HOLMES FUNDING LIMITED

Registered in England and Wales
No. 03982428

ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2021

STRATEGIC REPORT

The Directors submit the Strategic Report together with their Report of the Directors and the audited financial statements for the year ended 31 December 2021.

Principal activities

Holmes Funding Limited (the 'Company') was established for the purposes of receiving proceeds from Holmes Master Issuer plc, which issues debt securities (the "Notes") in the international capital markets and make such funds available to the Santander UK plc by purchasing a beneficial interest in a UK residential mortgage loan portfolio held by Holmes Trustees Limited (the 'Holmes Master Trust'). The Company receives a share of income from the Trust in proportion to its share of the total mortgage assets of the Trust.

The principal activities of the Company as defined in the Securitisation Transaction document which can be found at www.santander.co.uk/uk/about-santander-uk/investor-relations/holmes-master-trust (the "Transaction document") includes receiving loans under intercompany loan agreement from Holmes Master Issuer plc, acquiring a beneficial interest in a mortgage loan portfolio held by Holmes Trustees Limited, entering into financial instruments with other group companies and other activities reasonably incidental thereto.

The programme

The mortgage-backed programme was established on 28 November 2006. Notes issued under the programme have been and will be issued in series. Each series will normally: (a) be issued on a single date; (b) be subject to the terms and conditions of the Notes; and (c) consist of one or more classes (or sub-classes) of Notes. Notes of the same class rank pari passu and pro rata among themselves. Each series of the same class will not, however, be subject to identical terms in all respects (for example, interest rates, interest calculations, expected maturity and final maturity dates may differ).

Holmes Funding Limited uses a portion of the amounts received from its share in the trust property to meet its obligations to pay interest and principal due to Holmes Master Issuer plc under the intercompany loan.

The loans included within the underlying portfolio include repayment loans and interest only loans with balances of less than £750,000 at the point of securitisation.

The loans within the portfolio are monitored and assessed for impairment on a regular basis at a group level as, under International Financial Reporting Standard (IFRS) 9 – 'Financial Instruments,' the beneficial interest in a mortgage portfolio fails the criteria for recognition within the Company's financial statements and remains in the Balance Sheet of Santander UK plc.

The only asset held by the Company that is at risk of material impairment is the loan to Santander UK plc, the repayment of which is dependent upon the performance of the residential mortgage portfolio. The risk of impairment is mitigated by the collateral and credit enhancements within the Holmes securitisation structure.

The performance of the mortgage portfolio is continually assessed by Santander UK plc and external credit rating agencies. It follows that the impairment policies of Santander UK plc are applied by the Company.

The directors believe that the performance of the portfolio has been in line with management's expectations.

Key performance

During the year the Company received interest and similar income of £8m (2020: £22m) from related parties. The Company used its cash resources to pay interest expense and similar charges of £8m (2020: £25m) on the intercompany loan due to Holmes Master Issuer plc. The Company repaid £561m (2020: £1,214m) on the intercompany loans during the year, and made drawdowns of £1m (2020: £5m) on the intercompany loans during the year. All amounts were paid in full and on time.

The key performance indicators used by management are predominantly consideration of whether there have been breaches of the Transaction documents. However, there are certain measures (triggers) set out in the Transaction documents which are relevant to the Company including assessing whether all counterparties involved in the transaction have a rating that remains adequate to support their on-going roles in the programme, and arrears related events. There were no triggers breached in the year.

Fair review of the Company's Business

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

STRATEGIC REPORT (CONTINUED)

Section 172(1) statement

As a Special Purpose Vehicle (SPV) the governance structure of the Company is such that the key policies have been predetermined at the time of issuance. The directors have had regards to the matters set out in section 172(1) of the Companies Act 2006 as follows:

(a) the Transaction documents have been formulated to achieve the Company's purpose and business objectives, safeguard the assets and promote the success of the Company in accordance with relevant securitisation legislation the Company is only permitted to retain minimal profit;
(b) the company has no employees;
(c) the operational roles have been assigned to third parties with their roles strictly governed by the Transaction documents and fee arrangements agreed in advance
(d) as a securitisation vehicle the company has no physical presence or operations and accordingly has minimal impact on the community and the environment;
(e) the operational roles have been assigned to third parties, fee arrangements agreed in advance and supplier invoices paid strictly in accordance with the Transaction documents including a priority of payments, if applicable; and
(f) the Company has a sole member with the issued shares all held on a discretionary trust basis for the benefit of undisclosed charities.

The Directors consider the ongoing suitability of the governance structure of the Company by reference to the borrowing requirements of Santander UK plc and the performance of its mortgage portfolio and make changes where necessary.

Principal risks and uncertainties facing the Company

The Company's principal risks and uncertainties together with the processes that are in place to monitor and mitigate those risks where possible can be found in Note 3.

COVID-19

In 2021, there were ongoing challenges in terms of navigating the changing circumstances presented by the Covid-19 pandemic, including its impact on the economy and upon home and office working arrangements. The Company continues to monitor the impact of Covid-19 on its operations and customers and intends to take a coordinated approach with the other members of the Santander UK plc group where applicable. There has been no significant change to the carrying value of its assets and liabilities at the reporting date.

In April 2020, Santander UK plc followed FCA guidance on how they expect mortgage lenders and administrators to treat customers fairly during the Covid-19 pandemic and restructured all its securitisations to accommodate its obligations as servicer under the principles set out in the FCA Handbook and Mortgage Conduct of Business rules.

The granting of payment holidays to any securitised loans results in a corresponding decrease in revenue receipts available to the trust company to distribute to the funding entity on each distribution date. To mitigate the potential impact to the securitisations, the qualifying structured entities were amended to direct a cash payment to the funding entity in an amount equal to the funding entity's share of the aggregate amount of the interest that would have been due on any loans which are the subject of a payment holiday. To effect such cash payment, Santander UK plc's share of revenue receipts is reduced by such amount and the funding entity's share of revenue receipts increased accordingly, making the impact neutral to the securitisation.

Broader geopolitical and social risks, including invasion by Russia of Ukraine

During the course of the past two years, since the onset of the Covid-19 pandemic, a number of broader risks have evolved and may present future headwinds. These include geopolitical tensions between regions across the world, global supply chain pressures (which have already fuelled inflationary pressures), stretched household finances, and emerging social unrest. These factors are also likely to play into increased localised political risk, including in the UK. The Company is closely following these developments and the potential for any material impacts which may need to be taken into consideration in its future plans and intends to take a coordinated approach with the other members of the Santander UK plc group.

Streamlined Energy and Carbon Reporting (SECR)

The Company is out of scope of the Streamlined Energy and Carbon Reporting (SECR), as it does not meet the numerical thresholds in relation to turnover and number of employees.

