

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
DIRECTORS' REPORT AND FINANCIAL STATEMENTS
YEAR ENDED 31 DECEMBER 2009

DIRECTORS AND COMPANY INFORMATION

DIRECTORS

I G Stewart
T A Hill

SECRETARY

A Lockwood

REGISTERED OFFICE

Premier House
City Road
CHESTER
CH88 3AN

AUDITORS

PricewaterhouseCoopers LLP
Benson House
33 Wellington Street
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THURSDAY



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COMPANIES HOUSE

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 2009

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

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 February 2028. Thereafter, the interest rate applicable to the Notes is set at 5.50% per annum until 2073. 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

The Company is a subsidiary undertaking of Bank of Scotland plc ("BOS") and HBOS plc. HBOS plc was acquired by Lloyds Banking Group plc ("LBG"), previously known as Lloyds TSB Group plc, on 16 January 2009.

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, amounted to £219,498 (2008: £254,205 profit). No dividend was paid during the year (2008: £140,000).

BUSINESS REVIEW AND FUTURE DEVELOPMENTS

The Company's business will continue to unwind over the life of the mortgages issued as no further advances will be made. Cash is continuing to be collected.

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" below). In 2008 and 2009 the UK experienced a significant reduction in activity in the housing market, together with a growth in mortgage arrears, as the effects of recession became more widespread. This trend has not significantly affected the Company's arrears levels (see note 17) and no impairment provision was deemed necessary as at 31 December 2009 or 31 December 2008.

UK interest rates have remained both relatively stable and at historically low levels in 2009. However, the Company's net interest margin has not been adversely affected due to the fixing of rates in the original Programme Documentation. The underlying profits are determined by a margin earned between the interest received on the mortgages and the interest paid to the Note holders.

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

BUSINESS REVIEW AND FUTURE DEVELOPMENTS (CONTINUED)

Under International Financial Reporting Standards ("IFRSs") an effective yield adjustment is made on interest receivable and interest payable. The expected life of the mortgages and Notes was extended in 2008 to reflect actual payment experience. The net difference passed through the income statement for the year ended 31 December 2009 was £2,114 loss (31 December 2008 £2,115 loss).

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

POLICY AND PRACTICE ON PAYMENT OF CREDITORS

The majority of the Company's payments are in relation to the Notes and are due quarterly in accordance with the terms of the Notes. Payments are subject to the receipt of principal, interest and appreciation rights received on the underlying mortgage pool. All such payments were made on the due dates.

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 2009.

DIRECTORS

The directors who served during the year were as follows:

I G Stewart	
P A Curran	(Resigned 22 December 2009)
T A Hill	(Appointed 22 December 2009)

RISK MANAGEMENT

The majority of the Company's assets and liabilities have been classified as financial instruments in accordance with IAS 32 "Financial Instruments: Presentation".

The Company's financial instruments comprise a mortgage portfolio, cash and liquid resources, an embedded derivative, interest-bearing loans and borrowings and various other receivables and payables that arise directly from its operations. 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 principal risks arising from the Company's financial instruments are credit risk and interest rate risk. These and other risks which may affect the Company's performance are detailed below. Further analysis of the risks facing the Company on its financial instruments is provided in note 17.

Credit Risk

Credit risk arises on the individual loans within the mortgage loan portfolio which are in turn secured on the underlying UK residential properties. The performance of these loans is therefore influenced by the economic background and the UK housing market. However, the maximum loan-to-value of the original advances was 75% and the credit risk is considered to be low.

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

RISK MANAGEMENT (CONTINUED)

Credit Risk (continued)

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 earned on the mortgage portfolio and monies deposited in the Reserve Account with BOS (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 BOS.

The terms of the Mortgage Portfolio Agreement given by BOS in respect of the mortgages require BOS to repurchase any mortgage which is found to be in breach of warranty. BOS 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 BOS, the Note holder will not receive the benefit of any future payments of appreciation amounts or partial repayment of appreciation amounts in respect of the mortgages repurchased.

