

Registered Number 3331871

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
DIRECTORS' REPORT AND FINANCIAL STATEMENTS
YEAR ENDED 31 DECEMBER 2006

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**BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
DIRECTORS' REPORT AND FINANCIAL STATEMENTS**

CONTENTS

	Page
Directors and Company Information	2
Directors' Report	3 – 7
Statement of Directors' Responsibilities	8
Independent Auditors' report to the Member of BOS (Shared Appreciation Mortgages) NO 3 PLC	9 – 10
Income Statement	11
Statement of Recognised Income and Expense	12
Balance Sheet	13
Cash Flow Statement	14
Notes to the Financial Statements	15 – 27

BOS (SHARED APPRECIATION MORTGAGES) NO 3 PLC
DIRECTORS AND COMPANY INFORMATION

DIRECTORS

I G Stewart
P A Curran

SECRETARY

A Lockwood

REGISTERED OFFICE

Premier House
City Road
CHESTER
CH88 3AN

AUDITORS

KPMG Audit Plc
1 The Embankment
Neville Street
LEEDS
LS1 4DW

BOS (SHARED APPRECIATION MORTGAGES) NO 3 PLC DIRECTORS' REPORT

The directors present their report and the audited financial statements for the year ended 31 December 2006

BUSINESS REVIEW

PRINCIPAL ACTIVITY

The principal activity of BOS (Shared Appreciation Mortgages) NO 3 PLC (the "Company") is to finance mortgage lending. In 1998 the Company issued £46.6m fixed rate notes (the "Notes"). The interest payable on the Notes is set at 4.50% per annum until 2028. The Notes are secured on the mortgage portfolio. The capital appreciation arising on the sale of a mortgage holder's property is shared between the mortgage holder and the Company as set out in the original loan agreement. The Company pays its entire share of the appreciation to the Note holders.

The activities of the Company are conducted primarily by reference to a series of transaction documents (the "Programme Documentation").

Movements in the mortgage book are disclosed in the notes to the financial statements.

BUSINESS STRUCTURE

BOS (Shared Appreciation Mortgages) NO 3 PLC is a subsidiary company of Uberior Investments PLC, which is a wholly owned subsidiary of Bank of Scotland.

RISK MANAGEMENT

The Company's main financial instruments are mortgage loans, funds on deposit and Notes. The principal purpose of these financial instruments is to raise finance for the Company's operations. It is, and has been throughout the year under review, the Company's policy that no trading in financial instruments is undertaken.

The main risks arising from the Company's financial instruments are credit risk and interest rate risk. The Board reviews and agrees policies for managing these and the other risks arising on the Company's financial instruments and operations and they are summarised below.

Further analysis of the risks facing the Company on its financial instruments is provided in note 16.

Credit Risk

Credit risk arises on the individual loans within the mortgage portfolio which are secured on the underlying residential properties. The maximum loan-to-value of the original advances was 75% and the credit risk is considered to be low.

The extent to which the Company can meet its obligations to pay interest and ultimately repay the Notes will be dependent upon the receipt of funds received from the mortgage pool and monies deposited in the Reserve Account with UBS (see "Liquidity Risk"). To the extent that this income does not provide sufficient funds to cover the interest due on the Notes or the repayment of the Notes the Company has no claim on the assets of Bank of Scotland.

**BOS (SHARED APPRECIATION MORTGAGES) NO 3 PLC
DIRECTORS' REPORT (CONTINUED)**

RISK MANAGEMENT (CONTINUED)

Credit Risk (continued)

The terms of the Mortgage Portfolio Agreement given by Bank of Scotland in respect of the mortgages requires the Bank to repurchase any mortgage which is found to be in breach of warranty. The Bank will repurchase any mortgages that are found or held not to be valid, binding and enforceable.

Although in such an event the total value of the outstanding loan and any accrued interest will be covered by Bank of Scotland, the Note holder will not receive the benefit of any future payments of appreciation amounts or partial repayment appreciation amounts in respect of the mortgages repurchased.

Shared appreciation is subject to the movement in the market value of the property. This may provide a return on the Notes below initial expectations. Any expected increase in value can not be guaranteed.

Interest Rate Risk

Interest rate risk exists where assets and liabilities have interest rates set under a different basis or which reset at a different time. The Company minimises its exposure to interest rate risk by ensuring that the interest rate characteristics of assets and liabilities are similar. Mortgages have been issued at 5.95% and 5.75% per annum and interest is payable to Note holders at a rate of 4.50% per annum until February 2028 and thereafter at a rate of 5.50% per annum.

Liquidity Risk

The Company holds a Reserve Account of £1,396,800 deposited with UBS which, should it be needed, can be used to withdraw money to meet its obligations under the Notes. The Company has not drawn on this facility since inception.

Operational Risk

In accordance with the Programme Documentation the Company is bound to make payments to meet third party expenses.

