

Yorkshire Building Society Covered Bonds LLP

Registered Number: OC322580

Annual Report and Financial Statements
for the year ended 31 December 2020

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Members and Partnership Information

Members

Yorkshire Building Society
YBS Covered Bonds Finance Limited

Registered Office

Yorkshire House
Yorkshire Drive
Bradford
Yorkshire
BD5 8LJ

Account Bank

Yorkshire Building Society
Yorkshire House
Yorkshire Drive
Bradford
BD5 8LJ

Standby Account Bank

HSBC Bank plc
8 Canada Square
London
E14 5HQ

Independent Auditors

PricewaterhouseCoopers LLP
Central Square,
29 Wellington Street
Leeds
LS1 4DL

Members' Report

The members present their annual report and audited financial statements for Yorkshire Building Society Covered Bonds LLP (the LLP) for the year ended 31 December 2020.

Principal Activities

The LLP is a special purpose vehicle whose business is the acquisition and management of mortgage loans and their related security. The principal activities of the LLP are summarised in the LLP Deed dated 1 November 2006. The Covered Bonds Programme has allocated over £5 billion of mortgages originated by Yorkshire Building Society (YBS) to a designated pool that can be used as collateral to issue covered bond securities to external investors. When covered bonds are issued, and the mortgages allocated as collateral, the values flow through the LLP. The activities of the LLP are therefore dependent upon the future funding strategies of the YBS.

Going Concern

The operations of the LLP are supported by a financial guarantee from YBS so the going concern of the LLP is therefore linked to the going concern of YBS.

The YBS Board undertake regular assessments of whether the Group is a going concern, taking into account changing economic and market conditions, and using all available information about future risks and uncertainties. During the year to 31 December 2020 the impacts of COVID-19 resulted in a large contraction in the UK economy and increased uncertainty around the future direction of the macroeconomic environment. However, due to its strong capital position and high liquidity levels, the Group is well placed to cope with the economic downturn.

The retained deficit reported in the current year of £5.1 million (2019: £1.1 million surplus) is wholly driven by fair value adjustments on derivatives which do not affect the liquidity of the Partnership and are likely to reverse in future years. As there are no plans to terminate the operations of the LLP within the next year, the members of the LLP have a reasonable expectation that the LLP will be able to continue in operation for the foreseeable future and be able to meet its obligations as they fall due. It is therefore considered appropriate to adopt the going concern basis in preparing the financial statements.

Designated Members

The designated members during the year and to the date of this report were Yorkshire Building Society and YBS Covered Bonds Finance Limited. In the event of Yorkshire Building Society going into administration or liquidation, the second member, YBS Covered Bonds Finance Limited, will appoint another member.

Financial Instruments

The LLP's financial instruments comprise a loan to YBS (equivalent to the value of the LLP's investment in YBS mortgages), liquid assets, derivatives, loans and various receivables and payables that arise directly from its operations. The main purpose of these financial instruments is to raise finance for YBS.

It is, and has been throughout the year under review, the LLP's policy that no trading in financial instruments is undertaken. Further discussion of the LLP's approach to financial instruments is set out in the significant accounting policies note to the financial statements (note 1).

Audit Information


Each member at the date of approval of this annual report and financial statements confirms that:


- so far as the member is aware, there is no relevant audit information of which the firm's auditors are unaware; and
- the member has taken all the steps that they ought to have taken as a member in order to make themselves aware of any relevant audit information and to establish that the LLP's auditors are aware of that information.

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

Independent Auditors

PricewaterhouseCoopers LLP were approved and appointed as auditors by order of the Board of Directors.


A Lenman
on behalf of Yorkshire Building Society
8 March 2021


D Asker
on behalf of YBS Covered Bonds Finance Limited
8 March 2021

Statement of members' responsibilities in respect of the financial statements

The members are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulation.

