

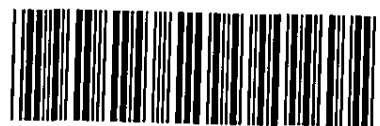
AIRE VALLEY MORTGAGES 2004 - 1 PLC

Directors' Report and Financial Statements

Registered number: 5154235

31 December 2007

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Directors' Report and Financial Statements

Contents	Page
Company Information	3
Directors' Report	4 - 5
Statement of Directors' Responsibilities	6
Independent Auditor's Report to the members of Aire Valley Mortgages 2004 - 1 plc	7
Income Statement	8
Balance Sheet	9
Statement of Changes in Equity	10
Cash Flow Statement	11
Notes to the Financial Statements	12 - 24

Company Information

Directors

Christopher Patrick Willford
SFM Directors Limited
SFM Directors (No 2) Limited

Company Secretary

SFM Corporate Services Limited

Registered Office

35 Great St Helen's
London
EC3A 6AP

Auditor

KPMG Audit Plc
1 The Embankment
Neville Street
Leeds
LS1 4DW

Directors' Report for the year ended 31 December 2007

The Directors present their Report and Financial Statements for the year ended 31 December 2007

Principal activities and business review

Aire Valley Mortgages 2004 - 1 plc ("the Company") is a limited liability company incorporated in the United Kingdom and registered in England and Wales under the Companies Act 1985. The Company is a subsidiary of Aire Valley Holdings Ltd, a limited liability company incorporated in the United Kingdom and registered in England and Wales under the Companies Act 1985.

The Company's principal activity is to issue floating and/or fixed rate debt securities and to enter into financial arrangements to fund the activities of certain subsidiaries of Aire Valley Holdings Limited by means of intercompany loans. The debt securities are issued in US Dollars, Euros and Sterling and are secured on a beneficial interest in a portfolio of mortgage loans held by Aire Valley Trustee Limited, under a master trust arrangement. These mortgage loans, which are originated by Bradford & Bingley plc, are secured on residential property in the UK. Details are set out in the offering circular pertinent to this Issue. The Company issued £2bn floating rate notes to the market on 5 October 2004. £225m of the notes were redeemed in September 2005, £500m in June 2007 and £500m in December 2007. As at 31 December 2007 £775m remained in issue. Interest expense has remained at £91m in the year (2006 £91m) because even though the principal amount reduced there was an increase in interest rates. Fair value movements of a loss of £229,000 (2006 £nil) arose due to the volatility in interest rates around the year end. This fair value loss is a timing effect only, which will reverse, and does not have cash implications.

The profits of the Company are pre-determined under the terms of the issue documentation. The results for the year are shown in the Income Statement on page 8. As a result of the fair value movements, the loss after taxation was £157,000 (2006 profit of £9,000).

The Company has met all its obligations under the terms of the issue documentation.

The key performance indicators used by management in assessing the performance of the Company are actual cash flows against planned cash flows and the credit ratings assigned to the loan notes. The performance of the Company is addressed in the quarterly trustee reports to investors, and there have been no changes in the credit ratings of the notes in the year.

Future developments

The Directors expect that during 2008 the Company will continue to meet the interest payments on the notes. At the present time the Directors do not foresee any changes in the Company's activities.

Dividend

No dividends were paid during the year or previous year, and the Directors do not recommend the payment of a final dividend for the year (2006 £nil).

Payment policy

Standard terms provide for payment of all invoices within 30 days of invoice date, except where different arrangements have been agreed with suppliers. It is the policy of the Company to abide by the agreed payment term.

Directors

The Directors who served during the year were as follows:

SFM Directors Limited

SFM Directors (No. 2) Limited

Christopher Patrick Willford (appointed 9 January 2007)

Christopher Donald Gillespie (resigned 9 January 2007)

Aire Valley Holdings Ltd holds 49,998 £1 quarter paid shares and one £1 fully paid share and SFM Nominees Ltd (the share nominee) holds one £1 fully paid share. Mr Willford, SFM Directors Limited and SFM Directors (No. 2) Limited are, or have been, Directors of Aire Valley Holdings Limited during the year. None of the Directors had any interest in the share or loan capital of the Company during the current or preceding year. Mr Willford also served as a Director of Bradford & Bingley plc, and his interests in that Company's share capital are disclosed in its Annual Report and Accounts.

Directors' Report for the year ended 31 December 2007 (continued)

Disclosure of information to auditors

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware, and each Director has taken all the steps that he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information

Risk management and control

In the ordinary course of business the Company is exposed to, and manages, a variety of risks, with credit risk, liquidity risk, currency risk and interest rate risk being of particular significance. The Directors have responsibility for the overall system of internal control and for reviewing its effectiveness. In general, when a transaction or group of transactions is entered into, derivative instruments are taken out to manage the associated risks. The effectiveness of the risk management is then monitored on an ongoing basis. Further details of these risks are provided in note 11.

