

AIRE VALLEY MORTGAGES 2005 - 1 PLC

Directors' Report and Financial Statements

Registered number: 5343520

31 December 2010

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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

Secretary

SFM Corporate Services Limited

Registered Office

35 Great St Helen's
London
EC3A 6AP

Auditor

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

Directors' Report for the year ended 31 December 2010

Registered number 5343520

The Directors present their Report and Financial Statements for the year ended 31 December 2010

Principal activities and business review

Aire Valley Mortgages 2005 - 1 plc ('the Company') is a public 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 a subsidiary of Aire Valley Holdings Limited, a limited liability company incorporated in the United Kingdom and registered in England and Wales under the Companies Act 1985.

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

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 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 held by Aire Valley Trustee Limited under a Master Trust arrangement. These mortgage loans, which are originated by Bradford & Bingley plc, are secured on residential property in the 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 and a further £16.2m in June 2008. £5.3m of the loan notes were redeemed in December 2010. At the exchange rates at issue, as at 31 December 2010 £493.7m (2009 £499.0m) remained in issue, of which £49.0m were redeemed in March 2011. 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 8. The profit after taxation was £590,000 (2009 profit £436,000). Fair value gains of £747,000 (2009 £550,000) 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.

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

The key performance indicators used by management in assessing the performance of the Company are actual cash flows against planned cash flows and the credit ratings assigned to the loan notes. The performance of the Company is addressed in the quarterly trustee reports to investors, and there have been no changes in the credit ratings of the notes in the year or previous year, or in 2011 up to the date of authorisation of this Report and Accounts.

The Company operates as a provider of mortgage loans secured on residential properties and of associated services. No new lending is carried out. On 1 October 2010 UK Asset Resolution Ltd ('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.

Future developments

The Directors expect that during 2011 the Company will continue to meet the interest payments on the notes. At the present time the Directors do not foresee any changes in the Company's activities.

Dividend

No dividends were paid during the year or previous year, and the Directors do not recommend the payment of a final dividend for the year (2009 nil).

Payment policy

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

Directors

The Directors who served during the year were as follows:

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

Directors' Report for the year ended 31 December 2010 (continued)

Registered number 5343520

Directors (continued)

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.

Disclosure of information to auditors

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

Risk management and control

In the ordinary course of business the Company is exposed to, and manages, a variety of risks, with credit risk, liquidity risk, currency risk and interest rate risk being of particular significance. The Directors have responsibility for the overall system of internal control and for reviewing its effectiveness. In general, when a transaction or group of transactions is entered into, derivative instruments are taken out to manage the associated 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 22, and further discussion in the context of the B&B Group as a whole is provided on pages 29-35 of that B&B Group's 2010 Annual Report & Accounts, which does 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. There have been no trigger events in the year under review, or in 2011 up to the date of authorisation of this Report and Accounts.

Political and charitable contributions

During the year no political or charitable contributions were made (2009 £nil).

Third party indemnities

Structured Finance Management Limited has made qualifying third party indemnity provisions for the benefit of SFM Directors Limited and SFM Directors (No 2) Limited. Bradford & Bingley plc has made qualifying third party indemnity provisions for the benefit of Mr McLelland.

Auditors

A resolution regarding appointment of auditors will be presented to the next Annual General Meeting.

By order of the Board



Helena Whitaker
per pro SFM Corporate Services Limited
Company Secretary
17 June 2011

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 they have elected to prepare the Financial Statements in accordance with IFRS as adopted by the EU and applicable law.

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 estimates that are reasonable and prudent,
- state whether they have been prepared in accordance with IFRS as adopted by the EU, and
- prepare the Financial Statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping 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 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 year ended 31 December 2010 set out on pages 8 to 24. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards ('IFRS') as adopted by the EU and, as regards the Company Financial Statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. 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 auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 6, 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 (APB's) Ethical Standards for Auditors.

Scope of the audit of the Financial Statements

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

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 2010 and of its profit for the year then ended,
- have been properly prepared in accordance with IFRS as adopted by the EU, 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.



