

UK Financial Investments Ltd

James Leigh-Pemberton
Executive Chairman

www.ukfi.co.uk

Rt Hon George Osborne MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
London
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15th March 2015

Dear Chancellor,

I am writing to you to set out why UKFI thinks now is the right time for UKAR to launch a major sale of its mortgage assets.

The preparation for this sale began in October last year, shortly after UKAR closed a previous sale of £2.7 billion of mortgage assets. In November, UKAR appointed Credit Suisse as its adviser to look at the opportunities for asset sales and, separately, the potential for divesting its operating platform. At the same time, we in UKFI appointed Moelis as our own independent adviser. Once advisers were in place, an initial programme of work to consider the options for sales ran through November and December. Then, with your agreement, UKAR and Credit Suisse conducted a discrete market testing in January, speaking privately to a number of potential buyers for UKAR assets to confirm market appetite.

In the light of that work, we recommended to you in February that UKAR should move to a formal divestment process, concentrating on the Granite mortgage securitisation vehicle, which was originally established by Northern Rock in 2001. As at 31 January 2015, Granite held £13.22 billion of mortgage loans. You have now agreed to that recommendation and, accordingly, UKAR is today issuing a market announcement to that effect.

I would highlight four reasons in particular for pushing ahead now:

- Market conditions for such a sale are as helpful as they have been since before the financial crisis. These supportive market conditions are underpinned, in particular, by historically low, and in some cases negative, risk free rates and high levels of liquidity seeking a return above the cost of funding. In such an environment, we can expect significant market demand for the type of assets that UKAR owns.
- We have seen a number of such sales executed in the market over recent months. In the last few days, we have seen Permanent TSB agree a sale of £2.5 billion of UK mortgages. And, in the

second-half of last year, UKAR made its own £2.7 billion sale, Lloyds sold €1.2 billion of Irish mortgages, and Catalunya Banc in Spain sold €6.5 billion of Spanish mortgages.

- The assets held within Granite and more broadly across both NRAM and B&B are increasingly attractive to investors, as they originated pre-crisis and are now benefitting from the recovery in UK house prices and improved affordability as employment and wages grow.
- We now know that there is specific market interest in UKAR's assets. Both UKFI and UKAR have been independently approached by a number of parties in recent months. And UKAR's market testing has confirmed that there is real and substantive interest for such a sale.

In the light of this – and subject, of course, to market conditions remaining favourable – my judgement is that a very significant sale of UKAR's mortgage assets is likely to be both achievable and value for money.

*yours sincerely,
James*

James Leigh-Pemberton
Executive Chairman