HBOS Social Housing Covered Bonds LLP

Members' report and Financial Statements for the year ended 31 December 2018

Registered office

Charterhall House
Charterhall Drive
Chester
CH88 3AN

Registered number

OC310386

Current members

Bank of Scotland plc
Addison Social Housing Limited

Management Committee
G Parker (Bank of Scotland plc)
F Kenny (Addison Social Housing Limited)

Member of Lloyds Banking Group

Members' report

For the year ended 31 December 2018

The members present their report and the audited financial statements of HBOS Social Housing Covered Bonds LLP ("the Partnership") for the year ended 31 December 2018.

General information

The Partnership is a limited liability partnership domiciled in England. The Partnership is registered in England and Wales (registered number: OC310386).

The Partnership is a special purpose entity whose business is the acquisition and management of Housing Association loans and their related security to support the Social Housing Covered Bonds issued by Bank of Scotland plc, a subsidiary of Lloyds Banking Group plc.

The activities of the Partnership are conducted primarily by reference to a series of securitisation transaction documents (the "Transaction Documentation") for the sale of the Housing Association loans. The securitisation structure had been established as a means of raising finance for Bank of Scotland plc and no business activities will be undertaken by the Partnership beyond those set out in the Transaction Documentation. The Transaction Documentation set out the workings of the transaction and the principal risks to the holders of the Notes (the "Note holders"). As such, these have not been reproduced in full in the financial statements.

In consideration for the beneficial interest in the Housing Association loans, the Partnership is required to give a combination of:

(i) a cash payment to Bank of Scotland plc from the proceeds of the term loan;
(ii) a record of a capital contribution in kind being made by Bank of Scotland plc; and
(iii) deferred consideration which will be paid by the Partnership on each designated payment date in accordance with the relevant priority of payments.

The programme allows a maximum covered bond issuance of £3bn, providing that the Housing Association loans acquired and other assets available meet the Asset Covered Test (the "ACT") per the Transaction Documentation, which states that the adjusted aggregate amounts of the Housing Association loans and other assets (primarily cash) must be of an amount equal to or greater than the total amounts of social housing covered bonds in issue after taking into consideration other deductions. More information on the ACT is provided in note 11.1 to the financial statements.

During the year loans totalling £110,923,000 (2017: £65,369,000) were removed from the portfolio and £273,115,000 of total loans were added to the portfolio (2017: £nil)

Principal risks and uncertainties

From the perspective of the Partnership, the principal risks and uncertainties are managed within the framework established for the Group and are not managed separately for the Partnership. Further details of the Partnership's and Group's risk management policy are contained in note 11 to the financial statements.

Key performance indicators ("KPIs")

Given the straightforward nature of the business, the Partnership's members are of the opinion that analysis using KPIs is not necessary for an understanding of the development, performance or position of the business. KPIs are monitored and reported at a divisional level.

Future outlook

The UK is planning to leave the European Union ("Brexit"). The full impact of Brexit on the economy will be uncertain although any economic downturn may impact on the ability of the underlying borrowers to repay their mortgages and potentially lead to increases in mortgage arrears and defaults. In the meantime this uncertainty is expected to result in market risk volatility in the short to medium term including sterling exchange rates and interest rates. However, the derivatives are utilised to economically hedge interest and FX rate risk and thus in the long term are perceived to have no impact.

Going concern

The members are satisfied that it is the intention of Lloyds Banking Group plc that its subsidiaries, including the Partnership, will continue to have access to adequate liquidity and capital resources for the foreseeable future and, accordingly, the financial statements have been prepared on a going concern basis.

Members' report (continued)

For the year ended 31 December 2018

Members

The current members of the Partnership are shown on the front cover.

There have been no changes to members between the beginning of the reporting period and the approval of the Members' report and financial statements.

Management Committee

The current management committee of the Partnership are shown on the front cover.

The following change has taken place between the beginning of the reporting period and the approval of the Members' report and Financial statements:

A Steele (Bank of Scotland plc)	(resigned 28 October 2018)
G Parker (Bank of Scotland plc)	(appointed 28 October 2018)

Statement of members' responsibilities

The members are responsible for preparing the Members' report and Financial statements in accordance with applicable law and regulation.

Company law, as applied to limited liability partnerships by the Limited Liability Partnership (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008 (the "Regulations"), requires the members to prepare financial statements for each financial year. Under that law the members have prepared the financial statements in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union. Under company law, as applied to limited liability partnerships, the members 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 limited liability partnership and of the profit or loss of the limited liability partnership for that period. In preparing the financial statements, the members 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 limited liability partnership will continue in business.

The members are responsible for keeping adequate accounting records that are sufficient to show and explain the limited liability partnership's transactions and disclose with reasonable accuracy at any time the financial position of the limited liability partnership and enable them to ensure that the financial statements comply with the Companies Act 2006 as applied to limited liability partnerships by the Regulations.

The members are also responsible for safeguarding the assets of the limited liability partnership and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent auditor and audit information

In the case of each member in office at the date the Members' report is approved:

- so far as the member is aware, there is no relevant audit information of which the limited liability partnership's auditors are unaware; and
- they have taken all the steps that they ought to have taken as a member in order to make themselves aware of any relevant audit information and to establish that the limited liability partnership's auditors are aware of that information.

