Southern Pacific Securities C plc

Directors' report and financial statements

31 December 2002
Registered number 3691880

Directors' report and financial statements

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Directors and company information

Directors

WE Cherry
PM Hills
BD Needham

Secretary

Clifford Chance Secretaries (CCA) Limited

Registered office

125 Kensington High Street
London
W8 5PA

Bankers

Barclays Bank PLC
Cheapside Business Centre
155 Bishopsgate
London
EC2M 3XA

Solicitors

Clifford Chance
200 Aldersgate Street
London
EC1A 4JJ

Auditors

Ernst & Young LLP
Rolls House
7 Rolls Buildings
Fetter Lane
London
EC4A 1NH

Directors' report

The directors present their report and the audited financial statements for the year ended 31 December 2002.

Principal activities

The principal activity of the company, is the investment in mortgage loans secured by first and second charges over properties within the United Kingdom.

Business review

The profit and loss account for the year to 31 December 2002 is set out on page 6. Both the level of business during the year and the financial position of the company at the end of the year were satisfactory.

Dividend

The directors do not recommend the payment of a dividend for the year *(2001:£nil)*.

Policy and practice on payment of creditors

The company does not follow any stated code on payment practice. It is the company'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 company to abide by the agreed terms of payment. There are no creditor days of suppliers' invoices outstanding at the year end *(2001: nil days)*.

Directors and directors' interests

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

WE Cherry (Chairman)
BD Needham
PM Hills

None of the directors who held office at the end of the year had any disclosable interest in the shares of the company *(2001: £nil)*.

Directors' report *(continued)*

Financial Instruments

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

The company also enters into derivative transactions (principally interest rate swaps) to manage its interest rate risk.

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

The main risks arising from the company's financial instruments are credit risk, interest rate risk and liquidity risk. The directors review and agree policies for managing each of these risks and they are summarised below. These policies have remained unchanged from 2001.

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 company in November 2001 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 company 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 company considers the use of derivative financial instruments to mitigate any residual interest rate risk.

Liquidity risks

The company'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 company holds a minimum cash balance to manage short term liquidity requirements.

Auditors

KPMG Audit Plc resigned as auditors on 8 November 2002 and the directors appointed Ernst & Young LLP.

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.

W E Cherry
Director

125 Kensington High Street
London
W8 5PA

16-7-03 DATE

Statement of directors' responsibilities

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that year. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable 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 company will continue in business.

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 1985. 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.

Independent auditors' report to the members of Southern Pacific Securities C plc

We have audited the company's financial statements for the year ended 31 December 2002 which comprise the Profit and Loss Account, Balance Sheet and the related Notes 1 to 19. These financial statements have been prepared on the basis of 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

As described in the Statement of Directors' Responsibilities the company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

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 if, in our opinion, the Directors' Report is not consistent with the financial statements, if 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 transactions with the company 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 United Kingdom Auditing Standards 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 judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the 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.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the company as at 31 December 2002 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Ernst & Young LLP

Ernst & Young LLP
Registered Auditor
London

16 July 2003

Profit and loss account

for the year ended 31 December 2002

	Note	**Year ended 31 December 2002 £'000**	As restated Year ended 31 December 2001 £'000
Interest receivable and similar income	*2*	**24,546**	3,463
Interest payable and similar charges	*3*	**(20,937)**	(3,242)
Net interest receivable		**3,609**	221
Other operating income	*4*	**9,225**	604
Total operating income		**12,834**	825
Operating expenses		**(12,804)**	(823)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION	*5*	**30**	2
Tax on profit on ordinary activities	*6*	**122**	-
PROFIT ON ORDINARY ACTIVITIES AFTER TAXATION	*15*	**152**	2

The profit for the year was derived from continuing operations.

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

The notes on pages 8 to 18 form part of these financial statements.

Balance sheet
at 31 December 2002

	Note	31 December 2002 £'000	As restated 31 December 2001 £'000
Current assets			
Debtors:			
Amounts falling due after one year	*10*	**200,107**	332,046
Amounts falling due within one year	*11*	**5,720**	12,777
Cash at bank and in hand		**16,574**	10,485
		222,401	355,308
Creditors: amounts falling due within one year	*12*	**(5,101)**	(5,673)
Net current assets		**217,300**	349,635
Total assets less current liabilities		**217,300**	349,635
Creditors: amounts falling due after more than one year	*13*	**(217,133)**	(349,620)
Net assets		**167**	15
Capital and reserves			
Called up share capital	*14*	**13**	13
Profit and loss account	*15*	**154**	2
Shareholders' funds	*16*	**167**	15

The notes on pages 8 to 18 form part of these financial statements.