Shared appreciation is subject to the movement in the market value of the property which is dependent upon house price inflation ("HPI"). This may provide a return on the Notes below initial expectations. Any expected increase in value cannot 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. Both the mortgage portfolio and the Notes issued by the Company are exposed to fair value interest rate risk as they carry fixed interest rates.

Liquidity Risk

The Company holds a Reserve Account of £1,396,800 deposited with BOS 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 LBG and is currently implementing processes to comply with the requirements of Sarbanes Oxley as part of the alignment with LBG.

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

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 financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. In preparing these financial statements, the directors have also elected to comply with IFRSs, issued by the International Accounting Standards Board (IASB). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and accounting estimates that are reasonable and prudent,
- state whether applicable International Financial Reporting Standards (IFRSs) as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements,

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

AUDITORS AND AUDIT INFORMATION

Following the resignation of KPMG Audit Plc on 13 May 2009, PricewaterhouseCoopers LLP were appointed as auditors of the Company with effect from the same date by resolution of the members dated 26 May 2009.

Pursuant to section 487 of the Companies Act 2006, auditors duly appointed by the members of the company shall, subject to any resolution to the contrary, be deemed to be reappointed for the next financial year and PricewaterhouseCoopers LLP will therefore continue in office.

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.

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

EMPLOYEES

The Company has employed no staff during the year ended 31 December 2009 or the previous year.

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

STATEMENT OF GOING CONCERN

As set out in the statement of compliance of the significant accounting policies section of the notes to the financial statements, 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

By Order of the Board



A Lockwood
Secretary

Premier House
City Road
CHESTER
CH88 3AN

DATE 25 March 2010

**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 2009 which comprise the Statement of comprehensive income, the Balance sheet, the Statement of changes in equity, the Cash flow statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 4, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit 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, including the opinions, has been prepared for and only for the Company's member as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion the financial statements

- give a true and fair view of the state of the Company's affairs as at 31 December 2009 and of its profit and cash flows for the year then ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006

Opinion on other matter prescribed by the Companies Act 2006

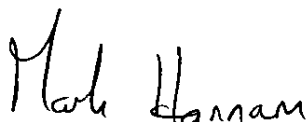
In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

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

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

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



Mark Hannam (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors

Benson House
33 Wellington Street
Leeds
LS1 4JP

Date

8 April 2010

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2009

	Notes	2009 £	2008 £
Interest receivable and similar income	2	1,324,631	1,401,223
Interest payable and similar charges	3	(963,977)	(987,557)
Net interest income		<u>360,654</u>	<u>413,666</u>
Other operating income	5	2,375	2,561
Operating expenses	6	(58,171)	(60,547)
Profit before tax for the year		<u>304,858</u>	<u>355,680</u>
Taxation	7	(85,360)	(101,475)
Profit / Total comprehensive income attributable to equity holders		<u><u>219,498</u></u>	<u><u>254,205</u></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.

There was no income or expense recognised directly in equity in the current or preceding year.

The notes on pages 12 to 29 form an integral part of these financial statements.

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
BALANCE SHEET AS AT 31 DECEMBER 2009

	Notes	2009 £	2008 £
Assets			
Mortgage portfolio	8	16,736,904	17,720,413
Shared appreciation rights receivable	9	25,345,015	29,756,188
Total non-current assets		42,081,919	47,476,601
Other receivables	10	1,130	1,541
Cash and cash equivalents	11	2,980,646	2,570,732
Total current assets		2,981,776	2,572,273
Total assets		45,063,695	50,048,874
Equity			
Called up share capital	12	50,001	50,001
Retained earnings		2,767,910	2,548,412
Total equity		2,817,911	2,598,413
Liabilities			
Interest-bearing loans and borrowings	13	16,300,015	17,276,482
Shared appreciation rights payable	14	25,345,015	29,756,188
Deferred tax liability	15	38,497	44,913
Total non-current liabilities		41,683,527	47,077,583
Interest-bearing loans and borrowings	13	54,003	57,397
Other payables	16	413,266	201,140
Bank overdraft	11	3,212	6,449
Current tax liability	7	91,776	107,892
Total current liabilities		562,257	372,878
Total liabilities		42,245,784	47,450,461
Total equity and liabilities		45,063,695	50,048,874

