4703210

# Preferred Residential Securities 6 PLC
**(Formerly Watchpark PLC)**

**Report and Financial Statements**

31 December 2003

Ernst & Young

Preferred Residential Securities 6 PLC
(Formerly Watchpark PLC)

Registered No: 4703210

**Directors**
A Attia
G M Fraser
SPV Management Limited
R G Baker

**Secretary**
Clifford Chance Secretaries (CCA) Limited

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

**Bankers**
Barclays Bank PLC
54 Lombard Street
London EC3V 9EX

**Solicitors**
Clifford Chance

**Registered Office**
Oakfield House
35 Perrymount Road
Haywards Heath
West Sussex
RH16 3BX

# Directors' report

The directors present their report and the audited financial statements for the period ended 31 December 2003.

## Principal activities

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

## Business review

The Company was incorporated as Watchpark PLC on 19 March 2003 and began trading on 4 July 2003. The Company changed its name to Preferred Residential Securities 6 PLC on 2 April 2003. On 4 July 2003 the Company purchased £261,021,302 of mortgages from Preferred Mortgages Limited, and on 14 August 2003 the Company purchased £38,584,915 of mortgages also from Preferred Mortgages Limited. Further consideration may be payable to Preferred Mortgages Limited dependent on the future performance of the mortgages.

The profit and loss account for the period ended 31 December 2003 is set out on page 6. Both the level of business during the period and the financial position of the Company at the end of the period were satisfactory.

## Dividend

The Directors do not recommend the payment of a dividend for the period.

## 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 period-end.

## Directors and directors' interests

The directors who held office during the period were as follows:

The present members of the Board are listed on page 1.

R G Baker and SPV Management Ltd were appointed as directors on 1 April 2003. G Fraser and A Attia were appointed as directors on 12 December 2003. Clifford Chance Secretaries Limited were appointed as secretary to the company on 12 December 2003 and resigned on 21 October 2004. Clifford Chance Secretaries (CCA) Limited were appointed a secretary to the company on 21 October 2004.

P E Hopes was appointed as director and secretary on 1 April 2003 and resigned as director and secretary on 12 December 2003.

D J Pudge was appointed as director on 19 March 2003 and resigned on 1 April 2003. Mr Layton was appointed as a director on 19 March 2003 and resigned on 1 April 2003. Clifford Chance Secretaries Limited were appointed as secretary to the Company on 19 March 2003 and resigned on 1 April 2003.

SPV Management Limited holds one fully paid up share of £1, on a discretionary trust basis, in each of Preferred Funding Limited, Preferred Funding One Ltd, Preferred Funding Two Ltd, Preferred Residential Securities 1 PLC, Preferred Residential Securities 2 PLC, Preferred Residential Securities 3 PLC, Preferred Residential Securities 4 PLC, Preferred Residential Securities 5 PLC and Preferred Residential Securities 6 PLC. SPV Management Limited holds 100% of the issued shares, on a discretionary trust basis, in PRS 1 Limited.

None of the other directors who held office at the end of the period had any disclosable interest in the shares of the Company, other than as disclosed above.

# Directors' report

### Financial instruments

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 also enters into derivative transactions where necessary (principally interest rate and currency swaps) to manage its exposure to interest rate and foreign currency risk.

It is, and has been throughout the period 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, foreign currency risk and liquidity risk. The directors review and agree policies for managing each of these risks and they are summarised below.

### 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 the period 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.

### Foreign exchange risk

Foreign exchange risk exists where loan notes are denominated in a currency which is different to the underlying sterling mortgage loans. The Company minimises its exposure to foreign currency risk by ensuring that the currency 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 foreign exchange risk.

### Liquidity risks

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.

## Auditors

Deloitte & Touche resigned as auditors on 12 December 2003 and the directors appointed Ernst & Young LLP.

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

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

Director

SPV MANAGEMENT LIMITED

# Statement of directors' responsibilities in respect of the financial statements

Company law requires the directors to prepare 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. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; 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 6 PLC (formerly Watchpark PLC)**

We have audited the Company's financial statements for the period ended 31 December 2003, which comprise the Profit and Loss Account, Balance Sheet and the related notes 1 to 17. These financial statements have been prepared on the basis of the accounting policies set out therein.

