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KNIGHTSTONE CAPITAL PLC

(Incorporated in England and Wales with limited liability under the Companies Act 2006, registered number 8691017)

£100,000,000 5.058 per cent. (Step up) Secured Bonds due 2048

**Issue Price: 100 per cent.,
payable as to £2,000,000 on 2nd October, 2013 and as to £98,000,000 on 30th November, 2017**

The £100,000,000 5.058 per cent. (Step up) Secured Bonds due 2048 (the **Bonds**) are issued by Knightstone Capital Plc (the **Issuer**).

Application has been made to the Financial Conduct Authority in its capacity as competent authority (the **UK Listing Authority**) for the Bonds to be admitted to the Official List of the UK Listing Authority and to the London Stock Exchange plc (the **London Stock Exchange**) for the Bonds to be admitted to trading on the London Stock Exchange's regulated market. The London Stock Exchange's regulated market is a regulated market for the purposes of Directive 2004/39/EC (the **Markets in Financial Instruments Directive**).

An investment in the Bonds involves certain risks. For a discussion of these risks see "Risk Factors".

Subject as set out below, the net proceeds from the issue of the Bonds, or in the case of £50,000,000 in nominal amount of the Bonds (the **Retained Bonds**) which will be immediately purchased by the Issuer on the Issue Date (as defined below) the net proceeds of the sale of the Bonds to a third party, will be advanced by the Issuer to Knightstone Housing Association Limited (the **Original Borrower**) pursuant to a bond loan agreement between the Original Borrower and the Issuer to be dated on or around the Issue Date (the **Knightstone Housing Association Loan Agreement**) to be applied in accordance with the Original Borrower's charitable objects. The Aggregate Funded Commitment (as defined below) may be drawn in one or more drawings, each in a nominal amount up to an amount which corresponds to the Minimum Value of any Properties (as defined below) which have been charged in favour of the Issuer and the Security Trustee (the **Charged Properties**) less the nominal amount of all previous drawings in respect of the Aggregate Funded Commitment. For so long as insufficient security has been granted (or procured to be granted) by the Original Borrower in favour of the Issuer and the Security Trustee to permit the drawing of the Aggregate Funded Commitment in full or the Original Borrower has not otherwise drawn any part of the Aggregate Funded Commitment, the amount of the Aggregate Funded Commitment that remains undrawn shall be retained in a charged account (the **Initial Cash Security Account**) of the Issuer in accordance with the terms of the Account Agreement (and may be invested in Permitted Investments (as defined below)) (the **Retained Proceeds**).

The Original Borrower will not charge any Properties in favour of the Security Trustee for the benefit of the Issuer (and the Bonds will not therefore be secured by real property) on the Issue Date. No valuation report is therefore included in this Prospectus. As at the date of this Prospectus, the Original Borrower does not intend to charge any Properties in favour of the Security Trustee for the benefit of the Issuer before 2016. However, the Original Borrower is required to charge real property no later than 30th November, 2017 (and expects to do so by in advance of this date) and is required to deliver a valuation report in respect of such real property to the Issuer and the Security Trustee prior to such property being charged. Such valuation report will be delivered to the Bond Trustee and made available to Bondholders (subject to the relevant Valuer's consent) together with an annual Compliance Certificate.

Consequently, the Original Borrower will not draw any part of the Aggregate Funded Commitment on the Issue Date and the Retained Proceeds on the Issue Date shall be the entire amount of the Aggregate Funded Commitment. Any Retained Proceeds (including the proceeds of the Final Instalment (as defined below) and any net sale proceeds from a sale by the Issuer of Retained Bonds (less any Retained Bond Premium Amount (as defined below) once received by the Issuer) and any net issue proceeds from a further issue of Bonds pursuant to Condition 19 (*Further Issues*)) shall be advanced to the Original Borrower and/or any other charitable Registered Provider of Social Housing of the Knightstone Housing Group that has acceded to the Security Trust Deed as a borrower in accordance with the terms thereto (together, the **Additional Borrowers** and each an **Additional Borrower** and, together with the Original Borrower, the **Borrowers** and each a **Borrower**) at a later date pursuant to the Knightstone Housing Association Loan Agreement or an additional bond loan agreement between an Additional Borrower and the Issuer (each an **Additional Loan Agreement** and, together with the Knightstone Housing Association Loan Agreement, the **Loan Agreements** and each a **Loan Agreement**), as applicable, to the extent that Properties of a corresponding value have been charged in favour of the Issuer and, if applicable, subject to the receipt of the Final Instalment, the sale by the Issuer of Retained Bonds and/or the issue by the Issuer of further Bonds.

Interest on the Bonds is payable semi-annually in arrear on 2nd April and 2nd October in each year (each an **Interest Payment Date**) on their Outstanding Principal Amount (as defined below), commencing on 2nd October, 2013, at the rate of 5.058 per cent. per annum in respect of the period from (and including) the Issue Date to (but excluding) the Final Instalment Payment Date (as defined below) and at the rate of 5.576 per cent. per annum from (and including) the Final Instalment Payment Date to (but excluding) the Maturity Date (as defined below), as described in Condition 7 (*Interest*). Subject as described in Condition 7 (*Interest*), in respect of the Interest Payment Date (as defined below) occurring on 2nd April, 2018 the Bonds will bear interest of £19.0059462 in respect of each £1,000 in nominal amount of the Bonds. Payments of principal of, and interest on, the Bonds will be made without withholding or deduction on account of United Kingdom taxes unless required by law. In the event that any such withholding or deduction is so required, the Issuer may opt to gross up payments due to the Bondholders in respect thereof as described in Condition 10 (*Taxation*).

The Bonds may be redeemed at any time after the Final Instalment Payment Date and prior to the Maturity Date upon the prepayment by a Borrower of its loan (each a **Loan**) in whole or in part in accordance with the terms of its Loan Agreement at the higher of their Outstanding Principal Amount and an amount calculated by reference to the sum of (i) the yield on the relevant outstanding United Kingdom government benchmark gilt having the nearest duration to that of the Bonds and (ii) 0.20 per cent., together with accrued interest (or, in respect of a prepayment of a Loan following an event of default thereunder, at their Outstanding Principal Amount, together with accrued interest). The Bonds will also be redeemed (a) at their Outstanding Principal Amount, plus accrued interest, in an aggregate Outstanding Principal Amount equal to the nominal amount outstanding of the relevant Loan in the event of a mandatory prepayment of a Loan following a Borrower ceasing to be a Registered Provider of Social Housing (other than if such Borrower regains its status as a Registered Provider of Social Housing within 180 days) or a Loan becoming repayable as a result of a Borrower Default (as defined in each Loan Agreement) or (b) at

their Outstanding Principal Amount, plus accrued interest, in full in the event of any withholding or deduction on account of United Kingdom taxes being required and the Issuer not opting to pay (or having so opted to pay notifying the Bond Trustee (as defined below) of its intention to cease to pay) additional amounts in respect of such withholding or deduction.

Unless previously redeemed, or purchased and cancelled, the Bonds will be redeemed at their Outstanding Principal Amount on 2nd October, 2048 (the **Maturity Date**).

The Bonds will initially be issued in denominations of £5,000,000 and integral multiples of £1,000 in excess thereof. However, provided the Bonds continue to be represented by one or both of the Global Bonds (as defined below) on the Final Instalment Payment Date, on and following the Final Instalment Payment Date the Bonds will be automatically redenominated and transferable in denominations of £100,000 and integral multiples of £1,000 in excess thereof. See Condition 2 (*Form, Denomination and Title*).

The Bonds will initially be represented by a temporary global bond (the **Temporary Global Bond**), without interest coupons, which will be deposited on or about 2nd October, 2013 (the **Closing Date**) with a common safekeeper for Euroclear Bank S.A./N.V. (**Euroclear**) and Clearstream Banking, *société anonyme* (**Clearstream, Luxembourg**). Interests in the Temporary Global Bond will be exchangeable for interests in a permanent global bond (the **Permanent Global Bond** and, together with the Temporary Global Bond, the **Global Bonds**), without interest coupons, on or after 11th November, 2013 (the **Exchange Date**), upon certification as to non-U.S. beneficial ownership. Interests in the Permanent Global Bond will be exchangeable for definitive Bonds only in certain limited circumstances. See "*Payment by Instalments*" and "*Form of the Bonds and Summary of Provisions relating to the Bonds while in Global Form*".

Arranger and Dealer
TradeRisks Limited

The date of this Prospectus is 27th September, 2013.

This Prospectus comprises a prospectus for the purposes of Directive 2003/71/EC (the *Prospectus Directive*).

The Issuer accepts responsibility for the information contained in this Prospectus. To the best of the knowledge of the Issuer (having taken all reasonable care to ensure that such is the case) the information contained in this Prospectus is in accordance with the facts and does not omit anything likely to affect the import of such information. The figures relating to the Nationwide House Price Index referred to in the risk factor entitled "*Housing Market Downturn Risk*" in the section "*Risk Factors*" were obtained from www.nationwide.co.uk/hpi/. The Issuer confirms that such figures have been accurately reproduced and that, as far as the Issuer is aware and is able to ascertain from information published by Nationwide, no facts have been omitted which would render the reproduced figures inaccurate or misleading.

The Original Borrower accepts responsibility for the information contained in this Prospectus relating to it and the security and the guarantee to be created by it, including but without limitation:

- (a) the information contained in the sections "*Description of the Original Borrower and the Knightstone Housing Group*" and "*Financial Statements of the Original Borrower*", under the heading "*Factors which may affect the Borrowers' ability to fulfil their obligations under the Loan Agreements*" in the section headed "*Risk Factors*" and the information relating to it under the headings "*Material or Significant Change*" and "*Litigation*" in the section headed "*General Information*";
- (b) the information contained in this Prospectus relating to the security to be created by the Original Borrower pursuant to any Security Agreement (as defined below) to be entered into by it under the heading "*Underlying Security*" in the section headed "*Overview*", under the heading "*Considerations relating to the Issuer Security and the Underlying Security*" in the section headed "*Risk Factors*" and contained in the section headed "*Description of the Security Agreements and the Security Trust Deed*"; and
- (c) the information contained in this Prospectus relating to the guarantee to be provided by it pursuant to the Knightstone Housing Association Loan Agreement under the heading "*Guarantee and Indemnity*" in the section headed "*Overview*" and in the section headed "*Description of the Loan Agreements*",

and, to the best of its knowledge (having taken all reasonable care to ensure that such is the case), such information is in accordance with the facts and does not omit anything likely to affect the import of such information.

Save for the Issuer and the Original Borrower, no other person has independently verified any information contained herein. No representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by TradeRisks Limited (the *Arranger* and the *Dealer*) or Prudential Trustee Company Limited (the *Bond Trustee*) as to the accuracy or completeness of the information contained in this Prospectus or any other information provided by the Issuer or the Original Borrower in connection with the offering of the Bonds. None of the Arranger, the Dealer and the Bond Trustee accepts any liability in relation to the information contained in this Prospectus or any other information provided by the Issuer in connection with the issue of the Bonds.

No person is or has been authorised by the Issuer, the Arranger, the Dealer or the Bond Trustee to give any information or to make any representation not contained in or not consistent with this Prospectus or any other information supplied in connection with the offering of the Bonds

and, if given or made, such information or representation must not be relied upon as having been authorised by the Issuer, the Arranger, the Dealer or the Bond Trustee.

To the fullest extent permitted by law, none of the Arranger, the Dealer and the Bond Trustee accepts any responsibility for the contents of this Prospectus or for any other statement made or purported to be made by it or on its behalf in connection with the Issuer, the Original Borrower or the issue and offering of the Bonds. Each of the Arranger, the Dealer and the Bond Trustee accordingly disclaims all and any liability whether arising in tort or contract or otherwise (save as referred to above) which it might otherwise have in respect of this Prospectus or any such statement.

Neither this Prospectus nor any other information supplied in connection with the Bonds should be considered as a recommendation by the Issuer, the Arranger, the Dealer or the Bond Trustee that any recipient of this Prospectus or any other information supplied in connection with the Bonds should purchase any Bonds. Each investor contemplating purchasing any Bonds should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Issuer and the Original Borrower. Neither this Prospectus nor any other information supplied in connection with the offering of the Bonds constitutes an offer or invitation by or on behalf of the Issuer, the Arranger, the Dealer or the Bond Trustee to any person to subscribe for or to purchase the Bonds.

Neither the delivery of this Prospectus nor the offering, sale or delivery of the Bonds shall in any circumstances imply that the information contained herein concerning the Issuer or the Original Borrower is correct at any time subsequent to the date hereof or that any other information supplied in connection with the offering of the Bonds is correct as of any time subsequent to the date indicated in the document containing the same. The Arranger, the Dealer and the Bond Trustee expressly do not undertake to review the financial condition or affairs of the Issuer or the Original Borrower during the life of the Bonds or to advise any investor in the Bonds of any information coming to their attention.

The Bonds have not been and will not be registered under the United States Securities Act of 1933, as amended (the *Securities Act*) and are subject to U.S. tax law requirements. Subject to certain exceptions, the Bonds may not be offered, sold or delivered within the United States or to, or for the account or benefit of, U.S. persons (see "*Purchase and Sale*").

This Prospectus does not constitute an offer to sell or the solicitation of an offer to buy any Bonds in any jurisdiction to any person to whom it is unlawful to make the offer or solicitation in such jurisdiction. The distribution of this Prospectus and the offer or sale of Bonds may be restricted by law in certain jurisdictions. The Issuer, the Arranger, the Dealer and the Bond Trustee do not represent that this Prospectus may be lawfully distributed, or that the Bonds may be lawfully offered or sold, in compliance with any applicable registration or other requirements in any such jurisdiction, or pursuant to an exemption available thereunder, or assume any responsibility for facilitating any such distribution or offering. In particular, no action has been taken by the Issuer, the Arranger, the Dealer or the Bond Trustee which is intended to permit a public offering of the Bonds or the distribution of this Prospectus in any jurisdiction where action for that purpose is required. Accordingly, no Bonds may be offered or sold, directly or indirectly, and neither this Prospectus nor any advertisement or other offering material may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations. Persons into whose possession this Prospectus or any Bonds may come must inform themselves about, and observe, any such restrictions on the distribution of this Prospectus and the offering and sale of Bonds. In particular, there are restrictions on the distribution of this Prospectus and the offer or sale of Bonds in the United States and the United Kingdom (see "*Purchase and Sale*").

Prospective purchasers of Bonds should ensure that they understand the nature of the Bonds and the extent of their exposure to risk, that they have sufficient knowledge, experience and access to professional advisers to make their own legal, tax, accounting and financial evaluation of the merits and the risks of investment in the Bonds and that they consider the suitability of the Bonds as an investment in light of their own circumstances and financial condition.

All references in this Prospectus to *Sterling* and £ refer to pounds sterling.

CONTENTS

Clause	Page
Overview.....	7
Structure Diagram of Transaction.....	23
Risk Factors	24
Payment by Instalments	40
Form of the Bonds and Summary of Provisions relating to the Bonds while in Global Form	42
Terms and Conditions of the Bonds.....	46
Use of Proceeds.....	67
Description of the Loan Agreements	68
Description of the Security Agreements and the Security Trust Deed	83
Description of the Account Agreement, the Custody Agreement and the Retained Bond Custody Agreement.....	88
Description of the Issuer	94
Description of the Original Borrower and the Knightstone Housing Group	96
Financial Statements of the Original Borrower	103
Taxation	160
Purchase and Sale	164
General Information.....	166

OVERVIEW

The following overview does not purport to be complete and is taken from, and is qualified in its entirety by, the remainder of this Prospectus.

This overview must be read as an introduction to this Prospectus and any decision to invest in the Bonds should be based on a consideration of this Prospectus as a whole.

Words and expressions defined in "*Form of the Bonds and Summary of Provisions relating to the Bonds while in Global Form*", "*Terms and Conditions of the Bonds*" and "*Description of the Loan Agreements*" shall have the same meanings in this overview.

Issuer: Knightstone Capital Plc

Description of the Bonds: £100,000,000 5.058 per cent. (Step up) Secured Bonds due 2048 (the **Bonds**), to be issued by the Issuer on 2nd October, 2013 (the **Issue Date**). £50,000,000 in nominal amount of the Bonds will be immediately purchased by or on behalf of the Issuer on the Issue Date (the **Retained Bonds**).

Issue Price: 100 per cent.

The Bonds will initially be issued in denominations of £5,000,000 and integral multiples of £1,000 in excess thereof. However, provided the Bonds continue to be represented by one or both of the Global Bonds on the Final Instalment Payment Date, on and following the Final Instalment Payment Date, the Bonds will be automatically redenominated and transferable in denominations of £100,000 and integral multiples of £1,000 in excess thereof.

The issue price in respect of the Bonds will be payable in two instalments as follows:

- (a) £20 of each £1,000 in nominal amount of the Bonds is due on the Issue Date; and
- (b) £980 of each £1,000 in nominal amount of the Bonds is due on 30th November, 2017 (the **Final Instalment Payment Date**).

Should any Bondholder fail to pay the full amount owing by it on the Final Instalment Payment Date, then (i) such Bondholder's position in respect of its Bonds will be blocked in accordance with the procedures of Euroclear or Clearstream, Luxembourg, as the case may be, until such amount is paid in full, and/or further notice from the Issuer, which will result in such Bondholder being unable to trade its Bonds and (ii) the Issuer may, once such failure has continued for 10 Business Days and the Issuer has made reasonable efforts to contact any such Bondholder in respect of the payment owing, elect to forfeit all or any of the Bonds in

respect of which such amount has not been duly paid, whereupon the Issuer shall be entitled to retain any amount(s) already paid to it under such Bonds and shall be discharged from any obligation to repay such amount(s) or to pay interest thereon, but shall have no other rights against any Bondholder whose Bonds have been so forfeited. Any forfeited Bonds shall be cancelled.

For the avoidance of doubt, in respect of any Retained Bonds which are held by or on behalf of the Issuer as at the Final Instalment Payment Date, both instalments of the issue price shall have been deemed to have been paid on the due dates thereof.

Use of Proceeds:

The net proceeds of the issue of the Bonds (or, in the case of the Retained Bonds, the net proceeds of the sale of the Bonds to a third party (after deduction of expenses payable by the Issuer)) will be on-lent by the Issuer to the Original Borrower or (to the extent that the Original Borrower has reduced the Original Knightstone Housing Association Commitment) to an Additional Borrower.

Subject as described in "*Initial Cash Security Account*" below, the Issuer will lend such proceeds to the Original Borrower and/or one or more Additional Borrowers pursuant to the relevant Loan Agreement to be applied in accordance with the charitable objects of the Original Borrower or such Additional Borrower, as the case may be.

The Issuer may from time to time invest the funds held in the Initial Cash Security Account and the Ongoing Cash Security Account in Permitted Investments (as defined below) until such time as such funds are on-lent, or returned, to the Borrower pursuant to the relevant Loan Agreement.

Form of Bonds:

The Bonds will be issued in bearer form as described in "*Form of the Bonds and Summary of Provisions relating to the Bonds while in Global Form*".

Interest:

The Bonds will bear interest on their Outstanding Principal Amount, payable semi-annually in arrear on 2nd April and 2nd October of each year, at a fixed rate of 5.058 per cent. per annum in respect of the period from (and including) the Issue Date to (but excluding) the Final Instalment Payment Date and at a fixed rate of 5.576 per cent. per annum in respect of the period from (and including) the Final Instalment Payment Date to (but excluding) 2nd October, 2048 (the **Maturity Date**), subject to adjustment in accordance with Condition 8.5 (*Payment Day*) (each, an **Interest Payment Date**). Subject to Condition 7 (*Interest*), in respect of the Interest Payment Date occurring on 2nd April, 2018 the Bonds will bear interest of £19.0059462 in respect of each £1,000 in nominal amount of the Bonds.

Final Redemption:	Unless previously redeemed or purchased and cancelled in accordance with Condition 9 (<i>Redemption and Purchase</i>), the Bonds (assuming that they are fully paid up) will be redeemed at their Outstanding Principal Amount, together with accrued interest, on 2nd October, 2048 (the Maturity Date).
Early Redemption:	Subject as described in " <i>Mandatory Early Redemption</i> " below, the Bonds may be redeemed at any time after the Final Instalment Payment Date and prior to the Maturity Date upon the optional prepayment by a Borrower of its loan (each a Loan) in accordance with the terms of the relevant Loan Agreement at the higher of their Outstanding Principal Amount and an amount calculated by reference to the sum of (i) the yield on the relevant outstanding UK Government benchmark conventional gilt having the nearest duration to that of the Bonds and (ii) 0.20 per cent., together with accrued interest.
Early Redemption for Tax Reasons:	The Issuer shall redeem the Bonds in whole, but not in part, at their Outstanding Principal Amount, together with any interest accrued, if, as a result of any actual or proposed change in tax law, the Issuer determines that it would be required to make a withholding or deduction on account of tax in respect of payments to be made by it in respect of the Bonds and the Issuer does not opt to pay additional amounts pursuant to Condition 10.2 (<i>No obligation to pay additional amounts</i>) or, having so opted, notifies the Bond Trustee of its intention to cease paying such additional amounts.
Mandatory Early Redemption:	<p>The Bonds shall be redeemed at their Outstanding Principal Amount, plus accrued interest, in an aggregate Outstanding Principal Amount equal to the nominal amount of the relevant Loan upon the mandatory prepayment of a Loan following the relevant Borrower ceasing to be a Registered Provider of Social Housing (other than if such Borrower regains its status as a Registered Provider of Social Housing within 180 days).</p> <p>In addition, if a Loan becomes repayable as a result of a Borrower Default the Bonds shall be redeemed at their Outstanding Principal Amount, plus accrued interest, in an aggregate Outstanding Principal Amount equal to the nominal amount of the relevant Loan.</p> <p>A Borrower Default includes non-payment, breach of other obligations, cross-acceleration, winding-up, cessation of business, insolvency, unlawfulness and breach of certain asset and interest cover ratios, in each case as set out in Clause 14 (<i>Borrower Default</i>) of each Loan Agreement (or as will be set out in the corresponding clause of each Additional Loan Agreement) and described further in "<i>Description of the Loan Agreements</i>".</p>
Purchase:	The Retained Bonds will be immediately purchased by the

Issuer on the Issue Date.

The Issuer, any Borrower and any other member of the Knightstone Housing Group may also purchase Bonds at any time in the open market or otherwise at any price.

Any Bonds so purchased by a Borrower or any other member of the Knightstone Housing Group may be surrendered to the Issuer for cancellation in consideration for an amount equal to the Outstanding Principal Amount of the Bonds being surrendered being deemed to be prepaid under the Loan Agreement specified by such Borrower or other member of the Knightstone Housing Group or, to the extent that the relevant Loan is not then outstanding, an amount of the Undrawn Commitment (as defined below) in respect of such Loan Agreement equal to the Outstanding Balance of the Bonds surrendered being deemed to be cancelled.

Retained Bonds:

Pursuant to the terms of the Retained Bond Custody Agreement, the Retained Bond Custodian will hold the Retained Bonds on the Issuer's behalf (see "*Account Agreement, Custody Agreement and Retained Bond Custody Agreement*" below), and the Issuer has instructed the Retained Bond Custodian to waive its rights to receive payments (of interest, principal or otherwise) on the Retained Bonds for so long as the Retained Bonds are held on the Issuer's behalf. Such waiver may not be revoked without the consent of the Bond Trustee.

Pursuant to the Bond Trust Deed, the Issuer has covenanted with the Bond Trustee that it will, immediately prior to a sale of any Retained Bonds by the Issuer, deliver to the Bond Trustee a certificate in writing signed by two directors of the Issuer addressed to the Bond Trustee confirming that, immediately following the sale of such Retained Bonds, the Borrower will be in compliance with the Asset Cover Test. For the purpose of giving such confirmation, the Issuer will require the Borrower to deliver a Retained Bond Compliance Certificate pursuant to the Loan Agreement, as described further in "*Description of the Loan Agreements*".

Events of Default:

Following an Event of Default, the Bond Trustee may, and if so requested by the holders of at least one-fourth in Outstanding Principal Amount of the Bonds then outstanding shall (subject to it being secured and/or indemnified and/or pre-funded to its satisfaction and, upon certain events, the Bond Trustee having certified to the Issuer that such event is, in its opinion, materially prejudicial to the interests of the Bondholders), give notice to the Issuer and the Bonds shall become immediately due and repayable.

The Events of Default include, *inter alia*, non-payment of any principal and interest due in respect of the Bonds, failure of the Issuer to perform or observe any of its other obligations

under the Conditions and the Bond Trust Deed, insolvency, unlawfulness and acceleration, or non-payment, in respect of other indebtedness in an aggregate amount equal to or in excess of £10,000,000 (or its equivalent).

Upon the Bonds becoming repayable prior to the Maturity Date (other than as a result of a prepayment or termination of a Loan Agreement), each Borrower is required to prepay its Loan in full together with accrued interest and commitment fee to and including the date of redemption. Each Borrower is also required to pay to the Issuer, within three Business Days of demand, its *pro rata* share of the Issuer's reasonable costs, expenses and liabilities throughout the life of the Bonds.

Issuer Security:

The Issuer's obligations in respect of the Bonds are secured pursuant to the Bond Trust Deed in favour of the Bond Trustee for the benefit of itself and the Bondholders and the other Secured Parties by the following (the **Issuer Security**):

- (a) an assignment by way of security of the Issuer's rights, title and interest arising under each Loan Agreement, the Security Agreements, the Security Trust Deed, the Agency Agreement, the Account Agreement and the Custody Agreement, in each case to the extent they relate to the Bonds;
- (b) a charge by way of first fixed charge over all moneys and/or securities from time to time standing to the credit of the Transaction Account, the Ongoing Cash Security Account, the Initial Cash Security Account and the Custody Account and all debts represented thereby; and
- (c) a charge by way of first fixed charge over all sums held from time to time by the Paying Agents for the payment of principal or interest in respect of the Bonds.

Initial Cash Security Account:

For so long as insufficient security has been granted (or procured to be granted) by the Borrowers in favour of the Issuer to permit the drawing of the Aggregate Funded Commitment in full or the Borrowers have not otherwise drawn any part of the Aggregate Funded Commitment, the amount of the Aggregate Funded Commitment that remains undrawn shall be retained in a charged account (the **Initial Cash Security Account**) of the Issuer (and may be invested in Permitted Investments) in accordance with the terms of the Account Agreement and the Custody Agreement (the **Retained Proceeds**).

For the avoidance of doubt, as the Original Borrower will not charge any Properties in favour of the Security Trustee for the benefit of the Issuer on the Issue Date, and consequently will not draw any part of the Original Knightstone Housing

Association Commitment on the Issue Date, the Retained Proceeds at that date shall be the entire amount of the Original Knightstone Housing Association Commitment (less the amount representing the aggregate of the Final Instalments and any amount which is to be funded by a sale of Retained Bonds). Any Retained Proceeds shall be advanced to one or more Borrowers at a later date pursuant to the relevant Loan Agreement to the extent that Properties of a corresponding value have been charged in favour of the Issuer and, if applicable, subject to receipt of the Final Instalment and/or the sale by the Issuer of Retained Bonds.

Funds standing to the credit of the Initial Cash Security Account may: (a) be held on deposit, in which case it shall accrue interest at a rate to be agreed from time to time between the Issuer and the Account Bank pursuant to the Account Agreement or (b) be invested in Permitted Investments in accordance with the Custody Agreement. See "*Permitted Investments*" below.

Pursuant to the Loan Agreements, each Borrower shall pay to the Issuer a commitment fee in respect of its Undrawn Commitment on each Loan Payment Date in an amount equal to its *pro rata* share of (a) the aggregate of the interest payable by the Issuer under the Bonds on the following Interest Payment Date less (b) the aggregate amount of interest received from the Borrowers under the Loan Agreements on such Loan Payment Date and the interest otherwise received by the Issuer in respect of the Retained Proceeds during that period (including, but not limited to, any income received in respect of any Permitted Investments in which any Retained Proceeds are, for the time being, invested).

See "*Description of the Loan Agreements*" below.

Ongoing Cash Security Account:

Pursuant to the Loan Agreements, each Borrower is (or will be) required to procure that the specified asset cover ratio is maintained (see "*Description of the Loan Agreements*" below). In the event that the value of any Charged Property is insufficient to maintain the relevant asset cover ratio, the Borrowers may deposit moneys into the Ongoing Cash Security Account. Such moneys will be charged in favour of the Bond Trustee pursuant to the terms of the Bond Trust Deed.

Funds standing to the credit of the Ongoing Cash Security Account may: (a) be held on deposit, in which case it shall accrue interest at a rate to be agreed from time to time between the Issuer and the Account Bank pursuant to the Account Agreement or (b) be invested in Permitted Investments in accordance with the Custody Agreement. See "*Permitted Investments*" below.

Moneys standing to the credit of the Ongoing Cash Security

Account may be withdrawn (a) to be applied in the acquisition of Property to be charged in favour of the Security Trustee for the benefit of the Issuer or (b) to the extent that the relevant asset cover ratio would not be breached immediately after such withdrawal.

Permitted Investments:

Permitted Investments shall consist of:

- (a) deposits with any United Kingdom bank or building society subject to such bank or building society having long term senior unsecured debt credit ratings of not less than "A" from Standard & Poor's Ratings Services ((S&P), "A" from Fitch Ratings Ltd (**Fitch**) and "A2" from Moody's Investors Services Limited (**Moody's**);
- (b) deposits with any non-United Kingdom bank subject to such bank having long term senior unsecured debt credit ratings of not less than "AA" from S&P and "Aa2" from Moody's;
- (c) full recourse debt instruments with a maturity no later than the earlier of (i) the date falling 5 years after the date of purchase and (ii) 2nd October, 2048 that are issued by EU credit institutions having long term senior unsecured debt credit ratings of not less than "AAA" from S&P and "Aaa" from Moody's that are fully secured or "covered" by a pool of on-balance sheet collateral;
- (d) securities with a maturity no later than the earlier of (i) the date falling 5 years after the date of purchase and (ii) 2nd October, 2048 that are issued by supranational agencies having long term senior unsecured debt credit ratings of not less than "AA" from "S&P" and "Aaa" from Moody's;
- (e) money market funds having long term senior unsecured debt credit rating of not less than "AAAm" from S&P, "Aaa-mf" from Moody's and "AAAmf" from Fitch; and
- (f) direct obligations of the United Kingdom or of any agency or instrumentality of the United Kingdom which are guaranteed by the United Kingdom with a maturity no later than the earlier of (i) the date falling 5 years after the date of purchase and (ii) 2nd October, 2048,

provided that, (i) in all cases, such investment shall be an investment which is denominated in Sterling and (ii) in the cases (a) to (e) above, no more than £20,000,000 shall be deposited with any one institution or invested in any one security.

In the event that any Permitted Investments are sold to fund a drawing by a Borrower pursuant to a Loan Agreement and such sale results in a loss realised by the Issuer, such drawing to be made by the Issuer to such Borrower pursuant to such Loan Agreement shall be advanced at a discount in an amount equal to the Actual Advance Amount (as defined in each Loan Agreement).

In the event that any Permitted Investments are sold to fund an advance to a Borrower pursuant to a Loan Agreement and such sale results in a gain realised by the Issuer (such gain, the **Permitted Investment Profit**), the Issuer shall advance monies to such Borrower at the nominal amount requested and shall make a gift aid payment to a charitable member of the Knightstone Housing Group (a **Charitable Group Member**) in an amount equal to the Permitted Investment Profit.

Immediately prior to the end of each accounting period, to the extent that the Issuer would otherwise be required to recognise a profit for tax purposes in respect of its Permitted Investments and/or Retained Bonds as a result of the movement in the fair value recognised in its accounts of such Permitted Investments and/or Retained Bonds for that accounting period, the Issuer shall sell Permitted Investments in an aggregate amount equal to the Accounting Profit (as defined in each Loan Agreement) and shall, in the same accounting period, make a gift aid payment to any Charitable Group Member in an amount equal to the Accounting Profit.

See "*Description of the Loan Agreements – Facility*".

Account Agreement, Custody Agreement and Retained Bond Custody Agreement:

The Issuer has appointed The Bank of New York Mellon, London Branch as its Account Bank, its Custodian and its Retained Bond Custodian pursuant to the Account Agreement, the Custody Agreement and the Retained Bond Custody Agreement, respectively.

Pursuant to the Account Agreement, the Account Bank shall maintain three accounts for the Issuer in respect of the Bonds: the Transaction Account, the Initial Cash Security Account and the Ongoing Cash Security Account. Pursuant to the Account Agreement and the Bond Trust Deed, the Issuer has entered into certain covenants in respect of the monies which may be credited to and debited from each Account.

Pursuant to the Custody Agreement, the Custodian shall, subject to receipt of such documents as it may require, open the Custody Account (consisting of the Disposal Proceeds Custody Sub-Account, the Initial Cash Security Custody Sub-Account, the Disposal Proceeds Cash Sub-Account and the Initial Cash Security Cash Sub-Account). The Issuer has authorised the Custodian to make payments and delivery out of the Custody Account only for the purpose of any

acquisition or sale of Permitted Investments or as set out therein.

Pursuant to the Retained Bond Custody Agreement, the Retained Bond Custodian shall, subject to receipt of such documents as it may require, open the Retained Bond Custody Account (consisting of the Retained Bond Custody Sub-Account and the Retained Bond Cash Sub-Account). The Retained Bond Custodian has agreed not to effect a transfer of any Retained Bonds except with the prior written consent of the Bond Trustee, and the Issuer has authorised the Retained Bond Custodian to make other payments and delivery out of the Retained Bond Custody Account only as set out therein.

See "*Description of the Account Agreement, the Custody Agreement and the Retained Bond Custody Agreement*" below.

Guarantee and Indemnity:

Pursuant to the Loan Agreements, the Original Borrower has (and each Additional Borrower will have) irrevocably and unconditionally:

- (a) guaranteed to the Issuer the punctual performance by each other Borrower of all such Borrowers' obligations under, *inter alia*, their respective Loan Agreements, the Security Trust Deed and their respective Security Agreements, other than each other Borrowers' obligations to repay principal and any prepayment premium thereon pursuant to their respective Loan Agreements (such amounts being, the **Guaranteed Interest and Fee Amounts**);
- (b) undertaken with the Issuer that, whenever any other Borrower does not pay any Guaranteed Interest and Fee Amounts when due under, its respective Loan Agreement, the Security Trust Deed or its respective Security Agreement(s), it must, immediately on demand by the Security Trustee and/or the Issuer, pay the Guaranteed Interest and Fee Amounts as if it were the principal obligor;
- (c) undertaken with the Issuer that, to the extent that the proceeds of the enforcement of the Underlying Security are insufficient to satisfy the Borrowers' obligations under their respective Loan Agreements in full (the shortfall being, the **Guaranteed Principal Amount**), it must, immediately on demand by the Security Trustee and/or the Issuer, pay the Guaranteed Principal Amount as if it were the principal obligor; and
- (d) agreed to indemnify the Issuer immediately on demand against any loss or liability suffered by the Issuer if any obligation guaranteed by it is or becomes illegal or invalid.

Underlying Security:

Pursuant to the Security Agreements and the Security Trust Deed, each Borrower will create or procure the creation by an Eligible Group Member (as defined in the Security Trust Deed) of the following security in favour of the Security Trustee for the benefit of itself and the Issuer:

- (a) first fixed legal mortgages over all of the right, title and interest from time to time in the Charged Properties of such Borrower or Eligible Group Member; and
- (b) first fixed charges over, *inter alia*, all plant and machinery of such Borrower or Eligible Group Member which form part of the Charged Properties and the benefit of the Insurances (as defined in the Security Agreements) and all present and future licences, consents and authorisations in respect thereof,

and will also covenant that it will, following an Enforcement Event (as defined in the Security Agreements) which has occurred and is continuing unremedied or unwaived and has not been remedied within any applicable grace period, assign or procure the assignment to the Security Trustee for the benefit of itself and the Issuer, all of the rights, title and interest in and to certain agreements and covenants held by such Borrower or the applicable Eligible Group Member as more particularly described in the Security Agreements, together, the **Underlying Security**, provided that it shall be entitled to exercise all its rights and claims under or in connection therewith until a Borrower Default has occurred and is outstanding.

The Issuer has secured its rights, title and interest in respect of the Underlying Security in favour of the Bond Trustee pursuant to the Bond Trust Deed.

See "*Description of the Security Agreements and the Security Trust Deed*" below.

Addition, substitution and release of Charged Properties:

Pursuant to the Security Trust Deed, on or prior to entering into a Security Agreement in respect of any Property for the benefit of the Issuer, the relevant Borrower or Eligible Group Member must, in respect of such security, provide the conditions precedent documents specified therein. In addition, pursuant to the Loan Agreements, the relevant Borrower or Eligible Group Member must provide a completed Additional Property Certificate confirming that, *inter alia*, the proposed Charged Properties are residential properties of a type and nature that are usually owned by Registered Providers of Social Housing, Full Valuation Reports in respect of each such Property and a Certificate of Title in respect of each tranche of Properties charged.

At the request and expense of a Borrower or an Eligible Group Member, the Security Trustee shall (subject to receiving an amended Security Certificate from the Borrowers and the Issuer in accordance with the Security Trust Deed) release from the relevant Security Documents (and/or reallocate, if applicable) such of the Properties forming part of the Issuer's Designated Security and substitute such of the Properties as may be selected by such Borrower or Eligible Group Member, provided that such Borrower or Eligible Group Member satisfies the conditions precedent specified in the Loan Agreements in relation to the Substitute Properties. Such conditions precedent include, *inter alia*, a completed Substitute Property Certificate certifying, *inter alia*, that the relevant Substitute Property is a residential property of a type and nature that is usually owned by Registered Providers of Social Housing, that, immediately following such release (and/or reallocation, if applicable) and substitution, the Asset Cover Test will not be breached as a result of the substitution of the relevant Charged Properties and that no Event of Default or Potential Event of Default has occurred and is continuing, Full Valuation Reports in respect of each Substitute Property and a Certificate of Title in respect of the Substitute Properties.

At the request and expense of a Borrower or an Eligible Group Member, the Security Trustee shall release (subject to receiving an amended Security Certificate from the Borrowers and the Issuer in accordance with the Security Trust Deed) from the relevant Security Documents (and/or reallocate, if applicable) such Charged Properties as may be selected by such Borrower or Eligible Group Member provided that such Borrower or Eligible Group Member delivers to the Issuer and the Security Trustee a completed Property Release Certificate, certifying that, immediately following such release (and/or reallocation, if applicable), the Asset Cover Test will not be breached as a result of the release (and/or reallocation, if applicable) of such part of the security and that no Event of Default or Potential Event of Default has occurred and is continuing.

Notwithstanding the above, where any disposal is a Statutory Disposal a Borrower or an Eligible Group Member shall have the right to withdraw such Property from the Issuer's Designated Security. In such circumstances such Borrower or Eligible Group Member is obliged to deliver (or procure the delivery), as soon as reasonably practicable after it has received notice of such Statutory Disposal, a completed Statutory Disposal Certificate to the Issuer and the Security Trustee confirming that the relevant withdrawal relates to a Statutory Disposal and, if the Statutory Disposal would result in a breach of the Asset Cover Test, confirming that it shall procure that additional Properties are charged pursuant to the

Security Trust Deed and/or moneys are deposited into the Ongoing Cash Security Account, in accordance with the Loan Agreements, such that any breach of the Asset Cover Test will be cured.

Enforcement of the Underlying Security and the Issuer Security:

Following a Borrower Default, the Issuer may declare the Underlying Security immediately repayable and/or declare the relevant Loan immediately repayable. Pursuant to the Security Trust Deed, the Security Trustee shall only be required to take action to enforce or protect the security in respect of the Loan Agreements if so instructed by the Issuer (and then only if it has been indemnified and/or secured to its satisfaction).

The Issuer has assigned its rights under, *inter alia*, the Security Agreements and the Security Trust Deed, and, pursuant to Condition 6.3, has covenanted not to take any action or direct the Security Trustee to take any action pursuant thereto except with the prior consent of the Bond Trustee. The Bond Trustee may, but is not obliged to, seek the consent of the Bondholders in accordance with the Bond Trust Deed prior to giving any such consent.

In enforcing the Issuer Security (including the Issuer's rights, title and interests in the Security Agreements and the Security Trust Deed insofar as they relate to the Bonds) the Bond Trustee may act in its discretion. It is, however, required to take action, pursuant to Condition 12.2, where so directed by the requisite majority of the Bondholders provided, however, that it is secured and/or indemnified and/or pre-funded to its satisfaction.

See "*Description of the Security Agreements and the Security Trust Deed*" below.

Priorities of Payments:

Prior to the enforcement of the Issuer Security, the Issuer shall apply the monies standing to the credit of the Transaction Account on each Interest Payment Date and such other dates on which a payment is due in respect of the Bonds in the following order of priority (the **Pre-enforcement Priority of Payment**):

- (a) first, in payment of any taxes due and owing by the Issuer to any taxing authority (insofar as they relate to the Bonds);
- (b) second, in payment of any unpaid fees, costs, charges, expenses and liabilities incurred by the Bond Trustee (including remuneration payable to it and any Appointee) in carrying out its functions under the Bond Trust Deed;
- (c) third, in payment of any unpaid fees and expenses of the Issuer owing to the Paying Agents under the

Agency Agreement, the Account Bank under the Account Agreement, the Custodian under the Custody Agreement and the Retained Bond Custodian under the Retained Bond Custody Agreement on a *pro rata* and *pari passu* basis;

- (d) fourth, in payment of any other unpaid fees, expenses and liabilities of the Issuer (in so far as they relate to the Bonds) on a *pro rata* and *pari passu* basis;
- (e) fifth, in payment, on a *pro rata* and *pari passu* basis, to the Bondholders of any interest due and payable in respect of the Bonds;
- (f) sixth, in payment, on a *pro rata* and *pari passu* basis, to the Bondholders of any principal due and payable in respect of the Bonds;
- (g) seventh, in payment, on a *pro rata* and *pari passu* basis, to the Borrowers of any amounts due and payable under the terms of the Loan Agreements; and
- (h) eighth, in payment of any Permitted Investment Profit, Accounting Profit or Retained Bond Premium Amount, as the case may be, to any Charitable Group Member.

Following the enforcement of the Issuer Security, all monies standing to the credit of the Transaction Account, the Ongoing Cash Security Account and the Initial Cash Security Account and the net proceeds of enforcement of the Issuer Security shall be applied in the following order of priority (the **Post-enforcement Priority of Payment**):

- (a) first, in payment of any unpaid fees, costs, charges, expenses and liabilities incurred by the Bond Trustee, any Appointee or any receiver in preparing and executing the trusts under the Bond Trust Deed (including the costs of realising any Issuer Security and the Bond Trustee's and such receiver's remuneration);
- (b) second, in payment of all amounts owing to the Paying Agents under the Agency Agreement, the Account Bank under the Account Agreement, the Custodian under the Custody Agreement and the Retained Bond Custodian under the Retained Bond Custody Agreement on a *pro rata* and *pari passu* basis;
- (c) third, in payment, on a *pro rata* and *pari passu* basis, to the Bondholders of any interest due and payable in respect of the Bonds;

- (d) fourth, in payment, on a *pro rata* and *pari passu* basis, to the Bondholders of any principal due and payable in respect of the Bonds;
- (e) fifth, in payment of any other unpaid fees and expenses of the Issuer (insofar as they relate to the Bonds) on a *pro rata* and *pari passu* basis;
- (f) sixth, in payment on a *pro rata* and *pari passu* basis, to the Borrowers of any amounts due and payable under the terms of the Loan Agreements; and
- (g) seventh, in payment of any Permitted Investment Profit, Accounting Profit or Retained Bond Premium Amount, as the case may be, to any Charitable Group Member.

Status of the Bonds:

The Bonds and Coupons will constitute direct, secured, unsubordinated obligations of the Issuer and will rank *pari passu* among themselves.

Covenants:

Pursuant to Condition 6 (*Covenants*), the Issuer has covenanted not to engage in any activity or do anything other than carry out the business of a company which has as its purpose raising finance and on-lending such finance for the benefit of the Borrowers or perform any act incidental to or necessary in connection with the aforesaid, without the consent of the Bond Trustee.

