

**PARAGON MORTGAGES (NO.9) PLC**

**Report and Financial Statements**

**Year ended 30 September 2012**



## **DIRECTORS' REPORT**

The directors present their Annual Report and the audited Financial Statements of Paragon Mortgages (No 9) PLC ('the Company'), registration no 4513176, for the year ended 30 September 2012

### **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 increased by 4% compared to the prior year (2011 19% increase). This was principally due to the average margin charged on the loans which increased due to the seasoning of the book. The retained profit has fallen from £354,000 to £192,000. This was mainly due to a release in provisions on first mortgage loans in the preceding year compared with a charge this year.

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 3% due to customers redeeming their accounts during the year. As a result the asset backed loan notes have reduced by 3% during the year, excluding the fair value adjustments in respect of the cross currency swaps. Details of amounts owed from and to other group companies are shown in notes 13 and 17.

No interim dividend was paid during the year (2011 £nil). No final dividend is proposed (2011 £nil).

The Company has entered into derivative contracts in order to provide an economic hedge against its exposure to fixed rate loans to customers. Although these instruments provide an economic hedge the prescriptive nature of the requirements of FRS 26 means that hedge accounting cannot always be achieved. This has led to the Company recognising a fair value net gain of £nil in the year (2011 £16,000) due to the ineffectiveness of the hedge relationship. This represents a timing difference and cumulative gains and losses recognised will tend to zero over time.

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 with its outstanding loan notes match-funded to maturity. An analysis of the Company's exposure to risk, including financial risk, and the steps taken to mitigate these risks are set out in note 3, and a discussion of critical accounting estimates is set out in note 2.

After considering the above, the directors have a reasonable expectation that the Company will have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the Financial Statements.

### **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

N Keen

R D Shelton

J G Gemmell

J Fairrie

J A Harvey

D P Stolp (alternate to J Fairrie)

### 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 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,

15 January 2013

**STATEMENT OF DIRECTORS' RESPONSIBILITIES**  
**in relation to Financial Statements**

The directors are responsible for preparing the Annual Report and the Financial Statements in accordance with applicable law and regulations

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have 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 judgments and estimates that are reasonable and prudent,
- state whether applicable UK 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 that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

## **INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF PARAGON MORTGAGES (NO.9) PLC**

We have audited the Financial Statements of Paragon Mortgages (No 9) PLC for the year ended 30 September 2012 which comprise the profit and loss account, the balance sheet, the statement of total recognised gains and losses, the statement of movement in shareholders' funds and the related notes 1 to 19. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. 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 auditor**

As explained more fully in the Statement of Directors' Responsibilities, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

### **Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### **Opinion on Financial Statements**

In our opinion the Financial Statements

- give a true and fair view of the state of the Company's affairs as at 30 September 2012 and of its profit for the year then ended,
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### **Opinion on other matters prescribed by the Companies Act 2006**

In our opinion the information given in the Directors' Report for the financial year for which the Financial Statements are prepared is consistent with the Financial Statements.

### **Matters on which we are required to report by exception**

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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



Peter Birch (Senior Statutory Auditor)

for and on behalf of Deloitte LLP

Chartered Accountants and Statutory Auditor

Birmingham, United Kingdom

15 January 2013

**PARAGON MORTGAGES (NO.9) PLC**

**PROFIT AND LOSS ACCOUNT**

**YEAR ENDED 30 SEPTEMBER 2012**

	<b>Note</b>	<b>2012 £000</b>	<b>2011 £000</b>
Interest receivable			
Mortgages		8,567	8,242
Other		101	132
		<u>8,668</u>	<u>8,374</u>
Interest payable and similar charges	4	(5,307)	(5,135)
Net interest income		<u>3,361</u>	<u>3,239</u>
Other operating income		33	54
Total operating income		<u>3,394</u>	<u>3,293</u>
Operating expenses		(2,460)	(3,979)
Provisions for losses	6	(849)	988
		<u>85</u>	<u>302</u>
Fair value net gain	7	-	16
Operating profit, being profit on ordinary activities before taxation	8	<u>85</u>	<u>318</u>
Tax on profit on ordinary activities	9	107	36
Profit on ordinary activities after taxation	15	<u>192</u>	<u>354</u>

