

Registered Number 3149607

BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC
DIRECTORS' REPORT AND FINANCIAL STATEMENTS
YEAR ENDED 31 DECEMBER 2007



**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
DIRECTORS' REPORT AND FINANCIAL STATEMENTS**

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BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
DIRECTORS AND COMPANY INFORMATION

DIRECTORS

I G Stewart
P A Curran

SECRETARY

A Lockwood

REGISTERED OFFICE

Premier House
City Road
CHESTER
CH88 3AN

AUDITORS

KPMG Audit Plc
1 The Embankment
Neville Street
LEEDS
LS1 4DW

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC DIRECTORS' REPORT

The directors present their report and the audited financial statements for the year ended 31 December 2007

BUSINESS REVIEW

PRINCIPAL ACTIVITY

The principal activity of BOS (Shared Appreciation Mortgages) NO 2 PLC (the "Company") is to finance mortgage lending. In 1997 the Company issued £105.6m floating rate notes (the "Notes"). The interest payable on the Notes is set at 60% of the three-month LIBOR rate for Sterling deposits less 0.30% per annum until August 2027. Thereafter, the interest rate applicable to the Notes will be 60% of the three-month LIBOR rate for Sterling deposits plus 0.10% per annum until 2072 when the Notes become due. The Notes are secured on the mortgage portfolio. 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 Note holders and the swap provider.

The activities of the Company are conducted primarily by reference to a series of transaction documents (the "Programme Documentation").

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

BUSINESS STRUCTURE

On 17 September 2007 the HBOS Group Reorganisation Act 2006 took effect. This brought together four of HBOS plc's main UK banking businesses (Halifax, Governor and Company of the Bank of Scotland, Capital Bank and HBOS Treasury Services) into a single legal entity, Bank of Scotland plc ("BOS"). On this date HBOS Treasury Services re-branded its business and now operates externally as Bank of Scotland Treasury. Internally, it is known as "Treasury".

BOS (Shared Appreciation Mortgages) NO 2 PLC was a subsidiary undertaking of Uberior Investments PLC, which is a wholly-owned subsidiary of BOS, until 31 July 2007. On this date the entire ordinary share capital of BOS (Shared Appreciation Mortgages) NO 2 PLC was transferred from Uberior Investments PLC to BOS. The Company is now a directly held subsidiary of BOS.

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 are principally a mortgage portfolio, cash and liquid resources, a derivative contract ("swap"), an embedded derivative, interest-bearing loans and borrowings and various other payables that arise directly from its operations. The principal purpose of these financial instruments is to raise finance for the Company's 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 risks arising from the Company's financial instruments are credit risk and interest rate risk. These 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 16.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
DIRECTORS' REPORT (CONTINUED)

RISK MANAGEMENT (CONTINUED)

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. The maximum loan-to-value of the original advances was 25% and the credit risk is considered to be low.

The extent to which the Company can meet its obligations to pay interest and ultimately repay the Notes will be dependent upon the receipt of funds earned on the Guaranteed Investment Contract (the "GIC"), the swap agreement with the external provider, principal receipts on the mortgages and the Letter of Credit issued by BOS (see "Liquidity Risk"). To the extent that this income does not provide sufficient funds to cover the interest due on the Notes or the repayment of the Notes the Company has no claim on the assets of BOS.

The terms of the Mortgage Portfolio Agreement given by BOS in respect of the mortgages requires 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 and any accrued interest 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.

Shared appreciation is subject to the movement in the market value of the property which is dependent upon house price inflation ("HPI"). This may provide a return on the Notes below initial expectations. Any expected increase in value can not be guaranteed.

Interest rate risk

Interest rate risk exists where assets and liabilities have interest rates set under a different basis or which reset at a different time. The Company minimises its exposure to interest rate risk by ensuring that the interest rate characteristics of assets and liabilities are similar.

The Company has also entered into an interest rate derivative with an external swap provider to manage the interest rate risk on its operations and sources of finance. The purpose of the interest rate swap is to reduce the interest rate risk on the Company's assets and liabilities by paying over a portion of capital appreciation on the mortgage loans in return for a fixed interest receipt. The Notes issued by the Company and the GIC account are exposed to cash flow interest rate risk as they carry a floating interest rate that is reset as market rates change.

Liquidity risk

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.

Operational risk

In accordance with the Programme Documentation the Company is bound to make payments to meet third party expenses.

The Company's operations are subject to periodic review by the Internal Audit function of HBOS plc.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
DIRECTORS' REPORT (CONTINUED)

PERFORMANCE

The Company will continue to unwind over the life of the mortgages issued as no further advances will be made. Cash is continuing to be collected.

