Preferred Residential Securities 5 PLC

Report and Financial Statements

30 November 2006

Registered No 4442862

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Directors
M H Filer
Wilmington Trust SP Services (London) Limited
R G Baker

Secretary
Clifford Chance Secretaries (CCA) Limited
10 Upper Bank Street
London E14 5JJ

Auditors
Ernst & Young LLP
1 More London Place
London SE1 2AF

Bankers
Barclays Bank Plc
54 Lombard Street
London EC3V 9EX

Solicitors
Clifford Chance LLP
10 Upper Bank Street
London E14 5JJ

Registered Office
25 Bank Street
London
E14 5LE

Directors' report

The directors present their report and the audited financial statements for the year ended 30 November 2006

Principal activities

The principal activity of the Company is the investment in mortgage loans secured by first charges over residential properties within the United Kingdom

Business review

The profit and loss account for the year ended 30 November 2006 is set out on page 8 Both the level of business during the year and the financial position of the Company at the year end were satisfactory

The Company's existing transaction was terminated on 15 March 2007 because the mortgage-backed loan notes were fully redeemed, in accordance with the arrangements established when the Company was formed in 2002 This was facilitated by Preferred Funding Five Limited purchasing the outstanding mortgages at a price equal to par plus accrued interest In addition, a premium was paid by Preferred Mortgages Limited which will be sufficient to cover costs incurred by the Company in redeeming the notes, settling creditor balances and the winding up (if applicable) of the Company

The directors have taken a view that at the time of approving the financial statements, the Company has adequate resources to continue in existence for the foreseeable future

At the year end the mortgage balance, after FRS 26 adjustments, was £22,240 019 At the December 2006 Interest Payment Date following the year end the Company held the following mortgage loans, excluding any FRS 26 adjustments

	Principal Balance £	*Number of loans*
First mortgages	22,249,918	399
Second mortgages	–	–
Total	22,249,918	399

These mortgages provide security against loan notes in issue totalling £19,079,808 as at the December Interest Payment The directors consider the mortgage loans to be adequate collateral against the loan notes in issue

At the year end the mortgages generated a weighted average margin over funding costs of 1 97% The weighted average cost of funds at the year end was 6 74% The directors consider there to be adequate arrangements in place to hedge against future movements in cost of funds

Directors' report

Business review (continued)

The mortgage loans exhibited the following quarterly arrears profile

	Q1 %	Q2 %	Q3 %	Q4 %
Delinquencies days – (excluding repossessions)				
Current	65 38	66 70	71 26	71 36
> 30 <= 60	7 85	7 76	8 14	10 05
> 60 <= 90	4 82	3 98	3 74	4 45
> 90 <= 120	2 07	3 46	2 22	1 48
> 120	19 88	18 10	14 64	12 66
Total	100 00	100 00	100 00	100 00

The directors consider the level of arrears to be within expectations

The performance of the mortgage loans during the year to 30 November 2006 enabled deferred consideration of £1,381,480 to be paid to Preferred Mortgages Limited from whom the mortgage loans were purchased

Going concern

The loss for the year includes FRS 26 adjustments totalling £232,000 the net effect of which resulted in a net liability position of £36,054 as at 30 November 2006 The directors are satisfied that these adjustments will reverse in future years Consequently, the directors believe that the Company is a going concern and accordingly have prepared the financial statements on this basis

Dividend

The Directors do not recommend the payment of a dividend for the year (2005 - £nil)

Policy and practice on payment of creditors

The Company does not follow any stated code on payment practice It is the Company's policy to agree terms of payment with suppliers when agreeing the terms of each transaction and to abide by those terms Standard terms provide for payment of all invoices within 30 days after the date of the invoice, except where different terms have been agreed with the suppliers at the outset It is the policy of the Company to abide by the agreed terms of payment There are no creditor days of suppliers' invoices outstanding at the year-end (2005 - £nil)

Directors

The present members of the board are listed on page 1

R G Baker and Wilmington Trust SP Services (London) Limited served throughout the year M H Filer was appointed as director on 10 November 2005, A Attia and G M Fraser resigned as directors on 10 November 2005

