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Preferred Residential Securities 06-1 PLC

Report and Financial Statements

Registered No 05595906

30 November 2009

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

Secretary
Wilmington Trust SP Services (London) Limited
Fifth Floor
6 Broad Street Place
London EC2M 7JH

Auditors
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1 More London Place
London SE1 2AF

Registered Office
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Fifth Floor
6 Broad Street Place
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Directors' report

The directors present their report and the audited financial statements for the year ended 30 November 2009

Principal activities

The principal activity of the Company is the investment in mortgage loans secured by first and second charges over residential properties within the United Kingdom

Business review

On 23 February 2006 the Company purchased £431,359,017 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 Company issued a series of mortgage-backed loans on 23 February 2006 These loan notes are listed on the Irish Stock Exchange

The mortgage servicing, cash bond administration and accounting services are provided by Capstone Mortgage Services Limited, an external party

The results for the year ended 30 November 2009 are set out on page 9 The Company'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 Company 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 obligation to the holders of the loan notes as and when the obligations fall due

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

On 22 September 2009 the Company filed claims of US $653,413 against the interest rate cap counterparty arising from the Swap Agreement and against Lehman Brothers Holdings Inc (LBHI) arising from a guarantee given by LBHI unconditionally guaranteeing the obligations of the Swap Counterparty in connection with the Swap Agreement The directors do not currently think that it is possible to quantify amounts that may eventually be recovered under these claims and therefore nothing has been recognised in the financial statements

As required by Financial Reporting Standard No 26, the result for the year includes a fair value gain on derivative financial instruments of £2,166,212 (2008 - £9,145,013) and an unrealised exchange loss on restatement of loan liabilities of £1,660,350 (2008 – £9,789,570)

At the year end the loan to originator balance after the Effective Interest Rate Adjustment, was £143,800,873 (2008 - £190,256,742) At the December 2009 Interest Payment Date the originator held the following mortgage loans underlying the loan to originator, excluding the Effective Interest Rate Adjustment

	Principal balance £000	*Number of loans*
First Mortgages	134,211	1,556
Second Mortgages	1,214	101
Total	135,425	1,657

Directors' report

Business review (continued)

These mortgages provide security against loan notes in issue totalling £144,858,030 as at the December 2009 Interest Payment date

The mortgage loans generated a weighted average margin over funding costs of 2 95% during the year, before considering the adjustments for Financial Reporting Standard No 26 The weighted average cost of funds for the year was 1 83%

The mortgage loans exhibited the following quarterly arrears profile

	Q1	*Q2*	*Q3*	*Q4*
	%	%	%	%
Delinquencies days – (excluding repossessions)				
Current	65 57	66 19	69 80	72 75
>30<=60	7 78	6 55	5 21	4 52
>60<=90	4 72	3 89	3 45	2 48
>90<=120	4 39	3 71	3 10	3 40
>120	17 54	19 66	18 44	16 85
Total	100 00	100 00	100 00	100 00

At the March 2010 Interest Payment Date following year end, the mortgage assets underlying the loan to originator balance, was £132,424,150, 23 03% 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 flow of the loan to originator

The performance of the mortgage loans during the year to 30 November 2009 enabled deferred consideration of £Nil (2008 – £Nil) to be paid to the current holder of the rights to the residual cash flows of the securitisation

Going concern

As described in the Business review, the Company has reported an operating loss for the year

The Company is also in a net liability position as at 30 November 2009 due to the amortisation of the premium paid to the mortgage loan originator and an adjustment to the expected cash flows of the loan to originator arising from the impairment of the underlying mortgage loans Should this impairment, not reverse in forthcoming periods the Company may be unable to meet capital repayments and interest due to the holders of the loan notes and subordinated loan note holder as and when the obligations fall due

It is the intention of the directors of the Company 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 non recourse loan notes The directors noted that as at 30 November 2009 the respective fair values of the mortgage assets underlying the loan to originator, and non recourse loan notes are less than the carrying values recorded in the balance sheet

Directors' report

Fair value (continued)

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 non recourse 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

The fair values disclosed do not necessarily represent the directors' view of the current value of the predicted future cash flows on either the mortgage asset receivables underlying the loan to originator or non recourse loan notes

Dividend

The directors do not recommend the payment of a dividend for the year (2008 - £Nil)