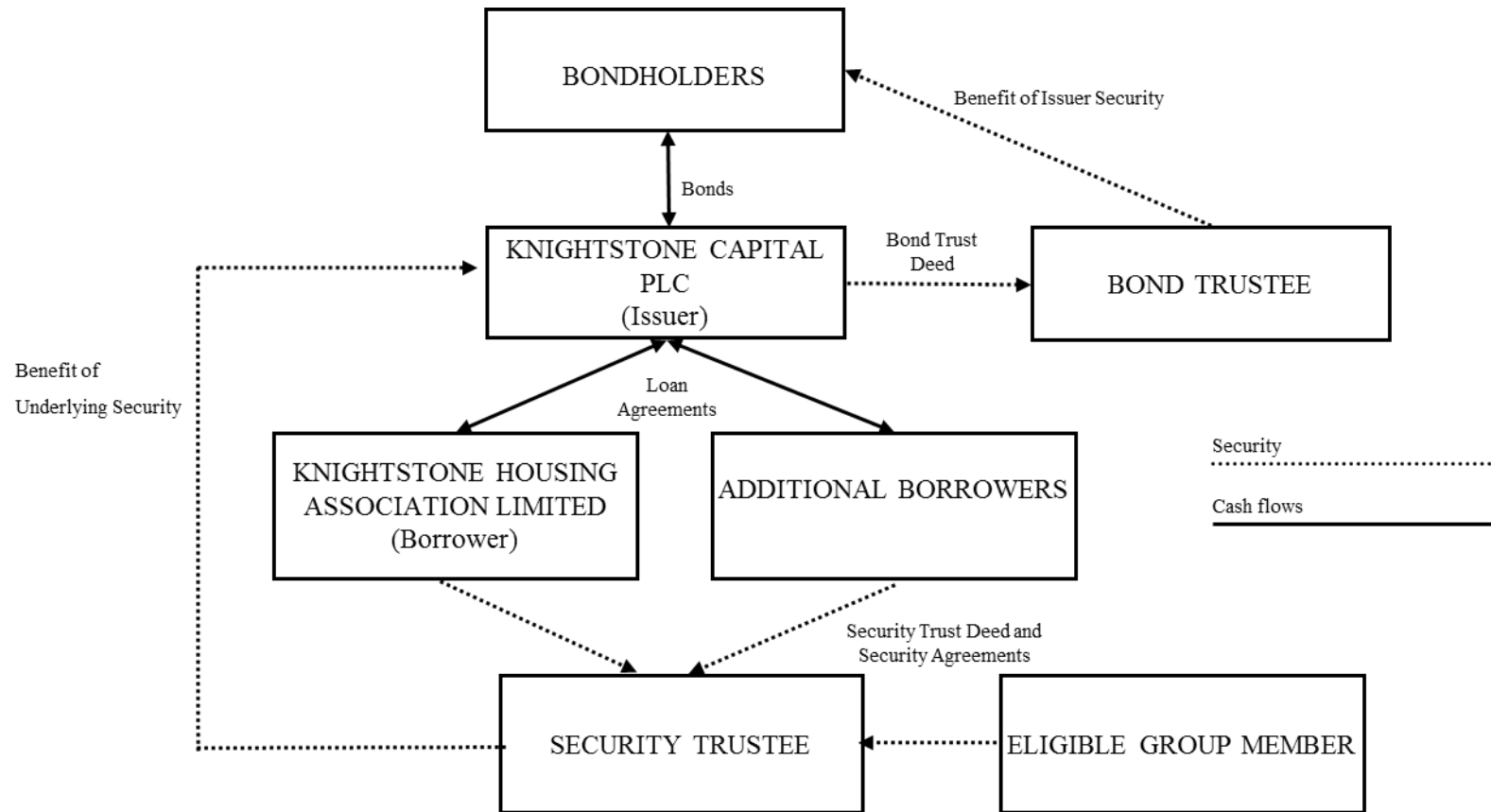
The Issuer has also covenanted to deliver to the Bond Trustee and, upon request by a Bondholder to the Issuer, to make available to any of the Bondholders, a copy of the Compliance Certificates and Security Adjustment Certificates received from the Borrowers pursuant to the terms of the Loan Agreements and a copy of the annual reports of each Borrower following publication of the same. In addition to the rights of Bondholders to convene a meeting pursuant to Condition 17 (*Meetings of Bondholders, Modification and Waiver*), at the request of the requisite majority of the Bondholders, the Issuer shall hold a meeting of the Bondholders to discuss the financial position of the Issuer and the Knightstone Housing Group.

In addition, the Issuer has covenanted that, for so long as any of the Bonds remain outstanding, it shall not consent to any waiver, amendment or modification of, or take any action or direct the Security Trustee to take any action pursuant to, the Loan Agreements, the Security Agreements or the Security Trust Deed except with the prior consent of the Bond Trustee. The Bond Trustee may seek the consent of the Bondholders in accordance with the Bond Trust Deed prior to giving any such consent.

Taxation:	<p>All payments in respect of the Bonds will be made without withholding or deduction for or on account of any taxes unless a tax deduction is required by law. In the event that any such withholding or deduction is required, the Issuer may at its option, but will not be obliged to, pay to Bondholders such additional amounts as may be necessary in order that the net amounts received by the Bondholders after such withholding or deduction will equal the amounts of principal and interest which would have been received in respect of the Bonds in the absence of such withholding or deduction. In the event that the Issuer does not opt to pay, or opts to pay and thereafter notifies the Bond Trustee and the Bondholders of its intention to cease paying, such additional amounts the Bonds shall be redeemed at their Outstanding Principal Amount, together with any accrued interest, in accordance with Condition 9.3 (<i>Early Redemption for Tax Reasons</i>).</p>
Meetings of Bondholders:	<p>The Terms and Conditions of the Bonds and the Bond Trust Deed contain provisions for calling meetings of Bondholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Bondholders including Bondholders who did not attend and vote at the relevant meeting and Bondholders who voted in a manner contrary to the majority.</p>
Risk Factors:	<p>There are certain factors that may affect the Issuer's ability to fulfil its obligations under the Bonds. These are set out under "<i>Risk Factors</i>" below and include factors which may affect the Issuer's and/or a Borrower's and/or an Eligible Group Member's ability to fulfil their obligations under the Bonds, the Loan Agreements and/or Security Agreements, respectively, factors which are material for the purpose of assessing the market risks associated with the Bonds, risks relating to the security for the Bonds and risks relating to the market generally.</p> <p>See "<i>Risk Factors</i>" below.</p>
Listing and admission to trading:	<p>Application has been made to the UK Listing Authority for the Bonds to be admitted to the Official List and to the London Stock Exchange for the Bonds to be admitted to trading on the London Stock Exchange's regulated market.</p>
No Rating:	<p>The Bonds will not be rated on the Issue Date. As at the date of this Prospectus, the Issuer does not intend to solicit a rating for the Bonds.</p>
Arranger:	TradeRisks Limited
Dealer	TradeRisks Limited
Principal Paying Agent:	The Bank of New York Mellon, London Branch

Account Bank:	The Bank of New York Mellon, London Branch
Custodian:	The Bank of New York Mellon, London Branch
Retained Bond Custodian:	The Bank of New York Mellon, London Branch
Bond Trustee:	Prudential Trustee Company Limited
Security Trustee:	Prudential Trustee Company Limited
Original Borrower:	Knightstone Housing Association Limited
Borrowers:	The Original Borrower and any other charitable member of the Knightstone Housing Group that is a Registered Provider of Social Housing and has acceded to the Security Trust Deed as an Additional Borrower.
Eligible Group Member	Any entity which has created (and which is subsisting) or will create security pursuant to the Security Trust Deed. Unless otherwise approved by the Security Trustee, each acceding Eligible Group Member must be a member of the Knightstone Housing Group and a Registered Provider of Social Housing.
Selling Restrictions:	There are restrictions on the offer, sale and transfer of the Bonds in the United States and the United Kingdom, see " <i>Purchase and Sale</i> ".
Governing Law:	The Bonds and any non-contractual obligations arising out of or in connection with them shall be governed by, and construed in accordance with, English law.

STRUCTURE DIAGRAM OF TRANSACTION



NOTE: On the Issue Date Knightstone Housing Association Limited will be the only Borrower and there will be no Eligible Group Members. However, Additional Borrowers and/or Additional Eligible Group Members to accede to the structure at a future date.

RISK FACTORS

The Issuer believes that the following factors (which include factors which may affect the ability of the Borrowers to fulfil their obligations under the Loan Agreements) may affect its ability to fulfil its obligations under the Bonds. Most of these factors are contingencies which may or may not occur and the Issuer is not in a position to express a view on the likelihood of any such contingency occurring.

In addition, factors which are material for the purpose of assessing the market risks associated with the Bonds issued are also described below.

The Issuer believes that the factors described below represent the principal risks inherent in investing in the Bonds, but the inability of the Issuer to pay interest, principal or other amounts on or in connection with the Bonds may occur for other reasons which may not be considered significant risks by the Issuer based on information currently available to it or which it may not currently be able to anticipate. This section is not intended to be exhaustive and prospective investors should also read the detailed information set out elsewhere in this Prospectus and reach their own views prior to making any investment decision. If any of the following risks actually materialise, the Issuer's and/or the Borrowers' business, financial condition and prospects could be materially and adversely affected. No assurance can be given that prospective Bondholders will receive full and/or timely payment of interest and principal or ultimate recovery in relation to the Bonds.

Factors which may affect the Issuer's ability to fulfil its obligations under the Bonds

Special Purpose Vehicle Issuer: The Issuer is a special purpose finance entity with no business operations other than the incurrence of financial indebtedness, including the issuance of the Bonds. As such the Issuer is entirely dependent upon receipt of funds received from the Borrowers in order to fulfil its obligations under the Bonds.

Credit Risk: The Issuer, and therefore payments by the Issuer in respect of the Bonds, will be subject to the credit risk of the Borrowers. The Issuer will be subject to the risk of delays in the receipt, or risk of defaults in the making, of payments due from the Borrowers in respect of the Loan Agreements. Delays in the receipt of payments due from the Borrowers under the Loan Agreements could adversely affect the ability of the Issuer to fulfil its payment obligations under the Bonds.

Effect of Losses on Loan on Interest Payments and Repayments on the Bonds: There can be no assurance that the levels or timeliness of payments of collections received in respect of the Loans will be adequate to ensure fulfilment of the Issuer's obligations in respect of the Bonds on each Interest Payment Date or on the Maturity Date. In addition, a default under a Loan Agreement could ultimately result in the enforcement of the Underlying Security. The proceeds of any such enforcement may be insufficient to cover the full amount due from the Borrowers resulting in a shortfall in funds available to repay the Bonds.

Factors which may affect the Borrowers' ability to fulfil their obligations under the Loan Agreements

Welfare Reform: A proportion of the rent received by the Borrowers from their tenants is derived from housing benefit payable by local authorities. The Original Borrower receives 54 per cent. of its rental income as housing benefit. If there is a reduction or termination by the Government of housing benefit, then this may accordingly have an adverse impact on the payment of rent, as the tenants would have to pay a higher proportion of the rent themselves.

The Welfare Reform Act 2012, which received royal assent on 8th March, 2012, sets out significant changes in the provision of welfare benefits. The Act provides for the introduction of a number of reforms including a total household benefit cap, which has been set at £26,000 per year for couples and lone parents, and £18,200 per year for single people without children. A new occupation size criteria for working age tenants occupying social housing and in receipt of housing benefit has also been introduced (initially as an amendment to the existing Housing Benefit Regulations, but there are provisions with the same effect contained within the Universal Credit Regulations 2013 and, as such, no change to the operation of the occupation size criteria would occur if the Regulations remain as drafted).

The under occupation penalty will reduce the amount of housing benefit (or the housing element of Universal Credit which will replace it) received by those who are deemed to be under occupying their home, by 14 per cent. where a household has one extra bedroom, and 25 per cent. where there are two or more extra bedrooms. The Government's impact assessment published in mid-2012 indicated that around 660,000 claimants were expected to be affected by the new measure and press reports indicate that households are going into arrears as a result of this reduction in housing benefit entitlement, which may have a knock-on effect on levels of rent arrears for Registered Providers of Social Housing.

Caps have already been introduced to the Local Housing Allowance, which applies to those living in the private rented sector. Currently these caps do not apply to tenants living within social housing, but Registered Providers of Social Housing are anticipating that in practice, local authorities may not pay out benefit above the level of the caps and are setting their Affordable Rent accordingly. Caps are primarily affecting those living in central London and the South East and would currently only affect a very small number of the Borrower's tenants.

Universal Credit, which will be phased in from October 2013, will be a single means-tested benefit paid to those of working age (in and out of work) which will include an amount in respect of housing costs which will replace housing benefit. Currently housing benefit can be paid directly to Registered Providers of Social Housing as long as tenant consent has been obtained, and it has been acknowledged by the Government that some households may go into rent arrears as a consequence of the introduction of Universal Credit and the related plans to introduce direct payment of housing benefit to claimants as the default position.

In order to allay the fears of Registered Providers of Social Housing and their lenders, the Department of Work and Pensions (the **DWP**) has agreed to safeguard landlords' income by putting in place protection mechanisms to allow for the payment of rent direct to landlords if tenants are vulnerable or fall into arrears of rent. These could include direct payment to landlords where two months of rent has accrued, or bi-monthly (instead of monthly) payments to the tenant. On 30th May, 2012 Moody's issued a special comment relating to direct payments of housing benefit. Moody's view the direct payment of housing benefit to working age tenants as a "manageable" risk. However, changes to the structure of the benefit system (including any system of direct payments of the housing component of Universal Credit to tenants) may affect the ability of claimants of housing benefit to pay their rent and also affect the ability of a Borrower to meet its payment obligations under its Loan Agreement on a timely basis.

Whilst existing social tenancies and rent levels remain unchanged, the Localism Act 2011, together with the new Regulatory Framework for social housing in England from April 2012 issued by the Homes and Communities Agency in its capacity as social housing regulator, introduces a new form of social housing rent level that allows Registered Providers of Social Housing to charge rents up to a maximum of 80 per cent. of the local market rent level on both newly developed stock and on new lettings of a proportion of existing stock as long as a framework agreement is in place with the Homes and Communities Agency. This new rent policy is known as Affordable Rent. There is a risk that those tenants on Affordable Rent will find it harder to pay their rent and that this may have a

corresponding effect on the ability of a Borrower to meet its payment obligations under its Loan Agreement on a timely basis. 0.6 per cent. of the Original Borrower's turnover was derived from affordable rents in the year ended 31st March, 2013, but this is expected to rise as long as affordable rents remain an option for new and re-let tenancies.

Rental Income Risk: The tenants of a Borrower's properties are personally responsible for the rental payments on the relevant occupied properties. There is currently a greater risk of non-payment for those tenants who are not in receipt of full or partial housing benefit or housing credit. This risk increases if payment of housing benefit direct to tenants becomes the default position, as there is a risk that tenants will fail to pass on such housing benefit payments to their landlord. In the event that any such tenants fail to pay rent in full on a timely basis, this could also affect the ability of a Borrower to meet its payment obligations on a timely basis under the relevant Loan Agreement, which in turn would impact the Issuer's ability to fulfil its obligations under the Bonds.

Aside from the risks associated with Welfare Reform set out above (which may be mitigated to an extent by the DWP's planned protection mechanisms allowing for payments to be made direct to landlords if tenants are vulnerable or if they fall into two months of arrears), payments of housing benefit by local authorities may be delayed as a result of, among other things, the need to establish a new claimant's entitlement thereto. The receipt of rental payments by a Borrower, as landlord, may be delayed by the failure of the claimant to regularly pay rent which is due in addition to the housing benefit and/or, in circumstances where the housing benefit is not paid direct to the landlord, a failure to pass on the housing benefit payments to the landlord. In such circumstances, the non-payment, or any delay in payment of material amounts of rental income, could affect the ability of a Borrower to meet its payment obligations under a Loan Agreement. The year-end arrears position of the Original Borrower for the last three years has been 2.3 per cent. (as at 31st March, 2013), 1.7 per cent. (as at 31st March, 2012) and 2.0 per cent (as at 31st March, 2011) of gross rent.

Rental Growth Risk: Levels of rental income are currently impacted each year by the Retail Price Index (**RPI**) which refers back to the figure published in the October (for the year to September) of the preceding year. The Chancellor presented the 2013 Spending Review to the House of Commons on 26th June, 2013. The Government announced that for the 10-year period between 2015-16 to 2024-25, social rents will rise annually by the Consumer Price Index (**CPI**) plus 1 per cent. The detail that has been published to date on the new rental formula does not include the previous provision of +/- £2 per week to allow convergence towards target rents. 10 years of certainty on the future rent regime is of considerable value to Registered Providers of Social Housing in developing their business. However, the CPI is typically lower than RPI and does not currently include housing costs. Historic and forecast future differences between the old and new rent setting regimes does not suggest that rental income will fall when the new regime is introduced in April 2015. The impact of the removal of the provision to charge +/- £2 per week to allow convergence towards target rents will differ for different Registered Providers of Social Housing, depending upon the number of tenancies where target rents will not be reached by March 2015. 90 per cent. of the Original Borrower's social rented tenancies were at or above target rent as at 31st March, 2013.

The Borrowers will apply future rent increases, or decreases in the case of negative RPI or CPI, in accordance with the Government rent regimes (if any) in place at that time. The current regime for regulated rents allows for increases at RPI plus 0.5 per cent. until March 2015 and CPI plus 1 per cent. for each of the 10 years thereafter. The Original Borrower's regulated rental income sensitivity to a 1 per cent. increase or decrease in RPI and CPI is circa £500,000 per annum based on its current year's rental income, which the Original Borrower does not deem material to its ability to meet its obligations under the Knightstone Housing Association Loan Agreement.

The Original Borrower has a number of mechanisms in place to mitigate the scenario of negative inflation including control over its cost base and inflation-linked swaps. In addition, the Original

Borrower considers the correlation between inflation and interest rates when managing its variable interest rate bill.

Shared Ownership and Outright Sales Risk: The Knightstone Housing Group also generates revenue from its housing for sale programme which is principally shared ownership through the Original Borrower and outright sales through Arc Developments South West Limited and is therefore exposed to market risk in relation to housing for sales, including both demand and pricing risks.

Shared ownership income is generated on the initial sale of the property (known as the "first tranche") which is sold to the "shared owner"; on subsequent sales of further "tranches" or portions of the property to the shared owner (known as "staircasings"); and in the form of subsidised rent on the part of the property which the shared owner does not own until the property is fully owned by the shared owner.

There is a risk that if a tenant of a shared ownership property borrows monies through a mortgage from a commercial lender (having obtained consent from a Borrower) then that lender's mortgage may take priority ahead of any security arrangements that are in place under the Security Trust Deed. However, if that commercial lender were to enforce its security following a tenant defaulting on its mortgage, such lender could staircase (i.e. purchase a portion of the freehold property) up to 100 per cent. in order to be able to sell the whole leasehold interest in which case the Borrower as landlord would receive such staircasing payments from the commercial lender. If the price for the full 100 per cent. receivable on sale is not sufficient to meet the principal outstanding (plus 12 months interest and other statutorily permitted costs) then the shortfall will remain as a debt due to the landlord from the defaulting leaseholder. Under the current rules of the Homes and Communities Agency (the **HCA**), any shortfall not recovered is borne first by the provider of any grant in respect of the property, and thus the Borrowers are only affected to the extent that the shortfall cannot be covered by grant monies. This only applies where shared ownership units are grant-funded. If a commercial lender did enforce its security by staircasing up to 100 per cent. and there was such a shortfall, a Borrower would no longer receive rent for its retained share of the property which could have an impact upon its rental income. Shared ownership units comprise 12 per cent. of unit numbers and around half of that figure in terms of value of the Original Borrower's housing stock. The Original Borrower does not plan on increasing this significantly in the future.

Housing Grant Risk: The Borrowers receive grant funding from a variety of sources, including the HCA. Due to the nature of grant funding, there is a risk that the amount of funding available and the terms of grants will vary. Following approval of a grant there is a risk that the HCA may revise the terms of a grant and reduce entitlement, suspend or cancel any instalment of such a grant. In certain circumstances, set out in the HCA regulatory framework, including but not limited to, failure to comply with conditions associated with the grant or a disposal of the property funded by a grant, the grant may be required to be repaid or reused. Any such reduction in, withdrawal of, repayment or re-use of grant funding could adversely impact the future development of a Borrower.

Since 2005, bids for social housing grants to supply new affordable housing have been accepted from unregistered bodies in addition to Registered Providers of Social Housing. This includes private developers and arm's length management organisations established by local authorities. One of the aims of the measure was to increase competition. In September 2008, as part of a package of measures announced to stimulate the housing market and deliver new social housing, the previous Government announced that local authorities who directly manage houses will also be invited to bid for grants.

In 2010 the Government announced a new funding framework – the 2011-2015 Affordable Homes Programme (the **Framework**). The Framework largely replaced the previous social housing grant programme, although outstanding grants agreed under the previous arrangements will be paid to Registered Providers of Social Housing. The Framework is designed to offer more flexibility to

registered housing providers, enabling them to use existing assets to support new development programmes, and to offer a wider range of housing options to people accessing social housing.

Under the Framework, the level of Government grant has been reduced significantly. To compensate for this, Registered Providers of Social Housing are able to charge Affordable Rents which are capped at 80 per cent. of market rents and, as such, are generally higher than existing target social housing rents. This additional rental income can be used to service additional funding requirements as a result of the reduced grant levels. The consequence of this for Registered Providers of Social Housing is an increase in debt and gearing levels, the scale of which varies depending on the areas of operation.

In addition to the changes to the rent setting regime noted above, the Government also announced, in the spending review announcement made in June 2013, a £3 billion capital investment in affordable housing whereby 165,000 new affordable homes are to be provided over three years from 2015. The grant rate per home will fall from an average £22,000 a home under the affordable homes programme to around £18,000.

The reduced amount of grant available means that a Borrower has an increased exposure to rental income and housing benefit risk which could affect its ability to meet its payment obligations on a timely basis under the relevant Loan Agreement.

Existing loan covenants include measures for minimum interest cover and maximum gearing ratios. Business planning and scenario testing show that neither of these requirements are threatened by existing changes made to grant rates.

Housing Market Downturn Risk: The majority of the properties of the Knightstone Housing Group are social rented (general needs, sheltered housing and supported housing), all of which have a limited exposure to housing market downturn risk. Rental income from these properties provides the major source of the Knightstone Housing Group's income.

The Knightstone Housing Group has exposure to housing market downturn risk through its shared ownership sales, its open market housing sales activity and redemptions and staircasings of shared equity and shared ownership properties.

The latest figures from the Nationwide House Price Index show that house prices in the UK are continuing to rise with a 0.6 per cent. increase for the month of August 2013. The smoother 3 month on 3 month rate of change has changed from a seasonally adjusted 1 per cent. increase in July 2013 to a 1.4 per cent. increase in August 2013, its strongest performance since mid-2010. The recent upturn is likely a result of an increase in consumer confidence over recent months due to modest gains in employment and indications that the UK economy is beginning to gather momentum. On an annual basis, house prices are 3.5 per cent. higher in August 2013 than for the same period last year. The figures seem to indicate that the property market remains relatively stable with a gradual continuing rise in prices.

Housing Market and Development Risk: Residential property investment is subject to varying degrees of market and development risk. Market risks which may impact upon both the rental market and the development of residential properties include the economic environment, the risk of changes to Government regulation, including, but not limited to, regulation relating to planning, taxation, landlords and tenants and welfare benefits which could affect positively and negatively tenant trends in the United Kingdom. Furthermore, the maintenance of existing properties, development of existing sites and acquisition of additional sites may be subject to economic and political conditions, the availability of finance facilities and the cost of facilities where interest rates and inflation may also have an effect.

Among other things, these market risks may impact upon the expenses incurred by each Borrower associated with existing residential properties, rental income produced by these properties, the value of its existing investments, its ability to develop land that it has acquired, its ability to sell properties and its ability to acquire additional sites. This could, in turn, impact upon such Borrower's cash flow and its ability to satisfy any covenants which it is required to maintain pursuant to the terms of any financing arrangements.

Operational Risk: Operational risks may result from major systems failure or breaches in systems security (although, in the case of the Original Borrower, it has prepared business continuity plans in order to mitigate against this, it is dependent upon its technology in order to deliver business processes) and the consequences of theft, fraud, health and safety and environmental issues, natural disaster and acts of terrorism. These events could result in financial loss to the Borrowers and hence the Issuer.

Notwithstanding anything in this risk factor, this risk factor should not be taken as implying that the Issuer will be unable to comply with its obligations as an entity with securities admitted to the Official List.

Regulatory Risk: The Housing and Regeneration Act 2008 as amended by the Localism Act 2011 (the **Act**) makes provision for the regulation of social housing provision in England.

Pursuant to the Act, the HCA acts as the regulator of Registered Providers of Social Housing (the **Regulator**). The HCA exercises its functions as Regulator acting through a separate committee established to undertake this regulatory role (the **Regulation Committee**). This arrangement came into force on 1st April, 2012. The statutory powers available to the Regulator are largely unchanged from those previously in place between April 2010 and April 2012, during which time the Tenant Services Authority (**TSA**) acted as the regulator of Registered Providers of Social Housing. The Regulator continues to provide economic regulation for Registered Providers of Social Housing in order to ensure they are financially viable and well governed and to support the confidence of private lenders to provide funds at competitive rates. It is intended that there will be a greater role for tenants' panels, councillors, MPs and the Ombudsmen in dealing with consumer issues than prior to 1st April, 2012.

The Regulator regulates Registered Providers of Social Housing in accordance with the publication entitled "The regulatory framework for social housing in England from April 2012" (the **Regulatory Framework**), setting out the standards which apply to Registered Providers of Social Housing from 1st April, 2012. The standards cover: governance and financial viability; value for money; rent; quality of accommodation; repairs and maintenance; allocations, mutual exchanges and tenure; neighbourhood management, local area co-operation and anti-social behaviour; and tenant involvement and empowerment. Registered Providers of Social Housing are expected to comply with the standards and to establish arrangements to ensure that they are accountable to their tenants, the Regulator and relevant stakeholders.

The enforcement by the Regulator of the standards other than those relating to governance and financial viability, rent and value for money is restricted to cases in which there is, or there is a risk of, serious detriment to tenants. The Regulatory Framework includes guidance as to how the Regulator will assess whether serious detriment may arise.

On 9th April, 2013 the Regulator published a discussion paper entitled "Protecting social housing assets in a more diverse sector" (the **Discussion Paper**), as part of a consultation regarding proposed changes to the way in which the Regulator regulates Registered Providers of Social Housing. The Discussion Paper sets out proposals: for the Regulatory Framework to address the ring-fencing of the social housing businesses of Registered Providers of Social Housing from other businesses carried on by them or by other members of their corporate groups; to require Registered Providers of Social

Housing to establish registers of information relating to their social housing businesses; and to restrict the ability of Registered Providers of Social Housing which are registered as profit-making organisations from applying profits arising on the disposal of social housing assets otherwise than for social housing purposes.

Responses to the Discussion Paper were invited up to 4th June, 2013, and a further consultation is expected to follow before any changes are made. The Chair of the Regulation Committee has indicated publically that the responses were broadly positively supportive of the second and third categories of proposal but that the ring-fencing proposals were less enthusiastically received. In the opinion of the Original Borrower the proposals in the Discussion Paper are not in themselves likely to give rise to any risk to the ability of any Borrower to fulfil its obligations under any Loan Agreement.

Capital Resources and Treasury Risk: To mitigate liquidity risk and augment its capital resources, the Knightstone Housing Group currently relies on financing through committed lines of credit from major banks and building societies and through secured term and revolving credit facilities. However, the Borrower could find itself unable to access sources of financing if bank or building society lines become unavailable to the Borrower (for example, if banks and building societies are unable to provide new facilities, or extend existing facilities, or are unable to meet commitments to provide funds under existing committed lines).

The Knightstone Housing Group is also subject to interest rate risk in respect of their variable rate borrowing although the Knightstone Housing Group's hedging strategy seeks to reduce interest rate risk volatility and uncertainty by allowing for a balance of fixed, floating and inflation-linked debt. As at 31st March, 2013 approximately 73 per cent. of the Knightstone Housing Group's borrowings were capped or fixed rate debt. Accessing the capital markets through the issue of the Bonds will reduce the reliance of the Knightstone Housing Group on funding from banks and building societies.

Pensions Risk: The Original Borrower participates in the Social Housing Pension Scheme (**SHPS**).

In accordance with the UK Government's regulations, all eligible employees will soon have to be auto-enrolled into a qualifying pension scheme. Employers can choose the qualifying scheme they use, which could include the National Employment Savings Trust (**NEST**). Each qualifying scheme must meet minimum standards in respect of the benefits it provides or the amount of contributions paid to it. The scheme must also provide auto-enrolment for all eligible workers, and for all new workers when they become eligible. Around 164 of the employees of the Knightstone Housing Group are enrolled in a pension scheme. Automatic enrolment for the Original Borrower's employees will become required from 1st January, 2014 and consequentially the number of employees participating in SHPS or NEST will increase, together with the cost of the employers' contribution. It is expected that the Original Borrower's costs will increase up to £240,000 per annum.

The SHPS is a multi-employer defined benefit scheme which is funded and contracted out of the State Pension Scheme. Employer participation in the SHPS is subject to adherence with the employer responsibilities and obligations as set out in the "SHPS House Policies and Rules Employer Guide" and under the rules of SHPS.

The SHPS operated a single benefit structure, with a 1/60th final salary accrual rate until 31st March, 2007. Thereafter, three benefit structures were available, namely, final salary with a 1/60th accrual rate, final salary with a 1/70th accrual rate and career average revalued earnings (**CARE**) with a 1/60th accrual rate. From April 2010 two further benefit structures were available, namely, final salary with a 1/80th accrual rate and career average revalued earnings with a 1/80th accrual rate. A defined contribution (**DC**) benefit structure was made available from 1st October, 2010.

An employer can elect to operate different benefit structures for their active members and their new entrants. An employer can only operate one open defined benefit structure plus the defined

contribution structure at any one time. An open benefit structure is one which new entrants are able to join.

The Original Borrower participates in the final salary, CARE and defined contribution sections of the SHPS. Employees who joined the Original Borrower before 1st April, 2013 are eligible to join the SHPS final salary 1/80th section or the SHPS DC section. Employees who join the Original Borrower after 1st April are only eligible to join the SHPS DC section. As at 31st March, 2013 there were 164 active members of SHPS employed by the Knightstone Housing Group. The annual pensionable payroll in respect of these members was £5.0 million. During 2013, the Original Borrower will continue to offer membership to the SHPS DC section to its new employees.

The last formal valuation of the SHPS was performed as at 30th September, 2011 by a professionally qualified actuary using the Projected Unit Method. The market value of the SHPS's assets at the valuation date was £2,062 million. The valuation revealed a shortfall of assets compared with the value of liabilities of £1,035 million, equivalent to a past service funding level of 67.0 per cent.

Following consideration of the results of the SHPS actuarial valuation it was agreed that the shortfall of £1,035 million would be dealt with by the payment of deficit contributions as detailed in the table below:

Valuation	Deficit basis	Increase basis	From April 2013	From April 2014
2008	Existing annual past service deficit	4.7 per cent. per annum compound	352,656	369,231
2011	New 'share of liability' annual deficit contribution	3.0 per cent. per annum compound	249,000	256,470
	Total annual deficit contribution		601,656	625,701

Employers that have closed the SHPS to new entrants but instead offer SHPS DC are required to pay an additional employer contribution loading of 1.5 per cent. to reflect the higher costs of a closed arrangement.

The SHPS's actuary has prepared an actuarial report that provides an approximate update on the funding position of the SHPS as at 30th September, 2012. Such a report is required by legislation for years in which a full actuarial valuation is not carried out. The market value of the SHPS's assets at the date of the actuarial report was £2,327 million. The actuarial report revealed a shortfall of assets compared with the value of liabilities of £1,241 million, equivalent to a past service funding level of 65 per cent.

As a result of pension scheme legislation there is a potential debt on the employer that could be levied by the trustee of the SHPS. The debt is due in the event of the employer ceasing to participate by ceasing to employ active members when another employer participating in SHPS continues to employ active members in the SHPS or the SHPS winding up.

The debt for the SHPS as a whole is calculated by comparing the liabilities for the SHPS (calculated on a buy-out basis, i.e. the cost of securing benefits by purchasing annuity policies from an insurer, plus an allowance for expenses) with the assets of the SHPS. If the liabilities exceed assets there is a buy-out debt.

The leaving employer's share of the buy-out debt is the proportion of the SHPS's liability attributable to employment with the leaving employer compared to the total amount of the SHPS's liabilities (relating to employment with all the currently participating employers). The leaving employer's debt therefore includes a share of any "orphan" liabilities in respect of previously participating employers. The amount of the debt therefore depends on many factors including total SHPS liabilities, SHPS investment performance, the liabilities in respect of current and former employees of the employer, financial conditions at the time of the cessation event and the insurance buy-out market. The amounts of debt can therefore be volatile over time.

The Original Borrower has been notified by The Pensions Trust of the estimated employer debt on withdrawal from SHPS based on the financial position of the SHPS as at 30th September, 2012. As of this date the estimated employer debt for the Original Borrower was £34.8 million.

Under the Pensions Act 2004, a person that is an employer in relation to certain occupational pension schemes, or 'connected with' or an 'associate' of such an employer, can be subject to either a contribution notice or a financial support direction in relation to that occupational pension scheme issued by the Pensions Regulator (contribution notices and financial support directions require financial support to be given to a pension scheme). As the Original Borrower participates in the SHPS, the Original Borrower is an employer participating in such a defined benefit occupational scheme and certain of its employees are members of the board of directors of the Issuer. On this basis, the Issuer is likely to be treated as 'connected with' the Original Borrower.

A contribution notice may be issued by the Pensions Regulator against the Issuer if it is party to an act, or a deliberate failure to act (or a series of acts or deliberate failures to act), the main purpose, or one of the main purposes, of which is either (i) to prevent the recovery of the whole or any part of a debt which is, or might become, due from the employer under Section 75 of the Pensions Act 1995 or (ii) to prevent such a debt becoming due, to compromise or otherwise settle such a debt, or to reduce the amount of such a debt which would otherwise become due. A contribution notice can be issued up to six years after such acts or failures to act.

Further, a contribution notice may be issued by the Pensions Regulator against the Issuer where it considers that an act, or a deliberate failure to act (or a series of acts or deliberate failures to act) is "materially detrimental" to the likelihood of a person receiving the accrued pension scheme benefits. This is a wide power and means that the Pension Regulator does not have to show an intention to prevent the recovery of an employer debt to the pension scheme under Section 75 of the Pensions Act 1995. This power applies retrospectively to acts or failures to act which occurred on or after 14th April, 2008.

A financial support direction could be served on the Issuer where the Original Borrower (as the employer in respect of the pension scheme) is insufficiently resourced or is a service company (i.e. a company whose turnover is solely or mainly derived from providing services to other group companies). An employer is deemed to be insufficiently resourced pursuant to the Pensions Act 2004 if the value of its resources is less than 50 per cent. of the pension scheme's deficit (calculated on an annuity buy-out basis) and at that time there is a connected or associated person or persons with sufficient resources (or connected or associated persons with sufficient aggregate resources) to meet at least 50 per cent. of the pension scheme's deficit when combined with the employer's resources.

If the Original Borrower's resources are subsequently valued at less than 50 per cent. of the pension scheme's deficit, a financial support direction could be issued at any time against the Issuer.

The Pensions Regulator can only issue a contribution notice or financial support direction where it considers that it is reasonable to do so, having regard to a number of factors.

If a contribution notice or financial support direction were to be issued against the Issuer, this could adversely affect the Issuer's ability to fulfil its obligations under the Bonds.

The Original Borrower complies with its funding obligations under the Pensions Act 2004 in relation to the SHPS.

Legal and Compliance Risk: The Knightstone Housing Group knows the significance to its operations of, and is focused on, adhering to all legal and compliance legislation. The Knightstone Housing Group is not currently aware of any material failure to adhere to applicable health and safety or environmental laws, litigation or breach of regulatory laws, or failure to comply with corporate, employee or taxation laws. If any of this were to occur in the future, this could have an adverse impact on the Borrowers' results of their operations.

To date, claims made against the Knightstone Housing Group have not had a material impact on the revenue or business of the Knightstone Housing Group, although there can be no assurance that the Knightstone Housing Group will not, in the future, be subject to a claim which may have a material impact upon its revenue or business.

Furthermore, the Knightstone Housing Group has the benefit of insurance for, among others, employer's liability, public liability and directors' and officers' liability at levels which the management of the Knightstone Housing Group considers to be prudent for the type of business in which the Knightstone Housing Group is engaged and commensurate with Registered Providers of Social Housing of a similar size.

Permitted Reorganisations: The Knightstone Housing Association Loan Agreement permits, and each Additional Loan Agreement will permit, the Borrowers to undertake Permitted Reorganisations. In such circumstances, the resulting entity's credit risk may change.

Factors which are material for the purpose of assessing the market risks associated with the Bonds

Liability under the Bonds: The Bonds are obligations of the Issuer only and do not establish any liability or other obligation of any other person mentioned in this Prospectus. The Bonds will constitute direct, general, secured obligations of the Issuer and will rank equally among themselves.

Partly paid risks: The issue price in respect of the Bonds is payable in two instalments. Any failure by a Bondholder to pay the Final Instalment in respect of their Bonds may result in (i) such Bondholder's position in respect of its Bonds being blocked in accordance with the procedures of Euroclear or Clearstream, Luxembourg, as the case may be, until such amount is paid in full, and/or further notice from the Issuer, which will result in such Bondholder being unable to trade its Bonds and (ii) the forfeiture of all or any Bonds in respect of which such amount has not been duly paid and such investor losing all of his/her investment.

Interest rate risks: The Bonds bear interest at a fixed rate and therefore involve the risk that subsequent changes in market interest rates may adversely affect the value of the Bonds.

Redemption prior to maturity: In the event that the Bonds become repayable prior to maturity either following a Loan becoming repayable as a result of a Borrower Default (which includes, *inter alia*, failure by the relevant Borrower to make payments of interest under the relevant Loan Agreement) or an Event of Default (as defined in Condition 12 (*Events of Default and Enforcement*)) or due to taxation (pursuant to Condition 9.3 (*Early Redemption for Tax Reasons*)), the Bonds will be redeemed

in full at their Outstanding Principal Amount, plus accrued interest. In such circumstances it may not be possible for an investor to reinvest the redemption proceeds at an effective rate of interest as high as the interest rate on the Bonds. Furthermore, the optional redemption feature of the Bonds is likely to limit their market value as the market value generally will not rise substantially above the price at which they can be redeemed.

Modification, waivers and substitution: The Conditions of the Bonds and the Bond Trust Deed contain provisions for calling meetings of Bondholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Bondholders, including Bondholders who did not attend and vote at the relevant meeting and Bondholders who voted in a manner contrary to the majority.

The Conditions of the Bonds and the Bond Trust Deed also provide that the Bond Trustee may, without the consent of Bondholders (i) agree to any modification (except as stated in the Bond Trust Deed) of, or to the waiver or authorisation of any breach or proposed breach of, any of the provisions of Bonds or any Transaction Document (to which it is a party) or (ii) determine without the consent of the Bondholders that any Potential Event of Default or Event of Default shall not be treated as such or (iii) agree to the substitution of another company, industrial and provident society or other entity as principal debtor under the Bonds in place of the Issuer, in the circumstances described in the Conditions, provided, in each case, that the Bond Trustee is of the opinion that to do so would not be materially prejudicial to the interest of Bondholders.

Denominations involve integral multiples: definitive Bonds: The Bonds initially have denominations consisting of a minimum of £5,000,000 plus one or more higher integral multiples of £1,000. Provided the Bonds continue to be represented by one or both of the Global Bonds on the Final Instalment Payment Date, on and following the Final Instalment Payment Date the Bonds will be automatically redenominated and transferable in denominations of £100,000 and integral multiples of £1,000 in excess thereof. It is possible that the Bonds may be traded in amounts that are not integral multiples of £5,000,000 or £100,000, as the case may be. In such a case a holder who, as a result of trading such amounts, holds an amount which is less than £5,000,000 or, following the Final Instalment Payment Date, £100,000 in his account with the relevant clearing system at the relevant time may not receive a definitive Bond in respect of such holding (should definitive Bonds be printed) and would need to purchase a nominal amount of Bonds such that its holding amounts to £5,000,000 or, following the Final Instalment Payment Date, £100,000.

If definitive Bonds are issued, holders should be aware that definitive Bonds which have a denomination that is not an integral multiple of £5,000,000 or, following the Final Instalment Payment Date, £100,000, may be illiquid and difficult to trade.

Denominations of definitive Bonds: If definitive Bonds are issued prior to the Final Instalment Payment Date, they will be issued in denominations of £5,000,000 plus one or more higher integral multiples of £1,000. To enable the definitive Bonds to be exchanged for definitive Bonds which are transferable in denominations of £100,000 and integral multiples of £1,000 in excess thereof, the Issuer will be required to prepare a further prospectus to be approved by the Financial Conduct Authority as a prospectus for the purpose of the Prospectus Directive. If the Issuer is unable to do so, the Bonds will be continue to be transferable only in denominations of £5,000,000 plus integral multiples of £1,000. This may result in the Bonds being illiquid and difficult to trade.

Change in Law: The structure of the issue of the Bonds is based on English law, regulatory and administrative practice in effect as at the date of this Prospectus, and has due regard to the expected tax treatment of all relevant entities under United Kingdom tax law and the published practice of HM Revenue & Customs in force or applied in the United Kingdom as at the date of this Prospectus. No assurance can be given as to the impact of any possible change to English law, regulatory or administrative practice in the United Kingdom, or to United Kingdom tax law, or the interpretation or

administration thereof, or to the published practice of HM Revenue & Customs as applied in the United Kingdom after the date of this Prospectus.

European Monetary Union: It is possible that, prior to the repayment in full of the Bonds, the United Kingdom may become a participating member state in the European Economic and Monetary Union and that the Euro will become the lawful currency of the United Kingdom. The introduction of the Euro could be accompanied by a volatile exchange rate and/or interest rate environment which could adversely affect holders of the Bonds. It cannot be said with certainty what effect the adoption of the Euro by the United Kingdom (if it occurs) will have on the holders of the Bonds.

Potential Conflicts of Interest: Each of the Transaction Parties (other than the Issuer) and their affiliates in the course of each of their respective businesses may provide services to other Transaction Parties and to third parties and in the course of the provision of such services it is possible that conflicts of interest may arise between such Transaction Parties and their affiliates or between such Transaction Parties and their affiliates and such third parties. Each of the Transaction Parties (other than the Issuer) and their affiliates may provide such services and enter into arrangements with any person without regard to or constraint as a result of any such conflicts of interest arising as a result of it being a Transaction Party.

Taxation: Under the Conditions of the Bonds (see Condition 10 (*Taxation*) below), the Issuer may, but will not be obliged to, gross up payments in respect of the Bonds if any deduction or withholding on account of tax is imposed. In the event that any deduction or withholding on account of tax is imposed and the Issuer does not opt to gross up payments in respect of the Bonds (or, if having previously opted to gross up notifies the Bond Trustee and the Bondholders of its intention to cease grossing up payments in respect of the Bonds), the Bonds will be redeemed in accordance with Condition 9.3 (*Early Redemption for Tax Reasons*). In such circumstances an investor may not be able to reinvest the redemption proceeds in a comparable security at an effective interest rate as high as that of the Bonds. In addition, any amounts in respect of accrued interest which fall due on any such redemption of the Bonds (and, where the redemption follows the next following Interest Payment Date, such Interest Payment Date) shall be paid subject to the required withholding or deduction and the Issuer shall not be obliged to pay any additional amounts in respect thereof. The Bondholders will therefore bear the risk of any such withholding or deduction in respect of the period from the previous Interest Payment Date to the date of redemption.

The Knightstone Housing Association Loan Agreement requires, and each Additional Loan Agreement will require, that if any withholding or deduction is required by law to be made by the relevant Borrower thereunder, the amount of the payment due from such Borrower shall be increased to an amount which (after making the tax deduction) leaves an amount equal to the payment which would have been due if no tax deduction had been required.

For a description of the current United Kingdom law and practice relating to withholding tax treatment of the Bonds, see below in "*Taxation*".

EU Savings Directive: Under EC Council Directive 2003/48/EC (the **Directive**) on the taxation of savings income, Member States are required to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State or to certain limited types of entities established in that other Member State. However, for a transitional period, Luxembourg and Austria are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have adopted similar measures (a withholding system in the case of Switzerland). In April 2013, the Luxembourg Government announced its intention to

abolish the withholding system with effect from 1st January, 2015, in favour of automatic information exchange under the Directive.

The European Commission has proposed certain amendments to the Directive, which may, if implemented, amend or broaden the scope of the requirements described above.

If a payment were to be made or collected through a Member State which has opted for a withholding system and an amount of, or in respect of, tax were to be withheld from that payment, neither the Issuer nor any Paying Agent nor any other person would be obliged to pay additional amounts with respect to any Bond as a result of the imposition of such withholding tax. The Issuer is required to maintain a Paying Agent in a Member State that is not obliged to withhold or deduct tax pursuant to the Directive.

Exchange rate risks and exchange controls: The Issuer will pay principal and interest on the Bonds in Sterling. This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the **Investor's Currency**) other than Sterling. These include the risk that exchange rates may significantly change (including changes due to devaluation of Sterling or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to Sterling would decrease (1) the Investor's Currency-equivalent yield on the Bonds, (2) the Investor's Currency-equivalent value of the principal payable on the Bonds and (3) the Investor's Currency-equivalent market value of the Bonds.

Government and monetary authorities may impose (as some have done in the past) exchange controls that could adversely affect an applicable exchange rate. As a result, investors may receive less interest or principal than expected, or no interest or principal.

