a mortgage portfolio. The balance of these notes at 31 December 2001 is shown net of the unamortised portion of initial funding costs incurred in arranging the transaction, which are being written off over the expected life of the transaction.

The loan notes are secured over a portfolio of mortgage loans secured by first charges over residential properties in the UK. The mortgages were purchased from Norwich Union Equity Release Limited, which is a wholly owned subsidiary of Norwich Union Life & Pensions Limited.

A start up loan of £50k was provided by Norwich Union Equity Release Limited on 30 March 2001 under a subordinated loan facility of £250k, at a rate of LIBOR + 0.50%. The start up loan ranks after the senior notes, but before the M notes in priority in point of payment.

The A1 and M notes were issued at par and the A2 notes were issued at 98.167%. This discount is amortised over the expected life of the A2 notes based on the scheduled repayment profile. The balance on the notes is shown net of the unamortised portion of the A2 discount.

Interest on the notes and the start up loan is payable quarterly in arrears, at the following rates, unpaid interest is capitalised quarterly:

£244.5 m Mortgage Backed Loan Notes	Capital Balance Outstanding At End of Year	Up to February 2011	After February 2011
Class A1 (£35 m)	£35,000,000	LIBOR + 0.45%	LIBOR + 2.50%
Class A2 (£197 m)	£197,000,000	5.70%	5.70%
Class M (£12.5 m)	£13,251,792	9.00%	9.00%

The A1 and A2 notes ('the senior notes') rank pari passu in point of payment and security without preference or priority amongst themselves. The senior notes rank in priority to the M notes in point of payment and security. A1 notes are to be redeemed as funds become available. Liquidity has been provided through the swap agreement (see note 14) and borrowing facility (see note 16) with the intention that the A1 notes will be redeemed in full in February 2011, unless redeemed prior to this date. A2 notes are to be redeemed according to a redemption schedule commencing in May 2015, although the company will be obliged to redeem (in all or in part) if certain early redemption conditions are satisfied. M notes are to be redeemed after the senior notes have been redeemed in full. The balance outstanding on the M notes includes £751,792 of capitalised interest

Unless previously redeemed in full, each class of notes will mature at its principal amounts outstanding on the interest payment date falling in:

A1 Notes	February 2026
A2 Notes	February 2031
M Notes	February 2031

Equity Release Funding (No. 1) plc may, as its option, redeem all (but not some only) of the notes at their principal amounts outstanding in the event of certain tax changes affecting the notes or the swap agreement (see note 14).

Notes to the accounts

		2001 £
12	**Called up share capital**	
	Authorised	
	Ordinary shares of £1 each	100,000
	Allotted, called up and fully paid	
	Ordinary shares of £1 each	2
	Allotted, called up and partly paid	
	Ordinary shares of £1 each (25p paid per share)	12,500
		12,502

During the period the company issued 50,000 ordinary shares of £1 each. Two of these shares were paid for in full, while 49,998 of these shares were partly paid for at £0.25 each.

13 Reconciliation of movement in shareholders' funds

Opening shareholders' funds – equity	-
Issue of ordinary share capital	12,502
Total recognised gains for year/period	778
Closing shareholders' funds – equity	13,280

14 Commitments

During the year the company entered into an interest rate swap agreement, the purpose of which is to protect the company from interest rate risk in respect of the floating rate notes and to provide liquidity to the company. The notional amount outstanding as at 31 December 2001 was £35m and the swap had an expiry date of February 2026. Under the terms of the swap the company receives an amount of three month LIBOR and pays an amount of 0.55%, of the notional amount quarterly. . In addition to the 0.55% interest payments the company is committed to make a series of scheduled payments under the swap arrangement totalling £108.4m commencing in February 2026. The company may terminate the swap prior to expiry and receive an early termination payment. The market value of this early termination payment has been hedged by the company through a second 'termination swap'.

15 Ultimate parent undertaking

The company is a wholly owned subsidiary of Equity Release Holdings Limited, a company incorporated in the UK. A copy of the consolidated group accounts and annual report may be obtained from its registered office at 78 Cannon Street, London, EC4P 5LN.

Notes to the accounts

16 Derivatives and other financial instruments

The company's policies with regard to derivatives and other financial instruments have been outlined in the directors' report.

Interest rate repricing

	Floating Rate £	Fixed Rate £	Non-interest Bearing £	2001 Total £
Assets				
Mortgage advances	-	222,957,897	-	222,957,897
Unamortised premium	-	-	3,629,467	3,629,467
Interest Receivable	-	-	187,825	187,825
Debtors	-	-	3,975	3,975
Cash	16,378,666	-	-	16,378,666
	16,378,666	222,957,897	3,821,267	243,157,830
Liabilities				
Deferred consideration	-	-	2,373,072	2,373,072
Mortgage backed notes	34,483,139	203,699,316	-	238,182,455
Interest payable	-	-	1,385,414	1,385,414
Loans	52,137	1,130,634	-	1,182,771
Other creditors	-	-	20,838	20,838
Capital and reserves	-	-	13,280	13,280
	34,535,276	204,829,950	3,792,604	243,157,830
Derivatives				
Interest rate swap	(35,000,000)	35,000,000		

The interest rate of floating rate assets and liabilities is determined with reference to the London Inter-Bank Offering Rate.

Maturity profile (for all fixed and floating rate items)
The maturity of the fixed rate mortgage backed loan notes and other loans is more than five years. The maturity profile of the mortgage advances, and accordingly the floating rate mortgage backed notes cannot be stated with sufficient certainty. (See note 11 for redemption details of the mortgage backed notes)

Borrowing facilities
At 31 December 2001, the group had a committed but undrawn 364 day borrowing facility of £70m.

Fair value of financial assets and liabilities
The fixed rate liabilities of the company include class M mortgage backed loan notes with a book value of £13.4m (including accrued interest of £0.9m). These rank at the end of the priority of payments, and can therefore be considered as quasi-equity. Excluding the M notes, the company has net fixed rate liabilities (including derivatives) of £4.6m. The directors therefore do not consider the fair value of the net assets and liabilities (including derivatives) to be materially different to their book value.

16 Derivatives and other financial instruments *(continued)*

Foreign currency
The company has not entered into transactions in any currency other than sterling throughout the period.

17 Approval of the financial statements

The board of directors approved these financial statements on 18 April 2002