

# **AIRE VALLEY MORTGAGES 2005-1 PLC**

**Directors' Report and Financial Statements**

**Registered number: 5343520**

**31 December 2011**

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**Directors' Report and Financial Statements**

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**Company Information**

**Directors**

Phillip Alexander McLelland  
SFM Directors Limited  
SFM Directors (No 2) Limited

**Company Secretary**

SFM Corporate Services Limited

**Registered Office**

35 Great St Helen's  
London  
EC3A 6AP

**Independent auditors**

PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
Benson House  
33 Wellington Street  
Leeds  
LS1 4JP

**Directors' Report for the year ended 31 December 2011****Registered number** 5343520

The Directors present their Report and the audited Financial Statements for the year ended 31 December 2011

**Ownership and control**

Aire Valley Mortgages 2005-1 plc ('the Company') is a public limited liability company incorporated and domiciled in the United Kingdom. The Company is a subsidiary of Aire Valley Holdings Limited, a private limited liability company incorporated and domiciled in the United Kingdom.

Aire Valley Holdings Limited holds one £1 fully paid share and 49,998 quarter paid up ordinary shares in the Company. One £1 ordinary fully paid share is held by SFM Nominees for the benefit of Aire Valley Holdings Limited.

On 1 October 2010 UK Asset Resolution Limited ('UKAR') was established as the holding company for Northern Rock (Asset Management) plc ('NRAM') and Bradford & Bingley plc ('B&B'), bringing together the two brands under shared management and a common Board of Directors.

**Principal activities**

The Company's principal activity is to issue debt securities and to enter into financial arrangements to fund the activities of certain subsidiaries of Aire Valley Holdings Limited and ultimately UKAR by means of intercompany loans. The debt securities were originally issued in US Dollars, Euros and Sterling and are secured on a beneficial interest in a portfolio of mortgage loans originated by the B&B Group, held under a Master Trust arrangement by Aire Valley Trustee Limited. These mortgage loans are secured on residential property in the United Kingdom. Details are set out in the offering circular pertinent to the issue. The Company issued £998.5m floating rate notes to the market on 28 April 2005. £216.2m of the notes were redeemed in December 2007, £267.1m were redeemed in March 2008, £16.2m in June 2008. £5.3m of the loan notes were redeemed in December 2010, £49m in March 2011, £16m in June 2011, £18m in September 2011 and £14m in December 2011. At the exchange rates at issue as at 31 December 2011 £396.7m (2010 £493.7m) loan notes remained in issue.

**Business review**

The profits of the Company are pre-determined under the terms of the issue documentation. The results for the year are shown in the Statement of Comprehensive Income on page 9. The profit after taxation was £3,871,000 (2010 £590,000). Fair value gains of £3,646,000 (2010 £747,000) arose due to the movements in interest rates and exchange rates over the course of the year. This fair value gain is a timing effect only, which will reverse, and does not have cash implications.

As described in note 16, on 10 May 2012 a non-asset trigger event occurred. This will affect the timing of future redemptions of the loan notes in issue.

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

**Key performance indicators**

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 monthly trustee reports to investors. Certain of the Company's debt securities in issue were downgraded during the year and subsequent to the year end.

Some of the key performance indicators of the mortgage pool of the Master Trust are

		2011	2010
Number of mortgage loans	No	87,771	90,841
Outstanding mortgage loans	£bn	10.9	11.3
Number of mortgage loans 3 months or more in arrears	No	1,578	2,553
Principal value of mortgage loans 3 months or more in arrears	£m	234.2	385.9
Arrears value of mortgage loans 3 months or more in arrears	£m	6.4	12.0
Mortgage loans in repossession	No	98	136
Mortgage loans in repossession	£m	15.5	19.1
Weighted average indexed current LTV	%	84.6	83.8

**Future developments**

The Directors expect that during 2012 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.

As described in note 16, on 10 May 2012 a non-asset trigger event occurred. This will affect the timing of future redemptions of the loan notes in issue.

**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 (2010 £nil).

**Directors' Report for the year ended 31 December 2011 (continued)****Registered number** 5343520**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 year and up to the date of signing the Financial Statements were as follows:

Philip Alexander McLelland  
SFM Directors Limited  
SFM Directors (No. 2) Limited

Mr McLelland, SFM Directors Limited and SFM Directors (No. 2) Limited are also Directors of Aire Valley Holdings Limited. None of the Directors had any interest in the share capital of Aire Valley Holdings Limited during the year. None of the Directors had an interest in the share or loan capital of B&B or in any of its subsidiary undertakings. Mr McLelland is a director of B&B.

