ABBEY COVERED BONDS LLP

Registered in England and Wales
No: OC312644

ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED
31 DECEMBER 2018

STRATEGIC REPORT

The Members submit the Strategic Report together with their Report of the members and the audited financial statements for the year ended 31 December 2018. The Strategic Report is required by law to be prepared in accordance with the Companies Act 2006, as applicable to qualifying partnerships.

Principal activities

The principal activity of Abbey Covered Bonds LLP (the "Partnership") ") as defined in the Securitisation Transaction document which can be found at http://www.santander.co.uk/uk/about-santander-uk/debt-investors/santander-uk-covered-bonds is to be a special purpose vehicle whose business is to acquire, inter alia, loans and their related security from Santander UK plc pursuant to the terms of the Mortgage Sale Agreement and to guarantee the Covered Bonds. The Partnership will hold the portfolio and the other charged property in accordance with the terms of the Transaction documents.

The Partnership has provided a guarantee covering all guaranteed amounts when the same shall become due for payment, but only following service of a Notice to Pay or an LLP Acceleration Notice. The obligations of the Partnership under the Covered Bond Guarantee and the other transaction documents to which it is a party are secured by the assets from time to time of the Partnership and recourse against the Partnership is limited to such assets.

Likely future developments

The members do not expect any significant change in the nature of business in the foreseeable future.

The programme

Santander UK plc (the Issuer) issues covered bonds, which are a direct, unsecured and unconditional obligation of the Issuer. The covered bonds benefit from a guarantee from Abbey Covered Bonds LLP. The Issuer makes a term advance to Abbey Covered Bonds LLP equal to the sterling proceeds of each issue of covered bonds. Abbey Covered Bonds LLP uses the proceeds of the term advance to purchase portfolios of residential mortgage loans and their security from Santander UK plc. Under the terms of the guarantee, Abbey Covered Bonds LLP has agreed to pay an amount equal to the guaranteed amounts when the same shall become due for payment but which would otherwise be unpaid by the Issuer.

Under the terms of the Trust Deed, the Partnership has provided a guarantee, in respect of payments of interest and principal under the Covered Bonds. The Partnership has agreed to pay an amount equal to the Guaranteed Amounts when the same shall become due for payment but which would otherwise be unpaid by the Issuer. The obligations of the Partnership under the Covered Bond Guarantee constitute direct and (following service of a Notice to Pay or an LLP Acceleration Notice) unconditional obligations of the Partnership, secured as provided in the Deed of Charge. The Bond Trustee will be required to serve a Notice to Pay on the Partnership following the occurrence of an Abbey Event of Default and service of an Abbey Acceleration Notice. An LLP Acceleration Notice may be served by the Bond Trustee on the Partnership following the occurrence of an LLP Event of Default.

If an LLP Acceleration Notice is served, the Covered Bonds will (if an Abbey Acceleration Notice has not already been served) become immediately due and payable as against the Issuer and the Partnership's obligations under the Covered Bond Guarantee will be accelerated.

Payments made by the Partnership under the Covered Bond Guarantee will be made subject to, and in accordance with, the Guarantee Priority of Payments or the Post-Enforcement Priority of Payments, as applicable. The recourse of the Covered Bondholders to the Partnership under the Covered Bond Guarantee will be limited to the assets of the Partnership from time to time.

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 Partnership'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 Partnership.

The loans included within the underlying portfolio include repayment loans and interest only loans with balances of less than £1million.

The members believe that the performance of the portfolio has been positive.

STRATEGIC REPORT (CONTINUED)

Key performance

The Partnership received interest and similar income of £431m (2017: £501m) and incurred interest expense and similar charges of £412m (2017: £478m) during the year. The increase in the loans and debts due to related parties of £1,840m (2017: decrease of £1,141m) is largely due to the £2,313m of bonds redeemed in the year (2017: £3,588m bonds redeemed) plus £4,281m of new bonds issued in the year (2017: £2,250m) on its behalf by Santander UK plc plus the foreign exchange gain of £27m (2017: foreign exchange loss £303m) less hedging movement of £156m (2017: loss £297m).

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 Partnership 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 Partnership's business

Santander UK Group Holdings plc group (the "Group") manages its operations on a divisional basis. For this reason, the members believe that further key performance indicators for the Partnership are not necessary or appropriate for an understanding of the development, performance or position of the business. The performances of the divisions of Santander UK plc, which include the Partnership, 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 Partnership 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 Partnership. 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 Partnership undertakes no obligation to update any forward-looking statement during the year. Nothing in this Report should be construed as a profit forecast.

Principal risks and uncertainties facing the Partnership

The Partnership'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 16.

Approved by the members

RMorrison

Rachel Morrison
Management Board
For and on behalf of the Partnership

15 May 2019

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

MEMBERS' REPORT

The members submit their report together with the Strategic Report and the audited financial statements for the year ended 31 December 2018.

Results

The total profit for the year ended 31 December 2018 amounted to £31m (2017: profit £89m).

Subsequent events

There have been £1bn new issuances between the 31 December 2018 and the date of signing. On 11 February 2019 Series 71 was issued for £1bn.

Designated members

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

Santander UK plc
Abbey Covered Bonds (LM) Limited

Members' interests

The policy regarding the allocation of results to members and the treatment of capital contributions and drawings is set out in the accounting policies in Note 1 to the financial statements.

