Equity Release Funding (No.1) plc

Directors and Officers

Directors

M Clarke-Whelan
D Wynne
Wilmington Trust SP Services (London) Limited

Company Secretary

Wilmington Trust SP Services (London) Limited

Independent Auditors

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Central Square
29 Wellington Street
Leeds
LS1 4DL

Registered Office

c/o Wilmington Trust SP Services (London) Limited
Third Floor
1 King's Arms Yard
London
EC2R 7AF

Company Number

Registered in England No. 4074907

Contents

The directors present their strategic report for Equity Release Funding (No.1) plc (the Company) for the year ended 31 December 2017.

Review of the company's business

The principal strategy and objective for the Company is investment in lifetime mortgage loans secured by first charges over properties within the United Kingdom using external funding, and to grant security over its assets. The directors consider that this strategy will continue unchanged into the foreseeable future.

The main assets of the Company consist of a largely closed book of lifetime mortgage loans. Cash flows received from these mortgages upon redemption are utilised to pay expenses and to repay the borrowings of the Company.

During the term of these transactions, any amounts realised from the mortgage portfolio in excess of that due to the providers of the funding, less any related administrative costs and the Company's entitlement to 0.01% of interest accruing on the mortgages, will be payable to the originator, Aviva Equity Release UK Limited (UKER), a wholly owned subsidiary of Aviva Life & Pensions UK Limited (ultimate controlling entity Aviva plc), in the form of deferred consideration. Any cash shortfalls will be met in the first instance out of this deferred consideration and ultimately, should shortfalls continue, will be borne by the noteholders.

Changes in market conditions have led to revisions in credit risk assumptions and changes in the discount rate. This has resulted in large fair value movements in the mortgage and loan note balances over their lives, the difference between them being reflected in the change in deferred consideration.

The entity bears the risk of sustained underperformance in the House Price Index (HPI), with the resultant increase in the likelihood that the mortgage debt will exceed the proceeds of the property sale at the date of redemption. A reinsurance contract is in place that has transferred the property risk onto a third party for 63% of the mortgages held by the company. For the remaining 37% of mortgages not covered by the reinsurance contract, the originator has committed to indemnify the Company against any losses on negative equity. The Company bears the initial risk.

Financial position and performance

Expense for the year is £11.8 million *(2016: £55.1 million income)* and profit before tax is £2,000 *(2016: £2,000 profit)*.

Shareholders' equity has increased by £1,000 *(2016: increase of £1,000)*, reflecting the profit for the year.

Future outlook

The directors consider that the Company will continue to operate in a manner consistent with 2017 into the foreseeable future.

Principal risks and uncertainties

The principal risks and uncertainties to which the company is exposed are outlined below:

Market Risk

Market risk is the risk of adverse financial impact due to changes in fair values or future cash flows of financial instruments from fluctuations in interest rates, equity prices and property prices (HPI). Market risk arises within the Company due to fluctuations in the value of lifetime mortgage assets relative to the value of the property on which they are secured.

Credit Risk

Credit risk is the risk of adverse financial impact resulting from fluctuations in credit quality of third parties including default, rating transition and credit spread movements.

Liquidity Risk

Liquidity risk is the risk that liabilities cannot be met in a timely and cost-effective manner as they fall due. Such differences would arise from mortality, morbidity and voluntary prepayment risks.

Operational Risk

Operational risk is the risk of loss arising from inadequate or failed internal processes, personnel or systems, or from external events.

The company uses a number of metrics to measure, monitor and control risks and a fuller explanation of these may be found in note 17 to the financial statements.

Key performance indicators (KPIs)

Expense for the year is £11.8 million *(2016: £55.1 million income).*

Finance costs and fee and commission expenses for the year are £12.0 million *(2016: £12.3 million).*

Profit after tax for the year is £1,000 *(2016: £1,000 profit).*

The decrease in deferred consideration for the year is £23.8 million *(2016: £42.7 million increase).*

By order of the Board

Mignon Clarke-Whelan for and on behalf of
Wilmington Trust SP Services (London) Limited
Company Secretary *18 June 2018*

The directors present their annual report and audited financial statements for Equity Release Funding (No.1) plc (the Company) for the year ended 31 December 2017.

Directors

The names of the present directors of the Company, all of whom served throughout the year, appear on page 1.

D Wynne was appointed as a director of the Company on 22 March 2017.

M H Filer resigned as a director of the Company on 10 April 2017.

Dividend

The directors do not recommend the payment of a dividend for the year *(2016: £nil).*

Financial instruments

The business of the Company includes the use of financial instruments. Details of the Company's risk management objectives and policies and exposures to risk relating to financial instruments are set out in note 17 to the financial statements.

Future developments

Expected future developments of the Company are included within the 'Future outlook' section of the strategic report.

Disclosure of information to the independent auditors

Each person who was a director of the Company on the date that this report was approved, confirms that:

- so far as the director is aware, there is no relevant audit information, being information needed by the independent auditors in connection with preparing their report, of which the independent auditors are unaware; and

- each director has taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the independent auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

Directors' indemnity arrangements

At no time during the year did any director hold a material interest in any contract of significance with the Company or any of its subsidiary undertakings other than a third-party indemnity provision between each director and the Company.

Corporate governance

The Company's ultimate controlling party is Aviva Plc. The directors of Aviva Group companies are committed to high standards of Corporate Governance and support, but do not fully implement, The UK Corporate Governance Code (September 2012) ('the Corporate Governance Code'). The Group's Corporate Governance manual is available on the Group website at www.aviva.com. Due to the nature of the securities which have been issued on the London Stock Exchange, the Directors are satisfied that there is no requirement to publish a corporate governance statement and that the Company is largely exempt from the disclosure requirements of the UK Corporate Governance Code.

A Group Reporting Manual, including International Financial Reporting Standards (IFRS), has been defined and rolled out across the Group. A Financial Reporting Control Framework (FRCF) is in place across the Group. FRCF relates to the preparation of reliable financial reporting and preparation of local financial statements in accordance with IFRS.

The FRCF process follows a risk based approach, with management identification, assessment (documentation and testing), remediation as required, reporting and certification over key financial reporting related controls. Management quality assurance procedures over the application of the FRCF process are signed off by the business unit and regional Chief Executives and Chief Financial Officers.

Statement of directors' responsibilities

The Directors are responsible for preparing the strategic report, directors' 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 prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to:

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

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. 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.