Legal investment considerations may restrict certain investments: The investment activities of certain investors are subject to legal investment laws and regulations, or review or regulation by certain authorities. Each potential investor should consult its legal advisers to determine whether and to what extent (1) the Bonds are legal investments for it, (2) the Bonds can be used as collateral for various types of borrowing and (3) other restrictions apply to its purchase or pledge of the Bonds. Financial institutions should consult their legal advisers or the appropriate regulators to determine the appropriate treatment of the Bonds under any applicable risk-based capital or similar rules.

Risks Relating to the Security of the Bonds

Considerations relating to the Issuer Security and the Underlying Security: The Bonds will be secured by the Issuer Security granted in favour of the Bond Trustee for the benefit of itself, the Bondholders and the other Secured Parties. Such Issuer Security will include security over the Loan Agreements, the Security Trust Deed and the Security Agreements. The Underlying Security to be created pursuant to the Security Trust Deed and the Security Agreements will include first legal mortgages, first fixed charges and assignments over the property and rights set out in the relevant Security Agreement given by the Borrowers and the Eligible Group Members in favour of the Security Trustee for the benefit of itself and, *inter alios*, the Issuer.

The validity of any security given by the Borrowers and the Eligible Group Members in connection with additions and substitutions of Charged Properties may depend on the solvency of the relevant Borrower or Eligible Group Member at the time of the grant.

Environmental Considerations: Under relevant UK environmental legislation, liability for environmental matters can be imposed on the "owner" or "person in control" of land. The term "owner" is not specifically defined and could include anyone with a proprietary interest in a property, which could include a representative of a trustee as a mortgagee in possession (in respect of which see

the risk factor entitled "*Mortgagee in Possession Liability*" below). Environmental laws may impose liability on the owner for clean-up costs if a property is or becomes contaminated. The Borrowers and the Eligible Group Members may therefore be liable for the entire amount of the clean-up and redemption costs for a contaminated site regardless of whether the contamination was caused by it or not. These costs may be significant and may affect the ability of the Borrowers to meet their payment obligations under their respective Loan Agreements.

In addition, the presence of hazardous or toxic substances, or the failure to adequately remedy adverse environmental conditions at a Charged Property, may adversely affect the market value of the Charged Property, as well as the Borrowers' or the Eligible Group Members' ability to sell, lease or refinance the Charged Property. Any environmental liability imposed on the Borrowers could also affect the ability of the Borrowers to meet their payment obligations under their respective Loan Agreements.

Sufficiency of Insurance: Although each Charged Property is required to be insured at appropriate levels and against customary risks, there can be no assurance that any loss incurred will be of a type covered by such insurance, nor can there be any assurance that the loss will not exceed the limits of such insurance. Any reduction in income or any loss or damage caused to a Charged Property not adequately covered by insurance could result in a shortfall in funds available to meet the Borrowers' payment obligations under the Loan Agreements.

Investment of Retained Proceeds in Permitted Investments: For so long as any part of the net proceeds of the issue of the Bonds remains undrawn pursuant to the Loan Agreements, the Issuer may invest such amounts in Permitted Investments in accordance with the Custody Agreement. The Issuer may also invest the Charged Cash in Permitted Investments in accordance with the Custody Agreement.

Although Permitted Investments are limited to highly rated securities which satisfy certain specified criteria (which, other than with respect to any investment in money market funds or deposits, includes a requirement that the investments have a maturity date which is no later than the earlier of the date falling 5 years after the date of purchase and 2nd October, 2048), the Issuer may be required to liquidate such Permitted Investments (a) prior to the enforcement of the Issuer Security, (in the case of the Permitted Investments purchased with Retained Proceeds) to fund advances to a Borrower pursuant to a Loan Agreement or to fund redemptions of the Bonds in accordance with the Conditions or (b) following the enforcement of the Issuer Security, to make payments in accordance with the Post-enforcement Priority of Payment, in either case at a time when the disposal proceeds of such Permitted Investments is less than the price paid by the Issuer upon the acquisition thereof.

Prior to the enforcement of the Issuer Security, any losses realised by the Issuer in respect of a sale of Permitted Investments purchased with Retained Proceeds is passed on to the Borrowers pursuant to the terms of the Loan Agreements as a result of (i) the Issuer's obligation to fund a nominal amount of an advance being such that it may be satisfied by funding such advance at a discount in proportion to any such losses and (ii) each Borrower's obligation to make further payments to the Issuer in respect of any prepayment of the loan in full to enable the Issuer to fund any shortfall on a redemption of the Bonds. However, following the enforcement of the Issuer Security, any losses in respect of the Permitted Investments will reduce the amounts available to the Issuer to satisfy its payment obligations in respect of the Bonds. For the purpose of calculating the Borrowers' compliance with the Asset Cover Test, the value of such Permitted Investments will be the purchase price thereof and the Borrowers shall not be required to monitor the market value of such Permitted Investments. Consequently, the value attributed to the Permitted Investments for this purpose may be more than the realisable value from time to time.

In the event that the enforcement of the Issuer Security takes place prior to the Charged Properties being charged, with an aggregate Minimum Value equal to the Outstanding Principal Amount of the

Bonds, and/or at a time when the Permitted Investments have been acquired with the Disposal Proceeds or otherwise charged by a Borrower as security, the value of the proceeds of enforcement of the Underlying Security, together with such amounts, may be insufficient to enable the Issuer to pay its obligations under the Bonds in full.

The Issuer's ability to meet its obligations under the Bonds after enforcement under a Loan:

Following default by a Borrower, the Security Trustee shall be entitled to call for payments of any unpaid sums by such Borrower to be made by one or more of the other Borrowers (if any) under and in accordance with the guarantee given by such other Borrowers pursuant to their respective Loan Agreement (subject to the limitations of each guarantee). If there are no other Borrowers or the other Borrowers do not make payment (or are not required to make payment as a result of the limitation of the relevant guarantee) of such amounts to the Issuer pursuant to their respective Loan Agreements, the Security Trustee may enforce the Underlying Security and appoint a Receiver pursuant to its powers under the Security Trust Deed.

The Issuer's ability to continue to pay principal and interest on the Bonds following default by a Borrower under a Loan is dependent upon the ability of the Issuer to receive from the Security Trustee pursuant to the collection of rental income or a disposal of the Underlying Security, sufficient funds to make such payment.

Fixed charges may take effect under English law as floating charges: Pursuant to the Bond Trust Deed, the Issuer has purported to grant fixed charges over, amongst other things, all rights and benefits under the Transaction Account, the Ongoing Cash Security Account and the Initial Cash Security Account. The law of England and Wales relating to the characterisation of fixed charges is unsettled. The fixed charges purported to be granted by the Issuer (other than assignment of security) may take effect under English law only as floating charges if, for example, it is determined that the Bond Trustee does not exert sufficient control over the charged assets for the security to be said to "fix" over those assets. If the charges take effect as floating charges instead of fixed charges, then the claims of the Bond Trustee will be subject to claims which are given priority over a floating charge by law, including, amongst other things, prior charges, certain subsequent charges, the expenses of any winding up or administration and the claims of preferential creditors.

Claims of Creditors of the Issuer other than Secured Parties: Under English law, any creditor (who has not entered into non-petition clauses) would (save where an administrator has been appointed) be able to commence insolvency or winding up proceedings against the Issuer in respect of any unpaid debt.

Mortgagee in Possession Liability: There is a risk that the Security Trustee may be deemed to be a mortgagee in possession if it physically enters into possession of a Charged Property or performs an act of control or influence which may amount to possession, such as submitting a demand direct to tenants requiring them to pay rents to the Security Trustee. The consequence of being a mortgagee in possession would be that the Security Trustee may be obliged to account to a Borrower or an Eligible Group Member for the income obtained from the Charged Property, be liable for any damage to the Charged Property, have a limited liability to repair the Charged Property and, in certain circumstances, be obliged to make improvements or incur financial liabilities in respect of the Charged Property. A mortgagee in possession may also be liable to a tenant for any mis-management of the relevant property and may incur liabilities to third parties in nuisance and negligence and, under certain statutes (including environmental legislation), the liabilities of a property owner. Pursuant to the Security Trust Deed the Issuer, the Borrowers and the Eligible Group Members, respectively, are required to indemnify the Security Trustee against all liabilities and expenses suffered or incurred by it and pursuant to the Loan Agreements, the Borrowers are (or will be) required to indemnify the Issuer and the Security Trustee on demand against any loss or liability incurred in connection with their respective Loan Agreement. The obligation to indemnify the Security Trustee may mean that

there is a shortfall in funds available to pay all amounts due and owing under the Bonds and/or the Loan Agreements.

Moratorium: In order to protect the interest of tenants and to preserve the housing stock of a Registered Provider of Social Housing within the social housing sector and within the regulatory regime, a 28 working day moratorium on the disposal of land (including the enforcement of any security) by an insolvent non-profit Registered Provider of Social Housing will apply, upon certain steps being taken in relation to that provider such as presenting a winding up petition or appointing an administrator. The Regulator will then seek to agree proposals about the future ownership and management of the provider's land with its secured creditors. The moratorium procedure may adversely affect the Issuer's ability to enforce its security over the Charged Properties, as the procedure stipulates actions that must be taken by a secured creditor prior to that secured creditor being able to enforce its security and gives powers to the Regulator in respect of certain secured assets. This, in turn, could affect the Bond Trustee's ability to enforce its security against the Issuer under the Bond Trust Deed.

Risks Relating to the Market Generally

Potential Limited Liquidity: The Bonds may not have an established market when issued. There can be no assurance of a secondary market for the Bonds or the continued liquidity of such market if one develops. The development or continued liquidity of any secondary market for the Bonds will be affected by a number of factors such as the state of credit markets in general and the creditworthiness of the Knightstone Housing Group, as well as other factors such as the time remaining to the maturity of the Bonds.

Global economic disruption: In addition, Bondholders should be aware of the prevailing and widely reported global credit market conditions (which continue at the date hereof), whereby there is a general lack of liquidity in the secondary market for instruments similar to the Bonds, concerns over the liquidity of major banks and building societies and the consequent effects on the general economy and the housing market. The Issuer cannot predict when these circumstances will change and, if and when they do, whether conditions of general market illiquidity for the Bonds and instruments similar to the Bonds will be available in the future.

PAYMENT BY INSTALMENTS

The Bonds will initially be issued in denominations of £5,000,000 and integral multiples of £1,000 in excess thereof. The issue price in respect of the Bonds will be payable in two instalments as follows:

- (a) £20 of each £1,000 in nominal amount of the Bonds (the **Initial Instalment**) is due on the Issue Date; and
- (b) £980 of each £1,000 in nominal amount of the Bonds (the **Final Instalment** and, together with the Initial Instalment, the **Purchase Instalments**) is due on 30th November, 2017 (the **Final Instalment Payment Date**).

Words and expressions defined in "*Form of the Bonds and Summary of Provisions relating to the Bonds while in Global Form*" and "*Terms and Conditions of the Bonds*" shall have the same meanings in this section.

Upon payment of the Initial Instalment on the Issue Date, the Temporary Global Bond will be issued and delivered to a common safekeeper for Euroclear and Clearstream, Luxembourg in the aggregate nominal amount of £100,000,000. Euroclear and Clearstream, Luxembourg will credit as partly-paid, to each person who has subscribed and paid the Initial Instalment, an Outstanding Principal Amount of Bonds equal to the Outstanding Principal Amount of Bonds in respect of which such person has paid the Initial Instalment.

Upon receipt of the Final Instalment on the Final Instalment Payment Date from a person shown in its records as being entitled to a partly-paid Bond (an **Entitled Accountholder**):

- (a) Euroclear and Clearstream, Luxembourg shall pay the same to the Issuer and credit as fully paid to such Entitled Accountholder the nominal amount of Bonds in respect of which the Final Instalment shall have been received; and
- (b) the Principal Paying Agent (on behalf of the Issuer) shall instruct Euroclear and Clearstream, Luxembourg to make appropriate entries in their records to reflect such payment.

Payment of the Final Instalment will be made by Clearstream, Luxembourg or Euroclear on behalf of an Entitled Accountholder by debiting the account of such holder with Clearstream, Luxembourg or Euroclear.

Pursuant to the Agency Agreement, the Issuer shall give notice to Bondholders, in accordance with Condition 15 (*Notices*), not later than 5 Business Days prior to the Final Instalment Payment Date, that the Final Instalment is due on the Final Instalment Payment Date and Entitled Accountholders will be advised by Clearstream, Luxembourg or Euroclear not later than 5 Business Days prior to the Final Instalment Payment Date of requisite funding arrangements.

The Issuer is entitled to accept payment of the Final Instalment in respect of any Bond which has not yet been forfeited at any time after due date for payment. If the Entitled Accountholder fails to pay in full the Final Instalment on the due date for payment (i) the Entitled Accountholder's position in respect of its Bonds will be blocked in accordance with the procedures of Euroclear or Clearstream, Luxembourg until the Final Instalment is paid in full, and/or further notice from the Issuer, which will result in the Entitled Accountholder being unable to trade its Bonds and (ii) the Issuer may, once such failure has continued for 10 Business Days and the Issuer has made reasonable efforts to contact such Entitled Accountholder in respect of the payments owing, elect to forfeit all or any of the Bonds in respect of which such amount has not been duly paid, whereupon the Issuer shall be entitled to retain any amount(s) already paid to it under such Bonds and shall be discharged from any obligation to

repay such amount(s) or to pay interest in respect of the Bonds so forfeited, but shall have no other rights against any holders whose Bonds have been so forfeited. Upon such forfeiture, the Issuer shall procure that details of such forfeiture shall be entered *pro rata* in the records of Clearstream, Luxembourg or Euroclear, and upon any such entry being made, any forfeited Bonds shall be cancelled and the aggregate Outstanding Principal Amount of the Bonds represented by the Permanent Global Bond shall be reduced by such forfeited amounts.

For the avoidance of doubt, in respect of any Retained Bonds which are held by or on behalf of the Issuer as at the Final Instalment Payment Date, both Purchase Instalments shall have been deemed to have been paid on the due dates thereof.

FORM OF THE BONDS AND SUMMARY OF PROVISIONS RELATING TO THE BONDS WHILE IN GLOBAL FORM

Form of the Bonds

Form, Exchange and Payments

The Bonds will be in bearer new global note (NGN) form and will be initially issued in the form of a temporary global bond (a **Temporary Global Bond**) which will be delivered on or prior to the issue date of the Bonds to a common safekeeper for Euroclear Bank S.A./N.V. (**Euroclear**) and/or Clearstream Banking, *société anonyme* (**Clearstream, Luxembourg**).

The Bonds are intended to be held in a manner which will allow Eurosystem eligibility. This means that the Bonds are intended upon issue to be deposited with Euroclear or Clearstream, Luxembourg as common safekeeper and does not necessarily mean that the Bonds will be recognised as eligible collateral for Eurosystem monetary policy and intra-day credit operations by the Eurosystem either upon issue or at any or all times during their life. Bondholders should note that the European Central Bank has applied a temporary extension of Eurosystem eligibility to Sterling denominated securities, the effective date for this temporary extension being 9th November, 2012. However, should this extension cease at any time during the life of the Bonds, the Bonds will not be in a form which can be recognised as eligible collateral.

Whilst the Bonds are represented by the Temporary Global Bond, payments of principal, interest (if any) and any other amount payable in respect of the Bonds due prior to the Exchange Date (as defined below) will be made only to the extent that certification (in a form to be provided) to the effect that the beneficial owners of interests in the Temporary Global Bond are not U.S. persons or persons who have purchased for resale to any U.S. person, as required by U.S. Treasury regulations, has been received by Euroclear and/or Clearstream, Luxembourg and Euroclear and/or Clearstream, Luxembourg, as applicable, has given a like certification (based on the certifications it has received) to the Principal Paying Agent.

On and after the date (the **Exchange Date**) which is 40 days after the Temporary Global Bond is issued, interests in the Temporary Global Bond will be exchangeable (free of charge) upon a request as described therein for interests recorded in the records of Euroclear or Clearstream, Luxembourg, as the case may be, in a permanent global bond (the **Permanent Global Bond** and, together with the Temporary Global Bond, the **Global Bonds**), against certification of beneficial ownership as described above unless such certification has already been given. The holder of the Temporary Global Bond will not be entitled to collect any payment of interest, principal or other amount due on or after the Exchange Date unless, upon due certification, exchange of the Temporary Global Bond for an interest in the Permanent Global Bond is improperly withheld or refused.

Payments of principal, interest (if any) or any other amounts on the Permanent Global Bond will be made through Euroclear and/or Clearstream, Luxembourg without any requirement for certification.

On each occasion of a payment in respect of a Global Bond the Principal Paying Agent shall instruct Euroclear and Clearstream, Luxembourg to make appropriate entries in their records to reflect such payment.

The Global Bonds will be exchangeable (free of charge), in whole but not in part, for definitive Bonds with interest coupons and talons attached only upon the occurrence of an Exchange Event. For these purposes, **Exchange Event** means that (i) an Event of Default (as defined in Condition 12 (*Events of Default*)) has occurred and is continuing, or (ii) the Issuer has been notified that both Euroclear and Clearstream, Luxembourg have been closed for business for a continuous period of 14 days (other

than by reason of holiday, statutory or otherwise) or have announced an intention permanently to cease business or have in fact done so and no successor clearing system satisfactory to the Bond Trustee is available or (iii) the Issuer has or will become subject to adverse tax consequences which would not be suffered were the Bonds represented by the relevant Global Bond in definitive form. The Issuer will promptly give notice to Bondholders in accordance with Condition 15 (*Notices*) if an Exchange Event occurs. In the event of the occurrence of an Exchange Event, Euroclear and/or Clearstream, Luxembourg (acting on the instructions of any holder of an interest in such Permanent Global Bond) or the Bond Trustee may give notice to the Principal Paying Agent requesting exchange and, in the event of the occurrence of an Exchange Event as described in (iii) above, the Issuer may also give notice to the Principal Paying Agent requesting exchange. Any such exchange shall occur not later than 45 days after the date of receipt of the first relevant notice by the Principal Paying Agent.

Legend concerning United States persons

The following legend will appear on all Bonds and on all interest coupons relating to the Bonds:

"ANY UNITED STATES PERSON WHO HOLDS THIS OBLIGATION WILL BE SUBJECT TO LIMITATIONS UNDER THE UNITED STATES INCOME TAX LAWS, INCLUDING THE LIMITATIONS PROVIDED IN SECTIONS 165(j) AND 1287(a) OF THE INTERNAL REVENUE CODE."

The sections referred to provide that United States holders, with certain exceptions, will not be entitled to deduct any loss on the Bonds or interest coupons and will not be entitled to capital gains treatment of any gain on any sale, disposition, redemption or payment of principal in respect of the Bonds or interest coupons.

Summary of Provisions relating to the Bonds while in Global Form

Denominations

The Bonds will initially be issued in denominations of £5,000,000 and integral multiples of £1,000 in excess thereof. However, provided the Bonds continue to be represented by one or both of the Global Bonds on the Final Instalment Payment Date, on and following the Final Instalment Payment Date the Bonds will be automatically redenominated and transferable in denominations of £100,000 and integral multiples of £1,000 in excess thereof.

If definitive Bonds are issued in exchange of the Permanent Global Bond prior to the Final Instalment Payment Date, they will be issued in denominations of £5,000,000 plus integral multiples of £1,000 in excess thereof. If definitive Bonds are issued in exchange of the Permanent Global Bond on or after the Final Instalment Payment Date, they will be issued in denominations of £100,000 plus integral multiples of £1,000 in excess thereof.

If definitive Bonds are issued in exchange of the Permanent Global Bond prior to the Final Instalment Payment Date in denominations of £5,000,000 and integral multiples of £1,000 in excess thereof, the Issuer shall use its reasonable endeavours to have a further prospectus approved by the Financial Conduct Authority as a prospectus for the purpose of the Prospectus Directive to enable such definitive Bonds to be exchanged for definitive Bonds which are transferable in denominations of £100,000 and integral multiples of £1,000 in excess thereof. The Issuer shall promptly notify Bondholders, in accordance with Condition 15 (*Notices*), of any action required to be taken by Bondholders to exchange their Bonds for definitive Bonds which are transferable in denominations of £100,000 and integral multiples of £1,000 in excess thereof.

Notices

For so long as all of the Bonds are represented by one or both of the Global Bonds and such Global Bond(s) is/are held on behalf of Euroclear and/or Clearstream, Luxembourg, notices to Bondholders (which includes, for this purpose, any Compliance Certificate, Security Adjustment Certificate or annual reports required to be made available pursuant to a request by any of the Bondholders pursuant to Condition 6.2 (*Information Covenants*)) may be given by delivery of the relevant notice to Euroclear and/or Clearstream, Luxembourg (as the case may be) for communication to the relative Accountholders (as defined below) rather than by publication as required by Condition 15 (*Notices*). Any such notice shall be deemed to have been given to the holders of the Bonds on the second day after the day on which such notice was delivered to Euroclear and/or Clearstream, Luxembourg (as the case may be) as aforesaid.

For so long as all of the Bonds are represented by one or both of the Global Bonds and such Global Bond(s) is/are held on behalf of Euroclear and/or Clearstream, Luxembourg, notices to be given by any Bondholder may be given to the Principal Paying Agent through Euroclear and/or Clearstream, Luxembourg and otherwise in such manner as the Principal Paying Agent and Euroclear and/or Clearstream, Luxembourg, as the case may be, may approve for this purpose.

Accountholders

For so long as any of the Bonds is represented by a Global Bond held on behalf of Euroclear and/or Clearstream, Luxembourg, each person (other than Euroclear or Clearstream, Luxembourg) who is for the time being shown in the records of Euroclear or of Clearstream, Luxembourg as the holder of a particular nominal amount of such Bonds (the **Accountholder**) (in which regard any certificate or other document issued by Euroclear or Clearstream, Luxembourg as to the nominal amount of such Bonds standing to the account of any person shall be conclusive and binding for all purposes save in the case of manifest error) shall be treated as the holder of such nominal amount of such Bonds for all purposes other than with respect to the payment of principal or interest on such nominal amount of such Bonds, for which purpose the bearer of the relevant Global Bond shall be treated as the holder of such nominal amount of such Bonds in accordance with and subject to the terms of the relevant Global Bond and the expressions **Bondholder** and **holder of Bonds** and related expressions shall be construed accordingly. In determining whether a particular person is entitled to a particular nominal amount of Bonds as aforesaid, the Bond Trustee may rely on such evidence and/or information and/or certification as it shall, in its absolute discretion, think fit and, if it does so rely, such evidence and/or information and/or certification shall, in the absence of manifest error, be conclusive and binding on all concerned.

Bonds which are represented by a Global Bond will be transferable only in accordance with the rules and procedures for the time being of Euroclear and Clearstream, Luxembourg, as the case may be.

Failure by a holder of Bonds to pay the Final Instalment

If an Accountholder fails to pay the Final Instalment in respect of the Bonds held by it in full on the Final Instalment Payment Date, such failure will result in such Accountholder's position in respect of its Bonds being blocked in accordance with the procedures of Euroclear or Clearstream, Luxembourg, as the case may be, until such Final Instalment is paid in full, and/or further notice from the Issuer, which will result in such Accountholder being unable to trade its Bonds.

The Issuer may, in respect of any amounts of the Final Instalment which are due and unpaid, elect to forfeit all or any of the Bonds in respect of which such amount has not been duly paid provided that the failure pay has been continuing for 10 Business Days and the Issuer has made reasonable efforts to contact the relevant Bondholder in respect of the payment owing. Upon such forfeiture, the Issuer shall be entitled to retain any amounts(s) paid to it under such Bonds and shall be discharged from any

obligation to repay such amount(s) or to pay interest in respect of the Bonds so forfeited, but shall have no other rights against Accountholders whose Bonds have been so forfeited.

Upon such forfeiture, the Issuer shall procure that details of such forfeiture shall be entered in the records of the relevant Clearing Systems, and, upon any such entry being made, any forfeited Bonds shall be cancelled and the aggregate nominal amount and the aggregate Outstanding Principal Amount of the Bonds represented by the Global Bonds shall be reduced by such forfeited amounts.

Prescription

Claims against the Issuer in respect of principal and interest on the Bonds represented by a Global Bond will be prescribed after 10 years (in the case of principal) and five years (in the case of interest) from the Relevant Date.

Cancellation

Cancellation of any Bond represented by a Global Bond and required by the Conditions of the Bonds to be cancelled following its redemption, purchase or forfeiture will be effected by entry in the records of Euroclear or Clearstream, Luxembourg, as the case may be.

Partial Redemption

For so long as all of the Bonds are represented by one or both of the Global Bonds and such Global Bond(s) is/are held on behalf of Euroclear and/or Clearstream, Luxembourg, no selection of Bonds will be required under Condition 9.5 (*Notice of Early Redemption*) in the event that the Bonds are to be redeemed in part pursuant to Condition 9.2 (*Early Redemption*) or Condition 9.4 (*Mandatory Early Redemption*). In such event, the standard procedures of Euroclear and/or Clearstream, Luxembourg shall operate to determine which interests in the Global Bond(s) are to be subject to such redemption.

TERMS AND CONDITIONS OF THE BONDS

The following are the Terms and Conditions of the Bonds which will be endorsed on each Bond in definitive form (if issued).

The £100,000,000 5.058 per cent. (Step up) Secured Bonds due 2048 (the **Bonds**, which expression shall in these Conditions, unless the context otherwise requires, include any further bonds issued pursuant to Condition 19 (*Further Issues*) and forming a single series with the Bonds) of Knightstone Capital Plc (the **Issuer**) are constituted by a Bond Trust Deed (as modified and/or amended and/or supplemented and/or restated from time to time, the **Bond Trust Deed**) dated 2nd October, 2013 made between the Issuer and Prudential Trustee Company Limited (the **Bond Trustee**, which expression shall include any successor as Bond Trustee) as trustee for the holders of the Bonds (the **Bondholders**) and the holders of the interest coupons appertaining to the Bonds (the **Couponholders** and the **Coupons** respectively, which expressions shall, unless the context otherwise requires, include the talons for further interest coupons (the **Talons**) and the holders of the Talons).

The Bonds have the benefit of an Agency Agreement (as amended and/or supplemented and/or restated from time to time, the **Agency Agreement**) dated 2nd October, 2013 and made between the Issuer, the Bond Trustee, The Bank of New York Mellon, London Branch as principal paying agent (the **Principal Paying Agent**, which expression shall include any successor agent) and the other paying agents named therein (together with the Principal Paying Agent, the **Paying Agents**, which expression shall include any additional or successor paying agents).

Copies of the Bond Trust Deed, the Agency Agreement, the Loan Agreements, the Security Agreements and the Security Trust Deed are available for inspection during normal business hours at the registered office for the time being of the Bond Trustee being at the date of the issue of the Bonds at Laurence Pountney Hill, London EC4R 0HH and at the specified office of each of the Paying Agents. The Bondholders and the Couponholders are deemed to have notice of, and are entitled to the benefit of, all the provisions of the Bond Trust Deed and the Agency Agreement. The statements in these Conditions include summaries of, and are subject to, the detailed provisions of and definitions in the Bond Trust Deed, which includes the form of the Bonds.

1. DEFINITIONS

Words and expressions defined in the Bond Trust Deed or the Agency Agreement shall have the same meanings where used in the Conditions unless the context otherwise requires or unless otherwise stated.

In these Conditions:

Account Agreement means the Account Agreement dated 2nd October, 2013 and made between the Issuer, the Bond Trustee and the Account Bank, as amended and/or supplemented and/or restated from time to time;

Account Bank means The Bank of New York Mellon, London Branch as account bank pursuant to the Account Agreement or any successor account bank appointed thereunder;

Accounting Profit has the meaning given to it in the Loan Agreements;

Additional Borrower means any entity which (i) is a charity; (ii) is a Registered Provider of Social Housing; (iii) is a member of the Knightstone Housing Group and (iv) has acceded to the Security Trust Deed as a borrower;

Additional Loan Agreement means a loan agreement between the Issuer, an Additional Borrower and the Security Trustee;

Appointee means any attorney, manager, agent, delegate, nominee, custodian, receiver or other person appointed by the Bond Trustee under, or pursuant to, these Conditions or the Bond Trust Deed;

Approved Valuer has the meaning given to it in the Loan Agreements;

Asset Cover Test has the meaning given to it in the Loan Agreements;

Bondholder Specific Withholding means any withholding or deduction of Taxes which is required in respect of any payment in respect of any Bond or Coupon:

- (a) presented for payment by or on behalf of a holder who is liable to the Taxes in respect of the Bond or Coupon by reason of his having some connection with the Relevant Jurisdiction other than the mere holding of the Bond or Coupon; or
- (b) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive; or
- (c) presented for payment by or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting the relevant Bond or Coupon to another Paying Agent in a Member State of the European Union; or
- (d) presented for payment more than 30 days after the Relevant Date except to the extent that a holder would have been entitled to additional amounts on presenting the same for payment on the last day of the period of 30 days assuming, whether or not such is in fact the case, that day to have been a Payment Day (as defined in Condition 8.5 (*Payment Day*));

Borrowers means the Original Borrower and any Additional Borrower, in each case for so long as it is a borrower under a Loan Agreement;

Borrower Default has the meaning given to it in the Loan Agreements;

Cancelled Retained Proceeds has the meaning given to it in the Loan Agreements;

Charged Cash means, at any time, the aggregate of all amounts (whether representing proceeds of disposal or other moneys) standing to the credit of the Ongoing Cash Security Account and, to the extent invested in Permitted Investments in accordance with the Custody Agreement, such Permitted Investments and any income received by the Issuer in respect of such Permitted Investments, provided however that, for the purpose of determining the compliance of the Borrowers with the Asset Cover Test, the value to be attributed to such Permitted Investments shall be the purchase price thereof;

Charitable Group Member means a charitable member of the Knightstone Housing Group;

Commitment has the meaning given to it in the Loan Agreements;

Compliance Certificate has the meaning given to it in the Loan Agreements;

Custodian means The Bank of New York Mellon, London Branch as custodian pursuant to the Custody Agreement or any successor custodian appointed thereunder;

Custody Account means the account of the Issuer set up with the Custodian in respect of the Permitted Investments in accordance with the Custody Agreement;

Custody Agreement means the Custody Agreement dated 2nd October, 2013 and made between the Issuer, the Bond Trustee and the Custodian, as amended and/or supplemented and/or restated from time to time;

Eligible Group Member means any entity which, unless otherwise approved by the Security Trustee, is (i) a member of the Knightstone Housing Group; and (ii) a Registered Provider of Social Housing and which, in each case, has created (and which is subsisting) or will create security pursuant to the Security Trust Deed;

Final Instalment Payment Date means 30th November, 2017;

Group Parent means Knightstone Housing Group Limited and any entity with which the Group Parent may merge or be consolidated with at any time;

Initial Cash Security Account means the account of the Issuer set up with the Account Bank in respect of the Retained Proceeds in accordance with the Account Agreement;

Issue Date means 2nd October, 2013;

Issuer Charged Property has the meaning given to it in Condition 4;

Issuer Security has the meaning given to it in Condition 4;

Knightstone Housing Group means the Group Parent and any other present or future, direct or indirect, subsidiaries of the Group Parent (which includes, for the avoidance of doubt, any entity with which any Borrower and/or any Eligible Group Member may merge or be consolidated with at any time including as a result of a Permitted Reorganisation);

Knightstone Housing Association Loan has the meaning given to it in the Knightstone Housing Association Loan Agreement;

Knightstone Housing Association Loan Agreement means the loan agreement dated on or about the Issue Date between the Issuer, the Original Borrower and the Security Trustee;

Loans means the Knightstone Housing Association Loan and the nominal amount of each Commitment which has been advanced to an Additional Borrower pursuant to the terms of an Additional Loan Agreement or the outstanding balance thereof for the time being (ignoring, for these purposes, any Actual Advance Amount or Retained Bond Actual Advance Amount (each as defined in the Knightstone Housing Association Loan Agreement));

Loan Agreements means the Knightstone Housing Association Loan Agreement and each Additional Loan Agreement;

Loan Payment Day means a day on which principal or interest in respect of a Loan is due and payable by a Borrower to the Issuer in accordance with the terms of a Loan Agreement;

Maturity Date means 2nd October, 2048;

Ongoing Cash Security Account means the account of the Issuer set up with the Account Bank in respect of the Charged Cash in accordance with the Account Agreement;

Original Borrower means Knightstone Housing Association Limited;

Outstanding Principal Amount means, in respect of each Bond, its paid up nominal amount;

Permitted Investments has the meaning given to it in the Loan Agreements;

Permitted Investment Profit means, in respect of any sale of Permitted Investments, the amount by which the sale price of such Permitted Investments exceeds the original purchase price of such Permitted Investments (if any);

Permitted Reorganisation means any amalgamation, merger, consolidation or transfer of engagements (whether entering into or acceptance thereof) of the whole of any Borrower's or any Eligible Group Member's property (including, for the avoidance of doubt, any statutory procedure as provided for under the Industrial and Provident Societies Act 1965) made between such Borrower or such Eligible Group Member, as the case may be, (**Party A**) and any other entity (**Party B**) provided that (i) Party B is a Registered Provider of Social Housing and any new amalgamated entity to be created as a result thereof will be a Registered Provider of Social Housing; (ii) following any such amalgamation, merger, consolidation or transfer of engagements in respect of which the property of Party A (including, for the avoidance of doubt, any liabilities) shall become vested in Party B or a new amalgamated entity, Party B or such new amalgamated entity will thereafter be responsible for all the liabilities of Party A pursuant to the Industrial and Provident Societies Act 1965; and (iii) a certificate executed by two authorised signatories of Party A or Party B confirming the above is provided to the Bond Trustee;

Potential Event of Default means any act, event or circumstance which with the expiry of a grace period, the giving of notice, determination of materiality or other determination would constitute an Event of Default;

Registered Provider of Social Housing means a person listed in the register of providers of social housing established under Chapter 3 of Part 2 of the Housing and Regeneration Act 2008 (as amended from time to time) or a person having a status which, in the opinion of the Issuer and the Bond Trustee, is substantially equivalent under any replacement or successor legislation thereto;

Relevant Date means the date on which the payment first becomes due but, if the full amount of the money payable has not been received by the Principal Paying Agent or the Bond Trustee on or before the due date, it means the date on which, the full amount of the money having been so received, notice to that effect has been duly given to the Bondholders by the Issuer in accordance with Condition 15 (*Notices*);

Relevant Jurisdiction means the United Kingdom or any political subdivision or any authority thereof or therein having power to tax or any other jurisdiction or any political subdivision or any authority thereof or therein having power to tax to which the Issuer becomes subject in respect of payments made by it of principal and interest on the Bonds or Coupons;

Retained Bond Premium Amount means, in respect of any sale by the Issuer of Retained Bonds, the amount by which the net sale price of such Retained Bonds exceeds the nominal amount of such Retained Bonds (if any);

Retained Bond Custodian means The Bank of New York Mellon, London Branch as custodian pursuant to the Retained Bond Custody Agreement or any successor custodian appointed thereunder;

Retained Bond Custody Agreement means the custody agreement relating to the Retained Bonds dated 2nd October, 2013 and made between the Issuer, the Bond Trustee and the Retained Bond Custodian, as amended and/or supplemented and/or restated from time to time;

Retained Bonds means £50,000,000 in nominal amount of the Bonds purchased by the Issuer on the Issue Date;

Retained Proceeds means, at any time, (a) an amount of the net issue proceeds of the Bonds (other than the Retained Bonds) which have not been advanced to a Borrower pursuant to a Loan Agreement at such time (if any) plus (b) an amount of the net sale proceeds of the Retained Bonds (less any Retained Bond Premium Amount) which are not advanced to a Borrower pursuant to a Loan Agreement immediately following receipt thereof by the Issuer and have not subsequently been advanced to a Borrower (if any);

Secured Parties means the Bond Trustee (for itself and on behalf of the Bondholders and Couponholders), the Principal Paying Agent, the other Paying Agents, the Account Bank, the Custodian and the Retained Bond Custodian;

Security Adjustment Certificate has the meaning given to it in the Loan Agreements;

Security Agreements means each security agreement entered into between a Borrower or an Eligible Group Member and the Security Trustee substantially in the form set out in the Security Trust Deed pursuant to which such Borrower or Eligible Group Member provides security in respect of a Borrower's obligations under a Loan Agreement;

Security Trust Deed means the Security Trust Deed dated 2nd October, 2013 between, *inter alios*, the Original Borrower and the Security Trustee (as amended from time to time);

Security Trustee means Prudential Trustee Company Limited as security trustee under the Security Trust Deed for, *inter alios*, the Issuer;

Taxes has the meaning given to it in Condition 10.1 (*Payments without withholding*);

Transaction Account means the account of the Issuer set up with the Account Bank in respect of the Bonds in accordance with the Account Agreement;

Transaction Documents means the Loan Agreements, the Bond Trust Deed, the Security Trust Deed, the Agency Agreement, the Account Agreement, the Custody Agreement and the Retained Bond Custody Agreement;

Transaction Parties means any person who is party to a Transaction Document;

UK Government Gilt means Sterling denominated gilts or stock issued by or on behalf of Her Majesty's Treasury;

Undrawn Commitment has the meaning given to it in the Loan Agreements; and

Valuation has the meaning given to it in the Loan Agreements.

2. FORM, DENOMINATION AND TITLE

The Bonds are in bearer form, serially numbered, with Coupons and Talons attached on issue. The Bonds shall be issued in the denomination of £[5,000,000][100,000]¹ and integral multiples of £1,000 in excess thereof up to and including £[9,999,000][199,000]² and no Bonds will be issued with a denomination above £[9,999,000][199,000]³.

Title to the Bonds and Coupons will pass by delivery.

3. STATUS

The Bonds and Coupons are direct obligations of the Issuer, secured in the manner set out in Condition 4 (*Security*), and rank *pari passu* without preference or priority amongst themselves.

4. SECURITY

The Issuer's obligations in respect of the Bonds are secured (subject as provided in these Conditions and the Bond Trust Deed) pursuant to the Bond Trust Deed in favour of the Bond Trustee for the benefit of itself and the Bondholders and the other Secured Parties as follows:

- (a) by an assignment by way of security of the Issuer's rights, title and interest arising under the Loan Agreements, the Security Trust Deed, the Security Agreements, the Agency Agreement, the Custody Agreement and the Account Agreement, in each case to the extent they relate to the Bonds;
- (b) by a charge by way of first fixed charge over all moneys and/or securities from time to time standing to the credit of the Transaction Account, the Ongoing Cash Security Account, the Initial Cash Security Account and the Custody Account and all debts represented thereby; and
- (c) by a charge by way of first fixed charge over all sums held from time to time by the Paying Agents for the payment of principal or interest in respect of the Bonds.

The property charged and assigned pursuant to the Bond Trust Deed listed in (a) to (c) above, together with any other property or assets held by and/or assigned to the Bond Trustee and/or any deed or document supplemental thereto, is referred to herein as the **Issuer Charged Property** and the security created thereby, the **Issuer Security**.

¹ The former will be inserted in respect of definitive Bonds issued in exchange for interests in the Permanent Global Bond prior to the Final Instalment Payment Date. The latter will be inserted in respect of definitive Bonds issued in exchange for interests in the Permanent Global Bond on or following the Final Instalment Payment Date.

² The former will be inserted in respect of definitive Bonds issued in exchange for interests in the Permanent Global Bond prior to the Final Instalment Payment Date. The latter will be inserted in respect of definitive Bonds issued in exchange for interests in the Permanent Global Bond on or following the Final Instalment Payment Date.

³ The former will be inserted in respect of definitive Bonds issued in exchange for interests in the Permanent Global Bond prior to the Final Instalment Payment Date. The latter will be inserted in respect of definitive Bonds issued in exchange for interests in the Permanent Global Bond on or following the Final Instalment Payment Date.

5. ORDER OF PAYMENTS

5.1 Pre-enforcement

Prior to the enforcement of the Issuer Security, the Issuer shall apply the monies standing to the credit of the Transaction Account on each Interest Payment Date and such other dates on which a payment is due in respect of the Bonds in the following order of priority (the **Pre-enforcement Priority of Payment**):

- (a) first, in payment of any taxes due and owing by the Issuer to any taxing authority (insofar as they relate to the Bonds);
- (b) second, in payment of any unpaid fees, costs, charges, expenses and liabilities incurred by the Bond Trustee (including remuneration payable to it and any Appointee) in carrying out its functions under the Bond Trust Deed;
- (c) third, in payment of any unpaid fees, expenses and liabilities of the Issuer owing to the Paying Agents under the Agency Agreement, the Account Bank under the Account Agreement, the Custodian under the Custody Agreement and the Retained Bond Custodian under the Retained Bond Custody Agreement on a *pro rata* and *pari passu* basis;
- (d) fourth, in payment of any other unpaid fees, expenses and liabilities of the Issuer (in so far as they relate to the Bonds) on a *pro rata* and *pari passu* basis;
- (e) fifth, in payment, on a *pro rata* and *pari passu* basis, to the Bondholders of any interest due and payable in respect of the Bonds;
- (f) sixth, in payment, on a *pro rata* and *pari passu* basis, to the Bondholders of any principal due and payable in respect of the Bonds;
- (g) seventh, in payment, on a *pro rata* and *pari passu* basis, to the Borrowers of any amounts due and payable under the terms of the Loan Agreements; and
- (h) eighth, in payment of any Permitted Investment Profit, Accounting Profit or Retained Bond Premium Amount, as the case may be, to any Charitable Group Member.

5.2 Post-enforcement

Following the enforcement of the Issuer Security, all monies standing to the credit of the Transaction Account, the Ongoing Cash Security Account and the Initial Cash Security Account and the net proceeds of enforcement of the Issuer Security shall be applied in the following order of priority (the **Post-enforcement Priority of Payment**):

- (a) first, in payment or satisfaction of the fees, costs, charges, expenses and liabilities incurred by the Bond Trustee, any Appointee or any receiver in preparing and executing the trusts under the Bond Trust Deed (including the costs of realising any Issuer Security and the Bond Trustee's and such receiver's remuneration);
- (b) second, in payment of all amounts owing to the Paying Agents under the Agency Agreement, the Account Bank under the Account Agreement, the Custodian under the Custody Agreement and the Retained Bond Custodian under the Retained Bond Custody Agreement on a *pro rata* and *pari passu* basis;

- (c) third, in payment, on a *pro rata* and *pari passu* basis, to the Bondholders of any interest due and payable in respect of the Bonds;
- (d) fourth, in payment, on a *pro rata* and *pari passu* basis, to the Bondholders of any principal due and payable in respect of the Bonds;
- (e) fifth, in payment of any other unpaid fees and expenses of the Issuer (in each case insofar as they relate to the Bonds) on a *pro rata* and *pari passu* basis;
- (f) sixth, in payment, on a *pro rata* and *pari passu* basis, to the Borrowers of any amounts due and payable under the terms of the Loan Agreements; and
- (g) seventh, in payment of any Permitted Investment Profit, Accounting Profit or Retained Bond Premium Amount, as the case may be, to any Charitable Group Member.

6. COVENANTS

6.1 General Covenants

In addition to the covenants of the Issuer set out in the Bond Trust Deed, for so long as any of the Bonds remain outstanding, the Issuer covenants that it will not, without the consent in writing of the Bond Trustee, engage in any activity or do anything other than:

- (a) carry out the business of a company which has as its purpose raising finance and on-lending such finance for the benefit of the Borrowers (including, without limitation, as envisaged by the Transaction Documents); and
- (b) perform any act incidental to or necessary in connection with (a) above.

The Issuer also covenants, for so long as any of the Bonds remain outstanding, not to create or permit to subsist, over any of the security constituted by or created pursuant to the Bond Trust Deed, any mortgage or charge or any other security interest ranking in priority to, or *pari passu* with, the security created by or pursuant to the Bond Trust Deed.

6.2 Information Covenants

For so long as any of the Bonds remain outstanding, the Issuer shall:

- (a) send to the Bond Trustee and, upon request by any Bondholder to the Issuer, make available to such Bondholder at the Issuer's registered office during normal business hours, a copy of the Compliance Certificates (and, subject to the consent of the relevant Approved Valuer(s), the Valuation(s) delivered for the purpose of preparing such Compliance Certificates) and the Security Adjustment Certificates promptly upon receipt of the same from the Borrowers pursuant to the terms of their respective Loan Agreements;
- (b) send to the Bond Trustee and, upon request by any Bondholder to the Issuer, make available to such Bondholder at the Issuer's registered office during normal business hours, a copy of the annual reports of each Borrower promptly upon publication of the same by the relevant Borrower; and
- (c) at the request of Bondholders holding not less than 33 per cent. in nominal amount of the Bonds for the time being outstanding, convene a meeting of the Bondholders to

discuss the financial position of the Issuer and the Knightstone Housing Group. Upon the request of Bondholders to convene any such meeting, as aforesaid, the Issuer shall notify all Bondholders of the date (which such date shall be no more than 21 days following such request), time and place of the meeting in accordance with Condition 15 (*Notices*). The Issuer shall act in good faith in addressing any questions regarding the financial position of itself or any other member of the Knightstone Housing Group raised at any such meeting, provided, however, that the Issuer shall not be obliged to disclose any information which it, in its absolute discretion, considers to be of a confidential nature. For the avoidance of doubt, the provisions of this Condition 6.2(c) are in addition to the meetings provisions set out in Condition 17 (*Meetings of Bondholders, Modification and Waiver*).

