Preferred Holdings Limited

Report and consolidated financial statements

30 November 2004

Ernst & Young

Registered No: 4191096

Directors
W Bilsborough
D Gibb
W Hinshelwood
N Ingram
C Rupp
R Taylor

Secretary
Clifford Chance Secretaries (CCA) Limited
10 Upper Bank Street
London
E14 5JJ

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

Bankers
Barclays Bank PLC
54 Lombard Street
London
EC3V 9EX

National Westminster Bank PLC
1 Princes Street
London
EC2R 8PB

Girobank PLC
Bridle Road
Bootle
Merseyside
GIR 0AA

Registered Office
Oakfield House
35 Perrymount Road
Haywards Heath
West Sussex
RH16 3BX

Directors' report

The directors present their report and the financial statements for the period ended 30 November 2004.

Principal activities

The principal activity of the Company and Group is the provision of loans secured on properties in the United Kingdom. The Company holds the entire share capital of Preferred Group Limited.

Future prospects

The directors are confident that the Company is well placed to continue its activities.

Going concern

The directors believe that the Group is a going concern and accordingly have prepared the financial statements on this basis.

Results and dividends

The results of the Group for the period are shown in the consolidated profit and loss account on page 6. The directors do not recommend the payment of a dividend (31 December 2003 - nil).

Directors and their interests

The directors who held office during the period, and after the period end, were as follows:

D Pitocco (resigned 31 May 2004)
G Fraser (resigned 9 November 2005)
G Patellis (resigned 9 November 2005)
J Webster (resigned 15 December 2005)
A Attia (resigned 18 May 2006)
W Bilsborough (appointed 9 November 2005)
D Gibb (appointed 17 May 2006)
W Hinshelwood (appointed 17 May 2006)
N Ingram (appointed 9 November 2005)
C Rupp (appointed 9 February 2006)
R Taylor (appointed 9 November 2005)

During the period, none of the directors who held office, nor any of their families, held any beneficial interest in the shares of the Company or of any group company.

Clifford Chance Secretaries Limited were appointed as secretary to the Company on 12 December 2003 and resigned on 1 November 2004. Clifford Chance Secretaries (CCA) Limited were appointed as secretary to the Company on 1 November 2004.

On acquisition of Preferred Holdings Limited on 12 December 2003, Lehman Brothers Holdings PLC purchased all of the directors' interests within the Company.

Events occurring after the balance sheet

On 31 January 2006 the Company disposed of £2,314,541 of assets at net book value to Capstone Mortgage Services Limited. This sale formed part of the implementation of a shared service centre within Capstone Mortgage Services Limited to provide support services to the Group and to other Lehman Brothers mortgage businesses in the United Kingdom.

Financial instruments

The Group's financial instruments comprise mortgages, borrowings, cash and liquid resources, and various items (such as trade debtors and trade creditors) that arise directly from its operations.

Directors' report

Financial instruments (continued)

The Group also enters into derivative transactions (principally interest rate swaps, caps and currency swaps) to manage the interest rate and currency risks arising within the securitised mortgage vehicles.

It is, and has been throughout the period 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, currency risk and liquidity risk. The directors review and agree policies for managing each of these risks and they are summarised below. These policies have remained unchanged from 2003.

Credit risk

Credit risk is principally the risk that borrowers will not be able to meet their obligations as they fall due, allied to the risk that property values will fall to the extent that borrowers' failure to meet obligations is translated into losses.

The Group has established detailed, documented credit policies, which are used to define, monitor and control the quality of new lending through analysis of new origination, existing portfolios and the wider marketplace. These policies control the approval of new origination sources, the approval of new products, the underwriting criteria development, underwriting and collection mandates and the criteria and processes for arrears collection, litigation and repossession.

The ongoing credit risk of the mortgage portfolio (and particularly in respect of accounts in arrears) is closely monitored by the directors.

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 considers the use of derivative financial instruments to mitigate any residual interest rate risk.

Foreign exchange risk

Foreign exchange risk exists where 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 considers the use of 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 with those of the cash payments due on the sources of financing, which include loan notes, funding facilities and subordinated loans.

Auditors

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

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

Director

Date 10 August 2006

Statement of directors' responsibilities in respect of the financial statements

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 of the Group and of the profit or loss of the Group for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; 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 proper accounting records which 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 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.

Independent auditors' report

to the members of Preferred Holdings Limited

We have audited the Group's financial statements for the period ended 30 November 2004 which comprise the Consolidated Profit and Loss Account, Consolidated Balance Sheet, Company Balance Sheet, the Consolidated Cash Flow Statement and the related notes 1 to 27. These financial statements have been prepared on the basis of the accounting policies set out therein.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. 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 auditors' 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 described in the Statement of Directors' Responsibilities the Company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the Group is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes 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 Group'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 the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 30 November 2004 and of the profit of the Group for the period then ended and have been properly prepared in accordance with the Companies Act 1985.

Ernst & Young LLP.

