SUSTAINABLE COMMUNITIES FOR LEEDS (FINANCE) PLC

(*incorporated with limited liability in England and Wales on 2 July 2013 under company number 08594721*)

£ 101,833,000

5.069 per cent. Fixed Rate Guaranteed Secured Bonds due September 2032

Issue Price: 100 per cent.

unconditionally and irrevocably guaranteed as to scheduled payments of principal and interest pursuant to a financial guarantee issued by

Assured Guaranty (Europe) Ltd.

(*incorporated with limited liability in England and Wales on 8 June 1990 under company number 02510099*)

and

Assured Guaranty Municipal Corp.

(*incorporated as an insurance company in the State of New York, U.S.A.*)

Lead Manager

10 July 2013

The £101,833,000, 5.069 per cent. Fixed Rate Guaranteed Secured Bonds due September 2032 (the "**Bonds**") of Sustainable Communities for Leeds (Finance) plc (the "**Issuer**") are the subject of the Financial Guarantees (as defined below) and will be issued on 11 July 2013 (the "**Issue Date**") pursuant to a bond trust deed (the "**Bond Trust Deed**") to be dated on or around 11 July 2013 between the Issuer, Assured Guaranty (Europe) Ltd. ("**AGE**") and Assured Guaranty Municipal Corp. ("**AGM**" and together with AGE the "**Financial Guarantors**" and each a "**Financial Guarantor**") and BNY Mellon Corporate Trustee Services Limited as bond trustee (the "**Bond Trustee**", which expression includes the trustee or trustees for the time being under the Bond Trust Deed).

The issue price of the Bonds will be 100 per cent. The Bonds, excluding those held by or on behalf of any of the Issuer, Sustainable Communities for Leeds Limited ("**ProjectCo**" or the "**Contractor**"), Sustainable Communities for Leeds (Holdings) Limited ("**HoldCo**" and, together with the Issuer and ProjectCo, the "**Obligors**"), Equitix Housing 2 Limited, Keepmoat Leeds PFI Limited and Uberior Infrastructure Investments (No.5) Limited (each and any successor in title to each, a "**HoldCo Shareholder**" and together the "**HoldCo Shareholders**") and Uberior Infrastructure Investments (No.6) Limited (the HoldCo Shareholders, the Obligors and Uberior Infrastructure Investments (No.6) Limited together, the "**Issuer Group**"), will be unconditionally and irrevocably guaranteed as to scheduled payments of principal and interest (but excluding any additional amounts payable upon early redemption or acceleration) in respect of the Bonds pursuant to a financial guarantee dated on 11 July 2013 by AGE (the "**AGE Financial Guarantee**") and a financial guarantee dated on 11 July 2013 by AGM (the "**AGM Financial Guarantee**", and together with the AGE Financial Guarantee, the "**Financial Guarantees**" and each a "**Financial Guarantee**") and as set out in the section entitled "*Form of AGE Financial Guarantee*" and the section entitled "*Form of AGM Financial Guarantee*".

Interest on the Bonds will be payable semi-annually in arrears on 31 March and 30 September (each, a "**Scheduled Payment Date**"), except that the first Scheduled Payment Date will be 30 September 2013 in respect of the period from, and including, the Issue Date to, but excluding, 30 September 2013 and the last Scheduled Payment Date will be 30 September 2032 in respect of the period from, and including, 31 March 2032 to 30 September 2032 (but excluding, 30 September 2032).

Unless previously redeemed or purchased and cancelled, the Bonds will mature on 30 September 2032 and will be subject to redemption in part from, and including, 30 September 2013 in accordance with the amortisation schedule set out in the section entitled "*Terms and Conditions of the Bonds – Payments and Exchange of Talons – Scheduled Payments*" below. The Bonds are also subject to redemption in whole but not in part at the "**Early Redemption Price**" at the option of the Issuer (as provided in Condition 6.2 (see the section entitled "*Terms and Conditions of the Bonds – Redemption and Purchase – Issuer Optional Redemption*" below)).

The Issuer is a special purpose vehicle whose principal purposes are, *inter alia*, (i) to issue the Bonds, (ii) to issue loan stock notes to HoldCo and (iii) to on-lend the proceeds to ProjectCo pursuant to two intercompany loan agreements (see section entitled "*The Financing of the Project*").

ProjectCo is a special purpose vehicle whose principal purposes are, *inter alia*, to (i) undertake the demolition, construction and refurbishment and the management and maintenance of the dwellings and/or properties in the Little London and Beeston Hill & Holbeck areas of Leeds owned by Leeds City Council (the "**Authority**"); and (ii) provide certain housing management services, all pursuant to the Private Finance Initiative ("**PFI**") and the terms of the single project agreement entered into between ProjectCo and the Authority (the "**Project Agreement**") (see the section entitled "*Overview of the Project*").

HoldCo is a special purpose vehicle established for the principal purpose of acting as the holding company of the Issuer and ProjectCo.

There is no recourse under the Bonds or the Financial Guarantees to any HoldCo Shareholder except to the extent described in this prospectus (the "**Prospectus**").

The obligations of the Issuer under the Bonds will be secured in favour of BNY Mellon Corporate Trustee Services Limited as security trustee (the "**Security Trustee**") as described in the section entitled "*The Financing of the Project – Security Arrangements*".

The Bonds are expected to be rated upon issue AA- by Moody's Investors Services Inc or any successor to this rating agency function ("**Moody's**") and AA3 by Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc. or any successor to this rating agency function ("**S&P**") (each, a "**Rating Agency**" and together, the "**Rating Agencies**"). These ratings will be based primarily upon the financial strength rating of the Financial Guarantors. A credit rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by any one or all of the Rating Agencies. A suspension, reduction or withdrawal of the rating assigned to the Bonds may adversely affect the market price of the Bonds.

The Bonds will be in bearer form and in denominations of £100,000 and integral multiples of £1,000 in excess thereof, up to and including £199,000. For so long as the Bonds are represented by a Global Bond (as defined below) and the relevant clearing system(s) so permit, the Bonds will be tradable only in the minimum authorised denomination of £100,000 and higher integral multiples of £1,000, notwithstanding that no Definitive Bonds (as defined below) will be issued with a denomination above £199,000. The Bonds will initially be in the form of a temporary global bond (the "**Temporary Global Bond**"), without receipts, coupons or talons attached, which will be deposited on or around the Issue Date with a common depositary for Euroclear Bank S.A./N.V. ("**Euroclear**") and Clearstream Banking, société anonyme, Luxembourg ("**Clearstream, Luxembourg**"). The Temporary Global Bond will be exchangeable, in whole or in part, not earlier than 40 days after the Issue Date upon certification of non-U.S. beneficial ownership, for interests in a permanent global bond (the "**Permanent Global Bond**" and, together with the Temporary Global Bond, the "**Global Bonds**" and each, a "**Global Bond**"), without receipts, coupons or talons attached, which will also be deposited with such common depositary for Euroclear and Clearstream, Luxembourg. Interest payments in respect of the Bonds cannot be collected without such certification of non-U.S. beneficial ownership. The Permanent Global Bond will be exchangeable in whole, but not in part, for Bonds in definitive form ("**Definitive Bonds**") in denominations of £100,000 and integral multiples of £1,000 in excess thereof up to and including £199,000, with receipts for principal, coupons for interest and talons for further receipts and coupons attached, only in the limited circumstances described in the section entitled "*Overview of Provisions relating to the Bonds while in Global Form*". If Definitive Bonds are required to be issued, such Definitive Bonds (a) will only be issued to the holders for the time being of one or more Bonds (the "**Bondholders**") holding Bonds having a nominal amount equal to or in excess of £100,000 and (b) will only be printed in denominations equal to or in excess of £100,000. No Definitive Bonds will be issued with a denomination above £199,000. If Definitive Bonds are required to be issued, the Issuer will inform the Central Bank of Ireland of all denominations which are in issue.

PARTICULAR ATTENTION IS DRAWN TO THE SECTION ENTITLED "RISK FACTORS" AT PAGE 7 BELOW.

IMPORTANT NOTICE

This document (the "**Prospectus**") has been approved by the Central Bank of Ireland as competent authority under Directive 2003/71/EC (the "**Prospectus Directive**"). The Central Bank of Ireland only approves this Prospectus as meeting the requirements imposed under Irish and European Union law pursuant to the Prospectus Directive. This Prospectus comprises a Prospectus for the purposes of Article 5 of the Prospectus Directive as implemented in Ireland by the Prospectus (Directive 2003/71/EC) Regulations 2005, as amended (the "**Prospectus Regulations**"). Application has been made to the Irish Stock Exchange (the "**Irish Stock Exchange**") for the Bonds to be admitted to the Official List (the "**Official List**") and trading on its regulated market (the "**Main Securities Market**"). The Main Securities Market is a regulated market for the purposes of the Markets in Financial Instruments Directive 2004/39/EC. No assurance can be given that the application will be granted. Furthermore, admission of the Bonds to the Official List and trading on its Main Securities Market is not an indication of the merits of the Issuer, the Financial Guarantors, the Bonds or the Financial Guarantees. References in this Prospectus to Bonds being "**listed**" (and all related references) shall mean that such Bonds have been admitted to trading on the Main Securities Market of the Irish Stock Exchange. There can be no assurance that a trading market in the Bonds will develop or be maintained.

The Issuer accepts responsibility for the information contained in this Prospectus. To the best of the knowledge of the Issuer (which has taken all reasonable care to ensure that such is the case), such information is in accordance with the facts and does not omit anything likely to affect the import of such information (other than the Excluded Information). ProjectCo accepts responsibility for the information contained in the section of this Prospectus entitled "*ProjectCo*" (see pages 130 and 131). HoldCo accepts responsibility for the information contained in the section of this Prospectus entitled "*HoldCo*" (see pages 131 and 132). To the best of the knowledge of each of ProjectCo and HoldCo respectively (each of which has taken all reasonable care to ensure that such is the case), such information is in accordance with facts and does not omit anything likely to affect the import of such information.

Lloyds TSB Bank Plc (the "**Lead Manager**"), the Bond Trustee and the Security Trustee have not independently verified the information contained in this Prospectus. Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by the Lead Manager, the Bond Trustee and the Security Trustee as to the accuracy or completeness of the information contained or incorporated in this Prospectus or any other information provided by the Issuer in connection with the offering of the Bonds. To the fullest extent permitted by law the Lead Manager, the Bond Trustee and the Security Trustee do not accept any responsibility whatsoever in relation to the information contained or incorporated by reference in this Prospectus or any other information provided by the Issuer in connection with the offering of the Bonds or their distribution.

The Authority accepts responsibility for the information contained in the section of this Prospectus entitled "*Leeds City Council*" (see page 168). To the best of the knowledge and belief of the Authority (which has taken all reasonable care to ensure that such is the case), such information relating to itself is in accordance with the facts and does not omit anything likely to affect the import of such information. The Authority does not accept any responsibility for other information contained in this Prospectus.