These financial statements were approved by the Board of Directors on 25 March 2010

and were signed on its behalf by


Ian Gordon Stewart

Director

The notes on pages 12 to 29 form an integral part of these financial statements

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2009

	Share Capital £	Retained Profits £	Total £
Balance at 1 Jan 2009	50,001	2,548,412	2,598,413
Profit for the year	-	219,498	219,498
Balance at 31 Dec 2009	50,001	2,767,910	2,817,911
	Share Capital £	Retained Profits £	Total £
Balance at 1 Jan 2008	50,001	2,434,207	2,484,208
Profit for the year	-	254,205	254,205
Dividends paid in the year	-	(140,000)	(140,000)
Balance at 31 Dec 2008	50,001	2,548,412	2,598,413

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2009

Direct Method		2009	2008
	Notes	£	£
Operating Activities			Restated
Inter-company fees paid		(32,137)	(33,753)
Audit fees paid		(4,370)	(3,902)
Administration expenses		(19,342)	(20,132)
Tax paid		(107,892)	(220,565)
Net cash from operating activities		(163,741)	(278,352)
Investing Activities			
Repayments on mortgage portfolio		1,090,792	474,777
Income earned on mortgage portfolio		1,091,762	1,138,942
Shared appreciation rights received		954,522	675,935
Net cash flows from investing activities		3,137,076	2,289,654
Financing Activities			
Bank interest received		124,369	153,780
Repayment on borrowings		(953,782)	(505,502)
Interest paid on borrowings		(841,804)	(863,921)
Shared appreciation rights paid		(888,967)	(658,591)
Dividends paid		-	(140,000)
Net cash from financing activities		(2,560,184)	(2,014,234)
Net increase / (decrease) in cash and cash equivalents		413,151	(2,932)
Cash and cash equivalents at 1 January		2,564,283	2,567,215
Cash and cash equivalents at 31 December	11	2,977,434	2,564,283

The comparative 2008 cash flow statement has been restated using the direct method to be consistent with the presentation adopted by other companies within the LBG Group

As explained in the accounting policies in note 1, cash is distributed in accordance with the Programme Documentation

The notes on pages 12 to 29 form part of these financial statements

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009

1. SIGNIFICANT ACCOUNTING POLICIES

(a) Statement of compliance

The financial statements for the year ended 31 December 2009 have been prepared in accordance with International Financial Reporting Standards (IFRSs) and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) as adopted by the European Union. The standards applied by the Company are those endorsed by the European Union and effective at the date the financial statements are approved by the Board. However the Company has not utilised the "carve-out" provisions in respect of full fair value and portfolio hedging of core deposits in IAS39 'Financial Instruments: Recognition and Measurement' as adopted by the European Union. Consequently, the financial statements comply with International Financial Reporting Standards.

The following new IFRS pronouncements, relevant to the Company, became effective in 2009 and have been adopted in these financial statements although they have no material impact on any part of the statements:

- IAS 1 (revised), 'Presentation of financial statements',
- Amendments to IFRS 7 'Financial Instruments: Disclosures – Improving Disclosures about Financial Instruments',
- IFRS 8 'Operating Segments'

The accounting policies set out below have been applied consistently in respect of the financial years ended 31 December 2009 and 31 December 2008.

The financial statements also comply with the relevant provisions of Part XV of the Companies Act 2006.

