

# **Preferred Residential Securities 05-1 Parent Limited**

## **Report and Financial Statements**

30 November 2010

Registered No 5348016

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## Preferred Residential Securities 05-1 Parent Limited

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### **Directors**

M H Filer  
Wilmington Trust SP Services (London) Limited  
J Schroeder

### **Secretary**

Wilmington Trust SP Services (London) Limited  
Third Floor  
1 King's Arms Yard  
London EC2R 7AF

### **Auditors**

Ernst & Young LLP  
1 More London Place  
London SE1 2AF

### **Note Trustee**

BNYM Corporate Trustee Services Limited  
One Canada Square  
London E14 5AL

### **Registered Office**

c/o Wilmington Trust SP Services (London) Limited  
Third Floor  
1 King's Arms Yard  
London EC2R 7AF

## Directors' report

The directors present their report and the audited financial statements for the year ended 30 November 2010

### Principal activities

The principal activity of the Company is that of a holding company. The principal activity of the Group is the investment in mortgage loans secured by first charges over residential properties within the United Kingdom.

### Business review

On 27 April 2005 the Group purchased £399,965,338 of mortgages from Preferred Mortgages Limited. Further consideration may be payable to Preferred Mortgages Limited dependent on future performance of the mortgages. The acquisition of these mortgage assets has been accounted for as a loan to originator as detailed in Note 1 of the financial statements. To facilitate the purchase, the Group issued a series of mortgage-backed loans on 27 April 2005. These loan notes are listed on the London Stock Exchange.

The mortgage servicing, cash bond administration and accounting services are provided to the Group by Acenden Limited (formerly Capstone Mortgage Services Limited), an external party.

The consolidated profit and loss account for the year ended 30 November 2010 is set out on page 9. The Group's business activities, together with the factors likely to affect its future development, financial performance and financial position are set out below.

The current economic environment is difficult and the Group has reported an operating loss for the year after Financial Reporting Standard No 26 adjustments, which are required in order to recognise the interest income on mortgage loan assets underlying the loan to originator on an Effective Interest Rate (EIR) basis. The directors consider that the outlook presents significant challenges in meeting the capital repayments and interest due to the holders of the loan notes as and when they fall due.

The directors have concluded that the Group will continue as a going concern and set out the basis for this conclusion in the Going Concern section of this report.

As required by Financial Reporting Standard No 26, the result for the year includes a fair value loss on derivative financial instruments of £414,906 (2009 – £495,958 gain) and an unrealised exchange gain on restatement of loan liabilities of £438,738 (2009 – £490,224 loss).

At the year end the loan to originator balance after the Effective Interest Rate Adjustment, was £74,014,996 (2009 – £83,724,967). At the December 2010 Interest Payment Date the originator held the following mortgage loans underlying the loan to originator, excluding the Effective Interest Rate Adjustment.

	<i>Principal balance £000</i>	<i>Number of loans</i>
First Mortgages	73,660	990
Total	<u>73,660</u>	<u>990</u>

These mortgages provide security against loan notes in issue totalling £73,659,551 as at the December 2010 Interest Payment date.

The mortgage loans generated a weighted average margin over funding costs of 3.48% during the year, before considering the adjustments for Financial Reporting Standard No 26. The weighted average cost of funds for the year was 0.67%.

## Directors' report

### Business review (continued)

The mortgage loans exhibited the following quarterly arrears profile

	<i>Q1</i>	<i>Q2</i>	<i>Q3</i>	<i>Q4</i>
	%	%	%	%
<b><i>Delinquencies days – (excluding repossessions)</i></b>				
Current	63.07	62.53	63.10	61.24
>30<=60	8.15	6.77	5.96	7.95
>60<=90	4.13	5.84	5.78	6.73
>90<=120	4.66	3.26	4.61	5.38
>120	19.99	21.60	20.55	18.70
Total	100.00	100.00	100.00	100.00

At the March 2011 Interest Payment Date following the year end, the mortgage assets underlying the loan to originator balance, was £72,313,244, 26.44% of the balance was greater than 3 months in arrears

The directors consider the level of arrears to be within expectations and have not made any adjustment to the expected cash flows of the loan to originator

The performance of the mortgage loans during the year to 30 November 2010 enabled deferred consideration of £2,354,944 (2009 – £173,790) to be paid to the current holder of the rights to the residual cash flows of the securitisation

### Future development

The directors of the company do not envisage any change to the principal activities of the Group in the future

### Going concern

As described in the Business review, the Group has reported an operating loss for the year. However the Group is in a net asset position as at 30 November 2010

It is the intention of the directors of the Group to continue operations until such a time as the amount due from mortgage loans underlying the loan to originator have been fully realised. Ultimately, due to the non-recourse nature of the mortgage backed loan notes, any shortfall in the proceeds from the mortgage assets will be a risk to the holders of those notes and accordingly the financial statements have been prepared on a going concern basis

### Fair value

Note 17 discloses the fair values of the mortgage assets underlying the loan to originator, and loan notes. The directors noted that as at 30 November 2010 the respective fair values of the mortgage assets underlying the loan to originator, and loan notes are less than the carrying values recorded in the balance sheet

The directors believe that this is reasonable, based on the global contraction of credit markets, the challenges faced by the sub prime mortgage sector and the decline in market demand for mortgage backed securities

As no liquid market exists for either the mortgage loans underlying the loan to originator or loan notes, the directors have ascribed an approximate fair value based on an internal discounted cash flow model that is used to value non-securitised mortgage loan receivables. This model takes into account expected prepayment rates, arrears levels, house price movements, level of repossessions, losses and discount rates based on the most recent available information

## Directors' report

### Dividend

The directors do not recommend the payment of a dividend for the year (2009 – £Nil)

### Policy and practice on payment of creditors

The Group does not follow any stated code on payment practice. It is the Group's policy to agree terms of payment with suppliers when agreeing the terms of each transaction and to abide by those terms. Standard terms provide for payment of all invoices within 30 days after the date of the invoice, except where different terms have been agreed with the suppliers at the outset. It is the policy of the Group to abide by the agreed terms of payment. There are no creditor days of suppliers' invoices outstanding at the year-end (2009 – nil days).

