

Company No. 3149607

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
REPORT AND ACCOUNTS
FOR THE PERIOD ENDED 31 DECEMBER 2001



BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC

REPORT OF THE DIRECTORS

Directors

D. R. McArthur

G. A. E. White

The Directors hereby submit their Report and the accounts for the period ended 31st December 2001.

Results for the period

The profit for the period amounted to £292,273 (28th February 2001: £331,521). The Directors recommend a dividend payment of £263,046 (28th February, 2001 £nil).

Accounting reference date

The Company has changed its accounting reference date to 31st December from 28th February to align its year-end with that of its ultimate parent undertaking, HBOS plc. Pursuant to schemes of arrangement under section 425 of the Companies Act, Bank of Scotland (the previous ultimate parent undertaking) and Halifax Group became subsidiaries of HBOS plc on 10th September 2001. The merged Group has a 31st December accounting reference date. These accounts are accordingly for a 10 month period.

Review of operations

The Company was established to finance mortgage lending. There has been no change in the structure of the business in the period. Movements in the mortgage book are disclosed in the notes to the accounts

The Directors consider the Company's position to be satisfactory.

Statement of payment practice

It is the Company's policy that payments to suppliers are made in accordance with those terms and conditions agreed between the Company and its suppliers. The Company did not, at any time during the period, obtain or seek to obtain credit from any of its suppliers. On this basis no calculation has been made for the average number of days credit taken at the period end.

Directors and their interests

The Directors at the date of this report are stated above.

No Director had a beneficial interest in the shares of the Company during the period.

No Director had a beneficial interest in the shares of any undertaking within the Bank of Scotland Group up to 10th September 2001, or within HBOS Group, from that date, to the end of the period, other than as below.

Under the terms of the merger, on 10th September 2001 each Halifax share or Bank of Scotland ordinary stock unit was exchanged for one HBOS plc ordinary share.

Directors' beneficial interests in the ordinary shares of HBOS plc were as follows:

	<u>At 28th February, 2001</u>	<u>At 31st December, 2001</u>
	<u>Ordinary Stock Units of 25p each</u>	<u>Ordinary Shares of 25p each</u>
D. R. McArthur	51,470	65,073
G. A. E. White	36,048	40,073

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC

REPORT OF THE DIRECTORS (continued)

Options to subscribe for Ordinary Stock of Bank of Scotland/HBOS plc were granted to or exercised by Directors during the period to 31st December, 2001 as follows:-

Executive Stock Options held by Directors

	<u>#Options held as at 28th February, 2001</u>	<u>#Options granted</u>	<u>#Options exercised</u>	<u>#Options held as at 31st December 2001</u>
D. R. McArthur	72,600	-	37,600	35,000
G. A. E. White	70,600	-	38,600	32,000

Ordinary Stock units/Shares of 25p each

HBOS policy is to make an annual grant of options over the ten year life of the Executive Stock Option Scheme.

Savings Related Stock Options held by Directors

	<u>#Options held as at 28th February, 2001</u>	<u>#Options granted</u>	<u>#Options exercised</u>	<u>#Options held as at 31st December 2001</u>
G. A. E. White	7,364	-	1,426	5,938

Ordinary Stock units/Shares of 25p each

At the beginning of the financial period, the interests of the Directors were in Bank of Scotland Ordinary Stock Units.

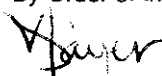
Secretary

On the 30th November, 2001 H. M. Lakin resigned as Secretary of the Company. S. Mayer was appointed Secretary on the same date.

Auditors

During the period, KPMG Audit Plc, were re-appointed as auditors. KPMG Audit Plc have signified their willingness to continue in office and a resolution for their re-appointment will be proposed at the Annual General Meeting.

By Order of the Board,


S Mayer/
Secretary

Registered Office
Premier House
City Road
CHESTER.

22 February 2002

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC

STATEMENT OF DIRECTORS' RESPONSIBILITIES

Company law requires the directors to prepare accounts for each financial period which give a true and fair view of the state of affairs of the Company and of the profit or loss for that period. In preparing those accounts, 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;

Prepare the accounts 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 accounts comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC

PROFIT AND LOSS ACCOUNT

For the period ended 31st December 2001

	Notes	<u>10 months to 31st December, 2001 £</u>	<u>Year to 28th February, 2001 £</u>
Interest receivable	2	2,744,953	4,010,602
Interest payable		(2,222,418)	(3,369,326)
Net Interest		522,535	641,276
Fees and commissions receivable		9,567	13,958
Shared appreciation receivable		1,825,076	1,480,849
Premium on redemption of loan notes		(1,825,076)	(1,480,849)
Other income		5,896	3,994
Operating expenses		(128,914)	(187,024)
Profit on ordinary activities before taxation	3	409,084	472,204
Taxation	4	(116,811)	(140,683)
Profit on ordinary activities after taxation		292,273	331,521
Dividend on equity shares - proposed		(263,046)	0
Retained profit for period		29,227	331,521
Profit and Loss account at 28th February, 2001		688,511	356,990
Profit and Loss account at 31st December, 2001		717,738	688,511

All gains and losses arising during the period have been recognised in the profit and loss account and derive from continuing activities.