The financial statements are presented in sterling which is the Company's functional and presentation currency and have been prepared on the historical cost basis (except that derivative financial instruments are stated at their fair value).

The Company is reliant on funding provided by BOS plc. Notwithstanding the improvement in market liquidity during 2009, the Company's ultimate parent company, Lloyds Banking Group plc, continues to be reliant on UK Government sponsored measures to maintain its wholesale funding position. The directors are satisfied that it is the intention of Lloyds Banking Group plc that its subsidiaries including the Company will continue to receive funding in the future and, accordingly, the financial statements have been prepared on a going concern basis.

(b) Revenue Recognition

Interest receivable and similar income have been calculated using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the expected life of the financial instrument. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability.

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009 (CONTINUED)

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(c) Segment Reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

The directors of the Company consider that the entity has only one geographical and one business segment and therefore is not required to produce additional segmental disclosure.

(d) Financial instruments

The Company's financial instruments comprise a mortgage portfolio, cash and liquid resources, an embedded derivative, interest-bearing loans and borrowings and various other receivables and payables 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.

(d)(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 date of sale of the property or the death of the mortgage account holder.

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 (d)(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.

(d)(ii) Cash and cash equivalents

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

These bank accounts are classified within "loans and receivables" in accordance with IAS 39. The initial measurement is at fair value. Subsequent measurement is at amortised cost with revenue being recognised using the effective interest method.

The Cash Flow Statement has been restated using the direct method of preparation.

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009 (CONTINUED)

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(d) Financial instruments (continued)

(d)(iii) Interest-bearing loans and borrowings

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

Interest-bearing loans and borrowings are recognised initially at fair value less directly related incremental transaction costs. Subsequent to initial recognition, interest-bearing loans and 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.

(d)(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.

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 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 (d)(i) and (d)(iii).

(e) Critical Accounting Judgements and Estimates

The preparation of the financial statements necessarily requires the exercise of judgement both in the application of accounting policies and in the selection of assumptions used in the calculation of estimates. These judgements are reviewed on an ongoing basis and are continually evaluated based on historical experience and other factors. The most significantly affected components of the financial statements and associated critical judgements are as follows:

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009 (CONTINUED)

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(e) Critical Accounting Judgements and Estimates (continued)

Effective Interest Rate Method

The effective interest rate is calculated on initial recognition of the financial asset or liability, estimating the future cash flows after considering all the contractual terms of the instrument but not future credit losses. The calculation includes all amounts expected to be paid or received by the Company including expected early redemption fees and related penalties and premiums and discounts that are an integral part of the overall return. Direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument are also taken into account in the calculation. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

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.

Fair Value Calculations

Fair value is defined as the value at which assets, liabilities or positions could be closed out or sold in a transaction with a willing and knowledgeable counterparty.

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.

(f) Taxation

Income tax recognised in the Income Statement comprises both current and deferred tax. Current income tax, which is payable on taxable profits, is recognised as an expense in the period in which the profits arise.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is determined using tax rates that have been enacted or substantially enacted by the balance sheet date which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

The Company's tax charge for 2009 is calculated on an IFRS basis and disclosed in accordance with IAS 12.

(g) 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.

(h) VAT

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

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009 (CONTINUED)

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(i) Dividends

Dividends on the equity shares of the Company are recognised in the year in which they are paid

(j) Related parties

In accordance with the provisions of IAS 24 "Related Party Disclosures", the Company has disclosed details of transactions with its related parties

(k) Other payables

Other payables are stated at cost or at amortised cost if deemed to be a financial liability

2. INTEREST RECEIVABLE AND SIMILAR INCOME

	2009 £	2008 £
Mortgage interest from customers	1,200,262	1,247,443
Bank interest from BOS	108,577	32,798
Bank interest	15,792	120,982
	1,324,631	1,401,223