### Directors

The directors who held office during the year were as follows

M H Filer

Wilmington Trust SP Services (London) Limited

J Schroeder

### Registered office

On 31 May 2011 the company changed its registered office. Details of the new registered office are shown on page 1.

### Principal risks and uncertainties

#### Financial instrument risk

The financial instruments held by the Group comprise mortgage assets underlying the loan to originator, borrowings, cash and various other items (such as other debtors, other creditors etc) that arise directly from its operations.

The Group also entered into derivative transactions where necessary (principally interest rate and currency swaps) to manage its interest rate risk and currency risk.

It is, and has been throughout the year under review, the Group's policy that no trading in financial instruments shall be undertaken.

The main risks arising from the Group's financial instruments are credit risk, interest rate risk, foreign exchange risk and liquidity risk. The directors review and agree policies for managing each of these risks and they are summarised below.

#### Credit risk

Credit risk is the risk that borrowers will not be able to meet their obligations as they fall due. All mortgages underlying the loan to originator were required to adhere to specific lending criteria. The ongoing credit risk of the mortgage portfolio (and particularly in respect of accounts in arrears) is closely monitored by the directors. The mortgage portfolio is recognised as a collateralised non-recourse loan to the originator as explained in note 1. In addition there is credit risk associated with the ability of the swap counterparty to meet its obligations under the swap agreement. This has been mitigated by the payment of cash collateral to the company.

## Directors' report

### Principal risks and uncertainties (continued)

#### Interest rate risk

Interest rate risk exists where assets and liabilities have interest rates set under different bases or which reset at different times. The Group minimises its exposure to interest rate risk by ensuring that the interest rate characteristics of its assets and liabilities are similar. Where this is not possible the Group has used derivative financial instruments to mitigate any residual interest rate risk.

#### Foreign exchange risk

Foreign exchange risk exists where the loan notes are denominated in a currency which is different to the underlying sterling mortgage loans. The Group minimises its exposure to foreign currency risk by ensuring that the currency characteristics of its assets and liabilities are similar. Where this is not possible the Group has used derivative financial instruments to mitigate any foreign exchange risk.

#### Liquidity risk

The Group's policy is to manage liquidity risk by matching the timing of the cash receipts from mortgage assets underlying the loan to originator with those of the cash payments due on the loan notes. In addition the Group holds a minimum cash balance to manage short term liquidity requirements.

#### Corporate governance

The Directors are responsible for internal control in Preferred Residential Securities 05-1 Parent Limited and for reviewing the effectiveness. Procedures 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 and can only provide reasonable and not absolute assurance against material misstatement, errors, losses or fraud. The procedures enable Preferred Residential Securities 05-1 Parent Limited to comply with the relevant regulatory obligations.

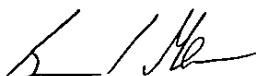
#### Disclosure of information to the auditors

So far as each person who was a director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing its report, of which the auditor is unaware. Having made enquiries of fellow directors and the Group's auditor, each director has taken all the steps that he is obliged to take as a director in order to make himself aware of any relevant audit information and to establish that the auditor is aware of that information.

#### Auditors

A resolution to reappoint Ernst & Young LLP as auditors will be put to the members at the Annual General Meeting.

Approved by the board of directors and signed on behalf of the board



**Sunil Masson**  
**Authorised Signatory**

**13 JUL 2011**

Director

**Wilmington Trust SP Services (London) Limited**

Date

## Statement of directors' responsibilities

The directors are responsible for preparing the Annual 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 elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards 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 Group and of the profit or loss of the Group for that period. In preparing these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgments and estimates that are reasonable and prudent,
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the financial position of the Group and to enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

# **Independent auditors' report**

## **to the members of Preferred Residential Securities 05-1 Parent Limited**

We have audited the financial statements of Preferred Residential Securities 05-1 Parent Limited for the year ended 30 November 2010 which comprise the Consolidated Profit and Loss Account, the Consolidated and Company Balance Sheets and the related notes 1 to 21. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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 Directors' Responsibilities Statement 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 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**

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 group's and the parent 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 accounts 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 group's and the parent company's affairs as at 30 November 2010 and of the group's loss for the year then ended,
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, 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.