By order of the Board

Mignon Clarke-Whelan for and on behalf of
Wilmington Trust SP Services (London) Limited
Company Secretary *18 June 2018*

Report on the audit of the financial statements

Opinion

In our opinion, Equity Release Funding (No.1) plc's financial statements:

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

We have audited the financial statements, included within the annual report and audited financial statements (the "Annual Report"), which comprise: the statement of financial position as at 31 December 2017; the income statement, the statement of changes in equity, the statement of cash flows, for the year then ended; the accounting policies; and the notes to the financial statements.

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

Basis for opinion

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

Independence

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

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

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

Our audit approach

Overview

Materiality	• Overall materiality: £3,211,410, based on 1% of total assets.
Audit Scope	• The Company is a special purpose vehicle that forms part of a securitisation structure, established primarily as a means of raising wholesale funding for Aviva plc ("Aviva") the ultimate controlling party. Aviva Equity Release UK Limited (UKER) manages the securitisation transaction in its role as administrator, servicer of the underlying mortgage loans and cash manager. • The activities of the Company are conducted primarily by reference to a series of transaction documents. We tailored the scope of our audit to ensure that we performed sufficient work to enable us to opine on the annual report and financial statements, ensuring audit procedures were performed in respect of every material financial statements line item. • In establishing the overall approach to the audit, we determined the type of work that needed to be performed by us taking into account the accounting processes and controls in place at Aviva as administrator and servicer, and the industry in which the Company operates.

	• We obtained an understanding of the control environment in place at the administrator and adopted a controls and substantive testing approach.
Key Audit Matters	Our key audit matters which involved the greatest allocation of our resources' effort comprise: • Valuation of equity release mortgages. • Risk of error in the priority of payments.

The scope of our audit

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

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

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

Key audit matters

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

Key audit matter	How our audit addressed the key audit matter
Valuation of equity release mortgages The valuation of equity release mortgages involves judgement and continues to be an area of inherent risk as quoted prices are not readily available.	We assessed the Directors' approach to valuation for these hard to value investments by performing the following procedures: We agreed data inputs to underlying documentation on a sample basis. We evaluated the methodology and assumptions used by management, including yield curves, discounted cash flows, property growth rates, longevity and liquidity premiums as relevant to each asset class. We tested the operation of data integrity and change management controls for the models, which we baseline every three years. We reconciled the model output to the financial statements and assessed the disclosures in the financial statements.

Key audit matter	How our audit addressed the key audit matter
	Based on the work performed and the evidence obtained, we consider the assumptions used by management to be appropriate.
Risk of error in the priority of payments The priority of payments (the "waterfall") is key to ensuring that expenses, interest and principal repayments on the notes in issue are paid in the appropriate order on each payment date. The revenue and principal priority of payments are outlined in the transaction documents. The transaction documents also include triggers and trigger events, the breach or occurrence of which may affect the waterfall and therefore the financial statements. We focused our audit testing on the revenue and principal waterfall, agreeing the order of payment back to the order in the transaction documents. Our audit approach also included testing of the repayments of debt securities in issue in line with the transaction documents and the recalculation of interest expense and accrued interest expense.	The following work was undertaken by us as part of the audit: We understood the design of the structure through a combination of inquiry with management and reviewing the transaction documents to understand the revenue and principal priority of payments for the Company and understand the relevant triggers and trigger events. We read the investor reports and minutes of the meetings of the board of directors in the year and up to the signing of the financial statements to identify and investigate any unusual trends or incidents that would indicate a misstatement in the preparation and calculation of the waterfalls. Tested that the priority of payments applied was in line with the transaction documents and the occurrence of any trigger breaches or trigger events per the transaction documents and any impact on the waterfall and financial statements. Tested the payments in the waterfall including expenses, interest and principal payments on notes and notes outstanding at the year-end. Tested the interest expense using interest rates set out in the transaction documents and, where applicable, independently sourced reference interest rates. *We found no material exceptions in performing these tests.*

How we tailored the audit scope

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

Materiality

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

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

Overall materiality	£3,211,410
How we determined it	1% of total assets.
Rationale for benchmark applied	The entity is a not-for-profit whose main priority is to remit the cash received in respect of its assets so as to repay its liabilities. As such total assets is considered an appropriate benchmark. Where total assets is used, if the company is a public interest entity, a rule of thumb of up to 1% can be applied. We have deemed this to be a public interest entity and have therefore applied 1% due to the fact the entity has listed debt.

We agreed with those charged with governance that we would report to them misstatements identified during our audit above £160,571 as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

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

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

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

Reporting on other information

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

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

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

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

Strategic Report and Directors' Report

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

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

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of directors' responsibilities set out on page 6, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report
This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

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

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

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the Aviva Audit Committee, we were appointed by the directors on 3 May 2012 to audit the financial statements for the year ended 31 December 2012 and subsequent financial periods. The period of total uninterrupted engagement is 6 years, covering the years ended 31 December 2012 to 31 December 2017.

Martin Cross (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Leeds
18 June 2018

The Company, a public limited company incorporated and domiciled in the United Kingdom (UK), invests in lifetime mortgage loans.

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

(A) Basis of presentation

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and as endorsed by the European Union (EU), and those parts of the Companies Act 2006 applicable to those reporting under IFRS. The financial statements have been prepared under the historical cost convention, except for mortgage loans and those financial instruments and financial liabilities at fair value through profit and loss.

The financial statements are prepared on the going concern basis.

The financial statements are stated in sterling, which is the Company's functional and presentational currency. Unless otherwise noted, the amounts shown in these financial statements are in thousands of pounds sterling (£'000).

Minor clarifications to existing guidance on a number of standards became effective for the reporting period beginning on 1 January 2017. The principle clarifications are to IAS 12, Recognition of Deferred Tax Assets for Unrealised Losses relating to recognition of deferred tax when an asset's fair value is below it tax base, IAS 7, Statement of Cash Flows, relating to additional disclosure of the movements in liabilities arising from financing activities, and IFRS 12, Disclosure of Interest In Other Entities, clarifying existing guidance. The amendments do not have any impact on the Company's financial statements. The additional disclosure required by the changes to IAS 7 have previously already been disclosed in the Company's financial statements.

The IASB has issued four new standards which are not yet effective and have not been adopted early by the Company.

(i) IFRS 9, Financial Instruments

In July 2014, the IASB published IFRS 9, Financial Instruments, which will replace IAS 39, Financial Instruments: Recognition and Measurement. The standard incorporates new classification and measurements requirements for financial assets, the introduction of an expected credit loss impairment model which will replace the incurred loss model of IAS 39, and new hedge accounting requirements. Under IFRS 9, all financial assets will be measured at either amortised cost or fair value. The basis of classification will depend on the business model and the contractual cash flow characteristics of the financial assets. The standard retains most of IAS 39's requirements for financial liabilities except for those designated at fair value through profit or loss whereby fair value changes attributable to own credit is to be recognised in other comprehensive income instead of the income statement.