Ernst & Young LLP
Registered Auditor
London

10 Aug 2006

Consolidated profit and loss account

for the period ended 30 November 2004

	Notes	*Period ended 30 November 2004 £000*	*Year ended 31 December 2003 £000*
Interest receivable and similar income	2	27,151	20,792
Interest payable and similar charges	3	(20,980)	(16,705)
Net interest income		6,171	4,087
Income from securitised operations	4	30,031	17,715
Profit on sale of mortgage assets	5	–	2,508
Other operating income	6	10,970	8,948
Operating income		47,172	33,258
Operating expenses		(32,751)	(23,894)
Operating profit		14,421	9,364
Provision for bad and doubtful debts		(2,355)	(1,027)
Profit on ordinary activities before taxation		12,066	8,337
Taxation	8	(54)	(2,609)
Profit on ordinary activities after taxation	21	12,012	5,728
Retained profit for the period		12,012	5,728

The profit for the period was derived from continuing operations.

There were no recognised gains or losses other than the profit for the period, accordingly no statement of recognised gains and losses is given.

The notes on pages 11 to 31 form part of these financial statements.

ERNST & YOUNG

Consolidated balance sheet

at 30 November 2004

	Notes	30 November 2004 £000	31 December 2003 £000
Fixed assets			
Intangible assets	11	7,047	7,437
Tangible assets	12	2,914	2,457
		9,961	9,894
Current assets			
Mortgage loans and other assets - securitised balances	15	1,395,736	574,833
Less: non recourse borrowings and other liabilities	15	(1,383,850)	(544,161)
		11,886	30,672
Mortgage loans - unsecuritised balances	14	378,637	487,146
		390,523	517,818
Debtors	17	43,440	23,026
Cash at bank and in hand		86,108	21,647
Total current assets		520,071	562,491
Creditors: amounts falling due within one year	18	(437,759)	(538,196)
Net current assets		82,312	24,295
Total assets less current liabilities		92,273	34,189
Creditors: amounts falling due after more than one year	19	(69,173)	(23,101)
Net assets		23,100	11,088
Capital and reserves			
Called up share capital	20	5	5
Share premium	21	490	490
Profit and loss account	21	22,605	10,593
Shareholders' funds	22	23,100	11,088

Included above within mortgages are balances due within one year and after more than one year, the analysis of which is provided in note 16.

The notes on pages 11 to 31 form part of these financial statements.

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

Director [signature]
Date 10 August 2006

Company balance sheet

at 30 November 2004

	Notes	*30 November 2004 £000*	*31 December 2003 £000*
Fixed assets			
Investments	13	–	–
		–	–
Current assets			
Debtors	17	368	368
Cash		1	1
Total current assets		369	369
Creditors: amounts falling due within one year	18	(310)	(302)
Net current assets		59	67
Total assets less current liabilities		59	67
Creditors: amounts falling due after more than one year		–	–
Net assets		59	67
Capital and reserves			
Called up share capital	20	5	5
Share premium	21	490	490
Profit and loss account	21	(436)	(428)
Equity shareholders' funds	22	59	67

The notes on pages 11 to 31 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 10 August 2006

ERNST & YOUNG

Consolidated cash flow statement

for the period ended 30 November 2004

	Notes	*Period ended 30 November 2004 £000*	*Year ended 31 December 2003 £000*
Net cash outflow from operating activities	24(a)	97,679	60,783
Returns on investments and servicing of finance	24(b)	(76,397)	(38,348)
Taxation		(4,485)	(1,616)
Capital expenditure and financial investment	24(b)	(527,395)	(449,538)
Cash outflow before use of liquid resources and financing		(510,598)	(428,719)
Financing	24(b)	767,907	456,930
Increase in cash in the period		257,309	28,211

Reconciliation of net cash flow to movement in net debt (note 24(c))

	Period ended 30 November 2004 £000	*Year ended 31 December 2003 £000*
Increase in cash in the period	257,309	28,211
Cash inflow from increase in debt financing	(767,737)	(457,124)
Change in net debt arising from cash flows	(510,428)	(428,913)
Net debt at 31 December 2003	(1,039,120)	(610,207)
Net debt at 30 November 2004	(1,549,548)	(1,039,120)

Notes to the financial statements

at 30 November 2004

1. Accounting policies

Basis of accounting

The financial statements have been prepared under the historical cost convention and in accordance with applicable accounting standards. The financial statements have been prepared on a going concern basis.

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiary undertakings made up to 30 November 2004. The acquisition method of accounting has been adopted.

Under section 230(4) of the Companies Act 1985 the Company is exempt from the requirement to present its own profit and loss account. The amount of profit for the period dealt with in the financial statements of Preferred Holdings Limited is disclosed in note 21.

Linked presentation

The Group has sold by securitisation, certain mortgages to other companies on a non-recourse basis. In accordance with the requirements of Financial Reporting Standard No 5 "Reporting the Substance of Transactions", these amounts cannot be derecognised and have been disclosed on the face of the balance sheet less any non-recourse finance, using the linked presentation basis.