The Company's operations are subject to periodic review by the Internal Audit function of HBOS plc.

PERFORMANCE

The Company will continue to unwind over the life of the mortgages issued as no further advances will be made. Cash is continuing to be collected and the business is being managed by its directors.

The underlying profits are determined by a margin earned between the interest received on the mortgages and the interest paid to the Note holders. This is fixed by the Programme Documentation and is subject to the funds actually being received. Under International Financial Reporting Standards ("IFRSs") an effective yield adjustment is made on interest receivable and interest payable and the net difference passed through the income statement for the year ended 31 December 2006 was £7,401 loss (31 December 2005 £7,401 loss).

BOS (SHARED APPRECIATION MORTGAGES) NO 3 PLC
DIRECTORS' REPORT (CONTINUED)

PERFORMANCE (CONTINUED)

The principal asset in the Company is a mortgage portfolio which is subject to an annual impairment review. The mortgage portfolio is subject to the economic factors relating to the housing market (see "Credit Risk" above) but no impairment was deemed necessary as at 31 December 2006 or 31 December 2005.

The key performance indicators used by management in assessing the performance of the Company are monitoring of actual interest cash flows against planned cash flows on the Notes. The Company's performance is addressed in the quarterly management accounts to the directors.

OTHER INFORMATION

The Company has employed no staff during the year ended 31 December 2006 or the previous year.

RESULTS AND DIVIDEND

No new mortgages were acquired or generated by the Company in the year and no new Notes were issued.

The profit after taxation for the year, prepared using IFRSs, amounted to £245,951 (2005 £250,925). The dividend paid in 2006 was £149,504 (2005 £228,423).

FUTURE DEVELOPMENTS

No changes in the business of the Company are envisaged.

SUPPLIER PAYMENT POLICY

It is the Company's policy that payments to suppliers are made in accordance with those terms and conditions agreed between the Company and its suppliers.

The Company owed no amounts to trade creditors at 31 December 2006.

COMPANY SECRETARY

S Mayer resigned as Company Secretary on 13 June 2006 and was replaced by A Lockwood on the same day.

DIRECTORS AND THEIR INTERESTS

The directors who served during the year were as follows:

I G Stewart

C W Haresnape (resigned 31 December 2006)

N Stockton (appointed 31 December 2006, resigned 1 March 2007)

P A Curran was appointed as a director of the Company after the year ended 31 December 2006 but before the signing date of these accounts.

P A Curran (appointed 1 March 2007)

**BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
DIRECTORS' REPORT (CONTINUED)**

DIRECTORS AND THEIR INTERESTS (CONTINUED)

DIRECTORS' BENEFICIAL INTERESTS IN THE ORDINARY SHARES OF HBOS PLC DURING THE YEAR WERE AS FOLLOWS:

References to "HBOS plc shares" are to ordinary shares of 25p each in HBOS plc

During the year, no director had any beneficial interest in the share capital of the Company or of any other Group undertaking other than HBOS plc, the ultimate holding company

The beneficial interests of the directors and their immediate families in HBOS plc shares are set out below

	At 31 12 05 or date of appointment if later HBOS plc shares	At 31 12 06 HBOS plc shares
I G Stewart	13,719	14,048
N Stockton	3,535	3,535

SHARESAVE PLAN

Share options granted under these plans are set out below

	At 31.12 05 or date of appointment if later	Grant (G) lapsed (L) or exercised (E) in year	At 31 12 06
N Stockton	1,585	—	1,585

Options under these plans were granted using middle market prices shortly before the dates of the grants, discounted by 20%

SHORT-TERM INCENTIVE PLAN – HBOS SCHEME AND FORMER HALIFAX SCHEME

Certain directors have conditional entitlements to shares arising from the annual incentive plan. Where the annual incentive for any year was taken in shares and these shares are retained in trust for three years, the following shares will also be transferred to the directors

	Grant effective from	Shares as at 31 12 06
N Stockton	March 2004	95
	March 2005	540
	March 2006	803
		1,438

**BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
DIRECTORS' REPORT (CONTINUED)**

DIRECTORS AND THEIR INTERESTS (CONTINUED)

LONG TERM INCENTIVE PLAN

HBOS SCHEME, FORMER BANK OF SCOTLAND SCHEME AND FORMER HALIFAX SCHEME

Share options granted between 1995 and 2000 under the Bank of Scotland Executive Stock Option Scheme 1995 are subject to performance pre-conditions which have now been satisfied. Share options granted under the other plans are not subject to a performance precondition. Details of the options outstanding under these plans are set out below.

	Options outstanding at 31 12 05 or date of appointment if later	Granted(G), lapsed (L) or exercised (E) in year	At 31 12 06
I G Stewart	9,043	-	9,043
N Stockton	35,956	-	35,956

GOING CONCERN

The directors are satisfied that the Company has adequate resources to continue in business for the foreseeable future and consequently the going concern basis continues to be appropriate in preparing the accounts.

