

T.H.F.C. (FUNDING NO. 2) PLC

Annual Report

For the year ended 31 December 2019

Companies House no: 06923641

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Directors

C. Burke
F. Edge
D. Stokes (appointed 1st November 2019)
P. Williamson

Company Secretary

C. Apthorpe (appointed 12th November 2019)

Registered Office

3rd Floor
17 St Swithin's Lane
London
EC4N 8AL

Company Number

06923641

Independent Auditor

Nexia Smith & Williamson Audit Limited
Chartered Accountants and Statutory Auditor
25 Moorgate
London
EC2R 6AY

DIRECTORS' REPORT

Year ended 31 December 2019

The directors submit their Directors' report, Strategic report and audited financial statements for the year ended 31 December 2019.

RESULTS AND DIVIDEND

T.H.F.C. (Funding No.2) Plc (the **company**) made neither a profit nor a loss for the year (2018: £Nil). The directors do not propose the payment of a dividend (2018: £Nil).

SHARE CAPITAL AND COMPANY STRUCTURE

T.H.F.C. (Funding No.2) Plc is a public limited company incorporated and domiciled in England and Wales. The entire issued share capital of the company is held by T.H.F.C. (Services) Limited.

DIRECTORS

The directors of the company who served throughout the year and up to the date of signing the financial statements were:

C. Burke

F. Edge

D. Stokes (appointed 1st November 2019)

P. Williamson

CORPORATE GOVERNANCE

As an issuer of asset-backed securities (the **secured bonds**), the operations of the company are conducted by an administrator, T.H.F.C. (Services) Limited, in accordance with the requirements of a corporate services agreement and the trust deed. This arrangement is monitored by the board of directors who are also directors of the administrator. There is no requirement for a separate audit committee.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union as applied in accordance with the provisions of the Companies Act 2006. Under company law the directors must not approve the financial statements unless they are satisfied that they 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 period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable International Financial Reporting Standards (IFRSs) as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements; and

DIRECTORS' REPORT (continued)
Year ended 31 December 2019

- 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 adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and 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.

The directors are responsible for the maintenance and integrity of any information published on the administrator's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

DISCLOSURE OF INFORMATION TO AUDITOR

In the case of each director in office at the date the Directors' report is approved:

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

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

This report was approved by the board and signed on its behalf by



Colin Burke
Director
10 March 2020

STRATEGIC REPORT

Year ended 31 December 2019

PRINCIPAL ACTIVITIES

The company was incorporated on 3 June 2009. The principal activity of the company is to provide finance to The Housing Finance Corporation Limited (THFC) (the **borrower**) for on-lending to registered providers of social housing, registered social landlords and registered housing associations, in England, Wales, Scotland and Northern Ireland (**HAs**) (the **Bond Issuance Authorised Borrowers**, as defined in the loan agreement between the company and THFC) through the issue of bonds ultimately secured on the assets of the company (the **secured bonds**).

On 8 July 2009 the company made an initial issue of secured bonds to a nominal value of £191,000,000, the proceeds of which were on-lent to THFC on terms that ensured the company was not exposed to any risk in changes of interest rates. A second issue of secured bonds to a nominal value of £72,250,000 was made on 22 March 2010 and a third and fourth issue of secured bonds of £76,600,000 and £31,000,000 respectively was made on 21 January 2011 and 4 April 2011.

All the company's operating costs, net of interest earned, are recoverable from the borrower.

The proceeds were on-lent by THFC to the HAs noted below:

A2Dominion Homes Limited
Accord Housing Association Limited
Apex Housing Limited
Choice Housing Ireland Limited (formerly known as Oaklee Trinity Limited)
Connswater Homes Limited
East Midlands Housing Association Limited
Glen Oaks Housing Association Limited
Hightown Praetorian and Churches Housing Association Limited (formerly known as Hightown Housing Association Limited)
Leeds Federated Housing Association Limited
New Gorbals Housing Association Limited
Notting Hill Genesis
Paradigm Homes Charitable Housing Association Limited
Portal Housing Association Limited
Radius Housing Association Limited
Southern Housing Group Limited
Staffordshire Housing Association Limited
Taff Housing Association Limited
Westward Housing Group Limited
Wirral Methodist Housing Association Limited

The Law Debenture Trust Corporation Plc acts as the Trustee on behalf of all secured bond holders, under the terms of a trust deed, and has the benefit of a floating charge over certain assets of the borrower.

The occurrence of an event of default under the secured bonds entitles the Trustee to accelerate the maturity of the secured bonds and to enforce the security for the secured bonds (including converting the floating charge granted by the company into a fixed charge). However, an event of default under the secured bonds will not, by itself, be an event of default under the loan agreement and accordingly acceleration of the maturity of the secured bonds and enforcement of security for the secured bonds will not, by itself, entitle the Trustee to accelerate the maturity of the loan agreement or to enforce the security given by THFC under the loan agreement except in predetermined circumstances.

The company expects to continue its principal activity for the life of the secured bonds, which have a final repayment date of 2041.

The company does not use derivative financial instruments in its risk management procedures.