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 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 the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable IFRSs as adopted by the European Union 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 also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for 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 of the ultimate parent company are responsible for the maintenance and integrity of the of 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 Partnership'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 Partnership, its cash flows, liquidity position and borrowing facilities are set out in the financial statements. In addition, Notes 3 and 16 to the financial statements include the Partnership's financial risk management objectives; its exposures to credit risk and liquidity risk; and its policies and processes for managing its capital.

The members acknowledge that the Partnership is in a net liability position. However, under the terms of the bonds in issue, the mortgage balance in the Partnership has to be maintained at a value at least equivalent to the value of note principal in issue. As at 31 December 2018, the book value of residential mortgage loans that Santander UK plc had assigned legal title to the Covered Bond structure was £21.6bn (2017: £19.7bn). The Covered Bond structure is over collateralised by £3.5bn (2017: £3.6bn). The Covered Bond structure acquired interest in a portfolio of mortgage loans was £21.6bn (2017: £19.7bn) and the sterling equivalent of notes issued by the Covered Bond programme was £18.1bn (2017: £16.1bn).

MEMBERS' REPORT (CONTINUED)

Statement of going concern (continued)

In addition, the Partnership has cash balances and reserves totalling £2,829m (2017: £3,846m).

The members, having considered the financial position of the Partnership and the Covered Bond structure as a whole, believe that the Partnership is well placed to manage its business risks successfully.

The members have a reasonable expectation that the Partnership has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis of accounting in preparing the Annual Report and Financial Statements.

Financial instruments

The Partnership's financial instruments, other than derivatives, comprise loans and other debts 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 Partnership also enters into derivative transactions (principally cross currency swaps and interest rate swaps). The purpose of such transactions is to manage the currency and interest rate risks arising from the Partnership's operations and its sources of finance.

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

The main risks arising from the Partnership's financial instruments are currency risk and interest rate risk. The Partnership has loans payable denominated in Euros and Norwegian Kroner. The Santander Board reviews and agrees policies for managing these risks. The Partnership's policy is to eliminate all exposures arising from movements in exchange rates and interest rates by the use of cross currency swaps or interest rate swaps to hedge payments of interest and principal on the securities.

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

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

Independent Auditors

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

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

This confirmation is given and should be interpreted in accordance with the Companies Act 2006 as applied to limited liability partnerships by the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008.

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

Approved by the members

RMorrison

Rachel Morrison
For and on behalf of the Partnership
Designated Member

15 May 2019

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

Independent auditors' report to the members of Abbey Covered Bonds LLP

Report on the audit of the financial statements

Opinion

In our opinion, Abbey Covered Bonds LLP's financial statements:

- give a true and fair view of the state of the limited liability partnership's affairs as at 31 December 2018 and of its profit 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 as applied to limited liability partnerships by the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008.

We have audited the financial statements, included within the Annual Report and Financial Statements (the "Annual Report"), which comprise: the balance sheet as at 31 December 2018, the statement of comprehensive income, the statement of changes in members' other interests and the statement of cash flows for the year then; 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 limited liability partnership 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

ISAs (UK) require us to report to you when:

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

We have nothing to report in respect of the above matters.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the limited liability partnership's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union are not clear, and it is difficult to evaluate all of the potential implications on the company's trade, customers, suppliers and the wider economy.

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 members 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 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.

Independent auditors' report to the members of Abbey Covered Bonds LLP (continued)

Responsibilities for the financial statements and the audit

Responsibilities of the members for the financial statements

As explained more fully in the Statement of members' responsibilities in respect of the financial statements set out on page 3, the members 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 members 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 members are responsible for assessing the limited liability partnership'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 members either intend to liquidate the limited liability partnership 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.

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 opinion, has been prepared for and only for the members of the partnership as a body in accordance with the Companies Act 2006 as applied to limited liability partnerships by the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008 and for no other purpose. We do not, in giving this opinion, 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 as applicable to limited liability partnerships 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 by the limited liability partnership, 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.

Jessica Miller

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

15 May 2019

PRIMARY FINANCIAL STATEMENTS

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December

Continuing operations	Note	Year ended 31 December 2018 £000	Year ended 31 December 2017 £000
Interest and similar income	5	430,832	500,631
Interest expense and similar charges	6	(412,157)	(477,954)
Net interest income		**18,675**	22,677
Administration expenses		(22,567)	(23,951)
Net other operating income	7	35,144	90,676
Total operating profit for the year	8	**31,252**	89,402
Other comprehensive income for the year		-	-
Total comprehensive income for the year		31,252	89,402

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

STATEMENT OF CHANGES IN MEMBERS' OTHER INTERESTS

For the year ended 31 December

	Members' capital £000	Members' accumulated losses £000	Members' other interests £000
Members' interest as at 31 December 2016 and 1 January 2017	-	(349,515)	(349,515)
Allocated result:			
Profit for the year available for division among members	-	89,402	89,402
Debit to loan capital	-	-	-
Members' interest as at 31 December 2017 and 1 January 2018	-	(260,113)	(260,113)
Allocated result:			
Profit for the year available for division among members	-	31,252	31,252
Debit to loan capital	-	-	-
Members' interest as at 31 December 2018	-	**(228,861)**	**(228,861)**