Policy and practice on payment of creditors

The Company does not follow any stated code on payment practice It is the Company'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 Company to abide by the agreed terms of payment There are no creditor days of suppliers' invoices outstanding at the year end (2008 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

Clifford Chance Secretaries (CCA) Limited resigned as Company Secretary on 27 January 2009, and Wilmington Trust SP Services (London) Limited was appointed as secretary to the Company on 27 January 2009

Principal risks and uncertainties

Financial instrument risk

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

The Company 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 Company's policy that no trading in financial instruments shall be undertaken

The main risks arising from the Company'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

Directors' report

Principal risks and uncertainties (continued)

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

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 Company 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 Company considers the use of 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 Company 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 Company considers the use of derivative financial instruments to mitigate any foreign exchange risk

Liquidity risk

The Company'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 Company holds a minimum cash balance to manage short term liquidity requirements

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 company'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

Responsibility statements under the Disclosure and Transparency Rules

The directors confirm that, to the best of each person's knowledge

- the financial statements in this report, which have been prepared in accordance with UK GAAP and the Companies Act 2006, give a true and fair view of the assets, liabilities, financial position and loss of the Company, and

- the directors' report includes a fair review of the development and performance of the business and the position of the Company together with a description of the principal risks and uncertainties that they face

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

Director **Mark Filer**

Date 27 MAY 2010

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 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 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 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 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 Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities

ERNST & YOUNG

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Independent auditors' report

to the members of Preferred Residential Securities 06-1 PLC

We have audited the financial statements of Preferred Residential Securities 06-1 PLC for the year ended 30 November 2009 which comprise the Profit and Loss Account, the Balance Sheet and the related notes 1 to 19 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 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

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 30 November 2009 and of its 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

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Independent auditors' report

to the members of Preferred Residential Securities 06-1 PLC (continued)

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

A. Woosey

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

Date 28 5.10

Profit and loss account

for the year ended 30 November 2009

	Notes	2009 £000	2008 £000
Interest receivable and similar income	2	5,822	29,182
Interest payable and similar charges	3	(6,545)	(19,607)
Net interest receivable		(723)	9,575
Net fair value gain on derivatives		2,166	9,145
Other operating income	4	719	713
Remeasurement adjustment of amortised cost of mortgage backed loan notes	13	(2,389)	8,246
Unrealised exchange loss on restatement of loan liabilities		(1,660)	(9,789)
Operating expenses		(7,661)	(15,463)
(Loss)/profit on ordinary activities before taxation	5	(9,548)	2,427
Tax on (loss)/profit on ordinary activities	6	898	(3,117)
Loss on ordinary activities after taxation	15	(8,650)	(690)

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 11 to 23 form part of these financial statements

Balance sheet
at 30 November 2009

	Notes	2009 £000	2008 £000
Fixed assets			
Loan to originator	8	143,801	190,257
Current assets			
Debtors			
Amounts falling due after one year	10	11,937	9,771
Amounts falling due within one year	11	366	950
Cash at bank and in hand		34,694	24,997
		46,997	35,718
Creditors: amounts falling due within one year	12	(30,260)	(6,418)
Net current assets		16,737	29,300
Creditors amounts falling due after one year	13	(172,044)	(222,413)
Net liabilities		(11,506)	(2,856)
Capital and reserves			
Issued share capital	14	13	13
Profit and loss account	15	(11,519)	(2,869)
Shareholders' deficit	16	(11,506)	(2,856)

The notes on pages 11 to 23 form part of these financial statements

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

Director **Mark Filer**

Date 27 MAY 2010

Notes to the financial statements

at 30 November 2009

1. Accounting policies

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

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 Company, derecognition is considered to be inappropriate for the portfolio seller's or originators' (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 Company's financial statements are therefore prepared on the basis that its acquisitions of beneficial interests in mortgage portfolios are recognised as a 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

The Company 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 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 in accordance with the provisions policy below

Provisions

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)

Notes to the financial statements

at 30 November 2009

1. Accounting policies (continued)

Premium paid on mortgage assets underlying the loan to originator

Gross cash receipts received by the Company on the issue of turbo notes are paid to Preferred Mortgages Limited as a premium on acquisition of the mortgage assets underlying the loan to originator This premium is capitalised by the Company and amortised over the expected repayment period of the Class DTc, ETc, and FTc Notes mentioned in note 13 The amortised balance is added to the loan to originator with the costs amortised in the year included in interest payable

