

HOLMES FUNDING 2 LIMITED

**Registered in England and Wales
No. 6922902**

ANNUAL REPORT AND ACCOUNTS FOR THE YEAR ENDED

31 DECEMBER 2010

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HOLMES FUNDING 2 LIMITED - 6922902

Report of the directors

The Directors submit their report together with the financial statements for the year ended 31 December 2010

The comparatives cover the period from incorporation on 3 June 2009 to 31 December 2009

Principal activity and review of the year

The principal activity of Holmes Funding 2 Limited, Company Number 6922902 (the "Company") is to acquire an interest in a portfolio of mortgage loans and enter into financial arrangements with other group companies in that connection

The legal structure of the Company is to invest in a beneficial interest in the assets of Holmes Trustees Limited ("the Trust"), whose assets comprise mortgage loans secured on residential property in England, Scotland and Wales ("the mortgage portfolio") The Company receives a share of income from the Trust in proportion to its share of the total mortgage assets of the Trust On 16 July 2009, the company acquired a beneficial interest of £28.8 billion mortgage portfolio from Holmes Funding Limited The company also acquired intercompany liabilities of the same amount

The Company had interest and similar income of £617m (2009 £407m) and an interest expense and similar charge of £597m (2009 £393m) During 2010, all the bonds from Holmes Master Issuer 2 Plc were redeemed This gave rise to the group loans of £28.9bn being significantly repaid

The Santander UK plc group (the "Group") manages its operations on a divisional basis For this reason, the Company's Directors believe that further key performance indicators for the Company are not necessary or appropriate for an understanding of the development, performance or position of the business The performance of the divisions of Santander UK plc, which include the Company, are discussed in the Group's Annual Report which does not form part of this Report

The purpose of this Report is to provide information to the members of the Company and as such it is only addressed to those members The Report may contain certain forward-looking statements with respect to the operations, performance and financial condition of the Company By their nature, these statements involve inherent risks and uncertainties since future events, circumstances and other factors can cause results and developments to differ materially from the plans, objectives, expectations and intentions expressed in such forward-looking statements Members should consider this when relying on any forward-looking statements The forward-looking statements reflect knowledge and information available at the date of preparation of this Report and the Company undertakes no obligation to update any forward-looking statement during the year Nothing in this Report should be construed as a profit forecast

The Directors do not expect any significant change in the level of business in the foreseeable future

Results and dividends

The profit for the year on ordinary activities after tax amounted to £237,372,000 (2009 loss for the period £237,278,000)

The Directors do not recommend the payment of a final dividend (2009 £nil)

Directors

The Directors who served throughout the year and to the date of this report, except as noted were

Mr M H Filer
Mr D M Green
Mr S Masson (Alternate director to R Samson)
Mr M McDermott
Ms R Samson
Wilmington Trust SP Services (London) Limited

At the year end, Holmes Holdings Limited and Mr M McDermott jointly held one share in the Company The other share in the Company was held by Holmes Holdings Limited

Wilmington Trust SP Services (London) Limited and Mr M McDermott held one share in the holding company, Holmes Holdings Limited, at the year end The other share in Holmes Holdings Limited was held by Wilmington Trust SP Services (London) Limited Mr M McDermott is also a Director of Wilmington Trust SP Services (London) Limited None of the other Directors had a beneficial interest in the shares of the Company, or of the holding company, Holmes Holdings Limited or its subsidiaries, at the year end

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Report of the directors (continued)

Directors' Responsibilities Statement

The Directors are responsible for preparing the report and the financial statements in accordance with applicable laws 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 International Financial Reporting Standards (IFRSs) as adopted by the European Union. The financial statements are required by law to be properly prepared in accordance with IFRSs as adopted by the European Union and the Companies Act 2006.

International Accounting Standard 1 requires that financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the Preparation and Presentation of Financial Statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRSs. Directors are also required to

- properly select and apply accounting policies,
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information,
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance, and
- make an assessment of the Company's ability to continue as a going concern.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company, and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Financial risk management and objectives

The Company's financial instruments, other than derivatives, comprise loans and advances to group companies, borrowings, cash and liquid resources, and various items, such as other assets and liabilities that arise directly from its operations. The main purpose of these financial instruments is to raise finance for the Company's operations.

The Company also enters into derivatives transactions (principally interest rate swaps). The purpose of such transactions is to manage the bank's risks arising from the Company's operations and its sources of finance.

All assets, liabilities and transactions are denominated in Sterling.

Further disclosures regarding financial risk management objectives and policies and the Company's exposure to principal risks can be found in note 2.

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Report of the directors (continued)

Statement of Going Concern

The Company's business activities, together with the factors likely to affect its future development, performance and position are set out above. The financial position of the Company, its cash flows, liquidity position and borrowing facilities are set out in the financial statements. In addition, notes 1, 2 and 18, to the financial statements include the Company's objectives, policies and processes for managing its capital, its financial risk management objectives, and its exposures to credit risk and liquidity risk.

The Company has adequate financial resources. As a consequence, the Directors believe that the Company is well placed to manage its business risks successfully despite the current uncertain economic outlook.

The Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis of accounting in preparing the annual report and accounts.

Third party indemnities

Enhanced indemnities are provided to the Directors of the Company by Santander UK plc, (where such person has been nominated in writing by Santander UK plc as its representative on the board), against liabilities and associated costs which they could incur in the course of their duties to the Company. All of the indemnities remain in force as at the date of this Report and Accounts. A copy of each of the indemnities is kept at the registered office address of Santander UK plc.

Payment Policy

Given the nature of the Company's business, the Company does not have any suppliers and therefore does not operate a payment policy. The Company has no creditors and is unable to quantify the practice on payment of creditors.

Auditors

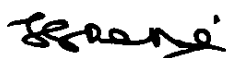
Each of the Directors as at the date of approval of this report confirms that

- so far as the Director is aware, there is no relevant audit information of which the Company's auditor is unaware, and
- the Director has taken all steps that he/she ought to have taken as a Director to make himself/herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006.

In accordance with Sections 485 and 487 of the Companies Act 2006, Deloitte LLP are deemed to have been re-appointed as auditors of the Company.