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

PRIMARY FINANCIAL STATEMENTS

BALANCE SHEET

As at 31 December

	Notes	2018 £000	2017 £000
Cash and cash equivalents	9	3,057,536	4,550,444
Derivative financial instruments – assets	10 & 11	2,064,624	2,251,234
Loans and other debts due from members	12	14,802,578	11,325,728
Total assets		19,924,738	18,127,406
Derivative financial instruments – liabilities	10 & 11	(561,072)	(575,093)
Loans and debts due to related parties	13	(18,694,668)	(16,854,496)
Other liabilities	14	(897,859)	(957,930)
Total liabilities		(20,153,599)	(18,387,519)
Net liabilities attributable to members		(228,861)	(260,113)
Members' other interests			
Members' capital		-	-
Members' accumulated losses		(228,861)	(260,113)
Total members' other interests		(228,861)	(260,113)
Total members' interests			
Members' accumulated losses		(228,861)	(260,113)
Loans and other debts due from members	12	(14,802,578)	(11,325,728)
Derivative financial instruments – liabilities	11	561,072	575,093
Loans and debts due to related parties	13	18,694,668	16,854,496
Total members' interests		4,224,301	5,843,748

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

The financial statements on pages 7 to 23 were approved by the members and signed on its behalf by:

Rachel Morrison
For and on behalf of the Partnership
Abbey Covered Bonds LLP

15 May 2019

PRIMARY FINANCIAL STATEMENTS

STATEMENT OF CASH FLOWS

For the year ended 31 December

	Note	2018 £000	2017 £000
Cash flows generated by operating activities			
Profit for the year		31,252	89,402
Adjustments for non-cash items included in profit:			
Foreign exchange movement on loans and debts due to related parties		-	(1,608)
Foreign exchange movement on derivative financial instruments		186,610	(29,715)
Foreign exchange movement on other liabilities			(751)
Movement on hedging instruments		(159,233)	218,218
Operating cash flows before movements in working capital		58,629	275,546
Decrease in total derivative financial instruments		(14,021)	(158,350)
(Decrease)/ increase in other liabilities		(60,071)	6,640
Net cash (used in) /generated by operating activities		(15,463)	123,836
Cash flows (utilised)/ generated by investing activities			
Loans (advanced to)/ repaid by members		(3,476,850)	1,967,328
Net cash (utilised)/ generated by investing activities		(3,476,850)	1,967,328
Cash flows generated/ (used) in financing activities			
Net redemption of loans to related parties		1,999,405	(1,357,402)
Net cash generated/ (used) in financing activities		1,999,405	(1,357,402)
Net (decrease)/ increase in cash and cash equivalents during the year		(1,492,908)	733,762
Cash and cash equivalents at beginning of year		4,550,444	3,816,682
Cash and cash equivalents at end of year	9	3,057,536	4,550,444

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

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

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 Partnership is a limited liability partnership, 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 Partnership 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 partnership reporting under IFRS.

The financial statements have been prepared under the historical cost convention and on a going concern basis as disclosed in the Directors' statement of going concern set out in the Report of the Directors, as modified by financial assets and financial liabilities held at fair value through profit or loss and all derivative contracts. 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 members' report.

The functional and presentation currency of the partnership is sterling.

Recent accounting developments

On 1 January 2018, the Partnership adopted IFRS 9 'Financial Instruments' (IFRS 9) and IFRS 15 'Revenue from Contracts with Customers' (IFRS 15). The application of IFRS 9 had no material impact on the Partnership's financial statements and comparatives have not been restated. The application of IFRS 15 had no material impact on the Partnership as there were no significant changes in the recognition of in scope income.The new or revised accounting policies set out below, have been applied from 1 January 2018.

Foreign currency translation

Items included in the financial statements of the Partnership are measured using the currency that best reflects the economic substance of the underlying events and circumstances relevant to the Partnership (the "functional currency"). The functional and presentation currency of the Partnership is Sterling.

Foreign currency transactions are translated into the functional currency at the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities that are denominated in foreign currencies are translated into the functional currency of the Partnership at the rates in effect at the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated. Foreign currency translation differences are recognised in profit or loss and are included in the Statement of Comprehensive Income.

Interest income and expense

Interest income on financial assets that are classified as financial assets at amortised cost 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 Partnership 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

Under IFRS 9 the beneficial interest in a mortgage portfolio fails the criteria for recognition within the Partnership's financial statements and remains in the Balance Sheet of Santander UK plc.

Financial instruments of the Partnership comprise loans and other debts due from members, derivative financial instruments, cash and cash equivalents and other receivables and payables arising from the Partnership's operations. These instruments are recognised, classified and subsequently measured in accordance with IFRS 9 as described below.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

1. ACCOUNTING POLICIES (CONTINUED)

a) Initial recognition and measurement

Financial assets and liabilities are initially recognised when the Partnership becomes a party to the contractual terms of the instrument. The Partnership 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 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.

b) Financial assets and liabilities

Classification and subsequent measurement
From 1 January 2018, the Partnership has applied IFRS 9 and classifies its financial assets in the measurement categories of amortised cost and 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.

a) Financial assets: debt instruments
Debt instruments are those instruments that meet the definition of a financial liability from the issuer's perspective, such as loans. Classification and subsequent measurement of debt instruments depend on the Partnership's business model for managing the asset, and the cash flow characteristics of the asset.