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

## Respective responsibilities of directors and auditors

As described in the Statement of Directors' Responsibilities the Company's directors are responsible for the preparation of the financial statements in accordance with United Kingdom law and accounting standards.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the Company is not disclosed.

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

## Basis of audit opinion

We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

## Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company as at 31 December 2003 and of its profit for the period then ended and have been properly prepared in accordance with the Companies Act 1985.

Ernst & Young LLP

Ernst & Young LLP
Registered Auditor
London

Date: 4 January 2005

# Profit and loss account

**for the period ended 31 December 2003**

| | Notes | 2003 £ |
|---|---|---|
| Interest receivable and similar income | 2 | 10,713,427 |
| Interest payable and similar charges | 3 | (6,902,982) |
| ***Net interest receivable*** | | 3,810,445 |
| Other operating income | 4 | 390,336 |
| ***Total operating income*** | | 4,200,781 |
| Operating expenses | | (4,197,025) |
| ***Profit on ordinary activities before taxation*** | 5 | 3,756 |
| Tax on profit on ordinary activities | 6 | (304) |
| Profit on ordinary activities after taxation | 14 | 3,452 |

The profit for the period was derived from continuing operations.

There were no recognised gains or losses other than the profit for the period, accordingly no statement of recognised gains and losses is given.

# Balance sheet

**as at 31 December 2003**

| | Notes | 2003 £ |
|---|---|---|
| ***Current assets*** | | |
| Debtors: | | |
| Amounts falling due after one year | 9 | 234,737,380 |
| Amounts falling due within one year | 10 | 48,879,593 |
| Cash at bank and in hand | | 10,557,287 |
| | | 294,174,260 |
| ***Creditors:*** amounts falling due within one year | 11 | (55,082,877) |
| ***Net current assets*** | | 239,091,383 |
| ***Creditors:*** amounts falling due after more than one year | 12 | (239,075,429) |
| ***Net assets*** | | 15,954 |
| ***Capital and reserves*** | | |
| Called up share capital | 13 | 12,502 |
| Profit and loss account | 14 | 3,452 |
| ***Shareholders' funds*** | 15 | 15,954 |

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

Director

for SPV MANAGEMENT LIMITED

# Notes to the financial statements

**at 31 December 2003**

## 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 rules. The financial statements have been prepared on a going concern basis.

### Mortgage loans

Mortgage loans are stated at cost 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 make recovery doubtful.

### Provisions

Specific provisions for losses on loans and advances to customers in arrears are made throughout the period and at the period-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 period and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

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

Deferred tax assets are recognised only to the extent that the directors consider 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 a non-discounted basis at the tax rates that are expected to apply in 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. Provision is made for deferred consideration within the financial statements as amounts become payable as a result of the performance of the acquired mortgages.

### Interest

Receipts and payments of interest are accounted for on an accruals basis.

### Redemption fee income

Redemption fees are receivable on mortgage loans when partially or fully repaid. The level of the fee is dependent on the specific product. The income is credited to the profit and loss account as received.

### Sundry fee income

Borrowers may be charged fees as a result of specific information requests and where mortgage accounts fall into delinquency. This income is credited to the profit and loss account on an accruals basis.

# Notes to the financial statements

**at 31 December 2003**

## 1. Accounting policies (continued)

### *Currency swaps*

A currency swap has been entered into, in order to manage the Company's currency rate exposure in relation to non-sterling denominated loan notes. The derivative contracts match the expected profile of the run-off of the non-sterling denominated loan notes. The net interest paid on the loan notes is recorded on an accruals basis and included within interest payable within the profit and loss account. Any foreign exchange gain or loss arising from the currency swaps in respect of capital and interest repayments is recorded on an accruals basis and is included in the interest receivable or payable within the profit and loss account.

### Issue costs

Initial issue costs incurred in arranging funding facilities are amortised over 3 years. Unamortised initial issue costs are deducted from the associated liability in accordance with Financial Reporting Standard No.4 and costs amortised in the period 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 6 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.

