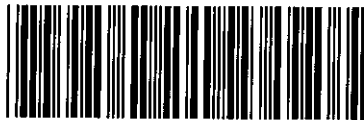


FIRST FLEXIBLE NO. 4 PLC

Report and Financial Statements

Year ended 30 September 2006

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DIRECTORS' REPORT

The directors present their annual report and the audited financial statements for the year ended 30 September 2006.

BUSINESS REVIEW AND PRINCIPAL ACTIVITIES

The Company is a wholly owned subsidiary of The Paragon Group of Companies PLC ('the Group') and was set up to provide finance for its mortgage loan assets, by issuing mortgage backed floating rate loan notes and using the proceeds to purchase mortgage loans from other Group companies.

Its principal activities are the provision of first mortgage loans. There have been no significant changes in the company's principal activities in the year under review. The directors are not aware, at the date of this report, of any likely major changes in the company's activities in the next year.

As shown in the company's profit and loss account on page 5, the company's net interest income decreased by 38% over the prior year. This was due to the effect of incorporating the effective interest rate in the current year and having a lower loan book during the current year compared to the previous year. The result has fallen from a retained profit of £20,000 to a retained loss of £158,000.

The balance sheet on page 6 of the financial statements shows the company's financial position at the year end. Loans to customers have decreased by 24% due to customers redeeming their accounts during the year. As a result the asset backed loan notes have reduced by 24% during the year. Details of amounts owed from and to other group companies are shown in notes 14 and 17.

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

PRINCIPAL RISKS AND UNCERTAINTIES

The Company is a securitisation company and has been structured so as to avoid, in as far as is possible all forms of financial risk. An analysis of the Company's exposure to financial risks is set out in note 3, other risks are set out in note 2.

Group risks are discussed in the group's Annual Report which does not form part of this Report.

ENVIRONMENT

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

EMPLOYEES

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

DIRECTORS' REPORT (CONTINUED)

DIRECTORS

The directors throughout the year and subsequently were:

J P J Fairrie
J G Gemmell
Wilmington Trust SP Services (London) Limited
M McDermott

The company is a wholly owned subsidiary of Arianty Holdings Limited, of which J P J Fairrie, J G Gemmell and Wilmington Trust SP Services (London) Limited are directors.

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

None of the directors received any remuneration for their services to the company apart from Wilmington Trust SP Services (London) Limited. Under the terms of a Corporate Services Agreement as amended by side letters, Wilmington Trust SP Services (London) Limited is contracted to receive fees in the year of £7,000 (2005: £7,000). J P J Fairrie and M McDermott are both directors of Wilmington Trust SP Services (London) Limited.

J G Gemmell is a director of MTL a related group of companies, with whom the company entered into a number of agreements. These are detailed in the financial statements of Arianty Holdings Limited. According to the Register of Directors' Interests J G Gemmell has an interest in the share capital of The Paragon Group of Companies PLC ("PGC"), the ultimate parent company of MTL. These interests are disclosed in the financial statements of MTL.

CREDITOR PAYMENT POLICY

The company agrees terms and conditions with its suppliers. Payment is then made on the terms agreed, subject to the appropriate terms and conditions being met by the supplier. The trade creditor days figure has not been stated as the measure is not appropriate to the business.

AUDITORS

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

A resolution for the re-appointment of Deloitte & Touche LLP as the auditors of the Company is to be proposed at the forthcoming Annual General Meeting.