3 INTEREST PAYABLE AND SIMILAR CHARGES

	2009 £	2008 £
Interest payable on Notes	949,024	972,604
Amortisation of issue costs	14,953	14,953
	963,977	987,557

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009 (CONTINUED)

4. NET FAIR VALUE GAINS AND LOSSES ON DERIVATIVES

	2009 £	2008 £
Fair value movement on shared appreciation rights receivable	(4,411,173)	(7,103,922)
Fair value movement on shared appreciation rights payable	4,411,173	7,103,922
	<u> </u>	<u> </u>
	-	-
	<u> </u>	<u> </u>

5. OTHER OPERATING INCOME

	2009 £	2008 £
Fees and commissions receivable	2,375	2,486
Shared appreciation receivable	954,522	675,935
Shared appreciation payable	(954,522)	(675,935)
Other income	-	75
	<u> </u>	<u> </u>
	2,375	2,561
	<u> </u>	<u> </u>

6. OPERATING EXPENSES

	2009 £	2008 £
Inter-company fees	32,059	33,507
Administration fees	21,742	22,759
Audit fees	4,370	4,281
	<u> </u>	<u> </u>
	58,171	60,547
	<u> </u>	<u> </u>

Audit fees relate to the statutory audit. There are no fees payable to the auditors and their associates for services other than the statutory audit.

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009 (CONTINUED)

7. TAXATION

	2009 £	2008 £
Current Tax		
Corporation tax charge for the year at a rate of 28% (2008 28.5%)	91,776	107,892
	91,776	107,892
Deferred Tax		
Deferred tax credit for the year at a rate of 28% (2008 28.5%)	(6,416)	(6,531)
Deferred tax change in tax rate – charge	-	114
Total income tax expense in income statement	85,360	101,475
Reconciliation of effective tax rate	2009 £	2008 £
Profit before tax	304,858	355,680
Profit before tax multiplied by the standard rate of corporation tax in the UK of 28% (2008 28.5%)	85,360	101,361
Effects of		
Deferred tax change in tax rate – charge	-	114
Total income tax expense in income statement	85,360	101,475

The current tax liability of £91,776 (2008 £107,892 liability) represents the amount of income tax payable in respect of the current year

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009 (CONTINUED)

8. MORTGAGE PORTFOLIO

	2009 £	2008 £
At 1 January	17,720,413	18,081,415
Mortgage redemptions in the year	(1,092,009)	(469,501)
Amortisation of discount	108,500	108,499
At 31 December	16,736,904	17,720,413

The mortgage loans advanced by the Company have no fixed maturity date but would terminate on the earlier of, the date of 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 embedded derivative liability has therefore been recognised in the balance sheet (note 14).

10. OTHER RECEIVABLES

	2009 £	2008 £
Other debtors	1,130	1,541

11. CASH AND CASH EQUIVALENTS

	2009 £	2008 £
Bank balances	2,980,646	2,570,732
Bank overdraft	(3,212)	(6,449)
Cash and cash equivalents	2,977,434	2,564,283

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

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009 (CONTINUED)

12. SHARE CAPITAL

	2009 £	2008 £
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
1 deferred share of £1	1	1

The Company is a directly held subsidiary undertaking of BOS

The £1 deferred share is held by Deutsche Trustee Company Limited (formerly Bankers Trustee Company Limited)

The holder of the ordinary shares is entitled to receive dividends as declared from time to time

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.

Capital disclosures

The Company is not subject to externally imposed capital requirements in either the current year or the prior year other than the minimum share capital required by the Companies Act with which it complies. The Company manages its ordinary share capital in order that there is sufficient capital, in the opinion of the directors, to support the transactions and level of business undertaken by the Company.

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009 (CONTINUED)

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 17.

	2009 £	2008 £
Non-current liabilities		
Notes	16,464,504	17,455,924
Deferred issue costs	(164,489)	(179,442)
	16,300,015	17,276,482
Current liabilities		
Accrued interest payable to Note holders	68,956	72,350
Deferred issue costs	(14,953)	(14,953)
	54,003	57,397

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 until 2073 when the Notes become due.

