Eurosail-UK 2007-3BL Parent Limited

Report and Financial Statements

30 November 2008

Registered No: 06240170

MONDAY

L0HJ5DNQ

LD5 28/09/2009 17

COMPANIES HOUSE

Registered No: 06240170

Directors
M H Filer
Wilmington Trust SP Services (London) Limited
J Traynor

Secretary
Wilmington Trust SP Services (London) Limited
5th floor, 6 Broad Street Place
London EC2M 7JH

Auditors
Ernst & Young LLP
1 More London Place
London SE1 2AF

Bankers
Barclays Bank plc
Cheapside Business Centre
155 Bishopsgate
London EC2M 3XA

Solicitors
Clifford Chance
10 Upper Bank Street
London E14 5JJ

Registered Office
Wilmington Trust SP Services (London) Limited
5th floor, 6 Broad Street Place
London EC2M 7JH

Directors' report

The directors present their report and the audited financial statements for the year ended 30 November 2008.

Principal activities

The principal activity of the Company is that of a holding company. The principal activity of the Group is the investment in mortgage loans secured by first and second charges over properties within the United Kingdom.

Business review

The company was incorporated on 8 May 2007 and commenced its activities on 16 July 2007. Eurosail-UK 2007-3BL Parent Limited acquired Eurosail-UK 2007-3BL plc on 2 July 2007.

On 16 July 2007 the Group purchased £649,529,050 of mortgages from Southern Pacific Mortgage Limited and Preferred Mortgages Limited. Further consideration may be payable dependent on future performance of the mortgages. To facilitate the purchase, the Group issued a series of mortgage-backed loans on 16 July 2007. These loan notes are listed on the Irish Stock Exchange.

The consolidated profit and loss account for the year ended 30 November 2008 is set out on page 9. The Group's business activities, together with the factors likely to affect its future development, performance and position are set out below.

The current economic environment is difficult and the Group has reported an operating loss for the year, after Financial Reporting Standard No. 26 adjustments and allowing for the impairment of the mortgage loans. The directors consider that the outlook presents significant challenges in meeting the obligation to the holders of the loan notes as and when the obligations fall due.

Furthermore, on 3 October 2008, the interest rate swap, interest rate cap and currency swap counterparty, Lehman Brothers Special Financing Inc filed for Chapter 11 bankruptcy. This has had an impact on the results of the Group for the year, and its ability to manage its significant risks and uncertainties, and the cash available to pay interest, and repay capital, owing to Mortgage Backed Loan Note Holders.

The swaps were in default at the year end. Future amounts due to the Group under the swaps will not be paid. It is anticipated that the Group is likely to continue to make losses as a result of not having swaps in place to manage its interest rate risk, however it is not possible to quantify the amount of these losses.

The directors have concluded that the Group will continue as a going concern and set out the basis for this conclusion in the Going concern section of this report.

As required by Financial Reporting Standard No. 26, the result for the year includes a fair value loss on derivative financial instruments of £12,421,061 (period ended 30 November 2007: £12,421,061 gain) and an unrealised exchange loss on restatement of loan liabilities of £75,211,141 (period ended 30 November 2007: £10,954,426).

At the year end the mortgage balance after the effective interest rate adjustment, was £525,331,237 (2007: £602,972,267). At December 2008 Interest Payment Date the Group held the following mortgage loans, excluding the effective interest rate adjustment:

	Principal balance £000	*Number of loans*
First Mortgages	597,116	5,413
Second Mortgages	58,051	2,253
Total	531,094	6,787

Directors' report

Business review (continued)

These mortgages provide security against loan notes in issue totalling £546,945,592 as at the December 2008 Interest Payment date.

The mortgage loans generated a weighted average margin over funding costs of 1.51% during the year, before considering the adjustments for Financial Reporting Standard No. 26. The weighted average cost of funds for the year was 6.00%.

The mortgage loans exhibited the following quarterly arrears profile:

	Q1	*Q2*	*Q3*	*Q4*
		%	%	%
Delinquencies days – (excluding repossessions)				
Current	81.01	79.31	77.99	75.94
>30<=60	6.46	7.24	6.53	7.07
>60<=90	4.33	4.14	4.56	4.43
>90<=120	2.78	2.67	3.28	3.26
>120	5.42	6.64	7.64	9.30
Total	100.00	100.00	100.00	100.00

At the March 2009 Interest Payment Date following the year end, the mortgage loan balance was £510,896,877, 15.62 % of the balance was greater than 3 months in arrears.

The directors consider the level of arrears to be within expectations and have not made any adjustment to the provisions recorded as at the year end.

The performance of the mortgage loans during the year to 30 November 2008 enabled deferred consideration of £nil (2007: £nil) to be paid to the current holder of the rights to the residual cash flows of the securitisation.

The mortgage portfolio originators (Southern Pacific Mortgage Limited and Preferred Mortgage Limited) no longer retain an interest in those portfolios as at 30 November 2008 and consequently the mortgage portfolios have been recognised as mortgage balances in the consolidated balance sheet rather than as loans to originators. The comparative figures have been restated accordingly.

Going concern

As described in the Business Review, the Group has reported an operating loss for the year.

The Group is in a net liability position as at 30 November 2008 due to the impact of adverse interest rate and foreign currency movements on the value of the mortgage backed loan notes, which are no longer covered by interest rate swaps and foreign currency hedges, amortisation of the premium paid to the mortgage loan originators and the impairment of the mortgage loans. Should these adverse interest rate and currency movements and this impairment not reverse in forthcoming periods the Group may be unable to meet its obligation to the holders of the loan notes as and when the obligations fall due.

It is the intention of the Directors of the Group to continue operations until such a time as the amount due from mortgage loans have been fully realised. Ultimately, due to the non-recourse nature of the mortgage backed loan notes, any shortfall in the proceeds from the mortgage assets will be a risk to the holders of those notes and accordingly the financial statements have been prepared on a going concern basis.