PricewaterhouseCoopers LLP are deemed to be re-appointed as auditors under section 487 of the Limited Liability Partnerships (Audit and Accounts) (Application of the Companies Act 2006) regulations 2008.

By order of the members

G Parker
on behalf of Bank of Scotland plc
Designated member

Date: 29 April **2019**

Statement of comprehensive income

For the year ended 31 December 2018

	Note	**2018**	2017
		£'000	£'000
Interest income		**8,057**	4,204
Interest expense		**(7,886)**	(4,031)
Net interest income	3	**171**	173
Other operating expenses	4	**(171)**	(173)
Result for the year, being total comprehensive result		**-**	-

The accompanying notes to the financial statements are an integral part of these financial statements.

Balance sheet
As at 31 December 2018

	Note	2018 £'000	2017 £'000
ASSETS			
Cash and cash equivalents	5	**38,454**	65,687
Deemed loan to originator	6	**1,161,992**	1,134,629
Total assets		**1,200,446**	1,200,316
LIABILITIES			
Borrowed funds	7	**1,200,356**	1,200,203
Trade and other payables	8	**90**	113
Total liabilities		**1,200,446**	1,200,316
MEMBERS' OTHER INTERESTS			
Retained earnings		**-**	-
Total members' other interests		**-**	-
Total members' other interests and liabilities		**1,200,446**	1,200,316
TOTAL MEMBERS' INTERESTS			
Retained earnings	9	**-**	-
Deemed loan to originator	6	**(1,161,992)**	(1,134,629)
Borrowed funds	7	**1,200,356**	1,200,203
		38,364	65,574

The accompanying notes to the financial statements are an integral part of these financial statements.

The financial statements were approved by the members and were signed on its behalf by:

G Parker
on behalf of Bank of Scotland plc
Designated member

29 April 2019

Statement of changes in member's other interests
For the year ended 31 December 2018

	Retained earnings £'000
At 1 January 2017	-
Result for the year being total comprehensive result	-
At 31 December 2017	-
Result for the year being total comprehensive result	-
At 31 December 2018	-

The accompanying notes to the financial statements are an integral part of these financial statements.

Cash flow statement

For the year ended 31 December 2018

	2018 £'000	2017 £'000
Cash flows used in operating activities		
Profit before tax	-	-
Adjustments for:		
- Interest income	(8,057)	(4,204)
- Interest expense	7,886	4,031
Changes in operating assets and liabilities:		
- Net (decrease)/increase in Trade and other payables	(23)	20
Net cash used in operating activities	(194)	(153)
Cash flows used in investing activities		
Principal repayments on Deemed loan to originator	(27,248)	(113,871)
Interest received on Deemed loan to originator	7,331	826
Bank interest received	611	467
Net cash used in investing activities	(19,306)	(112,578)
Cash flows used in financing activities		
Interest paid on term loan	(7,721)	(3,961)
Interest paid to members	(12)	(12)
Net cash used in financing activities	(7,733)	(3,973)
Change in Cash and cash equivalents	(27,233)	(116,704)
Cash and cash equivalents at beginning of year	65,687	182,391
Cash and cash equivalents at end of year	38,454	65,687

The accompanying notes to the financial statements are an integral part of these financial statements.

Notes to the financial statements
For the year ended 31 December 2018

1. Accounting policies

1.1 Basis of preparation

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied in both years presented, unless otherwise stated.

These financial statements have been prepared in accordance with applicable IFRSs as adopted by the European Union. IFRSs comprise accounting standards prefixed IFRS issued by the International Accounting Standards Board ("IASB") and those prefixed IAS issued by the IASB's predecessor body, as well as interpretations issued by the IFRS Interpretations Committee ("IFRS IC") and its predecessor body.

The financial statements also comply with the relevant provisions of Part 15 of the Companies Act 2006, as applicable to limited liability partnerships.

The following new IFRS pronouncements relevant to the Partnership have been adopted in these financial statements:

(i) IFRS 9 'Financial Instruments': Annual improvement to IFRSs (issued December 2016) - 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. IFRS 9 also replaces the existing 'incurred loss' impairment approach with an expected credit loss approach. 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.

(ii) IFRS 15 'Revenue from Contracts with customers': Replaces IAS 18 Revenue and IAS 11 Construction Contracts. Establishes principles for reporting useful information about the nature, amount and uncertainty of revenue and cash flows arising from an entity's contracts with customers.

The application of these pronouncements has not had any impact for amounts recognised in these financial statements.

There are no new IFRS pronouncements relevant to the Partnership requiring adoption in these financial statements.

The Partnership meets the definition of a special purpose entity under IFRSs. In accordance with the requirements of IFRS 10 "Consolidated Financial Statements", the Partnership's financial statements are consolidated within the group financial statements of LBG for the year ended 31 December 2018.

The financial statements have been prepared on a going concern basis as detailed in the Members' report and under the historical cost convention, modified for the fair value of derivative contracts.

