

Registered number: 03149607

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC

Annual report and financial statements
for the year ended 31 December 2018

THURSDAY



A88I80JT

A08

27/06/2019

#226

COMPANIES HOUSE

DIRECTORS AND COMPANY INFORMATION

Directors

Johan Robin Charles Von Schmidt Auf Altenstadt
Emma Louise Lawrence

Company Secretary

David Dermot Hennessey

Registered Office

Trinity Road
Halifax
HX1 2RG

Independent Auditors

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
7 More London Riverside
London
SE1 2RT

Strategic Report

For the year ended 31 December 2018

The directors present their Strategic report and the audited financial statements for BOS (Shared Appreciation Mortgages) No.2 plc ("the Company") for the year ended 31 December 2018.

Principal activities

The principal activity of the Company is to finance mortgage lending. In 1997 the Company issued £105,600,000 fixed rate notes (the "Notes"). Following a business restructure on 28 February 2011 the terms of the Notes were modified. The notes bear a zero rate of interest until August 2027. Under the business restructure, the interest rate applicable to the Notes will increase to 0.01% fixed from August 2027 until 2072 when the Notes become due. The Notes are secured on the mortgage portfolio. The capital appreciation realised on the sale of a mortgage holder's property is shared between the mortgage holder and the Company as set out in the original loan agreement. The Company pays its entire share of the appreciation to the Note holders and the swap provider.

The activities of the Company are conducted primarily by reference to a series of transaction documents under the offering circular for BOS (Shared Appreciation Mortgages) No.2 PLC (the "Programme Documentation").

Movements in the mortgage book are disclosed in the notes to the financial statements.

Business structure

The Company is a subsidiary undertaking of Bank of Scotland plc ("BOS") and ultimately Lloyds Banking Group plc ("LBG").

Business review and performance

No new mortgages were acquired or originated by the Company in the year and no new Notes were issued.

The profit for the financial year amounted to £46,320 (2017: £80,889). Total equity as at 31 December 2018 amounted to £1,494,541 (2017: £1,576,783).

The principal asset in the Company is a mortgage portfolio which is subject to an impairment review. The mortgage portfolio is subject to the economic factors relating to the housing market (see "Credit Risk" below). The Company's results are not impacted by changes in interest rates as the mortgage loans and Notes bear a zero rate of interest.

Key Performance Indicators

The Board is responsible for assessing the risk of irregularities, whether caused by fraud or error in the financial reporting and ensuring that processes are in place for the timely identification of internal and external matters with a potential effect on financial reporting.

The key performance indicator used by management in assessing the performance of the Company is the monitoring of actual cash flows against planned cash flows on the Notes.

In order to assist the directors to mitigate key risks, there is a Board meeting held quarterly with programme managers. This meeting analyses and discusses the trends for the quarter and identifies any issues or required changes. Any such issues are then reported, further discussed and collectively agreed. There were no significant issues impacting the Company in the current or previous year.

The Company has made all necessary payments on the Notes in accordance with the scheduled repayment dates for the year ended 31 December 2018.

Risk management

The majority of the Company's assets and liabilities have been classified as financial instruments in accordance with IAS 32 "Financial Instruments: Presentation". The Company's financial instruments comprise a mortgage portfolio, an embedded derivative (Financial assets held at fair value through profit or loss ("Financial assets FVTPL")), cash liquid resources, a derivative contract ("swap"), loans and borrowings (Financial liabilities designated at fair value through profit or loss ("Financial liabilities FVTPL")) and various other receivables and payables that arise directly from its operations.

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

The principal risk arising from the Company's financial instruments is credit risk. This and other risks which may affect the Company's performance are detailed below. Further analysis of the risks facing the Company on its financial instruments is provided in note 15.

Credit Risk

Credit risk arises on the individual loans within the mortgage loan portfolio which are in turn secured on the underlying UK residential properties. The performance of these loans is therefore influenced by the economic background and the UK housing market. However, with a maximum loan-to-value of the original advances being 25% and with the mortgage portfolio having a weighted average current loan-to-value of 6.2% as at 31 December 2018, the credit exposure is low.

The extent to which the Company can meet its obligations to pay interest and ultimately repay the Notes will be dependent upon the principal receipts on the mortgage loans. If this income does not provide sufficient funds, the Note holders have no claim on the assets of BOS.

The terms of the Mortgage Portfolio Agreement given by BOS in respect of the mortgages require BOS to repurchase any mortgage which is found to be in breach of warranty. BOS will repurchase any mortgages that are found or held not to be valid, binding and enforceable. There have been no such repurchases in the year.

In such an event the total value of the outstanding loan will be covered by BOS, the Note holder will not receive the benefit of any future payments of appreciation amounts or partial repayment of appreciation amounts in respect of the mortgages repurchased.

Strategic Report (continued)
For the year ended 31 December 2018

Risk management (continued)

Market risk

Market risk is the risk of financial losses to the Company in the event of movements in the prices of the market in which it operates. The Company's market is the UK residential housing market.

Under the terms of the Notes the Company is obligated to pay the Note holders and Swap provider the return on the shared appreciation that has accrued during the life of the mortgage loan at the rate implicit in the specific mortgage loan agreement as and when repaid by the mortgage loan customer. Shared appreciation is subject to the movement in the market value of the property which is dependent upon house price inflation, as measured by the Halifax House Price Index ("HPI").

However, the Company itself is not impacted by market risk as the risk of returns on the Notes being below initial expectations lies with the Note holder and there are no guarantees within the terms of the Notes for expected increases in value.

Interest rate risk

The Company has limited exposure to interest rate risk as both the mortgage loans and the remaining Notes pay a zero rate of interest. Therefore, it is not considered to be a significant risk.

Liquidity risk

All liabilities of the Company with the exception of the Notes are paid from receipt of funds earned on its bank deposits, the swap agreement with the external provider and the Letter of Credit issued by BOS.

The Company entered into an interest rate derivative with an external swap provider to manage the liquidity of the Company. The purpose of the swap was to provide a more stable cash flow to the Company by paying over the portion of the capital appreciation on the mortgage loans not due to investors, in return for a fixed interest

The Company has an unconditional and irrevocable 364-day revolving Letter of Credit provided by BOS. The Letter of Credit is for a maximum aggregate principal amount of £1,165,000 to assist the Company should it not be able to meet its obligations under the Notes. The reliance on this facility is therefore dependent upon the creditworthiness of BOS, which currently has a long term rating from Standard and Poor's (S&P) of A+ (2017: S&P long-term rating: A). The Company has not drawn on the Letter of Credit since inception.

Operational risk

In accordance with the Programme Documentation the Company is bound to make payments to meet third party expenses. To mitigate this risk the directors hold quarterly board meetings to review the performance of the Company and ensure that the Company is in a position to meet all necessary payments.

BOS has been appointed to act as account bank and servicer of the mortgage book on behalf of the Company. The Company also uses the Bank of New York Mellon to provide all corporate services in respect of the Notes in issue.

As approved by the Board of Directors and signed on behalf of the Board:



Johan Robin Charles Von Schmidt Auf Altenstadt
Director

Trinity Road
Halifax
HX1 2RG

DATE: 14 June 2019

Directors' Report

For the year ended 31 December 2018

The directors present their annual report and the audited financial statements for BOS (Shared Appreciation Mortgages) No.2 plc (the "Company") for the year ended 31 December 2018.

Directors

The directors of the Company during the year, and up to the date of signing the financial statements, were:

Emma Louise Lawrence
Johan Robin Charles Von Schmidt Auf Altenstadt (appointed 26th March 2019)
Janet Turner (resigned 26th March 2019)

Statement of directors' responsibilities in respect of the Financial Statements

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulation.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. 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 the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006.

The directors 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.