The underlying profits are determined by a margin earned between the interest received on the GLC, income on the swap and the interest paid to the Note holders. This is fixed by the Programme Documentation. Under International Financial Reporting Standards ("IFRSs") an effective yield adjustment is made on interest receivable and interest payable and the net difference passed through the income statement for the year ended 31 December 2007 was £174,264 profit (31 December 2006 £174,267 profit).

The principal asset in the Company is a mortgage portfolio which is subject to an annual impairment review. The mortgage portfolio is subject to the economic factors relating to the housing market (see "Credit Risk" above) but no impairment provision was deemed necessary as at 31 December 2007 or 31 December 2006.

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. The Company's performance is addressed in the quarterly management accounts provided to the directors.

OTHER INFORMATION

The Company has employed no staff during the year ended 31 December 2007 or the previous year.

RESULTS AND DIVIDENDS

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

The profit after taxation for the year, prepared using IFRSs, amounted to £372,949 (2006 £262,826). A dividend of £228,000 was paid in the year (2006 £230,451).

FUTURE DEVELOPMENTS

No changes in the business of the Company are envisaged.

SUPPLIER PAYMENT POLICY

It is the Company's policy that payments to suppliers are made in accordance with those terms and conditions agreed between the Company and its suppliers.

The Company owed no amounts to trade creditors at 31 December 2007.

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
DIRECTORS' REPORT (CONTINUED)**

DIRECTORS

The directors who served during the year were as follows

I G Stewart
N Stockton (resigned 1 March 2007)
P A Curran (appointed 1 March 2007)

GOING CONCERN

The directors are satisfied that the Company has adequate resources to continue in business for the foreseeable future and consequently the going concern basis continues to be appropriate in preparing the accounts

AUDIT INFORMATION

The directors who held office at the date of approval of this Directors' Report confirm that, so far as they each are aware, there is no relevant audit information of which the Company's auditors are unaware, and each director has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information

AUDITORS AND ANNUAL GENERAL MEETING

A resolution to re-appoint KPMG Audit Plc as auditors was proposed and approved by the member at the Annual General Meeting held on 30 March 2007

By Order of the Board



A Lockwood
Secretary

Premier House
City Road
CHESTER
CH88 3AN

28 March 2008

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
STATEMENT OF DIRECTORS' RESPONSIBILITIES
IN RESPECT OF THE DIRECTORS' REPORT AND THE FINANCIAL STATEMENTS

The directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare Company financial statements for each financial year. Under that law the directors have elected to prepare the Company financial statements in accordance with IFRSs as adopted by the EU.

The Company financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position of the Company and the performance for that period, the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing the Company 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,
- state whether they have been prepared in accordance with IFRSs as adopted by the EU, 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 proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a Directors' Report and a Business Review.

**INDEPENDENT AUDITORS' REPORT
TO THE MEMBER OF BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC**

We have audited the financial statements of BOS (Shared Appreciation Mortgages) NO 2 PLC for the year ended 31 December 2007 which comprise the Income Statement, the Balance Sheet, the Cash Flow Statement and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Company's member, 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 member those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's member as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU, are set out in the Statement of Directors' Responsibilities on page 7.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, 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 other transactions 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 International Standards on Auditing (UK and Ireland) 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 Company's circumstances, consistently applied and adequately disclosed.

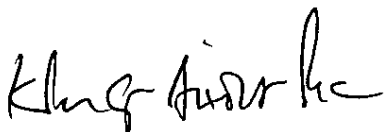
We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity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

**INDEPENDENT AUDITORS' REPORT
TO THE MEMBER OF BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
(CONTINUED)**

Opinion

In our opinion

- the financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Company's affairs as at 31 December 2007 and of its profit for the year then ended, and
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' Report is consistent with the financial statements



KPMG Audit Plc
Chartered Accountants
Registered Auditor

1 The Embankment
Neville Street
LEEDS
LS1 4DW

28 March 2008

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2007

	Notes	2007 £	2006 £
Interest receivable and similar income	2	5,124,657	4,759,870
Interest payable and similar charges	3	(4,418,320)	(4,037,434)
Net interest income		<u>706,337</u>	<u>722,436</u>
Net fair value gains and losses on derivatives held for economic hedging	4	(144,182)	(287,973)
Other operating income	5	7,397	6,150
Operating expenses	6	(63,541)	(65,147)
Profit before tax for the year		<u>506,011</u>	<u>375,466</u>
Income tax expense	7	(133,062)	(112,640)
Profit after tax for the year		<u>372,949</u>	<u>262,826</u>
Profit attributable to equity holders		<u>372,949</u>	<u>262,826</u>

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 statement of recognised income and expense has been omitted from the financial statements for the year ended 31 December 2007 as there was no income or expense recognised directly in equity in the current or preceding year.

