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 2016.

Principal activity

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 Group Holdings plc group 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 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 the 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.

The loans within the portfolio are monitored and assessed for impairment on a regular basis at a group level as, under International Accounting Standard (IAS) 39 – 'Financial Instruments: Recognition and Measurement,' 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 £90m (2015: £150m) from related parties. The Company used those cash resources to pay interest expense of £89m (2015: £149m) on the intercompany loan due to Holmes Master Issuer plc and other charges. The Company repaid £2,494m (2015: £2,676m) 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.

The purpose of this Report is to provide information to the members of the Company and as such it is only addressed to those members. The Report may contain certain forward-looking statements with respect to the operations, performance and financial condition of the Company. By their nature, these statements involve inherent risks and uncertainties since future events, circumstances and other factors can cause results and developments to differ materially from the plans, objectives, expectations and intentions expressed in such forward-looking statements. Members should consider this when relying on any forward-looking statements. The forward-looking statements reflect knowledge and information available at the date of preparation of this Report and the Company undertakes no obligation to update any forward-looking statement during the year. Nothing in this Report should be construed as a profit forecast.

STRATEGIC REPORT (CONTINUED)

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 Notes 3 and 18.

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

R J Morrison

Rachel Morrison
Director

11 April 2017

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 2016.

Results and dividends

The loss after tax for the year ended 31 December 2016 amounted to £7.5m (2015: profit of £27.2m). The Directors do not recommend the payment of a final dividend (2015: £nil).

Subsequent events

There are no subsequent events.

Directors

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

Mr M H Filer	
Mrs R J Morrison	(appointed 7 April 2016)
Wilmington Trust SP Services (London) Limited	

At the year-end and the previous year-end, Holmes Holdings Limited held one share in the Company and Holmes Holdings Limited and Martin McDermott jointly held the other share. On 24 January 2017 the share held jointly was transferred to Holmes Holdings Limited.

Wilmington Trust SP Services (London) Limited and Mr Martin McDermott jointly held one share in the holding company, Holmes Holdings Limited at 31 December 2016. The other share in Holmes Holdings Limited was held by Wilmington Trust SP Services (London) Limited. On 24 January 2017 the share held jointly was transferred to Wilmington Trust SP Services (London) Limited.

Mr M H Filer 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.

Directors' Responsibilities Statement

The Directors are responsible for preparing the Strategic Report, Report of the Directors 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. 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
- 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.

REPORT OF THE DIRECTORS (CONTINUED)

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.

The Company is in a net liabilities position at the year end (2015: net assets) as a result of generating a net loss in the year (2015: net profit). .
The loss is derived mainly from the fair value losses on derivative financial instruments (2015: 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 also has adequate financial resources and the Directors note that £3,226m (2015: £5,189m) of the liabilities are long terms loans due to fellow 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 swaps). 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 swaps 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.

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

RJ Morrison

Rachel Morrison
Director
11 April 2017

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 financial statements

Our opinion

In our opinion, Holmes Funding Limited's financial statements (the "financial statements"):

- give a true and fair view of the state of the company's affairs as at 31 December 2016 and of its loss and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

What we have audited

The financial statements, included within the Annual Report and Financial Statements (the "Annual Report"), comprise:

- the Balance Sheet as at 31 December 2016;
- the Statement of Comprehensive Income for the year then ended;
- the Cash Flow Statement for the year then ended;
- the Statement of Changes in Equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is IFRSs as adopted by the European Union, and applicable law.

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

Opinions 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 Report of the Directors for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Report of the Directors have been prepared in accordance with applicable legal requirements.

In addition, in light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we are required to report if we have identified any material misstatements in the Strategic Report and the Report of the Directors. We have nothing to report in this respect.

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received

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

- we have not received all the information and explanations we require for our audit; or
- 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.

We have no exceptions to report arising from this responsibility.

Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the Directors' Responsibilities Statement set out on page 3, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF HOLMES FUNDING LIMITED (CONTINUED)

What an audit of financial statements involves
We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report. With respect to the Strategic Report and Report of the Directors, we consider whether those reports include the disclosures required by applicable legal requirements.