Fair value

Note 19 discloses the fair values of the mortgage assets, and non recourse loan notes. The directors noted that as at 30 November 2008 the respective fair values of the mortgage assets and non recourse loan notes are less than the carrying values recorded in the balance sheet.

Directors' report

Fair value (continued)

The directors believe that this is reasonable, based on the global contraction of credit markets, the challenges faced by the sub prime mortgage sector and the decline in market demand for mortgage backed securities.

As no liquid market exists for either the mortgage loans or non recourse loan notes, the directors have ascribed an approximate fair value based on an internal discounted cash flow model that is used to value non-securitised mortgage loan receivables. This model takes into account expected pre-payment rates, arrears levels, house price movements, level of repossessions, losses and discount rates based on the most recent available information

The fair values disclosed do not necessarily represent the directors' view of the current value of the predicted future cash flows on either the mortgage asset receivables or non recourse loan notes.

Dividend

The directors do not recommend the payment of a dividend for the year (2007: £nil).

Policy and practice on payment of creditors

The Group does not follow any stated code on payment practice. It is the Group's policy to agree terms of payment with suppliers when agreeing the terms of each transaction and to abide by those terms. Standard terms provide for payment of all invoices within 30 days after the date of the invoice, except where different terms have been agreed with the suppliers at the outset. It is the policy of the Group to abide by the agreed terms of payment. There are no creditor days of suppliers' invoices outstanding at the year end.

Directors

The directors who held office during the year were as follows:

M H Filer
Wilmington Trust SP Services (London) Limited
R G Baker (resigned 28 February 2008)
J Traynor (appointed 28 February 2008)

Clifford Chance Secretaries (CCA) Limited resigned as Group Secretary on 6 February 2009, and Wilmington Trust SP Services (London) Limited was appointed as secretary to the Group on 6 February 2009.

Principal risks and uncertainties

Financial instrument risk

The financial instruments held by the Group comprise mortgage assets, borrowings, cash and various other items (such as trade debtors, trade creditors etc) that arise directly from its operations.

The Group also entered into derivative transactions where necessary (principally interest rate and currency swaps) to manage its interest rate risk and currency risk.

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

The main risks arising from the Group's financial instruments are credit risk, interest rate risk, currency risk and liquidity risk. The directors review and agree policies for managing each of these risks and they are summarised below.

Directors' report

Principal risks and uncertainties (continued)

Credit risk

Credit risk is the risk that borrowers will not be able to meet their obligations as they fall due. All mortgages purchased by the Group were required to adhere to specific lending criteria. The ongoing credit risk of the mortgage portfolio (and particularly in respect of accounts in arrears) is closely monitored by the directors.

Interest rate risk

Interest rate risk exists where assets and liabilities have interest rates set under different bases or which reset at different times. The Group minimises its exposure to interest rate risk by ensuring that the interest rate characteristics of its assets and liabilities are similar. Where this is not possible the Group had used derivative financial instruments to mitigate any residual interest rate risk. However, as stated on page 2, the interest rate cap and swap counterparty has filed for Chapter 11 bankruptcy, and has defaulted on the swaps and caps. The swap and cap agreements have not been replaced. The directors believe under current circumstances that it is not viable to replace the swaps and caps and until such time, the Group will continue with an unhedged interest rate risk.

Foreign exchange risk

Foreign exchange risk exists where the loan notes are denominated in a currency which is different to the underlying sterling mortgage loans. The Group minimises its exposure to foreign currency risk by ensuring that the currency characteristics of its assets and liabilities are similar. Where this is not possible the Group considers the use of derivative financial instruments to mitigate any foreign exchange risk. However, as stated on page 2, the foreign currency swap counterparty has filed for Chapter 11 bankruptcy, and has defaulted on the swaps which have not been replaced. The directors believe under current circumstances that it is not viable to replace the swaps and until such time, the Group will continue with an unhedged foreign currency risk exposure.

Liquidity risk

The Group's policy is to manage liquidity risk by matching the timing of the cash receipts from mortgage assets with those of the cash payments due on the loan notes. In addition the Group holds a minimum cash balance to manage short term liquidity requirements.

Disclosure of information to the auditors

So far as each person who was a director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing its report, of which the auditor is unaware. Having made enquiries of fellow directors and the Group's auditor, each director has taken all the steps that he is obliged to take as a director in order to make himself aware of any relevant audit information and to establish that the auditor is aware of that information.

Auditors

A resolution to reappoint Ernst & Young LLP as auditors will be put to the members at the Annual General Meeting.

Approved by the board of directors and signed on behalf of the board.

Director:

Date: 24 SEPTEMBER 2009

Statement of directors' responsibilities in respect of the financial statements

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The financial statements are required by law to give a true and fair view of the state of affairs of the Company and of the Group and of the profit or loss of the Group for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Group and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

ERNST & YOUNG

Independent auditors' report

to the members of Eurosail-UK 2007-3BL Parent Limited

We have audited the group and parent company financial statements of Eurosail-UK 2007-3BL Parent Limited for the year ended 30 November 2008 which comprise the Consolidated Profit and Loss Account, the Consolidated Balance Sheet, the Company Balance Sheet, and Consolidated Cash Flow Statement and the related notes 1 to 24. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

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

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

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the directors' report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed.

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

Independent auditors' report

to the members of Eurosail-UK 2007-3BL Parent Limited (continued)

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Group's and the parent company's affairs as at 30 November 2008 and of the Group's loss for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the directors' report is consistent with the financial statements.