J L Ellacott (Senior Statutory Auditor)
For and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
1 The Embankment
Neville Street
Leeds
LS1 4DW

17 June 2011

Statement of Comprehensive Income for the year ended 31 December

	<i>Note</i>	2010 £000	2009 £000
Interest receivable and similar income	<i>2</i>	4,642	9,044
Interest expense and similar charges	<i>3</i>	(4,607)	(9,014)
Net interest income		35	30
Operating expenses	<i>4</i>	(36)	(29)
Fair value movements	<i>11(e)</i>	747	550
Profit before taxation		746	551
Taxation	<i>5</i>	(156)	(115)
Profit for the financial year		590	436
Other comprehensive income for the year		-	-
Total comprehensive income for the year		590	436

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

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

Balance Sheet at 31 December

Registered number. 5343520

	Note	2010 £000	2009 £000
Assets			
Loans to Group undertakings	8	493,850	499,158
Total non-current assets		<u>493,850</u>	<u>499,158</u>
Cash and cash equivalents		87,636	99,081
Derivative financial instruments	11(e)	65,784	73,641
Prepayments and accrued income		-	6
Current tax asset		4	2
Total current assets		<u>153,424</u>	<u>172,730</u>
Total assets		<u>647,274</u>	<u>671,888</u>
Liabilities			
Interest-bearing loans and borrowings	7	558,310	572,291
Deferred tax liabilities	5	224	69
Total non-current liabilities		<u>558,534</u>	<u>572,360</u>
Deposits by banks		87,614	99,065
Interest-bearing loans and borrowings	7	201	128
Total current liabilities		<u>87,815</u>	<u>99,193</u>
Total liabilities		<u>646,349</u>	<u>671,553</u>
Equity			
Capital and reserves attributable to equity holders			
Share capital	12	13	13
Retained earnings		912	322
Total attributable equity		<u>925</u>	<u>335</u>
Total equity and liabilities		<u>647,274</u>	<u>671,888</u>

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

The Financial Statements were approved by the Board of Directors and authorised for issue on 17 June 2011 and signed on its behalf by


 Helena Whitaker
 per pro SFM Directors Limited
 As Director

17 June 2011

Statement of Changes in Equity for the year ended 31 December

	Share capital £000	Retained earnings £000	Total equity £000
At 1 January 2010	13	322	335
Profit for the financial year	-	590	590
At 31 December 2010	<u>13</u>	<u>912</u>	<u>925</u>
At 1 January 2009	13	(114)	(101)
Profit for the financial year	-	436	436
At 31 December 2009	<u>13</u>	<u>322</u>	<u>335</u>

Cash Flow Statement for the year ended 31 December

	2010 £000	2009 £000
Cash flows from operating activities		
Profit for the financial year	590	436
<i>Adjustments for</i>		
Interest on loans to Group undertakings	(4,588)	(8,902)
Interest on call loans	(54)	(142)
Interest on floating rate notes	4,569	8,791
Interest on call deposits	53	138
Amortisation of issue costs	6	24
Swap interest	(21)	61
Fair value movements	(747)	(550)
Income tax charge	156	115
Cash flows from operating activities before changes in operating assets and liabilities	(36)	(29)
<i>Net decrease in operating assets</i>		
Loans to Group undertakings	5,308	289
Prepayments and accrued income	6	(6)
Cash generated from operations	5,278	254
Taxation paid	(3)	-
Net cash from operating activities	5,275	254
<i>Cash flows from financing activities</i>		
Collateral (paid)/received	(11,451)	99,065
Interest received on loans to Group undertakings	4,588	8,902
Interest received on call loans	54	142
Interest paid on floating rate notes	(4,496)	(9,098)
Interest on call deposits	(53)	(138)
Swap interest paid	(18)	(61)
Repayment of floating rate notes	(5,344)	-
Net cash from financing activities	(16,720)	98,812
Net (decrease)/increase in cash and cash equivalents	(11,445)	99,066
Cash and cash equivalents at beginning of year	99,081	15
Cash and cash equivalents at end of year	87,636	99,081

Notes to the Financial Statements for the year ended 31 December 2010**1 Principal accounting policies**

Aire Valley Mortgages 2005 - 1 plc ('the Company') is a public limited company incorporated in the United Kingdom under the Companies Act 1985 and registered in England and Wales

(a) Statement of compliance

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

For these 2010 Financial Statements, including the 2009 comparative financial information where applicable, the Company has adopted for the first time the following statements