1.2 Income recognition

Interest income and expense are recognised in the Statement of comprehensive income for all interest bearing financial instruments using the effective interest rate method. The effective interest rate method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense to a period of account. The effective interest rate is the rate that discounts the estimated future cash payments or receipts over the expected life of the instrument 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 but not future credit losses.

Accrued interest

Accrued interest has been incorporated within the Deemed loan to originator and within the outstanding balance of debt securities in issue on the Balance sheet. A split between principal and accrued interest can be found in note 6.

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

1. Accounting policies (continued)

1.3 Financial assets and liabilities

Financial assets comprise Deemed loan to originator and Cash and cash equivalents. Financial liabilities comprise Amounts due to group undertakings and Trade and other payables.

Financial assets are derecognised when the contractual right to receive cash flows from those assets has expired or when the Group has transferred its contractual right to receive the cash flows from the assets and either: substantially all of the risks and rewards of ownership have been transferred; or the Group has neither retained nor transferred substantially all of the risks and rewards, but has transferred control.

Financial liabilities are derecognised when the obligation is discharged, cancelled or expires.

Deemed loan to originator

Under IFRS 9, if a transferor retains all the risk and rewards associated with the transferred assets, the transaction is accounted for as a financing transaction, notwithstanding that it is a sale transaction from a legal perspective. The members of the Partnership have concluded that the Originator has retained substantially all the risks and rewards of the portfolio of Housing Association loans sold to the Partnership and as a consequence, the Partnership does not recognise the Housing Association loans on its balance sheet but rather a Deemed loan to originator, where recourse to Bank of Scotland plc is limited to its cash flows from the Housing Association loans and any additional credit enhancement provided by Bank of Scotland plc.

The initial amount of the Deemed loan to originator corresponds to the consideration paid by the Partnership for the Housing Association loans. The Partnership recognises principal and interest cash flows from the underlying portfolio of Housing Association loans only to the extent that it is entitled to retain such cash flows. Cash flows attributable to the Originator are not recognised by the Partnership.

The Partnership has entered into an Interest Rate Swap Agreement with Bank of Scotland plc. The interest rate swap substantially eliminates the sensitivity to movements in interest rates. The swap is not separately recognised in the financial statements as it forms part of the Deemed loan (see note 11.3 for further details).

The initial measurement is at fair value with subsequent measurement being at amortised cost using the effective interest method. The effective interest on the Deemed loan to originator is calculated with reference to the interest earned on the beneficial interest in the Housing Association portfolio less the residual interest due to the Originator. Under the terms of the loan sale agreement, the Originator retains the right to receive excess income arising on those loans, after certain higher priority payments (predominantly "Expenses") have been met by the Partnership.

Impairment of financial assets
The deemed loan to the Originator is subject to impairment reviews in accordance with IFRS 9. A charge for impairment could occur if the credit quality of the mortgage assets that are pledged as collateral for the loan significantly deteriorated. Taking into account the credit enhancement provided by, amongst other features, the overcollateralisation of the LLP, the members currently consider that no impairment exists (see note 14 for further details).

1.4 Cash and cash equivalents

The Partnership holds deposits with the provider of a guaranteed investment contract ("GIC") and a transaction bank account with the same provider, Bank of Scotland plc in accordance with the Transaction Documentation. These accounts are held in the Partnership's name and meet the definition of cash and cash equivalents. For the purposes of the Cash flow statement, cash and cash equivalents comprise cash and non-mandatory balances with central banks and amounts due from banks with a maturity of less than three months. 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.

1.5 Loans and borrowings

Loans and borrowings are recognised initially at fair value plus 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 Statement of comprehensive income over the period of the borrowings on an effective interest basis. The term loans (equivalent to the proceeds of the covered bonds issued) which are received from Bank of Scotland plc are accounted for on this basis.

Capital contributions from members are non-interest bearing but a nominal profit share amount is paid out in accordance with the priority of payments (see 1.6 below) and included as part of interest payable and similar charges.

1. Accounting policies (continued)

1.6 Contribution and drawings

Under the terms of the Partnership deed (the "Deed"), the Originator is treated as having made a capital contribution to the Partnership in an amount equal to the difference in the current balance of the loans sold at transfer date and the cash payment made by the Partnership for the loans and relevant security on that transfer date.

If so requested by the Management Committee, the members (other than the liquidation member) may from time to time make cash contributions to the Partnership which will constitute cash capital contributions. Addison Social Housing Limited will not make any capital contributions to the Partnership. No interest is paid on the members' capital balances. Capital distributions may only be made in accordance with the Deed, where sufficient principal receipts are available and higher priority payments have been made.

The Partnership has no control over the repayment of the capital contributions, which are driven by actual repayment on the underlying loans in the portfolio which make cash available to be paid in accordance with the priority of payments. These loans may be repaid by the borrowers at any time.

Under the priority of payments, payments *pro rata* and *pari passu* to the members of the sum of £3,000 in aggregate (or such other sum as may be agreed by members from time to time) is allocated and paid to each member in proportion to their respective capital contribution balances as at each quarterly calculation date, subject to a minimum of £1 each, as their profit for their respective interests as members of the Partnership.

