HBOS Social Housing Covered Bonds LLP

Members' report and financial statements
for the year ended 31 December 2019

Registered office

Cawley House
Chester Business Park
Chester
CH4 9FB

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 2019

The Members present their annual report and audited financial statements of HBOS Social Housing Covered Bonds LLP ("the Partnership") for the year ended 31 December 2019.

General information

The Partnership is a limited liability partnership, incorporated in the United Kingdom, registered in England and Wales and domiciled in England (registered number: OC310386).

The Partnership is a special purpose entity whose business is the acquisition of a beneficial interest in loans originated by or acquired by Bank of Scotland plc, ("BoS" and the "Originator"), to housing associations or other registered social housing landlords ("Housing Associations") and their related security to support the covered bond programme (the "Programme"). The Programme enables BoS to issue bonds up to a maximum permitted nominal amount of £3bn, (the "Social Housing Covered Bonds").

The activities of the Partnership are conducted primarily by reference to a series of securitisation transaction documents (the "Transaction Documentation"). The securitisation structure has been established as a means of raising finance for BoS and no business activities are permitted to be undertaken by the Partnership beyond those set out in the Transaction Documentation. The Transaction Documentation sets out the workings of the transaction and the principal risks to the holders of the Social Housing Covered Bonds (the "Bondholders"). As such, these have not been reproduced in full in the financial statements.

Under the programme, a maximum issuance of £3bn of Social Housing Covered Bonds is permitted, provided that the Housing Association loans acquired and other assets available meet the asset coverage test (the "ACT") per the Transaction Documentation. The ACT states that the aggregate amount of the Housing Association loans and other assets (primarily cash), adjusted by an agreed discount factor, 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.

The consideration payable to acquire the beneficial interest in the Housing Associations loans and their related security is satisfied through either one or a combination of the following:

(i) a cash payment to BoS from the proceeds of a term loan or available principal receipts;
(ii) BoS being treated as having made a capital contribution in kind; and
(iii) deferred consideration paid by the Partnership on each designated payment date in accordance with the relevant priority of payments.

During the year, the Partnership did not make any cash payments to acquire beneficial interest in any Housing Association loans, (2018: £273,115,000)

Under the terms of the Transaction Documentation, should certain conditions exist in relation to individual Housing Association loans, depending on the condition, BoS shall, or may, repurchase the beneficial interest and related security from the Partnership. During the year, BoS repurchased Housing Association loans totalling £43,118,000 (2018: £110,923,000).

On 8th November 2019, two tranches of the Social Housing Covered Bonds totalling £600,000,000 were redeemed by BoS in line with their scheduled redemption date. Per the Transaction Documentation, £600,000,000 of the Deemed loan to originator that was associated with those tranches was repayable on 20th December 2019, to the extent the Partnership had sufficient funds available. Accordingly, on 20th December 2019, the Partnership repaid £453,061,000 with the balance of £146,939,000 being due once sufficient funds were available. Principal collections received by the Partnership in the following 3 month period exceeded the balance outstanding of the loan, therefore the £146,939,000 remaining was repaid on 20th March 2020.

Principal risks and uncertainties

From the perspective of the Partnership, the principal risks and uncertainties are managed within the framework established for the transaction. Further details of the Partnership's risk management policy are contained in note 11 to the financial statements.

In the context of operational resilience, the Company is assessing the risks associated with the current global health issue Covid-19 and continues to analyse the impacts. However, it is difficult at this stage to quantify risks and the degree to which they might crystallise.

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.

Members' report (continued)

For the year ended 31 December 2019

Going concern

The Members are satisfied that it is the intention of Lloyds Banking Group plc, ("LBG"), that its subsidiaries, including the Partnership, will continue to have access to adequate liquidity and capital resources for the foreseeable future. It was noted that a letter of support had been issued by Lloyds Banking Group plc (the Company's ultimate parent), dated 19 February 2020, confirming that it has the current intention to provide finanical support to Lloyds Bank plc and its subsidiaries to meet their respective financial liabilities as they fall due. Accordingly, the financial statements have been prepared on a going concern basis.

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.

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

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.

