AIRE VALLEY FUNDING 2 LIMITED

Directors' Report and Financial Statements

Registered number: 5165234

31 December 2008

Directors' Report and Financial Statements

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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 2008

The Directors present their Report and Financial Statements for the year ended 31 December 2008.

Principal activities and business review

Aire Valley Funding 2 Limited ("the Company") is a limited liability company incorporated in the United Kingdom under the Companies Act 1985 and registered in England and Wales.

Both the issued shares in the Company are held by Aire Valley Holdings Limited.

The Company's principal activity is to acquire an interest in a portfolio of mortgage loans by means of a beneficial interest in the assets of Aire Valley Trustee Limited ("the Trust"). These assets comprise mortgage loans originated by Bradford & Bingley plc, secured on residential property. The Company receives a share of the Trust's income in proportion to the Company's share of the mortgage assets of the Trust. As the loan notes have been redeemed, the Company no longer has a share of the mortgage pool.

The profits of the Company are pre-determined under the terms of the securitisation transaction to which the Company is a party. The Company retains the right to retain a maximum of 0.01% of available revenue receipts from the beneficial interest in the mortgage portfolio. Profits in excess of the retained amount accrue to Bradford & Bingley plc, the originator of the underlying mortgage loans. The results for the year are shown in the Income Statement on page 9. The profit after tax for the year ended 31 December 2008 was £1,000 (2007: profit £3,000).

The loan to originator of £1bn and other amounts owed to Group undertakings were repaid in July 2008.

The key performance indicators for the trust mortgage pool showed the following:

	As at 31-Dec-08	As at 31-Dec-07
Number of properties in possession	**86**	96
Principal value of these	**£14,760,481**	£15,531,554
Arrears value on these	**£824,274**	£1,051,280
Number of loans in arrears by more than 3 months	**3,457**	816
Principal value of these	**£518,711,414**	£117,903,724
Arrears value on these	**£16,239,469**	£3,989,106

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 (2007: £nil).

Future developments

There are no further mortgage portfolio transfers planned for 2009.

Directors' Report for the year ended 31 December 2008 (continued)

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 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 the Company's risks and their management and control are provided in note 13.

The Company has entered into contracts with a number of third parties to provide operational support including corporate services, cash management and servicing of the loans in the Trust.

The programme documentation also sets out a number of business risks through asset and non asset trigger events. The occurrence of these events would lead to the early redemption of inter company funding. There have been no trigger events in the period under review but the intercompany funding has been redeemed. The Company's operations are also subject to periodic review by the Bradford & Bingley plc internal audit department.

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 terms.

Directors and their interests

The Directors who served during the year were as follows:

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

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 capital of Aire Valley Holdings Limited at any time during the year 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.

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 that 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.

Political and charitable contributions

During the year no political or charitable contributions were made (2007: £nil).

Auditor

The Companies Act 2006 (the "Act") removes the requirement for a private company to hold an AGM for financial years ending after 1 October 2007. The Act also repeals the obligation to lay annual accounts and reports before the general meeting and provides for a duly appointed Auditor to remain in office without the need for annual reappointment. KPMG Audit plc have expressed their willingness to continue in office as Auditor.

By order of the Board

SFM Corporate Services Limited
Company Secretary

24 June 2009

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 and applicable laws.

The Financial Statements are required by law to present fairly the financial position 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 the 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 they 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 Funding 2 Ltd

We have audited the Financial Statements of Aire Valley Funding 2 Limited for the year ended 31 December 2008 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 whether in our opinion the Directors' Report is consistent with the Financial Statements.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We read the Directors' Report and consider whether it is consistent with the audited Financial Statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Financial Statements. Our responsibilities do not extend to any other information.

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.

Independent Auditor's Report to the members of Aire Valley Funding 2 Ltd (continued)

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 2008 and of its profit 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
24 June 2009

1 The Embankment
Neville Street
Leeds
LS1 4DW

Income Statement for the year ended 31 December

	Note	2008 £000	2007 £000
Interest receivable and similar income	2	**33,833**	62,676
Interest expense and similar charges	3	**(33,655)**	(62,372)
Net interest income		**178**	304
Operating expenses	4	**(175)**	(298)
Profit before taxation		**3**	6
Taxation	5	**(2)**	(3)
Profit for the financial year		**1**	3

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 United Kingdom.