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.

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. An embedded derivative liability has therefore been recognised in the balance sheet for the same value as the embedded derivative asset (note 9).

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009 (CONTINUED)

15. DEFERRED TAX LIABILITY

	2009 £	2008 £
At 1 January	44,913	51,330
Credit for year	(6,416)	(6,531)
Change in Tax Rate – charge	-	114
At 31 December	38,497	44,913

The deferred tax liability was recognised for the fair value adjustments that arose on transition to IFRS and is being released to the income statement over a period of ten years from adoption

16. OTHER PAYABLES

	2009 £	2008 £
Shared appreciation payable	136,274	70,719
Note redemptions payable	184,752	36,500
Accruals and deferred income	89,503	91,106
Amounts owed to BOS	2,737	2,815
	413,266	201,140

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009 (CONTINUED)

17. FINANCIAL INSTRUMENTS

The majority of the Company's assets and liabilities have been classified as financial instruments in accordance with IAS 32 "Financial Instruments Presentation"

The Company's financial instruments comprise a mortgage portfolio, cash and liquid resources, an embedded derivative, interest-bearing loans and borrowings and various other receivables and payables that arise directly from its operations

The principal risks arising from the Company's financial instruments are credit risk and interest rate risk. Further detailed analysis of the risks facing the Company in relation to its financial instruments is provided below

As noted in the Directors' Business Review, the activities of the Company are conducted primarily by reference to a series of transaction documents (the "Programme Documentation"). The structure was established as a means of raising finance for BOS and no business activities are undertaken by the Company beyond those set out in the Programme Documentation

The Company's exposure to risk on its financial instruments and the management of such risk is largely determined at the inception of the securitisation transaction. The Company's activities and the role of each party to the transaction is clearly defined and documented.

17(a) Credit risk

Credit risk is the risk of financial loss arising from a customer's failure to settle financial obligations as they fall due

Credit risk arises on the individual loans within the mortgage portfolio which are in turn secured on the underlying UK residential properties. The performance of these loans is therefore influenced by the economic background and the UK housing market. Mortgage loans are no longer offered by the Company

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 earned on the mortgage portfolio and monies deposited in the Reserve Account with BOS (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 BOS

The terms of the Mortgage Portfolio Agreement given by BOS in respect of the mortgages require BOS, to repurchase any mortgage which is found to be in breach of warranty. BOS 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 BOS the Note holder will not receive the benefit of any future payments of appreciation amounts or partial repayment of appreciation amounts in respect of the mortgages repurchased

In terms of the shared appreciation, in accordance with the Programme Documentation, amounts received by the Company from the borrower are required to be paid over to the Note holders

In terms of arrears management, the Company has engaged BOS as servicer of the loans in the portfolio to help reduce the risk of loss. The servicer is required to monitor repayments on the mortgage loans in accordance with its usual credit policies

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009 (CONTINUED)

17. FINANCIAL INSTRUMENTS (CONTINUED)

17(a) Credit risk (continued)

The mortgage balances are monitored as part of the HBOS plc Group impairment process. At each reporting period end, the Company assesses whether there is any objective evidence that mortgage loans within the portfolio are impaired. All loans in the mortgage portfolio pay a fixed rate of interest of 5.75% or 5.95%.

The total value of interest arrears at 31 December 2009 was £65,706 (2008: £201,271). All accounts in the mortgage portfolio had a maximum loan-to-value ratio of 75% and those accounts in interest arrears have a current loan-to-value ratio of less than 39% (2008: 30%). Credit risk is considered to be low. There are no properties in possession or bad debts within the Company. No impairment provision was deemed necessary at 31 December 2009 or 31 December 2008.

