AIRE VALLEY MORTGAGES 2005 - 1 PLC

Directors' Report and Financial Statements

Registered number: 5343520

31 December 2005

Company Information

Directors

Swift Incorporations Limited	(Appointed 26 January 2005, resigned 26 January 2005)
SFM Directors Limited	(Appointed 26 January 2005)
SFM Directors (No.2) Limited	(Appointed 26 January 2005)
Rosemary Prudence Thorne	(Appointed 4 March 2005, resigned 29 November 2005)
Christopher Donald Gillespie	(Appointed 29 November 2005)

Secretary

SFM Corporate Services Limited	(Appointed 26 January 2005)

Registered Office

35 Great St. Helen's
London
EC3A 6AP

Auditor

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

Directors' Report and Financial Statements

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Directors' Report for the period ended 31 December 2005

The Directors present their first Report and Financial Statements for the period ended 31 December 2005.

Principal activities

Aire Valley Mortgages 2005 - 1 Plc ("the Company") is a limited company incorporated on 26 January 2005 in the United Kingdom under the Companies Act 1985 and registered in England and Wales. The company is part of the Aire Valley Holdings Limited Group.

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.

The Company issued £1.0bn floating rate notes to the market on the 28th April 2005.

Aire Valley Holdings Limited holds 49,998 £1 quarter paid shares and one £1 fully paid share, and SFM Nominees Limited the share nominee owns one £1 fully paid share.

Business review

The results for the period are shown in the Income Statement on page 8. The profit after taxation was £2,358.

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. 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 11.

Dividend

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

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

The Directors who served during the period were as follows:

Swift Incorporations Limited	(Appointed 26 January 2005, resigned 26 January 2005)
SFM Directors Limited	(Appointed 26 January 2005)
SFM Directors (No.2) Limited	(Appointed 26 January 2005)
Rosemary Prudence Thorne	(Appointed 4 March 2005, resigned 29 November 2005)
Christopher Donald Gillespie	(Appointed 29 November 2005)

Rosemary Thorne, Christopher Gillespie, SFM Directors Limited and SFM Directors (No.2) Limited are or have been Directors of Aire Valley Holdings Limited during the period. No Director had any interest in the share or loan capital of the Company at any time during the period.

Directors' Report for the period ended 31 December 2005 (continued)

International Financial Reporting Standards
Aire Valley Mortgages 2005-1 Plc has adopted International Financial Reporting Standards (IFRS) with effect from incorporation on 26 January 2005.

Political and charitable contributions
During the period no political or charitable contributions were made.

Auditor
KPMG Audit plc was appointed auditor on 17 February 2005. 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 forthcoming Annual General Meeting.

By order of the Board

SFM Corporate Services Limited
Company Secretary

30 June 2006

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 they are required 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 for that period; 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 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 2005 - 1 Plc

We have audited the Financial Statements of Aire Valley Mortgages 2005 - 1 plc for the period ended 31 December 2005 which comprise the Income Statement, the Balance Sheet, the Cash Flow Statement, the Statement of Changes in Equity 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
As described in the Statement of Directors' Responsibilities set out on page 6 the Company's Directors are responsible for the preparation of the Financial Statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU.
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 not consistent with the Financial Statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and 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 2005 and of its profit for the period then ended; and
- have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants
Registered Auditor
30 June 2006

1 The Embankment
Neville Street
Leeds
LS1 4DW

Income Statement for the period ended 31 December 2005

	Note	2005 £000
Interest and similar income	2	33,702
Interest expense and similar charges	3	(33,674)
Net interest income		28
Operating expenses	4	(25)
Profit before taxation		3
Taxation	5	(1)
Profit for the financial period		2

The results above arise from the Company's single continuing activity and are attributable to the equity shareholders.

The notes on pages 12 to 25 form part of these Financial Statements.