AGE accepts responsibility for the information contained below in the sections of this Prospectus entitled "*Assured Guaranty (Europe) Ltd*" (see pages 117 to 122) and "*Form of AGE Financial Guarantee*" (see pages 83 to 99) and in the financial statements set out in Appendix 1 to this Prospectus (together, the "**AGE Information**"). To the best of the knowledge of AGE (which has taken all reasonable care to ensure that such is the case), the AGE Information is in accordance with the facts and does not omit anything likely to affect the import of such information. AGE accepts no responsibility for any other information contained in this Prospectus. Save for the AGE Information, AGE has not separately verified the information contained in this Prospectus. No representation, warranty or undertaking, expressed or implied, is made and no responsibility or liability is accepted by AGE as to the accuracy or completeness of any information contained in this Prospectus (other than the AGE Information) or any other information supplied in connection with the Bonds or their distribution. Each person receiving this Prospectus acknowledges that such person has not relied on AGE nor on any person affiliated with it in connection with its investment decision and investigation of the information contained in this Prospectus (other than the AGE Information).

AGM accepts responsibility for the information contained below in the sections of this Prospectus entitled "*Assured Guaranty Municipal Corp*." (see pages 122 to 127) and "*Form of AGM Financial Guarantee*" (see pages 100 to 116) and in the financial statements set out in Appendix 2 to this Prospectus (together, the "**AGM Information**"). To the best of the knowledge of AGM (which has taken all reasonable care to ensure that such is the case), the AGM Information is in accordance with the facts and does not omit anything likely to affect the import of such information. AGM accepts no responsibility for any other information contained in this Prospectus. Save for the AGM Information, AGM has not separately verified the information contained in this Prospectus. No representation, warranty or undertaking, expressed or implied, is made and no responsibility or liability is accepted by AGM as to the accuracy or completeness of any information contained in this Prospectus (other than the AGM Information) or any other information supplied in connection with the Bonds or their distribution. Each person receiving this Prospectus acknowledges that such person has not relied on AGM nor on any person affiliated with it in connection with its investment decision and investigation of the information contained in this Prospectus (other than the AGM Information).

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OVERVIEW OF THE PROJECT

The following is an overview of the Project (as defined below) and should be read in conjunction with the rest of this Prospectus.

1. GENERAL

The following is an overview of the Project and should be read in conjunction with the rest of this Prospectus. The summaries of the documents do not purport to be complete and are subject to the detailed provisions of such documents.

1.1 ProjectCo (also known as the "**Contractor**") has signed a project agreement (the "**Project Agreement**") with the Authority to be dated on the Issue Date. Pursuant to the Project Agreement, the Contractor will agree to develop and refurbish certain properties ("**Dwellings**") in the areas of Little London, Beeston Hill & Holbeck ("**Sites**") in the City of Leeds for the Authority and to maintain the Dwellings including:

(i) a total of 388 new build properties comprised of 275 new build properties in Beeston Hill & Holbeck and 113 new build properties in Little London (the "**New Build Properties**");

(ii) a total of 1,296 refurbishment properties (including 51 leasehold dwellings) comprised of 407 refurbishment properties in Beeston Hill & Holbeck and 889 refurbishment properties in Little London (the "**Refurbishment Properties**");

(iii) a total of 215 demolition properties comprised of 199 demolition properties in Beeston Hill & Holbeck and 16 demolition properties in Little London (the "**Demolition Properties**"); and

(iv) the provision of facilities management and lifecycle services (the "**Facilities Management Services**") to all 1,633 Dwellings (excluding 51 leasehold dwellings) in Beeston Hill, Holbeck and Little London,

together, (the "**Project**").

*Note: The core of the tenancy management functions such as allocation of tenants to the properties, enforcing rights of the landlord, eviction of problem tenants etc, will be retained by the Arms Length Management Organisation ("**ALMO**"), and will not form part of the Facilities Management Services of the Project*

1.2 The term of the Project will be 20 years and 3 months from the Issue Date (the "**Project Term**") unless it is terminated early. The Project is part of the PFI and approval for the Project has been given by the Department of Communities and Local Government on behalf of the Secretary of State for Communities and Local Government in England and Wales. The construction and refurbishment period is expected to last 45 months.

1.3 The Project Agreement will become effective upon the Issue Date. The issue of the Bonds is conditional upon the Project Agreement becoming effective (subject only to the issue of the Bonds).

1.4 It is a condition precedent to the issue of the Bonds that the Authority be given approval by the Secretary of State for Communities and Local Government pursuant to Section 27 of the Housing Act 1985 to enter into the Project. Each Project Document will be dated on or prior to the Issue Date and will be subject to the laws of England and Wales and the jurisdiction of the English courts.

1.5 Sources of funding for the Project include but are not limited to:

(i) Capital Contribution from the Authority of £42.6m (the "**Capital Contribution**");

(ii) subordinated debt drawdowns of circa £12.418m; and

(iii) Bond drawdowns of circa £100m.

These figures are indicative and subject to finalisation at financial close.

1.6 The Contractor has signed a fixed price turnkey "drop down" sub-contract (the "**Building Contract**") of a value of £145,187,363 (excluding VAT) (the "**Contract Sum**"), to be dated the Issue Date with Frank Haslam Milan & Co Limited (the "**Building Contractor**"). The Building Contractor will carry out all of the refurbishment, new build, demolition and environmental improvement works (the "**Works**") and will perform all other associated works and the other obligations set out in the Building Contract. The independent certifier is Sweett (UK) Limited (the "**Independent Certifier**") and will certify completion of the dwellings. For a detailed description, please see the section entitled "*Overview of the Project Documents*" below.

The Building Contractor will have a liability cap available to the Contractor, excluding *inter alia* breach of statutory duty, of an aggregate amount of 60% of the Contract Sum, which includes liabilities for liquidated damages in the event of delay. The obligations of the Building Contractor under the Building Contract are guaranteed jointly and severally by Keepmoat Regeneration Limited and Keepmoat Limited (the "**Construction Contractor Guarantors"**). The following additional performance security will be provided:

(i) a performance bond under the Building Contract, on the basis of an adjudication bond of an initial value of £17m, from Liberty Mutual Insurance Limited (the "**Performance Bond**"), acceptable to the Contractor, AGE, AGM, the Security Trustee, the Bond Trustee, the Paying Agent and any other person providing finance pursuant to the Collateral Deed, the Bonds and any other financing document (together, the "**Senior Funders**". This is payable upon the presentation of an adjudicator award setting out the amount (which is then payable by the surety if not paid either by the Building Contractor or either of the Construction Contractor Guarantors) or in relation to termination liabilities presentation of a certificate from the Independent Certifier setting out the amounts due. The Performance Bond has four step-downs depending on the number of Dwellings that have been certified as complete. For a detailed description, please see section 2.6 of "*Overview of the Project Documents*" below;

(ii) a letter of credit issued by Lloyds TSB Bank plc under the Building Contract, of an initial value of £7.5m (the "**Letter of Credit**"). The Letter of Credit steps down in four stages, depending on the number of Dwellings that have been certified as complete. For a detailed description, please see section 2.6 of "Overview of the Project Documents" below;

(iii) a maximum retention equal to 13.75% of the Contract Sum under the Building Contract, which shall be reduced on a Dwelling completion basis on certification of completion by the Independent Certifier and further reduced to 0% on expiry of the last defects liability period which will be 12 months from the certification of availability of the final Dwelling; and

(iv) a Financial Guarantee of £2.5m will be made available by AGE and AGM for two (2) years from the commencement of the Project Agreement, on the occurrence of an event of termination under the Building Contract and exhaustion of the Performance Bond, Letter of Credit and construction retention detailed above.

1.7 The Contractor will procure the Facilities Management Services through a sub-contract (the "**Facilities Management Contract**") to be signed and dated the Issue Date between the Contractor and Frank Haslam Milan & Co Limited (the "**Facilities Management Contractor**"). The value of the Facilities Management Contract will be £53,886,229 (unindexed and excluding VAT) (the "**FM Contract Sum**") and the Facilities Management Contractor will receive a monthly service fee for performance of the Facilities Management Services (the "**FM Service Fee**"). The Facilities Management Contractor will enter into a further sub-sub-contract with Keepmoat Property Services Limited (formerly Milnerbuild Limited), for the carrying out of all the Facilities Management Services, except for the lifecycle works, which will be retained by the Facilities Management Contractor. Deductions incurred under the Project Agreement will be passed down to the Facilities Management Contractor subject to the caps on liability (the "**Deductions**") (see below). Both the Facilities Management Contractor and Keepmoat Property Services Limited are wholly owned subsidiaries of Keepmoat Limited.

The Facilities Management Contractor has a liability cap available to the Contractor, excluding breach of statutory duty to the value of 100% annually of the FM Contract Sum, plus the annual lifecycle expenditure and 200% in the event of termination of the annual FM Contract Sum plus the annual average lifecycle expenditure. The obligations of the Facilities Management Contractor under the Facilities Management Contract will be jointly and severally guaranteed by Keepmoat Regeneration Limited and Keepmoat Limited (the "**Facilities Management Contractor Guarantors**").

The scope of the Facilities Management Services included within the Facilities Management Contract include:

(i) property repair and maintenance service;

(ii) re-servicing void properties inclusive of transfers and mutual exchanges;

(iii) caretaking and cleaning services to the communal areas;

(iv) environmental maintenance to the areas indicated in the output specification set out in the Project Agreement;

(v) customer access and liaison; and

(vi) contract management and reporting information.

1.8 The sub-contractors will enter into an agreement with the Contractor (the "**Interface Agreement**") defining:

(i) the terms by which each of the sub-contractors may seek a reallocation to the other sub-contractor of Deductions and other liabilities incurred by the Contractor under the Project Agreement and passed down to them under their sub-contracts ("**Pass-Down Liability**"); and

(ii) the terms under which the sub-contractors may be directly liable to each other for liabilities arising between each other independent of the Project Agreement ("**Domestic Liability**"). It will also cap the liability of each sub-contractor to the other for Domestic Liability. If these caps for Domestic Liabilities are breached, then the sub-contactor retains the liabilities which are not passed to the Contractor.

In the circumstance that a sub-contractor cannot recover an amount from the other sub-contractor due to the insolvency of the other sub-contractor, then the liability will pass back to the Contractor.

1.9 The Authority, the Security Trustee and the Contractor will enter into a direct agreement (the "**Funders' Direct Agreement**") to be dated the Issue Date relating to rights of step-in and step-out in default situations which might otherwise cause termination of the Project Agreement below). Similarly, the Contractor, the Security Trustee and each of the sub-contractors and the relevant guarantors will enter into direct agreements (the "**Senior Funder's (sub-contractor) Direct Agreements**") to be dated the Issue Date regulating their relationship with the funders in relation to the sub-contracts.

1.10 The Contractor will provide through the Facilities Management Contract:

(i) interim services to the Authority from 30 September 2013 (the "**Initial Services Commencement Date (Refurbishment)**") to the date of issue of the relevant certificate of availability (the "**Full Services Commencement Date**") in respect of each Dwelling; and

(ii) full services to the Authority from the Full Services Commencement Date in respect of each refurbishment dwelling ("**Refurbishment Dwelling**") and new build dwelling ("**New Build Dwelling**") until the termination of the Project Agreement or the expiry of the Project Term.