By Order of the Board



For and on behalf of
Abbey National Nominees Limited, Secretary

25 February 2011

Registered Office Address: 2 Triton Square, Regent's Place, London NW1 3AN

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INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF HOLMES FUNDING 2 LIMITED

We have audited the financial statements of Holmes Funding 2 Limited (the "Company") for the year ended 31 December 2010 which comprise the Statement of Comprehensive Income, the Statement of Changes in Equity, the Balance Sheet, the Cash Flow Statement and the related notes 1 to 18. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. 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 auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

As explained more fully in the Directors' Responsibilities Statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the Directors, and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion the financial statements

- give a true and fair view of the state of the company's affairs as at 31 December 2010 and of its profit for the year then ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Separate opinion in relation to IFRSs as issued by the IASB

As explained in Note 1 to the financial statements, the company in addition to applying IFRSs as adopted by the European Union, has also applied IFRSs as issued by the International Accounting Standards Board (IASB).

In our opinion the financial statements comply with IFRSs as issued by the IASB.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us, or
- the financial statements are not in agreement with the accounting records and returns, or
- certain disclosures of Directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit.



Caroline Britton (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditors
London, United Kingdom
25 February 2011

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Statement of Comprehensive Income

For the year ended 31 December 2010

Continuing operations		Year ended 31 December 2010 £000	Period ended 31 December 2009 £000
	Notes		
Interest and similar income	4	617,405	406,828
Interest expense and similar charges	5	(597,964)	(393,086)
Net interest income		19,441	13,742
Other operating income/(expense)		235,820	(237,317)
Administrative expenses		(17,868)	(13,688)
Profit/(loss) before tax	6	237,393	(237,263)
Tax charge	7	(21)	(15)
Profit/(loss) for the year/period		237,372	(237,278)
Other comprehensive income for the year/period		-	-
Total comprehensive income/(loss) for the year/period attributable to the equity holders of the Company		237,372	(237,278)

The accompanying notes form an integral part of the accounts

Statement of Changes in Equity

For the year ended 31 December 2010

	Share capital £000	Retained earnings £000	Total £000
At incorporation	-	-	-
Issue of share capital	-	-	-
Loss for the period	-	(237,278)	(237,278)
At 31 December 2009 and 1 January 2010	-	(237,278)	(237,278)
Profit for the year	-	237,372	237,372
At 31 December 2010	-	94	94

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Balance Sheet

As at 31 December 2010

	Notes	31 December 2010 £000	31 December 2009 £000
Loans and advances due from related parties	10	-	27,185,783
Other assets	11	14	1,789
Cash and cash equivalents	8	709	1,856,923
Total assets		723	29,044,495
Loans due to group companies	12	(607)	(28,858,830)
Derivative financial instruments		-	(237,326)
Other liabilities	13	(22)	(185,617)
Total liabilities		(629)	(29,281,773)
Net assets/(liabilities)		94	(237,278)
Equity			
Share capital	14	-	-
Retained earnings		94	(237,278)
Total equity		94	(237,278)

The accompanying notes form an integral part of the accounts

The financial statements were approved by the board of Directors and authorised for issue on 25 February 2011. They were signed on its behalf by

DAVID GREEN



Director
Holmes Funding 2 Limited

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Cash Flow Statement

For the year ended 31 December 2010

	Notes	Year ended 31 December 2010 £000	Period ended 31 December 2009 £000
Cash flows used in operating activities	15	(440,532)	(264,319)
Investing activities			
Amounts repaid by related parties	" " "	27,186,390	-
Cash flows provided by investing activities		27,186,390	-
Financing activities			
Amounts received from group companies		-	2,121,242
Amounts paid to group companies		(28,602,072)	-
Cash flows (used in)/provided by financing activities		(28,602,072)	2,121,242
Net increase in cash during the year/period		(1,856,214)	1,856,923
Cash and cash equivalents at beginning of year/period		1,856,923	-
Cash and cash equivalents at end of year/period	8	709	1,856,923

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Notes to the financial statements for the year ended 31 December 2010

1 Accounting policies

The principal accounting policies Holmes Funding 2 Limited (the "Company") in the preparation of financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted for use in the European Union that are effective or available for early adoption at the company's reporting date. The company, in addition to complying with its legal obligation to comply with IFRSs as adopted for use in the European Union, has also complied with the IFRSs as issued by the International Accounting Standards Board. The financial statements have been prepared under the historical cost convention, as modified by the revaluation of derivative financial instruments at fair value through profit or loss, and on the going concern basis as disclosed in the Directors' Statement of Going Concern set out in the Report of the Directors.

Because the nature of the business is to receive and provide interest-bearing loans and advances the Directors are of the opinion that it is more appropriate to use net interest income rather than turnover in presenting the statement of comprehensive income.

Interest income and expense

Interest income and expense is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts/payments through the expected life of the financial asset/financial liabilities to that asset's/liability's net carrying amount. Interest income and expenditure is shown gross on the face of the Statement of Comprehensive Income.

Financial assets

Financial assets include loans and advances to related parties shown on the face of the balance sheet and cash and cash equivalents shown on the face of the balance sheet.

Financial assets are considered to be "loans and receivables" as defined by IAS 39 – "Financial Instruments: Recognition and Measurement". They are therefore accounted for on the amortised cost basis.

The amortisation is to be calculated under the standards on an Effective Interest Rate ("EIR") method. The EIR method spreads the expected net income arising from a loan over its expected life. The EIR is that rate of interest which, at inception, exactly discounts the future cash payment and receipts arising from the loan to the initial carrying amount.

The difference between the EIR method prescribed and the accrued cost accounting adopted, is considered immaterial.

Loans and advances due from related parties

The Company's beneficial interest in the mortgage portfolio held by Holmes Trustees Limited has been legally acquired from Santander UK plc. The sale of the beneficial interest does not pass the derecognition criteria as described in IAS 39 "Financial Instruments: Recognition and Measurement" and therefore no beneficial interest in a mortgage portfolio is shown in the balance sheet as at 31 December 2010. This is further described in the paragraphs below.