Quasi-subsidiaries

Preferred Residential Securities 1 PLC, Preferred Residential Securities 2 PLC, Preferred Residential Securities 3 PLC, Preferred Residential Securities 4 PLC, Preferred Residential Securities 5 PLC and Preferred Residential Securities 6 PLC, Preferred Residential Securities 7 plc and Preferred Residential Securities 8 plc have been consolidated as quasi-subsidiaries under the linked presentation basis described above.

In addition, Preferred Funding One Limited, Preferred Funding Two Limited, Preferred Funding Four Limited and Preferred Mortgages Collections Limited and PRS 5&6 Sub Loan Holdings Ltd have been fully consolidated as quasi-subsidiaries.

Mortgage loans

Mortgage loans are stated at cost less provision made to reduce the value of the loans to their estimated recoverable amounts. Provisions are made against mortgages when, in the opinion of the Directors, credit risk or economic risk make recovery doubtful.

Income and expense recognition

Interest receivable and insurance commissions are accounted for on an accruals basis. Fees are credited to income when they have been charged to the borrower's account. Receipts and payments of expenses are accounted for on an accruals basis.

Provisions

Specific provisions for losses on loans and advances to customers in arrears are made throughout the period and at the period-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 2004

1. Accounting policies (continued)

Tangible fixed assets and depreciation

Tangible fixed assets are stated at cost less accumulated depreciation.

Depreciation is provided to write off the cost of tangible fixed assets on a straight line basis at the following rates per annum:

Office furniture, fixtures and fittings	15%
Office equipment and computer software	25%

Operating leases

Rental costs under operating leases are charged to the profit and loss account on a straight line basis over the period of the lease.

Origination costs deferral

Third party introduction fees incurred in originating mortgages are written off over the period in which early redemption charges apply (currently 36 months from the date of completion) or the life of the mortgage loan, whichever is the shorter.

Investments

In the Company's financial statements, investments in subsidiary undertakings are stated at cost, less any necessary provision for diminution in value.

Taxation

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

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transaction or events that result in an obligation to pay more, or a right to pay less tax in the future, have occurred at the balance sheet date.

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 reversal of the underlying timing differences can be deducted. Deferred tax is measured on a non-discounted basis at the tax rates that are expected to apply in periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

Turnover

The Group's trade and turnover are wholly within the UK and within a single market sector. Consequently, no segmental analysis has been prepared.

Deferred consideration

Deferred consideration represents further amounts payable on the acquisition of mortgages from Preferred Mortgages Limited, a subsidiary of the company, by the Preferred Residential Securities and Preferred Funding companies. The payment of these amounts is conditional on the performance of the acquired mortgages.

Notes to the financial statements

at 30 November 2004

1. Accounting policies (continued)

Foreign exchange currency swaps

A series of currency swaps has been entered into, in order to manage Preferred Residential Securities 6 PLC's and Preferred Residential Securities 8 PLC'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. The net interest paid on the loan notes is recorded on an accruals basis and included within interest payable within the income from securitised operations. Any foreign exchange gain or loss arising from the currency swaps in respect of capital and interest repayments is recorded on an accruals basis and is included in interest receivable or payable.

Pension costs

The Group pays contributions to defined contribution pension schemes that are either personal pension plans or group personal pension schemes. Such contributions are charged in the financial statements as they accrue.

Finance leases

Assets held under finance leases are capitalised as tangible fixed assets and are depreciated over the shorter of the lease term and their useful lives. The capital elements of future lease obligations are recorded as liabilities, while the interest elements are charged to the profit and loss account over the period of the lease.

2. Interest receivable

	Period ended 30 November 2004 £000	*Year ended 31 December 2003 £000*
Mortgage interest	24,421	19,444
Bank interest	2,081	1,348
Other	649	–
	27,151	20,792

3. Interest payable and similar charges

	Period ended 30 November 2004 £000	*Year ended 31 December 2003 £000*
Loan facilities	20,641	15,173
Loan note interest	–	835
Other interest	339	697
	20,980	16,705

Notes to the financial statements

at 30 November 2004

4. Income from securitised and unsecuritised operations

(a) Securitised operations

Preferred Residential Securities 1 PLC, Preferred Residential Securities 2 PLC, Preferred Residential Securities 3 PLC, Preferred Residential Securities 4 PLC, Preferred Residential Securities 5 PLC, Preferred Residential Securities 6 PLC, Preferred Residential Securities 7 plc and Preferred Residential Securities 8 plc all hold securitised mortgage assets. The summarised profit and loss account for these companies is as follows:

	Period ended 30 November 2004	*Year ended 31 December 2003*
	£000	*£000*
Interest receivable	90,417	41,934
Interest payable	(57,863)	(23,632)
Other operating income	3,938	2,851
Operating expenses	(2,435)	(1,817)
Provision for bad and doubtful debts	(4,002)	(1,619)
Corporation tax charge	(24)	(2)
	30,031	17,715

(b) Unsecuritised operations

Prior to acquisition by Lehman Brothers Holdings PLC, Preferred Mortgages Limited a subsidiary of the company transferred mortgages on an ongoing basis to Preferred Funding One Limited, Preferred Funding Two Limited, Preferred Funding Three Limited and Preferred Funding Four Limited. On acquisition the mortgages and loan facilities within these companies were transferred to Preferred Funding Five Limited.