The Company has adopted IFRS 9 from 1 January 2018. The standard is not expected to have a significant impact on the Company's statement of financial position.

(ii) IFRS 15, Revenue from Contracts with Customers

In May 2014, the IASB issued IFRS 15 Revenue from Contracts with Customers. This standard applies to annual reporting periods beginning on or after 1 January 2018 and has been endorsed by the EU. The standard is not expected to have a significant impact on the Company's financial statements.

(iii) IFRS 16, Leases

In January 2016, the IASB published IFRS 16, Leases, which will replace IAS 17, Leases. The standard removes the distinction between finance leases and operating leases for lessees, and proposes a new model whereby lessees include all lease contracts on the balance sheet. Lessor accounting remains similar to current practice. The standard is not expected to have a significant impact on the Company's financial statements.

This standard applies to accounting periods beginning on or after 1 January 2019 and has been endorsed by the EU.

(iv) IFRS 17, Insurance Contracts

In May 2017 the IASB published IFRS 17 Insurance Contracts, a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure. Once effective, IFRS 17 will replace IFRS 4 which was issued in 2005 and applies to all types of insurance contracts as well as to certain guarantees and financial instruments with discretionary participation features. IFRS 17 provides a comprehensive and consistent approach to insurance contracts. The core of IFRS 17 is the general model, supplemented by a specific adaption for contracts with direct participation features (the variable fee approach) and a simplified approach (the premium allocation approach) mainly for short duration contracts.

The impact of the adoption of IFRS 17 has yet to be fully assessed by the Company. This standard applies to annual reporting periods beginning on or after 1 January 2021 and has not yet been endorsed by the EU.

The IASB has issued a number of amendments to standards which are not yet effective and have not been adopted early by the Company.

- IAS 28 Investments in Associates
- IAS 40, Investment Property
- IFRS 2, Classification and Measurement of Share-Based Payment Transactions
- IFRS 12, Disclosure of Interest in Other Entities

The amendments to IAS 28 and IFRS 12 have been endorsed by the EU. The amendments to IAS 40 and IFRS 2 have not been endorsed by the EU. The amendments are not expected to have a material impact on the financial statements.

(B) Critical accounting estimates and judgements

The preparation of the Company's financial statements in accordance with IFRS, requires management to make judgements, estimates and assumptions in applying the accounting policies that affect the reported amounts of assets, liabilities, income and expenses. These major areas of judgement on policy application are summarised below:

(i) Estimation of fair value of loan assets (set out in policy I and note 7)
(ii) Estimation of fair value of borrowings (set out in policy N and note 13)

All estimates are based on management's knowledge of current facts and circumstances, assumptions based on that knowledge and their predictions of future events and actions. Actual results may differ from those estimates, possibly significantly. The list below sets out those items we consider particularly susceptible to changes in estimates and assumptions, and the relevant accounting policy:

(i) Financial instruments (set out in policy H and note 6)
(ii) Deferred consideration (set out in policy L)
(iii) Borrowings (set out in policy N and note 6)

(C) Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. This presumes that the transaction takes place in the principal (or most advantageous) market under current market conditions. Fair value is a market-based measure and in the absence of observable market prices in an active market, it is measured using the assumptions that market participants would use when pricing the asset or liability.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price i.e. the fair value of the consideration given or received. In certain circumstances, the fair value at initial recognition may differ from the transaction price.

If the fair value is not evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging), or is based on a valuation technique whose variables include only data from observable markets, then the difference between the fair value at initial recognition and the transaction price is not recognised immediately in the income statement but deferred and recognised in the income statement on an appropriate basis over the life of the instrument but no later than when the valuation is supported wholly by observable market data or the transaction is closed out or otherwise matured.

(D) Fee and commission income

Fee and commission income consists primarily of administration fees and early redemption fees. These fees are recognised as revenue in the period they are collected.

(E) Interest and similar income

Interest and similar income consists of interest receivable for the year. Interest income is recognised as it accrues, taking into account the effective yield on the investment.

(F) Other operating income

Other operating income consists of reinsurance rebates which are recognised on an accruals basis.

(G) Fee and commission expense

Fee and commission expense consists primarily of fees payable to the originator, UKER, for administration of the mortgage and loan note portfolios which are recognised on an accruals basis.

(H) Financial instruments

The Company classifies the lifetime mortgages and the associated liabilities at fair value through profit and loss, since they are managed as a portfolio on a fair value basis. Presentation at fair value provides more relevant information and ensures that any accounting mismatch is minimised.

All financial instruments in the fair value category are classified as other than trading. Changes in the fair value of other than trading instruments are included in the income statement in the period in which they arise.

(I) Loans

Lifetime mortgages are designated at fair value through profit and loss, since they are managed as a portfolio on a fair value basis, and presentation at fair value provides more relevant information and ensures that any accounting mismatch with the associated liabilities is minimised. The fair values are estimated using discounted cash flow forecasts, as described in note 6. They are revalued at each period end, with movements in their fair values being taken to the income statement.

(J) Collateral

The Company receives and pledges collateral in the form of non-cash assets in respect of loans, in order to reduce the credit risk of these transactions.

Non-cash collateral pledged is not derecognised from the statement of financial position unless the Company defaults on its obligations under the relevant agreement, and therefore continues to be recognised on the statement of financial position within the appropriate asset classification.

(K) Statement of cash flows

Cash and cash equivalents

Cash and cash equivalents consist of cash at banks and in hand, deposits held on call with banks, treasury bills and other short-term highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are those with less than three months' maturity from the date of acquisition, or which are redeemable on demand with only an insignificant change in their fair values.

Operating cash flows

Purchases and sales of loans and financial instruments are included within operating cash flows as they represent the operating activities of the Company.

(L) Deferred consideration

During the term of this securitisation transaction, any amounts realised from the mortgage portfolio in excess of that due to the providers of the funding, less any related administrative costs and the Company's entitlement to 0.01% of interest accruing on the mortgages, will be payable on the maturity of the fund to the originator, UKER, in the form of deferred consideration. Any cash shortfalls will be met in the first instance out of this deferred consideration and ultimately, should shortfalls continue, will be borne by the noteholders.

Where the cumulative income of the Company exceeds the expenditure, the gains are recorded in the statement of financial position within liabilities as deferred consideration.

(M) Income taxes

Taxation comprises current and deferred tax. Current tax and deferred tax are recognised in profit or loss except to the extent that they relate to items recognised directly in equity or other comprehensive income. The Company is within the permanent regime for taxation of securitisation companies, under which they are taxed by reference to their contractually retained profits (to the extent that they are realised). Taxable profits under the permanent regime will normally equal the contractual profit as defined by the original transaction documentation. Consequently, neither current tax nor deferred tax will be affected by any fair value gains or losses arising on derivatives and other financial instruments.