Company law, as applied to limited liability partnerships by the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008 (the "Regulations"), requires the members to prepare financial statements for each financial year. Under that law the members have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) in conformity with the requirements of the Companies Act 2006 as applied to limited liability partnerships.

Under company law, as applied to limited liability partnerships, members 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 LLP and of the profit or loss of the LLP for that period. In preparing the financial statements, the members are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable IFRSs in conformity with the requirements of the Companies Act 2006 as applied to limited liability partnerships have been followed, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the LLP will continue in business.

The members are also responsible for safeguarding the assets of the LLP and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The members are responsible for keeping adequate accounting records that are sufficient to show and explain the LLP's transactions and disclose with reasonable accuracy at any time the financial position of the LLP and enable them to ensure that the financial statements comply with the Companies Act 2006, as applied to limited liability partnerships.

The members are responsible for the maintenance and integrity of the LLP's financial statements published on the ultimate parent company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Strategic Report

Business Review

The LLP's business activities, together with the factors likely to affect the future development, performance and position are described below. The financial position of the LLP, its cash flows, liquidity position and borrowing facilities are disclosed in the financial statements. The LLP's objectives, policies and processes for managing its capital are described in note 14 to the financial statements.

Details of the LLP's financial risk management objectives, its financial instruments and hedging activities, and its exposures to operational, liquidity risk and other risks are set out in note 13 to the financial statements.

YBS is required to buy back mortgages that breach representations and warranties from the LLP, or if the property has been voluntarily surrendered by the borrower. There is no loss suffered by the LLP, as this buy-back comprises all outstanding amounts, including all arrears on the mortgage accounts. Details of this financial guarantee from YBS are described in more detail in note 11 to the financial statements.

The financial performance and position of Yorkshire Building Society and its controlled entities (the YBS Group), which includes the LLP, are included in the YBS Group's annual report and accounts, available on the YBS website.

The LLP made a loss for the year of £6.1 million (2019 - £3.5 million) arising from fair value changes on financial instruments.

Risk Management

Day to day risk management within the LLP is performed centrally by YBS management. The YBS Group maintains an independent risk management function that applies its risk management policies and techniques to the risks of the YBS Group as a whole, with appropriate risk management activities being deployed wherever risks arise.

The YBS Group, through its treasury function, monitors and manages wholesale credit risk using its own internal rating for all its counterparties, and sets individual limits accordingly. These limits are reviewed internally and against external rating agencies regularly, with revocation or suspension taking place where considered appropriate. Wholesale related credit risks are reported and discussed monthly at the Asset and Liability Committee ("ALCO"). Market risk within the LLP is minimised by the use of loans and deposits with YBS.

The most significant retail credit risk that the YBS Group is exposed to, which has particular relevance to the LLP, relates to its core business of providing loans secured on residential property. The beneficial interests in the mortgage portfolio represent the collateral for the deemed loan. A robust credit risk framework helps to ensure that lending remains within risk appetite limits. Adherence is monitored regularly through governance committees. The YBS Group lends to households across the UK and does not consider there to be any significant concentration of credit risks in any particular part of the UK.

In addition to the risk management explained above, the LLP has in place a Covered Bond Management Committee. This committee meets monthly and is chaired by the Director of Treasury. Its objective is to review and approve a number of reports relating to the Covered Bond programme, including investor reports, ALCO papers and asset coverage test reports.



A Lenman
on behalf of
Yorkshire Building Society
8 March 2021



D Asker
on behalf of
YBS Covered Bonds Finance Limited
8 March 2021

Independent Auditors' Report to the Members of Yorkshire Building Society Covered Bonds LLP

Report on the audit of the financial statements

Opinion

In our opinion, Yorkshire Building Society Covered Bonds LLP's financial statements:

- give a true and fair view of the state of the limited liability partnership's affairs as at 31 December 2020 and of its loss and cash flows for the year then ended;
- have been properly prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006 as applied to limited liability partnerships; and
- have been prepared in accordance with the requirements of the Companies Act 2006 as applied to limited liability partnerships by the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008.