6.3 Loan Agreements, Security Agreements and Security Trust Deed Consents Covenant

For so long as any of the Bonds remain outstanding, the Issuer covenants that it shall not consent to any waiver, amendment or modification of, or take any action or direct the Security Trustee to take any action pursuant to, the Loan Agreements, the Security Agreements or the Security Trust Deed except with the prior consent of the Bond Trustee. The Bond Trustee may seek the consent of the Bondholders in accordance with the Bond Trust Deed prior to giving any such consent.

7. INTEREST

7.1 Interest Rate and Interest Payment Dates

The Bonds bear interest on the Outstanding Principal Amount from (and including) 2nd October, 2013, payable semi-annually in arrear on 2nd April and 2nd October in each year (each, an **Interest Payment Date**), at the rate of 5.058 per cent. per annum in respect of the period from (and including) the Issue Date to (but excluding) 30th November, 2017 and at the rate of 5.576 per cent. per annum from (and including) 30th November, 2017 to (but excluding) the Maturity Date. Subject to this Condition 7, in respect of the Interest Payment Date occurring on 2nd April, 2018 the Bonds will bear interest of £19.0059462 in respect of each £1,000 in nominal amount of the Bonds.

7.2 Interest Accrual

Each Bond will cease to bear interest from (and including) its due date for redemption unless, upon due presentation, payment of the principal in respect of the Bond is improperly withheld or refused or unless default is otherwise made in respect of payment, in which event interest shall continue to accrue as provided in the Bond Trust Deed.

7.3 Calculation of Broken Interest

When interest is required to be calculated in respect of a period of less than a full half year, it shall be calculated on the basis of (a) the actual number of days in the period from (and including) the date from which interest begins to accrue (the **Accrual Date**) to (but excluding) the date on which it falls due divided by (b) the actual number of days from and including the Accrual Date to (but excluding) the next following Interest Payment Date multiplied by 2, and multiplying this by the relevant rate of interest specified in Condition 7.1 above and the relevant Outstanding Principal Amount of the Bonds.

8. PAYMENTS

8.1 Payments in respect of Bonds and Coupons

Subject as follows, payments of principal and interest in respect of each Bond will be made against presentation and surrender (or, in the case of part payment only, endorsement) of the Bond.

Payments of interest on an Interest Payment Date will be made against presentation and surrender (or in the case of part payment only, endorsement) of the relevant Coupon, in each case at the specified office outside the United States of any of the Paying Agents.

8.2 Method of Payment

Payments will be made by credit or transfer to an account in Sterling maintained by the payee with, or, at the option of the payee, by a cheque in Sterling drawn on, a bank in London.

8.3 Missing Unmatured Coupons

Each Bond should be presented for payment together with all relative unmatured Coupons (which expression shall, for the avoidance of doubt, include Coupons falling to be issued on exchange of matured Talons), failing which the full amount of any relative missing unmatured Coupon (or, in the case of payment not being made in full, that proportion of the full amount of the missing unmatured Coupon which the amount so paid bears to the total amount due) will be deducted from the amount due for payment. Each amount so deducted will be paid in the manner mentioned above against presentation and surrender (or, in the case of part payment only, endorsement) of the relative missing Coupon at any time before the expiry of 10 years after the Relevant Date in respect of the relevant Bond (whether or not the Coupon would otherwise have become void pursuant to Condition 11 (*Prescription*)) or, if later, five years after the date on which the Coupon would have become due, but not thereafter.

8.4 Payments subject to Applicable Laws

Payments in respect of principal and interest on the Bonds are subject in all cases to any fiscal or other laws and regulations applicable thereto in the place of payment.

8.5 Payment Day

If the date for payment of any amount in respect of any Bond or Coupon is not a Payment Day, the holder thereof shall not be entitled to payment until the next following Payment Day in the relevant place and shall not be entitled to further interest or other payment in respect of such delay.

For these purposes, **Payment Day** means any day which (subject to Condition 11 (*Prescription*)):

- (a) is, or falls after, the relevant due date;
- (b) is, or falls at least one Business Day after, the corresponding Loan Payment Day;
- (c) is a Business Day in the place of the specified office of the Paying Agent at which the Bond or Coupon is presented for payment; and

- (d) in the case of payment by a credit or transfer to a Sterling account in London as referred to above, is a Business Day in London.

In this Condition, **Business Day** means, in relation to any place, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in that place.

8.6 Initial Paying Agents

The names of the initial Paying Agents and their initial specified offices are set out at the end of these Conditions. The Issuer reserves the right, subject to the prior written approval of the Bond Trustee, at any time to vary or terminate the appointment of any Paying Agent and to appoint additional or other Paying Agents provided that:

- (a) there will at all times be a Principal Paying Agent;
- (b) there will at all times be at least one Paying Agent (which may be the Principal Paying Agent) having its specified office in a European city which so long as the Bonds are admitted to official listing on the London Stock Exchange shall be London or such other place as the UK Listing Authority may approve; and
- (c) the Issuer undertakes to maintain a Paying Agent in a Member State of the European Union that is not obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive.

Notice of any termination or appointment and of any changes in specified offices will be given to the Bondholders promptly by the Issuer in accordance with Condition 15 (*Notices*).

In acting under the Agency Agreement, the Paying Agents act solely as agents of the Issuer and, in certain circumstances specified therein, of the Bond Trustee and do not assume any obligation to, or relationship of agency or trust with, any Bondholders or Couponholders. The Agency Agreement contains provisions permitting any entity into which any Paying Agent is merged or converted or with which it is consolidated or to which it transfers all or substantially all of its assets to become the successor paying agent.

8.7 Interpretation of principal and interest

Any reference in these Conditions to principal in respect of the Bonds shall be deemed to include, as applicable:

- (a) any additional amounts which may be payable with respect to principal under Condition 10 (*Taxation*); and
- (b) any specific redemption price referred to in Condition 9 (*Redemption and Purchase*) which may be payable by the Issuer under or in respect of the Bonds.

Any reference in these Conditions to interest in respect of the Bonds shall be deemed to include, as applicable, any additional amounts which may be payable with respect to interest under Condition 10 (*Taxation*).

9. REDEMPTION AND PURCHASE

9.1 Redemption at Maturity

Unless previously redeemed, or purchased and cancelled, the Bonds (assuming them to be fully paid up) will be redeemed by the Issuer at their Outstanding Principal Amount, together with accrued interest, on the Maturity Date.

9.2 Early Redemption

Subject to Condition 9.4 (*Mandatory Early Redemption*) below, if in accordance with a Loan Agreement, a Borrower elects to prepay its Loan in whole or in part prior to the repayment date specified in the relevant Loan Agreement or the relevant Loan otherwise becomes prepayable in whole or in part prior to the repayment date specified in the relevant Loan Agreement (other than as a result of the Bonds becoming due and repayable), then, (if no replacement Commitment is put in place with another Borrower), the Issuer shall redeem the Bonds in whole or, in respect of a prepayment in part, in an aggregate Outstanding Principal Amount equal to the nominal amount of the relevant Loan to be repaid on the date which is two Business Days after that on which payment is made by the relevant Borrower under the relevant Loan Agreement (the **Loan Prepayment Date**).

Redemption of the Bonds pursuant to this Condition 9.2 shall be made at the higher of the following:

- (a) their Outstanding Principal Amount; and
- (b) the amount (as calculated by a financial adviser nominated by the Issuer and approved by the Bond Trustee (the **Nominated Financial Adviser**) and reported in writing to the Issuer and the Bond Trustee) which is equal to the Outstanding Principal Amount of the Bonds to be redeemed multiplied by the price (expressed as a percentage and calculated by the Nominated Financial Adviser) (rounded to three decimal places (0.0005 being rounded upwards)) at which the Gross Redemption Yield on the Bonds (if the Bonds were to remain outstanding until their original maturity) on the Determination Date would be equal to the sum of (i) the Gross Redemption Yield at 3:00 pm (London time) on the Determination Date of the Benchmark Gilt and (ii) 0.20 per cent.,

together with any interest accrued up to (but excluding) the Loan Prepayment Date.

For the purposes of this Condition:

Benchmark Gilt means the 4¼% Treasury Gilt 2049 or such other conventional (i.e. not index-linked) UK Government Gilt as the Issuer (with the advice of the Nominated Financial Adviser) may determine (failing such determination, as determined by the Bond Trustee with such advice) to be the most appropriate benchmark conventional UK Government Gilt;

Determination Date means three Business Days prior to the Loan Prepayment Date; and

Gross Redemption Yield means a yield calculated by the Nominated Financial Adviser on the basis set out by the United Kingdom Debt Management Office in the paper "*Formulae for Calculating Gilt Prices from Yields*" page 5, Section One: Price/Yield Formulae (Conventional Gilts; Double-dated and Undated Gilts with Assumed (or Actual) Redemption on a Quasi-Coupon Date) (published on 8th June, 1998 and updated on 15th January, 2002 and 16th March, 2005) (as amended or supplemented from time to time).

9.3 Early Redemption for Tax Reasons

If as a result of any actual or proposed change in tax law, the Issuer determines (in its reasonable commercial judgement), and certifies to the Bond Trustee, that it would, on the next following Interest Payment Date, be required to make a withholding or deduction in respect of payments to be made on such Interest Payment Date (other than in respect of a Bondholder Specific Withholding) and the Issuer does not opt to pay additional amounts pursuant to Condition 10.2 (*No obligation to pay additional amounts*) or, having so opted, notifies the Bond Trustee and the Bondholders, in accordance with Condition 15 (*Notices*), of its intention to cease paying such additional amounts, the Issuer shall redeem the Bonds in whole, but not in part, at their Outstanding Principal Amount, plus accrued interest to (but excluding) the date of redemption, as soon as reasonably practicable prior to the next following Interest Payment Date or, if it is not reasonably practicable for the Issuer to redeem the Bonds prior to the next following Interest Payment Date, within three Business Days thereafter. For the avoidance of doubt, any amounts in respect of accrued interest which fall due on any such redemption of the Bonds (and, where the redemption follows the next following Interest Payment Date, such Interest Payment Date) shall be paid subject to the required withholding or deduction and the Issuer shall not be obliged to pay any additional amounts in respect thereof.

9.4 Mandatory Early Redemption

If a Loan becomes repayable:

- (a) as a result of a Borrower Default; or
- (b) following a Borrower ceasing to be a Registered Provider of Social Housing (other than if the Borrower regains its status as a Registered Provider of Social Housing within 180 days),

then (unless the Issuer has increased the Commitment of another Borrower by the relevant amount of the Loan to be repaid within 14 days of the date of such Borrower Default or upon the expiry of the 180 days as aforesaid) the Issuer shall redeem the Bonds in an aggregate Outstanding Principal Amount equal to the nominal amount of the relevant Loan at their Outstanding Principal Amount, plus accrued interest to (but excluding) the date of redemption of the Bonds, no later than (i) 14 days following the date of such Borrower Default or the date of the expiry of the period of 180 days, as the case may be, or, if later, (ii) two Business Days following the date on which the Loan is repaid.

9.5 Notice of Early Redemption

Notice of any early redemption in accordance with Condition 9.2 (*Early Redemption*), Condition 9.3 (*Early Redemption for Tax Reasons*) or Condition 9.4 (*Mandatory Early Redemption*) above shall be given by the Issuer to the Bond Trustee, the Paying Agents and the Bondholders, in accordance with Condition 15 (*Notices*), as promptly as practicable.

In the case of a partial redemption of Bonds, Bonds to be redeemed will be selected in such place as the Bond Trustee may approve and in such manner and at such time as the Bond Trustee may deem appropriate and fair. Notice of any such selection will be given by the Issuer to the Bondholders as promptly as practicable. Each notice will specify the date fixed for redemption, the early redemption amount and the aggregate Outstanding Principal Amount of the Bonds to be redeemed, the serial numbers of the Bonds called for redemption, the serial numbers of Bonds previously called for redemption and not presented for payment

and the aggregate Outstanding Principal Amount of the Bonds which will be outstanding after the partial redemption.

9.6 Calculations

Each calculation, by or on behalf of the Issuer, for the purposes of this Condition 9 shall, in the absence of manifest error, be final and binding on all persons. If the Issuer does not at any time for any reason calculate amounts referred to in this Condition 9, such amounts may be calculated by the Bond Trustee, or an agent appointed (at the expense of the Issuer) by the Bond Trustee for this purpose, (without any liability accruing to the Bond Trustee as a result) based on information supplied to it by the Issuer and each such calculation shall be deemed to have been made by the Issuer.

9.7 Purchase of Bonds by a Borrower or any other member of the Knightstone Housing Group

A Borrower or any other member of the Knightstone Housing Group may at any time purchase Bonds in the open market or otherwise at any price. Following any such purchase, such Borrower or other member of the Knightstone Housing Group, as the case may be, may (but is not obliged to) surrender the Bonds to the Issuer for cancellation. An amount equal to the Outstanding Principal Amount of the Bonds being surrendered shall be deemed to be prepaid under the Loan Agreement specified by such Borrower or other member of the Knightstone Housing Group, as the case may be (but, for the avoidance of doubt, without triggering a redemption under Condition 9.2 (*Early Redemption*)) or, to the extent that the relevant Loan is not then outstanding, an amount of the Undrawn Commitment of the relevant Borrower equal to the Outstanding Balance of the Bonds surrendered shall be deemed to be cancelled for the purposes of such Loan Agreement and an amount of Retained Proceeds equal to the Cancelled Retained Proceeds shall be paid by the Issuer to such Borrower or other member of the Knightstone Housing Group, as applicable.

9.8 Purchase of Bonds by the Issuer

The Issuer shall purchase the Retained Bonds on 2nd October, 2013 and may at any time purchase Bonds in the open market or otherwise at any price.

9.9 Cancellation of purchased or redeemed Bonds

All Bonds redeemed by the Issuer pursuant to Condition 9.2 (*Early Redemption*), Condition 9.3 (*Early Redemption for Tax Reasons*) or Condition 9.4 (*Mandatory Early Redemption*) or surrendered to the Issuer for cancellation pursuant to Condition 9.7 (*Purchase of Bonds by a Borrower or any other member of the Knightstone Housing Group*) shall be cancelled and may not be issued or resold.

The Issuer (a) may cancel any Retained Bonds held by it or on its behalf following a request by a Borrower, pursuant to a Loan Agreement, to cancel a corresponding amount of such Borrower's Undrawn Commitment; (b) shall cancel all Retained Bonds held by or on behalf of the Issuer (i) immediately prior to such Retained Bonds being redeemed on the Maturity Date; and (ii) forthwith upon notice that the Bonds are to be redeemed (and, in any event, prior to such redemption) in accordance with Condition 9.3 (*Early Redemption for Tax Reasons*) or Condition 12 (*Events of Default and Enforcement*); (c) shall, forthwith upon notice that the Bonds are to be redeemed in full or in part in accordance with Condition 9.4 (*Mandatory Early Redemption*), cancel Retained Bonds held by or on behalf of the Issuer in an aggregate Outstanding Principal Amount equal to the nominal amount of the Undrawn Commitment (if any) of the relevant Borrower whose Loan has become repayable; and (d)

may cancel any Bonds (other than Retained Bonds) held by it or on its behalf at any time at its discretion.

10. TAXATION

10.1 Payments without withholding

All payments of principal and interest in respect of the Bonds and Coupons by or on behalf of the Issuer shall be made without withholding or deduction for, or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature (**Taxes**) imposed or levied by or on behalf of the Relevant Jurisdiction, unless such withholding or deduction is required by law in which case the relevant payment will be made subject to such withholding or deduction.

10.2 No obligation to pay additional amounts

Subject as follows, neither the Issuer, the Bond Trustee nor any Paying Agent shall be obliged to pay any additional amounts to the Bondholders or Couponholders as a result of any withholding or deduction made in accordance with Condition 10.1 (*Payments without withholding*).

Notwithstanding the foregoing, in the event that the Issuer would, on the next Interest Payment Date, be required to make a withholding or deduction in respect of tax (other than in respect of a Bondholder Specific Withholding), the Issuer may, provided that it has given notice to the Bond Trustee and the Bondholders, in accordance with Condition 15 (*Notices*), of its intention to do so prior to such Interest Payment Date, pay to Bondholders such additional amounts as may be necessary in order that the net amounts received by the Bondholders after such withholding or deduction will equal the amounts of principal and interest which would have been received in respect of the Bonds in the absence of such withholding or deduction. If at any time the Issuer intends to cease paying such additional amounts it may do so by giving notice to the Bondholders and the Bond Trustee of its intention to do so with effect from the next Interest Payment Date.

11. PRESCRIPTION

The Bonds and Coupons will become void unless presented for payment within a period of 10 years (in the case of principal) and five years (in the case of interest) after the Relevant Date therefor.

There shall not be included in any Coupon sheet issued on exchange of a Talon any Coupon the claim for payment in respect of which would be void pursuant to this Condition or Condition 8 (*Payments*) or any Talon which would be void pursuant to Condition 8 (*Payments*).

12. EVENTS OF DEFAULT AND ENFORCEMENT

12.1 Events of Default

The Bond Trustee at its discretion may, and if so requested in writing by the holders of at least one-fourth in Outstanding Principal Amount of the Bonds then outstanding or if so directed by an Extraordinary Resolution shall (subject in each case to being secured and/or indemnified and/or pre-funded to its satisfaction), (but in the case of the happening of any of the events described in paragraphs 12.1(b), (c) and (i) below, only if the Bond Trustee shall have certified in writing to the Issuer that such event is, in its opinion, materially prejudicial

to the interests of the Bondholders), give notice in writing to the Issuer that the Bonds are, and the Bonds shall thereupon immediately become, due and repayable at their Outstanding Principal Amount together with accrued interest as provided in the Bond Trust Deed if any of the following events (each an **Event of Default**) shall occur:

- (a) if default is made in the payment of any principal or interest due in respect of the Bonds or any of them and the default continues for a period of seven days in the case of principal and fourteen days in the case of interest; or
- (b) if the Issuer fails to perform or observe any of its other obligations under, or in respect of, the Conditions or the Bond Trust Deed or if any representation given by the Issuer to the Bond Trustee in the Bond Trust Deed is found to be untrue, incorrect or misleading as at the time it was given and (except in any case where, in the opinion of the Bond Trustee, the failure or inaccuracy is incapable of remedy when no such continuation or notice as is hereinafter mentioned will be required) the failure or inaccuracy continues for the period of 30 days next following the service by the Bond Trustee on the Issuer of notice requiring the same to be remedied; or
- (c) (A) any other present or future indebtedness of the Issuer for or in respect of moneys borrowed or raised becomes due and payable prior to its stated maturity by reason of any actual or potential default, event of default or the like (howsoever described), or (B) any such indebtedness is not paid when due or, as the case may be, within any originally applicable grace period, or (C) the Issuer fails to pay when due any amount payable by it under any present or future guarantee for, or indemnity in respect of, any moneys borrowed or raised provided that the aggregate amount of the relevant indebtedness, guarantees and indemnities in respect of which one or more of the events mentioned above in this paragraph (c) have occurred equals or exceeds £10,000,000 or its equivalent in other currencies (as reasonably determined by the Bond Trustee); or
- (d) if any order is made by any competent court or resolution passed for the winding up or dissolution of the Issuer save for the purposes of a reorganisation on terms previously approved in writing by the Bond Trustee or by an Extraordinary Resolution; or
- (e) if the Issuer ceases or threatens to cease to carry on the whole or, in the opinion of the Bond Trustee, substantially all of its business, save for the purposes of a reorganisation on terms previously approved in writing by the Bond Trustee or by an Extraordinary Resolution; or
- (f) if the Issuer stops or threatens to stop payment of, or is unable to, or admits inability to, pay, its debts (or any class of its debts) as they fall due, or is deemed unable to pay its debts pursuant to or for the purposes of any applicable law, or is adjudicated or found bankrupt or insolvent; or
- (g) if (A) proceedings are initiated against the Issuer under any applicable liquidation, insolvency, composition, reorganisation or other similar laws, or an application is made (or documents filed with a court) for the appointment of an administrative or other receiver, liquidator, manager, administrator or other similar official, or an administrative or other receiver, liquidator, manager, administrator or other similar official is appointed, in relation to the Issuer or, as the case may be, in relation to all or substantially all of the Issuer's undertaking or assets, or an encumbrancer takes possession of all or substantially all of the Issuer's undertaking or assets, or a distress, execution, attachment, sequestration or other process is levied, enforced upon, sued

out or put in force against all or substantially all of the Issuer's undertaking or assets and (B) in any such case (other than the appointment of an administrator) is not discharged within 14 days; or

- (h) if the Issuer initiates or consents to judicial proceedings relating to itself under any applicable liquidation, insolvency, composition, reorganisation or other similar laws (including the obtaining of a moratorium) or makes a conveyance or assignment for the benefit of, or enters into any composition or other arrangement with, its creditors generally (or any class of its creditors) or any meeting is convened to consider a proposal for an arrangement or composition with its creditors generally (or any class of its creditors); or
- (i) if it is or will become unlawful for the Issuer to perform or comply with any of its obligations under or in respect of the Bonds, the Bond Trust Deed or any Loan Agreement.

12.2 Enforcement

The Bond Trustee may at any time, at its discretion and without notice, take such proceedings and/or other steps or action (including lodging an appeal in any proceedings) against or in relation to the Issuer as it may think fit to enforce the provisions of the Bond Trust Deed, the Bonds, the Coupons and/or any of the other Transaction Documents or otherwise, but it shall not be bound to take any such proceedings or other steps or any other action unless (i) it shall have been so directed by an Extraordinary Resolution or so requested in writing by the holders of at least one-fourth in Outstanding Principal Amount of the Bonds then outstanding and (ii) it shall have been secured and/or indemnified and/or pre-funded to its satisfaction.

The Bond Trustee may refrain from taking any action in any jurisdiction if the taking of such action in that jurisdiction would, in its opinion based upon legal advice in the relevant jurisdiction, be contrary to any law of that jurisdiction. Furthermore, the Bond Trustee may also refrain from taking such action if it would otherwise render it liable to any person in that jurisdiction or if, in its opinion based upon such legal advice, it would not have the power to do the relevant thing in that jurisdiction by virtue of any applicable law in that jurisdiction or if it is determined by any court or other competent authority in that jurisdiction that it does not have such power.

No Bondholder, Couponholder or any Secured Party (other than the Bond Trustee) shall be entitled to (i) take any steps or action against the Issuer to enforce the performance of any of the provisions of the Bond Trust Deed, the Bonds, the Coupons or any of the other Transaction Documents or (ii) take any other action (including lodging an appeal in any proceedings) in respect of or concerning the Issuer, in each case unless the Bond Trustee, having become bound so to take any such steps, actions or proceedings, fails so to do within a reasonable period and the failure shall be continuing.

13. REPLACEMENT OF BONDS, COUPONS AND TALONS

Should any Bond, Coupon or Talon be lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Principal Paying Agent (subject to all applicable laws and the requirements of the UK Listing Authority or the London Stock Exchange) upon payment by the claimant of such costs and expenses as may be incurred in connection therewith and on such terms as to evidence and indemnity as the Issuer may reasonably require. Mutilated or defaced Bonds, Coupons or Talons must be surrendered before replacements will be issued.

14. EXCHANGE OF TALONS

On and after the Interest Payment Date on which the final Coupon comprised in any Coupon sheet matures, the Talon (if any) forming part of such Coupon sheet may be surrendered at the specified office of the Principal Paying Agent or any other Paying Agent in exchange for a further Coupon sheet including (if such further Coupon sheet does not include Coupons to (and including) the final date for the payment of interest due in respect of the Bond to which it appertains) a further Talon, subject to the provisions of Condition 11 (*Prescription*).

15. NOTICES

All notices regarding the Bonds will be deemed to be validly given if published in a leading English language daily newspaper of general circulation in London. It is expected that any such publication in a newspaper will be made in the *Financial Times* in London. The Issuer shall also ensure that notices are duly published in a manner which complies with the rules and regulations of any stock exchange or other relevant authority on which the Bonds are for the time being listed or by which they have been admitted to trading. Any such notice will be deemed to have been given on the date of the first publication or, where required to be published in more than one newspaper, on the date of the first publication in all required newspapers. If, in the opinion of the Bond Trustee, publication as provided above is not practicable, a notice shall be validly given if published in another leading daily English language newspaper with general circulation in Europe.

Notices to be given by any Bondholder shall be in writing and given by lodging the same, together with the relative Bond or Bonds, with the Principal Paying Agent.

Couponholders shall be deemed for all purposes to have notice of the contents of any notice given to the holders of the Bonds in accordance with this Condition 15 (*Notices*).

16. SUBSTITUTION

The Bond Trust Deed contains provisions permitting the Bond Trustee, subject to any required amendment of the Bond Trust Deed, without the consent of the Bondholders or the Couponholders or any Secured Party, to agree with the Issuer to the substitution in place of the Issuer (or of any previous substitute under this Condition) as the principal debtor under the Bonds, the Coupons and the Bond Trust Deed of another company, industrial and provident society or other entity subject to:

- (a) the Bond Trustee being satisfied that the interests of the Bondholders will not be materially prejudiced by the substitution; and
- (b) certain other conditions set out in the Bond Trust Deed being complied with.

Any such substitution shall be notified to the Bondholders in accordance with Condition 15 (*Notices*) as soon as practicable thereafter.

17. MEETINGS OF BONDHOLDERS, MODIFICATION AND WAIVER

17.1 Meetings of Bondholders

The Bond Trust Deed contains provisions for convening meetings of the Bondholders to consider any matter affecting their interests, including the sanctioning by Extraordinary Resolution of a modification of the Bonds, the Coupons or any of the provisions of the Bond Trust Deed (as more particularly described in the Bond Trust Deed). Such a meeting may be

convened by the Issuer or the Bond Trustee and shall be convened by the Issuer if required in writing by Bondholders holding not less than ten per cent. in Outstanding Principal Amount of the Bonds for the time being remaining outstanding (other than in respect of a meeting requested by Bondholders to discuss the financial position of the Issuer and the Knightstone Housing Group, which shall be requested in accordance with, and shall be subject to, Condition 6.2(c) (*Information Covenants*)). The quorum at any such meeting for passing an Extraordinary Resolution is one or more persons holding or representing in aggregate more than 50 per cent. of the Outstanding Principal Amount of the Bonds for the time being outstanding, or at any adjourned meeting one or more persons being or representing Bondholders whatever the Outstanding Principal Amount of the Bonds so held or represented, except that at any meeting the business of which includes any matter defined in the Bond Trust Deed as a Basic Terms Modification, including, *inter alia*, modifying any date for payment of principal or interest thereon, reducing or cancelling the amount of principal or the rate of interest payable in respect of the Bonds or altering the currency of payment of the Bonds or the Coupons, the quorum shall be one or more persons holding or representing in aggregate not less than 75 per cent. in Outstanding Principal Amount of the Bonds for the time being outstanding, or at any such adjourned meeting one or more persons holding or representing in aggregate not less than 25 per cent. in Outstanding Principal Amount of the Bonds for the time being outstanding. The Bond Trust Deed provides that (i) a resolution passed at a meeting duly convened and held in accordance with the Bond Trust Deed by a majority consisting of not less than 75 per cent. of the votes cast on such resolution, (ii) a resolution in writing signed by or on behalf of the holders of not less than 75 per cent. in Outstanding Principal Amount of the Bonds for the time being outstanding or (iii) consent given by way of electronic consents through the relevant clearing system(s) (in a form satisfactory to the Bond Trustee) by or on behalf of the holders of not less than 75 per cent. in Outstanding Principal Amount of the Bonds for the time being outstanding, shall, in each case, be effective as an Extraordinary Resolution of the Bondholders. An Extraordinary Resolution passed by the Bondholders shall be binding on all the Bondholders, whether or not (in the case of Extraordinary Resolutions passed at any meeting) they are present at any meeting and whether or not they voted on the resolution, and on all Couponholders.

17.2 Modification, Waiver, Authorisation and Determination

The Bond Trustee may agree, without the consent of the Bondholders, Couponholders or any Secured Party, to any modification (except as stated in the Bond Trust Deed) of, or to the waiver or authorisation of any breach or proposed breach of, any of the provisions of the Bonds, the Bond Trust Deed, any Security Agreement or any other Transaction Document, or determine, without any such consent as aforesaid, that any Potential Event of Default or Event of Default shall not be treated as such, where, in any such case, it is not, in the opinion of the Bond Trustee, materially prejudicial to the interests of the Bondholders so to do or may agree, without any such consent as aforesaid, to any modification which, in the opinion of the Bond Trustee, is of a formal, minor or technical nature or to correct a manifest error or an error which is, in the opinion of the Bond Trustee, proven. Any such modification, waiver, authorisation or determination shall be binding on the Bondholders, the Couponholders and the Secured Parties and (unless the Bond Trustee otherwise agrees) shall be notified to the Bondholders in accordance with Condition 15 (*Notices*) as soon as practicable thereafter.

17.3 Bond Trustee to have regard to interests of Bondholders as a class

In connection with the exercise by it of any of its trusts, powers, authorities and discretions (including, without limitation, any modification, waiver, authorisation, determination or substitution), the Bond Trustee shall have regard to the general interests of the Bondholders (excluding the Issuer, for so long as it holds any Bonds) as a class (but shall not have regard

to any interests arising from circumstances particular to individual Bondholders or Couponholders whatever their number) and, in particular but without limitation, shall not have regard to the consequences of any such exercise for individual Bondholders or Couponholders (whatever their number) resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory or any political sub-division thereof and the Bond Trustee shall not be entitled to require, nor shall any Bondholder or Couponholder be entitled to claim, from the Issuer, the Bond Trustee or any other person any indemnification or payment in respect of any tax consequences of any such exercise upon individual Bondholders or Couponholders.

18. INDEMNIFICATION AND PROTECTION OF THE BOND TRUSTEE AND BOND TRUSTEE CONTRACTING WITH THE ISSUER

The Bond Trust Deed contains provisions for the indemnification of the Bond Trustee and for its relief from responsibility and liability towards the Issuer, the Bondholders and the Couponholders, including (i) provisions relieving it from taking action unless secured and/or indemnified and/or pre-funded to its satisfaction and (ii) provisions limiting or excluding its liability in certain circumstances. The Bond Trustee is exempted from any liability in respect of any loss, diminution in value or theft of all or any part of the Issuer Charged Property, from any obligation to insure all or any part of the Issuer Charged Property (including, in either such case, any documents evidencing, constituting or representing the same or transferring any rights, benefits and/or obligations thereunder), or to procure the same to be insured.

The Bond Trust Deed also contains provisions pursuant to which the Bond Trustee is entitled, *inter alia*, (a) to enter into or be interested in any contract or financial or other transaction or other arrangement with the Issuer and/or any other Transaction Party or any person or body corporate associated with the Issuer and/or any Transaction Party and (b) to accept or hold the trusteeship of any other trust deed constituting or securing any other securities issued by, or relating to, the Issuer and/or any Transaction Party or any such person or body corporate so associated or any other office of profit under the Issuer and/or any Transaction Party or any such person or body corporate so associated.

The Bond Trustee shall not be bound to take any step or action in connection with the Bond Trust Deed or the Bonds or obligations arising pursuant thereto or pursuant to the other Transaction Documents, where it is not satisfied that it is indemnified and/or secured and/or pre-funded against all its liabilities and costs incurred in connection with such step or action and may demand, prior to taking any such step or action, that there be paid to it in advance such sums as it considers (without prejudice to any further demand) shall be sufficient so as to indemnify it.

The Bond Trustee shall have no responsibility for the validity, sufficiency or enforceability of the Issuer Security. The Bond Trustee shall not be responsible for monitoring the compliance by any of the other Transaction Parties with their obligations under the Transaction Documents, neither shall the Bond Trustee be responsible for monitoring the compliance by the Borrowers or any of the other parties to the Security Agreements and the Security Trust Deed of their obligations under the Security Agreements, the Security Trust Deed or any other document.

19. FURTHER ISSUES

The Issuer shall be at liberty from time to time without the consent of the Bondholders or the Couponholders to create and issue further bonds having terms and conditions (and backed by the same assets) the same as the Bonds or the same in all respects save for the amount and date of the first payment of interest thereon and so that the same shall be consolidated and

form a single series with the outstanding Bonds. Any further bonds so created and issued shall be constituted by a trust deed supplemental to the Bond Trust Deed.

20. CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999

No person shall have any right to enforce any term or condition of this Bond under the Contracts (Rights of Third Parties) Act 1999, but this does not affect any right or remedy of any person which exists or is available apart from that Act.

21. GOVERNING LAW

The Bond Trust Deed, the Loan Agreements, the Agency Agreement, the Account Agreement, the Bonds and the Coupons, and any non-contractual obligations or matters arising from or in connection with them, shall be governed by, and construed in accordance with, English law.

22. SUBMISSION TO JURISDICTION

The Issuer has, in the Bond Trust Deed, irrevocably agreed for the benefit of the Bond Trustee, the Bondholders and the Couponholders that the courts of England are to have exclusive jurisdiction to settle any disputes that may arise out of or in connection with the Bond Trust Deed, the Bonds or the Coupons (including a dispute relating to non-contractual obligations arising out of or in connection with the Bond Trust Deed, the Bonds or the Coupons) and accordingly has submitted to the exclusive jurisdiction of the English courts.

The Issuer has, in the Bond Trust Deed, waived any objection to the courts of England on the grounds that they are an inconvenient or inappropriate forum. The Bond Trustee, the Bondholders and the Couponholders may take any suit, action or proceeding arising out of or in connection with the Bond Trust Deed, the Bonds or the Coupons respectively (including any suit, action or proceedings relating to any non-contractual obligations arising out of or in connection with the Bond Trust Deed, the Bonds or the Coupons) (together referred to as **Proceedings**) against the Issuer in any other court of competent jurisdiction and concurrent Proceedings in any number of jurisdictions.

USE OF PROCEEDS

Subject as set out below, the net proceeds from the issue of the Bonds or, in the case of the Retained Bonds, the net proceeds of the sale of the Bonds to a third party (after deduction of expenses payable by the Issuer) will be advanced by the Issuer to one or more Borrowers pursuant to the Loan Agreements to be applied in the achievement of such Borrower's charitable objects (including, for the avoidance of doubt, the repayment of any existing indebtedness of such Borrower and any other amounts due and payable thereunder).

For so long as insufficient security has been granted (or procured to be granted) by the Borrowers in favour of the Issuer to permit the drawing of the Aggregate Funded Commitment in full, the amount of the Aggregate Funded Commitment which remains undrawn (the **Retained Proceeds**) shall be retained in the Initial Cash Security Account in accordance with the terms of the Account Agreement and the Custody Agreement (and may be invested in Permitted Investments). For the avoidance of doubt, as the Original Borrower will not charge any Properties in favour of the Security Trustee for the benefit of the Issuer on the Issue Date, and consequently will not draw any part of the Original Knightstone Housing Association Commitment on the Issue Date, the Retained Proceeds on the Issue Date shall be the entire amount of the Original Knightstone Housing Association Commitment (less any amount which is to be funded by the Final Instalment in respect of the Bonds or a sale of Retained Bonds). Any Retained Proceeds (and the Final Instalment in respect of the Bonds and any net sale proceeds from a sale by the Issuer of Retained Bonds (less any Retained Bond Premium Amount)) may be advanced to the Borrowers at a later date pursuant to the Loan Agreements to the extent that Properties of a corresponding value have been charged in favour of the Security Trustee and allocated as Designated Security for the benefit of the Issuer. In addition, in the event that any losses are made in respect of any Retained Proceeds which have been invested in Permitted Investments, each drawing to be made by the Issuer to a Borrower pursuant to a Loan Agreement shall be advanced at a discount in accordance with the terms of such Loan Agreement.

DESCRIPTION OF THE LOAN AGREEMENTS

The following description of the Loan Agreements consists of a summary of certain provisions of the Loan Agreements and is subject to the detailed provisions thereof. The Loan Agreements are not, however, incorporated by reference into, and therefore do not form part of, this Prospectus.

Definitions used in this section but not otherwise defined in this Prospectus have the meanings given to them in the Loan Agreements.

Facility

Subject to the provisions of the bond loan agreement (the **Knightstone Housing Association Loan Agreement**) dated on or around the Issue Date between the Issuer, the Original Borrower and the Security Trustee, the Issuer shall commit to make a loan to the Original Borrower in the nominal amount of £100,000,000 (the **Original Knightstone Housing Association Commitment** and, together with any further commitments, the **Knightstone Housing Association Commitment**). The **Loan**, in respect of the Knightstone Housing Association Loan Agreement, is the nominal amount of the Knightstone Housing Association Commitment that has been advanced to the Original Borrower or the outstanding balance thereof.

Upon the sale by the Issuer of Retained Bonds or the issue by the Issuer of any further Bonds pursuant to Condition 19 (*Further Issues*), the Issuer may commit (subject, with respect to sale proceeds of the Retained Bonds, to the Original Knightstone Housing Association Commitment being reduced accordingly by the Original Borrower) to making a loan to the Original Borrower and/or one or more other charitable Registered Providers of Social Housing of the Knightstone Housing Group (together, the **Additional Borrowers** and each an **Additional Borrower** and, together with the Original Borrower, the **Borrowers**) in a nominal amount which reflects such sale or issue proceeds (each a **Commitment** and, together with the Knightstone Housing Association Commitment, the **Commitments**) pursuant to the Knightstone Housing Association Loan Agreement or to one or more additional bond loan agreements (each an **Additional Loan Agreement** and, together with the Knightstone Housing Association Loan Agreement, the **Loan Agreements**). The **Loan**, in respect of each Additional Loan Agreement, is the nominal amount of the Commitment that has been advanced to the relevant Additional Borrower or the outstanding balance thereof.

Each Commitment may be drawn in one or more drawings, and the maximum nominal amount of each drawing shall be an amount which corresponds to the Minimum Value of any Charged Properties which have, on or before the date of such drawing, been charged in favour of the Security Trustee, for the benefit of the Issuer, less the aggregate amount of all Commitments which have previously been drawn.

Each of the Issuer and the Original Borrower have acknowledged (and each Additional Borrower will be required to acknowledge) that any drawing of a Commitment shall be subject to the Security Trustee being satisfied that the value of the Issuer's Designated Security (based solely on the relevant confirmation from the Original Borrower and each Additional Borrower of the Minimum Value of the Properties forming part of the Issuer's Designated Security (which itself shall be evidenced by the relevant Valuation), which the Security Trustee is entitled to rely upon without further enquiry or investigation in respect thereof) is such that the Asset Cover Test is satisfied immediately following such drawing and, in respect of any part of a Commitment which is to be funded by the Issuer by the Final Instalments in respect of the Bonds and/or a sale of Retained Bonds and/or an issue of further Bonds, the receipt by the Issuer of such Final Instalments, net sale proceeds or issue proceeds thereof.

The Original Borrower has acknowledged (and each Additional Borrower will be required to acknowledge) that the Issuer may invest all or any part of the Retained Proceeds in Permitted

Investments in accordance with the Custody Agreement and that, as a result of (i) any losses made by the Issuer in respect of such Permitted Investments and/or (ii) any issue or sale of Bonds by the Issuer made at a discount to the nominal amount of such Bonds, the amount of Retained Proceeds held by the Issuer, at the time of any drawdown request, may be less than the Undrawn Commitment which is to be funded from such Retained Proceeds. In such circumstances, each drawing to be funded from the Retained Proceeds shall be advanced at a discount in an amount equal to the Actual Advance Amount.

For this purpose, **Actual Advance Amount** means, in respect of each drawing funded from Retained Proceeds, the nominal amount of such drawing multiplied by the result of dividing (i) the amount of Retained Proceeds held by the Issuer at the time of the drawdown request (for the avoidance of doubt, excluding any Permitted Investment Profit) by (ii) the Undrawn Commitment which is to be funded from such Retained Proceeds.

For the avoidance of doubt:

- (a) no Borrower shall be required to monitor the market value of any Permitted Investments;
- (b) any difference between the nominal amount of a drawing and the relevant Actual Advance Amount shall be ignored in determining the amount of the relevant Loan and, *inter alia*, the calculation of interest, principal and premium payments payable in respect thereon; and
- (c) any income received by the Issuer in respect of Permitted Investments shall not be credited to the Initial Cash Security Account but shall instead be credited to the Transaction Account in accordance with the Account Agreement.

The Issuer and the Original Borrower have agreed (and each Additional Borrower shall agree) that:

- (a) where the Issuer is required to sell any Permitted Investments to fund a drawing under a Loan Agreement and such sale results in a Permitted Investment Profit, the Issuer shall make a gift aid payment to a Charitable Group Member in an amount equal to the Permitted Investment Profit and, for the avoidance of doubt, such drawing shall be advanced at the nominal amount requested; and
- (b) immediately prior to the end of each accounting period, to the extent that the Issuer would otherwise be required to recognise a profit for tax purposes in respect of its Permitted Investments and/or Retained Bonds as a result of the movement in the fair value recognised in its accounts of such Permitted Investments and/or Retained Bonds for that accounting period, the Issuer shall sell Permitted Investments in an aggregate amount equal to the Accounting Profit and shall, in the same accounting period or, where the Issuer makes a valid claim under section 199 of the Corporation Tax Act 2010, within nine months of the end of that accounting period, make a Gift Aid Payment to a Charitable Group Member in an amount equal to the Accounting Profit.

The Issuer and the Original Borrower have also agreed (and each Additional Borrower shall agree, to the extent that any Retained Bonds are held by the Issuer upon the date of its accession as a Borrower) that, upon a sale (if any) of the Retained Bonds by the Issuer:

- (a) in the event that such sale produces a Retained Bond Premium Amount, the Issuer shall make a gift aid payment to a Charitable Group Member in an amount equal to the Retained Bond Premium Amount and, for the avoidance of doubt, where the Issuer is required to sell such Retained Bonds to directly fund a drawing under a Loan Agreement, such drawing shall be advanced at the nominal amount requested; and

- (b) where the Issuer is required to sell any Retained Bonds to directly fund a drawing under a Loan Agreement and such sale is made at a discount to the nominal amount of such Retained Bonds, such drawing shall be advanced at a discount in an amount equal to the Retained Bond Actual Advance Amount.

For this purpose, **Retained Bond Actual Advance Amount** means, in relation to each drawing under a Loan Agreement which is funded directly by a sale of Retained Bonds, the nominal amount of such drawing multiplied by the result of dividing (i) the net proceeds of sale of such Retained Bonds by (ii) the nominal amount of such Retained Bonds.

For the avoidance of doubt:

- (a) no Borrower shall be required to monitor the market value of any Retained Bonds; and
- (b) any difference between the nominal amount of a drawing and the relevant Retained Bond Actual Advance Amount shall be ignored in determining the amount of the relevant Loan and, *inter alia*, the calculation of interest, principal and premium payments payable in respect thereon.

The Original Borrower has agreed (and each Additional Borrower shall agree, to the extent that it accedes as a Borrower prior to the Final Instalment Payment Date and/or any Retained Bonds are held by the Issuer upon the date of its accession as a Borrower) that, where the Issuer needs to receive the Final Instalment in respect of any Bonds or is required to sell any Retained Bonds in order to fund a drawdown request, the Issuer's obligations to fund such drawdown will be subject to receipt of such Final Instalment or the ability of the Issuer to sell such Retained Bonds to a third party, as the case may be.

For so long as any Retained Bonds are held by or on behalf of the Issuer, a Borrower may request that an amount of its Commitment be cancelled (provided that such amount does not exceed the nominal amount of Retained Bonds held by or on behalf of the Issuer at that time). As soon as practicable following any such request, the Issuer shall cancel Retained Bonds in a corresponding amount. Such cancellation of the relevant Commitment shall take effect upon the cancellation of such Retained Bonds.

Subject to the conditions precedent set out in Clause 4.2 (*Conditions to the Making of Further Knightstone Housing Association Commitments*) of the Knightstone Housing Association Loan Agreement and any corresponding clause in any Additional Loan Agreement, the Issuer may make further commitments to each Borrower, each in an amount to be agreed between the Issuer, the relevant Borrower and the Security Trustee, following the issuance of further bonds pursuant to Condition 19 (*Further Issues*).

Purpose

The proceeds of each Loan may only be used by a Borrower in accordance with such Borrower's charitable objects, as permitted by its Rules including, for the avoidance of doubt, the repayment of any existing indebtedness of such Borrower and any other amounts due and payable thereunder.

Interest

Rate of Interest

Following its advance, each Loan will carry interest from (and including) the date of its initial advance, payable in arrear by half yearly instalments on each Loan Payment Date (being four Business Days prior to each Interest Payment Date), at the rate of (i) 5.058 per cent. per annum in

respect of any period to (but excluding) the Final Instalment Payment Date and (ii) at the rate of 5.576 per cent. per annum in respect of any period from (and including) the Final Instalment Payment Date to (but excluding) the Maturity Date.

Interest Periods

Notwithstanding the fact that interest is payable on each Loan Payment Date, interest will accrue on each Loan from (and including) an Interest Payment Date (or, in the case of the first interest period of a Loan, the date of its initial advance) to (but excluding) the immediately following Interest Payment Date (each, a **Loan Interest Period**).