Auditors and disclosure of information to auditors

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 BoS
Designated Member

24 April 2020

Statement of comprehensive income

For the year ended 31 December 2019

	Note	**2019 £'000**	2018 £'000
Interest income		**9,915**	8,057
Interest expense		**(9,703)**	(7,886)
Net interest income	3	**212**	171
Other operating expenses	4	**(212)**	(171)
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 2019
Company no: OC310386

	Note	2019 £'000	2018 £'000
ASSETS			
Cash and cash equivalents	5	**21,852**	38,454
Deemed loan to originator	6	**725,438**	1,161,992
Total assets		**747,290**	1,200,446
LIABILITIES			
Borrowed funds	7	**747,135**	1,200,356
Trade and other payables	8	**155**	90
Total liabilities		**747,290**	1,200,446
MEMBERS' OTHER INTERESTS			
Retained earnings		**-**	-
Total Members' other interests		**-**	-
Total Members' other interests and liabilities		**747,290**	1,200,446
TOTAL MEMBERS' INTERESTS			
Retained earnings		**-**	-
Deemed loan to originator	6	**(725,438)**	(1,161,992)
Borrowed funds	7	**747,135**	1,200,356
	9	**21,697**	38,364

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 BoS
Designated Member

24 April 2020

Statement of changes in Members' other interests

For the year ended 31 December 2019

	Retained earnings £'000
At 1 January 2018	-
Result for the year being total comprehensive result	-
At 31 December 2018	**-**
Result for the year being total comprehensive result	-
At 31 December 2019	**-**

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

Cash flow statement

For the year ended 31 December 2019

	2019 £'000	2018 £'000
Cash flows used in operating activities		
Result for the year being total comprehensive result	**-**	-
Adjustments for:		
- Interest income	**(9,915)**	(8,057)
- Interest expense	**9,703**	7,886
Changes in operating assets and liabilities:		
- Net increase/(decrease) in Trade and other payables	**65**	(23)
Net cash used in operating activities	**(147)**	(194)
Cash flows generated from/(used in) investing activities		
Principal receipts from/(repayments on) Deemed loan to originator	**439,542**	(27,248)
Interest received on Deemed loan to originator	**5,894**	7,331
Bank interest received	**1,033**	611
Net cash generated from/(used in) investing activities	**446,469**	(19,306)
Cash flows used in financing activities		
Repayment of Borrowed funds	**(453,061)**	-
Interest paid on term loan	**(9,851)**	(7,721)
Interest paid to Members	**(12)**	(12)
Net cash used in financing activities	**(462,924)**	(7,733)
Change in Cash and cash equivalents	**(16,602)**	(27,233)
Cash and cash equivalents at beginning of year	**38,454**	65,687
Cash and cash equivalents at end of year	**21,852**	38,454

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 2019

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.

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

Details of those pronouncements which will be relevant to the Partnership but which were not effective at 31 December 2019 and which have not been applied in preparing these financial statements are given in note 14. No standards have been early adopted.

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 2019.

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.

1.3 Financial assets and liabilities

Financial assets comprise Deemed loan to originator and Cash and cash equivalents. Financial liabilities comprise Borrowed funds 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 BoS is limited to its cash flows from the Housing Association loans and any additional credit enhancement provided by BoS.

Notes to the financial statements (continued)

For the year ended 31 December 2019

1. Accounting policies (continued)

1.3 Financial assets and liabilities (continued)

Deemed loan to originator (continued)

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 BoS. 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 Partnership, the Members currently consider that no impairment exists.

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, BoS 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 BoS 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.

1.6 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. Accounting policies (continued)

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 BoS. Following a BoS 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 BoS 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 (2018: £nil).

Following amendments to the Covered Bonds Swap Agreement in December 2012 it has been agreed that BoS 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.

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 expected credit losses ("ECLs") is a critical accounting estimate.

3. Net interest income

	2019 £'000	2018 £'000
Interest income		
Interest receivable on Deemed loan (see note 10)	**8,882**	7,446
Bank interest receivable (see note 10)	**1,033**	611
	9,915	8,057
Interest expense		
Interest payable on term loans (see note 10)	**(9,691)**	(7,874)
Interest payable to Members (see note 10)	**(12)**	(12)
	(9,703)	(7,886)
	212	171

4. Other operating expenses

	2019 £'000	2018 £'000
Administration charges	**198**	158
Audit fees	**14**	13
	212	171

The Partnership has also accrued an audit fee of £1,260 (2018: £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.