Approved by the Board of Directors
and signed on behalf of the Board



J G Gemmell
Secretary,
28 March 2007

STATEMENT OF DIRECTORS' RESPONSIBILITIES

in relation to Financial Statements

The directors are responsible for preparing the Annual Report and the financial statements. The directors have chosen to prepare accounts for the company in accordance with United Kingdom Generally Accepted Accounting Practice (UK GAAP). Company law requires the directors to prepare such financial statements for each financial year which 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 and comply with UK GAAP and the Companies Act 1985. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable 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, for safeguarding the assets, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a directors' report which comply with the requirements of the Companies Act 1985.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF FIRST FLEXIBLE NO. 4 PLC

We have audited the financial statements of First Flexible No. 4 PLC for the year ended 30 September 2006 which comprise the profit and loss, the balance sheet, the statement of total recognised gains and losses and the related notes 1 to 21. These financial statements have been prepared under 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

The directors' responsibilities for preparing the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

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 whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, 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 other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies within it.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) 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 judgments 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, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 30 September 2006 and of its loss for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

Deloitte & Touche LLP

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
Birmingham, United Kingdom

28 March 2007

PROFIT AND LOSS ACCOUNT

Year ended 30 September 2006

	Note	2006 £'000	2005 £'000
Interest receivable			
Mortgages		13,568	19,407
Other		589	802
		<u>14,157</u>	<u>20,209</u>
Interest payable and similar charges	4	(12,111)	(16,926)
Net interest income		<u>2,046</u>	<u>3,283</u>
Operating expenses		(2,337)	(3,209)
Provisions for losses	6	(71)	(45)
		<u>(362)</u>	<u>29</u>
Fair value net gains	7	114	-
Operating (loss) / profit, being (loss) / profit on ordinary activities before taxation	8	<u>(248)</u>	<u>29</u>
Tax on (loss) / profit on ordinary activities	9	90	(9)
(Loss) / profit on ordinary activities after taxation	16	<u>(158)</u>	<u>20</u>

All activities derive from continuing operations.

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

Year ended 30 September 2006

	Note	2006 £'000	2005 £'000
(Loss) / profit attributable to members of the Company		(158)	20
Total recognised gains and losses for the year		<u>(158)</u>	<u>20</u>
Change in accounting policy on adoption of FRS 25 and FRS 26	1	590	
Total Gains and losses recognised since last Annual Report and Financial Statements		<u>432</u>	

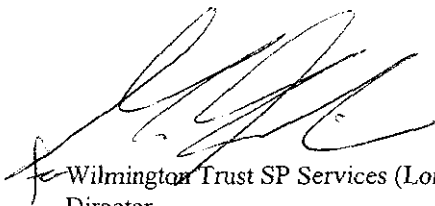
BALANCE SHEET

30 September 2006

	Note	2006 £'000	2005 £'000
ASSETS EMPLOYED			
FIXED ASSETS			
Financial assets	10	201,215	265,264
CURRENT ASSETS			
Debtors falling due within one year	14	979	1,250
Cash at bank		14,466	18,839
		<u>15,445</u>	<u>20,089</u>
		<u>216,660</u>	<u>285,353</u>
FINANCED BY			
SHAREHOLDERS' FUNDS			
Called up share capital	15	12	12
Profit and loss account	16	511	79
		<u>523</u>	<u>91</u>
CREDITORS			
Amounts falling due within one year	17	1,178	1,234
Amounts falling due after more than one year	17	214,959	284,028
		<u>216,137</u>	<u>285,262</u>
		<u>216,660</u>	<u>285,353</u>

These financial statements were approved by the Board of Directors on 28 March 2007.

Signed on behalf of the Board of Directors



Wilmington Trust SP Services (London) Limited
Director

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

1. ACCOUNTING POLICIES

The financial statements are prepared in accordance with applicable UK accounting standards. The particular accounting policies adopted are described below. They have been applied consistently throughout the current and preceding years with the exception of the policy in respect of loans to customers, impairment, borrowings and derivatives (see below).

Financial Reporting Standards 25 and 26 'Financial instruments: Disclosure and Presentation' and 'Financial Instruments: Recognition and Measurement' respectively, have been applied for the first time in the year and balances brought forward at 1 October 2005 have been adjusted accordingly, increasing the value of loans to customers by £995,000, recognising derivative financial instruments at a fair value liability of £153,000 resulting in an increase in profit and loss reserves by £590,000.

