

United Kingdom Overseas Company Number : FC019688
Cayman Islands Company Number : 66878

ZOPHONUS LIMITED
FINANCIAL STATEMENTS
FOR THE YEAR ENDED
31 DECEMBER 1997



ZOPHONUS LIMITED

STATEMENT OF DIRECTORS' RESPONSIBILITIES

UK Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and the group and of the profit or loss of the group for that year. In preparing these financial statements, the directors are required to :

- (a) select suitable accounting policies and apply them consistently;
- (b) make judgements and estimates that are reasonable and prudent;
- (c) state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- (d) 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 proper accounting records, which disclose with reasonable accuracy at any time the financial position of the company and the group and to enable them to ensure that the financial statements comply with the Companies Act 1985. 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.

By order of the Board



Director on behalf of SPV Management Limited
9 April 1998

ZOPHONUS LIMITED
REPORT OF THE AUDITORS
TO THE MEMBERS OF ZOPHONUS GROUP LIMITED

We have audited the financial statements on pages 3 to 23.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

As described on page 1 the directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

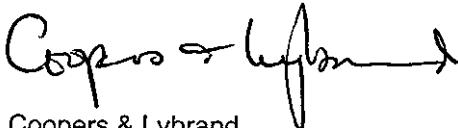
BASIS OF OPINION

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes the examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated overall adequacy of the presentation of information in the financial statements

OPINION

In our opinion the financial statements present fairly the state of affairs of the company and the group as at 31 December 1997 and of the profit of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985 applicable to Oversea Companies.



Coopers & Lybrand
Chartered Accountant and Registered Auditors
Croydon
9 April 1998

ZOPHONUS LIMITED

CONSOLIDATED PROFIT AND LOSS ACCOUNT

for the year ended 31 December 1997

		1997 £000	1997 £000	Period 1996 £000	Period 1996 £000
Continuing activities	Notes				
Operating income			66,893		31,095
Income from mortgages subject to non-recourse funding :					
Income		10,951		4,550	
Expenses		<u>(10,823)</u>		<u>(4,491)</u>	
			128		59
TURNOVER			<u>67,021</u>		<u>31,154</u>
Cost of funding	2	(56,033)		(25,837)	
Exceptional cost of funding	3	<u>1,817</u>		<u>-</u>	
			<u>(54,216)</u>		<u>(25,837)</u>
GROSS PROFIT			12,805		5,317
Administrative expenses		(9,169)		(1,672)	
Exceptional administrative credit	4	<u>8,495</u>		<u>2,014</u>	
			<u>(674)</u>		<u>342</u>
OPERATING PROFIT			12,131		5,659
Costs of integration	5		-		(2,025)
Interest receivable and similar income			6,328		2,414
Premium received on the sale of mortgage assets			1,074		1,606
Interest payable	6		<u>(12,948)</u>		<u>(6,186)</u>
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION	7		6,585		1,468
Tax on profit on ordinary activities			(5,940)		(1,485)
PROFIT ON ORDINARY ACTIVITIES AFTER TAX			<u>645</u>		<u>(17)</u>
Dividends	17		(8)		-
RETAINED PROFIT/(LOSS) FOR THE FINANCIAL PERIOD	18		<u>637</u>		<u>(17)</u>

The comparatives are for the period from incorporation on 19 July 1996 to 31 December 1996.

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

There were no other recognised gains or losses for 1996 and 1997 other than those included in the profit and loss account.

ZOPHONUS LIMITED
CONSOLIDATED BALANCE SHEET

at 31 December 1997

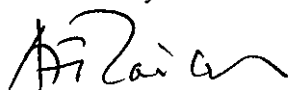
	<u>Notes</u>	1997 £000	1997 £000	1996 £000	1996 £000
FIXED ASSETS					
Tangible assets	9		58		484
Investments	10		-		14,288
			<hr/> 58		<hr/> 14,772
MORTGAGE ADVANCES					
Mortgage debtors securitised	11		685,999		856,652
Mortgage debtors subject to non- recourse funding	12				
Mortgage debtors		118,804		140,712	
less: non-recourse funding		(118,804)		(140,712)	
		<hr/>	-	<hr/>	-
			<hr/> 686,057		<hr/> 871,424
CURRENT ASSETS					
Debtors	13		7,381		5,552
Cash at bank and in hand	14		60,482		69,827
			<hr/> 67,863		<hr/> 75,379
TOTAL ASSETS			<hr/> 753,920		<hr/> 946,803
CAPITAL AND RESERVES					
Called-up share capital	15		-		-
Profit and loss account	18		555		(17)
			<hr/>		<hr/>
EQUITY SHAREHOLDERS' FUNDS	19		555		(17)
PROVISIONS FOR LIABILITIES AND CHARGES	20		4,388		3,734
CREDITORS : amounts due within 1 year	21		23,951		44,316
CREDITORS : amounts due after 1 year	22		725,026		898,770
			<hr/> 753,920		<hr/> 946,803