- The January 2008 amendment to IFRS 3 'Business Combinations' This amendment does not change the treatment of business combinations which occurred in prior years and has had no impact on the Company's Income Statement, Balance Sheet or Cash Flow Statement
- The May 2008 amendment to IAS 27 'Consolidated and Separate Financial Statements' This amendment has had no impact on the Company's Income Statement, Balance Sheet or Cash Flow Statement
- The July 2008 amendment to IAS 39 'Financial Instruments Recognition and Measurement' relating to eligible hedged items This amendment has had no impact on the Company's Income Statement, Balance Sheet or Cash Flow Statement

For these 2010 Financial Statements the Company has not adopted the following statement

- IFRS 9 'Financial Instruments', issued in October 2010 as part of the International Accounting Standards Board's ('IASB's') project to replace IAS 39 'Financial Instruments Recognition and Measurement' This 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 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 prepared on the historical cost basis except for financial instruments classified as 'at fair value through profit or loss', and on a going concern basis given the 'bankruptcy remote' nature of the entity as a special purpose vehicle

The Financial Statements are presented in pounds sterling, which is the currency of the Company's primary operating environment Actual results in the future could be affected by differences between these estimates and assumptions and actual outcomes In accordance with IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' the financial effect of any change in estimates and any difference between estimates and actual outcomes is included and if material disclosed, in the year of the change Further details of accounting estimates and judgements are provided in note 10 The Directors consider that the accounting policies set out below are the most appropriate to the Company's circumstances

(c) Interest income and expense

For all 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

Notes to the Financial Statements for the year ended 31 December 2010 (continued)**1. Principal accounting policies (continued)****(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 substantially 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.

Deferred tax assets are recognised only when it is probable that future taxable profits will be available against which these temporary differences can be utilised.

(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.

(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. Any net movements in fair value are included in the Statement of Comprehensive Income as 'fair value movements'.

Notes to the Financial Statements for the year ended 31 December 2010 (continued)

1. Principal accounting policies (continued)

(h) Derivative financial instruments

All derivatives are carried in the Balance sheet at fair value, as assets when the fair value is positive and as liabilities when the fair value is negative. Changes in the fair value of derivatives are charged immediately in the 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 2010 (continued)

2. Interest receivable and similar income

	2010 £000	2009 £000
Interest on loans to Group undertakings	4,588	8,902
Interest on call loans	54	142
	<u>4,642</u>	<u>9,044</u>
Interest income for the year on impaired assets was £nil (2009 £nil)		

3. Interest expense and similar charges

	2010 £000	2009 £000
Interest on floating rate notes	4,569	8,791
Interest on call deposits	53	138
Swap interest	(21)	61
Amortisation of issue costs	6	24
	<u>4,607</u>	<u>9,014</u>

4 Operating expenses

	2010 £000	2009 £000
Legal and professional fees	<u>36</u>	<u>29</u>

Auditors' remuneration of £2,767 (2009 £2,767) was borne by B&B

5 Taxation

	2010 £000	2009 £000
Current taxation charge		
UK corporation tax on profit for the year	-	-
Deferred taxation temporary differences (see below)	1	(1)
Origination and reversal of temporary differences	166	116
Change in rate effective 1 April 2011 on deferred tax items	(11)	-
Total taxation charge per the Statement of Comprehensive Income	<u>156</u>	<u>115</u>
Profit before taxation	<u>746</u>	<u>551</u>
UK corporation tax at 28%	<u>209</u>	<u>154</u>
Effects of		
Change in rate effective 1 April 2011 on deferred tax items	(11)	-
Other tax rates	(53)	(38)
Adjustments in respect of previous periods	11	(1)
Total taxation charge per the Statement of Comprehensive Income	<u>156</u>	<u>115</u>
The deferred tax (liability)/asset is attributable to the following		
Fair value movements	<u>(224)</u>	<u>(69)</u>

The movement in the year was recognised in income

The Emergency Budget on 22 June 2010 announced that the UK corporation tax rate would reduce from 28% to 27% on 1 April 2011 and would further reduce by 1% each year for the next 3 years, ultimately reducing to 24% on 1 April 2014. The Budget on 23 March 2011 amended this to a reduction of 2% to 26% on 1 April 2011, further reducing by 1% each year ultimately to 23% on 1 April 2014. The Company's deferred taxation reflects the changes which had been substantively enacted by 31 December 2010, i.e. a reduction to 27% on 1 April 2011.