Balance Sheet as at 31 December 2005

	Note	£000
Assets		
Loans to Group undertaking	8	999,961
Total non-current assets		**999,961**
Loans and advances to banks		13
Derivative financial instruments	11	2,049
Prepayments and accrued income		2
Total current assets		**2,064**
Total assets		**1,002,025**
Equity		
Capital and reserves attributable to equity holders		
Share capital	12	13
Retained earnings		2
Total attributable equity		**15**
Liabilities		
Floating rate notes	7	1,000,833
Total non-current liabilities		**1,000,833**
Accruals and deferred income		1,176
Current tax liabilities	5	1
Total current liabilities		**1,177**
Total liabilities		**1,002,010**
Total equity and liabilities		**1,002,025**

The notes on pages 12 to 25 form part of these Financial Statements.

The Financial Statements were approved by the Board of Directors and authorised for issue on 30 June 2006 and signed on its behalf by:

per pro SFM Directors Limited
as Director

Director

Statement of Changes in Equity

	Share Capital £000	Retained earnings £000	Total Equity £000
On incorporation as at 26 January 2005	-	-	-
Issue of share capital	13	-	13
Profit for the period	-	2	2
As at 31 December 2005	13	2	15

The notes on pages 12 to 25 form part of these Financial Statements.

Cash Flow Statement for the period ended 31 December 2005

	2005 £000
Cash flows from operating activities	
Profit for the financial period	2
Adjustments for:	
Income tax expense	1
Cash flows from operating activities before changes in operating assets and liabilities	3
Net (increase) in operating assets:	
Loans to Group undertaking	(999,961)
Prepayments and accrued income	(2)
Derivative financial instruments	(2,049)
Net increase in operating liabilities:	
Accruals and deferred income	1,176
Other non-cash items	2,464
Cash absorbed by operations	(998,369)
Taxation paid	-
Net cash from operating activities	(998,369)
Cash flows from financing activities:	
Issue of floating rate notes	998,369
Issue of share capital	13
Net cash from financing activities	998,382
Net increase in cash and cash equivalents	13
Cash and cash equivalents at beginning of period	-
Cash and cash equivalents at end of period	13
Represented by cash and assets with original maturity of 3 months or less within:	
Loans and advances to banks	13
	13

The notes on pages 12 to 25 form part of these Financial Statements.

Notes to the Financial Statements for the period ended 31 December 2005

1. Significant accounting policies

Aire Valley Mortgages 2005 - 1 Plc (the "Company") is a 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 IFRSs").

(b) Basis of preparation

The Financial Statements are prepared on the historical cost basis.

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

The Directors consider that the accounting policies set out below are the most appropriate to the Company's circumstances and have been consistently applied.

(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 period 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 at the Balance Sheet date in accordance with IAS 12 "Income Taxes", 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 period ended 31 December 2005 (continued)

1. Significant 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) 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 amortised cost; or
(vi) At fair value through profit or loss.

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

The Company does not carry any financial instruments at "fair value".

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 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 that occur will be included in the Income Statement as "fair value movements on financial instruments".

(g) 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. The carrying value of floating rate notes which are effectively hedged is adjusted by the change in fair value of the hedged risk.

Notes to the Financial Statements for the period ended 31 December 2005 (continued)

1. Significant accounting policies (continued)

(h) Derivative financial instruments

All derivatives are carried at fair value in the Balance Sheet in accordance with IAS 39; as assets when the fair value is positive and as liabilities when the fair value is negative. Changes in the fair value of the derivatives are charged immediately to the Income Statement as the "fair value movements on financial instruments".

(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 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 "interest and similar income" or "interest expense and similar charges" depending on whether the underlying instrument is an asset or a liability.

(j) Profit retention

Under the terms of the securitisation the Company retains the right to the maximum of 0.01% of interest received on loans to Aire Valley Funding 1 Limited.

