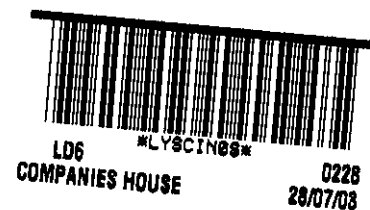


**Equity Release Funding (No. 1) plc**

**Directors' Report  
and  
Financial Statements**

**Year Ended: 31 December 2002**

**Registered Number: 4074907**



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## ***Directors and other information***

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### **Directors:**

M McDermott  
J Fairrie  
SPV Management Limited

### **Alternate Directors:**

R Baker (alternate to James Fairrie)  
S Cloke (alternate to M McDermott)

### **Secretary:**

SPV Management Limited

### **Bankers:**

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

### **Solicitors:**

Slaughter and May  
1 Bunhill Row  
London  
EC1Y 8YY

### **Auditors:**

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

### **Registered Office:**

78 Cannon Street  
London  
EC4P 5LN

Registered in England No. 4074907

## **Directors' Report**

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The directors present their report and financial statements for the year ended 31 December 2002.

### **Principal activities, review of business and future developments**

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 year ended 31 December 2002 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

P Minoprio (Resigned 11 January 2002)

SPV Management Limited

J Fairrie (Appointed 11 January 2002)

R Baker (Appointed as alternate Director to J Fairrie 11 January 2002)

S Cloke (Appointed as alternate Director to M McDermott 11 January 2002)

P Minoprio jointly held one share with Equity Release Holdings Ltd in the company up to 8 April 2002, when the joint holding was transferred to S Cloke. The directors had no other interest in the share capital or loan stock of the company or group companies during the period.

### **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 financial statements;
- ♦ prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records 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 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.

### **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 2002.

## Directors' Report

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### 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. The company minimises its exposure to liquidity risk by modelling its cashflows using multiple state modelling. The remaining risk is managed by the liquidity provided through the facility agreement (see note 15) and the swap agreement (see note 13).

### Auditors

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

23 July 2003



SPV Management Limited  
Director

**Auditors' report to the members of  
Equity Release Funding (No.1) plc**

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

We have audited the Company's financial statements for the year ended 31 December 2002 which comprise the profit and loss account, balance sheet and the related notes 1 to 15. These financial statements have been prepared on the basis of the accounting policies set out therein.

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

**Respective responsibilities of directors and auditors**

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.

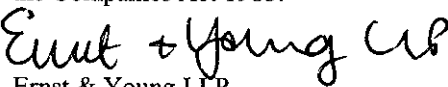
**Basis of audit opinion**

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 2002 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

  
Ernst & Young LLP  
Registered Auditor  
London

28 July 2003

**Profit and loss account**

for the year ended 31 December 2002

		Year Ended 31 December 2002	15 Month Period ended 31 December 2001
	Note	£	£
Interest receivable and similar income	2	20,715,738	15,880,323
Interest payable and similar charges	3	(15,981,170)	(12,185,690)
Net income		4,734,568	3,694,633
Other operating expenses		(4,732,725)	(3,693,264)
Operating profit on ordinary activities before taxation	4	1,843	1,369
Tax on profit on ordinary activities	6	313	(591)
Profit for the Year		2,156	778

**Statement of total recognised gains and losses**

for the year ended 31 December 2002

The Company has no recognised gains or losses other than those included in the results above. Accordingly, a statement of total recognised gains and losses is not given.

**Reconciliation of movements in shareholders' funds**

for the year ended 31 December 2002

	Year ended 31 December 2002	15 Month Period ended 31 December 2001
	£	£
Profit for the financial year	2,156	778
Share issue	-	12,502
Net increase in shareholders' funds	2,156	13,280
Opening shareholders' funds	13,280	-
Closing shareholders' funds	15,436	13,280

**Balance sheet**

at 31 December 2002

		As at 31 December 2002 £	As at 31 December 2001 £
	<i>Note</i>		
<b>Intangible fixed assets</b>			
Unamortised premium	8	3,357,280	3,629,467
<b>Current assets</b>			
Mortgage advances	7	223,650,924	222,957,897
Debtors	9	225,393	191,800
Cash at bank and in hand		17,370,734	16,378,666
		<u>241,247,051</u>	<u>239,528,363</u>
<b>Creditors: amounts falling due within one year</b>	10	<u>(1,398,830)</u>	<u>(1,406,252)</u>
<b>Net current assets</b>		<u>239,848,221</u>	<u>238,122,111</u>
<b>Total assets less current liabilities</b>		<u>243,205,501</u>	<u>241,751,578</u>
<b>Creditors: amounts falling due after one year</b>	11	<u>(243,190,065)</u>	<u>(241,738,298)</u>
<b>Net Assets</b>		<u>15,436</u>	<u>13,280</u>
<b>Capital and reserves</b>			
Called up share capital	12	12,502	12,502
Profit and loss account		<u>2,934</u>	<u>778</u>
<b>Shareholders' funds – equity</b>	13	<u>15,436</u>	<u>13,280</u>