Ernst & Young LLP

Ernst & Young LLP
Registered Auditor
London
Date 25 September 2009

Consolidated profit and loss account

for the year ended 30 November 2008

	Notes	*Year ended 30 November 2008 £000*	*Period ended 30 November 2007 £000*
Interest receivable and similar income	2	48,862	19,562
Interest payable and similar charges	3	(40,914)	(20,827)
Net interest receivable/(payable)		7,948	(1,265)
Net fair value (loss)/gain on derivatives		(12,421)	12,421
Other operating income	4	3,171	1,780
Remeasurement adjustment of amortised cost of Mortgage Backed Loan Notes	15	5,790	–
Unrealised exchange loss on restatement of loan liabilities		(75,211)	(10,954)
Total operating (loss)/income		(70,723)	1,982
Operating expenses		(24,288)	(5,420)
Loss on ordinary activities before taxation	5	(95,011)	(3,438)
Tax on loss on ordinary activities	6	(1,330)	410
Loss on ordinary activities after taxation	17	(96,341)	(3,028)

The loss for the year was derived from continuing operations.

There were no recognised gains or losses other than the loss for the year, accordingly no statement of recognised gains and losses is given.

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

Consolidated balance sheet

at 30 November 2008

	Notes	2008 £000	2007 £000
Current assets			
Debtors:			
Amounts falling due after one year	12	519,011	610,355
Amounts falling due within one year	13	13,402	18,601
Cash at bank and in hand		31,542	38,522
		563,955	667,478
Creditors: amounts falling due within one year	14	(20,927)	(20,432)
Net current assets		543,028	647,046
Creditors: amounts falling due after one year	15	(642,384)	(650,061)
Net liabilities		(99,356)	(3,015)
Capital and reserves			
Called up share capital	16	13	13
Profit and loss account	17	(99,369)	(3,028)
Shareholders' deficit	18	(99,356)	(3,015)

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

These financial statements were approved by the board of directors and were signed on its behalf by:

Director

Date 24 SEPTEMBER 2009

Company balance sheet

at 30 November 2008

	Notes	2008 £000	2007 £000
Fixed assets			
Investments	8	13	13
Net assets		13	13
Capital and reserves			
Called up share capital	16	13	13
Profit and loss account	17	–	–
Shareholder's funds	18	13	13

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

These financial statements were approved by the board of directors and were signed on its behalf by:

Director

Date: 24 SEPTEMBER 2009

Consolidated cash flow statement

for the year ended 30 November 2008

	Notes	*Year ended 30 November 2008 £000*	*Period ended 30 November 2007 £000*
Net cash outflow from operating activities	20	(6,927)	(1,774)
Returns on investment and servicing of finance			
Interest on mortgage loans		44,420	16,263
Other interest received		1,416	180
Interest on mortgage backed loan notes		(39,991)	(6,957)
		5,845	9,486
Capital expenditure and financial investment			
Purchase of mortgage loans		–	(649,529)
Proceeds from mortgage loans		71,440	39,064
		71,440	(610,465)
Net cash inflow / (outflow) before management of liquid cash resources and financing		70,358	(602,753)
Financing			
Proceeds from mortgage backed loan notes		–	659,750
Repayment of mortgage backed loan notes	21	(77,338)	(18,488)
Issue of ordinary share capital		–	13
		(77,338)	641,275
(Decrease)/increase in cash in year		(6,980)	38,522

Reconciliation of movement in net cash flow to movement in net debt

	Notes	*Year ended 30 November 2008 £000*	*Period ended 30 November 2007 £000*
(Decrease)/increase in cash in year/period		(6,980)	38,522
Repayment/(proceeds) from mortgage backed loan notes		77,338	(641,262)
Change in net debt resulting from cash flows	21	70,358	(602,740)
Fair value movements		(81,842)	1,467
Movement in capitalised issue costs		(240)	2,155
Movement in net debt		(11,274)	(599,118)
Net debt as at 1 December	21	(599,118)	–
Net debt as at 30 November	21	(610,842)	(599,118)

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

Notes to the financial statements

at 30 November 2008

1. Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Group's financial statements:

Basis of preparation

The financial statements have been prepared in accordance with applicable UK accounting standards and under the historical cost convention except for derivative financial instruments which are carried at fair value through profit and loss account. The financial statements have been prepared on a going concern basis as referred to in the Directors' Report.

Basis of consolidation

The Group's financial statements consolidate the financial statements of the Company and all its subsidiaries for the year ended 30 November 2008. All the subsidiaries are accounted for using acquisition accounting.

In accordance with section 230 (4) of the Companies Act 1985, Eurosail-UK 2007-3BL Parent Limited is exempt from the requirement to present its own profit and loss account. The result for the year of Eurosail-UK 2007-3BL Parent Limited is disclosed in note 17 to the financial statements.

Income recognition

Interest income on mortgage loan assets is recognised in the profit and loss account on an Effective Interest Rate (EIR) basis. The EIR recognises revenue equivalent to the rate that effectively discounts estimated future cash flows throughout the estimated life to the net carrying value of the loan.

Mortgage loans

Mortgage loans are valued on the amortised cost basis using the effective interest rate method, less provision made to reduce the value of the loans to their estimated recoverable amount. Provisions are made against mortgages when in the opinion of the directors, credit risk or economic risk make recovery doubtful. A loan premium is recognised where mortgages are acquired at amounts in excess of the amount recoverable from customers. This loan premium is amortised over the expected life of the mortgages.

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

A charge for impairment would be recognised where there is a risk that the income on the mortgage assets will be significantly reduced. This could occur if the credit quality of the mortgage assets deteriorated significantly and is calculated in accordance with the provisions policy below.

Provisions

Specific provisions for losses on loans and advances to customers are made throughout the year and at the year-end on a case by case basis (calculated with reference to the probability of the loan defaulting and the value of the security held against the loan). The specific provision for properties in possession is based on the balance outstanding less a discounted valuation of the security held (with adjustments for expenses of sale).