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 Company 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

Derivatives

The Company uses derivative financial instruments to hedge its exposure to interest rate and currency risk arising from operational, financing and investment activities The Company 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 Company 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 Company's interest rate risk in relation to fixed rate mortgage loans underlying the loan to originator The derivative contracts match the expected profile of the run-off of the fixed rate loans

Notes to the financial statements

at 30 November 2009

1. Accounting policies (continued)

Currency swaps

A series of currency swaps were entered into in order to manage the Company's currency rate exposure in relation to non-sterling denominated Loan Notes The derivative contracts 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

The Company has taken advantage of the exemption conferred by paragraph 3(c) of Financial Reporting Standard No 8, not to disclose transactions with related parties since the Company is 100% owned by Preferred Residential Securities 06-1 Parent Limited and is included in its consolidated financial statements which are publicly available

Financial instruments disclosure

The Company has taken advantage of the exemption conferred by paragraph 2(d) of Financial Reporting Standard No 29, not to disclose Financial Instruments disclosures since the Company is 100% owned by Preferred Residential Securities 06-1 Parent Limited and is included in its consolidated financial statements which complies with these disclosure requirements and are publicly available

Statement of cash flows

Under Financial Reporting Standard No 1 (Revised), the Company is exempt from the requirement to prepare a statement of cash flows on the grounds that a parent undertaking includes the Company in its own published consolidated financial statements

Turnover

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

Notes to the financial statements

at 30 November 2009

2. Interest receivable and similar income

	2009	*2008*
	£000	*£000*
On loan to originator	5,424	28,010
Other interest	398	1,172
	5,822	29,182

3. Interest payable and similar charges

	2009	*2008*
	£000	*£000*
Mortgage backed loan notes	4,655	15,684
Detachable 'A' coupon interest	559	2,358
Subordinated loan interest	898	1,406
Amortisation of capitalised issue costs	158	158
Other interest	275	1
	6,545	19,607

4. Other operating income

	2009	*2008*
	£000	*£000*
Redemption fees	88	211
Sundry fee income	631	502
	719	713

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

This is stated after charging

	2009	*2008*
	£000	*£000*
Auditors' remuneration – For audit services	13	10
Other fees to auditors – taxation services	8	8
Adjustment to the expected cash flows of the loan to originator arising from the impairment of the underlying mortgages	(977)	987
Deferred consideration	–	9,151
Adjustment to the expected cash flows of the loan to originator arising from bad debts incurred on the underlying mortgages	7,793	2,460

Auditors' remuneration of £4,759 (2008 – £4,657) and taxation services of £1,763 (2008 – £1,725) for the parent company, Preferred Residential Securities 06-1 Parent Limited was borne by the Company

Notes to the financial statements

at 30 November 2009

6. Tax

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

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

	2009 £000	2008 £000
Current tax		
UK corporation tax on (loss)/profit in the year	–	–
Adjustment in respect of prior years	–	(6)
Total current tax (note 6(b))	–	(6)
Deferred tax		
Origination and reversal of timing differences	(898)	3,151
Effect of rate change on opening liability	–	(28)
Total deferred tax (credit)/charge (note 18)	(898)	3,123
Tax on (loss)/profit on ordinary activities	(898)	3,117

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

The tax rate assessed for the year is lower than the small companies rate of corporation tax in the UK of 21% (2008 21%) The factors affecting the tax (credit)/charge are explained below

	2009 £000	2008 £000
(Loss)/profit on ordinary activities before tax	(9,548)	2,427
(Loss)/profit on ordinary activities multiplied by the standard rate of corporation tax for small companies of 21% (2008 21%)	(2,005)	502
Effects of		
Other short-term timing differences	898	(3,102)
Tax losses not recognised in the year	1,107	2,594
Current tax credit for the year (note 6(a))	–	(6)

7. Information regarding directors and employees

The Company has no employees (2008 – none) The directors received no remuneration from the Company during the year (2008 – £nil)