(N) Borrowings

Loan notes backed by mortgages are designated at fair value through profit and loss as presentation at fair value provides more relevant information and ensures that any accounting mismatch is minimised. The fair values are estimated using discounted cash flow forecasts, as described in note 6.

Borrowings that provide liquidity only are valued at amortised cost. The effective interest rate method is used for loans held at amortised cost.

All borrowing costs are expensed as they are incurred.

(O) Share capital

Equity instruments

An equity instrument is a contract that evidences a residual interest in the assets of an entity after deducting all its liabilities. Accordingly, a financial instrument is treated as equity if:

(i) there is no contractual obligation to deliver cash or other financial assets or to exchange financial assets or liabilities on terms that may be unfavourable; and

(ii) the instrument will not be settled by delivery of a variable number of shares or is a derivative that can be settled other than for a fixed amount of cash, shares or other financial assets.

(P) Receivables, payables and other financial liabilities

All other receivables and financial liabilities are initially recognised at cost, being fair value. Subsequent to initial measurement they are measured at amortised cost which, given the short term nature of these items, is considered a reasonable approximation to fair value.

Equity Release Funding (No.1) plc
Income statement
For the year ended 31 December 2017

	Note	2017 £'000	2016 £'000
Income			
Interest and similar income	E & 1	**14,701**	15,431
Unrealised (losses)/gains on financial instruments	H & 1	**(27,297)**	38,952
Fee and commission income	D & 1	**742**	687
Other operating income	F & 1	**49**	4
		(11,805)	55,074
Expenses			
Fee and commission expense	G & 2	**(872)**	(854)
Other operating expenses	2	**23,756**	(42,763)
Finance costs	2	**(11,077)**	(11,455)
		11,807	(55,072)
Profit before tax		**2**	2
Tax charge	M & 5	**(1)**	(1)
Profit for the year		**1**	1

The Company has no other comprehensive income.

The accounting policies (identified alphabetically) on pages 12to 15 and notes (identified numerically) on pages 20 to 33 are an integral part of these financial statements.

Equity Release Funding (No.1) plc
Statement of financial position
As at 31 December 2017

	Note	2017 £'000	2016 £'000
Assets			
Loans	H, I, J & 7	**272,504**	278,777
Receivables	P & 8	**-**	111
Prepayments and accrued income		**17**	16
Cash and cash equivalents	K & 15(b)	**48,620**	50,724
Total assets		**321,141**	329,628
Equity			
Ordinary share capital	O & 9	**13**	13
Retained earnings	10	**20**	19
Total equity		**33**	32
Liabilities			
Tax liabilities	M & 11	**1**	1
Deferred consideration	L & 12	**40,662**	64,473
Borrowings	H, N & 13	**279,323**	264,948
Payables and other financial liabilities	P & 14	**1,122**	174
Total liabilities		**321,108**	329,596
Total equity and liabilities		**321,141**	329,628

The financial statements were authorised for issue by the Board of directors on 18 June 2018 and were signed on its behalf by

Mignon Clarke-Whelan for and on behalf of
Wilmington Trust SP Services (London) Limited
Director

The accounting policies (identified alphabetically) on pages 12 to 15 and notes (identified numerically) on pages 20 to 33 are an integral part of these financial statements.

Equity Release Funding (No.1) plc
Statement of changes in equity
For the year ended 31 December 2017

	Note	Ordinary share capital £'000	Retained earnings £'000	Total equity £'000
Balance at 1 January 2016		13	18	31
Profit for the year	10	-	1	1
Balance at 31 December 2016		13	19	32
Profit for the year	10	**-**	**1**	**1**
Balance at 31 December 2017		**13**	**20**	**33**

The accounting policies (identified alphabetically) on pages 12 to 15 and notes (identified numerically) on pages 20 to 33 are an integral part of these financial statements.

Equity Release Funding (No.1) plc
Statement of cash flows
For the year ended 31 December 2017

The cash flows presented in this statement cover all the Company's activities.

	Note	2017 £'000	2016 £'000
Cash flows from operating activities			
Cash generated from operations	15(a)	**7,641**	9,483
Tax paid		**(1)**	(1)
Net cash generated from operating activities		**7,640**	9,482
Cash flows from financing activities			
Repayment of borrowings		**(9,744)**	(6,493)
Net cash used in financing activities		**(9,744)**	(6,493)
Net (decrease)/increase in cash and cash equivalents		**(2,104)**	2,989
Cash and cash equivalents at 1 January		**50,724**	47,735
Cash and cash equivalents at 31 December	15(b)	**48,620**	50,724

The accounting policies (identified alphabetically) on pages 12 to 15 and notes (identified numerically) on pages 20 to 33 are an integral part of these financial statements.

1. Income

	2017 £'000	2016 £'000
Interest and similar income	**14,701**	15,431
Financial instruments		
Unrealised gains on mortgage loans	**1,922**	40,425
Unrealised losses on loan notes	**(29,219)**	(1,473)
	(27,297)	38,952
Fee and commission income	**742**	687
Other operating income		
Reinsurance rebates	**49**	4
Total income	**(11,805)**	55,074

All revenue from external customers is derived from interest income received on mortgage loans and early redemption fees received. All revenue and non-current assets are attributable to the United Kingdom and are attributable to one segment only. The Company has no reliance on major customers as all mortgages are granted on individual personal property.

2. Expenses

	2017 £'000	2016 £'000
Fee and commission expense	**872**	854
Other operating expenses		
Audit fees	**32**	31
Losses due to negative equity	**23**	30
(Decrease)/increase in deferred consideration	**(23,811)**	42,702
	(23,756)	42,763
Finance costs		
Interest expenses:		
Securitised mortgage loan notes	**10,396**	10,813
Liquidity facility	**681**	642
	11,077	11,455
Total expenses	**(11,807)**	55,072

There were no employees during the year.

3. Directors' emoluments

Wilmington Trust SP Services (London) Limited received fees of £14,891 *(2016: £14,985)* including VAT during the year to 31 December 2017, in respect of structuring and management services.

4. Independent auditors' remuneration

	2017	2016
	£'000	£'000
Fees for the statutory audit of the Company's financial statements for the year	**32**	31

In addition, a proportion of audit fees in respect of the audit of a fellow group undertaking are borne by the Company.