Fixed asset investment

The Company's investment in subsidiary companies is stated at cost, less provision for diminution in value where the directors consider this necessary.

Notes to the financial statements

at 30 November 2008

1. Accounting policies (continued)

Premium paid to mortgage loan originator

Gross cash receipts received by the Group on the issue of turbo notes are paid to Southern Pacific Mortgage Limited and Preferred Mortgages Limited as a premium on acquisition of the mortgage assets. This premium is capitalised by the Group and amortised over the expected repayment period of the Class ETc Notes mentioned in note 15. The amortised balance is shown in debtors, amounts falling due within one year with costs amortised in the year included in interest payable.

Discount on purchase of mortgage assets

Cash received from the originator on acquisition of the mortgage assets to cover start up costs is amortised over the expected life of the mortgage assets. The amortised balance is shown in creditors' amounts falling due within one year with the income for the year included in interest receivable.

Taxation

The charge for taxation is based on the profit for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred taxation is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that have occurred at that date that will result in an obligation to pay more, or a right to pay less tax with the following exceptions:

Deferred tax assets are recognised only to the extent that the directors consider it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted. Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in years in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

Deferred consideration

Deferred consideration represents further amounts payable on the acquisition of mortgages from Southern Pacific Mortgage Limited and Preferred Mortgages Limited. The payment of these amounts is conditional on the performance of the mortgages.

Under the terms of the securitisation the Group earns an annual profit in an amount equal to 0.01 per cent of the aggregate balance of the revenue ledger as described in the Cash Bond Administration agreement. This is reflected in the profit and loss before any movements on fair value gains and losses on derivatives and Effective Interest Rate adjustments.

Profits in excess of 0.01 per cent accrue to the current holder of the rights to the residual cash flows of the securitisation, as deferred consideration. Accordingly, amounts owing to the current holder of the rights to the residual cash flows of the securitisation are recognised as creditors in the balance sheet.

Derivatives

The Group used derivative financial instruments to hedge its exposure to interest rate and currency risk arising from operational, financing and investment activities. The Group does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

Financial Reporting Standard No. 26 requires all derivative financial instruments to be recognised initially at fair value on the balance sheet. Subsequent to initial recognition, derivatives are remeasured to fair value. Where the value of the derivative is positive, it is carried as a derivative asset and, where negative, as a derivative liability. The gain or loss on remeasurement to fair value is recognised immediately in the profit and loss account. The fair value of the interest rate swaps and caps, and currency swaps is the estimated amount that the Group would receive or pay to terminate the swap at the balance sheet date.

Notes to the financial statements

at 30 November 2008

1. Accounting policies (continued)

Interest rate caps

A series of amortising interest rate caps were entered into in order to manage the Group's interest rate risk in relation to fixed rate mortgage loans. The derivative contracts matched the expected profile of the run-off of the fixed rate loans.

Currency swaps

A series of currency swaps were entered into in order to manage the Group's currency rate exposure in relation to non-sterling denominated Loan Notes. The derivative contracts match the expected profile of the run-off of the non-sterling denominated Loan Notes.

Foreign currencies

Mortgage-backed floating rate notes included in financial liabilities, denominated in foreign currencies at the balance sheet date, are reported at the rates of exchange prevailing at the reporting date. Any exchange differences arising in the year on the settlement or retranslation of foreign currency liabilities are included in the profit and loss account.

Issue costs

Initial issue costs incurred in arranging funding facilities are amortised over the life of the facility. Unamortised initial issue costs are deducted from the associated liability in accordance with Financial Reporting Standard No. 26 and costs amortised in the year are included in interest payable.

Mortgage-backed loan notes

Mortgage-backed loan notes are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, the mortgage-backed loan notes are stated at amortised cost with any difference between cost and redemption value being recognised in the profit and loss account over the period of the borrowings on an effective interest basis.

The repayment of the loan notes is dependent on principal and interest collections on the mortgage loans. The directors periodically review the estimated future cash flows on the mortgage loans to determine whether the amortised cost carrying value of the loan notes requires adjustment. If a shortfall in the cash flows is identified, an adjustment is credited to the profit and loss account to reduce the carrying value of the loan notes.

Turnover

The Group's income and trade are wholly within the UK and within a single market sector and therefore no segmental analysis has been presented.

Notes to the financial statements

at 30 November 2008

2. Interest receivable and similar income

	Year ended 30 November 2008 £000	*Period ended 30 November 2007 £000*
On mortgage loans	46,579	14,628
Other interest	1,300	508
Amortisation of start up costs on the mortgage loans	983	4,426
	48,862	19,562

3. Interest payable and similar charges

	Year ended 30 November 2008 £000	*Period ended 30 November 2007 £000*
Mortgage backed loan notes	38,869	16,905
Amortisation of premium paid to mortgage loan originator	2,045	3,922
	40,914	20,827

4. Other operating income

	Year ended 30 November 2008 £000	*Period ended 30 November 2007 £000*
Redemption fees	1,947	1,099
Sundry fee income	1,224	681
	3,171	1,780

5. Loss on ordinary activities before taxation

This is stated after charging:

	Year ended 30 November 2008 £000	*Period ended 30 November 2007 £000*
Auditors' remuneration – For audit services – Group	13	10
– Company	4	4
Provision of mortgage loans	8,466	3,601
Bad debts incurred on mortgage loans	805	1

Notes to the financial statements

at 30 November 2008

6. Tax on loss on ordinary activities

(a) Analysis of tax charge in the year

	Year ended 30 November 2008 £000	*Period ended 30 November 2007 £000*
Current tax:		
UK corporation tax on loss in the year/period	–	–
Total current tax (note 6(b))	–	–
Deferred tax:		
Origination and reversal of timing differences	1,350	(410)
Effect of tax charge on opening liability	(20)	–
Total deferred tax charge/(credit) (note 22)	1,330	(410)
Tax on loss on ordinary activities	1,330	(410)