The Company has entered into contracts with a number of third parties to provide operational support including corporate service providers, paying agents and swap providers. Bradford & Bingley plc acts as a bank account and cash manager. The Company's operations are subject to periodic review by the Bradford & Bingley plc internal audit department.

The issue documentation also sets out a number of business risks through a number of asset and non asset trigger events. The occurrence of trigger events could lead to early redemption of the floating rate notes. There have been no trigger events in the year under review.

Political and charitable contributions

During the year no political or charitable contributions were made (2006: £nil)

Auditor

In accordance with Section 384 of the Companies Act 1985, a resolution for the re-appointment of KPMG Audit PLC as auditor of the Company is to be proposed at the forth coming Annual General Meeting.

By order of the Board



SFM Corporate Services Limited
Company Secretary

1 July 2008

Statement of Directors' Responsibilities in respect of the Directors' Report and Financial Statements

The Directors are responsible for preparing the Directors' Report and 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 IFRS as adopted by the EU.

The Financial Statements are required by law to present fairly the financial position of the Company and the performance of the Company, the Companies Act 1985 provides in relation to such Financial Statements that references in the relevant part of that Act to Financial Statements giving a true and fair view are references to their achieving a fair presentation.

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 the Financial Statements have been prepared in accordance with IFRS as adopted by the EU, 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 which enable them to ensure that the Financial Statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

Independent Auditor's Report to the members of Aire Valley Mortgages 2004 - 1 plc

We have audited the Financial Statements of Aire Valley Mortgages 2004 - 1 plc for the year ended 31 December 2007 which comprise the Income Statement, the Balance Sheet, the Statement of Changes in Equity, the Cash Flow Statement and the related notes. These Financial Statements have been prepared under the accounting policies set out therein.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's 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

The Directors' responsibilities for preparing the Financial Statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the EU, are set out in the Statement of Directors' Responsibilities on page 6.

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 whether the Financial Statements have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is consistent with the Financial Statements.

In addition we report to you 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 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 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, in accordance with IFRS as adopted by the EU, of the state of the Company's affairs as at 31 December 2007 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.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants
Registered Auditor

1 July 2008

1 The Embankment
Neville Street
Leeds
LS1 4DW

Income Statement for the year ended 31 December

	<i>Note</i>	2007 £000	2006 £000
Interest receivable and similar income	2	91,159	90,742
Interest expense and similar charges	3	(91,113)	(90,693)
Net interest income		<u>46</u>	<u>49</u>
Operating expenses	4	(37)	(40)
Fair value movements	11(e)	(229)	-
Loss before taxation		<u>(220)</u>	<u>9</u>
Taxation	5	63	-
Loss for the financial year		<u><u>(157)</u></u>	<u><u>9</u></u>

The results above arise from the Company's single continuing activity and are attributable to the equity shareholders. The Company operates in a single business segment and all of the Company's activities are in the UK.

The notes on pages 12 to 24 form part of these Financial Statements.

Balance Sheet as at 31 December

	Note	2007 £000	2006 £000
Assets			
Loans to Group undertakings	8	774,853	1,775,000
Deferred tax assets	5	64	-
Total non-current assets		<u>774,917</u>	<u>1,775,000</u>
Cash and cash equivalents		313	252
Loans to Group undertakings	8	1,495	2,951
Derivative financial instruments		32,768	-
Prepayments and accrued income		2	8
Total current assets		<u>34,578</u>	<u>3,211</u>
Total assets		<u>809,495</u>	<u>1,778,211</u>
Equity			
Capital and reserves attributable to equity holders			
Share capital	12	13	13
Retained earnings		(139)	18
Total attributable equity		<u>(126)</u>	<u>31</u>
Liabilities			
Interest-bearing loans and borrowings	7	808,126	1,738,288
Total non-current liabilities		<u>808,126</u>	<u>1,738,288</u>
Interest-bearing loans and borrowings	7	1,495	2,761
Derivative financial instruments		-	37,131
Total current liabilities		<u>1,495</u>	<u>39,892</u>
Total liabilities		<u>809,621</u>	<u>1,778,180</u>
Total equity and liabilities		<u>809,495</u>	<u>1,778,211</u>

The notes on pages 12 to 24 form part of these Financial Statements

The Financial Statements were approved by the Board of Directors and authorised for issue on 01 July 2008 and signed on its behalf by


per pro SFM Directors Limited
Director

01/07 2008

Statement of Changes in Equity for the year ended 31 December

	Share capital £000	Retained earnings £000	Total equity £000
At 1 January 2007	13	18	31
Loss for the year	-	(157)	(157)
At 31 December 2007	<u>13</u>	<u>(139)</u>	<u>(126)</u>
At 1 January 2006	13	9	22
Profit for the year	-	9	9
At 31 December 2006	<u>13</u>	<u>18</u>	<u>31</u>