Jessica Miller

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

12 April 2017

STATEMENT OF COMPREHENSIVE INCOME

For the years ended 31 December

Continuing operations	Notes	2016 £000	2015 £000
Interest and similar income	5	90,061	149,763
Interest expense and similar charges	6	(88,980)	(148,716)
Net interest income		1,081	1,047
Net other operating (expense) / income	7	(7,522)	27,167
Administrative expenses		(1,077)	(1,033)
(Loss) / profit before tax	8	(7,518)	27,181
Tax charge on (loss) / profit for the year	9	(1)	(1)
(Loss) / profit for the year		(7,519)	27,180
Other comprehensive income for the year		-	-
Total net comprehensive (expense) / income for the year attributable to the equity holders of the Company		(7,519)	27,180

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

STATEMENT OF CHANGES IN EQUITY

For the years ended 31 December

	Share capital £000	(Accumulated losses)/ retained earnings £000	Total equity £000
1 January 2015	-	(22,796)	(22,796)
Profit for the year	-	27,180	27,180
At 31 December 2015 and 1 January 2016	-	4,384	4,384
Loss for the year	-	(7,519)	(7,519)
At 31 December 2016	-	(3,135)	(3,135)

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

BALANCE SHEET

As at 31 December

	Notes	2016 £000	2015 (Restated*) £000
Assets			
Cash and cash equivalents	10	450,231	798,372
Loans and advances due from related parties	11	2,779,623	4,922,617
Derivative financial instruments	12 & 13	2,318	10,202
Other assets	14	2,678	3,357
Total assets		3,234,850	5,734,548
Liabilities			
Loans due to group undertakings	15	(3,225,874)	(5,719,970)
Derivative financial instruments	12 & 13	(12,110)	(10,193)
Current tax liabilities		(1)	(1)
Total liabilities		(3,237,985)	(5,730,164)
Net (liabilities) / assets		(3,135)	4,384
Equity			
Share capital	16	-	-
(Accumulated losses)/ retained earnings		(3,135)	4,384
Total (deficit) / equity		(3,135)	4,384

* The 2015 comparative information has been restated to recognise £465m of cash reserves held by related party Santander UK plc as "Cash and cash equivalents". The balance was previously recognised as a loan within "Loans and advances due from related parties".

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

The financial statements were approved by the Board of Directors, authorised for issue, and signed on its behalf by:

RJ Morrison

Rachel Morrison
Director

11 April 2017

CASH FLOW STATEMENT

For the years ended 31 December

	Notes	2016 £000	2015 (Restated*) £000
Cash flow from operating activities			
(Loss) / profit before tax		(7,518)	27,181
Adjustments for movements in working capital:			
Corporation tax paid		(1)	(1)
Decrease in other assets		680	3,368
Increase / (decrease) in derivative financial instrument liabilities		9,802	(30,630)
Cash flows generated by / (used in) operating activities		2,963	(82)
Financing activities			
Loan advances from group undertakings		2,142,993	2,567,299
Repayment of loans to group undertakings		(2,494,097)	(2,676,255)
Cash flows used in financing activities		(351,104)	(108,956)
Net decrease in cash during the year		(348,141)	(109,038)
Cash and cash equivalents at beginning of year*		798,372	907,410
Cash and cash equivalents at end of year	10	450,231	798,372

* The 2015 comparative information has been restated to recognise £465m of cash reserves held by related party Santander UK plc as "Cash and cash equivalents". The balance was previously recognised as a loan within "Loans and advances due from related parties". A corresponding adjustment has also been made to restate "Cash and cash equivalents at beginning of year" for the current and previous year.

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

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

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 limited liability company, 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

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and IFRS Interpretations Committee (IFRS IC) interpretations as adopted by the European Union and the Companies Act 2006 applicable to companies reporting under IFRS.

The functional and presentation currency of the Company is sterling.

The financial statements have been prepared on the going concern basis using the historical cost convention, as modified by financial assets and financial liabilities held at fair value through profit or loss. 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.

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.

Loans and other debts due from related parties

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 IA 39 and therefore no beneficial interest in a mortgage portfolio is shown in the Balance Sheet as at 31 December 2016. This is further described in the paragraphs below.