REVIEW OF BUSINESS AND FUTURE DEVELOPMENTS

The company has fulfilled its obligations under the bonds. Given the straightforward nature of the business, the company's directors are of the opinion that analysis using key performance indicators is not necessary for an understanding of the development, performance or position of the business.

The directors consider the position of the company at the year end to be satisfactory.

FINANCIAL RISK MANAGEMENT

The key financial risks of the company and how they are mitigated are explained in note 3.

SECTION 172(1) STATEMENT

Long-term consequences

The Board's objective is to have a long-term beneficial impact on the company and the wider affordable housing sector through the delivery of cost-effective funding to The Housing Finance Corporation Limited (THFC). THFC on-lends the proceeds of its funding from the company to UK housing associations.

The length and secured nature of the loan to THFC requires the company to ensure that both the borrower and the company will continue to meet their respective legal and other obligations to both the company and bondholders as detailed in the relevant transaction documents.

The loan agreement stipulates that all on going costs of the issuer are recoverable from the borrower. All expenses of the company are funded before they are incurred.

Material risks of the borrower are monitored by its board on a regular basis. The majority of Board members of the issuer are also Board members of the borrower.

Interests of employees

Due to the nature of the activities of the business the only employees are the Board of Directors. Each of these employees has a say over the decisions of the business and has full knowledge of all decisions taken throughout the year. There are no plans for the business to hire further employees in the foreseeable future.

Foster business relationships

The company has one borrower which is a related party of the company and the majority of the company's Board also serve on the borrower's Board.

The administrator, who supplies all services to the company (and is a subsidiary of the borrower), has a structure that incorporates Relationship Management (for liaison with borrowers to whom funds have been on-lent as well as potential borrowers), Treasury (who maintain relationships with current and potential investors in the company's bonds through regular updates and meetings), Finance (who manage relationships with suppliers and ensure the efficient collection and distribution of coupons between the borrower and investors (or their duly appointed agent)) and Secretarial who manage compliance obligations with various stakeholders.

Lending requires a constant focus on maintaining stakeholder relationships and the administrator's team has a wealth of experience in all relevant areas.

Impact of operations on community and environment

Our corporate objective, and that of our related party borrower, is to deliver cost-effective funding to housing associations. In so doing, we aim to boost the provision and quality of affordable housing for the benefit of tenants and communities throughout the UK. The company operates on a not-for-profit basis and makes no surplus or loss after cost recoveries.

The company ensures its employees are aware of the changing landscape of regulation and best practice, whether environmental or social in nature. Every effort is made to consider the environmental impact of decisions taken, although due to the nature of its activities the company's direct environmental impact is limited.

Maintaining reputations

The intention of the Board is to operate the business responsibly and in line with the good industry practice and governance expected of a lending business and in so doing, will contribute to the delivery of our plan. The ongoing operations of the business are conducted by an administrator under a corporate services agreement. This arrangement is monitored by the Board of the administrator through periodic reporting.

Acting fairly between members of the company

As a Board of Directors, we have a responsibility to act fairly between members of the company. The entire issued share capital is held by T.H.F.C. (Services) Limited on a fiduciary basis on behalf of qualifying charities as defined in the Declaration of Trust. The majority of the company's Board also serve on the Board of T.H.F.C. (Services) Limited.

This report was approved by the board and signed on its behalf by



Colin Burke

Director

10 March 2020

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF T.H.F.C. (FUNDING NO. 2) PLC
Year ended 31 December 2019

Opinion

We have audited the financial statements of T.H.F.C. (Funding No.2) Plc (the **company**) for the year ended 31 December 2019 which comprise the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Cash Flows and the notes to the financial statements, including a summary of significant accounting policies. 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.

In our opinion, the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2019 and of its result 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.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Other information

The other information comprises the information included in the Annual Report, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

T.H.F.C. (FUNDING NO. 2) PLC

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF T.H.F.C. (FUNDING NO. 2) PLC (continued) Year ended 31 December 2019

We have nothing to report in this regard.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic report and the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic report and the Directors' report have been prepared in accordance with applicable legal requirements.

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified material misstatements in the Strategic report or the Directors' report.

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.

Responsibilities of directors

As explained more fully in the Statement of Directors' Responsibilities set out on pages 1 to 2, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

T.H.F.C. (FUNDING NO. 2) PLC

**INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF T.H.F.C. (FUNDING NO. 2) PLC
(continued)**

Year ended 31 December 2019

Use of our report

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.

Nexia Smith & Williamson

Guy Swarbreck
Senior Statutory Auditor, for and on behalf of
Nexia Smith & Williamson
Statutory Auditor
Chartered Accountants

25 Moorgate
London
EC2R 6AY

12 March 2020

T.H.F.C. (FUNDING NO. 2) PLC**STATEMENT OF COMPREHENSIVE INCOME**
Year ended 31 December 2019

	Note	2019 £	2018 £
OPERATING INCOME			
Interest receivable	4	23,017,659	23,045,541
Costs receivable from borrower		<u>28,267</u>	<u>30,294</u>
		<u>23,045,926</u>	<u>23,075,835</u>
OPERATING EXPENDITURE			
Interest payable	5	23,017,659	23,045,541
Operating expenses	6	<u>28,267</u>	<u>30,294</u>
		<u>23,045,926</u>	<u>23,075,835</u>
RESULT BEFORE AND AFTER TAXATION	7	<u>-</u>	<u>-</u>
Other comprehensive income		-	-
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		<u><u>-</u></u>	<u><u>-</u></u>

There have been no changes in equity or reserves in the current or prior year, therefore no separate statement of changes in equity has been prepared.