1.7 Taxation, including deferred income taxes

Taxation on all partnership profits is solely the personal liability of individual Members. Consequently, neither taxation nor related deferred taxation in the Partnership are accounted for in these financial statements.

1.8 Other payables

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

1.9 Value added tax

Value added tax is not recoverable by the Partnership and is included with the related costs.

1.10 Covered bonds swap agreement

The Partnership has entered into a Covered Bonds Swap Agreement with Bank of Scotland plc. Following a Bank of Scotland plc event of default and the service on the Partnership of a notice to pay, this agreement provides a hedge against interest rate, currency and/or other risks in respect of amounts received by the Partnership from the Housing Association loans and the interest rate swap and amounts payable by the Partnership under the Covered Bonds Guarantee in respect of the Covered Bonds.

The Covered Bonds Swap Agreement provides a hedge against risks the Partnership is exposed to following a Bank of Scotland plc event of default and the service on the Partnership of a notice to pay. As such, no payments of interest or exchanges of principal are due and payable under this agreement prior to these events. In accordance with the terms of this swap, the swap provider will pay to the Partnership amounts equivalent to the amounts that would be payable by the Partnership under the Covered Bonds guarantee in respect of interest and principal payable under the Covered Bonds and, in return, the Partnership will pay to the Covered Bonds swap provider on each Partnership payment date an amount equal to three-month Sterling LIBOR for the relevant interest period plus a spread.

No such event of default or service on the Partnership of a notice to pay has yet occurred and therefore no values are recorded on the Balance Sheet date (2017: £nil).

Following amendments to the Covered Bonds Swap Agreement in December 2012 it has been agreed that Bank of Scotland plc is only required to post collateral should its credit rating fall below A (long term) or A-1 (short term) by S&P, or P-1 (short term) by Moody's. The collateral posted would only be utilised by the Partnership in the event of a default occurring as referred to in the Transaction Documentation. There was no fall in credit rating below stipulated ratings during the year. This policy applies to the Deemed loan to the originator within the financial statements.

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

1. Accounting policies (continued)

1.11 Financial guarantee

Financial guarantees are contracts that require the Partnership to make specified payments to reimburse the Noteholder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. No additional liability over and above the interest and principal already detailed in the accounts would be payable.

Where the Partnership enters in financial guarantee contracts to guarantee the indebtedness of Bank of Scotland plc, the Partnership treats such guarantee contracts as a contingent liability until such time as it becomes probable that the partnership will be required to make payments under the guarantee.

2. Critical accounting estimates and judgements in applying accounting policies

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 accounting estimates. In these financial statements the Deemed loan to originator (Note 1.3) is a critical accounting judgment and the estimation of ECLs (Note 14) is a critical accounting estimate.

3. Net interest income

	2018 £'000	2017 £'000
Interest income		
Interest receivable on Deemed Loan (see note 10)	7,446	3,738
Bank interest receivable (see note 10)	611	466
	8,057	4,204
Interest expense		
Interest payable on term loans (see note 10)	(7,874)	(4,019)
Interest payable to members (see note 10)	(12)	(12)
	(7,886)	(4,031)
	171	173

4. Other operating expenses

	2018 £'000	2017 £'000
Administration charges	158	160
Audit fees	13	13
	171	173

The Partnership has also accrued an audit fee of £1,200 (2017: £1,200) on behalf of Addison Social Housing Limited and Addison Social Housing Holdings Limited. There are no fees payable to the auditors and their associates for services other than the statutory audit.

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

5. Cash and cash equivalents

Cash and cash equivalents for the purposes of the Cash flow statement include the following:

	2018 £'000	2017 £'000
Cash at bank	**38,454**	65,687

The Partnership has placed its deposit account with a provider of a GIC, Bank of Scotland plc, a subsidiary undertaking of LBG. Withdrawals from this account are restricted by the detailed priority of payments set out in the Transaction Documentation. The Partnership is contractually entitled to a variable rate of interest of 0.25 per cent per annum below LIBOR for three-month Sterling deposits, which is recorded as interest receivable in the Statement of Comprehensive Income.

6. Deemed loan to originator

	2018 £'000	2017 £'000
Deemed loan to originator (see note 10)	**1,161,992**	1,134,629

Income on the Deemed Loan to Originator, arising on the underlying loans, reflects fixed, variable and tracker rates. Deferred consideration is deducted from this income in order to arrive at the effective yield on the Deemed Loan.

Represented by:	2018 £'000	2017 £'000
Non-current	**1,127,454**	919,849
Current	**34,538**	214,780
	1,161,992	1,134,629

7. Borrowed funds

	2018 £'000	2017 £'000
Amounts due to group undertakings (see note 10)	**1,200,356**	1,200,203
Represented by:		
Non-current	**600,000**	1,200,000
Current	**600,356**	203
	1,200,356	1,200,203

Borrowed funds comprise a series of term loans from Bank of Scotland plc, equivalent to the amounts raised under its covered bonds programme. Each term loan advance bears interest at a rate equal to LIBOR for three-month Sterling deposits.