## 2. *Interest receivable and similar income*

| | *2003* |
|---|---|
| | *£* |
| On mortgage loans | 10,455,194 |
| Other interest | 258,233 |
| | 10,713,427 |

## 3. Interest payable and similar charges

| | *2003* |
|---|---|
| | *£* |
| Subordinated loan interest | 225,288 |
| Mortgage backed loan notes | 6,338,436 |
| Amortisation of capitalised issue costs | 339,258 |
| | 6,902,982 |

# Notes to the financial statements

**at 31 December 2003**

## 4. Other operating income

| | *2003* |
|---|---|
| | *£* |
| Sundry fee income | 390,336 |

Sundry fee income includes redemption fees, insurance renewal commission and sundry fee income.

## 5. Profit on ordinary activities before taxation

*This is stated after charging:*

| | *2003* |
|---|---|
| | *£* |
| Auditors' remuneration - audit services | 2,993 |
| Provision for mortgage losses | 944,200 |
| Amortisation of capitalised issue costs | 339,258 |
| Deferred consideration | 2,712,213 |

## 6. Tax on profit on ordinary activities

(a) Analysis of tax charge in the period

| | *2003* |
|---|---|
| | *£* |
| UK Corporation tax: | |
| Current year tax charge | 304 |
| Total current tax (note 6(b)) | 304 |

(b) Factors affecting the tax charge in the period

The tax assessed on the profit/(loss) on ordinary activities for the period is equal to the small companies rate of corporation tax in the UK, currently 19%. Accordingly no reconciliation is required to be shown below.

| | *2003* |
|---|---|
| | *£* |
| Profit on ordinary activities before tax | 3,756 |
| Profit on ordinary activities multiplied by the small companies rate of corporation tax of 19% | 714 |
| Effects of: | |
| Small Companies Rate | (410) |
| Total current tax (note 6(a)) | 304 |

## 7. Information regarding directors and employees

The Company has no employees. The directors received no remuneration from the Company during the period.

# Notes to the financial statements

**at 31 December 2003**

## 8. Mortgage loans – net balances

| | *Mortgages* | *Mortgage loss provision* | *Total* |
|---|---|---|---|
| | *£* | *£* | *£* |
| At start of period | – | – | – |
| Net movement in the period | 282,580,047 | (944,200) | 281,635,847 |
| At 31 December 2003 | 282,580,047 | (944,200) | 281,635,847 |

Net mortgage loans of £281,635,847 are held as security against the loan notes referred to in note 12.

## 9. **Debtors:** amounts falling due after more than one year

| | *2003* |
|---|---|
| | *£* |
| Mortgage loans: net balances | 234,737,380 |

## 10. **Debtors:** amounts falling due within one year

| | *2003* |
|---|---|
| | *£* |
| Mortgage loans: Net balances | 46,898,467 |
| Prepayments and accrued income | 26,198 |
| Other debtors | 1,954,928 |
| | 48,879,593 |

## 11. **Creditors:** amounts falling due within one year

| | *2003* |
|---|---|
| | *£* |
| Mortgage backed notes due 2035 – Class A1 | 40,864,000 |
| Mortgage backed notes due 2035 – Class A2 | 5,936,000 |
| Corporation tax | 304 |
| Deferred consideration | 1,957,281 |
| Accruals and deferred income | 565,635 |
| Subordinated loan | 3,567,000 |
| Other creditors | 2,877,227 |
| Less: Issue costs | (684,570) |
| | 55,082,877 |

# Notes to the financial statements

**at 31 December 2003**

## 12. **Creditors:** amounts falling due after more than one year

| | *2003* |
|---|---|
| | *£* |
| GBP denominated mortgage backed loan notes due 2035 – Class A1 | 177,530,592 |
| EUR denominated mortgage backed loan notes due 2035 – Class A2 | 26,754,504 |
| GBP denominated mortgage backed loan notes due 2035 – Class M1 | 27,500,000 |
| EUR denominated mortgage backed loan notes due 2035 – Class M2 | 5,556,327 |
| Subordinated loan | 2,745,725 |
| Less: Issue costs | (1,011,719) |
| | 239,075,429 |

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

The mortgage backed floating rate notes due 2035 are secured over a portfolio of mortgage loans secured by first and second 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 6 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 September 2035.