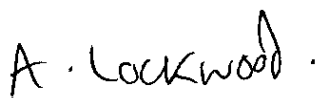
AUDIT INFORMATION

The directors who held office at the date of approval of this Directors' Report confirm that, so far as they each are aware, there is no relevant audit information of which the Company's auditors are unaware, and each director has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

AUDITORS AND ANNUAL GENERAL MEETING

KPMG Audit Plc were re-appointed as auditors of the Company on 17 March 2006. A resolution to re-appoint KPMG Audit Plc as auditors will be proposed by the members at the forthcoming Annual General Meeting.

By Order of the Board



A Lockwood
Secretary

Premier House
City Road
CHESTER
CH88 3AN

30 March 2007

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare Company financial statements for each financial year. Under that law the directors have elected to prepare the Company financial statements in accordance with IFRSs as adopted by the EU.

The Company financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position of the Company and the performance for that period, the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing the Company financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and estimates that are reasonable and prudent,
- state whether they have been prepared in accordance with IFRSs as adopted by the EU, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a Directors' Report and a Business Review.

**INDEPENDENT AUDITORS' REPORT
TO THE MEMBER OF BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC**

We have audited the financial statements of BOS (Shared Appreciation Mortgages) NO 3 PLC for the year ended 31 December 2006 which comprise the Income Statement, the Balance Sheet, the Cash Flow Statement, the Statement of Recognised Income and Expense and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Company's member, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's member those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's member as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU, are set out in the Statement of Directors' Responsibilities on page 8.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

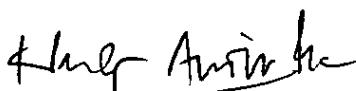
We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

**INDEPENDENT AUDITORS' REPORT
TO THE MEMBER OF BOS (SHARED APPRECIATION MORTGAGES) NO 3 PLC
(CONTINUED)**

Opinion

In our opinion

- the financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Company's affairs as at 31 December 2006 and of its profit for the year then ended, and
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' Report is consistent with the financial statements



KPMG Audit Plc
Chartered Accountants
Registered Auditor

1 The Embankment
Neville Street
LEEDS
LS1 4DW

30 March 2007

BOS (SHARED APPRECIATION MORTGAGES) NO 3 PLC
INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2006

	Notes	2006 £	2005 £
Interest receivable and similar income	2	1,786,547	1,876,336
Interest payable and similar charges	3	(1,392,511)	(1,469,263)
Net interest income		<u>394,036</u>	<u>407,073</u>
Net fair value gains and losses on derivatives	4	-	-
Other operating income	5	6,367	5,195
Operating expenses	6	(49,044)	(53,803)
Profit before tax for the year		<u>351,359</u>	<u>358,465</u>
Income tax expense	7	(105,408)	(107,540)
Profit for the year		<u>245,951</u>	<u>250,925</u>
Profit attributable to equity holders		<u>245,951</u>	<u>250,925</u>

The profit shown above is derived from continuing operations. The Company operates in a single business segment and all of the Company's activities are in the UK.

The notes on pages 15 to 27 form part of these financial statements.

BOS (SHARED APPRECIATION MORTGAGES) NO 3 PLC
STATEMENT OF RECOGNISED INCOME AND EXPENSE
FOR THE YEAR ENDED 31 DECEMBER 2006

	2006 £	2005 £
Profit for the year	245,951	250,925
Total recognised income and expense for the year attributable to equity holders	<u>245,951</u>	<u>250,925</u>
 Change in accounting policy on adoption of IAS 39	 -	 229,150
Tax on items taken directly to equity	-	(68,745)
 Net income recognised directly in equity	 <u>-</u>	 <u>160,405</u>

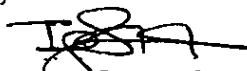
The notes on pages 15 to 27 form part of these financial statements

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
BALANCE SHEET AS AT 31 DECEMBER 2006

	Notes	2006 £	2005 £
Assets			
Mortgage portfolio	8	18,461,646	19,711,988
Shared appreciation rights receivable	9	32,015,524	31,132,674
Total non-current assets		50,477,170	50,844,662
Other receivables	10	1,130	1,130
Cash and cash equivalents	11	2,515,013	2,857,026
Total current assets		2,516,143	2,858,156
Total assets		52,993,313	53,702,818
Equity			
Called up share capital		50,001	50,001
Retained earnings		2,338,920	2,242,473
Total equity	12	2,388,921	2,292,474
Liabilities			
Interest-bearing loans and borrowings	13	18,095,325	19,558,471
Shared appreciation rights payable	14	32,015,524	31,132,674
Deferred tax liability	7	61,871	68,745
Total non-current liabilities		50,172,720	50,759,890
Other payables	15	314,895	537,553
Current tax liability	7	112,282	107,540
Bank overdraft	11	4,495	5,361
Total current liabilities		431,672	650,454
Total liabilities		50,604,392	51,410,344
Total equity and liabilities		52,993,313	53,702,818