Commitment Fee

Each Borrower shall pay to the Issuer a commitment fee in respect of its Undrawn Commitment on each Loan Payment Date in an amount equal to, its *pro rata* share (based on the aggregate amount of all Undrawn Commitments of all Borrowers) of the aggregate of the interest payable by the Issuer under the Bonds on the following Interest Payment Date less (a) the aggregate of the interest received from the Borrowers under all Loan Agreements on such Loan Payment Date and (b) the interest otherwise received by the Issuer in respect of the Retained Proceeds in the relevant Loan Interest Period (including, but not limited to, any income received by the Issuer in respect of any Permitted Investments in which any Retained Proceeds are, for the time being, invested). The commitment fee shall accrue on a daily basis.

Repayment, Purchase and Prepayment

Repayment

Each Borrower must repay its Loan in full four Business Days prior to the Interest Payment Date in October 2048 (the **Loan Maturity Date**).

Bond Purchase

Each Borrower or any other member of the Knightstone Housing Group may at any time purchase Bonds on the London Stock Exchange, by tender (available to all Bondholders alike) or by private treaty at any price. Following any such purchase, such Borrower or the relevant member of the Knightstone Housing Group may (but is not obliged to) surrender the Bonds to the Issuer to be cancelled. An amount of the outstanding balance of the relevant Loan equal to the Outstanding Principal Amount of the Bonds surrendered shall be deemed to be prepaid (or, to the extent that no Loan is then outstanding, then an amount of the relevant Undrawn Commitment equal to the Outstanding Principal Amount of the Bonds surrendered shall be deemed to be cancelled for the purposes of the relevant Loan Agreement and a corresponding portion of the Retained Proceeds shall be paid by the Issuer to the relevant Borrower or the relevant member of the Knightstone Housing Group).

The Original Borrower has acknowledged (and each Additional Borrower shall acknowledge) that the terms of the Bond Trust Deed provide that any Bonds which are for the time being held by or on behalf of, *inter alios*, a Borrower or any member of the Knightstone Housing Group as beneficial owner shall be deemed not to remain outstanding for the purpose of, *inter alia*, the right to attend and vote at any meeting of the Bondholders.

Optional Prepayment

Pursuant to Clause 5.3 (*Optional Prepayment*) of the Knightstone Housing Association Loan Agreement and the corresponding clause in any Additional Loan Agreement, each Borrower may, at

any time (a) on or after the later of the Final Instalment Payment Date and the Final Retained Bond Disposal Date and (b) before the Loan Maturity Date, by giving not less than 45 nor more than 60 days' notice in writing to the Issuer and the Security Trustee, prepay the whole or (as the case may be) any part of the outstanding balance of its Loan, together with any interest accrued up to and including the date of prepayment and the relevant Prepayment Premium (being, for so long as any Bonds are outstanding, an amount equal to the excess of the amount notified to such Borrower by the Issuer as being the price determined under the Bond Trust Deed for the redemption of a corresponding nominal amount of the Bonds over the Outstanding Principal Amount and otherwise zero).

Mandatory Prepayment – Redemption of Bonds

If the Bonds become redeemable prior to the Maturity Date, other than as a result of a prepayment or termination of a Loan Agreement, each Borrower shall prepay, at least one Business Day prior to the relevant date of redemption of the Bonds, the outstanding balance of the Loan, together with accrued interest and accrued commitment fee thereon up to and including the date of redemption.

Mandatory Prepayment – Cancellation of Status

Pursuant to Clause 5.6 (*Mandatory Prepayment – Cancellation of Status*) of the Knightstone Housing Association Loan Agreement and the corresponding clause in any Additional Loan Agreement, each Borrower shall promptly notify the Issuer and the Security Trustee if it ceases to be a Registered Provider of Social Housing. Within 180 days of such notification, such Borrower shall prepay the whole of the outstanding balance of its Loan, together with any interest and commitment fee accrued up to and including the date of prepayment, provided, however, that if such Borrower regains its status as a Registered Provider of Social Housing within such period of 180 days, the relevant Borrower shall no longer be required to prepay the Loan in accordance with the above-mentioned Clause 5.6 (*Mandatory Prepayment – Cancellation of Status*) or such corresponding clause.

Redemption of Bonds – Further Payment in Respect of Retained Proceeds Par Amount

In the event that a Borrower elects to, or is otherwise required to, prepay the whole of the outstanding balance of its Loan and the Issuer is required to notify such Borrower of the price determined under the Conditions for the redemption of a corresponding Outstanding Principal Amount of the Bonds, then the Issuer shall be entitled to also take account of the redemption of such Outstanding Principal Amount of the Bonds (if no Commitment is put in place with another Borrower) that shall correspond to the Retained Proceeds Par Amount (being an amount equal to the Retained Proceeds including, where any Retained Proceeds are invested in Permitted Investments, the purchase price of the relevant Permitted Investments and ignoring, for these purposes, any increase or decrease in such Retained Proceeds as a result of gains or losses in respect of such Permitted Investments and/or any discount on a sale of Retained Bonds by the Issuer), and the price notified to such Borrower shall be increased accordingly.

Warranties and Covenants

Each Borrower will make various warranties and covenants pursuant to, in the case of the Original Borrower, Clause 8 (*Warranties and Covenants by the Original Borrower*) of the Knightstone Housing Association Loan Agreement and, in the case of any Additional Borrower, the corresponding clause in its Loan Agreement. These warranties and covenants include (or will include, as the case may be), *inter alia*, the following:

Information Covenants

Each Borrower must supply to the Issuer and the Security Trustee not later than 180 days after the end of each relevant financial year (i) a copy of the audited financial statements of such Borrower for such

financial year; (ii) a certificate setting out, among other things, calculations in respect of the asset cover ratio and the interest cover ratio substantially in the form set out in the Loan Agreement (the **Compliance Certificate**) signed by two Authorised Signatories of such Borrower; and (iii) a certificate setting out, among other things, a summary of the additions, withdrawals and substitutions of Charged Properties which have taken place during the preceding financial year substantially in the form set out in the Loan Agreement (the **Security Adjustment Certificate**) signed by two Authorised Signatories of such Borrower.

Each Borrower must, following receipt of a notice from the Issuer stating that it intends to sell any Retained Bonds, supply to the Issuer and the Bond Trustee not later than three Business Days prior to the date of such sale, a certificate setting out, among other things, calculations in respect of the asset cover ratio substantially in the form set out in Schedule 3 to the Loan Agreement (the **Retained Bond Compliance Certificate**) signed by two Authorised Signatories of the Borrower confirming whether, immediately following such sale, the Borrower will be in compliance with the Asset Cover Test.

Negative Pledge

No Borrower shall create or allow to exist (and each Borrower shall procure that no Eligible Group Member creates or allows to exist) any Security Interest on any assets which are Security Assets, except as set out in, in the case of the Original Borrower, Clause 8.2(c)(ii) (*General Covenants*) of the Knightstone Housing Association Loan Agreement and, in the case of any Additional Borrower, the corresponding clause in its Loan Agreement, which includes (or will include, as the case may be) the Security Interests created pursuant to, *inter alia*, the Security Trust Deed and the Security Agreements and any Security Interests created with the prior written consent of the Issuer or by operation of law.

Charged Properties

Each Borrower shall obtain (and each Borrower shall procure that each Eligible Group Member obtains) any authorisation or licence required in order to enable the Security Trustee pursuant to the powers of enforcement conferred on it by the Security Documents to sell vacant Charged Properties and maintain insurances on and in relation to its Charged Properties.

Covenants

Each Borrower shall (and each Borrower shall procure that each Eligible Group Member shall), unless the Security Trustee otherwise agrees in writing, comply in all material respects with any covenants or restrictive covenants relating to a Charged Property which are binding on it.

Guarantee and Indemnity

Pursuant to Clause 9 (*Guarantee and Indemnity*) of the Knightstone Housing Association Loan Agreement and the corresponding clause in each Additional Loan Agreement, each Borrower has (or will have) irrevocably and unconditionally:

- (a) guaranteed to the Issuer the punctual performance by each other Borrower of all such Borrowers' obligations under, *inter alia*, their respective Loan Agreements, the Security Trust Deed and their respective Security Agreements, other than each other Borrowers' obligations to repay principal and any prepayment premium thereon pursuant to their respective Loan Agreements (such amounts being, the **Guaranteed Interest and Fee Amounts**);
- (b) undertaken with the Issuer that, whenever any other Borrower does not pay any Guaranteed Interest and Fee Amounts when due under its respective Loan Agreement, the Security Trust Deed or its respective Security Agreement(s), it must, immediately on demand by the Security

Trustee and/or the Issuer, pay the Guaranteed Interest and Fee Amounts as is if it were the principal obligor;

- (c) undertaken with the Issuer that, to the extent that the proceeds of the enforcement of the Underlying Security are insufficient to satisfy the Borrowers' obligations under their respective Loan Agreements in full (the shortfall being, the **Guaranteed Principal Amount**), it must, immediately on demand by the Security Trustee and/or the Issuer, pay the Guaranteed Principal Amount as if it were the principal obligor; and
- (d) agreed to indemnify the Issuer immediately on demand against any loss or liability suffered by the Issuer if any obligation guaranteed by it is or becomes illegal or invalid.

Asset Cover Ratio

Pursuant to Clause 10.1 (*Financial Covenants – Asset Cover Ratio*) of the Knightstone Housing Association Loan Agreement and the corresponding clause in each Additional Loan Agreement, each Borrower shall procure that at all times the sum of:

- (a) the Minimum Value of the Properties forming part of the Issuer's Designated Security;
- (b) the Retained Proceeds Par Amount; and
- (c) the Charged Cash,

will not be less than the Aggregate Funded Commitment,

provided however, that from and including the Final Charging Date, the Retained Proceeds Par Amount shall be deemed to be zero for the purpose of determining the Borrowers' compliance with the Asset Cover Test.

Interest Cover Ratio

Pursuant to Clause 10.2 (*Financial Covenants – Interest Cover Ratio*) of the Knightstone Housing Association Loan Agreement and the corresponding clause in each Additional Loan Agreement, each Borrower shall procure that, for so long as the Bonds remain outstanding:

- (a) the aggregate of the Operating Surpluses of all the Borrowers, determined by reference to the Borrowers' most recent audited financial statements, divided by the aggregate Net Interest Payable in relation to the same financial year (expressed as a percentage) shall not be less than 90 per cent.; and
- (b) the aggregate of the Operating Surpluses of all the Borrowers, determined by reference to the Borrowers' audited financial statements for each financial year during each successive period of three financial years, divided by the aggregate of the Net Interest Payable for each financial year during the corresponding period for each of three financial years (expressed as a percentage) shall not be less than 105 per cent.

In the event that the Borrowers are not in compliance with the above test (the **Interest Cover Test**), the Original Borrower shall procure that, together with delivery of a Compliance Certificate, the Borrowers' auditors shall provide to the Bond Trustee as soon as practicable but in any event not later than the earlier of 180 days after the end of the relevant accounting period and one week after the date of the auditors' report on the accounts in respect of such period, a report (the **Interest Cover Test Auditors' Report**) confirming:

- (a) the results of the Interest Cover Test shown by reference to the audited accounts and stating that, in the auditors' opinion, the breach will not adversely affect the ability of the Borrowers to perform their obligations; and
- (b) that, taking into account the Borrowers' business as carried on since the end of such relevant accounting period and having regard to the level of reserves of the Borrowers and their projected or expected expenditure and business over the period of 12 months following the date of the Interest Cover Test Auditors' Report, the Borrowers will be able to meet their obligations over such period of 12 months.

Interpretation

For these purposes:

Aggregate Funded Commitment means the aggregate amount of the Commitments under all Loan Agreements, less (a) the aggregate nominal amount of Retained Bonds held by or on behalf of the Issuer and (b) any Final Instalments which have not been paid by the relevant Bondholders;

Charged Properties means any Properties which have been charged in favour of the Security Trustee, for the benefit of the Issuer, for the purpose of providing underlying security for the Bonds;

Designated Security means the assets, rights and property mortgaged or charged or assigned or the subject of any security created pursuant to any Security Document, the proceeds of which are allocated in the reduction of all monies, liabilities and obligations owing by the Borrowers to the Issuer under the Loan Agreements;

Final Charging Date means 30th November, 2017;

Minimum Value means:

$$\left(\frac{A}{115} + \frac{B}{125} \right) \times 100$$

where:

A = the Value of the residential EUV-SH Charged Properties determined on the basis of EUV-SH; and

B = the Value of the residential MV-ST Charged Properties determined on the basis of MV-ST.

The Properties forming part of the Issuer's Designated Security shall each be treated as EUV-SH Charged Properties for the purpose of determining the Minimum Value unless and until a Value, determined on the basis of MV-ST, is given by an Approved Valuer in respect of any such Property and the Approved Valuer has confirmed that it has reviewed a Certificate of Title in respect of such Property certifying that it may be disposed of by the relevant Borrower or Eligible Group Member on an unfettered basis (meaning subject only to any existing tenancies disclosed in the Certificate of Title but not subject to any security interest, option or other encumbrance or to any restriction preventing or restricting its sale to, or use by, any person for residential use);

Net Interest Payable means, in relation to any financial year and to a Borrower, as determined from the audited annual financial statements of such Borrower, the aggregate amounts shown as interest payable (but not counting as interest paid or payable either capitalised or deferred interest, or change in mark-to-mark valuation of interest rates of inflation swaps) after deducting any interest receivable

and other investment income and adding other finance payments payable by such Borrower as shown in the audited financial statements of such Borrower for that financial year;

Operating Surplus means, in relation to a Borrower, the operating surplus as shown in the audited financial statements including gift aid receipts plus any surplus arising from the sale of housing properties and adding back for the avoidance of doubt any housing depreciation and impairment;

Property means all estates or interests of a Borrower or an Eligible Group Member in any freehold, heritable or leasehold property wheresoever situate now or in future belonging to it and all buildings, fixtures, fittings (other than tenants fixtures and fittings) and fixed plant and machinery from time to time thereon (and **Properties** shall be construed accordingly);

Retained Proceeds Par Amount means an amount equal to the Retained Proceeds at the time of calculation and, for this purpose, (a) where any Retained Proceeds are at that time invested in Permitted Investments, the amount of such Retained Proceeds shall be taken as the purchase price of the relevant Permitted Investments ignoring any gains or losses in respect of those Permitted Investments since the date of purchase and (b) where the source of any Retained Proceeds is the net sale proceeds of any Retained Bonds which were sold at a discount, the amount of such Retained Proceeds shall be taken as the nominal amount of such Retained Bonds; and

Value means, at any time and in relation to the Charged Properties, the value of those properties as shown in the then latest Full Valuation Report or Desk Top Valuation Report on the basis of EUV-SH or, as the case may be, MV-ST (provided that if any Charged Property or part thereof is sold pursuant to a Right to Buy, the Value of the relevant Charged Property shall, for the purposes of this definition and with effect from the date of the relevant sale or release, be zero (if the entire relevant Charged Property has been sold) or (if only part of the relevant Charged Property has been sold) shall be the proportion of the value of the Charged Property which has not been sold pursuant to the relevant Right to Buy).

Substitution and Release of Charged Properties and Statutory Disposals

Substitution

At the request and expense of a Borrower or Eligible Group Member, the Security Trustee shall (subject to receiving instructions to do so and an amended Security Certificate from the Borrowers and the Issuer in accordance with the Security Trust Deed) release from the relevant Security Documents (and/or reallocate, if applicable) such of the Properties (the **Released Properties**) forming part of the Issuer's Designated Security and substitute for the Released Properties other Properties (each, a **Substitute Property**) as may be selected by such Borrower or Eligible Group Member, provided that such Borrower or Eligible Group Member satisfies the conditions precedent specified in the applicable Loan Agreement in relation to the Substitute Properties. Such conditions precedent include, *inter alia*, a completed Substitute Property Certificate certifying, *inter alia*, that the relevant Substitute Property is a residential property of a type and nature that is usually owned by Registered Providers of Social Housing, that, immediately following such release (and/or reallocation, if applicable) and substitution, the Asset Cover Test will not be breached as a result of the substitution of the relevant Charged Properties and that no Event of Default or Potential Event of Default has occurred and is continuing, a Full Valuation Report in respect of each Substitute Property and a Certificate of Title in respect of the Substitute Properties.

Cash Security

Each Borrower or Eligible Group Member may deposit the proceeds of disposal of the relevant Charged Properties which are released from charge under the Security Trust Deed into the Ongoing Cash Security Account of the Issuer for the purpose of maintaining the Asset Cover Test (for the

avoidance of doubt, no Borrower or Eligible Group Member shall be required to monitor the market value of any Permitted Investments). The Charged Cash may be withdrawn from the Ongoing Cash Security Account (a) to be applied by the relevant Borrower or Eligible Group Member (provided, for the avoidance of doubt, that such Borrower or Eligible Group Member continues, at such time, to be a Registered Provider of Social Housing) in the acquisition of a Substitute Property or (b) to the extent that such withdrawal would not cause a breach of the Asset Cover Test.

Notwithstanding the above, any Borrower or Eligible Group Member may, at any time, deposit, or arrange for the deposit of, any other money into the Ongoing Cash Security Account for the purposes of satisfying the Asset Cover Test.

The Original Borrower has acknowledged (and each Additional Borrower and Eligible Group Member will be required to acknowledge) that the money standing to the credit of the Ongoing Cash Security Account shall be charged in favour of the Bond Trustee pursuant to the terms of the Bond Trust Deed.

The Original Borrower has also acknowledged (and each Additional Borrower and Eligible Group Member will be required to acknowledge) that the Issuer may invest all or any part of the Charged Cash in Permitted Investments in accordance with the Custody Agreement and that, as a result of any gains or losses made by the Issuer in respect of such Permitted Investments and any income received thereon (which shall, for the avoidance of doubt, be credited to the Ongoing Cash Security Account), the amount of such Charged Cash may be greater or less than the amount deposited in Ongoing Cash Security Account by such Borrower or Eligible Group Member. The Original Borrower has acknowledged (and each Additional Borrower and Eligible Group Member will be required to acknowledge) that it shall not have any recourse to the Issuer in respect of any losses realised by the Issuer in respect of the Charged Cash as a result of investment in any Permitted Investments.

Following the redemption in full of the Bonds, the Issuer shall return any amount standing to the credit of the Ongoing Cash Security Account to the relevant Borrowers and/or Eligible Group Members, to the extent that such balance has not otherwise been applied in accordance with the terms of the Bond Trust Deed.

Release and reallocation

At the request and expense of a Borrower or an Eligible Group Member, the Security Trustee shall release (subject to receiving instructions to do so and an amended Security Certificate from the Borrowers and the Issuer in accordance with the Security Trust Deed) from the relevant Security Documents (and/or reallocate, if applicable) such Properties forming part of the Issuer's Designated Security as may be selected by such Borrower or Eligible Group Member, provided that such Borrower or Eligible Group Member delivers to the Issuer and the Security Trustee a completed Property Release Certificate, certifying that, immediately following such release (and/or reallocation, if applicable), the Asset Cover Test will not be breached as a result of the release (and/or reallocation, if applicable) of such part of the Issuer's Designated Security and that no Event of Default or Potential Event of Default has occurred and is continuing.

Statutory Disposals

Each Borrower and Eligible Group Member shall have the right to withdraw Property from the Issuer's Designated Security pursuant to any Statutory Disposal and the relevant Borrower or Eligible Group Member shall deliver to the Issuer and the Security Trustee, as soon as reasonably practicable after it has received notice of such Statutory Disposal, a completed Statutory Disposal Certificate, certifying that the relevant withdrawal relates to a Statutory Disposal.

Additional Properties

Pursuant to Clause 2 (*Designation of Security Assets*) of the Security Trust Deed (see "*Security*" below), on or prior to creating a Security Agreement in respect of any Property for the benefit of the Issuer, the relevant Borrower or Eligible Group Member must, in respect of such security, provide the conditions precedent documents specified in the Security Trust Deed. In addition, pursuant to the relevant Loan Agreement, the relevant Borrower or Eligible Group Member must provide a completed Additional Property Certificate (signed by the relevant Borrower or Eligible Group Member) confirming that, *inter alia*, the proposed Charged Properties are residential properties of a type and nature that are usually owned by Registered Providers of Social Housing, Full Valuation Reports in respect of each such Property and a Certificate of Title in respect of each tranche of Properties charged.

Valuations

Full Valuations and Desk Top Valuations

In accordance with Clause 12.1 (*Full Valuations and Desk Top Valuations*) of the Knightstone Housing Association Loan Agreement and the corresponding clause in any Additional Loan Agreement, each Borrower shall deliver, or procure the delivery, to the Issuer and the Security Trustee of:

- (a) a Full Valuation Report prepared by an Approved Valuer which values all Charged Properties on a full valuation basis at least once in every period of five calendar years. The first such Full Valuation Report must be delivered in the period between 31st March, 2017 and the date falling 120 days thereafter (or, at the option of the Borrowers acting together, within the same period in any prior calendar year) and unless the Issuer and each Borrower agree otherwise, thereafter within 120 days of each consecutive fifth anniversary of the date on which the Full Valuation Report was previously provided; and
- (b) a Desk Top Valuation Report prepared by an Approved Valuer which values all the Charged Properties on a "desk-top" basis in the period between 31st March and the date falling 120 days thereafter in each year other than a year in respect of which such Charged Properties have been valued on a full valuation basis through the delivery of a Full Valuation Report. The first such Desk Top Valuation Report must be delivered within 120 days of 31st March, 2018.

Pursuant to the Bond Trust Deed, the Bond Trustee may at any time (upon the request of any Bondholder) require the Issuer to procure that each Borrower delivers, or procures the delivery, to the Issuer and the Bond Trustee of a Full Valuation Report or a Desk Top Valuation, as so requested, prepared by an Approved Valuer. On any request by the Issuer, each Borrower shall procure delivery of such Full Valuation Report or Desk Top Valuation, as the case may be, to the Issuer, the Bond Trustee and the relevant Bondholder within 120 days thereof, subject to such indemnity or pre-funding as to the costs of preparing the same as the Borrower shall require from the relevant Bondholder.

For these purposes **Approved Valuer** means any of Countrywide plc, Jones Lang LaSalle Limited, Mazars Property Consultancy Limited or Savills (L&P) Ltd, or any subsidiary of any of them or such other reputable firm of surveyors which is a member of the Royal Institute of Chartered Surveyors as may be selected by any Borrower and approved by the Security Trustee from time to time.

Loan Events of Default and Enforcement

Borrower Default

Each of the following (which is set out in more detail in Clause 14 (*Borrower Default*) of the Knightstone Housing Association Loan Agreement and will be set out in more detail in the corresponding clause in any Additional Loan Agreement) is a **Borrower Default**:

- (a) **Non-payment:** The Borrower does not pay on the due date any amount payable by it under the Finance Documents in the manner required under the Finance Documents, unless the non-payment continues for a period of not more than seven days in the case of principal and not more than fourteen days in the case of interest.
- (b) **Breach of other obligations:** The Borrower or any Eligible Group Member fails to perform or observe any of its obligations under the Finance Documents (other than as referred to in (a) above, and (j) and (k) below) and (except in any case where, in the opinion of the Security Trustee, the failure is incapable of remedy when no such continuation or notice as is hereinafter mentioned will be required) the failure continues for the period of 30 days next following the service by the Security Trustee on the relevant Borrower or Eligible Group Member of notice requiring the same to be remedied.
- (c) **Other non-payment:** (A) Any other present or future indebtedness of the Borrower or an Eligible Group Member for or in respect of moneys borrowed or raised becomes due and payable prior to its stated maturity by reason of any actual default, event of default or the like (howsoever described), or (B) any such indebtedness is not paid when due or, as the case may be, within any originally applicable grace period, or (C) the Borrower or any Eligible Group Member fails to pay when due any amount payable by it under any present or future guarantee for, or indemnity in respect of, any moneys borrowed or raised provided that the aggregate amount of the relevant indebtedness, guarantees and indemnities in respect of which one or more of the events mentioned in (A), (B) or (C) above in this paragraph (c) have occurred equals or exceeds £10,000,000 or its equivalent in other currencies (as reasonably determined by the Security Trustee) (and provided further, for the avoidance of doubt, that the amounts mentioned in (A), (B) or (C) above in this paragraph (c) shall exclude the amount of any Public Sector Subsidy except for any Public Sector Subsidy which is or becomes due and payable to the relevant grant making body or organisation).
- (d) **Enforcement Event:** An Enforcement Event occurs under a Finance Document.
- (e) **Winding-up:** Any order is made by any competent court or resolution passed for the winding up or dissolution of the Borrower or any Eligible Group Member save for the purposes of a Permitted Reorganisation or a reorganisation on terms previously approved in writing by the Security Trustee.
- (f) **Cessation of Business:** The Borrower or an Eligible Group Member ceases or threatens to cease to carry on the whole or, as determined by the Security Trustee, substantially the whole of its business, save for the purposes of a Permitted Reorganisation or a reorganisation on terms previously approved in writing by the Security Trustee.
- (g) **Failure or inability to pay debts:** The Borrower or an Eligible Group Member stops or threatens to stop payment of, or is unable to, or admits inability to, pay, its debts (or any class of its debts) as they fall due, or is deemed unable to pay its debts pursuant to or for the purposes of any applicable law, or is adjudicated or found bankrupt or insolvent.

- (h) **Insolvency:** Any of the insolvency related events occurs or proceedings are taken as referred to in Clause 14.9 (*Insolvency*) or Clause 14.10 (*Insolvency Proceedings*), respectively (which exclude any Permitted Reorganisation or reorganisation on terms previously approved in writing by the Security Trustee).
- (i) **Unlawfulness:** It is or becomes unlawful for the Borrower or any Eligible Group Member to perform any of its obligations under the Finance Documents to which they are, respectively, a party.
- (j) **Breach of the Asset Cover Test:** The Borrower fails to perform its obligations under Clause 10.1 (*Asset Cover Ratio*) of the Knightstone Housing Association Loan Agreement (or the corresponding clause in the relevant Additional Loan Agreement, as applicable) and (except in any case where, in the opinion of the Security Trustee, the failure is incapable of remedy when no such continuation or notice as is hereinafter mentioned will be required) the failure continues for the period of 60 days next following the service by the Security Trustee on the Borrower of notice requiring the same to be remedied.
- (k) **Breach of the Interest Cover Test:** (A) The Borrower fails to perform its obligations under Clause 10.2 (*Interest Cover Ratio*) of the Knightstone Housing Association Loan Agreement (or the corresponding clause in the relevant Additional Loan Agreement, as applicable) and (except in any case where, in the opinion of the Security Trustee, the failure is incapable of remedy when no such continuation or notice as is hereinafter mentioned will be required) the failure continues for the period of 60 days next following the service by the Security Trustee on the Borrower of notice requiring the same to be remedied; (B) notwithstanding (A) above, the Borrower fails to procure the delivery of the Interest Cover Test Auditors' Report by the Borrowers' auditors to the Bond Trustee pursuant to Clause 10.2 (*Interest Cover Ratio*); or (C) notwithstanding the findings of the Interest Cover Test Auditors' Report, the Borrowers are, in aggregate, not in compliance with the Interest Cover Test for a period of three successive financial years.

Obligation to Notify the Issuer and the Security Trustee

Each Borrower shall notify the Issuer and the Security Trustee of any Borrower Default (and the steps, if any, being taken to remedy it) or potential Borrower Default in respect of its Loan Agreement promptly upon becoming aware of the same. The Issuer shall also notify the Security Trustee of any Borrower Default or potential Borrower Default promptly upon becoming aware of the same (unless the Issuer is aware that a notification has already been provided by the relevant Borrower) including, but not limited to, the non-payment by a Borrower of any amounts owing to the Issuer under its Loan Agreement on the due date for payment thereof.

Borrower Default Notice

Following the occurrence of a Borrower Default (but in the case of the happening of any of the events described in paragraphs (b) (*Breach of other obligations*), (c) (*Other non-payment*) and (i) (*Unlawfulness*) above, only if the Security Trustee shall have certified in writing to the Borrower that such event is, in its opinion, materially prejudicial to the interests of the Issuer), the Issuer may declare by notice to the relevant Borrower either:

- (a) that the security for the relevant Loan has become, whereupon the security for the relevant Loan shall become, immediately enforceable (and the Issuer shall notify the Security Trustee of the same in accordance with the Security Trust Deed); and/or
- (b) (irrespective of whether a notice to the effect set out in (a) shall have already been given) that the Loan has become due and repayable, whereupon that Loan shall become immediately due

and repayable at the outstanding balance thereof together with accrued interest, premium (if any) and any other amounts and the security therefor shall become immediately enforceable.

Enforcement

If the security constituted under any Security Documents for the benefit of the Issuer becomes enforceable as a result of the service of a notice pursuant to Clause 14.14 (*Borrower Default Notice*) (or the corresponding clause in any Additional Loan Agreement), then the Security Trustee or any Receiver (where appropriate) shall hold the monies arising from any sale, calling in, collection or conversion under, or otherwise arising from the exercise of, the powers of conversion contained in the Security Documents after the security has become enforceable upon trust to apply the same:

- (a) first, in payment or retention of all costs, charges, expenses and liabilities incurred in or about the exercise of such powers or otherwise in accordance with the Security Documents and payments made by the Security Trustee, any Appointee or any Receiver in accordance with the Security Documents and of all remuneration payable to the Security Trustee, any Appointee or any Receiver in accordance with the Security Documents with interest thereon as provided in the Security Documents;
- (b) second, in or towards payment to the Issuer of all interest then due and remaining unpaid on the relevant Loan and all commitment fees then due and remaining unpaid;
- (c) third, in or towards payment to the Issuer of all principal and premium (if any) then due and remaining unpaid in respect of the relevant Loan; and
- (d) fourth, in or towards payment to the Issuer of all other amounts then due and remaining unpaid under the relevant Loan Agreement.

Taxes

Each Borrower must make all payments to be made by it to the Issuer under, *inter alia*, its Loan Agreement, the Security Agreements and the Security Trust Deed, without any deduction or withholding for or on account of tax, unless a deduction or withholding is required by law.

If a deduction or withholding from any such payment is required by law to be made by the such Borrower, the amount of the payment due from such Borrower shall be increased to an amount which (after making such deduction or withholding) leaves an amount equal to the payment which would have been due if no deduction or withholding had been required.

If, as a result of any actual or proposed change in tax law, the Issuer determines (in its reasonable commercial judgement) that it would on the next following Interest Payment Date be required to make a withholding or deduction in respect of payments to be made by the Issuer to the Bondholders pursuant to the Conditions (other than in respect of a Bondholder Specific Withholding), the Issuer shall notify each Borrower of the same. Each Borrower may (but, for the avoidance of doubt, shall not be obliged to), in its sole discretion, pay to the Issuer its *pro rata* share of such additional amounts as will enable the Issuer (after such withholding or deduction) to pay to the Bondholders the amounts of principal and interest which they would have received in respect of the Bonds in the absence of such withholding or deduction. Each Borrower shall continue to pay such additional amounts to the Issuer unless and until such Borrower delivers to the Issuer a notice stating that it shall cease to make such additional payments with effect from the next following Interest Payment Date.

In the event that one or more Borrowers does not choose to make such additional payments (or indicates that it intends to cease to make such additional payments), the remaining Borrowers may

(but, for the avoidance of doubt, shall not be obliged to), in their sole discretion, pay to the Issuer such increased amount as will enable the Issuer (after such withholding or deduction) to pay to the Bondholders the amounts of principal and interest which they would have received in respect of the Bonds in the absence of such withholding or deduction. If the remaining Borrowers (either collectively or individually) do not choose to make such payments and as a result the Issuer will not have sufficient funds to pay the additional amounts in respect of the Bonds, the Issuer shall not opt to pay such additional amounts (or, having so opted, will notify the Bond Trustee and the Bondholders of its intention to cease paying such additional amounts) and the Bonds shall be redeemed in accordance with Condition 9.3 (*Early Redemption for Tax Reasons*), whereupon each Borrower shall be required to prepay the outstanding balance of its Loan, together with accrued interest and accrued commitment fee thereon up to and including the date of redemption.

Governing Law

Each Loan Agreement, and any non-contractual obligations or matters arising from or connected with it, shall be governed by, and construed in accordance with, English law.

DESCRIPTION OF THE SECURITY AGREEMENTS AND THE SECURITY TRUST DEED

The Issuer's obligations in respect of the Bonds are secured pursuant to the Bond Trust Deed in favour of the Bond Trustee for the benefit of itself and the Bondholders and the other Secured Parties by the Issuer Security, which includes an assignment by way of security of the Issuer's rights, title and interest arising under the Security Agreements and the Security Trust Deed.

The following description of the Security Agreements and the Security Trust Deed consists of a summary of certain provisions of the Security Agreements and the Security Trust Deed and is qualified by reference to the detailed provisions thereof. The Security Agreements and the Security Trust Deed are not, however, incorporated by reference into, and therefore do not form part of, this Prospectus.

Definitions used in this section but not otherwise defined in this Prospectus have the meanings given to them in the Security Agreements and/or the Security Trust Deed.

SECURITY AGREEMENTS

No Properties shall be charged as underlying security for the Bonds on the Closing Date. The Borrowers shall, in relation to any Properties to be charged as underlying security for the Bonds, enter into one or more Security Agreements substantially in the form set out in the Security Trust Deed.

Eligible Group Members

Any Borrower may procure that Properties are charged as underlying security for the Bonds by an Eligible Group Member. Eligible Group Members include any member of the Knightstone Housing Group which is approved by each existing Obligor and which has acceded to the Security Trust Deed and has created (and which is subsisting) or will create security pursuant to a Security Agreement substantially in the form set out in the Security Trust Deed. Unless otherwise approved by the Security Trustee, each such Eligible Group Member must be (i) a member of the Knightstone Housing Group and (ii) a Registered Provider of Social Housing.

Fixed Legal Mortgage and Charge

Pursuant to the Security Agreements, each Borrower and Eligible Group Member will charge, as security for the payment and discharge of all Secured Liabilities in favour of the Security Trustee for the benefit of the chargor and, *inter alios*, the Issuer:

- (a) by way of a first fixed legal mortgage all the Properties specified therein together with all buildings and Fixtures, erections and structures thereon or in the course of construction thereon, the proceeds of sale of all or any part thereof and (so far as the same are capable of being mortgaged) the benefit of any covenants for title given or entered into by any predecessor in title of such Borrower or Eligible Group Member and any moneys paid or payable in respect of such covenants; and
- (b) by way of first fixed charge:
 - (i) all plant and machinery now or in the future owned by such Borrower or Eligible Group Member and its interest in any plant and machinery in its possession which form part of or are operated by such Borrower or Eligible Group Member on the Charged Property;

- (ii) all benefits in respect of the Insurances and all claims and returns of premiums in respect of the Charged Property;
- (iii) the benefit of all present and future licences, consents and authorisations (statutory or otherwise) held in connection with its business so far as it relates to the Security Assets or the use of any of the Security Assets specified in (a) and (b)(i) above and the right to recover and receive all compensation which may at any time become payable to it in respect thereof; and
- (iv) if and in so far as the legal mortgage set forth in (a) above or the assignments set forth in the section entitled "*Assignment*" below shall for any reason be ineffective as legal mortgages or assignments, the assets referred to therein.

Assignment

Pursuant to the Security Agreements, each Borrower and Eligible Group Member will covenant, as security for payment and discharge of the Secured Liabilities, to assign to the Security Trustee for the benefit of itself and, *inter alios*, the Issuer all of its rights, title and interest in and to:

- (a) the personal agreements and covenants by the tenants, lessees, licensees or other parties under the Letting Documents and by all guarantors and all security held by such Borrower or Eligible Group Member in respect of the obligations of the tenants, lessees, licensees or other parties under the Letting Documents (including, without limiting the generality of the foregoing, all moneys due and owing to such Borrower or Eligible Group Member or which may become due and owing to such Borrower or Eligible Group Member at any time in the future in connection therewith);
- (b) all agreements now or from time to time entered into or to be entered into to for the sale, letting or other disposal or realisation of the whole or any part of the Security Assets (including, without limiting the generality of the foregoing, all moneys due and owing to such Borrower or Eligible Group Member or which may become due and owing to such Borrower or Eligible Group Member at any time in the future in connection therewith);
- (c) all agreements, contracts, deeds, licences, undertakings, guarantees, covenants, warranties, representations and other documents (including all documents entered into now or in the future so as to enable such Borrower or Eligible Group Member to perfect its rights under the Security Agreement or any such agreement, contract, deed, licence, undertaking, guarantee, covenant, warranty, representation or other documents) now or hereafter entered into by or given to such Borrower or Eligible Group Member in respect of the Charged Properties and all claims, remedies, awards or judgments paid or payable to such Borrower or Eligible Group Member (including, without limitation, all liquidated and ascertained damages payable to such Borrower or Eligible Group Member under the above) in each case relating to the Charged Properties;
- (d) all licences held now or in the future in connection with the relevant Charged Property and also the right to recover and receive all compensation which may at any time become payable to such Borrower or Eligible Group Member in relation to the relevant Charged Property;
- (e) all rights and claims to which such Borrower or Eligible Group Member is now or may hereafter become entitled in relation to any development, construction project, redevelopment, refurbishment, repair or improvement of or on the relevant Charged Property;
- (f) all guarantees, warranties, bonds and representations given or made now or hereafter by, and any rights or remedies against, all or any of the designers, builders, contractors, surveyors,

valuers, professional advisers, sub-contractors, manufacturers, suppliers and installers of any Fixtures in respect of the relevant Charged Property; and

- (g) all rental income and disposal proceeds in each case relating to the relevant Charged Property which has not been assigned as set forth in (a), (b) or (c) above and the right to make demand for and receive the same,

provided always that, until an Enforcement Event has occurred and is outstanding (but subject to the terms of the Finance Documents), the Original Borrower (and any Additional Borrower or Eligible Group Member) shall be entitled to exercise all their rights and claims under or in connection with the agreements and covenants referred to in paragraphs (a) to (g) above.

Representations, Warranties and Undertakings

Each Borrower and each Eligible Group Member shall make various representations in respect of the Charged Properties including as to ownership, planning permission, covenants and security interests. In addition, each Borrower and each Eligible Group Member shall undertake to, *inter alia*, repair, insure, pay or procure the payment of taxes in respect of and comply with all leases in respect of, the Charged Properties.

Enforcement of Security

Each Security Agreement will provide that, at any time after an Enforcement Event has occurred and is continuing, the security created by or pursuant to such Security Agreement will be immediately enforceable and the Security Trustee may enforce all or any part of such security.

The Security Agreements further shall entitle the Security Trustee and, *inter alios*, the Issuer to be indemnified out of the Security Assets in respect of, *inter alia*, all liabilities and expenses properly incurred by them in the execution or purported execution in good faith of any of the powers, authorities or discretions vested in them pursuant to the Security Agreements.

Governing Law

The Security Agreements, and any non-contractual obligations or matters arising from or connected with them, are, or will be, governed by and construed in accordance with English law.

SECURITY TRUST DEED

The benefit of the security created by the Borrowers and the Eligible Group Members pursuant to the Security Agreements shall be held by the Security Trustee on trust for the benefit of itself and, *inter alios*, the Issuer on the terms of the Security Trust Deed.

The Security

Designation of Security Assets

The Security Trust Deed provides that the Security Trustee, the Borrowers and, in the case of the Loan Agreements, the Issuer shall schedule and agree the allocation of Properties which shall comprise the Issuer's Designated Security in respect of the Loan Agreements. All Properties which are not Designated Security shall form the Undesignated Security.

Security

Pursuant to Clause 2.3 (*Additional Charged Properties*), on or prior to a Borrower or Eligible Group Member entering into a Security Agreement in respect of any Property for the benefit of the Issuer, such Borrower or Eligible Group Member must deliver to the Security Trustee the documentation relating thereto as set out therein. Such documents must be in the form and substance satisfactory to the Security Trustee and the Issuer.

Release and Reallocation of Security

Pursuant to the terms of the Security Trust Deed, the Borrowers and the Issuer may agree to amend the Issuer's Designated Security by either removing Designated Security or by designating any Undesignated Security as the Issuer's Designated Security by, *inter alia*, delivering an amended Security Certificate signed by each Borrower and the Issuer to the Security Trustee.

At any time prior to the Security Trustee taking any steps to enforce the Undesignated Security, upon receiving instructions from the relevant Borrower or Eligible Group Member, the Security Trustee shall release the benefit of any encumbrance, rights or obligations held by it over the Undesignated Security provided that such Borrower or Eligible Group Member shall have paid to the Security Trustee, or provided for to the satisfaction of the Security Trustee, all Trustee Costs which relate to that Undesignated Security.

Any such release or reallocation will be subject to the requirements set out in the Loan Agreements (see "*Description of the Loan Agreements*" above).

Application of Proceeds

Upon the enforcement of, *inter alia*, all rights vested in the Security Trustee by virtue of, or pursuant to, its holding the interests conferred on it by the Security Documents, and after satisfying claims which at law rank in priority to sums owing under or in respect of any of the Relevant Documents, the Security Trustee shall apply all Proceeds and all money derived therefrom:

- (a) in respect of Designated Security in the following order:
 - (i) first, in payment of all Relevant Trustee Costs;
 - (ii) second, in satisfaction when due of the Secured Liabilities (other than Relevant Trustee Costs) owed to the Relevant Beneficiary arising under or in connection with the Loan Agreement relating to such Designated Security in the order of priority set out therein;
 - (iii) third, to the extent not recovered under (i) above, in or towards payment of all Trustee Costs;
 - (iv) fourth, in satisfaction when due of the Secured Liabilities owed to each Other Beneficiary arising under or in connection with the Other Loan Agreements; and
 - (v) fifth, in payment of any surplus to the relevant Borrower or Eligible Group Member.
- (b) Any moneys received by the Security Trustee or by any Receiver appointed by it pursuant to any Security Document in respect of any Undesignated Security (together with the Related Security Assets) shall be applied by the Security Trustee in the following order:

- (i) first, to the extent not recovered under paragraphs (a) above, in or towards payment of all Trustee Costs;
- (ii) second, to the extent not recovered under paragraph (a) above, in or towards payment of the Secured Liabilities owed to each Beneficiary arising under or in connection with its respective Loan Agreement; and
- (iii) third, in payment of any surplus to the relevant Borrower or Eligible Group Member.

Enforcement of Security

Pursuant to Clause 4.3 of the Security Trust Deed, the Security Trustee shall only be required to take action to enforce or protect the security in respect of the Loan Agreements if so instructed by the Issuer (and then only if it has been indemnified and/or secured and/or pre-funded to its satisfaction).

In respect of instructions given by the Issuer, the Issuer has assigned its rights under, *inter alia*, the Security Trust Deed and the Security Agreements to the Bond Trustee and, pursuant to Condition 6.3, has covenanted not to take any action or direct the Security Trustee to take any action pursuant thereto except with the prior consent of the Bond Trustee. The Bond Trustee may, but is not obliged to, seek the consent of the Bondholders in accordance with the Bond Trust Deed prior to giving any such consent.

In enforcing the Issuer Security (including the Issuer's rights, title and interests in the Security Trust Deed and the Security Agreements insofar as they relate to the Bonds) the Bond Trustee may act in its discretion. It is, however, required to take action, pursuant to Condition 12.2, where so directed by the requisite majority of the Bondholders provided, however, that it is secured and/or indemnified and/or pre-funded to its satisfaction.

Governing Law

The Security Trust Deed, and any non-contractual obligations or matters arising from or connected with it, are governed by and shall be construed in accordance with English law.

DESCRIPTION OF THE ACCOUNT AGREEMENT, THE CUSTODY AGREEMENT AND THE RETAINED BOND CUSTODY AGREEMENT

The Issuer has appointed The Bank of New York Mellon, London Branch, a banking corporation organised under the laws of the State of New York and operating through its branch in London at One Canada Square, London E14 5AL, United Kingdom, as its Account Bank pursuant to the Account Agreement, its Custodian pursuant to the Custody Agreement and its Retained Bond Custodian pursuant to the Retained Bond Custody Agreement, in each case in relation to the issue of the Bonds.

The Bank of New York Mellon, London Branch is a wholly owned subsidiary of The Bank of New York Mellon Corporation, which is incorporated, with limited liability by Charter, under the Laws of the State of New York by special act of the New York State Legislature, Chapter 616 of the Laws of 1871, with its head office at One Wall Street, New York, NY 10286, USA and having a branch registered in England and Wales with FC Number 005522 and BR Number 000818 with its principal office in the United Kingdom at One Canada Square, London, E14 5AL. The Bank of New York Mellon's corporate trust business services \$12 trillion in outstanding debt from 55 locations around the world. It services all major debt categories, including corporate and municipal debt, mortgage-backed and asset-backed securities, collateralised debt obligations, derivative securities and international debt offerings. The Bank of New York Mellon's corporate trust and agency services are delivered through the Bank of New York Mellon and the Bank of New York Mellon Trust Company, N.A.