SPV Management Limited changed its name to Wilmington Trust Services SP (London) Limited on 19 December 2005

Directors' report

Principal risks and uncertainties

Financial instrument risk

The financial instruments held by the Company comprise mortgages, borrowings, cash and various other items (such as trade debtors, trade creditors etc) that arise directly from its operations

The Company enters into derivative transactions where necessary (principally interest rate and currency swaps) to manage the exposure to interest rate and foreign currency risk

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

The main risks arising from the Company's financial instruments are credit risk, interest rate risk and liquidity risk The directors review and agree policies for managing each of these risks and they are summarised below These policies have remained unchanged from 2005

Credit risk

Credit risk is the risk that borrowers will not be able to meet their obligations as they fall due All mortgages purchased by the Company in June 2002 were required to adhere to specific lending criteria The ongoing credit risk of the mortgage portfolio (and particularly in respect of accounts in arrears) is closely monitored by the directors

Interest rate risk

Interest rate risk exists where assets and liabilities have interest rates set under different bases or which 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 the Company considers the use of derivative financial instruments to mitigate any residual interest rate risk

Liquidity risk

The Company's policy is to manage liquidity risk by matching the timing of the cash receipts from mortgage assets with those of the cash payments due on the loan notes In addition the Company holds a minimum cash balance to manage short term liquidity requirements

Disclosure of information to the auditors

So far as each person who was a director at the date of approving this report is aware there is no relevant audit information, being information needed by the auditor in connection with preparing its report, of which the auditor is unaware Having made enquiries of fellow directors and the group's auditor, each director has taken all the steps that he/she is obliged to take as a director in order to make himself/herself aware of any relevant audit information and to establish that the auditor is aware of that information

Auditors

A resolution to reappoint Ernst & Young LLP as auditors will be put to the members at the next General Meeting

Approved by the board of directors and signed on behalf of the board

Director Robin Baker

Date 20/12/2007

Statement of directors' responsibilities in respect of the financial statements

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable United Kingdom law and United Kingdom Generally Accepted Accounting Practice

Company law requires the directors to prepare financial statements for each financial year Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law) The financial statements are required by law to give a true and fair view of the state of affairs of the Company and 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 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 and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to 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

ERNST & YOUNG

Independent auditors' report

to the members of Preferred Residential Securities 5 PLC

We have audited the Company's financial statements for the year ended 30 November 2006 which comprise the Profit and Loss Account and the Balance Sheet and the related notes 1 to 18 These financial statements have been prepared under the accounting policies set out in Note 1

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 Annual Report and the financial statements in accordance with applicable United Kingdom law and 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 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

Independent auditors' report

to the members of Preferred Residential Securities 5 PLC (continued)

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 November 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.

Ernst + Young LLP

Ernst & Young LLP
Registered Auditor
London
Date 21. 12. 07

Profit and loss account

for the year ended 30 November 2006

	Notes	2006 £	2005 £
Interest receivable and similar income	2	3,219,582	7,450,322
Interest payable and similar charges	3	(2,256,443)	(5,306,946)
Net interest receivable		963,139	2,143,376
Other operating income	4	154,599	321,830
Total operating income		1,117,738	2,465,206
Operating expenses		(1,345,986)	(2,457,270)
(Loss)/profit on ordinary activities before taxation	5	(228,248)	7,936
Tax on (loss)/profit on ordinary activities	6	43,394	(1,508)
(Loss)/profit on ordinary activities after taxation	14	(184,854)	6,428

The loss for the year was derived from continuing operations

There were no recognised gains or losses other than the loss for the year, accordingly no statement of recognised gains and losses is given The FRS 26 opening adjustments for the prior year are disclosed in note 14

The notes on pages 10 to 18 form part of these financial statements

Balance sheet
as at 30 November 2006

	Notes	2006 £	2005 £
Current assets			
Debtors			
Amounts falling due after one year	9	21,719,176	24,416,232
Amounts falling due within one year	10	569,331	25,940,832
Cash at bank and in hand		9,404,981	12,699,845
		31,693,488	63,056,909
Creditors: amounts falling due within one year	11	(8,043,334)	(5,608,497)
Net current assets		23,650,154	57,448,412
Creditors amounts falling due after one year	12	(23,686,208)	(57,403,320)
Net assets		(36,054)	45,092
Capital and reserves			
Called up share capital	13	12,501	12,501
Profit and loss account	14	(48,555)	32,591
Shareholders' (deficit)/funds	15	(36,054)	45,092

The notes on pages 10 to 18 form part of these financial statements

These financial statements were approved by the board of directors and were signed on its behalf by

Director Robin Baker

Date 20/12/2007.