Disclosure of information to auditors

In accordance with Section 418 (2) of the Companies Act 2006, in the case of each director in office at the date the report is approved:

- so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- The director has taken all the steps that he or she ought to have taken as a director in order to make him or herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

Directors' indemnities

LBG has granted to the Directors of the Company, (including former directors who have resigned in the year), a deed of indemnity through deed poll which constituted 'qualifying third party indemnity provisions' for the purposes of the Companies Act 2006. The deed was in force during the whole of the financial year and at the date of approval of the financial statements or from the date of appointment in respect of the Directors who joined the Board of the Company during the financial year. Directors no longer in office but who served on the Board of the Company at any time in the financial year had the benefit of this contract of indemnity during that period of service. The indemnity remains in force for the duration of the Directors' period of office. The deed indemnifies the Directors to the maximum extent permitted by law. Directors no longer in office but who served on the Board of the Company at any time in the financial year had the benefit of this contract of indemnity during that period of service.

Future Developments

The Company's business will continue to unwind over the life of the mortgages issued as no further advances will be made. Cash is continuing to be collected. A review of the business can be found in the Strategic Report.

The directors' assessment suggests that performance of the mortgage portfolio should continue to be satisfactory. Whilst consensus suggests that interest rates will continue to remain low, as will unemployment rates, inflationary pressures and higher prices caused by sterling weakness may put further pressure on household incomes, which may feed through further increases in mortgage arrears. The situation will be monitored and the Servicer, on behalf of the Company, will continue to adopt appropriate forbearance measures.

The UK is planning to leave the European Union ('Brexit'). The full impact of Brexit on the economy will be uncertain although any economic downturn may impact on the ability of the underlying borrowers to repay their mortgages and potentially lead to increases in mortgage arrears and defaults. In the meantime this uncertainty is expected to result in market risk volatility in the short to medium term including sterling exchange rates and interest rates.

However, the derivatives are utilised to economically hedge interest and FX rate risk and thus in the long term are perceived to have no impact.

The directors are aware of the ongoing process to replace LIBOR and will assess the impact at a future date once there is more market clarity on the timing and nature of the replacement.

Dividends

The directors did not recommend the payment of a dividend during the year ended 31 December 2018 (2017: £Nil).

Corporate governance

The Directors have been charged with governance in accordance with the Programme Documentation describing the structure and operation of the transaction. The governance structure of the Company is such that the key policies have been predetermined at the time of issuance and the operational roles have been assigned with their roles strictly governed by the Programme Documentation.

The Programme Documentation provides for procedures that have been designed for safeguarding assets against unauthorised use or disposition; for maintaining proper accounting records; and for the reliability and usefulness of financial information used within the business or for publication. Such procedures are designed to manage rather than eliminate the risk of failure to achieve business objectives whilst enabling them to comply with the regulatory obligations.

Due to the nature of the securities which have been issued, the Company is largely exempt from the requirements of the Financial Conduct Authority pertaining to the Disclosure and Transparency Rules (DTR) as detailed in DTR 7.1 Audit Committees and 7.2 Corporate Governance statements (save for the rule DTR 7.2.5 requiring a description of the features of the internal control and risk management systems), which would otherwise require the Company respectively, to have an audit committee in place and include a corporate governance statement in the report of the directors. The directors are therefore satisfied that there is no requirement for an audit committee or a supervisory body entrusted to carry out the functions of an audit committee or to publish a corporate governance statement.

From the perspective of the Company, the daily operational internal controls and risk management systems are integrated with those of LBG, the Company's ultimate controlling party. Therefore additional information may be found in section "Internal Control" of the 2018 Annual Report of LBG, which does not form part of this report. Details of where to get access to the 2018 Annual Report of LBG can be found in note 21.

Directors' Report (continued)
For the year ended 31 December 2018

Risk Management

Further details on the risks facing the Company and how these risks are managed are detailed in the Strategic Report.

Employees

The Company had no employees during the year ended 31 December 2018 or the previous year.

None of the directors received any emoluments from the Company in the current or previous year.

Independent auditors

The Company's directors give the LBG Audit Committee the authority to appoint the auditors of the Company. At the 2018 LBG Annual General Meeting, a resolution will be proposed to re-appoint PricewaterhouseCoopers LLP as auditors of LBG, in turn re-appointing PricewaterhouseCoopers LLP as auditors of the Company.

Statement of going concern

The Company has continued to perform in line with the Programme Documentation. The directors are satisfied that the Company has adequate resources to continue to operate for the foreseeable future and is financially sound. For this reason, they continue to adopt the going concern basis in preparing these financial statements.

As approved by the Board of Directors and signed on behalf of the Board by:



Johan Robin Charles Von Schmidt Auf Altenstadt
Director

Trinity Road
Halifax
HX1 2RG

DATE: 14 June 2019

Statement of comprehensive income

For the year ended 31 December 2018

	Note	2018 £	2017 £
Interest receivable and similar income	2	3,821	1,205,315
Interest payable and similar charges		-	(1,250,883)
Net interest income		3,821	(45,568)
Other income on financial assets and liabilities at fair value through profit or loss	3	6,911	-
Net fair value gains and losses on derivatives	4	98,553	192,056
Other operating income	5	650	750
Operating expenses	6	(52,750)	(46,864)
Profit before tax		57,185	100,374
Taxation	7	(10,865)	(19,485)
Profit for the financial year/ total comprehensive income attributable to owner		46,320	80,889

The profit shown above is derived from continuing operations. The Company operates in a single business segment and all of the Company's activities are in the UK.

The accompanying notes on pages 10 to 21 are an integral part of the financial statements

Balance sheet
As at 31 December 2018

	Note	2018 £	2017 £
Assets			
Cash and cash equivalents	8	1,475,933	1,344,033
Mortgage portfolio	9	-	10,619,884
Financial assets held at fair value through profit or loss	9	112,105,215	-
Shared appreciation rights receivable	9	-	120,833,139
Deferred tax asset	12	24,217	-
Total assets		<u>113,605,365</u>	<u>132,797,056</u>
Equity and liabilities			
Bank overdraft	8	210	251
Loans and borrowings	10	-	10,409,807
Financial liabilities designated at fair value through profit or loss	10	95,086,651	-
Shared appreciation rights payable	10	-	100,694,283
Derivative liability	11,15	16,299,260	19,409,267
Current tax liability	7	7,906	32,309
Trade and other payables	13	716,797	674,356
Total liabilities		<u>112,110,824</u>	<u>131,220,273</u>
Share capital	14	50,001	50,001
Retained earnings		1,444,540	1,526,782
Total equity		<u>1,494,541</u>	<u>1,576,783</u>
Total equity and liabilities		<u>113,605,365</u>	<u>132,797,056</u>

The financial statements on pages 6 to 21 were approved by the Board of Directors on 14 June 2019 and were signed on behalf of the Board by:



Johan Robin Charles Von Schmidt Auf Altenstadt
Director

The accompanying notes on pages 10 to 21 are an integral part of the financial statements

Statement of changes in equity

For the year ended 31 December 2018

	Note	Share capital £	Retained earnings £	Total equity £
Balance at 1 January 2018		50,001	1,526,782	1,576,783
Profit for the financial year / total comprehensive income for the year		-	46,320	46,320
Adoption of IFRS 9	17	-	(128,562)	(128,562)
Balance at 31 December 2018		<u>50,001</u>	<u>1,444,540</u>	<u>1,494,541</u>
		Share capital £	Retained earnings £	Total equity £
Balance at 1 January 2017		50,001	1,445,893	1,495,894
Profit for the financial year / total comprehensive income for the year		-	80,889	80,889
Balance at 31 December 2017		<u>50,001</u>	<u>1,526,782</u>	<u>1,576,783</u>

The accompanying notes on pages 10 to 21 are an integral part of the financial statements.