Notes to the financial statements

at 30 November 2009

8. Loan to originator – net balances

	2009 £000	2008 £000
At 1 December	190,257	261,622
Movement in unamortised premium on acquisition of mortgage loans underlying the loan to originator (Note 9)	–	–
Principal repayments and mortgage redemptions	(39,640)	(67,918)
Adjustment to the expected cash flows of the loan to originator arising from the impairment of the underlying mortgages	977	(987)
Adjustment to the expected cash flows of the loan to originator arising from bad debts incurred on the underlying mortgage loans	(7,793)	(2,460)
At 30 November	143,801	190,257

The Company 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 Company Accordingly, the Company 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 2 to 374 months remaining with current interest rates ranging from 2 43% to 12 18% per annum

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

9. Premium on mortgages underlying the loan to originator

	2009 £000	2008 £000
At the start of the year	5,220	5,220
Amortisation in the year	–	–
At the end of the year	5,220	5,220

10 Debtors: amounts falling due after one year

	2009 £000	2008 £000
Derivative financial instruments	11,937	9,771

The above mark to market gain is net of a credit valuation adjustment of £956,741 in respect of counterparty default risk (2008 – £1,247,798)

Notes to the financial statements

at 30 November 2009

11. Debtors: amounts falling due within one year

	2009 £000	2008 £000
Amounts owed by group undertakings	–	778
Corporation tax	6	–
Prepayments and accrued income	15	171
Other debtors	345	1
	366	950

12. Creditors: amounts falling due within one year

	2009 £000	2008 £000
Amounts owed to group undertakings	108	887
Other creditors	27,677	153
Accruals and deferred income	806	2,811
Deferred taxation (note 18)	1,669	2,567
	30,260	6,418

Other creditors include £27,648,000 (2008 – £Nil) 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 £27,648,000 is included in Cash at bank and in hand

13. Creditors: amounts falling due after one year

	2009 £000	2008 £000
EUR Denominated Mortgage backed loan notes due 2043 - Class A2a	21,928	34,127
USD Denominated Mortgage backed loan notes due 2043 - Class A2b	4,179	7,671
GBP Denominated Mortgage backed loan notes due 2043 - Class A2c	57,341	98,573
EUR Denominated Mortgage backed loan notes due 2043 - Class B1a	4,148	3,756
GBP Denominated Mortgage backed loan notes due 2043 - Class B1c	21,481	21,481
EUR Denominated Mortgage backed loan notes due 2043 - Class C1a	12,822	11,608
GBP Denominated Mortgage backed loan notes due 2043 - Class C1c	5,370	5,370
EUR Denominated Mortgage backed loan notes due 2043 - Class D1a	11,389	10,310
GBP Denominated Mortgage backed loan notes due 2043 - Class D1c	8,262	8,262
GBP Denominated Mortgage backed loan notes due 2043 - Class E1c	6,709	6,709
GBP Denominated Mortgage backed loan notes due 2043 - Class ETc	2,899	2,899
GBP Denominated Mortgage backed loan notes due 2043 - Class FTc	6,434	5,859
	162,962	216,625
Subordinated loan	15,572	14,825
Less Issue costs	(633)	(791)
Less Remeasurement adjustment to amortised cost	(5,857)	(8,246)
	172,044	222,413

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 loans secured by first and second charges over residential properties in the United Kingdom

Notes to the financial statements

at 30 November 2009

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

The mortgages underlying the loan to originator are administered by Capstone Mortgage Services Limited on behalf of Preferred Residential Securities 06-1 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 mortgages underlying the loan to originator 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 06-1 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 December 2043

The loan notes are repayable out of capital receipts from the mortgages underlying the loan to originator, 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 rank in priority to the Class E Notes, which rank in priority to the Class F Notes

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

Class A1b	DOLLAR LIBOR + 0 055%
Class A1c	LIBOR + 0 07%
Class A2a	EURIBOR + 0 19%
Class A2b	DOLLAR LIBOR + 0 19%
Class A2c	LIBOR + 0 19%
Class A Detachable coupons	See below
Class B1a	EURIBOR + 0 28%
Class B1c	LIBOR + 0 30%
Class C1a	EURIBOR + 0 51%
Class C1c	LIBOR + 0 53%
Class D1a	EURIBOR + 0 95%
Class D1c	LIBOR + 1 00%
Class DTc	LIBOR + 1 00%
Class E1c	LIBOR + 3 75%
Class ETc	LIBOR + 3 50%
Class FTc	LIBOR + 6 50%