These financial statements were approved by the Board of Directors on 30 March 2007

and were signed on its behalf by


 Ian Gordon Stewart

Director

The notes on pages 15 to 27 form part of these financial statements

BOS (SHARED APPRECIATION MORTGAGES) NO 3 PLC
CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2006

Indirect Method		2006	2005
	Notes	£	£
Cash flows from operating activities			
Profit before tax for the year		351,359	358,465
<i>Adjustments for</i>			
Interest income	2	(1,786,547)	(1,876,336)
Interest expense	3	1,340,174	1,416,926
Amortisation of issue costs	3	52,337	52,337
Shared appreciation income	5	(2,003,724)	(1,835,800)
Shared appreciation expense	5	2,003,724	1,835,800
Operating loss before changes in working capital and provisions		(42,677)	(48,608)
Increase in other receivables		-	(410)
Increase in other payables		123,617	16,734
Cash generated from operations		80,940	(32,284)
Income taxes paid		(107,540)	(103,303)
Net cash from operating activities		(26,600)	(135,587)
Cash flows from investing activities			
Mortgage interest received		1,243,281	1,349,389
Bank interest received		163,516	147,197
Repayment of mortgages	8	1,630,092	1,482,229
Shared appreciation received		2,003,724	1,835,800
Net cash from investing activities		5,040,613	4,814,615
Cash flows from financing activities			
Interest paid on borrowings		(960,253)	(1,034,212)
Repayment of borrowings	13	(1,895,404)	(1,244,869)
Dividends paid	12	(149,504)	(228,423)
Shared appreciation paid		(2,349,999)	(1,537,324)
Net cash flows from financing activities		(5,355,160)	(4,044,828)
Net (decrease) / increase in cash and cash equivalents		(341,147)	634,200
Cash and cash equivalents at 1 January		2,851,665	2,217,465
Cash and cash equivalents at 31 December	11	2,510,518	2,851,665

As explained in the accounting policies on page 16, cash is distributed in accordance with the Programme Documentation

The notes on pages 15 to 27 form part of these financial statements

BOS (SHARED APPRECIATION MORTGAGES) NO 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006

1 SIGNIFICANT ACCOUNTING POLICIES

BOS (Shared Appreciation Mortgages) NO 3 PLC is a Company domiciled in the United Kingdom

(a) Statement of compliance

The financial statements for the year ended 31 December 2006 have been prepared in accordance with International Financial Reporting Standards (IFRSs) and its interpretations as endorsed by the EU and effective at 31 December 2006. The accounting policies set out below have been applied in respect of the financial year ended 31 December 2006.

The accounts also comply with the relevant provisions of Part VII of the Companies Act 1985, as amended by the Companies Act 1985 (International Accounting Standards and Other Accounting Amendments) Regulations 2004.

(b) Basis of preparation

The financial statements are presented in sterling.

The financial statements have been prepared on the historical cost basis (except that derivative financial instruments are stated at their fair value), and on a going concern basis.

The preparation of the financial statements necessarily requires the exercise of judgement both in the application of accounting policies which are set out in the sections below and in the selection of assumptions used in the calculation of estimates. These estimates and judgements are reviewed on an ongoing basis and are continually evaluated based on historical experience and other factors. However, actual results may differ from these estimates. The most significantly affected components of the financial statements and associated critical judgements are as follows:

For the purpose of the effective yield calculation on the Notes, an average expected life has been calculated based on prepayment expectations for the mortgages. This is revised on a regular basis in light of actual redemption experience.

The value of the embedded derivative has been calculated by discounting future cash flows at an appropriate market rate. The valuation method is consistent with commonly used market techniques. All inputs into the valuation models are obtained from observable market data. No assumption for future HPI has been included as this is not considered to be practical.

(c) Financial instruments

The Company's financial instruments comprise a mortgage portfolio, cash and cash equivalents, derivatives and interest-bearing borrowings that arise directly from its operations. The main purpose of these financial instruments is to raise finance for the Company's operations. These financial instruments are classified in accordance with the principles of IAS 39 as described below.

(c)(i) Mortgage portfolio

The Company's mortgage portfolio comprises mortgage loans with no fixed maturity date. The individual mortgage loans terminate on the earlier of the sale of the property or the death of the mortgage account holder.

BOS (SHARED APPRECIATION MORTGAGES) NO 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED)

1 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(c)(i) Mortgage portfolio (continued)

Under IAS 39, the mortgage portfolio is classified within "loans and receivables". The initial measurement is at fair value (excluding amounts for the shared appreciation referred to in (c)(iv) below). Subsequent measurement is at amortised cost with revenue being recognised using the effective interest method. The discount arising on initial recognition is being amortised over the expected life of the mortgages.

At each reporting period end, the Company assesses whether there is any objective evidence that mortgage loans within the portfolio are impaired. The directors do not consider that a provision for impaired assets is currently required.