## Independent auditors' report

to the members of Preferred Residential Securities 05-1 Parent Limited

### 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 by the parent company, or returns adequate for our audit have not been received from branches not visited by us, or
- the parent company 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

*Ernst & Young LLP*

Amarjit Singh (Senior Statutory Auditor)  
for and on behalf of Ernst & Young LLP, Statutory Auditor  
London

Date 14 July 2011

## Consolidated profit and loss account

for the year ended 30 November 2010

	Notes	2010 £000	2009 £000
Interest receivable and similar income	2	2,629	9,314
<b>Interest payable and similar charges</b>	3	(1,153)	(2,643)
<b>Net interest receivable</b>		1,476	6,671
Net fair value (loss)/gain on derivatives		(415)	496
Other operating income	4	308	493
Unrealised exchange gain/(loss) on loan liabilities		438	(490)
Operating expenses		(2,662)	(3,443)
<b>(Loss)/profit on ordinary activities before taxation</b>	5	(855)	3,727
Tax on (loss)/profit on ordinary activities	6	179	(783)
<b>(Loss)/profit on ordinary activities after taxation</b>	15	(676)	2,944

The loss for the year was derived from continuing operations

There were no recognised gains or losses other than the loss for the year, accordingly no statement of recognised gains and losses is given

The notes on pages 12 to 28 form part of these financial statements

## Consolidated balance sheet

at 30 November 2010

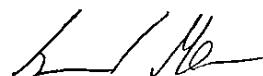
	Notes	2010 £000	2009 £000
<b>Fixed assets</b>			
Loan to originator	9	74,015	83,725
<b>Current assets</b>			
Debtors			
Amounts falling due after one year	10	886	1,302
Amounts falling due within one year	11	23	155
Cash at bank and in hand		33,543	34,675
		<u>34,452</u>	<u>36,132</u>
<b>Creditors</b> , amounts falling due within one year	12	(31,828)	(31,914)
<b>Net current assets</b>		<u>2,624</u>	<u>4,218</u>
<b>Creditors</b> , amounts falling due after one year	13	(76,438)	(87,066)
<b>Net assets</b>		<u>201</u>	<u>877</u>
<b>Capital and reserves</b>			
Issued share capital	14	13	13
Profit and loss account	15	188	864
<b>Shareholders' funds</b>	16	<u>201</u>	<u>877</u>

The notes on pages 12 to 28 form part of these financial statements

These financial statements were approved by the board of directors and were signed on its behalf by

Director

Date



Sunil Masson 13 JUL 2011  
Authorised Signatory

Wilmington Trust SP Services (London) Limited


## Company balance sheet

at 30 November 2010

	Notes	2010 £000	2009 £000
<b>Fixed assets</b>			
Investments	8	13	13
<b>Net assets</b>		<u>13</u>	<u>13</u>
<b>Capital and reserves</b>			
Issued share capital	14	13	13
Profit and loss account	15	–	–
<b>Shareholders' funds</b>	16	<u>13</u>	<u>13</u>

The notes on pages 12 to 28 form part of these financial statements

These financial statements were approved by the board of directors and were signed on its behalf by

 **Sunil Masson** 13 JUL 2011  
**Authorised Signatory**  
Director      **Wilmington Trust SP Services (London) Limited**  
Date

## Notes to the financial statements

at 30 November 2010

### 1. Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Group's financial statements

#### ***Basis of preparation***

The financial statements have been prepared in accordance with applicable UK accounting standards and under the historical cost convention except for derivative financial instruments which are carried at fair value through the profit and loss account. The financial statements have been prepared on a going concern basis as referred to in the Going concern section of the Directors' report.

#### ***Basis of consolidation***

The Group financial statements consolidate the financial statements of the Company and all its subsidiaries for the year ended 30 November 2010. All the subsidiaries are accounted for using acquisition accounting.

In accordance with section 408(4) of the Companies Act 2006, Preferred Residential Securities 05-1 Parent Limited is exempt from the requirement to present its own profit and loss account. The result for the year of Preferred Residential Securities 05-1 Parent Limited is disclosed in note 15 to the financial statements.

#### ***Income recognition***

Interest income on mortgage loan assets underlying the loan to originator is recognised in the profit and loss account on an Effective Interest Rate (EIR) basis. The EIR recognises revenue equivalent to the rate that effectively discounts estimated future cash flows throughout the estimated life to the net carrying value of the loan.

#### ***Loan to originator***

Where a transfer of a financial asset does not qualify for derecognition, the transferee does not recognise the transferred asset for financial reporting purposes, as its asset. The transferee derecognises the cash or other consideration paid and recognises a receivable from the transferor. In relation to the mortgage portfolio transferred to the Group, derecognition is considered to be inappropriate for the portfolio seller's or originator's (Preferred Mortgages Limited) own financial statements as the originator has retained significant risks, in the form of credit enhancement paid in, and rewards, in the form of deferred purchase consideration to be paid out, of that financial asset. The Group's financial statements are therefore prepared on the basis that its acquisitions of beneficial interests in mortgage portfolios are recognised as collateralised non-recourse loan to the originator.

The loan to originator is classified within 'loans and receivables'. The initial measurement is at fair value with subsequent measurement being at amortised cost using the effective interest rate method. The effective interest on the loan to the originator is calculated with reference to the interest earned on the beneficial interest in the mortgage portfolio less the residual interest due to the current holder of the rights to the residual cash flows of the securitisation.

## Notes to the financial statements

at 30 November 2010

### 1. Accounting policies (continued)

#### *Loan to originator* (continued)

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred loss event) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

An adjustment to the expected cash flows of the loan to originator balance would be recognised where there is a risk that the income on the loan to portfolio seller will be significantly reduced. This could occur if the credit quality of the mortgage assets that are pledged as collateral for the loan deteriorated significantly and is calculated using the methodology below.

Specific provisions for losses on loans and advances to customers which underlie the loan to originator are made throughout the year and at the year-end on a case by case basis (calculated with reference to the probability of the loan defaulting and the value of the security held against the loan). The specific provision for properties in possession is based on the balance outstanding less a discounted valuation of the security held (with adjustments for expenses of sale).

#### *Fixed asset investment*

The Company's investment in subsidiary companies is stated at cost less provision for diminution in value where the directors consider this necessary.