Business model

The business model reflects how the Partnership manages the assets in order to generate cash flows and, specifically, whether the Partnership'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.

SPPI

Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the Partnership assesses whether the assets' cash flows represent SPPI. In making this assessment, the Partnership 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 Partnership 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 or FVOCI 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 Partnership 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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

1. ACCOUNTING POLICIES (CONTINUED)

Accounting policies applied until 31 December 2017

The Company has applied IFRS 9 retrospectively, but has elected not to restate comparative information. As a result, the comparative information provided continues to be accounted for in accordance with the Company's previous accounting policy.

Classification

Until 31 December 2017, the group classified its financial assets in the following categories:
- financial assets at fair value through profit or loss;
- loans and receivables;
- held-to-maturity investments; and
- available-for-sale financial assets.

The classification depended.on the purpose for which the assets were acquired. Management determined the classification of its assets at initial recognition and, classified as held-to-maturity, re-evaluated this designation at the end of each reporting period.

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.

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 Partnership holds cross currency swaps in order to manage foreign currency risk arising on the foreign denominated loans due to related parties. The Partnership also 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 Partnership holds no exchange traded derivatives.

Derivatives are contracted with Abbey National Treasury Services plc or counterparties laid out in 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.

Hedge accounting

The Partnership applies hedge accounting to represent, to the maximum possible extent permitted under accounting standards, the economic effects of its risk management strategies. Derivatives are used to hedge exposures to interest rates and exchange rates.

The Partnership decided to continue adopting IAS 39 hedge accounting and consequently there have been no changes to the hedge accounting policies and practices following the adoption of IFRS 9. However, additional hedge accounting disclosure requirements of IFRS 7 'Financial Instruments: Disclosures' (IFRS 7) have been included in these financial statements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

1. ACCOUNTING POLICIES (CONTINUED)

Hedge accounting (continued)

At the time a financial instrument is designated as a hedge (i.e., at the inception of the hedge), the Partnership formally documents the relationship between the hedging instrument(s) and hedged item(s), its risk management objective and strategy for undertaking the hedge. The documentation includes the identification of each hedging instrument and respective hedged item, the nature of the risk being hedged (including the benchmark interest rate being hedged in a hedge of interest rate risk) and how the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value attributable to the hedged risk is to be assessed. Accordingly, the Partnership formally assesses, both at the inception of the hedge and on an on-going basis, whether the hedging derivatives have been and will be highly effective in offsetting changes in the fair value attributable to the hedged risk during the period that the hedge is designated. A hedge is normally regarded as highly effective if, at inception and throughout its life, the Partnership can expect, and actual results indicate, that changes in the fair value or cash flow of the hedged items are effectively offset by changes in the fair value or cash flow of the hedging instrument. If at any point it is concluded that it is no longer highly effective in achieving its documented objective, hedge accounting is discontinued.

Where derivatives are held for risk management purposes, and when transactions meet the required criteria for documentation and hedge effectiveness, the derivatives may be designated as either: (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments ('fair value hedges'); (ii) hedges of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction ('cash flow hedges'); or (iii) a hedge of a net investment in a foreign operation ('net investment hedges'). The Partnership applies fair value hedge accounting but not cash flow hedge accounting or hedging of a net investment in a foreign operation.

a) Fair value hedge accounting

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the Statement of Comprehensive Income, together with the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, changes in the fair value of the hedged item attributable to the hedged risk are no longer recognised in the Statement of Comprehensive Income. For fair value hedges of interest rate risk, the cumulative adjustment that has been made to the carrying amount of the hedged item is amortised to the Statement of Comprehensive Income using the effective interest method over the period to maturity.

b) Cash flow hedge accounting

The effective portion of changes in the fair value of qualifying cash flow hedges is recognised in other comprehensive income in the cash flow hedging reserve. The gain or loss relating to the ineffective portion is recognised immediately in the Statement of Comprehensive Income. Amounts accumulated in equity are reclassified to the Statement of Comprehensive Income in the periods in which the hedged item affects profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised in the Statement of Comprehensive Income when the forecast transaction is ultimately recognised in the Statement of Comprehensive Income. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to Statement of Comprehensive Income.

The Partnership is exposed to foreign currency risks on its debt issuances denominated in foreign currency. Cash flow hedging is used to hedge the variability in cash flows arising from this foreign currency risk.

Contributions and drawings

Under the terms of the Limited Liability Partnership Deed describing the sale of the beneficial interest in the mortgage portfolio, Santander UK plc is legally treated as having made a capital contribution to the Partnership in an amount equal to the difference between the current balance of the loans assigned at transfer date and the cash payment made by the Partnership for the loans and relevant security on that transfer date. Transfers of mortgages in kind are also treated as capital contributions.

The member companies of the Partnership are Santander UK plc, the controlling party and Abbey Covered Bonds (LM) Limited. Both companies are incorporated in England and Wales.

Each member may from time to time make cash contributions to the Partnership which will constitute cash capital contributions. It is not intended that Abbey Covered Bonds (LM) Limited will make any capital contributions to the Partnership either in cash or in kind. No interest is paid on the members' capital balances.

Capital distributions are made in accordance with the Limited Liability Partnership Deed only once payments of a higher priority have been made and if sufficient principal receipts are available. All profits will be retained within the partnership until the maturity or redemption of the debt in issue. All retained profits will be allocated to Santander UK plc at this time.