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

7. Borrowed funds (continued)

Bank of Scotland plc will not be relying on repayment of any term loan by the Partnership nor the interest thereon in order to meet its repayment or interest obligations under the covered bonds programme. The term loans will not be repaid by the Partnership until all amounts payable under the corresponding series of covered bonds have been repaid in full. Amounts by the Partnership will be subordinated to amounts under the covered bond guarantee described below.

The covered bonds are unconditionally guaranteed by HBOS plc (the "Group Guarantor"). Under the terms of the Trust Deed, the Partnership has also provided a guarantee as to payments of interest and principal under the covered bonds programme, where amounts would otherwise be unpaid by Bank of Scotland plc or the Group Guarantor. The obligations of the Partnership under its guarantee constitute direct obligations of the Partnership secured against the assets from time to time of the Partnership and recourse against the Partnership is limited to such assets. The principal asset is beneficial interest in the Housing Association loans acquired from Bank of Scotland plc.

The term loans due to Bank of Scotland plc mature following repayment of the covered bonds on the following dates:

Covered bond issuance	Maturity date	2018 £'000	2017 £'000
2004-1	20 December 2024	**500,000**	500,000
2008-1 (Tranche 2)	8 November 2019	**100,000**	100,000
2008-2 (Tranche 2)	8 November 2019	**500,000**	500,000
2008-2 (Tranche 3)	8 November 2022	**100,000**	100,000
		1,200,000	1,200,000

8. Trade and other payables

	2018 £'000	2017 £'000
Accruals and deferred income	**90**	113

Included within Accruals and deferred income is £13,000 (2017: £26,000) in respect of audit fee accrual.

9. Member's interest

2018	Members' capital £'000	Retained earnings £'000	Total £'000	Loans due to/(from) members £'000	Total £'000
Members' interest as at 1 January	-	-	-	65,574	65,574
Interest on Bank of Scotland plc term loan	-	-	-	153	153
Movements in amounts due to/(from) members	-	-	-	(27,363)	(27,363)
Members' interests as at 31 December 2018	-	-	-	**38,364**	**38,364**

The loans and other debts due to/(from) members can be analysed as follows:

	Members' interests as at 31 December 2018 £'000
Amounts due to members	1,200,356
Amounts due from members	(1,161,992)
	38,364

9. Member's interest (continued)

2017	Members' capital £'000	Retained earnings £'000	Total £'000	Loans due to/(from) members £'000	Total £'000
Members' interests as at 1 January	-	-	-	182,298	182,298
Interest on Bank of Scotland plc term loan	-	-	-	59	59
Movements in amounts due to/(from) members	-	-	-	(116,783)	(116,783)
Members' interests as at 31 December 2017	-	-	-	65,574	65,574

The loans and other debts due to/(from) members can be analysed as follows:

	Members' interests as at 31 December 2017 £'000
Amounts due to members	1,200,203
Amounts due from members	(1,134,629)
	65,574

10. Related party transactions

The Partnership is controlled by Bank of Scotland plc. A number of transactions are entered into with related parties in the normal course of business. These include loan and fee transactions. A summary of the outstanding balances at the year end and the related income and expense for the year are set out below.

	2018 £'000	2017 £'000
Deemed loan to originator		
Bank of Scotland plc (see note 6)	**1,161,992**	1,134,629
Amounts due to group undertakings		
Bank of Scotland plc (see note 7)	**1,200,356**	1,200,203
Cash and cash equivalents held with group undertakings		
Bank of Scotland plc (see note 5)	**38,454**	65,687
Interest receivable on Deemed Loan		
Bank of Scotland plc (see note 3)	**7,446**	3,738
Bank interest receivable		
Bank of Scotland plc (see note 3)	**611**	466
Interest payable on term loans		
Bank of Scotland plc (see note 3)	**7,874**	4,019
Interest payable to members		
Bank of Scotland plc (see note 3)	**12**	12

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

10. Related party transactions (continued)

The above balances are unsecured in nature and are expected to be settled in cash or by cash equivalents. Transactions in the year are those reflected through the Statement of comprehensive income.

The Partnership pays a corporate services fee to Intertrust Management Limited and Intertrust Offshore Limited in connection with its provision of corporate management services, which includes the provision of members. This amounted to an expense in the Statement of comprehensive income of £9,000 (2017: £14,000) and £6,000 (2017: £10,000) respectively for the year ended 31 December 2018. Of this £5,000 (2017: £6,000) relates to the provision of members.

The Partnership is required to pay cash and administration servicing fees to Bank of Scotland plc in connection with its provision of services defined under the Covered Bonds agreements. This amounted to an expense in the Statement of comprehensive income of £375,000 (2017: £375,000) for the year ended 31 December 2018.

11. Financial risk management

The principal risks arising from the Partnership's financial instruments are credit risk, interest rate risk, liquidity risk and prepayment risk. Further detailed analysis of the risks facing the Partnership in relation to its financial instruments is provided below.

The activities of the Partnership are conducted primarily by reference to the Transaction Documentation which covers the purchase of the Housing Association loans. The structure was established as a means of raising finance for Bank of Scotland plc and no business activities are undertaken by the Partnership beyond those set out in the Transaction Documentation.