The Bank of New York Mellon Corporation is a global financial services company focused on helping clients manage and service their financial assets, operating in 34 countries and serving more than 100 markets. The company is a leading provider of financial services for institutions, corporations and high-net-worth individuals, providing superior asset management and wealth management, asset servicing, issuer services, clearing services and treasury services through a worldwide client-focused team. It has more than \$23 trillion in assets under custody and administration and more than \$1.1 trillion in assets under management. Additional information is available at www.bnymellon.com.

The following description of the Account Agreement, the Custody Agreement and the Retained Bond Custody Agreement consists of a summary of certain provisions of the Account Agreement, the Custody Agreement and the Retained Bond Custody Agreement and is qualified by reference to the detailed provisions thereof. The Account Agreement, the Custody Agreement and the Retained Bond Custody Agreement are not, however, incorporated by reference into, and therefore do not form part of, this Prospectus.

Definitions used in this section but not otherwise defined in this Prospectus have the meanings given to them in the Account Agreement, the Custody Agreement and the Retained Bond Custody Agreement.

ACCOUNT AGREEMENT

Accounts

The Account Bank shall maintain three accounts for the Issuer in respect of the Bonds: the Transaction Account, the Initial Cash Security Account and the Ongoing Cash Security Account.

Initial Deposits

Pursuant to the Account Agreement, the Issuer shall on the issue date of the Bonds credit the Initial Cash Security Account with the Retained Proceeds to the extent that such amount is not invested

directly in Permitted Investments which are deposited in the Initial Cash Security Custody Sub-Account.

The Issuer shall, upon receipt, credit to the Ongoing Cash Security Account all amounts received from a Borrower pursuant to Clause 11.3 (*Cash Security*) of the Loan Agreements.

Retained Bond Deposits

Pursuant to the Account Agreement, the Issuer shall, upon the sale of any Retained Bonds:

- (a) credit the Initial Cash Security Account with the net sale proceeds of such Retained Bonds (less any Retained Bond Premium Amount), to the extent that such amount is not paid directly to a Borrower pursuant to, and in accordance with, a Loan Agreement; and
- (b) credit the Transaction Account with the Retained Bond Premium Amount (if any), pending application in accordance with the Conditions.

Future Deposits and Withdrawals

The Issuer has covenanted, pursuant to the Bond Trust Deed, that:

- (a) prior to the enforcement of the Issuer Security, payments from the Initial Cash Security Account shall only be made to fund:
 - (i) the Commitments pursuant to, and in accordance with the terms of, the Loan Agreements;
 - (ii) payment to a Borrower or another member of the Knightstone Housing Group in respect of any Bonds surrendered for cancellation in accordance with the Loan Agreements;
 - (iii) the purchase of Permitted Investments pursuant to the Custody Agreement; or
 - (iv) redemptions of the Bonds in accordance with the Conditions;
- (b) it shall sell or otherwise dispose of all Permitted Investments standing to the credit of the Initial Cash Security Custody Sub-Account and shall transfer all monies standing to the credit of the Initial Cash Security Account (if any) to the Transaction Account, in each case on the date falling five Business Days prior to the Loan Maturity Date;
- (c) prior to the enforcement of the Issuer Security, payments from the Ongoing Cash Security Account shall only be made to a Borrower pursuant to, and in accordance with the terms of, the relevant Loan Agreement or to purchase Permitted Investments in accordance with the Custody Agreement; and
- (d) no payments from the Transaction Account will be made other than in accordance with the Conditions and the Issuer has undertaken to procure that amounts are paid into and out of the Transaction Account only in accordance with the Conditions, the Account Agreement and the Agency Agreement.

The Account Bank is under no obligation to monitor compliance with the above covenants.

Interest

Any monies standing to the credit of the Transaction Account, the Initial Cash Security Account and/or the Ongoing Cash Security Account will earn interest at the rate(s) agreed from time to time between the Account Bank and the Issuer.

Pursuant to the Account Agreement, interest accrued on the Transaction Account and the Initial Cash Security Account shall be credited to the Transaction Account and interest accrued on the Ongoing Cash Security Account shall be credited to the Ongoing Cash Security Account.

Change of Account Bank

The appointment of the Account Bank may, with the prior written approval of the Bond Trustee, be terminated upon 45 days' written notice or forthwith at any time the Account Bank is adjudged bankrupt or insolvent. The appointment of the Account Bank shall also be terminated (a) at any time when the Bonds have been assigned a rating by Moody's, in the event that the short-term senior, unsecured and unguaranteed indebtedness rating of the Account Bank as assigned by Moody's falls below "P-1" or is withdrawn and (b) at any time when the Bonds have been assigned a rating by S&P, in the event that the short-term senior, unsecured and unguaranteed indebtedness rating of the Account Bank as assigned by S&P falls below "A-1" or is withdrawn and, in each case, there are amounts standing to the credit of the Initial Cash Security Account and/or the Ongoing Cash Security Account (subject to the Issuer using all reasonable endeavours to secure the appointment of a replacement Account Bank within 30 days of notice to the Bond Trustee and (if applicable) Moody's and/or S&P of such termination).

The Account Bank may resign its appointment upon giving at least 60 days' written notice (subject to the appointment of a replacement Account Bank).

Pursuant to the Account Agreement, the appointment of any replacement Account Bank shall be subject to the prior written approval of the Bond Trustee, be on substantially the same terms as the Account Agreement and, at any time when the Bonds have been assigned a rating by Moody's and/or S&P, be subject to the condition that it must have a short-term senior, unsecured and unguaranteed indebtedness rating of no less than "P-1" from Moody's and/or no less than "A-1" from S&P, as applicable.

CUSTODY AGREEMENT

Custody Account

Pursuant to the Custody Agreement, the Custodian shall, subject to receipt of such documents as it may require, open, in the name of the Issuer, the Ongoing Cash Security Custody Sub-Account and the Initial Cash Security Custody Sub-Account (the **Custody Sub-Accounts**) and the Ongoing Cash Security Sub-Account and the Initial Cash Security Cash Sub-Account (the **Cash Sub-Accounts** and, together with the Custody Sub-Accounts, the **Custody Account**).

Payments and Delivery

The Issuer has authorised the Custodian to make payments and delivery out of the Custody Account only for the purpose of any acquisition or sale of Permitted Investments or as provided below.

Pursuant to the Custody Agreement, unless otherwise instructed pursuant to Instructions to make a payment out of the proceeds of any Distributions in respect of Permitted Investments purchased by or on behalf of the Issuer in the settlement of an acquisition of other Permitted Investments on or prior to the date of receipt of such Permitted Investments (subject as provided below), the Issuer has agreed to

give Instructions to the Custodian, forthwith upon receipt by the Custodian of any Distributions, to transfer:

- (a) all Distributions credited to the Ongoing Cash Security Sub-Account to the Ongoing Cash Security Account;
- (b) all Distributions (including any amount representing Permitted Investment Profit (if any)) credited to the Initial Cash Security Cash Sub-Account (other than Distributions which represent redemption and/or sale proceeds less any Permitted Investment Profit (if any)) to the Transaction Account; and
- (c) all Distributions credited to the Initial Cash Security Cash Sub-Account (other than those to be credited to the Transaction Account pursuant to (b) above) to the Initial Cash Security Account,

subject, in each case, to any deductions in respect of any taxes or levies required by any revenue or governmental authority.

The Issuer has agreed that it shall not instruct the Custodian pursuant to Instructions to make a payment out of the proceeds of any Distributions standing to the credit of the Initial Cash Security Cash Sub-Account other than Distributions which represent redemption and/or sale proceeds (but excluding any amount representing Permitted Investment Profit (if any)) and that such amounts shall forthwith upon receipt be transferred to the Transaction Account in accordance with (b) above.

Interest

Any monies standing to the credit of the Disposal Proceeds Cash Sub-Account and the Initial Cash Security Cash Sub-Account will earn interest at the rate(s) agreed from time to time between the Issuer and the Custodian.

Change of Custodian

The appointment of the Custodian may, with the prior written approval of the Bond Trustee, be terminated upon 45 days' written notice (subject to the appointment of a replacement Custodian) or forthwith at any time the Custodian is adjudged bankrupt or insolvent. The appointment of the Custodian shall also be terminated (a) at any time when the Bonds have been assigned a rating by Moody's, in the event that the short-term senior, unsecured and unguaranteed indebtedness rating of the Custodian as assigned by Moody's falls below "P-1" or is withdrawn and (b) at any time when the Bonds have been assigned a rating by S&P, in the event that the short-term senior, unsecured and unguaranteed indebtedness rating of the Custodian as assigned by S&P falls below "A-1" or is withdrawn and, in each case, there are Permitted Investments standing to the credit of the Custody Account (subject to the appointment of a replacement Custodian).

The Custodian may resign its appointment upon giving at least 30 days' written notice to the Issuer and the Bond Trustee (subject to the appointment of a replacement Custodian).

Pursuant to the Custody Agreement, the appointment of any replacement Custodian shall be subject to the prior written approval of the Bond Trustee, be on substantially the same terms as the Custody Agreement and, at any time when the Bonds have been assigned a rating by Moody's and/or S&P, be subject to the condition that it must have a short-term senior, unsecured and unguaranteed indebtedness rating of no less than "P-1" from Moody's and/or no less than "A-1" from S&P, as applicable.

RETAINED BOND CUSTODY AGREEMENT

Retained Bond Custody Account

Pursuant to the Retained Bond Custody Agreement, the Retained Bond Custodian shall, subject to receipt of such documents as it may require, open, in the name of the Issuer, the Retained Bond Custody Sub-Account and the Retained Bond Cash Sub-Account (together with the Retained Bond Custody Sub-Account, the **Retained Bond Custody Account**).

Payments and Delivery

The Issuer has authorised the Retained Bond Custodian to make payments and delivery out of the Retained Bond Custody Account only as provided below.

Pursuant to the Retained Bond Custody Agreement, the Retained Bond Custodian shall not effect a transfer of any Retained Bonds except with the prior written consent of the Bond Trustee in the form of a Retained Bond Consent Letter which has been countersigned on behalf of the Bond Trustee.

Pursuant to the Retained Bond Custody Agreement, unless otherwise instructed pursuant to Instructions to make a payment out of any Sale Proceeds (other than any Retained Bond Premium Amount) to a Borrower in satisfaction of the Issuer's obligation to make an advance pursuant to its Loan Agreement, the Issuer shall give Instructions to the Retained Bond Custodian, forthwith upon receipt by the Retained Bond Custodian of any Sale Proceeds to transfer:

- (a) all Sale Proceeds (other than any Retained Bond Premium Amount) to the Initial Cash Security Account, and
- (b) all Retained Bond Premium Amounts to the Transaction Account,

in each case, subject to any withholding as required by applicable tax laws.

Payment Waiver

Notwithstanding any other provision of the Retained Bond Custody Agreement to the contrary and subject to the following paragraph, the Issuer has, pursuant to Clause 1.3 of the Retained Bond Custody Agreement, unconditionally and irrevocably:

- (a) waived its rights to receive payments of interest, principal or otherwise in respect of the Retained Bonds and, for the avoidance of doubt, such waiver by the Issuer of such rights will continue to be effective following the occurrence of an Event of Default or Potential Event of Default (each as defined in the Bond Trust Deed);
- (b) authorised the Retained Bond Custodian to disclose the waiver referred to in (a) above in respect of the Retained Bonds (and the Retained Bonds position with the Retained Bond Custodian) to the Principal Paying Agent and any applicable international clearing system for the Retained Bonds to ensure that the waiver of the right to receive payments of interest, principal or otherwise in respect of the Retained Bonds is effected; and
- (c) directed the Retained Bond Custodian, in respect of each Retained Bond held by the Retained Bond Custodian on behalf of the Issuer in the Retained Bond Custody Sub-Account in definitive certificated form, (i) on each Interest Payment Date, to surrender the interest coupon for such Retained Bond corresponding to such Interest Payment Date to the Principal Paying Agent for cancellation and (ii) to surrender the definitive certificate representing such

Retained Bond to the Principal Paying Agent for cancellation on any date on which the Retained Bonds are to be redeemed in full.

The Retained Bond Custodian and the Issuer have each acknowledged and agreed that the waiver, authorisation and direction provided by the Issuer as described above are irrevocable except with the prior written consent of the Bond Trustee in the form of a Retained Bond Consent Letter which has been countersigned on behalf of the Bond Trustee.

Interest

Any monies standing to the credit of the Retained Bond Cash Sub-Account will earn interest at the standard rate(s) set by the Retained Bond Custodian in its deposit terms and conditions, as may be issued by it from time to time.

Termination of Retained Bond Custody Agreement

Either of the Issuer or the Retained Bond Custodian may terminate the Retained Bond Custody Agreement by giving to at least 90 days' written notice to the other party.

Either of the Issuer or the Retained Bond Custodian may further terminate the Retained Bond Custody Agreement immediately upon notice to the other party upon the dissolution of that other party, or upon the commencement of any action or proceedings seeking liquidation (or equivalent) of that other party.

Pursuant to the Retained Bond Custody Agreement, the Issuer has covenanted for the benefit of the Bond Trustee that, in the event that the Retained Bond Custody Agreement is terminated, it shall appoint a successor custodian to hold the Retained Bonds on substantially the same terms as the Retained Bond Custody Agreement, in particular, but without limitation to, the payment waiver and transfer restrictions applicable to the Retained Bonds, as described above.

DESCRIPTION OF THE ISSUER

Incorporation and Status

Knightstone Capital Plc (the **Issuer**) is a public limited company incorporated in England and Wales with registered number 8691017 on 16th September, 2013 under the Companies Act 2006.

The registered address of the Issuer is Station Road, Worle, Weston-super-Mare BS22 6AP. The telephone number of its registered address is 01934 524300. The Issuer has no subsidiaries.

Principal Activities

The Issuer is a special purpose vehicle established for the purpose of issuing the Bonds (and incurring other indebtedness (including other secured indebtedness but subject to the covenant set out in Condition 6.1 (*General Covenants*))) and lending the proceeds thereof to the Borrowers to be applied in the achievement of each Borrower's charitable objects.

Directors

The directors of the Issuer and their principal activities outside of the Issuer are as follows:

Name	Principal activities outside the Issuer
Nicholas Horne	Group Chief Executive Board Member of Knightstone Housing Group Limited Board Member of Knightstone Housing Association Limited Director of Great Western Assured Growth Limited Director of Great Western Housing Limited Member of the Social Housing Pension Scheme Committee Chair of the NHF South West Regional Executive Member of West of England Local Enterprise Partnership Infrastructure & Place Group Shareholder of Bristol Community Housing Foundation
Richard Taylor	Board Member of Knightstone Housing Group Limited Board Member of Knightstone Housing Association Limited Director of Great Western Assured Growth Limited Director of Great Western Housing Limited Director of Knightstone Charitable Housing Limited Director of Inscape Design Services Ltd Director of Cornwall Editions Ltd Director of Locally Ltd Member of NED panel of Finance Cornwall Ltd

Name	Principal activities outside the Issuer
Stewart Wright	Board Member of Knightstone Housing Group Limited Board Member of Knightstone Housing Association Limited Director/Chair of Great Western Assured Growth Limited Director/Chair of Great Western Housing Limited Honorary Treasurer of the Anchor Society and Director of the Anchor Society Ltd, a not-for-profit subsidiary of the Anchor Society Trustee of Lady Haberfield's Almshouse Charity Member of the Salvation Army, Bristol, Easton Corps
Duncan Brown	Group Director of Resources

The business address of each of the above directors is Station Road, Worle, Weston-super-Mare BS22 6AP.

The Secretary of the Issuer is Charlotte Ferris whose business address is at Station Road, Worle, Weston-super-Mare BS22 6AP.

There are no potential conflicts of interest between any duties to the Issuer of the directors of the Issuer and their private interests and/or duties. However, each of the directors of the Issuer are board members or employees of the Original Borrower.

In accordance with the Issuer's Articles of Association, provided a director of the Issuer has disclosed the nature and extent of their interest (each, a **Conflict**) and the other directors have authorised such Conflict (such authorisation being deemed to have been given where the Conflict arises as a result of their connection with any parent or subsidiary of the Issuer) he or she may have such an interest and there is no restriction on such directors being able to vote at a board meeting of the Issuer. The Issuer acts in conformity with its constitutional documents.

The Issuer has no employees but has available to it the treasury and business resources of the Original Borrower to enable it to administer its business and perform its obligations.

Share Capital and Major Shareholders

The entire issued share capital of the Issuer comprises 50,000 ordinary shares of £1 each, all of which are paid up to 25 pence.

The Original Borrower holds all of the shares of the Issuer.

The Original Borrower exercises control over the Issuer through its full ownership of the Issuer.

Operations

Since the date of incorporation, the Issuer has not commenced operations and no financial statements have been made up as at the date of this Prospectus.

DESCRIPTION OF THE ORIGINAL BORROWER AND THE KNIGHTSTONE HOUSING GROUP

ORIGINAL BORROWER

Incorporation and Status

Knightstone Housing Association Limited (the **Original Borrower**) was incorporated on 14th February, 1974 and is registered in England with limited liability under the Industrial and Provident Societies Acts 1965-2003 (with registered number IP21080R) and is registered with the Regulator (such registration being dated 15th July, 1975 with registered number L0291). It is also affiliated to the National Housing Federation. The Original Borrower is an exempt charity.

The registered office of the Original Borrower is Station Road, Worle, Weston-super-Mare BS22 6AP. The telephone number of its registered address is 01934 524300.

Background and History

The Original Borrower is a subsidiary of Knightstone Housing Group Limited (the **Group Parent**), a company registered in England with limited liability under the Industrial and Provident Societies Acts 2003 (with registered number IP2986R). The Group Parent is a registered with the Regulator (with registered number L4436) and is affiliated to the National Housing Federation.

The Original Borrower's subsidiaries (together with the Original Borrower, the **Borrower Group**) are as follows:

- Knightstone Charitable Housing Limited, a company registered with the Industrial and Provident Society (registered number IP19165R). The principal activity of this company is to support the charitable activities of the Original Borrower. This company is an exempt charity;
- Great Western Housing Limited, a private limited company incorporated in England and Wales (registered number 02792288). The principal activity of this company is the management of social housing, however the company is currently dormant and has been dormant since 1st April, 2013;
- Great Western Assured Growth Limited, a private limited company incorporated in England and Wales (registered number 02525892). The principal activity of this company is the management of social housing;
- Arc Homes (South West) Limited, a private limited company incorporated in England and Wales (registered number 06447504). The company is currently dormant and has been dormant since incorporation; and
- Arc Developments South West Limited, a company limited by guarantee and incorporated in England and Wales (with registered number 05716836). The principal activity of this company is the development of homes for open market sale.

By virtue of section 400 of the Companies Act 2006, the Original Borrower is exempted from producing consolidated financial statements as these are produced by its parent company, the Group Parent.

The operational activity of the Original Borrower's five subsidiaries is summarised above, with the key financial measures set out below. In view of the immateriality of these subsidiaries to the

Original Borrower and that such subsidiaries are not representative of the Borrower Group, the board members of the Original Borrower believe that the production of consolidated financial statements will not provide additional information of any value.

The key financial information in respect of the Borrower Group is set out below:

Financial statements for the financial year ended 31st March, 2013

		Knightstone Housing Association Limited	Knightstone Charitable Housing Limited	Great Western Housing Limited	Great Western Assured Growth Limited	Arc Developments South West Limited	Arc Homes (South West) Limited *
Turnover	£'000	56,123	199	3	791	9,453	0
	%	84.3%	0.3%	0.0%	1.2%	14.2%	0.0%
Operating surplus	£'000	11,970	16	0	247	491	0
	%	94.1%	0.1%	0.0%	1.9%	3.9%	0.0%
Surplus/ (deficit) after tax	£'000	9,513	16	(259)	113	416	0
	%	97.1%	0.2%	(2.7%)	1.2%	4.2%	0.0%
Net current assets/ (liabilities)	£'000	25,807	351	0	(263)	4,487	0
	%	84.9%	1.2%	0.0%	(0.9%)	14.8%	0.0%
Gross current assets	£'000	44,365	568	0	208	5,127	0
	%	88.3%	1.1%	0.0%	0.4%	10.2%	0.0%

*Arc Homes (South West) Limited was dormant during the financial year ended 31st March, 2013.

Principal Activities of the Original Borrower

The Original Borrower is a leading Registered Provider of Social Housing focusing on providing customers with a range of good quality, good value services including housing management, supported housing, property investment, property development and business support services across 37 Local Authority areas in the South West. Its services meet the needs of a variety of personal and corporate customers, including residents, homeowners, Local Authority partners and funders.

It is the principal asset holder for the Knightstone Housing Group. Its main activities are:

- the ownership, management and provision of services to 12,000 homes and over 23,000 residents in its core operating areas. These include general needs, shared ownership, care and supported housing and foyer accommodation; and

- developing a wide range of affordable housing options in high quality developments, including low-cost rented homes and schemes to help local people on moderate incomes become first-time buyers.

Activities of the Knightstone Housing Group

The Knightstone Housing Group as a whole employs over 400 people and, in addition to the above, its main activities are:

- providing housing management and repairs and maintenance services to all general needs residents;
- providing housing related support and accommodation to more than 1,500 people;
- providing management services to homeowners and marketing new homes;
- providing a range of social and economic regeneration activities and programmes for people in the local community aimed at raising aspirations, promoting community cohesion and giving people a chance to succeed; and
- developing new properties for general needs and supported residents, for homeownership and sale.

The Knightstone Housing Group has begun implementing its strategic plan, "Take on the Future". By 2015 the Knightstone Housing Group aims to:

- reduce its operating area from 37 local authority areas to nine in Somerset and the West of England. This refocus is also enabling the Knightstone Housing Group to make savings that it is using to invest in services and in its communities and in helping to deliver more complex development plans;
- swap homes and carry out sales and management agreements with other landlords to improve financial and operational strength and improve the effectiveness and localness of services to residents. The Knightstone Housing Group has already transferred 1,356 homes to other organisations and acquired 1,950 to concentrate its homes into a smaller geographical area and to improve the financial capacity of its business for additional investment;
- develop 1,500 new homes in Somerset and the West of England over the five year period from 2011-2015;
- lead a consortium of registered providers, KeyWest, to channel grant funding from the HCA into the completion of new homes in Somerset and the West of England;
- restructure its housing and support services to deliver better, more locally responsive services across Somerset and the West of England;
- help residents prepare for the Government's welfare reforms. The Knightstone Housing Group is working hard to minimise the impact of welfare reform both on its customers and its business; and
- deliver supported housing in ever more efficient ways.

Board

The role of the board is to provide strategic leadership for the Original Borrower within a framework of prudent and effective controls which enable risk to be assessed and managed. Whilst the board has overall responsibility for the affairs of the Original Borrower, day to day operational responsibility is delegated to the Chief Executive and committees. There are, however, certain matters for which the board reserves its powers. The board sets the Original Borrower's strategic aims; ensures that the necessary financial and human resources are in place for the Original Borrower to meet its objectives; reviews management performance; sets the Original Borrower's values and standards; and ensures that its obligations to its stakeholders are understood and met.

The board members of the Original Borrower and their principal activities outside the Original Borrower, where these are significant with respect to the Original Borrower, are as follows:

Name	Principal activities outside the Original Borrower
Nick Medhurst	Board Member/Chair of Knightstone Housing Group Limited Board Member/Chair of Knightstone Housing Association Limited
Barrie Dale (Vice Chair)	Board Member/Vice Chair of Knightstone Housing Group Limited Board Member/Vice Chair of Knightstone Housing Association Limited
Jamir Ali	Board Member of Knightstone Housing Association Limited Director of Knightstone Charitable Housing Limited
Jacqui Cross	Knightstone resident Director of Knightstone Housing Group Limited Director of Knightstone Housing Association Limited Director of Knightstone Charitable Housing Limited Director of Westworks Procurement Limited Trustee of Mind (Taunton & West Somerset)
Tony Gosling	Knightstone resident Board Member of Knightstone Housing Group Limited Board Member of Knightstone Housing Association Limited Director of Knightstone Charitable Housing Limited Director of I-Contact Video Ltd Director of Bristol Broadband Co-operative Ltd Director of Bristol CLT Ltd (Community Land Trust)

Name	Principal activities outside the Original Borrower
Nicholas Horne	<p>Group Chief Executive Board Member of Knightstone Housing Group Limited Board Member of Knightstone Housing Association Limited Director of Great Western Assured Growth Limited Director of Great Western Housing Limited Member of the Social Housing Pension Scheme Committee Chair of the NHF South West Regional Executive Member of West of England Local Enterprise Partnership Infrastructure & Place Group Shareholder of Bristol Community Housing Foundation</p>
Richard Taylor	<p>Board Member of Knightstone Housing Group Limited Board Member of Knightstone Housing Association Limited Director of Great Western Assured Growth Limited Director of Great Western Housing Limited Director of Knightstone Charitable Housing Limited Director of Inscape Design Services Ltd Director of Cornwall Editions Ltd Director of Locally Ltd Member of NED panel of Finance Cornwall Ltd</p>
Delyth Lloyd-Evans	<p>Board Member of Knightstone Housing Group Limited Board Member of Knightstone Housing Association Limited Company Secretary & Director of PD Properties South West Limited Chair North Somerset Community Services Partnership Business Coach</p>
Stewart Wright	<p>Board Member of Knightstone Housing Group Limited Board Member of Knightstone Housing Association Limited Director/Chair of Great Western Assured Growth limited Director/Chair of Great Western Housing Limited Honorary Treasurer of the Anchor Society and Director of the Anchor Society Ltd, a not-for-profit subsidiary of the Anchor Society Trustee of Lady Haberfield's Almshouse Charity Member of the Salvation Army, Bristol, Easton Corps</p>
Graham Watts	<p>Board Member and shareholder of Knightstone Housing Group Limited Board Member and shareholder of Knightstone Housing Association Limited Non-executive director of the Oil and Gas Pipeline Agency</p>

The business address of each of the above board members is Station Road, Worle, Weston-super-Mare BS22 6AP.

The Knightstone Housing Group operates a common board structure for its parent and operating companies. With the exception of Jamir Ali, who acts on the Board of the Original Borrower only, each board member acts on the Boards of both the Group Parent and the Original Borrower.

There are no potential conflicts of interest between any duties to the Original Borrower of the board members of the Original Borrower and their private interests and/or duties. Although, Nicholas Horne, Richard Taylor and Stewart Wright are also directors of the Issuer, the Rules of the Original Borrower provide that, for the purposes of the rules governing board members' interests, a board member does not have a financial interest in any contract or other transaction with the Original Borrower as a director of any other group member.

Corporate Governance

The Knightstone Housing Group has established a governance framework which encourages all board members to bring an independent judgement to bear on issues of strategy, performance and resources, including key appointments and standards of conduct. The Chief Executive is a full member of both the boards of the Group Parent and the Original Borrower and this strengthens the link between executive and non-executive directors.

The Original Borrower has adopted and complies with the principal recommendations of the Code of Governance for members of the National Housing Federation. The ways the Original Borrower achieves good governance are outlined below.

The board conducts an annual review of its effectiveness with a view to improving individual contributions and collective achievement. There is an on-going training programme for board members and board composition is kept under review.

The board is supported by three Knightstone Housing Group wide sub-committees as follows:

- Remuneration and Nominations Committee

The Remuneration and Nominations Committee is a group-wide committee which is responsible for reviewing the salary of the Chief Executive and receives recommendations from the Chief Executive in respect of salary levels for the Executive Team. Other key activities include succession planning for boards and committees and overseeing board member recruitment, induction, appraisal and effectiveness processes.

- Audit and Assurance Committee

The Audit and Assurance Committee is a group-wide committee which is responsible for reviewing the work of the external assurance providers including external auditors and reviewing the Knightstone Housing Group's system of risk management and internal control. The Audit and Assurance Committee meets with management as well as privately with the auditors. The Chair reports the outcome of meetings to the board and the board receives minutes of all committee meetings.

The Audit and Assurance Committee has authority to investigate any matters within its Terms of Reference, to access resources, to call for information and to obtain external professional advice.

- Resources Committee

The Resources Committee is a group-wide committee which is responsible for considering and recommending to the boards the Group's Treasury Policy and Annual Treasury Plans, reviewing the management of treasury risks and approving the Knightstone Housing Group's financing programme. The Chair reports the outcome of meetings to the board and the board receives minutes of all committee meetings.

The Resources Committee also has oversight of the development programme, facilities management, procurement, information technology and human resources services.

The Resources Committee has authority to investigate any matters within its Terms of Reference, to access resources, to call for information and to obtain external professional advice.

The Executive Team comprises the following:

Name	Role
Nicholas Horne	Chief Executive
Duncan Brown	Group Director of Resources
Mark Beard	Director of Customer and Community Operations
Mike Day	Director of Development and Home Ownership
Anne Duff	Director of Corporate Services
Charlotte Ferris	Company Secretary

The business address of each of the above Executive Team members is Station Road, Worle, Weston-super-Mare BS22 6AP.

There are no potential conflicts of interest between any duties to the Original Borrower of the Executive Team of the Original Borrower and their private interests and/or duties.

Share Capital and Major Shareholders

The Original Borrower is an industrial and provident society in respect of which all current board members (with the exception of the Chief Executive) hold one share of £1 each. In addition, shares have been issued to two Knightstone residents in accordance with the membership policy of the Original Borrower. The total number of shareholding members is 11, all of whom hold a £1 share. The Group Parent has the right to appoint and remove all board members and shareholders.

Recent Developments

There have been no recent events particular to the Original Borrower that are, to a material extent, relevant to the evaluation of the Original Borrower's solvency.

FINANCIAL STATEMENTS OF THE ORIGINAL BORROWER

The audited financial statements, including the reports of the auditors, for the financial years ended 31st March, 2012 and 31st March, 2013 for the Original Borrower are set out below.

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

FINANCIAL STATEMENTS FOR THE
YEAR ENDED 31 MARCH 2012

KNIGHTSTONE HOUSING ASSOCIATION LIMITED
FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2012

CONTENTS

Board Members, Advisers and Bankerspage 1

Report of the Boardpage 2

Independent Auditors' Report.....page 6

Income and Expenditure Account.....page 8

Statement of Total Recognised Surpluses and Deficits.....page 9

Balance Sheetpage 10

Notes to the Financial Statementspage 11

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

BOARD MEMBERS, ADVISERS AND BANKERS AS AT 19 JULY 2012

BOARD MEMBERS

Chairman

D Lloyd-Evans

Vice Chairman

B Dale

Other Board Members

N J Horne

R Taylor

J Ali

J Cross

S Wright

T Gosling

R Lloyd

SECRETARY

C Ferris

AUDITORS

Mazars LLP

BANKERS

Barclays Bank plc

REGISTERED OFFICE

Station Road

Worle

Weston-super-Mare

BS22 6AP

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

REPORT OF THE BOARD

Introduction

The Board presents its annual report and audited financial statements for the year ended 31 March 2012.

Principal activity

The Association's principal activity is the management of social housing.

Financial review of the year and future prospects

The Association made a surplus of £5.2 million for the year which compared with a surplus of £14.8 million for the year to 31 March 2011. The prior year included an exceptional item of £7.9 million relating to the transfer of engagements of Knightstone Community Homes Limited on 11 October 2010.

There has been a prior year adjustment as a result of adopting the Statement of Recommended Practice (SORP): Accounting by registered social housing providers Update 2010 in the current financial year (see Note 25). The change of estimation basis for component accounting has resulted in a restated surplus in the year to 31 March 2011 of £14.8 million compared to the published financial statements which had a surplus of £13.1 million. At the end of the year, the Association had accumulated surpluses of £53 million which included a prior year reduction in reserves of £11 million. The Board believes that the Association will continue to perform well in the future.

Statement of the responsibilities of the Board

The Industrial and Provident Societies Acts and registered social housing legislation require the Board to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Association as at the end of the financial year and of the surplus or deficit for that period. In preparing those financial statements, the Board has:

- selected suitable accounting policies and applied them consistently;
- made judgements and estimates that are reasonable and prudent;
- followed applicable accounting standards and;
- prepared the financial statements on a going concern basis.

The Board is responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Association and enable it to ensure that the financial statements comply with the Industrial and Provident Societies Acts 1965 to 2003 and the Accounting Requirements for Registered Social Landlords General Determination 2006. It is also responsible for safeguarding the assets of the Association and for the system of internal control and hence for taking reasonable steps for the prevention and detection of risks including fraud and other irregularities.

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

REPORT OF THE BOARD – (continued)

Internal control and risk management

The Board acknowledges its responsibilities for the system of internal control and for reviewing its effectiveness. The Board also acknowledges its responsibility for the wider aspects of risk management.

The Association adopts the same systems of internal control and risk management used by its parent body, Arcadia Housing Limited. These are designed to manage, rather than eliminate, the risk of failure to achieve the Association's Business Plan objectives. Furthermore, they are designed to provide reasonable, but not absolute, assurance regarding the safeguarding of assets, the maintenance of proper accounting records, the reliability of financial information and the management of risks which could adversely affect the Association's ability to achieve its Business Plan objectives.

The Board has reviewed the effectiveness of the systems of internal control and risk management for the period 1 April 2011 to 19 July 2012, the date of this report. The review has been conducted through a variety of mechanisms, including approval of its annual risk review, regular reports from the Audit and Assurance Committee and minutes of its meetings, an annual internal control report from the Audit and Assurance Committee, incorporating assurances from the Group Chief Executive, an annual review of Standing Orders and Financial Regulations, regular reports on performance against key indicators; internal audits; external audit; and review of the Group's fraud register. Information contained within the Fraud Register has been reflected within the Board's annual review of the effectiveness of internal controls.

The following mechanisms are in place to provide effective internal control:

- clearly defined corporate and divisional management and reporting structures;
- careful staff recruitment, appropriate training and individual performance monitoring systems;
- Standing Orders and financial regulations setting out clearly the system of delegation;
- procedure manuals for staff;
- corporate, divisional, area and scheme management information and performance control systems with regular reporting of financial results and other performance indicators against budgets and other internal and external targets;
- clearly defined business and strategic planning processes including the preparation of area, central office and consolidated annual budgets, rolling business plans and a 30 year financial forecasting model supported by specific financial, operational and development action plans and a process for the monitoring of results against forecasts and development plans;
- a Board approved Treasury Policy & Strategy and an annual Treasury Plan which is reported against on a quarterly basis;
- a Whistleblowing Policy and a Fraud, Bribery, Theft and Corruption Policy which covers the prevention, detection and reporting of fraud, and the recovery of assets; and
- monitoring of the control system by the Audit and Assurance Committee, the internal audit service and senior management.

No significant systemic internal control weaknesses were identified as a result of this review. Where other weaknesses or areas for improvements have been identified, appropriate arrangements have been put in place to address them. Implementation of agreed actions is monitored by the Audit and Assurance Committee on behalf of the Board.

The Board acknowledges its responsibility for the management of fraud and prevention of bribery. The Group has a current strategy and policy on fraud and bribery covering prevention, detection, reporting and the recovery of assets.

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

REPORT OF THE BOARD – (continued)

Internal control and risk management – (continued)

The Association's processes for identifying, evaluating and managing significant financial, operational and business risks are ongoing. Processes have been operational for the period 1 April 2011 to 19 July 2012, the date of this report. These are regularly reviewed by the Board and its sub-Committees.

The following are the key processes adopted by the Group for this purpose.

- a Group-wide risk register regularly reviewed by senior management and the Audit and Assurance Committee as part of the business planning and performance management process;
- regular consideration by the Audit and Assurance Committee of significant risks and during 2011/12 receipt of reports from the senior team on each of the risks identified and considered by the Audit and Assurance Committee on behalf of the Board;
- processes for reviewing wider sociological, technological, economic, environmental and political factors and their implications for the Group in the context of the Business Plan review, the annual review of the Treasury Policy and Strategy and the annual review of the long-term financial forecast;
- a sophisticated approach to treasury management to minimise exposure to interest rate changes through the use of interest rate hedging;
- clearly defined processes for investment appraisal prior to undertaking the development of new schemes or embarking on major reinvestment in existing properties;
- a process involving members of the Board for reviewing the risks associated with non-traditional development schemes or major projects as and when necessary; and
- an established programme of internal audit activities derived from an assessment of key business risks.

Legal status

The Association is registered under the Industrial and Provident Societies Act 1965 (Registration No. 21080R) and is also registered with the Housing Regulator pursuant to sections 111 and 112 of the Housing and Regeneration Act 2008 (Registration No. L0291). The Association has charitable status for tax purposes.

Board Membership

The Board members who served during the year are shown below:

D Lloyd-Evans, S Wright, Rev. J N O Williams, N J Horne, R Taylor, B Dale, J Ali, J Cross, T Gosling, R Lloyd, L Nee and A Weiler.

Stewart Wright was Chair of KHA for the period 1 April 2011 to 15 September 2011.

Barrie Dale was Chair of KHA for the period 16 September 2011 to 31 December 2011.

Delyth Lloyd-Evans was Chair of KHA for the period 1 January 2012 to 31 March 2012 and continues to act in this capacity.

Barrie Dale was Vice Chair of KHA for the period 1 April 2011 to 15 September 2011.

There was no Vice Chair of KHA for the period 16 September 2011 to 31 December 2011.

Barrie Dale was Vice Chair of KHA for the period 1 January 2012 to 31 March 2012 and continues to act in this capacity.

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

REPORT OF THE BOARD – (continued)

Board Membership – (continued)

L Nee resigned from the Board on 27 April 2011. A Weiler and Rev. J N O Williams resigned from the Board on 31 December 2011.

D Lloyd-Evans and R Lloyd were appointed to the Board on 1 January 2012.

Code of Governance

Knightstone Housing Association Limited is a subsidiary of Arcadia Housing Limited. The Group has formally adopted the National Housing Federation's Code - *Excellence in Governance* - with effect from 1 April 2010 (including all subsequent updates) and complies with all the principal elements of the Code.

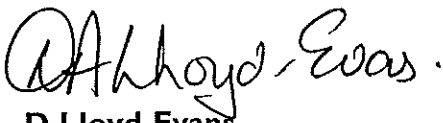
Annual General Meeting

The Annual General Meeting will be held on 29 September 2012.

Auditors

A resolution to re-appoint Mazars LLP as auditors will be proposed at the forthcoming Annual General Meeting. Mazars LLP have expressed their willingness to continue in office.

The report of the Board was approved on 19 July 2012 and signed on its behalf by



D Lloyd-Evans
Chairman

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF KNIGHTSTONE HOUSING ASSOCIATION LIMITED

We have audited the financial statements of Knightstone Housing Association Limited for the year ended 31 March 2012 which comprise the Income and Expenditure Account, the Statement of Total Recognised Surpluses and Deficits, the Balance Sheet and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Respective responsibilities of the board and the auditor

As explained more fully in the Statement of Board's Responsibilities set out on page 2, the Board is responsible for the preparation of 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). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report is made solely to the Association's members, as a body, in accordance with section 9 of the Friendly and Industrial and Provident Societies Act 1968 and the Housing and Regeneration Act 2008. Our audit work has been undertaken so that we might state to the Association's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Association and the Association's members as a body for our audit work, for this report, or for the opinions we have formed.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Association's affairs as at 31 March 2012 and of its income and expenditure for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been properly prepared in accordance with the Industrial and Provident Societies Acts, 1965 to 2003, the Housing and Regeneration Act 2008 and the Accounting Requirements for Registered Social Landlords General Determination 2006.

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

**INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF
KNIGHTSTONE HOUSING ASSOCIATION LIMITED**

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Industrial and Provident Societies Acts, 1965 to 2003 require us to report to you if, in our opinion:

- a satisfactory system of control over transactions has not been maintained; or
- the Association has not kept proper accounting records; or
- the financial statements are not in agreement with the books of account; or
- we have not received all the information and explanations we need for our audit.

Mazars LLP

Mazars LLP
Chartered Accountants
And Statutory Auditor
45 Church Street
Birmingham
B3 2RT

27 July 2012

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

INCOME AND EXPENDITURE ACCOUNT

For the year ended 31 March 2012

	Notes	2012 £' 000	Restated 2011 £' 000
TURNOVER	2	50,840	47,887
OPERATING COSTS	2	(39,791)	(38,177)
OPERATING SURPLUS	2	11,049	9,710
Surplus on sale of housing properties	8	1,695	4,573
Interest receivable	9	330	129
Interest payable and similar charges	10	(8,014)	(7,657)
		(7,684)	(7,528)
SURPLUS ON ORDINARY ACTIVITIES BEFORE EXTRAORDINARY ITEMS AND TAXATION	11	5,060	6,755
Transfer of Engagements from Knightstone Community Homes Limited		-	7,868
SURPLUS FOR THE FINANCIAL YEAR BEFORE GIFT AID		5,060	14,623
Gift aid received		162	164
SURPLUS FOR THE FINANCIAL YEAR	23	5,222	14,787

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

STATEMENT OF TOTAL RECOGNISED SURPLUSES AND DEFICITS

For the year ended 31 March 2012

		2012 £' 000	Restated 2011 £' 000
Surplus for the financial year		5,222	<u>14,787</u>
Prior year adjustment	25	<u>(10,968)</u>	
Total gains and losses recognised since last annual report		<u>(5,746)</u>	

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

ASSOCIATION BALANCE SHEET

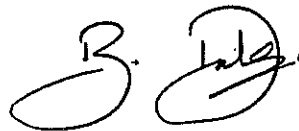
As at 31 March 2012

	Notes	2012 £' 000	Restated 2011 £' 000
TANGIBLE FIXED ASSETS			
Housing properties at cost	13	600,776	554,750
Social Housing Grant	13	(290,810)	(282,190)
Other capital grants	13	(32,966)	(32,710)
Depreciation	13	(53,695)	(49,153)
		<u>223,305</u>	<u>190,697</u>
Non-housing tangible fixed assets	14	3,671	2,469
		<u>226,976</u>	<u>193,166</u>
INVESTMENTS			
Fixed asset investment	15	5,847	5,847
Homebuy and Keyworker loans	15	4,363	4,664
Homebuy and Keyworker grants	15	(4,026)	(4,326)
		<u>6,185</u>	<u>6,185</u>
CURRENT ASSETS			
Work in progress and properties for sale	16	5,921	2,581
Debtors	17	14,134	7,974
Cash at bank and in hand		<u>29,724</u>	<u>14,636</u>
		<u>49,779</u>	<u>25,191</u>
CREDITORS			
Amounts falling due within one year	18	(17,322)	(13,437)
NET CURRENT ASSETS		<u>32,457</u>	<u>11,754</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>265,618</u>	<u>211,105</u>
CREDITORS			
Amounts falling due after more than one year			
Loans	19	208,452	159,215
Grant recycling fund	21	<u>4,052</u>	<u>3,997</u>
		<u>212,504</u>	<u>163,212</u>
CAPITAL, SURPLUSES AND RESERVES			
Non-equity share capital	22	-	-
Restricted reserves	23	139	139
Accumulated surpluses	23	<u>52,974</u>	<u>47,762</u>
ASSOCIATION'S FUNDS	23	<u>53,113</u>	<u>47,891</u>
		<u>265,618</u>	<u>211,105</u>

The financial statements were approved by the Board on 19th July 2012 and were signed on its behalf by:



D Lloyd Evans, Chairman



B Dale, Vice Chairman



C Ferris, Secretary

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2012

1 ACCOUNTING POLICIES

(a) Basis of accounting

The financial statements are prepared under the historical cost convention in accordance with applicable United Kingdom accounting standards and comply with the Statement of Recommended Practice: Accounting by Registered Social Housing Providers issued in 2010, the Housing and Regeneration Act 2008 and the Accounting Requirements for Registered Social Landlords General Determination 2006.

(b) Tangible fixed assets - housing properties

Housing properties are stated at historic cost less Social Housing Grant (SHG), other grants and depreciation. Cost includes the cost of acquiring land and buildings, relevant development costs, expenditure incurred in respect of improvements and, in respect of years prior to 1989 and after 1 April 1997, interest charges incurred during the development year.

Depreciation is charged so as to write down the net book value of housing properties to their estimated residual value, on a straight line basis, over their useful economic lives. Freehold land is not depreciated.

For the purpose of depreciation, SHG is apportioned on the same basis as the apportionment of the carrying value of the land and buildings.

The Association's housing properties are depreciated over the following years:

	Houses	Flats
Listed buildings	150	150
New build	100	100
Rehabilitated	50	50
Sheltered	50	50

Communal assets are depreciated over 1 to 25 years.

Properties held on long leases are depreciated over their estimated useful economic lives or the lease if shorter. For properties where a structure has an estimated useful economic life of more than 50 years, impairment reviews are carried out on an annual basis in accordance with FRS 11.

Major components of housing properties are treated as separate assets and depreciated over their expected useful economic lives or the lives of the properties to which they relate, if shorter, at the following annual rates:

Roof	60 years
Doors and windows	30 years
Kitchen	20 years
Bathroom	30 years
Heating system	15 years
Lift	25 years

The costs of replacing these components are capitalised in full. The costs of partially replacing or repairing these components are charged to the Income and Expenditure Account.

Any impairment in value of properties would be charged to the Income and Expenditure account.

Rented and Shared Ownership housing properties are classified in Note 13 as being 'under construction' or 'completed'. They are transferred to completed assets on practical completion.