The loans and advances due from related parties are held at amortised cost.

Derecognition

As a result of IAS 39 "Financial Instruments: Recognition and Measurement" the legal transfer of the beneficial interest in the Trust mortgage portfolio from Santander UK plc to the Company fails the criteria for derecognition. As no transfer has occurred for accounting purposes the beneficial interest has not been recognised in the Company's financial statements and remains on the balance sheet of Santander UK plc.

The beneficial interest in the mortgage portfolio is replaced by a related party loan included in Loans and advances from related parties on the Company's balance sheet. The related party loan is recorded at the book value of the beneficial interest in the mortgage portfolio to Santander UK plc at the time of transfer less any subsequent transfers and repayments of capital, less deferred consideration due. A provision for losses is maintained by the Company to cover default of these loans and subsequent reduction in interest receivable on the intercompany loan.

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Notes to the financial statements for the year ended 31 December 2010

1 Accounting policies (continued)

Impairment of financial assets

At each balance sheet date, the Company assesses whether, as a result of one or more events occurring after initial recognition, there is objective evidence that a financial asset or group of financial assets classified as available for sale or loans and receivables have become impaired. Evidence of impairment may include indications that the borrower or group of borrowers have defaulted or are experiencing significant financial difficulty.

The impairment losses on loans and advances represents Holmes Funding 2's share of impairment losses recognised on the underlying mortgages held by Santander UK plc. The loans and advances due from related parties, being the beneficial interest in the mortgage portfolio, is not impaired. As with all other intercompany expenses, interest revenue equal to the expense recognised as a result of the impairment loss is recognised in the financial statements. Currently, the amount of interest revenue on the intercompany assets available to Holmes Funding 2 is sufficient to cover the level of expenses recognised in the financial statements. Any overall profit or loss in the Statement of Comprehensive Income relates to foreign exchange, derivative valuation movements, and Tax.

Deferred consideration

Under the terms of the mortgage sale agreement, Santander UK plc, as the originator of the mortgage loans, legally retains the right to receive excess income (deferred consideration) arising on those loans, after certain higher priority payments have been met.

On application of IFRS, deferred consideration is treated as a reduction in the interest due from Santander UK plc on the related party loan arising on the failure to derecognise the sale of the beneficial interest in the mortgage portfolio. Any deferred consideration due at the end of the year is treated as a reduction in the capital balance of the amounts due from related parties. Incremental elements of deferred consideration are spread on an effective interest rate basis, all other elements are accounted for as incurred.

Income taxes

The tax expense represents the sum of the income tax currently payable and deferred income tax.

Income tax payable on profits, based on the applicable tax law in each jurisdiction is recognised as an expense in the year in which profits arise. Taxable profit differs from net profit as reported in the Statement of Comprehensive Income because it excludes items of income or expense that are taxable or deductible in other periods and it further excludes items that are never taxable or deductible. The liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date. The tax effects of income tax losses available to carry forward are recognised as an asset when it is probable that future taxable profits will be available against which tax losses can be utilised.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition of other assets (other than in a business combination) and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax is calculated at the tax rates that are expected to apply in the year when the liability is settled or the asset is realised. Deferred tax is charged or credited in the Statement of Comprehensive Income, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Current tax assets and liabilities are only offset when they arise in the same tax reporting group and where there is both the legal right and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

Cash and cash equivalents

For the purposes of the balance sheet and cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash and non-restricted balances with central banks, treasury bills and other eligible bills, loans and advances to banks, amounts due from other banks and short term investments in securities.

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Notes to the financial statements for the year ended 31 December 2010

1 Accounting policies (continued)

Financial liabilities

Financial liabilities include Loans and advances to group companies on the face of the balance sheet, accrued interest shown within other liabilities on the face of the balance sheet

Financial liabilities are accounted for on the amortised cost basis

The amortisation is to be calculated under the standards on an Effective Interest Rate ("EIR") method. The EIR method spreads the expected net income arising from a loan over its expected life. The EIR is that rate of interest which, at inception, exactly discounts the future cash payment and receipts arising from the loan to the initial carrying amount.

The difference between the EIR method prescribed and the accrued cost accounting adopted, is considered immaterial.

Loans and advances due to group companies and related parties

Loans and advances due to group companies and related parties are held at amortised cost.

Application of new and revised International Financial Reporting Standards

In 2010, the Company adopted the following significant new or revised standards or amendments to standards:

a) IFRS 3 'Business Combinations'

In January 2008, the IASB issued an amendment to IFRS 3 which clarifies and changes certain elements of accounting for a business combination, including the measurement and accounting for non-controlling interests, contingent consideration, step acquisitions and acquisition-related costs and also widens the scope of the standard. There are also associated amendments to IAS 27, IAS 28 and IAS 31.

IFRS 3 (2008) has been applied in the current year prospectively to business combinations for which the acquisition date is on or after 1 January 2010. Its adoption has affected the accounting for business combinations in the current year as follows:

IFRS 3 (2008) allows a choice on a transaction-by-transaction basis for the measurement of non-controlling interests at the date of acquisition (previously referred to as 'minority' interests) either at fair value or at the non-controlling interests' share of recognised identifiable net assets of the acquiree.

IFRS 3 (2008) changes the recognition and subsequent accounting requirements for contingent consideration. Previously, contingent consideration was recognised at the acquisition date only if payment of the contingent consideration was probable and it could be measured reliably, any subsequent adjustments to the contingent consideration were always made against the cost of the acquisition.

Notes to the financial statements for the year ended 31 December 2010

1 Accounting policies (continued)

Under the revised Standard, contingent consideration is measured at fair value at the acquisition date, subsequent adjustments to the consideration are recognised against the cost of the acquisition only to the extent that they arise from new information obtained within the measurement period (a maximum of 12 months from the acquisition date) about the fair value at the date of acquisition. All other subsequent adjustments to contingent consideration classified as an asset or a liability are recognised in profit or loss.

Any adjustments to contingent considerations for acquisitions made prior to 1 January 2010 which result in an adjustment to goodwill continue to be accounted for under IFRS 3 (2004) and IAS 27 (2005).

