

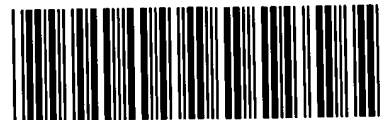
Registered Number 03149607

BOS (SHARED APPRECIATION MORTGAGES) NO.2 PLC

ANNUAL REPORT AND FINANCIAL STATEMENTS

YEAR ENDED 31 DECEMBER 2016

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

DIRECTORS

Mark Stuart Dolman
Tracey Anne Hill
Emma Louise Lawrence

COMPANY SECRETARY

David Dermot Hennessey

REGISTERED OFFICE

Trinity Road
Halifax
HX1 2RG

INDEPENDENT AUDITORS

PricewaterhouseCoopers LLP
7 More London Riverside
London
SE1 2RT

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

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 2016.

PRINCIPAL ACTIVITIES

The principal activity of the Company is to finance mortgage lending. In 1997 the Company issued £105,600,000 floating 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 0.50% 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 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

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 £8,257 (2015: £23,942). Total equity as at 31 December 2016 amounted to £1,495,894 (2015: £1,487,637).

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" 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. No impairment provision was deemed necessary as at 31 December 2016 or 31 December 2015.

Under International Financial Reporting Standards ("IFRSs") the mortgages and Notes are recognised initially at fair value with an appropriate effective yield adjustment recognised in the income statement. 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.

KEY PERFORMANCE INDICATORS

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

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

KEY PERFORMANCE INDICATORS (CONTINUED)

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 2016.

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, cash and liquid resources, a derivative contract ("swap"), an embedded derivative, loans and borrowings and various other 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 16.

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 6.7% as at 31 December 2016, the credit exposure is low.

The extent to which the Company can 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.

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.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

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

On 28 February 2011, with the closure of the Guaranteed Investment Contract account (the "GIC") and partial repayment of the Notes for which the GIC account was a guarantee for their repayment, 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 (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 (2015: S&P long-term rating: A). The Company has not drawn on the Letter of Credit since inception.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

RISK MANAGEMENT (CONTINUED)

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 by order of the Board by:



Mark Stuart Dolman
Director

Trinity Road
Halifax
HX1 2RG

DATE: 26 April 2017

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2016**

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 2016.

DIRECTORS

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

Tracey Anne Hill	
Emma Louise Lawrence	(appointed 28 April 2016)
Ian Gordon Stewart	(resigned 9 December 2016)
Mark Stuart Dolman	(appointed 9 December 2016)

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 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.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

DIRECTORS' INDEMNITIES

Lloyds Banking Group plc 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.

DIVIDENDS

The directors did not recommend the payment of a dividend during the year ended 31 December 2016 (2015: £950,000).

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 2016 Annual Report of LBG, which does not form part of this report. Details of where to get access to the 2016 Annual Report of LBG can be found in note 21.

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)**

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 2016 or the previous year.

INDEPENDENT AUDITORS

A resolution will be proposed at the 2017 Annual General Meeting to re-appoint PricewaterhouseCoopers LLP as auditors of the Company.

STATEMENT OF GOING CONCERN

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 by order of the Board by:



Mark Stuart Dolman
Director
Trinity Road
Halifax
HX1 2RG

DATE: 26 April 2017

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

Report on the financial statements

Our opinion

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

- give a true and fair view of the state of the company's affairs as at 31 December 2016 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.

What we have audited

The financial statements, included within the Annual Report and Financial Statements (the "Annual Report"), comprise:

- the Balance Sheet as at 31 December 2016;
- the Statement of Comprehensive Income for the year then ended;
- the Cash Flow Statement for the year then ended;
- the Statement of Changes in Equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is IFRSs as adopted by the European Union, and applicable law.

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

Opinions on other matters prescribed by the companies act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In addition, in light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we are required to report if we have identified any material misstatements in the Strategic Report and the Directors' Report. We have nothing to report in this respect.

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received

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, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

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

Other matters on which we are required to report by exception (continued)

Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the Statement of Directors' Responsibilities, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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.

What an audit of financial statements involves

We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report. With respect to the Strategic Report and Directors' Report, we consider whether those reports include the disclosures required by applicable legal requirements.