As permitted by FRS 25 and 26, comparative amounts have not been restated and are presented in accordance with the accounting policies adopted in preparing the financial statements for the year ended 30 September 2005, and, in particular, those provisions of FRS 13 – 'Derivatives and other Financial Instruments: Disclosures' which are superseded by FRS 25 and 26.

The principal adjustments which would have been required to make the comparative amounts conform to the requirements of FRS 25 and 26 derive from the use of the Amortised Cost method to value the company's loans to its customers, the recognition of income on the Effective Interest Rate basis, the adoption of the impairment methodology required by FRS 26, the valuation of derivative financial instruments at fair value and the use of the hedging provisions of the new standard.

As the information needed to account for certain financial instruments in the comparative period was not available at the time, especially with regard to hedging, it is not practicable to quantify the impact of this change on the profit figure for the preceding year.

Accounting Convention

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

Loans to Customers*In the results for the year ended 30 September 2006*

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

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

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

The Company's policy is to hedge against any exposure to fixed rate loan assets.

In the results for the year ended 30 September 2005

Interest arising on loans is recognised in the profit and loss account as it is charged to borrowers, to the extent that is expected to be recoverable. Other fee income arising from borrower accounts is recognised in 'other income' as it is charged.

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

1. ACCOUNTING POLICIES (CONTINUED)

Impairment of Loans and Receivables

In the results for the year ended 30 September 2006

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

In the results for the year ended 30 September 2005

The amount provided is an estimate of the amount needed to reduce the carrying value of the asset to its expected recoverable amount and is based on the application of formulae which take into account the nature of each portfolio, borrower payment profile and expected losses.

Related party disclosures

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

Deferred purchase consideration

Under the Mortgage sale agreement profits from First Flexible No 4 PLC are paid up to the companies which originated the loans by way of deferred purchase consideration. Deferred purchase consideration is recognised in the period in which it is paid.

Corporation Tax

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

Deferred Taxation

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

Borrowings

In the results for the year ended 30 September 2006

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

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

In the results for the year ended 30 September 2005

Borrowings are stated at their outstanding value less unamortised issue costs and discounts on issue.

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

1. ACCOUNTING POLICIES (CONTINUED)

Derivative Financial instruments*In the results for the year ended 30 September 2006*

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

The Company does not enter into speculative derivative contracts.

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

In the results for the year ended 30 September 2005

Derivative instruments utilised by the Company comprise currency swaps and interest rate swaps. All such instruments are used for hedging purposes to alter the risk profile of the existing underlying exposure of the Company in line with the Company's risk management policies. Amounts payable or receivable in respect of interest rate swaps are recognised as adjustments to interest expense over the period of the contracts. The Company does not enter into speculative derivative contracts.

Hedging*In the results for the year ended 30 September 2006*

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

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

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

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

1. ACCOUNTING POLICIES (CONTINUED)

Cashflow Statement

The Company has taken advantage of the exemption granted by Financial Reporting Standard 1 - 'Cashflow Statements' and does not therefore provide a cashflow statement as it is a wholly owned subsidiary of The Paragon Group of Companies PLC and its accounts are publicly available.

2. CRITICAL ACCOUNTING ESTIMATES

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

Impairment losses on loans to customers

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

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

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

Effective interest rates

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

Fair values

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

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

3. FINANCIAL RISK MANAGEMENT

The Company's operations are financed principally by floating rate, asset backed loan notes and, to a lesser extent, by a mixture of share capital and loans from other group companies. The Company issues financial instruments to finance the acquisition of its portfolio of loans to customers and uses derivative financial instruments to hedge interest rate risk arising from fixed rate lending. In addition, various financial instruments, for example debtors, prepayments and accruals, arise directly from the Company's operations.

It is, and has been throughout the year under review, the Company's policy that no trading in financial instruments shall be undertaken.

The principal risks arising from the Company's financial instruments are credit risk, liquidity risk and interest rate risk. The board of the Company's holding company reviews and agrees policies for all companies in the Group managing each of these risks and they are summarised below. These policies have remained unchanged throughout the year and since the year end.