We have audited the financial statements, included within the Annual Report and Financial Statements (the "Annual Report"), which comprise: the statement of financial position as at 31 December 2020; the income statement, the statement of cash flows, the statement of changes in members' interest for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the LLP in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Conclusions relating to going concern

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the LLP's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

In auditing the financial statements, we have concluded that the members' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

However, because not all future events or conditions can be predicted, this conclusion is not a guarantee as to the LLP's ability to continue as a going concern.

Our responsibilities and the responsibilities of the members with respect to going concern are described in the relevant sections of this report.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The members are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

Independent Auditors' Report to the Members of Yorkshire Building Society Covered Bonds LLP

Responsibilities for the financial statements and the audit

Responsibilities of the members for the financial statements

As explained more fully in the Statement of members' responsibilities in respect of the financial statements, the members are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The members are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the members are responsible for assessing the LLP's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the members either intend to liquidate the LLP or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud, is detailed below.

Based on our understanding of the LLP and industry, we identified that the principal risks of non-compliance with laws and regulations related to the the UK tax legislation, and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the financial statements such as the Companies Act 2006 as applied to limited liability partnerships by the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to the posting of inappropriate manual journal entries to manipulate financial performance, management bias in significant accounting estimates and significant one-off or unusual transactions. Audit procedures performed included:

- Enquiries of management and those charged with governance throughout the year including consideration of known or suspected instances of noncompliance with laws and regulations
- Incorporation of an element of unpredictability in our testing through altering the nature, timing and/or extent of work performed
- Challenging estimates and judgements made by management in their significant accounting estimates
- Identifying and testing journal entries, in particular those posted by senior management, posted with descriptions indicating higher level of risk, posting to unusual account combinations based on our understanding of business operations and material late adjustments

Independent Auditors' Report to the Members of Yorkshire Building Society Covered Bonds LLP

Auditors' responsibilities for the audit of the financial statements (continued)

There are inherent limitations in the audit procedures described above. We are less likely to become aware of instances of non-compliance with laws and regulations that are not closely related to events and transactions reflected in the financial statements. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

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

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 as applicable to limited liability partnerships we are required to report to you if, in our opinion:

- we have not obtained all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the LLP, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.



Martin Cross (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Leeds
8 March 2021

Income Statement

for the year ended 31 December 2020

	Note	2020 £000	2019 £000
Interest revenue calculated using the effective interest method	3	31,119	33,811
Interest expense	4	(31,091)	(33,804)
Net interest income		28	7
Operating expenses	5	(28)	(7)
Operating result		-	-
Net (losses) from financial instruments held at fair value	6	(6,108)	(3,470)
Loss before tax		(6,108)	(3,470)
Loss for the year for discretionary division among members		(6,108)	(3,470)

The loss shown above is derived from continuing operations.

Yorkshire Building Society Covered Bonds LLP has no other income or expense in the year other than the loss stated above. Consequently no Statement of Comprehensive Income has been presented.

The notes on pages 11 to 18 form part of these financial statements.

Statement of Financial Position
as at 31 December 2020

	Note	2020 £000	2019 £000
Assets			
Deemed loan	7	3,241,102	3,131,766
Derivative financial instruments		198,685	170,614
Loans and advances to credit institutions		100,396	120,467
Total assets		3,540,183	3,422,847
Liabilities			
Interest bearing loans and borrowings	8	3,523,765	3,403,148
Other payables	9	12,607	12,989
Derivative financial instruments		8,864	5,655
Total liabilities		3,545,236	3,421,792
Equity			
Retained (deficit)/surplus	14	(5,053)	1,055
Total equity		(5,053)	1,055
Total liabilities and equity		3,540,183	3,422,847

Statement of Changes in Members' Interests
for the year ended 31 December 2020

	2020 £000	2019 £000
Net assets attributable to members		
Balance at 1 January	1,055	4,525
Loss for the year	(6,108)	(3,470)
Balance at 31 December	(5,053)	1,055

The notes on pages 11 to 18 form part of these financial statements.