(c)(ii) Cash and cash equivalents

The Company holds bank accounts with an external provider. These accounts are held in the Company's name and meet the definition of cash and cash equivalents but their use is restricted by a detailed priority of payments set out in the Programme Documentation. The cash can only be used to meet certain specific liabilities and is not available to be used with discretion.

The bank accounts are classified within "loans and receivables" in accordance with IAS 39 and income is being recorded using the effective interest method.

The Cash Flow Statement has been presented using the indirect method of preparation.

(c)(iii) Interest-bearing borrowings

The Company's interest-bearing borrowings comprise mortgage-backed fixed rate Notes that have been issued in the capital market.

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

(c)(iv) Embedded derivatives

Certain derivatives are embedded within other non-derivative host financial instruments to create a hybrid instrument. Where the economic characteristics and risks of the embedded derivatives are not closely related to the economic characteristics and risks of the host instrument, and where the hybrid instrument is not measured at fair value, the embedded derivative is separated from the host instrument with changes in fair value of the embedded derivative recognised in the income statement. Depending on the classification of the host instrument, the host is then measured in accordance with IAS 39.

The capital appreciation arising on the sale of a mortgage holder's property is shared between the mortgage holder and the Company as set out in the original loan agreement. The Company pays its entire share of the appreciation to the Note holders.

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED)

1 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(c)(iv) Embedded derivatives (continued)

The economic characteristics and risks of the shared appreciation rights receivable and payable are not viewed as being closely related to those arising on the mortgages and Notes, respectively. The shared appreciation rights receivable and payable have therefore been valued separately from the mortgages and Notes using discounted cash flow techniques and taking account of current House Price Inflation ("HPI"). There is uncertainty regarding the timing of any future shared appreciation receipts and the directors do not consider that it is practical to include an estimate of future HPI in these valuations. The resulting fair value movements of these embedded derivatives are recorded in net fair value gains and losses on derivatives in the income statement and the embedded derivatives are shown separately on the face of the balance sheet. The host instruments are valued at amortised cost, as noted above in (c)(i) and (c)(iii).

(d) Fees and commissions

Fees and commissions receivable for the continuing service of loans and advances are recognised on the basis of work done. Other fees are recognised when receivable.

(e) Income tax

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided: the initial recognition of assets and liabilities that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates at the balance sheet date.

Deferred tax has been charged or credited to equity for the adjustments to retained earnings that have been recognised on the adoption of IAS 39 at 1 January 2005.

(f) VAT

Value Added Tax is not recoverable by the Company and is included with its related costs.

(g) Dividends

Dividends on the equity shares of the Company are recognised as a liability in the period in which they are paid.

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED)

1 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(h) Related parties

In accordance with the provisions of IAS 24 "Related Party Disclosures", the Company has disclosed details of transactions with its related parties, including those with fellow HBOS plc Group companies

(i) IFRSs not yet applied

The following standards and interpretations have been adopted by the EU but are not effective for the year ended 31 December 2006 and have not been applied in preparing the financial statements

- IFRS 7 'Financial instruments: Disclosure' and the Capital disclosure amendment' to IAS 1 'Presentation of financial statements' which are applicable for periods commencing on or after 1 January 2007. The application of these standards in 2006 would not have affected the balance sheet, income statement or cash flow statement as they are only concerned with disclosure
- IFRIC 9 'Reassessment of Embedded Derivatives' which is effective for periods commencing on or after 1 June 2006. The application of this Interpretation in 2006 would not have affected the balance sheet, income statement or cash flow statement because the Company's approach to reassessing embedded derivatives already reflects the requirements of the Interpretation

The following standards and interpretations have not yet been adopted by the EU, are not effective for the year ended 31 December 2006 and have not been applied in preparing the financial statements

- IFRS 8 'Operating Segments' which is applicable for periods commencing on or after 1 January 2009. The application of this standard in 2006 would not have affected the balance sheet, income statement or cash flow statements as it is only concerned with disclosure
- IFRIC 10 'Interim Financial Reporting and Impairment' which is effective for periods commencing on or after 1 November 2006. The application of this Interpretation in 2006 would not have affected the balance sheet, income statement or cash flow statement as no reversals to impairment losses within the scope of this Interpretation have been made

2 INTEREST RECEIVABLE AND SIMILAR INCOME

	2006 £	2005 £
Mortgage interest from customers	1,623,031	1,729,139
Bank interest from group undertakings	25,392	19,638
Bank interest	138,124	127,559
	1,786,547	1,876,336

Interest on impaired assets is £nil for the year ended 31 December 2006 (2005 £nil)

BOS (SHARED APPRECIATION MORTGAGES) NO 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED)

3 INTEREST PAYABLE AND SIMILAR CHARGES

	2006 £	2005 £
Interest payable on Notes	1,340,174	1,416,926
Amortisation of issue costs	52,337	52,337
	<u>1,392,511</u>	<u>1,469,263</u>