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

W E Cherry
Director

Date: 16-7-03

Notes

(forming part of the financial statements)

1 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the company's financial statements. In preparing the financial statements for the current year, the company has adopted FRS 18 'Accounting Policies' and FRS 19 'Deferred Tax'. The adoption of FRS 19 has resulted in a change of accounting policy for deferred tax. Deferred tax is recognised on a full provision basis in accordance with the accounting policy described below. Previously deferred tax was provided for on a partial provision basis, whereby provision was made on all timing differences to the extent that they were expected to reverse in the future without replacement. This change in accounting policy has not resulted in a prior year adjustment.

Adoption of FRS 18 has not required any revisions to the financial statements in either the current or prior years.

The company has restated its balance sheet, profit and loss account for 2001.

In prior years the company recognised in full its estimate of the deferred consideration payable on the acquired mortgage portfolio. In preparing the financial statements for the year ended 31 December 2002, the directors consider that a policy of recognising only the actual deferred consideration payable would give a fairer presentation of the results and financial position of the company. Accordingly, the 2001 figures have been restated on the basis of the new policy. This has resulted in a net adjustment to the profit for the prior year of £nil, and a reduction in debtors due within one year of £3,384,520, a reduction in debtors due after more than one year of £8,326,621, a reduction in creditors: amounts falling due within one year of £133,532, and a reduction in creditors: amounts falling due after more than one year of £11,577,609.

Basis of accounting

The financial statements have been prepared in accordance with applicable accounting standards and under the historical cost convention. The financial statements have been prepared on a going concern basis.

Mortgage loans

Mortgage loans are stated at cost 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.

Provisions

Specific provisions for losses on loans and advances to customers in arrears is 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).

A general provision for losses is made for the general risk of default by customers which is inherent in a mortgage portfolio on balances excluding those in arrears and possession provided for specifically.

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 tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transaction or events that result in an obligation to pay more, or a right to pay less tax in the future, have occurred at the balance sheet date.

Notes *(continued)*

1 Accounting policies *(continued)*

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 the future reversal of the underlying timing differences can be deducted. Deferred tax is measured on a non-discounted basis at the tax rates that are expected to apply in periods 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. The payment of these amounts is conditional on the performance of the acquired mortgages. Provision is made for deferred consideration within the financial statements as amounts become payable as a result of the performance of the acquired mortgages.

Interest

Receipts and payments of interest are accounted for on an accrual basis.

Redemption fee income

Redemption fees are receivable on mortgage loans when partially or fully repaid. The level of the fee is dependent on the specific product. The income is credited to the profit and loss account as received.

Sundry fee income

Borrowers may be charged fees as a result of specific information requests and where mortgage accounts fall into delinquency. This income is credited to the profit and loss account on an accruals basis.

Interest rate swaps

A series of amortising interest rate swaps have been entered into, in order to manage the company's interest rate risk in relation to fixed rate mortgage loans. The derivative contracts match the expected profile of the run-off of the fixed rate loans. The net interest paid or received under interest rate swaps is recorded on an accruals basis and included within interest payable within 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.4 and costs amortised in the year are included in interest payable.

Related party transaction

Under Financial Reporting Standard No.8 the company is exempt from the requirement to disclose transactions with entities within the Southern Pacific B Limited group as all of its voting rights are controlled by Southern Pacific B Limited, whose financial statements are publicly available.

Southern Pacific Mortgage Limited retains an interest in the cashflows and profits of Southern Pacific Securities C plc. Accordingly Southern Pacific Mortgage Limited, whilst having no direct investment in the company or it's parent, is treated as a related party.

Cash flow statement

Under Financial Reporting Standard No.1 (Revised), the company is exempt from the requirement to prepare a cash flow statement on the grounds that a parent undertaking includes the company in its own published consolidated financial statements.

Interest receivable

The company's turnover and trade are wholly within the UK and within a single market sector.

Notes *(continued)*

2 Interest receivable and similar income

	Year ended 31 December 2002 £'000	As restated Year ended 31 December 2001 £'000
On mortgage advances	**23,517**	3,284
Other Interest	**1,029**	179
	24,546	3,463

3 Interest payable and similar charges

	Year ended 31 December 2002 £'000	Year ended 31 December 2001 £'000
Start up loan	**360**	44
Other interest payable	**737**	-
Mortgage backed loan notes	**18,947**	3,060
Amortisation of initial issue costs	**893**	138
	20,937	3,242

4 Other operating income

	Year ended 31 December 2002 £'000	Year ended 31 December 2001 £'000
Redemption fees	**7,760**	459
Sundry fee income	**1,465**	145
	9,225	604

Notes *(continued)*

5 Profit on ordinary activities before taxation

	Year ended 31 December 2002 £'000	As restated Year ended 31 December 2001 £'000
Profit on ordinary activities before taxation is stated		
After charging:		
Auditors' remuneration – For audit services	**6**	5
Provision for mortgage losses	**1,079**	355
Amortisation of capitalised issue costs	**893**	138
Deferred consideration	**10,857**	-
After crediting:		
Deferred consideration	**-**	(134)