Credit risk

The Company's credit risk is primarily attributable to its loans to customers. The maximum credit risk at 30 September 2006 approximates to the carrying value of loans to customers (note 11). There are no significant concentrations of credit risk due to the large number of customers included in the portfolios.

The Company acquired mortgages from Arianty Holdings Limited, its immediate parent company which places a strong emphasis on good credit management at the time of underwriting new loans.

The acquired mortgages are secured by first charges over residential properties in the United Kingdom. Despite this security, in assessing credit risk an applicant's ability to repay the loan remains the overriding factor in the decision to lend by the originating lender. Additionally, each mortgage has the benefit of one or more life assurance policies and certain mortgages have the benefit of a mortgage guarantee indemnity insurance policy.

Mortgages Trust Services PLC continues to administer the mortgages on behalf of First Flexible No. 4 PLC and the collections process is the same as that utilised for all companies in the Mortgage Trust Services PLC.

In order to control credit risk relating to counterparties to the Company's financial instruments, the board of the Company's holding company determines on a group basis, which counterparties the group of companies will deal with, establishes limits for each counterparty and monitors compliance with those limits.

Liquidity risk

The Company's assets are principally financed by asset backed loan notes issued through the securitisation process. Details of the Company's borrowings are given in note 19. Securitisation effectively eliminates the Company's liquidity risk by matching the maturity profile of the Company's funding to the profile of the assets to be funded.

NOTES TO THE ACCOUNTS**Year ended 30 September 2006****3. FINANCIAL RISK MANAGEMENT (CONTINUED)****Interest rate risk**

The Company's policy is to maintain floating rate liabilities and match these with floating rate assets by the use of interest rate swap or cap agreements.

The rates payable on the asset backed loan notes issued by the Company are reset monthly on the basis of LIBOR. The interest rates charged on the Company's variable rate loan assets are determined by reference to, inter alia, the Company's funding costs and the rates being charged on similar products in the market. Generally this ensures the matching of changes in interest rates on the Company's loan assets and borrowings and any exposure arising on the interest rate resets is relatively short term.

In part, the Company's interest rate hedging objectives are achieved by the controlled mismatching of the dates on which instruments mature, redeem or have their interest rates reset. The table below summarises these repricing mismatches. For the purposes of the table, loan assets, borrowings and derivatives are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date and the maturity dates. For those fixed rate loan assets where the customer has contracted to make regular repayments of both capital and interest, the assets have been allocated across the time bands in the table by reference to the contracted repayments. The analysis takes no account of early terminations which are likely to occur in practice. In determining the amount of hedging required, the Company makes assumptions about the level of regular capital repayments and early terminations of its loan assets. The actual interest rate sensitivity will therefore be determined by reference to subsequent customer and management decisions and is expected to be less sensitive than shown.

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

	3 months or less	More than 3 months but not more than 6 months	More than 6 months but not more than 1 year	More than 1 year but not more than 5 years	More than 5 years	Non interest bearing	Total
At 30 September 2006	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Financial assets	173,543	5,930	12,263	9,479	-	-	201,215
Debtors	-	-	-	-	-	979	979
Cash at bank and in hand	14,466	-	-	-	-	-	14,466
Total assets	188,009	5,930	12,263	9,479	-	979	216,660
Shareholders' funds	-	-	-	-	-	(523)	(523)
Asset backed loan notes	(207,655)	-	-	-	-	-	(207,655)
Derivative financial liabilities	(60)	-	-	-	-	-	(60)
Deferred Purchase Consideration	-	-	-	-	-	(7,222)	(7,222)
Other liabilities	-	-	-	-	-	(1,200)	(1,200)
Total liabilities and shareholders' funds	(207,715)	-	-	-	-	(8,945)	(216,660)
Notional swap principal	12,850	(1,750)	(3,000)	(8,100)	-	-	-
Interest rate repricing gap	(6,856)	4,180	9,263	1,379	-	(7,966)	-
Cumulative gap	(6,856)	(2,676)	6,587	7,966	7,966	-	-