ZOPHONUS LIMITED
COMPANY BALANCE SHEET
at 31 December 1997

	<u>Notes</u>	1997 £000	1996 £000
FIXED ASSETS			
Investments	10	21,019	22,281
CURRENT ASSETS			
Debtors	13	2,847	4,728
Cash at bank and in hand		15,472	17,033
TOTAL ASSETS		<hr/> 39,338 <hr/>	<hr/> 44,042 <hr/>
CAPITAL AND RESERVES			
Called-up share capital	15	-	-
Profit and loss account	18	-	-
EQUITY SHAREHOLDERS' FUNDS		<hr/> - <hr/>	<hr/> - <hr/>
 CREDITORS : amounts due within 1 year			
	21	5,168	8,610
CREDITORS : amounts due after 1 year			
	22	34,170	35,432
		<hr/> 39,338 <hr/>	<hr/> 44,042 <hr/>

The group has taken advantage of the modifications and exemptions from disclosure that are set out in the Oversea Companies (Accounts) (Modifications and Exemptions) Order 1990.

The financial statements on pages 3 to 23 were approved by the Board of Directors on 9 April 1998 and were signed on its behalf by:



Director on behalf of SPV Management

ZOPHONUS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

31 December 1997

1. **PRINCIPAL ACCOUNTING POLICIES**

(a) **Basis of Accounting**

The financial statements are prepared under the historical cost convention and are in accordance with applicable Accounting Standards in the United Kingdom.

Under the provisions of Financial Reporting Standard No. 1 (Revised), the group has not prepared a cash flow statement because its ultimate parent undertaking, SeaHorse Limited, which is registered in England and Wales as an overseas company, has prepared consolidated financial statements which include the cash flows of the group for the year.

(b) **Turnover**

Turnover comprises interest, commissions, rental income on investment properties and miscellaneous fee income recognised as it becomes receivable. Interest includes that which is recoverable from the Inland Revenue under MIRAS (mortgage interest relief at source).

(c) **Depreciation**

Depreciation is provided at rates calculated to write-off the cost of fixed assets on a straight-line basis over their expected useful life, as follows:

Leasehold improvements	Over the life of the lease to a maximum of 20 years
Fixtures, fittings and equipment	4 - 5 years
Computer equipment	3 - 5 years
Motor cars	3 years

(d) **Pension Costs**

The group accounts for pension costs in accordance with Statement of Standard Accounting Practice 24. For the defined contribution scheme, the charge recorded in the profit and loss account is the amount of contribution payable in respect of the period, plus administration costs incurred by the fund.

Further information on pension costs is provided in note 23(b)

(e) **Leases**

Rentals under operating leases are primarily charged on a straight-line basis to the profit and loss account over the term of the lease. Where the group has vacated, or intends to vacate space, a provision is established for the estimated net future liability of the space vacated.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1. PRINCIPAL ACCOUNTING POLICIES (Continued)

(f) Goodwill

Goodwill is written off in the year of acquisition against reserves in the consolidated balance sheet.

(g) Taxation

Corporation tax is provided on taxable profits at the current rate.

Deferred taxation is calculated on the liability method at the rate of tax at which the liability is likely to be paid. Deferred taxation is provided to take account of the difference in timing between certain items for financial statement purposes and taxation purposes. Deferred taxation is not provided on timing differences which, in the opinion of management, will probably not reverse.

(h) Mortgage Advances

Mortgage advances comprise loans which are secured by way of a mortgage over freehold and leasehold residential properties located in England, Wales and Scotland.