#### *Taxation*

The charge for taxation is based on the profit for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred taxation is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that have occurred at that date that will result in an obligation to pay more, or a right to pay less tax with the following exceptions:

Deferred tax assets are recognised only to the extent that the directors consider it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted. Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in years in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

#### *Deferred consideration*

Deferred consideration represents further amounts payable on the acquisition of mortgages from Preferred Mortgages Limited. The payment of these amounts is conditional on the performance of the mortgages underlying the loan to originator.

Under the terms of the securitisation the Group earns an annual profit in an amount equal to 0.01 per cent of the aggregate balances of the loans in the mortgage pool. This is reflected in the profit and loss before any movements on fair value gains and losses on derivatives and Effective Interest Rate adjustments.

Profits in excess of 0.01 per cent accrue to the current holder of the rights to the residual cash flows of the securitisation, as deferred consideration. Accordingly, amounts owing to the current holder of the rights to the residual cash flows of the securitisation are recognised as creditors in its balance sheet.

## Notes to the financial statements

at 30 November 2010

### 1. Accounting policies (continued)

#### **Derivatives**

The Group uses derivative financial instruments to hedge its exposure to interest rate and currency risk arising from operational, financing and investment activities. The Group does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

Financial Reporting Standard No. 26 requires all derivative financial instruments to be recognised initially at fair value on the balance sheet. Subsequent to initial recognition, derivatives are remeasured to fair value. Where the value of the derivative is positive, it is carried as a derivative asset and, where negative, as a derivative liability. The gain or loss on remeasurement to fair value is recognised immediately in the profit and loss account. The fair value of the interest rate swaps caps and currency swaps is the estimated amount that the Group would receive or pay to terminate the swap at the balance sheet date.

#### **Interest rate caps**

A series of amortising interest rate caps were entered into in order to manage the Group's interest rate risk in relation to fixed rate mortgage loans underlying the loan to originator. The derivative contracts were designed to match the expected profile of the run-off of the fixed rate loans.

#### **Currency swaps**

A series of currency swaps were entered into in order to manage the Group's currency rate exposure in relation to non-sterling denominated Loan Notes. The derivative contracts were designed to match the expected profile of the run-off of the non-sterling denominated Loan Notes.

#### **Foreign currencies**

Mortgage-backed floating rate notes included in financial liabilities, denominated in foreign currencies at the balance sheet date, are reported at the rates of exchange prevailing at the reporting date. Any exchange differences arising in the year on the settlement or retranslation of foreign currency liabilities are included in the profit and loss account.

#### **Issue costs**

Initial issue costs incurred in arranging funding facilities are amortised over the life of the facility. Unamortised initial issue costs are deducted from the associated liability in accordance with Financial Reporting Standard No. 26 and costs amortised in the year are included in interest payable.

#### **Mortgage-backed loan notes**

Mortgage-backed loan notes are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, the mortgage-backed loan notes are stated at amortised cost with any difference between cost and redemption value being recognised in the profit and loss account over the period of the borrowings on an effective interest basis.

The repayment of the loan notes is dependent on principal and interest collections on the mortgage loans. The directors periodically review the estimated future cash flows on the mortgage loans to determine whether the amortised cost carrying value of the loan notes requires adjustment. If a shortfall in the cash flows is identified, an adjustment is credited to the profit and loss account to reduce the carrying value of the loan notes.

#### **Related party transactions**

Preferred Mortgages Limited retains an interest in the cash flows and profits of Preferred Residential Securities 05-1 plc, a wholly owned subsidiary of Preferred Residential Securities 05-1 Parent Limited. Accordingly Preferred Mortgages Limited whilst having no direct investment in the Group is treated as a related party.

## Notes to the financial statements

at 30 November 2010

### 1. Accounting policies (continued)

#### Statement of cash flows

Under Financial Reporting Standard No 1 (Revised), the Group is exempt from the requirement to prepare a statement of cash flows on the grounds that it is included in publicly available consolidated financial statements

#### Turnover

The Group's income and trade are wholly within the UK and within a single market sector and therefore no segmental analysis has been presented

### 2. Interest receivable and similar income

	2010 £000	2009 £000
On loan to originator	2,416	9,037
Other interest	213	277
	<u>2,629</u>	<u>9,314</u>

### 3. Interest payable and similar charges

	2010 £000	2009 £000
Mortgage backed loan notes	860	2,277
Other interest	263	306
Amortisation of capitalised issue costs	30	60
	<u>1,153</u>	<u>2,643</u>

### 4. Other operating income

	2010 £000	2009 £000
Redemption fees	17	63
Sundry fee income	291	430
	<u>308</u>	<u>493</u>



## Notes to the financial statements

at 30 November 2010

### 5. (Loss)/profit on ordinary activities before taxation

This is stated after charging/(crediting)

	2010 £000	2009 £000
Auditors' remuneration – for audit services – Group	14	13
– Company	5	5
Other fees to auditors – taxation services – Group	9	8
– Company	1	2
Adjustment to the expected cash flows of the loan to originator arising from the impairment of the underlying mortgages	(23)	(1,033)
Deferred consideration	2,509	(1,557)
Adjustment to the expected cash flows of the loan to originator arising from bad debts incurred on the underlying mortgages	(214)	5,347

### 6. Tax

(a) Tax on (loss)/profit on ordinary activities

The tax (credit)/charge is made up as follows

	2010 £000	2009 £000
Current tax		
UK corporation tax on (loss)/profit in the year	2	–
Total current tax (note 6(b))	2	–
Deferred tax		
Origination and reversal of timing differences	(181)	783
Effect of rate change on opening liability	–	–
Total deferred tax (credit)/charge (note 18)	(181)	783
Tax on (loss)/profit on ordinary activities	(179)	783