The maximum exposure to credit risk arising on the Company's financial assets at the reporting date is disclosed in the table below:

	Note	Carrying amount 2009 £	Maximum exposure 2009 £	Carrying amount 2008 £	Maximum exposure 2008 £
Assets held at amortised cost:					
Mortgage portfolio	8	16,736,904	18,038,904	17,720,413	19,130,915
Cash and cash equivalents	11	2,980,646	2,980,646	2,570,732	2,570,732
Assets held at fair value:					
Shared appreciation rights receivable	9	25,345,015	25,345,015	29,756,188	29,756,188
Total Assets		45,062,565	46,364,565	50,047,333	51,457,835

17(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. Both the mortgage portfolio and the Notes issued by the Company are exposed to fair value interest rate risk as they carry fixed interest rates.

At 31 December 2009, if interest rates had been 25 basis points higher or lower with all other variables held constant, the net effect on the Company's income statement would be insignificant. All items remain unaffected by interest rate changes except for interest earned on bank accounts but a 25 basis points change would not give rise to a significant impact on bank interest.

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009 (CONTINUED)

17. FINANCIAL INSTRUMENTS (CONTINUED)

17(c) Liquidity risk

Liquidity risk is the risk that the Company is not able to meet its financial obligations as they fall due or can do so only at an unacceptably high cost

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 earned on the mortgage portfolio and the monies deposited in the Reserve Account with BOS £1,396,800 has been placed on deposit to assist the Company should it not be able to meet its obligations under the Notes. The reliance on this facility is therefore dependent upon the creditworthiness of BOS. The Company has not drawn on this facility since inception.

The liquidity tables reflect the undiscounted cash payments which will fall due if the structure continues until the earliest contractual maturity date as set out in the Programme Documentation. The Note repayment profile mirrors the repayment of the mortgages, and based on current modelling assumptions, it is not anticipated that any mortgages will still be outstanding beyond the step-up date of February 2028.

2009	Carrying amount	Contractual repayment value	Not later than one month	Later than one month not later than three months	Later than three months but not later than one year	Later than one year and not later than five years	Later than five years
	£	£	£	£	£	£	£
Principal							
Notes	16,464,504	17,976,630	-	-	-	-	17,976,630
Shared appreciation payable	25,345,015	24,336,855	-	-	-	-	24,336,855
Other payables	413,266	413,266	46,837	366,429	-	-	-
Interest payable							
Interest payable on Notes	68,956	14,559,962	-	199,330	609,064	3,235,793	10,515,775
	<u>42,291,741</u>	<u>57,286,713</u>	<u>46,837</u>	<u>565,759</u>	<u>609,064</u>	<u>3,235,793</u>	<u>52,829,260</u>
2008	Carrying amount	Contractual repayment value	Not later than one month	Later than one month not later than three months	Later than three months but not later than one year	Later than one year and not later than five years	Later than five years
	£	£	£	£	£	£	£
Principal							
Notes	17,455,924	18,930,411	-	-	-	-	18,930,411
Shared appreciation payable	29,756,188	28,994,476	-	-	-	-	28,994,476
Other payables	201,140	201,140	59,840	141,300	-	-	-
Interest payable							
Interest payable on Notes	72,350	16,194,838	-	214,718	637,151	3,409,808	11,933,161
	<u>47,485,602</u>	<u>64,320,865</u>	<u>59,840</u>	<u>356,018</u>	<u>637,151</u>	<u>3,409,808</u>	<u>59,858,048</u>

BOS (SHARED APPRECIATION MORTGAGES) NO 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009 (CONTINUED)

17. FINANCIAL INSTRUMENTS (CONTINUED)

17(d) Fair values

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

	Note	Carrying amount 2009 £	Fair value 2009 £	Carrying amount 2008 £	Fair value 2008 £
Loans and Receivables at amortised cost					
Mortgage portfolio	8	16,736,904	18,952,787	17,720,413	20,639,414
Financial liabilities at amortised cost					
Interest-bearing loans and borrowings	13	(16,354,018)	(17,833,861)	(17,333,879)	(19,295,254)

The embedded derivatives for shared appreciation receivable and payable are recognised in the balance sheet at fair value

The following comments summarise the main methods and assumptions used in estimating the fair value of financial instruments

The mortgage portfolio, shared appreciation rights receivable, shared appreciation rights payable and interest-bearing loans and borrowings have 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.