Mortgage advances include properties in possession and are stated after deducting a provision for loan losses. The provision is maintained at a level that is considered adequate by management to absorb losses inherent in the loan portfolio of the group. A judgement as to the adequacy of the provision is made at the period end and includes anticipated recoveries under mortgage indemnity guarantees and other insurance policies. Should the provision be judged inadequate either because of reductions due to write-offs or because of changes to the size and characteristics of the portfolio, the provision is increased and charged to administrative expenses in the current period.

(i) Investments

Properties were recorded at cost less provisions for permanent diminution in value and represented properties which were sold to non-group companies organised under a business expansion scheme ("BES"). The group had granted options which would require the group to repurchase these properties at a future date. Therefore, the group did not account for these transactions as a sale, and a corresponding liability was reported in creditors. During the year, these companies exercised these options.

The liability was adjusted at each period end based on managements' estimate of the future liability that might have arisen and the movement was charged or credited to the profit and loss account.

Investments in subsidiary companies are stated at cost less provision for permanent diminution in value.

(j) Floating rate notes

The floating rate notes' outstanding principal declines over time as the proceeds from redemptions on mortgage advances are used to repay noteholders, along with accrued interest, on each quarterly interest payment date. Costs relating to the issue of the floating rate notes are deducted from the principal balance on the notes. These costs are charged to the profit and loss account in line with redemptions of the underlying mortgages; costs are fully amortised by the earliest date at which an option to redeem the floating rate notes may be exercised.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1. PRINCIPAL ACCOUNTING POLICIES (Continued)

(k) Assets and Liabilities recognised by The Company

In order to comply with the requirements of Financial Reporting Standard No 5, ("FRS No 5"), the group has presented on its balance sheet in a linked presentation format mortgage advances for which it sold the rights to cash flows equating to the future cash flows less 0.1% to Mortgage Trust Limited.

(l) Format of Accounts

The cost of funding heading within the profit and loss account has been adapted from that prescribed by Schedule 4 to the Companies Act 1985 in view of the nature of the business. Mortgage debtors have been presented separately on the face of the balance sheet rather than included as part of current assets. In the opinion of the directors, this departure from the format of Schedule 4 of the Companies Act 1985 is required to give a true and fair view of the state of the company's affairs since to present mortgage advances as part of current assets would not fairly reflect the liquidity of these assets.

No profit and loss account has been presented for the company as permitted by Section 230 of the Companies Act 1985. The company made a profit of nil (1996: £300) in the year.

2. COST OF FUNDING

Cost of funding comprises:

	Group	Group
	1997	Period
	£000	1996
		£000
Interest charged on floating rate notes	55,362	25,420
Issue costs charged to profit and loss	671	417
	<hr/>	<hr/>
	56,033	25,837
	<hr/>	<hr/>

3. EXCEPTIONAL COST OF FUNDING

	Group	Group
	1997	Period
	£000	1996
		£000
Release of BES funding liability	1,817	-
	<hr/>	<hr/>

NOTES TO THE FINANCIAL STATEMENTS (Continued)

4. EXCEPTIONAL ADMINISTRATION CREDIT

	Group	Group
	1997	Period
	£000	1996
		£000
Negligence recoveries	8,495	2,014
	<hr/>	<hr/>

5. COSTS OF INTEGRATION

	Group	Group
	1997	Period
	£000	1996
		£000
Severance payments paid and accrued	-	1,084
Severance related professional fees	-	115
Provision for costs of vacated property	-	266
Write down of leasehold improvements	-	560
	<hr/>	<hr/>
	-	2,025
	<hr/>	<hr/>

In order to rationalise costs, a decision was made in 1996 to relocate all subsidiaries to headquarters based in Epsom, Surrey during 1997.

6. INTEREST PAYABLE

	Group	Group
	1997	Period
	£000	1996
		£000
Interest payable on bank loan and overdraft	1,178	948
Interest payable on other loan	326	-
Debenture interest	11,444	5,238
	<hr/>	<hr/>
	12,948	6,186
	<hr/>	<hr/>

NOTES TO THE FINANCIAL STATEMENTS (Continued)

7. PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION

Profit on ordinary activities before taxation is stated after charging

	Group 1997 £000	Group 1996 £000
Depreciation of owned assets	358	476
Hire of equipment - operating leases	40	11
Hire of other assets - operating leases	1,571	655
Auditors' remuneration - audit (Company: £5,000 1996 £6,000)	89	37
Auditors' remuneration - other services	73	9

8. STAFF COSTS

Seconded employee costs during the year amounted to:

	Group 1997 £000	Group Period 1996 £000
Wages and salaries	3,250	2,509
Social security costs	323	127
Other pension costs	192	106
	<hr/> 3,765 <hr/>	<hr/> 2,742 <hr/>

There were no persons employed by the group in the period. The group's staffing requirements are met through a secondment arrangement with a related party and have continued to be paid by the group (see note 24).