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

	3 months or less	More than 3 months but not more than 6 months	More than 6 months but not more than 1 year	More than 1 year but not more than 5 years	More than 5 years	Non interest bearing	Total
At 30 September 2005	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Financial assets	244,954	2,715	12,395	5,200	-	-	265,264
Debtors	-	-	-	-	-	1,250	1,250
Cash at bank and in hand	18,839	-	-	-	-	-	18,839
Total assets	263,793	2,715	12,395	5,200	-	1,250	285,353
Shareholders' funds	-	-	-	-	-	(91)	(91)
Asset backed loan notes	(276,564)	-	-	-	-	178	(276,386)
Deferred Purchase Consideration	-	-	-	-	-	(7,642)	(7,642)
Other liabilities	-	-	-	-	-	(1,234)	(1,234)
Total liabilities and shareholders' funds	(276,564)	-	-	-	-	(8,789)	(285,353)
Notional swap principal	1,280	(1,100)	(180)	-	-	-	-
Interest rate repricing gap	(11,491)	1,615	12,215	5,200	-	(7,539)	-
Cumulative gap	(11,491)	(9,876)	2,339	7,539	7,539	-	-

The Company monitors the interest rate risk exposure on its loan assets and asset backed loan notes and ensures compliance with the requirements of the trustees in respect of the notes.

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

Currency risk

The company has no material exposure to foreign currency risk.

Use of derivative financial instruments

The Company uses derivative financial instruments for risk management purposes. Such instruments are used only to limit the exposure of the Company to movements in market interest or exchange rates, as described above.

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

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

Fair values of financial assets and financial liabilities

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

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

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

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

Set out below is a comparison by category of book values and fair values of the Company's derivative financial instruments as they were disclosed at 30 September 2005 under UK GAAP.

	2005 Book value £'000	2005 Fair value £'000
Derivative financial instruments held to manage the interest rate profile		
Swaps	-	(153)

4. INTEREST PAYABLE AND SIMILAR CHARGES

	2006 £'000	2005 £'000
Asset backed loan notes	12,037	16,598
Amortised issue costs	-	241
Interest rate swaps	43	-
Commitment fee	31	87
	<u>12,111</u>	<u>16,926</u>

As permitted by FRS 26 the interest figures shown above for the years ended 30 September 2006 and 30 September 2005 are prepared under different bases (see note 1). They are therefore not directly comparable.

5. DIRECTORS AND EMPLOYEES

Directors' remuneration from the company during the year is stated in note 8.

The only employees during the year or the preceding year were the directors as disclosed on page 2.

6. PROVISIONS FOR LOSSES

	2006 £'000	2005 £'000
Impairment of financial assets		
First mortgage loans	<u>71</u>	<u>45</u>

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

7. FAIR VALUE NET GAINS

The fair value net gain of £114,000 (2005: £nil) represents the accounting volatility on derivative instruments which are matching risk exposure on an economic basis. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting has not been adopted or is not achievable on certain items. The gain is primarily due to timing differences in income recognition between the derivative instruments and the economically hedged assets and liabilities.

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

	2006 £'000	2005 £'000
Operating (loss) / profit is after charging:		
Directors' fees	7	7
Auditors' remuneration - audit services	7	7

Non audit fees provided to the group are disclosed in the accounts of the parent company and the exemption to disclose non-audit services in these accounts has been taken.

9. TAX ON PROFIT ON ORDINARY ACTIVITIES

a) Tax (credit) / charge for the year

	2006 £'000	2005 £'000
UK corporation tax at 30% (2005: 30%) based on the (loss) / profit for the year		
Corporation tax	-	9
Prior year credit	(9)	-
Deferred tax (note 18)	(81)	-
	(90)	9

b) Factors affecting the current tax (credit) / charge

	£'000	£'000
(Loss) / profit before tax	(248)	29
Tax at 30%	(75)	9
Effect of expenses not deductible for tax purposes	627	857
Group relief surrendered for nil value	(624)	(857)
Movement on short term timing differences	81	-
Prior year credit	(9)	-
	-	9

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

10. FINANCIAL ASSETS

	2006	2005
	£'000	£'000
Loans to customers (note 11)	201,199	265,264
Fair value adjustments from portfolio hedging	(45)	-
Derivative financial assets (note 13)	61	-
	<u>201,215</u>	<u>265,264</u>

11. LOANS TO CUSTOMERS

These comprise mortgage loans secured on residential properties in the United Kingdom and are categorised as loans and receivables as defined by FRS 26 (note 12).