For this reason, in accordance with "IFRS 7 Financial Instruments Disclosures", the fair value measurement for the shared appreciation is deemed to be Level 2 in the Fair Value Hierarchy. The change in fair value that has been calculated using this valuation technique has been recognised in the income statement for the year ended 31 December 2009.

The cash and cash equivalents, other payables and receivables are recognised on an amortised cost basis that is considered to be a close approximation to fair value.

BOS (SHARED APPRECIATION MORTGAGES) NO. 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009 (CONTINUED)

18 RELATED PARTIES

The Company is a subsidiary undertaking of BOS, HBOS and ultimately LBG. The Company receives bank interest from BOS, its immediate parent undertaking. BOS administers the mortgage portfolio on behalf of the Company, for which quarterly service fees are paid. No dividends were paid in 2009 (2008: £140,000). The Company's transactions with related parties are summarised below:

	Lloyds Banking Group plc and subsidiaries 2009 £	HBOS plc and subsidiaries 2008 £
Income Statement		
Interest receivable and similar income	108,577	32,798
Operating expenses	(32,059)	(33,507)
Balance Sheet		
Equity		
Dividends paid	-	(140,000)
Assets		
Cash and cash equivalents	2,980,646	890,846
Liabilities		
Other payables	(2,737)	(2,815)
Bank overdraft	(3,212)	(6,449)

BOS (SHARED APPRECIATION MORTGAGES) NO 3 PLC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009 (CONTINUED)

19. ACCOUNTING PRONOUNCEMENTS EFFECTIVE AFTER 2009

The following pronouncements will be relevant to the Company but were not effective at 31 December 2009 and have not been applied in preparing these financial statements. The full impact of these accounting changes is being assessed by the Company. The initial view is that none of these pronouncements are expected to cause any material adjustments to reported numbers in the financial statements.

Pronouncement	Nature of change	IASB effective date
Amendment to IAS 39 <i>Financial Instruments: Recognition and Measurement – Eligible Hedged Items</i>	Clarifies how the principles underlying hedge accounting should be applied in particular situations	Annual periods beginning on or after 1 July 2009
Improvements to IFRSs (issued April 2009)	Sets out minor amendments to IFRS standards as part of annual improvements process	Dealt with on a standard by standard basis but not earlier than annual periods beginning on or after 1 January 2010
IFRS 9 <i>Financial Instruments: Classification and Measurement</i>	Simplifies the way entities will classify financial assets and reduces the number of classification categories to two, fair value and amortised cost. The existing available-for-sale and held-to-maturity categories have been eliminated. Classification will be made on the basis of the objectives of entity's business model for managing the assets and the characteristics of the contractual cash flows.	Annual periods beginning on or after 1 January 2013
IAS24 <i>Related Party Disclosures</i>	Simplifies the definition of a related party and provides a partial exemption from the disclosure requirements for government related entities	Annual periods beginning on or after 1 January 2011

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NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009 (CONTINUED)

20 PARENT UNDERTAKINGS

The Company's immediate parent company is BOS plc. The company regarded by the directors as the ultimate parent company is Lloyds Banking Group plc, a limited liability company incorporated and domiciled in Scotland, which is also the parent undertaking of the largest group of undertakings for which group accounts are drawn up and of which the Company is a member. BOS plc is the parent undertaking of the smallest such group of undertakings. Copies of the group accounts of both companies may be obtained from Group Secretariat, Lloyds Banking Group plc, The Mound, Edinburgh, EH1 1YZ.