The notes on pages 13 to 25 form part of these Financial Statements.

Balance Sheet at 31 December

	Note	2008 £000	2007 £000
Assets			
Deferred tax assets	8	7	6
Total non-current assets		7	6
Cash and cash equivalents		7,575	29,230
Loan to originator due within one year	7	-	1,003,605
Derivative financial instruments		-	402
Current tax assets		2	3
Prepayments and accrued income		13	110
Total current assets		7,590	1,033,350
Total assets		7,597	1,033,356
Equity			
Capital and reserves attributable to equity holder:			
Share capital	9	-	-
Retained earnings		13	12
Total attributable equity		13	12
Liabilities			
Interest-bearing loans and borrowings due within one year	10	7,584	1,032,942
Accruals and deferred income		-	402
Total current liabilities		7,584	1,033,344
Total liabilities		7,584	1,033,344
Total equity and liabilities		7,597	1,033,356

The notes on pages 13 to 25 form part of these Financial Statements.

The Financial Statements were approved by the Board of Directors and authorised for issue on 26 June 2009 and signed on its behalf by:

per pro SFM Directors Limited
Director
26 June 2009

Statement of Changes in Equity for the year ended 31 December

	Share capital £000	Retained earnings £000	Total equity £000
At 1 January 2008	**-**	**12**	**12**
Profit for the financial year	**-**	**1**	**1**
At 31 December 2008	**-**	**13**	**13**
At 1 January 2007	-	9	9
Profit for the financial year	-	3	3
At 31 December 2007	-	12	12

Cash Flow Statement for the year ended 31 December

	2008	2007
	£000	£000
Cash flows from operating activities		
Profit for the financial year	**1**	3
Adjustments for:		
Income tax expense	**2**	3
Cash flows from operating activities before changes in operating assets and liabilities	**3**	6
Net decrease/(increase) in operating assets:		
Derivative financial instruments	**402**	2,487
Prepayments and accrued income	**97**	(18)
Loan to originator	**1,003,605**	(3,958)
Net (decrease)/increase in operating liabilities:		
Accruals and deferred income	**(402)**	252
Cash generated from operations	**1,003,705**	(1,231)
Taxation paid	**(2)**	(8)
Net cash from operating activities	**1,003,703**	(1,239)
Cash flows from financing activities:		
Amounts due to Group undertakings	**(1,004,858)**	9,935
Swap collateral	**-**	(22,142)
Subordinated liabilities	**(20,500)**	-
Net cash from financing activities	**(1,025,358)**	(12,207)
Net (decrease) in cash and cash equivalents	**(21,655)**	(13,446)
Cash and cash equivalents at beginning of year	**29,230**	42,676
Cash and cash equivalents at end of year	**7,575**	29,230

Notes to the Financial Statements for the year ended 31 December 2008

1. Principal accounting policies

Aire Valley Funding 2 Limited ("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 2008 the Company has not adopted the February 2008 amendment to IAS 1 "Presentation of Financial Statements" or IFRS 8 "Operating Segments" issued by the IASB in November 2006. They are both mandatory for 2009 financial statements; these statements relate 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".

The Financial Statements are presented in pounds sterling, which is the currency of the Company's primary operating environment, and on a going concern basis, given the "bankruptcy remote" nature of the entity as a special purpose vehicle.

Judgements made by the Directors in the application of these accounting policies that have significant effect on the Financial Statements and estimates with a significant risk of material adjustment in the next year are discussed in note 12.
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 financial instruments measured at amortised cost, 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 discounts as well as interest.

(d) Taxation

The charge for taxation is based on the result 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 2008 (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) Subordinated liabilities and amounts owed to Group undertakings

On initial recognition, subordinated liabilities and amounts owed to Group undertakings are measured at their fair value net of directly attributable transaction costs and discounts, in accordance with IAS 39 "Financial Instruments: Recognition and Measurement". Subsequent measurement is at amortised cost using the EIR method.