These financial statements were approved by the members and authorised for issuance on 8 March 2021 and were signed on their behalf by:



A Lenman
on behalf of
Yorkshire Building Society



D Asker
on behalf of
YBS Covered Bonds Finance Limited

Statement of Cash Flows
for the year ended 31 December 2020

	Note	2020 £000	2019 £000
Cash flows from operating activities			
Loss before tax		(6,108)	(3,470)
Change in operating assets:			
Net increase in deemed loan		(109,336)	(1,150,547)
Net (increase)/decrease in derivative financial instruments		(28,071)	89,554
Change in operating liabilities:			
Net increase/(decrease) in loans and borrowings		112,777	(86,190)
Net (decrease)/increase in other payables		(382)	4,492
Net increase in derivative financial instruments		3,209	5,655
Net cash flows (used in)/generated from operating activities		(27,911)	(1,140,506)
Cash flows from financing activities			
Proceeds from loans and borrowings	10	455,600	1,177,560
Redemption of loans and borrowings	10	(447,760)	-
Net cash flows generated from/(used in) financing activities		7,840	1,177,560
Net increase in cash and cash equivalents		(20,071)	37,054
Opening balance		120,467	83,413
Total closing cash and cash equivalents		100,396	120,467
Cash and cash equivalents			
Loans and advances to credit institutions		100,396	120,467

The notes on pages 11 to 18 form part of these financial statements.

Notes to the Financial Statements

1. Significant Accounting Policies

Yorkshire Building Society Covered Bonds LLP (the LLP) is a special purpose vehicle whose business is the acquisition and management of mortgage loans and their related security. It is a Limited Liability Partnership domiciled and registered in the United Kingdom.

Basis of preparation

The financial statements have been prepared in accordance with international accounting standards, being International Accounting Standards (IAS), International Financial Reporting Standards (IFRS) and interpretations issued by the International Accounting Standards Board (IASB) that are effective as at 31 December 2020 and have been endorsed by the European Union.

The financial statements have been prepared on the historical cost basis, as modified by the revaluation of derivative financial instruments as described below.

Pounds sterling is both the functional currency of the LLP and the presentation currency applied to these financial statements. Except where otherwise stated, all figures in the financial statements are presented in thousands of pounds sterling (£000).

The financial statements have been prepared on the going concern basis as discussed in the Members' Report on page 2, under the heading, 'Going concern'.

The preparation of financial statements under IFRS requires the use of certain critical accounting estimates and judgement. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are described in Note 2.

Accounting Developments

Changes to Accounting Standards Effective in the Period

Various IFRS amendments became mandatorily effective for periods commencing on or after 1 January 2020 none of which have had any material impact on the disclosures or on the amounts reported in these financial statements.

Standards issued but not yet effective

The following standards or amendments were in issue but were either optional, or not yet effective, and have not been adopted in these financial statements.

IFRS 9 *Financial Instruments* was issued in 2014 as a replacement of IAS 39 *Financial Instruments: Recognition and Measurement* and was mandatorily effective for periods beginning on or after 1 January 2018. However, IFRS 9 did not replace the requirements for portfolio fair value hedge accounting for interest rate risk since this phase of the project was separated out due to its longer term nature. This is currently at the discussion paper phase and the IASB plans to review the core model feedback in late 2021.

As a result, IFRS 9 included a transitional relief allowing the continued use of the hedge accounting requirements of IAS 39, and the LLP continue to adopt this approach. The development of the discussion paper will be closely monitored and the LLP will continue to assess the impacts of full adoption of IFRS 9 for hedge accounting.

IFRS 17 *Insurance Contracts* is the comprehensive standard establishing recognition and measurement requirements for insurance contracts. It is expected that this standard will be effective for periods beginning on or after 1 January 2023. Its adoption will have no impact on these financial statements.