(b) Factors affecting the tax charge in the year

The tax assessed for the year is higher than the small companies rate of corporation tax in the UK of 21% (period ended 30 November 2007: 20%). The factors affecting the tax charge are explained below:

	Year ended 30 November 2008 £000	*Period ended 30 November 2007 £000*
Loss on ordinary activities before tax	(95,011)	(3,438)
Loss on ordinary activities multiplied by the standard rate of corporation tax for small companies of 21% (period ended 30 November 2007: 20%)	(19,639)	(688)
Effects of:		
Other short-term timing differences	16,481	410
Unrelieved tax losses and other deductions arising in the year/period	3,158	278
Current tax charge for the year (note 6(a))	–	–

7. Information regarding directors and employees

The Group has no employees (2007: none). The directors received no remuneration from the Group during the year (2007: £nil).

Notes to the financial statements

at 30 November 2008

8. Investments

Company

	Shares in group undertakings £000
At 30 November 2007 and 2008	13

The undertakings in which the Company's interest at 30 November 2008 is more than 20% are as follows:

Company	*Principal activity*	*Proportion held*
Eurosail-UK 2007-3BL plc	Investment in residential loans	100%

At 30 November 2008 the Company held 49,998 ordinary shares of £1 each in Eurosail 2007-3BL Plc, and has paid up 25p on each share. The Company also held one fully paid share of £1 in the same company. These holdings represent the entire issued share capital of that company except for one fully paid ordinary share of £1 held by Wilmington Trust SP Services (London) Limited on a discretionary basis.

Eurosail 2007-3BL Plc acts as an investment company, holding mortgages financed by Mortgage Backed Floating Rate Notes. The subsidiary is registered and operates in the United Kingdom. The following information is presented in respect of its financial statements for the year ended 30 November 2008:

	2008 £000	*2007 £000*
Aggregate capital and reserves	(99,356)	(3,015)
Loss for the year/period	(96,341)	(3,028)

9. Mortgage loans – net balances

Group

	Mortgage £000	*Mortgage loss provision £000*	*Total £000*
At 1 December 2007	606,949	(3,977)	602,972
Net movement in the year	(69,175)	(8,466)	(77,641)
At 30 November 2008	537,774	(12,443)	525,331

Mortgage loans of £525,331,237 (2007: £602,972,267) are held as security against the loan notes referred to in note 15.

The current mortgage loans in the pool have loan periods of between 1 to 401 months remaining with current interest rates ranging from 3.04% to 18.00% per annum.

Notes to the financial statements

at 30 November 2008

10. Premium paid to mortgage loan originator

Group

	2008	*2007*
	£000	*£000*
At start of year/period	5,828	–
Premium paid on purchase of mortgage assets	–	9,750
Amortisation in the year/period	(2,045)	(3,922)
At end of year/period	3,783	5,828

11. Mortgage loans - Unamortised premium

Group

	2008	*2007*
	£000	*£000*
At start of year/period	376	–
Premium on acquisition	–	423
Amortisation in the year/period	(42)	(47)
At end of year/period	334	376

12. Debtors: amounts falling due after one year

Group

	2008	*2007*
	£000	*£000*
Mortgage balances	518,718	597,647
Premium paid on purchase of mortgage assets	293	287
Derivative financial instruments	–	12,421
	519,011	610,355

13. Debtors: amounts falling due within one year

Group

	2008	*2007*
	£000	*£000*
Mortgage balances	6,613	5,325
Premium paid to mortgage loan originator	3,783	5,828
Premium paid on purchase of mortgage assets	41	89
Prepayments and accrued income	1,983	2,700
Other debtors	982	4,249
Deferred tax (note 22)	–	410
	13,402	18,601

Notes to the financial statements

at 30 November 2008

14. Creditors: amounts falling due within one year

Group

	2008	*2007*
	£000	*£000*
Accruals and deferred income	16,922	19,995
Other creditors	3,085	437
Deferred tax (note 22)	920	–
	20,927	20,432

15. Creditors: amounts falling due after one year

Group

	2008	*2007*
	£000	*£000*
USD Denominated Mortgage backed loan notes due 2027 - Class A1b	77,534	88,624
GBP Denominated Mortgage backed loan notes due 2027 - Class A1c	52,611	93,397
EUR Denominated Mortgage backed loan notes due 2045 - Class A2a	53,306	46,063
USD Denominated Mortgage backed loan notes due 2045 - Class A2b	65,015	48,631
GBP Denominated Mortgage backed loan notes due 2045 - Class A2c	63,000	63,000
EUR Denominated Mortgage backed loan notes due 2045 - Class A3a	177,685	153,543
GBP Denominated Mortgage backed loan notes due 2045 - Class A3c	64,500	64,500
EUR Denominated Mortgage backed loan notes due 2045 - Class B1a	12,397	10,712
GBP Denominated Mortgage backed loan notes due 2045 - Class B1c	23,000	23,000
EUR Denominated Mortgage backed loan notes due 2045 - Class C1a	20,661	17,854
GBP Denominated Mortgage backed loan notes due 2045 - Class C1c	10,000	10,000
EUR Denominated Mortgage backed loan notes due 2045 - Class D1a	21,074	18,211
GBP Denominated Mortgage backed loan notes due 2045 - Class E1c	5,525	5,525
GBP Denominated Mortgage backed loan notes due 2045 - Class ETc	3,782	9,156
	650,090	652,216
Less: Issue costs	(1,916)	(2,155)
Less: Remeasurement adjustment to amortised cost	(5,790)	–
	642,384	650,061

All amounts falling due after one year fall due after five years.

The mortgage backed floating rate notes due 2027 and 2045 are secured over a portfolio of mortgage loans secured by first and second charges over residential properties in the United Kingdom.