All activities derive from continuing operations

# PARAGON MORTGAGES (NO.9) PLC

## BALANCE SHEET

30 SEPTEMBER 2012

	Note	2012 £000	2012 £000	2011 £000	2011 £000
<b>ASSETS EMPLOYED</b>					
<b>FIXED ASSETS</b>					
Financial assets	10		338,655		363,071
<b>CURRENT ASSETS</b>					
Debtors falling due within one year	13	222		139	
Short-term investments		12,320		13,320	
Cash at bank		2,281		2,170	
			14,823		15,629
			353,478		378,700
<b>FINANCED BY</b>					
<b>SHAREHOLDERS' FUNDS</b>					
Called up share capital	14	12		12	
Cash flow hedging reserve	15	142		254	
Profit and loss account	15	5,321		5,129	
			5,475		5,395
<b>PROVISIONS FOR LIABILITIES</b>	16		1,460		1,611
<b>CREDITORS</b>					
Amounts falling due within one year	17	1,919		2,084	
Amounts falling due after more than one year	17	344,624		369,610	
			346,543		371,694
			353,478		378,700

These Financial Statements were approved by the Board of Directors on 15 January 2013

Signed on behalf of the Board of Directors



R D Shelton

Director

**STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES**

**YEAR ENDED 30 SEPTEMBER 2012**

	<b>2012 £000</b>	<b>2011 £000</b>
Profit attributable to members of the Company	192	354
Cash flow hedge loss taken to equity	(148)	(22)
Tax on items taken directly to equity	36	13
Total gains and losses recognised since last Annual Report and Financial Statements	<u>80</u>	<u>345</u>

**STATEMENT OF MOVEMENT IN SHAREHOLDERS' FUNDS**

**YEAR ENDED 30 SEPTEMBER 2012**

	<b>2012 £000</b>	<b>2011 £000</b>
Profit attributable to shareholders	192	354
Cash flow hedge loss taken to equity net of tax	(112)	(9)
Net movement in shareholders' funds	<u>80</u>	<u>345</u>
Opening shareholders' funds	5,395	5,050
Closing shareholders' funds	<u>5,475</u>	<u>5,395</u>

## NOTES TO THE ACCOUNTS

### YEAR ENDED 30 SEPTEMBER 2012

#### 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 year. The Financial Statements have been prepared on a going concern basis as described in the Directors' Report.

##### **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**

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

Such loans are valued at inception as the amount of initial advance, 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 (note 3).

##### **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 – short-term 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.

##### **Related party disclosures**

The Company has taken advantage of the exemption granted by Financial Reporting Standard 8 - 'Related Party Disclosures' and does not therefore provide details of transactions with other group companies as it is a wholly owned subsidiary of The Paragon Group of Companies PLC, the accounts of which are publicly available.

##### **Current 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 substantively 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 the 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.

## NOTES TO THE ACCOUNTS

### YEAR ENDED 30 SEPTEMBER 2012

#### 1. ACCOUNTING POLICIES (CONTINUED)

##### **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 (note 3).

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 arrangements 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.

##### **Revenue**

The revenue of the Company comprises interest receivable and other income. The accounting policy for the recognition of each element of revenue is described separately within these accounting policies.

##### **Fee and commission income**

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

##### **FRS 29 disclosure**

The Company has taken advantage of the exemption granted by Financial Reporting Standard 29 - 'Financial Instruments: Disclosures' and does not therefore provide the disclosures required by the Standard as it is a wholly owned subsidiary of The Paragon Group of Companies PLC, the accounts of which are publicly available.

**NOTES TO THE ACCOUNTS**

**YEAR ENDED 30 SEPTEMBER 2012**

**1. ACCOUNTING POLICIES (CONTINUED)**

**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 pound sterling. Transactions which are not denominated in sterling are translated into sterling at the spot rate of exchange on the date of the 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.

**Cash flow statement**

The Company has taken advantage of the exemption granted by Financial Reporting Standard 1 - 'Cash Flow Statements' and does not therefore provide a cash flow statement as it is a wholly owned subsidiary of The Paragon Group of Companies PLC, the accounts of which 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.