T.H.F.C. (FUNDING NO. 2) PLC**STATEMENT OF FINANCIAL POSITION****As at 31 December 2019**

	Note	2019 £	2018 £
ASSETS			
Non-current assets			
Loan to borrower	9	389,166,461	389,727,209
Current assets			
Other receivables	10	11,933,443	11,904,415
Cash and cash equivalents		<u>13,212</u>	<u>13,245</u>
TOTAL ASSETS		<u>401,113,116</u>	<u>401,644,869</u>
EQUITY & LIABILITIES			
Current liabilities			
Other payables	11	11,934,155	11,905,160
Non-current liabilities			
Financial liabilities – secured bonds	12	<u>389,166,461</u>	<u>389,727,209</u>
TOTAL LIABILITIES		<u>401,100,616</u>	<u>401,632,369</u>
EQUITY			
Share capital	13	12,500	12,500
Retained earnings		-	-
TOTAL EQUITY		<u>12,500</u>	<u>12,500</u>
TOTAL EQUITY & LIABILITIES		<u>401,113,116</u>	<u>401,644,869</u>

The accompanying notes on pages 12-26 are an integral part of these financial statements.

These financial statements on pages 9-26 were approved by the board and signed on its behalf by



Fenella Edge
Director
10 March 2020

T.H.F.C. (Funding No. 2) Plc

Registration Number 06923641

T.H.F.C. (FUNDING NO. 2) PLC**STATEMENT OF CASH FLOWS****Year ended 31 December 2019**

	Note	2019 £	2018 £
NET CASH FLOW FROM OPERATING ACTIVITIES			
Cash (used in) / generated from operations	14	(33)	745
Interest paid on bonds		(23,548,975)	(23,548,975)
Interest received on loan		<u>23,548,975</u>	<u>23,548,975</u>
NET CASH (OUTFLOW) / INFLOW FROM OPERATING ACTIVITIES		<u>(33)</u>	<u>745</u>
NET (DECREASE) / INCREASE IN CASH AND CASH EQUIVALENTS IN THE YEAR		(33)	745
CASH AND CASH EQUIVALENTS AT 1 JANUARY		<u>13,245</u>	<u>12,500</u>
CASH AND CASH EQUIVALENTS AT 31 DECEMBER		<u><u>13,212</u></u>	<u><u>13,245</u></u>

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

1 GENERAL INFORMATION

T.H.F.C. (Funding No. 2) Plc the **company**) provides finance to The Housing Finance Corporation Limited (THFC) (the **borrower**) for on-lending registered providers of social housing, registered social landlords and registered housing associations, in England, Wales, Scotland and Northern Ireland (HAs) (the **Bond Issuance Authorised Borrowers**, as defined in the loan agreement between the company and THFC). The company is a public limited company limited by shares which has secured bonds listed on the Professional Securities Market of the London Stock Exchange. It is incorporated and domiciled in England and Wales. The address of the registered office is 3rd Floor, 17 St Swithin's Lane, London, EC4N 8AL.

The company on-lent the proceeds of the issue of the secured bonds to The Housing Finance Corporation Limited (THFC), which on-lent the funds to certain HAs being the Bond Issuance Authorised Borrowers (as defined in the loan agreement).

2 ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented unless otherwise stated.

Basis of preparation

The financial statements have been prepared on a going concern basis in accordance with International Financial Reporting Standards (**IFRSs**) as adopted by the European Union, applied in accordance with the provisions of the Companies Act 2006.

The financial statements have been prepared under the historical cost convention.

Going concern

In determining the going concern basis for the company the directors considered the credit risk of the borrowers and their expected likelihood of making interest payments for the foreseeable future.

In addition all of the company's operating costs are recoverable from its borrower throughout the life of the bonds and on this basis the directors are of the opinion that the company has adequate resources to continue in operational existence for the foreseeable future. For this reason, the directors continue to adopt the going concern basis in preparing the financial statements

Changes in accounting policies and disclosures

(a) New and amended Standards and Interpretations adopted by the company

In the current year, the following new and amended Standards and Interpretations have been adopted by the company:

- Amendments to IFRS 9. Prepayment Features with Negative Compensation (Effective: 1 January 2019): These amendments to IFRS 9 Financial Instruments are designed to enable, if certain conditions are met, companies to measure at amortised cost certain prepayable financial assets with so-called negative compensation and also clarifies the accounting for non-substantial modifications of financial liabilities should follow the same process as financial assets in similar circumstances.

The adoption of these amendments has not had a material impact on the reported results or financial position of the company and has not given rise to any additional disclosure requirements.