Cash flow statement
For the year ended 31 December 2018

	Note	2018 £	2017 £
Operating Activities			
BOS administration fees paid		(21,011)	(22,266)
External audit fees paid		(1,200)	(1,200)
Administration expenses paid		(17,339)	(24,995)
Tax Paid		(32,309)	(13,685)
Net cash flows used in operating activities		(71,859)	(62,146)
Investing Activities			
Repayments on mortgage portfolio		707,735	848,369
Shared appreciation rights received		5,424,818	5,113,310
Bank interest received		3,821	1,044
Net cash flows generated from investing activities		6,136,374	5,962,723
Financing Activities			
Swap interest received		196,101	206,724
Repayment on borrowings		(790,944)	(938,721)
Shared appreciation rights paid to Note holders		(4,446,316)	(4,806,553)
Shared appreciation rights paid to swap provider		(891,415)	(1,004,685)
Net cash flows used in financing activities		(5,932,574)	(6,543,234)
Net increase /(decrease) in cash and cash equivalents		131,941	(642,659)
Cash and cash equivalents at start of year		1,343,782	1,986,441
Cash and cash equivalents at end of year	8	1,475,723	1,343,782

The cash flow statement is presented using the direct method.

The accompanying notes on pages 10 to 21 are an integral part of the financial statements.

Notes to the financial statements

For the year ended 31 December 2018

1. Significant Accounting policies

BOS (Shared Appreciation Mortgages) No.2 plc is a public limited liability company domiciled in England and incorporated in England and Wales.

(a) Basis of preparation

The financial statements for the year ended 31 December 2018 have been prepared in accordance with EU adopted International Financial Reporting Standards (IFRSs) and interpretations issued by the IFRS Interpretations Committee (IFRS IC). The standards applied by the Company are those endorsed by the European Union and effective at the date the financial statements are approved by the Board. All accounting policies have been consistently applied in the financial statements.

The financial statements have been prepared in accordance with the Companies Act 2006 as applicable to companies using IFRSs.

In the year the company has adopted IFRS 9 which requires financial instruments to be classified based on the business model (assessment of whether the intention is to hold to maturity) and nature of the instrument ('do the cashflows of the instrument comprise solely of payments of principal and interest?' ('SPPI')). Both LBG's and the Shared Appreciation Mortgages ('SAMs') structures' business plan is to hold these financial instruments to maturity however due to the nature of Shared Appreciation Mortgages the related cashflows consist of principal, interest, and the proportionate shared of the property's appreciation and as a result the SPPI test is failed.

As a result of this the mortgage portfolio and shared appreciation rights receivable (previous recognised separately under IAS39) are now categorised as Financial assets held at fair value through profit or loss ("Financial assets FVTPL"). Likewise the loans and borrowings and shared appreciation rights payable (previously recognised separately under IAS 39) are now recognised together as Financial liabilities designated at fair value through profit or loss ("Financial liabilities FVTPL").

In accordance with the transition requirements of IFRS 9, comparative information for 2017 has not been restated and transitional adjustments have been accounted for through retained earnings as detailed in note 17.

The Company is reliant on funding provided by BOS which is a subsidiary of LBG. LBG has provided letters of support dated 19 February 2019 stating that in its capacity as the indirect parent of BOS, it will continue to provide access to adequate liquidity and capital resources for the foreseeable future and, accordingly, the directors of the Company are satisfied that the financial statements have been prepared on a going concern basis.

The financial statements are presented in Sterling which is the Company's functional and presentation currency and have been prepared on the historical cost basis (except for Financial assets FVTPL, Financial liabilities FVTPL which are stated at fair value).

(b) Interest income and interest payable

Interest income from and interest payable on Financial assets FVTPL and Financial liabilities FVTPL have been calculated using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the expected life of the financial instrument. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the future cash flows are estimated after considering all the contractual terms of the instrument.

(c) Taxation

Tax expense comprises current and deferred tax. Current and deferred tax are charged or credited in the statement of comprehensive income except to the extent that the tax arises from a transaction or event which is recognised, in the same or a different period, outside the statement of comprehensive income (either in other comprehensive income, directly in equity, or through a business combination), in which case the tax appears in the same statement as the transaction that gave rise to it.

Current tax is the amount of corporate income taxes expected to be payable or recoverable based on the profit for the period as adjusted for items that are not taxable or not deductible, and is calculated using tax rates and laws that were enacted or substantively enacted at the balance sheet date.

Current tax includes amounts provided in respect of uncertain tax positions when management expects that, upon examination of the uncertainty by Her Majesty's Revenue and Customs ("HMRC") or another tax authority, it is more likely than not that an economic outflow will occur. Provisions reflect management's best estimate of the ultimate liability based on their interpretation of tax law, precedent and guidance, informed by external tax advice as necessary. Changes in facts and circumstances underlying these provisions are reassessed at each balance sheet date, and the provisions are re-measured as required to reflect current information.

Deferred tax is recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the balance sheet. Deferred tax is calculated using tax rates and laws that have been enacted or substantively enacted at the balance sheet date, and which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax liabilities are generally recognised for all taxable temporary differences but not recognised for taxable temporary differences arising on investments in subsidiaries, associates and joint arrangements where the reversal of the temporary difference can be controlled and it is probable that the difference will not reverse in the foreseeable future. Deferred tax liabilities are not recognised on temporary differences that arise from goodwill which is not deductible for tax purposes.

Deferred tax assets are recognised to the extent it is probable that taxable profits will be available against which the deductible temporary differences can be utilised, and are reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are not recognised in respect of temporary differences that arise on initial recognition of assets and liabilities acquired other than in a business combination. Deferred tax is not discounted.

(d) Financial instruments

The Company's financial instruments comprise Financial assets held at fair value through profit or loss (a mortgage portfolio including an embedded derivative), cash and liquid resources, a derivative contract ("swap"), Financial liabilities designated at fair value through profit or loss (loans and borrowings including an embedded derivative) and various other receivables and payables that arise directly from its operations.

The main purpose of these financial instruments is to raise finance for the Company's operations. These financial instruments are classified in accordance with the principles of IFRS 9 as described above.

(d)(i) Cash and cash equivalents

The Company holds bank accounts with BOS, its parent undertaking. These accounts are held in the Company's name and meet the definition of cash and cash equivalents. The use of certain accounts is restricted by a detailed priority of payments set out in the Programme Documentation. As the cash can only be used to meet certain specific liabilities and is not available to be used with discretion, it is viewed as restricted cash.

These bank accounts are classified as "loans and receivables" in accordance with IFRS 9 and income is being recognised using the effective interest method.

The comparative figures are accounted for under IAS39, this accounting treatment is the same under IFRS 9 as above.

Notes to the financial statements (continued)

For the year ended 31 December 2018

1. Significant Accounting policies (continued)

(d) Financial instruments (continued)

(d)(ii) Embedded derivatives

Certain derivatives are embedded within other non-derivative host financial instruments to create a hybrid instrument. The economic characteristics and risks of the embedded derivatives are closely related to the economic characteristics and risks of the host instrument. The hybrid instrument is measured at fair value, and the embedded derivative is no longer separated from the host instrument with changes in fair value of the embedded derivative recognised in the income statement in accordance with IFRS 9.

The capital appreciation arising on the sale of a mortgage holder's property is shared between the mortgage holder and the Company as set out in the original loan agreement. The Company pays its entire share of the appreciation to the Note holders and the swap provider.

The economic characteristics and risks of the shared appreciation rights receivable and payable are viewed as being closely related to those arising on the mortgages and Notes, respectively. There is uncertainty regarding the timing of any future shared appreciation, and therefore the shared appreciation rights receivable and payable have been valued with the mortgages and Notes using HPI forecasts and actual past sales.

(d)(iii) Derivatives

IFRS 9 requires all derivative financial instruments to be recognised initially at fair value on the balance sheet and to be re-measured to fair value at subsequent reporting dates. 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 re-measurement to fair value is recognised immediately in the income statement.

The Company uses a derivative financial instrument to provide an interest flow for the Company. In accordance with its treasury policy, the Company does not hold or issue derivative financial instruments for trading purposes.

The gain or loss on re-measurement of the interest rate swap to fair value has been recognised immediately in net fair value gains and losses on derivatives in the income statement.

The fair value of the swap is the estimated amount that the Company would receive or pay to terminate the swap at the balance sheet date, taking into account HPI forecasts, past actual sales and the expected future net cash flows based on average mortgage balances and a yield curve discounted back to present value.