Cash Flow Statement for the year ended 31 December

	2007 £000	2006 £000
Cash flows from operating activities		
Loss for the financial year	(157)	9
<i>Adjustments for</i>		
Interest on loans to Group undertakings	(91,144)	(90,729)
Bank interest	(15)	(13)
Interest on floating rate notes	76,597	72,449
Swap interest	14,516	18,244
Fair value movements	229	-
Income tax credit	(63)	-
Cash flows from operating activities before changes in operating assets and liabilities	(37)	(40)
<i>Net decrease/(increase) in operating assets</i>		
Loans to Group undertakings	1,000,337	(448)
Debt securities	-	31,127
Prepayments and accrued income	6	(2)
Cash generated from/(absorbed by) operations	1,000,306	30,637
Taxation paid	(1)	(3)
Net cash from operating activities	1,000,305	30,634
<i>Cash flows from financing activities</i>		
Interest received on loans to Group undertakings	92,410	90,729
Bank interest	15	13
Interest paid on floating rate notes	(77,824)	(71,795)
Swap interest paid	(14,845)	(18,451)
Repayment of floating rate notes	(1,000,000)	(31,127)
Net cash used in financing activities	(1,000,244)	(30,631)
Net increase in cash and cash equivalents	61	3
Cash and cash equivalents at beginning of year	252	249
Cash and cash equivalents at end of year	313	252

Notes to the Financial Statements for the year ended 31 December 2007**1. Principal accounting policies**

Aire Valley Mortgages 2004 - 1 plc ("the Company") is a limited liability company incorporated in the United Kingdom under the Companies Act 1985 and registered in England and Wales

(a) Statement of compliance

The Company's Financial Statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards as adopted by the EU ("Adopted IFRS")

In the 2007 Financial Statements, including the 2006 comparative financial information, the Company has adopted for the first time the following statements

- The Capital Disclosures amendment to IAS 1 "Presentation of Financial Statements", and
- IFRS 7 "Financial Instruments Disclosures"

These two statements relate to disclosures only, and early adoption of them had no impact on the Company's Income Statement, Balance Sheet or Cash Flow Statement

The Company has not adopted IFRS8 "Operating Segments" issued by the IASB in November 2006 and mandatory for 2009 financial statements, this statement relates to disclosures only, and adoption would have no impact on the Company's Income Statement, Balance Sheet or Cash Flow Statement

The Financial Statements also comply with the relevant provisions of Part VII of the Companies Act 1985, as amended by the Companies Act 1985 (International Accounting Standards and Accounting Amendments) Regulations 2004

(b) Basis of preparation

The Financial Statements are prepared on the historical cost basis, except for financial instruments classified as "at fair value through profit or loss", and on a going concern basis

The Financial Statements are presented in pounds sterling, which is the currency of the Company's primary operating environment

Judgements made by the Directors in the application of these accounting policies that have a significant effect on the Financial Statements and estimates with a significant risk of material adjustment in the next year are discussed in note 10

The Directors consider that the accounting policies set out below are the most appropriate to the Company's circumstances

(c) Interest income and expense

For all financial instruments measured at amortised cost (including loans to Group undertakings and floating rate notes) interest income and expense are recognised in the Income Statement on an Effective Interest Rate ("EIR") basis. The EIR basis spreads the interest income or interest expense over the expected life of the instrument. The EIR is the rate that at the inception of the instrument exactly discounts expected future cash payments and receipts through the expected life of the instrument back to the initial carrying amount. When calculating the EIR future cash flows are estimated considering all contractual terms of the instrument (for example prepayment options) but potential future credit losses are not considered. The calculation includes all directly attributable incremental fees and costs and all other premia and discounts as well as interest

(d) Taxation

The charge for taxation is based on the profit for the year and takes into account taxation deferred or accelerated arising from temporary differences between the carrying amounts of certain items for taxation and for accounting purposes. Deferred taxation is provided for in full at the tax rate which is expected to apply to the period when the deferred taxation is expected to be realised, including on tax losses carried forward, and is not discounted to take account of the expected timing of realisation. Deferred taxation assets are recognised only to the extent that it is probable that future taxable profits will be available against which the taxable differences can be utilised

Notes to the Financial Statements for the year ended 31 December 2007 (continued)**1. Principal accounting policies (continued)****(e) Cash and cash equivalents**

For the purposes of the Cash Flow Statement, cash and cash equivalents comprise balances which had an original maturity of three months or less

(f) Floating rate notes

On initial recognition, debt issued is measured at its fair value net of directly attributable transaction costs and discounts, in accordance with IAS 39. Subsequent measurement is at amortised cost using the EIR method to amortise incremental attributable issue and transaction costs, premia and discounts over the life of the instrument, these costs are charged along with interest on the debt to "interest expense and similar charges". Unamortised amounts are added to or deducted from the carrying value of the instrument.