**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.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

**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 risk. The effectiveness of the risk management is then monitored on an ongoing basis. Details of the Company's risks and their management and control are provided in note 11, and further discussion in the context of the B&B Group as a whole is provided on pages 10-13 of that B&B Group's 2011 Annual Report & Accounts, which do not form part of this Report and Financial Statements.

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. B&B acts as bank account and cash manager. The Company's operations are subject to periodic review by the B&B 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.

As described in note 16, on 10 May 2012 a non-asset trigger event occurred. This will affect the timing of future redemptions of the loan notes in issue.

**Corporate governance**

The Directors have been charged with governance in accordance with the transaction documents describing the structure and operation of the transaction. The structure of the Company is such that the key policies have been predetermined at the time of issuance and the operational roles have been assigned to third parties with their roles strictly governed by the transaction documents.

The transaction documents provide for procedures that have been designed for safeguarding assets against unauthorised use or disposition, for maintaining proper accounting records, and for the reliability and usefulness of financial information used within the business or for publication. Such procedures are designed to manage rather than eliminate the risk of failure to achieve business objectives whilst enabling them to comply with the regulatory obligations.

Due to the nature of the securities which have been issued, the Company is exempt from the requirements of Disclosure and Transparency Rules 7.1 audit committees and 7.2 Corporate governance statements, which would otherwise require the Company respectively to have an audit committee in place and include a corporate governance statement in the Directors' Report. The Directors are therefore satisfied that there is no requirement for an audit committee or a supervisory body entrusted to carry out the functions of an audit committee or to publish a corporate governance statement.

**Directors' Report for the year ended 31 December 2011 (continued)**

**Registered number** 5343520

**Political and charitable contributions**

During the year no political or charitable contributions were made (2010 £nil)

**Third party indemnities**

Qualifying third party indemnity provision for the benefit of the Directors was in force during the year under review and remains in force as at the date of approval of the Directors' Report and Financial Statements

**Independent auditors**

During the year KPMG Audit Plc resigned as auditors to the Company, and PricewaterhouseCoopers LLP ('PwC') were appointed

In accordance with the Companies Act 2006 a resolution for the re-appointment of PwC as auditor of the Company will be proposed at the forthcoming Annual General Meeting

By order of the Board



**Helena Whitaker**  
per pro SFM Corporate Services Limited  
Company Secretary  
25 June 2012

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

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

Company law requires the Directors to prepare Financial Statements for each financial year. Under that law the Directors have prepared the Financial Statements in accordance with International Financial Reporting Standards ('IFRS') as adopted by the European Union ('EU'). Under company law the Directors must not approve the Financial Statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these Financial Statements, the Directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and accounting estimates that are reasonable and prudent,
- state whether applicable IFRS as adopted by the EU have been followed, subject to any material departures disclosed and explained in the Financial Statements,
- 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 adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the Financial Statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

**Independent 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 year ended 31 December 2011 which comprise the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity, the Cash Flow Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRS) as adopted by the European Union.

**Respective responsibilities of directors and auditors**

As explained more fully in the Statement of Directors' Responsibilities set out on page 7, the Directors are responsible for the preparation of the Financial Statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the Financial Statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

**Scope of the audit of the Financial Statements**

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

**Opinion on Financial Statements**

In our opinion the Financial Statements

- give a true and fair view of the state of the Company's affairs as at 31 December 2011 and of its profit and cash flows for the year then ended,
- have been properly prepared in accordance with IFRS as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006

**Opinion on other matter prescribed by the Companies Act 2006**

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

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

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

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



**Mark Hannam (Senior Statutory Auditor)**

For and on behalf of PricewaterhouseCoopers LLP

Chartered Accountants and Statutory Auditors

Leeds

25<sup>th</sup> June 2012

**Statement of Comprehensive Income for the year ended 31 December**

	<i>Note</i>	<b>2011 £000</b>	<b>2010 £000</b>
Interest receivable and similar income	2	4,902	4,642
Interest expense and similar charges	3	(4,863)	(4,607)
<b>Net interest income</b>		<u>39</u>	<u>35</u>
Operating expenses	4	(38)	(36)
Fair value movements	11(e)	3,646	747
<b>Profit before taxation</b>		<u>3,647</u>	<u>746</u>
Taxation	5	224	(156)
<b>Profit for the financial year</b>		<u>3,871</u>	<u>590</u>
Other comprehensive income for the financial year		-	-
<b>Total comprehensive income for the financial year</b>		<u><u>3,871</u></u>	<u><u>590</u></u>

The Company's business and operations comprise one single activity in the United Kingdom, and the Company has only one operating segment for the purpose of IFRS 8 'Operating Segments'. The results above arise from continuing activities and are attributable to the equity shareholder.