Fees paid to PricewaterhouseCoopers LLP and its associates for services other than the statutory audit of the Company are not disclosed in these financial statements since the consolidated financial statements of the Company's ultimate controlling entity, Aviva plc (see note 18), are required to disclose other (non-audit) services on a consolidated basis.

5. Tax charge

(a) Tax charged to the income statement

The total tax charged to the income statement is as follows:

	2017	2016
	£'000	£'000
Current tax		
For the year	**1**	1
Total tax charged to the income statement (note 5(b))	**1**	1

(b) Tax reconciliation

The tax on the Company's profit before tax differs from the tax calculated at the standard UK corporation tax rate as follows:

	2017	2016
	£'000	£'000
Profit before tax	**2**	2
Tax calculated at standard UK corporation tax rate of 19.25% *(2016: 20%)*	**-**	-
Disallowable expenses	**1**	1
Total tax charge for the year (note 5(a))	**1**	1

The rate of corporation tax changed to 19% with effect from 1 April 2017. The Finance Act 2016, which received Royal Assent on 15 September 2016, will reduce the corporation tax rate further to 17% from 1 April 2020. The changes in future tax rates are not expected to have any material impact on the Company's net assets.

6. Fair value methodology

(a) Basis for determining fair value hierarchy of financial instruments

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the 'fair value hierarchy' described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

Quoted market prices in active markets – ('Level 1')

Inputs to Level 1 fair values are quoted prices (unadjusted) in active markets for identical assets and liabilities.

Modelled with significant observable market inputs – ("Level 2")

Inputs to Level 2 fair values are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the instrument. Level 2 inputs include the following:

- Quoted prices for similar assets and liabilities in active markets;
- Quoted prices for identical or similar assets and liabilities in markets that are not active, the prices are not current, or price quotations vary substantially either over time or among market makers, or in which little information is released publicly;
- Inputs other than quoted prices that are observable for the asset or liability (for example, interest rates and yield curves observable at commonly quoted intervals, implied volatilities and credit spreads);
- Inputs that are derived principally from, or corroborated by, observable market data by correlation or other means (market-corroborated inputs).

Modelled with significant unobservable market inputs – ("Level 3")

Inputs to Level 3 fair values are unobservable inputs for the asset or liability. Unobservable inputs may have been used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, i.e. an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability. Therefore, unobservable inputs reflect the assumptions the business unit considers that market participants would use in pricing the asset or liability. Examples are certain borrowings backing lifetime mortgage loans.

Changes to valuation techniques:

There were no changes in the valuation techniques during the year compared to those described in the 2016 financial statements.

Comparison of the carrying amount and fair values of financial instruments

Fair value of the following assets and liabilities approximate to their carrying amounts:

- Receivables
- Prepayments and accrued income
- Cash and cash equivalents
- Payables and other financial liabilities
- Tax liabilities

(b) Fair value hierarchy analysis

An analysis of financial assets and liabilities according to fair value hierarchy is given below:

	2017 Fair value hierarchy	
	Level 3 £'000	**Total fair value £'000**
Financial assets		
Loans	**272,504**	**272,504**
Financial liabilities		
Borrowings	**(279,323)**	**(279,323)**

	2016 Fair value hierarchy	
	Level 3 £'000	Total fair value £'000
Financial assets		
Loans	278,777	278,777
Financial liabilities		
Borrowings	(264,948)	(264,948)

Transfers between levels of the fair value hierarchy

For recurring fair value measurements, the Company determines whether transfers have occurred between the levels of the fair value hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of the reporting year. If transaction prices used in the valuation of loans and loan notes becomes stale, and in the absence of any additional market transactions, the instruments may be reclassified.

(c) Further information on Level 3 assets and liabilities

The table below shows movements in the Level 3 financial liabilities measured at fair value.

	2017		2016	
	Loans £'000	**Borrowings £'000**	Loans £'000	Borrowings £'000
Balance at 1 January	**278,777**	**(264,948)**	-	(49,632)
Accrued interest	**14,596**	**-**	-	-
Redemptions	**(22,791)**	**14,844**	-	2,399
Gains/(losses) recognised in the income statement	**1,922**	**(29,219)**	-	(4,538)
Transfers in to Level 3	**-**	**-**	278,777	(213,177)
Balance at 31 December	**272,504**	**(279,323)**	278,777	(264,948)

The Company assesses the fair value hierarchy of its financial investments annually at 31 December. Transfers between fair value hierarchy levels are deemed to have occurred at the assessment date.

A loss of £27.3 million *(2016: £4.5 million)* was recognized in the income statement during the year in relation to fair value movements generated by movement in credit risk assumptions and discount rates.

Lifetime mortgage loans amounting to £272.5 million *(2016: £278.8 million)* and securitised mortgage loan notes amounting to £279.3 million *(2016:£264.9 million)* are classified as Level 3 and valued using a discounted cash flow model. Cash flows are adjusted for credit risk and discounted using a yield curve and global assumptions for the liquidity premium. The model derives a best estimate view on property growth and explicitly calculates the additional return that would be demanded by investors due to uncertainties in the asset cash flows. The assets and liabilities have been classified as Level 3 as assumptions used to derive the property growth rates, mortality and morbidity assumptions, cost of capital, liquidity premium and credit risk are not deemed to be market observable. The liquidity premium has ranged between 195bps to 255bps.

During 2016 there was a change to the model and assumptions used to value the lifetime mortgage loans and securitised mortgage loan notes. The loans and loan notes were previously valued using an internal Discounted Cash Flow (DCF) model. The revised DCF model, as described below, incorporates a greater number of inputs relevant to calculating a fair value of lifetime mortgage loans and the related liabilities, and provides a more robust fair value. Several significant inputs to the revised model are not deemed to be market observable, resulting in the transfer of the loans and remainder of the loan notes to Level 3. The impact of applying the revised model to these assets and liabilities in 2016 was to recognise net fair value gains of £43.2 million in profit before tax for the prior year.

The table below shows the sensitivity of the fair value of Level 3 investments at 31 December to changes in unobservable inputs to a reasonable alternative.

	2017		Change in fair value	
	Fair value £m	Most significant unobservable inputs	Positive impact £m	Negative impact £m
Loans	272.5	Credit spreads – 50bps	12.1	(11.3)
Borrowings	279.3	Credit spreads – 50bps	8.0	(8.4)

Changes in unobservable inputs to reasonable alternatives for other assumptions (e.g. property growth rates, mortality and morbidity) will produce smaller changes in fair value which will also largely offset.

7. Loans

(a) Carrying amounts

On 30 March 2001, the Company purchased £214.0 million of mortgage assets at market value from Aviva Equity Release UK Limited (UKER). These assets are a portfolio of UK lifetime 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 loan 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 UKER.