6 Employees and Directors' emoluments

There were no employees during the year (2009 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 2010 (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 or repossession of the mortgage assets held in trust on behalf of Aire Valley Funding 1 Limited, over which the note holders have a floating charge, may result in a reduction in the liability under the notes. Shortfalls are allocated against the notes in reverse order to the seniority of the class of the note, resulting in any such reductions being first allocated against Class C notes

Class	Final maturity	In currency 31 December 2010	In currency 31 December 2009	31 December 2010 £000	31 December 2009 £000
Series 2 A1	Sep 2066	£226,247,411	£229,000,000	226,247	229,000
Series 2 A2	Sep 2066	€ 272,682,469	€ 276,000,000	235,052	245,171
Series 2 A3	Sep 2066	\$49,398,998	US\$50,000,000	31,813	30,845
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	19,826	20,431
Series 2 C2	Sep 2066	€ 41,800,000	€ 41,800,000	36,032	37,131
				<u>558,970</u>	<u>572,578</u>
Issue costs				(3)	(9)
Hedge adjustments				(657)	(278)
				<u>558,310</u>	<u>572,291</u>
Accrued interest - current				201	128
				<u>558,511</u>	<u>572,419</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. A further £49.0m were redeemed in March 2011.

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 Ltd, 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 2010 (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 loan will coincide with the repayment of the floating rate notes as they become due for payment.

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 an employee 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 £10,286 (2009: £9,782).

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

	Aire Valley Holdings Limited and subsidiaries 2010 £000	Aire Valley Holdings Limited and subsidiaries 2009 £000
Interest receivable and similar income		
Interest on loans to Group undertakings	4,588	8,902
Non-current assets		
Loans to Group undertakings	493,850	499,158

Auditors' remuneration of £2,767 (2009: £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 2010 (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 2010

	Assets at fair value through profit or loss - on initial recognition	Loans and receivables	Total carrying value	Fair value	If fair values increased by 1%
Financial assets	£000	£000	£000	£000	£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
Total financial assets	65,784	581,486	647,270	524,243	5,242

	Liabilities at fair value through profit or loss - on initial recognition	Liabilities at amortised cost	Total carrying value	Fair value	If fair values increased by 1%
Financial liabilities	£000	£000	£000	£000	£000
Interest-bearing loans and borrowings	-	558,511	558,511	435,483	4,355
Total financial liabilities	-	558,511	558,511	435,483	4,355

At 31 December 2009

	Assets at fair value through profit or loss - on initial recognition	Loans and receivables	Total carrying value	Fair value	If fair values increased by 1%
Financial assets	£000	£000	£000	£000	£000
Loans to Group undertakings	-	499,158	499,158	318,935	3,189
Derivative financial instruments	73,641	-	73,641	73,641	736
Cash and cash equivalents	-	99,081	99,081	99,081	991
Total financial assets	73,641	598,239	671,880	491,658	4,917

	Liabilities at fair value through profit or loss - on initial recognition	Liabilities at amortised cost	Total carrying value	Fair value	If fair values increased by 1%
Financial liabilities	£000	£000	£000	£000	£000
Interest-bearing loans and borrowings	-	572,419	572,419	392,197	3,922
Total financial liabilities	-	572,419	572,419	392,197	3,922

Notes to the Financial Statements for the year ended 31 December 2010 (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

	2010 Income £000	2010 Expense £000	2009 Income £000	2009 Expense £000
Interest on loans to Group undertakings	4,588	-	8,902	-
Interest on floating rate notes	-	4,569	-	8,791
Amortisation of issue costs	-	6	-	24

Interest income on impaired assets is £nil (2009 £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 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 2010 (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.

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. A change in interest rates would also affect the fair value movements in the Statement of Comprehensive Income. A 1% increase in LIBOR for three-month Sterling deposits would give rise to a fair value loss in the Statement of Comprehensive Income of £823,809 due to changes in the fair value of derivatives, and similarly a 1% decrease would give rise to a fair value gain in the Statement of Comprehensive Income of £800,936. If LIBOR for three-month Euro and US \$ deposits were 1% higher or lower, there would be no impact on fair value gains/losses in the Statement of Comprehensive Income as any change in the value of the cross currency interest rate swaps would be offset by a corresponding movement in the value of Euro and US \$ interest-bearing loans and borrowings under the designated hedging relationship.

Other market risks

At the year end the Company had no other material exposure to market risks (2009: £nil).