(c) Social Housing Grant and other grants

Where developments have been financed by Social Housing Grant (SHG), the cost of those developments has been reduced by the amount of grant received. SHG is recognised on the balance sheet when the conditions for its receipt have been met. SHG due but not received is also treated as a current asset.

SHG is subordinated to loans by agreement with the Homes and Communities Agency. Other grants include cash payments by local authorities and other grant giving organisations.

SHG and other grants received in respect of revenue expenditure are credited to the Income and Expenditure account in the same year as the expenditure to which they relate. SHG may be repayable in certain circumstances, (even where it has been treated as a revenue grant for accounting purposes) such as where a property is sold.

(d) Non-housing tangible fixed assets

Non-housing tangible fixed assets are stated at historic cost less accumulated depreciation. Depreciation is charged on a straight line basis over the expected useful lives of the assets. Any impairment in value of such assets is charged to the Income and Expenditure account.

The rates of depreciation are as follows:

Freehold offices	50 years
Lease premiums	over life of lease
Office improvements	5 years
Furniture, fixtures and fittings	10 years
Vehicles	4 years
Office equipment	5 years
Computer equipment	5 years
Computer software	5 years

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2012

(e) Leased assets

Where assets are financed by leasing agreements ('finance leases'), the assets are included in the Balance Sheet at cost less depreciation in accordance with the Associations normal accounting policies. The present value of future rentals is shown as a liability. The interest element of the rental obligations is charged to the Income and Expenditure account over the year of the lease in proportion to the capital balance outstanding.

Rental payments under operating leases are charged to the Income and Expenditure account as incurred.

(f) Properties for outright sale

All properties held for outright sale are valued at the lower of cost to the Association or net realisable value.

ACCOUNTING POLICIES (continued)

(g) Reserves management policy

The proceeds from shared ownership sales in one local authority area are ring-fenced in accordance with an agreement with the local authority and can only be utilised in certain further shared ownership transactions which are subject to restrictions. These proceeds are reflected through the income and expenditure account and a transfer to restricted reserves made as appropriate, the reverse transfer made when the proceeds are utilised.

(h) Interest payable

Interest payable represents amounts due for the period on each of the Associations sources of finance and is calculated in accordance with the terms of each loan agreement.

Interest on borrowings used to finance the construction of new housing properties is capitalised during the construction period. The rate at which interest is capitalised is calculated by applying the Associations average cost of borrowing in the year to the net cost of construction (after deduction of SHG).

(i) Taxation

The charge for taxation is based on surpluses arising on certain activities which are liable to tax.

Deferred tax is provided in full on timing differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in years different from those in which they are included in financial statements. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

(j) Pensions

The Association participates in an industry wide defined benefit pension scheme. The assets of the scheme are invested and managed independently of the finances of the Association. Pension costs are assessed in accordance with the advice of an independent qualified actuary. Costs include the regular cost of providing benefits which it is intended should remain a substantially level percentage of current and expected future earnings of the employees concerned. Variations from the regular pension costs are spread evenly over the average remaining service lives of current employees.

(k) Grant recycling and disposal funds

The Association has established grant recycling and disposal funds in accordance with the provisions of the Housing and Regeneration Act 2008 which are administered in accordance with regulations issued by the Homes and Communities Agency.

(l) Turnover

Turnover represents rental income receivable and proceeds from the first tranche sale of shared ownership properties together with revenue grants from local authorities and the Homes and Communities Agency and charitable fees and donations. All income is accounted for on a receivable basis. However, property sales are not accounted for as being receivable until all of the requirements of the sale contract have been satisfied including receipt of the proceeds and legal transfer of the property has taken place.

(m) Supported housing and hostels

The Association provides property maintenance and other services in respect of hostels which it owns but which are managed by external agencies. Included within supported housing accommodation in Note 4 to the accounts is income representing the charges made for these services and expenditure representing the Association's costs in providing these services.

The figures exclude any income and costs relating to hostels where the risks and rewards of running the hostels accrue to the agencies that manage them and not to the Association.

(n) Shared ownership properties

The cost of the initial equity to be sold in a new shared ownership property is included in current assets. The sales proceeds from the initial equity sale are included within turnover and the cost of sale is transferred from current assets to operating costs. The retained equity is included in fixed assets net of SHG and depreciation with properties under development being separately disclosed in the note to the accounts. Proceeds from subsequent tranche sales are treated as disposals of fixed assets.

(o) Investments

Investments held as fixed assets are stated at cost less provision for any impairment in value.

(p) Cash Flow Statement

The Association has taken advantage of the exemption contained in Financial Reporting Standard No 1 (Revised) from the requirement to present a cash flow statement, on the grounds that its cash flows are included in the consolidated accounts of the ultimate parent company.

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2012

2 PARTICULARS OF TURNOVER, OPERATING COSTS AND OPERATING SURPLUS

	YEAR 2012		
	Turnover £' 000	Operating Costs £' 000	Operating Surplus/(Deficit) £' 000
Social housing lettings (note 4)	45,955	(35,211)	10,744
Other social housing activities			
Development and agency	2,311	(2,037)	274
First tranche sale of shared ownership.	2,473	(2,477)	(4)
Non social housing activities			
Lettings (note 3)	101	(66)	35
2012 TOTAL	50,840	(39,791)	11,049

	YEAR 2011		
	Turnover £' 000	Operating Costs £' 000	Operating Surplus/(Deficit) £' 000
Social Housing lettings (note 4)	43,211	(34,125)	9,086
Other social housing activities			
Development and agency	1,974	(1,618)	356
First tranche sale of shared ownership.	2,573	(2,349)	224
Non social housing activities			
Lettings (note3)	129	(85)	44
2011 TOTAL	47,887	(38,177)	9,710

3 PARTICULARS OF TURNOVER FROM NON SOCIAL HOUSING ACTIVITIES

	2012 £' 000	2011 £' 000
Non social housing		
Market renting	101	129
Student accommodation	-	-
	101	129

4 PARTICULARS OF INCOME AND EXPENDITURE FROM SOCIAL HOUSING LETTINGS

	General Housing £' 000	Supported Housing £' 000	Intermediate Rent £' 000	Temporary Social Housing £' 000
Net rents receivable	33,811	5,405	436	116
Revenue grants from local authorities and other agencies	30	3,185	1	-
Revenue grants received for major repairs	-	-	-	-
Turnover from social housing lettings	33,841	8,590	437	116
Services	(1,599)	(3,759)	(6)	(7)
Management	(6,009)	(2,900)	(96)	(72)
Response repairs	(8,860)	(770)	(23)	(23)
Void and cyclical repairs	(2,351)	(392)	(10)	(50)
Rent losses from bad debts	(266)	(61)	-	(2)
Major repair expenditure	(1,276)	(995)	-	(1)
Depreciation	(4,522)	(108)	(7)	(2)
Impairment	-	-	-	-
Other costs	(66)	(61)	-	-
Operating costs from social housing lettings	(24,969)	(9,046)	(142)	(157)
OPERATING SURPLUS FROM SOCIAL HOUSING LETTINGS	8,872	(456)	295	(41)
Void Losses	(202)	(306)	(14)	(8)

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2012

	Residential Care Homes £' 000	Shared Ownership £' 000	Keyworker Accommodation £' 000	Year 2012 £' 000	Restated Year 2011 £' 000
Net rents receivable	99	2,155	89	42,111	39,471
Revenue grants	276	352	-	3,844	3,740
Turnover from social housing lettings	375	2,507	89	45,955	43,211
Services	(34)	(64)	(2)	(5,471)	(5,798)
Management	(16)	(527)	(34)	(9,654)	(9,056)
Response repairs	(105)	(8)	(7)	(9,796)	(6,280)
Void and cyclical repairs	(28)	(9)	(3)	(2,843)	(5,982)
Rent losses from bad debts	-	(14)	(3)	(348)	(184)
Major repair expenditure	(22)	(10)	-	(2,304)	(1,642)
Depreciation	-	(2)	-	(4,641)	(4,760)
Impairment	-	-	-	-	(175)
Other costs	-	(9)	-	(156)	(248)
Operating costs from social housing lettings	(205)	(643)	(49)	(35,211)	(34,125)
OPERATING SURPLUS FROM SOCIAL HOUSING LETTINGS	170	1,864	40	10,744	9,086
Void Losses	(3)	4	(9)	(538)	(538)

5 ACCOMMODATION IN MANAGEMENT

The number of units of accommodation in management for each class of accommodation is as follows:

	2012	2011
Social housing	Number	Number
General needs housing accommodation	7,506	7,294
Supported housing accommodation - Directly Managed	847	856
Supported housing accommodation - Agency Managed	399	395
Intermediate rented	118	80
Residential care homes - Directly Managed	6	7
Residential care homes - Agency Managed	124	124
Temporary social housing	18	17
Key Worker accommodation	24	27
Shared Ownership and Do It Yourself Shared Ownership	1,293	1,217
Total units owned	10,335	10,017
Leasehold schemes for the elderly	64	64
Right to Buy leaseholders	859	840
Managed for others	2	2
Managed by others	(466)	(46)
Total managed	10,794	10,877
Non social housing		
Market rented	21	21
Student Accommodation	-	-
TOTAL HOMES MANAGED	10,815	10,898

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2012

6 BOARD MEMBERS AND SENIOR MANAGEMENT

The emoluments of the current Board and senior management team who served during the year were:

	Earnings	Pension Costs	Benefits in kind	2012 Total	2011 Total
	£' 000	£' 000	£' 000	£' 000	£' 000
M Beard (Director of Operations)	98	4	1	103	101
T Gosling (Board Member) appointed 15.09.11	2	-	-	2	2
J Cross (Board Member)	4	-	-	4	4
L Nee (Board Member) - resigned 27.4.11	-	-	-	-	4
J Ali (Board Member)	4	-	-	4	4
B Dale (Board Member)	5	-	-	5	4
A Weiler (Board Member) - resigned 31.12.11	3	-	-	3	4
R J H Taylor (Board Member)	4	-	-	4	4
J Williams (Board member) - resigned 31.12.11	3	-	-	3	4
Total emoluments of the senior management team	123	4	1	128	131

Expenses paid during the year to the members of the Board amounted to £8,709 (2011 - £12,051)

Other directors and senior management team members are remunerated by Arcadia Housing Limited and their costs are included as part of the recharge from Arcadia Housing Limited. The Association participates in The Social Housing Pension Scheme (see note 24) of which the senior management team are members on the same terms as other employee members.

7 EMPLOYEES AND STAFF COSTS

	2012 Number	2011 Number
Number of full time equivalents as at the end of the year	357	334
Staff headcount as at the end of the year	391	370
Staff costs during the year were:	2012 £' 000	2011 £' 000
Wages and salaries	9,358	8,689
Social security costs	793	679
Pension costs	456	447
Total staff costs	10,607	9,815

8 SURPLUS ON SALE OF HOUSING PROPERTIES

	PROCEEDS	2012 COST OF SALES	SURPLUS	PROCEEDS	2011 COST OF SALES	SURPLUS
	£' 000	£' 000	£' 000	£' 000	£' 000	£' 000
Shared ownership staircasing	1,268	(789)	479	1,201	(656)	545
Stock transfer to other Registered Providers	-	-	-	6,459	(3,392)	3,067
Asset Sales	3,673	(2,457)	1,216	2,401	(1,440)	961
	4,941	(3,246)	1,695	10,061	(5,488)	4,573

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2012

9 INTEREST RECEIVABLE

	2012 £' 000	2011 £' 000
Interest receivable from Group undertakings	188	44
Bank interest	142	85
	<u>330</u>	<u>129</u>

10 INTEREST PAYABLE AND SIMILAR CHARGES

	2012 £' 000	2011 £' 000
Interest on bank loans	(8,626)	(8,220)
Finance leases	(66)	(64)
	<u>(8,692)</u>	<u>(8,284)</u>
Interest payable capitalised on housing properties under construction	766	696
Historic loan arrangement fees written off	(88)	(69)
Total interest payable and similar charges	<u>(8,014)</u>	<u>(7,657)</u>

The amount added to Work in Progress is based on an interest rate of 4.64%

11 SURPLUS ON ORDINARY ACTIVITIES BEFORE EXTRAORDINARY ITEMS AND TAXATION

	2012 £' 000	Restated 2011 £' 000
<i>Amount stated after charging/(crediting):</i>		
Depreciation of housing properties	4,642	4,760
Impairment on housing properties	-	175
Depreciation on non-housing fixed assets	394	1,346
External auditors' remuneration in their capacity as auditors	23	24
External auditors' remuneration in their capacity as consultants	7	7
Operating lease rentals - land and buildings	186	203
Bad debts written off	119	146
Total revenue grants receivable - lettings	<u>(3,185)</u>	<u>(3,741)</u>

12 TAXATION

The Association has received confirmation from the HMRC's Claims Branch (Trusts & Charities Division) that the Association has been granted exemption from tax as a charitable body. The exemption applies to all activities of the Association within the charitable objects set out in its Rules.

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2012

13 TANGIBLE FIXED ASSETS - HOUSING PROPERTIES

	UNDER CONSTRUCTION		COMPLETED PROPERTIES		Restated TOTAL
	Shared Ownership Properties £' 000	Rented Properties £' 000	Shared Ownership Properties £' 000	Rented Properties £' 000	£' 000
COST					
At 1 April 2011	1,682	12,347	44,042	478,581	536,652
Prior Year Adjustment	-	(19)	-	18,117	18,098
At 1 April 2011 Restated	1,682	12,328	44,042	496,698	554,750
Works to existing properties	11,557	29,049	636	32,391	73,633
Disposals	(5,746)	(1,560)	(957)	(19,344)	(27,607)
Transferred to completed schemes	(4,393)	(24,341)	4,393	24,341	-
At 31 March 2012	3,100	15,476	48,114	534,086	600,776
SOCIAL HOUSING GRANT					
At 1 April 2011	1,273	9,502	22,725	249,576	283,076
Prior Year Adjustment	-	-	-	(886)	(886)
At 1 April 2011 Restated	1,273	9,502	22,725	248,690	282,190
Additions	2,156	4,133	-	13,430	19,719
Disposals	-	-	(320)	(10,779)	(11,099)
Transferred to completed schemes	(2,420)	(9,241)	2,420	9,241	-
At 31 March 2012	1,009	4,394	24,825	260,582	290,810
OTHER CAPITAL GRANTS					
At 1 April 2011	409	1,108	1,927	29,264	32,708
Prior Year Adjustment	-	-	-	2	2
At 1 April 2011 Restated	409	1,108	1,927	29,266	32,710
Additions	352	(79)	-	-	273
Disposals	-	-	(17)	-	(17)
Transferred to completed schemes	(352)	227	352	(227)	-
At 31 March 2012	409	1,256	2,262	29,039	32,966
DEPRECIATION					
At 1 April 2011	-	-	2,396	17,159	19,555
Prior Year Adjustment	-	-	(1,118)	30,716	29,598
At 1 April 2011 Restated	-	-	1,278	47,875	49,153
Charge for the year	-	-	179	4,463	4,642
Disposals	-	-	(23)	(77)	(100)
At 31 March 2012	-	-	1,434	52,261	53,695
NET BOOK VALUE					
At 31 March 2012	1,682	9,826	19,593	192,204	223,305
At 31 March 2011	-	1,718	18,112	170,867	190,697

The completed rented property additions comprise £10.146 million of component replacement works to existing properties. There is also property related expenditure amounting to £10.470 million within the income and expenditure account.

In January 2012 the Group swapped housing properties with another housing association. The Group disposed of 338 properties with a historic cost of £18,673 million and a net book value of £9.019 million, and acquired 388 properties in return which have been attributed a historic cost of £22.856 million and a net book value of £9.425 million.

An amount of £990,475 (2011 - £1,501,069) has been capitalised in respect of the costs of administering the development programme. Shared ownership properties with a net book value of £533,339 (2011 - £533,339) after deducting SHG of £797,202 (2011 - £797,202) have been financed through sale and leaseback transactions. No new funds were advanced to the Association during the year (2011 Nil) and no repayments have been made (2011 Nil). The remaining finance, which has no fixed repayment date, is to be repaid on any subsequent sale of the remaining interest in these properties.

The Association has granted fixed charges over its housing assets as security for borrowings and margin calls under interest rate swap transactions.

	2012 £' 000	2011 £' 000
The total accumulated Social Housing Grant receivable up to the year ended 31 March 2012 was:		
Capital grants	323,776	314,899
Revenue grants	3,185	3,351
	<u>326,961</u>	<u>318,250</u>

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2012

	2012 £' 000	Restated 2011 £' 000
HOUSING PROPERTIES COMPRISE:		
Freehold land and buildings	200,741	168,163
Long leasehold land and buildings	22,427	22,397
Short leasehold land and buildings	136	137
	<u>223,304</u>	<u>190,697</u>

14 NON-HOUSING TANGIBLE FIXED ASSETS

ASSOCIATION

	Under Construction Offices £' 000	Freehold Offices £' 000	Office Improve- ments £' 000	Furniture Fixtures and Fittings £' 000	Office Equipment £' 000	Vehicle £' 000	Computer Equipment £' 000	2012 Total £' 000
COST								
At 1 April 2011	-	3,164	397	241	178	86	3,187	7,253
Additions	951	-	6	2	2	50	709	1,720
Disposals	-	-	-	(5)	-	-	(551)	(556)
At 31 March 2012	<u>951</u>	<u>3,164</u>	<u>403</u>	<u>238</u>	<u>180</u>	<u>136</u>	<u>3,345</u>	<u>8,417</u>
DEPRECIATION								
At 1 April 2011	-	1,705	391	241	178	6	2,262	4,783
Charge for year	-	42	6	-	-	26	320	394
Disposals	-	-	-	(5)	1	-	(427)	(431)
At 31 March 2012	<u>-</u>	<u>1,747</u>	<u>397</u>	<u>236</u>	<u>179</u>	<u>32</u>	<u>2,155</u>	<u>4,746</u>
NET BOOK VALUE								
At 31 March 2012	<u>951</u>	<u>1,417</u>	<u>6</u>	<u>2</u>	<u>1</u>	<u>104</u>	<u>1,190</u>	<u>3,671</u>
At 31 March 2011	-	1,459	5	-	-	80	925	2,469

15 FIXED ASSET INVESTMENTS

	2012 £' 000	Restated 2011 £' 000
Investment in Great Western Assured Growth Limited	4,686	4,686
Investment in Great Western Housing Limited	1,161	1,161
Homebuy loan	3,570	3,849
Homebuy grant	(3,232)	(3,511)
Keyworker loan	793	815
Keyworker grant	(793)	(815)
	<u>6,185</u>	<u>6,185</u>

Homebuy and Keyworker homes were built and sold in previous years under specific grant-funded initiatives. The Group retains a charge over the properties and, when they are sold, the Group receives a payment and repays the grant. The investment balance represents the value of the charge over these properties, net of the grant.

16 WORK IN PROGRESS AND PROPERTIES HELD FOR SALE

	2012 £' 000	2011 £' 000
Work in Progress		
Shared ownership	3,031	1,583
Commercial properties	447	167
	<u>3,478</u>	<u>1,750</u>
Properties held for Sale		
	2012 £' 000	2011 £' 000
Shared ownership	2,443	705
Commercial properties	-	173
Less: Provision for loss on sale	-	(47)
	<u>2,443</u>	<u>831</u>
	<u>5,921</u>	<u>2,581</u>

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2012

17 DEBTORS

Amounts falling due within one year	2012 £' 000	2011 £' 000
Arrears of rent and service charges	1,530	2,192
Less: Provision for bad and doubtful debts	(820)	(585)
	710	1,607
Amounts due from other Group Companies	9,395	3,571
Other debtors	3,779	2,293
Grant and other amounts due	250	503
	14,134	7,974

The rental debtors as at 31 March 2012 includes £371k (2011 - £941k) of outstanding Housing Benefit.

18 CREDITORS

Amounts falling due within one year	2012 £' 000	2011 £' 000
Accruals and deferred income	3,939	3,404
Capital retentions	2,669	1,500
Net borrowings (note 20)	1,712	1,507
Trade Creditors	1,544	2,440
Other creditors	1,364	343
Accrued interest on loans	1,256	1,150
Social Housing Grant received in advance	1,099	794
Amounts held on behalf of Home Owners	1,080	864
Recycled Capital Grants (note 21)	978	380
Amounts due to other Group Companies	689	472
Rent in advance	684	265
Salary related creditors	308	318
	17,322	13,437

For security provided on the loans please see note 20 for details

19 CREDITORS

Amounts falling due after more than one year

	2012 £' 000	2011 £' 000
Net borrowings (note 20)	208,452	159,215

For security provided on the loans please see note 20 for details

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2012

20 BORROWINGS

	2012 £' 000	2011 £' 000
Housing loans	211,497	161,973
Obligations under finance leases	533	533
TOTAL BORROWINGS	212,030	162,506
Less loan arrangement fees	(1,866)	(1,784)
NET BORROWINGS	210,165	160,722

Borrowings comprise loans at fixed, variable and index linked interest rates and are repayable as follows:

	2012 £' 000	2011 £' 000
up to one year (note 18)	1,712	1,507
over one year and up to two years	1,812	1,658
over two years and up to five years	7,295	5,997
over five years	189,346	151,560
Total due after more than one year (note 19)	208,452	159,215
NET BORROWINGS	210,165	160,722

Borrowings are secured by:
a fixed charge over the asset financed by the loan
finance leases on the assets to which they relate

	2012 £' 000	2011 £' 000
	211,497	161,973
	533	533
TOTAL BORROWINGS	212,030	162,506
Loan arrangements fees	(1,866)	(1,784)
NET BORROWINGS	210,164	160,722

	2012 £' 000	2011 £' 000
Fixed rate	26,823	27,415
Variable rate	175,000	124,500
Indexed linked	9,674	10,058
Finance lease	533	533
TOTAL BORROWINGS	212,030	162,506
Loan arrangements fees	(1,866)	(1,784)
NET BORROWINGS	210,164	160,722

Where loans are borrowed at variable rates, the Association uses interest rate swaps and a limited range of other financial instruments to manage interest rate risk. The final instalments on these loans fall in the year 2035 to 2041.

Housing loans repayable by half-yearly instalments after one year are secured at fixed rates of interest ranging from 5.65% to 12.1%. The final instalments on these loans fall in the period 2020 to 2029.

The housing loan repayable by bullet repayment is secured at a fixed rate of interest of 5.1% and repayable in 2035.

Total committed loan facilities are £242m (2011 - £243m) of which £30m (2011 - £80.5m) are undrawn at 31 March 2012

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2012

21 RECYCLED CAPITAL GRANT FUND

	2012 £' 000	2011 £' 000
Opening balance	3,997	2,958
Grants recycled	1,424	2,489
Interest accrued	25	290
New build	(416)	(1,305)
Major repairs & works to existing stock - capital	-	(55)
Repayment of grant to the Homes and Communities Agency	-	-
Carried forward	5,030	4,377
Grants to be recycled less than 1 year (see note 18)	(978)	(380)
As at 31 March 2012	4,052	3,997
Included in the RCGF balance is £770k (2011 £748k) which relates to non-repayable keyworker grant		

22 ASSOCIATION SHARE CAPITAL

	2012 £	2011 £
At start of year	42	45
Shares issued during year	3	-
Shares surrendered during year	(3)	(3)
At end of year	42	42

The shares provide members with the right to vote at general meetings, but do not provide any rights to dividends or distribution on a winding up.

23 RESERVES

ASSOCIATION	Restated Accumulated Surpluses £' 000	Restated Restricted Reserves £' 000	Restated Total £' 000
At 1 April 2011 as previously reported	58,720	139	58,859
Prior Year Adjustment (Note 25)	(10,968)	-	(10,968)
At 1 April 2011 as restated	47,752	139	47,891
Surplus for the financial year	5,222	-	5,222
Transfer to/from restricted reserves	-	-	-
At 31 March 2012	52,974	139	53,113

The restricted reserves relates to the Kennet Fund

24 PENSION OBLIGATIONS

Knightstone Housing Association Limited participates in the Social Housing Pension Scheme (the Scheme). The Scheme is funded and is contracted-out of the State Pension scheme.

It is not possible in the normal course of events to identify on a consistent and reasonable basis the share of underlying assets and liabilities belonging to individual participating employers. This is because the Scheme is a multi-employer scheme where the Scheme assets are co-mingled for investment purposes, and benefits are paid from total Scheme assets. Accordingly, due to the nature of the Scheme, the accounting charge for the period under FRS17 represents the employer contribution payable.

The Trustee commissions an actuarial valuation of the Scheme every three years. The main purpose of the valuation is to determine the financial position of the Scheme in order to address the level of future contributions required so that the Scheme can meet its pension obligations as they fall due.

The last formal valuation of the Scheme was performed as at 30 September 2008 by a professionally qualified Actuary using the Projected Unit Method. The market value of the Scheme's assets at the valuation date was £1,527 million. The valuation revealed a shortfall of assets compared with the value of liabilities of £663 million, equivalent to a past service funding level of 69.7%.

The Scheme Actuary has prepared an Actuarial Report that provides an approximate update on the funding position of the Scheme as at 30 September 2010. Such a report is required by legislation for years in which a full actuarial valuation is not carried out. The funding update revealed an increase in the assets of the Scheme to £ 1,985 million and indicated a reduction in the shortfall of assets compared to liabilities to approximately £497 million, equivalent to a past service funding level of 80.0%.

The Scheme's 30 September 2011 valuation is currently in progress and will be finalised by 31 December 2012. The results of the 2011 valuation will be included in next year's Disclosure Note.

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2012

25 PRIOR YEAR ADJUSTMENT

Knightstone Housing Association Ltd has adopted the Statement of Recommended Practice (SORP): Accounting by registered social housing providers Update 2010 in this current year ended 31st March 2012. This has resulted in the provisions for component accounting being implemented this year. Major components are now treated as separable assets and depreciated over their expected useful economic lives or the lives of the properties to which they relate, if shorter. Significant costs relating to the replacement of major components were previously treated as revenue expenditure. Comparative figures have been restated to reflect this change of accounting policy

	2011 £' 000
Costs previously treated as revenue expenditure now capitalised	34,295
Net of eliminated costs of replaced components	(16,197)
Prior year adjustment to cost	16,098
Prior year adjustment to grant	531
Increase accumulated depreciation charged on net costs capitalised	(29,598)
Prior year adjustment to revenue reserves brought forward	(10,968)

Included within the prior year adjustment is Social Housing Grant of £353,000 which has been transferred to Fixed Asset Investments as it relates to grant on homebuy grants.

26 CAPITAL COMMITMENTS

ASSOCIATION	2012 £' 000	2011 £' 000
Expenditure contracted but not provided in the financial statements	33,695	45,511
Expenditure authorised by the Board but not contracted	131,187	73,710
TOTAL	164,882	119,221

The total expenditure contracted but not yet provided for in the financial statements is £33,695,318 (2011 £45,511,225). This is funded by grants of £7,269,249 (2011 £20,930,280) and NBHB sales proceeds of £6,716,496 (2011 £5,348,798), and committed loan facilities of £19,709,573 (2011 £19,232,147).

The expenditure authorised by Board but not yet contracted is £131,187,246 (2011 £73,710,470). This is funded by grants of £7,572,653 (2011 £14,685,502), sales proceeds of £88,932,254 (2011 £14,229,329), cash balances of £29,723,710 (2011 £14,636,391) and committed loan facilities of £4,958,630 (2011 £6,906,970).

27 OPERATING LEASES

The Association holds several office premises on non-cancellable operating leases. At 31 March 2012 the Association had annual commitments under these leases of:

ASSOCIATION	2012 £' 000 Land & Buildings	2011 £' 000 Land & Buildings
Leases expiring:		
In less than one year	77	3
In one to five years	71	71
In more than five years	38	129
TOTAL	186	203

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2012

28 POST BALANCE SHEET EVENTS

The Association purchased 312 properties from Home Group in July 2012, a deposit was paid on 30 March 2012.

The Association is in negotiation with a different housing association in order to swap a further 700 properties in October 2012

29 SUBSIDIARY UNDERTAKINGS

Details of the organisations concerned are:

Name	Legal Status	Charitable Status	Company Number	Industrial & Provident Registration Number
Knightstone Charitable Housing Limited	Industrial & Provident Society	Exempt Charity	N/A	19165R
Great Western Assured Growth Limited	Private Limited Company (Shares)	Non Charitable	2525892	-
Great Western Housing Limited	Private Limited Company (Shares)	Non Charitable	2792288	-
Arc Developments South West Limited	Private Limited Company (Guarantee)	Non Charitable	5716836	-
Arc Homes (South West) Limited	Private Limited Company (Shares)	Non Charitable	6447504	-

Knightstone Housing Association Limited holds all of the issued share capital in Great Western Assured Growth Limited, Great Western Housing Limited and Arc Homes (South West) Limited and is the sole member of Arc Developments South West Limited.

Arc Homes (South West) Limited has been a dormant company since its incorporation on 7 December 2007.

Related Party Transactions

The Group has taken advantage of the exemption contained in Financial Reporting Standard 8 'Related Party Transactions' and has not disclosed transactions with other group entities.

No payments or benefits, other than those permitted, were made to the persons referred to in section 122 of the Housing and Regeneration Act 2008.

30 ULTIMATE PARENT UNDERTAKING AND CONTROLLING PARTY

The Board of Knightstone Housing Association Limited regards Arcadia Housing Limited a housing association registered under the Industrial and Provident Societies Act 1965 (No. 29867R) and registered with the Housing Regulator pursuant to sections 111 and 112 of the Housing and Regeneration Act 2008 (Registered No. L4436) as the ultimate parent undertaking and controlling party. Copies of group accounts can be obtained from the registered office at Station Road, Worle, Weston-super-Mare, BS22 6AP.

**Industrial and Provident Societies Act 1965 No. 21080R
Homes and Communities Agency No. L0291**

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

Financial Statements

Year ended 31 March 2013

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

CONTENTS

Board Members, Advisors and Bankers	1
Report of the Board	2
Independent Auditor's Report	6
Income and Expenditure Account	7
Balance Sheet	8
Notes to the Financial Statements	9

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

BOARD MEMBERS, ADVISERS AND BANKERS

As at 18 July 2013

BOARD MEMBERS

CHAIRMAN

Nick Medhurst

VICE CHAIRMAN

Barrie Dale

OTHER BOARD MEMBERS

Jamir Ali

Jacqui Cross

Tony Gosling

Nick Horne

Roger Lloyd

Delyth Lloyd-Evans

Richard Taylor

Stewart Wright

SECRETARY

Charlotte Ferris

AUDITORS

Mazars LLP

BANKERS

Barclays Bank Plc

REGISTERED OFFICE

Station Road

Worle

Weston-Super-Mare

BS22 6AP

Knightstone Housing Association Limited is incorporated under the Industrial and Provident Societies Act 1965, (registration number 21080R) and registered with the Homes and Communities Agency (registration number L0291).

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

REPORT OF THE BOARD

INTRODUCTION

The Board presents its annual report and audited financial statements for the year ended 31 March 2013.

PRINCIPAL ACTIVITY

The Association's principal activity is management of social housing.

FINANCIAL REVIEW OF THE YEAR AND FUTURE PROSPECTS

The Association made a surplus of £9.5 million for the year which compared with a surplus of £5.2 million for the year to 31 March 2012.

STATEMENT OF RESPONSIBILITIES OF THE BOARD

The Industrial and Provident Societies Acts and registered social housing legislation requires the Board to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Association as at the end of the financial year and of the surplus or deficit for that period. In preparing those financial statements, the Board has:

- selected suitable accounting policies and applied them consistently;
- made judgements and estimates that are responsible and prudent;
- followed applicable accounting standards; and
- prepared the financial statements on a going concern basis.

The Board is responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Association and enable it to ensure that the financial statements comply with the Industrial and Provident Societies Acts 1965 to 2003 and the Accounting Direction for Private Registered Providers of Social Housing 2012. It is also responsible for safeguarding the assets of the Association and for the system of internal control and hence for taking reasonable steps for the prevention and detection of risks including fraud and other irregularities.

The parent body of the Association changed its name from Arcadia Housing Limited to Knightstone Housing Group Limited on 25 April 2013.

INTERNAL CONTROL AND RISK MANAGEMENT

The Board acknowledges its responsibilities for the system of internal control and for reviewing its effectiveness. The Board also acknowledges its responsibilities for the wider aspects of risk management.

The Association adopts the same systems of internal control and risk management used by its parent body, Knightstone Housing Group Limited. These are designed to manage, rather than eliminate, the risk of failure to achieve the Association's Business Plan objectives. Furthermore, they are designed to provide reasonable, but not absolute, assurance regarding the safeguarding of assets, the maintenance of proper accounting records, the reliability of financial information and the management of risks which could adversely affect the Association's ability to achieve its Business Plan objectives.

The Board has reviewed the effectiveness of the systems of internal control and risk management for the period 1 April 2012 to 18 July 2013, the date of this report. The review has been conducted through a variety of mechanisms, including approval of its annual risk review, regular reports from the Audit and Assurance Committee and minutes of its meetings, an annual internal control report from the Audit and Assurance Committee, incorporating an annual review of Standing Orders and Financial Regulations, regular reports on performance against key indicators; internal audits; external audit; and review of the Group's Fraud Register. Information contained within the Fraud Register has been reflected within the Board's annual review of the effectiveness of internal controls.

The following mechanisms are in place to provide effective internal control:

- clearly defined corporate and divisional management and reporting structures;
- careful staff recruitment, appropriate training and individual performance monitoring systems;
- Standing Orders and financial regulations setting out clearly the system of delegation;

INTERNAL CONTROL AND RISK MANAGEMENT (Continued)

- procedure manuals for staff;
- corporate, divisional, area and scheme management information and performance control systems with regular reporting of financial results and other performance indicators against budgets and other internal and external targets;
- clearly defined business and strategic planning processes including the preparation of area, central office and consolidated annual budgets, rolling business plans and a 30 year financial forecasting model supported by specific financial, operational and development action plans and a process for the monitoring of results against forecasts and development plans;
- a Board approved Treasury Policy & Strategy and an annual Treasury Plan which is reported against on a quarterly basis;
- a Whistleblowing Policy and a Fraud, Bribery, Theft and Corruption Policy which covers the prevention, detection and reporting of fraud and the recovery of assets; and
- monitoring of the control system by the Audit and Assurance Committee, the external assurance process and senior management.

No significant systematic internal control weaknesses were identified as a result of this review. Where other weaknesses or areas for improvements have been identified, appropriate arrangements have been put in place to address them. Implementation of agreed actions is monitored by the Audit and Assurance Committee on behalf of the Board.

The Board acknowledges its responsibility for the management of fraud and prevention of bribery. The Group has a current strategy and policy on fraud and bribery covering prevention, detection, reporting and the recovery of assets.

The Association's processes for identifying, evaluating and managing significant financial, operational and business risks are ongoing. Processes have been operational for the period 1 April 2012 to 18 July 2013, the date of this report. These are regularly reviewed by the Board and its sub-Committees.

The following are the key processes adopted by the Group for this purpose.

- a Group-wide risk register regularly reviewed by senior management and the Audit and Assurance Committee as part of the business planning and performance management process;
- regular consideration by the Audit and Assurance Committee of significant risks and during 2012/13 receipt of reports from the senior team on each of the risks identified and considered by the Audit and Assurance Committee on behalf of the Board;
- processes for reviewing wider sociological, technological, economic, environmental and political factors and their implications for the Group in the context of the Business Plan review, the annual review of the Treasury Policy and strategy and the annual review of the long-term financial forecast;
- a sophisticated approach to treasury management to minimise exposure to interest rate changes through the use of interest rate hedging;
- clearly defined processes for investment appraisal prior to undertaking the development of new schemes or embarking on major reinvestment in existing properties;
- a process involving members of the Board for reviewing the risks associated with non-traditional development schemes or major projects as and when necessary; and
- an established programme of assurance activities derived from an assessment of key business risks.

LEGAL STATUS

The Association is registered under the Industrial and Provident Societies Act 1965 (registration number 21080R) and is also registered with the Housing Regulator pursuant to sections 111 and 112 of the Housing and Regeneration Act 2008 (registration number L0291). The Association has charitable status for tax purposes.

BOARD MEMBERS

The Board members who served during the year are shown below:

Nick Medhurst (appointed 1 January 2013), Barrie Dale, Jamir Ali, Jacqui Cross, Tony Gosling, Nick Horne, Roger Lloyd, Delyth Lloyd-Evans, Richard Taylor and Stewart Wright.

Delyth Lloyd-Evans was Chair of KHA for the period 1 April 2012 to 31 December 2012 (having completed her maximum term of office as Chair).

Nick Medhurst was Chair of KHA for the period 1 January 2013 to 31 March 2013 and continues to act in this capacity.

Barrie Dale was Vice Chair of KHA for the period 1 April 2012 to 31 March 2013 and continues to act in this capacity.

CODE OF GOVERNANCE

Knightstone Housing Association Limited is a subsidiary of Knightstone Housing Group Limited. The Group has formally adopted the National Housing Federation's code - *Excellence in Governance* - with effect from 1 April 2010 (including all subsequent updates) and complies with all the principal elements of the Code.

STATEMENT AS TO DISCLOSURE OF INFORMATION TO AUDITORS

Each of the Board members at the date of approval of this report has confirmed that:

- So far as the Board member is aware, there is no relevant audit information of which the Association's auditors are unaware; and
- The Board member has taken all the steps that he/she ought to have taken as a Board member to make himself/herself aware of any information needed by the Association's auditors in connection with preparing their report and to establish that the Association's auditors are aware of that information.

VALUE FOR MONEY

The Board recognises that if we continue to achieve the same performance whilst consuming fewer resources we will build the capacity to do more of the things that matter most to our customers. This is our approach to Value For Money – finding ways to increase our financial capacity so that we can invest more in existing homes and communities and building new homes.

Our Take On The Future programme of business transformation is significantly increasing our financial capacity:

- By refocusing our area we have increased our property numbers but focussed our activities on a smaller geographical area with lower operating costs
- By reshaping our services we have prepared ourselves for the challenges presented by welfare reform and created a new ICE service to support and develop our communities
- By refreshing our ways of working we are making our services more accessible to our customers and using the latest technology to service our customers more efficiently.

We use the operating margin to measure the success of Take On The Future. The operating margin indicates the capacity we have to build new homes after investing in ICE and maintaining our existing assets. Over the last five years we have increased the operating margin from 15% to 21% despite a 70% increase in expenditure to maintain existing assets and the creation of the ICE service with a further investment of £2m p.a. These increases allow Knightstone Housing Association Limited to invest more than most other housing associations in existing homes and communities and new homes.

Knightstone Housing Association Limited is already re-investing the savings made from Take On The Future through our programme of 1,500 new homes over the 2011-15 period. In June 2013 we submitted a bid to the HCA for more grant to increase our development programme and we know that we'll have the financial capacity to develop more new homes after 2015.

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

REPORT OF THE BOARD

ANNUAL GENERAL MEETING

The Annual General Meeting will be held on 12 September 2013.

AUDITORS

A resolution to re-appoint Mazars LLP as auditors will be proposed at the forthcoming Annual General Meeting. Mazars LLP have expressed their willingness to continue in office.

The report of the Board was approved on 18 July 2013 and signed on its behalf by



N Medhurst
Chairman

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF KNIGHTSTONE HOUSING ASSOCIATION LIMITED

We have audited the financial statements of Knightstone Housing Association Limited for the year ended 31 March 2013 which comprise the Income and Expenditure Account, the Balance Sheet and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Respective responsibilities of the board and the auditor

As explained more fully in the Statement of Board's Responsibilities set out on page 2, the Board is responsible for the preparation of 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). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

This report is made solely to the Association's members as a body in accordance with section 9 of the Friendly and Industrial and Provident Societies Act 1968 and the Housing and Regeneration Act 2008. Our audit work has been undertaken so that we might state to the Association's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Association and the Association's members as a body for our audit work, for this report, or for the opinions we have formed.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on the financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Association's affairs as at 31 March 2013 and of the income and expenditure for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the Industrial and Provident Societies Acts, 1965 to 2003, the Housing and Regeneration Act 2008 and the Accounting Direction for Private Registered Providers of Social Housing 2012.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Industrial and Provident Societies Acts, 1965 to 2003 require us to report to you if, in our opinion:

- a satisfactory system of control over transactions has not been maintained; or
- the Association has not kept proper accounting records; or
- the financial statements are not in agreement with the books of account; or
- we have not received all the information and explanations we need for our audit.

Mazars LLP
Chartered Accountants
And Statutory auditor
45 Church Street
Birmingham
West Midlands
B3 2RT

18 July 2013

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

INCOME AND EXPENDITURE ACCOUNT

For the year ended 31 March 2013

		2013	2012
	Notes	£'000	£'000
TURNOVER	2	56,123	50,840
OPERATING COSTS	2	(44,153)	(39,791)
OPERATING SURPLUS	2	11,970	11,049
Surplus on sale of housing properties	7	4,743	1,695
Interest receivable	8	265	330
Interest payable and similar charges	9	(8,381)	(8,014)
SURPLUS BEFORE GIFT AID	10	8,597	5,060
Gift aid received		916	162
SURPLUS FOR THE FINANCIAL YEAR	21	9,513	5,222

The Association's results all relate to continuing activities.

The surplus for the year has been calculated on the historical cost basis.


KNIGHTSTONE HOUSING ASSOCIATION LIMITED

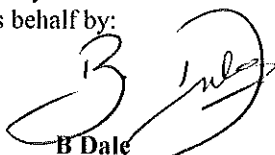
ASSOCIATION BALANCE SHEET

As at 31 March 2013

	Notes	2013 £'000	2012 £'000
TANGIBLE FIXED ASSETS			
Housing properties at cost	12	671,611	600,776
Social Housing Grant	12	(288,292)	(290,810)
Other capital grants	12	(66,049)	(32,966)
Depreciation	12	(51,469)	(53,695)
		<u>265,801</u>	<u>223,305</u>
Non-housing tangible fixed assets	13	<u>10,092</u>	<u>3,671</u>
		<u>275,893</u>	<u>226,976</u>
INVESTMENTS			
Fixed asset investment	14	5,847	5,847
Homebuy and Keyworker loans	14	3,950	4,363
Homebuy and Keyworker grants	14	(3,612)	(4,025)
		<u>6,185</u>	<u>6,185</u>
CURRENT ASSETS			
Work in progress and properties for sale	15	1,497	3,478
Stock held for sale	15	3,698	2,443
Debtors	16	11,775	14,134
Cash at bank and in hand		<u>27,395</u>	<u>29,723</u>
		<u>44,365</u>	<u>49,778</u>
CREDITORS			
Amounts falling due within one year	17	<u>(18,558)</u>	<u>(17,322)</u>
NET CURRENT ASSETS			
		<u>25,807</u>	<u>32,456</u>
TOTAL ASSETS LESS CURRENT LIABILITIES			
		<u>307,885</u>	<u>265,617</u>
CREDITORS			
Amounts falling due after more than one year			
Loans	18	241,968	208,452
Grant recycling fund	19	<u>3,291</u>	<u>4,052</u>
		<u>245,259</u>	<u>212,504</u>
CAPITAL, SURPLUS AND RESERVES			
Non-equity share capital	20	-	-
Restricted reserves	21	140	139
Accumulated surpluses	21	<u>62,486</u>	<u>52,974</u>
ASSOCIATION'S FUNDS			
	21	<u>62,626</u>	<u>53,113</u>
		<u>307,885</u>	<u>265,617</u>

The financial statements were approved by the Board and authorised for issue on 18 July 2013 and were signed on its behalf by:


N Medhurst
Chairman


B Dale
Vice Chair


C Ferris
Secretary

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2013

1. ACCOUNTING POLICIES

(a) Basis of accounting

The financial statements are prepared under the historical cost convention in accordance with applicable United Kingdom accounting standards and comply with the Statement of Recommended Practice: Accounting by Registered Social housing providers: Update 2010, the Housing and Regeneration Act 2008 and the Accounting Direction for Private Registered Providers of Social Housing 2012.

(b) Tangible fixed assets - housing properties

Housing properties are stated at cost less Social Housing Grant (SHG), other grants and depreciation. Cost includes the cost of acquiring land and buildings, relevant development costs, expenditure incurred in respect of improvements and, in respect of years prior to 1989 and after 1 April 1997, interest charges incurred during the development year.

Depreciation is charged so as to write down the net value of housing properties to their estimated residual value, on a straight line basis, over their useful economic lives. Freehold land is not depreciated. For the purpose of depreciation, SHG is apportioned on the same basis as the apportionment of the carrying value of the land and buildings.

The Association's housing properties are depreciated over the following years

	Houses	Flats
Listed buildings	150	150
New build	100	100
Rehabilitated	50	50
Sheltered	50	50

Communal assets are depreciated over 1 to 40 years.

Properties held on long leases are depreciated over their estimated useful economic lives or the term of the lease if shorter. For properties where a structure has an estimated useful life of more than 50 years, impairment reviews are carried out on an annual basis in accordance with FRS 11.