Likely Future Developments

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

On behalf of the Board

S D Affleck
Director
20 June 2022

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

REPORT OF THE DIRECTORS

The Directors submit their report together with the Strategic Report and the audited financial statements for the year ended 31 December 2021.

Results and dividends

The profit for the year ended 31 December 2021 amounted to £9.1m (2020: £7.8m). The Directors do not recommend the payment of a dividend (2020: £nil).

Directors and their interests

The Directors who served throughout the year and to the date of this report were as follows:

Mr S D Affleck (appointed 31 December 2021)
Mrs R J Morrison (resigned 31 December 2021)
Mr D J Wynne
Wilmington Trust SP Services (London) Limited

Mr D J Wynne is also a director of Wilmington Trust SP Services (London) Limited.

None of the other Directors had a beneficial interest in the shares of the Company, or of the holding company, Holmes Holding Limited or its subsidiaries, at the year-end.

Statement of Directors' responsibilities in respect of the financial statements

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulation.

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 UK-adopted international accounting standards.

Under company law, 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 the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable UK-adopted international accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for 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 also 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.

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

Statement of Going Concern

The Company's business activities, together with the factors likely to affect its future development, performance and position are set out in the Strategic Report. The financial position of the Company, its cash flows, liquidity position and borrowing facilities are set out in the financial statements. In addition, Notes 3 and 18 to the financial statements include the Company's financial risk management objectives; its exposures to credit risk and liquidity risk objectives; and its policies and processes for managing its capital.

REPORT OF THE DIRECTORS (CONTINUED)

Statement of Going Concern (continued)

The Company is in a net assets position at the year end (2020: net liabilities). The profit for the year is derived mainly from the fair value gains on Derivative financial instruments (2020: fair value gains). The directors consider the gains and losses on Derivative financial instruments to level out over the long term duration of the liabilities.

The Company has adequate financial resources and the Directors note that £605m (2020: £1,167m) of the liabilities are long term loans due to group undertakings. The loans are repaid in line with the receipts of funds from the underlying mortgages. As a consequence, the Directors believe that the Company is well placed to manage its business risks successfully despite the current uncertain economic outlook.

The Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for at least the period of 12 months from the date the financial statements are authorised for issue. Accordingly, they continue to adopt the going concern basis of accounting in preparing the Annual Report and Financial Statements.

Financial Instruments

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

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

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

The main risk arising from the Company's financial instruments is interest rate risk. The Company holds a beneficial interest in a mortgage portfolio with fixed and variable interest rates. The Company's policy is to eliminate all exposures arising from movements in interest rates by the use of interest rate swap contracts to hedge receipts of interest from the mortgage pool.

All other assets, liabilities and transactions are denominated in Sterling.

Further disclosures regarding financial risk management objectives and policies and the Company's exposure to principal risks can be found in Note 3.

Qualifying third party indemnities

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

Corporate governance

As more fully described in the Section 172(1) statement in the Strategic Report the directors have been charged with governance in accordance with the Transaction documents describing the structure and operation of the transaction.

The Transaction documents provide for procedures that have been designed for safeguarding assets against unauthorised use or disposition, for maintaining proper accounting records, and for the reliability and usefulness of financial information used within the business or for publication. Such procedures are designed to manage rather than eliminate the risk of failure to achieve business objectives whilst enabling them to comply with the regulatory obligations.

REPORT OF THE DIRECTORS (CONTINUED)

Independent Auditors

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

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

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

PricewaterhouseCoopers LLP are deemed to be re-appointed as auditors under Section 487(2) of the Companies Act 2006.
On behalf of the Board

S D Affleck
Director
20 June 2022

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

Independent auditors' report to the members of Holmes Funding Limited

Report on the audit of the financial statements

Opinion

In our opinion, Holmes Funding Limited's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2021 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with UK-adopted international accounting standards; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report and Financial Statements (the "Annual Report"), which comprise: Balance Sheet as at 31 December 2021; the Statement of Comprehensive Income, the Cash Flow Statement, the Statement of Changes in Equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Conclusions relating to going concern

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

However, because not all future events or conditions can be predicted, this conclusion is not a guarantee as to the company's ability to continue as a going concern.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

Independent auditors' report to the members of Holmes Funding Limited (continued)

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance 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 an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic report and Report of the Directors, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on our work undertaken in the course of the audit, the Companies Act 2006 requires us also to report certain opinions and matters as described below.

Strategic report and Report of the Directors

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic report and Report of the Directors for the year ended 31 December 2021 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic report and Report of the Directors.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of Directors' responsibilities in respect of the financial statements, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they 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.

Auditors' 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 auditors' 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.

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud, is detailed below.

Independent auditors' report to the members of Holmes Funding Limited (continued)

Based on our understanding of the company and industry, we identified that the principal risks of non-compliance with laws and regulations related to the transaction documents, and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the financial statements such as the Companies Act 2006. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to the posting of inappropriate journal entries. Audit procedures performed by the engagement team included:

- Making inquiries with management and those charged with governance in relation to known or suspected instances of non-compliance with laws and regulations and fraud
- Evaluating the business rationale for any significant transactions that are unusual or outside the scope of business
- Testing journal entries to supporting documentation using risk-based criteria

There are inherent limitations in the audit procedures described above. We are less likely to become aware of instances of non-compliance with laws and regulations that are not closely related to events and transactions reflected in the financial statements. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

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

Use of this report

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

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

We have no exceptions to report arising from this responsibility.

Jessica Miller

Jessica Miller (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
21/6/ 2022

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December

Continuing operations	Note	2021 £000	2020 £000
Interest and similar income	5	8,279	22,020
Interest expense and similar charges	6	(7,684)	(20,296)
Net interest income		595	1,724
Net other operating income	7	9,039	6,755
Administrative expenses		(583)	(650)
Profit before tax	8	9,051	7,829
Tax charge on profit for the year	9	-	-
Profit for the year		9,051	7,829
Other comprehensive income for the year		-	-
Total net comprehensive income for the year		9,051	7,829

The accompanying notes form an integral part of the financial statements.

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December

	Share capital £000	(Accumulated losses)/Retained reserves £000	Total equity £000
At 1 January 2020	-	(10,187)	(10,187)
Total comprehensive income for the year	-	7,829	7,829
At 31 December 2020 and 1 January 2021	-	(2,358)	(2,358)
Total comprehensive income for the year	-	9,051	9,051
At 31 December 2021	-	6,693	6,693

The accompanying notes form an integral part of the financial statements.