(g) Classification of financial instruments

In accordance with IAS 39 each financial asset is classified at initial recognition into one of four categories

- (i) Financial assets at fair value through profit or loss,
- (ii) Held to maturity investments,
- (iii) Loans and receivables, or
- (iv) Available for sale,

and each financial liability into one of two categories

- (v) Financial liabilities at fair value through profit or loss, or
- (vi) Other liabilities

Measurement of financial instruments is either amortised cost (categories (ii), (iii) and (vi) above) or at fair value (categories (i), (iv) and (v) above), depending on the category of financial instrument.

The Company does not carry any financial instruments at fair value other than derivative financial instruments.

Amortised cost is the amount measured at initial recognition, adjusted for subsequent principal and other payments, less cumulative amortisation calculated using the EIR method, the amortisation is taken to interest income or expense depending on whether the instrument is an asset or liability. The amortised cost balance is reduced where appropriate by an allowance for amounts which are considered to be impaired or uncollectible.

Any profit or loss on sale of an instrument carried at amortised cost is recognised immediately in the Income Statement in interest income or expense depending on whether the instrument is an asset or a liability.

Fair value is the amount for which an asset can be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Where a market exists, fair values are based on quoted market prices. For instruments which do not have active markets, fair value is calculated using present value models which take individual cash flows together with assumptions based on market conditions and credit spreads and are consistent with accepted economic methodologies for pricing financial instruments. Any net movements in fair value are included in the Income Statement as "fair value movements".

Notes to the Financial Statements for the year ended 31 December 2007 (continued)**1 Principal accounting policies (continued)****(h) Derivative financial instruments**

All derivatives are carried in the Balance Sheet at fair value, as assets when the fair value is positive and as liabilities when the fair value is negative. Changes in the fair value of derivatives are charged immediately in the Income Statement as "fair value movements".

(i) Foreign currencies

Foreign currency transactions, assets and liabilities are accounted for in accordance with IAS 21 "The Effects of Changes in Foreign Exchange Rates". The presentational and functional currency of the Company is pounds sterling. Transactions which are not denominated in pounds 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 pounds sterling are translated into sterling at the closing rate of exchange at the Balance Sheet date.

Any foreign exchange gains or losses arising from settlement of transactions at rates different from those at the date of the transaction, and any unrealised foreign currency exchange gains and losses on unsettled foreign currency monetary assets and liabilities, are included in the Income Statement in "fair value movements".

(j) Hedge accounting

The Company applies fair value hedge accounting to its floating rate notes. Provided that the hedge arrangement meets the requirements of IAS 39 to be classed as "highly effective" the hedged item is carried on the Balance Sheet at fair value in respect of the hedged risk, with any gain or loss in that fair value being included in the Income Statement as "fair value movements".

Notes to the Financial Statements for the year ended 31 December 2007 (continued)

2. Interest receivable and similar income

	2007	2006
	£000	£000
Interest on loans to Group undertakings	91,144	90,729
Bank interest	15	13
	<u>91,159</u>	<u>90,742</u>

Interest received for the year on impaired assets was £nil (2006 £nil)

3. Interest expense and similar charges

	2007	2006
	£000	£000
Interest on floating rate notes	76,597	72,449
Swap interest	14,516	18,244
	<u>91,113</u>	<u>90,693</u>

4 Operating expenses

	2007	2006
	£000	£000
Legal and professional fees	<u>37</u>	<u>40</u>

Auditors' remuneration of £3,000 (2006 £3,000) was borne by Bradford & Bingley plc

5. Taxation

	2007	2006
	£000	£000
Current taxation credit		
UK corporation tax on loss for the year	2	2
Deferred taxation temporary differences (see below)	(64)	-
Adjustments in respect of previous years	(1)	(2)
Total taxation credit per the Income Statement	<u>(63)</u>	<u>-</u>
Loss before taxation	<u>(220)</u>	<u>9</u>
UK corporation tax at 30%	(66)	3
Effects of		
Other tax rates	4	(1)
Adjustments in respect of previous years	(1)	(2)
Total taxation credit per the Income Statement	<u>(63)</u>	<u>-</u>

The deferred tax asset is attributable to the following

Fair value movements	<u>64</u>	<u>-</u>
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The movement in the year was recognised in income

Deferred taxation appropriately reflects the change to the standard rate of UK corporation tax from 30% to 28% effective from 1 April 2008

Notes to the Financial Statements for the year ended 31 December 2007 (continued)

6. Employees and Directors' emoluments

There were no employees during the year (2006: none) and none of the Directors received emoluments in respect of their services to the Company. A corporate service fee is paid to Structured Finance Management Limited in connection with its supply of corporate management services including the provision of directors (see note 9).

7. Interest-bearing loans and borrowings

Interest-bearing loans and borrowings comprise floating rate notes issued on 5 October 2004.

Under the terms of the notes any shortfalls arising on the redemption or repossession of the mortgage assets held in trust on behalf of Aire Valley Funding 1 Limited, over which the note holders have a floating charge, may result in a reduction in the liability under the notes. Shortfalls are allocated against the notes in reverse order to the seniority of the class of the note, resulting in any such reductions being first allocated against Class D notes.