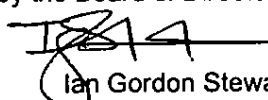
The notes on pages 13 to 30 form part of these financial statements.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
BALANCE SHEET AS AT 31 DECEMBER 2007

	Notes	2007 £	2006 £
Assets			
Mortgage portfolio	8	15,182,033	15,083,238
Shared appreciation rights receivable	9	170,357,061	148,681,334
Total non-current assets		185,539,094	163,764,572
Cash and cash equivalents	10	37,612,969	39,253,176
Total current assets		37,612,969	39,253,176
Total assets		223,152,063	203,017,748
Equity			
Called up share capital		50,001	50,001
Retained earnings		1,690,154	1,545,205
Total equity	11	1,740,155	1,595,206
Liabilities			
Interest-bearing loans and borrowings	12	51,551,824	53,129,364
Shared appreciation rights payable	13	140,695,746	122,483,552
Deferred tax liability	14	200,112	192,965
Total non-current liabilities		192,447,682	175,805,881
Interest-bearing loans and borrowings	12	170,855	131,765
Other payables	15	830,905	1,150,099
Derivative liability		27,810,200	24,200,674
Bank overdraft	10	3,499	43
Current tax liability	7	148,767	134,080
Total current liabilities		28,964,226	25,616,661
Total liabilities		221,411,908	201,422,542
Total equity and liabilities		223,152,063	203,017,748

These financial statements were approved by the Board of Directors on 28 March 2008

and were signed on its behalf by


Ian Gordon Stewart

Director

The notes on pages 13 to 30 form part of these financial statements

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2007

Indirect Method	Notes	2007 £	2006 £
Cash flows from operating activities			
Profit before tax for the year		506,011	375,466
<i>Adjustments for</i>			
Interest income	2	(5,124,657)	(4,759,870)
Interest expense	3	4,371,056	3,990,170
Amortisation of issue costs	3	47,264	47,264
Net fair value gains and losses on derivatives held for economic hedging	4	144,182	287,973
Shared appreciation income	5	(6,285,727)	(8,245,659)
Shared appreciation expense	5	6,285,727	8,245,659
		<hr/>	<hr/>
Operating loss before changes in working capital and provisions		(56,144)	(58,997)
Increase in other payables		420,725	60,686
		<hr/>	<hr/>
Cash generated from operations		364,581	1,689
Income taxes refunded / (paid)		22,851	(141,450)
		<hr/>	<hr/>
Net cash from operating activities		387,432	(139,761)
		<hr/>	<hr/>
Cash flows from investing activities			
Bank interest received		2,529,853	2,138,618
Premium interest received		401,996	428,439
Repayment of mortgages	8	1,335,637	2,183,406
Shared appreciation received		6,285,727	8,245,659
		<hr/>	<hr/>
Net cash flows from investing activities		10,553,213	12,996,122
		<hr/>	<hr/>
Cash flows from financing activities			
Interest paid on borrowings		(2,313,422)	(1,959,555)
Repayment of borrowings		(3,643,348)	(5,656,187)
Dividends paid	11	(228,000)	(230,451)
Shared appreciation paid		(7,157,914)	(8,354,765)
		<hr/>	<hr/>
Net cash flows from financing activities		(13,342,684)	(16,200,958)
		<hr/>	<hr/>
Net decrease in cash and cash equivalents		(2,402,039)	(3,344,597)
Cash and cash equivalents at 1 January		46,836,892	50,181,489
		<hr/>	<hr/>
Cash and cash equivalents at 31 December	10	44,434,853	46,836,892

As explained in the accounting policies in note 1, cash is distributed in accordance with the Programme Documentation

The notes on pages 13 to 30 form part of these financial statements

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2007

1. SIGNIFICANT ACCOUNTING POLICIES

BOS (Shared Appreciation Mortgages) NO 2 PLC is a company domiciled in the United Kingdom

(a) Statement of compliance

The financial statements for the year ended 31 December 2007 have been prepared in accordance with International Financial Reporting Standards (IFRSs) and its interpretations as endorsed by the EU and effective at 31 December 2007

The accounting policies set out below have been applied in respect of the financial year ended 31 December 2007. IFRS 7 "Financial Instruments Disclosures" became effective for all accounting periods ending on or after 1 January 2007. The principles in this standard complement the principles for recognising, measuring and presenting financial assets and liabilities in IAS 32 "Financial Instruments Presentation" and IAS 39 "Financial Instruments Recognition and Measurement".

Adoption of the Capital disclosure amendment to IAS 1 "Presentation of financial statements" became mandatory for all accounting periods ending on or after 1 January 2007. The adoption of this amendment has had no quantitative impact on the financial data presented in either the current or the comparative year. Additional disclosure is presented in the total equity note.