As the sale of the beneficial interest in the mortgage portfolio does not pass the recognition criteria as described in IFRS 9, capital contributions represent cash capital contributions only, as it has been deemed that the transfer of mortgages has never occurred. Therefore no capital contributions in kind have been recorded in these financial statements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

1. ACCOUNTING POLICIES (CONTINUED)

Hedge accounting (continued)

Under the priority of payments, payment pro rata and pari passu to the members of the sum of £3,000 (or such other sum as may be agreed by members from time to time) in aggregate, is allocated and paid to each member in proportion to their respective legal capital contribution balances calculated as per the Limited Liability Partnership Deed as at the relevant calculation date subject to a minimum of £1 per annum each, as their profit for their respective interests as members of the Partnership.

Deferred purchase consideration

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 Partnership. Deferred consideration is treated as a reduction in the interest due from Santander UK plc on the loans and other debts due from members arising on the failure to recognise the sale of the mortgages. Incremental elements of deferred consideration are recognised on an effective interest rate basis; all other elements are accounted for as incurred.

Cash and cash equivalents

For the purposes of the Statement of Cash Flows, 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.

Financial Guarantee

Financial guarantees are defined as contracts whereby an entity undertakes to make specific payments on behalf of a third party if the latter fails to do so, irrespective of the various legal forms they may have, such as guarantees, insurance policies or credit derivatives.

The financial guarantee is reviewed periodically to determine any credit risk exposure associated with the guarantee and, if appropriate, to consider whether a provision is required.

2. CRITICAL ACCOUNTING POLICIES AND AREAS OF SIGNIFICANT MANAGEMENT JUDGEMENT

The preparation of the Partnership'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.

In the course of preparing the financial statements, no significant judgements have been made in the process of applying the Partnership's accounting policies.

3. FINANCIAL RISK MANAGEMENT

The Partnership's risk management focuses on the major areas of credit risk, market 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 Partnership losing amounts advanced together with interest on those advances. The main source of credit risk is in the loans and other debts due from members and derivative financial instruments assets.

On 1 January 2018, IFRS 9 replaced IAS 39, and introduced new rules on how to classify and measure financial assets, as well as new concepts, principles and measures for credit impairment methodology. The methodologies for calculating incurred losses under IAS 39 and ECLs under IFRS 9 are fundamentally different.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

Key metrics introduces by adopting 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 Partnership'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 other debts due from members of £14.8bn (2017: £11.3bn) and the fair value of derivative financial assets of £2.1bn (2017: £2.3bn).

At the balance sheet date no ECL allowance was recognised on all financial assets subject to credit risk due to the credit enhancement features applied by the Partnership.

As at 31 December 2018, the book value of residential mortgage loans that Santander UK plc had assigned legal title to the Covered Bond structure was £21.6bn (2017: £19.7bn). The Covered Bond structure is over collateralised by £3.5bn (2017: £3.6bn). The Covered Bond structure acquired interest in a portfolio of mortgage loans was £21.6bn (2017: £19.7bn) and the sterling equivalent of notes issued by the Covered Bond programme was £18.1bn (2017: £16.1bn).

The loans included within the underlying portfolio include repayment loans and interest only loans with balances of less than £1million. These are all secured on residential properties in the UK. For details on repurchase of loans please refer to the Securitisation Transaction document which can be found at http://www.santander.co.uk/uk/about-santander-uk/debt-investors/santander-uk-covered-bonds.

Derivatives are contracted with Abbey National Treasury Services plc or counterparties laid out in 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.

Loans and advances to group companies represents a 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 loan to Santander UK plc for impairment, the Members 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 Partnership in the structure. Accordingly, expected losses for the loans to Santander UK plc would arise if the ECL on the underlying assets is greater than the available credit enhancements.

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 Covered Bond structure are secured on mortgage assets within Santander UK plc. Santander UK plc, issues covered bonds on behalf of the Covered Bonds securitisation structure, which are guaranteed by a pool of Santander UK plc's mortgage loans that it has transferred into the structure and enters into financing arrangements with Group companies.

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 Abbey Covered Bond.

Santander UK plc's current credit ratings were:

	S & P	Moody's	Fitch
Long-term rating	A	Aa3	A+
Long-term rating outlook	Stable	Positive	Rating Watch Negative
Short term rating	A-1	P-1	F1

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk

Liquidity risk is the potential that, although remaining solvent, the Partnership 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.

In recognition that the Partnership is in a net liabilities position, the members ensure there are sufficient funds to meet payments as they fall due through related party funding.

The Partnership does not issue debt securities. These are issued by Santander UK plc on behalf of the Covered Bonds securitisation structure. The loans due from members are repayable when the associated bonds in issue are redeemed.