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

**Balance Sheet at 31 December****Registered number: 5343520**

	Note	2011 £000	2010 £000
<b>Assets</b>			
Loans to Group undertakings	8	396,808	493,850
Derivative financial instruments	11(e)	50,731	65,784
<b>Total non-current assets</b>		<b>447,539</b>	<b>559,634</b>
Cash and cash equivalents		68,882	87,636
Current tax assets		3	4
<b>Total current assets</b>		<b>68,885</b>	<b>87,640</b>
<b>Total assets</b>		<b>516,424</b>	<b>647,274</b>
<b>Liabilities</b>			
Interest-bearing loans and borrowings	7	442,552	558,310
Deferred tax liabilities	5	-	224
<b>Total non-current liabilities</b>		<b>442,552</b>	<b>558,534</b>
Deposits by banks	11(c)	68,864	87,614
Interest-bearing loans and borrowings	7	212	201
<b>Total current liabilities</b>		<b>69,076</b>	<b>87,815</b>
<b>Total liabilities</b>		<b>511,628</b>	<b>646,349</b>
<b>Equity</b>			
Capital and reserves attributable to equity holders			
Share capital	12	13	13
Retained earnings		4,783	912
<b>Total attributable equity</b>		<b>4,796</b>	<b>925</b>
<b>Total equity and liabilities</b>		<b>516,424</b>	<b>647,274</b>

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

The Financial Statements were approved by the Board of Directors and authorised for issue on 25 June 2012 and signed on its behalf by



**Helena Whitaker**  
per pro SFM Directors Limited  
As Director  
25 June 2012

**Statement of Changes in Equity for the year ended 31 December**

	<b>Share capital £000</b>	<b>Retained earnings £000</b>	<b>Total equity £000</b>
<b>At 1 January 2011</b>	<b>13</b>	<b>912</b>	<b>925</b>
<b>Total comprehensive income for the financial year</b>	<b>-</b>	<b>3,871</b>	<b>3,871</b>
<b>At 31 December 2011</b>	<b>13</b>	<b>4,783</b>	<b>4,796</b>
<b>At 1 January 2010</b>	<b>13</b>	<b>322</b>	<b>335</b>
<b>Total comprehensive income for the financial year</b>	<b>-</b>	<b>590</b>	<b>590</b>
<b>At 31 December 2010</b>	<b>13</b>	<b>912</b>	<b>925</b>

**Cash Flow Statement for the year ended 31 December**

	<b>2011</b>	<b>2010</b>
	<b>£000</b>	<b>£000</b>
<b>Cash flows from operating activities</b>		
<b>Profit before tax</b>	<b>3,647</b>	<b>746</b>
<i>Adjustments for</i>		
Interest on loans to Group undertakings	(4,751)	(4,588)
Interest on call loans	(151)	(54)
Interest on floating rate notes	5,547	4,569
Interest on call deposits	156	53
Amortisation of issue costs	2	6
Swap interest	(842)	(21)
Fair value movements	(3,646)	(747)
<b>Cash flows used in operating activities before changes in operating assets</b>	<b>(38)</b>	<b>(36)</b>
<i>Net decrease in operating assets</i>		
Loans to Group undertakings	97,042	5,308
Prepayments and accrued income	-	6
<b>Cash generated from operations</b>	<b>97,004</b>	<b>5,278</b>
Taxation received/ (paid)	1	(3)
<b>Net cash generated from operating activities</b>	<b>97,005</b>	<b>5,275</b>
<i>Cash flows from financing activities</i>		
Repayment of deposits by banks	(18,750)	(11,451)
Interest received on loans to Group undertakings	4,751	4,588
Interest received on call loans	151	54
Interest paid on floating rate notes	(5,535)	(4,496)
Interest on call deposits	(156)	(53)
Swap interest received/(paid)	842	(18)
Repayment of floating rate notes	(97,062)	(5,344)
<b>Net cash used in financing activities</b>	<b>(115,759)</b>	<b>(16,720)</b>
<b>Net decrease in cash and cash equivalents</b>	<b>(18,754)</b>	<b>(11,445)</b>
Cash and cash equivalents at beginning of year	87,636	99,081
<b>Cash and cash equivalents at end of year</b>	<b>68,882</b>	<b>87,636</b>
<b>Cash collateral held</b>	<b>68,864</b>	<b>87,614</b>
<b>Cash at bank</b>	<b>18</b>	<b>22</b>
	<b>68,882</b>	<b>87,636</b>