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 UKER in the form of deferred consideration. UKER administers the mortgage portfolio.

The carrying amounts of loans at 31 December were as follows:

	2017 £'000	2016 £'000
Lifetime mortgage loans (gross of indemnified guarantees)	**259,985**	265,840
Fair value of indemnified guarantees	**12,519**	12,937
Lifetime mortgage loans	**272,504**	278,777

Of the above total, £252.1 million *(2016: £260.3 million)* is expected to be recovered more than one year after the statement of financial position date. This is because the loans are lifetime mortgages which by their nature do not have any contractual maturity and significant levels of early redemption are not anticipated.

The change in fair value of mortgage loans during the year attributable to a change in credit risk was a loss of £5.7 million *(2016: gain of £29.3 million)*. The cumulative change attributable to changes in credit risk to 31 December 2017 was a loss of £10.9 million *(2016: loss of £5.2 million)*. The amount has been determined as the amount that is not attributable to changes in market conditions that give rise to market risk. Further details of the fair value methodology are given in note 6.

(b) Collateral

The Company holds collateral in respect of all loans, in order to reduce the risk of non-recovery. This collateral generally takes the form of liens or charges over properties. As security for the lifetime mortgage and any other money owing from the customer, the property is charged to the Company by way of a legal mortgage with full title guarantee.

8. Receivables

	2017	2016
	£'000	£'000
Amounts due from other related parties	**-**	111

None of the above total *(2016: £nil)* is expected to be recovered more than one year after the statement of financial position date.

9. Ordinary share capital

Details of the Company's ordinary share capital at 31 December are as follows:

	2017	2016
	£	£
The authorised share capital of the Company was:		
100,000 ordinary shares of £1 each *(2016: 100,000)*	**100,000**	100,000
The allotted, called up and fully paid share capital of the Company was:		
2 ordinary shares of £1 each *(2016: 2)*	**2**	2
The allotted, called up and partly paid share capital of the Company was:		
49,998 ordinary shares of £1 each (25p paid per share) *(2016: 49,998)*	**12,500**	12,500
	12,502	12,502

All shares are of the same class and rank pari passu.

10. Retained earnings

	2017	2016
	£'000	£'000
Balance at 1 January	**19**	18
Profit for the year	**1**	1
At 31 December	**20**	19

11. Tax liabilities

General

The current tax liability is £1,000 *(2016: £1,000).* Tax liabilities payable in more than one year are £nil *(2016: £nil).*

12. Deferred consideration

	2017	2016
	£'000	£'000
Balance at 1 January	**64,473**	21,771
(Decrease)/increase in deferred consideration	**(23,811)**	42,702
Balance at 31 December	**40,662**	64,473

All of the above consideration *(2016: all)* is expected to be paid more than one year after the statement of financial position date.

The Company has a contractual obligation to pay any surplus on the maturity of the fund to UKER. The deferred consideration balance represents management's best estimate at the year end of the amount that will be payable (accounting policy L).

13. Borrowings

(a) Carrying amount

	2017	2016
	£'000	£'000
Securitised mortgage loan notes	**279,323**	264,948

The carrying amount of the above borrowings that are stated at amortised cost is £nil *(2016: £nil).*

The change in fair value of mortgage loan notes during the year attributable to a change in credit risk was a loss of £6.1 million *(2016: gain of £74.7 million).* The cumulative change attributable to changes in credit risk to 31 December 2017 was a gain of £19.1 million *(2016: £25.2 million).* The amount has been determined as the amount that is not attributable to changes in market conditions that give rise to market risk. The above liabilities stated at fair value have been calculated in a consistent manner with the assets stated at fair value. Further details of the fair value methodology are included in note 6.

Of the above total £247.8 million *(2016: £240.8 million)* is expected to be paid more than one year after the statement of financial position date.

(b) Loan notes and other borrowings

(i) Loan notes

On 30 March 2001, the Company issued £244.5 million of mortgage backed loan notes (class A1, A2 and M notes) in order to fund the purchase of a mortgage portfolio from UKER. All of the £35 million of A1 notes, which were issued at par, were fully redeemed by 2006. The balance of other notes at 31 December 2017 is shown at fair value. The loan notes are secured on the portfolio of mortgage loans by first charges over residential properties in the UK.

The M notes were provided by UKER and issued at par. The A2 notes were issued at 98.167%.

Interest on the A2 notes is paid quarterly in arrears and unpaid interest on M notes is capitalised quarterly. Interest payable on the notes, which are listed on the London Stock Exchange, is as follows:

	Capital balance outstanding at end of year Total £217.5m	**Credit rating (S&P, Moody's)**	**Interest rate**
Class A2 (£197.0m)	£175,900,000	A-, Aaa	5.70%
Class M (£12.5m)	£41,600,000	Not rated	9.00%

The A2 notes rank in priority to the M notes in point of payment and security. A2 notes are to be redeemed according to a redemption schedule which commenced in May 2015, although the Company will be obliged to redeem (in full 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 capital balance outstanding on the M notes includes £29.1 million *(2016: £30.3 million)* 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:

A2 notes	February 2031
M notes	February 2031

The Company may, at 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.

(ii) **Other loans**

On 30 March 2001, the Company entered into an agreement with Barclays Bank plc to provide a 364 day borrowing facility of £70.0 million. The borrowing facility is renewed annually and is available to draw upon when mortgage redemptions are insufficient to cover the expenses of the Company and the interest payable on the loan notes. At 31 December 2017, the undrawn balance was £66.3 million *(2016: £69.4 million)*.

14. Payables and other financial liabilities

	2017 £'000	2016 £'000
Amounts due to UKER	**592**	80
Other financial liabilities	**530**	94
	1,122	174

None of the above total *(2016: £nil)* is expected to be paid more than one year after the statement of financial position date.

15. Statement of cash flows

(a) The reconciliation of profit before tax to the net cash inflow from operating activities is:

	2017 £'000	2016 £'000
Profit before tax	**2**	2
Adjustments for:		
Fair value gains on mortgage loans	**(1,922)**	(40,425)
Fair value losses on loan notes	**29,219**	1,473
Interest receivable on mortgage loans	**(14,596)**	(15,239)
Changes in working capital:		
Decrease in receivables	**111**	444
(Increase)/decrease in prepayments and accrued income	**(1)**	9
(Decrease)/increase in deferred consideration	**(23,811)**	42,702
Increase/(decrease) in payables and other financial liabilities	**948**	(518)
Decrease in interest on borrowings	**(5,100)**	(2,399)
Proceeds from redemption of mortgages	**22,791**	23,434
Cash generated from operations	**7,641**	9,483

Redemptions of mortgages are included within operating cash flows as they represent the operating activities of the Company.