Maturities of financial liabilities

The table below analyses the maturities of the undiscounted cash flows relating to the financial liabilities of the Partnership 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 2018	On demand £000	1-3 months £000	3-12 months £000	1-5 years £000	Over 5 years £000	2018 Total £000
Loans and debts due to related parties	-	-	(1,488,071)	(12,557,387)	(4,649,210)	(18,694,668)
Derivative financial liabilities	-	(4,681)	(19,242)	(377,294)	(159,855)	(561,072)
Interest payable to related parties	(33,811)	(64,349)	(296,063)	(914,168)	(485,219)	(1,793,610)
Total	(33,811)	(69,030)	(1,803,376)	(13,848,849)	(5,294,284)	(21,049,350)

At 31 December 2017	On demand £000	1-3 months £000	3-12 months £000	1-5 years £000	Over 5 years £000	2017 Total £000
Loans and debts due to related parties	-	(1,350,293)	(838,760)	(10,095,441)	(4,570,002)	(16,854,496)
Derivative financial liabilities	-	(25,477)	(58,652)	(333,979)	(156,985)	(575,093)
Interest payable to related parties	(35,478)	(67,523)	(314,726)	(1,230,307)	(731,660)	(2,379,694)
Total	(35,478)	(1,443,293)	(1,212,138)	(11,659,727)	(5,458,647)	(19,809,283)

The maturity analyses 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 only the amounts payable under the contract. Under the terms of the contract these cash outflows are accompanied by related cash inflows.

Collateral calls on derivatives positions can pose a significant liquidity risk. Collateral calls may arise at times of market stress and when asset liquidity may be tightening. The timing of the cash flows on a derivative hedging an asset may be different to the timing of the cash flows of the asset being held, even if they are similar in all other respects. Collateral calls may be triggered by a credit downgrading. The Partnership manages these risks by including collateral calls in stress tests on liquidity, and by maintaining a portfolio of assets held for managing liquidity risk. As at 31 December 2018, the Partnership held cash collateral of £691m (2017: £702m).

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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

3. FINANCIAL RISK MANAGEMENT (CONTINUED)

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 Partnership is subject to market risk in the form of interest rate risk from fluctuations in LIBOR rates and currency risks from the fluctuations in the Euro and Norwegian Krone currencies.

In order to hedge against currency risks, the Partnership enters into cross currency swaps and as a result of this, the Partnership's total interest income and expense on financial assets and liabilities is based on the same rate of sterling LIBOR; it therefore has no material cash flow sensitivity to changes in currency rates in either 2018 or 2017. As a result, no sensitivity analysis is presented for currency risk as the changes to the two instruments will be equal and offsetting.

The Partnership also enters into interest rate swap contracts with Abbey National Treasury Services plc, a related party, to manage basis risk between interest flows on the cross currency swaps and on interest payments received from Santander UK plc. Hedge accounting is adopted for that funding so that the Partnership is hedged against the exposure to interest rate volatility from 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 floating rate interest bearing assets at the end of the reporting period. The analysis is prepared assuming that amount outstanding, for which amounts receivable 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 a decrease in operating profit and increase in net liabilities of £27.0m (2017: £31.0m). 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 £27.0m (2017: £31.0m).

The process for the UK leaving the EU impacts the economic, legal and regulatory environment for Santander UK Group's customers and across the financial services industry. In addition, the use of LIBOR, which is expected to cease in 2021, and its transition to (near) Risk Free Reference Rates (RFR) is also a significant issue across the industry. The Santander UK Group has put in place appropriate contingency plans to address the potential risks and will update and implement in this Partnership as necessary.

4. BUSINESS AND GEOGRAPHICAL SEGMENTS

The Partnership operates in one business sector and all of the Partnership's activities are in the UK.

The process for the UK leaving the EU impacts the economic, legal and regulatory environment for Santander Group's customers and across the financial services industry. Santander Group has put in place appropriate contingency plans to address potential risks and will update and implement those plans in the Partnership as necessary.

5. INTEREST AND SIMILAR INCOME

	Year ended 31 December 2018 £000	Year ended 31 December 2017 £000
Interest income from members	**336,926**	440,856
Bank interest income	**24,062**	10,800
Swap interest income	**69,844**	48,975
	430,832	500,631

6. INTEREST EXPENSE AND SIMILAR CHARGES

	Year ended 31 December 2018 £000	Year ended 31 December 2017 £000
Interest expense to Santander UK plc	**412,157**	477,954
	412,157	477,954

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

7. NET OTHER OPERATING INCOME

	Year ended 31 December 2018 £000	Year ended 31 December 2017 £000
Fair value hedging:		
- Losses on hedging instruments	(122,111)	(218,218)
- Gains on hedged items attributable to hedged risks	159,235	222,364
Fair value hedging effectiveness	37,124	4,146
Fair value (losses) /gains on derivatives	(7,761)	54,456
Foreign exchange (losses)/ gains on loans and debts due to related parties	(424)	1,608
Foreign exchange gains on derivative financial instruments	6,117	29,715
Foreign exchange gains on other liabilities	88	751
	35,144	90,676

The gain / (loss) arising on adjustment for the hedged item in a designated fair value hedge accounting relationship relates to the loans and debts due to related parties, details of which are disclosed in note 13. This gain/ (loss) forms part of the net gains or net losses on financial liabilities carried at amortised cost.

8. TOTAL OPERATING PROFIT FOR THE YEAR

Staff costs

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

Auditors' remuneration

The audit fee for the current year is £12,000 (2017: £12,000). The audit fee for the current year has been charged to the income statement. The audit fee for the prior year has been paid on the Partnership's behalf by Santander UK plc, in accordance with the Partnership's policy, for which no recharge has been made.

9. CASH AND CASH EQUIVALENTS

	2018 £000	2017 £000
Cash and cash equivalents	3,057,536	4,550,444
	3,057,536	4,550,444

Cash and cash equivalent balances due from Abbey National Treasury Services plc, a related party, was £nil (2017: £702m) and cash due from Santander UK plc, also a related party, was £3,055m (2017: £3,848m).