All of the cash collateral held is in respect of collateral received from derivative counterparties pursuant to the provisions of associated credit support agreements and is repayable on demand

All cash is deposited with a third party bank with a credit rating of A or above

**Notes to the Financial Statements for the year ended 31 December 2011****1. Principal accounting policies**

Aire Valley Mortgages 2005-1 plc ('the Company') is a public limited liability company incorporated and domiciled in the United Kingdom

**(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')

For these 2011 Financial Statements, including the 2010 comparative financial information where applicable, the Company has adopted for the first time the following statements

- The November 2009 amendments to IAS 24 'Related Party Disclosures', which clarified the disclosure requirements for Government-related entities and was effective from 1 January 2011
- The October 2010 amendments to IFRS 7 'Financial Instruments Disclosures' regarding enhancement of disclosures of transfers of financial assets

For these 2011 Financial Statements the Company has not adopted the following statements

- IFRS 9 'Financial Instruments', sections of which have been issued as part of the International Accounting Standard Board's ('IASB's') project to replace IAS 39 'Financial Instruments Recognition and Measurement', and the associated amendments to IFRS 7. These statements are expected to be mandatory for 2015 Financial Statements, with 2014 comparative information, but have not yet been adopted for use in the EU
- IFRS 13 'Fair Value Measurement'. This statement is expected to be mandatory for 2013 Financial Statements, with 2012 comparative information, but has not yet been adopted for use in the EU
- The December 2010 amendments to IAS 12 'Income Taxes' relating to 'Deferred Tax Recovery of Underlying Assets'. This amendment is expected to be mandatory for 2012 Financial Statements, with 2011 comparative information, but has not yet been adopted for use in the EU
- The June 2011 amendments to IAS 1 'Presentation of Financial Statements' relating to 'Presentation of Items of Other Comprehensive Income'. This statement is expected to be mandatory for 2013 Financial Statements, with 2012 comparative information, but has not yet been adopted for use in the EU
- The December 2011 amendments to IFRS 7 and IAS 32 'Financial Instruments Presentation' relating to the offsetting of financial assets and financial liabilities. This statement is expected to be mandatory for 2013 Financial Statements, with 2012 comparative information, but has not been adopted for use in the EU

All other new standards, amendments to standards and interpretations are not considered relevant to and have no impact upon the Financial Statements of the Company

The Financial Statements also comply with the relevant provisions of Part 15 of the Companies Act 2006 and regulations made thereunder

**(b) Basis of preparation**

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. The Financial Statements are prepared on the historical cost basis except for financial instruments classified as 'at fair value through profit or loss'.

The Directors consider that the accounting policies set out in this note are the most appropriate to the Company's circumstances, have been consistently applied to the Company in dealing with items which are considered material, and are supported by reasonable and prudent estimates and judgements.

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.

**Notes to the Financial Statements for the year ended 31 December 2011 (continued)****1 Principal accounting policies (continued)****(b) Basis of preparation (continued)**

The Directors consider the business to comprise one operating and geographical segment due to the similarity of risks faced within its UK based residential portfolios

The Financial Statements have been prepared in accordance with EU adopted IFRS, IFRIC interpretations issued by the IFRS Interpretations Committee (formerly the International Financial Reporting Interpretations Committee) and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. A summary of accounting policies is set out below. The preparation of the Financial Statements in conformity with these accounting policies and generally accepted accounting principles requires the use of estimates and assumptions that affect the reported values of assets and liabilities at the date of the Financial Statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amounts, event or actions, actual results ultimately may differ from those estimates (see note 10)

**(c) Interest income and expense**

For all interest-bearing financial instruments except derivatives interest income and expense are recognised in the Statement of Comprehensive Income on an Effective Interest Rate ('EIR') basis

The EIR method calculates the amortised cost of a financial asset or financial liability and spreads the resulting interest income or interest expense on a level yield basis over the expected life of the instrument. The EIR is the rate which at the inception of the instrument exactly discounts expected future cash flows over the expected life of the instrument 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, premia on acquisition of mortgage portfolios and all other premia and discounts as well as interest

When a financial asset or a group of similar financial assets is written down as a result of an impairment loss, interest income continues to be recognised by applying the applicable EIR to the reduced balance

**(d) Taxation****(i) Current tax**

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. Tax relating to items which are taken directly to reserves is also taken directly to reserves

**(ii) Deferred tax**

Deferred tax is calculated using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Financial Statements. Deferred tax is determined using tax rates and laws that have been enacted or substantively enacted by the Balance Sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled. The principal temporary differences arise from unrealised fair value movements

**(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. 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 year ended 31 December 2011 (continued)****1 Principal accounting policies (continued)****(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 at 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. For assets the amortised cost balance is reduced where appropriate by an allowance for amounts which are considered to be impaired or uncollectable

**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

**(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 reflected immediately in the Statement of Comprehensive Income 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.