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

$$D\% \quad x \quad \frac{A}{A2c}$$

Where

D% means, on each of the first to fourth Interest Determination Dates, the rate of 1%, on each of the 5^{th} to 6^{th} Interest determination dates, the rate of 2%, on the 7^{th} Interest determination date, the rate of 2 1%, on each of the 8^{th} to 11^{th} Interest determination dates, the rate of 2 2%, on the 12^{th} Interest determination date, the rate of 2 3%, and 0% at all other times,

A means the aggregate Sterling Equivalent 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 2009

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

On 23 February 2006, Preferred Mortgages Limited made available to the Company a subordinated loan The loan is repayable on or before March 2028 using the amounts available in accordance with the priority of payments as set out in the Note Terms and Conditions Interest is payable at a rate of 4% above the London Interbank Offered Rate for three month sterling deposits

14. Issued share capital

	2009	*2008*
	£000	*£000*
Allotted and called up		
2 shares 100% called and fully paid	–	–
49,998 shares 25% called and fully paid	13	13
	13	13

Share capital of £2 was issued on incorporation on 18 October 2005 Share capital of 49,998 was issued on 20 December 2005

15. Profit and loss account

	2009	*2008*
	£000	*£000*
Loss brought forward	(2,869)	(2,179)
Loss for the year	(8,650)	(690)
Loss carried forward	(11,519)	(2,869)

16. Reconciliation of movement in shareholders' funds

	2009	*2008*
	£000	*£000*
Opening shareholders' deficit	(2,856)	(2,166)
Loss for the year	(8,650)	(690)
Closing shareholders' deficit	(11,506)	(2,856)

Notes to the financial statements

at 30 November 2009

17. Derivatives and other financial instruments

As explained on page 4 the Company uses financial instruments in its normal course of business The following analysis gives an indication of the significance of these instruments to the Company

(a) Interest rate risk profile of financial liabilities as at 30 November

	Total	*Total Variable rate*	*Total fixed rate*	*Weighted average interest rate*	*Weighted average time for which rate is fixed*
	£000	*£000*	*£000*	*%*	*Years*
2009					
Interest rate profile	200,325	200,325	–	–	–
2008					
Interest rate profile	223,204	223,204	–	–	–

(b) Interest rate risk profile of financial assets as at 30 November

	Total	*Total Variable rate*	*Total fixed rate*	*Weighted average interest rate*	*Weighted average time for which rate is fixed*
	£000	*£000*	*£000*	*%*	*Years*
2009					
Interest rate profile	190,432	190,432	–	–	–
2008					
Interest rate profile	225,025	225,025	–	–	–

The Company also has certain financial instruments included within debtors (note 11) and creditors (note 12) which are not subject to interest rate risk as they bear no interest

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 Offer Rate The rates of interest payable on the mortgage backed loan notes are set as detailed in note 13

Notes to the financial statements

at 30 November 2009

17. Derivatives and other financial instruments (continued)

(c) Foreign currency risk

With the exception of the Mortgage Backed Loan Notes, all financial instruments are denominated in sterling The Mortgage Backed Loan Notes were issued in the following tranches

USD denominated mortgage backed loan notes due 2028 - Class A1b (Notional USD 125,000,000)
GBP denominated mortgage backed loan notes due 2028 - Class A1c (Notional GBP 57,100,000)
EUR denominated mortgage backed loan notes due 2043 - Class A2a (Notional EUR 70,000,000)
USD denominated mortgage backed loan notes due 2043 - Class A2b (Notional USD 20,000,000)
GBP denominated mortgage backed loan notes due 2043 with detachable coupons due 2009 - Class A2c (Notional GBP 167,100,000)
EUR denominated mortgage backed loan notes due 2043 - Class B1a (Notional EUR 5,500,000)
GBP denominated mortgage backed loan notes due 2043 - Class B1c (Notional GBP 26,000,000)
EUR denominated mortgage backed loan notes due 2043 - Class C1a (Notional EUR 17,000,000)
GBP denominated mortgage backed loan notes due 2043 - Class C1c (Notional GBP 6,500,000)
EUR denominated mortgage backed loan notes due 2043 - Class D1a (Notional EUR 15,100,000)
GBP denominated mortgage backed loan notes due 2043 - Class D1c (Notional GBP 10,000,000)
GBP denominated mortgage backed loan notes due 2043 - Class DTc (Notional GBP 4,750,000)
GBP denominated mortgage backed loan notes due 2043 - Class E1c (Notional GBP 8,120,000)
GBP denominated mortgage backed loan notes due 2043 - Class ETc (Notional GBP 4,540,000)
GBP denominated mortgage backed loan notes due 2043 - Class FTc (Notional GBP 4,320,000)