(b) Cash and cash equivalents in the statement of cash flows at 31 December comprised:

	2017 £'000	2016 £'000
Cash at bank and in hand	**48,620**	50,724

16. Capital

In managing its capital, the Company seeks to retain financial flexibility by maintaining strong liquidity. The Company has a committed but undrawn 364 day borrowing facility of £66.3 million *(2016: £69.4 million)* which has been sized to cover significant stresses on mortgage cash flows. The Company is not subject to any externally imposed capital requirements.

The Company manages shareholders' equity of £33,000 *(2016: £32,000)* as capital.

17. Risk management

(a) Risk management framework

The ultimate controlling party, Aviva plc, and its subsidiaries, joint ventures and associates (collectively known as "the Group") operate a risk management framework ("RMF"), which forms an integral part of the management and board processes and decision-making framework across the Group. The key elements of the Group's risk management framework comprise risk strategy and risk appetite, risk policy categorisation, enterprise-wide approach to managing risk, including how to identify, measure, manage, monitor and report risks, and risk governance and oversight (including boards and board committees, risk policies and business standards, delegated authorities and management committees, and roles and responsibilities). The Group's approach to risk management ensures that significant existing or emerging risks are actively identified, measured, managed, monitored and reported on a continuous basis. The RMF has been adopted within the businesses collectively referred to as "UK Life" (including this Company).

For the purposes of risk identification and measurement, risks are usually grouped by risk type: market, credit, life insurance, liquidity and operational risk. Risks falling within these types may affect a number of key metrics, including those relating to balance sheet strength, liquidity and profit. They may also affect the performance of the products that the Company delivers to customers and the service to customers and distributors, which can be categorised as risks to our brand and reputation or as conduct risk.

Risk models are an important tool in the Company's measurement of risk and are used to support the monitoring and reporting of the risk profile and in the consideration of the risk management actions available. The Company carries out a range of stress (where one risk factor, such as longevity, is assumed to vary) and scenario (where combinations of risk factors are assumed to vary) tests to evaluate their impact on the business and the management actions available to respond to the conditions envisaged. Board oversight of risk and risk management across the Group is maintained on a regular basis through its Risk Committee. The Board has overall responsibility for determining risk appetite, which is an expression of the risk it is willing to take. The Group's position against risk appetite is monitored and reported to the Board on a regular basis. A similar arrangement prevails at the UK Life business level.

UK Life sets limits to manage material risks to ensure the risks stay within risk tolerance (the desired or upper bound on the level of risk that UK Life will take in pursuit of its purpose and strategy). UK Life assesses the size and scale of a risk by considering how likely it is that the risk will materialise and the potential impact the risk could have on its business and its stakeholders.

Where risks are outside of tolerance, actions are agreed to bring the risks within tolerance. Impact assessments are considered against financial, operational and reputational criteria and take into account underlying factors such as economic conditions, for example, UK economic growth and inflation.

UK Life business has an established governance framework, which has the following key elements:

- Defined terms of reference for the legal entity boards and the associated board committees within the UK Life business, including the Risk Committee, Conduct Committee, Audit Committee, Investment Committee, With Profits Committee and Independent Governance Committee.
- A clear organisational structure with documented delegated authorities and responsibilities from the legal entity boards to CEOs and senior management. Often the senior management are assisted in discharging their delegated authority through the discussions at management committees (for example, the Executive Committee, Operational Risk and Conduct Committee and Asset Liability Committee).
- Adoption of the Group policy framework that defines risk appetite measures and sets out risk management and control standards for the Group's worldwide operations. The risk policies and associated business standards also set out the roles and responsibilities of Group, Businesses, Policy and Standard Owners, and Board and Management Committees.

UK Life operates within a three lines of defence risk management model that encourages close working relationships between line management and the risk function whilst facilitating independent assurance by internal audit, and the roles of the three lines of defence each contribute to embedded risk management:

- First line of defence (Management): Primary responsibility for risk identification, measurement, management, monitoring and reporting lies with management. The first-line management is responsible for the implementation and practice of risk management.
- Second line of defence (Risk function): Responsibility for reviewing and challenging the completeness and accuracy of risk identification, measurement, management, monitoring and reporting, and the adequacy of, and progress against, mitigation plans lies with the Risk function. This necessitates the early involvement by management of the risk function in key business decisions or projects, both in relation to customer and shareholder risks. The Risk function is responsible for overseeing effective operation of the Risk Management framework, particularly in relation to setting Risk Appetite, and compliance with Solvency II requirements.
- Third line of defence (Internal Audit function): Responsibility for assessing and reporting (to group and business unit audit, risk and governance committees, as appropriate) on the effectiveness of the design and operation of the framework of controls which enable risk to be assessed and managed lies with Internal Audit.

The Regulators also require UK Life to assess its economic capital requirements to ensure that it adequately reflects the risks facing the business. UK Life has accordingly developed economic capital models that support the measurement, comparison and further understanding of its risks. The results of the modelling are incorporated into key strategic planning and decision-making processes. These models show the relative impact to economic capital from the risks faced. In turn this supports the assessment of appropriate and effective mitigating strategies where risks are outside of appetite.

(b) Market risk

Market risk is the risk of adverse financial impact due to changes in fair values or future cash flows of financial instruments from fluctuations in interest rates and property prices (HPI). Market risk arises within the Company due to fluctuations in the value of lifetime mortgage assets relative to their funding and to the value of the property on which they are secured.

For each of the major components of market risk, described in more detail below, UK Life has put in place additional policies and procedures to set out how each risk should be managed and monitored, and the approach to setting an appropriate risk appetite. UK Life monitors adherence to this market risk policy and regularly reviews how these risks are being managed.

Profit for the Company for the year is calculated as 0.01% of interest accruing on the mortgages, with any excess or shortfall of income over expenditure reported in the statement of financial position, as described in accounting policy L. Accordingly, the impact on the Company of changes in economic factors and assumptions would be reflected in a change in the value of deferred consideration rather than profit. Consequently, the Company has not provided any detailed sensitivity analysis as required by IFRS 7 and the impact of the risks referred to below is restricted to the statement of financial position of the Company. Exposure to these risks is borne by the noteholders and other creditors of the company.

(i) Property price risk

Property price risk arises from sustained underperformance in the HPI, with the resultant increase in the likelihood that the mortgage debt will exceed the proceeds of the property sale at the date of redemption. A reinsurance contract is in place that has transferred the property risk onto a third party, that covers 63% of the mortgages and accordingly, no sensitivity tests have been performed for changes in property prices.