6 Tax on profit on ordinary activities

(a) Analysis of tax charge in the year

	Year ended 31 December 2002 £'000	Year ended 31 December 2001 £'000
Current tax:		
Adjustments in respect of prior years	**4**	-
Deferred tax:		
Current year charge	**5**	-
Adjustments in respect of prior years	**(131)**	-
	(122)	-

Notes *(continued)*

6 Taxation (continued)

(b) Factors affecting the tax charge in the year

The tax assessed for the year is higher than the standard rate for current corporation tax in the UK of 30% (2001: 30%). The differences are explained below:

	Year ended 31 December 2002 £'000	Year ended 31 December 2001 £'000
Profit on ordinary activities before tax	**30**	2
Profit on ordinary activities multiplied by the standard rate of corporation tax of 30% (2001 : 30%)	**9**	-
Effects of:		
Short-term timing differences	**(5)**	-
Small companies rate	**(4)**	
	-	-

7 Information regarding directors and employees

The company has no employees. The directors received no remuneration from the company during the year.

8 Mortgage loans – net balances

	Mortgages £000	**Mortgage loss provision £000**	**Total £000**
At start of year	342,854	(1,890)	340,964
Acquired during year	-	-	-
Net movement in the year	(137,692)	(406)	(138,098)
At 31 December 2002	**205,162**	**(2,296)**	**202,866**

Notes *(continued)*

9 Mortgage loans - unamortised premium

	2002 **£'000**	As restated 2001 £'000
At start of year	**1,536**	-
Acquired during year	**-**	1,536
Amortisation in the year	**(541)**	-
At end of year	**995**	1,536

10 Debtors: amounts falling due after one year

	31 December 2002 **£'000**	As restated 31 December 2001 £'000
Mortgage loans:		
Net balances	**199,410**	330,954
Unamortised premium on acquisition	**697**	1,092
	200,107	332,046

Mortgage loans of £202,866,000 *(2000: £340,964,000)* are held as security against the loan notes referred to in note 13.

11 Debtors: amounts falling due within one year

	31 December 2002 **£'000**	As restated 31 December 2001 £'000
Mortgage loans:		
Net balances	**3,456**	10,010
Unamortised premium on acquisition	**298**	444
Prepayments and accrued income	**1,832**	2,323
Deferred Taxation	**8**	
Other debtors	**126**	-
	5,720	12,777

Notes *(continued)*

12 Creditors: amounts falling due within one year

	31 December 2002 £'000	As restated 31 December 2001 £'000
Amounts owed to related parties	**855**	3,857
Corporation tax	**4**	-
Deferred consideration	**3,571**	349
Accruals and deferred income	**671**	1,467
	5,101	5,673

13 Creditors: amounts falling due after more than one year

	31 December 2002 £'000	As restated 31 December 2001 £'000
Mortgage backed loan notes due 2039 – Class A	**162,344**	295,953
Mortgage backed loan notes due 2039 – Class B	**28,350**	28,350
Mortgage backed loan notes due 2039 – Class M	**20,120**	20,120
	210,814	344,423
Less: Issue costs	**(1,894)**	(2,128)
Start up loan	**8,213**	7,325
	217,133	349,620

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

The mortgage backed floating rate notes due 2039 are secured over a portfolio of mortgage loans secured by first charges over residential properties in the United Kingdom.

The mortgages were purchased from Southern Pacific Mortgages Limited. The mortgages are administered by a third party administrator on behalf of Southern Pacific Securities C plc.

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 mortgages. If not otherwise redeemed or purchase and cancelled, the notes will be redeemed at their principal amount outstanding on the interest payment date falling in September 2039. Interest on the notes is payable monthly in arrears at the following rates above the London Interbank Offered Rate for three month sterling deposits until the interest payment date falling in September 2008 and thereafter at the following rates:

Notes *(continued)*

	Up to September 2008	After September 2008
Class A with Class A ordinary coupons	LIBOR + 0.44%	LIBOR + 0.88%
Class A with detachable coupons	2.00%	2.00%
Class M	LIBOR + 1.40%	LIBOR + 2.80%
Class B	LIBOR + 2.75%	LIBOR + 3.75%

The start up loan is repayable to Southern Pacific Mortgage Limited on or before 2039. Interest is payable at a rate of 0.75% above the London Interbank Offered Rate for three month sterling deposits.