BALANCE SHEET

As at 31 December

	Notes	2021 £000	2020 £000
Assets			
Current assets			
Cash and cash equivalents	10	70,409	290,162
Loans and advances due from related parties	11	10	23
Other assets	14	-	95
Total current assets		70,419	290,280
Non-current assets			
Loans and advances due from related parties	11	541,358	884,801
Derivative financial instruments	12 & 13	2,058	-
Total assets		613,835	1,175,081
Liabilities			
Current liabilities			
Loans due to group undertakings	15	(827)	(1,632)
Other liabilities		(38)	(19)
Total current liabilities		(865)	(1,651)
Non-current liabilities			
Loans due to group undertakings	15	(605,271)	(1,166,664)
Derivative financial instruments	12 & 13	(1,006)	(9,124)
Total liabilities		(607,142)	(1,177,439)
Net assets/(liabilities)		6,693	(2,358)
Equity			
Share capital	16	-	-
Retained earnings/(Accumulated losses)		6,693	(2,358)
Total equity		6,693	(2,358)

The accompanying notes form an integral part of the financial statements.

The financial statements on pages 9 to 26 were approved by the Board of Directors and signed on its behalf by:

S D Affleck
Director
20 June 2022

CASH FLOW STATEMENT

For the year ended 31 December

	Note	2021 £000	2020* £000
Profit before tax		9,051	7,829
Adjustment for non-cash items included in profit:			
Fair value gains on derivatives		(9,039)	(6,755)
Add: Interest expense		7,684	20,296
Less: Interest income		(8,279)	(22,020)
Operating cash flows before movements in working capital		(583)	(650)
Cash flows (used in)/generated from operating activities			
Adjustments for movements in working capital:			
Decrease in other assets		95	266
Increase in other liabilities		19	19
(Decrease)/Increase in derivative financial instrument assets and liabilities		(1,137)	1,889
Cash flows (used in)/generated from operating activities		(1,606)	1,524
Investing activities			
Repayment of loans from related parties		343,456	1,112,609
Interest received		8,279	22,020
Cash flows generated from investing activities		351,735	1,134,629
Financing activities			
Repayment of loans to group undertakings		(561,393)	(1,213,892)
Interest paid		(8,489)	(25,319)
Net cash flows used in financing activities		(569,882)	(1,239,211)
Net decrease in cash and cash equivalents		(219,753)	(103,058)
Cash and cash equivalents at the beginning of the year		290,162	393,220
Cash and cash equivalents at the end of the year	10	70,409	290,162

* The 2020 comparatives include £6,755,000 of fair value gains, £20,296,000 of Interest expense and £22,020,000 of interest income as part of operating cash flow movements before movements in working capital. Previously, these amounts were included within cash flows from operating activities. The change has been made to better reflect the nature of these items.

The accompanying notes form an integral part of the financial statements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021

1. ACCOUNTING POLICIES

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

General information

The Company is a private limited liability company which is limited by shares, domiciled and incorporated in the United Kingdom and is part of a European listed group whose ultimate parent is Banco Santander SA. The registered office address of the Company is 2 Triton Square, Regent's Place, London NW1 3AN.

Basis of preparation

These financial statements are prepared for Holmes Funding Limited (the Company) under the Companies Act 2006.

The Company's financial statements have been prepared in accordance with UK-adopted international accounting standards (IAS). On 31 December 2020, International Financial Reporting Standards (IFRSs) as adopted by the European Union at that date were brought into UK law and became UK-adopted IAS, with future changes being subject to endorsement by the UK Endorsement Board. The Company transitioned to UK-adopted IAS in its financial statements on 1 January 2021, however, this change had no impact on recognition, measurement or disclosures in the periods reported.

The functional and presentation currency of the Company is sterling.

The financial statements have been prepared under the historical cost convention as modified by financial assets and financial liabilities held at fair value through profit or loss, and on a going concern basis as disclosed in the Directors' statement of going concern set out in the Report of the Directors. An assessment of the appropriateness of the adoption of the going concern basis of accounting is disclosed in the statement of going concern set out in the Report of the Directors.

Future accounting developments

At 31 December 2021, for the Company, there were no significant new or revised standards and interpretations, and amendments thereto, which have been issued but which are not yet effective.

Interest Rate Benchmark Reform

In 2020, the Company applied 'Interest Rate Benchmark Reform – Phase 2 - Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16' to all loans whose interest rates were based on LIBOR that were transitioning to alternative benchmark interest rates. During 2021, the Company applied the practical expedient in these amendments, to account for a change in the basis for determining the contractual cash flows by updating the effective interest rate using the guidance in IFRS 9. This resulted in no immediate gain or loss being recognised. There were no loans or other instruments remaining that are affected by IBOR reform as at 31 December 2021.

As the Company has no IAS 39 compliant hedge accounting relationships, the Phase 1 amendments and the amendments relating to hedge accounting in Phase 2 do not apply.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (CONTINUED)

1. ACCOUNTING POLICIES (CONTINUED)

Interest income and expense

Interest income on financial assets that are classified as loans and advances due from related parties and interest expense on financial liabilities other than those at fair value through profit and loss are determined using the effective interest method. The effective interest rate is the rate that discounts the estimated future cash payments or receipts over the expected life of the instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability.

When calculating the effective interest rate, the future cash flows are estimated after considering all the contractual terms of the instrument excluding future credit losses. The calculation includes all amounts paid or received by the Company that are an integral part of the overall return, direct incremental transaction costs related to the acquisition, issue or disposal of the financial instrument and all other premiums or discounts.

Interest income and expense is shown gross in the Statement of Comprehensive Income.

Financial Instruments

Financial instruments of the Company comprise loans and advances due from related parties, Derivative financial instruments, loans due to group undertakings, cash and cash equivalents and other receivables and payables arising from the Company's operations. These instruments are recognised, classified and subsequently measured in accordance with IFRS 9 as described below.

a) Initial recognition and measurement

Financial assets and liabilities are initially recognised when the Company becomes a party to the contractual terms of the instrument. The Company determines the classification of its financial assets and liabilities at initial recognition and measures a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at Fair Value through profit and loss (FVTPL), transaction costs that are incremental and directly attributable to the acquisition or issue of the financial asset or financial liability. Transaction costs of financial assets and financial liabilities carried at fair value through profit or loss are expensed in profit or loss. Immediately after initial recognition, an expected credit loss (ECL) allowance is recognised for financial assets measured at amortised cost.

Financial instruments (continued)

b) Financial assets and liabilities

Classification and subsequent measurement

The Company classifies its financial assets in the measurement categories of amortised cost and Fair value through profit and loss (FVTPL).