Class	Maturity	Amount in currency	31 December 2007 £000	31 December 2006 £000
Series 2 A1	Sep 2034	£250,000,000	-	250,000
Series 2 A2	Sep 2034	Euro803,000,000	-	539,535
Series 2 A3	Sep 2034	US\$360,000,000	-	183,589
Series 2 B1	Sep 2066	£20,000,000	20,000	20,000
Series 2 B2	Sep 2066	Euro65,500,000	48,025	44,009
Series 2 C1	Sep 2066	£20,000,000	20,000	20,000
Series 2 C2	Sep 2066	Euro75,500,000	55,357	50,728
Series 3 A1	Sep 2066	£215,000,000	215,000	215,000
Series 3 A2	Sep 2066	Euro460,000,000	337,272	309,074
Series 3 B1	Sep 2066	£20,000,000	20,000	20,000
Series 3 B2	Sep 2066	Euro25,000,000	18,330	16,798
Series 3 C1	Sep 2066	£20,000,000	20,000	20,000
Series 3 C2	Sep 2066	Euro31,000,000	22,729	20,829
Series 3 D1	Sep 2066	£15,000,000	15,000	15,000
Series 3 D2	Sep 2066	Euro22,000,000	16,130	14,782
			<u>807,843</u>	<u>1,739,344</u>
Issue costs			(68)	(107)
Hedge adjustments			<u>351</u>	<u>(949)</u>
			808,126	1,738,288
Accrued interest - current			<u>1,495</u>	<u>2,761</u>
			<u><u>809,621</u></u>	<u><u>1,741,049</u></u>

Notes to the Financial Statements for the year ended 31 December 2007 (continued)**7. Interest-bearing loans and borrowings (continued)**

Subject to their scheduled redemption dates, the Class A notes rank, irrespective of series, without preference or priority amongst themselves. Subject to the relevant scheduled and/or, as applicable, permitted redemption dates or other payment conditions of the issuer notes, payments of principal and interest due and payable on the Class A notes will rank ahead of payments of principal and interest due and payable on the Class B, C and D notes, subject to the terms and conditions of the notes, the issuer cash management agreement, the issuer deed of charge and the other issuer transaction documents. Similarly, payments of principal and interest due and payable on the Class B notes will rank ahead of payments of principal and interest due and payable on the Class C and D notes, and payments of principal and interest due and payable on the Class C notes will rank ahead of payments of principal and interest due and payable on the Class D notes.

Interest is payable on the Series 2 Class B2, Series 2 Class C2, Series 3 Class B2, Series 3 Class C2 and Series 3 Class D2 notes at variable rates based upon three month EURIBOR. Interest is payable on Series 2 Class B1, Series 2 Class C1, Series 3 Class A1, Series 3 Class B1, Series 3 Class C1 and Series 3 Class D1 notes at variable rates based upon three month sterling LIBOR.

The Company's obligations to noteholders and to other secured creditors are secured under a deed of charge which grants security over all its assets in favour of the security trustee. The principal assets of the Company are loans made by it to Aire Valley Funding 1 Limited, a fellow subsidiary of Aire Valley Holdings Limited, whose obligations in respect of these loans are secured pursuant to a deed of charge which grants security over all its assets, primarily consisting of its beneficial interest in a portfolio of residential mortgage loans, in favour of the security trustee. The security trustee holds this security for the benefit of all secured creditors of Aire Valley Funding 1 Limited, including the Company.

8 Loans to Group undertakings

Loans to Group undertakings comprise a single loan to Aire Valley Funding 1 Limited, denominated in Sterling and at a variable rate of interest. The loan has ultimately been secured against a beneficial interest in a mortgage portfolio held in trust on behalf of the Aire Valley Holdings Limited Group.

Aire Valley Funding 1 Limited's ability to pay amounts due on the intercompany loan will depend mainly upon it receiving sufficient revenue receipts and principal on the trust property from Aire Valley Trustee Limited, receiving the required funds from the swap provider and amounts available in the reserve funds.

The repayment of the intercompany loan will coincide with the repayment of the floating rate notes as they become due for payment.

Notes to the Financial Statements for the year ended 31 December 2007 (continued)**9 Related party disclosures**

The Company is a special purpose vehicle controlled by its Board of Directors, which comprises three directors. Two of the Company's three directors are provided by Structured Finance Management Limited and the third director is an employee of Bradford & Bingley plc (the ultimate controlling party under IFRS). The Company pays a corporate services fee to Structured Finance Management Limited in connection with its supply of corporate management services including the provision of directors. The fee amounted to £12,242 (2006: £11,914).