The following is a list of the LLP's significant accounting policies:

Interest income and expense

Interest revenue and expense on financial instruments are recognised in the income statement using the effective interest rate basis being the rate that exactly discounts estimated cash flows (excluding credit losses) through the expected life of the instrument to the net carrying amount at initial recognition.

Notes to the Financial Statements (continued)

1. Significant Accounting Policies (continued)

Tax

The LLP is not subject to UK Corporation Tax and therefore no tax impacts on transactions are recognised in the financial statements.

Operating Expenses

The LLP pays cash management and mortgage loan servicing fees to Yorkshire Building Society (YBS), the originator of the mortgage loans transferred to the LLP, and the LLP's controlling entity. These fees are recognised as incurred.

Financial Instruments

The LLP's financial instruments comprise a deemed loan to YBS (equivalent to the value of the LLP's investment in YBS mortgages), derivatives, loans and advances to credit institutions, loans and borrowings and various receivables and payables that arise directly from its operations. The main purpose of these financial instruments is to raise finance for YBS to offer mortgages to customers and to manage interest rate risk.

Financial instrument	Significant terms and conditions	Accounting treatment
Deemed loan – between the LLP and YBS equivalent to the value of mortgages transferred under the sale agreement.	Long term. Fixed and variable interest rate via look through to the underlying mortgage assets	Amortised cost
Derivative financial instruments – purchased to manage interest rate risk within the LLP	Medium term. Value derived from underlying price or rate	Fair value through profit or loss
Loans and advances to credit institutions – a liquidity account to facilitate payments under the Secured Funding Programme	Short-term. Variable interest rates	Amortised cost
Interest bearing loans and borrowings – amount due to YBS equivalent to the covered bond securities issued to external investors	Long term. Fixed interest rate	Amortised cost except where hedge accounting allows a fair value adjustment to be made
Other payables	Short term	Amortised cost

Deemed loan

Under the terms of the mortgage sale agreement from YBS to the LLP, YBS retains the right to receive excess income arising on the loans and is therefore deemed to retain the significant risks and rewards of ownership of the financial assets.

As a result, YBS does not qualify for derecognition of these loans in its financial statements and therefore the LLP does not recognise the transferred mortgage assets on its statement of financial position. Instead, the LLP derecognises the cash, or other consideration paid, and recognises a receivable from YBS as a 'deemed loan'. The deemed loan is measured at amortised cost, being the carrying value of the underlying pool of mortgage assets.

Derivative financial instruments

The LLP uses derivative financial instruments to hedge its exposure to interest rate risk arising from investment activities. The LLP does not hold or issue derivative financial instruments for trading purposes.

Derivative financial instruments are recognised initially at fair value in the statement of financial position with any gain or loss on re-measurement to fair value recognised immediately in the income statement. The fair value of interest rate swaps is the estimated amount that the LLP would receive or pay to terminate the swap or transfer to another party at the reporting date taking into account current interest rates and the current creditworthiness of the swap counterparty.

Interest income and expense on the swaps is accounted for under the effective interest rate method within interest income and expense in the income statement.

Notes to the Financial Statements (continued)

1. Significant Accounting Policies (continued)

Financial Instruments (continued)

Loans and advances to credit institutions

The LLP places available revenue and principal receipts on mortgages into a deposit account with an external credit institution. Withdrawals from this account are restricted by the detailed priority of payments set out in the Secured Funding 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. However, it is considered as cash for the purposes of the statement of cash flows.

The LLP is contractually entitled to a variable rate of interest of 0.25 per cent per annum below London Interbank Offered Rate (LIBOR) for one-month sterling deposits. The Financial Conduct Authority have informed all market participants that they must remove any dependency on LIBOR by end 2021 and the LLP will amend the loan agreements to reflect new alternative measures as appropriate.

Interest bearing loans and borrowings

Interest-bearing loans and borrowings comprise a series of term advances from YBS, equivalent to the amounts raised by YBS under its covered bonds programme.

