Company Registration No: 4513176

# PARAGON MORTGAGES (NO. 9) PLC

## Interim Accounts

## Period ended 31 August 2006

# PROFIT AND LOSS ACCOUNT

## Period ended 31 August 2006

| | Note | £'000 |
|---|---|---|
| Interest receivable | | |
| Mortgages | | 36,367 |
| Other | | 1,234 |
| | | 37,601 |
| Interest payable and similar charges | 3 | (32,451) |
| Net interest income | | 5,150 |
| Other operating income | | 264 |
| Total operating income | | 5,414 |
| Operating expenses | | (2,767) |
| Provisions for losses | | (114) |
| | | 2,533 |
| Fair value net gains | | 147 |
| Operating profit, being profit on ordinary activities before taxation | | 2,680 |
| Tax on profit on ordinary activities | | (1,033) |
| Profit on ordinary activities after taxation | 7 | 1,647 |

All activities derive from continuing operations.

### STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

| | £'000 |
|---|---|
| Profit attributable to members of the company | 1,647 |
| Total recognised gains and losses for the year | 1,647 |
| Change in accounting policy on adoption of FRS 25 and FRS 26 | 1,562 |
| Total Gains and losses recognised since last Financial Statements | 3,209 |

## BALANCE SHEET
## 31 August 2006

| | Note | £'000 | £'000 |
|---|---|---|---|
| **ASSETS EMPLOYED** | | | |
| **FIXED ASSETS** | | | |
| Financial Assets | 4 | | 626,684 |
| | | | |
| **CURRENT ASSETS** | | | |
| Debtors falling due within one year | 5 | 179 | |
| Investments | | 10,000 | |
| Cash at bank | | 8,819 | |
| | | | 18,998 |
| | | | 645,682 |
| **FINANCED BY** | | | |
| **SHAREHOLDERS' FUNDS** | | | |
| Called up share capital | 6 | 12 | |
| Profit and loss account | 7 | 3,348 | |
| | | | 3,360 |
| | | | |
| **CREDITORS** | | | |
| Amounts falling due within one year | 8 | 6,550 | |
| Amounts falling due after more than one year | 8 | 635,772 | |
| | | | 642,322 |
| | | | 645,682 |

These financial statements were approved by the Board of Directors on 9 January 2007.

Signed on behalf of the Board of Directors

J G Gemmell
Director

# NOTES TO THE INTERIM ACCOUNTS

## Period ended 31 August 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 £2,314,000, recognising derivative financial instruments at a fair value of £33,000 and increasing reserves by £1,562,000.

**Accounting Convention**

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

**Loans to Customers**

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 procuration 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.

**Impairment of Loans and Receivables**

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.

**Current assets - Investments**

Balances shown as current asset investments in the balance sheet comprise short-term deposits with banks with maturities of more than 7 days and not more than 90 days.

# NOTES TO THE INTERIM ACCOUNTS

## Period ended 31 August 2006

### ACCOUNTING POLICIES (continued)

**Corporation Tax**
Current tax, including UK corporation, 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**

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.

**Derivative Financial instruments**

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.

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.

**Hedging**

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.

## NOTES TO THE INTERIM ACCOUNTS

### Period ended 31 August 2006

**ACCOUNTING POLICIES (continued)**

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.

**Fee and commission income**

Other income includes administration fees charged to borrowers, which are credited when the related service is performed.

**Foreign currency**

Foreign currency transactions, assets and liabilities are accounted for in accordance with Financial Reporting Standard 23 – 'The Effects of Changes in Foreign Exchange Rates'. The functional currency of the Company is the pound sterling. Transactions which are not denominated in sterling are translated into sterling at the spot rate of exchange on the date of transaction. Monetary assets and liabilities which are not denominated in sterling are translated at the closing rate on the balance sheet date.

Gains and losses on retranslation are included in interest payable or interest receivable depending on whether the underlying instrument is an asset or a liability, except where deferred in equity in accordance with cash flow hedging provisions of FRS 26.

**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.

## NOTES TO THE INTERIM ACCOUNTS

## Period ended 31 August 2006

### 2. CRITICAL ACCOUNTING ESTIMATES (CONTINUED)

**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.

### 3. INTEREST PAYABLE AND SIMILAR CHARGES

| | £'000 |
|---|---|
| Asset backed loan notes | 30,782 |
| Internal funding costs | 245 |
| Interest on fee letter | 288 |
| Interest rate swap | 135 |
| Subordinated loan interest | 1,001 |
| | 32,451 |

### 4 FINANCIAL ASSETS

| | £'000 |
|---|---|
| Loans to customers (note 11) | 626,222 |
| Fair value adjustments from portfolio hedging | (1,101) |
| Derivative financial assets (note 13) | 1,563 |
| | 626,684 |

### 5. DEBTORS

| | £'000 |
|---|---|
| Amounts falling due within one year: | |
| Amount due from Group companies | 155 |
| Prepayments and accrued income | 24 |
| | 179 |

# NOTES TO THE INTERIM ACCOUNTS

## Period ended 31 August 2006

### 6. CALLED UP SHARE CAPITAL

| | £ |
|---|---|
| Authorised: | |
| 50,000 ordinary shares of £1 each | 50,000 |
| Allotted: | |
| 49,998 ordinary shares of £1 each (25p called up and paid) | 12,500 |
| 2 ordinary shares of £1 each (fully paid) | 2 |
| | 12,502 |

### 7. COMBINED STATEMENT OF MOVEMENTS IN SHAREHOLDER'S FUNDS AND STATEMENT OF MOVEMENT ON RESERVES

| | Share capital £'000 | Profit and loss account £'000 | Shareholders' funds £'000 |
|---|---|---|---|
| At 30 September 2005 | 12 | 139 | 151 |
| FRS 26 transition | - | 2,231 | 2,231 |
| Deferred tax on FRS 26 adjustments | - | (669) | (669) |
| At 1 October 2005 | 12 | 1,701 | 1,713 |
| Profit for the financial year | - | 1,647 | 1,647 |
| At 30 September 2006 | 12 | 3,348 | 3,360 |

## NOTES TO THE INTERIM ACCOUNTS

## Period ended 31 August 2006

### 8. CREDITORS

| | £'000 |
|---|---|
| Amounts falling due within one year: | |
| Amounts due to Group companies | 3,066 |
| Corporation tax | 423 |
| Deferred tax | 1,340 |
| Accruals and deferred income | 1,721 |
| | 6,550 |

| | £'000 |
|---|---|
| Amounts falling due after more than one year : | |
| Asset backed loan notes | 616,580 |
| Derivative financial liabilties | 6,872 |
| Intercompany subordinated loan | 12,320 |
| | 635,772 |