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

| | |
|---|---|
| Class A1 | LIBOR + 0.52% |
| Class A2 | EURIBOR + 0.52% |
| Class M1 | LIBOR + 1.85% |
| Class M2 | EURIBOR + 2.05% |

On 4 July 2003, Preferred Mortgages Limited made available to the Company a subordinated loan ("the loan") comprising of three tranches. The first tranche of the loan was £2,100,000 and was used for meeting the costs and expenses arising in respect of the issue of the Notes. The second tranche was an amount of £3,897,184 that was used in initially funding the Non-Performing Reserve Fund. The third tranche was an amount of £90,254 that was used in funding the Prefunding Interest Shortfall. Interest on the loan is charged at a rate of LIBOR plus 4% per annum.

Each tranche of the loan is repayable using the amounts available in accordance with the priority of payments as set out in Condition 2 of the Note Terms and Conditions. Any balance outstanding on the loan is due and payable in September 2035.

# Notes to the financial statements

**at 31 December 2003**

## 13. Called up share capital

| | 2003 |
|---|---|
| | £ |
| Authorised | |
| Ordinary shares of £1 each | 50,000 |
| Allotted and called up | |
| Ordinary shares of £1 | |
| 2 shares 100% called and fully paid | 2 |
| 49,998 shares 25% called and fully paid | 12,500 |
| | 12,502 |

Share capital of £2 was issued on incorporation on 19 March 2003. Share capital of £12,500 was issued on 1 April 2004.

## 14. Profit and loss account

| | 2003 |
|---|---|
| | £ |
| Profit for the period | 3,452 |
| Retained profit carried forward | 3,452 |

## 15. Reconciliation of movement in shareholders' funds

| | 2003 |
|---|---|
| | £ |
| Issue of ordinary share capital | 12,500 |
| Retained profit for the period | 3,452 |
| Net increase in shareholders' funds | 15,952 |
| Shareholders' funds at incorporation | 2 |
| Closing shareholders' funds | 15,954 |

# Notes to the financial statements

**at 31 December 2003**

## 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* |
|---|---|---|---|---|---|
| | *£* | *£* | *£* | *%* | |
| 2003 | | | | | |
| Interest rate profile | 290,454,148 | 290,454,148 | – | – | – |

(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* |
|---|---|---|---|---|---|
| | *£* | *£* | *£* | *%* | |
| 2003 | | | | | |
| Interest rate profile | 293,137,334 | 293,137,334 | – | – | – |

(c) Foreign currency risk

With the exception of the mortgage backed loan notes, all financial instruments are denominated in sterling. The mortgage backed loan notes were issued in the following tranches:

GBP denominated mortgage backed loan notes due 2035 – Class A1 (Notional GBP 232,000,000)
EUR denominated mortgage backed loan notes due 2035 – Class A2 (Notional EUR 50,000,000)
GBP denominated mortgage backed loan notes due 2035 – Class M1 (Notional GBP 27,500,000)
EUR denominated mortgage backed loan notes due 2035 – Class M2 (Notional EUR 8,000,000)

A currency swap has been entered into, in order to manage the Company's currency rate exposure in relation to non-sterling denominated loan notes.

The rates of interest receivable and payable on variable rate financial instruments, with the exception of the mortgage backed loan notes, 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 31 December 2003**

## 16. Derivatives and other financial instruments (continued)

(d) Fair value disclosures

| | *Book value 2003* | *Fair value 2003* |
|---|---|---|
| | *£* | *£* |
| On balance sheet | | |
| Mortgage loans | 282,580,047 | 282,580,047 |
| Cash and deposits | 10,557,287 | 10,557,287 |
| Mortgage backed loan notes due 2035 | 284,141,423 | 284,141,423 |
| Start up loan | 6,312,725 | 6,312,725 |

The Company uses foreign currency swaps in certain circumstances to hedge against any currency exposure rates. At 31 December 2003 the notional value of swaps held was £40,971,389 and the unrecognised positive fair value was £522,978.

## 17. Parent undertaking and control

The Company is controlled by its parent undertaking, PRS 6 Parent Limited, which is registered and operates in the United Kingdom.

The entire issued share capital of PRS 6 Parent 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 Holdings Limited, registered in England and Wales. The consolidated accounts of these groups are available from Oakfield House, 35 Perrymount Road, Haywards Heath, West Sussex RH16 3BX.