	2006	2005
	£'000	£'000
Balance at 1 October 2005	265,264	361,327
Adoption of FRS 25 & 26 (note 1)	995	-
Additions	6,471	10,597
Other debits	13,984	20,008
Repayments and redemptions	(85,515)	(126,668)
Balance at 30 September 2006	<u>201,199</u>	<u>265,264</u>

Other debits includes primarily interest receivable on loans outstanding and discount effect of EIR. As permitted by FRS 26 the interest figures shown above for the years ended 30 September 2006 and 30 September 2005 are prepared under different bases (see note 1). They are therefore not directly comparable.

12. LOANS AND RECEIVABLES

Loans and receivables at 30 September 2006 and 30 September 2005, which are all denominated and payable in sterling, were first mortgages which are secured on residential property within the United Kingdom.

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

The average rate of interest being charged on customer accounts and the average rate at which income is being recognised under the effective interest rate method at 30 September 2006 was;

	Average rate charged to customers	Average effective interest rate
	2006	2006
Mortgage loans	<u>6.0%</u>	<u>5.92%</u>

The interest rate repricing profile of the above loans is shown in note 3. All the mortgage loans are pledged as collateral for liabilities at 30 September 2006 and 30 September 2005.

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

13. DERIVATIVE FINANCIAL ASSETS AND LIABILITIES

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

	2006 Notional Amount £'000	2006 Assets £'000	2006 Liabilities £'000
Derivatives in accounting hedge relationships			
<i>Fair value hedges</i>			
Interest rate swaps	11,550	51	(11)
	<hr/> 11,550	<hr/> 51	<hr/> (11)
Other derivatives			
Interest rate swaps	159,768	10	(49)
	<hr/> 159,768	<hr/> 10	<hr/> (49)
 Total recognised derivative assets / (liabilities)	 <hr/> 171,318	 <hr/> 61	 <hr/> (60)

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

13. DERIVATIVE FINANCIAL ASSETS AND LIABILITIES (CONTINUED)

Under UK GAAP changes in the fair value of instruments used as hedges were not recognised in the financial statements until the hedged position matures. Set out below is an analysis of those unrecognised gains and losses at 30 September 2005 as required under UK GAAP.

	2005 Gains	2005 Losses	2005 Total net gains / (losses)
	£'000	£'000	£'000
Unrecognised gains and losses on hedges at 1 October 2004	393	(278)	115
Gains and losses arising in previous years that were recognised in the year	(376)	-	(376)
Gains and losses arising before 1 October 2004 that were not recognised in the year	17	(278)	(261)
Gains and losses arising in the year that were not recognised in the year	(11)	119	108
Unrecognised gains and losses on hedges at 30 September 2005	6	(159)	(153)
Of which:			
Gains and losses expected to be realised in the year to 30 September 2006	6	(61)	(55)
Gains and losses expected to be realised in the year to 30 September 2007 or later	-	(98)	(98)
	6	(159)	(153)

14. DEBTORS

	2006 £'000	2005 £'000
Amounts falling due within one year:		
Other debtors	946	1,207
Prepayments and accrued income	33	41
Corporation tax	-	2
	979	1,250

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

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

15. CALLED UP SHARE CAPITAL

	2006 £	2005 £
Authorised:		
100,000 ordinary shares of £1 each	100,000	100,000
Allotted:		
50,000 ordinary shares of £1 each (25p paid)	12,500	12,500