Recognition
Under IAS 39, 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 other debts 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.

Financial assets and liabilities

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 financial liabilities at initial recognition. Financial assets are classified as financial assets at fair value through profit or loss, loans and receivables, available-for-sale and held to maturity financial assets. The Company does not hold available-for-sale and held to maturity financial assets.

Financial assets are derecognised when the rights to receive cash flows have expired or the Company has transferred its contractual right to receive the cash flows from the assets and either: (1) substantially all the risks and rewards of ownership have been transferred; or (2) the Company has neither retained nor transferred substantially all of the risks and rewards, but has transferred control. Financial liabilities are derecognised when extinguished, cancelled or expire.

A regular way purchase is a purchase of a financial asset under a contract whose terms require delivery of the asset within the timeframe established generally by regulation or convention in the market place concerned. Regular way purchases of financial assets classified as loans and receivables are recognised on settlement date; all other regular way purchases are recognised on trade date.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

1. ACCOUNTING POLICIES (CONTINUED)

a) Financial assets and financial liabilities at fair value through profit or loss
Financial assets and financial liabilities are classified as fair value through profit or loss if they are designated at fair value through profit or loss on initial recognition. Financial assets and financial liabilities classified as fair value through profit or loss are initially recognised at fair value and transaction costs are taken directly to the Statement of Comprehensive Income. Gains and losses arising from changes in fair value are included directly in the Statement of Comprehensive Income. The Company's financial assets that are classified as fair value through profit or loss are derivatives financial instruments.

b) Borrowings
Borrowings (which include loans due to group undertakings shown in the Balance Sheet) are recognised initially at fair value, being their issue proceeds (fair value of consideration received) net of transactions costs incurred. Borrowings are subsequently valued at amortised cost, using the effective interest method, or fair value through profit or loss dependents on designation at initial recognition.

For each class of assets and liabilities not measured at fair value in the statement of financial position but for which the fair value is disclosed, an entity discloses the information required by paragraph 93(b), (d) and (i) of IFRS 13. However, an entity is not required to provide the quantitative disclosures about significant unobservable inputs used in fair value measurements categorised within Level 3 of the fair value hierarchy required by paragraph 93(d) of IFRS 13. For such assets and liabilities, an entity does not need to provide the other disclosures required by this IFRS.

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 swaps 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 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.

The Company does not apply hedge accounting for these derivatives.

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.

The Company first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If there is no objective evidence of impairment for an individually assessed financial asset it is included in a group of financial assets with similar credit risk characteristics and collectively assessed for impairment.

Impairment for collectively assessed loans are calculated based on the probability of default, exposure at default and the loss given default, using historical data adjusted as considered appropriate to reflect current market conditions. An adjustment is made for the effect of discounting cash flows.

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 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.

1. ACCOUNTING POLICIES (CONTINUED)

Valuation of financial instruments

Financial instruments that are classified or designated at fair value through profit or 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.

(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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

1. ACCOUNTING POLICIES (CONTINUED)

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 2016 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 swaps and option contracts. As the inputs used in the valuation are based on observable market data, these derivatives are classified within level 2 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.

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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

1. ACCOUNTING POLICIES (CONTINUED)

Future accounting developments

The Company has not yet adopted the following significant new or revised standards and interpretations, and amendments thereto, which have been issued but which are not yet effective for the Company:

a) IFRS 9 'Financial Instruments' (IFRS 9) – In July 2014, the International Accounting Standards Board (IASB) approved IFRS 9 to replace IAS 39 'Financial Instruments: Recognition and Measurement', in accordance with the guidelines which were prepared during the G-20 meeting in April 2009.

IFRS 9 sets out the requirements for recognition and measurement of both financial instruments and certain types of contracts for the sale of non-financial items. The main new developments of the standard are discussed below.