The financial statements on pages 7 to 15 were approved by the Board on 23 July 2003 and were signed on its behalf by:

  
SPV Management Limited  
Director



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**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 tax charge in the profit and loss account is based on the taxable profits for the year, after any adjustments in respect of prior years. Tax, including tax relief for losses if applicable, is allocated over profits on ordinary activities and amounts charged or credited to reserves as appropriate.

Provision is made for deferred tax liabilities, on all material timing differences. Deferred taxation is calculated at the rates at which it is expected that the tax will arise, and discounted to take into account the likely timing of payments and pattern of expected realisation of investments. The discount rates used are the post-tax yields to maturity that could be obtained at the balance sheet date on government bonds with maturity dates and in currencies similar to those of the deferred tax assets or liabilities.

This is a change in accounting policy to reflect the requirements of FRS 19. The financial statements are unaffected by this change (2001: unaffected).

**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

	Year Ended 31 December 2002 £	15 Month Period Ended 31 December 2001 £
<b>2 Interest receivable and similar income</b>		
Mortgage interest receivable	18,402,060	13,789,490
On interest rate swaps (see note 13)	1,419,047	1,342,523
Bank interest receivable	657,693	670,836
Other income	236,938	77,474
	<u>20,715,738</u>	<u>15,880,323</u>

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

	Year Ended 31 December 2002 £	15 Month Period Ended 31 December 2001 £
<b>3 Interest payable and similar charges</b>		
On mortgage backed loan notes	14,005,976	10,746,382
On interest rate swaps	1,858,416	1,417,147
On interest rate swaps (loan element)	114,362	20,024
On start up loan (see note 11)	2,416	2,137
	<u>15,981,170</u>	<u>12,185,690</u>

	Year Ended 31 December 2002 £	15 Month Period Ended 31 December 2001 £
<b>4 Operating profit on ordinary activities</b>		
<i>Profit on ordinary activities is stated after charging</i>		
Auditors' remuneration – audit fee	<u>10,400</u>	<u>8,500</u>
Deferred consideration	<u>2,976,549</u>	<u>2,373,072</u>
Amortisation of initial funding costs	<u>202,459</u>	<u>151,844</u>

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

**5 Directors Emoluments**

SPV Management Limited received fees of £14,330 (2001:£31,682) including VAT during the year to 31 December 2002, in respect of structuring and management services.

## Notes to the accounts

	Year Ended 31 December 2002 £	Restated 15 Month Period Ended 31 December 2001 £
<b>6 a) Tax on profit on ordinary activities</b>		
Tax charged/(credited) in the profit & loss account comprises:		
UK Corporation tax	78	591
Prior Year Adjustment	(391)	-
	<u>(313)</u>	<u>591</u>
<b>b) Factors affecting current tax charge for the year</b>		
Profit on ordinary activities before tax	1,843	1,369
Current tax charge at standard UK corporation tax rate of 10% up to 31 March 2002 and 0% thereafter (ie 2.5% for the year) (2001: 30%)	46	411
Adjustment to tax charge in respect of prior years	(391)	-
Utilisation of brought forward tax losses	33	-
Other disallowable expenses	-	180
Other Items	(1)	-
	<u>(313)</u>	<u>591</u>

**c) Factors that may affect future tax charges**

Formation costs are amortised through the profit & loss account and are non-allowable for tax purposes. The balance of unamortised costs was £19,052 at 31 December 2002 (2001: £20,356)

**7 Mortgage Advances**

On 30 March 2001, the company purchased £214m 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 in the form of deferred consideration.

Norwich Union Equity Release Limited administers the mortgage portfolio.