(g) Deferred consideration

Under the terms of the beneficial interest in the mortgage portfolio, the Company retains the right to a maximum of 0.01% of interest receivable on the beneficial interest in the underlying mortgage portfolio. Profits in excess accrue to Bradford & Bingley plc, the originator of the underlying mortgages. The payment of deferred consideration is strictly governed by the priority of payments which set out how the cash is utilised. Deferred consideration is deducted from interest receivable and similar income.

(h) Derivative financial instruments

Derivative financial instruments are carried at their fair value. Changes in fair value are taken to the Income Statement.

(i) Loan to originator

Mortgages are not carried on the Company's Balance Sheet because Bradford & Bingley plc retains much of the risks and rewards associated with the mortgages. Instead, the Company carries on its Balance Sheet a "loan to originator". The loan is carried at fair value.

(j) 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) 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.

Notes to the Financial Statements for the year ended 31 December 2008 (continued)

1. Principal accounting policies (continued)

(j) Classification of financial instruments (continued)

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 uncollectable.

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 expected future cash flows 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 that occur are included in the Income Statement.

2. Interest receivable and similar income

	2008	2007
	£000	£000
Interest on loan to originator	26,290	53,729
Bank interest	3,129	2,122
Swap interest	4,414	6,825
	33,833	62,676

Deferred consideration has been deducted from interest receivable on loan to originator, as part of the effective yield.
No assets were considered to be impaired during the year or previous year, and consequently the interest income for the year on impaired assets was £nil (2007: £nil).

3. Interest expense and similar charges

	2008	2007
	£000	£000
Interest on amounts owed to Group undertakings	32,723	59,826
Interest on subordinated liabilities	831	1,523
Amortisation of issue costs	13	-
Interest on swap collateral	88	1,023
	33,655	62,372

4. Operating expenses

	2007	2007
	£000	£000
Cash management fees	139	250
Legal and professional fees	36	48
	175	298

Auditors' remuneration of £5,424 (2007: £6,000) was borne by Bradford & Bingley plc.

Notes to the Financial Statements for the year ended 31 December 2008 (continued)

5. Taxation

	2008	2007
	£000	£000
Current taxation expense:		
UK corporation tax on profit for the year	**1**	1
Adjustments in respect of previous years	**1**	(1)
Total current taxation	**2**	-
Deferred taxation:		
Origination and reversal of temporary differences	**-**	3
Total taxation expense per the Income Statement	**2**	3
Profit before taxation	**3**	6
UK corporation tax at 28.5% (2007: 30%)	**1**	2
Effects of other tax rates/credits	**-**	(1)
Adjustments in respect of previous years	**1**	2
Total taxation expense per the Income Statement	**2**	3

6. Employees and Directors' emoluments

There were no employees during the year or previous year 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 11).

Notes to the Financial Statements for the year ended 31 December 2008 (continued)

7. Loan to originator

	2008 Loan to originator £000	**2008 Fair value adjustment £000**	**2008 Total £000**
At 1 January 2008	**1,004,565**	**(960)**	**1,003,605**
Net increase/(decrease)	**(1,004,565)**	**960**	**(1,003,605)**
At 31 December 2008	**-**	**-**	**-**

Non-current assets	-
Current assets	-
At 31 December 2008	-

	2007 Loan to originator £000	2007 Fair value adjustment £000	2007 Total £000
At 1 January 2007	1,002,417	(2,770)	999,647
Net increase	2,148	1,810	3,958
At 31 December 2007	1,004,565	(960)	1,003,605

Non-current assets	-
Current assets	1,003,605
At 31 December 2007	1,003,605

The mortgage loan portfolio, which is accounted for as a loan to originator, and in which the Company holds a beneficial interest, is held on trust for the Company and the originator of the mortgage loans by Aire Valley Trustee Limited ("the Trust"). The mortgage loans are secured on residential property in England, Wales and Scotland.

Income on the loan to originator, which arises on the underlying mortgages, reflects fixed, variable and tracker rates but the basis swap converts the rate to a LIBOR-based rate.