IFRS 3 (2008) requires the application of acquisition accounting only at the point where control is achieved, for a business combination achieved in stages (step acquisition). If an acquirer has a pre-existing equity interest in an acquiree and increases its equity interest sufficiently to achieve control, it must remeasure its previously-held equity interest in the acquiree at acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss. Once control is achieved, all other increases and decreases in ownership interests are treated as transactions among equity holders and reported within equity. Goodwill does not arise on any increase, and no gain or loss is recognised on any decrease.

IFRS 3 (2008) requires acquisition-related costs to be accounted for separately from the business combination, generally leading to those costs being recognised as an expense in profit or loss as incurred, whereas previously they were accounted for as part of the cost of the acquisition.

IFRS 3 (2008) requires the recognition of a settlement gain or loss when the business combination in effect settles a pre-existing relationship between the Company and the acquiree.

The adoption of IFRS 3 (2008) did not affect the Company.

b) IAS 27 'Consolidated and Separate Financial Statements'

In January 2008, the IASB issued an amendment to IAS 27, to reflect the amendment in IFRS 3. The changes in the accounting policy have been applied prospectively from 1 January 2010. The application of IAS 27 (2008) has resulted in changes in the Company's accounting policies for changes in ownership interests in subsidiaries.

Specifically, the revised Standard has affected the Company's accounting policies regarding changes in ownership interests in its subsidiaries that do not result in loss of control. In prior years, in the absence of specific requirements in IFRSs, increases in interests in existing subsidiaries were treated in the same manner as the acquisition of subsidiaries, with goodwill or a bargain purchase gain being recognised, when appropriate, for decreases in interests in existing subsidiaries that did not involve a loss of control, the difference between the consideration received and the adjustment to the non-controlling interests was recognised in profit or loss. Under IAS 27 (2008), all such increases or decreases are dealt with in equity, with no impact on goodwill or profit or loss.

When control of a subsidiary is lost as a result of a transaction, event or other circumstance, the revised Standard requires the Company to derecognise all assets, liabilities and non-controlling interests at their carrying amount and to recognise the fair value of the consideration received. Any retained interest in the former subsidiary is recognised at its fair value at the date control is lost. The resulting difference is recognised as a gain or loss in profit or loss.

The adoption of IAS 27 (2008) did not affect the Company.

c) IAS 28 'Investment in Associates' and IAS 31 'Interest in Joint Ventures'

In January 2008, the IASB made consequential amendments to IAS 28 and IAS 31 to extend the changes in IAS 27.

The principle adopted in IAS 27 (2008) that a change in accounting basis is recognised as a disposal and re-acquisition of any retained interest at fair value is extended to IAS 28 and IAS 31 as follows.

IAS 28 is amended such that for a change in equity interest in an associate, the investor remeasures at acquisition date fair value any investment retained in the former associate, with any consequential gain or loss compared to its carrying amount under IAS 28 recognised in profit or loss.

IAS 31 is amended such that for a change in joint control interest in an entity, the investor remeasures at fair value any investment retained in the former jointly controlled entity, with any consequential gain or loss compared to its carrying amount under IAS 31 recognised in profit or loss.

Any amount that has previously been recognised in other comprehensive income, and that would be reclassified to profit or loss following a disposal, is similarly reclassified to profit or loss.

The adoption of IAS 28 (2008) did not affect the Company.

Notes to the financial statements for the year ended 31 December 2010

1 Accounting policies (continued)

New and revised International Financial Reporting Standards in issue but not yet effective

The Company has not yet adopted the following significant new or revised standards and interpretations, and amendments thereto, which have been issued but which are not yet effective for the Company

IFRS 9 'Financial Instruments' – In November 2009, the IASB issued IFRS 9 and in October 2010, issued an amendment to IFRS 9 which introduce new requirements for the classification and measurement of financial assets and financial liabilities and for derecognition. IFRS 9 is effective for annual periods beginning on or after 1 January 2013, with earlier application permitted

IFRS 9 requires all recognised financial assets that are within the scope of IAS 39 'Financial Instruments: Recognition and Measurement' to be subsequently measured at amortised cost or fair value. Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortised cost at the end of subsequent accounting periods. All other debt investments and equity investments are measured at their fair values at the end of subsequent accounting periods.

The most significant effect of IFRS 9 regarding the classification and measurement of financial liabilities relates to the accounting for changes in fair value of a financial liability (designated as at fair value through profit or loss) attributable to changes in the credit risk of that liability. Specifically, under IFRS 9, for financial liabilities that are designated as at fair value through profit or loss, the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is recognised in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss. Previously, under IAS 39, the entire amount of the change in the fair value of the financial liability designated as at fair value through profit or loss was recognised in profit or loss.

The Company anticipates that IFRS 9 will be adopted in the Company's financial statements for the annual period beginning on or after 1 January 2013 and that the application of the new Standard may have a significant impact on amounts reported in respect of the Company's financial assets and financial liabilities. However, it is not practicable to provide a reasonable estimate of that effect until a detailed review has been completed.

IFRS 7 'Financial Instruments: Disclosures' – In October 2010, the IASB issued amendments to IFRS 7 that increase the disclosure requirements for transactions involving transfers of financial assets. The amendments are intended to provide greater transparency around risk exposures when a financial asset is transferred but the transferor retains some level of continuing exposure in the asset. The amendments also require disclosures where transfers of financial assets are not evenly distributed throughout the period. The amendments to IFRS 7 are effective for annual periods beginning on or after 1 July 2011, with earlier application permitted.

The Company does not anticipate that these amendments to IFRS 7 will have a significant effect on the Company's disclosures regarding transfers of financial assets. However, if the Company enters into other types of transfers of financial assets in the future, disclosures regarding those transfers may be affected.

IAS 24 'Related Party Transactions' – In November 2009, the IASB issued amendments to IAS 24, effective for annual periods beginning on or after 1 January 2011, with earlier application permitted. The revised standard modifies the definition of a related party and simplifies disclosures for government-related entities.