Interest payable comprises amounts arising on the Notes and is calculated on an effective yield basis

4 NET FAIR VALUE GAINS AND LOSSES ON DERIVATIVES

	2006 £	2005 £
Fair value movement on shared appreciation rights receivable	882,850	(774,578)
Fair value movement on shared appreciation rights payable	(882,850)	774,578
	<u>-</u>	<u>-</u>

5 OTHER OPERATING INCOME

	2006 £	2005 £
Fees and commissions receivable	6,335	4,975
Shared appreciation receivable	2,003,724	1,835,800
Shared appreciation payable	(2,003,724)	(1,835,800)
Other income	32	220
	<u>6,367</u>	<u>5,195</u>

6 OPERATING EXPENSES

	2006 £	2005 £
Bank administration fees	36,919	40,113
Trustees fee	4,511	4,615
Legal fees	2,350	2,350
Audit fees	4,113	4,116
Other fees	1,151	2,609
	<u>49,044</u>	<u>53,803</u>

In the year ended 31 December 2006 and the comparative period the Company has no employees and none of the directors receive any emoluments from the Company

Audit fees relate to the statutory audit. Fees payable to the auditor and its associates for services other than the statutory audit are not disclosed since the consolidated accounts of HBOS plc, the ultimate controlling party, are required to disclose non-audit fees on a consolidated basis

BOS (SHARED APPRECIATION MORTGAGES) NO 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED)

7 INCOME TAX EXPENSE

	2006 £	2005 £
Current Tax		
Corporation tax charge for the year at a rate of 30% (2005 30%)	112,282	107,540
	<u>112,282</u>	<u>107,540</u>
Deferred Tax		
Deferred tax credit for the year at a rate of 30% (2005 30%)	(6,874)	-
	<u>105,408</u>	<u>107,540</u>
Reconciliation of effective tax rate	2006 £	2005 £
The tax for the year is equal to the standard rate of corporation tax in the UK of 30%		
Profit before tax	351,359	358,465
	<u>105,408</u>	<u>107,540</u>
Profit multiplied by the standard rate of corporation tax in the UK		
Deferred tax balance	2006 £	2005 £
At 1 January	68,745	-
Change in accounting policy on adoption of IAS 39	-	68,745
	<u>-</u>	<u>68,745</u>
Opening balance restated	-	68,745
Credit for year	(6,874)	-
	<u>61,871</u>	<u>68,745</u>
At 31 December		
Deferred tax recognised directly in equity	2006 £	2005 £
Relating to effective yield adjustments on adoption of IAS 39	-	68,745
	<u>-</u>	<u>68,745</u>

BOS (SHARED APPRECIATION MORTGAGES) NO 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED)

8. MORTGAGE PORTFOLIO

	2006 £	2005 £
At 1 January	19,711,988	23,472,717
Adjustment on adoption of IAS 39	-	(2,658,250)
Capitalised fees and interest	108,209	(4,503)
Mortgage redemptions in the year	(1,738,301)	(1,477,726)
Amortisation of discount	379,750	379,750
At 31 December	18,461,646	19,711,988

The mortgage loans advanced by the Company have no fixed maturity date but would terminate on the earlier of, the sale of the property, or the death of the mortgage account holder

9 SHARED APPRECIATION RIGHTS RECEIVABLE

The right for the Company to receive a share of the capital appreciation arising on the individual mortgages, as set out in the original loan agreements, is classified as an embedded derivative, in accordance with the principles of IAS 39. The embedded derivative has been valued separately from the host contract using discounted cash flow techniques. No estimate has been made of the effect of future HPI as the directors consider that this is impractical.

The Company is contractually obliged to pay to the Note holders any amounts received from mortgage customers for the shared appreciation. A corresponding derivative liability has therefore been recognised in the balance sheet for the same value as the derivative asset (note 14).

10 OTHER RECEIVABLES

	2006 £	2005 £
Other debtors	1,130	1,130

11 CASH AND CASH EQUIVALENTS

	2006 £	2005 £
Bank balances	2,515,013	2,857,026
Bank overdraft	(4,495)	(5,361)
Cash and cash equivalents in the cash flow statement	2,510,518	2,851,665

The Company holds bank accounts with an external provider. These accounts are held in the Company's name and meet the definition of cash and cash equivalents but their use is restricted by a detailed priority of payments set out in the Programme Documentation. The cash can only be used to meet certain specific liabilities and is not available to be used with discretion.