1.11 The Authority will be obliged to make:

(i) unitary charge payments in accordance with the payment mechanism of the Project Agreement (the **"Unitary Charge"**); and

(ii) payment of the Capital Contribution to the Contractor on completion of the Dwellings.

The Unitary Charge is subject to a detailed availability based performance measurement regime and may be subject to Deductions for poor performance and unavailability, in accordance with the payment mechanism of the Project Agreement. The Unitary Charge will continue (subject to availability and performance deductions, relief events, force majeure and uninsurable risks) until the termination of the Project Agreement or the expiry of the Project Term. Deductions are passed down to the Facilities Management Contractor subject to the liability caps in the Facilities Management Contract.

1.12 Grounds maintenance, caretaking and cleaning services will be subject to market testing. For a detailed description, please see section 1.10 of "*Overview of the Project Documents*" below. The Unitary Charge is adjusted for the results of the market testing, such that any increase or decrease in real terms from the Facilities Management Contractor's underlying cost of providing these services increases or reduces the payment for the Facilities Management Services on a pound for pound basis. 24% of the Unitary Charge is subject to retail price indexation ("**RPI**") from a base date of April 2010.

1.13 The project will be financed in the manner described in the section below entitled "*The Financing of the Project*". In brief , the Project will be financed by:

(i) the proceeds of the issue of the Bonds by the Issuer which will be on-lent by the Issuer to ProjectCo pursuant to an agreement between the Issuer, ProjectCo and the Security Trustee (the **"Bonds Proceeds Onloan Agreement"**);

(ii) the proceeds of the subscription by HoldCo for shares in the Issuer and ProjectCo and the £12,680,000 subordinated loan notes issued by the Issuer which will be on-lent by the Issuer to ProjectCo pursuant to an agreement between the Issuer and ProjectCo (the **"Equity Proceeds Onloan Agreement"**);

(iii) the Capital Contribution, in the sum of £42,600,000, which will be received by ProjectCo from the Authority following completion of certain elements of the Works;

(iv) certain revenues earned by ProjectCo as a result of the phased completion of the Works and the commencement of the Facilities Management Services; and

(v) interest accrued on certain of ProjectCo's bank accounts with The Bank of New York Mellon, London Branch (the "**Account Bank**"), in accordance with the account bank agreement made between the Obligors, the Security Trustee, the Bond Trustee, AGE, AGM and the Account Bank (the **"Account Bank Agreement"**); income earned from authorised investments made in accordance with the Account Bank Agreement; and investment return earned on the guaranteed investment contract entered into by the Project Co on or about the Issue Date (the "**GIC**").

The Bonds will have the benefit of the Financial Guarantees issued by the Financial Guarantors unconditionally and irrevocably guaranteeing amounts unpaid by the Issuer in respect of scheduled instalments of principal and interest due thereon.

Interest and principal on the Bonds will be payable in arrears on 31 March and 30 September (unless this is not a business day in which case the next following business day) in each year in accordance with the terms and conditions of the Bonds. Interest and principal payable under the Bond Proceeds Onloan Agreement will match interest and principal payable on the Bonds.

The financing is described in greater detail in the section below entitled "*The Financing of the Project*".

RISK FACTORS

This section is an overview of certain factors (including certain risks and mitigating factors) involved in the Project which may affect the ability of the Issuer to make payments of interest and principal on the Bonds. In the case of certain risks, this may lead to, amongst other things:

(i) *an event of default under the Collateral Deed (see the section entitled "The Financing of the Project – Collateral Deed") and hence, at the option of the Financial Guarantors while they are the Majority Creditors (but subject to the provisions of the Security Trust and Intercreditor Deed), acceleration of the Bonds (see the sections entitled "Terms and Conditions of the Bonds – Events of Default"; and/or*

(ii) *non-payment of those amounts due on the Bonds and not guaranteed under the Financial Guarantees (see the section entitled "The Financing of the Project – The Bonds and the Financial Guarantees"), and if additionally either AGE or AGM were to default on its obligations under its Financial Guarantee, non-payment of amounts due on the Bonds which are guaranteed under the Financial Guarantees.*

Prospective investors should note that the following factors may affect the Issuer's, AGE's or AGM's ability to fulfil their respective obligations under the Bonds, the Bond Trust Deed and the Financial Guarantees (as relevant) and that investors could lose some or all of their investment. All of these factors are contingencies which may or may not occur and no view is expressed on the likelihood of any such contingency occurring.

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

The Issuer believes that the factors described below represent the principal risks inherent in investing in the Bonds, but the inability of the Issuer to pay interest, principal or other amounts on or in connection with the Bonds may occur for other reasons which may not be considered significant risks by the Issuer based on information currently available to it or which it may not be able to anticipate.

This section is not intended to be, and is not, exhaustive. Prospective investors should also read the detailed information set out elsewhere in this Prospectus and reach their own views prior to making any investment decision. Further, any prospective investors should take their own legal, financial, accounting, tax and other relevant advice as to the structure and viability of their investment.

The Bonds will be obligations solely of the Issuer and will have the benefit of (a) the Financial Guarantees issued by the Financial Guarantors (excluding any Bonds for so long as they are held by or on behalf of the Issuer Group) and (b) the guarantees granted by HoldCo and the Contractor under the Collateral Deed. The Bonds will not be guaranteed by the Lead Manager, the Bond Trustee, the Security Trustee or the HoldCo Shareholders.

1. RISKS RELATING TO THE ISSUER, THE CONTRACTOR, HOLDCO AND THE PROJECT

Introduction

The contractual arrangements for the Project are generally structured to minimise the retention by the Contractor of risks inherent in the Project. Risks under the Project Agreement are generally borne by the Contractor, unless assumed by the Authority. To the extent borne by the Contractor under the Project Agreement, most risks are passed to the sub-contractors under the relevant sub-contracts or managed through insurance. However, to the extent that the sub-contractors, their respective guarantors, the Authority or insurers fail to meet their obligations in respect of risks under the Project Documents which have been passed on to them by the Contractor or claims by the Contractor exceed agreed limits on liability under the sub-contracts, the Contractor will continue to bear such risk to the extent defined in the Project Agreement. This is the standard position in PFI projects.

The Project Agreement follows the guidelines issued by Local Partnerships under the "Local Partnerships Housing Procurement Pack" standard form (as updated in October 2011) and includes certain provisions from the "Standardisation of PF2 Contracts " provisions issued by HM Treasury.

Deductions

(i) The Unitary Charge is the primary source of revenue enabling the Contractor to pay principal and interest in respect of the Bonds.

(ii) The Unitary Charge is subject to Deductions for:

(a) poor performance or non-performance of the services ("**Performance Deductions**");

(b) unavailability of the properties (or part or parts of them) ("**Unavailability Deductions**"); and

(c) failures in connection with reporting requirements under the Project Agreement ("**Reporting Failure Deductions**"),

in each case as defined and measured under the Project Agreement.

(iii) Deductions from the Unitary Charge for poor performance or unavailability are passed down to the Facilities Management Contractor carrying out the Facilities Management Services. As such, Deductions will in most cases either be recovered by the Contractor from the Facilities Management Contractor or from business interruption insurance (in the event of associated physical damage). In limited cases, the Contractor may suffer Deductions from the Unitary Charge for which it will not have recourse against a sub-contractor or an insurer, including where:

(a) the Deductions are caused directly by acts or omissions of the Contractor; or

(b) the value of the Deduction is below the relevant insurance deductible or excess.

(iv) There are however the following caps which provide a degree of protection to the Contractor under the Project Agreement:

(a) an annual cap on Deductions;

(b) an annual cap on Performance Deductions; and

(c) limitation on what Deductions can be applied during the bedding-in period (which is the first three (3) months after the Initial Services Commencement Date (Refurbishment)).

(v) The procedure for the initial allocation of Deductions is set out in the Interface Agreement which is entered into between the Contractor and the sub-contractors.

(vi) To the extent that Deductions from the Unitary Charge exceed the relevant sub-contractor's liability cap or are otherwise not passed down to a sub-contractor, and subject to any relevant insurances and reserves, the ability of the Contractor to make payments in respect of the Bond Proceeds Onloan Agreement and hence the ability of the Issuer to make payments in respect of the Bonds may be adversely affected. The limits on liability of the sub-contractors and, ultimately, the related sub-contractor termination triggers have been set at levels intended to minimise the residual risk to the Contractor.

(vii) To the extent that Unitary Charge uplifts are triggered late, such that the net revenue received by the Contractor during the period prior to completion of all the Works is less than forecast, then the ability of the Contractor to meet its liabilities in respect of the Works may be adversely affected. The Contractor's insurances have been put in place to mitigate this risk. To the extent delays are caused by the Building Contractor, the liquidated and ascertained damages under the Building Contract have been structured to minimise the risk of any shortfall.

Costs Overrun, Construction Delay and Compliance with Specification

(i) Principal risks which may arise in relation to the Works include:

(a) the Works not being completed within the agreed price in the Building Contract;

(b) the Works not being completed on time which may affect the stepping-up of the Unitary Charge and receipt of the Capital Contributions and may lead to a claim by the Authority for liquidated damages in the Project Agreement and potential termination; and

(c) the design and construction of the Works not being undertaken in compliance with the specifications and construction obligations.

(ii) Risks assumed by the Contractor in relation to the carrying out of the Works under the Project Agreement relating to design, price overrun, technical compliance, delay, defects and resulting losses of availability are borne by the Building Contractor under the Building Contract subject to an agreed cap which is sixty per cent (60%) of the Contract Sum under the Building Contract including liquidated damages for delay.

(iii) The obligations of the Building Contractor under the Building Contract are guaranteed by the Building Contractor's guarantors on a joint and several basis, pursuant to the guarantees provided in accordance with the Building Contract.

(iv) Progress of the Works is measured by way of milestones ("**Milestones**"). Milestones are divided into both new build milestones and refurbishment milestones. A certain number of New Build Properties and a certain number of Refurbishment Properties are required to be completed by the relevant Milestone dates (the "**Milestone Dates**"). Milestone Dates are set three months apart commencing twelve months after the Initial Services Commencement Date (Refurbishment). A failure to achieve a Milestone by the relevant Milestone Date results in the awarding of a default termination point (a "**Default Termination Point**"). An event of default of the Contractor under the Project Agreement occurs if five Default Termination Points are outstanding in respect of either New Build Properties or five Default Termination Points are outstanding in respect of Refurbishment Properties. Where however a Milestone for which a Default Termination Point has been awarded is achieved by a later Milestone Date, then the relevant Default Termination Point which was previously awarded is then removed.

A failure to meet certain Milestones which may lead to termination have been agreed at the Project Agreement level and have been dropped down to the Building Contract in such a way intended to enable the Contractor to step in and replace the defaulting Building Contractor prior to termination being triggered at Project Agreement level.

(v) The risk of delays in completing the Works has been passed down to the Building Contractor under the Building Contract with appropriate headroom. Any shortfall in Unitary Charge arising out of a delay in the Works is recovered through the liquidated damages regime for delay detailed in the Building Contract.