Foreign exchange gains and losses resulting from the restatement and settlement of such transactions are recognised in the Statement of Comprehensive Income 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 Statement of Comprehensive Income as 'fair value movements'

## Notes to the Financial Statements for the year ended 31 December 2011 (continued)

## 2 Interest receivable and similar income

	2011 £000	2010 £000
Interest on loans to Group undertakings	4,751	4,588
Interest on call loans	151	54
	<u>4,902</u>	<u>4,642</u>

Interest income for the year on impaired assets was £nil (2010 £nil) as no financial asset is impaired

## 3 Interest expense and similar charges

	2011 £000	2010 £000
Interest on floating rate notes	5,547	4,569
Interest on cash collateral	156	53
Swap interest	(842)	(21)
Amortisation of issue costs	2	6
	<u>4,863</u>	<u>4,607</u>

## 4 Operating expenses

	2011 £000	2010 £000
Legal and professional fees	38	36

Auditors' remuneration of £2,475 (2010 £2,767) was borne by B&B

## 5 Taxation

	2011 £000	2010 £000
Current taxation charge		
UK corporation tax on profit for the year	-	-
Origination and reversal of temporary differences	(224)	167
Change in rate effective 1 April 2011 on deferred tax items	-	(11)
Total taxation (credit)/charge per the Statement of Comprehensive Income	<u>(224)</u>	<u>156</u>
Profit before taxation	<u>3,647</u>	<u>746</u>
UK corporation tax at 26.5% (2010 28%)	<u>966</u>	<u>209</u>
Effects of		
Change in rate effective 1 April 2011 on deferred tax items	-	(11)
Income not taxable	(966)	-
Other tax rates	-	(53)
Adjustments in respect of previous years	(224)	11
Total taxation (credit)/charge per the Statement of Comprehensive Income	<u>(224)</u>	<u>156</u>

The deferred tax liability is attributable to the following

	Recognised in income 2011 £000	As at 31 December 2011 £000	Recognised in income 2010 £000	As at 31 December 2010 £000
Fair value movements	224	-	(156)	(224)

The standard rate of Corporation Tax in the UK changed from 28% to 26% with effect from 1 April 2011. Accordingly, the Company's profits for this accounting period are taxed at an effective rate of 26.5%.

The carrying amount of deferred tax relating to fair value movements has been reassessed as being nil because it is not expected to result in an actual future tax payment or receipt.

## 6 Employees and Directors' emoluments

There were no employees during the year (2010 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).

## Notes to the Financial Statements for the year ended 31 December 2011 (continued)

## 7 Interest-bearing loans and borrowings

Interest-bearing loans and borrowings comprise floating rate notes issued on 28 April 2005

Under the terms of the Notes, any shortfalls arising on the redemption of the Loan to Group undertaking, over which the Noteholders have a charge, may result in a reduction in the liability under the Notes, due to their limited recourse nature. Such shortfall on the redemption of the Loan to Group undertaking may arise if the underlying mortgage pool against which the Loan to Group undertaking is secured does not generate sufficient cash to repay the Loan to Group undertaking and the credit enhancement in the structure is not sufficient to cover such shortfall.

Class	Final maturity	In currency 31 December 2011	In currency 31 December 2010	31 December 2011 £000	31 December 2010 £000
Series 2 A1	Sep 2066	£176,251,957	£226,247,411	176,252	226,247
Series 2 A2	Sep 2066	€ 212,425,939	€ 272,682,469	177,567	235,052
Series 2 A3	Sep 2066	US\$38,482,960	US\$49,398,998	24,777	31,813
Series 2 B1	Sep 2066	£10,000,000	£10,000,000	10,000	10,000
Series 2 B2	Sep 2066	€ 23,000,000	€ 23,000,000	19,226	19,826
Series 2 C2	Sep 2066	€ 41,800,000	€ 41,800,000	34,941	36,032
				<u>442,763</u>	<u>558,970</u>
Issue costs				(1)	(3)
Hedge adjustments				(210)	(657)
				<u>442,552</u>	<u>558,310</u>
Accrued interest - current				212	201
				<u>442,764</u>	<u>558,511</u>

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 notes and the Class C 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 notes.