For the prior year, cash held with Abbey National Treasury Services plc is classified as restricted, as it was held until the swap was terminated either on maturity or on default, in accordance with the terms of the securitisation structure.

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.

10. DERIVATIVE FINANCIAL INSTRUMENTS

Hedge accounting

The Partnership applies hedge accounting on a fair value basis depending on the nature of the underlying exposure. The hedge ratio is established by matching the notional of the derivative with the underlying position being hedged. Only the designated risk is hedged and therefore other risks, such as credit risk, are managed but not hedged.

The Partnership obtains funding in international market, issuing fixed rate debts in GBP and EUR. Therefore, it is exposed to changes in fair value due to changes in market interest rates and/or foreign exchange rates in EUR, which is mitigated through the use of receive fixed/pay floating rate interest rate and cross currency swaps.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

10. DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

Fair value hedges

Micro hedge of interest rate risk and foreign currency risk
The interest rate risk component is the change in fair value of the fixed rate debts due to changes in the benchmark LIBOR rate. The foreign exchange component is the change in the fair value of the fixed rate debt issuances due to changes in foreign exchange rates prevailing from the time of execution. Effectiveness is assessed by using linear regression techniques to compare changes in the fair value of the debt caused by changes in the benchmark interest rates and foreign exchange rates, with changes in the fair value of the interest rate and cross currency swaps.

Possible sources of hedge ineffectiveness
Possible sources of fair value hedge ineffectiveness are set out below:

- Hedging derivative with a non-zero fair value at date of initial designation
- Differences in discounting between hedged item and hedging instrument as cash collateralised swaps discount using Overnight Indexed Swaps (OIS) discount curves, not applied to underlying hedged item
- Counterparty credit risk impacts fair value of derivative but not hedged item
- Differences in discounting between hedged item and hedging instrument as cash collateralised cross currency swaps discount using OIS discount curves, not applied to underlying hedged item

Maturity profile and average price/rate of hedging instruments

The following table sets out the maturity profile and average price/rate of the hedging instruments used in the Partnership's hedging strategies:

Fair value hedges		Later than one year and not later than five years	Later than five years	Total
Interest rate risk	Interest rate contracts - nominal amount (£000)	1,250,000	1,750,000	3,000,000
	Average fixed interest rate - GBP (%)	5.13%	5.54%	
Interest rate/ foreign exchange (FX) risk	Exchange rate contracts - nominal amount (£000)	944,823	372,720	1,317,543
	Average GBP - EUR exchange rate	1.2006	1.1715	
	Average fixed interest rate - EUR (%)	4.07%	4.22%	

Net gains or losses arising from fair value hedges included in net other operating income
Hedge ineffectiveness can be analysed by risk category as follows:

Hedging ineffectiveness by risk category

	Changes in FV of hedging instruments to calculate hedge ineffectiveness £000	Changes in FV of hedged items to calculate hedge ineffectiveness £000	Hedge ineffectiveness recognised in income statement £000
Fair value hedges			
Interest rate risk	(97,128)	98,655	1,527
Interest rate/FX risk	(24,983)	60,580	35,597
	(122,111)	159,235	37,124

Hedged exposures

The following table sets out the exposures covered by the Partnership's hedging strategies, in connection with the debt securities in issue:

Fair value hedges	Hedged item balance sheet line item	Carrying value £000	Accumulated amount of FV hedge adjustments on hedged item in carrying value of hedged item £000	Change in value used for calculating hedge ineffectiveness £000	Accumulated amount of FV hedge adjustments on balance sheet for discontinued hedges £000
Interest rate/FX risk	Loans and debts due to related parties	4,927,528	588,544	159,235	557,741

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

11. 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 2018 and 2017, analysed by the valuation methodology used by the Partnership to determine their fair value, including their levels in the fair value hierarchy – level 1, level 2 and level 3.

31 December 2018 Balance Sheet category		Level 1 £000	Level 1 %	Level 2 £000	Level 2 %	Level 3 £000	Level 3 %	Total £000	Total %	Valuation Technique
		Internal models based on								
Assets										
Derivative assets	Foreign exchange contracts	-	-	1,585,569	77	-	-	1,585,569	77	
	Interest rate swaps	-	-	479,055	23	-	-	479,055	23	
Total assets at fair value		-	-	2,064,624	100	-	-	2,064,624	100	A
Liabilities										
Derivative liabilities	Foreign exchange contracts	-	-	18,872	100	-	-	18,872	3	A
	Interest rate swaps	-	-	-	-	542,200	100	542,200	97	B
Total liabilities at fair value		-	-	18,872	100	542,200	100	561,072	100	

31 December 2017 Balance Sheet category		Level 1 £000	Level 1 %	Level 2 £000	Level 2 %	Level 3 £000	Level 3 %	Total £000	Total %	Valuation Technique
		Internal models based on								
Assets										
Derivative assets	Foreign exchange contracts	-	-	1,673,670	74	-	-	1,673,670	74	
	Interest rate swaps	-	-	577,564	26	-	-	577,564	26	
Total assets at fair value		-	-	2,251,234	100	-	-	2,251,234	100	A
Liabilities										
Derivative liabilities	Foreign exchange contracts	-	-	14,211	100	-	-	14,211	2	A
	Interest rate swaps	-	-	-	-	560,882	100	560,882	98	B
Total liabilities at fair value		-	-	14,211	100	560,882	100	575,093	100	