## Notes to the financial statements

at 30 November 2010

### 6. Tax (continued)

(b) Factors affecting the tax (credit)/charge in the year

The tax rate assessed for the year is equal to the small companies rate of corporation tax in the UK of 21% (2009 – 21%) The factors affecting the tax charge are explained below

	2010 £000	2009 £000
(Loss)/profit on ordinary activities before tax	(855)	3,727
(Loss)/profit on ordinary activities multiplied by the standard rate of corporation tax for small companies of 21% (2009 – 21%)	(179)	783
Effects of Other short-term timing differences	181	(783)
Current tax charge for the year (note 6(a))	2	–

### 7 Information regarding directors and employees

The Group has no employees (2009 – none) The directors received no remuneration from the Group during the year (2009 – £Nil)

### 8. Investments

*Company*

*Shares in  
group  
undertakings  
£000*

At 30 November 2010 and 2009 13

The undertakings in which the Company's interest at 30 November 2010 is more than 20% are as follows

<i>Company</i>	<i>Principal activity</i>	<i>Proportion held</i>
Preferred Residential Securities 05-1 plc	Investment in residential loans	100%

At 30 November 2010 the Company held 49,998 ordinary shares of £1 each in Preferred Residential Securities 05-1 plc, and has paid up 25p on each share The Company also held one fully paid share of £1 in the same company These holdings represent the entire issued share capital of that company except for one fully paid ordinary share of £1 held by Wilmington Trust SP Services (London) Limited on a discretionary basis

## Notes to the financial statements

at 30 November 2010

### 8. Investments (continued)

Preferred Residential Securities 05-1 plc acts as an investment company, holding mortgages financed by Mortgage Backed Floating Rate Notes. The subsidiary is registered and operates in the United Kingdom. The following information is presented in respect of its financial statements for the year ended 30 November 2010.

	2010 £000	2009 £000
Aggregate capital and reserves	201	877
(Loss)/profit for the year	(676)	2,944

### 9. Loan to originator – net balances

Group	2010 £000	2009 £000
At 1 December	83,725	104,924
Principal repayments and mortgage redemptions	(9,947)	(16,885)
Adjustment to the expected cash flows of the loan to originator arising from the impairment of the underlying mortgages	23	1,033
Adjustment to the expected cash flows of the loan to originator arising from bad debts incurred on the underlying mortgage loans	214	(5,347)
At 30 November	74,015	83,725

The Group purchased a portfolio of mortgage loans from Preferred Mortgages Limited. However, as the principal economic risk and rewards associated with these mortgage loans remain with Preferred Mortgages Limited, these loans are not deemed for accounting purposes to have been transferred to the Group. Accordingly, the Group accounts for the transaction as a loan to Preferred Mortgages Limited, as the originator of the loans. The repayment of the loan to originator is linked to the repayment of the loan notes referred to in note 13.

The loan to Preferred Mortgages Limited is denominated in Sterling and bears interest at a variable rate. It is secured on the beneficial interest in a portfolio of residential mortgage loans.

The current mortgage loans in the pool have loan periods of between 3 to 353 months remaining with current interest rates ranging from 2.48% to 6.98% per annum.

The mortgage loans are held as security against the loan notes referred to in note 13.

### 10. Debtors – amounts falling due after one year

Group	2010 £000	2009 £000
Derivative financial instruments	886	1,302

## Notes to the financial statements

at 30 November 2010

### 11. Debtors: amounts falling due within one year

<i>Group</i>	<i>2010</i>	<i>2009</i>
	<i>£000</i>	<i>£000</i>
Prepayments and accrued income	23	10
Other debtors	–	145
	<u>23</u>	<u>155</u>

### 12. Creditors: amounts falling due within one year

<i>Group</i>	<i>2010</i>	<i>2009</i>
	<i>£000</i>	<i>£000</i>
Amounts owed to related parties	37	40
Corporation tax	6	4
Deferred taxation (note 18)	30	211
Other creditors	28,184	28,227
Accruals and deferred income	329	344
Deferred consideration	3,242	3,088
	<u>31,828</u>	<u>31,914</u>

Other creditors include £26,800,000 (2009 – £26,800,000) owing to the liquidity facility provider. This arises from the drawdown of the facility due to the counterparty default risk of the provider. The cash drawing of £26,800,000 (2009 – £26,800,000) is included in Cash at bank and in hand.

### 13. Creditors: amounts falling due after one year

<i>Group</i>	<i>2010</i>	<i>2009</i>
	<i>£000</i>	<i>£000</i>
EUR denominated mortgage backed loan notes due 2024 – Class A1a	–	–
GBP denominated mortgage backed loan notes due 2043 – Class A2c	29,184	39,404
EUR denominated mortgage backed loan notes due 2043 – Class B1a	4,738	5,176
GBP denominated mortgage backed loan notes due 2043 – Class B1c	18,307	18,307
GBP denominated mortgage backed loan notes due 2043 – Class C1c	8,748	8,748
GBP denominated mortgage backed loan notes due 2043 – Class D1c	12,798	12,798
GBP denominated mortgage backed loan notes due 2043 – Class E	2,754	2,754
	<u>76,529</u>	<u>87,187</u>
Less: Issue costs	(91)	(121)
	<u>76,438</u>	<u>87,066</u>

The mortgage backed loan notes with nil value have been fully repaid.

All amounts falling due after one year fall due after five years.

The mortgage backed floating rate notes due 2043 are secured over a portfolio of mortgage loan secured by first and second charges over residential properties in the United Kingdom.