(vi) In addition, Capital Contributions are paid on a per Dwelling basis having reached practical completion and a certificate of availability (the "**Certificate of Availability**") having been issued. The cash flow risk that may arise from a shortfall in Capital Contributions has been passed down to the Building Contractor.

(vii) Compensation Events (as defined below), Force Majeure, Relief Events, Authority's Changes and qualifying Changes of Law occurring in the construction period (the "**Works Period**") will not extend the Project Term. However, they will cause the affected planned works completion dates to be adjusted to allow for any delay suffered (provided such adjustment is applied for promptly in accordance with the Project Agreement's procedures) and therefore, adjust the Milestone Dates respectively.

(viii) Compensation events ("**Compensation Events**") trigger compensation entitlements for the Contractor which would entitle the Contractor to such compensation as would place it in no better or no worse position than it would have been in had the Compensation Event not occurred.

Service Performance and Availability

(i) The Facilities Management Contractor will be monitored against agreed measures. Deficient performance can progressively reduce the Unitary Charge and the FM Service Fee payable in respect of Facilities Management Services.

(ii) A certain level of deficient performance may lead to Deductions. The receipt of the Unitary Charge without Deductions is the primary source of revenue enabling the Contractor to pay principal and interest in connection with the Bonds. Unavailability Deductions may result in a lower than forecast Unitary Charge, for which recourse will be against the Facilities Management Contractor subject to liability caps. Unavailability Deductions may also arise as a consequence of insured events in which case recovery would be made under the project insurance policies subject to excess and policy terms.

(iii) Ultimately, at higher thresholds of Deductions, the Authority will be able to terminate the Project Agreement for poor service performance.

(iv) The termination triggers at Project Agreement level for poor performance have been dropped down to the Facilities Management Contractor under their sub-contract with headroom with the intention to enable the Contractor to terminate and replace the poor performing sub-contractor prior to termination being triggered at the Project Agreement level.

Replacement of sub-contractors

(i) As described above the Contractor has flowed down the provisions of the Project Agreement to the Building Contractor or the Facilities Management Contractor (as applicable) subject to the caps on liability. Where a sub-contractor replacement is necessary, there are potential risks of increased costs and/or amendments to contract terms. Mitigation of the risks are sought through the provision of the following:

 (a) For the Building Contractor, a security package in the form of:

(I) guarantee provided by the parent company of the Building Contractor;

(II) Performance Bond;

(III) Letter of Credit;

(IV) cash retention; and

(V) additional credit enhancement as referred to in Section 6 of the Overview of the Project.

(b) For the Facilities Management Contractor: a guarantee provided by the parent company of the Facilities Management Contractor.

Site conditions, contamination and asbestos

(i) Site conditions (unforeseen)

Generally the Contractor is responsible for unforeseen ground conditions and contamination as follows:

(a) New Build Properties – the Contractor is taking the risk of site conditions and contamination which are not under existing buildings on all new build sites as indicated in the Project Agreement;

(b) Refurbishment Properties – the Contractor is responsible for all site conditions and contamination on all refurbishment sites to the extent that such site conditions and contamination have been or could have been revealed from surveys of the Sites; and

(c) This risk has been passed down to the sub-contractors who have mitigated their exposure through carrying out surveys across the Sites as well as through their contract pricing.

(ii) Site conditions (known and foreseeable)

(a) The Contractor is responsible for all known and foreseeable site conditions including the Japanese knotweed which has been identified and quantified within the Project Agreement.

(b) This risk has been passed down to the sub-contractors who have mitigated their exposure through carrying out surveys across the Sites as well as through their contract pricing.

(iii) Asbestos

The Contractor is responsible for asbestos in the Demolition Properties and the Refurbishment Properties that was identified in the Type 2 Asbestos surveys carried out or would have been identified had such other surveys "that as it would have been reasonable to expect a reasonably experienced contractor exercising reasonable skill and care to have carried out in the circumstances or otherwise would have been revealed by a non-intrusive inspection".

Rights and Access

(i) There is a risk that the Contractor may not be able to obtain access to relevant parts of a Site and/or Dwelling due to the rights of other parties, including the Authority and tenants, because the licences granted by the Authority to the Contractor are subject to these rights.

(ii) The Authority warrants it has disclosed all rights and titles that could prevent or disturb the carrying out of the Works or Facilities Management Services (the "**Adverse Rights**") in respect of the Sites, save that non-disclosed Adverse Rights which were discoverable by the Contractor remain at the Contractor's risk. The Contractor has undertaken legal due diligence on the relevant titles to identify and mitigate any further issues.

(iii) There is a risk that the actions of tenants at the Site and/or Dwelling could affect the Contractor's ability to perform its obligations, for example failing to grant access to a Dwelling for Works to be undertaken. Certain tenant actions that impact on the Contractor's ability to perform are treated as Excusing Events and Relief Events, including where a tenant, or a third party, has damaged a Dwelling where access is refused to the Dwelling and/or Site ("**Access Refusal Event**"), where a tenant has refused to be rehoused ("**Rehousing Refusal Event**") and where a tenant has waived having works undertaken (a "**Tenant Waiver Event**"). There are provisions set out in the Project Agreement setting out criteria for when these events will be deemed to have occurred and the responsibilities of the Authority and the Contractor on how to deal with these events.

(iv) The effect of this is that (provided that the Contractor has complied with the relevant protocol governing such events) the Contractor is relieved from termination and the Unitary Charge is payable as if such impact had not occurred. Additionally, the occurrence of an Access Refusal Event, Rehousing Refusal Event and Tenant Waiver Event cannot prevent the Contractor from obtaining a Certificate of Availability and uplift in the Unitary Charge by the end of the Works Period.

Defects

(i) The Contractor takes the risk of defects in New Build Properties and Refurbishment Properties to the extent identified by stock condition surveys or as may reasonably be interpreted from such surveys. Otherwise the Authority takes the risk of defects in Refurbishment Properties.

(ii) For the first 12 years from the issue of the Certificate of Availability for the final Dwelling, risk of latent defects has been flowed down to the Building Contractor. The Facilities Management Contractor takes the risk of defects in any property from year 12 of the issue of the Certificate of Availability for the final Dwelling for the Works.

(iii) The sub-contractors have sought to mitigate the risk through the following:

(a) additional stock condition surveys where required;

(b) pricing allowance for back-log maintenance at Initial Services Commencement Date (Refurbishment); and

(c) scoping of the Works based on experience of refurbishment work on the same archetype properties in the locality.

Termination of the Project Agreement

(i) As is usual in PFI projects the Project Agreement incorporates termination rights for the Authority and the Contractor and provides for compensation from the Authority in the case of termination for any reason of the Project Agreement, with the amount received varying depending on the reason for termination and other circumstances.

(ii) The amount of compensation payable by the Authority if termination of the Project is due to voluntary termination by the Authority or Authority default is intended to enable the Contractor to meet its obligations under the Bond Proceeds Onloan Agreement and hence the ability of the Issuer to make payments in respect of Bonds (including the bond spens amount) as referred to in the following paragraph.

(iii) The bond spens amount is calculated in accordance with Condition 6.3 (*Mandatory Redemption*) (see the section entitled "*Terms and Conditions of the Bonds – Redemption and Purchase"*).

(iv) The amount of compensation payable by the Authority if termination of the Project is due to a Force Majeure Event; corrupt gifts and fraud; wilful breach of the refinancing provisions; or occurrence of an uninsurable risk has been structured to enable ProjectCo to meet its obligations under the Bonds (excluding the bond spens amount referred to above).

(v) Accordingly payment by the Authority of such compensation may not be sufficient or sufficiently timely to enable the Contractor to meet its obligations under the Bonds as they fall due.

(vi) For termination by reason of default of the Contractor (other than corrupt gifts or wilful breach of the refinancing provisions) the amount of compensation will depend on the Project's value as assessed either by bidders in the market or by expert valuation. In any event, there is no prescribed minimum valuation and the compensation may well not be sufficient to enable the Contractor to meet its obligations under the Bonds. Prospective investors should also note that if the Bonds become subject to redemption under Condition 6.3 of the Bonds by reason of termination of the Project Agreement due to Contractor Default, the redemption amount payable on the Bonds will be calculated on the basis of the spens formula set out in that Condition. This risk has been mitigated to an extent through the negotiation of termination events in the Project Agreement including headroom at sub-contract level which are designed to enable the Contractor to replace a defaulting sub-contractor prior to triggering termination at Project Agreement level as well as through a comprehensive security package for each of the sub-contractors (see the section entitled "*Overview of Project Documents*").

(vii) In addition, under the Funders' Direct Agreement, in relation to events of default by the Contractor, there is a step-in right under the Project Agreement designed in part to enable the Security Trustee to step-in and rescue the project in accordance with the Funders' Direct Agreement by replacing the Contractor (and relevant sub-contractors) prior to Project Agreement termination.

(viii) In the event of termination of the Project Agreement, the Contractor will transfer to the Authority those assets and contracts acquired or entered into by the Contractor that it requires in order to continue to carry out the Project.

Lifecycle

(i) Under the Project Agreement, the Contractor is responsible for performing the lifecycle works (the "**Lifecycle Works**") and assumes the risk of inadequacy of the cost allowances throughout the Project Term. This obligation is passed down to the Facilities Management Contractor under the Facilities Management Contract and the Facilities Management Contractor is assuming risks for the sufficiency of the lifecycle account and the delivery of the Lifecycle Works.

(ii) The Facilities Management Contractor has sought to mitigate the risk through the following:

(a) scoping of the Works based on experience of repairs and maintenance work on similar properties in the locality;

(b) specification of materials and goods to optimise life expectancy; and

(c) adoption of an integrated approach between the Building Contractor and Facilities Management Contractor through a common supply chain.

Indemnities

(i) Under the Project Agreement, the Contractor indemnifies the Authority in respect of the following heads of claim which may materialise:

(a) claims for death or personal injury;

(b) damage or loss to Authority's property;

(c) third party actions and claims; and

(d) breach of statutory duty, up to certain monetary caps.

(ii) These indemnities are passed down to the sub-contractors where their activities have given rise to the claim (and are excluded from their sub-contract liability caps) and in the majority of circumstances, insured.

Planning and consents

(i) Detailed planning permissions for all Sites in connection with the Project have been achieved. The Contractor is obliged to obtain stopping-up orders ("**Stopping Up Orders**") to carry out the Works.

(ii) The Contractor has passed down to the Building Contractor the risk of obtaining Stopping Up Orders, other relevant consents and discharging the reserved matters associated with the planning permissions required to carry out the Project. In the event that Stopping Up Orders cannot be obtained, the Project Agreement provides for the Contractor's protection through the Authority's change regime.

Change of Law

(i) The Contractor takes the risk of:

(a) general change of law ("**General Change of Law**") during the Works Period;

(b) any General Changes of Law that are foreseeable; and

(c) during the period in which services are being provided in accordance with the Project Agreement (**"Service Period"**), any General Change of Law that involves operational expenditure.

The Contractor has passed the above risks of change of law ("**Change of Law**") to the Building Contractor and the Facilities Management Contractor.

(ii) The Authority takes the risk for:

(a) specific and discriminatory Changes of Law; and

(b) during the Services Period, for General Changes of Law that come into effect and which involves capital expenditure.