NOTES TO THE FINANCIAL STATEMENTS (continued)
Year ended 31 December 2019

(b) New and amended Standards and Interpretations mandatory for the first time for the financial year beginning 1 January 2019 but not currently relevant to the company

Other standards effective or amended in the year have not had a material impact on the reported results or financial position of the company.

(c) New and amended Standards and Interpretations issued but not mandatory for the financial year beginning 1 January 2019.

- Amendments to IAS 1 and IAS 8: Definition of Material. Effective for periods beginning on or after 1 January 2020. The amendments to both IAS 1 and IAS 8 refine the definition of 'material' and clarify its application. The amendments improve understanding of the existing requirements, but because they are based on existing guidance, they do not significantly affect how materiality judgements are made in practice or significantly affect entities' financial statements.
- Conceptual Framework for Financial Reporting. Effective for periods beginning on or after 1 January 2020. The amendments build upon the existing Conceptual Framework to provide a comprehensive set of concepts for financial reporting. There have been new concepts added for measurement, presentation and disclosure and derecognition. Updated concepts for definitions and recognition and clarifications to concepts for stewardship, measurement uncertainty, substance over form and the return of a clarified concept of prudence.

The directors are currently assessing the impact and timing of adoption of these Standards on the company's results and financial position.

The effect of all other new and amended Standards and Interpretations which are in issue but not yet mandatorily effective is not expected to be material.

Critical accounting judgements and key sources of estimation uncertainty

The preparation of financial statements in accordance with IFRSs requires the use of certain critical accounting adjustments; these require management's judgement in applying the accounting policies. The area involving a higher degree of judgement or complexity or where assumptions are significant to the financial statements is the evaluation as to whether the loans to HAs, and therefore potentially the loan to the borrower, are impaired.

Impairment of Loans to Borrowers (Note 9)

The directors have concluded that no impairment provision is required in relation to the loan to THFC in accordance with IFRS9 (2018: £Nil). This is for a number of reasons which includes, but is not limited to, the credit quality of THFC's borrowers and the company's zero loss experience to date. As the company is not subject to any net credit risk any incurred loss impairment would be matched by a similar adjustment to the gross liability. At 31 December 2019, the carrying value of the loans from borrowers is £389,727,209 (2018: £390,258,525).

Interest

Interest receivable on the loan to THFC, and interest payable on the secured bonds is accounted for using the effective interest rate method. Any premium/discounts on issue are added to/deducted from the original loan amount or secured bond nominal value using the effective interest rate method and charged/credited to the statement of comprehensive income over the expected life of the loan or bonds so that the interest receivable and payable, as adjusted for the amortisation of premiums/discounts, gives a constant yield to maturity.

Costs recoverable

All operating costs are recovered from the borrower in line with contractual arrangements. All recovered costs are recognised within operating income over the period in which costs are recovered.

Issue costs incurred during the issue of the loans to borrowers are recovered from the borrower and recognised within operating income on the completion of the loan transaction.

Fees are measured at the transaction price received or receivable allocated to the performance obligation satisfied and represents amounts receivable for goods and services provided in the normal course of business, net of discounts, VAT and other sales related taxes. As the expected period between transfer of a promised good or service and payment from the borrower is one year or less then no adjustment for a financing component has been made.

Financial Instruments

Initial recognition and measurement

Financial assets and financial liabilities are recognised when the company becomes a party to the contractual provisions of the instrument.

Financial assets and financial liabilities are initially measured at fair value. Net transaction costs that are directly attributable to the acquisition or issue of the financial assets and financial liabilities (other than financial assets and financial liabilities at FVPL) are respectively added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. The company's only borrower, THFC, incurs and recovers all transaction costs, so they do not form part of the fair value at recognition.

Financial assets

Classification and measurement

The company applies IFRS 9 and classifies its financial assets in the following measurement categories:

- fair value through profit or loss (FVPL); or
- fair value through other comprehensive income (FVOCI); or
- amortised cost.

The classification requirements for debt instruments are described below. Classification and subsequent measurement of debt instruments depend on:

- 1) the company's business model for managing the asset; and
- 2) the cash flow characteristics of the asset ("SPPI test").

1) *Business model*: The business model reflects how the company manages the assets in order to generate cash flows. That is, whether the company's objective is:

- solely to collect the contractual cash flows from the assets ("Hold to collect"); or
- to collect both the contractual cash flows and cash flows arising from sale of the assets ("Hold to collect and sell"); or
- neither of these ("Other").

NOTES TO THE FINANCIAL STATEMENTS (continued)
Year ended 31 December 2019

Factors considered by the company in determining the business model for a group of assets include past experience of how the cash flows for these assets were collected, how the assets' performance is evaluated and reported to key management personnel, the likely future experience of cash flows, and how credit risks are assessed and managed.

2) *SPPI test*: Where the business model is "Hold to collect" or "Hold to collect and sell", the company assesses whether the financial instruments' contractual cash flows represent solely payment of principal and interest on that principal ("SPPI"). In making this assessment, the company considers whether those cash flows are consistent with a basic lending arrangement (i.e. interest includes only consideration for the time value of money, credit risk and other basic lending risks that are consistent with a basic lending arrangement) or reflect exposure to risk or volatility that are inconsistent with a basic lending arrangement.