## Notes to the financial statements

at 30 November 2010

### 13. Creditors amounts falling due after one year (continued)

The mortgages underlying the loan to originator are administered by Acenden Limited on behalf of Preferred Residential Securities 05-1 plc

The loan notes are repaid as the underlying portfolio redeems. The terms and conditions of the loan notes provide that the loan note holders will receive interest and principal only to the extent that sufficient funds are generated from the mortgage loans. The priority and amount of claims on the portfolio proceeds are determined in accordance with a strict priority of payments. Note holders have no recourse to Preferred Residential Securities 05-1 plc in any form.

The mortgage backed floating rate notes are subject to mandatory redemption in part at each interest payment date in an amount equal to the principal received or recovered in respect of the mortgages underlying the loan to originator. If not otherwise redeemed or purchased and cancelled, the notes will be redeemed at their principal amount outstanding on the interest payment date falling in June 2043.

The loan notes issued by Preferred Residential Securities 05-1 plc are full recourse obligations of that Company and are issued subject to an option of Eurosail Options Limited, a related party, to acquire the notes for nominal consideration, the post enforcement call option, should any of the notes remain outstanding following enforcement of their rights and realisation of the assets of the Company. The Post-Enforcement Call Option may be exercised by Eurosail Options Limited on the date following the enforcement by the Note Trustee of the Issuer Security on which the Note Trustee determines that there are no further assets available to pay amounts due and owing to the Noteholders. Noteholders will be bound by the terms of the Post-Enforcement Call Option granted to Eurosail Options Limited and the Noteholders will not be paid more than a nominal amount for that transfer.

The loan notes are repayable out of capital receipts from the mortgage loan receivables, with the Class A Notes ranking in priority to the Class B Notes, which rank in priority to the Class C Notes, which rank in priority to the Class D Notes, which ranks in priority to Class E Notes.

Interest on the notes is payable quarterly in arrears at the following annual rates for three month deposits

Class A1a	EURIBOR + 0.07 pa
Class A2c	LIBOR + 0.16% pa
Class A Detachable Coupons	see below
Class B1a	EURIBOR + 0.25% pa
Class B1c	LIBOR + 0.25% pa
Class C1C	LIBOR + 0.44% pa
Class D1C	LIBOR + 0.70% pa
Class E	LIBOR + 3.25% pa

The Detachable A Coupon rate means on any Interest Payment Date the rate (expressed as a percentage per annum) is the product of the following

$$D\% \times \frac{A}{A2c}$$

Where

D% means on the first to fourth Interest Determination Dates, the rate of 0.10%. On each of the fifth to the eighth Interest Determination Dates, the rate of 2.25%, on each of the ninth to the twelfth Interest Determination Dates the rate of 2.45%, and 0% at all other times,

A means the aggregate principal amount outstanding in respect of the A notes, and

A2c means the aggregate principal amount outstanding in respect of the A2c notes

## Notes to the financial statements

at 30 November 2010

### 14. Issued share capital

	2010 £000	2009 £000
<i>Allotted and called up</i>		
12,501 ordinary shares 100% called and fully paid	13	13

Share capital of £1 was issued on incorporation on 31 January 2005 and settled for cash on 2 March 2005. 12,500 shares were allotted, called-up and fully paid on 3 March 2005.

### 15 Profit and loss account

	<i>Group</i> <i>2010</i> <i>£000</i>	<i>Company</i> <i>2010</i> <i>£000</i>	<i>Group</i> <i>2009</i> <i>£000</i>	<i>Company</i> <i>2009</i> <i>£000</i>
Retained profit/(loss) brought forward	864	—	(2,080)	—
(Loss)/profit for the year	(676)	—	2,944	—
Retained profit carried forward	188	—	864	—

### 16. Reconciliation of movement in shareholders' funds

	<i>Group</i> <i>2010</i> <i>£000</i>	<i>Company</i> <i>2010</i> <i>£000</i>	<i>Group</i> <i>2009</i> <i>£000</i>	<i>Company</i> <i>2009</i> <i>£000</i>
Opening shareholders' funds/(deficit)	877	13	(2,067)	13
(Loss)/profit for the year	(676)	—	2,944	—
Closing shareholders' funds	201	13	877	13

### 17. Derivatives and other financial instruments

#### Nature and extent of risks arising from financial instruments

The main risks arising from the Group's financial instruments are credit risk, interest rate risk, foreign exchange risk and liquidity risk. Financial instruments used by the Group for risk management purposes include derivative instruments. Such instruments are used only for commercial hedging purposes, not for trading or speculative purposes. The principal derivative instruments used by the Group in managing its risks are interest rate caps and foreign currency swaps. The maturity profile of the derivative instruments reflects the nature of exposures arising from underlying business activities. All of the Group's derivatives activities are contracted with financial institutions.

During the year, the Group recognised net fair value gains of £23,832 (2009 – £5,734 gain) due to the movements in the fair value of derivatives and exchange rate movements on the loan notes.

## Notes to the financial statements

at 30 November 2010

### 17. Derivatives and other financial instruments (continued)

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

The main risks arising from the Group's financial instruments and management of these risks are summarised below

##### **Credit risk**

Credit risk arises primarily from the potential for default in the mortgage loan portfolio. Credit risk is managed through the arrears management process which ensures that mortgages going into arrears are quickly identified and closely monitored.

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

##### **Liquidity risk**

The underlying mortgage loan assets are funded by the issue of floating rate loan notes. Liquidity risk is managed by matching the timing of the cash receipts from mortgage assets with those of the cash payments due on the loan notes. The Group holds a minimum cash balance to manage short-term liquidity requirements.