The average number of employees seconded under this agreement during the period was 143 (1996 : 174).

NOTES TO THE FINANCIAL STATEMENTS (Continued)

9. TANGIBLE FIXED ASSETS

	<u>Computer Equipment</u>	<u>Motor Cars</u>	<u>Leasehold Improvements</u>	<u>Fixtures, Fittings & Equipment</u>	<u>Total</u>
	£000	£000	£000	£000	£000
COST					
At 1 January 1997	3,329	102	2,754	2,136	8,321
Disposals	-	(66)	(2,754)	(2,037)	(4,857)
At 31 December 1997	3,329	36	-	99	3,464
DEPRECIATION					
At 1 January 1997	3,117	55	2,614	2,051	7,837
Charge	174	5	140	39	358
Disposals	-	(40)	(2,754)	(1,995)	(4,789)
At 31 December 1997	3,291	20	-	95	3,406
NET BOOK VALUE					
At 31 December 1997	38	16	-	4	58
At 31 December 1996	212	47	140	85	484

NOTES TO THE FINANCIAL STATEMENTS (Continued)

10. INVESTMENTS

	Group 1997 £000	Company 1997 £000
	Properties	Investment in subsidiary
Cost		
At 1 January 1997	14,879	22,281
Disposals	(14,879)	-
Return of capital	-	(1,262)
	<hr/>	<hr/>
At 31 December 1997	-	21,019
	<hr/>	<hr/>
Provisions		
At 1 January 1997	591	-
Disposals	(591)	-
	<hr/>	<hr/>
At 31 December 1997	-	-
	<hr/>	<hr/>
Net Book Value		
At 31 December 1997	-	21,019
	<hr/>	<hr/>
At 31 December 1996	14,288	22,281
	<hr/>	<hr/>

NOTES TO THE FINANCIAL STATEMENTS (Continued)

11. ASSETS SECURITISED

Mortgage debtors securitised comprise:

	Group 1997 £000	Group 1996 £000
Mortgage debtors	865,411	-
Additions in respect of new subsidiaries	-	937,733
Redemptions in period	(173,152)	(72,322)
	<hr/> 692,259	<hr/> 865,411
Provisions for mortgage related charges	(6,260)	(8,759)
	<hr/> 685,999	<hr/> 856,652
At 31 December 1997	<hr/> 685,999	<hr/> 856,652

Mortgage debtors are all due to be repaid after more than one year.

12. MORTGAGE DEBTORS SUBJECT TO NON-RECOURSE FUNDING

	Group 1997 £000	Group 1996 £000
Mortgage debtors	116,726	136,879
Investments	2,078	3,833
	<hr/> (118,804)	<hr/> 140,712
less : non-recourse funding	(118,804)	(140,712)
	<hr/> -	<hr/> -

NOTES TO THE FINANCIAL STATEMENTS (Continued)

12. MORTGAGE DEBTORS SUBJECT TO NON-RECOURSE FUNDING (continued)

On 7th August 1996, The Mortgage Corporation ("TMC"), a wholly owned subsidiary of the group, sold the cash flows equating to the future cash flows less 0.1% on a mortgage portfolio of £146.7m to Mortgage Trust Limited (see note 24). Investments represent redemption proceeds on mortgage debtors.

In accordance with Financial Reporting Standard Number 5 "Reporting the substance of transactions", these mortgages have been included in these financial statements using linked presentation, whereby the non-recourse funding is shown deducted from the mortgage debtors.

The directors confirm that:

- (a) The group is not obliged to support any losses of its independent providers of finance, nor does it intend to do so: and
- (b) The providers of finance have agreed in writing that they will only seek repayment of finance, as to both principal and interest, to the extent sufficient funds are generated by or attached to the mortgages they have financed and they will not seek recourse in any other form.

The group has no option or obligation to purchase the mortgages concerned.