The Company undertook the following transactions with companies in the Bradford & Bingley plc Group and the Aire Valley Holdings Ltd Group

	Bradford & Bingley plc and subsidiaries	Aire Valley Holdings Ltd and subsidiaries	Bradford & Bingley plc and subsidiaries	Aire Valley Holdings Ltd and subsidiaries
	2007	2007	2006	2006
	£000	£000	£000	£000
Interest receivable and similar income				
Interest on loans to Group undertakings	-	91,144	-	90,729
Non-current assets				
Loans to Group undertakings	-	774,853	-	1,775,000
Current assets				
Loans to Group undertakings	-	1,495	-	2,951

Auditors' remuneration of £3,000 (2006: £3,000) was borne by Bradford & Bingley plc

10. Critical accounting judgements and estimates

In preparation of the Company's Financial Statements estimates and assumptions are made which affect the reported amounts of assets and liabilities, estimates and assumptions are kept under continuous evaluation. Estimates and judgements are based on historical experience, expectations of future events and other factors.

Effective interest rate

Certain financial instruments are accounted for on an effective interest rate basis, under which the income or expense associated with the instrument is spread over the instrument's expected life. On a quarterly basis, models are reviewed to re-assess expected life.

Fair values of financial instruments

Certain financial instruments are carried at fair value. Where a market exists, fair values are based on quoted market prices. For instruments which do not have an active market, fair value is calculated using present value models.

Qualifying hedge relationships

In designating a financial instrument as part of a qualifying hedge relationship, the Company has determined that the hedge is expected to be highly effective over the life of the hedging instrument.

Notes to the Financial Statements for the year ended 31 December 2007 (continued)

11. Financial instruments

(a) Categories of financial assets and financial liabilities; carrying value compared to fair value

At 31 December 2007

Financial assets	Assets at fair value through profit or loss - on initial recognition £000	Loans and receivables £000	Total carrying value £000	Fair value £000	If fair values increased by 1% £000
Loans to Group undertakings	-	776,348	776,348	759,712	7,597
Derivative financial instruments	32,768	-	32,768	32,768	328
Cash and cash equivalents	-	313	313	313	3
	32,768	776,661	809,429	792,793	7,928

Financial liabilities	Liabilities at fair value through profit or loss - on initial recognition £000	Liabilities at amortised cost £000	Total carrying value £000	Fair value £000	If fair values increased by 1% £000
Interest-bearing loans and borrowings	-	809,621	809,621	792,985	7,930
Total financial liabilities	-	809,621	809,621	792,985	7,930

At 31 December 2006

Financial assets	Assets at fair value through profit or loss - on initial recognition £000	Loans and receivables £000	Total carrying value £000	Fair value £000	If fair values increased by 1% £000
Loans to Group undertakings	-	1,777,951	1,777,951	1,781,839	17,818
Cash and cash equivalents	-	252	252	252	3
	-	1,778,203	1,778,203	1,782,091	17,821

Financial liabilities	Liabilities at fair value through profit or loss - on initial recognition £000	Liabilities at amortised cost £000	Total carrying value £000	Fair value £000	If fair values increased by 1% £000
Derivative financial instruments	37,131	-	37,131	£37,131	371
Interest-bearing loans and borrowings	-	1,741,049	1,741,049	1,744,937	17,449
Total financial liabilities	37,131	1,741,049	1,778,180	1,782,068	17,820

Notes to the Financial Statements for the year ended 31 December 2007 (continued)

11 Financial instruments (continued)**a Categories of financial assets and financial liabilities; carrying value compared to fair value (continued)**

No financial instruments were reclassified during the year or previous year between amortised cost and fair value categories.

The fair value of loans to Group undertakings has been adjusted to reflect the market yields implied by the floating rate valuations

The fair value of interest-bearing loans and borrowings is based upon quoted market prices in active markets

The fair value of derivatives is their carrying amount

b Interest income and expense on financial instruments that are not at fair value through profit or loss

	2007	2007	2006	2006
	Income	Expense	Income	Expense
	£000	£000	£000	£000
Bank interest	15	-	13	-
Interest on loans to Group undertakings	91,144	-	90,729	-
Interest on floating rate notes	-	76,597	-	72,449

Interest income on impaired assets is £nil (2006 £nil) as the loans to Group undertakings are not regarded as impaired

c Nature and extent of risks arising from financial instruments

The Company's exposure to risk on financial instruments and the management of this risk is established at the commencement of the securitisation transactions with the Company's activities and the roles of other parties defined in the programme documentation. Financial instruments used by the Company for risk management purposes include derivative instruments. Such instruments are used for commercial hedging purposes only, not for trading or speculative purposes, to hedge interest rate and currency risk arising as part of the securitisation transaction. The principal derivative instruments used by the Company in managing its risk are currency swaps. The duration of derivative instruments is generally short to medium term and their maturity profile reflects the nature of exposures arising from underlying business activities. All of the Company's derivatives activity is contracted with financial institutions.