In particular, if the impact of economic factors such as employment levels on customers is worse than is implicit in the model then the number of accounts requiring provision might be greater than suggested by the model, while falls in house prices, over and above any assumed by the model might increase the provision required in respect of accounts currently provided.

**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 2012

## 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 and accruals, arise directly from the Company's operations.

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 2012 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 Paragon Mortgages Limited and Mortgage Trust Services PLC, fellow group companies which place 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.

Paragon Finance PLC and Mortgage Trust Services PLC, fellow group companies, continues to administer the mortgages on behalf of Paragon Mortgages (No 9) PLC and the collections process is the same as that utilised for all companies in the Group.

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 notes 17 and 18. 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.

**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 agreements.

The rates payable on the asset backed loan notes issued by the Company are reset quarterly on the basis of LIBOR, USD LIBOR or EURIBOR. The Company's assets predominantly bear LIBOR linked interest rates or are hedged fixed rate assets. 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.

## NOTES TO THE ACCOUNTS

## YEAR ENDED 30 SEPTEMBER 2012

## 3. FINANCIAL RISK MANAGEMENT (CONTINUED)

## Currency risk

All of the Company's assets and liabilities are denominated in sterling with the exception of the asset backed loan notes denominated in euros and US dollars, described in note 18. Although FRS 26 requires that they be accounted for as currency liabilities and valued at their spot rates, it was a condition of the issue of these notes that the interest rate and currency swaps were put in place for the duration of the borrowing, having the effect of converting the liability to a LIBOR linked floating rate sterling borrowing. As a result the Company has no material exposure to foreign currency risk.

The equivalent sterling principal amounts of notes in issue under these arrangements, and their carrying values at 30 September 2012 and 30 September 2011 are

	2012 Equivalent sterling principal £000	2012 Carrying value £000	2011 Equivalent sterling principal £000	2011 Carrying value £000
US dollar notes	13,083	14,340	13,459	15,301
Euro notes	151,965	175,956	156,341	195,785

## 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 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.

The Company has also designated cash flow hedging relationships, principally arising from currency borrowings, where a specified foreign exchange basis swap, set up as part of the terms of the borrowing is used.

## 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 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 not be materially different to the amortised cost value at which they are disclosed.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2012

4. INTEREST PAYABLE AND SIMILAR CHARGES

	2012 £000	2011 £000
Asset backed loan notes	4,496	3,992
Interest rate swaps	187	516
Subordinated loan interest	614	590
Interest payable to group companies	10	37
	<u>5,307</u>	<u>5,135</u>

5. DIRECTORS AND EMPLOYEES

Directors' received no remuneration for the services provided to the Company during either the current or the preceding year

The Company had no employees in the current or preceding year. All administration is performed by employees of the Group. The directors of the Company are all employed by Paragon Finance PLC, a fellow group company, and their remuneration is disclosed within the financial statements of that company, which do not form part of this Report.

6. PROVISIONS FOR LOSSES

	2012 £000	2011 £000
Impairment of financial assets / (release of provision)		
First mortgage loans	849	(988)

7. FAIR VALUE NET GAIN

The fair value net gain of £nil (2011: £16,000) 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 PROFIT, BEING PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION

	2012 £000	2011 £000
Operating profit is after charging		
Directors' fees	2	2
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 from disclosure of fees payable to the Company's auditors in respect to non-audit services in these financial statements has been taken.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2012

9. TAX ON PROFIT ON ORDINARY ACTIVITIES

a) Tax credit for the year

	2012 £000	2011 £000
Current tax		
Corporation tax	8	9
	<u>8</u>	<u>9</u>
Deferred tax (note 16)		
Origination and reversal of timing differences	13	77
Rate change	(128)	(122)
	<u>(115)</u>	<u>(45)</u>
	<u>(107)</u>	<u>(36)</u>

b) Factors affecting the current tax credit

	2012 £000	2011 £000
Profit before tax	85	318
UK corporation tax at 25% (2011 27%) based on the profit for the year	21	86
Effects of		
Movement on short term timing differences	(13)	(77)
	<u>8</u>	<u>9</u>