	2002 Mortgage Advances £	2001 Mortgage Advances £
At start of year	222,957,897	-
On purchase	-	214,253,566
Loan substitution – net effect	-	(12,898)
Amounts redeemed	(17,709,033)	(5,072,261)
Interest	18,402,060	13,789,490
At end of year	<u>223,650,924</u>	<u>222,957,897</u>

**Notes to the accounts**

	<b>Year Ended 31 December 2002</b>	<b>Restated 15 Month Period Ended 31 December 2001</b>
	<b>£</b>	<b>£</b>

*Mortgage premium*

At start of year	3,629,467	-
On purchase	-	3,839,135
Amortisation in year	(272,187)	(209,668)
At end of year	<u>3,357,280</u>	<u>3,629,467</u>

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

	<b>Year Ended 31 December 2002</b>	<b>Restated 15 Month Period Ended 31 December 2001</b>
	<b>£</b>	<b>£</b>
<b>9 Debtors</b>		
Interest Receivable	188,158	187,825
Reinsurance Rebates	33,616	-
Corporation Tax	186	-
Prepayments	3,433	3,975
	<u>225,393</u>	<u>191,800</u>

All amounts fall due within one year.

	<b>Year Ended 31 December 2002</b>	<b>Restated 15 Month Period Ended 31 December 2001</b>
	<b>£</b>	<b>£</b>
<b>10 Creditors: amounts falling due within one year</b>		
Accruals and deferred income	23,527	20,247
Corporation tax	-	591
Amounts owed to Group companies	68	-
Interest payable	1,375,235	1,385,414
	<u>1,398,830</u>	<u>1,406,252</u>

## Notes to the accounts

	Year Ended 31 December 2002 £	Restated 15 Month Period Ended 31 December 2001 £
<b>11 Creditors: amounts falling due after one year</b>		
Deferred consideration	5,349,620	2,373,072
Mortgage backed loan notes	238,366,423	241,876,356
Less: unamortised element of initial funding costs	(3,491,442)	(3,693,901)
Swap – loan element	2,910,912	1,130,634
Start up loan	54,552	52,137
	<b>243,190,065</b>	<b>241,738,298</b>

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 2002 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	From February 2011
Class A1 (£35 m)	£30,082,150	LIBOR + 0.45%	LIBOR + 2.50%
Class A2 (£197 m)	£197,000,000	5.70%	5.70%
Class M (£12.5 m)	£14,485,312	9.00%	9.00%

## Notes to the accounts

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 13) and borrowing facility (see note 15) 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 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 balance outstanding on the M notes includes £1,985,312 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

The company 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 13).

12	Called up share capital	Year Ended 31 December 2002 £	Restated 15 Month Period Ended 31 December 2001 £
	<i>Authorised</i>		
	Ordinary shares of £1 each	100,000	100,000
	<i>Allotted, called up and fully paid</i>		
	Ordinary shares of £1 each	2	2
	<i>Allotted, called up and partly paid</i>		
	Ordinary shares of £1 each (25p paid per share)	12,500	12,500
		12,502	12,502

## 13 Commitments

On 30 March 2001 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 2002 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'.

## 14 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

### 15 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*

The interest rate profile of the Group's assets and liabilities at 31 December 2002 was:

	Floating Rate £	Fixed Rate £	Non interest Bearing £	Total Book Value £	Fair Value of financial assets / liabilities £
<b>Assets</b>					
Mortgage advances (*)	-	223,650,924	-	223,650,924	236,343,262
Unamortised premium	-	-	3,357,280	3,357,280	
Interest Receivable	-	-	188,158	188,158	188,158
Debtors	-	-	37,235	37,235	37,235
Cash	17,370,734	-	-	17,370,734	17,370,734
	<b>17,370,734</b>	<b>223,650,924</b>	<b>3,582,673</b>	<b>244,604,331</b>	
<b>Liabilities</b>					
Deferred consideration	-	-	5,349,620	5,349,620	709,211
Mortgage backed notes	30,082,150	208,284,272	-	238,366,422	253,457,068
Issue costs	-	-	(3,491,442)	(3,491,442)	
Interest payable	-	-	1,375,235	1,375,235	1,375,235
Loans	54,553	2,910,912	-	2,965,465	3,280,105
Other creditors	-	-	23,595	23,595	23,595
Capital and reserves	-	-	15,436	15,436	
	<b>29,675,718</b>	<b>208,164,727</b>	<b>6,763,886</b>	<b>244,604,331</b>	
<b>Derivatives</b>					
Interest rate swap	(35,000,000)	35,000,000	-	-	(1,383,952)

\* The Fair Value of Mortgage advances incorporates the premium shown under Assets.

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 2002, the group had a committed but undrawn 364 day borrowing facility of £70m.

#### *Fair value of financial assets and liabilities*

Set out above is a comparison by category of book values and fair values of the Group. Fair values have been determined have been calculated by discounting cash flows at prevailing rates.

#### *Foreign currency*

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