The Partnership's exposure to risk on its financial instruments and the management of such risk is largely determined at the initial set-up of the Partnership. The Partnership's activities and the role of each party to the transaction is clearly defined and documented. Cash flow modelling, including multiple stress scenarios, is carried out as part of the structuring of the transaction, and is required by the rating agencies.

In addition, an interest rate swap is entered into with the Originator as part of the transaction to hedge against interest rate risk arising in the transaction including the obligations under the term loans. The derivative counterparty is selected as a regulated financial institution and this reduces the risk of default and loss for the Partnership. Additional credit protection may be afforded by the requirement for the derivative counterparties to post collateral in the event of a downgrade to a counterparty's credit rating.

Following initial set-up, the members monitor the Partnership's performance, reviewing monthly reports on the performance of the Housing Association loans and the quarterly investor reports. Such review is designed to ensure that the terms of the Transaction Documentation have been complied with, that no unforeseen risks have arisen and that the interest and principal on the term loans have been paid on a timely basis. Where necessary, the members also make appropriate enquiries of the Partnership's professional advisers concerning specific matters which may affect the nature and extent of particular risk to the Partnership.

11.1 Credit risk

Credit risk arises where there is a possibility that a counterparty may default on its financial obligations resulting in a loss to the Partnership.

Credit risk arises on the individual loans within the Housing Association loan portfolio. The ability of the Partnership to pay the term loan interest and principal to Bank of Scotland plc will depend on the amount and timing of payment of interest and principal on the Housing Association loans by the borrowers as well as timely receipt from the swap counterparty.

In terms of arrears management, the Partnership has engaged Bank of Scotland plc to administer and service the loans (the "Servicer") in the portfolio to reduce the risk of loss. The Services is required to monitor repayments on the Housing Association loans in accordance with the usual credit policies. The Servicer is also responsible for ensuring Housing Association loans in the portfolio meet the eligibility criteria set out in the Transaction Documentation.

Credit enhancement is provided to the Partnership by Bank of Scotland plc. The income on the Housing Association loan portfolio is expected to exceed the Partnership's expenses and the interest payable on the term loans. Any excess income, known as excess spread, that is not required to meet expenses or interest payments is returned to the Originator as a deferred consideration payment.

11. Financial risk management (continued)

11.1 Credit risk (continued)

Credit risk for the Partnership is mitigated by the amount of overcollateralisation of the beneficial interest in loans and which is monitored using an asset coverage test. The overcollateralisation is available in full for the benefit of the Partnership. The Transaction Documentation provides that the Partnership and its members should ensure that the adjusted aggregate loan portfolio asset is at least equal to or greater than the aggregate amount outstanding on the covered bonds on each calculation date. The adjusted loan amount is the balance of the Housing Association loans after adjusting for various set-offs and adjustments unique to particular groups of loans, together with allowances for loan defaults.

In the event that there is a breach of the ACT, the members (excluding the liquidation member) are required to take steps to make good the deficit in providing either the necessary capital contributions to enable further Housing Association loans to be acquired or in cash, as a cash capital contribution, in order that the ACT breach is cured before the next ACT calculation. If there is a breach at the following calculation date, this will constitute a Bank of Scotland plc event of default, which will enable the Bond Trustee to serve a Bank of Scotland plc Accelerated Notice on the issuer of the covered bonds and the Group Guarantor, Bank of Scotland plc. Upon service of such notice, the Bond Trustee will serve a Notice to Pay on the Partnership under the covered bond guarantee. This would require the Partnership to repay all amounts outstanding on the covered bonds, including principal and accrued interest amounts.

In accordance with the Transaction Documentation the Originator shall be entitled to remove Loans (the "Removed Loans") and their Related Security from the portfolio, provided that before and following such removal, the ACT shall continue to be satisfied and that no Event of Default has occurred.

During 2018, loans totalling £110,923,000 (2017: £65,369,000) were removed from the portfolio. The ACT continued to be satisfied following the removal of these loans.

The Transaction Documentation also provides for the inclusion of new loans in the portfolio. The inclusion of new loans provides additional credit enhancement by adding to the amount of over collateralisation of the beneficial interest in the loans which is monitored using the ACT. During 2018, £273,115,000 (2017: £nil) of loans were added to the portfolio.

The total loan portfolio made available to the Partnership at 31 December 2018 amounted to £1,168,480,000 (2017: £1,141,233,000). As noted in the accounting policies section, the Partnership does not recognise the loan portfolio, but rather a Deemed loan to originator to the extent that the cash contribution paid to Bank of Scotland plc.

To the extent that the cash flows on the Deemed loan does not provide sufficient funds to recover the Partnership's investment in the Housing Association loan portfolio, the Partnership has no claim on the assets of Bank of Scotland plc. During the current year, sufficient cash has been received from the Deemed loan to enable the Partnership to make all necessary payments on the term loans following repayment of the related series of covered bonds from Bank of Scotland plc.

During 2018, there were no redemptions of the covered bond issuance (2017: £nil).