Financial assets and financial liabilities are classified as FVTPL where there is a requirement to do so or where they are otherwise designated at FVTPL on initial recognition. Financial assets and financial liabilities which are required to be held at FVTPL include:

- Financial assets and financial liabilities held for trading
- Debt instruments that do not have solely payments of principal and interest (SPPI) characteristics. Otherwise, such instruments are measured at amortised cost.

Financial assets and financial liabilities are classified as held for trading if they are Derivatives or if they are acquired or incurred principally for the purpose of selling or repurchasing in the near-term, or form part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking.

In certain circumstances other financial assets and financial liabilities are designated at FVTPL where this results in more relevant information. This may arise because it significantly reduces a measurement inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains or losses on them on a different basis, where the assets and liabilities are managed and their performance evaluated on a fair value basis or, in the case of financial liabilities, where it contains one or more embedded Derivatives which are not closely related to the host contract.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (CONTINUED)

1. ACCOUNTING POLICIES (CONTINUED)

Financial assets: debt instruments

Classification and subsequent measurement of debt instruments depend on the Company's business model for managing the asset, and the cash flow characteristics of the asset.

Business model
The business model reflects how the Company manages the assets in order to generate cash flows and, specifically, whether the Company's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of the assets. If neither of these is applicable, such as where the financial assets are held for trading purposes, then the financial assets are classified as part of an 'other' business model and measured at FVTPL. Factors considered in determining the business model for a group of assets include past experience on how the cash flows for these assets were collected, how the assets' performance is evaluated and reported to key management personnel and how risks are assessed and managed.

Solely Payment of Principal and Interest ("SPPI ")
Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the Company assesses whether the assets' cash flows represent SPPI. In making this assessment, the Company considers whether the contractual cash flows are consistent with a basic lending arrangement (i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement). Where the contractual terms introduce exposure to risk or volatility that is inconsistent with a basic lending arrangement, the related asset is classified and measured at FVTPL.

Financial assets with embedded Derivatives are considered in their entirety when determining whether their cash flows are SPPI.

Based on these factors, the Company classifies its debt instruments into one of the following measurement categories:

– Amortised cost – Financial assets that are held for collection of contractual cash flows where those cash flows represent SPPI, and that are not designated at FVTPL, are measured at amortised cost. The carrying amount of these assets is adjusted by any ECL recognised. Interest income from these financial assets is included in 'Finance income' using the effective interest rate method. When the estimates of future cash flows are revised, the carrying amount of the respective financial assets or financial liabilities is adjusted to reflect the new estimate discounted using the original effective interest rate. Any changes are recognised in the income statement.

– FVTPL – Financial assets that do not meet the criteria for amortised cost are measured at FVTPL. A gain or loss on a debt instrument that is subsequently measured at FVTPL, including any debt instruments designated at fair value, is recognised in profit or loss and presented in the income statement in 'Other gains/losses' in the period in which it arises.

The Company reclassifies financial assets 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. Such changes are expected to be very infrequent.

Impairment of debt instrument financial assets

Expected credit losses are recognized on all financial assets at amortised cost or at fair value through other comprehensive income. The expected credit loss considers forward looking information to recognise impairment allowances earlier in the lifecycle of a product. A three-stage approach to impairment measurement is adopted as follows:

- Stage 1 - the recognition of 12 month expected credit losses (ECL), that is the portion of lifetime expected credit losses from default events that are expected within 12 months of the reporting date, if credit risk has not increased significantly since initial recognition;
- Stage 2 - lifetime expected credit losses for financial instruments for which credit risk has increased significantly since initial recognition; and
- Stage 3 - lifetime expected credit losses for financial instruments which are credit impaired.

The measurement of ECL reflects:

– An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
– The time value of money; and
– Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Financial assets are written off when it is reasonably certain that receivables are irrecoverable.

Loans and advances due from related parties represent a deemed loan to Santander UK plc, the repayment of which is dependent upon the performance of the underlying residential mortgage portfolio. At each balance sheet date an assessment is made as to whether, as a result of one or more events, there is a significant increase in credit risk since initial recognition. In assessing the loans and advances due from related parties for impairment, the Directors first consider the impairment of the underlying mortgage loans using the above 3 stage approach and consider the ECL of the loans and advances due from related parties taking into account the relevant credit enhancements available for the Company in the structure. Expected losses for loans and advances due from related parties are immaterial and are only likely to be material if the ECL on the underlying assets exceeded the available credit enhancements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (CONTINUED)

1. ACCOUNTING POLICIES (CONTINUED)

Loans and advances due from related parties

Loans and advances due from related parties are debt instrument financial assets measured at amortised cost. The Directors consider that the relevant business model for the loans and advances due from related parties to be 'hold to collect' in order to service the Company's liabilities. The Directors assessed that the contractual cash flows under the deemed loan represent SPPI.

The Company's beneficial interest in the mortgage portfolio held by Holmes Trustees Limited has been legally acquired from Santander UK plc. The sale by Santander UK plc of the beneficial interest does not, however, pass the recognition criteria as described in IFRS 9 and therefore no beneficial interest in a mortgage portfolio is shown in the Balance Sheet as at 31 December 2021. This is further described in the paragraphs below.

Recognition

Under IFRS 9, the legal transfer of the beneficial interest in the Trust mortgage portfolio from Santander UK plc to the Company fails the criteria for recognition in the financial statements of the Company. As no transfer has occurred for accounting purposes the beneficial interest has not been recognised in the Company's financial statements and remains in the Balance Sheet of Santander UK plc.

The beneficial interest in the mortgage portfolio is replaced by a related party deemed loan included in Loans and advances due from related parties on the Company's Balance Sheet. The related party loan is recorded at the book value of the issuance at the time of transfer less any subsequent repayments of capital less deferred consideration due.

Derivative financial instruments

Derivative financial instruments ('Derivatives') are contracts or agreements whose value is derived from one or more underlying indices or asset values inherent in the contract or agreement, which require no or little initial net investment and are settled at a future date.

The Company holds interest rate swap contracts to hedge significant future transactions and cash flows dependent on movement in interest rates.

Derivatives are recognised initially (on the date on which a Derivative contract is entered into), and are subsequently remeasured, at their fair value. Fair values of over-the-counter Derivatives are obtained using valuation techniques, including effective interest rate, discounted cash flow and option pricing models. The Company holds no exchange traded Derivatives.

Derivatives are contracted with Santander UK plc or counterparties that meet standards set out in the relevant Prospectus. If subsequently there is a ratings downgrade of the counterparty credit rating, remedial measures include provision of collateral for obligations under the relevant swap contract.

The Company does not apply hedge accounting for these Derivatives.

Valuation of financial instruments

Financial instruments that are classified or designated at fair value through profit and loss and all Derivatives are stated at fair value. The fair value of such financial instruments is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Company has access at that date. The fair value of a liability reflects its non-performance risk.