BOS (SHARED APPRECIATION MORTGAGES) NO 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED)

12 TOTAL EQUITY

Reconciliation of movement in capital and reserves

	Share Capital £	Retained Earnings £	Total Equity £
Balance at 1 January 2006	50,001	2,242,473	2,292,474
Total recognised income and expense	-	245,951	245,951
Dividends to shareholders	-	(149,504)	(149,504)
Balance at 31 December 2006	50,001	2,338,920	2,388,921

	Share Capital £	Retained Earnings £	Total Equity £
Balance at 1 January 2005	50,001	2,059,566	2,109,567
Total recognised income and expense (includes accounting policy changes)	-	411,330	411,330
Dividends to shareholders	-	(228,423)	(228,423)
Balance at 31 December 2005	50,001	2,242,473	2,292,474

Share capital

	2006 £	2005 £
Authorised		
50,000 ordinary shares of £1 each	50,000	50,000
1 deferred share of £1	1	1
Allotted, called up and fully paid		
50,000 ordinary shares of £1 each	50,000	50,000

BOS (SHARED APPRECIATION MORTGAGES) NO 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED)

12 TOTAL EQUITY (CONTINUED)

The deferred share carries no entitlement to any dividend or to any share in any surplus assets of the Company on a winding-up, other than the right to be repaid the amount of any paid up share capital thereon. The right to be repaid any paid up share capital in the deferred share shall be deferred until after all paid up share capital has been first repaid on all other classes of issued share capital in the Company.

The deferred share carries the right to receive notice of all general meetings of the Company but does not carry the right to attend, speak or vote at a general meeting unless a resolution is to be proposed abrogating, varying or modifying any of the rights or privileges of the holder of the deferred share, or for the winding up or administration of the Company under the Insolvency Act 1986, or for the entry by the Company with any other party into a merger, reconstruction, scheme of arrangement or amalgamation of or affecting the Company, in any of which cases such holder shall have the right to attend such general meeting and shall be entitled to speak and vote. Whenever the holder of the deferred share is entitled to vote at a general meeting, such holder shall have one vote and on a poll such number of votes as is equal to 34% of the number of votes attached to all other issued shares of the Company.

13 INTEREST-BEARING LOANS AND BORROWINGS

This note provides information about the contractual terms of the Company's interest-bearing loans and borrowings. For more information about the Company's exposure to interest rate risk and the fair value of its financial instruments, see note 16.

	2006 £	2005 £
At 1 January	19,787,656	23,355,427
Adjustment on adoption of IAS 39	-	(2,710,054)
Loan note redemptions	(1,895,404)	(1,244,869)
Amortisation of discount	387,151	387,151
	18,279,403	19,787,655
Deferred issue costs	(261,685)	(314,022)
Accrued interest	77,607	84,838
At 31 December	18,095,325	19,558,471

The mortgage backed fixed rate Notes are due in 2073. The interest rate applicable on the Notes up to and including the period ending 28 February 2028 is 4.50% per annum. Thereafter, the interest rate applicable to the Notes will be 5.50% per annum. The Notes carry, in addition to interest, rights to receive certain amounts calculated by reference to the value of shared appreciation proceeds received from redeemed mortgages.

The Notes are subject to mandatory part redemption from time to time based on the level of redeemed mortgages and can be redeemed in full, in certain circumstances, at the option of the Company. The Notes are secured on the mortgage portfolio and certain other assets of the Company.

BOS (SHARED APPRECIATION MORTGAGES) NO 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED)

14 SHARED APPRECIATION RIGHTS PAYABLE

The Company is contractually obliged to pay to the Note holders any amounts received from mortgage customers for the shared appreciation arising on the sale of the property. A derivative liability has therefore been recognised in the balance sheet for the same value as the derivative asset (note 9)

15 OTHER PAYABLES

	2006 £	2005 £
Accruals and deferred income	314,895	537,553

16. FINANCIAL INSTRUMENTS

The Company's financial instruments comprise a mortgage portfolio, cash and cash equivalents, derivatives and interest-bearing borrowings that arise directly from its operations. Exposure to credit and interest rate risk arises in the normal course of the Company's business.

16(a) Credit risk

Credit risk arises on the individual loans within the mortgage portfolio which are secured on the underlying residential properties. Mortgage loans are no longer offered by the Company. The maximum loan-to-value of the original advances was 75% and the credit risk is considered to be low. The mortgage balances are monitored as part of the HBOS plc Group impairment process but no impairment provision is considered to be necessary at 31 December 2006. The maximum exposure to credit risk is represented by the carrying amount of the mortgages.

The Company has no exposure to credit risk on the shared appreciation. In accordance with the legal documents, only amounts actually received by the Company from the borrower are required to be paid over to the Note holders.

16(b) Interest rate risk

Interest rate risk exists where assets and liabilities have interest rates set under a different basis or which reset at a different time. The Company minimises its exposure to interest rate risk by ensuring that the interest rate characteristics of assets and liabilities are similar. Mortgages have been issued at 5.99% per annum and interest is payable to Note holders at a rate of 4.50% per annum until February 2028 and thereafter at a rate of 5.50% per annum.