The notes on pages 7 to 10 form part of the financial statements.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC

BALANCE SHEET

As at 31st December, 2001

	<u>Notes</u>	<u>31st</u> <u>December,</u> <u>2001</u> <u>£</u>	<u>28th</u> <u>February,</u> <u>2001</u> <u>£</u>
<u>Fixed Assets Investments</u>			
Mortgage portfolio	5	37,182,778	38,510,107
Deposit account	6	55,801,104	57,731,760
		92,983,882	96,241,867
<u>Current Assets</u>			
Amount due from ultimate parent undertaking		688,060	769,434
Deferred expenditure		397,572	480,880
Interest receivable		214,226	0
Cash at bank and in hand		124,537	4,541
		1,424,395	1,254,855
<u>Creditors: Amounts falling due within one year</u>			
Corporation tax payable		(116,810)	(140,683)
Accruals and deferred income		(302,546)	(27,881)
Proposed dividend		(263,046)	(370,000)
		(682,402)	(538,564)
<u>Net Current Assets</u>		741,993	716,291
<u>Creditors: Amounts falling due after more than one year</u>			
Floating rate loan notes	7	(92,958,136)	(96,219,646)
		767,739	738,512
<u>Share Capital and Reserves</u>			
Called up share capital	8	50,001	50,001
Profit and loss account		717,738	688,511
<u>Equity Shareholders' Funds</u>	9	767,739	738,512

..... *D. H. McArthur* Director
 *[Signature]* Director
 *22 February* 2002

The notes on pages 7 to 10 form part of the financial statements.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC

NOTES ON THE ACCOUNTS

1. Accounting policies

1.1 Basis of preparation

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

1.2 Interest receivable and payable is accrued on a daily basis.

1.3 Shared appreciation received is accounted for as received.

1.4 The charge for taxation takes into account the timing differences in the accounting and taxation treatment of certain items to the extent that they are expected to reverse in the future. Deferred taxation is provided on the liability method.

1.5 Arrangement fees and commissions receivable for the continuing service of loans and advances are recognised on the basis of work done. Other fees are recognised when receivable.

1.6 Issue costs in respect of the Fixed Rate Loan Notes, have been deferred and are being charged to the Profit and Loss Account over a ten year period.

1.7 The company is exempt from preparing a Cash Flow Statement under FRS 1 as the results are consolidated within the financial statements of the HBOS group.

2. Interest receivable

Interest receivable includes interest receivable from ultimate parent undertaking of £25,253 (28th February, 2001: £31,750).

3. Profit on ordinary activities before taxation

The profit on ordinary activities before taxation is stated after charging:

	<u>10 months to</u> <u>31st</u> <u>December,</u> <u>2001</u> £	<u>Year to 28th</u> <u>February,</u> <u>2001</u> £
Auditors' Remuneration:		
Audit Services	<u>(2,291)</u>	<u>(2,291)</u>

The Company has no employees and none of the Directors receive any emoluments from the Company.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC

NOTES ON THE ACCOUNTS (continued)

4 Taxation

The taxation charge is based on the profit arising from ordinary activities and comprises

	<u>10 months to</u> <u>31st</u> <u>December,</u> <u>2001</u> <u>£</u>	<u>Year to 28th</u> <u>February,</u> <u>2001</u> <u>£</u>
UK Corporation Tax	116,811	140,683
	<u>116,811</u>	<u>140,683</u>

5 Mortgage Portfolio

	<u>31st</u> <u>December,</u> <u>2001</u> <u>£</u>	<u>28th</u> <u>February,</u> <u>2001</u> <u>£</u>
Opening balance	38,510,107	40,057,253
Fees capitalised	3,525	5,405
Mortgage redemptions in period	(1,330,854)	(1,552,551)
Closing balance	<u>37,182,778</u>	<u>38,510,107</u>

6 Deposit Account

This account represents a cash balance held with a third party under a guaranteed investment contract. The Company earns a LIBOR related return on the account, which is recorded as interest income in the Profit & Loss Account. Withdrawals from this deposit account are restricted to certain circumstances, primarily in relation to the redemption of the loan notes.