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

	Share capital £'000	Profit and loss account £'000	Shareholders' Funds £'000
At 1 October 2004	12	59	71
Profit for the financial year	-	20	20
At 30 September 2005	12	79	91
FRS 25 and 26 transition	-	842	842
Deferred tax on FRS 25 and 26 adjustments	-	(252)	(252)
Change of accounting policy on adoption of FRS 25 and 26	-	590	590
At 1 October 2005	12	669	681
Profit for the financial year	-	(158)	(158)
At 30 September 2006	12	511	523

NOTES TO THE ACCOUNTS

Year ended 30 September 2006

17. CREDITORS

	2006 £'000	2005 £'000
Amounts falling due within one year:		
Other creditors	71	72
Corporation tax	2	-
Deferred tax (note 18)	171	-
Accruals	934	1,162
	<u>1,178</u>	<u>1,234</u>
	£'000	£'000
Amounts falling due after more than one year :		
Asset backed loan notes	207,655	276,386
Derivative financial liabilities (note 13)	60	-
Deferred purchase consideration – Arianty No.1 PLC	7,222	7,597
Deferred income discount reserve	22	45
	<u>214,959</u>	<u>284,028</u>

A maturity analysis and further details of the Asset backed loan notes are given in note 19.

18. DEFERRED TAX

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

	2006 £'000	2005 £'000
Balance at 1 October 2005	-	-
Adoption of FRS 25 / 26 (note 1)	252	-
Profit and loss credit	(81)	-
Balance at 30 September 2006	<u>171</u>	<u>-</u>
The net deferred tax liability for which provision has been made is analysed as follows:		
Other timing differences	<u>171</u>	<u>-</u>

NOTES TO THE ACCOUNTS**Year ended 30 September 2006****19. BORROWINGS**

The Mortgage Backed Floating Rate Notes are secured over a portfolio comprising variable rate mortgage loans secured by first charges over residential properties in the United Kingdom. The Notes are subject to mandatory redemption in part on each Interest payment Date in an amount equal to the principal received or recovered in respect of the mortgage. The maturity date of the notes matches the maturity date of the underlying assets. It is likely that a substantial proportion of these notes will be repaid within five years.

The Company has the option to repay all of the notes at an earlier date, at the outstanding principal amount.

Interest is payable at a fixed margin above:

- the London Interbank Offered Rate ('LIBOR') on notes denominated in sterling;

All payments in respect of the notes are required to be made in the currency in which they are denominated.

Notes in issue at 30 September 2006 and 30 September 2005 were:

Notes	Maturity date	Call date	Principal Outstanding		Note Margin	
			2006 £m	2005 £m	Current	Step up
'A'	July 2036	July 2008	167.7	236.6	0.27%	0.54%
'B'	July 2036	July 2008	35.0	35.0	0.85%	1.70%
'M'	July 2036	July 2008	5.0	5.0	1.80%	2.80%

There are no amounts of committed but undrawn facilities at 30 September 2006 and September 2005.

20. RELATED PARTY TRANSACTIONS

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

Transactions with Mortgage Trust Services PLC (MTS) group

At the balance sheet date MTS, a company under common control as defined by FRS8, acted as servicer of the mortgages for the company and earned £232,000 during the year (2005: £311,000) in servicing fees. At the balance sheet date the company owed £16,000 (2005: £21,000) to MTS in relation to servicing fees plus £35,000 (2005: £42,000) for mortgage fees and insurance, which is included in other creditors. The company was owed £946,000 (2005: £1,207,000) by MTS relating to monies collected by the servicer, that are yet to be passed onto the company, which is included in other debtors.

21. ULTIMATE PARENT COMPANY

The immediate parent undertaking is Arianty Holdings Limited. The smallest group into which the company is consolidated is that of Arianty Holdings Limited, registered in England and Wales. The largest group into which the company is consolidated is that of The Paragon Group of Companies PLC, registered in England and Wales.

The directors regard The Paragon Group of Companies PLC as the ultimate controlling party.

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