Increase of insurance premia risk

(i) Risk of increases in insurance costs primarily sits with the Contractor. However, if there is a movement of more than 30% in the projected operational insurance costs on account of market wide factors, any excess will be shared 85% to the Authority and 15% to the Contractor.

(ii) The Contractor believes that it has made an adequate allowance for bid market insurance costs. To the extent that the Contractor's insurance premia are affected by actions of the sub-contractors, the risk of additional insurance costs have been passed down to the Building Contractor and Facilities Management Contractor.

Local authority covenants

(i) The Contractor relies on revenues in the form of payment of the Unitary Charge and Capital Contributions by the Authority.

(ii) The Authority will issue a certificate pursuant to the Local Government (Contracts) Act 1997 in respect of both the Project Agreement and the Funders' Direct Agreement, so that each of these is a certified contract. The certificate certifies that the contract has effect (and be deemed always to have effect) as if the local authority had power to enter into it and had exercised that power properly in entering into it.

(iii) The Department for Communities and Local Government has written to the Authority stating that grant support will be provided based on a maximum level of £176.5m in net present value terms, which may be adjusted following the Issue Date to a lower level though still sufficient to ensure affordability of the Project for the Project Term.

Security package and excluded liability

(i) The Contractor has negotiated security packages to be provided by the sub-contractors to support their sub-contract obligations, as follows:

(a) the Building Contractor's obligation under the Building Contract will be supported by a Performance Bond, of an initial value of £17m. The Performance Bond will be issued by Liberty Mutual; and

(b) costs arising under, out of or in respect of the funding agreement and costs that are financing costs are excluded liabilities under the Performance Bond, i.e. they are not covered by the bond amount. Liquidated damages, actual net loss, any interim account, cost to complete, delay damages, any initial statement amount and any compensation shortfall are not financing costs or costs arising under a funding agreement.

(ii) The expiry date of the Performance Bond is on the first to occur of:

(a) the date of issue of the relevant Certificate of Availability demonstrating that a cumulative total of 1,530 Dwellings have been completed in accordance with the Building Contract;

(b) three months after the date of termination of the Building Contract; and

(c) the date five years less one day after the date of the Performance Bond.

(iii) The performance bond has four step-downs being on the certification of 826 Dwellings, 1,242 Dwellings, 1,437 Dwellings and lastly 1,631 Dwellings. For the surety to make a payment to the Contractor, a valid claim must be issued to the surety. Before a valid claim can be issued to the surety and a claim be paid by the surety, the Contractor must have made written demand on the Building Contractor Guarantors under the parent company guarantee for payment of the claim amount and the Building Contractor Guarantors have failed to pay such claim amount.

Letter of Credit

(i) The initial value of the Letter of Credit is £7.5m. There are five step downs of the Letter of Credit with an expiry date of 31 March 2017 subject to receipt of the final Certificate of Availability. The step down dates for the Letter of Credit are the following:

(a) first step down is on the later of month 24 or certification of the 744th Dwelling;

(b) second step down is on the later of month 36 or certification of the 1,535th Dwelling;

(c) third step down is on the later of month 39 or certification of the 1,631st Dwelling;

(d) fourth step down is on the later of month 42 or certification of the 1,654th Dwelling; and

(e) final step down is the completion of 1,684th Dwelling or the final dwelling if the total number of Dwellings has been reduced.

Retention

The Contractor will be entitled to retain and deduct the retention percentage of the gross valuation (as certified by the technical adviser to the Senior Funder) under the Building Contract as follows:

(i) from the date of the Building Contract to month 10 or certification of the 40th Dwelling, the sum equal to 13.75% of the gross valuation of Works executed;

(ii) then to month 28 or certification of the 1,071st Dwelling, the sum equal to 10% of the gross valuation of Works executed;

(iii) then to month 46 or certification of the 1,684th Dwelling, a sum equal to 5% of the gross valuation of Works executed;

(iv) then and until the last day of the defects liability period a sum equal to 2.5% of the gross valuation of Works executed.

Credit Enhancement

Assured Guaranty has entered into an agreement to provide additional credit enhancement of £2.5m for two (2) years from the commencement of the Project Agreement, on the occurrence of an event of termination under the Building Contract and exhaustion of the Performance Bond, Letter of Credit and construction retention detailed above (the **"Construction Reserve Finance Guarantee"**).

2. RISKS RELATING TO THE FINANCIAL GUARANTORS

Ratings of Bonds affected by the Financial Guarantors

The ratings of the Bonds are based primarily on the Financial Guarantees issued by the Financial Guarantors with respect to the Bonds. The financial strength ratings assigned by S&P and Moody's to the Financial Guarantors provide the rating agencies' opinions of each Financial Guarantor's financial strength and ability to meet ongoing obligations to policyholders and cedants in accordance with the terms of the financial guarantees it has issued or the reinsurance agreements it has executed. The ratings also reflect qualitative factors, such as the rating agencies' opinion of a financial guarantor's business strategy and franchise value, the anticipated future demand for its product, the composition of its portfolio, and its capital adequacy, profitability and financial flexibility. A downgrade by a rating agency of the financial strength ratings of either of the Financial Guarantors could impair the Financial Guarantors' financial condition, results of operation, liquidity, business prospects or other aspects of the Financial Guarantors' business.

The ratings assigned by S&P and Moody's to the Financial Guarantors are subject to frequent review and may be lowered by a rating agency at any time and without notice to the Financial Guarantors as a result of a number of factors over which the Financial Guarantors have no control, including, but not limited to, the rating agency's revised stress loss estimates for a Financial Guarantor's portfolio, adverse developments in a Financial Guarantor's financial condition or results of operations because of underwriting or investment losses or other factors, changes in the rating agency's outlook for the financial guarantee industry or in the markets in which the Financial Guarantors operate, or a revision in the rating agency's capital model or ratings methodology.

A downgrade may have a negative impact on a Financial Guarantor in respect of transactions that it has insured or reinsurance that it has assumed. For example, a downgrade of one of the Financial Guarantors may result in increased claims under certain financial guarantees issued by such Financial Guarantor, including, with respect to AGM, (i) termination of certain interest rate swaps guaranteed by AGM which in turn may result in claims to AGM if the obligor owed a termination payment as a result and AGM guaranteed such termination payment; (ii) early termination of all leases under leveraged lease transactions insured by AGM which in turn may result in claims to AGM to the extent the early termination payment owing to the lessor within such a transaction is not paid by the municipal lessee (this is mitigated by a liquidity facility with Dexia Crédit Local S.A.); and (iii) certain GICs issued by AGM's former affiliates that are guaranteed by AGM may come due or may come due if the GIC issuers do not post collateral.

In addition, the rating agencies may change their requirements for the Financial Guarantors' respective capital adequacy. Changes in the rating agencies' capital models or ratings methodology could require additional capital to be raised to maintain the Financial Guarantors' current ratings levels, even if there are no adverse developments with respect to any specific investment or insured risk. The amount of such capital required may be substantial, and may not be available to the Financial Guarantors on favourable terms and conditions or at all. Accordingly, the Financial Guarantors cannot ensure that they will seek to, or be able to, complete a required capital raising. The failure to raise additional required capital could result in a downgrade of the Financial Guarantors' ratings or the Financial Guarantors' being unable to write new business.

Financial guarantees issued by the Financial Guarantors ensure the credit performance of guaranteed obligations over an extended period of time, in some cases 30 years or more, and in most circumstances, the Financial Guarantors have no right to cancel such financial guarantees. As a result, each Financial Guarantor's estimate of ultimate losses on a financial guarantee is subject to significant uncertainty over the life of the guaranteed transaction because of the potential for significant variability in credit performance as a result of changing economic, fiscal and financial market variability over the long duration of most contracts. If a Financial Guarantor's actual losses exceed its current estimates, this may result in adverse effects on the relevant Financial Guarantor's financial condition, results of operations, liquidity, business prospects, financial strength ratings and ability to raise additional capital.

Rating agencies and insurance regulatory authorities impose capital requirements on the Financial Guarantors. These capital requirements, which include leverage ratios and surplus requirements, limit the amount of financial guarantees that the Financial Guarantors may write. The Financial Guarantors have several alternatives available to control their leverage ratios, including obtaining capital contributions from Assured Guaranty Ltd., purchasing reinsurance or entering into other loss mitigation agreements, or reducing the amount of new business written. However, a material reduction in the capital and surplus of a Financial Guarantor, whether resulting from underwriting or investment losses, a change in regulatory capital requirements or otherwise, or a disproportionate increase in the amount of risk in force, could increase such Financial Guarantor's leverage ratio. This in turn could require that Financial Guarantor to obtain reinsurance for existing business (which may not be available, or may only be available on terms that such Financial Guarantor considers unfavourable), or add to its capital base to maintain its financial strength ratings. Failure to maintain regulatory capital levels could limit a Financial Guarantor's ability to write new business.

Reliance on the Financial Guarantors

Pursuant to the Financial Guarantees, the Financial Guarantors guarantee scheduled payments of principal and interest under the Bonds. The payment of the guaranteed amounts as defined in the Financial Guarantees ("**Guaranteed Amounts**") will depend upon each of the Financial Guarantors performing its obligations under its respective Financial Guarantee. The likelihood of payment of the Guaranteed Amounts will depend upon the creditworthiness of each of the Financial Guarantors. Consequently, investors are relying not only on the creditworthiness of the Issuer, but also on the creditworthiness of each of the Financial Guarantors to perform its obligations under the relevant Financial Guarantee. The insolvency of either of the Financial Guarantors or a default by it under its respective Financial Guarantee may adversely affect the likelihood of investors receiving scheduled payments of principal and interest and could result in a withdrawal or downgrade of the ratings of the Bonds.

The Financial Guarantees only guarantee scheduled principal and scheduled interest payments by the Issuer on the date(s) when such amounts are initially scheduled to become due and payable (subject to and in accordance with each Financial Guarantee), and do not guarantee the market price, or liquidity of any securities, nor do they guarantee that the ratings on such securities will not be revised or withdrawn.

Reliance by AGE on AGM

The financial strength ratings of AGE are based primarily on the ratings of and the capital support and reinsurance provided by AGM to AGE pursuant to certain intercompany support agreements (the "**Support Agreements**"). Any downgrade of the ratings of AGM would very likely result in a downgrade of the ratings of AGE. The Support Agreements are not, and should not be regarded as, conferring any recourse against AGM or any other person under the Support Agreements. See "Description of the Financial Guarantors" below for further details on the Support Agreements.

Regulation

AGE is authorised by the UK Prudential Regulation Authority (the "**PRA**") to carry out and effect "credit", "suretyship" and "miscellaneous financial loss" insurance business in the United Kingdom and, pursuant to the EC third non-life insurance directive (No. 92/49/EEC), various European countries (such authorisation being the "**Insurance Business Authorisation**") and is regulated by the PRA and the UK Financial Conduct Authority.

The Insurance Business Authorisation may be revoked, withdrawn or restrictively modified by the PRA. Such revocation, withdrawal or restrictive modification could have a material adverse impact on AGE, including its ability to generate new business or increased costs of regulatory compliance.