(e) Critical accounting judgements and estimates

The preparation of the financial statements necessarily requires the exercise of judgement both in the application of accounting policies and in the selection of assumptions used in the calculation of estimates. These judgements are reviewed on an ongoing basis and are continually evaluated based on historical experience and other factors. The most significantly affected components of the financial statements and associated critical judgements are as follows:

Deferred Tax

Estimation of income taxes includes the assessment of recoverability of deferred tax assets. Deferred tax assets are only recognised to the extent they are considered more likely than not to be recoverable based on existing tax laws and forecasts of future taxable profits against which the underlying tax deductions can be utilised.

Fair value

Fair value is defined as the value at which assets, liabilities or positions could be closed out or sold in a transaction with a willing and knowledgeable counterparty.

The fair value of the embedded derivative and the host contract has been calculated by discounting expected cash flows at an appropriate market rate, together with a dilapidations rate based on previous experience of redemptions, and are reported within Financial assets FVTPL and Financial liabilities FVTPL.

The swap derivative is calculated using HPI forecasts and past actual sales and by discounting the future cash flows at an appropriate market rate.

There are no other derivative financial instruments.

(f) Fees and commissions

Fees and commissions receivable for the continuing servicing of loans and receivables are recognised on the basis of services provided. Other fees are recognised when receivable.

(g) Dividends

Dividends on ordinary shares are recognised in equity in the year in which they are paid.

(h) Trade and other payables

Trade and other payables are stated at cost.

(i) Capital Management

The Company is not subject to externally imposed capital requirements in the current and prior year. The Company manages its ordinary share capital in order that there is sufficient capital, in the opinion of the directors, to support the transactions and level of business undertaken by the Company.

Notes to the financial statements (continued)

For the year ended 31 December 2018

1. Significant Accounting policies (continued)

(i) Financial Instruments under IAS 39

The comparative figures have been prepared under IAS 39 as follows:

(i)(i) Mortgage portfolio

The Company's mortgage portfolio comprises mortgage loans with no fixed maturity date. The individual mortgage loans terminate on the earlier of the date of sale of the property or the death of the mortgage account holder.

Under IAS 39, the mortgage portfolio is classified as "loans and receivables". The initial measurement is at fair value (excluding amounts for the shared appreciation referred to below). Subsequent measurement is at amortised cost with revenue being recognised using the effective interest method. The discount arising on initial recognition is being amortised over the expected life of the mortgages.

At each reporting period end, the Company assesses whether there is any objective evidence that mortgage loans within the portfolio are impaired. The directors do not consider that a provision for impaired assets is currently required.

(i)(ii) Interest-bearing loans and borrowings

The Company's loans and borrowings comprise mortgage-backed fixed rate Notes that have been issued in the capital market.

Loans and borrowings are recognised initially at fair value less directly related incremental transaction costs. Subsequent to initial recognition, loans and borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

(i)(iii) Embedded derivatives

Certain derivatives are embedded within other non-derivative host financial instruments to create a hybrid instrument. Where the economic characteristics and risks of the embedded derivatives are not closely related to the economic characteristics and risks of the host instrument, and where the hybrid instrument is not measured at fair value, the embedded derivative is separated from the host instrument with changes in fair value of the embedded derivative recognised in the income statement. Depending on the classification of the host instrument, it is then measured in accordance with IAS 39.

The capital appreciation arising on the sale of a mortgage holder's property is shared between the mortgage holder and the Company as set out in the original loan agreement. The Company pays its entire share of the appreciation to the Note holders and the swap provider.

The economic characteristics and risks of the shared appreciation rights receivable and payable are not viewed as being closely related to those arising on the mortgages and Notes, respectively. The shared appreciation rights receivable and payable have therefore been valued separately from the mortgages and Notes using current HPI at the balance sheet date. There is uncertainty regarding the timing of any future shared appreciation. As a borrower could sell immediately the directors consider that spot price is the best estimate of shared appreciation and therefore current HPI is used.

The resulting fair value movements of these embedded derivatives are recorded in net fair value gains and losses on derivatives in the income statement and the embedded derivatives are shown separately on the face of the balance sheet. The host instruments are valued at amortised cost, as noted above

2. Interest receivable and similar income

	2018 £	2017 £
Interest receivable on mortgage portfolio	-	1,204,271
Bank interest receivable	3,821	1,044
	<u>3,821</u>	<u>1,205,315</u>

The mortgage loans bear a zero rate of interest. The interest receivable is the effective yield adjustment, being the discount arising on initial recognition amortising over the life of the mortgages.

Following the adoption of IFRS 9, the interest receivable on the mortgage portfolio has been re-classified as Other income on financial assets and liabilities at fair value through profit or loss, as detailed in note 3.

3. Other income on financial assets and liabilities at fair value through profit or loss

	2018 £	2017 £
Fair value loss on Financial assets FVTPL	(1,875,286)	-
Fair value gain on Financial liabilities FVTPL	1,882,197	-
	<u>6,911</u>	<u>-</u>

Due to the adoption of IFRS 9 there have been significant classification changes see note 17.

Notes to the financial statements (continued)

For the year ended 31 December 2018

4. Net fair value gains and losses on derivatives

	2018 £	2017 £
Fair value movement on shared appreciation rights receivable	(17,055,650)	(2,111,190)
Fair value movement on shared appreciation rights payable	14,213,042	1,759,324
Fair value movement on interest rate derivative	2,746,225	336,668
	<u>(96,383)</u>	<u>(15,198)</u>
Income receivable on interest rate derivative	194,936	207,254
	<u>98,553</u>	<u>192,056</u>

5. Other operating income

	2018 £	2017 £
Fees and commissions receivable	650	750
Shared appreciation receivable	5,423,879	5,113,310
Shared appreciation payable	(5,423,879)	(5,113,310)
	<u>650</u>	<u>750</u>

6. Operating expenses

	2018 £	2017 £
Intercompany fees	21,011	19,918
Administration fees	17,339	25,746
Audit fees	14,400	1,200
	<u>52,750</u>	<u>46,864</u>

The Company has no employees (2017: nil) and none of the directors received any emoluments from the Company in the current or previous year.

Audit fees relate to the statutory audit. There were no fees payable to the auditors and their associates for services other than the statutory audit (2017: £nil).

The audit fee for the current year, net of VAT, was £12,000 (2017: £1,000).

7. Taxation

	2018 £	2017 £
Current Tax		
Corporation tax charge for the year	7,906	32,309
Adjustments in respect of previous years	-	-
	<u>7,906</u>	<u>32,309</u>
Deferred Tax		
Origination and reversal of timing differences	2,959	(12,993)
Impact of deferred tax rate change	-	169
	<u>2,959</u>	<u>(12,824)</u>
Tax charge	<u>10,865</u>	<u>19,485</u>

Corporation tax is calculated at a rate of 19.00% (2017: 19.25%) of the taxable profit for the year.

	2018 £	2017 £
Reconciliation of effective tax rate		
The tax assessed for the year is equal to (2017: equal to) the standard average rate of corporation tax in the UK of 19.00% (2017: 19.25%)		
Profit before tax	57,185	100,374
Profit before tax multiplied by the standard rate of corporation tax in the UK of 19.00% (2017: 19.25%)	10,865	19,316
Effects of:		
Effect of reduction in tax rate and related impacts	-	169
Adjustments in respect of prior years	-	-
Total tax charge / (credit) for the year	<u>10,865</u>	<u>19,485</u>

The current tax liability of £7,906 (2017: £32,309) represents the net amount of income tax payable in respect of the current year.

The Finance Act 2016, reduced the corporate tax rate to 17% with effect from 1 April 2020.

Notes to the financial statements (continued)

For the year ended 31 December 2018

8. Cash and cash equivalents

	2018 £	2017 £
Bank accounts	1,475,933	1,344,033
Bank overdraft	(210)	(251)
	<hr/>	<hr/>
Cash and cash equivalents per the cash flow statement	1,475,723	1,343,782

The Company holds bank accounts with BOS. The use of the accounts is restricted by a detailed priority of payments set out in the Programme Documentation. As the cash can only be used to meet certain specific liabilities and is not available to be used with discretion, it is viewed as restricted cash. The accounts are held in the Company's name and meet the definition of cash and cash equivalents. The amounts are repayable on demand.