Notes to the Financial Statements for the year ended 31 December 2008 (continued)

8. Deferred tax

	Assets 2008 £000	Assets 2007 £000	**Liabilities 2008 £000**	Liabilities 2007 £000	**Net 2008 £000**	Net 2007 £000
Other assets	**7**	6	**-**	-	**7**	6
Other liabilities	**-**	-	**-**	-	**-**	-
	7	6	**-**	-	**7**	6

The movements in the Company's temporary differences during the year were as follows:

	As at 1 January 2008 £000	**Recognised in income £000**	**As at 31 December 2008 £000**
Other assets	**6**	**1**	**7**
Other liabilities	**-**	**-**	**-**
	6	**1**	**7**

	As at 1 January 2007 £000	Recognised in income £000	As at 31 December 2007 £000
Other assets	9	(3)	6
Other liabilities	-	-	-
	9	(3)	6

9. Called up share capital

Ordinary shares of £1 each	**2008 Shares**	2007 Shares	**2008 £**	2007 £
Authorised				
At start and end of year	**100**	100	**100**	100
Allotted, issued and fully paid				
At start and end of year	**2**	2	**2**	2

These shares rank equally in respect of rights attached to voting, dividends and in the event of a winding up.

10. Interest-bearing loans and borrowings

	2008 £000	2007 £000
Current liabilities		
Amounts owed to Group undertakings	**7,584**	1,012,442
Subordinated liabilities	**-**	20,500
	7,584	1,032,942

Notes to the Financial Statements for the year ended 31 December 2008 (continued)

10. Interest-bearing loans and borrowings (continued)

The subordinated debt represented the start up loan repayable to Bradford & Bingley plc. The loan was in place to contribute to the purchase of the beneficial interest in the Trust, create a reserve fund to support any future losses and to fund issue costs. In August 2008, the start up loan was re-paid to Bradford & Bingley plc.

As at 31 December 2007 amounts owed to Group undertakings represented loans from Aire Valley Warehousing 3 Limited which were denominated in Sterling and at a variable rate of interest. These loans were ultimately secured against a beneficial interest in a mortgage portfolio held in trust on behalf of Aire Valley Funding 2 Limited.

The floating rate notes were repaid in July 2008.

11. Related parties 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, the third is an employee of Bradford & Bingley plc (the controlling party under IFRS). The Company pays a corporate service fee to SFM in connection with its supply of corporate management services, including the provision of directors. The fee payable amounted to £6,000 (2007: £7,000).

The Company pays cash management fees and mortgage loan administration servicing fees to Bradford & Bingley plc.

Bradford & Bingley plc has provided the Company with start-up loans and is the counterparty to an interest rate swap agreement on which there is an associated interest benefit. The start-up loan was re-paid to Bradford & Bingley plc in August 2008.

Notes to the Financial Statements for the year ended 31 December 2008 (continued)

11. Related parties disclosures (continued)

During the year and previous year the Company undertook the following transactions with companies within the Aire Valley Holdings Limited Group and the Bradford & Bingley plc Group.

	Bradford & Bingley plc and subsidiaries 2008 £000	**Aire Valley Holdings Limited and subsidiaries 2008 £000**	Bradford & Bingley plc and subsidiaries 2007 £000	Aire Valley Holdings Limited and subsidiaries 2007 £000
Interest receivable and similar income				
Interest on loan to originator	**26,290**	-	53,729	-
Swap interest	**4,414**	-	6,825	-
Interest expense and similar charges				
Interest on amounts owed to Group undertakings	-	**(32,723)**	-	(59,826)
Interest on subordinated liabilities	**(831)**	-	(1,523)	-
Interest on swap collateral	**(88)**	-	(1,023)	-
Operating expenses				
Cash management fees	**(139)**	-	(250)	-
Current assets				
Loan to originator due within one year	-	-	1,003,605	-
Derivative financial instruments	-	-	402	-
Current liabilities				
Amounts owed to Group undertakings	-	**(7,584)**	-	(1,012,442)
Subordinated liabilities	-	-	(20,500)	-
Accruals and deferred income	-	-	(402)	-

Auditors remuneration of £5,424 (2007: £6,000) was borne by Bradford & Bingley plc.

12. Critical accounting judgements and estimates

In preparation of the Company's Financial Statements judgements and estimates are made which affect the reported amounts of assets and liabilities; judgements and estimates are kept under continuous evaluation. Judgements and estimates 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 discounted expected future cash flows.