Major components of housing properties are treated as separate assets and depreciated over their expected useful economic lives or the lives of the properties to which they relate, if shorter, at the following annual rates:

Roof	60 years
Doors and windows	30 years
Kitchen	20 years
Bathroom	30 years
Heating system	15 years
Lift	25 years

The costs of replacing these components are capitalised in full. The costs of partially replacing or repairing these components are charged to the Income and Expenditure Account.

Where there are improvements rather than component replacements these are capitalised and treated as fixed asset additions.

Directly attributable development costs such as staff costs are also capitalised in full.

Any impairment in value of properties would be charged to the Income and Expenditure account.

Rented and Shared Ownership housing properties are classified in Note 12 as being 'under construction' or 'completed'. They are transferred to completed assets on practical completion.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2013

1. ACCOUNTING POLICIES (Continued)

(c) Social Housing Grant and other grants

Where developments have been financed by Social Housing Grant (SHG), the cost of those developments has been reduced by the amount of grant received. SHG is recognised on the balance sheet when the conditions for its receipt have been met. SHG due but not received is also treated as a current asset.

SHG is subordinated to loans by agreement with the Homes and Communities Agency. Other grants include cash payments by local authorities and other grant giving organisations.

SHG and other grants received in respect of revenue expenditure are credited to the Income and Expenditure account in the same year as the expenditure to which they relate. SHG may be repayable in certain circumstances, (even where it has been treated as a revenue grant for accounting purposes) such as where a property is sold.

(d) Non-housing tangible fixed assets

Non-housing tangible fixed assets are stated at historical cost less accumulated depreciation. Depreciation is charged on a straight line basis over the expected useful lives of the assets. Any impairment in value of such assets is charged to the Income and Expenditure account.

The rates of depreciation are as follows:

	Years
Freehold offices	50
Lease premiums	over life of lease
Office improvement	5
Furniture, fixtures & fittings	10
Vehicle	4
Office equipment	5
Computer equipment	5
Computer software	5

(e) Leased assets

Where assets are financed by leasing agreements ('finance leases'), the assets are included in the Balance Sheet at cost less depreciation in accordance with the Association's normal accounting policies. The present value of future rentals is shown as a liability. The interest element of the rental obligations is charged to the Income and Expenditure account over the life of the lease in proportion to the capital balance outstanding.

Rental payments under operating leases are charged to the Income and Expenditure account as incurred.

(f) Properties for outright sale

All properties held for outright sale are valued at the lower cost to the Association or net realisable value.

(g) Reserves management policy

The proceeds from shared ownership sales in one local authority area are ring-fenced in accordance with an agreement with the local authority and can only be utilised in certain further shared ownership transactions which are subject to restrictions. These proceeds are reflected through the Income and Expenditure account and a transfer to restricted reserves made as appropriate, the reverse transfer made when the proceeds are utilised.

(h) Interest payable

Interest payable represents amounts due for the period on each of the Association's sources of finance and is calculated in accordance with the terms of each loan agreement.

Interest on borrowings used to finance the construction of new housing properties is capitalised during the construction period. The rate at which interest is capitalised is calculated by applying the Association's average cost of borrowing in the year to the net cost of construction (after deduction of SHG).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2013

1. ACCOUNTING POLICIES (Continued)

(i) Taxation

The charge for taxation is based on surpluses arising on certain activities which are liable to tax.

Deferred tax is provided in full on timing differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in years different from those in which they are included in financial statements. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

(j) Pensions

The Association participates in an industry wide defined benefit pension scheme. The assets of the scheme are invested and managed independently of the finances of the Association. Pension costs are assessed in accordance with the advice of an independent qualified actuary. Costs include the regular cost of providing benefits which it is intended should remain a substantially level percentage of current and expected future earnings of the employees concerned. Variations from the regular pension costs are spread evenly over the average remaining service lives of current employees.

(k) Grant recycling and disposal funds

The Association has established grant recycling and disposal funds in accordance with the provisions of the Housing and Regeneration Act 2008 which are administered in accordance with regulations issued by the Homes and Communities Agency.

(l) Turnover

Turnover represents rental income receivable and proceeds from the first tranche sale of shared ownership properties together with revenue grants from local authorities and the Homes and Communities Agency and charitable fees and donations. All income is accounted for on a receivable basis. However, property sales are not accounted for as being receivable until all of the requirements of the sale contract have been satisfied including receipt of the proceeds and legal transfer of the property has taken place.

(m) Supported housing and hostels

The Association provides property maintenance and other services in respect of hostels which it owns but which are managed by external agencies. Included within supported housing accommodation in Note 3 to the accounts is income representing the charges made for these services and expenditure representing the Association's costs in providing these services.

The figures exclude any income and costs relating to hostels where the risks and rewards of running the hostels accrue to the agencies that manage them and not to the Association.

(n) Shared ownership properties

The cost of the initial equity to be sold in a new shared ownership property is included in current assets. The sales proceeds from the initial equity sale are included within turnover and the cost of sale is transferred from current assets to operating costs. The retained equity is included in fixed assets net of SHG and depreciation with properties under development being separately disclosed in the note to the accounts. Proceeds from subsequent tranche sales are treated as disposals of fixed assets.

(o) Investments

Investments held as fixed assets are stated at cost less provision for any impairment in value.

(p) Cash Flow Statement

The Association has taken advantage of the exemption contained in Financial Reporting Standard No.1 (Revised) from the requirement not to present a cash flow statement, on the grounds that its cash flows are included in the consolidated accounts of the ultimate parent company.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2013

1. ACCOUNTING POLICIES (Continued)

(q) Loan arrangement fees

Housing loans are stated in the balance sheet at the amount of the net proceeds. Loan issue costs are deducted from the nominal value of the loans and are allocated to the income and expenditure account over the terms of the loans.

(r) General Needs Managed Properties

Where properties are managed by other housing associations who provide housing management, maintenance and in some cases major repairs functions, the income recorded in the financial statements is the net rental income after deduction of allowance for voids and bad debts. The expenditure recorded in the financial statements relates to the fees paid to the other housing associations to provide these services.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2013

2. PARTICULARS OF TURNOVER, OPERATING COSTS AND OPERATING SURPLUS

	YEAR 2013		
	Turnover £'000	Operating Costs £'000	Operating Surplus/ (Deficit) £'000
Social housing lettings (note 3)	50,403	(38,993)	11,410
Other social housing activities			
Development and agency	1,973	(1,864)	109
First tranche sale of shared ownership	3,671	(3,275)	396
Non social housing activities			
Lettings	76	(21)	55
2013 TOTAL	56,123	(44,153)	11,970

	YEAR 2012		
	Turnover £'000	Operating Costs £'000	Operating Surplus/ (Deficit) £'000
Social housing lettings (note 3)	45,955	(35,211)	10,744
Other social housing activities			
Development and agency	2,311	(2,037)	274
First tranche sale of shared ownership	2,473	(2,477)	(4)
Non social housing activities			
Lettings	101	(66)	35
2012 TOTAL	50,840	(39,791)	11,049

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2013

3. PARTICULARS OF INCOME AND EXPENDITURE FROM SOCIAL HOUSING LETTINGS

	General Housing £'000	Supported Housing £'000	Intermediate Rent £'000	Temporary Social Housing £'000	Residential Care Homes £'000	Shared Ownership £'000	Keyworker Accommodation £'000	Year 2013 £'000	Year 2012 £'000
Net rents receivable	36,382	4,639	542	90	1	2,215	70	43,939	39,591
Service Charges receivable	1,434	1,115	2	19	30	117	15	2,732	2,520
Revenue grants from local authorities and other agencies	8	3,080	5	-	254	385	-	3,732	3,844
Turnover from social housing letting	37,824	8,834	549	109	285	2,717	85	50,403	45,955
Services	(1,989)	(3,602)	(22)	(7)	(35)	(74)	(1)	(5,730)	(5,471)
Management	(6,959)	(2,879)	(160)	(44)	(48)	(712)	(26)	(10,827)	(9,654)
Routine maintenance	(11,819)	(1,546)	(79)	(60)	(111)	(68)	(20)	(13,703)	(12,639)
Rent losses from bad debts	(88)	(68)	(3)	(2)	-	7	-	(161)	(346)
Major repair expenditure	(1,934)	(441)	-	(10)	-	-	-	(2,385)	(2,304)
Depreciation	(4,441)	(642)	(74)	(13)	(57)	(702)	(10)	(5,939)	(4,641)
Other costs	(129)	(93)	(3)	-	(1)	(21)	(1)	(248)	-
Fixed asset impairment	-	-	-	-	-	-	-	-	(156)
Operating costs from social housing lettings	(27,359)	(9,271)	(341)	(136)	(252)	(1,570)	(58)	(38,993)	(35,211)
OPERATING SURPLUS FROM SOCIAL HOUSING LETTINGS	10,465	(437)	208	(27)	33	1,140	27	11,410	10,744
Void lettings	(432)	(447)	(18)	(8)	-	-	(18)	(923)	(538)

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2013

4. ACCOMMODATION IN MANAGEMENT

The number of units of accommodation in management for each class of accommodation is as follows:

	2013 Number	2012 Number
Social housing		
General needs housing accommodation – social rented	7,617	7,434
General needs housing accommodation – affordable rented	266	72
Supported housing accommodation - directly managed	1,100	847
Supported housing accommodation - agency managed	405	399
Intermediate rented	154	118
Residential care homes - directly managed	6	6
Residential care homes - agency managed	105	124
Temporary social housing	17	18
Keyworker accommodation	19	24
Shared ownership and Do It Yourself shared ownership	1,370	1,293
Total social housing units owned	11,059	10,335
Leasehold schemes for the elderly	984	923
Managed for others	-	2
Managed by others	(410)	(367)
Total social housing units managed	11,633	10,893
Non social housing		
Market rented	16	21
TOTAL HOMES MANAGED	11,649	10,914

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2013

5. BOARD MEMBERS AND SENIOR MANAGEMENT

The emoluments of the current Board and senior management team who served during the year were:

	Salary Paid £'000	Employers NI & Pension Costs £'000	Benefits in kind £'000	2013 Total £'000	2012 Total £'000
Mark Beard (Director of Customer and Community Operations)	101	4	1	106	103
Tony Gosling (Board Member)	-	-	-	-	2
Jacqui Cross (Board Member)	-	-	-	-	4
Jamir Ali (Board Member)	4	-	-	4	4
Barrie Dale (Board Member)	-	-	-	-	5
Richard Taylor (Board Member)	-	-	-	-	4
Annerose Weiler (Board Member) resigned 31.12.11	-	-	-	-	3
Nick Williams (Board Member) resigned 31.12.11	-	-	-	-	3
Total emoluments of the senior management team and Board Members	105	4	1	109	128

Expenses paid during the year to the members of the Board amounted to £6,183 (2012: £8,709)

Other directors and senior management are remunerated by Knightstone Housing Group Limited and their costs are included as part of the recharge from Knightstone Housing Group Limited. The Association participates in The Social Housing Pension Scheme (see note 22) of which the senior management team are members on the same terms as other employee members. Board Members do not participate in The Social Housing Pension Scheme.

6. EMPLOYEE AND STAFF COSTS

	FTE	Headcount	2013 Wages & Salaries £'000	Ers NI £'000	Ers Pension £'000	Total £'000
Bands (£)	Number	Number				
30,000-39,999	229	267	8,357	690	95	9,142
40,000-49,999	16	16	791	79	17	888
50,000-59,999	115	129	439	45	12	496
60,000-69,999	5	5	327	34	12	373
70,000-79,999	-	-	-	-	-	-
80,000-89,999	-	-	-	-	-	-
90,000-99,999	-	-	-	-	-	-
100,000-109,999	1	1	101	12	4	117
At 31 March 2013	366	418	10,016	859	140	11,015
At 31 March 2012	357	391	9,358	793	134	10,285

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2013

The full time equivalent calculation for the Association is based on 37.5 hours per week.

FULL TIME EQUIVALENTS BY CATEGORY

	2013 FTE Number	2013 FTE Number
Housing management	154	153
Supported housing	114	113
Asset management and maintenance	46	46
Development and home ownership	32	32
Direct labour organisation (DLO)	12	13
Central support services	9	-
Total full time equivalents	366	357

7. SURPLUS ON SALE OF HOUSING PROPERTIES

	2013			2012		
	Proceeds £'000	Cost of sales £'000	Surplus £'000	Proceeds £'000	Cost of sales £'000	Surplus £'000
Shared ownership staircasing	1,086	(481)	605	1,268	(789)	479
Stock transfer to other Registered Providers	7,120	(3,608)	3,512	-	-	-
Asset sales	3,202	(2,576)	626	3,673	(2,457)	1,216
	11,408	(6,665)	4,743	4,941	(3,246)	1,695

8. INTEREST RECEIVABLE

	2013 £'000	2012 £'000
Interest receivable from Group undertakings	205	188
Bank interest	60	142
	265	330

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2013

9. INTEREST PAYABLE AND SIMILAR CHARGES

	2013 £'000	2012 £'000
Interest on bank loans	(8,932)	(8,626)
Finance leases	(70)	(66)
	<u>(9,002)</u>	<u>(8,692)</u>
Interest payable capitalised on housing properties under construction	715	766
Historic loan arrangement fees written off	(94)	(88)
Total interest payable and similar charges	<u>(8,381)</u>	<u>(8,014)</u>

Interest is capitalised at a rate of 4% (2012: 4.64%)

10. SURPLUS BEFORE GIFT AID

	2013 £'000	2012 £'000
<i>Amount stated after charging/(crediting):</i>		
Depreciation of housing properties	5,935	4,642
Depreciation on non-housing fixed assets	500	394
External auditors' remuneration in their capacity as auditors (excluding VAT)	20	19
External auditors' remuneration in their capacity as consultants (excluding VAT)	3	6
Operating lease rentals – land and buildings	185	186
Bad debts written off	161	119
Total revenue grants receivable – lettings	<u>(3,732)</u>	<u>(3,185)</u>

11. TAXATION

The Association has received confirmation from HMRC's Claims Branch (Trusts & Charities Division) that the Association has been granted exemption from tax as a charitable body. The exemption applies to all activities of the Association within the charitable objects set out in its Rules.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2013

12. TANGIBLE FIXED ASSETS – HOUSING PROPERTIES

	UNDER CONSTRUCTION		COMPLETED PROPERTIES		TOTAL
	Shared Ownership Properties £'000	Rented Properties £'000	Shared Ownership Properties £'000	Rented Properties £'000	£'000
COST					
At 1 April 2012	3,100	15,476	48,115	534,085	600,776
Works to existing properties	-	-	29	9,210	9,239
Additions	5,742	21,638	92	50,862	78,334
Disposals	(1,985)	(1,192)	(521)	(13,040)	(16,738)
Transferred to completed schemes	(5,639)	(20,362)	5,639	20,362	-
At 31 March 2013	1,218	15,560	53,354	601,479	671,611
SOCIAL HOUSING GRANT					
At 1 April 2012	1,009	4,394	24,825	260,582	290,810
Additions	684	4,819	1,167	20,628	27,298
Disposals	-	-	(2,793)	(27,023)	(29,816)
Transferred to completed schemes	(1,398)	(4,867)	1,398	4,867	-
At 31 March 2013	295	4,346	24,597	259,054	288,292
OTHER CAPITAL GRANTS					
At 1 April 2012	409	1,256	2,262	29,039	32,966
Additions	962	1,822	396	30,572	33,752
Disposals	-	-	(8)	(661)	(669)
Transferred to completed schemes	(1,371)	(2,365)	1,371	2,365	-
At 31 March 2013	-	713	4,021	61,315	66,049
DEPRECIATION					
At 1 April 2012	-	-	1,433	52,262	53,695
Charge for the year	-	-	215	5,720	5,935
Disposals	-	-	(50)	(8,111)	(8,161)
At 31 March 2013	-	-	1,598	49,871	51,469
NET BOOK VALUE					
At 31 March 2013	923	10,501	23,138	231,239	265,801
At 31 March 2012	1,682	9,826	19,595	192,202	223,305

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2013

12. TANGIBLE FIXED ASSETS – HOUSING PROPERTIES (Continued)

During the 2012-13 financial year the Association swapped housing properties with another housing association. The Group disposed of 968 properties with a historic cost of £49.300 million, grant of £25,445 million and a net book value of £20.165 million and acquired 1,227 properties in return to which a historic cost of £67.815 million, grant of £47,609 million and a net book value of £20.206 million have been attributed. The net increase in costs is shown within the completed properties additions.

The Association also purchased 312 properties at a cost of £31.348 million with grant of £5.153 million from another housing association.

The completed property additions also includes £9.239 million of component replacement works and £1.091 million of improvements to existing properties.

An amount of £1.285 million (2012: £990 thousand) has been capitalised in respect of the costs of administering the development programme. Shared ownership properties with a net book value of £533 thousand (2012: £533 thousand) after deducting SHG of £797 thousand (2012: £797 thousand) have been financed through sale and leaseback transactions. No new funds were advanced to the Association during the year (2012 Nil) and no repayments have been made (2012 Nil). The remaining finance, which has no fixed repayment date, is to be repaid on any subsequent sale of the remaining interest in these properties.

The Association has granted fixed charges over its housing assets as security for borrowings and margin calls under interest rate swap transactions.

2013	2012
£'000	£'000

The total accumulated Social Housing Grant receivable up to the year ended 31 March 2013 were:

Capital grants	288,292	290,810
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2013	2012
£'000	£'000

HOUSING PROPERTIES COMPRISE:

Freehold land and buildings	243,994	200,742
Long leasehold land and buildings	21,677	22,427
Short leasehold land and buildings	130	136
	265,801	223,305

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2013

13. NON-HOUSING TANGIBLE FIXED ASSETS

	Furniture Fixtures and Fittings £'000	Office Equipment £'000	Computer Equipment £'000	Office Improvements £'000	Freehold Offices £'000	Commercial Properties £'000	Vehicles £'000	2013 Total £'000
COST								
At 1 April 2012	237	180	3,346	401	4,080	35	136	8,415
Additions	1	-	1,127	7	5,787	-	-	6,922
Disposals	-	-	-	-	-	-	-	-
At 31 March 2013	238	180	4,473	408	9,867	35	136	15,337
DEPRECIATION								
At 1 April 2012	236	179	2,154	396	1,713	35	32	4,745
Charge for year	-	-	420	2	44	-	34	500
Disposals	-	-	-	-	-	-	-	-
At 31 March 2013	236	179	2,574	398	1,757	35	66	5,245
NET BOOK VALUE								
At 31 March 2013	2	1	1,899	10	8,110	-	70	10,092
At 31 March 2012	1	1	1,192	5	2,368	-	104	3,671

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2013

14. FIXED ASSET INVESTMENTS

	2013 £'000	2012 £'000
Investment in Great Western Assured Growth Limited	5,847	4,686
Investments in Great Western Housing Limited	-	1,161
Homebuy loan	3,252	3,570
Homebuy grant	(2,914)	(3,232)
Keyworker loan	698	793
Keyworker grant	(698)	(793)
	<u>6,185</u>	<u>6,185</u>

Homebuy and Keyworker homes were built and sold in previous years under specific grant-funded initiatives. The Group retains a charge over the properties and, when they are sold, the Group receives a payment and repays the grant. The investment balance represents the value of the charge over these properties, net of the grant.

15. WORK IN PROGRESS AND PROPERTIES HELD FOR SALE

	2013 £'000	2012 £'000
Work in Progress		
Shared ownership	791	3,031
Commercial properties	706	447
	<u>1,497</u>	<u>3,478</u>

Included within the work in progress there is £136k (2012: £117k) of capitalised interest.

	2013 £'000	2012 £'000
Properties held for sale		
Shared ownership	3,698	2,443
	<u>3,698</u>	<u>2,443</u>
	<u>5,195</u>	<u>5,921</u>

KNIGHTSTONE HOUSING ASSOCIATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2013

16. DEBTORS

	2013 £'000	2012 £'000
Amounts falling due within one year		
Arrears of rent and service charges	1,955	1,530
Less: Provision for bad and doubtful debts	(1,070)	(820)
	<u>885</u>	<u>710</u>
Amounts due from other Group Companies	5,620	9,395
Other debtors	1,100	1,415
Amounts due from managing agents	1,268	267
Prepayments and rental cash due	1,820	1,029
Sundry debtors	372	186
Capital debtors	311	535
Insurance control	399	347
Grant and other amounts due	-	250
	<u>11,775</u>	<u>14,134</u>

The rental debtors as at 31 March 2013 includes £421k (2012 - £371k) of outstanding housing benefit.

17. CREDITORS

	2013 £'000	2012 £'000
Amounts falling due within one year		
Accruals and deferred income	4,642	3,939
Capital retentions	2,892	2,669
Net borrowings (note 18)	1,878	1,712
Trade creditors	1,770	1,544
Amounts held on behalf of home owners	1,663	1,080
Accrued interest on loans	1,507	1,256
Recycled capital grants (note 19)	1,506	978
Rent in advance	1,322	684
Provisions	764	689
Taxation and social security	311	308
Other creditors	222	1,364
Amounts due to other Group Companies	81	-
Social Housing Grant received in advance	-	1,099
	<u>18,558</u>	<u>17,322</u>

For security provided on the loans please see note 18 for details.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2013

18. BORROWINGS

	2013 £'000	2012 £'000
Housing loans	245,650	211,497
Obligations under finance leases	533	533
TOTAL BORROWINGS	246,183	212,030
Less loans falling due within one year (note 17)	(1,878)	(1,712)
Less loan arrangement fees	(2,337)	(1,866)
NET BORROWINGS	241,968	208,452
	2013 £'000	2012 £'000
Borrowings comprise loans at fixed, variable and index linked interest rates and are repayable as follows:		
Up to one year (note 17)	1,878	1,712
Over one year and up to two years	1,985	1,812
Over two years and up to five years	31,050	7,295
Over five years	211,270	201,211
TOTAL BORROWINGS	246,183	212,030
By interest rate basis:		
Fixed rate	26,113	26,823
Variable rate	210,500	175,000
Indexed linked	9,037	9,674
Finance lease	533	533
TOTAL BORROWINGS	246,183	212,030

Where loans are borrowed at variable rates, the Association uses interest rate swaps and a limited range of other financial instruments to manage interest rate risk. The final instalments on these loans fall in years 2035 to 2041.

Housing loans repayable by half-yearly instalments after one year are secured at fixed rates of interest ranging from 5.65% to 12.1%. The final instalment on these loans fall in the period 2020 to 2029.

There are two housing loans repayable by bullet repayment; one secured at a fixed rate of interest of 5.1% and repayable in 2035 and a new £20m loan on a variable rate of interest repayable in March 2018.

Total committed loan facilities are £260.7m (2012: £242m) of which £14.5m (2012: £30m) are undrawn at 31 March 2013.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2013

19. RECYCLED CAPITAL GRANT FUND

	2013 £'000	2012 £'000
Opening balance	4,051	3,997
Grant recycled	2,578	1,424
Interest accrued	23	25
New build	(1,345)	(416)
Major repairs & works to existing stock – capital	(510)	-
Carried forward	4,797	5,030
Grants to be recycled in less than 1 year (see note 17)	(1,506)	(978)
As at 31 March 2013	3,291	4,052

20. ASSOCIATION SHARE CAPITAL

	2013 £'000	2012 £'000
At start of year	42	42
Shares issued during the year	3	3
Shares surrendered during the year	(34)	(3)
At end of the year	11	42

The shares provide members with the right to vote at the general meetings, but do not provide any rights to dividends or distribution on a winding up.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2013

21. RESERVES

	Accumulated Surpluses £'000	Restricted Reserves £'000	Total £'000
At 1 April 2012	52,974	139	53,113
Surplus for the year	9,513	-	9,513
Transfer to/from restricted reserves	(1)	1	-
At 31 March 2013	62,486	140	62,626

The restricted reserves relate to the Kennet Fund.

22. PENSION OBLIGATIONS

Knightstone Housing Association Limited participates in the Social Housing Pension Scheme (the Scheme). The Scheme is funded and is contracted-out of the State Pension scheme.

It is not possible in the normal course of events to identify on a consistent and reasonable basis the share of underlying assets and liabilities belonging to individual participating employers. This is because the Scheme is a multi-employer scheme where the Scheme assets are co-mingled for investment purposes, and benefits are paid from total Scheme assets. Accordingly, due to the nature of the Scheme, the accounting charge for the period under FRS17 represents the employer contribution payable.

The Trustee commissions an actuarial valuation of the Scheme every three years. The main purpose of the valuation is to determine the financial position of the Scheme in order to address the level of future contributions required so that the Scheme can meet its pension obligations as they fall due.

The last formal valuation of the Scheme was performed as at 30 September 2011 by a professionally qualified Actuary using the Projected Unit Method. The market value of the Scheme's assets at the valuation date was £2,062 million. The valuation revealed a shortfall of assets compared with the value of liabilities of £1,035 million, equivalent to a past service funding level of 67.0%.

The Scheme Actuary has prepared an Actuarial Report that provides an approximate update on the funding position of the Scheme as at 30 September 2012. Such a report is required by legislation for years in which a full actuarial valuation is not carried out. The market value of the Scheme's assets at the date of the Actuarial Report was £2,327 million. The Actuarial Report revealed a shortfall of assets compared with the value of liabilities of £1,241 million, equivalent to a past service funding level of 65%.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2013

23. CAPITAL COMMITMENTS

	2013 £'000	2012 £'000
Expenditure authorised by the Board and contracted for	37,508	33,695
Expenditure authorised by the Board but not contracted	71,888	131,187
TOTAL	109,396	164,882

The total expenditure authorised and contracted but not yet provided for in the financial statements is £37.508m (2012: £33.695m). This is funded by grants of £5.575m (2012: £7.269m) and NBHB sales proceeds of £8.528m (2012: £6.716m), and £23.405m from cash balances (2012: £19.709m).

24. OPERATING LEASES

The Association has several office premises on non-cancellable operating leases. At 31 March 2013 the Association had annual commitments under these leases of:

	2013 £'000 Land & Buildings	2012 £'000 Land & Buildings
Leases expiring:		
In less than one year	136	77
In one to five years	12	71
In more than five years	38	38
TOTAL	186	186

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 March 2013

25. POST BALANCE SHEET EVENTS

The Group has continued with the stock rationalisation policy during 2013/14. The table below shows the activity that has taken place since the balance sheet date.

DATE	LOCAL AUTHORITY	RENTED	SHARED OWNERSHIP	SUPPORTED HOUSING	TOTAL
30 April 2013	Gloucestershire	-	-	10	10
13 May 2013	Swindon and Wiltshire	-	-	54	54
20 May 2013	Dorset	9	3	-	12
20 May 2013	New Forest	115	-	-	115
	TOTAL	124	3	64	191

26. SUBSIDIARY UNDERTAKINGS

Details of other subsidiary organisations within the Knightstone Housing Group are:

Name	Legal Status	Charitable Status	Company Number	Industrial & Provident Registered Number
Knightstone Charitable Housing Limited	Industrial & provident Society	Exempt Charity	N/A	19165R
Great Western Assured Growth Limited	Private Limited Company (Shares)	Non Charitable	2525892	-
Great Western Housing Limited	Private Limited Company (Shares)	Non Charitable	2792288	-
Arc Development South West Limited	Private Limited Company (Guarantee)	Non Charitable	5716836	-
Arc Homes (South West) Limited	Private Limited Company (Shares)	Non Charitable	6447504	-

Knightstone Housing Association Limited holds all of the issued share capital in Great Western Assured Growth Limited, Great Western Housing Limited and Arc Homes (South West) Limited and is the sole member of Arc Developments South West Limited.

Arc Homes (South West) Limited has been a dormant company since its incorporation on 7 December 2007.

Within the Group only Knightstone Housing Group Limited (Parent) and Knightstone Housing Association Limited are Registered Providers.

Related Party Transactions

The Group has taken advantage of the exemption contained in Financial Reporting Standard 8 'Related Party Transactions' and has not disclosed transactions with other group entities.

No payment or benefits, other than those permitted, were made to the persons referred to in section 122 of the Housing and Regeneration Act 2008.

Resident Board Members are entitled to the same expenses as other Board Members and do not have any preferential rates for their rent and service charges.

27. ULTIMATE PARENT UNDERTAKING AND CONTROLLING PARTY

The Board of Knightstone Housing Association Limited regards Knightstone Housing Group Limited, a housing association registered under the Industrial and Provident Societies Act 1965 (No. 29867R) and registered with the Housing Regulator pursuant to sections 111 and 112 of the Housing and Regeneration Act 2008 (Registered No. L4436), as the ultimate parent undertaking and controlling party. Copies of group accounts can be obtained from the registered office at Station Road, Worle, Weston-super-Mare, BS22 6AP.

Knightstone Housing Association Limited does not produce consolidated group accounts because it is included in the Group financial statements of Knightstone Housing Group Limited

TAXATION

United Kingdom Taxation

The following applies only to persons who are the beneficial owners of Bonds and is a summary of the Issuer's understanding of current United Kingdom law and published HM Revenue & Customs practice relating to certain aspects of United Kingdom taxation as at the date of this Prospectus. Some aspects do not apply to certain classes of person (such as dealers and persons connected with the Issuer) to whom special rules may apply. The United Kingdom tax treatment of prospective Bondholders depends on their individual circumstances and may be subject to change at any time in the future, possibly with retrospective effect. This is not intended to constitute a complete analysis of all tax consequences relating to the ownership of the Bonds and it is not intended to be, nor should it be considered to be, legal or tax advice. Prospective Bondholders who may be subject to tax in a jurisdiction other than the United Kingdom or who may be unsure as to their tax position should seek their own professional advice.

A. Interest on the Bonds

1. *Payment of interest on the Bonds*

Payments of interest by the Issuer on the Bonds may be made without deduction of or withholding on account of United Kingdom income tax provided that the Bonds continue to be listed on a "recognised stock exchange" within the meaning of section 1005 of the Income Tax Act 2007. The London Stock Exchange is a recognised stock exchange for these purposes. Securities will be treated as listed on the London Stock Exchange if they are included in the Official List (within the meaning of and in accordance with the provisions of Part 6 of the Financial Services and Markets Act 2000) and admitted to trading on the London Stock Exchange. Provided, therefore, that the Bonds remain so listed, interest on the Bonds will be payable without withholding or deduction on account of United Kingdom tax.

Interest on the Bonds may also be paid without withholding or deduction on account of United Kingdom tax where interest on the Bonds is paid by a company and, at the time the payment is made, the Issuer reasonably believes (and any person by or through whom interest on the Bonds is paid reasonably believes) that the beneficial owner is within the charge to United Kingdom corporation tax as regards the payment of interest, provided that HM Revenue & Customs (HMRC) has not given a direction (in circumstances where it has reasonable grounds to believe that it is likely that the above exemption is not available in respect of such payment of interest at the time the payment is made) that the interest should be paid under deduction of tax.

In other cases, an amount must generally be withheld from payments of interest on the Bonds on account of United Kingdom income tax at the basic rate (currently 20 per cent.). However, where an applicable double tax treaty provides for a lower rate of withholding tax (or for no tax to be withheld) in relation to a Bondholder, HMRC can issue a notice to the Issuer to pay interest to the Bondholder without deduction of tax (or for interest to be paid with tax deducted at the rate provided for in the relevant double tax treaty).

HMRC has powers, in certain circumstances, to obtain information about: payments derived from securities (whether income or capital); certain payments of interest; and securities transactions.

The persons from whom HMRC can obtain information include: a person who receives (or is entitled to receive) a payment derived from securities; a person who makes such a payment (received from, or paid on behalf of, another person); a person by or through whom interest is paid or credited; a person who effects or is a party to securities transactions (which includes an issue of securities) on behalf of others; registrars or administrators in respect of securities transactions; and each registered or inscribed holder of securities.

The information HMRC can obtain includes: details of the beneficial owner of securities; details of the person for whom the securities are held, or the person to whom the payment is to be made (and, if more than one, their respective interests); information and documents relating to securities transactions; and, in relation to interest paid or credited on money received or retained in the United Kingdom, the identity of the security under which interest is paid. HMRC is generally not able to obtain information (under its power relating solely to interest) about a payment of interest to (or a receipt for) a person that is not an individual. This limitation does not apply to HMRC's power to obtain information about payments derived from securities.

In certain circumstances the information which HMRC has obtained using these powers may be exchanged with tax authorities in other jurisdictions.

2. *EU Savings Directive*

Under EC Council Directive 2003/48/EC (the **Directive**) on the taxation of savings income, Member States are required to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State or to certain limited types of entities established in that other Member State. However, for a transitional period, Luxembourg and Austria are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have adopted similar measures (a withholding system in the case of Switzerland). In April 2013, the Luxembourg Government announced its intention to abolish the withholding system with effect from 1st January, 2015, in favour of automatic information exchange under the Directive.

The European Commission has proposed certain amendments to the Directive, which may, if implemented, amend or broaden the scope of the requirements described above.

If a payment were to be made or collected through a Member State which has opted for a withholding system and an amount of, or in respect of, tax were to be withheld from that payment, neither the Issuer nor any paying agent nor any other person would be obliged to pay additional amounts to the holder of the Bonds or to otherwise compensate the holder of the Bonds for the reduction in the amounts that they will receive as a result of the imposition of such withholding tax.

3. *Further United Kingdom Income Tax Issues*

Interest on the Bonds constitutes United Kingdom source income for tax purposes and, as such, may be subject to income tax by direct assessment even where paid without withholding.

However, interest with a United Kingdom source received without deduction or withholding on account of United Kingdom tax will not be chargeable to United Kingdom tax in the hands

of a Bondholder (other than certain trustees) who is not resident for tax purposes in the United Kingdom unless that Bondholder carries on a trade, profession or vocation in the United Kingdom through a United Kingdom branch or agency in connection with which the interest is received or to which the Bonds are attributable (and where that Bondholder is a company, unless that Bondholder carries on a trade in the United Kingdom through a permanent establishment in connection with which the interest is received or to which the Bonds are attributable). There are exemptions for interest received by certain categories of agent (such as some brokers and investment managers). The provisions of an applicable double taxation treaty may also be relevant for such Bondholders.

B. United Kingdom Corporation Tax Payers

4. In general, Bondholders which are within the charge to United Kingdom corporation tax will be charged to tax as income on all returns, profits or gains on, and fluctuations in value of, the Bonds (whether attributable to currency fluctuations or otherwise) broadly in accordance with their statutory accounting treatment.

C. Other United Kingdom Tax Payers

5. *Taxation of Chargeable Gains*

The Bonds will constitute "qualifying corporate bonds" within the meaning of section 117 of the Taxation of Chargeable Gains Act 1992. Accordingly, a disposal by a Bondholder of a Bond will not give rise to a chargeable gain or an allowable loss for the purposes of the UK taxation of chargeable gains.

6. *Accrued Income Scheme*

On a disposal of Bonds by a Bondholder, any interest which has accrued since the last interest payment date may be chargeable to tax as income under the rules of the accrued income scheme as set out in Part 12 of the Income Tax Act 2007, if that Bondholder is resident in the United Kingdom or carries on a trade in the United Kingdom through a branch or agency to which the Bonds are attributable.

The Bonds are likely to constitute variable rate securities for the purposes of the accrued income scheme. Under the accrued income scheme on a disposal of Bonds by a Bondholder who is resident or ordinarily resident in the United Kingdom or carries on a trade in the United Kingdom through a branch or agency to which the Bonds are attributable the Bondholder may be charged to income tax on an amount of income which is just and reasonable in the circumstances. The purchaser of such a Bond will not be entitled to any equivalent tax credit under the accrued income scheme to set against any actual interest received by the purchaser in respect of the Bonds (which may therefore be taxable in full).

7. *Taxation of Discount*

HMRC's published practice is that securities having similar terms of early redemption as the Bonds are not treated by HMRC as "deeply discounted securities" and accordingly the Bonds should not be treated as "deeply discounted securities" for the purposes of Chapter 8 of Part 4 of the Income Tax (Trading and Other Income) Act 2005.

D. Stamp Duty and Stamp Duty Reserve Tax (SDRT)

8. No United Kingdom stamp duty or SDRT is payable on the issue of the Bonds or on a transfer by delivery of the Bonds.

The Proposed Financial Transactions Tax (FTT)

The European Commission has published a proposal for a Directive for a common FTT in Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia (the **participating Member States**).

The proposed FTT has very broad scope and could, if introduced in its current form, apply to certain dealings in the Bonds (including secondary market transactions) in certain circumstances.

Under current proposals the FTT could apply in certain circumstances to persons both within and outside of the participating Member States. Generally, it would apply to certain dealings in the Bonds where at least one party is a financial institution, and at least one party is established in a participating Member State. A financial institution may be, or be deemed to be, "established" in a participating Member State in a broad range of circumstances, including (a) by transacting with a person established in a participating Member State or (b) where the financial instrument which is subject to the dealings is issued in a participating Member State.

The FTT proposal remains subject to negotiation between the participating Member States and is the subject of legal challenge. It may therefore be altered prior to any implementation, the timing of which remains unclear. Additional EU Member States may decide to participate. Prospective holders of the Bonds are advised to seek their own professional advice in relation to the FTT.

PURCHASE AND SALE

The Arranger and the Dealer have, pursuant to a purchase agreement (the **Purchase Agreement**) dated 27th September, 2013, agreed to purchase the Bonds (other than the Retained Bonds) at the issue price of 100 per cent. of the nominal amount of the Bonds (other than the Retained Bonds). The Issuer has agreed separately a fee with the Arranger and the Dealer and shall also reimburse the Arranger and the Dealer in respect of certain of their expenses. In addition, the Issuer has agreed to indemnify each of the Arranger and the Dealer against certain liabilities, incurred in connection with the issue of the Bonds. The Purchase Agreement may be terminated in certain circumstances prior to payment to the Issuer.

The issue price in respect of the Bonds will be payable in two instalments. See "*Payment by Instalments*".

United States

The Bonds have not been and will not be registered under the Securities Act and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except in certain transactions exempt from the registration requirements of the Securities Act.

The Bonds are subject to U.S. tax law requirements and may not be offered, sold or delivered within the United States or its possessions or to a United States person, except in certain transactions permitted by U.S. tax regulations. Terms used in this paragraph have the meanings given to them by the U.S. Internal Revenue Code of 1986 and regulations thereunder.

Each of the Arranger and the Dealer has represented and agreed that, except as permitted by the Purchase Agreement, it will not offer, sell or deliver Bonds (a) as part of its distribution at any time or (b) otherwise until 40 days after the later of the commencement of the offering and the Issue Date within the United States or to, or for the account or benefit of, U.S. persons.

In addition, until 40 days after the commencement of the offering of the Bonds, an offer or sale of Bonds within the United States by any dealer that is not participating in the offering may violate the registration requirements of the Securities Act.

Terms used above have the meanings given to them by Regulation S under the Securities Act.

United Kingdom

Each of the Arranger and the Dealer has represented and agreed that:

- (a) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the Financial Services and Markets Act 2000 (the **FSMA**)) received by it in connection with the issue or sale of any Bonds in circumstances in which Section 21(1) of the FSMA does not apply to the Issuer or the Original Borrower; and
- (b) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to any Bonds in, from or otherwise involving the United Kingdom.

General

Each of the Arranger and the Dealer has agreed that it will, to the best of its knowledge and belief, comply with all applicable securities laws and regulations in force in any jurisdiction in which it purchases, offers, sells or delivers Bonds or possesses or distributes this Prospectus and will obtain any consent, approval or permission which is, to the best of its knowledge and belief, required by it for the purchase, offer, sale or delivery by it of Bonds under the laws and regulations in force in any jurisdiction to which it is subject or in which it makes such purchases, offers, sales or deliveries.

None of the Issuer, the Original Borrower, the Bond Trustee, the Arranger or the Dealer represents that Bonds may at any time lawfully be sold in compliance with any applicable registration or other requirements in any jurisdiction, or pursuant to any exemption available thereunder, or assumes any responsibility for facilitating such sale.

GENERAL INFORMATION

Authorisation

The issue of the Bonds has been approved by a resolution of the Board of Directors of the Issuer dated 26th September, 2013.

Listing of Bonds

It is expected that the official listing of the Bonds will be granted on or about 2nd October, 2013 subject only to the issue of the Temporary Global Bond. Application has been made to the UK Listing Authority for the Bonds to be admitted to the Official List and to the London Stock Exchange for the Bonds to be admitted to trading on the London Stock Exchange's regulated market.

The Issuer estimates that the total expenses related to the admission to trading will be £12,635. The Original Borrower shall pay to the Issuer, *inter alia*, an amount equal to such expenses in accordance with Clause 19 (*Expenses*) of the Knightstone Housing Association Loan Agreement.

Documents Available

For the period of 12 months following the date of this Prospectus, copies of the following documents will, when published, be available for inspection from the registered office of the Issuer and from the specified office of the Paying Agent for the time being in London:

- (a) the constitutional documents of the Issuer and each Borrower;
- (b) the audited financial statements, including the reports of the auditors, of the Original Borrower in respect of the financial years ended 31st March, 2012 and 31st March, 2013. The Original Borrower currently prepares audited accounts on an annual basis;
- (c) the most recently published audited annual financial statements (if any) of the Issuer, each Additional Borrower and each Eligible Group Member and the most recently published unaudited interim financial statements (if any) of the Issuer, each Additional Borrower and each Eligible Group Member, in each case together with any audit or review reports prepared in connection therewith;
- (d) the Bond Trust Deed, the Agency Agreement, the Account Agreement, the Custody Agreement, the Retained Bond Custody Agreement, each Loan Agreement, the Security Trust Deed and the Security Agreements;
- (e) a copy of this Prospectus; and
- (f) any future offering circulars, prospectuses and information memoranda and any other documents incorporated therein by reference.

Clearing Systems

The Bonds have been accepted for clearance through Euroclear and Clearstream, Luxembourg. The ISIN and the Common Code for the Bonds is XS0975249714 and 097524971, respectively.

The address of Euroclear is Euroclear Bank S.A./N.V., 1 Boulevard du Roi Albert II, B-1210 Brussels and the address of Clearstream, Luxembourg is Clearstream Banking, 42 Avenue JF Kennedy, L-1855 Luxembourg.

Characteristics of underlying assets

The Knightstone Housing Association Loan Agreement has, and each Additional Loan Agreement will have, characteristics that demonstrate the capacity to produce funds to service any payments due and payable on the Bonds.

Material or Significant Change

There has been no material adverse change in the financial position or prospects of the Issuer since its date of incorporation.

There has been no significant change in the financial or trading position of the Knightstone Housing Group since 31st March, 2013 and there has been no material adverse change in the prospects of the Knightstone Housing Group since 31st March, 2013.

There has been no significant change in the financial or trading position of the Original Borrower since 31st March, 2013 and there has been no material adverse change in the prospects of the Original Borrower since 31st March, 2013.

Litigation

There are no governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Issuer is aware) since the date of its incorporation which may have, or have had in the recent past significant effects on the Issuer's financial position or profitability.

There are no governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Original Borrower is aware) in the 12 months preceding the date of this Prospectus which may have, or have had in the recent past significant effects on the Original Borrower's financial position or profitability.

There are no governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Issuer or the Original Borrower are aware) in the 12 months preceding the date of this Prospectus which may have, or have had in the recent past significant effects on the Knightstone Housing Group's financial position or profitability.

Auditors

The auditors of the Issuer are Mazars LLP, Chartered Accountants and Registered Auditor. As at the date of this Prospectus no financial statements have been prepared in respect of the Issuer. The auditors of the Issuer have no material interest in the Issuer.

The auditors of the Original Borrower are Mazars LLP, Chartered Accountants and Registered Auditor, who have audited the Original Borrower's accounts, without qualification, in accordance with generally accepted accounting principles in the United Kingdom for each of the two financial years ended on 31st March, 2012 and 31st March, 2013. The auditors of the Original Borrower have no material interest in the Original Borrower.

Post-issuance information

The Issuer does not intend to provide any post-issuance information in relation to the Bonds, the Issuer Security or the Underlying Security, other than as required pursuant to Condition 6.2 (*Information Covenants*).

Arranger and Dealer transacting with the Issuer or the Original Borrower

The Arranger, the Dealer and each of their affiliates may in the future engage in investment banking and/or commercial banking transactions with, and may perform services for, the Issuer and/or the Original Borrower and their respective affiliates in the ordinary course of business.

Yield

Indication of the yield on the Bonds: 5.57 per cent. (semi annual). The yield is calculated at the Issue Date on the basis of the Issue Price. It is not an indication of future yield.

ISSUER

Knightstone Capital Plc
Station Road
Worle
Weston-super-Mare BS22 6AP

BOND TRUSTEE AND SECURITY TRUSTEE

Prudential Trustee Company Limited
Laurence Pountney Hill
London EC4R 0HH

PRINCIPAL PAYING AGENT, ACCOUNT BANK, CUSTODIAN AND RETAINED BOND CUSTODIAN

The Bank of New York Mellon, London Branch
One Canada Square
London E14 5AL

ARRANGER AND DEALER

TradeRisks Limited
21 Great Winchester Street
London EC2N 2JA

LEGAL ADVISERS

*To the Issuer and the Original Borrower as to
English law*

*To the Arranger, the Dealer, the Bond Trustee
and the Security Trustee as to English law*

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London E1 6AD

AUDITORS

To the Issuer and the Original Borrower

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Birmingham B3 2RT