The disclosure exemptions introduced in IAS 24(2009) do not affect the Company because the Company is not a government-related entity. However, disclosures regarding related party transactions and balances in these consolidated financial statements may be affected when the revised version of the Standard is applied in future accounting periods because some counterparties that did not previously meet the definition of a related party may come within the scope of the Standard.

Notes to the financial statements for the year ended 31 December 2010

1 Accounting policies (continued)

Valuation of financial instruments

Financial instruments that are classified at fair value through profit or loss ('FVTPL'), including those held for trading purposes, or available-for-sale, and all derivatives, are stated at fair value. The fair value of such financial instruments is the estimated amount at which the instrument could be exchanged in a current transaction between willing knowledgeable parties, other than in a forced or liquidation sale.

Initial measurement

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price unless the instrument is evidenced by comparison with other observable current market transactions in the same instrument or based on a valuation technique whose variables include significant data from observable markets. Any difference between the transaction price and the value based on a valuation technique where the inputs are not based on data from observable current markets is not recognised in profit or loss on initial recognition. Subsequent gains or losses are only recognised to the extent that they arise from a change in a factor that market participants would consider in setting a price.

Subsequent measurement

Fair value hierarchy

The Company applies the following fair value hierarchy that prioritises the inputs to valuation techniques used in measuring fair value. The hierarchy establishes three categories for valuing financial instruments, giving the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The three categories are: quoted prices in active markets (Level 1), internal models based on observable market data (Level 2) and internal models based on other than observable market data (Level 3). If the inputs used to measure an asset or a liability fall to different levels within the hierarchy, the classification of the entire asset or liability will be based on the lowest level input that is significant to the overall fair value measurement of the asset or liability.

The Company categorises assets and liabilities measured at fair value within the fair value hierarchy based on the inputs to the valuation techniques as follows:

- Level 1 Unadjusted quoted prices for identical assets or liabilities in an active market that the Company has the ability to access at the measurement date. Level 1 positions include debt securities and exchange traded derivatives.
- Level 2 Quoted prices in markets that are not active, quoted prices for similar assets or liabilities, recent market transactions, inputs other than quoted market prices for the asset or liability that are observable either directly or indirectly for substantially the full term, and inputs to valuation techniques that are derived principally from or corroborated by observable market data through correlation or other statistical means for substantially the full term of the asset or liability. The Company has no assets or liabilities that are classified as Level 2.
- Level 3 Inputs to the pricing or valuation techniques that are significant to the overall fair value measurement of the asset or liability are unobservable. The Company has no assets or liabilities measured at fair value that are classified as Level 3.

The Company assesses active markets for equity instruments based on the average daily trading volume both in absolute terms and relative to the market capitalisation for the instrument. The Company assesses active markets for debt instruments based on both the average daily trading volume and the number of days with trading activity. The Company assesses active markets for exchange traded derivatives based on the average daily trading volume both in absolute terms and relative to the market capitalisation for the instrument. Market activity and liquidity is discussed in the relevant monthly Risk Forum as well as being part of the daily update given by each business at the start of the trading day. This information, together with the observation of active trading and the magnitude of the bid-offer spreads, allow consideration of the liquidity of a financial instrument. All underlying assets and liabilities are reviewed to consider the appropriate adjustment to mark the mid price reported in the trading systems to a realisable value. This process takes into account the liquidity of the position in the size of the adjustment required. These liquidity adjustments are presented and discussed at the monthly Risk Forum.

In determining the appropriate measurement levels, the Company performs regular analyses on the assets and liabilities. All underlying assets and liabilities are regularly reviewed to determine whether a position should be regarded as illiquid, the most important practical consideration being the observability of trading. Where the bid-offer spread is observable, this is tested against actual trades. If trades are not observed, the bid-offer spread is disregarded as a sign of liquidity and the position is regarded as illiquid.

Changes in the observability of significant valuation inputs during the reporting period may result in a reclassification of certain assets and liabilities within the fair value hierarchy.

Notes to the financial statements for the year ended 31 December 2010

1 Accounting policies (continued)

Financial instruments valued using observable market prices

If a quoted market price in an active market is available for an instrument, the fair value is calculated based on the market price

Financial instruments valued using a valuation technique

In the absence of a quoted market price in an active market, management uses internal models to make its best estimate of the price that the market would set for that financial instrument. In order to make these estimations, various techniques are employed, including extrapolation from observable market data and observation of similar financial instruments with similar characteristics. Wherever possible, valuation parameters for each product are based on prices directly observable in active markets or that can be derived from directly observable market prices. Valuation parameters for each type of financial instrument are discussed below.

The Company did not make any material changes to the valuation techniques and internal models it used during the year ended 31 December 2010.

Derivative financial instruments and hedge accounting

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and option pricing models as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The entity designates derivatives as hedges of the fair value of recognised assets or liabilities (fair value hedge). Hedge accounting is used for derivatives designated in this way provided certain criteria are met.

The entity documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The entity also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. Hedge accounting is not adopted for the interest rate swap contracts with other group companies.

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Notes to the financial statements for the year ended 31 December 2010

1 Accounting policies (continued)

Fair value valuation bases

The following tables summarise the fair values at 31 December 2010 of the asset and liability classes accounted for at fair value, by the valuation methodology used by the Company to determine their fair value. The tables also disclose the percentages that the recorded fair values of financial assets and liabilities represent of the total assets and liabilities, respectively, that are recorded at fair value in the balance sheet.

31 December 2010

There are no fair value assets at the balance sheet date.

31 December 2009

31 December 2009		Internal models based on								Valuation technique		
Balance sheet category		Quoted prices in active markets		Market observable data		Other than market observable data		Total				
		£000	%	£000	%	£000	%	£000	%			
Assets												
Financial assets designated at fair value		-	-	-	-	-	-	-	-	A		
Total assets at fair value		-	-	-	-	-	-	-	-			
Liabilities												
Financial liabilities designated at fair value		Interest rate contracts		-	-	237,326	100	-	-	237,326	100	A
Total liabilities at fair value		-	-	237,326	100	-	-	237,326	100			

Valuation techniques

The main valuation techniques employed in the Company's internal models to measure the fair value of the financial instruments disclosed above are set out below. The principal inputs into these models are derived from observable market data.