Bank of Scotland plc as provider of:		**Rating as at 31 December 2018 Moody's/S&P**		**Rating as at date of approval of financial statements Moody's/S&P**
Covered bonds swap, interest rate swap and bank accounts	Short term:	P-1/A-1	Short term:	P-1/A-1
	Long term:	Aa3/A+	Long term:	Aa3/A+

In the event that a swap counterparty is downgraded by the rating agency below the ratings specified in the relevant swap agreement, the relevant swap provider will be required to take certain remedial measures as defined in that agreement which may include providing collateral for its obligations under the relevant swap, arranging for its obligations to be transferred to an entity with a sufficient rating, procuring another entity with sufficient rating to become co-obliger for its obligations, or taking such action as it may agree with the relevant rating agency.

Credit concentration - Deemed loan to originator

The Partnership has a concentration of risk to the Originator of the Housing Association loans as the Partnership's bank accounts, including those covered by the GIC, are held with Bank of Scotland plc whom also acts as swap counterparty, servicer of the Housing Association loans and cash manager.

11. Financial risk management (continued)

11.1 Credit risk (continued)

Financial assets subject to credit risk

The maximum exposure to credit risk arising on the Partnership's financial assets at the reporting date is disclosed in the table below and equates to carrying value.

	2018 £'000	2017 £'000
Deemed loan to originator	1,161,992	1,134,629
Cash and cash equivalents	38,454	65,687
	1,200,446	1,200,316

At the Balance Sheet date all financial assets subject to credit risk were neither past due nor impaired. A financial asset is "past due" if a counterparty has failed to make a payment when contractually due. Bank of Scotland plc is required to buy back all defaulting Housing Association loans from the Partnership once they reach more than 60 days in arrears. There is no loss suffered by the Partnership, as this buy-back includes all outstanding amounts, including all arrears on the Housing Association loans. Accordingly the Members consider the credit risk to be sufficiently mitigated. As at 31 December 2018 no loan accounts were considered past due (2017: nil).

11.2 Liquidity risk

Liquidity risk is the risk that the Partnership is not able to meet its financial obligations as they fall due.

The Partnership's ability to meet its payments on the term loans as they fall due is dependent on the amounts and timing of the interest and principal repayments on the loans which underlie the Deemed loan to originator and timely receipts from Bank of Scotland plc in their capacity as the swap counterparty. The timely receipt of funds from the Deemed loan may be delayed due to slow repayment on the loan portfolio (see 11.1 Credit risk above and 11.4 Prepayment risk below).

Principal repayments are made on the term loans with Bank of Scotland plc in accordance with the Partnership's principal priority of payments and reflect the amount of principal collections on the underlying Housing Association loans. The Partnership will seek to accumulate funds from its share of the loan portfolio in order to repay the term loans in accordance with the expected maturity dates of the covered bonds issued by Bank of Scotland plc.

In the event that the Partnership does not have sufficient cash flows from the underlying Housing Association loans in order to be able to repay the term loans as and when they fall due, the members may be required to make cash capital contributions in accordance with the terms of the Transaction Documentation.

The liquidity tables reflect the undiscounted contractual cash payments which will fall due if the structure continues until the contractual maturity date as defined in the Transaction Documentation. It is anticipated that the interest and principal received on the Deemed Loan to Originator will be sufficient to allow repayment of the term loans.

As at 31 December 2018

	Up to 1 month £'000	1-3 months £'000	3-12 months £'000	1-5 years £'000	Over 5 years £'000	Contractual repayment value £'000
Principal						
Borrowed funds	-	-	600,000	100,000	500,000	1,200,000
Interest						
Borrowed funds	-	2,700	7,455	20,869	4,437	35,461
	-	**2,700**	**607,455**	**120,869**	**504,437**	**1,235,461**

11. Financial risk management (continued)

11.2 Liquidity risk (continued)

As at 31 December 2017

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Contractual repayment value
	£'000	£'000	£'000	£'000	£'000	£'000
Principal						
Borrowed funds	-	-	-	700,000	500,000	1,200,000
Trade and other payables	-	-	113	-	-	113
Interest						
Borrowed funds	-	1,563	4,690	15,210	5,211	26,674
	-	1,563	4,803	715,210	505,211	1,226,787

Carrying value of the principal Borrowed funds, Trade and other payables and interest on Borrowed funds are respectively £600,000,000 (2017: £1,200,000,000), £nil (2017: £113,000) and £600,356,000 (2017: £203,000).

11.3 Interest rate risk

Interest rate risk exists where assets and liabilities have interest rates set under a different basis or which reset at different times. The Partnership 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 Partnership uses derivative financial instruments to mitigate interest rate risk. The Deemed Loan, the term loans and the cash and cash equivalents are exposed to cash flow interest rate risk caused by floating interest rates that are reset periodically.

The interest rate swap substantially eliminates the sensitivity to movements in interest rates. The swap is not separately recognised in the financial statements as it forms part of the Deemed loan.

The underlying loan portfolio comprises loans which are subject to variable rates of interest set by the Servicer, loans which track the Bank of England Base Rate and loans which bear fixed rates of interest. Under the terms of the swap, the Partnership pays the interest received from the loan portfolio and receives interest on a LIBOR rate set with reference to three-month Sterling deposits.