Classification and measurement of financial assets and financial liabilities: Under IFRS 9, financial assets are classified on the basis of the business model within which they are held and their contractual cash flow characteristics. These factors determine whether the financial assets are measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss. For many financial assets, the classification and measurement outcomes will be similar to IAS 39. However, under IFRS 9, embedded derivatives are not separated from host financial assets and equity securities are measured at fair value either through profit or loss or, in certain circumstances, an irrevocable election may be made to present fair value movements in other comprehensive income. The requirements for the classification and measurement of financial liabilities were carried forward unchanged from IAS 39, however, the requirements relating to the fair value option for financial liabilities were changed to address own credit risk and, in particular, the presentation of gains and losses within other comprehensive income.

Impairment: IFRS 9 introduces fundamental changes to the impairment of financial assets measured at amortised cost or at fair value through other comprehensive income, lease receivables and certain commitments to extend credit and financial guarantee contracts. It is no longer necessary for losses to be incurred before credit losses are recognised. Instead, under IFRS 9, an entity always accounts for expected credit losses (ECLs), and any changes in those ECLs. The ECL approach must reflect both current and forecast changes in macroeconomic data over a horizon that extends from 12 months to the remaining life of the asset if a borrower's credit risk is deemed to have deteriorated significantly at the reporting date compared to the origination date. These macroeconomic forecasts are required to be unbiased and probability weighted amounts determined by evaluating a range of possible outcomes and considering reasonable and supportable information at the reporting date. Similar to the current incurred credit loss provisioning approach, management will exercise judgement as to whether additional adjustments are required in order to adequately reflect possible events or current conditions that could affect credit risk.

For financial assets, an ECL is the current value of the difference between the contractual cash flows owed to the entity according to the contract and the cash flows which the entity expects to receive. For undrawn loan commitments, an ECL is the current value of the difference between the contractual cash flows owed to the entity and the cash flows which the entity expects to receive if the loan is drawn.

An assessment of each facilities' credit risk profile will determine whether they are to be allocated to one of three stages:

- Stage 1: when it is deemed there has been no significant increase in credit risk since initial recognition, a loss allowance equal to a 12-month ECL – i.e. the proportion of lifetime expected losses resulting from possible default events within a the next 12-months - will be applied;
- Stage 2: when it is deemed there has been a significant increase in credit risk since initial recognition, but no credit impairment has materialised, a loss allowance equal to the lifetime ECL – i.e. lifetime expected loss resulting from all possible defaults throughout the residual life of a facility – will be applied; and
- Stage 3: when it has been deemed there has been a significant increase in credit risk since initial recognition, and the facility is considered credit impaired, a loss allowance equal to the lifetime ECL will be applied. Similar to incurred losses under IAS 39, objective evidence of credit impairment is required.

The assessment of whether a significant increase in credit risk has occurred since initial recognition involves the application of both quantitative measures and qualitative factors, and requires management judgement.

Hedge accounting: The general hedge accounting requirements align more closely with risk management practices and establish a more principle-based approach thereby allowing hedge accounting to be applied to a wider variety of hedging instruments and risks. Macro hedge accounting is being dealt with as a separate project. Until such time as that project is complete, and to remove any potential conflict between any existing macro hedge accounting undertaken under IAS 39 and the new general hedge accounting requirements of IFRS 9, entities can choose to continue to apply the existing hedge accounting requirements in IAS 39. Based on the analysis performed to date, the Company expects to continue IAS 39 hedge accounting. No changes are currently being implemented to hedge accounting policies and practices.

Transition: IFRS 9 has been endorsed for use in the European Union. The mandatory effective date of IFRS 9 is 1 January 2018. The classification and measurement and impairment requirements will be applied retrospectively by adjusting the opening balance sheet at the date of initial application. There is no requirement to restate comparative information. The Company is assessing the likely impacts of the new financial asset classification & measurement and impairment requirements. Upon the satisfactory completion of this work, including formal testing of the ECL models during 2017, the Company will quantify the indicative impact when that information is known or reasonably estimable, and by no later than the end of 2017. It is not yet practicable to quantify the effect of IFRS 9 in these Financial Statements.