Recognition and derecognition

Where a transfer of financial assets does not qualify for derecognition the transferee does not recognise the transferred asset; instead it recognises the consideration paid and a receivable from the transferor. In respect of the interest in the mortgage portfolio transferred to Aire Valley Trustee Ltd, it is considered that the significant risks and rewards of ownership remain with the loan originator, Bradford & Bingley plc. Therefore the Company recognises the acquisition of the beneficial interest in the mortgage portfolio as a collateralised loan with the originator.

Notes to the Financial Statements for the year ended 31 December 2008 (continued)

13. Financial instruments

The Company's financial instruments comprise a loan to Bradford & Bingley plc (representing the Company's investment in a beneficial interest in Bradford & Bingley plc mortgage portfolios), derivative contracts, cash and interest bearing loans and borrowings

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

At 31 December 2008 **Financial assets**	Assets at fair value through profit or loss on initial recognition	Loans and receivables	Total carrying value	Fair value	If fair values increased by 1%
	£000	£000	£000	£000	£000
Cash and cash equivalents	-	7,575	7,575	7,575	76
Prepayments and accrued income	-	13	13	13	-
Total financial assets	-	7,588	7,588	7,588	76

Financial liabilities	Liabilities at amortised cost	Total carrying value	Fair value	If fair values increased by 1%
	£000	£000	£000	£000
Amounts owed to Group undertakings	7,584	7,584	7,584	76
Total financial liabilities	7,584	7,584	7,584	76

At 31 December 2007 Financial assets	Assets at fair value through profit or loss on initial recognition	Loans and receivables	Total carrying value	Fair value	If fair values increased by 1%
	£000	£000	£000	£000	£000
Cash and cash equivalents	-	29,230	29,230	29,230	292
Loan to originator	1,003,605	-	1,003,605	1,003,605	10,036
Derivative financial instruments	402	-	402	402	4
Prepayments and accrued income	-	110	110	110	1
Total financial assets	1,004,007	29,340	1,033,347	1,033,347	10,333

Financial liabilities	Liabilities at amortised cost	Total carrying value	Fair value	If fair values increased by 1%
	£000	£000	£000	£000
Amounts owed to Group undertakings	1,012,442	1,012,442	1,012,442	10,124
Subordinated liabilities	20,500	20,500	20,500	205
Accruals and deferred income	402	402	402	4
Total financial liabilities	1,033,344	1,033,344	1,033,344	10,333

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

The loan to originator and derivative financial instruments are carried at fair value, derived by use of net present value models.

Notes to the Financial Statements for the year ended 31 December 2008 (continued)

13. Financial instruments (continued)

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

During the year total income and expense (calculated using the Effective Interest Rate method) for financial assets and financial liabilities that are not at fair value through profit or loss were:

	2008	2007
	£000	£000
Interest receivable		
Bank interest	3,129	2,122
	3,129	2,122
Interest expense		
Interest on amounts owed to Group undertakings	32,723	59,826
Interest on subordinated liabilities	831	1,523
Amortisation of issue costs	13	-
Interest on swap collateral	88	1,023
	33,655	62,372

No assets were considered to be impaired during the year or previous year, and consequently the interest income for the year on impaired assets was £nil (2007: £nil).

(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 are established on the commencement of the securitisation transactions, with the Company's activities and the roles of other parties defined in the programme documentation.

The Company does not enter into transactions involving financial assets or liabilities which are listed or publicly traded or for which a liquid market exists.

The main financial risks arising from the Company's activities are credit risk, liquidity risk and interest rate risk. Financial instruments used by the Company for risk management purposes include derivative instruments. Such instruments are used only for commercial hedging purposes, not for trading or speculative purposes, to hedge interest rate risk arising as part of the securitisation transaction. 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.

Credit risk

Credit risk reflects the risk that a counterparty of the Company will be unable or unwilling to meet a contractual commitment that it has entered into with the Company. The Company is exposed to credit risk arising from the loan to originator, derivative counterparties and deposits with third party banks.

The Company's ability to meet payments on its liabilities relies on the receipt of funds on the loan to originator which is in turn 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 document. Credit risk also exists on the derivative contracts entered into; the swap counterparties are required to have a minimum credit rating as outlined in the transaction document.