Preferred Funding One Limited, Preferred Funding Two Limited and Preferred Funding Four Limited are wholly owned by a charitable trust and as detailed in note 1, have been consolidated as quasi-subsidiaries. Preferred Funding One Limited, Preferred Funding Two Limited and Preferred Funding Four Limited have traded throughout the accounting period.

Preferred Holdings Limited is not obliged to support any losses of Preferred Funding One Limited, Preferred Funding Two Limited and Preferred Funding Four Limited and does not intend to do so. The liabilities of Preferred Funding One Limited, Preferred Funding Two Limited and Preferred Funding Four Limited, are only repayable out of funds generated by the mortgage loans and there is no recourse to the Group for any shortfall.

Both Preferred Funding Three Limited and Preferred Funding Five Limited are wholly owned subsidiaries of Preferred Mortgages Limited. All of above mentioned funding companies carry out the principal activity of financing the provision of residential mortgages.

Notes to the financial statements

at 30 November 2004

4. Income from securitised and unsecuritised operations (continued)

The summarised profit and loss account for Preferred Funding One Limited, Preferred Funding Two Limited and Preferred Funding Four Limited for the period ending 30 November 2004, were as follows:

	Period ended 30 November 2004 £000	*Year ended 31 December 2003 £000*
Interest receivable	501	14,816
Interest payable	–	(10,593)
Net interest income	501	4,223
Other operating income	1,326	494
Operating expenses	(1,827)	(4,710)
Operating profit	–	7
Taxation	–	–
Profit after taxation	–	7

Operating expenses includes the provision/(write back) of deferred consideration payable to Preferred Mortgages Limited, of which the Company is parent, of (£1,247,448) (31 December 2003 - £4,314,685).

5. Profit on sale of mortgage assets

During the period Preferred Mortgages Limited sold no mortgage assets (year ended 31 December 2003 - £68,952,000) and consequently did not recognise a profit (year ended 31 December 2003 - £2,507,548).

6. Other operating income

	Period ended 30 November 2004 £000	*Year ended 31 December 2003 £000*
Commissions and fee income	10,970	8,948

Commissions and fee income includes redemption fee income, insurance commission income and sundry fee income.

Notes to the financial statements

at 30 November 2004

7. Profit on ordinary activities before taxation

Profit on ordinary activities before taxation is stated after charging:

	Period ended 2004 £000	*Year ended 2003 £000*
Auditors' remuneration:		
Audit services - audit fees	150	115
- non-audit fees	–	5
Depreciation of tangible fixed assets	1,005	870
Amortisation of goodwill	390	424
Operating lease rentals in respect of:		
Land and buildings	508	564
Other	103	111

8. Taxation

(a) Tax charge for the period

	Period ended 30 November 2004 £000	*Year ended 31 December 2003 £000*
UK corporation tax at 30%	–	2,493
Prior year adjustment	180	–
Total current tax for period (note 8(b))	180	2,493
Deferred taxation		
Origination and reversal of timing differences	(126)	116
Total deferred tax (note 8(c))	(126)	116
Total current tax	54	2,609

Notes to the financial statements

at 30 November 2004

8. Taxation (continued)

(b) Factors affecting tax charge for the period

The tax assessed on the profit on ordinary activities for the period is lower than the companies rate of corporation tax in the UK, currently 30% (2003: 30%). The differences are explained below:

	Period ended 30 November 2004 £000	*Year ended 31 December 2003 £000*
Profit before taxation	12,066	8,337
Expected tax charge at 30%	3,620	2,501
Expenditure not qualifying for tax relief	19	225
Capital allowances in excess of depreciation	71	34
Non deductible goodwill	117	128
Other timing differences	–	(142)
Group relief claimed for nil consideration	(3,807)	–
Utilisation of tax losses	–	(154)
Starting rate of tax	–	(4)
Consolidation adjustments	(20)	(95)
Underprovision in previous years	180	–
Total current tax	180	2,493

(c) Deferred tax

The deferred tax asset can be analysed as follows:

	Period ended 30 November 2004 £000	*Year ended 31 December 2003 £000*
Capital allowances in excess of depreciation	(126)	(40)

Notes to the financial statements

at 30 November 2004

8. Taxation (continued)

The deferred tax asset can be analysed as follows:

	Period ended 30 November 2004 £000	*Year ended 31 December 2003 £000*
Balance at 1 January	(40)	76
(Debit)/credit to profit and loss account	126	(116)
	86	(40)

9. Directors' emoluments

Directors' emoluments are as follows:

	Period ended 30 November 2004 £000	*Year ended 31 December 2003 £000*
Salaries	673	1,046
Other	33	67
Aggregate remuneration	706	1,113
Remuneration of the Chairman	–	25
Remuneration of the highest paid director	437	533

None of the directors are members of a company pension scheme, but during the period, the Group has made contributions to personal pensions plans for the directors totalling £6,110 (31 December 2003 - £13,525).