The level of HPI is monitored and the impact of exposure to adverse movements in the HPI regularly reviewed. To mitigate this risk the loan to value ratios on origination are at low levels and the performance of the mortgage portfolio is monitored through dilapidation reviews.

For the Company to make significant losses on negative equity, there would need to be a decrease in property values leading to house price deflation, alongside an unexpected rise in short term mortality and morbidity rates.

Exposure to property price risk is borne by the noteholders and other creditors of the company. The HPI adjusted Loan to Value (LTV) percentage of the mortgage asset interest bearing balances are as follows:

Age	Under 75	75-79	80-84	85-89	90-94	95-99	100+	Total
LTV	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Up to 40%	0.2	22.4	66.5	56.3	24.4	3.7	-	**173.5**
Up to 50%	-	4.1	14.2	28.2	16.2	3.4	-	**66.1**
Up to 60%	-	0.2	6.7	7.7	6.7	2.3	-	**23.6**
Up to 70%	-	-	0.3	4.5	2.0	0.3	0.3	**7.4**
Up to 80%	-	-	-	0.2	1.3	0.2	-	**1.7**
Up to 90%	-	-	-	-	-	-	-	-
Up to 100%	-	-	-	-	-	-	-	-
Above 100%	-	-	-	0.2	-	-	-	**0.2**
Total	**0.2**	**26.7**	**87.7**	**97.1**	**50.6**	**9.9**	**0.3**	**272.5**

The LTVs in the table above are as at 31 December 2017. LTVs are published quarterly, (February, May, August and November), in the Investor Reports, which are available at www.erfunding.co.uk.

(ii) Interest rate risk

Interest rate risk arises primarily from fluctuations in the value of lifetime mortgage assets and their related funding. Interest rate risk is controlled through the close matching of the duration and value of mortgages and mortgage funding in order to hedge against unfavourable or unmatched market movements in interest rates inherent in the underlying mortgages and funding. The impact of exposure to sustained adverse interest rates is regularly monitored.

(iii) Prepayment risk

Prepayment risk is the risk that the Equity Release mortgages will be repaid in a materially different profile to the expected profile at securitisation. This could lead to changes in the expected repayment rate of loan note interest and principal. This risk is mitigated by repayment charges applied to early redemptions.

(c) Credit risk

Credit risk is the risk of adverse financial impact resulting from fluctuations in credit quality of third parties, including default, rating transition and credit spread movements. The Company's management of credit risk under the oversight of ALCO, includes the articulation of risk appetite, exposure limit frameworks and investment and lending criteria within credit risk policies and management agreements. The credit ratings of financial institutions to which the Company is exposed are monitored and if these fall below a certain threshold collateralisation or other risk mitigation techniques are implemented.

The carrying amount of assets included in the statement of financial position represents the maximum credit exposure of the Company at the statement of financial position date. There are no financial assets which are either past due or impaired.

Concentrations of credit risk

Individual loans represent little credit risk as the debt is ultimately repayable from the proceeds of the sale of the property on death of the mortgagee or on their transfer to long-term care.

The impact of collateral held on the net credit exposure is shown below.

			2017
	Carrying value in the statement of financial position £'000	**Collateral held £'000**	**Net credit exposure £'000**
Loans	**272,504**	**272,312**	**192**

			2016
	Carrying value in the statement of financial position £'000	Collateral held £'000	Net credit exposure £'000
Loans	278,777	278,491	286

Additional information in respect to collateral is provided in note 7(b).

To the extent that collateral held is greater than the amount receivable that it is securing, the table above shows only an amount equal to the latter. In the event of default, any over-collateralised security would be returned to the relevant counterparty.

(d) 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 cash flows from the mortgages differ from those expected. Such differences would arise from mortality, morbidity and voluntary prepayment risks.

The Company has a committed but undrawn 364 day borrowing facility of £66.3 million *(2016: £69.4 million)* which has been sized to cover significant stresses on mortgage cash flows.

The contractual undiscounted cash flows in relation to liabilities have the following maturities:

	Within 1 year £m	**1-5 years £m**	**Over 5 years £m**	**2017 No contractual maturity £m**
Liabilities				
Borrowings	**31.5**	**106.9**	**204.5**	**-**
Deferred consideration	**-**	**-**	**-**	**40.7**
Payables and other financial liabilities	**1.1**	**-**	**-**	**-**

	Within 1 year £m	1-5 years £m	Over 5 years £m	2016 No contractual maturity £m
Liabilities				
Borrowings	24.1	102.8	191.9	-
Deferred consideration	-	-	-	64.5
Payables and other financial liabilities	0.2	-	-	-

The carrying value of the loan notes is £61.8 million higher *(2016: £33.8 million higher)* than the anticipated payment at maturity.

18. Related party transactions

(a) The members of the Board of Directors are listed on page 1 of these financial statements.

Included within the loan notes issued by the Company are £101.7 million *(2016: £76.0 million)* of loan notes which are held by related parties within the Group. Interest settled during the year in respect of these loan notes amounted to £5.3 million (*2016: £3.6 million*).

(b) Expenses payable to related parties

UKER	**2017 Expense incurred in year £'000**	2016 Expense incurred in year £'000
Cash handling and portfolio administration fees	**785**	818
Loan interest	**3,942**	3,844
Deferred consideration	**(23,811)**	42,702
	(19,084)	47,364

(c) Payable at year end

	2017	2016
UKER	£'000	£'000
M note	74,574	51,771
Deferred consideration	40,662	64,473
Other	592	80
	115,828	116,324

(d) Receivable at year end

	2017	2016
	£'000	£'000
Other related parties	-	111

(e) Key management compensation

Wilmington Trust SP Services (London) Limited received fees of £14,891 *(2016: £14,985)* including VAT during the year to 31 December 2017, in respect of structuring and management services.

There are no amounts receivable from or payments due to members of key management.

(f) Ultimate parent undertaking and controlling party

The immediate parent undertaking is Equity Release Holdings Limited, a company incorporated in England and Wales. The shares in Equity Release Holdings Limited are held by Wilmington Trust SP Services (London) Limited, a company incorporated in England and Wales, under a declaration of trust for charitable purposes. Wilmington Trust SP Services (London) Limited has no beneficial interest in the shares and therefore considers Equity Release Holdings Limited to be the ultimate parent undertaking.

The ultimate controlling party is Aviva plc, a company incorporated in England and Wales. Aviva plc is the parent undertaking of the smallest and largest group of undertakings to consolidate these financial statements at 31 December 2017. The consolidated financial statements of Aviva plc are available on www.aviva.com or by application to the Group Company Secretary, Aviva plc, St. Helen's,1 Undershaft, London EC3P 3DQ.