Based on these factors, the company classifies its debt instruments into one of the measurement categories detailed above. All of the company's financial assets have been assessed as falling within a "Hold to collect" business model whose contractual cash flows are SPPI and therefore measured at amortised cost.

Amortised cost is the amount at which the financial asset is measured at initial recognition minus the principal repayments, plus the cumulative amortisation using the effective interest rate method, adjusted for any loss allowance.

The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to the gross carrying amount of an asset.

Interest income from these financial assets is calculated by applying the effective interest rate to the gross carrying amount of the financial asset and is included in the statement of comprehensive income within 'operating income'.

Reclassification

The company reclassifies debt investments when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change.

The company holds the following debt instrument under financial assets:

Loan receivable

The Loan receivable represents monies lent to The Housing Finance Corporation Limited ("THFC" "The Borrower"), a related party of the company, under a loan agreement and held at amortised cost.

Cash and bank balances

Cash and cash equivalents comprise cash balances that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value.

Trade and other receivables

Other receivables are recognised at transaction price and are subsequently measured at amortised cost.

NOTES TO THE FINANCIAL STATEMENTS (continued)
Year ended 31 December 2019

Impairment

The company assesses on a forward-looking basis the expected credit losses (ECL) associated with any debt instruments carried at amortised cost. The company may recognise a loss allowance for such losses at each reporting date.

IFRS 9 permits the use of models for estimating expected losses that do not require explicit scenario and probability analysis. The directors are of the opinion that historical average credit loss experience in relation to its sole loan is a reasonable estimate of the probability-weighted amount.

The IFRS 9 impairment model has three stages – Stage 1, Stage 2 and Stage 3 (default).

The company may recognise a 12-month expected credit loss allowance on initial recognition (stage 1) and a lifetime expected loss allowance when there has been a significant increase in credit risk (stage 2) that would no longer render the instrument low risk. Stage 3 requires objective evidence that an asset is credit impaired.

The measurement of ECL of the loan reflects:

- (a) The loss experience of the company in relation to its loan;
- (b) reasonable and supportable information on the social housing sector that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of the future operating environment; and
- (c) Performance of the borrower in relation to the loan.

The company has one loan outstanding to a single borrower which has been compliant since inception on 2nd July 2009. The company has the benefit of a floating charge over all the assets of its borrower which are principally its loans and receivables which are all performing and have no loss experience.

Collateral arrangements are described in note 3 on page 19.

To date the borrower has not provided for an expected credit loss on its loans which are secured by fixed charges.

The directors' view therefore is that the calculation of expected credit loss for this loan is zero.

The directors monitor the performance of its borrower and its loan book and may consider a provision based on the performance of one or both.

Significant Increase in Credit Risk (movement from stage 1 to stage 2)

The company has identified a number of early warning indicators (EWIs) against which its loan is monitored. If any of the events occur, internal consideration is given as to whether the loan should move to stage 2 classification.

EWIs include but are not restricted to, the following:

- (a) borrower's annual financial statements carry an auditor's qualification;
- (b) government or regulatory action which negatively impacts on the borrower's business;
- (c) down grade of the borrower to below investment grade rating;
- (d) payment of interest and capital after due date for other than operational reasons;
- (e) borrower records an impairment loss.

NOTES TO THE FINANCIAL STATEMENTS (continued)
Year ended 31 December 2019

Definition of default (movement to stage 3)

The company has identified a series of quantitative and qualitative criteria that will be used to determine if an account meets the definition of default, and therefore should move to stage 3:

- (a) payment default;
- (b) cross default;
- (c) breach of covenant(s).

Derecognition

Financial assets, or a portion thereof, are derecognised when the contractual rights to receive the cash flows from the assets have expired, or when they have been transferred and either:

- The company transfers substantially all the risks and rewards of ownership; or
- The company neither transfers nor retains substantially all the risks and rewards of ownership and the company has not retained control.

Financial Liabilities - Secured bonds

Classification and measurement

Financial liabilities are recognised where the substance of the contractual arrangement results in the company having an obligation to either deliver cash or another financial asset to the holder.

Financial liabilities include borrowings and trade and other payables.

Initial recognition and subsequent measurement

Financial liabilities (other than derivatives) are initially recognised at the fair value of consideration less directly attributable net transaction costs and subsequently at amortised cost using the effective interest rate method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the effective interest rate method.

Derecognition

Financial liabilities are derecognised when they are extinguished (i.e. when the obligation specified in the contract is discharged, cancelled or expires).

Netting

The company does not net financial assets and liabilities and has no other enforceable offsets.

Fair Values

The fair value of a financial instrument is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

IFRS 13 *Fair value measurement* requires an entity to classify for disclosure purposes its financial instruments held at amortised cost according to a hierarchy that reflects the significance of observable market inputs. The three levels of the fair value hierarchy are defined below.