Notes to the Financial Statements for the year ended 31 December 2007 (continued)

11 Financial instruments (continued)

c Nature and extent of risks arising from financial instruments (continued)

Credit risk

Credit risk is the risk that a counterparty of the Company will be unable or unwilling to meet a commitment that has entered into with the Company. The Company is exposed to credit risk via amounts due from the loan to Group undertakings, derivative counterparties and deposits with third party banks.

The Company's ability to meet payments under the floating rate notes relies on the receipt of funds on the loans to Group undertakings, which in turn is dependent on receipt of payments on the mortgage portfolio held in trust. To minimise risk any mortgage included in the portfolio is required to meet a number of criteria as determined in the transaction documentation. Credit risk also exists on the derivative contracts entered into. The swap counterparties are required to have minimum credit ratings as outlined in the transaction documentation.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset, as set out in the table in note 11c(i).

Liquidity risk

Liquidity risk is the risk that the Company is not able to meet its financial obligations as they fall due. The Company's policy is to maintain sufficient funds in a liquid form at all times to ensure that the Company can meet its liabilities as they fall due. The Company's ability to meet payments under the floating rate notes relies on the receipt of funds on the loan to Group undertakings, which is in turn dependent on the receipt of payments on the mortgage portfolio held in trust.

Currency risk

The Company has floating rate notes in issue denominated in US Dollars and Euros. The Company's policy is to eliminate all exposures arising from movements in exchange rates by the use of cross currency swaps to hedge payments of interest and principal on the notes. All other assets, liabilities and transactions are denominated in Sterling. The table in note 11c(ii) summarises the Company's assets and liabilities denominated in foreign currencies.

Interest rate risk

Interest rate risk exists where assets and liabilities have interest rates set under a different basis or which reset at different times. To minimise exposure to interest rate risk the Company ensures that the interest rate profile of the loans due from Group undertakings and interest-bearing loans and borrowings are similar. Where this is not possible derivative financial instruments are also used to reduce any residual interest rate risk. If LIBOR for three month-Sterling deposits was 1% higher or lower, with all other variables held constant, the effect on the Company's net interest income would be immaterial due to movements on interest on the loan to Group undertakings being offset by movements on interest on the loan notes. This would also apply if LIBOR for three-month Euro and US \$ deposits was 1% higher or lower, with all other variables held constant, as movements in interest on foreign currency loan notes would be offset by a corresponding movement in interest on the currency swaps and on loans to Group undertakings. A change in interest rates would also affect the fair value movements in the Income Statement. A 1% increase in LIBOR for three-month sterling deposits would give rise to a fair value gain in the Income Statement of £74,000 due to changes in the fair value of derivatives, and similarly a 1% decrease would give rise to a fair value loss in the Income Statement of £74,000. If LIBOR for three-month Euro and US \$ deposits was 1% higher or lower, there would be no impact on fair value gains/losses in the Income Statement as any change in the value of the cross currency interest rate swaps would be offset by a corresponding movement in the value of Euro and US \$ interest bearing loans and borrowings under the designated hedging relationship.

Other market risks

At the period end the Company had no other material exposure to market risks.

(i) Credit risk

Before taking account of any collateral, the maximum exposure to credit risk as at 31 December was

	2007	2006
	£000	£000
Cash and cash equivalents	313	252
Derivative financial instruments	32,768	-
Loans to Group undertakings	776,348	1,777,951
Total on-Balance Sheet and maximum exposure to credit risk	809,429	1,778,203

No impairment has been recognised in respect of any financial asset, and no financial assets were past due.

Notes to the Financial Statements for the year ended 31 December 2007 (continued)

11 Financial instruments (continued)

c Nature and extent of risks arising from financial instruments (continued)

(u) Liquidity risk

There is a liquidity facility of £30 0m provided by Rabobank Group in the event that the Company is unable to meet its financial commitments, on a temporary basis, in certain circumstances and subject to certain criteria. This facility was not required during the current or preceding year.

The contractual undiscounted cash flows associated with financial liabilities were as follows:

2007	On demand £000	In not more than three months £000	In more than three months but not more than one year £000	In more than one year but not more than five years £000	In more than five years £000	Total £000
Interest-bearing loans and borrowings	-	154,748	27,967	757,686	-	940,401
Total	-	154,748	27,967	757,686	-	940,401

2006	On demand £000	In not more than three months £000	In more than three months but not more than one year £000	In more than one year but not more than five years £000	In more than five years £000	Total £000
Derivative financial instruments	-	4,368	42,584	27,214	-	74,166
Interest-bearing loans and borrowings	-	20,384	1,157,838	737,572	-	1,915,794
Total	-	24,752	1,200,422	764,786	-	1,989,960

The cash flows above assume that the loan notes are redeemed on the earliest possible date that the Company could be compelled to redeem them.

(v) Currency risk

The Group's policy is to hedge all material foreign currency exposures. Due to the use of derivatives, at 31 December 2007 the Company had no net material exposure to foreign exchange fluctuations or changes in foreign currency interest rates. The impact on the Company's profit of reasonably possible changes in exchange rates compared to actual rates would have been immaterial at 31 December 2007, the movement in value of the floating rate notes would be offset by movement in value of derivatives.