A number of new standards and amendments to standards and interpretations have been issued but are not yet effective for the current accounting period. None of these are expected to have a material impact on the financial statements of the Company.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

2. CRITICAL ACCOUNTING POLICIES AND AREAS OF SIGNIFICANT MANAGEMENT JUDGEMENT

The preparation of the Company's financial statements requires management to make estimates and judgements 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 estimates and judgements on an on-going basis. Management bases its estimates and judgements on historical experience and on other factors that are believed to be reasonable under the circumstances. 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.

In calculating each estimate, a range of outcomes was calculated based principally on management's conclusions regarding the input assumptions relative to historic experience. The actual estimates were based on what management concluded to be the most probable assumptions within the range of reasonably possible assumptions. There were no changes in the year.

Valuation of financial instruments
When estimating the value of its derivative assets and liabilities management considers a range of interest rates, counterparty credit ratings and other similar inputs, all of which vary across maturity bands. These are chosen to best reflect the particular characteristics of each transaction based on observable inputs and adjustments to these inputs for Level 2 instruments. Detailed disclosures on financial instruments can be found in note 1 and 13.

Impairment losses
The Company asses its financial assets for objective evidence of impairment at the Balance Sheet date. An impairment loss is recognised if, and only if, there is a loss event that has occurred after initial recognition and before the Balance Sheet date and that has a reliably measurable impact on the estimated future cash flows of the financial assets.

3. FINANCIAL RISK MANAGEMENT

The Company's risk management focuses on the major areas of credit risk, market risk, operational risk and liquidity risk. 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.

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 £2,780m (2015: £4,923m), the fair value of derivative financial assets of £2m (2015: £10m) and the carrying amount of other assets of £3m (2015: £3m).

At the balance sheet date all financial assets subject to credit risk were neither past due nor impaired.

Loans 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 2016, the book value of residential mortgage loans that Santander UK plc had assigned legal title to the Holmes securitisation structure was £5.56bn (2015: £7.05bn). The Holmes securitisation structure comprising fellow subsidiaries is over collateralised by £2.58bn (2015: £1.66bn). The Holmes securitisation structure acquired interest in a portfolio of mortgage loans (Funder share) was £2.98bn (2015: £5.39bn) and the Santander UK plc seller share was £2.58bn (2015: £1.66bn).

The Holmes securitisation structure has cash balances and reserves of £0.69bn (2015: £0.87bn) 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.

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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

The loans within the portfolio are monitored and assessed for impairment on a regular basis at a group level as, under International Accounting Standard ("IAS") 39 'Financial Instruments: Recognition and Measurement,' the beneficial interest in a mortgage portfolio fails the criteria for recognition within in 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.

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	Aa3	A
Long-term rating outlook	Negative	Negative	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.

Maturities of financial liabilities

The table below analyses the maturities of the undiscounted cash flows relating to the financial liabilities of the Company based on the remaining period to the contractual maturity date at the Balance Sheet date. There are no significant financial liabilities related to financial guarantee contracts.

At 31 December 2016	Within 1 month £000	1-3 months £000	3-12 months £000	1-5 years £000	Over 5 years £000	2016 Total £000
Loans due to group undertakings	-	-	-	-	(3,214,525)	(3,214,525)
Derivative financial instruments	(6,045)	-	(25,923)	(38,942)	-	(70,910)
Interest payable on loans	(11,348)	-	(54,025)	(288,135)	(2,365,108)	(2,718,616)
Total liabilities	(17,393)	-	(79,948)	(327,077)	(5,579,633)	(6,004,051)

At 31 December 2015	Within 1 month £000	1-3 months £000	3-12 months £000	1-5 years £000	Over 5 years £000	2015 Total £000
Loans due to group undertakings	-	-	-	-	(5,697,136)	(5,697,136)
Derivative financial instruments	(4,458)	-	(8,034)	2,337	-	(10,155)
Interest payable on loans	(22,835)	-	(81,203)	(433,085)	(3,663,174)	(4,200,297)
Total Liabilities	(27,293)	-	(89,237)	(430,748)	(9,360,310)	(9,907,588)

The maturity analysis for interest payable on loans reflects the maximum potential cash outflows if the loans due to group undertakings are not repaid until the legal maturity date of October 2054. If the cash outflows of interest payable on loans reflected the scheduled repayment terms, rather than the legal maturity date, the total undiscounted cash flows would be £85.8m (2015: £157.8m).