The Company has appointed Bradford & Bingley Plc as servicer of the loans in the mortgage portfolio to help reduce the risk of loss. The repayment of mortgage loans is monitored in line with Bradford & Bingley Plc credit policy. The servicer is also responsible for ensuring mortgages in the Trust meet the eligibility criteria determined in the transaction documentation, Further information on the credit quality of the portfolio of mortgages in the Trust is provided in the Directors' report on page 4.

The exposure to credit risk is represented by the carrying amount of each financial asset, as set out in the table in note 13 c(i).

Notes to the Financial Statements for the year ended 31 December 2008 (continued)

13. Financial instruments (continued)

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

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, by smoothing mismatches between maturing assets and liabilities. The Company's ability to meet payments on the intercompany borrowings from Aire Valley Warehousing 3 relies on the receipt of payments on the loan to originator, which is in turn dependent on the payments on the underlying mortgage portfolios. Table 13c (ii) below summarises the undiscounted cash flows associated with the Company's financial liabilities as at 31 December 2008 and 31 December 2007.

Interest rate risk

The Company is exposed to movements in interest rates due to mismatches between the dates on which interest receivable on assets and interest payable on liabilities are next reset, or maturity if earlier. The Company takes out derivative instruments to manage interest rate mismatches.

Other market risks

At the year end the Company had no other material exposure to market risks (2007: £nil).

Notes to the Financial Statements for the year ended 31 December 2008 (continued)

13. Financial instruments (continued)

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

(i) Credit risk

Before taking account of any collateral, the exposure to credit risk was:

	2008	2007
	£000	£000
Cash and cash equivalents	7,575	29,230
Loan to originator	-	1,003,605
Derivative financial instruments	-	402
Prepayments and accrued income	13	110
Total maximum exposure to credit risk	**7,588**	1,033,347

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

(ii) Liquidity risk

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

At 31 December 2008	On demand £000	In not more than 3 months £000	In more than 3 months but not more than 1 year £000	In more than 1 year but not more than 5 years £000	In more than 5 years £000	Total £000
Interest-bearing loans and borrowings	7,584	-	-	-	-	7,584
Total outflows	7,584	-	-	-	-	7,584

At 31 December 2007	On demand £000	In not more than 3 months £000	In more than 3 months but not more than 1 year £000	In more than 1 year but not more than 5 years £000	In more than 5 years £000	Total £000
Interest-bearing loans and borrowings	5,674	11,347	1,043,194	-	-	1,060,215
Accruals and deferred income	402	-	-	-	-	402
Total outflows	6,076	11,347	1,043,194	-	-	1,060,617

The undiscounted cash flows above assume the following:

- Loan notes are redeemed on the scheduled dates;
- The loan to originator reduces pro-rata to the redemption of the loan notes;
- Interest rates remain unchanged from the rates as at the Balance Sheet date; and
- The rate of interest on the loan to originator remains constant after the Balance Sheet date through to final redemption of the loan notes and the loan to originator.

Notes to the Financial Statements for the year ended 31 December 2008 (continued)

13. Financial instruments - (continued)

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

(iii) Interest rate risk

The Company's loan to originator and amounts owed to Group undertakings were repaid in July 2008 and therefore the Company is no longer subject to interest rate risk.

(d) Derivatives

The Company had the following types of derivatives:

	Nominal amounts	Fair value
At 31 December 2008	**£000**	**£000**
Interest rate swaps	**-**	**-**
At 31 December 2007		
Interest rate swaps	1,000,000	402

Fair value movements in the Income Statement comprised the following:	**2008**	2007
	£000	£000
Net (losses) on interest rate swaps	**(960)**	(1,810)
Net gains on fair value adjustment to loan to originator	**960**	1,810
	-	-

Interest rate swaps are used as an economic hedge against interest rate risk on the loan to originator, but hedge accounting is not applied; instead the loan to originator is carried at fair value.

14. 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.

15. Ultimate parent undertaking

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

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

Under IFRS, the Company's controlling party is Bradford & Bingley plc, a company incorporated in the United Kingdom under the Companies Act 1985 and registered in England and Wales. 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.

As a result of The Bradford & Bingley plc Transfer of Securities and Property etc. Order 2008, which transferred all shares in Bradford & Bingley plc to the Treasury Solicitor as nominee for HM Treasury on 29 September 2008, the Company considers Her Majesty's Government to be the ultimate controlling party from that date.