5. Cash and cash equivalents

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

	2019 £'000	2018 £'000
Cash at bank (see note 10)	**21,852**	38,454

The Partnership has placed its deposit account with a provider of a GIC, BoS, 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

	2019 £'000	2018 £'000
Deemed loan to originator (see note 10)	**725,438**	1,161,992

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.

6. Deemed loan to originator (continued)

Represented by:	2019 £'000	2018 £'000
Non-current	**556,772**	1,127,454
Current	**168,666**	34,538
	725,438	1,161,992

7. Borrowed funds

	2019 £'000	2018 £'000
Amounts due to group undertakings (see note 10)	**747,135**	1,200,356

Represented by:		
Non-current	**600,000**	600,000
Current	**147,135**	600,356
	747,135	1,200,356

Borrowed funds comprise a series of term loans from BoS that are agreed and drawn in amounts 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.

BoS 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 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.

On 8th November 2019, two tranches of the Social Housing Covered Bonds totalling £600,000,000 were redeemed by BoS in line with their scheduled redemption date. Per the Transaction Documentation, £600,000,000 of the Deemed loan to originator that was associated with these tranches was repayable on 20th December 2019, to the extent the Partnership had sufficient funds available. Accordingly, on 20th December 2019, the Partnership repaid £453,061,000 with the balance of £146,939,000 being due once sufficient funds were available. Principal collections received by the Partnership in the following 3 month period exceeded the balance outstanding of the loan. Therefore the remaining £146,939,000 was repaid on 20th March 2020.

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 BoS 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 BoS.

The term loans due to BoS mature following repayment of the covered bonds on the following dates:

Covered bond issuance	**Maturity date**	**2019 £'000**	2018 £'000
2004-1	20 December 2024	**500,000**	500,000
2008-1 (Tranche 2)	8 November 2019	**-**	100,000
2008-2 (Tranche 2)	8 November 2019	**-**	500,000
2008-2 (Tranche 3)	8 November 2022	**100,000**	100,000
		600,000	1,200,000

8. Trade and other payables

	2019 £'000	2018 £'000
Accruals and deferred income	**154**	90

Included within Accruals and deferred income is £26,000 (2018: £13,000) in respect of audit fee accrual.

9. Total Members' interest

2019	**Members' capital £'000**	**Retained earnings £'000**	**Total £'000**	**Loans due to/(from) Members £'000**	**Total £'000**
Members' interest as at 1 January	-	-	-	38,364	38,364
Repayment of BoS term loan	-	-	-	(453,061)	(453,061)
Interest on BoS term loan	-			(160)	(160)
Movements in amounts due to/(from) Members	-	-	-	436,554	436,554
Members' interests as at 31 December 2019	-	-	-	**21,697**	**21,697**

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

	Members' interests as at 31 December 2019 £'000
Amounts due to Members (see note 7)	747,135
Amounts due from Members (see note 6)	(725,438)
	21,697

2018	**Members' capital £'000**	**Retained earnings £'000**	**Total £'000**	**Loans due to/(from) Members £'000**	**Total £'000**
Members' interests as at 1 January	-	-	-	65,574	65,574
Interest on BoS 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 (see note 7)	1,200,356
Amounts due from Members (see note 6)	(1,161,992)
	38,364

10. Related party transactions

The Partnership is controlled by BoS. 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.

	2019 £'000	2018 £'000
Deemed loan to originator		
BoS (see note 6)	**725,438**	1,161,992
Amounts due to group undertakings		
BoS (see note 7)	**747,135**	1,200,356
Cash and cash equivalents held with group undertakings		
BoS (see note 5)	**21,852**	38,454
Interest receivable on Deemed loan		
BoS (see note 3)	**8,882**	7,446
Bank interest receivable		
BoS (see note 3)	**1,033**	611
Interest payable on term loans		
BoS (see note 3)	**9,691**	7,874
Interest payable to Members		
BoS (see note 3)	**12**	12

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 in connection with its provision of corporate management services to Addison Social Housing Limited and Intertrust Offshore Limited in connection with its provision of corporate management services to Addison Social Housing Holdings Limited, which includes the provision of Directors to these entities. This amounted to an expense in the Statement of comprehensive income of £14,000 (2018: £9,000) and £10,000 (2018: £6,000) respectively for the year ended 31 December 2019. Of this £9,000 (2018: £5,000) relates to the provision of Directors.