The accounts also comply with the relevant provisions of Part VII of the Companies Act 1985, as amended by the Companies Act 1985 (International Accounting Standards and Other Accounting Amendments) Regulations 2004.

(b) Basis of preparation

The financial statements are presented in sterling and have been prepared on the historical cost basis (except that derivative financial instruments are stated at their fair value), and on a going concern basis.

The preparation of the financial statements necessarily requires the exercise of judgement both in the application of accounting policies which are set out in the sections below and in the selection of assumptions used in the calculation of estimates. These estimates and judgements are reviewed on an ongoing basis and are continually evaluated based on historical experience and other factors. However, actual results may differ from these estimates. The most significantly affected components of the financial statements and associated critical judgements are as follows:

For the purpose of the effective yield calculation on the Notes, an average expected life has been calculated based on prepayment expectations for the mortgages. This is revised on a regular basis in light of actual redemption experience.

The value of the embedded derivative has been calculated by discounting future cash flows at an appropriate market rate. The valuation method is consistent with commonly used market techniques. All inputs into the valuation models are obtained from observable market data. No assumption for future HPI has been included as this is not considered to be practical.

(c) Financial instruments

The Company's financial instruments are principally a mortgage portfolio, cash and liquid resources, a derivative contract, an embedded derivative, interest-bearing borrowings and various other payables that arise directly from its operations.

BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2007 (CONTINUED)

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(c) Financial instruments (continued)

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 IAS 39 as described below.

(c)(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 within "loans and receivables". The initial measurement is at fair value (excluding amounts for the shared appreciation referred to in (c)(iv) 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.

(c)(ii) Cash and cash equivalents

The Company holds bank accounts with both an external provider and BOS. 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. The cash can only be used to meet certain specific liabilities and is not available to be used with discretion.

These bank accounts are classified within "loans and receivables" in accordance with IAS 39. The initial measurement is at fair value. Subsequent measurement is at amortised cost with revenue being recognised using the effective interest method. The discount on the GIC arising on initial recognition is being amortised over the expected life of the mortgages and Notes.

The Cash Flow Statement has been presented using the indirect method of preparation.

(c)(iii) Interest-bearing borrowings

The Company's interest-bearing borrowings comprise mortgage-backed floating rate notes that have been issued in the capital market.

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing 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.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2007 (CONTINUED)

1 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(c) Financial instruments (continued)

(c)(iv) 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, the host 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 discounted cash flow techniques and taking account of current HPI. There is uncertainty regarding the timing of any future shared appreciation receipts and the directors do not consider that it is practical to include an estimate of future HPI in these valuations. The resulting fair value movements of these embedded derivatives are recorded in net fair value gains and losses on derivatives held for economic hedging 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 in (c)(i) and (c)(iii).

(c)(v) Derivatives

IAS 39 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. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged.

The Company uses a derivative financial instrument to hedge its exposure to interest rate risk arising from operational, financing and investment activities. In accordance with its treasury policy, the Company does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

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 held for economic hedging in the income statement.

Amounts receivable on the interest rate swap are accounted for on an accruals basis within interest receivable in the income statement. The shared appreciation payable is recorded in other operating income.

The fair value of interest rate swaps is the estimated amount that the Company would receive or pay to terminate the swap at the balance sheet date, taking into account current interest rates and the current creditworthiness of the swap counterparties.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2007 (CONTINUED)

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(d) Fees and commissions

Fees and commissions receivable for the continuing service of loans and advances are recognised on the basis of work done. Other fees are recognised when receivable.

(e) Income tax

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Temporary differences arising from the initial recognition of assets and liabilities that affects neither accounting nor taxable profit are not provided for. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates at the balance sheet date.

(f) VAT

Value Added Tax is not recoverable by the Company and is included with its related costs.

(g) Dividends

Dividends on the equity shares of the Company are recognised as a liability in the period in which they are paid.

(h) Related parties

In accordance with the provisions of IAS 24 "Related Party Disclosures", the Company has disclosed details of transactions with its related parties, including those with fellow HBOS plc Group companies.

(i) Other payables

Other payables are stated at cost or at amortised cost if deemed to be a financial liability.

(j) IFRSs not yet applied

The following standards and interpretations have been adopted by the European Union but are not effective for the year ended 31 December 2007 and have not been applied in preparing the financial statements:

IFRS 8 'Operating Segments' which is applicable for periods commencing on or after 1 January 2009. The application of this standard in 2007 would not have had any financial impact as it is only concerned with disclosure.

The following standards and interpretations have not yet been adopted by the European Union, are not effective for the year ended 31 December 2007 and have not been applied in preparing the financial statements:

IAS 1 "Presentation of Financial Statements" which is effective for periods commencing on or after 1 January 2009. The application of this revised standard in 2007 would not have had a material impact on the financial statements.

BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2007 (CONTINUED)

2 INTEREST RECEIVABLE AND SIMILAR INCOME

	2007 £	2006 £
Mortgage interest from customers	1,434,432	1,434,437
Bank interest from BOS	72,309	55,694
Bank interest	3,617,916	3,269,739
	<hr/>	<hr/>
	5,124,657	4,759,870
	<hr/>	<hr/>

Interest receivable and similar income is calculated using the effective interest method

As the mortgage portfolio is not regarded as impaired the interest received on impaired assets is
£ nil (2006 £ nil)

3 INTEREST PAYABLE AND SIMILAR CHARGES

	2007 £	2006 £
Interest payable on Notes	4,371,056	3,990,170
Amortisation of issue costs	47,264	47,264
	<hr/>	<hr/>
	4,418,320	4,037,434
	<hr/>	<hr/>

Interest payable is calculated using the effective interest method

4. NET FAIR VALUE GAINS AND LOSSES ON DERIVATIVES HELD FOR ECONOMIC HEDGING

	2007 £	2006 £
Fair value movement on shared appreciation rights receivable	21,675,727	7,337,142
Fair value movement on shared appreciation rights payable	(18,212,194)	(6,140,849)
Fair value movement on interest rate derivative	(3,607,715)	(1,484,266)
	<hr/>	<hr/>
	(144,182)	(287,973)
	<hr/>	<hr/>

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2007 (CONTINUED)

5 OTHER OPERATING INCOME

	2007 £	2006 £
Fees and commissions receivable	5,330	5,950
Shared appreciation receivable	6,285,727	8,245,659
Shared appreciation payable	(6,285,727)	(8,245,659)
Other income	2,067	200
	<u>7,397</u>	<u>6,150</u>

6. OPERATING EXPENSES

	2007 £	2006 £
Bank administration fees	50,851	53,798
Rating agency fees	9,000	9,000
Audit fees	3,690	2,350
Other fees	-	(1)
	<u>63,541</u>	<u>65,147</u>

In the year ended 31 December 2007 and the comparative period the Company had no employees and none of the directors received any emoluments from the Company

Audit fees relate to the statutory audit. Included within the current year audit charge is an under-accrual of £670 relating to the prior year. Fees payable to the auditor and its associates for services other than the statutory audit are not disclosed since the consolidated accounts of HBOS plc, the ultimate controlling party, are required to disclose non-audit fees on a consolidated basis.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2007 (CONTINUED)

7 INCOME TAX EXPENSE

	2007 £	2006 £
Current Tax		
Corporation tax charge for the year at a rate of 30% (2006 30%)	156,958	134,080
Corporation tax credit in respect of earlier periods	(31,043)	-
	<u>125,915</u>	<u>134,080</u>
Deferred Tax		
Deferred tax credit for the year at a rate of 30% (2006 30%)	-	(21,440)
Deferred tax charge in respect of earlier periods	21,440	-
Deferred tax change in tax rate	(14,293)	-
	<u>7,147</u>	<u>21,440</u>
Total income tax expense in income statement	<u>133,062</u>	<u>112,640</u>
 Reconciliation of effective tax rate	 2007 £	 2006 £
The tax for the year is lower than the standard rate of corporation tax in the UK of 30% (2006 30%)		
Profit before tax	506,011	375,466
	<u>506,011</u>	<u>375,466</u>
Profit before tax multiplied by the standard rate of corporation tax in the UK	151,803	112,640
Effects of		
Corporation tax prior year	(31,043)	-
Items not taxable under securitisation tax rules	5,155	21,440
Change in current tax rate	(14,293)	-
Deferred tax prior year	21,440	-
Deferred tax provided	-	(21,440)
	<u>133,062</u>	<u>112,640</u>

The current tax liability of £148,767 (2006 £134,080 liability) represents the net amount of income tax payable in respect of the current year after accounting for a repayment due of £8,191 in respect of the prior year

BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2007 (CONTINUED)

8. MORTGAGE PORTFOLIO

	2007 £	2006 £
At 1 January	15,083,238	15,832,207
Mortgage redemptions in the year	(1,335,637)	(2,183,406)
Amortisation of discount	1,434,432	1,434,437
	<hr/>	<hr/>
At 31 December	15,182,033	15,083,238
	<hr/>	<hr/>

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

9. SHARED APPRECIATION RIGHTS RECEIVABLE

The right for the Company to receive a share of the capital appreciation arising on the individual mortgages, as set out in the original loan agreements, is classified as an embedded derivative, in accordance with the principles of IAS 39. The embedded derivative has been valued separately from the host contract using discounted cash flow techniques. No estimate has been made of the effect of future HPI as the directors consider that this is impractical.