7. Floating Rate Loan Notes

	<u>31st</u> <u>December,</u> <u>2001</u> <u>£</u>	<u>28th</u> <u>February,</u> <u>2001</u> <u>£</u>
Opening balance	96,219,646	100,102,146
Redemption of loan notes in period	(3,261,510)	(3,882,500)
Closing balance	<u>92,958,136</u>	<u>96,219,646</u>

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC

NOTES ON THE ACCOUNTS (continued)

7. Floating Rate Loan Notes (continued)

The Asset Backed Floating Rate Loan Notes are due in 2072. The interest rate applicable on the loan notes up to and including the interest period ending in the quarter to 31st August 2027 is 60 per cent of the London Inter Bank Offered Rate for three month sterling deposits less 0.30% per annum. Thereafter, the interest rate applicable to the loan notes will be 60 per cent of the London Inter Bank Offered Rate for three month sterling deposits plus 0.10% per annum. The loan notes carry, in addition to interest, rights to receive certain amounts calculated by reference to the value of shared appreciation proceeds received from redeemed mortgages. The loan notes are subject to mandatory part redemption from time to time based on the level of redeemed mortgages and can be redeemed in full, in certain circumstances, at the option of the Company. The loan notes are secured on the mortgage portfolio, the guaranteed investment contract and certain other assets of the Company.

8. Share Capital

	<u>31st</u> <u>December,</u> <u>2001</u> <u>£</u>	<u>28th</u> <u>February,</u> <u>2001</u> <u>£</u>
<u>Authorised</u>		
50,000 ordinary shares of £1 each	<u>50,000</u>	<u>50,000</u>
1 deferred share of £1	<u>1</u>	<u>1</u>
<u>Allotted called up and fully paid</u>		
50,000 ordinary shares of £1 each	<u>50,000</u>	<u>50,000</u>
1 deferred share of £1	<u>1</u>	<u>1</u>

The deferred share carries no entitlement to any dividend or to any share in any surplus assets of the Company on a winding-up, other than the right to be repaid the amount of any paid up share capital thereon. The right to be repaid any paid up share capital in the Deferred Share shall be deferred until after all paid up share capital has been first repaid on all other classes of issued share capital in the Company.

The deferred share carries the right to receive notice of all general meetings of the Company but does not carry the right to attend, speak or vote at a general meeting unless a resolution is to be proposed (1) abrogating, varying or modifying any of the rights or privileges of the holder of the Deferred Share, (2) for the winding up or administration of the Company under the Insolvency Act 1986, or (3) for the entry by the Company with any other party into a merger, reconstruction, scheme of arrangement or amalgamation of or affecting the Company, in any of which cases such holder shall have the right to attend such general meeting and shall be entitled to speak and vote. Whenever the holder of the Deferred Share is entitled to vote at a general meeting, such holder shall have one vote and on a poll such number of votes as is equal to 34 per cent of the number of votes attached to all other issued shares of the Company.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC

NOTES ON THE ACCOUNTS (continued)

9. Reconciliation of Equity Shareholders' Funds

	<u>31st</u> <u>December,</u> <u>2001</u> <u>£</u>	<u>28th</u> <u>February,</u> <u>2001</u> <u>£</u>
Profit attributable to shareholders	29,227	331,521
Equity Shareholders' Funds at 28th February, 2001	738,512	406,991
Equity Shareholders' Funds at 31st December, 2001	<u>767,739</u>	<u>738,512</u>

10. Financial and Derivative Instruments

The Company's financial instruments comprise mortgages, funds on deposit and loan notes. The Company's operations are structured so that it does not retain any interest rate or credit risk.

It is not practical to calculate the fair market value of the mortgages and loan notes because the amount and timing of future cashflows in relation to shared appreciation is uncertain. The carrying value of other current assets and liabilities approximates fair market value.

In addition a derivative contract, which matures on 28th February 2072, was entered into on 25th July 1997 with a UK Financial Institution. As at 31st December 2001 the replacement cost of the contract is £nil and its fair value is a liability of £4,564,362.

11. Parent Undertakings

The Company's intermediate parent undertaking is the Governor and Company of the Bank of Scotland, incorporated by Act of the Scottish Parliament in 1695, and its ultimate parent undertaking is HBOS plc. The Company is included within the group accounts of HBOS and Bank of Scotland and copies of their Annual Report and Accounts are available from their Head Office at The Mound, Edinburgh, EH1 1YZ.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF
BOS (Shared Appreciation Mortgages) No.2 PLC

We have audited the accounts on pages 5 to 10.

Respective responsibilities of Directors and auditors

The directors are responsible for preparing the directors' report and, as described on page 4, the accounts in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance.

We report to you our opinion as to whether the accounts 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 accounts, 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.

Basis of audit opinion

We conducted our audit in accordance with 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 accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the accounts, 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 accounts 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 accounts.

Opinion

In our opinion the accounts give a true and fair view of the state of the Company's affairs as at 31st December, 2001 and of its profit for the period then ended and have been properly prepared in accordance with the Companies Act 1985.



KPMG Audit Plc
Chartered Accountants
Registered Auditor
Edinburgh

22 February 2002