Excluding the effects of derivatives, the amounts of financial assets and liabilities denominated in foreign currencies were as follows:

	Sterling £000	Euro £000	US \$ £000	Total £000
At 31 December 2007				
Financial assets				
Loans to Group undertakings	776,348	-	-	776,348
Cash and cash equivalents	313	-	-	313
Derivative financial instruments	(471,462)	504,230	-	32,768
Total financial assets	305,199	504,230	-	809,429
Financial liabilities				
Interest-bearing loans and borrowings	310,958	498,663	-	809,621
Total financial liabilities	310,958	498,663	-	809,621

Notes to the Financial Statements for the year ended 31 December 2007 (continued)

11 Financial instruments (continued)

(iii) Currency risk (continued)

	Sterling £000	Euro £000	US \$ £000	Total £000
At 31 December 2006				
Financial assets				
Loans to Group undertakings	1,777,951	-	-	1,777,951
Cash and cash equivalents	252	-	-	252
Total financial assets	1,778,203	-	-	1,778,203
Financial liabilities				
Interest-bearing loans and borrowings	559,983	997,137	183,929	1,741,049
Derivative financial instruments	1,226,044	(1,004,592)	(184,321)	37,131
Total financial liabilities	1,786,027	(7,455)	(392)	1,778,180

(d) Concentrations of risk

The Company operates primarily in the UK and adverse changes to the UK economy could impact on all areas of the Company's business. The loan to Group undertakings is due from one entity, Aire Valley Funding 1 Limited, and represents an interest in a portfolio of mortgage loans secured on residential properties in England, Scotland and Wales. In turn Aire Valley Funding 1 Limited's ability to meet its loan obligations to the Company is based upon its cash receipts from its interest in the portfolio.

(e) Derivatives and hedging

The Company had the following types of derivatives and hedges

	Nominal amounts £000	Fair value hedges £000	Total derivatives £000
At 31 December 2007			
Cross-currency interest rate swaps	465,000	32,768	32,768
Total asset balances	465,000	32,768	32,768
At 31 December 2006			
Cross-currency interest rate swaps	1,215,000	(37,131)	(37,131)
Total liability balances	1,215,000	(37,131)	(37,131)
Fair value movements in the Income Statement comprised the following		2007 £000	2006 £000
Net gains/(losses) on hedging swaps		69,570	(46,360)
Net (losses)/gains on hedged instruments		(69,799)	46,360
		(229)	-

Cross-currency swaps are used to hedge the interest and exchange rate risk on the floating rate notes. This represents an effective economic hedge, but for accounting purposes there is some hedge ineffectiveness which is a timing issue only.

Notes to the Financial Statements for the year ended 31 December 2007 (continued)

12 Called up share capital

Ordinary shares of £1 each	2007 Shares	2006 Shares	2007 £	2006 £
Authorised				
At 1 January and 31 December	<u>100,000</u>	<u>100,000</u>	<u>100,000</u>	<u>100,000</u>
Allotted, issued and fully paid				
At 1 January and 31 December				
Ordinary shares of £1 each fully paid	2	2	2	2
Ordinary shares of £1 each partly paid	<u>49,998</u>	<u>49,998</u>	<u>12,499</u>	<u>12,499</u>
	<u>50,000</u>	<u>50,000</u>	<u>12,501</u>	<u>12,501</u>

The shares rank equally in respect of rights attaching to voting, dividends and in the event of a winding up

13 Capital structure

The Company's capital is represented by the capital and reserves attributable to equity holders. The Company is not subject to externally imposed capital requirements other than the minimum share capital required by the Companies Act, with which it complies. The Company manages its capital and reserves in order that there is sufficient capital to meet the needs of the Company in its operations.

14 Ultimate parent undertaking

The Company's immediate parent undertaking is Aire Valley Holdings Limited, a limited liability company incorporated in the United Kingdom and registered in England and Wales.

The Company's ultimate parent undertaking is SFM Corporate Services Limited, a limited liability company incorporated in the United Kingdom and registered in England and Wales under the Companies Act 1985, which holds the shares of Aire Valley Holdings Limited on a discretionary trust basis for charitable purposes.

Copies of the financial statements of SFM Corporate Services Limited and Aire Valley Holdings Limited may be obtained from the Company Secretary at 35 Great St Helen's, London EC3A 6AP.

Under IFRS, the Company's ultimate controlling party is Bradford & Bingley plc, a company incorporated in the United Kingdom and registered in England and Wales under the Companies Act 1985. Bradford & Bingley plc heads the largest and smallest group of companies into which the Financial Statements of the Company are consolidated. Copies of the financial statements of Bradford & Bingley plc may be obtained from the Company Secretary at Croft Road, Crossflatts, Bingley, West Yorkshire BD16 2UA.