Changes in the valuation of such financial instruments, including Derivatives, are included in the line item 'Net other operating income' in the Statement of Comprehensive Income.

(i) Initial measurement

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

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (CONTINUED)

1. ACCOUNTING POLICIES (CONTINUED)

Valuation of financial instruments (continued)

(ii) Subsequent measurement

The Company applies the following fair value hierarchy that prioritises the inputs to valuation techniques used in measuring fair value. The hierarchy establishes three categories for valuing financial instruments, giving the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

The three categories are: quoted prices in active markets (Level 1), internal models based on observable market data (Level 2) and internal models based on other than observable market data (Level 3). If the inputs used to measure an asset or a liability fall to different levels within the hierarchy, the classification of the entire asset or liability will be based on the lowest level input that is significant to the overall fair value measurement of the asset or liability.

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

Level 1: Unadjusted quoted prices for identical assets or liabilities in an active market that the Company has the ability to access at the measurement date. The Company has no assets or liabilities measured at fair value that are classified as Level 1.

Level 2: Quoted prices in non-active markets, quoted prices for similar assets or liabilities, recent market transactions, inputs other than quoted market prices for the asset or liability that are observable either directly or indirectly for substantially the full term, and inputs to valuation techniques that are derived principally from or corroborated by observable market data through correlation or other statistical means for substantially the full term of the asset or liability. The Company has no assets or liabilities measured at fair value that are classified as Level 2.

Level 3: Inputs to the pricing or valuation techniques that are significant to the overall fair value measurement of the asset or liability are unobservable. Level 3 positions include interest rate Derivatives

Financial instruments valued using a valuation technique

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

Valuation techniques

The main valuation techniques employed in the Company's internal models to measure the fair value of the financial instruments disclosed above at 31 December 2021 are set out below.

A In the valuation of financial instruments requiring static hedging (for example interest rate Derivatives), the 'present value' method is used. Expected future cash flows are discounted using the interest rate curves of the applicable currencies. The interest rate curves are generally observable market data and reference yield curves derived from quoted interest rates in appropriate time bandings, which match the timings of the cash flows and maturities of the instruments.

B In the valuation of Derivatives used to manage the interest rate risk associated with the beneficial interest on the mortgage portfolio, the 'present value' method is used. Expected future cash flows are discounted using the three-month sterling LIBOR rate curves. The three-month sterling LIBOR rate curves are generally observable market data which match the timings of the cash flows and maturities of the instruments. The future repayment of mortgages, which is a key input in the calculation of the future cash flows, is not observable market data.

Internal models based on observable market data - Derivative assets and liabilities

These instruments consist of interest rate contracts. The models used in estimating the fair value of these Derivatives do not contain a high level of subjectivity as the methodologies used in the models do not require significant judgement, and the inputs used in the models are observable market data such as plain vanilla interest rate swap contracts and option contracts. As the inputs used in the valuation are not observable, these Derivatives are classified within level 3 of the valuation hierarchy.

Deferred purchase consideration and start-up costs

Under the terms of the mortgage sale agreement, Santander UK plc, as the originator of the mortgage loans, legally retains the right to receive excess income ("deferred consideration") arising on those loans, after certain higher priority payments have been met by the Company. Deferred consideration is treated as a reduction in the interest due from Santander UK plc on the loans and other debts due from related parties arising on the failure to recognise the sale of the beneficial interest in the mortgage portfolio. Incremental elements of deferred consideration are recognised on an effective interest rate basis; all other elements are accounted for as incurred.

Deferred start-up costs are capitalised and then amortised over the contractual life of the loan Note.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (CONTINUED)

1. ACCOUNTING POLICIES (CONTINUED)

Income taxes

The directors are satisfied that the Company meets the definition of a 'securitisation company' as defined by both the Finance Act 2005 and the subsequent secondary legislation and that no incremental unfunded tax liabilities will arise. As a result, no deferred tax amounts are recognised.

Under the powers conferred by the Act, secondary legislation was enacted in 2006 which ensures that, subject to certain conditions being met and an election being made, for periods commencing on or after 1 January 2007, corporation tax for a 'securitisation company' will be calculated by reference to the profit of the securitisation company required to be retained in accordance with the relevant capital market arrangement.

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

Income tax payable on profits, based on the applicable tax law in each jurisdiction is recognised as an expense in the period in which profits arise. Taxable profit differs from net profit as reported in the Statement of Comprehensive Income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the Balance Sheet date.

Cash and cash equivalents

For the purposes of the Cash Flow Statement, cash and cash equivalents comprise assets with less than three months' maturity from the date of acquisition, including cash, restricted balances and non restricted balances with central banks, loans and advances to banks and amounts due from other banks.

Impairment of financial assets

A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of events that occurred after the initial recognition of the asset (a 'loss event') and that loss event has an impact on the estimated future cash flows of the financial asset or group of financial assets.

2. CRITICAL ACCOUNTING ESTIMATES AND AREAS OF SIGNIFICANT MANAGEMENT JUDGEMENT

There were no critical accounting judgements applied by management during the year. The following accounting estimates are considered important.

The preparation of the Company's financial statements requires management to make judgements and accounting estimates that affect the reported amount of assets and liabilities at the date of the financial statements and the reported amount of income and expenses during the reporting period. Management evaluates its judgements and accounting estimates, which are based on historical experience and on other factors that are believed to be reasonable under the circumstances, on an on-going basis. Actual results may differ from these estimates under different assumptions or conditions.

The following accounting estimates and judgements are considered important to the portrayal of the Company's financial results and financial condition because: (i) they are highly susceptible to change from period to period as assumptions are made to calculate the estimates, and (ii) any significant difference between the estimated amounts and actual amounts could have a material impact on the Company's future financial results and financial condition:

Impairment of Loans and advances due from related parties

As described under the 'Impairment of debt instrument financial assets' above, the repayment of the Loans due to group companies is dependent on the performance of the underlying residential mortgage portfolio. At each balance sheet date an assessment is made as to whether, as a result of one or more events, there is a significant increase in credit risk since initial recognition. In assessing the loans due to group companies for impairment, the Directors first consider the impairment of the underlying mortgage loans using the above 3 stage approach and consider the ECL of the loans and advances due from related parties taking into account the relevant credit enhancements available for the Company in the structure. Expected losses for loans and advances due from related parties are immaterial and are only likely to be material if the ECL on the underlying assets exceeded the available credit enhancements.

Derivative financial instruments

As described under "Derivative financial instruments" above, the Company holds interest rate swap contracts to hedge significant future transactions and cash flows dependent on movement in interest rates.