9. Financial assets held at fair value through profit or loss

	Note	2018 £	2017 £
At 1 January		10,619,884	10,258,311
Brought forward adjustment on transition to IFRS 9	17	2,414,077	-
Shared appreciation receivable		101,717,000	120,833,139
Mortgage redemptions in the year		(770,459)	(842,697)
Amortisation of discount		-	1,204,270
Fair value adjustment		(1,875,287)	-
		<hr/>	<hr/>
At 31 December		112,105,215	131,453,023

The mortgage loans advanced by the Company have no fixed maturity date but would terminate on the earlier of, the date of sale of the property, or the death of the mortgage account holder. All mortgage loans are considered to be non-current as maturity cannot be reasonably determined, with the exception of an amount of £nil (2017: £910,298) in respect of the discount amortisation due within 12 months.

Following the adoption of IFRS 9 the discount amortisation has been removed, as the mortgage loans advances are now re-classified as Financial assets held at fair value through profit or loss. See note 17.

As the shared appreciation rights receivable (under IFRS 9 now re-classified and reported within Financial assets held at fair value through profit or loss) are intrinsically linked to the maturity of the mortgage loans which have no fixed maturity, the balance is considered to be non-current (see note 17).

Notes to the financial statements (continued)

For the year ended 31 December 2018

10. Financial liabilities designated at fair value through profit or loss

This note provides information about the contractual terms of the Company's loans and borrowings. For more information about the Company's exposure to interest rate risk and the fair value of its financial instruments, see note 15.

	Note	2018 £	2017 £
At 1 January		10,409,807	14,358,050
Brought forward adjustment on transition to IFRS 9	17	2,569,816	-
Deferred Issue Costs		-	(144,334)
Effective yield		-	(3,729,089)
Shared appreciation payable		84,764,167	100,694,283
Repayments in the year		(774,942)	(74,820)
Fair value adjustment		(1,882,197)	-
		<hr/>	<hr/>
At 31 December		95,086,651	111,104,090
		<hr/>	<hr/>
		2018 £	2017 £
Non-current liabilities			
Notes		13,508,715	10,554,141
Deferred issue costs		-	(109,101)
Adoption of IFRS 9		(3,186,231)	-
Shared appreciation payable		84,764,167	100,694,283
		<hr/>	<hr/>
		95,086,651	111,139,323
		<hr/>	<hr/>
Current liabilities			
Deferred issue costs		-	(35,233)
		<hr/>	<hr/>
		-	(35,233)
		<hr/>	<hr/>
At 31 December		95,086,651	111,104,090
		<hr/>	<hr/>

The mortgage-backed fixed rate Notes are due to redeem in 2072. The interest rate payable on the Notes up to and including the interest period ending in the quarter to 31 August 2027 is 0.00% per annum. Thereafter, the interest rate payable on the Notes will be 0.50% per annum until 2072 when the Notes are due to redeem. At the end of the year the Notes, as rated by S&P, had a rating of A+ (2017: rating of A+).

The Notes carry rights to receive certain amounts calculated by reference to the value of shared appreciation proceeds received from redeemed mortgages. The Notes are subject to mandatory part redemption from time to time based on the level of redeemed mortgages and can be redeemed in full, in certain circumstances, at the option of the Company. The Notes are secured on the mortgage portfolio, the bank accounts and certain other assets of the Company.

The Company is contractually obliged to pay to the Note holders or the swap provider any amounts received from mortgage customers for the shared appreciation. Corresponding shared appreciation and a derivative liability have therefore been recognised in the balance sheet.

11. Shared appreciation rights payable and derivative liabilities

	2018 £	2017 £
Note holder	84,764,167	100,694,283
	<hr/>	<hr/>
Swap provider	16,299,260	19,409,267
	<hr/>	<hr/>

As the shared appreciation rights payable are intrinsically linked to the amounts received following maturity of the mortgage loans which have no fixed maturity, the balance is considered to be non-current (see note 10).

Following the adoption of IFRS 9, shared appreciation rights payable are now re-classified as Financial liabilities designated at fair value through profit or loss (see note 10).

Notes to the financial statements (continued)
For the year ended 31 December 2018

12. Deferred tax asset

	2018 £	2017 £
At 31 December 2017	-	-
Adoption of IFRS 9	27,176	-
At 1 January 2018	<u>27,176</u>	<u>-</u>
Charge for the year	(2,959)	-
At 31 December	<u>24,217</u>	<u>-</u>
The deferred tax credit in the period comprises the following temporary differences:		
Other temporary differences	(2,959)	-
	<u>(2,959)</u>	<u>-</u>
Deferred tax asset comprises:		
Other temporary differences	24,217	-
	<u>24,217</u>	<u>-</u>

The deferred tax asset was recognised for the fair value adjustments that arose on transition to IFRS 9 and is being taken directly to retained earnings. The impact of the adoption and implementation of IFRS 9 is recognised over a period of ten years resulting in the deferred tax temporary difference.

13. Trade and other payables

	2018 £	2017 £
Shared appreciation payable	571,505	492,228
Note redemptions payable	72,501	88,930
Accruals and deferred income	72,791	93,198
	<u>716,797</u>	<u>674,356</u>

All amounts are due within 12 months of the balance sheet date.

14. Share capital

	2018 £	2017 £
Authorised		
50,000 (2017: 50,000) ordinary shares of £1 each	<u>50,000</u>	<u>50,000</u>
1 (2017: 1) deferred share of £1	<u>1</u>	<u>1</u>
Allotted, called up and fully paid		
50,000 (2017: 50,000) ordinary shares of £1 each	<u>50,000</u>	<u>50,000</u>
1 (2017: 1) deferred share of £1	<u>1</u>	<u>1</u>

The Company is a directly held subsidiary undertaking of BOS.

The £1 deferred share is held by Deutsche Trustee Company Limited.

The holder of the ordinary shares is entitled to receive dividends as declared from time to time.

The deferred share carries no entitlement to any dividend or to any share in any surplus assets of the Company on a winding-up, other than the right to be repaid the amount of any paid-up share capital thereon. The right to be repaid any paid-up share capital in the deferred share shall be deferred until after all paid-up share capital has been first repaid on all other classes of issued share capital in the Company.

The deferred share carries the right to receive notice of all general meetings of the Company but does not carry the right to attend, speak or vote at a general meeting unless a resolution is to be proposed abrogating, varying or modifying any of the rights or privileges of the holder of the deferred share, or for the winding up or administration of the Company under the Insolvency Act 1986, or for the entry by the Company with any other party into a merger, reconstruction, scheme of arrangement or amalgamation of or affecting the Company, in any of which cases such holder shall have the right to attend such general meeting and shall be entitled to speak and vote. Whenever the holder of the deferred share is entitled to vote at a general meeting, such holder shall have one vote and on a poll such number of votes as is equal to 34% of the number of votes attached to all other issued shares of the Company.

Notes to the financial statements (continued)

For the year ended 31 December 2018

15. Management of risk

The principal risk arising from the Company's financial instruments is credit risk. However, considerable resource is given to maintaining effective controls to manage, measure and mitigate this risk. Further detailed analysis of this risk and other risks facing the Company in relation to its financial instruments is provided below.

The Company's exposure to risk on its financial instruments and the management of such risk is largely determined at the inception of the securitisation transaction. The Company's activities and the role of each party to the transaction are clearly defined and documented.

15(a). Credit risk

Credit risk is the risk of financial loss arising from a customer's failure to settle financial obligations as they fall due.

Credit risk arises on the individual loans within the mortgage portfolio which are in turn secured on the underlying UK residential properties. The performance of these loans is therefore influenced by the economic background and the UK housing market. Mortgage loans are no longer offered by the Company but the maximum loan-to-value of the original advances was 25% and the credit risk is considered to be low.