AGM is licensed to write financial guaranty insurance and reinsurance (which is classified in some states as surety or another line of insurance) in the 50 states of the United States of America, the District of Columbia and Puerto Rico. The New York Department of Financial Services (NY DFS) is the regulatory authority of the State of New York, U.S.A., which is AGM's state of organisation and domicile.

State insurance authorities have broad regulatory powers with respect to various aspects of the business of U.S. insurance companies, including licensing these companies to transact business, accreditation of reinsurers, admittance of assets to statutory surplus, regulating unfair trade and claims practices, establishing reserve requirements and solvency standards, regulating investments and dividends and, in certain instances, approving policy forms and related materials and approving premium rates. If AGM fails to comply with applicable insurance laws and regulations it could be exposed to fines, the loss of insurance licenses, limitations on its right to originate new business and restrictions on its ability to pay dividends, all of which could have an adverse impact on its business results and prospects.

Concentration of business

Each of the Financial Guarantors is engaged exclusively in the business of writing financial guarantees, and, in the case of AGM, related lines of insurance and reinsurance.

Although it is the Financial Guarantors' policy to diversify and manage exposure to single obligors and to particular business sectors, it may have individual large exposures to single obligors or particular business sectors; if a material adverse event or series of events occurs with respect to one or more of these concentrations that is more severe than the assumptions used by the Financial Guarantors, such event or series of events could result in losses to the Financial Guarantors and could harm the Financial Guarantors' business.

As one example, AGM guarantees the obligations of state and local governments in the U.S. The economic crisis caused many state and local governments that issue some of the obligations that AGM guarantees to experience significant budget deficits and revenue collection shortfalls that require them to significantly raise taxes and/or cut spending in order to satisfy their obligations. If the issuers of the obligations in AGM's public finance portfolio do not have sufficient funds to cover their expenses and are unable or unwilling to raise taxes, decrease spending or receive federal assistance, AGM may experience increased levels of losses or impairments on its public finance obligations.

AGM's risk of loss on and capital charges for municipal credits could also be exacerbated by rating agency downgrades of municipal credit ratings. A downgraded municipal issuer may be unable to refinance maturing obligations or issue new debt, which could exacerbate the municipality's inability to service its debt. In addition, obligations supported by specified revenue streams, such as revenue bonds issued by toll road authorities, municipal utilities or airport authorities, may be adversely affected by revenue declines resulting from reduced demand, changing demographics or other factors associated with an economy in which unemployment remains high, housing prices have not yet stabilised and growth is slow.

Impact of Market Conditions

The Financial Guarantors' loss reserves, profitability, financial position, insured portfolio, investment portfolio, cash flow and statutory capital could be materially affected by the global markets. Upheavals in the financial markets can affect the Financial Guarantors' business through their effects on general levels of economic activity and employment. The global recession and disruption of the financial markets has led to concerns over capital markets access and the solvency of certain European Union member states, including Greece, Portugal, Ireland, Italy and Spain, and of financial institutions that have significant direct or indirect exposure to debt issued by these countries. In the U.S., the unemployment rate remains high and housing prices have only recently shown signs of stabilisation. The Financial Guarantors' and their financial position will continue to be subject to risk of the global financial and economic conditions that could materially and negatively affect the demand for their products, the amount of losses incurred on transactions they guarantee and the value of their investment portfolios.

The issuers or borrowers whose obligations the Financial Guarantors guarantee or hold may default on their obligations because of bankruptcy, insolvency, lack of liquidity, adverse economic conditions, operational failure, fraud or other reasons. Additionally, the underlying assets supporting structured finance obligations that the Financial Guarantors have guaranteed may deteriorate, causing these obligations to incur losses. These losses could be significantly more than the Financial Guarantors expect and could materially adversely impact their financial strength, ratings and prospects for future business.

Since mid-2007 there have been several adverse developments in the credit and financial guarantee markets that have affected AGM's business, financial condition, results of operation and future business prospects. In particular, U.S. residential mortgages and residential mortgage back securities transactions ("**RMBS**") that were issued in the 2005-2007 period have generated losses far higher than originally expected and higher than experienced in the last several decades. This poor performance led to price declines for RMBS securities and the rating agencies downgrading thousands of such transactions. In addition, the material amount of the losses that have been incurred by insurers of these mortgages, such as Fannie Mae or private mortgage insurers, by guarantors of RMBS securities or of securities that contain significant amounts of RMBS, and by purchasers of RMBS securities have resulted in the insolvency or significant financial impairment of many of these companies.

In addition, AGM has been affected by a negative perception of financial guarantors arising from the financial distress suffered by other companies in the industry during the financial crisis, some of which entered into rehabilitation proceedings or were required by their regulators to suspend claim payments. The demand for AGM's financial guarantees has also been negatively affected by its credit spread, which is a reflection of the risk that investors perceive in AGM, among other factors; the higher AGM's credit spread, the lower the benefit of AGM's financial guarantee to certain investors. If investors view AGM as being only marginally less risky, or perhaps even as risky, as the uninsured security, the coupon on a security guaranteed by AGM may not be much lower than, or may be the same as, an uninsured security offered by the same issuer. If the guarantee does not lower the cost of issuance in a material respect, issuers may be unwilling to pay AGM a fee for such guarantee. The decreased demand for AGM's financial guarantees may be exacerbated in a low interest rate environment, where the credit spread between high quality or insured obligations versus lower rated or uninsured obligations is narrow and, as a result, financial guarantees typically provide lower interest cost savings to issuers than they would during periods of relatively wider credit spreads. These factors may result in decreased demand for AGM's financial guarantees, which may have a negative impact on AGM's long-term financial prospects.

Control by the Financial Guarantors

While the Financial Guarantees mitigate the credit risks to which potential investors in the Bonds would otherwise be exposed, the involvement of the Financial Guarantors has certain consequences. For example, for so long as they are the Majority Creditor(s), the Financial Guarantors will have the right to exercise many of the discretions which would otherwise rest in the Bond Trustee and the Security Trustee (including the discretion as to whether to declare events of default or enforcement events or to accelerate payments of principal and interest, and in respect of which the Bond Trustee might otherwise have sought the directions of the Bondholders). In addition, in the event that the Financial Guarantors are required to make a payment under the Financial Guarantees, the Issuer will be required to reimburse the Financial Guarantors and to pay various fees, costs and expenses to the Financial Guarantors.

Acceleration of Bonds

The terms of each Financial Guarantee provide that amounts of principal on any Bonds which have become immediately due and payable (whether by virtue of acceleration, prepayment or otherwise) will not be treated as Guaranteed Amounts which are due for payment unless the relevant Financial Guarantor in its sole discretion elects so to do by notice in writing to the Bond Trustee. If no such election is made, that Financial Guarantor will continue to be liable to make payments of Guaranteed Amounts in respect of the Bonds pursuant to the relevant Financial Guarantee on the dates on which such payments would have been required to be made if such amounts had not become immediately due and payable.

Withholding Tax

If any withholding tax is imposed on payments under the Bonds or the Financial Guarantees, the Financial Guarantors are not required to "gross up" payments to the holders of the Bonds. In such circumstances, holders of the Bonds will receive payments from the Financial Guarantors net of such withholding tax.

3. RISKS RELATING TO THE BONDS AND THE MARKET

Risks related to the Bonds generally

Set out below is a brief description of certain risks relating to the Bonds generally:

An active trading market for the Bonds may not develop

The Bonds will be new securities which may not be widely distributed and for which there is currently no active trading market. There can be no assurance that an active trading market for the Bonds will develop, or, if one does develop, that it will be maintained. If an active trading market for the Bonds does not develop or is not maintained, the market or trading price and liquidity of the Bonds may be adversely affected. The Issuer and its affiliates are (subject to the terms of the Collateral Deed and the Bond Trust Deed) entitled to buy and sell the Bonds for their own account or for the account of others, and to issue further Bonds. Such transactions may favourably or adversely affect the price development of the Bonds. If additional and competing products are introduced in the markets, this may adversely affect the value of the Bonds.

Unsuitability

The Bonds may not be a suitable investment for all investors. Each potential investor in the Bonds must determine the suitability of that investment in light of its own circumstances. In particular, each potential investor should:

(i) have sufficient knowledge and experience to make a meaningful evaluation of the Bonds, the merits and risks of investing in the Bonds and the information contained or incorporated by reference in this Prospectus or any applicable supplement;

(ii) have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Bonds and the impact the Bonds will have on its overall investment portfolio;

(iii) have sufficient financial resources and liquidity to bear all of the risks of an investment in the Bonds;

(iv) understand thoroughly the terms of the Bonds and be familiar with the behaviour of any relevant indices and financial markets; and

(v) be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.

The Bonds are complex financial instruments. Sophisticated institutional investors generally do not purchase complex financial instruments as stand-alone investments. They purchase complex financial instruments as a way to reduce risk or enhance yield with an understood, measured, appropriate addition of risk to their overall portfolios. A prospective investor should not invest in the Bonds which are complex financial instruments unless it has the expertise (either alone or with a financial adviser) to evaluate how the Bonds will perform under changing conditions, the resulting effects on the value of the Bonds and the impact this investment will have on the potential investor's overall investment portfolio.

Changes in Rating

If the rating initially assigned to the Bonds is subsequently lowered or withdrawn for any reason, no person or entity will be obliged to provide any additional credit enhancement in respect of the Bonds.

Hiring Incentives to Restore Employment Act withholding may affect payments on the Securities

The U.S. “Hiring Incentives to Restore Employment Act 2010” (the “**HIRE Act**”) imposes a 30% withholding tax on amounts attributable to U.S. source dividends that are paid or “deemed paid” under certain financial instruments if certain conditions are met. While significant aspects of the application of the relevant provisions of the HIRE Act to the Bonds are uncertain, if the Issuer or any withholding agent determines that withholding is required, neither the Issuer nor any withholding agent will be required to pay any additional amounts with respect to amounts so withheld. Prospective investors should refer to the section “Taxation – Hiring Incentives to Restore Employment Act”.

Foreign Account Tax Compliance withholding may affect payments on the Securities

The U.S. “Foreign Account Tax Compliance Act 2010” (or “**FATCA**”) imposes a new reporting regime and, potentially, a 30% withholding tax with respect to (i) certain payments from sources within the United States, (ii) “foreign passthru payments” made to certain non-U.S. financial institutions that do not comply with this new reporting regime, and (iii) payments to certain investors that do not provide identification information with respect to interests issued by a participating non-U.S. financial institution. The Issuer is classified as a financial institution for these purposes. If an amount in respect of such withholding tax were to be deducted or withheld from interest, principal or other payments made in respect of the Bonds, neither the Issuer nor any other person would, pursuant to the conditions of the Bonds, be required to pay additional amounts as a result of the deduction or withholding. As a result, investors may receive less interest or principal than expected. Prospective investors should refer to the section "Taxation – Foreign Account Tax Compliance Act".

EU Savings Directive

Under EC Council Directive 2003/48/EC on the taxation of savings income, each Member State of the European Union is required to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in that other Member State; however, for a transitional period, Austria and Luxembourg may instead apply a withholding system in relation to such payments, deducting tax at a rate of 35 per cent. The transitional period is to terminate at the end of the first full fiscal year following agreement by certain non-EU countries to the exchange of information relating to such payments.