The maturity analysis above for derivative financial liabilities include the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows. The undiscounted cash flows for the derivative financial instruments comprise the amounts payable under the contract. Under the terms of the contract these cash outflows are accompanied by related cash inflows.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

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.

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 amount outstanding, for which amounts receivable and payable are based upon, was outstanding for the whole year.

A 50bp adverse movement in interest rates, with all other variables held constant, would result in a decrease in operating profit and increase in net liabilities of £15.6m (2015: £26.2m). A 50bp positive movement in interest rates, with all other variables held constant, would result in an increase in operating profit and decrease in net liabilities of £15.6m (2015: £26.2m).

During the year, the Company incurred fair value losses on derivative financial instruments of £7.5m (2015: fair value gains of £27.2m). This volatility is expected to even out over the long term.

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 2016 £000	Year ended 31 December 2015 £000
Interest income from Santander UK plc	87,298	145,954
Bank interest income from Santander UK plc	2,763	3,809
	90,061	149,763

6. INTEREST EXPENSE AND SIMILAR CHARGES

	Year ended 31 December 2016 £000	Year ended 31 December 2015 £000
Swap interest expense	8,388	22,261
Issuance fee expense	3,061	3,368
Interest expense on loans from group undertakings	77,531	123,087
	88,980	148,716

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

7. NET OTHER OPERATING (EXPENSE) / INCOME

	Year ended 31 December 2016 £000	Year ended 31 December 2015 £000
Fair value (loss) / gain on derivative financial instruments	(7,522)	27,167

8. (LOSS) / 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 £11,500 (2015: £12,045), 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 (2015: £nil).

Staff costs

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

Auditor remuneration

The audit fee for the current and prior year has been paid on the Company's behalf by Santander UK plc, in accordance with Company policy, for which no recharge has been made. The audit fee for the current year is £11,000 (2015: £11,996).

9. TAX CHARGE ON (LOSS)/PROFIT FOR THE YEAR

	Year ended 31 December 2016 £000	Year ended 31 December 2015 £000
Current tax:		
UK corporation tax on (loss) / profit for the year	1	1
Tax charge on profit for the year	1	1

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 20% (2015: 20%) of the estimated assessable profits of the year.

The Finance (No. 2) Act 2015, which provides for reductions in the main rate of UK corporation tax to 19% effective from 1 April 2017 and to 18% from 1 April 2020 was enacted on 18 November 2015.The Finance Act 2016, which was substantively enacted on 6 September 2016, introduced a further reduction in the corporation tax rate to 17% from 2020.

The tax on the Company's (loss) / profit before tax differs from (2015: differs from) the theoretical amount that would arise using the basic tax rate of the Company as follows:

	Year ended 31 December 2016 £000	Year ended 31 December 2015 £000
(Loss) / profit before tax	(7,518)	27,181
Tax calculated a tax rate of 20% (2015: 20%)	(1,504)	5,436
Non-taxable income	1,505	(5,435)
Tax charge for the year	1	1

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

	2016 £000	2015 (Restated*) £000
Deposits with Santander UK plc	450,231	798,372
	450,231	798,372

* The 2015 comparative information has been restated to recognise £465m of cash reserves held by related party Santander UK plc as "Cash and cash equivalents". The balance was previously recognised as a loan within "Loans and advances due from related parties".

Cash and cash equivalent balances due from Santander UK plc, a related party was £450m (2015: £798m).

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.

11. LOANS AND ADVANCES DUE FROM RELATED PARTIES

	2016 £000	2015 (Restated*) £000
Loans and advances due from related parties	2,779,623	4,922,617

	2016 £000	2015 £000
Repayable:		
In more than five years	2,779,623	4,922,617
	2,779,623	4,922,617

* The 2015 comparative information has been restated to recognise £465m of cash reserves held by related party Santander UK plc as "Cash and cash equivalents". The balance was previously recognised as a loan within "Loans and advances due from related parties".