11.4 Prepayment risk

Cash flows on the Deemed Loan to Originator are dependent on the underlying Housing Association loans which have a final legal maturity of December 2024. However, in the normal course of business, a proportion of borrowers repay their loans in advance of their contractual maturity. As a result the weighted average life of the Deemed Loan and of the term loans may be significantly less than that implied by the contractual maturity dates of the Housing Association loans.

The rate of prepayment of loans is influenced by a wide variety of economic, social and other factors, including prevailing market interest rates, the availability of alternative financing programmes and local and regional economic conditions.

Prepayment on the Housing Association loans will not impact the weighted average life of the term loans as the Covered Bonds will only be repaid in line with contractual maturity dates.

The Constant Prepayment Rate ("CPR") rate for the underlying loan portfolio is as follows

	Monthly CPR %	**1-month** %	**3-month** %	**12-month** %
31 December 2018	**1.70%**	**18.64%**	**36.23%**	**23.61%**
31 December 2017	1.57%	17.31%	15.14%	26.42%

11. Financial risk management (continued)

11.5 Financial strategy

The Partnership uses financial instruments to mitigate interest rate risk. However, the Partnership does not trade in financial instruments.

11.6 Fair values of financial assets and liabilities

The manner in which financial instruments are designated for measurement purposes is set out in the accounting policies. The main methods and assumptions used in estimating the fair value of financial instruments are summarised therein.

Other financial instruments held at amortised cost

Cash and cash equivalents and Trade and other payables are recognised on an amortised cost basis that is considered to be a close approximation to fair value. For the Deemed loan to originator, the carrying value of the variable rate loans is assumed to be their fair value. The principal of the loan is consideration for the underlying pool of loans which are significantly held at variable rate. For these reasons, the fair value of this asset is considered to be a close approximation to amortised cost.

12. Contingent liabilities and capital commitments

There were no contingent liabilities or contracted capital commitments at the Balance sheet date (2017: £nil), other than those disclosed in note 1.11.

13. Post balance sheet events

There are no post balance sheet events requiring disclosure in these financial statements.

14. Implementation of IFRS 9 Financial Instruments

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

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

Classification and measurement

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

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

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

Impairment

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

14. Implementation of IFRS 9 Financial Instruments (continued)

Impairment - Deemed loan to originator

The deemed loan to originator for this entity is not expected to result in a day one ECL. Unlike other financial instruments, the deemed loan to originator is, by its construction, an instrument that incorporates credit enhancement. As previously noted the interest due on the deemed loan to originator is only due to the extent it matches the obligations of the entity. All securitisation programmes incorporate credit enhancement in the form of excess spread and various reserve funds for use in the event the excess spread for a particular payment period is insufficient. Expected losses for the deemed loan to originator would only therefore be recognised where the ECLs on the underlying assets were large enough that no credit enhancement remained. To date, no permanent losses have occurred in the loans to related company since the structure's inception, and credit enhancement has remained more than sufficient to cover losses on underlying assets. Given the headroom available, the probability of default (PD) on the loans to related company is considered as close to zero, and therefore the initial 12 month ECL recognised in the accounts is nil.

Impact on the financial statements

The Company has adopted IFRS 9 from 1 January 2018. In accordance with the transition requirements of IFRS 9, comparative information for 2017 hs not been restated and transitional adjustments have been accounted for through retained earnings as at 1 January 2018.

The Company has conducted an analysis of these changes and does not consider there to be any significant impact of applying IFRS 9 to the financial statements.

15. Ultimate parent undertaking and controlling party

The Partnership's immediate parent company is Bank of Scotland plc (incorporated in Scotland). The company regarded by the members as the ultimate parent company and controlling party is Lloyds Banking Group plc (incorporated 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 Partnership is a member. Bank of Scotland plc is the parent undertaking of the smallest such group of undertakings. Copies of the financial statements of both companies may be obtained from Group Secretariat, Lloyds Banking Group plc, 25 Gresham Street, London, EC2V 7HN. The Lloyds Banking Group plc financial statements may be downloaded via www.lloydsbankinggroup.com.

Independent auditors' report to the members of HBOS Social Housing Covered Bonds LLP

Report on the audit of the financial statements

Opinion

In our opinion, HBOS Social Housing Covered Bonds LLP's financial statements:

- give a true and fair view of the state of the limited liability partnership's affairs as at 31 December 2018 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 as applied to limited liability partnerships by the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008.

We have audited the financial statements, included within the Members' Report and Financial Statements (the "Annual Report"), which comprise: the balance sheet as at 31 December 2018; the statement of comprehensive income, the statement of changes in members' other interests, the statement of cash flows for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Basis for opinion

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

Independence

We remained independent of the limited liability partnership in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Conclusions relating to going concern

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

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

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

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

Reporting on other information

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

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

Responsibilities for the financial statements and the audit

Responsibilities of the members for the financial statements

As explained more fully in the Statement of members' responsibilities set out on page 2, the members are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The members are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditors' responsibilities for the audit of the financial statements

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

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

Use of this report

This report, including the opinion, has been prepared for and only for the members of the partnership as a body in accordance with the Companies Act 2006 as applied to limited liability partnerships by the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 as applicable to limited liability partnerships we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the limited liability partnership, 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.

Darren Meek (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
29 April 2019