Notes to the financial statements

at 30 November 2008

15. Creditors: amounts falling due after one year (continued)

The mortgages are administered by Capstone Mortgage Services Limited on behalf of Eurosail-UK 2007-3BL plc.

The loan notes are repaid as the underlying portfolio redeems. The terms and conditions of the loan notes provide that the loan note holders will receive interest and principal only to the extent that sufficient funds are generated from the mortgage loans. The priority and amount of claims on the portfolio proceeds are determined in accordance with a strict priority of payments. Note holders have no recourse to Eurosail 2007-3BL PLC in any form.

The mortgage backed floating rate notes are subject to mandatory redemption in part at each interest payment date in an amount equal to the principal received or recovered in respect of the mortgage loans. If not otherwise redeemed or purchased and cancelled, the notes will be redeemed at their principal amount outstanding on the interest payment date falling in September 2027 or June 2045.

The loan notes are repayable out of capital receipts from the mortgage loan receivables, with the Class A Notes ranking in priority to the Class B Notes, which rank in priority to the Class C Notes, which rank in priority to the Class D Notes, which rank in priority to Class E Notes.

Interest on the notes is payable quarterly in arrears at the following annual rates for three month deposits:

Class A1b	USD LIBOR + 0.07%
Class A1c	Sterling LIBOR + 0.08%
Class A2a	EUR LIBOR + 0.13%
Class A2b	USD LIBOR + 0.13%
Class A2c	Sterling LIBOR + 0.13%
Class A3a	EURIBOR + 0.17%
Class A3c	Sterling LIBOR + 0.17%
Class B1a	EURIBOR + 0.30%
Class B1c	Sterling LIBOR + 0.30%
Class C1a	EURIBOR + 0.55%
Class C1c	Sterling LIBOR + 0.55%
Class D1a	EURIBOR +1.35%
Class E1c	Sterling LIBOR + 4.00%
Class Etc	Sterling LIBOR + 4.00%

16. Called up share capital

	2008	*2007*
	£000	*£000*
Authorised		
Ordinary shares of £1 each	13	13
Allotted and called up		
12,501 shares 100% called and fully paid	13	13

Share capital of £1 was issued on incorporation on 8 May 2007. Share Capital of £12,500 was issued on 2 July 2007.

Notes to the financial statements

at 30 November 2008

17. Profit and loss account

	Group 2008 £000	*Company 2008 £000*	*Group 2007 £000*	*Company 2007 £000*
Retained loss brought forward	(3,028)	–	–	–
Loss for the year/period	(96,341)	–	(3,028)	–
Retained loss carried forward	(99,369)	–	(3,028)	–

18. Reconciliation of movement in shareholders' funds

	Group 2008 £000	*Company 2008 £000*	*Group 2007 £000*	*Company 2007 £000*
Opening shareholders' (deficit)/funds	(3,015)	13	–	–
Issue of ordinary share capital	–	–	13	13
Loss for the year/period	(96,341)	–	(3,028)	–
Net (decrease)/increase in shareholders' funds	(99,356)	–	(3,015)	13
Closing shareholders' (deficit)/funds	(99,356)	13	(3,015)	13

19. Derivatives and other financial instruments

Nature and extent of risks arising from financial instruments

The main risks arising from the Group's financial instruments are credit risk, interest rate risk, foreign currency risk and liquidity risk. Financial instruments used by the Group for risk management purposes include derivative instruments. Such instruments are used only for commercial hedging purposes, not for trading or speculative purposes. The principal derivative instruments used by the Group in managing its risks are interest rate caps, interest rate swaps and foreign currency swaps. The maturity profile of the derivative instruments reflects the nature of exposures arising from underlying business activities. All of the Group's derivatives activities are contracted with financial institutions.

During the year, the Group recognised net fair value losses of £87,632,202 (2007: £1,466,635 gain) due to the movements in the fair value of derivatives and exchange rate movements on the loan notes.

The main risks arising from the Group's financial instruments and management of these risks are summarised below:

Credit risk

Credit risk arises primarily from the potential for default in the mortgage loan portfolio. Credit risk is managed through the arrears management process which ensures that mortgages going into arrears are quickly identified and closely monitored.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset as set out in table (a).

Notes to the financial statements

at 30 November 2008

19. Derivatives and other financial instruments (continued)

Nature and extent of risks arising from financial instruments (continued)

Liquidity risk

The underlying mortgage loan assets are funded by the issue of non-recourse floating rate loan notes. Liquidity risk is managed by matching the timing of the cash receipts from mortgage assets with those of the cash payments due on the loan notes. The Group holds a minimum cash balance to manage short-term liquidity requirements.

Foreign currency risk

Certain loan notes are issued in Euro and US dollar denominations and repayments of principal and payments of interest are made in Euro and US dollars. The Group takes out derivative instruments to manage movements in foreign currency exchange rates. However, on 3 October 2008, the foreign currency swap counterparty has filed for Chapter 11 bankruptcy, and has defaulted on the swap. The swap agreement was terminated and was not replaced.

Interest rate risk

The Group is exposed to interest rate risk where assets and liabilities have interest rates set under different bases or which reset at different times. The Group minimises its exposure to interest rate risk by ensuring that the interest rate characteristics of its assets and liabilities are similar. Where this is not possible the Group takes out derivative financial instruments to manage interest rate mismatches. However, on 3 October 2008, the interest rate swap counterparty has filed for Chapter 11 bankruptcy, and has defaulted on the swap which has not been replaced. The directors believe under the current circumstances that it is not viable to replace the swap and until such time the Group will continue with an unhedged interest rate risk exposure.