BOS (SHARED APPRECIATION MORTGAGES) NO 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED)

16 FINANCIAL INSTRUMENTS (CONTINUED)

16(b) Interest rate risk (continued)

Effective interest rates and repricing analysis

In respect of income-earning financial assets and interest-bearing financial liabilities, the following table indicates their effective interest rates at the balance sheet date and the periods in which they reprice, if this is earlier than the maturity date

2006	Effective interest Rate %	Total £	6 months or less £	6 – 12 months £	1 – 2 years £	2 – 5 years £	More than 5 years £
Mortgage portfolio*	8.55	18,461,646	-	-	-	-	18,461,646
Cash and cash equivalents	6.16	2,515,013	2,515,013	-	-	-	-
Notes*	7.09	(18,095,325)	-	-	-	-	(18,095,325)
Bank overdraft	0.00	(4,495)	(4,495)	-	-	-	-
2005	Effective interest Rate %	Total £	6 months or less £	6 – 12 months £	1 – 2 years £	2 – 5 years £	More than 5 years £
Mortgage portfolio*	8.48	19,711,988	-	-	-	-	19,711,988
Cash and cash equivalents	6.10	2,857,026	2,857,026	-	-	-	-
Notes*	7.00	(19,558,471)	-	-	-	-	(19,558,471)
Bank overdraft	0.00	(5,361)	(5,361)	-	-	-	-

* These assets/liabilities bear interest at a fixed rate

BOS (SHARED APPRECIATION MORTGAGES) NO 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006(CONTINUED)

16 FINANCIAL INSTRUMENTS (CONTINUED)

16(c) Fair values

The fair values of the Company's financial instruments, together with the carrying amounts shown in the balance sheet are as follows

	Note	Fair Value 2006 £	Carrying Amount 2006 £	Fair Value 2005 £	Carrying Amount 2005 £
Mortgage portfolio	8	20,284,820	18,461,646	22,661,475	19,711,988
Shared appreciation rights receivable	9	32,015,524	32,015,524	31,132,674	31,132,674
Cash and cash equivalents	11	2,515,013	2,515,013	2,857,026	2,857,026
Interest-bearing loans and borrowings	13	(19,809,654)	(18,095,325)	(22,113,627)	(19,558,471)
Shared appreciation rights payable	14	(32,015,524)	(32,015,524)	(31,132,674)	(31,132,674)
Bank overdraft	11	(4,495)	(4,495)	(5,361)	(5,361)
		<u>2,985,684</u>	<u>2,876,839</u>	<u>3,399,513</u>	<u>3,005,182</u>
Unrecognised gain			1,823,174		2,949,487
Unrecognised loss			(1,714,329)		(2,555,156)
			<u>108,845</u>		<u>394,331</u>

Estimation of fair values

The following comments summarise the main methods and assumptions used in estimating the fair value of financial instruments that are reflected in the table above

Cash and cash equivalents and bank overdrafts are recognised on an amortised cost basis that is considered to be a close approximation to fair value

The fair value of the mortgage portfolio, shared appreciation rights receivable, interest-bearing loans and shared appreciation rights payable has been calculated by discounting future cash flows at an appropriate market rate. The valuation method is consistent with commonly used market techniques. All inputs into the valuation models are obtained from observable market data.

The current value of house price inflation has been included in the embedded derivative for shared appreciation rights receivable and payable, following the adoption of IAS 39.

BOS (SHARED APPRECIATION MORTGAGES) NO 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006 (CONTINUED)

17 RELATED PARTIES

The Company is a subsidiary undertaking of HBOS plc Group

The Company receives interest from Bank of Scotland, a fellow subsidiary and Bank of Scotland administers the mortgage portfolio on behalf of the Company, for which quarterly service fees are paid. Dividends were paid to Uberior Investments PLC, the immediate parent undertaking of the Company. The Company's transactions with related parties are summarised below

	HBOS plc and subsidiaries 2006 £	HBOS plc and subsidiaries 2005 £
Income Statement		
Interest receivable and similar income	25,392	19,638
Operating expenses	(36,919)	(40,113)
Balance Sheet		
Equity		
Dividends paid	149,504	228,423
Assets		
Cash and cash equivalents	680,814	549,128
Liabilities		
Other payables	3,061	3,328
Bank overdraft	4,495	5,361

18 PARENT UNDERTAKINGS

HBOS plc is the ultimate parent undertaking of BOS (Shared Appreciation Mortgages) NO 3 PLC and heads the largest group into which the accounts of the Company are consolidated. The consolidated accounts of HBOS plc may be obtained from its head office at The Mound, Edinburgh, EH1 1YZ

The Governor and Company of the Bank of Scotland heads the smallest group into which the accounts of the Company are consolidated. The accounts of The Governor and Company of the Bank of Scotland may be obtained from its head office at The Mound, Edinburgh, EH1 1YZ

The Company is a wholly owned subsidiary of Uberior Investments PLC, which is a wholly owned subsidiary of Bank of Scotland