The ability of the Company to meet its obligations to repay the Notes will be dependent upon the principal receipts on the mortgage loans. If this income does not provide sufficient funds, the Note holders have no claim on the assets of BOS.

The terms of the Mortgage Portfolio Agreement given by BOS in respect of the mortgages require BOS to repurchase any mortgage which is found to be in breach of warranty. BOS will repurchase any mortgages that are found or held not to be valid, binding and enforceable.

Although in such an event the total value of the outstanding loan will be covered by BOS, the Note holder will not receive the benefit of any future payments of appreciation amounts or partial repayment of appreciation amounts in respect of the mortgages repurchased. In terms of the shared appreciation, in accordance with the Programme Documentation, amounts received by the Company from the borrower are required to be paid over to the Note holders and swap provider.

Credit risk also exists on the derivative contract with an external provider that the Company has entered into to manage the interest rate risk arising on its operations and sources of finance (see 16c below). The swap counterparty, UBS, is a regulated financial institution with a long term rating from Standard and Poor's (S&P) of A+ (2017: S&P long-term rating: A+).

All loans in the mortgage portfolio pay a zero rate of interest. As a result, there are no arrears of interest, properties in possession or bad debts within the Company.

The maximum exposure to credit risk arising on the Company's financial assets at the reporting date is disclosed in the table below.

	Note	Carrying amount 2018 £	Maximum Exposure 2018 £	Carrying amount 2017 £	Maximum Exposure 2017 £
Assets held at amortised cost:					
Cash and cash equivalents	8	1,475,933	1,475,933	1,344,033	1,344,033
Mortgage portfolio	9	-	-	10,619,884	14,412,155
Assets held at fair value					
Financial assets held at fair value through profit or loss	9	112,105,215	112,105,215	-	-
Shared appreciation rights receivable	9	-	-	120,833,139	120,833,139
Total Assets		113,581,148	113,581,148	132,797,056	136,589,327

15(b). Market risk

Market risk is the risk of financial losses to the Company in the event of movements in the prices of the market in which it operates. The Company's market is the UK residential housing market.

Under the terms of the Notes the Company is obligated to pay the Note holders or swap provider the return on the shared appreciation that has accrued during the life of the mortgage loan at the rate implicit in the specific mortgage loan agreement as and when repaid by the mortgage loan customer. Shared appreciation is subject to the movement in the market value of the property which is dependent upon house price inflation, as measured by the Halifax House Price Index ("HPI").

However, the Company itself is not impacted by market risk as the risk of returns on the Notes being below initial expectations lies with the Note holder and there are no guarantees within the terms of the Notes for expected increases in value.

Notes to the financial statements (continued)

For the year ended 31 December 2018

15. Management of risk (continued)

15(c). Liquidity risk

Liquidity risk is the risk that the Company is not able to meet its financial obligations as they fall due or can do so only at an unacceptably high cost.

All liabilities of the Company with the exception of the Notes are paid from receipt of funds earned on its bank deposits, the swap agreement with the external provider and the Letter of Credit issued by BOS (see "Liquidity Risk" below).

The Company entered into an interest rate derivative with an external swap provider to manage the liquidity of the Company. The purpose of the swap was to provide a more stable cash flow to the Company by paying over the portion of the capital appreciation on the mortgage loans not due to investors, in return for a fixed interest receipt.

The Company has an unconditional and irrevocable 364-day revolving Letter of Credit provided by BOS. The Letter of Credit is for a maximum aggregate principal amount of £1,165,000 to assist the Company should it not be able to meet its obligations under the Notes. The reliance on this facility is therefore dependent upon the creditworthiness of BOS, which currently has a long term rating from Standard and Poor's (S&P) of A+ (2017: S&P long-term rating: A). The Company has not drawn on the Letter of Credit since inception.

The liquidity tables reflect the undiscounted cash payments which will fall due if the structure continues until the earliest contractual maturity date as set out in the Programme Documentation. The Note repayment profile mirrors the repayment of the mortgages, and based on current modelling assumptions, it is not anticipated that any mortgages will still be outstanding beyond the step-up date of August 2027.

	Carrying amount	Contractual repayment value	Not later than one month	Later than one month but not later than three months	Later than three months but not later than one year	Later than one year and not later than five years	Later than five years
2018	£	£	£	£	£	£	£
Principal							
Financial liabilities designated at fair value through profit or loss	95,086,651	95,086,651	-	-	-	-	95,086,651
Derivative liability (swap)	16,299,260	18,160,055	(32,291)	(30,729)	(142,705)	(760,921)	19,126,700
Shared appreciation payable	-	-	-	-	-	-	-
Trade and other payables	716,797	716,797	-	716,797	-	-	-
Bank overdraft	210	210	210	-	-	-	-
	112,102,918	113,963,713	(32,081)	686,068	(142,705)	(760,921)	114,213,351
	Carrying amount	Contractual repayment value	Not later than one month	Later than one month but not later than three months	Later than three months but not later than one year	Later than one year and not later than five years	Later than five years
2017	£	£	£	£	£	£	£
Principal							
Loans and borrowings (excluding deferred issue costs)	10,554,141	14,220,041	-	-	-	-	14,220,041
Derivative liability (swap)	19,409,267	18,477,172	-	(49,752)	(152,019)	(807,633)	19,486,576
Shared appreciation payable	100,694,283	100,694,283	-	-	-	-	100,694,283
Trade and other payables	674,357	674,357	-	674,357	-	-	-
Bank overdraft	251	251	251	-	-	-	-
	131,332,299	134,066,104	251	624,605	(152,019)	(807,633)	134,400,900

Note – the shared appreciation payable in both tables is contractually due when the mortgage loan becomes due on either the date of sale of the property or on the death of the customer.

Notes to the financial statements (continued)

For the year ended 31 December 2018

15. Management of risk (continued)

15(d). Fair values

The financial instruments below are analysed by valuation method. The different levels are defined as follows:

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

Financial assets and liabilities carried at fair value

The table below analyses the financial assets and liabilities of the Company which are carried at fair value:

	2018 £ Level 3	2017 £ Level 2
Shared appreciation rights receivable	-	120,833,139
Shared appreciation rights payable	-	(100,694,283)
Financial assets held at fair value through profit or loss	112,105,215	-
Financial liabilities designated at fair value through profit or loss	(95,086,651)	-
Derivative liability	(16,299,260)	(19,409,267)
	<hr/> 719,304	<hr/> 729,589

Shared appreciation rights

The shared appreciation rights receivable and mortgage portfolio as a whole (Financial assets FVTPL), and shared appreciation rights payable (Financial liabilities FVTPL) are measured at fair value in the prior year. The fair value has been calculated by discounting expected cash flows at an appropriate market rate, together with a dilapidations rate based on previous experience of redemptions. For this reason, in accordance with IFRS 7 Financial Instruments: Disclosures ("IFRS 7"), the fair value measurement is considered to be Level 3 in the Fair Value Hierarchy.

Derivatives

The fair value of the derivative liabilities have been calculated by discounting expected cash flows at an appropriate market rate, together with a dilapidations rate based on previous experience of redemptions and interest rate yield curves which are developed from publicly quoted rates. The fair value measurement is considered to be Level 3 in the Fair Value Hierarchy.

Financial assets and liabilities carried at amortised cost

The table below analyses the fair values of the financial assets and liabilities of the Company which are carried at amortised cost.

	Note	Carrying amount 2018 £	Fair Value 2018 £	Carrying amount 2017 £	Fair Value 2017 £
Loans and receivables at amortised cost					
Mortgage portfolio	9	-	-	10,619,884	13,039,724
		<hr/>	<hr/>	<hr/>	<hr/>
Financial liabilities at amortised cost					
Loans and borrowings	10	-	-	(10,409,807)	(12,922,200)
		<hr/>	<hr/>	<hr/>	<hr/>

The fair value of the mortgage portfolio and loans and borrowings have been calculated by discounting future cash flows at an appropriate market rate and are considered to be Level 2 in the Fair Value Hierarchy in accordance with "IFRS 7 Financial Instruments: Disclosures".