NOTES TO THE FINANCIAL STATEMENTS (continued)
Year ended 31 December 2019

Quoted market prices – Level 1

Financial instruments are classified as Level 1 if their value is observable in an active market. Fair values for such instruments are reported by reference to unadjusted quoted prices for identical assets or liabilities where the quoted price is readily available, and the price represents actual and regularly occurring market transactions on an arm's length basis.

Valuation technique using observable inputs – Level 2

Financial instruments classified as Level 2 are fair valued using models whose inputs (for example, interest rates and credit spreads) are observable in an active market.

Valuation technique using significant unobservable inputs – Level 3

Financial instruments are classified as Level 3 if their valuation incorporates significant inputs that are not based on observable market data. The company has no instruments classified in Level 3 (2018: none).

The company's Secured Bonds are tradable and the markets are considered to be active and the Secured Bonds are therefore classified Level 1. Accordingly quoted market prices at, or close to, the balance sheet date has been used to evaluate the fair value of the Secured Bonds. The fair value of the associated fixed rate loan to THFC is based on the same quoted market price on the basis that the Standard and Poor's credit rating of the company is dependent on that of THFC.

Prepayment

It is expected that each loan will run to maturity however THFC, or any Bond Issuance Authorised Borrower, may at any time purchase bonds and, following such purchase, THFC, or any Bond Issuance Authorised Borrower, may surrender the bonds to the company for cancellation. An amount equal to the outstanding principal amount of the bonds being surrendered shall be deemed prepaid under the loan Agreement. The prepaid amount of the loan and the equivalent bond nominal amount is removed from the statement of financial position on delivery of the deed of surrender.

Segmental Analysis

All operating income and expenditure is derived from activities undertaken in the United Kingdom. The company's only activity is to provide finance to THFC for on-lending to HAs. Therefore 100% of interest income is receivable from THFC.

3 FINANCIAL RISK MANAGEMENT

The proceeds from the issue of the 6.35% secured bonds due 2039/41 were used to make a loan to the borrower.

Credit risk

The company is subject to gross credit risk on its loan to THFC but no net risk.

The ability of the company to make payments of interest, principal and any other sums due in respect of the bonds will depend on the issuer receiving like amounts from the borrower THFC under its loan agreement.

To the extent that the company does not receive sufficient amounts in respect of the loan agreement (whether in the ordinary course of business, following the enforcement of its security obtained in respect

NOTES TO THE FINANCIAL STATEMENTS (continued)
Year ended 31 December 2019

of the loan agreement or otherwise) then the company will not have sufficient monies to pay interest, principal or other sums due in respect of the bonds. Non-payment by the company may not necessarily constitute an event of default under the bonds.

Gross credit risk on the loans is mitigated by the collateral and security arrangements described below.

THFC has a general obligations A rating from Standard and Poor's. THFC only makes loans to HAs registered with, and regulated by, the Regulator of Social Housing (or other relevant authority for housing associations outside England) for the purposes of funding social housing. The Regulator of Social Housing has a range of statutory powers as set out in chapter 6 of Housing and Regeneration Act 2008 as amended by the Localism Act 2011. These include enforcement powers and the ability to call a moratorium in certain circumstances.

The carrying value of the loan represents the maximum exposure to credit risk. No part of the loan is past due or impaired at 31 December 2019 (2018: none).

Collateral and security arrangements

THFC has granted security to the company under the loan agreement in the form of a floating charge over its undertaking, property and assets. This floating charge ranks *pari passu* with a number of existing floating charges previously granted by THFC to secure other existing borrowings. THFC's undertakings, property and assets largely consist of its existing loan book together with some accumulated reserves.

HAs who borrow money from THFC create either a first floating charge over the whole or an identifiable part of its property, undertaking and assets in favour of THFC or a fixed first charge in favour of THFC. All of the THFC's assets, including the loans to the HAs, and the security granted in respect of its assets are pooled rather than being allocated to specific liabilities of THFC. As such, the loan to THFC is indirectly secured by the properties owned by the HA borrowers.

THFC is required to obtain a charge over the assets of HAs which, at all times during the life of each loan, covers at least 150% of the outstanding loan balance. For loans secured by fixed charges formal property valuations of the specific security are undertaken at least every five years. For loans secured by floating charge compliance is measured by reference to the statement of financial position of the underlying HA.

In addition THFC monitors the financial position of its HA borrowers on an on-going basis, including measurement against covenant undertakings. The large number of borrowing HAs assists in diversification of the credit risks inherent in the loan to THFC. All HA borrowers are subject to external regulation by the Regulator of Social Housing.

The obligations of the company to the holders of the secured bonds are secured by a first floating charge on the whole of the company's undertaking, property and assets, and a first ranking assignment by way of security of the benefit of the floating charge granted to the company by THFC as described above.

Collateral, unless subject to enforcement, is not recorded on the company's statement of financial position. However, the value of collateral affects the calculation of expected credit losses.

Liquidity risk

To mitigate liquidity risk to the company, the borrower collects interest and capital repayments from the Bond Issuance Authorised Borrowers one month prior to the scheduled date of payment by the company.

NOTES TO THE FINANCIAL STATEMENTS (continued)
Year ended 31 December 2019

Additionally Bond Issuance Authorised Borrowers are required to maintain an Interest Service Reserve Fund with THFC, amounting to a minimum of one year's worth of interest, that can be drawn upon in the event of a late payment.