Highest paid director

The highest paid director in 2004, was D J Pitocco (31 December 2003 - D J Pitocco).

	30 November 2004 £000	*31 December 2003 £000*
Total emoluments	437	533
Contributions to personal pension plan	–	–

Notes to the financial statements

at 30 November 2004

10. Employees

The average number of employees, including directors, during the period was 271 (31 December 2003 - 208) and they were employed in the following areas of the business:

	30 November 2004 No.	*31 December 2003 No.*
Sales and marketing	24	25
Administration	247	183
	271	208

The costs incurred in respect of these employees were:

	30 November 2004 £000	*31 December 2003 £000*
Salaries	7,359	6,131
Pension costs	193	176
Social security costs	808	658
	8,360	6,965

Pension costs represent contributions made by the Group to the personal pension plans or group personal pension schemes of certain employees.

11. Intangible fixed assets

	Goodwill 30 November 2004 £000	*Goodwill 31 December 2003 £000*
Cost:		
At 1 January 2004 and 30 November 2004	8,498	8,498
Accumulated amortisation		
At 1 January 2004	1,061	637
Charge for period	390	424
At 30 November 2004	1,451	1,061
Net book value		
At end of period	7,047	7,437
At start of period	7,437	7,861

Notes to the financial statements

at 30 November 2004

12. Tangible fixed assets

Group

	Office equipment £000	*Fixtures and furniture £000*	*Total £000*
Cost			
At 1 January 2004	3,801	588	4,389
Additions	1,331	131	1,462
At 30 November 2004	5,132	719	5,851
Depreciation:			
At 1 January 2004	1,684	248	1,932
Charge for the period	922	83	1005
At 30 November 2004	2,606	331	2,937
Net book value			
At 30 November 2004	2,526	388	2,914
At 31 December 2003	2,117	340	2,457

The Company has no tangible fixed assets.

13. Fixed asset investments

Company

	Shares in subsidiary undertakings £
Cost	
At 31 December 2003 and 30 November 2004	1
Net book value	
At 31 December 2003 and 30 November 2004	1

Subsidiary undertakings	*Country of registration and operation*	*Activity*	*Portion of ordinary shares held*
Preferred Group Limited	England and Wales	Investment holding company	100%
Preferred Mortgages Limited*	England and Wales	Provision of loans secured on properties	100%
Yellow Brick Road Direct Mortgages Limited*	England and Wales	Dormant	100%
Preferred Home Loans Limited*	England and Wales	Dormant	100%

Notes to the financial statements

at 30 November 2004

13. Fixed asset investments (continued)

With the exception of the companies marked with an asterisk, all shareholdings are in the name of Preferred Holdings Limited. All subsidiaries have been included in the consolidation.

The following information is presented in the financial statements of Preferred Group Limited for the period ended 30 November 2004:

	2004
	£000
Aggregate capital and reserves	367
(Loss) for the period	(1,944)

The following information is presented in the consolidated financial statements of Preferred Mortgages Limited, a subsidiary of Preferred Group Limited, for the period ended 30 November 2004:

	2004
	£000
Aggregate capital and reserves	31,354
Profit for the period	10,466

14. Mortgage loans – unsecuritised balances

Group

	Mortgages	*Mortgage loss provision*	*Total*
	£000	*£000*	*£000*
At beginning of the period	488,624	(1,478)	487,146
Net movement	(106,154)	(2,355)	(108,509)
At end of the period	382,470	(3,833)	378,637

Notes to the financial statements

at 30 November 2004

14. Mortgage loans – unsecuritised balances (continued)

The summarised balance sheets as at 30 November 2004 prior to consolidation adjustments for Preferred Funding One Limited, Preferred Funding Two Limited and Preferred Funding Four Limited were as follows:

	30 November 2004 £000	*31 December 2003 £000*
Current assets		
Debtors:		
Amounts falling due after one year	18	3,411
Amounts falling due within one year	7,781	14,490
Cash at bank and in hand	7,348	7,120
	15,147	25,021
Creditors: amounts falling due within one year	(15,135)	(25,009)
Net assets	12	12
Capital and reserves		
Called up share capital	–	–
Profit and loss account	12	12
	12	12

15. Mortgage loans – securitised balances

(a) Consolidation using link presentation

During the period the Group securitised £598.9 mortgages within Preferred Residential Securities 7 PLC and £337.3m mortgages within Preferred Residential Securities 8 plc, owned by a charitable trust. As at 30 November 2004 the Group had securitised mortgages of £1,169.6m within the eight special purpose companies, Preferred Residential Securities 1 PLC, Preferred Residential Securities 2 PLC, Preferred Residential Securities 3 PLC, Preferred Residential Securities 4 PLC, Preferred Residential Securities 5 PLC Preferred Residential Securities 6 PLC, Preferred Residential Securities 7 plc and Preferred Residential Securities 8 plc. These special purpose companies are consolidated within the financial statements of the Group on a linked presentation basis, in accordance with FRS5. The consolidated results of those companies are detailed in note 4. All of the companies invest in residential mortgage loans secured by first or second charges.