YBS does not rely on repayment of these term advances, or the interest thereon, in order to meet its repayment or interest obligations to covered bond investors. The term advances will not be repaid by the LLP until all amounts payable under the corresponding series of covered bonds have been repaid in full. Amounts owed by the LLP will be subordinated to amounts owed by the LLP under the Covered Bond Guarantee described below.

The covered bonds are unconditionally guaranteed by YBS. Under the terms of the Trust Deed, the LLP has also provided a guarantee of payments of interest and principal to covered bond investors should these be unpaid by YBS. The obligations of the LLP under its guarantee constitute direct obligations of the LLP secured against its assets, primarily the beneficial interest in the mortgage loans acquired from YBS. In this respect, the LLP treats the above guarantee contract as a contingent liability until such time as it becomes probable that the LLP will be required to make a payment under the guarantee.

Interest-bearing loans and borrowings are recognised initially at fair value, being the amount advanced, and subsequent measured at amortised cost with amounts being recognised in income statement under the effective interest rate method.

Other payables

Under the terms of the mortgage sale agreement from YBS to the LLP, YBS retains the right to receive excess income arising on those loans, after certain higher priority payments have been met by the LLP. In addition, any surplus receipts from the receivables after servicing the notes and all other obligations of the LLP are payable to YBS. These amounts are presented as interest expense in the income statement with amounts outstanding at year end being recorded as 'Other payables' on the statement of financial position.

Hedging

All derivatives entered into by the LLP are for the purposes of providing an economic hedge. Hedge accounting is applied when the specific accounting standard rules and conditions are fulfilled. The LLP has classified its derivatives as fair value hedges in order to reduce volatility in the income statement.

Where the fair value hedging requirements are met, changes in the fair value of the hedged item arising from the hedged risk are taken to the income statement thereby offsetting the effect of the related movements in the fair value of the derivative. Where the hedge no longer meets the criteria, or is terminated for any other reason, the adjustment to the hedged item is released to the income statement, over its remaining life, using the effective interest rate method.

Notes to the Financial Statements (continued)

2. Critical Accounting Judgements and Key Sources of Estimation Uncertainty

The LLP makes no key judgements in applying its accounting policies that have a significant impact on the amounts recognised in the financial statements.

Estimates and assumptions are used which could affect the reported amounts of assets and liabilities. The most critical key source of estimation uncertainty relates to fair value.

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale and are measured at fair value with the resultant profits or losses included in the income statement.

The fair values of the derivatives are based on counterparty valuations, which is the best estimate of the exit value of the derivatives. This is analysed further in Note 12.

3. Interest Revenue calculated using the effective interest method

	2020	2019
	£000	£000
On deemed loan	29,360	33,353
On other liquid assets	125	427
On derivative financial instruments in hedge relationships	1,634	31
	<u>31,119</u>	<u>33,811</u>

4. Interest Expense

	2020	2019
	£000	£000
On deposits from connected undertakings	22,441	20,272
On derivative financial instruments in hedge relationships	8,650	13,532
	<u>31,091</u>	<u>33,804</u>

5. Operating Expenses

	2020	2019
	£000	£000
Servicer fees	(28)	(7)
	<u>(28)</u>	<u>(7)</u>

Fees payable of £13,500 (2019 - £12,500) to the LLP's auditors for the audit of the LLP's annual financial statements have been borne by Yorkshire Building Society, the LLP's controlling entity. There were no other fees paid to the auditors.

6. Net (losses) from financial instruments held at fair value

	2020	2019
	£000	£000
Derivative financial instruments and hedging	(6,108)	(3,470)
	<u>(6,108)</u>	<u>(3,470)</u>

7. Deemed Loan

	2020	2019
	£000	£000
At 1 January	3,131,766	1,981,219
Pool additions	1,190,279	2,461,127
Repayments	(1,080,943)	(1,310,580)
At 31 December	<u>3,241,102</u>	<u>3,131,766</u>

The deemed loan is due in over 1 year. This is collateralised by the benefit interests in the underlying mortgage portfolios.