- A** In the valuation of financial instruments requiring static hedging (for example interest rate and currency derivatives) and in the valuation of loans and advances and deposits, the 'present value' method is used. Expected future cash flows are discounted using the interest rate curves of the applicable currencies. The interest rate curves are generally observable market data and reference yield curves derived from quoted interest rates in appropriate time bandings, which match the timings of the cashflows and maturities of the instruments.
- B** In the valuation of equity financial instrument requiring dynamic hedging (principally equity securities, options and other structured instruments), proprietary stochastic volatility models are used. These types of models are widely accepted in the financial services industry. Observable market inputs are used in these models to generate variables such as the bid-offer spread, foreign currency exchange rates, credit risk, volatility, correlation between indices and market liquidity as appropriate.
- C** In the valuation of financial instruments exposed to interest rate risk that require either static or dynamic hedging (such as interest rate futures, caps and floors, and options), the present value method (futures), Black's model (caps/floors) and the Markov functional model (Bermudan options) are used. These types of models are widely accepted in the financial services industry. The significant inputs used in these models are observable market data, including appropriate interest rate curves, volatilities, correlations and exchange rates.

In determining fair value, the Company also considers both the credit risk of its counterparties, as well as its own creditworthiness. The Company attempts to mitigate credit risk to third parties by entering into netting and collateral arrangements. Net counterparty exposure (counterparty positions netted by offsetting transactions and both cash and securities collateral) is then valued for counterparty creditworthiness and this resultant value is incorporated into the fair value of the respective instruments. The Company generally calculates the credit risk adjustment for derivatives on observable credit data.

Credit risk is measured using dynamic models that calculate the probability and potential future exposure given default. The main inputs used in these models are generally data relating to individual issuers in the portfolio and correlations thereto. The main inputs used in determining the underlying cost of credit for credit risk derivatives are quoted credit spreads and the correlation between individual issuers' quoted credit derivatives.

Notes to the financial statements for the year ended 31 December 2010

2 Financial risk management

The Company's activities expose it to a variety of financial risks. The Company's risk management focuses on the major areas of fair value, interest rate risk, credit risk and liquidity risk. The Company's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Company's financial performance. The Company uses derivative financial instruments to hedge certain risk exposures.

Risk management is carried out by the central risk management function of the Santander UK Group. Santander UK's Risk Framework ensures that risk is managed and controlled on behalf of shareholders, customers, depositors, employees and the Santander UK Group's regulators. Effective and efficient risk governance and oversight provide management with assurance that the Santander UK Group's business activities will not be adversely impacted by risks that could have been reasonably foreseen. This in turn reduces the uncertainty of achieving the Santander UK Group's strategic objectives. Authority flows from the Santander UK plc Board of Members to the Chief Executive Officer and from her direct reports. Delegation of authority is to individuals. Formal standing committees are maintained for effective management of oversight.

The Santander UK Group has three tiers of risk governance.

The first is provided by the Santander UK Board which approves Santander UK's risk appetite for each of the risks below, in consultation with Banco Santander, S.A. as appropriate, and approves the strategy for managing risk and is responsible for the Santander UK Group's system of internal control. Within this tier, there is a process for transaction review and approval within certain thresholds, discharged by the Credit Approval Committee. Transactions reviewed which exceed the threshold limits set are subject to prior review by Banco Santander, S.A. Risk before final approval by the Credit Approval Committee.

The second comprises the Santander UK Board and is supported by the Risk Division. The role of the Chief Risk Officers and Risk Division include development of risk measurement methodologies, risk approval, risk monitoring, risk reporting and escalation of risk issues in line with the relevant risk policies for all risks in the Santander UK Group. The Santander UK Group's central risk function provides services to the Company, monitors and manages the financial risks relating to the operations of the Company through internal risk reports which ensure compliance with Group policies and limits, including risk policies, limits and parameters, an approval process relating to transactions that exceed local limits and the systematic review of exposures to large clients, sectors, geographical areas and different risk types.

The third tier comprises Risk Assurance, who provides independent objective assurance on the effectiveness of the management and control of risk across all of the Santander UK Group. This is provided through the Non-Executive Directors, Internal Audit function and the Audit and Risk Committee.

Market risk

Market risk is the potential for loss of income or decrease in value of net assets caused by movements in the levels and prices of financial instruments. The Company is subject to market risk in the form of interest rate risk. The Company enters into interest rate swap contracts with Abbey National Treasury Services plc, a related party, to manage interest rate risks associated with the Company's financial assets and liabilities. Hedge accounting is not adopted by the Company for these derivatives and therefore the results of the Company are subject to volatility due to the movement in fair value of those interest rate swap contracts.

A 50bp adverse movement in interest rates would result in a reduction in operating profit and net assets of £nil (2009: £86.3m).
A 50bp positive movement in interest rates would result in an increase in operating profit and net assets of £nil (2009: £86.3m).

Liquidity risk

Liquidity risk is the potential that, although remaining solvent, the Company does not have sufficient liquid financial resources to enable it to meet its obligations as they fall due, or can secure them only at excessive cost.

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Notes to the financial statements for the year ended 31 December 2010

2 Financial risk management (continued)

Liquidity risk (continued)

The table below analyses the Company's financial liabilities into relevant maturity groupings based on the remaining period at balance sheet date to contractual maturity date. There are no significant financial liabilities related to financial guarantee contracts.

At 31 December 2010

There were no financial liabilities at the balance sheet date

	On demand	1-3	3-12	1-5	Over 5	2009
At 31 December 2009	£000	months £000	months £000	years £000	years £000	Total £000
Loans due to group companies	-	(46,661)	-	-	(28,858,830)	(28,905,491)
Interest payable on loans	-	(16,370)	(381,970)	(1,991,702)	(9,759,337)	(12,149,379)
Total Liabilities	-	(63,031)	(381,970)	(1,991,702)	(38,618,167)	(41,054,870)

The maturity analyses above for loans due to group companies include the remaining contractual maturities for those loans for which contractual maturities are essential for an understanding of the timing of the cash flows.