Notes to the financial statements

at 30 November 2004

15. Mortgage loans – securitised balances (continued)

The summary consolidated balance sheet of these eight companies is as follows:

	30 November 2004 £000	*31 December 2003 £000*
Mortgage loans (note 15(b))	1,169,661	537,524
Debtors due within one year	3,360	1,923
Cash at bank	222,765	35,386
Total assets	1,395,736	574,833
Mortgaged Backed Loan Notes (note 15(c))	1,359,880	541,981
Other creditors:		
Due within one year	23,970	846
Due after one year	–	1,334
Total liabilities	1,383,850	544,161
Net securitised assets	11,886	30,672

The Group is not obliged to support any losses of the securitisation companies and does not intend to do so. The providers of finance have given notice in writing that they will seek repayment of the finance, both principle and interest, only to the extent that sufficient funds are generated by the securitised assets and they will not seek any other form of recourse from the Group.

The priority and amount of claims on the proceeds generated by the assets are determined in accordance with a strict priority of payments. The Group is entitled to additional deferred consideration and/or residual income, in addition to the non-recourse consideration already received, depending upon the performance of the securitised assets.

(b) Analysis of securitised mortgage balances

	Mortgages £000	*Mortgage loss provision £000*	*Total £000*
Group			
At beginning of the period	543,174	(5,650)	537,524
Net movement	634,242	(2,155)	632,087
At end of the period	1,177,416	(7,805)	1,169,611

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at 30 November 2004

15. Mortgage loans – securitised balances (continued)

(c) Analysis of non recourse borrowings

	30 November 2004 £000	*31 December 2003 £000*
Capital value of borrowings	1,359,880	541,981
Interest payable on borrowings	16,690	1,156
	1,376,570	543,137

16. Mortgage loans: amounts falling due within one and after one year

	Group 30 November 2004 £000	*Group 31 December 2003 £000*
Securitised mortgages	1,169,611	537,524
Non-securitised mortgages	378,637	487,146
	1,548,248	1,024,670
Amounts falling due within one year	373,195	201,975
Amounts falling due after one year	1,175,053	822,695
	1,548,248	1,024,670

17. Debtors: amounts due within one year

Group

	30 November 2004 £000	*31 December 2003 £000*
Deferred origination costs	19,441	14,344
Deferred taxation	86	–
Corporation tax	3,466	–
Other debtors	19,944	8,249
Prepayments and accrued income	503	433
	43,440	23,026

Company

	30 November 2004 £000	*31 December 2003 £000*
Amounts owed by related companies	368	368

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18. **Creditors:** amounts falling due within one year

Group

	30 November 2004 £000	*31 December 2003 £000*
Loan facility	397,847	505,523
Loan finance	28,747	16,947
Bank overdraft	2,774	8,243
Social security and other taxes	224	560
Trade creditors	420	850
Other creditors	4,268	2,574
Deferred tax	–	40
Corporation tax	–	878
Accruals and deferred income	3,479	2,223
Amounts owed to parent company	–	358
	437,759	538,196

Company

	30 November 2004 £000	*31 December 2003 £000*
Amounts owed to related companies	301	285
Accruals and deferred income	9	17
	310	302

19. **Creditors:** amounts falling due after more than one year

	30 November 2004 £000	*31 December 2003 £000*
Finance lease	198	368
Parent company loan	41,591	22,733
Residual Finance Companies Loan	27,384	–
	69,173	23,101

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20. Called up share capital

		30 November 2004 £	31 December 2003 £
Authorised			
16,868	Deferred shares of 1p each	500	169
36,949	Ordinary shares of 10p each	5,000	3,695
124,963	A ordinary shares of 1p each	–	1,250
32,215	B ordinary shares of 1p each	–	322
10,001	C ordinary shares of 1p each	–	100
1,291	D ordinary shares of 10p each	–	129
450,000	X Ordinary shares of 1p each	4,500	–
		10,000	5,665

		30 November 2004 £	31 December 2003 £
Issued:			
16,868	Deferred shares of 1p each	169	169
30,638	Ordinary shares of 10p each	3,193	3,064
124,963	A ordinary shares of 1p each	–	1,250
27,214	B ordinary shares of 1p each	–	272
7,001	C ordinary shares of 1p each	–	70
1,291	D ordinary shares of 10p each	–	129
159,178	X Ordinary shares of 1p each	1,592	–
		4,954	4,954

On 3 January 2003, 4,989 ordinary A shares of 1p each and 1,262 ordinary B shares of 1p each were allotted.