Loans and advances due from related parties represents an intercompany loan, generated as a result of the beneficial interest in the mortgage portfolio failing the derecognition criteria described in IAS 39. 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 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 a rate linked to three month sterling LIBOR. 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 2016, the Company held derivative assets of £2.3m (2015: £10.2m) and derivative liabilities of £12.1m (2015: £10.2m).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

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 2016 and 2015, 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 2016		Internal models based on								
Balance sheet category		Level 1		Level 2		Level 3		Total		Valuation
		£'000	%	£'000	%	£'000	%	£'000	%	technique
Assets										
Financial assets designated at fair value through profit and loss	Derivative assets: Interest rate swaps	-	-	-	-	2,318	100	2,318	100	
Total assets at fair value		-	-	-	-	2,318	100	2,318	100	B
Liabilities										
Financial liabilities designated at fair value through profit and loss	Derivative liabilities: Interest rate swaps	-	-	-	-	(12,110)	100	(12,110)	100	
Total liabilities at fair value		-	-	-	-	(12,110)	100	(12,110)	100	B

31 December 2015		Internal models based on								
Balance sheet category		Level 1		Level 2		Level 3		Total		Valuation
		£'000	%	£'000	%	£'000	%	£'000	%	technique
Assets										
Financial assets designated at fair value through profit and loss	Derivative assets: Interest rate swaps	-	-	-	-	10,202	100	10,202	100	
Total assets at fair value		-	-	-	-	10,202	100	10,202	100	B
Liabilities										
Financial liabilities designated at fair value through profit and loss	Derivative liabilities: Interest rate swaps	-	-	-	-	(10,193)	100	(10,193)	100	
Total liabilities at fair value		-	-	-	-	(10,193)	100	(10,193)	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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

13. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

Effect of changes in significant unobservable assumptions to reasonably possible alternatives (Level 3) (continued)
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 2016

	Fair value £'000	Assumption description	Shift	Sensitivity Favourable changes £'000	Unfavourable changes £'000
Derivative assets: Interest rate swaps	2,318	Weighted Average Mortgage Rate Payable	1%	95	(95)
Derivative liabilities: Interest rate swaps	(12,110)	Weighted Average Mortgage Rate Payable	1%	1,801	(1,801)

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 2016	10,202	(10,193)
Decrease/ increase	(7,884)	(1,917)
At 31 December 2016	2,318	(12,110)

14. OTHER ASSETS

	2016 £000	2015 £000
Deferred start-up costs	2,678	3,357
	2,678	3,357

The carrying amount of other assets approximates to their fair value. Other assets due after one year at 31 December 2016 amount to £1.3m (2015: £1.3m).

15. LOANS DUE TO GROUP UNDERTAKINGS

	2016 £000	2015 £000
Loans due to group undertakings	3,225,874	5,719,970
These borrowings are repayable as follows:		
Greater than five years	3,225,874	5,719,970
	3,225,874	5,719,970

Interest payable on the loans from group undertakings is based on LIBOR.

16. SHARE CAPITAL

	2016 £	2015 £
Issued and fully paid:		
2 (2015: 2) Ordinary shares of £1 each	2	2

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016 (CONTINUED)

17. RELATED PARTY TRANSACTIONS

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

	Interest income 2016 £000	Interest expense 2016 £000	Fees payable 2016 £000	Loans and advances due from related parties 2016 £000	Loans and advances due to group undertakings 2016 £000	Accrued interest payable 2016 £000
Santander UK plc	90,061	-	238	2,779,623	-	-
Santander UK plc – cash and cash equivalents	-	-	-	450,231	-	-
Holmes Master Issuer plc	-	77,531	120	-	3,214,526	11,348

	Interest income 2015 £000	Interest expense 2015 £000	Fees payable 2015 £000	Loans and advances due from related parties 2015 £000	Loans and advances due to group undertakings 2015 £000	Accrued interest payable 2015 £000
Santander UK plc	149,763	-	243	4,922,617	-	-
Santander UK plc – cash and cash equivalents	-	-	-	798,372	-	-
Holmes Master Issuer plc	-	123,087	120	-	5,697,135	22,835

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 8. 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.

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 the 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.