Notes to the financial statements

at 30 November 2006

1. 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 applicable accounting standards and under the historical cost convention The financial statements have been prepared taking into account the fact that the mortgage-backed loan notes have been redeemed and the underlying mortgage assets sold to Preferred Mortgage Limited, and as such the Company is no longer engaging in its principal activities

Income recognition

Interest income on mortgage loan assets is recognised in the profit and loss account on an Effective Interest Rate (EIR) basis The EIR recognised revenue equivalent to the rate that effectively discounts estimated future cash flows throughout the estimated life to the net carrying value of the loan

The corresponding charge or release to the profit and loss account related to the prior year has been adjusted in the retained profits

Mortgage loans

Mortgage loans are valued on the amortised cost basis using the effective interest rate method less provision made to reduce the value of the loans to their estimated recoverable amount Provisions are made against mortgages when in the opinion of the directors, credit risk or economic risk made recovery doubtful

Provisions

Specific provisions for losses on loans and advances to customers in arrears are made throughout the year and at the year-end on a case by case basis (calculated with reference to the probability of the loan defaulting and the value of the security held against the loan) The specific provision for properties in possession is based on the balance outstanding less a discounted valuation of the security held (with adjustments for expenses of sale)

Taxation

The charge for taxation is based on the profit for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes

Deferred taxation is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more, or right to pay less tax, with the following exceptions in the future, have occurred at the balance sheet date

Deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date

Deferred consideration

Deferred consideration represents further amounts payable on the acquisition of mortgages from Preferred Mortgages Limited The payment of these amounts is conditional on the performance of the acquired mortgages

Notes to the financial statements

at 30 November 2006

1 Accounting policies (continued)

Issue costs

Initial issue costs incurred in arranging funding facilities are amortised over three years Unamortised initial issue costs are deducted from the associated liability in accordance with Financial Reporting Standard No 26 and costs amortised in the year are included in interest payable

Related party transactions

The Company has taken advantage of the exemption conferred by paragraph 3 (c) of Financial Reporting Standard No 8, since the Company is 100% owned by PRS 1 Limited and is consolidated under Financial Reporting Standard No 5 into the consolidated financial statements of Preferred Holdings Limited, which are publicly available

Preferred Mortgages Limited retains an interest in the cashflows and profits of the Company Accordingly Preferred Mortgages Limited, whilst having no direct investment in the Company or its parent, is treated as a related party

Cash flow statement

Under Financial Reporting Standard No 1 (Revised), the Company is exempt from the requirement to prepare a cash flow statement on the grounds that a parent undertaking includes the Company in its own consolidated financial statements

Turnover

The Company's turnover and trade are wholly within the UK and within a single market sector Consequently no segmental analysis has been prepared

2. Interest receivable and similar income

	2006	*2005*
	£	*£*
On mortgage loans	2,899,186	7,151,546
Other interest	320,396	298,776
	3,219,582	7,450,322

3. Interest payable and similar charges

	2006	*2005*
	£	*£*
Detachable 'A' coupon interest	143,430	630,296
Subordinated loan interest	–	95,066
Mortgage backed loan notes	2 113,013	4,219,038
Amortisation of capitalised issue costs	–	362,546
	2,256,443	5,306,946

Notes to the financial statements

at 30 November 2006

4. Other operating income

	2006 £	2005 £
Insurance renewal commission	11,733	8,898
Redemption fees	95,709	218,534
Sundry fee income	47,157	94,398
	154,599	321,830