A number of non-EU countries, have adopted similar measures (either provision of information or transitional withholding) in relation to payments made by a person within its jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in a Member State. In addition, the Member States have entered into provisions of information or transitional withholding arrangements with certain of those dependent or associated territories in relation to payments made by a person in a Member State to, or collected by such a person for, an individual resident or certain limited types of entity established in one of those territories.

The European Commission has proposed certain amendments to the Directive, which may, if implemented, amend or broaden the scope of the requirements described above. Investors who are in any doubt as to their position should consult their professional advisers.

Risks related to the structure of the Bonds

The Bonds may have features which contain particular risks for potential investors. Set out below is a description of certain such features:

Trading in Clearing Systems

For so long as the Bonds are represented by a Global Bond and the relevant clearing system(s) so permit, the Bonds will be tradable only in the minimum authorised denomination of £100,000 and higher integral multiples of £1,000, notwithstanding that no Definitive Bonds will be issued with a denomination above £199,000. If, as a result of trading such amounts, a Bondholder holds a principal amount of Bonds of less than £100,000, that Bondholder may not receive a Definitive Bond in respect of such holding (should Definitive Bonds be printed) and may need to purchase a principal amount of Bonds such that its holding amounts to £100,000.

Exchange rate risks

The Issuer will pay principal, any premium and interest on the Bonds in Pound Sterling. This may present certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit other than Pound Sterling.

Modification, waivers and substitution

The conditions of the Bonds contain provisions for calling meetings of Bondholders to consider matters affecting their interest generally. These provisions permit defined majorities to bind all Bondholders including Bondholders who did not attend and vote at the relevant meeting and Bondholders who voted in a manner contrary to the majority.

The conditions of the Bonds also provide that the Bond Trustee may, without the consent of Bondholders if directed by the Financial Guarantors (for so long as they are the Majority Creditor(s) and other than with respect to Reserved Matters and Entrenched Rights) (at all times subject to the provisions of the Security Trust and Intercreditor Deed (defined in paragraph 5 (*Security Arrangements*) of the section of this Prospectus entitled "*The Financing of the Project*"), agree to (i) any modification of, or to the waiver or authorisation of any breach or proposed breach of, any of the provisions of the Bonds; or (ii) determine without the consent of the Bondholders that any Event of Default or potential Event of Default shall not be treated as such.

Change of law

The conditions of the Bonds are based on English law in effect as at the date of this Prospectus. No assurance can be given as to the impact of any possible judicial decision or change to English law or administrative practice after the date of this Prospectus.

Terms of the Security Trust and Intercreditor Deed

The Security Trust and Intercreditor Deed (as defined below) will provide for an order of priority of payment under which the proceeds of enforcement of the security and the joint and several guarantee granted by the Obligors are to be applied following enforcement of such security. This is relevant to Bondholders to the extent that an amount due to be paid to the Bondholders is not covered by, or paid under, the Financial Guarantees (see the section entitled "*Terms and Conditions of the Bonds - Financial Guarantee*"). Certain claims of the other Senior Creditors will, in accordance with such order of priority, be paid in priority to payment of certain amounts due to the Bondholders (see the section entitled "*The Financing of this Project*"). In particular, payment of any principal amount owed to Bondholders is subordinated to certain claims the Financial Guarantors as subrogated creditors.

Even in cases where the compensation on termination provisions of the Project Agreement are structured with the intention of enabling ProjectCo to meet its obligations to the Issuer in respect of the Bond Proceeds Onloan Agreement and of enabling the Issuer to meet its obligations under the Bonds, ProjectCo may not be entitled to claim from the Authority certain amounts needed to meet liabilities that rank in priority to amounts due to the Issuer in respect of amounts due to Bondholders. Therefore, the proceeds of enforcement of the security may not be sufficient to enable ProjectCo to make payment to the Issuer of all amounts due to Bondholders in accordance with the order of priority of payments set out in the Security Trust and Intercreditor Deed (see the section entitled "*Financing of the Project – The Security Arrangements – Security Trust and Intercreditor Deed*").

Events of Default in relation to Major Project Parties

The events of default set out in the Collateral Deed (as defined below) in respect of cross-default, insolvency, insolvency proceedings, creditors' process and cessation of business relate to all "**Major Project Parties**" (as defined in the Collateral Deed, subject to certain time limits and exceptions, to include the Building Contractor, the Facilities Management Contractor, the guarantors of the Building Contractor and Facilities Management Contractor, the HoldCo Shareholders and Sponsors, the Management Services Provider, the Building Contractor Parallel Loan Provider and the FM Contractor Parallel Loan Provider). The occurrence of an Event of Default in relation to these entities may result from circumstances unrelated to the Project over which the Issuer and the Contractor have no influence. Upon the occurrence of an Event of Default, the Majority Creditor may (without further notice) declare the Bonds to be immediately due and payable. In such circumstances the Issuer may have insufficient funds available to it to redeem the Bonds.

Limitations on Mandatory Redemption of the Bonds following a Spens (Full) Acceleration Event or a Spens (Modified) Acceleration Event

The mandatory redemption of the Bonds under Condition 6 of the Bonds following the occurrence of a Spens (Full) Acceleration Event or a Spens (Modified) Acceleration Event (each as defined in Condition 6 of the Bonds) is dependent on there being sufficient funds available to pay the claims of all the Senior Creditors thus enabling the Security Trustee to issue the Sufficiency Certificate, which is a precondition to such mandatory redemption. Therefore, if the Authority were to pay compensation to ProjectCo in an amount which was intended to enable ProjectCo, in turn, to pay the Issuer an amount sufficient for the Issuer to pay the Default Amount (as defined in Condition 6 of the Bonds) to the Bondholders, such mandatory redemption may, however, not occur, since there may be other claims not covered by the compensation payments from the Authority or other monies available to the Security Trustee. In such circumstances the Financial Guarantors (so long as they are the Majority Creditor(s)) will retain the discretion as to whether or not to direct the Bond Trustee to declare the Bonds immediately due and payable by the Issuer (see the section entitled "*Terms and Conditions of the Bonds*").

Taxation

The conditions of the Bonds provide that to the extent that the Issuer is obliged to make any deduction or withholding in respect of payments of principal and interest on the Bonds, the Issuer will not be obliged to make any additional payments to the Bondholders in respect of any such withholding or deduction. If the Issuer is obliged to make such deduction or withholding, there is no obligation on the Financial Guarantors to pay out under the Financial Guarantees any such amount so deducted or withheld. In addition, the Financial Guarantors is not required to make any additional payments under the Financial Guarantees in respect of any deduction or withholding in respect of taxation on any payments made by it under the Financial Guarantees.

Withholding Tax

Under EC Council Directive 2003/48/EC on the taxation of savings income, Member States of the European Union are required to provide to the tax authorities of another Member State details of payments of interest or similar income paid by a person within its jurisdiction to an individual resident in that other Member State. However, for a transitional period, Belgium, Luxembourg and Austria are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have agreed to adopt similar measures (a withholding system in the case of Switzerland) with effect from the same date (see the section entitled "*United Kingdom Taxation*").

Risks related to the market generally

Set out below is a brief description of certain risks relating to the market generally.

Interest rate risks

The Bonds bear interest at a fixed rate. Therefore, investment in the Bonds involves the risk that subsequent changes in market interest rates may adversely affect the value of the Bonds.

Credit ratings may not reflect all risks

The ratings assigned to the Bonds by Moody's and S&P may not reflect the potential impact of all risks relating to structure, market, additional factors discussed above, and other factors that may affect the value of the Bonds. A credit rating is not a recommendation to buy, sell or hold securities and may be raised or withdrawn by the rating agency at any time.

Legal investment considerations may restrict certain investments

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

Fixed charges may take effect under English law as floating charges

Pursuant to the terms of the Security Documents, the Obligors will purport to grant fixed charges over, amongst other things, their rights and benefits in their bank accounts and all authorised investments purchased from time to time.

The law in England and Wales relating to the characterisation of fixed charges is unsettled. The fixed charges purported to be granted by the Obligors may take effect under English law as floating charges only, if, for example, it is determined that the Security Trustee does not exert sufficient control over the charged property for the security to be said to constitute fixed charges. If the charges take effect as floating charges instead of fixed charges, then, ordinarily as a matter of law, certain claims would have priority over the claims of the Security Trustee in respect of the floating charge assets.

THE FINANCING OF THE PROJECT

The following is an overview of the financing of the Project and should be read in conjunction with the rest of this Prospectus. The overview of the documents set out below do not purport to be complete and are subject to the detailed provisions of the relevant Finance Documents (as defined below, see the sub-section entitled "Collateral Deed").

1. GENERAL

The Project will be financed by:

(i) the proceeds of the issue of the Bonds by the Issuer (see the sub-section below entitled "*The Bonds and the Financial Guarantees*") which will be on-lent by the Issuer to ProjectCo (as defined below, see the section entitled "*Terms and Conditions of the Bonds*") pursuant to an intercompany loan agreement dated on the Issue Date (as defined below, see the section entitled "*Terms and Conditions of the Bonds*") between the Issuer, ProjectCo and the Security Trustee (as defined below, see the section entitled "*Terms and Conditions of the Bonds*") (the "**Bond Proceeds Onloan Agreement**");

(ii) the proceeds of the subscription by HoldCo (as defined below, see the sub-section entitled "*Terms and Conditions of the Bonds*") for shares in the Issuer and ProjectCo and the £12,680,000 subordinated loan notes issued by the Issuer (the "**Issuer Loan Notes**"), as more particularly defined below (see the section below entitled "*HoldCo Shareholder Contribution to Financing*") subscribed for by HoldCo pursuant to an equity subscription agreement (the "**Equity Subscription Agreement**") which will be on-lent by the Issuer to ProjectCo pursuant to an inter-company loan agreement dated on the Issue Date between the Security Trustee, the Issuer and ProjectCo (the "**Equity Proceeds Onloan Agreement**") (the Bond Proceeds Onloan Agreement and the Equity Proceeds Onloan Agreement together the "**Proceeds Onloan Agreements**");

(iii) capital contributions, in the sum of £42,600,000, which will be received by ProjectCo from the Authority following completion of certain elements of the Works;

(iv) certain revenues earned by ProjectCo as a result of the phased completion of the Works and the commencement of the Facilities Management Services; and

(v) interest accrued on certain of ProjectCo's bank accounts with the Account Bank, in accordance with the Account Bank Agreement (each as defined in the sub-section below entitled "*Account Bank Agreement*"); income earned from authorised investments made in accordance with the Account Bank Agreement; and investment return earned on the GIC (as defined in the sub-section below entitled "*Guaranteed Investment C*ontract").

The Bonds will be initially subscribed by the Lead Manager (as defined below, see the section entitled "*Terms and Conditions of the Bonds*").