A series of currency swaps have been entered into, in order to manage the Company's currency rate exposure in relation to non-sterling denominated Loan Notes

(d) Fair value of financial instruments

	Book value 2009 £000	*Fair value 2009 £000*	*Book value 2008 £000*	*Fair value 2008 £000*
On balance sheet				
Loan to originator	143,801	102,060	190,257	141,255
Cash and deposits	34,694	34,694	24,997	24,997
Mortgage backed loan notes due 2043	(162,962)	(106,763)	(216,625)	(159,072)
Subordinated loan	(9,715)	(9,715)	(6,579)	(6,579)
Liquidity facility provider creditor	(27,648)	(27,648)	–	–
Derivative financial instruments	11,937	11,937	9,771	9,771

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

As no liquid market exists for either the mortgage loans underlying the loan to originator or non recourse 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

The detachable A coupon notes have no value in the balance sheet but a notional value of £7,497,719 was ascribed to these notes at issue

Notes to the financial statements

at 30 November 2009

17. Derivatives and other financial instruments (continued)

The Company uses interest rate caps in certain circumstances to hedge against movements in interest rates At 30 November 2009, the notional value of these caps was £Nil (2008 - £129,600,000) and the recognised positive fair value was £Nil (2008 – £46)

The Company uses foreign currency swaps in certain circumstances to hedge against any currency exposure risks At 30 November 2009, the notional value of the swaps held was £41,766,994 (2008 – £67,470,439) and the recognised positive fair value of the Euro swaps and US dollar swap was £11,731,549 and £205,800 respectively (2008 – £9,092,076 and £679,015)

On 22 September 2009 the Company filed claims of US $653,413 against the interest rate cap counterparty arising from the Swap Agreement and against Lehman Brothers Holdings Inc (LBHI) arising from a guarantee given by LBHI unconditionally guaranteeing the obligations of the Swap Counterparty in connection with the Swap Agreement The directors do not currently think that it is possible to quantify amounts that may eventually be recovered under these claims and therefore nothing has been recognised in the financial statements

18. Deferred taxation

	2009	*2008*
	£000	*£000*
(Liability)/asset at start of year	(2,567)	556
Deferred tax credit/(charge) during the year (note 6)	898	(3,123)
Liability at the end of the year	(1,669)	(2,567)

Full provision has been made for deferred tax liabilities arising as a result of Financial Reporting Standard No 26 adjustments Losses of £17,816,997 resulting in a deferred tax asset of £3,741,569 have not been recognised The deferred tax asset has not been recognised due to uncertainty surrounding the Company's future profitability

Deferred taxation has been recognised at 21% (2008 – 21%) being the UK small companies' corporation tax rate at the balance sheet date

	2009	*2008*
	£000	*£000*
Effect of Financial Reporting Standard No 26 adjustment for EIR	(599)	(1,102)
Effect of Financial Reporting Standard No 26 adjustment for Derivatives	(2,507)	(2,052)
Effect of Financial Reporting Standard No 26 adjustment for FX hedge	2,667	2,319
Remeasurement adjustment of amortised cost of Mortgage Backed Loan Notes	(1,230)	(1,732)
Total deferred tax liability recognised at 21%	(1,669)	(2,567)

Notes to the financial statements

at 30 November 2009

19. Parent undertaking and control

The Company is controlled by its parent undertaking, Preferred Residential Securities 06-1 Parent Limited, which is registered and operates in the United Kingdom

The entire issued share capital of Preferred Residential Securities 06-1 Parent Limited is held by a Trustee under a declaration of trust for charitable purposes

The smallest group in which the results of the Company are consolidated is that headed by Preferred Residential Securities 06-1 Parent Limited, registered in England and Wales At the largest group level, the Company's results get consolidated on a Linked Presentation basis in Preferred Mortgages Limited The financial statements of these groups are available to the public and may be obtained from the Registrar of Companies, Companies House, Crown Way, Maindy, Cardiff CF14 3UZ