5. (Loss)/profit on ordinary activities before taxation

	2006 £	2005 £
This is stated after charging		
Auditors' remuneration - audit services	8,500	8,400
Provision for mortgage losses	(1,316,519)	283,334
Deferred consideration	1,456 082	1,727,245

6 Tax on (loss)/profit on ordinary activities

(a) Analysis of tax charge in the year

	2006 £	2005 £
Current tax		
UK corporation tax on profits of the year	707	1,508
Total current tax (note 6(b))	707	1,508
Deferred tax		
Origination and reversal of timing differences (note 17)	(44,101)	–
Tax on profit on ordinary activities	(43,394)	1,508

Notes to the financial statements

at 30 November 2006

6 Tax on (loss)/profit on ordinary activities (continued)

(b) Factors affecting the tax charge in the year

The tax assessed for the year is lower than the small companies rate of corporation tax in the UK, currently 19% (2005 - 19%) The differences are explained below

	2006 £	*2005* £
(Loss)/profit on ordinary activities before tax	(228,248)	7,936
(Loss)/profit on ordinary activities before tax multiplied by the small companies rate of corporation tax of 19% (2005 - 19%)	(43,367)	1,508
Effects of		
Short-term timing differences (note 17)	44,101	–
Small Companies Rate	(27)	–
Total current tax (note 6(a))	707	1,508

7. Information regarding directors and employees

The Company has no employees (2005 - nil employees) The directors received no remuneration from the Company during the year

8. Mortgage loans – net balances

	Mortgages £	*Mortgage loss provision* £	*Total* £
At 30 November 2005	50,738,418	(1,298,754)	49,439,664
Net movement in the year	(28 498,399)	1,136,519	(27 361,880)
At 30 November 2006	22,240,019	162,235	22,077,784

Net mortgage loans of £22,077,784 (2005 - £49,439,664) are held as security against the loan notes referred to in note 12

Notes to the financial statements

at 30 November 2006

9. Debtors: amounts falling due after one year

	2006	*2005*
	£	*£*
Mortgage loans Net balances (note 8)	21,719,176	24,416,232

10. Debtors: amounts falling due within one year

	2006	*2005*
	£	*£*
Mortgage loans Net balances (note 8)	358,608	25,023,432
Prepayments and accrued income	77,245	88,896
Other debtors	89,377	828,504
Deferred tax	44,101	–
	569,331	25,940,832

11. Creditors: amounts falling due within one year

	2006	*2005*
	£	*£*
Other creditors	3,518,792	456,436
Corporation tax	2,215	1,508
Deferred consideration	4,175,710	4,464,234
Accruals and deferred income	346,617	686,423
	8,043,334	5,608,497

12. Creditors: amounts falling due after one year

	2006	*2005*
	£	*£*
Mortgage backed loan notes due 2034 – Class A	–	33,403,320
Mortgage backed loan notes due 2034 – Class M	15,686,208	16,000,000
Mortgage backed loan notes due 2034 – Class B	8,000,000	8,000,000
	23,686 208	57,403,320

All amounts falling due after more than one year fall due after less than five years

The mortgage backed floating rate notes due 2034 are secured over a portfolio of mortgage loans secured by first charges over residential properties in the United Kingdom

The mortgages were purchased from Preferred Mortgages Limited The mortgages are administered by Preferred Mortgages Limited on behalf of Preferred Residential Securities 5 PLC

The mortgage backed floating rate notes are subject to mandatory redemption in part at each interest payment date in an amount equal to the principal received or recovered in respect of the mortgages If not otherwise redeemed or purchased and cancelled, the notes will be redeemed at their principal amount outstanding on the interest payment date falling in December 2034

Notes to the financial statements

at 30 November 2006

12. Creditors: amounts falling due after one year (continued)

Interest on the notes is payable quarterly in arrears at the following rates for three month sterling deposits

Class A with Class A ordinary coupons	LIBOR + 0 40%
Class A with detachable coupons	1 25%
Class M	LIBOR + 1 25%
Class B	LIBOR + 2 60%

13. Called up share capital

	2006	2005
	£	£
Authorised		
Ordinary shares of £1 each	50,000	50,000
Allotted and called up		
2 shares 100% called and fully paid	2	2
49,998 shares 25% called and fully paid	12,499	12,499
	12,501	12,501