Derivatives are contracted with Santander UK plc or counterparties that meet standards set out in the relevant Prospectus.

The Directors monitor the performance of Derivatives on an ongoing basis. If subsequently there is a ratings downgrade of the counterparty credit rating, remedial measures include provision of collateral for obligations under the relevant swap contract.

3. FINANCIAL RISK MANAGEMENT

The Company's risk management focuses on the major areas of credit risk, market risk, operational risk and liquidity risk. The Transaction documents are also a source of financial risk to the Company. Risk management is carried out by the central risk management function of the Santander UK Group. Authority flows from the Santander UK plc Board to the Chief Executive Officer and from him to his direct reports. Delegation of authority is to individuals. Formal standing committees are maintained for effective management of oversight.

Credit risk

Credit risk is the risk that counterparties will not meet their financial obligations and may result in the Company losing the principal amount lent, the interest accrued and any unrealised gains, less any security held. The main source of credit risk is in the loans and advances to group undertakings, Derivative financial instruments assets and other assets.

Key metrics under IFRS 9 are as follows:

Metric	Description
Expected credit losses (ECL)	ECL tells us what credit risk is likely to cost us either over the next 12 months on qualifying exposures, or defaults over the lifetime of the exposure where there is evidence of a significant increase in credit risk (SICR) since origination. We explain how we calculate ECL below.
Stages 1, 2 and 3	We assess each facility's credit risk profile to determine which stage to allocate them to, and we monitor where there is a SICR and transfers between the stages. We explain how we allocate a facility to Stage 1, 2 or 3 below.
Significant increase in credit risk (SICR)	Loans which have suffered a SICR since origination are subject to a lifetime ECL assessment which extends to a maximum of the contractual maturity of the loan. Loans which have not experienced a SICR are subject to 12 month ECL. We assess each facility's credit risk profile to determine which of three stages to allocate them to, see the company's accounting policies on Note 1.

The maximum exposure to credit risk without taking into account collateral or credit enhancements is the carrying amount of the loans and advances due from related parties of £541m (2020: £885m), the fair value of Derivative financial assets of £2m (2020: £nil) and the carrying amount of other assets of £nil (2020: £nil).

Loans and advances due from related parties represent the deemed loan to Santander UK plc, the repayment of which is dependent upon the performance of the underlying residential mortgage portfolio. At each balance sheet date, an assessment is made as to whether, as a result of one or more events, there is a significant increase in credit risk since initial recognition. In assessing the deemed loan to Santander UK plc for impairment, the Directors first consider the impairment of the underlying mortgage loans using the above 3-stage approach and consider the ECL of the loan taking into account the relevant credit enhancements available for the Company in the structure. Expected losses for the deemed loan to Santander UK plc arises if the ECL on the underlying assets is greater than the available credit enhancements.

At the balance sheet date the impact of ECL has been assessed as immaterial on all financial assets subject to credit risk, due to the credit enhancement features applied by the Company. As such no ECL allowance was recognised.

Loans and advances from Holmes Master Issuer plc can only be paid by the Company if the Company receives cash from mortgages advanced by Santander UK plc. This risk is mitigated as the securitisation structure is over collateralised and impairment risk is low. There is limited recourse under the loans as Holmes Master Issuer plc only pays loan Notes to the extent that it has available cash.

As at 31 December 2021, the book value of residential mortgage loans that Santander UK plc had assigned legal title to the Holmes securitisation structure was £2,294m (2020: £3,037m). The Holmes securitisation structure acquired interest in a portfolio of mortgage loans (Funder share) was £556m (2020: £989m) and the Santander UK plc seller share was £1,739m (2020: £2,083m). The seller share does not provide credit enhancement.

The Holmes securitisation structure has cash balances and reserves of £129m (2020: £383m) which also acts as a credit enhancement feature. Cash balances are held with Santander UK plc. All cash balances held with Santander UK plc are held under a Guaranteed Investment Contract and are classified as restricted funds, as withdrawals are restricted by a priority of payments in accordance with the terms of the securitisation structure.

Derivatives are contracted with Santander UK plc or counterparties that meet standards set out in the relevant Transaction documents. If subsequently there is a ratings downgrade of the counterparty credit rating, remedial measures include provision of collateral for obligations under the relevant swap contract.

The maximum LTV ratio of the securitised mortgages within the structure at origination is 95% with arrears rates significantly below the rate that can be absorbed by the level of over collateralisation currently within the structure. There are no repurchase obligations on the underlying loans.

The loans within the portfolio are monitored and assessed for impairment on a regular basis at a group level as, under IFRS 9 the beneficial interest in a mortgage portfolio fails the criteria for recognition within the Company's financial statements and remains in the Balance Sheet of Santander UK plc. The impairment policy applied by Santander UK plc is equivalent to the impairment of financial assets policy of the Company.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (CONTINUED)

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

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

Santander UK plc's credit ratings are disclosed below as the financial assets of the Holmes securitisation structure are secured on mortgage assets within Santander UK plc.

Further details can be found in the notes to the Group financial statements of Santander UK plc's Annual Report and Financial Statements and monthly investor reports of Holmes Master Trust.

Santander UK plc's current credit ratings were:

	S & P	Moody's	Fitch
Long-term rating	A	A1	A+
Long-term rating outlook	Stable	Stable	Stable
Short term rating	A-1	P-1	F1

Liquidity risk

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

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

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This includes regulatory, legal and compliance risk. Operational risk is monitored and managed within the Group. An independent central operational risk function has responsibility for establishing the framework within which these risks are managed and is aligned to operational risk professionals within business areas to ensure consistent approaches are applied across the Group. The primary purpose of the framework is to define and articulate the Group-wide policy, processes, roles and responsibilities.

The day-to-day management of operational risk is the responsibility of business managers who identify, assess and monitor the risks, in line with the processes described in the framework. The operational risk function ensures that all key risks are regularly reported to the Group's risk committee and board of directors.

The Transaction documents provide for procedures that have been designed for safeguarding assets against unauthorised use or disposition, for maintaining proper accounting records, and for the reliability and usefulness of financial information used within the business or for publication. Such procedures are designed to manage rather than eliminate the risk of failure to achieve business objectives whilst enabling them to comply with the regulatory obligations.

Market risk

Market risk is potential for loss of income or decrease in the value of net assets caused by movements in the levels and prices of financial instruments. The Company is subject to market risk in the form of interest rate risk.

In order to hedge against interest risks, the Company enters into interest rate swap contracts with Santander UK plc, a related party, to manage basis risk between interest flows on the intercompany loan with Holmes Master Issuer plc and on interest payments received from Santander UK plc. Hedge accounting is not adopted by the Company for these Derivatives and therefore the results of the Company are subject to volatility due to the movement in fair value of those interest rate swap contracts.