Liquidity is managed by the Company by matching the terms of the financial instruments so that cash inflows meet cash outflows. The receipts from the intercompany loan asset and the payments in respect of the derivative financial instruments described above are matched. The receipts from the derivative financial instruments and the payments required in respect of the debt securities in issue described above are also matched.

Collateral calls on derivatives positions can pose a significant liquidity risk. Collateral calls may arise at times of market stress and when asset liquidity may be tightening. The timing of the cashflows on a derivative hedging an asset may be different to the timing of the cashflows of the asset being held, even if they are similar in all other respects. Collateral calls may be triggered by a credit downgrading. The Company manages these risks by including collateral calls in stress tests on liquidity, and by maintaining a portfolio of assets held for managing liquidity risk.

Credit risk

Credit risk is the risk that counterparties will not meet their financial obligations and may result in the Company losing the principal amount lent, the interest accrued and any unrealised gains, less any security held. The main source of credit risk is in the intercompany balances held.

The maximum exposure to credit risk without taking into account collateral or credit enhancements is the carrying amount of the loans and advances to group companies as disclosed in Note 10 and the fair value of derivative financial assets as shown in the Balance Sheet.

There were no financial assets past due but not impaired at the year end. A description of how impairment is measured can be found in the accounting policies on page 8.

Derivatives are contracted with the Santander UK Group or counterparties that meet Santander UK Group credit policies. If subsequently there is a ratings downgrade remedial measures include provision of collateral for obligations under the relevant swap.

The Holmes structure, comprising the immediate parent and fellow subsidiaries, is over collateralised by £5.0 billion (2009: £13.0 billion).

The structure has a cash balance of £0.3 billion (2009: £1.9 billion), which is also a credit enhancement feature.

Santander UK plc is rated periodically by credit rating agencies Standard & Poor's, Moody's Investors Service and Fitch Ratings, Ltd.

Santander UK plc credit rating is disclosed below as the financial assets of the Holmes securitisation structure are secured on mortgage assets within Santander UK plc. Details of the mortgage assets are disclosed in the notes to the financial statements of Santander UK plc.

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Notes to the financial statements for the year ended 31 December 2010

2 Financial risk management (continued)

Credit risk (continued)

Santander UK's current credit ratings are

	S & P	Moody's	Fitch
Long-term rating	AA	Aa3	AA-
Long-term rating outlook	Negative	Negative	Stable
Short term	A-1+	P-1	F1+

Fair value estimation

Where a financial instrument is primarily sensitive to changes in interest rates, such as derivatives held by the Company, valuation is made using discounted cash flow techniques which reference yield curves derived from quoted interest rates in appropriate time bandings, which match the timings of the cash flows and maturities of the instruments

3 Business and geographical segments

All of the Company's income is derived from activities in the same business and geographical segment. There were no discontinued operations during the year.

4 Interest and similar income

	Year ended 31 December 2010 £000	Period ended 31 December 2009 £000
Interest receivable from related parties	608,883	401,322
Bank interest receivable	8,522	5,506
	617,405	406,828

The mortgage portfolio is held on trust by Holmes Trustees Limited, a group undertaking for the benefit of Santander UK plc

5 Interest expense and similar charges

	Year ended 31 December 2010 £000	Period ended 31 December 2009 £000
Other interest payable	1,785	2,058
Swap interest payable	412,781	257,797
Interest payable on loans from group companies	183,398	133,231
	597,964	393,086

6 Profit/(loss) for the year

The profit/(loss) for the year has been arrived at after charging/(crediting)

	Year ended 31 December 2010 £000	Period ended 31 December 2009 £000
Foreign exchange (gains)/losses on hedged liabilities	(237,316)	237,316
Fair value gain on hedging instruments	-	(257,796)

Fees payable to the company's auditors for the audit of the company's annual accounts for the current year are £11,400 (2009 £11,400) and have been borne by Santander UK plc, for which no recharge has been made in the current year.

No Directors were remunerated for their services to the Company. Directors' emoluments are borne by, Santander UK plc. No emoluments were paid by the Company to Directors during the year. The Company had no employees in the current year or previous period.

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Notes to the financial statements for the year ended 31 December 2010

7 Tax

	Year ended 31 December 2010 £000	Period ended 31 December 2009 £000
Current tax		
UK corporation tax		
Current year	21	15
	21	15

UK corporation tax is calculated at 28% (2009 28%) of the estimated assessable profits for the year

The Finance (No 2) Act 2010, which provides for a reduction in the main rate of UK corporation tax from 28% to 27% effective from 1 April 2011, was enacted on 27 July 2010. The effect of the rate reduction was not material. The UK Government has also indicated that it intends to enact future reductions in the main tax rate of 1% each year down to 24% by 1 April 2014.

The tax on the Company's profit/(loss) before tax differs from the theoretical amount that would arise using the basic tax rate of the Company as follows

	Year ended 31 December 2010 £000	Period ended 31 December 2009 £000
Profit/(loss) before tax	237,393	(237,263)
Tax at the UK corporation tax rate of 28%	66,470	(66,434)
Non taxable derivative fair value movement	(66,449)	66,449
Tax charge for the year/period	21	15

The Company has elected to adopt the Tax of Securitisation Companies Regulations 2006

8 Cash and cash equivalents

	2010 £000	2009 £000
Guaranteed Investment Contract	709	1,768,770
Share of Trust cash	-	88,153
	709	1,856,923

The Guaranteed Investment Contract pays interest based on LIBOR. All the cash and cash equivalents are deposits with banks.

9 Beneficial interest in mortgage portfolio

The mortgage loans are secured on residential property in England and Wales. At 31 December 2010 the total mortgage asset held on trust for the beneficiaries amounted to £nil (2009 £53,568,416,156).