The notes are now in 'pass through', and will be partially redeemed on each quarterly interest payment date to the extent that funds are available, in accordance with the terms set out in the Offering Circular. The timing of future redemptions will be dependent on the availability of funds, and cannot be reliably forecast and hence the notes have all been described as non-current liabilities.

As described in note 16, on 10 May 2012 a non-asset trigger event occurred. This will affect the timing of future redemptions of the loan notes in issue.

Interest is payable on the Series 2 Class A1 and Class B1 notes at a variable rate based on three month sterling LIBOR.  
Interest is payable on the Series 2 Class A2, Class B2 and Class C2 notes at a variable rate based on three month EURIBOR.  
Interest is 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 fellow subsidiary undertaking 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.

## Notes to the Financial Statements for the year ended 31 December 2011 (continued)

**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. This 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. The ability of Aire Valley Funding 1 Limited 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 loans will coincide with the repayment of the floating rate notes as they become due for payment, only to the extent these are available, and hence the loans have all been described as non-current assets.

**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 corporate directors provided by Structured Finance Management Limited and the third is a director of B&B (the 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 £10,093 (2010 £10,286).

The Company undertook the following transactions with companies in the B&B Group and the Aire Valley Holdings Limited Group

	<b>Aire Valley Holdings Limited and subsidiaries</b>	<b>Aire Valley Holdings Limited and subsidiaries</b>
	<b>2011</b>	<b>2010</b>
	<b>£000</b>	<b>£000</b>
<b>Interest receivable and similar income</b>		
Interest on loans to Group undertakings	<b>4,751</b>	<b>4,588</b>
<b>Non-current assets</b>		
Loans to Group undertakings	<b>396,808</b>	<b>493,850</b>

Auditors' remuneration of £2,475 (2010 £2,767) was borne by B&B

**10 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 expected future cash flows for which assumptions are made.

## Notes to the Financial Statements for the year ended 31 December 2011 (continued)

## 10 Critical accounting judgements and estimates (continued)

## 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

## 11 Financial instruments

(a) Categories of financial assets and financial liabilities: carrying value compared to fair value  
At 31 December 2011

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	-	396,808	396,808	293,301	2,933
Derivative financial instruments	50,731	-	50,731	50,731	507
Cash and cash equivalents	-	68,882	68,882	68,882	689
<b>Total financial assets</b>	<b>50,731</b>	<b>465,690</b>	<b>516,421</b>	<b>412,914</b>	<b>4,129</b>

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	-	442,764	442,764	339,257	3,393
Deposits by banks	-	68,864	68,864	68,864	689
<b>Total financial liabilities</b>	<b>-</b>	<b>511,628</b>	<b>511,628</b>	<b>408,121</b>	<b>4,081</b>

At 31 December 2010

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	-	493,850	493,850	370,823	3,708
Derivative financial instruments	65,784	-	65,784	65,784	658
Cash and cash equivalents	-	87,636	87,636	87,636	876
<b>Total financial assets</b>	<b>65,784</b>	<b>581,486</b>	<b>647,270</b>	<b>524,243</b>	<b>5,242</b>

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	-	558,511	558,511	435,483	4,355
Deposits by banks	-	68,864	68,864	68,864	689
<b>Total financial liabilities</b>	<b>-</b>	<b>627,375</b>	<b>627,375</b>	<b>504,347</b>	<b>5,044</b>

## Notes to the Financial Statements for the year ended 31 December 2011 (continued)

## 11. Financial instruments (continued)

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

No financial assets were reclassified during the 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 notes valuations

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

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

	2011 Income £000	2011 Expense £000	2010 Income £000	2010 Expense £000
Interest on loans to Group undertakings	4,751	-	4,588	-
Interest on floating rate notes	-	5,547	-	4,569
Interest on call deposits	-	156	-	53
Amortisation of issue costs	-	2	-	6

Interest income for the year on impaired assets was £nil (2010 £nil) as no financial asset is 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 cross 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 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 to 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 loan to Group undertakings, 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 minimum credit ratings as outlined in the transaction documentation.

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

## Notes to the Financial Statements for the year ended 31 December 2011 (continued)

## 11 Financial instruments (continued)

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

*Liquidity risk*

During the year the Company had floating rate notes in issue denominated in Sterling, US Dollars and Euros. 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 receipt of payments on the mortgage portfolio held in trust (note 11c (ii)).

*Currency risk*

During the year the Company had 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(iii) 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 profiles of the loans to Group undertakings and of the 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 were 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.

*Other market risks*

At the year end the Company had no other material exposure to market risks (2010: £nil).