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

27th April 2017

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2016

	Note	2016 £	2015 £
Interest receivable and similar income	2	1,503,945	1,975,357
Interest payable and similar charges	3	(1,559,014)	(2,032,931)
Net interest expense		(55,069)	(57,574)
Net fair value gains and losses on derivatives	4	125,344	129,426
Other operating income	5	1,100	1,350
Operating expenses	6	(63,607)	(41,254)
Profit before tax		7,768	31,948
Taxation	7	489	(8,006)
Profit for the financial year / total comprehensive income attributable to the owner		8,257	23,942

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 15 to 35 are an integral part of the financial statements.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
BALANCE SHEET AS AT 31 DECEMBER 2016

	Note	2016 £	2015 £
Assets			
Cash and cash equivalents	8	1,986,532	1,619,489
Mortgage portfolio	9	10,258,311	10,214,134
Shared appreciation rights receivable	10	122,944,329	120,521,304
		<hr/>	<hr/>
Total assets		135,189,172	132,354,927
		<hr/>	<hr/>
Equity and liabilities			
Bank overdraft	8	91	1,533
Loans and borrowings	11	10,002,828	9,913,586
Shared appreciation rights payable	12	102,453,607	100,434,420
Derivative liability	12	19,746,463	19,242,087
Current tax liability	7	13,685	21,505
Deferred tax liability	13	12,823	26,997
Trade and other payables	14	1,463,781	1,227,162
		<hr/>	<hr/>
Total liabilities		133,693,278	130,867,290
		<hr/>	<hr/>
Share capital	15	50,001	50,001
Retained earnings		1,445,893	1,437,636
		<hr/>	<hr/>
Total equity		1,495,894	1,487,637
		<hr/>	<hr/>
Total equity and liabilities		135,189,172	132,354,927
		<hr/>	<hr/>

The financial statements on pages 11 to 35 were approved by the Board of Directors on
26 April 2017 and were signed on behalf of the Board by:



Mark Stuart Dolman
Director

The accompanying notes on pages 15 to 35 are an integral part of the financial statements.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
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The financial statements on pages 11 to 35 were approved by the Board of Directors on **26 April 2017** and were signed on behalf of the Board by:

Mark Stuart Dolman
Director

The accompanying notes on pages 15 to 35 are an integral part of the financial statements.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2016

	Share capital £	Retained earnings £	Total equity £
Balance at 1 January 2016	50,001	1,437,636	1,487,637
Profit for the financial year / total comprehensive income for the year	-	8,257	8,257
Dividends paid in the year	-	-	-
	<hr/>	<hr/>	<hr/>
Balance at 31 December 2016	50,001	1,445,893	1,495,894
	<hr/>	<hr/>	<hr/>

	Share capital £	Retained earnings £	Total equity £
Balance at 1 January 2015	50,001	2,363,694	2,413,694
Profit for the financial year / total comprehensive income for the year	-	23,942	23,942
Dividends paid in the year	-	(950,000)	(950,000)
	<hr/>	<hr/>	<hr/>
Balance at 31 December 2015	50,001	1,437,636	1,487,637
	<hr/>	<hr/>	<hr/>

The accompanying notes on pages 15 to 35 are an integral part of the financial statements.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2016

	Note	2016 £	2015 £
Operating Activities			
BOS administration fees paid		(24,103)	(29,157)
External audit fees paid		(1,200)	(1,200)
Administration expenses paid		(37,507)	(9,783)
Tax paid		(21,505)	(45,760)
		<hr/>	<hr/>
Net cash flows used in operating activities		(84,315)	(85,900)
		<hr/>	<hr/>
Investing Activities			
Repayments on mortgage portfolio		1,473,755	1,546,387
Shared appreciation rights received		9,054,260	10,150,301
Bank interest received		3,027	18,181
		<hr/>	<hr/>
Net cash flows generated from investing activities		10,531,042	11,714,869
		<hr/>	<hr/>
Financing Activities			
Swap interest received		225,882	247,036
Repayment of borrowings		(1,418,272)	(1,499,588)
Shared appreciation rights paid to Note holders		(7,404,877)	(8,010,281)
Shared appreciation rights paid to swap provider		(1,480,975)	(1,602,056)
Dividends paid		-	(950,000)
		<hr/>	<hr/>
Net cash flows used in financing activities		(10,078,242)	(11,814,889)
		<hr/>	<hr/>
Net increase in cash and cash equivalents		368,485	(185,920)
Cash and cash equivalents at start of year		1,617,956	1,803,876
		<hr/>	<hr/>
Cash and cash equivalents at end of year	8	1,986,441	1,617,956
		<hr/>	<hr/>

The cash flow statement is presented using the direct method.