(k) Hedge accounting

The Company applies fair value hedge accounting. 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 period ended 31 December 2005 (continued)

2 Interest and similar income

	2005
	£000
Interest on loans to Group undertaking	33,702
	33,702

The interest received on impaired assets is £nil

3 Interest expense and similar charges

	2005
	£000
Interest on floating rate notes	23,072
Swap interest	10,602
	33,674

4 Operating expense

	2005
	£000
Legal and professional fees	25

Auditors' remuneration for 2005 was borne by Aire Valley Funding 1 Limited

5 Taxation

	2005
	£
Current tax expense:	
UK corporation tax on profits for the period	1,011
Total current taxation	1,011
Deferred taxation expense	
Origination and reversal of temporary differences	-
Total taxation expense per the Income Statement	1,011

	2005
	£
Profit before taxation	3,369
UK Corporation tax at 30%	1,011
Effects of:	
Expenses not deductible for taxation	-
	1,011

There was no deferred tax provided or unprovided during the period.

6 Employees and Directors emoluments

There were no employees during the period 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 for the provision of Directors (see Note 9)

Notes to the Financial Statements for the period ended 31 December 2005 (continued)

7 *Floating rate notes*

The floating rate notes were issued on 28 April 2005.

Under the terms of the notes any shortfalls arising on the redemption or repossesion of the mortgage assets held in 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 C notes.

	2005
	£000
Series 1 A1 Floating Rate Notes 2066	140,000
Series 1 A2 Floating Rate Notes 2066	304,927
Series 1 B1 Floating Rate Notes 2066	6,000
Series 1 B2 Floating Rate Notes 2066	19,894
Series 1 C2 Floating Rate Notes 2066	28,675
Series 2 A1 Floating Rate Notes 2066	229,000
Series 2 A2 Floating Rate Notes 2066	189,336
Series 2 A3 Floating Rate Notes 2066	26,247
Series 2 B1 Floating Rate Notes 2066	10,000
Series 2 B2 Floating Rate Notes 2066	15,778
Series 2 C2 Floating Rate Notes 2066	28,675
Fair value hedge adjustment	2,464
Issue Costs	(163)
	1,000,833
Non-current	1,000,833
Current	-
	1,000,833

The floating rate notes are denominated in the following currencies:

	2005
	£000
Sterling	385,000
US Dollars	26,247
Euros	587,285
Fair value hedge adjustment	2,464
Issue costs	(163)
	1,000,833

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 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 notes and the Class C notes, subject to the terms and conditions of the notes, the cash management agreement, the deed of charge and the other transaction documents.
Similarly, payments of principal and interest due and payable on the Class B issuer notes will rank ahead of payments of principal and interest due and payable on the Class C issuer notes.

Notes to the Financial Statements for the period ended 31 December 2005 (continued)

7 Floating rate notes (continued)

Interest is payable on the Series 1 Class A1, Class B1, Series 2 Class A1 and Class B1 notes at a variable rate based on three month LIBOR. Interest is payable on the Series 1 Class A2, Class B2, Class C2, Series 2 Class A2, Class B2 and Class C2 notes at a variable rate based on three month EURIBOR. Interest payable on the Series 2 Class A3 notes at variable rates based upon three month US Dollar 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 Group Company, 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.

The estimated market values of the floating rate notes, based on the mid-market price on 31 December 2005, are as follows:

	2005
	£
Series 1 A1 Floating Rate Notes 2066	140,070,000
Series 1 A2 Floating Rate Notes 2066	305,079,464
Series 1 B1 Floating Rate Notes 2066	5,998,800
Series 1 B2 Floating Rate Notes 2066	19,890,021
Series 1 C2 Floating Rate Notes 2066	28,674,800
Series 2 A1 Floating Rate Notes 2066	229,000,000
Series 2 A2 Floating Rate Notes 2066	189,336,000
Series 2 A3 Floating Rate Notes 2066	26,246,719
Series 2 B1 Floating Rate Notes 2066	9,995,000
Series 2 B2 Floating Rate Notes 2066	15,770,111
Series 2 C2 Floating Rate Notes 2066	28,674,800
	998,735,715

8 Loans to Group undertaking

The intercompany loan to Aire Valley Funding 1 Limited is denominated in sterling and is at a variable rate of interest. These loans have 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 loans will depend mainly upon it receiving sufficient revenue receipts and principal on the trust property from the Mortgage Trustee, receiving the required funds from Aire Valley Funding 1 Limited swap provider and utilising amounts available in t reserve funds.