13. DEBTORS

	Group		Company	
	1997	1996	1997	1996
	£000	£000	£000	£000
Amounts falling due within one year:				
Group relief	-	-	527	233
Prepayments and accrued income	2,842	3,664	1,310	311
Other debtors	4,539	1,888	-	-
Dividends receivable from subsidiary undertakings	-	-	1,010	4,184
	<hr/>	<hr/>	<hr/>	<hr/>
	7,381	5,552	2,847	4,728
	<hr/>	<hr/>	<hr/>	<hr/>

Included in other debtors for the group is an amount of £nil (1996: £1,046,183) relating to ACT recoverable after more than one year.

14. CASH AT BANK AND IN HAND

Cash at bank and in hand at 31 December 1997 in the group accounts includes segregated funds of £13,627,408 (1996: £13,478,502) which have been established to meet potential claims by group subsidiary companies for losses on repossessed properties.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

15. CALLED - UP SHARE CAPITAL

	Group 1997 £000	Group 1996 £000
Authorised :		
2 ordinary 'A' shares of US \$1 each	-	-
49,998 'B' shares of US \$1 each	31	31
	<hr/>	<hr/>
	31	31
	<hr/>	<hr/>
Allotted, called up and fully paid :		
2 ordinary 'A' shares of US \$1 each	-	-
	<hr/>	<hr/>

All shares carry the same rights and rank pari passu.

16. ACQUISITIONS

On 28 May 1997, the group acquired the whole of the share capital of Cavendish Home Investments No. 1 Limited (CHI No.1), Cavendish Home Investments No. 2 Limited (CHI No.2) and Cavendish Home Investments No.3 Limited (CHI No.3) for a total consideration of £20.817 million stated at fair value. The consideration was satisfied in total by cash.

The summarised profit and loss account and statement of total recognised gains and losses for the acquired companies for the period from 1 April 1997, the beginning of the subsidiaries financial year, to the date of acquisition are as follows:

Profit and loss account

	Period ended 31 May 1997 £000
Turnover	65
Profit on ordinary activities before taxation	190
Profit on ordinary activities after taxation	165

The profit on ordinary activities after taxation for the year ended 31 March 1997 was £338,667.

Statement of total recognised gains and losses

There were no other recognised gains or losses in the period to 31 May 1997 other than those shown above.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

16. ACQUISITIONS (continued)

The assets and liabilities acquired of £20.817 million are set out below:

	Book value £000	Revaluation £000	Fair value £000
Investment properties	13,466	1,451	14,917
Current assets			
Debtors	100	-	100
Cash at bank and in hand	2,453	-	2,453
Total assets	16,019	1,451	17,470
Liabilities			
Creditors and provisions	(391)	106	(285)
Net assets	15,628	1,557	17,185
Adjustment			3,567
Goodwill			65
			20,817
Satisfied by:			
Cash			20,817

Investment properties were revalued as at 1 June 1997 resulting in an increase in book value of £1.451 million.

Provisions for repairs on properties were released as at 1 June 1997 resulting in an increase in book value of £106,000

The adjustment is the derecognition of the assets and liabilities previously recognised for the BES properties under FRS5.

Impact on profit and loss account

CHI No.1, CHI No.2 and CHI No.3 did not have a material impact on the consolidated profit and loss account of the group.

17. DIVIDENDS

	Group 1997 £000	Group 1996 £000
Equity dividend paid of £4,000 per share (1996 : £nil)	8	-

NOTES TO THE FINANCIAL STATEMENTS (Continued)

18. RESERVES

Profit and loss account	Group 1997 £000	Company 1996 £000
At 1 January 1997	(17)	-
Profit in the period	637	-
Write off of goodwill	(65)	-
	<hr/>	<hr/>
At 31 December 1997	555	-
	<hr/>	<hr/>

19. RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	Group		Company	
	1997 £000	1996 £000	1997 £000	1996 £000
Issue of fully paid share capital	-	-	-	-
Profit/(loss) for the year	637	(17)	-	-
Write off of goodwill	(65)	-	-	-
Opening shareholders' funds	(17)	-	-	-
	<hr/>	<hr/>	<hr/>	<hr/>
Closing shareholders' funds	555	(17)	-	-
	<hr/>	<hr/>	<hr/>	<hr/>

NOTES TO THE FINANCIAL STATEMENTS (Continued)

20. PROVISIONS FOR LIABILITIES AND CHARGES

Provisions for liabilities and charges comprises:

	Group 1997 £000
Provisions for mortgage related charges:	
At 1 January 1997	1,137
Release for the year	(211)
Charge for the year	1,396
	<hr/>
At 31 December 1997	2,322
	<hr/>
Lease costs:	
At 1 January 1997	1,913
Utilised for the year	(282)
	<hr/>
At 31 December 1997	1,631
	<hr/>
Deferred taxation:	
At 1 January 1997	684
Transfer to profit and loss account	(249)
	<hr/>
	435
	<hr/>
Total provisions at 31 December 1997	4,388
	<hr/>
Total provisions at 31 December 1996	3,734
	<hr/>

Provisions for mortgage related charges primarily consist of recoveries for shortfalls on the sale of repossessed properties and associated insurance claims by fellow subsidiary undertakings, as well as other liabilities relating to its fellow subsidiary undertakings.

Lease costs represent a provision for the estimated future payments on premises sublet by the group. The estimated future payments are net of income from sub-leasing the vacant space.

Deferred taxation arises from timing differences relating to issuer costs.

NOTES TO THE FINANCIAL STATEMENTS (Continued)

21. CREDITORS : AMOUNTS FALLING DUE WITHIN ONE YEAR

	Group		Company	
	1997	1996	1997	1996
	£000	£000	£000	£000
Overdrafts	2,136	212	1,788	-
Corporation Tax	8,005	6,181	-	-
Other taxation and social security	340	198	-	-
Other creditors and accruals (see (a) below)	13,470	37,725	3,380	6,924
Amounts owed to subsidiary undertakings	-	-	-	1,686
	<hr/> 23,951 <hr/>	<hr/> 44,316 <hr/>	<hr/> 5,168 <hr/>	<hr/> 8,610 <hr/>

- (a) Included in the group's other creditors and accruals at 31 December 1996 was an amount of £19.672 million provided through a business expansion scheme ("BES"). Under the terms of the transaction, the group had sold repossessed properties to three BES companies, who in turn marketed them as rental properties. In connection with the sale, the group had granted an option to each of the BES companies. The option, if exercised, required the group to repurchase the properties at such a price that would enabled the BES companies to make a distribution of £1.37 for each £1 invested by their shareholders.

On 28 May 1997, in relation to the above option, the group acquired the entire share capital of the three BES companies: Cavendish Homes No.1 plc, Cavendish Homes No.2 plc and Cavendish Homes No.3 plc for a consideration of £20,817,000 (including stamp duty of £102,750). Subsequent to their acquisition, on 25 June 1997, the BES companies exercised their options, resulting in TMC acquiring the BES properties from them for a consideration of £18,484,052. On 26 June 1997, Mortgage Trust Limited then exercised its call option (see note 24), and acquired these properties from the group for a consideration of £14,916,900, being the market value at that time.

22. CREDITORS : AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	Group		Company	
	1997	1996	1997	1996
	£000	£000	£000	£000
Bank loan (see (a) below)	10,000	15,000	10,000	15,000
Other loan (see (b) below)	5,000	-	5,000	-
Debentures (see (c) below)	19,170	20,432	19,170	20,432
Floating rate notes (see (d) below)	690,856	863,338	-	-
	<hr/> 725,026 <hr/>	<hr/> 898,770 <hr/>	<hr/> 34,170 <hr/>	<hr/> 35,432 <hr/>

- (a) The bank loan is not repayable by instalments, does not have a fixed repayment date and is secured by fixed and floating charges over the assets of the group

NOTES TO THE FINANCIAL STATEMENTS (Continued)

22. CREDITORS : AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR (Continued)

- (b) The other loan is not repayable by instalments, does not have a fixed repayment date and is secured by fixed and floating charges over the assets of the group
- (c) The debentures are not repayable by instalments, do not have a fixed repayment date and are secured by fixed and floating charges over the assets of the group.
- (d) Floating rate notes comprise:

	Group 1997	1996
	£000	£000
Principal outstanding	692,259	865,411
Unamortised issue costs	<u>(1,403)</u>	<u>(2,073)</u>
	<u>690,856</u>	<u>863,338</u>

Floating rate notes are credit facilities which fall due after 5 years and bear interest rates at varying rates above LIBOR. They are secured on mortgage advances.