The accompanying notes on pages 15 to 35 are an integral part of the financial statements.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016

1. SIGNIFICANT ACCOUNTING POLICIES

BOS (Shared Appreciation Mortgages) No. 2 plc is a public limited company domiciled and incorporated in the United Kingdom.

(a) Basis of preparation

The financial statements for the year ended 31 December 2016 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.

There are no new or amended accounting standards that have required a change to accounting policies for the year.

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

The Company is reliant on funding provided by Bank of Scotland plc (BOS) which is a subsidiary of Lloyds Banking Group plc (LBG). Lloyds Bank plc has provided letters of support dated 21 February 2017 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 that derivative financial instruments are stated at fair value).

(b) Interest income and interest payable

Interest receivable and similar income and interest payable and similar charges 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.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(c) Taxation

Income tax recognised in the Statement of Comprehensive Income comprises both current and deferred tax. Current income tax, which is payable on taxable profits, is recognised as an expense in the period in which the profits arise.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is determined using tax rates that have been enacted or substantially enacted by the balance sheet date which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

The Company's tax charge is calculated on an IFRS basis and disclosed in accordance with IAS 12.

(d) Financial instruments

The Company's financial instruments comprise a mortgage portfolio, cash and liquid resources, a derivative contract ("swap"), an embedded derivative, loans and borrowings and various other 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 IAS 39 as described below:

(d)(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 (d)(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.

(d)(ii) 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 within "loans and receivables" in accordance with IAS 39 and income is being recognised using the effective interest method.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(d) Financial instruments (continued)

(d)(iii) Loans and borrowings

The Company's loans and borrowings comprise mortgage-backed 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.

(d)(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, 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 historic 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 in (d)(i) and (d)(iii).

(d)(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.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(d) Financial instruments (continued)

(d)(v) Derivatives (continued)

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 current HPI at the balance sheet date 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:

Effective interest rate method

The effective interest rate is calculated on initial recognition of the financial asset or liability, estimating the future cash flows after considering all the contractual terms of the instrument. The calculation includes all amounts expected to be paid or received by the Company including expected early redemption fees and related penalties and premiums and discounts that are an integral part of the overall return. Direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument are also taken into account in the calculation. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

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, considering actual redemption experience and actual contractual terms of Notes.

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)**

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(e) Critical accounting judgements and estimates (continued)

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 value of the embedded derivative has been calculated separately from the host contract. The shared appreciation rights have been calculated using current HPI at the balance sheet date which is observable market data. No assumption for future HPI has been included as the directors do not consider it is possible to make a reliable estimate on this basis. As a borrower could sell immediately, spot price is deemed more appropriate to use.

The derivative is calculated using current HPI at the balance sheet date and by discounting the future cash flows at an appropriate market rate.

There are no other derivative financial instruments in the form of a swap.

(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 or at amortised cost if deemed to be a financial liability.

(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.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

2. INTEREST RECEIVABLE AND SIMILAR INCOME

	2016 £	2015 £
Interest receivable on mortgage portfolio	1,500,918	1,957,176
Bank interest receivable	3,027	18,181
	<hr/>	<hr/>
	1,503,945	1,975,357
	<hr/>	<hr/>

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.

3. INTEREST PAYABLE AND SIMILAR CHARGES

	2016 £	2015 £
Interest payable on Notes	1,500,921	1,957,179
Amortisation of issue and restructuring costs	58,093	75,752
	<hr/>	<hr/>
	1,559,014	2,032,931
	<hr/>	<hr/>

4. NET FAIR VALUE GAINS AND LOSSES ON DERIVATIVES

	2016 £	2015 £
Fair value movement on shared appreciation rights receivable	2,423,025	3,516,839
Fair value movement on shared appreciation rights payable	(2,019,187)	(2,930,699)
Fair value movement on interest rate derivative	(500,726)	(702,864)
	<hr/>	<hr/>
	(96,888)	(116,724)
Income receivable on interest rate derivative	222,232	246,150
	<hr/>	<hr/>
	125,344	129,426
	<hr/>	<hr/>

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

5. OTHER OPERATING INCOME

	2016 £	2015 £
Fees and commissions receivable	1,100	1,350
Shared appreciation receivable	9,054,260	10,150,301
Shared appreciation payable	(9,054,260)	(10,150,301)
	<hr/> 1,100	<hr/> 1,350

6. OPERATING EXPENSES

	2016 £	2015 £
Inter-company fees	23,891	28,922
Administration fees	38,516	11,132
Audit fees	1,200	1,200
	<hr/> 63,607	<hr/> 41,254

The Company has no employees (2015: 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 for the statutory audit (2015: £nil).