On 12 December 2003, the entire share capital of Preferred Holdings Limited was acquired by Lehman Brothers Holdings PLC. As part of the acquisition agreement, 71 ordinary 10p shares, 12,899 A ordinary 1p shares and 3,259 B ordinary 1p shares were converted to 16,868 Deferred 1p shares. Also, 1,291 ordinary 10p shares were converted to 1,291 D ordinary 10p shares.

On 5 May 2004, the existing issued and authorised share capital was redenominated whereby the Class A ordinary shares of 1p, the Class B ordinary shares of 1p and the Class C ordinary shares of 1p were each redenominated to Class X ordinary shares of 1p each. Similarly, the Class D ordinary shares of 10p were denominated as ordinary shares of 10p each.

On 5 May 2004, a resolution was passed to increase the Company's authorised share capital from £5,665 to £10,000.

On 31 January 2006, the entire share capital of Preferred Holdings Limited was acquired by Resetfan Limited. The entire share capital of Resetfan Limited is owned by Lehman Brothers Holdings PLC.

Notes to the financial statements

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21. Statement of movement on reserves

Group

	Share premium account £000	*Profit and loss account £000*	*Total £000*
Balance at 1 January 2004	490	10,593	11,083
Retained profit for the period	–	12,012	12,012
Balance at 30 November 2004	490	22,605	23,095

Company

	Share premium account £000	*Profit and loss account £000*	*Total £000*
Balance at 1 January 2004	490	(428)	62
Retained loss for the period	–	(8)	(8)
Balance at 30 November 2004	490	(436)	54

22. Reconciliation of movements in shareholders' funds

Group

	30 November 2004 £000	*31 December 2003 £000*
Profit for the financial period	12,012	5,728
Issue of shares (share premium)	–	8
Net addition to shareholders' funds	12,012	5,736
Opening shareholders' funds	11,088	5,352
Closing shareholders' funds	23,100	11,088

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at 30 November 2004

22. Reconciliation of movements in shareholders' funds (continued)

Company

	30 November 2004 £000	*31 December 2003 £000*
Loss for the financial period	(8)	(302)
Issue of shares (share premium)	–	8
Net decrease to shareholders' funds	(8)	(294)
Opening shareholders' funds	67	361
Closing shareholders' funds	59	67

23. Operating lease commitments

The charge payable in the next period in respect of operating leases is as follows:

	30 November 2004 £000	*31 December 2003 £000*
Land and buildings		
Leases terminating between 1 and 2 years	644	508
Leases terminating between 2 and 5 years	–	–
Other		
Leases terminating in less than 12 months	5	29
Leases terminating between 1 and 2 years	8	5
Leases terminating between 2 and 5 years	22	8

24. Cash flow statement

(a) Reconciliation of operating profit to net cash inflow from operating activities

	30 November 2004 £000	*31 December 2003 £000*
Operating profit after provision	12,066	8,337
Depreciation of fixed assets	1,005	870
Interest – loan facilities	20,641	15,173
Interest – mortgage backed loan notes	55,417	21,643
Interest – other	339	1,532
Amortisation of goodwill	390	424
Origination costs	(5,097)	(6,688)
Finance lease	(170)	202
Loan loss provision	2,355	1,027
Other debtors	(13,241)	14,017
Other creditors	23,974	4,246
Net cash inflow from operating activities	97,679	60,783

Notes to the financial statements

at 30 November 2004

24. Cash flow statement (continued)

(b) Analysis of cash flows for headings netted in the cash flow statement

	30 November 2004 £000	31 December 2003 £000
Returns on investments and servicing of finance		
Interest paid on mortgage backed floating rate notes	(55,417)	(21,643)
Interest paid on loan facilities and other interest	(20,980)	(16,705)
	76,397)	(38,348)
Capital expenditure and financial investment		
Payments to acquire tangible fixed assets	1,462	(960)
Payments to acquire mortgages	525,933	(448,578)
	527,395	449,538
Financing		
Issue of ordinary shares	–	8
Issue of loan notes	817,899	109,916
(Decrease)/increase in bank facility	(107,676)	338,574
(Decrease)/increase in loan finance	39,184	(14,659)
Increase in loan from parent company	18,500	23,091
	767,907	456,930

(c) Analysis of net debt

	31 December 2003 £000	Cash flow £000	30 November 2004 £000
Cash in hand	57,033	251,840	308,873
Bank overdraft	(8,243)	5,469	(2,774)
	48,790	257,309	306,099
Parent company loan	(23,091)	(18,500)	(41,591)
Non recourse facilities	(541,981)	(817,899)	(1,359,880)
Other loan facilities	(522,838)	68,662	(454,176)
	(1,039,120)	(510,428)	(1,549,548)

Notes to the financial statements

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25. Financial instruments

As explained on page 3 the Group uses financial instruments in its normal course of business. The following numerical analysis gives an indication of the significance of these instruments to the Group.