## (i) Credit risk

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

	2011	2010
	£000	£000
Loans to Group undertakings	396,808	493,850
Derivative financial instruments	50,731	65,784
Cash and cash equivalents	68,882	87,636
Total on-Balance Sheet and maximum exposure to credit risk	<u>516,421</u>	<u>647,270</u>

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

Further information regarding the number and credit quality of loans in the mortgage pool is provided in the Key Performance Indicators on page 4.

## Notes to the Financial Statements for the year ended 31 December 2011 (continued)

## 11. Financial instruments (continued)

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

## (ii) Liquidity risk

There is a liquidity reserve fund provided by Aire Valley Funding 1 Limited 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 fund was not drawn upon during the current or preceding year or in 2012 up to the date of authorisation of these Financial Statements

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

	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
<b>At 31 December 2011</b>						
Interest-bearing loans and	-	17,180	22,726	238,274	190,253	468,433
Deposits by banks	68,864	-	-	-	-	68,864
<b>Total</b>	<b>68,864</b>	<b>17,180</b>	<b>22,726</b>	<b>238,274</b>	<b>190,253</b>	<b>537,297</b>
<b>At 31 December 2010</b>						
Interest-bearing loans and	-	50,022	77,104	211,021	253,011	591,158
Deposits by banks	87,614	-	-	-	-	87,614
<b>Total</b>	<b>87,614</b>	<b>50,022</b>	<b>77,104</b>	<b>211,021</b>	<b>253,011</b>	<b>678,772</b>

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

As described in note 16, on 10 May 2012 a non-asset trigger event occurred. This will affect the timing of future redemptions of the loan notes in issue

## (iii) Currency risk

The Group's policy is to hedge all material foreign currency exposures, by the use of derivatives. Consequently, at 31 December 2011 and 31 December 2010 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 and equity of reasonably possible changes in exchange rates compared to actual rates would not have been material at 31 December 2011, the movement in value of the floating rate notes would be offset by movement in value of derivatives

The amounts of financial assets and liabilities denominated in foreign currencies were as follows

	Euro £000	US \$ £000	Total £000
<b>At 31 December 2011</b>			
<b>Financial assets</b>			
Loans to Group undertakings	-	-	-
Derivative financial instruments	231,863	24,783	256,646
Cash and cash equivalents	68,864	-	68,864
<b>Total financial assets</b>	<b>300,727</b>	<b>24,783</b>	<b>325,510</b>
<b>Financial liabilities</b>			
Deposits by banks	68,864	-	68,864
Interest-bearing loans and borrowings	231,863	24,783	256,646
<b>Total financial liabilities</b>	<b>300,727</b>	<b>24,783</b>	<b>325,510</b>
<b>Net currency gap</b>	<b>-</b>	<b>-</b>	<b>-</b>

## Notes to the Financial Statements for the year ended 31 December 2011 (continued)

## 11 Financial instruments (continued)

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

## (iii) Currency risk (continued)

	Euro £000	US \$ £000	Total £000
At 31 December 2010			
Financial assets			
Loans to Group undertakings	-	-	-
Derivative financial instruments	291,033	31,818	322,851
Cash and cash equivalents	87,614	-	87,614
<b>Total financial assets</b>	<b>378,647</b>	<b>31,818</b>	<b>410,465</b>
Financial liabilities			
Deposits by banks	87,614	-	87,614
Interest-bearing loans and borrowings	291,033	31,818	322,851
<b>Total financial liabilities</b>	<b>378,647</b>	<b>31,818</b>	<b>410,465</b>
<b>Net currency gap</b>	<b>-</b>	<b>-</b>	<b>-</b>

## (d) Concentrations of risk

The Company operates primarily in the United Kingdom, and adverse changes to the United Kingdom 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 the United Kingdom. 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 2011			
Cross-currency interest rate swaps	256,510	50,731	50,731
<b>Total asset balances</b>	<b>256,510</b>	<b>50,731</b>	<b>50,731</b>
At 31 December 2010	£000	£000	£000
Cross-currency interest rate swaps	322,723	65,784	65,784
<b>Total asset balances</b>	<b>322,723</b>	<b>65,784</b>	<b>65,784</b>

Fair value movements in the Statement of Comprehensive Income comprised the following	2011 £000	2010 £000
Net losses on hedging swaps	(15,053)	(7,857)
Net gains on hedged items due to exchange rate movements	19,147	8,263
Net (losses)/ gains on hedged items due to interest rate movements	(448)	341
	<b>3,646</b>	<b>747</b>

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 2011 (continued)

## 11 Financial instruments (continued)

## (f) Fair value measurement

Financial assets and liabilities carried at fair value are valued on the following bases