During the year ended 30 September 2011 the United Kingdom Government enacted provisions reducing the rate of corporation tax to 26% with effect from 1 April 2011 and 25% from 1 April 2012. During the year ended 30 September 2012 enacted provisions further reducing the rate of corporation tax to 24% with effect from 1 April 2012 and 23% from 1 April 2013. Therefore the standard rate of corporation tax applicable to the Company for the year ended 30 September 2012 is 25% and the rate is expected to be 23.5% in the year ending 30 September 2013 and 23% thereafter. The expected impact of the change to 25% on the values at which deferred tax amounts are expected to crystallise was accounted for in the year ended 30 September 2011, while the expected impacts of the changes to 24% and 23% have been accounted for in the year ended 30 September 2012.

The Government has announced its intention to make further reductions in the rate of corporation tax in future years. The effect of any such changes on deferred tax balances will be accounted for in the period in which any such changes are enacted.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2012

10. FINANCIAL ASSETS

	2012 £000	2011 £000
Loans to customers (note 11)	312,943	321,056
Fair value adjustments from portfolio hedging	548	706
Derivative financial assets (note 12)	25,164	41,309
	<u>338,655</u>	<u>363,071</u>

11. LOANS TO CUSTOMERS

Loans to customers at 30 September 2012 and 30 September 2011, which are all denominated and payable in sterling, were first mortgages which are secured on residential property within the United Kingdom and are categorised as loans and receivables as defined by FRS 26

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 early settlement does take place. All borrowers are required to make monthly payments, except where an initial deferred period is included in the contractual terms.

All the mortgage loans are pledged as collateral for asset backed loan notes at 30 September 2012 and 30 September 2011.

	2012 £000	2011 £000
Balance at 1 October 2011	321,056	329,067
Additions	516	412
Other debits	8,351	9,889
Repayments and redemptions	(16,980)	(18,312)
Balance at 30 September 2012	<u>312,943</u>	<u>321,056</u>

Other debits include primarily interest charged to customers on loans outstanding, impairment movements on these loans and other changes in the amortised cost of the assets caused by the effective interest rate method.

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2012

12. 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 of 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.

	2012	2012	2012	2011	2011	2011
	Notional	Assets	Liabilities	Notional	Assets	Liabilities
	amount			amount		
	£000	£000	£000	£000	£000	£000
<b>Derivatives in accounting hedge relationships</b>						
<i>Fair value hedges</i>						
Interest rate swaps	4,000	-	(131)	4,600	-	(292)
	4,000	-	(131)	4,600	-	(292)
<i>Cash flow hedges</i>						
Foreign exchange basis swaps	165,048	25,164	-	169,800	41,309	-
	165,048	25,164	-	169,800	41,309	-
Total recognised derivative assets / (liabilities)	169,048	25,164	(131)	174,400	41,309	(292)

13. DEBTORS

	2012	2011
	£000	£000
Amounts falling due within one year		
Amounts due from group companies	213	121
Prepayments and accrued income	9	18
	222	139

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 2012

## 14. CALLED UP SHARE CAPITAL

	2012 £	2011 £
Allotted		
49,998 ordinary shares of £1 each (25p called up and paid)	12,500	12,500
2 ordinary shares of £1 each (fully paid)	2	2
	<u>12,502</u>	<u>12,502</u>

## 15. RESERVES

	Profit and loss account £000	Cash flow hedging reserve £000	Total reserves £000
At 1 October 2010	4,775	263	5,038
Profit for the financial year	354	-	354
Movement in fair value of hedging derivatives net of tax	-	(9)	(9)
At 30 September 2011	<u>5,129</u>	<u>254</u>	<u>5,383</u>
Profit for the financial year	192	-	192
Movement in fair value of hedging derivatives net of tax	-	(112)	(112)
At 30 September 2012	<u>5,321</u>	<u>142</u>	<u>5,463</u>

## 16. PROVISIONS FOR LIABILITIES

## Deferred tax

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

	2012 £000	2011 £000
Balance at 1 October 2011	1,611	1,669
Credit to equity	(36)	(13)
Profit and loss charge (note 9)	13	77
Rate change (note 9)	(128)	(122)
Balance at 30 September 2012	<u>1,460</u>	<u>1,611</u>
The net deferred tax liability for which provision has been made is analysed as follows		
Other timing differences	<u>1,460</u>	<u>1,611</u>