The sensitivity analysis below has been determined based on the exposure to interest rates for both Derivatives and floating rate interest bearing assets at the end of the reporting period. The analysis is prepared assuming that the amount outstanding, for which amounts receivable and payable are based upon, was outstanding for the whole year.

A 50bp positive or adverse movement in interest rates, with all other variables held constant, would result in an immaterial movement in operating profit and in net liabilities.

During the year, the Company incurred fair value gains on Derivative financial instruments of £9.0m (2020: fair value gains of £6.8m). This volatility is expected to even out over the long term.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (CONTINUED)

4. BUSINESS AND GEOGRAPHICAL SEGMENTS

All of the Company's income is derived from activities in the same business and geographical segment, within the UK.

5. INTEREST AND SIMILAR INCOME

	Year ended 31 December 2021 £000	Year ended 31 December 2020 £000
Interest income from Santander UK plc	8,130	20,931
Bank interest income from Santander UK plc	149	1,089
	8,279	22,020

6. INTEREST EXPENSE AND SIMILAR CHARGES

	Year ended 31 December 2021 £000	Year ended 31 December 2020 £000
Interest expense on swap contracts	2,365	4,761
Issuance fee expense	95	266
Interest expense on loans from group undertakings	5,224	15,269
	7,684	20,296

7. NET OTHER OPERATING INCOME

	Year ended 31 December 2021 £000	Year ended 31 December 2020 £000
Fair value gain on Derivative financial instruments	9,039	6,755

8. PROFIT BEFORE TAX

Directors' emoluments

The Directors' services to the Company are an incidental part of their duties. No Directors were remunerated for their services to the Company. Directors' emoluments are borne by Santander UK plc and corporate service fees of £10,000 (2020: £12,033), which include the provision of Directors, were paid by Holmes Funding Limited. No emoluments were paid by the Company to the Directors during the year (2020: £nil).

Staff costs

The Company had no employees in the current or previous financial year.

Auditors' remuneration

The audit fee for the current and prior years have been paid by the Company. The audit fee for the current year is £15,965 (2020: £15,965).

No fees for non-audit services were paid by the Company to the auditors during the year 2021 (2020: nil).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (CONTINUED)

9. TAX CHARGE ON PROFIT FOR THE YEAR

	Year ended 31 December 2021 £000	Year ended 31 December 2020 £000
Current tax:		
UK corporation tax on profit for the year	-	-
Tax charge on profit for the year	-	-

For UK corporation tax purposes, the Company has been considered as a Securitisation Company under the 'Taxation of Securitisation Companies Regulations (SI 2006/3296)'. Therefore, the Company is not required to pay corporation tax on its accounting profit or loss. Instead, the Company is required to pay tax on its retained profits as specified in the documentation governing the Transaction.

UK corporation tax is calculated at 19% (2020: 19%) of the estimated assessable profits for the year.

The UK government announced in its budget on 3 March 2021 that it would increase the main rate of corporation tax from 19% to 25% with effect from 1 April 2023.

The tax on the Company's profit before tax is lower (2020: lower) than the theoretical amount that would arise using the basic tax rate of the Company as follows:

	Year ended 31 December 2021 £000	Year ended 31 December 2020 £000
Profit before tax	9,051	7,829
Tax calculated a tax rate of 19% (2020: 19%)	1,720	1,488
Non-taxable income	(1,720)	(1,488)
Tax charge for the year	-	-

The Company meets the requirements of a securitisation company for tax purposes and is taxed on the margin that it receives in return for participating in the securitisation structure under the waterfall arrangement. Any other amounts that form part of its retained profit and all other amounts that it receives are disregarded for tax purposes.

10. CASH AND CASH EQUIVALENTS

	2021 £000	2020 £000
Deposits with Santander UK plc	70,409	290,162
	70,409	290,162

Cash and cash equivalent balances due from Santander UK plc, a related party was £70m (2020: £290m).

All cash balances held with Santander UK plc are held under a Guaranteed Investment Contract and are classified as restricted funds, as withdrawals are restricted by a priority of payments in accordance with the terms of the securitisation structure.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (CONTINUED)

11. LOANS AND ADVANCES DUE FROM RELATED PARTIES

	2021 £000	2020 £000
Loans and advances due from related parties	541,368	884,824

	2021 £000	2020 £000
Repayable:		
On demand or at short notice	10	23
In more than five years	541,358	884,801
	541,368	884,824

Loans and advances due from related parties represents financial assets at amortised cost in the form of an intercompany loan, generated as a result of the beneficial interest in the mortgage portfolio failing the derecognition criteria described in IFRS 9. The intercompany loan replaces the beneficial interest in the mortgage portfolio legally held by the Company and represents the substance of the transaction for accounting purposes.

The Mortgage Loans advanced by Santander UK plc to its customers are being amortised, however the repayments are not contractually certain. Consequently, the Loans and advances due from Santander UK plc to the Company have been classified as amounts falling due after five years.

The loans and advances due from related parties are all designated in Sterling and are either non-interest bearing, at fixed rates or at variable rates of interest, based on the standard variable rate of the administrator, Santander UK plc. The carrying value of loans from related parties approximates to its fair value.

12. DERIVATIVE FINANCIAL INSTRUMENTS

The Company holds Derivatives to manage the interest rate risks associated with the beneficial interest on the mortgage portfolio. These Derivatives are held with Santander UK plc, a related party, and require the Company to pay a weighted average of the mortgage interest earned on the beneficial interest in the mortgage portfolio and receive payments based on rates linked to compounded daily SONIA. These Derivatives are recorded at fair value through profit or loss.

The use of Derivatives is determined in the Transaction documents at the time of issue of each series of debt securities in issue.

At 31 December 2021, the Company held Derivative assets of £2.1m (2020: nil) and Derivative liabilities of £1.0m (2020: £9.1m).

13. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following tables summarise the fair values of the financial asset and liability classes accounted for at fair value at 31 December 2021 and 2020, analysed by the valuation methodology used by the Company to determine their fair value, including their levels in the fair value hierarchy – level 1, level 2 and level 3.