Trade and other payables are recognised at cost. The fair value of these liabilities is considered to be a close approximation to cost due to the short term nature of these liabilities.

Notes to the financial statements (continued)

For the year ended 31 December 2018

16. Related parties

The Company is a subsidiary undertaking of BOS and ultimately LBG.

The Company receives bank interest from BOS on its bank deposits. BOS administers the mortgage portfolio on behalf of the Company, for which quarterly service fees are paid. No dividend was paid during the year (2017: £nil).

During the year the Company undertook the following transactions with companies in LBG:

	Parent and subsidiary undertakings 2018 £	Parent and subsidiary undertakings 2017 £
Statement of Comprehensive Income		
Interest receivable and similar income	3,821	1,044
Operating expenses	21,011	19,918
Balance Sheet		
Assets		
Cash and cash equivalents	1,475,933	1,344,033
Liabilities		
Bank overdraft	(210)	(251)

17. Implementation of IFRS 9 Financial Instruments

This note explains the impact of the adoption of IFRS 9 Financial Instruments on the Company's financial statements.

IFRS 9 replaces the provisions of IAS 39 that relate to the recognition, classification and measurement of financial assets and financial liabilities, derecognition of financial instruments, impairment of financial assets and hedge accounting.

Classification and measurement

IFRS 9 requires financial assets to be classified into one of three measurement categories, fair value through profit or loss, fair value through other comprehensive income or amortised cost.

Financial assets will be measured at amortised cost if they are held within a business model the objective of which is to hold financial assets in order to collect contractual cash flows, and their contractual cash flows represent solely payments of principal and interest. Financial assets will be measured at fair value through other comprehensive income if they are held within a business model the objective of which is achieved by both collecting contractual cash flows and selling financial assets and their contractual cash flows represent solely payments of principal and interest. Financial assets not meeting either of these two business models; and all equity instruments (unless designated at inception to fair value through other comprehensive income); and all derivatives are measured at fair value through profit or loss.

An entity may, at initial recognition, designate a financial asset as measured at fair value through profit or loss if doing so eliminates or significantly reduces an accounting mismatch.

Impairment

IFRS 9 replaces the existing 'incurred loss' impairment approach with an expected credit loss ('ECL') model resulting in earlier recognition of credit losses compared with IAS 39. The ECL model has three stages. Entities are required to recognise a 12 month expected loss allowance on initial recognition (stage 1) and a lifetime expected loss allowance when there has been a significant increase in credit risk since initial recognition (stage 2). Stage 3 requires objective evidence that an asset is credit-impaired, which is similar to the guidance on incurred losses in IAS 39.

Impact on the financial statements

IFRS 9 replaces the provisions of IAS 39 that relate to the recognition, classification and measurement of financial assets and financial liabilities, derecognition of financial instruments, impairment of financial assets and hedge accounting.

The Company adopted IFRS 9 from 1 January 2018. In accordance with the transition requirements if IFRS 9, comparative information for 2017 has not been restated and transitional adjustments have been accounted for through retained earnings as at 1 January 2018, the date of initial application; and as a result the shareholders' equity decreased by £155,738.

The Company has considered the application of IFRS 9. The Company has financial assets in the form of mortgage loans, with the capital appreciation arising on the sale of a mortgage holder's property being shared between the mortgage holder and the Company. The contractual cash flows of the mortgage loans and shared appreciation receivable do not represent solely payments of principal and interest. Therefore, under IFRS 9, the mortgage loans and shared appreciation receivable are to be presented as a single item (as they are a contractually linked financial instrument) and measured at fair value with all changes recorded through profit or loss.

The fair value of the mortgage loans will be calculated by discounting back to present value the expected future interest cash flows against market interest cash flows. The fair value of the shared appreciation receivable will be unchanged under IFRS 9, calculated using HPI forecasts and past actual sales.

Under IFRS 9, where to address an accounting mismatch, the Company can elect to measure its financial liabilities at fair value with all changes recorded through profit or loss. The Company has elected to apply this to its interest-bearing loans and borrowings. The fair value of the interest-bearing loans and borrowings, will be calculated by discounting back to present value the expected future interest cash flows against market interest cash flows.

The re-classification and measurement of financial assets and liabilities under IFRS 9 results in an increase to the carrying value of financial assets of £2,414,077 and an increase to the carrying value of financial liabilities of £2,569,816. This is mainly as a result of a reduction in market interest rates since the mortgages and notes were written. The pre tax impact on shareholders' equity is a decrease of £155,738.

Notes to the financial statements (continued)

For the year ended 31 December 2018

17. Implementation of IFRS 9 Financial Instruments (continued)

Impact on the financial statements (continued)

The following table summarises the adjustments arising on the adoption of IFRS 9 to the Company's balance sheet as at 1 January 2018. No impact arises from the requirements of IFRS 9 Impairment, with all changes detailed resultant purely from classification and measurement impacts.

	As at 31 December 2017	IFRS 9: Classification & Measurement AC to FV	IFRS 9: Classification & Measurement SAR incl. in FV of	Adjusted as at 1 January 2018
	£	£	£	
Assets				
Mortgage portfolio	10,619,884	2,414,077	(13,033,961)	0
Shared appreciation receivable	120,833,139	-	(120,833,139)	-
Financial assets held at fair value through profit or loss	-	-	133,867,100	133,867,100
Deferred Tax Asset	-	-	27,176	27,176
Total Assets	131,453,023	2,414,077	27,176	133,894,276
Equity and Liabilities				
Loans and borrowings	10,409,807	2,569,816	(12,979,623)	-
Shared appreciation rights payable	100,694,283	-	(100,694,283)	-
Financial liabilities designated at fair value through profit or loss	-	-	113,673,906	113,673,906
Total Liabilities	111,104,090	2,569,816	-	113,673,906
Retained earnings	1,526,782	(155,738)	27,176	1,398,220
Total equity	1,526,782	(155,738)	27,176	1,398,220

18. Subsequent events

Post balance sheet date there has been a change in director. Janet Turner resigned on 26th March 2019 and Johan Robin Charles Von Schmidt Auf Altenstadt was appointed on 26th March 2019.

19. Contingent liabilities

LBG provides for potential tax liabilities that may arise on the basis of the amounts expected to be paid to tax authorities. This includes open matters where Her Majesty's Revenue and Customs (HMRC) adopt a different interpretation and application of tax law which might lead to additional tax. LBG has an open matter in relation to a claim for group relief of losses incurred in its former Irish banking subsidiary, which ceased trading on 31 December 2010. In 2013 HMRC informed LBG that their interpretation of the UK rules, permitting the offset of such losses, denies the claim; if HMRC's position is found to be correct management estimate that this would result in an increase in current tax liabilities for the company of approximately £996k (including interest). LBG does not agree with HMRC's position and, having taken appropriate advice, does not consider that this is a case where additional tax will ultimately fall due.

In addition, during the ordinary course of business the Company is subject to other complaints and threatened or actual legal proceedings (including class or group action claims) brought by or on behalf customers as well as legal and regulatory reviews, challenges, investigations and enforcement actions. All such material matters are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of the Company incurring a liability. In those instances where it is concluded that it is more likely than not that a payment will be made, a provision is established to management's best estimate of the amount required at the relevant balance sheet date. In some cases it will not be possible to form a view, for example because the facts are unclear or because further time is needed properly to assess the merits of the case, and no provisions are held in relation to such matters. In these circumstances, specific disclosure in relation to a contingent liability will be made where material. However the Company does not currently expect the final outcome of any such case to have a material adverse effect on its financial position, operations or cash flows.

20. Future Accounting Pronouncements

There are no new future pronouncements applicable to the Company.

21. Parent undertaking and controlling party

The Company's immediate parent company is Bank of Scotland plc. The company regarded by the directors as the ultimate controlling party is Lloyds Banking Group plc, a limited liability company incorporated and domiciled in Scotland, which is also the parent undertaking of the largest group of undertakings for which group financial statements are drawn up and of which the Company is a member. Bank of Scotland plc is the parent undertaking of the smallest such group of undertakings. Copies of the group financial statements of both companies may be obtained from Group Secretariat, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN or downloaded via www.lloydsbankinggroup.com.