Notes to the Financial Statements (continued)

8. Interest Bearing Loans and Borrowings

The amounts due to Yorkshire Building Society mature on the following dates:

Covered Bond	Maturity Date	Interest Date	2020	2019
			£000	£000
9	11 June 2021	Fixed 1.250%	453,017	428,400
10	19 June 2020	Fixed 0.500%	-	426,583
11	10 November 2022	Fixed 0.750%	450,361	425,887
12	11 April 2023	Fixed 0.375%	451,103	426,591
13	20 November 2023	SONIA	500,375	500,754
14	08 May 2024	Fixed 0.125%	450,251	425,794
15	21 November 2024	SONIA	750,493	751,061
16	13 October 2027	SONIA	449,900	-
Fair value hedging adjustments			18,265	18,078
			3,523,765	3,403,148

9. Other Payables

	2020	2019
	£000	£000
Deferred consideration	12,595	12,983
Intercompany liability	12	6
	12,607	12,989

10. Notes to the Statement of Cash Flows

The Statement of Cash Flows has been prepared in compliance with 'International Accounting Standard 7 Statement of Cash Flows' and is presented under the indirect method.

The Statement of Cash Flows presents cash flows classified by operating, investing and financing activities. The net cash flows from all three categories are totalled to show the movement in cash and cash equivalents during the year, which is then used to reconcile cash and cash equivalents.

Reconciliation of liabilities arising from financing activities

	Brought forward	Cash flows		Non cash changes caused by			Carried forward
		Redemption	Issue	Foreign exchange	Accrued interest	Fair value adjustment	
	£000	£000	£000	£000	£000	£000	£000
Loans and borrowings							
2020	3,403,148	(447,760)	455,600	114,360	(1,769)	187	3,523,765
2019	2,311,778	-	1,177,560	(90,570)	1,099	3,281	3,403,148

11. Financial Guarantee

Yorkshire Building Society is required to buy back all mortgages that breach Representations and Warranties from the LLP, or if the property has been voluntarily surrendered by the borrower. There is no loss suffered by the LLP, as this buy-back comprises all outstanding amounts, including all arrears on the mortgage accounts. The maximum potential amount payable to the LLP under the guarantee is equal to the amount outstanding on the deemed loan, being £3,241,102,000 at 31 December 2020 (2019 - £3,131,766,000).

Notes to the Financial Statements (continued)

12. Fair Values

The following is a comparison of the carrying value and fair values of the LLP's financial instruments held at amortised cost. Where external market prices are available they have been used to determine fair values, otherwise internal pricing models using external market data have been used.

	2020		2019	
	Carrying value £000	Fair value £000	Carrying value £000	Fair value £000
Assets				
Deemed loan	3,241,102	3,241,102	3,131,766	3,131,766
Loans and advances to credit institutions	100,396	100,396	120,467	120,467
Liabilities				
Loans and borrowings	3,523,765	3,556,075	3,403,148	3,444,980
Other payable	12,607	12,607	12,989	12,607

For the deemed loan, loans and advances to credit institutions and other payables, amortised cost is considered to be a close approximation to fair value.

The fair value of derivative financial instruments is determined by using a discounted cash flow analysis model that is consistent with commonly used market techniques. All inputs into valuation models adopted by the entity, including the sterling zero coupon yield curve used as the discount rate on the swap, are obtained from observable market data. This is deemed to be level 2 per the following accounting standard definition of fair value inputs.

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs)

	Fair Value			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
As at 31 December 2020				
Derivative asset	-	198,685	-	198,685
Derivative liability	-	8,864	-	8,864
As at 31 December 2019				
Derivative asset	-	170,614	-	170,614
Derivative liability	-	5,655	-	5,655

Notes to the Financial Statements (continued)

13. Market risk

The LLP has been established in such a way that market risk is minimal. Certain derivatives have been placed into hedge relationships so as to maintain a neutral position.