31 December 2021	Internal models based on								
Balance sheet category	Level 1 £000	%	Level 2 £000	%	Level 3 £000	%	Total £000	%	Valuation technique (Note 1)
Derivative asset: Interest rate swap contracts									
Financial assets designated at fair value through profit and loss	-	-	-	-	2,058	100	2,058	100	
Total assets at fair value	-	-	-	-	2,058	100	2,058	100	B

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (CONTINUED)

13. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

31 December 2021 Balance sheet category	Internal models based on Level 1 £000	%	Level 2 £000	%	Level 3 £000	%	Total £000	%	Valuation technique (Note 1)
Derivative liabilities: Interest rate swap contracts									
Financial liabilities designated at fair value through profit and loss	-	-	-	-	1,006	100	1,006	100	
Total liabilities at fair value	-	-	-	-	1,006	100	1,006	100	B

31 December 2020 Balance sheet category	Internal models based on Level 1 £000	%	Level 2 £000	%	Level 3 £000	%	Total £000	%	Valuation technique (Note 1)
Financial assets designated at fair value through profit and loss									
Derivative assets: Interest rate swap contracts	-	-	-	-	-	-	-	-	
Total assets at fair value	-	-	-	-	-	-	-	-	B

31 December 2020 Balance sheet category	Internal models based on Level 1 £000	%	Level 2 £000	%	Level 3 £000	%	Total £000	%	Valuation technique (Note 1)
Financial liabilities designated at fair value through profit and loss									
Derivative liabilities: Interest rate swap contracts	-	-	-	-	9,124	100	9,124	100	
Total liabilities at fair value	-	-	-	-	9,124	100	9,124	100	B

Effect of changes in significant unobservable assumptions to reasonably possible alternatives (Level 3)

The fair value of financial instruments are, in certain circumstances, measured using valuation techniques that incorporate assumptions that are not evidenced by prices from observable current market transactions in the same instrument and are not based on observable market data and, as such require the application of a degree of judgement. Changing one or more of the inputs to the valuation models to reasonably possible alternative assumptions would change the fair values significantly. The following table shows the sensitivity of these fair values to reasonably possible alternative assumptions. Favourable and unfavourable changes are determined on the basis of changes in the value of the instrument as a result of varying the levels of the unobservable input as described in the table below. The potential effects do not take into effect any hedged positions.

31 December 2021

	Fair value £000	Assumption description	Shift	Sensitivity Favourable changes £000	Unfavourable changes £000
Derivative assets and liabilities: Interest rate swap contracts	1,052	Weighted Average Mortgage Rate Payable	1.0%	55	55

31 December 2020

	Fair value £000	Assumption description	Shift	Sensitivity Favourable changes £000	Unfavourable changes £000
Derivative liabilities: Interest rate swap contracts	9,124	Weighted Average Mortgage Rate Payable	1.0%	116	(116)

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (CONTINUED)

13. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

Reconciliation of fair value measurements in Level 3 of the fair value hierarchy

The following table provides a reconciliation of the movement between opening and closing balances of level 3 financial instruments, measured at fair value using a valuation technique with significant unobservable inputs:

	Derivatives	
	Assets £000	Liabilities £000
At 1 January 2020	1,457	15,447
Decrease	(1,457)	(6,323)
At 31 December 2020 and 1 January 2021	-	9,124
Increase/(Decrease)	2,058	(8,118)
At 31 December 2021	**2,058**	**1,006**

14. OTHER ASSETS

	2021 £000	2020 £000
Deferred start-up costs	-	95
Assets fall due:		
Less than 1 year	-	95
Greater than 1 year	-	-
	-	95

The carrying amount of other assets approximates to their fair value. Other assets due after one year at 31 December 2021 amount to £nil (2020: £nil).

15. LOANS DUE TO GROUP UNDERTAKINGS

	2021 £000	2020 £000
Loans due to group undertakings	606,098	1,168,296
These borrowings are repayable as follows:		
Within one year	827	1,632
Greater than five years	605,271	1,166,664
	606,098	1,168,296

The Mortgage Loans advanced by Santander UK plc to its customers are being amortised, however the repayments are not contractually certain. Consequently, the principal Loans and advances due to group undertakings by the Company have been classified as amounts falling due after five years.

16. SHARE CAPITAL

	2021 £	2020 £
Issued and fully paid:		
2 (2020: 2) Ordinary shares of £1 each	2	2

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (CONTINUED)

17. RELATED PARTY TRANSACTIONS

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

	Interest income 2021 £000	Interest expense 2021 £000	Fees Payable 2021 £000	Loans and advances due from related parties 2021 £000	Loans and advances due to group undertakings 2021 £000	Accrued interest payable 2021 £000
Santander UK plc	8,279	-	118	541,368	-	-
Santander UK plc – cash and cash equivalents	-	-	-	70,409	-	-
Holmes Master Issuer plc	-	7,684	-	-	605,271	827

	Derivative assets 2021 £000	Derivative liabilities 2021 £000
Santander UK plc	2,058	1,006

	Interest income 2020 £000	Interest expense 2020 £000	Fees Payable 2020 £000	Loans and advances due from related parties 2020 £000	Loans and advances due to group undertakings 2020 £000	Accrued interest payable 2020 £000
Santander UK plc	22,020		118	884,824	9	-
Santander UK plc – cash and cash equivalents	-	-	-	290,162	-	-
Holmes Master Issuer plc	-	20,296	-	-	1,166,655	1,632

	Derivative assets 2020 £000	Derivative liabilities 2020 £000
Santander UK plc	-	9,124

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

18. CAPITAL MANAGEMENT AND RESOURCES

Santander UK plc adopts a centralised capital management approach, based on an assessment of both regulatory requirements and the economic capital impacts of businesses in the Santander UK group. Disclosures relating to the Company's capital management can be found in the Santander UK Annual Report and Financial Statements.

Capital held by the Company and managed centrally as part of Santander UK plc, comprises share capital and reserves which can be found in the Balance Sheet on page 10. The Company's capital is not externally regulated.

Capital is managed by way of processes set up at inception of the Company and subsequently there is no active process for managing its own capital. The Company is designed to hold minimum reserves once all amounts due on the related party loans have been received and amounts owing, including deferred consideration, have been paid.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2021 (CONTINUED)

19. PARENT UNDERTAKING AND CONTROLLING PARTY

The Company's immediate parent company is Holmes Holdings Limited. Wilmington Trust SP Services (London) Limited, a company incorporated in Great Britain and registered in England and Wales, holds the entire share capital of Holmes Holdings Limited as trustee under a discretionary charitable trust, dated 17 February 1999, for the benefit of certain charities.

The administration, operations, accounting and financial reporting functions of the Company are performed by Santander UK plc, which is incorporated in Great Britain and registered in England and Wales.

Santander UK plc has been delegated administration and servicing functions in respect of the loans on behalf of the mortgages' trustee and the beneficiary as the service providers.

The Company is a Special Purpose Entity controlled by and consolidated within the group financial statements of Santander UK Group Holdings plc.

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

Copies of all sets of group financial statements, which include the results of the Company, are available from Secretariat, Santander UK plc, 2 Triton Square, Regent's Place, London NW1 3AN.