(i) Credit risk

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

	2010	2009
	£000	£000
Loans to Group undertakings	493,850	499,158
Derivative financial instruments	65,784	73,641
Cash and cash equivalents	87,636	99,081
Total on-Balance Sheet and maximum exposure to credit risk	647,270	671,880

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

Notes to the Financial Statements for the year ended 31 December 2010 (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 No 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 2011 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	Total £000
At 31 December 2010					
Interest-bearing loans and borrowings	-	1,489	563,436	-	564,925
Total	-	1,489	563,436	-	564,925
At 31 December 2009					
Interest-bearing loans and borrowings	-	1,186	576,136	-	577,322
Total	-	1,186	576,136	-	577,322

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.

(iii) Currency risk

The Group's policy is to hedge all material foreign currency exposures, by the use of derivatives. Consequently, at 31 December 2010 and 31 December 2009 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 2010, 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

	Sterling £000	Euro £000	US \$ £000	Total £000
At 31 December 2010				
Financial assets				
Loans to Group undertakings	493,850	-	-	493,850
Derivative financial instruments		59,897	5,887	65,784
Cash and cash equivalents	87,636	-	-	87,636
Total financial assets	581,486	59,897	5,887	647,270
Financial liabilities				
Interest-bearing loans and borrowings	235,788	290,910	31,813	558,511
Total financial liabilities	235,788	290,910	31,813	558,511
Net financial assets/(liabilities)	345,698	(231,013)	(25,926)	88,759

Notes to the Financial Statements for the year ended 31 December 2010 (continued)

11. Financial instruments (continued)

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

(iii) Currency risk (continued)

	Sterling £000	Euro £000	US \$ £000	Total £000
At 31 December 2009				
Financial assets				
Loans to Group undertakings	499,158	-	-	499,158
Derivative financial instruments		69,044	4,597	73,641
Cash and cash equivalents	99,081	-	-	99,081
Total financial assets	598,239	69,044	4,597	671,880
Financial liabilities				
Interest-bearing loans and borrowings	238,841	302,733	30,845	572,419
Total financial liabilities	238,841	302,733	30,845	572,419
Net financial assets/(liabilities)	359,398	(233,689)	(26,248)	99,461

(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 2010			
Cross-currency interest rate swaps	322,723	65,784	65,784
Total asset balances	322,723	65,784	65,784
At 31 December 2009			
Cross-currency interest rate swaps	333,578	73,641	73,641
Total asset balances	333,578	73,641	73,641
Fair value movements in the Statement of Comprehensive Income comprised the following		2010 £000	2009 £000
Net gains/(losses) on hedging swaps		(7,895)	(25,743)
Net gains/(losses) on hedged items due to exchange rate movements		8,263	25,321
Net gains/(losses) on hedged items due to interest rate movements		379	972
		747	550

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 2010 (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
At 31 December 2010				
Financial assets				
Derivative financial instruments	-	65,784	-	65,784
At 31 December 2009				
Financial assets				
Derivative financial instruments	-	73,641	-	73,641

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

These definitions have been taken from the March 2009 amendment to IFRS 7 'Improving Disclosures about Financial Instruments'

12. Called up share capital

	2010 Shares	2009 Shares	2010 £	2009 £
Authorised				
Ordinary shares of £1 each				
At 1 January and 31 December	100,000	100,000	100,000	100,000
Allotted, issued and fully paid				
At 1 January and 31 December				
Ordinary shares of £1 each fully paid	2	2	2	2
Ordinary shares of £1 each partly paid	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.

Notes to the Financial Statements for the year ended 31 December 2010 (continued)**14. Ultimate parent undertaking**

The Company's immediate parent undertaking is Aire Valley Holdings Limited, a limited liability company incorporated in the United Kingdom and registered in England and Wales. The Company's ultimate parent undertaking is SFM Corporate Services Limited, a limited liability company incorporated in the United Kingdom and registered in England and Wales under the Companies Act 1985, which holds the shares of Aire Valley Holdings Limited on a discretionary trust basis for charitable purposes. Copies of the Financial Statements of SFM Corporate Services Limited and Aire Valley Holdings Limited may be obtained from the Company Secretary at 35 Great St Helen's, London EC3A 6AP.

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

As a result of The Bradford & Bingley plc Transfer of Securities and Property etc Order 2008, which transferred all shares in 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 in the United Kingdom under the Companies Act 2006 and registered in England and Wales, 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.

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.