(a) Credit risk

Before taking account of any collateral, the maximum exposure to credit risk as at 30 November was:

	2008	*2007*
	£000	*£000*
Mortgage loans	525,331	602,972
Derivative financial instruments	–	12,421
Cash at bank and in hand	31,542	38,522
	556,873	653,915

Notes to the financial statements

at 30 November 2008

19. Derivatives and other financial instruments (continued)

Nature and extent of risks arising from financial instruments (continued)

(b) Liquidity risk

The contractual undiscounted cash flows associated with financial liabilities were as follows:

At 30 November 2008

Financial liabilities	*Less than 1 year £000*	*1-2 years £000*	*2-3 years £000*	*3-4 years £000*	*4-5 years £000*	*5+ years £000*	*Total £000*
Loan notes	98,777	79,096	70,091	62,123	55,073	347,629	712,789
Gross financial liabilities	64,949	55,395	49,013	43,367	38,371	398,995	650,090

At 30 November 2007

Financial liabilities	*Less than 1 year £000*	*1-2 years £000*	*2-3 years £000*	*3-4 years £000*	*4-5 years £000*	*5+ years £000*	*Total £000*
Loan notes	132,343	122,359	95,287	80,994	68,845	341,627	841,455
Gross financial liabilities	96,508	91,776	69,590	59,151	50,279	284,912	652,216

There is no contractual obligation to pay down the loan notes other than as set out in note 15.

The undiscounted cash flows have been estimated by applying a constant (per annum) prepayment rate to the principal balance of the mortgage loans and using the weighted average interest rate prevailing at the balance sheet date. However, it is not expected that the loans will repay at a constant rate until maturity, that all of the loans will prepay at the same rate or that there will be no defaults or delinquencies on the loans, therefore the amounts disclosed above are only estimates of the possible future cash outflows on the loan notes.

(c) Foreign currency risk

The Group used foreign currency swaps in certain circumstances to hedge against any currency exposure risks. Following the default of the swap counterparty at 30 November 2008, the notional value of the swaps held was £Nil (2007: £416,884,271) and the recognised fair value of the Euro swap and US Dollar swap was £Nil (2007: £11,665,787 and (£2,854,359) respectively.

Excluding the effect of derivatives, the amounts of financial assets and liabilities denominated in foreign currencies were as follows:

Notes to the financial statements

at 30 November 2008

19. Derivatives and other financial instruments (continued)

Nature and extent of risks arising from financial instruments (continued)

(c) Foreign currency risk (continued)

At 30 November 2008

	Euro *£000*	*USD* *£000*	*Total* *£000*
Financial liabilities			
USD Denominated Mortgage backed loan notes due 2027 - Class A1b	–	77,354	77,354
EUR Denominated Mortgage backed loan notes due 2045 - Class A2a	53,306	–	53,306
USD Denominated Mortgage backed loan notes due 2045 - Class A2b	–	65,015	65,015
EUR Denominated Mortgage backed loan notes due 2045 - Class A3a	177,685	–	177,685
EUR Denominated Mortgage backed loan notes due 2045 - Class B1a	12,397	–	12,397
EUR Denominated Mortgage backed loan notes due 2045 - Class C1a	20,661	–	20,661
EUR Denominated Mortgage backed loan notes due 2045 - Class D1a	21,074	–	21,074
	285,123	142,369	427,492

At 30 November 2007

	Euro *£000*	*USD* *£000*	*Total* *£000*
Financial liabilities			
USD Denominated Mortgage backed loan notes due 2027 - Class A1b	–	88,624	88,624
EUR Denominated Mortgage backed loan notes due 2045 - Class A2a	46,063	–	46,063
USD Denominated Mortgage backed loan notes due 2045 - Class A2b	–	48,631	48,631
EUR Denominated Mortgage backed loan notes due 2045 - Class A3a	153,543	–	153,543
EUR Denominated Mortgage backed loan notes due 2045 - Class B1a	10,712	–	10,712
EUR Denominated Mortgage backed loan notes due 2045 - Class C1a	17,854	–	17,854
EUR Denominated Mortgage backed loan notes due 2045 - Class D1a	18,211	–	18,211
	246,383	137,255	383,638

There were no financial assets that were denominated in foreign currencies.

Notes to the financial statements

at 30 November 2008

19. Derivatives and other financial instruments (continued)

Nature and extent of risks arising from financial instruments (continued)

(d) Interest rate risk

The table below summarises the interest rate risk profile of the Group's financial instruments.

At 30 November 2008

	Total	*Total non-interest bearing*	*Within 3 months*	*After 3 months but within 6 months*	*After 6 months but within 1 year*	*After 1 year but within 5 years*	*Weighted average interest rate*	*Weighted average time for which rate is fixed*
	£000	*£000*	*£000*	*£000*	*£000*	*£000*	*%*	*Years*
Financial assets								
Mortgage loans	525,331	–	282,229	126,088	80,614	36,400	6.17	0.39
Cash and deposits	31,542	–	31,542	–	–	–	–	
Total assets	556,873	–	313,771	126,088	80,614	36,400		
Financial liabilities								
Mortgage backed loan notes due 2027 and 2045	644,299	80,375	563,924	–	–	–		
Total liabilities	644,299	80,375	563,924	–	–	–		

Notes to the financial statements

at 30 November 2008

19. Derivatives and other financial instruments (continued)

Nature and extent of risks arising from financial instruments (continued)

(d) Interest rate risk (continued)

At 30 November 2007

	Total £000	*Total non-interest bearing* £000	*Within 3 months* £000	*After 3 months but within 6 months* £000	*After 6 months but within 1 year* £000	*After 1 year but within 5 years* £000	*Weighted average interest rate* %	*Weighted average time for which rate is fixed* *Years*
Financial assets								
Mortgage loans	602,972	–	147,846	706	71,385	383,035	6.12	1,.29
Cash and deposits	38,522	–	38,522	–	–	–	–	
Derivative financial Instruments	12,421	12,421	–	–	–	–		
Total assets	653,915	12,421	186,368	706	71,385	383,035		
Financial liabilities								
Mortgage backed loan notes due 2027 and 2045	652,216	10,954	641,262	–	–	–		
Total liabilities	652,216	10,954	641,262	–	–	–		

The rates of interest receivable and payable on variable rate financial instruments, with the exception of the mortgage backed loan notes, are set with reference to the London Interbank Offer Rate. The rates of interest payable on the mortgage backed loan notes are set as detailed in note 15.