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. A corresponding embedded derivative liability has therefore been recognised in the balance sheet (note 13).

10. CASH AND CASH EQUIVALENTS

	2007 £	2006 £
GIC account	42,688,852	44,377,192
Accrued interest on GIC account	223,656	181,384
Unamortised discount on GIC account	(6,825,383)	(7,583,759)
Other bank accounts	1,525,844	2,278,359
	<hr/>	<hr/>
Bank overdraft	37,612,969 (3,499)	39,253,176 (43)
	<hr/>	<hr/>
Total cash and cash equivalents	37,609,470	39,253,133
Unamortised discount on GIC account	6,825,383	7,583,759
	<hr/>	<hr/>
Cash and cash equivalents in the cash flow statement	44,434,853	46,836,892
	<hr/>	<hr/>

The Company holds the GIC bank account with an external provider. The Company is contractually entitled to a LIBOR related return on this account and the income is accounted for on an effective yield basis. The use of the account is restricted by a detailed priority of payments set out in the Programme Documentation. The cash can only be used to meet certain specific liabilities and is not available to be used with discretion. All of the accounts, both internal and external, are held in the Company's name and meet the definition of cash and cash equivalents.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2007 (CONTINUED)

11. TOTAL EQUITY

Reconciliation of movement in capital and reserves

	Share Capital £	Retained Earnings £	Total Equity £
Balance at 1 January 2007	50,001	1,545,205	1,595,206
Total recognised income and expense	-	372,949	372,949
Dividends to shareholders	-	(228,000)	(228,000)

Balance at 31 December 2007	50,001	1,690,154	1,740,155
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	Share Capital £	Retained Earnings £	Total Equity £
Balance at 1 January 2006	50,001	1,512,830	1,562,831
Total recognised income and expense	-	262,826	262,826
Dividends to shareholders	-	(230,451)	(230,451)

Balance at 31 December 2006	50,001	1,545,205	1,595,206
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Share capital

	2007 £	2006 £
Authorised		
50,000 ordinary shares of £1 each	50,000	50,000
1 deferred share of £1	1	1
Allotted, called up and fully paid		
50,000 ordinary shares of £1 each	50,000	50,000
1 deferred share of £1	1	1

BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2007 (CONTINUED)

11. TOTAL EQUITY (CONTINUED)

The entire ordinary share capital of the Company was transferred from Uberior Investments PLC to BOS on 31 July 2007. The Company is now a directly held subsidiary of BOS. The £1 deferred share continues to be held by Bankers Trustee Company Limited.

The holders of ordinary shares are 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.

Capital disclosures

The Company is not subject to externally imposed capital requirements in either the current year or the prior year other than the minimum share capital required by the Companies Act with which it complies. 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.

12 INTEREST-BEARING LOANS AND BORROWINGS

This note provides information about the contractual terms of the Company's interest-bearing 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 16.

	2007 £	2006 £
Non-current liabilities		
Notes	51,929,936	53,554,740
Deferred issue costs	(378,122)	(425,376)
	<hr/> 51,551,814	<hr/> 53,129,364
Current liabilities		
Accrued interest payable to Note holders	218,119	179,029
Deferred issue costs	(47,254)	(47,264)
	<hr/> 170,865	<hr/> 131,765

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2007 (CONTINUED)

12 INTEREST-BEARING LOANS AND BORROWINGS (CONTINUED)

The mortgage-backed floating rate Notes are due in 2072. The interest rate applicable on the Notes up to and including the interest period ending in the quarter to 31 August 2027 is 60% of the three-month LIBOR rate for Sterling deposits less 0.30% per annum. Thereafter, the interest rate applicable to the Notes will be 60% of the three-month LIBOR rate for Sterling deposits plus 0.10% per annum until 2072 when the Notes become due.

The Notes carry, in addition to interest, 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 GIC and certain other assets of the Company.

13. SHARED APPRECIATION RIGHTS PAYABLE

The Company is contractually obliged to pay to the Note holders and swap provider any amounts received from mortgage customers for the shared appreciation arising on the sale of the property. An embedded derivative liability has therefore been recognised in the balance sheet for the same value as the embedded derivative asset (note 9).