The Partnership is required to pay cash and administration servicing fees to BoS 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 £364,000 (2018: £375,000) for the year ended 31 December 2019.

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 BoS 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.

11. Financial risk management (continued)

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 BoS 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 BoS 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 BoS. 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.

Credit risk for the Partnership is mitigated by the amount of overcollateralisation of the beneficial interest in loans and which is monitored using an ACT. 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.

In accordance with the Transaction Documentation the Originator shall be entitled to remove Housing Association 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 2019, BoS repurchased Housing Association loans totalling £43,118,000 (2018: £110,923,000). The ACT continued to be satisfied following the removal of these Housing Association loans.

The Transaction Documentation also provides for the inclusion of new Housing Association loans in the portfolio. The inclusion of new Housing Association 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 2019, the Partnership did not make any cash payments to acquire beneficial interest in any Housing Association loans, (2018: £273,115,000)

The total loan portfolio made available to the Partnership at 31 December 2019 amounted to £728,938,000 (2018: £1,168,480,000). 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 BoS.

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 BoS. In such circumstances the Members may be required to make a capital contribution.

During 2019, two tranches of the Social Housing Covered Bonds totalling £600,000,000 were redeemed on their scheduled redemption date (2018: £nil).

11. Financial risk management (continued)

11.1 Credit risk (continued)

BoS as provider of:		Rating as at 31 December 2019 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-obligor 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 BoS whom also acts as swap counterparty, servicer of the Housing Association loans and cash manager.

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.

	2019 £'000	2018 £'000
Deemed loan to originator	725,438	1,161,992
Cash and cash equivalents	21,852	38,454
	747,290	1,200,446

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. BoS 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 2019 no loan accounts were considered past due (2018: 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 BoS 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).

Notes to the financial statements (continued)

For the year ended 31 December 2019

11. Financial risk management (continued)

11.2 Liquidity risk (continued)

Principal repayments are made on the term loans with BoS 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 BoS.

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, payments of interest and principal may be deferred in accordance with the terms of the Transaction Documentation.

During the year, sufficient cash has been received from the Deemed loan to enable the Partnership to make all necessary interest payments on the term loans following repayment of the related series of covered bonds notes.

During 2019, two tranches of the Social Housing Covered Bonds totaling £600,000,000 were redeemed. The corresponding term loans were repaid to the extent of available funds. This amounted to £453,061,000 with the balance of £146,939,000 deferred and paid on 20th March 2020.

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 2019

	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	**-**	146,939	-	600,000	-	746,939
Interest						
Borrowed funds	**-**	1,488	3,578	17,349	-	22,415
	-	**148,427**	**3,578**	**617,349**	**-**	**769,354**

As at 31 December 2018

	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	**-**	-	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

Carrying value of the principal Borrowed funds and Interest on borrowed funds are respectively £746,939,000 (2018: £1,200,000,000) and £1,347,000 (2018: £600,356,000).

11. Financial risk management (continued)

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.

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 (2018: £nil).

13. Post balance sheet events

There are risks arising from the outbreak of Coronavirus which has occurred since the balance sheet date. In view of its evolving nature, the Members are unable to estimate its financial effect.

Notes to the financial statements (continued)
For the year ended 31 December 2019

14. Future developments

The following pronouncement will be relevant to the Partnership but was not effective at 31 December 2019 and has not been applied in preparing these financial statements.

Pronouncement	Nature of change	Effective date
Minor amendments to other accounting standards	The IASB has issued a number of minor amendments to IFRSs (including IFRS 3 Business Combinations and IAS 1 Presentation of Financial Statements).	Annual periods beginning on or after 1 January 2020

The full impact of this pronouncement is being assessed by the Partnership. However, the initial view is that this is not expected to cause any material adjustments to the reported numbers in the financial statements.

15. Ultimate parent undertaking and controlling party

The Partnership's immediate parent company is BoS (incorporated in Scotland). The company regarded by the Members as the ultimate parent company and controlling party is LBG (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. BoS 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, LBG, 25 Gresham Street, London, EC2V 7HN. The LBG financial statements may be downloaded via www.lloydsbankinggroup.com.