Liquidity risk

Liquidity risk is managed at YBS Group level and is monitored on a daily basis by the independent Group Risk function. All liquidity risk in subsidiary companies, including the LLP, is eliminated by the use of appropriate inter-company loans and deposits. The table below illustrates the gross contractual cash flows on the LLP's financial liabilities.

	Repayable up to one year	Repayable between one and five years	More than five years	Total
	£000	£000	£000	£000
31 December 2020				
Loans and borrowings	469,228	2,629,122	449,980	3,548,330
Other payables	12,607	-	-	12,607
	481,835	2,629,122	449,980	3,560,937
31 December 2019				
Loans and borrowings	454,351	3,028,353	-	3,482,704
Other payables	12,989	-	-	12,989
	467,340	3,028,353	-	3,495,693

Credit risk

Key concentrations of credit risk to the LLP are in respect of the deemed loan, and more generally, to Yorkshire Building Society in its role as the mortgage administrator and cash manager. The LLP's financial statements are prepared on the basis that its acquisitions of beneficial interests in mortgage portfolios are recognised as a deemed collateralised loan to the originator, YBS.

To the extent that the mortgage loans in the portfolios do not provide sufficient funds to recover the LLP's investment in the mortgage portfolio, the LLP has no preferential claim on the assets of Yorkshire Building Society. To provide protection for the Covered Bond structure, additional mortgage loan collateral over and above the loans and borrowings owed are held. Rating agencies have determined that level of this 'over-collateralisation' is adequate given the quality of the underlying pool of mortgage loans.

As at 31 December 2020 the value of the dedicated mortgage pool backing the covered bond programme is £5.1 billion (2019 - £4.9 billion) compared to the covered bonds issued of £3.5 billion (2019 - £3.5 billion).

The LLP's maximum gross exposure to credit loss is equal to the balance on the mortgage portfolio as shown above plus credit risk exposure to the deposit account balance within loans with credit institution and the derivative asset balance. No further analysis has been provided on the credit quality of deemed loans as the balance is within the stage 1 expected credit loss category, is less than 30 days past due and is deemed to be low risk.

Interest rate risk

The LLP is protected from the interest rate risk by the provision of interest rate swaps.

Currency risk

The LLP minimises currency risk by matching its currency financial assets and liabilities and through the use of cross currency interest rate swaps.

14. Capital Management

Capital is managed centrally at the YBS Group level. The entity is not subject to any externally imposed capital requirements.

The retained deficit at 31 December 2020 of £5.1 million (2019: £1.1 million surplus) is wholly driven by fair value adjustments on derivatives which do not affect the liquidity of the LLP and are likely to reverse in future years.

Notes to the Financial Statements (continued)

15. Related Parties

The LLP has two designated members, YBS and YBS Covered Bonds Finance Limited, itself a controlled entity of YBS. Both members are therefore related parties of the LLP, along with other members of the YBS Group. During the year, the LLP undertook the transactions set out below entities within the YBS Group.

The LLP has provided a loan to YBS on which it receives income. In addition, the LLP pays cash management and mortgage loan servicing fees to YBS in connection with its provision of services defined under the Programme Documentation. YBS is the counterparty to an interest rate swap agreement, on which there is an associated interest benefit for the LLP.

YBS has provided a series of term advances to the LLP, on which the LLP pays a variable rate of interest. Certain expenses, which are included in other professional and legal expenses, may subsequently be paid or reimbursed by YBS.

	Carrying value £000	Interest revenue £000	Interest expense £000
31 December 2020			
Assets			
Deemed loan	3,241,102	29,360	-
Liabilities			
Loans and borrowings	3,523,766	-	22,441
31 December 2019			
Assets			
Deemed loan	3,131,765	33,353	-
Liabilities			
Interest bearing loans and borrowings	3,403,148	-	20,272