The Group used interest rate caps in certain circumstances to hedge against movements in interest rates. Following the default of the cap counterparty at 30 November 2008, the notional value of these caps was £Nil (2007: £585,000,000) and the recognised positive fair value was £Nil (2007: £13,026 positive).

The Group used interest rate swaps in certain circumstances to hedge against interest rate fluctuations when mortgage loans have fixed interest rates while the mortgage backed loan notes have variable rates. Following the default of the swap counterparty at 30 November 2008, the notional value of the swaps held was £Nil (2007: £470,458,727) and the recognised positive fair value was £Nil (2007: £3,596,794 positive).

Notes to the financial statements

at 30 November 2008

19. Derivatives and other financial instruments (continued)

Nature and extent of risks arising from financial instruments (continued)

(e) Fair values

The fair values together with the carrying amounts shown in the balance sheet are as follows:

	At 30 November 2008			*At 30 November 2007*		
	Book value	*Fair value*	*If fair values Increased by 1%*	*Book value*	*Fair value*	*If fair values increased by 1%*
	£000	*£000*	*£000*	*£000*	*£000*	*£000*
Financial assets						
Mortgage loans	525,331	335,847	3,358	602,972	596,381	5,964
Cash and deposits	31,542	31,542	315	38,522	38,522	385
Derivative financial instruments	–	–	–	12,421	12,421	124
	556,873	367,389	3,673	653,915	647,324	6,473
Financial liabilities						
Mortgage backed loan notes due 2027 and 2045	(644,299)	(353,846)	(3,538)	(652,216)	(631,173)	(6,312)
	(644,299)	(353,846)	(3,538)	(652,216)	(631,173)	(6,312)

The directors have considered the fair values of the Group's main financial instruments, which are mortgage loan receivables and non recourse loan notes.

As no liquid market exists for either the mortgage loans or non recourse loan notes, the directors have ascribed an approximate fair value based on an internal discounted cash flow model that is used to value non-securitised mortgage loan receivables. This model takes into account expected prepayment rates, arrears levels, house price movements, level of repossessions, losses and discount rates based on the most recent available information.

(f) Interest income and expense on financial instruments that are not at fair value through profit and loss

	2008	*2007*
	£000	*£000*
Interest receivable on mortgage loans	46,579	14,628
Interest expense on loan notes	(38,869)	(16,905)
	7,710	(2,277)

Notes to the financial statements

at 30 November 2008

20. Reconciliation of operating profit to net cash outflow from operating activities

	Year ended 30 November 2008 £000	*Period ended 30 November 2007 £000*
Operating loss	(95,011)	(3,438)
Interest payable on mortgage backed loan notes	38,869	16,904
Other interest receivable	(1,300)	(508)
Amortisation of start up costs on mortgage loans	(983)	(4,426)
Amortisation of premium paid to mortgage loan originator	2,045	3,922
Interest on mortgage loans	(46,579)	(14,628)
Fair value movements	81,842	(1,467)
Change in other debtors	6,258	(11,354)
Change in other creditors	(534)	9,244
Movement in provision for mortgage losses	8,466	3,977
Net cash outflow from operating activities	(6,927)	(1,774)

21. Analysis of net debt

	At 1 December 2007 £000	*Cash flow £000*	*Non-cash movement £000*	*At 30 November 2008 £000*
Cash in hand and at bank	38,522	(6,980)	(69,421)	31,542
Mortgage backed loan notes	(639,795)	77,338	(81,842)	(644,299)
Issue costs	2,155	–	(240)	1,915
Net debt carried forward	(599,118)	70,358	(82,082)	(610,842)

Notes to the financial statements

at 30 November 2008

22. Deferred taxation

	2008	*2007*
	£000	*£000*
Asset at the start of the year/period	410	–
Deferred tax (charge)/credit during the year/period (note 6)	(1,330)	410
(Liability)/asset at the end of the year/period	(920)	410

Full provision has been made for deferred tax liabilities arising as a result of Financial Reporting Standard No. 26 adjustments. Losses of £16,666,077 resulting in a deferred tax asset of £3,499,876 have not been recognised. The deferred tax asset has not been recognised due to the uncertainty surrounding the Group's future profitability.

Deferred taxation has been recognised at 21% (2007: 20%) being the UK small companies' corporation tax rate at the balance sheet date.

	2008	*2007*
	£000	*£000*
Effect of Financial Reporting Standard No. 26 adjustment for EIR	296	703
Effect of Financial Reporting Standard No. 26 adjustment for Derivatives	–	(2,484)
Effect of Financial Reporting Standard No. 26 adjustment for FX hedge	–	2,191
Effect of Financial Reporting Standard No. 26 adjustment for impairment	(1,216)	–
Total deferred tax asset recognised at 20%	–	410
Total deferred tax (liability)/asset recognised at 21%	(920)	430

23. Capital structure

The Company's capital is represented by the capital and reserves attributable to equity holders. The Company is not subject to externally imposed capital requirements other than the minimum share capital required by the Companies Act 1985, with which it complies. The Company manages its ordinary share capital in order that there is sufficient capital to meet the needs of the Company in its operation.

24. Parent undertaking and control

The entire issued share capital of Eurosail-UK 2007-3BL Parent Limited is held by a Trustee under a declaration of trust for charitable purposes.