There is also a two year maturity mis-match between expected and legal maturity of the secured bonds. This means if the borrower has insufficient funds to repay the principal amount outstanding of its loan on the expected maturity date than repayment of the loan and bond will be postponed to the legal maturity date.

The loan agreements provide that the Bond Issuance Authorised Borrowers must repay their loans in full to THFC, three business days before 8 July 2039 (expected maturity) or 8 July 2041 (legal maturity). Interest is receivable half yearly in arrears. The maturity profile of liabilities is given in note 12.

As with credit risk to the extent that the company does not receive sufficient amounts in respect of the loan agreement (whether in the ordinary course of business, following the enforcement of its security obtained in respect of each loan agreement or otherwise) then the company will not have sufficient monies to pay interest, principal or other sums due in respect of the bonds. Non-payment by the company may not necessarily constitute an event of default under the bonds.

Interest rate risk

The interest charged on the loan is fixed and is equal to the interest payable on the related secured bonds. Accordingly, the directors consider that the company is not subject to any risk on the fluctuation of interest rates.

Fair value risk and market price risk

There is a gross fair value risk on the loan and secured bonds but there is no net risk. Market price risk is not expected to impact on the company because (i) the loan and secured bonds are held at amortised cost in the financial statements and (ii) the company expects to hold them until maturity.

Currency risk

All financial assets and liabilities are denominated in sterling and hence there is no currency risk.

4 INTEREST RECEIVABLE

	2019	2018
	£	£
On loan to borrower	23,548,975	23,548,975
Amortisation of premium	(531,316)	(503,434)
	<u>23,017,659</u>	<u>23,045,541</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)
Year ended 31 December 2019

5 INTEREST PAYABLE

	2019 £	2018 £
On 6.35% secured bonds due 2039/41	23,548,975	23,548,975
Amortisation of premium	<u>(531,316)</u>	<u>(503,434)</u>
	<u>23,017,659</u>	<u>23,045,541</u>

6 OPERATING EXPENSES

Operating expenses comprise management fees payable to T.H.F.C. (Services) Limited and other professional service fees.

7 RESULT BEFORE AND AFTER TAXATION

The result before taxation is wholly attributable to the company's principal activity, arose wholly within the United Kingdom and is stated after charging:

	2019 £	2018 £
Fees paid to current auditor for annual audit of financial statements - current year	<u>8,004</u>	<u>8,688</u>

8 EMPLOYEES

There were no employees during the year (2018: None) other than the directors. The directors received no remuneration during the year directly from the company in respect of their qualifying services (2018: £Nil). All directors are remunerated by T.H.F.C. (Services) Limited for their services to the company. It is not practicable to obtain the relevant data to accurately disclose the company's share of this cost.

9 LOAN TO BORROWER

	2019 £	2018 £
Loan value at 1 January	370,850,000	370,850,000
Unamortised premium at 1 January	<u>19,408,525</u>	<u>19,911,959</u>
	390,258,525	390,761,959
Premium amortised in the year	<u>(531,316)</u>	<u>(503,434)</u>
Amortised cost at end of year	389,727,209	390,258,525
Premium due within one year	<u>(560,748)</u>	<u>(531,316)</u>
Non-current amortised cost	<u>389,166,461</u>	<u>389,727,209</u>

Collateral arrangements are set out in note 3

NOTES TO THE FINANCIAL STATEMENTS (continued)
Year ended 31 December 2019

10 OTHER RECEIVABLES

	2019 £	2018 £
Premium on loan due within one year	560,748	531,316
Interest receivable	11,355,122	11,355,122
Other receivables	17,573	17,977
	<u>11,933,443</u>	<u>11,904,415</u>

11 OTHER PAYABLES

	2019 £	2018 £
Premium on secured bonds due within one year	560,748	531,316
Interest payable	11,355,122	11,355,122
Accruals	18,285	18,722
	<u>11,934,155</u>	<u>11,905,160</u>

12 FINANCIAL LIABILITIES – SECURED BONDS

	2019 £	2018 £
Loan value at 1 January	370,850,000	370,850,000
Unamortised premium at 1 January	19,408,525	19,911,959
	<u>390,258,525</u>	<u>390,761,959</u>
Premium amortised in the year	(531,316)	(503,434)
Amortised cost at end of year	389,727,209	390,258,525
Premium due within one year	(560,748)	(531,316)
Non-current amortised cost	<u>389,166,461</u>	<u>389,727,209</u>

Details of security are set out in note 3.

The 6.35% secured bonds are listed and repayable between 2039 and 2041 and were issued in the following tranches:

	Nominal Value £	Premium £
8 July 2009	191,000,000	76,400
22 March 2010	72,250,000	7,951,112
21 January 2011	76,600,000	10,504,158
4 April 2011	31,000,000	4,255,370
	<u>370,850,000</u>	<u>22,787,040</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)
Year ended 31 December 2019

The net premium and cumulative amortisation at the beginning of the year was £19,408,525 and £3,378,515 (2018: £19,911,959 and £2,875,081) respectively. Amortisation charged during the year was £531,316 (2018: £503,434).