(a) Interest rate risk profile of financial liabilities

	Total	*Total variable rate*	*Total fixed rate*	*Weighted average interest rate*	*Weighted average time for which rate is fixed*
	£000	*£000*	*£000*	*%*	*Years*
30 November 2004					
Interest rate and currency profile	1,858,238	1,858,238	–	–	–
31 December 2003					
Interest rate and currency profile	1,095,427	1,095,427	–	–	–

(b) Interest rate risk profile of financial assets

	Total	*Total variable rate*	*Total fixed rate*	*Weighted average interest rate*	*Weighted average time for which rate is fixed*
	£000	*£000*	*£000*	*%*	*Years*
30 November 2004					
Interest rate and currency profile	1,868,759	1,858,739	10,020	7.14	1.46
31 December 2003					
Interest rate and currency profile	1,081,702	1,080,420	1,282	6.66	0.75

All financial assets are denominated in pounds sterling.

The rates of interest receivable and payable on variable rate financial instruments are set with reference to the London Interbank Offered Rate.

Notes to the financial statements

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25. Financial instruments (continued)

(c) Foreign currency risk

With the exception of the mortgage backed loan notes in Preferred Residential Securities 6 PLC and Preferred Residential Securities 8 PLC, all financial instruments are denominated in sterling. The mortgage backed loan notes were issued in the following tranches in Preferred Residential Securities 6 PLC:

GBP denominated mortgage backed loan notes due 2035 – Class A1 (Notional GBP 232,000,000)
EUR denominated mortgage backed loan notes due 2035 – Class A2 (Notional EUR 50,000,000)
GBP denominated mortgage backed loan notes due 2035 – Class M1 (Notional GBP 27,500,000)
EUR denominated mortgage backed loan notes due 2035 – Class M2 (Notional EUR 8,000,000)

The mortgage backed loan notes were issued in the following tranches in Preferred Residential Securities 8 PLC.

GBP denominated mortgage backed loan notes due 2042 with detachable coupons due 2007 – Class A1a1 (Notional GBP 181,000,000)
GBP denominated mortgage backed loan notes due 2042 with detachable coupons due 2007 – Class A1a2 (Notional GBP 100,000,000)
USD denominated mortgage backed loan notes due 2042 – Class A1b (Notional USD 100,000,000)
EUR denominated mortgage backed loan notes due 2042 – Class A1e (Notional EUR 100,000,000)
GBP denominated mortgage backed loan notes due 2042 – Class B1a (Notional GBP 18,500,000)
EUR denominated mortgage backed loan notes due 2042 – Class B1c (Notional EUR 8,500,000)
GBP denominated mortgage backed loan notes due 2042 – Class C1a (Notional GBP 5,900,000)
EUR denominated mortgage backed loan notes due 2042 – Class C1c (Notional EUR 5,000,000)
GBP denominated mortgage backed loan notes due 2042 – Class D1a (Notional GBP 16,200,000)
EUR denominated mortgage backed loan notes due 2042 – Class D1e (Notional EUR 5,000,000)
GBP denominated mortgage backed loan notes due 2042 – Class E (Notional GBP 4,600,000)

A series of currency swaps has been entered into, in order to manage the Group's currency rate exposure in relation to non-sterling denominated loan notes. At 30 November 2004 the notional value of swaps held was £177,037,964 (2003 - £40,971,389) and the unrecognised positive fair value was £666,537 (2003 - £522,978)

(d) Fair value of financial instruments

	Book value 30 November 2004 £000	*Fair value 30 November 2004 £000*	*Book value 31 December 2003 £000*	*Fair value 31 December 2003 £000*
Non-securitised operations				
Cash and deposits	86,108	86,108	21,647	21,647
Mortgage loans	382,470	382,470	487,146	487,146
Loan facilities	397,847	397,847	505,523	505,523
Bank overdraft	2,774	2,774	8,243	8,243
Loan finance	56,131	56,131	16,947	16,947
Parent company loan	41,591	41,591	22,733	22,733
Loan notes	–	–	–	–
Securitised operations				
Mortgage loans	1,177,416	1,177,416	537,524	537,524
Cash and deposits	222,765	222,765	35,386	35,386
Mortgage Backed Loan Notes	1,359,880	1,359,880	541,981	541,981

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26. Related party transactions

In accordance with Financial Reporting Standard No. 8 "Related Party Transactions", transactions between the Company, other group undertakings and investee related parties of the Company have not been disclosed in these financial statements.

Amounts owed to the shareholders of Preferred Holdings Limited during the period are £41,590,378 (31 December 2003 - £23,091,000) and are included within creditors (note 19).

27. Parent company and ultimate controlling party

The Company's parent company is Lehman Brothers Holdings PLC. The smallest and largest group in which the results of the Company are consolidated is that headed by Lehman Brothers Holdings Inc., incorporated in the United States of America. The consolidated financial statements of this Group are available from 745 Seventh Avenue, New York, USA.