

Company No. 3149607

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC
REPORT AND ACCOUNTS
FOR THE YEAR ENDED 31 DECEMBER 2003



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BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC

REPORT OF THE DIRECTORS

Directors

J.H. Lloyd

I.G. Stewart

The Directors hereby submit their Report and the accounts for the year ended 31st December 2003

Results for the year to 31st December 2003

The profit after taxation for the year amounted to £322,269 (31st December 2002: £298,056). An interim dividend of £139,864 was paid at the half year (30th June 2002: £130,101). The Directors recommend a final dividend payment of £150,177 (31st December 2002: £138,179).

Review of operations

The Company was established to finance mortgage lending. There has been no change in the structure of the business in the year. 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 year, 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 year end.

Directors and their interests

The Directors who served during the year were as follows:

G.A.E White (resigned on 30 April 2003)

I.G. Stewart

J.H. Lloyd (appointed on 30 April 2003)

During the year, no Director had any beneficial interest in the share capital of the Company or of any other Group undertaking other than in HBOS plc, the ultimate holding company.

The beneficial interests of the Directors and their immediate families in HBOS plc shares are set out below:-

	At 31.12.02 or date of appointment if later HBOS plc shares	At 31.12.03 or date of appointment if later HBOS plc shares
J. H. Lloyd	10,007	10,921
I.G. Stewart	6,239	8,146

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC

REPORT OF THE DIRECTORS (continued)

Short-term Incentive plan - HBOS scheme and former Halifax scheme

Certain Directors have conditional entitlements to shares arising from the annual incentive plan. Where the annual incentive for any year was taken in shares and these shares are retained in trust for three years, the following shares will also be transferred to the Directors:

	Grant effective from	Shares as at 31.12.03
J.H. Lloyd	March 2003	1,264

Long-term Incentive Plan - HBOS scheme and former Halifax scheme

Details of the shares which have been conditionally awarded to Directors under the plans are set out below. The conditions relating to the long-term incentive plan may be found in the HBOS plc Annual Report & Accounts 2003.

		At 31.12.02	Granted (G) or lapsed (L) in year	Added as a result of performance	Dividend reinvestment shares	Released in year	At 31.12.03
I.G. Stewart	January 2000	4,056	-	4,056	1,066	9,178	-
I.G. Stewart	January 2001	3,931	-	-	-	-	3,931

Shares granted under these plans can crystallise at any level between 0% and 200% of the conditional award noted in the above table, dependent upon performance. The performance period for the January 2000 grant ended on 31 December 2002 and, in the light of performance outcome, grants were released at 200% of the conditional award. On maturity, dividend reinvestment shares equivalent to approximately 26% of the original conditional grant were also released to participants in accordance with the rules of the plan.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC

REPORT OF THE DIRECTORS (continued)

Long-term Incentive Plan

HBOS Scheme, former Bank of Scotland scheme and former Halifax Scheme

Share options granted between 1995 and 2000 under the Bank of Scotland Executive Stock Option Scheme 1995 are subject to performance pre-conditions which have now been satisfied. Share options granted under other plans are not subject to a performance precondition. Details of the options outstanding under these plans are set out below.

	Options Outstanding at 31.12.02 or date of appointment		Granted (G), lapsed (L) or exercised (E) in year	At 31.12.03
I.G. Stewart	2,768	(G)	3,256	6,024
J.H. Lloyd	17,902	(G)	1,743	19,645

Sharesave Plan

Share options granted under these plans are set out below

	At 31.12.02		Granted (G), Lapsed (L) or exercised (E) in year	At 31.12.03
J.H. Lloyd	3,291	(G)	964	4,255

Options under these plans were granted using middle market prices shortly before the dates of the grants, discounted by 20%.

Auditors and Annual General Meeting

During the year, 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

Premier House
City Road
CHESTER.

19 February 2004

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ACCOUNTS

Company law requires the directors to prepare accounts 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 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 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 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 year ended 31st December 2003

	Note	2003	2002
		£	£
Interest receivable	2	2,290,074	2,560,892
Interest payable		(1,681,727)	(1,959,546)
Net Interest		608,347	601,346
Fees and commissions receivable		3,425	1,350
Shared appreciation receivable		3,277,747	3,833,805
Shared appreciation payable		(3,277,747)	(3,833,805)
Other income		3,050	9,412
Operating expenses		(154,438)	(186,313)
Profit on ordinary activities before taxation	3	460,384	425,795
Taxation	4	(138,115)	(127,739)
Profit on ordinary activities after taxation		322,269	298,056
Dividend on equity shares - paid		(139,864)	(130,101)
Dividend on equity shares - proposed		(150,177)	(138,179)
Retained profit for year		32,228	29,776
Retained profit at the start of the year		747,514	717,738
Retained profit at the end of the year		779,742	747,514

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

The notes on pages 8 to 11 form part of the financial statements.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC

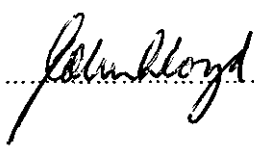
BALANCE SHEET

As at 31st December, 2003

	Note	2003	2002
		£	£
<u>Fixed Assets Investments</u>			
Mortgage portfolio	5	34,044,969	35,373,650
Deposit account	6	51,096,786	53,371,445
		<u>85,141,755</u>	<u>88,745,095</u>
<u>Current Assets</u>			
Amount due from ultimate parent undertaking		825,478	707,336
Deferred expenditure		205,770	287,390
Interest receivable		219,175	205,145
Cash at bank and in hand		276,101	689,245
		<u>1,526,524</u>	<u>1,889,116</u>
<u>Creditors: Amounts falling due within one year</u>			
Corporation tax payable		(138,115)	(127,739)
Accruals and deferred income		(455,591)	(870,041)
Proposed dividend		(150,177)	(138,179)
		<u>(743,883)</u>	<u>(1,135,959)</u>
<u>Net Current Assets</u>		<u>782,641</u>	<u>753,157</u>
<u>Total Assets less Current Liabilities</u>		<u>85,924,396</u>	<u>89,498,252</u>
<u>Creditors: Amounts falling due after more than one year</u>			
Floating rate loan notes	7	(85,094,653)	(88,700,737)
<u>Net Assets</u>		<u>829,743</u>	<u>797,515</u>
<u>Share Capital and Reserves</u>			
Called up share capital	8	50,001	50,001
Profit and loss account		779,742	747,514
<u>Equity Shareholders' Funds</u>	9	<u>829,743</u>	<u>797,515</u>

The notes on pages 8 to 11 form part of the financial statements.

The accounts were approved by the board of directors on 19 February 2004

and were signed on its behalf by:  Director

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

Interest receivable comprises interest arising on cash deposits held in the Guaranteed Investment Contract (GIC) account. No interest is receivable from the customers during the life of the mortgages.

Interest payable is to Bondholders at a fixed rate. All interest receivable and payable is accrued on a daily basis.

1.3 Shared Appreciation

The capital appreciation arising on the sale of a mortgage holder's property is shared between the mortgage holder and the Company as set out in the original loan agreement. The Company pays its share of the appreciation to the bondholders and a third party swap provider as part of a swap agreement entered into to pass on the risk attached to the potential appreciation received.

- 1.4 Deferred tax is recognised at the standard rate of corporation tax, without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date, (except as otherwise required by FRS 19) based on the corporation tax rate expected when the timing differences reverse.

- 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 Floating 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 the ultimate parent undertaking of £23,167 (31st December, 2002: £24,621).

3. Profit on ordinary activities before taxation

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

	2003 £	2002 £
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

Tax on Profit on Ordinary Activities

	2003 £	2002 £
The charge for the period based on a corporation tax rate of 30% (2002: 30%) comprises:		
UK Corporation tax:	<u>138,115</u>	<u>127,739</u>

5 Mortgage Portfolio

	2003 £	2002 £
Opening balance	35,373,650	37,182,778
Fees capitalised	2,745	7,145
Mortgage redemptions in year	<u>(1,331,426)</u>	<u>(1,816,273)</u>
Closing balance	<u>34,044,969</u>	<u>35,373,650</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

	2003 £	2002 £
Opening balance	88,700,737	92,958,136
Redemption of loan notes in year	<u>(3,606,084)</u>	<u>(4,257,399)</u>
Closing balance	<u>85,094,653</u>	<u>88,700,737</u>

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.

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC

NOTES ON THE ACCOUNTS (continued)

8. Share Capital

	2003 £	2002 £
<u>Authorised</u>		
50,000 ordinary shares of £1 each	50,000	50,000
1 deferred share of £1	1	1
<u>Allotted called up and fully paid</u>		
50,000 ordinary shares of £1 each	50,000	50,000
1 deferred share of £1	1	1

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.

9. Reconciliation of Equity Shareholders' Funds

	2003 £	2002 £
Profit attributable to shareholders	32,228	29,776
Opening Equity Shareholders' Funds	797,515	767,739
Closing Equity Shareholders' Funds	829,743	797,515

10. Financial and Derivative Instruments

The Company's financial instruments comprise mortgages, funds on deposit and loan notes.

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 2040, was entered into on 28th Feb, 1999 with a UK Financial Institution. As at 31st December 2003 the replacement cost of the contract is £nil. and its fair value is a liability of £13,873,010

BOS (SHARED APPRECIATION MORTGAGES) NO. 2 PLC

NOTES ON THE ACCOUNTS (continued)

11 Related Party Transactions

The company's ultimate parent is HBOS plc. The consolidated financial statements of HBOS plc are publicly available and include all transactions with group members who are related parties of the group. Under the provisions of Financial Reporting Standard No.8, transactions with related parties of this company have not been disclosed other than as required under Companies Act 1985.

12 Parent Undertakings

HBOS plc is the ultimate parent undertaking of BOS (Shared Appreciation Mortgages) No. 2 PLC and heads the largest group into which the accounts of the Company are consolidated. The consolidated accounts of HBOS plc may be obtained from its head office at The Mound, Edinburgh EH1 1YZ.

The Governor and Company of the Bank of Scotland heads the smallest group into which the accounts of the Company are consolidated. The accounts of The Governor and Company of the Bank of Scotland may be obtained from its head office at The Mound, Edinburgh, EH1 1YZ.

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

We have audited the financial statements on pages 6 to 11.

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 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 audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

The directors are responsible for preparing the directors' report and, as described on page 5, the financial statements 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 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.

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 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 the Company as at 31st December 2003 and of the profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc

KPMG Audit Plc

Registered Auditor
1 The Embankment
Neville Street
Leeds
LS1 4DW

19 Feb 2004