NOTES TO THE ACCOUNTS

YEAR ENDED 30 SEPTEMBER 2012

17. CREDITORS

	2012 £000	2011 £000
Amounts falling due within one year		
Amounts due to group companies	792	786
Corporation tax	8	9
Accruals and deferred income	1,119	1,289
	<u>1,919</u>	<u>2,084</u>

Included within the accruals and deferred income balance is an amount of £231,000 (2011 £237,000) due to fellow subsidiaries of The Paragon Group of Companies PLC

	2012 £000	2011 £000
Amounts falling due after more than one year		
Asset backed loan notes	307,194	316,021
Asset backed loan notes – fair value adjustment	24,979	40,977
	<u>332,173</u>	<u>356,998</u>
Derivative financial liabilities (note 12)	131	292
Intercompany subordinated loan	12,320	12,320
	<u>344,624</u>	<u>369,610</u>

The Company's securitisation borrowings are denominated in sterling, US dollars and euros. All currency borrowings are swapped at inception so that they have the effect of sterling borrowings. These swaps provide an effective hedge against exchange rate movements, but the requirement to carry them at fair value leads, when exchange rates have moved significantly since the issue of the notes, to large balances for the swaps being carried in the balance sheet. This is currently the case with US dollar swaps, although the credit balance is compensated for by retranslating the borrowings at the current exchange rate. A maturity analysis and further details of the asset backed loan notes are given in note 18.

## NOTES TO THE ACCOUNTS

## YEAR ENDED 30 SEPTEMBER 2012

## 18. 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. As a result of this structure, cash received in respect of loan assets is not immediately available for distribution. At 30 September 2012, the amount of restricted cash and investments held within the Company was £14,601,000 (2011: £15,490,000). 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 (the 'call date'), or at any interest payment date thereafter, at the outstanding principal amount.

Interest is payable at a fixed margin above:

- the London Interbank Offered Rate ('LIBOR') on notes denominated in sterling,
- the London Interbank Offered Rate ('US Dollar LIBOR') on notes denominated in US dollars, and
- the Euro Interbank Offered Rate ('EURIBOR') on notes denominated in euros.

The margin stepped-up to a higher rate in May 2010.

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 2012 and 30 September 2011 were:

Notes	Maturity date	Call date	Principal outstanding		Note margin	
			2012	2011	Current	Previous
			£m	£m		
'Aa'	May 2041	May 2009	133.5	137.4	0.36%	0.18%
'Ba'	May 2041	May 2009	6.1	6.3	0.58%	0.29%
'Ca'	May 2041	May 2009	2.6	2.7	1.04%	0.52%
			\$m	\$m		
'Ac'	May 2041	May 2009	23.2	23.8	0.36%	0.18%
			€m	€m		
'Ab'	May 2041	May 2009	137.0	140.9	0.36%	0.18%
'Bb'	May 2041	May 2009	25.9	26.7	0.58%	0.29%
'Cb'	May 2041	May 2009	58.0	59.6	1.04%	0.52%

There is a subordinated loan facility under which an amount was drawn down by the Company to establish the first loss fund, which is repayable to Mortgage Trust Services PLC and Paragon Loan Finance (No 2) PLC on the earlier of the last interest payment date in May 2041 or the first day on which there are no notes outstanding, except that on any interest payment date sums borrowed will be repaid to the extent of any amount released from the first loss fund. Interest is payable at the rate of 4% above the London Interbank Offered Rate for three month sterling deposits.

There are no amounts of committed but undrawn facilities at 30 September 2012 and September 2011.

## 19. ULTIMATE PARENT COMPANY

The smallest and largest group into which the Company is consolidated, and the Company's immediate and ultimate parent company and ultimate controlling party is The Paragon Group of Companies PLC, a company registered in England and Wales.

Copies of the Group's financial statements are available from that company's registered office at 51 Homer Road, Solihull, West Midlands, B91 3QJ.