##### **Foreign exchange risk**

Certain loan notes are issued in Euro denominations and repayments of principal and payments of interest are made in Euros. The Group takes out derivative instruments to manage movements in foreign currency exchange rates.

##### **Interest rate risk**

The Group is exposed to interest rate risk where assets and liabilities have interest rates set under different bases or which reset at different times. The Group minimises its exposure to interest rate risk by ensuring that the interest rate characteristics of its assets and liabilities are similar. Where this is not possible the Group takes out derivative financial instruments to manage interest rate mismatches.

##### (a) Credit risk

Before taking account of any collateral, the maximum exposure to credit risk as at 30 November was

	2010	2009
	£000	£000
Loan to originator	74,015	83,725
Cash at bank and in hand	33,543	34,675
Derivative financial instruments	886	1,302
	<u>108,444</u>	<u>119,702</u>

## Notes to the financial statements

at 30 November 2010

### 17. Derivatives and other financial instruments (continued)

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

##### (b) Liquidity risk

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

At 30 November 2010

<i>Financial</i>	<i>Less than</i>						
<i>liabilities</i>	<i>1 year</i>	<i>1-2 years</i>	<i>2-3 years</i>	<i>3-4 years</i>	<i>4-5 years</i>	<i>5+ years</i>	<i>Total</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>
Loan notes	7,789	6,494	5,951	5,453	53,873	—	79,560

At 30 November 2009

<i>Financial</i>	<i>Less than</i>						
<i>liabilities</i>	<i>1 year</i>	<i>1-2 years</i>	<i>2-3 years</i>	<i>3-4 years</i>	<i>4-5 years</i>	<i>5+ years</i>	<i>Total</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>
Loan notes	15,751	12,131	10,166	51,246	—	—	89,294

There is no contractual obligation to pay down the loan notes other than as set out in note 13

The undiscounted cash flows have been estimated by applying a constant (per annum) prepayment rate to the principal balance of the mortgage loans underlying the loan to originator and using the weighted average interest rate prevailing at the balance sheet date. However, it is not expected that the loans will repay at a constant rate until maturity, that all of the loans will prepay at the same rate or that there will be no defaults or delinquencies on the loans, therefore the amounts disclosed above are only estimates of the possible future cash outflows on the loan notes

##### (c) Foreign exchange risk

The Group uses foreign currency swaps in certain circumstances to hedge against any currency exposure risks. At 30 November 2010, the notional value of the swaps held was £3,888,095 (2009 – £3,888,095) and the recognised positive fair value of the Euro swaps was £886,567 (2009 – £1,301,472)



## Notes to the financial statements

at 30 November 2010

### 17. Derivatives and other financial instruments (continued)

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

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

#### (c) Foreign exchange risk (continued)

	2010	2009
	Euro	Euro
	£000	£000
<i>Financial liabilities</i>		
EUR Denominated Mortgage backed loan notes due 2043 – Class B1a	4,738	5,176
	<u>4,738</u>	<u>5,176</u>

There were no financial assets that were denominated in foreign currencies

#### (d) Interest rate risk

The table below summarises the interest rate risk profile of the Group's financial instruments

At 30 November 2010

	<i>Total</i>		<i>After</i>		<i>After</i>	<i>After</i>	<i>Weighted</i>	<i>Weighted</i>
	<i>non-interest</i>		<i>3 months</i>		<i>6 months</i>	<i>1 year</i>	<i>average</i>	<i>average</i>
	<i>Total</i>	<i>bearing</i>	<i>3 months</i>	<i>6 months</i>	<i>1 year</i>	<i>5 years</i>	<i>fixed</i>	<i>time for</i>
	£000	£000	£000	£000	£000	£000	rate	is fixed
							%	Years
<i>Financial assets</i>								
Loan to originator	74,015	–	74,015	–	–	–	N/A	N/A
Cash and deposits	33,543	–	33,543	–	–	–		
Derivative financial instruments	886	886	–	–	–	–		
Total assets	<u>108,444</u>	<u>886</u>	<u>107,558</u>	<u>–</u>	<u>–</u>	<u>–</u>		
<i>Financial liabilities</i>								
Mortgage backed loan notes due 2024 and 2043	(76,529)	(849)	(75,680)	–	–	–		
Liquidity facility provider creditor	(26,800)	–	(26,800)	–	–	–		
Total liabilities	<u>(103,329)</u>	<u>(849)</u>	<u>(102,480)</u>	<u>–</u>	<u>–</u>	<u>–</u>		

## Notes to the financial statements

at 30 November 2010

### 17. Derivatives and other financial instruments (continued)

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

##### (d) Interest rate risk (continued)

At 30 November 2009

	<i>Total</i>		<i>After</i>		<i>After</i>	<i>After</i>	<i>Weighted</i>	<i>Weighted</i>
	<i>non-interest</i>		<i>3 months</i>		<i>6 months</i>	<i>1 year</i>	<i>average</i>	<i>average</i>
	<i>Total</i>	<i>bearing</i>	<i>Within</i>	<i>but within</i>	<i>but within</i>	<i>but within</i>	<i>fixed</i>	<i>time for</i>
	<i>£000</i>	<i>£000</i>	<i>3 months</i>	<i>6 months</i>	<i>1 year</i>	<i>5 years</i>	<i>interest</i>	<i>is fixed</i>
			<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>rate</i>	<i>rate</i>
							<i>%</i>	<i>Years</i>
<i>Financial assets</i>								
Loan to originator	83,725	–	83,725	–	–	–	N/A	N/A
Cash and deposits	34,675	–	34,675	–	–	–		
Derivative financial instruments	1,302	1,302	–	–	–	–		
<b>Total assets</b>	<b>119,702</b>	<b>1,302</b>	<b>118,400</b>	<b>–</b>	<b>–</b>	<b>–</b>		
<i>Financial liabilities</i>								
Mortgage backed loan notes due 2024 and 2043	(87,187)	(1,288)	(85,899)	–	–	–		
Liquidity facility provider creditor	(26,800)	–	(26,800)	–	–	–		
<b>Total liabilities</b>	<b>(113,987)</b>	<b>(1,288)</b>	<b>(112,699)</b>	<b>–</b>	<b>–</b>	<b>–</b>		