The movements on the floating rate notes were as follows:

	Group 1997 £000
Balance at 1 January 1997	865,411
Principal repaid during the year	<u>(173,152)</u>
Balance at 31 December 1997	<u>692,259</u>

23. GUARANTEES AND OTHER FINANCIAL COMMITMENTS

(a) Lease Commitments

The minimum annual rentals under operating leases are as follows:

	1997 Property £000	Group 1997 Equipment £000	1996 Property £000	1996 Equipment £000
Operating leases which expire :-				
within 2-5 years	-	60	-	41
after 5 years	<u>1,571</u>	<u>-</u>	<u>1,571</u>	<u>-</u>
	<u>1,571</u>	<u>60</u>	<u>1,571</u>	<u>41</u>

NOTES TO THE FINANCIAL STATEMENTS (Continued)

GUARANTEES AND OTHER FINANCIAL COMMITMENTS (continued)

(b) Pension Arrangements

Eligible employees of the group participate in The Mortgage Corporation Pension Plan ("the Plan"). The Plan is a funded pension scheme providing defined contribution benefits and insured death benefits.

The assets of the Plan are held separately from those of the group and are administered by a trustee.

Total costs relating to the Plan for the period were £191,697. (1996: £105,935)

24. RELATED PARTY TRANSACTIONS

The group has taken advantage under Financial Reporting Standard 8, "Related Party Transactions" ("FRS8"), not to disclose transactions or balances between group entities that have been eliminated on consolidation.

The group has identified the following transactions which fall within the disclosure requirements of FRS 8:

Transactions with senior management

At the balance sheet date The Mortgage Corporation ("TMC"), a wholly owned subsidiary of the group, had entered into one secured loan totalling £89,000 (1996 : £89,000) with a senior manager of the group.

This is at a commercial rate of interest.

Transactions with Mortgage Trust Limited ("MTL")

During 1996, TMC entered into a number of agreements with MTL, a company under common control, as defined by FRS8. The following agreements remained effective during 1997:

- a mortgage sale agreement under which MTL purchased the entire un-insured TMC mortgage portfolio of £40.2 million for consideration of £41.3 million. The book value of these loans at 31 December 1997 was £34.4 million (1996: £41.2 million)
- a participation agreement, under which MTL purchased the future benefits of the entire insured TMC mortgage portfolio of £146.8 million for consideration of £150.8 million. The book value of these loans at 31 December 1997 was £116.7million (1996 : £136.9 million).

MTL has a floating charge over the TMC assets as security for these mortgages.

During the year mortgage assets with a book value of £628,000 (1996: £nil) were transferred from MTL to TMC for a consideration of £628,000 under this participation agreement.

Under the terms of the above agreements, TMC continue to administer the uninsured mortgage portfolio and have entered into a sub-participation for the insured mortgage portfolio, receiving total fees during the year of £172,700 (1996: £76,000)

NOTES TO FINANCIAL STATEMENTS (continued)

24. RELATED PARTY TRANSACTIONS (continued)

Transactions with Mortgage Trust Limited ("MTL")

- MTL purchased for consideration of £1 an option to buy the equitable title for the portfolio noted above. This option is exercisable within 21 years from 7 August 1996.
- a secondment agreement under which the employment of all the group's staff were transferred to MTL, with the relevant staff then being seconded back to the group. TMC paid the costs associated with the seconded staff. In addition, the group has paid and recharged staff costs for MTL employees of £2.8 million in 1997 (1996 : £nil)
- a consultancy agreement, under which MTL can provide consultancy services to TMC on the latter's request. During the year TMC paid £nil (1996: £nil) for such consultancy services.

Zophonous Group sold to MTL, for the consideration of £1, an option for MTL to buy certain properties from the group. On 26 June 1997, MTL exercised its call option, and acquired the beneficial title of these properties from the company for a consideration of £14.9 million, being their market value at that time.

During the year MTL recharged £778,300 (1996: £nil) of administrative expenses, incurred on behalf of the group, relating to canteen facilities, systems maintenance and human resource expenditure. MTL also charged a management fee to TMC of £9,000 (1996: £nil).

In April 1997 TMC moved into the same premises as MTL. MTL pays the lease costs and service charge of the property but has not made a recharge to TMC for its occupancy during the year.

As at 31 December 1997, Zophonous Group owed £3.650 million (1996: £3.844 million) to MTL and was owed £13,000 (1996 : £76,000) by MTL.