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 2018

	Fair value £'000	Assumption description	Shift	Sensitivity: Favourable changes £'000	Sensitivity: Unfavourable changes £'000
Derivative liabilities: Interest rate swaps	(542,200)	Weighted Average Mortgage Rate Payable	1%	23,748	(23,748)

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

11. 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:

	Derivative liabilities £'000
At 1 January 2018	(560,882)
-Interest movements	(11,661)
-Fair value movements	30,343
At 31 December 2018	**(542,200)**

12. LOANS AND OTHER DEBTS DUE FROM MEMBERS

	2018 £000	2017 £000
Loans and other debts due from Santander UK plc	**14,802,578**	11,325,728

The carrying amount of loans and other debts due from members approximates to their fair value.

13. LOANS AND DEBTS DUE TO RELATED PARTIES

	2018 £000	2017 £000
Loans and debts due to related parties	**18,694,668**	16,854,496
These borrowings are repayable as follows:		
Less than 3 months	-	1,350,293
Between 3 and 12 months	1,488,071	838,760
Between 1 and 5 years	12,557,387	10,095,441
Greater than five years	4,649,210	4,570,002
	18,694,668	16,854,496

The amount owing to related parties comprises a term advance equivalent to the amounts raised by Santander UK plc under its Covered Bond programme. The rate of interest payable in respect of each term advance matches the interest rate payable in respect of the corresponding tranche or series of covered bonds that funded the tranche.

Santander UK plc will not be relying on repayment of any term advances by the Partnership or the interest thereon in order to meet its repayment or interest obligations under the Covered Bond programme. The term advances will not be repaid by the Partnership until all amounts payable under the corresponding series of covered bonds have been repaid in full. Amounts owed by the Partnership to Santander UK plc will be subordinated to amounts owed by the Partnership under the Covered Bond Guarantee described below.

Under the terms of the trust deed, the Partnership has provided a guarantee as to payments of interest and principal under the covered bonds, where amounts would otherwise be unpaid by Santander UK plc. The obligations of the Partnership under its guarantee constitute direct obligations of the Partnership secured against the assets of the Partnership and recourse against the Partnership is limited to such assets. The principal asset is the interest in the mortgage portfolio acquired from Santander UK plc.

The amounts due to Santander UK plc mature at various dates between 8 July 2019 and 6 February 2032. The carrying amount of loans and debt from related parties approximates to its fair value.

Included in the carrying amount of loans from related parties are the following fair value hedge accounting valuation adjustments arising from these loans.

	2018 £000	2017 £000
Fair value hedge accounting valuation adjustments	**588,544**	701,784

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

13. LOANS AND DEBTS DUE TO RELATED PARTIES (CONTINUED)

The movements of the fair value hedge accounting valuation adjustments were:

	£000
At 1 January 2017	883,608
Movements during the year	(222,364)
Foreign exchange adjustments	40,540
At 31 December 2017 and 1 January 2018	701,784
Movements during the year	122,111
Foreign exchange adjustments	(235,351)
At 31 December 2018	588,544

14. OTHER LIABILITIES

	2018 £000	2017 £000
Accrued expenses	12	-
Accrued interest payable	207,233	255,775
Cash collateral (restricted)	690,614	702,155
	897,859	957,930

Other liabilities include £207.2m (2017: £255.8m) of accrued interest payable to Santander UK plc. Other liabilities are deemed repayable within one year.

15. RELATED PARTY TRANSACTIONS

During the year, the Partnership entered into the following transactions with related parties:

	Interest income 2018 £000	Interest expense 2018 £000	Amounts due from related parties 2018 £000	Amounts due to related parties 2018 £000	Derivative financial instruments receivable 2018 £000	Derivative financial instruments payable 2018 £000
Santander UK plc	360,988	483,564	17,857,549	18,385,389	727,324	561,072

	Interest income 2017 £000	Interest expense 2017 £000	Amounts due from related parties 2017 £000	Amounts due to related parties 2017 £000	Derivative financial instruments receivable 2017 £000	Derivative financial instruments payable 2017 £000
Santander UK plc	1,286,466	477,954	11,325,728	16,854,496	-	560,882
Abbey National Treasury Services plc	-	-	-	-	1,452,302	14,211

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

16. 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 Partnership's capital management can be found in the Santander UK Annual Report and Financial Statements.

Capital held by the Partnership and managed centrally as part of Santander UK plc, comprises members' interests which can be found in the Balance Sheet on page 8. The Partnership's capital is not externally regulated.

Capital is managed by way of processes set up at inception of the Partnership and subsequently there is no active process for managing its own capital. The Partnership 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.

17. PARENT UNDERTAKING AND CONTROLLING PARTY

The member companies of the Partnership are Santander UK plc, the controlling party, and Abbey Covered Bonds (LM) Limited. Both companies are registered in England and Wales.

The administration, operations, accounting and financial reporting functions of the Partnership 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 Partnership is a Special Purpose Entity controlled by and is therefore consolidated within the Santander UK Group Holdings plc group financial statements.

The Partnership'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 Partnership 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 of which the Partnership is a member.

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