Called up share capital	**31 December 2002 £**	31 December 2001 £
Authorised		
Ordinary shares of £1 each	**50,000**	50,000
Allotted and called up		
Ordinary shares of £1 each		
2 shares 100% called and fully paid	**2**	2
49,998 shares 25% called and fully paid	**12,500**	12,500
	12,502	12,502

14 Profit and loss account

	31 December 2002 £'000	31 December 2001 £'000
Retained profit brought forward	**2**	-
Profit for the year	**152**	2
Retained profit carried forward	**154**	2

15 Reconciliation of movement in shareholders' funds

	31 December 2002 £'000	31 December 2001 £'000
Retained profit for the year	**152**	2
Net increase in shareholders' funds	**152**	2
Opening shareholders' funds	**15**	13
Closing shareholders' funds	**167**	15

Notes *(continued)*

16 Derivatives and other financial instruments

As explained on page 3, the company uses financial instruments in its normal course of business. The following numerical analysis gives an indication of the significance of these instruments to the company.

a. Interest rate risk

The table below summarises the interest rate profile of the company's financial instruments after taking into account the effect of any interest rate derivatives used to manage the risk associated with these instruments. The analysis excludes short term debtors and creditors. All instruments are denominated in sterling.

	Floating	**Fixed**	**Non-interest bearing**	**2002 Total**
Financial assets:	**£000**	**£000**	**£000**	**£000**
Mortgages	**202,866**	**-**	**-**	**202,866**
Cash at bank and in hand	**16,574**	**-**	**-**	**16,574**
	219,440	**-**	**-**	**219,440**
Financial liabilities:				
Mortgage backed loan notes due 2039	**(208,920)**	**-**	**-**	**(208,920)**
Start up loan	**(8,213)**	**-**	**-**	**(8,213)**
	(349,620)	**-**	**-**	**(349,620)**

	Floating	Fixed	Non-interest bearing	2001 Total
Financial assets:	£'000	£'000	£'000	£'000
Mortgages	340,964	-	-	340,964
Cash at bank and in hand	10,485	-	-	10,485
	351,449	-	-	351,449
Financial liabilities:				
Mortgage backed loan notes due 2039	(342,295)	-	-	(342,295)
Start up loan	(7,325)	-	-	(7,325)
	(217,133)	-	-	(217,133)

The rates of interest receivable and payable on variable rate financial instruments are set with reference to the London Interbank Offered Rate.

Notes *(continued)*

b. Fair value of financial instruments

	Book value 2002 £'000	**Fair value 2002 £'000**	Book value 2001 £'000	Fair value 2001 £'000
On balance sheet				
Mortgage loans	**202,866**	**202,866**	340,964	340,964
Cash and deposits	**16,574**	**16,574**	10,485	10,485
Mortgage backed loan notes due 2039	**(208,920)**	**(208,920)**	(342,295)	(342,295)
Start up loan	**(8,213)**	**(8,213)**	(7,325)	(7,325)

The company uses interest rate swaps in certain circumstances to hedge against movements in interest rates. At 31 December 2002 the interest rate swap previously held expired. The notional value of this swap was £nil *(2001:£209,911,207)* and the unrecognised fair value was £nil *(2001: £133,993).*

The detachable A coupon notes have no value in the balance sheet but a notional value of £10,070,000 was ascribed to these notes at issue.

17 Deferred taxation

	31 December 2002 £000	31 December 2001 £000
Decelerated capital allowances	**-**	-
Other short term timing differences	**126**	-
	126	-
Provision at start of year	**-**	-
Deferred tax credit in the profit and loss account (note 6)	**126**	-
Provision at the end of year	**126**	-

Notes *(continued)*

18 Related party disclosures

During the year, the company has been charged the following amounts of interest and administration fees by Southern Pacific Mortgage Limited.

	2002	2001
	£'000	£'000
A note detachable coupons	**4,917**	770
Start up loan	**360**	45
Service Bureau & Cash/bond administration fees	**736**	108

The interest accrued but unpaid at 31 December 2002 on the A note detachable coupons was £205,000 *(2001:£357,000)*. Service fees accrued but unpaid at 31 December 2002 for the service bureau were £5,000 *(2001:72,000)* and the cash/bond administrator were £2,667 *(2001:2,874)*.

19 Parent undertaking and control

The company is controlled by its parent undertaking, Southern Pacific B Limited, which is registered and operates in the United Kingdom.

The entire issued share capital of Southern Pacific B Limited is held by a Trustee under the terms of a trust primarily for the benefit of the creditors of the company or, if none, for the benefit of the holders of notes issued by Southern Pacific Securities C plc, and ultimately for charitable purposes.

The largest group in which the results of the company are consolidated is that headed by Lehman Brothers Holdings Inc., incorporated in the United States of America. The smallest group in which they are consolidated is that headed by Southern Pacific B Limited, registered in England and Wales. The consolidated accounts of these groups are available from 745 Seventh Avenue, New York, USA and 125 Kensington High Street, London, W8 5PA respectively.