14. DEFERRED TAX LIABILITY

	2007 £	2006 £
At 1 January	192,965	214,405
Charge / (Credit) for year	21,440	(21,440)
Change in Tax Rate - Income	(14,293)	-
	<hr/>	<hr/>
At 31 December	200,112	192,965
	<hr/>	<hr/>

15. OTHER PAYABLES

	2007 £	2006 £
Shared appreciation payable	-	872,187
Note redemptions payable	-	221,813
Accruals and deferred income	696,825	56,099
Amounts owed to BOS	134,080	-
	<hr/>	<hr/>
	830,905	1,150,099
	<hr/>	<hr/>

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2007 (CONTINUED)

16 FINANCIAL INSTRUMENTS

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 are principally a mortgage portfolio, cash and liquid resources, a derivative contract, an embedded derivative, interest-bearing borrowings and various other payables that arise directly from its operations

The principal risks arising from the Company's financial instruments are credit risk and interest rate risk. Further detailed analysis of the 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 transaction. The Company's activities and the role of each party to the transaction is clearly defined and documented

16(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 extent to which the Company can meet its obligations to pay interest and ultimately repay the Notes will be dependent upon the receipt of funds earned on the GIC account, the swap agreement with the external provider, principal receipts on the mortgages and the Letter of Credit issued by BOS (see "Liquidity Risk"). To the extent that this income does not provide sufficient funds to cover the interest due on the Notes or the repayment of the Notes the Company has no claim on the assets of BOS

The terms of the Mortgage Portfolio Agreement given by BOS in respect of the mortgages requires 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 and any accrued interest 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

BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2007 (CONTINUED)

16 FINANCIAL INSTRUMENTS (CONTINUED)

16(a) Credit risk (continued)

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 and therefore no impairment provision is considered to be necessary at 31 December 2007 (2006: £nil).

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 2007 £	Maximum exposure 2007 £	Carrying amount 2006 £	Maximum exposure 2006 £
Assets held at amortised cost:					
Mortgage portfolio	8	15,182,033	15,182,033	15,083,238	15,083,238
Cash and cash equivalents	10	37,612,969	37,612,969	39,253,176	39,253,176
Assets held at fair value:					
Shared appreciation rights receivable	9	170,357,061	170,357,061	148,681,334	148,681,334
Total Assets		223,152,063	223,152,063	203,017,748	203,017,748

16(b) Market risk

Market risk is defined as the potential loss in value or earnings of an organisation arising from changes in external market factors.

The Company is exposed to market risk which comprises interest rate risk and is explained in more detail below.

Interest rate risk exists where assets and liabilities have interest rates set under a different basis or which reset at a different time. The Company minimises its exposure to interest rate risk by ensuring that the interest rate characteristics of assets and liabilities are similar, where this is not possible the Company uses a derivative financial instrument to mitigate interest rate risk. The Notes issued by the Company and the GIC account are exposed to cash flow interest rate risk as they carry a floating interest rate that is reset as market rates change.

The Company has entered into an interest rate derivative with an external swap provider to manage the interest rate risk on its operations and sources of finance. The purpose of the interest rate swap is to reduce the interest rate risk on the Company's assets and liabilities by paying over a portion of capital appreciation on the mortgage loans in return for a fixed interest receipt.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2007 (CONTINUED)

16. FINANCIAL INSTRUMENTS (CONTINUED)

16(b) Market risk (continued)

At 31 December 2007, if interest rates had been 25 basis points higher or lower with all other variables held constant, the net effect on the Company's income statement would be as shown in the table below

	-25bps 2007 £	Per Income Statement 2007 £	+25bps 2007 £
Profit before tax for the year	562,530	506,011	449,492
	-----	-----	-----
	-25bps 2006 £	Actual 2006 £	+25bps 2006 £
Profit before tax for the year	434,758	375,466	316,174
	-----	-----	-----

The impact on profit is due to variable rate movements on interest payable on the Notes, movements on the derivative and interest receivable on the GIC. All other items remain unaffected by interest rate changes (except for interest earned on other bank accounts, however, a 25 basis points change would not give rise to a material impact on these financial statements)

16(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

The extent to which the Company can meet its obligations to pay interest and ultimately repay the Notes will be dependent upon the receipt of funds earned on the GIC, the swap agreement with the external provider, principal receipts on the mortgages and the Letter of Credit issued by BOS. 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. To the extent that this income does not provide sufficient funds to cover the interest due on the Notes or the repayment of the Notes the Company has no claim on the assets of BOS. 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.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2007 (CONTINUED)

16. FINANCIAL INSTRUMENTS (CONTINUED)

16(c) Liquidity Risk (continued)