The rates of interest receivable and payable on variable rate financial instruments, with the exception of the mortgage backed loan notes, are set with reference to the London Interbank Offered Rate. The rates of interest payable on the mortgage backed loan notes are set as detailed in note 13.

The Group used interest rate caps in certain circumstances to hedge against movements in interest rates. The interest rate caps have expired and as at 30 November 2010, the notional value of these caps was £Nil (2009 – £Nil) and the recognised positive fair value was £Nil (2009 – £Nil).

## Notes to the financial statements

at 30 November 2010

### 17. Derivatives and other financial instruments (continued)

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

##### (e) Fair values

The fair values together with the carrying amounts shown in the balance sheet are as follows

	At 30 November 2010			At 30 November 2009		
	Book value	Fair value	If fair values increased by 1%	Book value	Fair value	If fair values increased by 1%
	£000	£000	£000	£000	£000	£000
<i>Financial assets</i>						
Loan to originator	74,015	62,138	621	83,725	73,070	731
Cash and deposits	33,543	33,543	335	34,675	34,675	347
Derivative financial instruments	886	886	9	1,302	1,302	13
	<u>108,444</u>	<u>96,567</u>	<u>965</u>	<u>119,702</u>	<u>109,047</u>	<u>1,091</u>
<i>Financial liabilities</i>						
Mortgage backed loan notes due 2024 and 2043	(76,529)	(63,301)	(633)	(87,187)	(76,467)	(765)
Liquidity facility provider creditor	(26,800)	(26,800)	(268)	(26,800)	(26,800)	(268)
	<u>(103,329)</u>	<u>(90,101)</u>	<u>(901)</u>	<u>(113,987)</u>	<u>(103,267)</u>	<u>(1,033)</u>

The directors have considered the fair values of the Group's main financial instruments, which are mortgage loan receivables underlying the loan to originator and loan notes

As no liquid market exists for either the mortgage loans underlying the loan to originator or loan notes, the directors have ascribed an approximate fair value based on an internal discounted cash flow model that is used to value non-securitised mortgage loan receivables. This model takes into account expected payment rates, arrears, house price movements, level of repossessions, losses and discount rates based on the most recent available information.

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

	2010 £000	2009 £000
Interest receivable on loan to originator	2,416	9,037
Interest expense on loan notes	(860)	(2,277)
	<u>1,556</u>	<u>6,760</u>

## Notes to the financial statements

at 30 November 2010

### 18. Deferred taxation

	2010 £000	2009 £000
(Liability)/asset at start of year	(211)	572
Deferred tax credit/(charge) during the year (note 6)	181	(783)
Liability at the end of the year	(30)	(211)

Full provision has been made for deferred tax liabilities arising as a result of Financial Reporting Standard No 26 adjustments

Deferred taxation has been recognised at 21% (2009 – 21%) being the UK small companies' corporation tax rate at the balance sheet date

	2010 £000	2009 £000
Effect of Financial Reporting Standard No 26 adjustment for EIR	(22)	(209)
Effect of Financial Reporting Standard No 26 adjustment for Derivatives	(186)	(273)
Effect of Financial Reporting Standard No 26 adjustment for FX hedge	178	271
Total deferred tax liability recognised at 21%	(30)	(211)

In the Budget 2011 on 25 March 2011 the small companies corporation tax rate was reduced to 20% as from 1 April 2011. This was enacted on 29 March 2011 following the House of Commons approval of the Budget resolution.

The directors estimate that the effect of these changes will be to decrease the Group's deferred tax liability by £1,450 as a result of the reversal of timing differences in the following years.

### 19. Related party transactions

During the year, Preferred Residential Securities 05-1 plc has paid the following amounts to Preferred Mortgages Limited and Wilmington Trust SP Services (London) Limited, and the amounts outstanding at the end of the year were:

Preferred Residential Securities 05-1 plc

	Amount charged 2010 £000	Amount outstanding 2010 £000	Amount charged /(credited) 2009 £000	Amount outstanding 2009 £000
<b>Preferred Mortgages Limited</b>				
Mortgage related amounts payable	–	37	–	40
Deferred consideration	2,509	3,242	(1,557)	3,088
<b>Wilmington Trust SP Services (London) Limited</b>				
Corporate services fees	8	–	8	4
Company secretarial fees	4	–	3	3

## Notes to the financial statements

at 30 November 2010

### 20. 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 2006, with which it complies. The Company manages its ordinary share capital in order that there is sufficient capital to meet the needs of the Company in its operation.

### 21. Parent undertaking and control

The entire issued share capital of Preferred Residential Securities 05-1 Parent Limited is held by a Trustee under a declaration of trust for charitable purposes.

Preferred Residential Securities 05-1 Parent Limited is included in the financial statements of Preferred Mortgages Limited, a company registered in England and Wales under linked presentation. The financial statements of this group are available to the public and may be obtained from the Registrar of Companies, Companies House, Crown Way, Mandy, Cardiff CF14 3UZ.