The audit fee for the current year, net of VAT, was £1,000 (2015: £1,000).

7. TAXATION

	2016 £	2015 £
Current Tax		
Corporation tax charge for the year	15,053	20,136
Adjustments in respect of prior years	(1,368)	1,369
	<hr/> 13,685	<hr/> 21,505
Deferred Tax		
Deferred tax change in tax rate – debit	(675)	168
Deferred tax credit for the year	(13,499)	(13,667)
	<hr/>	<hr/>
Total tax (credit) / charge for the year	<hr/> (489)	<hr/> 8,006

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

7. TAXATION (CONTINUED)

Reconciliation of effective tax rate	2016	2015
The tax assessed for the year is lower than (2015: higher than) the standard rate of corporation tax in the UK of 20.00% (2015: 20.25%)	£	£
Profit before tax	7,768	31,948
Profit before tax multiplied by the standard rate of corporation tax in the UK of 20.00% (2015: 20.25%)	1,554	6,469
Effects of:		
Deferred tax change in tax rate – (credit) / debit	(675)	168
Adjustments in respect of prior years	(1,368)	1,369
Total tax (credit) / charge for the year	(489)	8,006

The current tax liability of £13,685 (2015: £21,505) represents the net amount of income tax payable in respect of the current year.

The adjustments in respect of prior years relates to an amount of group relief paid for by the company but subsequently made available for £nil payment. The credit represents the reversal of the tax charge.

The Finance Act 2013 which was substantively enacted on 2 July 2013 reduced the main rate of corporation tax to 21% with effect from 1 April 2014 and 20% with effect from 1 April 2015.

The Finance (No. 2) Act 2015 which was substantively enacted on 26 October 2015 reduced the main rate of corporation tax to 19% with effect from 1 April 2017 and 18% with effect from 1 April 2020.

The Finance Act 2016, which was substantively enacted on 6 September 2016, further reduced the corporate tax rate to 17% with effect from 1 April 2020.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

8. CASH AND CASH EQUIVALENTS

	2016 £	2015 £
Bank accounts	1,986,532	1,619,489
Bank overdraft	(91)	(1,533)
	<hr/>	<hr/>
Cash and cash equivalents per the cash flow statement	1,986,441	1,617,956
	<hr/>	<hr/>

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. MORTGAGE PORTFOLIO

	2016 £	2015 £
At 1 January	10,214,134	9,804,201
Mortgage redemptions in the year	(1,456,741)	(1,547,243)
Amortisation of discount	1,500,918	1,957,176
	<hr/>	<hr/>
At 31 December	10,258,311	10,214,134
	<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. All mortgage loans are considered to be non-current as maturity cannot be reasonably determined, with the exception of an amount of £1,204,270 (2015: £1,752,717) in respect of the discount amortisation due within 12 months.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

10. SHARED APPRECIATION RIGHTS RECEIVABLE

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 (note 12).

As the shared appreciation rights receivable 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 9).

11. LOANS AND BORROWINGS

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 16.

	2016	2015
	£	£
Non-current liabilities		
Notes	10,193,773	10,162,624
Deferred issue costs	(144,334)	(181,199)
	<hr/>	<hr/>
	10,049,439	9,981,425
Current liabilities		
Deferred issue costs	(46,611)	(67,839)
	<hr/>	<hr/>
At 31 December	<hr/> 10,002,828	<hr/> 9,913,586

The mortgage-backed Notes are due to redeem in 2072. After the 2011 restructure, the interest rate payable on the Notes was changed as part of a restructure and the Notes now bear a zero rate of interest until August 2027. Thereafter the interest rate applicable to the Notes will increase to 0.50% fixed until 2072 when the Notes become due. At the end of the year the Notes, as rated by S&P, had a rating of A (2015: 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. As the Notes do not have a fixed maturity, the balance is considered to be non-current. The Notes are secured on the mortgage portfolio, the bank accounts and certain other assets of the Company.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

12. SHARED APPRECIATION RIGHTS PAYABLE AND DERIVATIVE LIABILITIES

The Company is contractually obliged to pay all of the Shared Appreciation arising on the sale of properties from mortgage customers to the Note holders and swap provider, which is split as follows.

	2016 £	2015 £
Note holder	102,453,607	100,434,420
Swap provider	19,746,463	19,242,087

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 9).