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

Notes to the Financial Statements for the period ended 31 December 2005 (continued)

9 Related parties

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 cash manager and parent undertaking of Mortgage Express, the mortgage loan administrator). The Company pays a corporate service fee to Structured Finance Management Limited in connection with its provision of corporate management services, which includes the provision of two directors to the company. The fees payable for providing this service amounted to £3,271.

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

	Bradford & Bingley Plc and its subsidiaries 2005 £000	Aire Valley Holdings Ltd and its subsidiaries 2005 £000
Interest and similar income		
Income from loans to Group undertaking	-	**33,702**
Non-current assets		
Loans to Group undertaking	-	**999,961**

10 Key sources of estimation uncertainty and judgements in application of accounting policies

In preparation of the Company's accounts 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.

Notes to the Financial Statements for the period ended 31 December 2005 (continued)

11 Financial instruments

a Fair values of financial assets and financial liabilities as at 31 December 2005

	Carrying value £000	Fair value £000
Financial assets		
Loans to Group undertaking	999,961	999,961
Loans and advances to banks	13	13
Derivative financial instruments	2,049	2,049
Total financial assets	1,002,023	1,002,023

	Carrying value £000	Fair value £000
Financial liabilities		
Floating rate notes	1,000,833	998,735
Accruals and deferred income	1,176	1,176
Total financial liabilities	1,002,009	999,911

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

No financial assets were categorised as "held for trading" or "at fair value through profit or loss" during the period.

Notes to the Financial Statements for the period ended 31 December 2005 (continued)

11 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 interest 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:

	2005
	£000
Interest income	
Interest on loan to group undertaking	33,702
	33,702

c Nature and extent of risks arising from financial instruments

The main financial risks arising from the Company's activities are credit risk, liquidity risk, currency 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. The principal derivative instruments used by the Company in managing its risks 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. Substantially all of the Company's derivatives activity is contracted with Group undertakings.

Notes to the Financial Statements for the period ended 31 December 2005 (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 it 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 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

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 minimising mismatches between maturing assets and liabilities. The table in note 11c(ii) summarises the contractual maturities of the Company's assets and liabilities as at 31 December 2005.

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.

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 table in note 11c(iii) summarises interest repricing mismatches as at 31 December 2005.

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 2005 was:

	£000
Loans and advances to banks	13
Loans to Group undertaking	999,961
Derivative financial instruments	2,049
Maximum exposure to credit risk	1,002,023

Notes to the Financial Statements for the period ended 31 December 2005 (continued)

11 Financial instruments (continued)

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

(ii) Liquidity risk

Certain financial instruments may be settled earlier than on their contractual maturity dates, in particular, some of the loans to Group undertakings may mature early, as the debt that the loan supports may be repaid early.

The contractual maturities of the Company's assets and liabilities are as follows:

At 31 December 2005	On demand	In not more than three months	In more than three months but not more than one year	In more than one year but not more than five years	In more than five years	Total
	£000	£000	£000	£000	£000	£000
Assets						
Loans to Group undertaking	-	-	-	-	999,961	999,961
Loans and advances to banks	13	-	-	-	-	13
Derivative financial instruments	2,049	-	-	-	-	2,049
Prepayments and accrued income	2	-	-	-	-	2
Total assets	2,064	-	-	-	999,961	1,002,025
Liabilities						
Floating rate notes	-	-	-	162	1,000,671	1,000,833
Accruals and deferred income	-	1,176	-	-	-	1,176
Current tax liabilities	1	-	-	-	-	1
Total liabilities	1	1,176	-	162	1,000,671	1,002,010
Net liquidity gap	2,063	(1,176)	-	(162)	(710)	15

There is a liquidity facility of provided by Rabo Bank 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. At 31 December 2005 this facility was not required.