Independent auditors' report to the members of BOS (Shared Appreciation Mortgages) No. 2 plc

Report on the audit of the financial statements

Opinion

In our opinion, BOS (Shared Appreciation Mortgages) No. 2 plc's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2018 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual report and financial statements (the "Annual Report"), which comprise: the Balance sheet as at 31 December 2018; the Statement of comprehensive income, the Cash flow statement, the Statement of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to those charged with governance.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

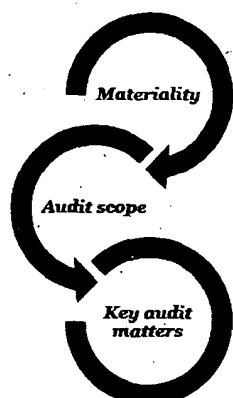
We remained independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the company.

We have provided no non-audit services to the company in the period from 1 January 2018 to 31 December 2018.

Our audit approach

Overview



- Overall materiality: £1,136,054 (2017: £1,327,971), based on 1% of total assets.
- The Company is a special purpose vehicle that forms part of a securitisation structure, established primarily as a means of raising wholesale funding for Bank of Scotland plc ("BOS") and subsequently Lloyds Banking Group plc ("LBG") the ultimate parent undertaking. LBG manages the securitisation transaction in its role as administrator, servicer of the underlying mortgage loans and cash manager.
- The capital appreciation realised on the sale of a mortgage holder's property is shared between the mortgage holder and the Company. This appreciation is passed on in full to note holders.
- The activities of the Company are conducted primarily by reference to a series of transaction documents (the "Programme Documentation"). We tailored the scope of our audit to ensure that we performed sufficient work to enable us to opine on the annual report and financial statements, ensuring audit procedures were performed in respect of every material financial statements line item.
- In establishing the overall approach to the audit, we determined the type of work that needed to be performed by us taking into account the accounting processes and controls in place at LBG as administrator and servicer, and the industry in which the Company operates.
- We obtained an understanding of the control environment in place at the administrator and adopted a controls and substantive testing approach.

Our key audit matters which involved the greatest allocation of our resources' effort comprise:

- The risk of errors in the priority of payments (the "Waterfalls") due to a lack of understanding of the transaction.
 - The risk of misstatement in the valuation of assets and liabilities held at fair value through the profit and loss.
-

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements.

Capability of the audit in detecting irregularities, including fraud

Based on our understanding of the company and industry, we identified that the principal risks of non-compliance with laws and regulations related to the underlying legal documents and agreements governing this securitisation transaction, and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the preparation of the financial statements such as the Companies Act 2006. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. Audit procedures performed by the engagement team included:

- Management inquiries;
- Review of board meeting minutes; and
- Review and testing where applicable of the transaction documents.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter	How our audit addressed the key audit matter
<p><i>Errors in the priority of payments (the "Waterfalls") due to a lack of understanding of the transaction</i></p> <p>Due to the complexity of the securitisation structure contractual terms and the special purpose nature of the entity, the Waterfalls present a pervasive risk to the overall accounting for the entity.</p> <p>If the Waterfalls are incorrectly processed, there is a risk that interest expense and principal balances payable to investors are not appropriately calculated and settled, and the cash flows returned to the seller as excess spread are incorrect.</p> <p>While the entity is well-established with management who are experienced in calculating Waterfalls, there is also an independent 3rd party paying agent who calculates the expected payments in parallel.</p> <p>Due to the complexity and pervasive nature of the Waterfalls, this was an area of focus in our audit.</p>	<p>We understood the design of the securitisation structure through discussions with management and review of primary contractual programme documentation.</p> <p>We tested the design and operating effectiveness of management's Waterfalls calculation and preparation control through:</p> <ul style="list-style-type: none">• Discussion with management and by review of Waterfalls working papers for consistency with the base prospectus; and• Inspection of supporting documentation and recalculation of relevant data points for a sample of Waterfalls in the year. <p>We performed substantive testing over this sample of Waterfalls to ensure no errors were made in Waterfalls preparation, including agreeing cash balances and transactions to cash account records, and agreeing cash collections balances agreed to system reports.</p> <p>We additionally tested key system reports to validate that pool assets were completely and accurately identified in source system to support the cash collections as presented in the Waterfalls working papers.</p>

Key audit matter	How our audit addressed the key audit matter
<p>Valuation of assets and liabilities held at fair value through the profit and loss</p> <p>The shared appreciation mortgages include terms that entitle the Company to a share of the capital appreciation of the property on which the mortgage is secured as realised on the eventual sale of the property. The value of the Company's interest on this appreciation is calculated by reference to the sale proceeds and a formula established and agreed at the origination of the mortgage, including the loan to value ratio on the original advance.</p> <p>The loan notes in issue are secured on the mortgage portfolio. The Company pays its entire share of the appreciation to the note holders and the swap counterparty as agreed within the terms on the notes.</p> <p>As this shared appreciation entitlement is dependent on economic characteristics and risks not closely related the basic lending arrangement within the mortgage agreement, the overall contract is considered a hybrid instrument. Under IFRS9 both the mortgage and corresponding shared appreciation are classified as one financial asset valued at fair value through profit and loss.</p> <p>Due to the pass through nature of the entity, a separate financial instrument is recognised in both assets (as receivable from mortgage holders, and in liabilities (as payable to note holders).</p> <p>Management's fair value estimate of both the asset and liability is based on the principal balances of the mortgage loans, shared appreciation percentage as agreed in the original loan agreement, and changes in the regional House Price Index ("HPI") between the origination date and the balance sheet date.</p> <p>These items are disclosed as a 'financial asset held at FVTPL', and a 'financial liability held at FVTPL' on the balance sheet.</p>	<p>We performed an independent recalculation of the year end shared appreciation rights for all securitised mortgages. As part of this we independently obtained regional HPI data from an external provider covering the period from origination to the balance sheet date, and agreed the shared appreciation percentages on a mortgage by mortgage basis to management's mortgage schedule.</p> <p>Additionally, we have reviewed the reasonableness of the shared appreciation rights model through an independent valuation performed by the PwC Valuations team. Further to this, we ensured that the models were compliant under IFRS9, including all applicable disclosures in the financial statements.</p> <p>Management's mortgage schedule has been separately validated through agreement to the origination documentation on a sample basis in prior years. As no new mortgages have been written, this audited schedule has been validated year on year by agreeing the outstanding principal balances to system reports in order to identify any inappropriate changes.</p>

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the company, the accounting processes and controls, and the industry in which it operates.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall materiality	£1,136,054 (2017: £1,327,971).
How we determined it	1% of total assets.
Rationale for benchmark applied	The entity is a not-for-profit whose main priority is to remit the cash received in respect of its assets so as to repay its liabilities. As such total assets is considered an appropriate benchmark. Where total assets is used, if the company is a public interest entity, a rule of thumb of up to 1% can be applied. We have deemed this to be a public interest entity and have therefore applied 1% due to the fact the entity has listed debt.

We agreed with those charged with governance that we would report to them misstatements identified during our audit above £56,803 (2017: £66,399) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

ISAs (UK) require us to report to you when:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

We have nothing to report in respect of the above matters.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union are not clear, and it is difficult to evaluate all of the potential implications on the company's trade, customers, suppliers and the wider economy.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, ISAs (UK) require us also to report certain opinions and matters as described below.

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of directors' responsibilities set out on page 4, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the Lloyds Banking Group audit committee, we were appointed by the directors on 31 March 2009 to audit the financial statements for the year ended 31 December 2009 and subsequent financial periods. The period of total uninterrupted engagement is 10 years, covering the years ended 31 December 2009 to 31 December 2018.

The audit of Lloyds Banking Group and its subsidiaries was tendered in 2014 and we were re-appointed with effect from 1 January 2016. There will be a mandatory rotation of Lloyds Banking Group for the 2021 audit.



Jessica Miller (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
17 June 2019