13. DEFERRED TAX LIABILITY

	2016 £	2015 £
At 1 January	26,997	40,496
Credit for year	(13,499)	(13,667)
Change in Tax Rate – debit	(675)	168
At 31 December	12,823	26,997

The deferred tax liability was recognised for the fair value adjustments that arose on transition to IFRS and is being released to the income statement over a period of ten years from adoption.

Included in the balance at the balance sheet date is an amount of £12,823 due within 12 months (2015: £13,499).

The Finance Act 2013 which was substantively enacted on 2 July 2013 reduced the main rate of corporation tax to 21% with effect from 1 April 2014 and 20% with effect from 1 April 2015.

The Finance (No. 2) Act 2015 which was substantively enacted on 26 October 2015 reduced the main rate of corporation tax to 19% with effect from 1 April 2017 and 18% with effect from 1 April 2020.

The Finance Act 2016, which was substantively enacted on 6 September 2016, further reduced the corporate tax rate to 17% with effect from 1 April 2020.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

14. TRADE AND OTHER PAYABLES

	2016 £	2015 £
Shared appreciation payable	1,190,250	1,021,842
Note redemptions payable	183,750	132,250
Accruals and deferred income	87,433	70,510
Amounts owed to BOS	2,348	2,560
	<hr/>	<hr/>
	1,463,781	1,227,162
	<hr/>	<hr/>

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

15. SHARE CAPITAL

	2016 £	2015 £
Authorised		
50,000 (2015: 50,000) ordinary shares of £1 each	50,000	50,000
	<hr/>	<hr/>
1 (2015: 1) deferred share of £1	1	1
	<hr/>	<hr/>
Allotted, called up and fully paid		
50,000 (2015: 50,000) ordinary shares of £1 each	50,000	50,000
	<hr/>	<hr/>
1 (2015: 1) deferred share of £1	1	1
	<hr/>	<hr/>

The Company is a directly held subsidiary undertaking of BOS.

The £1 deferred share is held by Deutsche Trustee Company Limited (formerly Bankers 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

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

15. SHARE CAPITAL (CONTINUED)

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.

16. 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 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 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 16(c) below). The swap counterparty, UBS, is a regulated financial institution with a long term rating from Standard and Poor's (S&P) of A+ (2015: 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. With this combined with the low loan-to-value of the properties no impairment provision is considered to be necessary at 31 December 2016 or 31 December 2015.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

16. MANAGEMENT OF RISK (CONTINUED)

16(a) Credit risk (continued)

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 2016 £	Maximum Exposure 2016 £	Carrying Amount 2015 £	Maximum Exposure 2015 £
Assets held at amortised cost:					
Cash and cash equivalents	8	1,986,532	1,986,532	1,619,489	1,619,489
Mortgage portfolio	9	10,258,311	15,191,661	10,214,134	16,648,402
Assets held at fair value:					
Shared appreciation rights receivable	10	122,944,329	122,944,329	120,521,304	120,521,304
Total Assets		<u>135,189,172</u>	<u>140,122,522</u>	<u>132,354,927</u>	<u>138,789,195</u>

16(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 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.

**BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)**

16. MANAGEMENT OF RISK (CONTINUED)

16(c) Interest rate risk

On 28 February 2011, with the closure of the Guaranteed Investment Contract account (the "GIC") and partial repayment of the Notes for which the GIC account was a guarantee for their repayment, 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 with no impact if there was a 100 basis points movement in interest rates.

The main impact on profit is from the movement in fair value on the derivative.

16(d) 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 (2015: 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.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

16. MANAGEMENT OF RISK (CONTINUED)

16(d) Liquidity risk (continued)

2016	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
	£	£	£	£	£	£	£
Principal							
Loans and borrowings (excluding deferred issue costs)	10,193,773	15,127,133	-	-	-	-	15,127,133
Derivative liability (swap)	19,746,463	18,203,066	-	(52,442)	(160,241)	(851,315)	19,267,064
Shared appreciation payable	102,453,607	102,453,607	-	-	-	-	102,453,607
Trade and other payables	1,463,781	1,463,781	-	1,463,781	-	-	-
Bank overdraft	91	91	91	-	-	-	-
	<u>133,857,715</u>	<u>137,247,678</u>	<u>91</u>	<u>1,411,339</u>	<u>(160,241)</u>	<u>(851,315)</u>	<u>136,847,804</u>
2015	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
	£	£	£	£	£	£	£
Principal							
Loans and borrowings (excluding deferred issue costs)	10,162,624	16,596,905	-	-	-	-	16,596,905
Derivative liability (swap)	19,242,087	17,346,147	-	(58,110)	(175,606)	(932,949)	18,512,812
Shared appreciation payable	100,434,420	100,434,420	-	-	-	-	100,434,420
Trade and other payables	1,227,162	1,227,162	-	1,227,162	-	-	-
Bank overdraft	1,533	1,533	1,533	-	-	-	-
	<u>131,067,826</u>	<u>135,606,167</u>	<u>1,533</u>	<u>1,169,052</u>	<u>(175,606)</u>	<u>(932,949)</u>	<u>135,544,137</u>