Notes to the Financial Statements for the period ended 31 December 2005 (continued)

11 Financial instruments (continued)

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

(iii) Interest rate risk

As at 31 December 2005 effective interest rates on financial instruments fell into the following ranges:

	%
Financial assets	
Loans and advances to banks	3.82 - 5.50
Loans to Group undertaking	2.84 - 3.96
Financial liabilities	
Floating rate notes	2.25 - 5.13

A positive interest rate sensitivity gap exists when more assets than liabilities re-price during a given period. Although net interest income tends to benefit from a positive gap when interest rates are rising (and suffer a negative gap when rates are falling), the actual effect will depend upon a number of factors, including the extent to which repayments are made earlier or later than the next reset or maturity date. The carrying amount of derivative financial instruments, which are principally used to reduce the Company's exposure to currency
movements, are included under the heading "non-interest bearing". The following tables analyse the re-pricing periods of the Company's financial assets and liabilities at 31 December 2005:

Notes to the Financial Statements for the period ended 31 December 2005 (continued)

11 Financial instruments (continued)

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

(iii) Interest rate risk (continued)

After taking into account the cross currency swaps entered into by Credit Suisse First Boston International, ABN AMRO and Barclays Capital on behalf of the Company the interest rate profile of the Company's financial assets and liabilities as at 31 December 2005 was:

	Within 3 months	After 3 months but within 6 months	After 6 months but within 1 year	After 1 year but within 5 years	After 5 years	Non-interest bearing	Total
	£000	£000	£000	£000	£000	£000	£000
At 31 December 2005							
Assets							
Loans to Group undertaking	999,961	-	-	-	-	-	999,961
Loans and advances to banks	13	-	-	-	-	-	13
Derivative financial instruments	-	-	-	-	-	2,049	2,049
Total financial assets	**999,974**	**-**	**-**	**-**	**-**	**2,049**	**1,002,023**
Liabilities							
Floating rate notes	998,369	-	-	-	-	2,464	1,000,833
Accruals and deferred income	-	-	-	-	-	1,176	1,176
Total financial liabilities	**998,369**	**-**	**-**	**-**	**-**	**3,640**	**1,002,009**
Interest rate sensitivity gap	**1,605**	**-**	**-**	**-**	**-**	**(1,591)**	**14**
Cumulative gap	1,605	1,605	1,605	1,605	1,605	14	14

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 loans to Group undertaking are due from one entity, Aire Valley Funding 1 Limited, and are ultimately secured on a benefical interest in a portfolio of mortgage loans secured on residentia properties in England, Scotland and Wales.

Notes to the Financial Statements for the period ended 31 December 2005 (continued)

12 Called up share capital

	2005 Shares	2005 £
Authorised		
Ordinary shares of £1 each		
Issued on incorporation	100,000	100,000
As at 31 December	100,000	100,000
Allotted, issued and fully paid		
Issued on incorporation:		
Ordinary shares of £1 each fully paid	2	2
Ordinary shares of £1 each partly paid	49,998	12,499
As at 31 December	50,000	12,501

The issued share capital comprises two ordinary shares of £1 each, which are fully paid up, and 49,998 ordinary shares of £1 each which are one quarter paid up.

13 Ultimate parent undertaking

The immediate parent undertaking of Aire Valley Mortgages 2005 - 1 Plc is Aire Valley Holdings Limited a Company incorporated and registered in England and Wales.

The ultimate parent undertaking of Aire Valley Mortgages 2005 - Plc is SFM Corporate Services Limited, a Company incorporated 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 consolidated accounts 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.