During 1997 fixed rate notes issued by TMC P.I.M.B.S. First Financing Plc, TMC P.I.M.B.S Fifth Financing Plc and TMC Mortgage Securities No. 11 Plc, wholly owned subsidiaries of the group, were sold by a third party to MTL. The nominal value of these notes was £6.7 million and they were purchased for consideration of £6.6 million. The book value of these loans at 31 December 1997 was £6.7 million. Interest payable by the group on these loans totalled £13,600 during 1997.

As at 31 December 1997, the group was obliged to pay £6.7 million principal and £13,600 accrued interest under this agreement.

During the year, loans totalling £5 million were assigned to MTL by First National Building Society "FNBS", of whom Zophonous Group is a quasi subsidiary. Under this agreement, the group is obliged to pay to MTL the interest accrued up to the date of purchase, totalling £420,171. Interest accrues on these loans from the date of purchase at base rate and during 1997 the group was obliged to pay interest of £325,800.

As at 31 December 1997, the Company was obliged to pay £5 million principal and £4,000 accrued interest under this agreement.

Transactions with MTL (Funding) Mayfair Limited ("Mayfair")

- During the year CHI No.1, a wholly owned subsidiary of Zophonous Group, collected rental monies and proceeds from the sale of a property on behalf of Mayfair, a company under common control as defined by FRS8. The amounts collected during the year amounted to £130,938.

CHI No. 1 holds tenants deposits on behalf of Mayfair which at 31 December 1997 amounted to £32,621.

At 31 December 1997 the amounts due to Mayfair from the group totalled £163,559.

NOTES TO FINANCIAL STATEMENTS (continued)

24. RELATED PARTY TRANSACTIONS (continued)

Transactions with MTL (Funding) Mayfair Limited ("Mayfair")

- During the year CHI No.2, a wholly owned subsidiary of Zophonus Group, collected rental monies on behalf of Mayfair, a company under common control as defined by FRS8. The amounts collected during the year totalled £90,519.

CHI No. 2 holds tenants deposits on behalf of Mayfair which at 31 December 1997 amounted to £27,860.

At 31 December 1997 the amounts due to Mayfair from the group totalled £118,379.

- During the year CHI No.3, a wholly owned subsidiary of Zophonus Group, collected rental monies on behalf of Mayfair, a company under common control as defined by FRS8. The amounts collected during the year totalled £106,522.

CHI No. 3 holds tenants deposits on behalf of Mayfair which at 31 December 1997 amounted to £30,501.

At 31 December 1997 the amounts due to Mayfair from the group totalled £137,023.

Transactions with First National Building Society ("FNBS")

During 1996, Zophonus Group entered into a number of agreements with FNBS, of which Zophonus Limited is a quasi subsidiary company. The following agreements remained effective during 1997:

- a debenture to FNBS from Zophonus Limited, a wholly owned subsidiary of the group, for a principal amount of £19.9 million under which FNBS is entitled to interest at 1% above LIBOR. As at 31 December 1997 the balance outstanding on this debenture was £19.17 million (1996 : £20.43 million). The interest accrued in the year under this agreement was £1.49 million (1996: £0.55 million) and the amount outstanding at 31 December 1997 was £6,000 (1996: £555,000)
- a £10 million (1996 : £15 million) loan to Zophonus Limited from FNBS on which interest is paid at base rate. The interest accrued under this agreement in the year was £651,600 (1996: £362,500) and the interest outstanding at 31 December 1997 was £86,300 (1996: £362,500)
- during the year Zophonus Group placed deposits with FNBS. At 31 December 1997 the amount outstanding was £471,500 (1996: £2.032 million)

Transactions with First National Holdings UK Limited ("FNBS Holdings UK")

During 1996, Zophonus Group entered into a number of agreements with FNBS Holdings UK Limited, of which Zophonus Limited is under common control, as defined by FRS8. The following agreements remained effective during 1997:

- a debenture to FNBS, which was subsequently assigned to FNBS Holdings UK from Zophonus Limited for a principal amount of £1,000,000, under which FNBS Holdings UK is entitled to interest equating to 1% above Libor and any surplus distributable income or capital received within Zophonus Limited. As at 31 December 1997 the balance outstanding on this debenture was £1 (1996: £496,000) with associated interest accrued in the year of £9.95 million (1996: £5.26 million) and interest outstanding of £1.24 million (1996: £1.68 million).