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.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

16. MANAGEMENT OF RISK (CONTINUED)

16(e) 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:

	2016 £ Level 2	2015 £ Level 2
Shared appreciation rights receivable	122,944,329	120,521,304
Shared appreciation rights payable	(102,453,607)	(100,434,420)
Derivative liability	(19,746,463)	(19,242,087)
	<hr/>	<hr/>

Share appreciation rights

The shared appreciation rights receivable and shared appreciation rights payable are measured at fair value. The fair value has been calculated by discounting expected cash flows at an appropriate market rate. All significant inputs into the valuation models are obtained from observable market data. For this reason, in accordance with "IFRS 7 Financial Instruments: Disclosures", the fair value measurement is considered to be Level 2 in the Fair Value Hierarchy.

Derivatives

The fair value of the derivative liabilities have been calculated using discounted cash flow model; the most significant inputs into this model are current HPI at the balance sheet date and interest rate yield curves which are developed from publicly quoted rates. The fair value measurement is considered to be Level 2 in the Fair Value Hierarchy.

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16. MANAGEMENT OF RISK (CONTINUED)

16(e) Fair values (continued)

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 2016 £	Fair Value 2016 £	Carrying Amount 2015 £	Fair Value 2015 £
Loans and Receivables at amortised cost					
Mortgage portfolio	9	10,258,311	13,874,181	10,214,134	14,854,419
		<hr/>	<hr/>	<hr/>	<hr/>
Financial liabilities at amortised cost					
Loans and borrowings	11	(10,002,828)	(13,815,140)	(9,913,586)	(14,808,416)
		<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 on an amortised cost basis that is considered to be a close approximation to fair value due to the short nature of these liabilities.

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17. 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 (2015: £950,000).

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

	Parent and subsidiary undertakings	Parent and subsidiary undertakings
	2016 £	2015 £
Statement of Comprehensive Income		
Interest receivable and similar income	3,027	18,181
Operating expenses	(23,891)	(28,922)
Balance Sheet		
Assets		
Cash and cash equivalents	1,986,532	1,619,489
Liabilities		
Bank overdraft	(91)	(1,533)
Other payables	(2,348)	(2,560)
Equity		
Dividends paid in the year	-	(950,000)

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FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

18. FUTURE ACCOUNTING PRONOUNCEMENTS

The following pronouncements are not applicable for the year ended 31 December 2016 and have not been applied in preparing these financial statements. Save as disclosed below, the full impact of these accounting changes is being assessed by the Company.

IFRS 9 Financial Instruments

IFRS 9 replaces IAS 39 Financial Instruments: Recognition 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 and amortised cost, on the basis of the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instruments. These changes are expected to have some impact on the Company.

IFRS 9 also replaces the existing 'incurred loss' impairment approach with an expected credit loss approach. This change in approach is not expected to have a significant impact on the Company.

The hedge accounting requirements of IFRS 9 are more closely aligned with risk management practices and follow a more principle-based approach than IAS 39. The revised requirements are not expected to have a significant impact on the Company.

IFRS 9 is effective for annual periods beginning on or after 1 January 2018. This standard was endorsed in November 2016.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 replaces IAS 18 Revenue and IAS 11 Construction Contracts. IFRS 15 establishes principles for reporting useful information about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognised at an amount that reflects the consideration to which the entity expects to be entitled in exchange for goods and services. Financial instruments, leases and insurance contracts are out of scope and so this standard is not expected to have a significant impact on the Company.

IFRS 15 is effective for annual periods beginning on or after 1 January 2018. As at March 2017, this standard is awaiting EU endorsement.

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FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

19. DIVIDENDS

	2016 £	2015 £
Ordinary shares		
£nil per £1 share (2015: £19 per £1 share)	-	950,000
Deferred shares		
£nil per £1 share (2015: £nil per £1 share)	-	-
	<hr/>	<hr/>
	-	950,000
	<hr/>	<hr/>

20. CONTINGENT LIABILITIES

The Group 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. The Group 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 the Group 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 £947k (including interest). The Group 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.

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.