14. Profit and loss account

	2006	2005
	£	£
Retained profit brought forward	136,299	26,163
Adjustment due to adoption of FRS 25 and 26	–	103,708
(Loss)/profit for the year	(184,854)	6,428
Retained profit carried forward	(48,555)	136 299

15. Reconciliation of movement in shareholders' funds

	2006	2005
	£	£
Retained profit brought forward	148,800	38,664
Retained (loss)/profit for the year	(184,854)	6,428
Retained (loss)/profit carried forward	(36,054)	45,092
Opening adjustment due to adoption of FRS 25 and 26	–	103,708
Closing shareholders funds	(36,054)	148,800

Notes to the financial statements

at 30 November 2006

16. Derivatives and other financial instruments

As explained on page 3 the Company uses financial instruments in its normal course of business The following analysis gives an indication of the significance of these instruments to the Company

(a) Interest rate risk profile of financial liabilities

	Total £	*Total variable rate* £	*Total fixed rate* £	*Weighted average interest rate* %	*Weighted average time for which rate is fixed years*
2006					
Interest rate profile	23,686,208	23,686,208	–	–	–
2005					
Interest rate profile	57,403,216	57,403,216	–	–	–

All financial liabilities are denominated in pounds sterling

(b) Interest rate risk profile of financial assets

	Total £	*Total variable rate* £	*Total fixed rate* £	*Weighted average interest rate* %	*Weighted average time for which rate is fixed years*
2006					
Interest rate profile	31,645,000	31,645,000	–	–	–
2005					
Interest rate profile	63,438,263	63,438,263	–	–	–

All financial assets are denominated in pounds sterling

The rates of interest receivable and payable on variable rate financial instruments are set with reference to the London Interbank Offered Rate The rates of interest payable on the mortgage backed loan notes are set as detailed in note 12

Notes to the financial statements

at 30 November 2006

16. Financial instruments (continued)

(c) Fair value disclosures

	Book value 2006 £	*Fair value 2006* £	*Book value 2005* £	*Fair value 2005* £
On balance sheet				
Mortgage loans	22 240,019	22,240,019	50,738 418	50,738,418
Cash and deposits	9,404,981	9 404,981	12,699,845	12,699,845
Mortgage backed loan notes due 2034	23,686,208	23,686,208	57,403,216	57,403,216
Start up loan	–	–	–	–

The detachable A coupon notes have no value in the balance sheet but a notional value of £4,400,000 was ascribed to these notes at issue

17. Deferred taxation

	2006 £	*2005* £
Asset/(liability) at start of year	–	–
Deferred tax credit/(charge) in the profit and loss account	44,101	–
Asset/(liability) at the end of the year	44,101	–

Full provision is made for deferred tax assets arising as a result of FRS 26 adjustments

Deferred taxation has been recognised at 19% (2005 19%) being the UK small companies corporation tax rate at the balance sheet date

As of 1 April 2007 the UK corporation tax rate increased to 20% The impact of the rate change on the deferred tax asset/(liability) expected to reverse is greater than one year would be an increase of £2 321

	2006 £	*2005* £
Effect of FRS 26 adjustment for EIR	44,101	–
Total deferred tax asset/(liability) recognised at 19%	44,101	–
Total deferred tax asset/(liability) recognised at 20%	46,422	–
Difference	2 321	–

Notes to the financial statements

at 30 November 2006

18. Parent undertaking and control

The Company is controlled by its parent undertaking, PRS 1 Limited, which is registered and operates in the United Kingdom

The entire issued share capital of PRS 1 Limited is held by a Trustee under the terms of a trust primarily for the benefit of the creditors of the Company or, if none, for the benefit of the holders of notes issued by the Company, and ultimately for charitable purposes

The largest group in which the results of the Company are consolidated is that headed by Lehman Brothers Holdings Inc , incorporated in the United States of America The smallest group in which they are consolidated is that headed by Preferred Residential Securities 1 Limited, registered in England and Wales The consolidated accounts of these groups are available from First Floor, No 6 Broadgate, London EC2M 2QS