All premiums have been added to the value of the secured bonds and are amortised through the statement of comprehensive income over the life of the secured bonds, this includes an amount that was previously written off on the original issue and has been reinstated during the prior year.

The net proceeds of the above issues were used to make loans to the borrower, THFC. The secured bonds are repayable in full between 8 July 2039 and 8 July 2041. Interest on the secured bonds is payable half yearly in arrears. All issue costs relating to the secured bonds are borne by the borrower, THFC.

Contractual cash flows on secured bonds

2019	Due within one year £	Due within one to two years £	Due within two to five years £	Due in over five years £	Total 2019 £
Principal	-	-	-	370,850,000	370,850,000
Interest	23,548,975	23,548,975	70,646,925	353,234,625	470,979,500
Total	23,548,975	23,548,975	70,646,925	724,084,625	841,829,500

2018	Due within one year £	Due within one to two years £	Due within two to five years £	Due in over five years £	Total 2018 £
Principal	-	-	-	370,850,000	370,850,000
Interest	23,548,975	23,548,975	70,646,925	376,783,600	494,528,475
Total	23,548,975	23,548,975	70,646,925	747,633,600	865,378,475

13 SHARE CAPITAL

	2019 £	2018 £
<i>Allotted and part paid</i>		
50,000 (2018: 50,000) ordinary shares of £1 each of which 25p per share is paid.	12,500	12,500

The company's capital comprises only its share capital which the directors consider adequate for its ongoing working capital requirements in relations to its obligation under the bonds. The company is not subject to externally imposed capital requirements.

NOTES TO THE FINANCIAL STATEMENTS (continued)
Year ended 31 December 2019

14 RECONCILIATION OF RESULT BEFORE TAXATION TO CASH (USED IN) / GENERATED FROM OPERATIONS

	2019 £	2018 £
Result before taxation	-	-
Adjustments for:		
Interest receivable	(23,017,659)	(23,045,541)
Interest payable	23,017,659	23,045,541
Changes in working capital:		
Decrease / (increase) in receivables	404	(1,379)
(Decrease) / increase in payables	(437)	2,124
Cash (used in) / generated from operations	<u>(33)</u>	<u>745</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)
Year ended 31 December 2019

15 FAIR VALUE OF FINANCIAL INSTRUMENTS

The Level 1 fair value of the 6.35% secured bonds due 2039/2041 and the Level 1 fair value of the associated loan, as at 31 December 2019 are shown below. The fair value is derived from the market value of the secured bonds at that date. There is no difference between the fair value and carrying value of all other financial assets and liabilities.

	2019		2018	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	£	£	£	£
Financial assets:				
<i>Classified as loans & receivables</i>				
Loan to borrower(s)				
Non-current	389,166,461		389,727,209	
Current	560,748		531,316	
Total	389,727,209	591,227,918	390,258,525	531,220,679
Interest receivable	11,355,122	11,355,122	11,355,122	11,355,122
Other receivables	17,573	17,573	17,977	17,977
Total financial assets	401,099,904	602,600,613	401,631,624	542,593,778
Financial liabilities:				
<i>Classified as financial liabilities at amortised cost</i>				
Secured Bonds				
Non-current	389,166,461		389,727,209	
Current	560,748		531,316	
Total	389,727,209	591,227,918	390,258,525	531,220,679
Interest payable	11,355,122	11,355,122	11,355,122	11,355,122
Other payables and accruals	18,285	18,285	18,722	18,722
Total financial liabilities	401,100,616	602,601,325	401,632,369	542,594,523

16 ULTIMATE PARENT COMPANY

At 31 December 2019 the company's immediate and ultimate holding company was T.H.F.C. (Services). The share capital is held by T.H.F.C. (Services) Limited on a fiduciary basis on behalf of qualifying charities as defined in the Declaration of Trust and hence no group financial statements are prepared.

17 RELATED PARTY TRANSACTIONS

All administrative services are provided under a management agreement with T.H.F.C. (Services) Limited. The directors are employees of T.H.F.C. (Services) Limited. Management fees payable to T.H.F.C. (Services) Limited during the year amounted to £Nil (2018: £Nil). T.H.F.C. (Services) Limited reserves the right to charge such fees in the future.

NOTES TO THE FINANCIAL STATEMENTS (continued)
Year ended 31 December 2019

THFC, the borrower, is the parent of T.H.F.C. (Services) Limited. Transactions with and balances due from the borrower are set out in notes 4, 9 and 10 of these financial statements.

During the year, the company recovered costs of £28,267 (2018: £30,294) from THFC. At the end of the year, THFC owed the company for costs of £70 (2018: £7).

18 TAXATION

The company has incurred no tax liability in the current year or prior year.

19 SECURITY OFFERED TO INVESTORS

T.H.F.C. (Funding No.2) Plc is a special purpose vehicle and the security offered to investors is limited only to the assets of the company being principally the secured loans and share capital. The shareholders of the company's parent, T.H.F.C. (Services) Limited cannot be held liable for the debts of the company in the event of insolvency.