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Notes to the financial statements for the year ended 31 December 2010

10 Loans and advances due from related parties

	31 December 2010 £000	31 December 2009 £000
Loans and advances due from related parties	-	27,185,783
	31 December 2010 £000	31 December 2009 £000
Repayable		
In more than five years	-	27,185,783
	-	27,185,783

Loans and advances due from related parties represents an intercompany loan, generated as a result of the beneficial interest in the mortgage portfolio failing the de-recognition criteria described in IAS 39. The intercompany loan replaces the beneficial interest in the mortgage portfolio legally held by the Company, and represents the substance of the transaction for accounting purposes.

If the de-recognition criteria had been met the Company would have shown a beneficial interest in a mortgage portfolio of £nil as at 31 December 2010 (2009 £28,256,357,713) all of which are secured on residential property.

The loans and advances due from related parties are all designated in sterling and are either non interest bearing, at fixed rates or at variable rates of interest, based on the standard variable rate of the administrator, Santander UK plc.

The maturity of these balances is matched to the maturity of the loan notes as stated within Note 2.

11 Other assets

	31 December 2010 £000	31 December 2009 £000
Unamortised issue costs	-	1,786
Other assets	14	3
	14	1,789

The carrying amount of other assets approximates to their fair value. £nil will be amortised within a year (2009 £369,000).

12 Loans due to group companies

	31 December 2010 £000	31 December 2009 £000
Loans due to group companies	607	28,858,830
These borrowings are repayable as follows		
Due over five years	607	28,858,830
	607	28,858,830

Interest payable on the loans from group undertakings is based on LIBOR.

The fair value of the loans and advances due to related parties at 31 December 2010 was £607,000 (2009 £28,858,830,000).

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Notes to the financial statements for the year ended 31 December 2010

13 Other liabilities

	31 December 2010 £000	31 December 2009 £000
Current tax liability	22	15
Amounts due to group companies	-	46,661
Accrued interest payable to group companies	-	138,941
	22	185,617

The amounts are repayable as follows

	31 December 2010 £000	31 December 2009 £000
Less than 1 year	22	185,617
	22	185,617

Interest payable on the start up loans is based on LIBOR, all other balances are non interest bearing. Amounts due over five years are paid in order of priority when cash is available after other commitments have been met.

The carrying amounts of the other liabilities approximates to their fair value

14. Share capital

	31 December 2010 £	31 December 2009 £
Issued and fully paid		
2 Ordinary shares	2	2

15 Notes to the cash flow statement

	Year ended 31 December 2010 £000	Period ended 31 December 2009 £000
Profit/(loss) before tax	237,393	(237,263)
Adjustments for		
Losses on derivatives	176,961	67,181
Interest payable	360,647	393,086
Interest receivable	(617,406)	(671,151)
Operating cash flows before movements in working capital	157,595	(448,147)
Movement in other receivables	1,775	(1,789)
Movement in other payables	(599,888)	185,617
Cash generated by operations	(440,518)	(264,319)
Tax paid	(14)	-
Net cash generated by operations	(440,532)	(264,319)

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Notes to the financial statements for the year ended 31 December 2010

16 Related party transactions

During the current year, the Company entered into the following transactions with related parties

	Interest receivable 2010 £000	Interest receivable 2009 £000	Interest payable 2010 £000	Interest payable 2009 £000	Fees payable 2010 £000	Fees payable 2009 £000
Holmes Master Issuer 2	-	-	-	-	-	-
Santander UK plc	608,883	401,322	183,398	133,231	186	108
Santander UK plc – cash and cash equivalents	-	-	-	-	-	-
Wilmington Trust	-	-	-	-	10	5

	Loans and advances due (to)/from related parties 2010 £000	Loans and advances due (to)/from related parties 2009 £000	Loans and advances due to group companies 2010 £000	Loans and advances due to group companies 2009 £000
Holmes Master Issuer 2	-	-	607	28,858,830
Santander UK plc	-	27,185,783	-	-
Santander UK plc – cash and cash equivalents	709	1,768,770	-	-

The Company holds derivatives to manage the interest rate risk associated with the beneficial interest on the mortgage portfolio. These derivatives are held with Abbey National Treasury Services plc, a related party and amounted to nil (2009 £376,273,395). Net interest income/expense and fair value gain and losses on the derivatives are disclosed in notes 5 and 6 respectively.

There were no related party transactions during the year, or existing at the balance sheet date, with the Company's or parent company's key management personnel.

17 Capital management and resources

Capital held by the Company and managed centrally as part of the Santander UK plc Group, comprises share capital and reserves which can be found in the Balance Sheet on page 6.

Capital is managed by way of processes set up at inception of the Company and subsequently there is no active process for managing its own capital. The Company is designed to hold minimum reserves once all amounts due on the intercompany loans have been received and amounts owing to the bondholders have been paid. The Company's capital is not externally regulated.

Movements in reserves, and therefore capital, are primarily due to the unrealised fair value of the cross currency/interest rate derivatives which will unwind over the lifetime of the Company.

18. Parent undertaking and controlling party

The Company's immediate parent company is Holmes Holdings Limited. Holmes Holdings Limited is owned by Wilmington Trust SP Services (London) Limited, a Company incorporated in Great Britain and registered in England and Wales, holding all of the shares in the Company (one jointly with M McDermott as nominee) as trustee under a discretionary charitable trust, dated 17 February 1999, for the benefit of nurses employed in the United Kingdom and for charitable purposes.

The administration, operations, accounting and financial reporting functions of the Company are performed by Santander UK plc, which is incorporated in Great Britain and registered in England and Wales. Santander UK plc has delegated administration and servicing functions in respect of the loans on behalf of the mortgages' trustee and the beneficiaries to a service provider.

The Company meets the definition of a Special Purpose Entity and is consolidated within the Santander UK plc group accounts.

The Company's ultimate parent undertaking and controlling party is Banco Santander S A, a Company incorporated in Spain. Banco Santander, S A is the parent undertaking of the largest group of undertakings for which group accounts are drawn up and of which the Company is a member. Santander UK plc is the parent undertaking of the smallest group of undertakings for which the group accounts are drawn up and of which the Company is a member.

Copies of all sets of group accounts, which include the results of the Company, are available from Secretariat, Santander UK plc, 2 Triton Square, Regents Place, London NW1 3AN.