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
<b>At 31 December 2011</b>				
<b>Financial assets</b>				
Derivative financial instruments	-	-	50,731	50,731
<b>At 31 December 2010</b>				
<b>Financial assets</b>				
Derivative financial instruments	-	-	65,784	65,784

Level 1	Quoted prices (unadjusted) in active markets for identical assets or liabilities
Level 2	Inputs other than quoted prices that are observable for the asset or liability, either directly (i.e. as price) or indirectly (i.e. derived from the implications of prices)
Level 3	Inputs for the asset or liability that are not based on observable market data or have significant unobservable inputs

The movement in assets and liabilities measured using a valuation technique for which any significant input is not based on observable market data (Level 3) is as follows

	Financial assets Derivative financial instruments £'000	Financial liabilities Derivative financial instruments £'000	Total £'000
<b>At 1 January 2011</b>	65,784	-	65,784
Total losses in the Statement of Comprehensive Income	(15,053)	-	(15,053)
Transfers from assets to liabilities	-	-	-
<b>At 31 December 2011</b>	<b>50,731</b>	<b>-</b>	<b>50,731</b>
	Financial assets Derivative financial instruments £'000	Financial liabilities Derivative financial instruments £'000	Total £'000
<b>At 1 January 2010</b>	73,641	-	73,641
Total losses in the Statement of Comprehensive Income	(7,857)	-	(7,857)
Transfers from assets to liabilities	-	-	-
<b>At 31 December 2010</b>	<b>65,784</b>	<b>-</b>	<b>65,784</b>

## Notes to the Financial Statements for the year ended 31 December 2011 (continued)

## 12 Share capital

	2011 Number	2010 Number	2011 £	2010 £
<b>Authorised</b>				
Ordinary shares of £1 each				
At 1 January and 31 December	100,000	100,000	100,000	100,000
<b>Issued</b>				
At 1 January and 31 December				
Ordinary shares of £1 each fully paid	2	2	2	2
Ordinary shares of £1 each partly paid	49,998	49,998	12,499	12,499
	50,000	50,000	12,501	12,501

These 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 and domiciled in the United Kingdom.

The Company's ultimate parent undertaking is SFM Corporate Services Limited, a limited liability company incorporated and domiciled in the United Kingdom, 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.

As a result of The Bradford & Bingley plc Transfer of Securities and Property etc. Order 2008, which transferred all shares in B&B to the Treasury Solicitor as nominee for HM Treasury on 29 September 2008, the Company considered Her Majesty's Government to be its ultimate controlling party from that date. On 1 October 2010 all shares in B&B were acquired via a share-for-share exchange by UK Asset Resolution Limited, a private limited company incorporated and domiciled in the United Kingdom, which is wholly owned by the Treasury Solicitor as nominee for HM Treasury. The Company considers Her Majesty's Government to remain its ultimate controlling party. UKAR heads the largest group of companies into which the Financial Statements of the Company are consolidated. Copies of the financial statements of UKAR may be obtained from the Company Secretary at Croft Road, Crossflatts, Bingley, West Yorkshire, BD16 2UA.

## 15 Operations of the Company

B&B, the originator of the mortgage loans in the Master Trust pool, carries the pool mortgages on its balance sheet. The cash receipts in respect of the mortgage loans in the pool are collected by B&B and paid to the Trustee. On a monthly basis the Trustee allocates this cash between Aire Valley Funding 1 Limited, the other funding companies in the Master Trust structure and to B&B (which holds a share of the pool mortgages) according to the rules of the structure. On a monthly basis Aire Valley Funding 1 Limited allocates this cash between the Company and the other issuing companies in the Aire Valley Funding 1 Limited structure. The Company uses its cash receipts to service its loan notes in accordance with their terms.

As described in note 16, on 10 May 2012 a non-asset trigger event occurred. This will affect the timing of future redemptions of the loan notes in issue.

## 16 Events after the reporting period

On 10 May 2012 a Non-Asset Trigger Event occurred within the structure of the Master Trust, due to the aggregate Current Balance of Loans comprising the Trust Property falling below the minimum trust size of £10.7 billion. The impact of this event is to change the order of priority of the Funding 1 Available Principal Receipts as set out on pages 122 to 126 of the Company's Offering Circular. As a result of the Non-Asset Trigger Event, all principal is allocated to Funding 1 and will continue to be so allocated until all holders of Aire Valley residential mortgage-backed securities have been repaid in full if sufficient funds are available. The principal is then passed to the Issuers based on their respective notes outstanding. Each Issuer then utilises this principal to pay down pro rata and sequentially by Class of Note. The timing of future redemptions will be dependent on the availability of funds, and cannot be reliably forecast.