2007	Carrying Value	Contractual repayment value	Not later than one month	Later than one month 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
	£	£	£	£	£	£	£
Principal							
Notes	51,929,936	70,096,847					70,096,847
Derivative (swap)	27,810,200	21,927,019	(33,403)	(63,575)	(296,312)	(1,573,149)	23,893,458
Shared appreciation payable	140,695,746	148,306,573					148,306,573
Other payables	830,905	830,905	616,870	79,955	134,080		
Interest payable/(receivable)							
Interest payable to Note holders	218,119	45,439,047		582,390	1,728,178	9,242,268	33,886,211
	<u>221,484,906</u>	<u>286,600,391</u>	<u>583,467</u>	<u>598,770</u>	<u>1,565,946</u>	<u>7,669,119</u>	<u>276,183,089</u>
2006	Carrying Value	Contractual repayment value	Not later than one month	Later than one month 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
	£	£	£	£	£	£	£
Principal							
Notes	53,554,740	73,740,195					73,740,195
Derivative (swap)	24,200,674	26,683,772	(34,991)	(66,595)	(310,401)	(1,647,946)	19,743,705
Shared appreciation payable	122,483,552	130,988,913					130,988,913
Other payables	1,150,099	1,150,099	50,917	1,099,182			
Interest payable/(receivable)							
Interest payable to Note holders	179,029	43,962,560		536,200	1,591,115	8,509,259	33,325,986
	<u>201,568,094</u>	<u>267,525,539</u>	<u>15,926</u>	<u>1,568,787</u>	<u>1,280,714</u>	<u>6,861,313</u>	<u>257,798,799</u>

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2007 (CONTINUED)

16. FINANCIAL INSTRUMENTS (CONTINUED)

16(d) Fair Values

The fair values of the Company's financial instruments, together with the carrying amounts shown in the balance sheet are as follows

	Note	Fair Value 2007 £	Carrying Amount 2007 £	Fair Value 2006 £	Carrying Amount 2006 £
Loans and Receivables					
at amortised cost					
Mortgage portfolio	8	5,631,345	15,182,033	4,621,800	15,083,238
Cash and cash equivalents	10	37,612,969	37,612,969	39,253,176	39,253,176
Financial assets held at fair value					
Shared appreciation rights receivable	9	170,357,061	170,357,061	148,681,334	148,681,334
Financial liabilities at amortised cost					
Interest-bearing loans and borrowings	12	(51,722,679)	(51,722,679)	(53,261,129)	(53,261,129)
Bank overdraft	10	(3,499)	(3,499)	(43)	(43)
Other Payables	15	(830,905)	(830,905)	(1,150,099)	(1,150,099)
Financial liabilities held at fair value					
Shared appreciation rights payable	13	(140,695,746)	(140,695,746)	(122,483,552)	(122,483,552)
Derivative liability		(27,810,200)	(27,810,200)	(24,200,674)	(24,200,674)
		<u>(7,461,654)</u>	<u>2,089,034</u>	<u>(8,539,187)</u>	<u>1,922,251</u>
Unrecognised loss			<u>9,550,688</u>		<u>10,461,438</u>

Estimation of fair values

The following comments summarise the main methods and assumptions used in estimating the fair value of financial instruments that are reflected in the table above

The fair value of the mortgage portfolio, shared appreciation rights receivable, shared appreciation rights payable and derivative liability have been calculated by discounting future cash flows at an appropriate market rate. The valuation method is consistent with commonly used market techniques. All inputs into the valuation models are obtained from observable market data.

These calculations do not necessarily represent the fair value that could be obtained for the instruments if they were to be sold.

BOS (SHARED APPRECIATION MORTGAGES) NO 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2007 (CONTINUED)

16. FINANCIAL INSTRUMENTS (CONTINUED)

16(d) Fair Values (continued)

Estimation of fair values (continued)

Cash and cash equivalents, interest-bearing loans and borrowings, other payables and the bank overdraft are recognised on an amortised cost basis that is considered to be a close approximation to fair value

The sensitivity to a 1% change in fair value of the Company's financial assets and liabilities amounts to £74,617 (2006 £85,392)

17. RELATED PARTIES

The Company is a subsidiary undertaking of BOS and HBOS plc. The Company receives bank interest from BOS, its immediate parent undertaking. BOS administers the mortgage portfolio on behalf of the Company, for which quarterly service fees are paid. In 2007, a final dividend was paid to BOS. The Company's transactions with related parties are summarised below

	HBOS plc and subsidiaries 2007 £	HBOS plc and subsidiaries 2006 £
Income Statement		
Interest receivable and similar income	72,309	55,694
Operating expenses	(50,851)	(53,798)
Balance Sheet		
Equity		
Dividends paid	228,000	230,451
Assets		
Cash and cash equivalents	1,510,313	1,190,989
Liabilities		
Other payables	(138,285)	(4,433)
Bank overdraft	(3,499)	(43)

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2007 (CONTINUED)**

18 PARENT UNDERTAKINGS

HBOS plc is the ultimate parent undertaking of BOS (Shared Appreciation Mortgages) NO 2 PLC and heads the largest group into which the accounts of the Company are consolidated. The consolidated accounts of HBOS plc may be obtained from its head office at The Mound, Edinburgh, EH1 1YZ.

Bank of Scotland plc heads the smallest group into which the accounts of the Company are consolidated. The accounts of Bank of Scotland plc may be obtained from its head office at The Mound, Edinburgh, EH1 1YZ.