The proceeds of the Bonds net of:

(i) in relation to the Financial Guarantees fees and any costs and expenses;

(ii) the Lead Manager's fees and any costs and expenses;

(iii) rating agencies' fees and any costs and expenses;

(iv) the Bond Trustee's, Security Trustee's and the Paying Agent(s)' (as defined below, in the section entitled "*Terms and Conditions of the Bonds*") fees and any costs and expenses;

(v) the fees costs and expenses of Faithful+Gould or any other technical adviser appointed under the Collateral Deed (the "**Technical Advisor**");

(vi) Willis Group Holdings or any other firm of insurance adviser appointed under the Collateral Deed's (the "**Insurance Advisor**") fees and any costs and expenses;

(vii) legal fees and any costs and expenses; and

(viii) any auditor to the Financial Guarantors' fees and any costs and expense,

will be deposited into the escrow account in the name of ProjectCo maintained with the Account Bank (the "**Escrow Account**") and/or invested in the GIC.

Uberior Infrastructure Investments (No. 6) Limited, Equitix Housing 2 Limited and Keepmoat Leeds PFI Limited will subscribe for the loan notes in Holdco and, in turn, HoldCo will subscribe for the loan notes in the Issuer (in accordance with the Equity Subscription Agreement). Such amounts will be advanced by the Issuer to ProjectCo under the Equity Proceeds Onloan Agreement and will be paid into the GIC.

ProjectCo may apply amounts deposited into the Escrow Account and/or invested in the GIC only for the purposes set out in the Collateral Deed (as defined below, see subsection entitled "*Collateral Deed*") and the Account Bank Agreement.

The Bonds will have the benefit of the Financial Guarantees issued by the Financial Guarantors. Under the Financial Guarantees, the Financial Guarantors unconditionally and irrevocably guarantee in favour of the Bond Trustee amounts unpaid by the Issuer in respect of scheduled payments of principal and interest in respect of the Bonds (in each case excluding Default Interest (as defined in Condition 5.1 of the Bonds) and excluding any excess above the outstanding principal amount of any Bonds to be redeemed). The Financial Guarantees expressly exclude Bonds which are held by or on behalf of the Issuer Group (as defined below, see the subsection entitled "*Terms and Conditions of the Bonds*") (see the sections entitled "*Form of AGE Financial Guarantee*" and "*Form of AGM Guarantee*").

The Financial Guarantees will be issued pursuant to a Reimbursement and Indemnity Deed to be entered into between the Obligors and Financial Guarantors (the "**Reimbursement and Indemnity Deed**") on or before the Issue Date. Under the Reimbursement and Indemnity Deed, the Obligors agree to reimburse the Financial Guarantors for any payments made by them under the Financial Guarantees. In addition, Financial Guarantors will be subrogated to the rights of the Bondholders, Couponholders (as defined below in the section entitled "*Terms and Conditions of the Bonds*") and/or the Bond Trustee (as applicable) in respect of any payments made by the Financial Guarantors under the Financial Guarantees. The rights of Financial Guarantors to reimbursement in respect of any payments made under the relevant Financial Guarantee will have the benefit of the security granted by the Obligors to the Security Trustee. Under the terms of the Collateral Deed, the Obligors will grant a joint and several guarantee of their obligations to make, *inter alia*, reimbursements to Financial Guarantors under the Reimbursement and Indemnity Deed.

Interest on the Bonds will be payable in arrears on 31 March and 30 September (unless this is not a business day in which case the next following business day) in each year in accordance with the terms and conditions of the Bonds (the "**Conditions**").

Unless previously redeemed or purchased and cancelled, the Bonds will mature on 30 September 2032 and the outstanding principal amount of each Bond will be subject to amortisation from and including 30 September 2013 in accordance with the schedule set out in the section entitled "*Terms and Conditions of the Bonds – Payments and Exchange of Talons – Scheduled Payments*". The Bonds are also subject to redemption in whole but not in part at the Early Redemption Price at the option of the Issuer (as provided in Condition 6.2 (see the section entitled "*Terms and Conditions of the Bonds – Redemption and Purchase – Issuer Optional Redemption*" below)).

Payments in respect of the Bonds will be made in accordance with the Paying Agency Agreement (as defined below, in the section entitled "*Terms and Conditions of the Bonds*") and which expression includes any modification or supplement thereto to be entered into on or before the Issue Date between the Issuer, the Bond Trustee and The Bank of New York Mellon, London branch as principal paying agent (the "**Principal Paying Agent**"), and, the Paying Agents (as defined below, see the section entitled "*Terms and Conditions of the Bonds*"). Under the Collateral Deed, the Issuer agrees to ensure that it will maintain, at all times, a Paying Agent with a specified office in London.

The Issuer will pay or procure to be paid to:

(i) each Financial Guarantor, in consideration of the issuance by each Financial Guarantor of the AGE Financial Guarantee and AGM Financial Guarantee respectively, a guarantee fee, (the "**Guarantee Fee**") a portion of which is payable on the Issue Date and the balance of which is payable over time in accordance with the provisions of the AGE Financial Guarantee Fee Letter, the AGM Financial Guarantee Fee Letter (each defined below, see sub-section entitled "*Collateral Deed*") and of the Reimbursement and Indemnity Deed, in consideration for the issuance of the Financial Guarantee;

(ii) the Bond Trustee, for its services as Bond Trustee, remuneration on the issue of the Bonds and on each anniversary of the issue of the Bonds in such amounts and upon such terms as are agreed between the Issuer and the Bond Trustee;

(iii) the Principal Paying Agent (for the account of the Paying Agents) for their services as Paying Agents under the Paying Agency Agreement, remuneration in such amounts and upon such terms as are agreed between the Principal Paying Agent and the Issuer;

(iv) the Security Trustee, for its services as Security Trustee, remuneration in such amounts and on such terms as are agreed between the Obligors and the Security Trustee;

(v) the Lead Manager, a management commission, on the Issue Date; and

(vi) the Lead Manager, certain fees, costs and expenses payable in connection with the issue of the Bonds, on the Issue Date.

The Issuer will also pay to each of the Bond Trustee, the Security Trustee, the Principal Paying Agent for the account of the Paying Agents, the Lead Manager and the Financial Guarantors all fees, costs and expenses in connection with the issue of, and each of their on-going duties under the Finance Documents, including (but not limited to) their agreed legal fees, costs, expenses and disbursements in accordance with the terms of their respective engagements.

2. THE BONDS AND THE FINANCIAL GUARANTEE

The following is an overview of the principal terms of the Terms and Conditions of the Bonds which are set out on pages 54 to 78 of this Prospectus and of the Financial Guarantees, the form of which is set out on pages 83 to 116 of this Prospectus, and should be read in conjunction with them.

Issuer:	Sustainable Communities for Leeds (Finance) plc.
Issue:	5.069 per cent. Fixed Rate Guaranteed Secured Bonds due September 2032.
Issue Price:	100 per cent.
Final Maturity:	30 September 2032
Lead Manager:	Lloyds TSB Bank plc.
Interest and Redemption:	Payments of interest and principal on the Bonds will be due as set out in the sections entitled "*Terms and Conditions of the Bonds – Condition 4 - Interest*" and "*Terms and Conditions of the Bonds – Condition 6 - Redemption and Purchase*".
Financial Guarantees:	An unconditional and irrevocable financial guarantee policy provided by each of the Financial Guarantors as to scheduled payments of principal and interest (but excluding default interest, any additional amounts relating to the prepayment of the Bonds and accelerated amounts) on the Bonds (excluding those held by or on behalf of the Issuer or Issuer Group) will be issued in favour of the Bond Trustee (for the benefit of the Bondholders) on the same date as other Finance Documents come out of escrow, 11 July 2013. To the extent that the Early Redemption Price (as defined in Condition 6.2 of the Bonds) or the Default Interest (as defined in Condition 5.1 of the Bonds) exceeds the outstanding principal amount of any Bonds to be redeemed, payment of such excess is not guaranteed by the Financial Guarantors under the Financial Guarantees. The Financial Guarantors are not obliged to make any payment under the Financial Guarantees in respect of any amounts of principal and interest that become due and payable on an accelerated basis pursuant to either Condition 6.2 or default interest payable pursuant to Condition 5.1 of the Bonds but are unpaid, other than on the dates on which such payments would have been required to be made if they had not become so due and payable.
Reimbursement and Indemnity Deed:	Pursuant to the provisions of the Reimbursement and Indemnity Deed, the Obligors will be obliged to reimburse Financial Guarantors in respect of payments made under the Financial Guarantees. In addition, Financial Guarantors will be subrogated to the rights of

the Bondholders and the Bond Trustee in respect of any payments made by it under the Financial Guarantees.

Status of Financial Guarantees: The Financial Guarantees to be provided by Financial Guarantors in respect of the Bonds will constitute a direct and unsecured obligation of Financial Guarantors which will rank at least *pari passu* with all other unsecured obligations of Financial Guarantors save for such obligations as may be preferred by provisions of law that are both mandatory and of general application.

Status of Bonds: The Bonds will constitute direct, secured full recourse and unconditional obligations of the Issuer which will rank *pari passu* and rateably without any preference or priority among themselves and will rank in priority to all unsecured obligations of the Issuer, save for such obligations as may be preferred by provisions of law that are both mandatory and of general application.

Listing: Application has been made for the Bonds to be admitted to the Irish Stock Exchange.

Ratings: The Bonds are expected to be rated, upon issue AA- by S&P and AA3 by Moody's, and the underlying rating is expected to be at least investment grade by each of S&P and Moody's.

Settlement/Clearance: Euroclear and Clearstream, Luxembourg and any additional or substitute clearing system from time to time (nominated in accordance with the Bond Trust Deed).

Bond Trustee and Security Trustee: BNY Mellon Corporate Trustee Services Limited.

Principal Paying Agent: The Bank of New York Mellon, London Branch.

Form and Denomination: The Bonds will be in bearer form in denominations of £100,000 and integral multiples of £1,000 in excess thereof, up to and including £199,000. For so long as the Bonds are represented by a Global Bond and the relevant clearing system(s) so permit, the Bonds will be tradeable only in the minimum authorised denomination of £100,000 and higher integral multiples of £1,000, notwithstanding that no Definitive Bonds will be issued with a denomination above £199,000.

The Bonds will initially be represented by the Temporary Global Bond, without receipts, coupons or talons attached, deposited with a common depositary for Euroclear and Clearstream, Luxembourg. The Temporary Global Bond will be exchangeable, in whole or in part, not earlier than 40 days after the Issue Date of the Bonds and upon certification of the non-U.S. beneficial ownership, for interests in the Permanent Global Bond, without receipts, coupons or talons attached, which will also be deposited with such common depositary for Euroclear and Clearstream, Luxembourg. Interest payments in respect of the Bonds cannot be collected without such certification of non-U.S. beneficial ownership. The Permanent Global Bond will be exchangeable in whole but not in part, for Bonds in definitive form in denominations of £100,000 and integral multiples of £1,000 in excess thereof up to and including £199,000, with receipts for principal, coupons for interest and talons for further receipts and coupons attached in the limited circumstances described in the section entitled "*Overview of the Provisions relating to the Bonds while in Global Form*". If Definitive Bonds are required to be issued, such Definitive Bonds (a) will only be issued to Bondholders holding Bonds having a nominal amount equal to or in excess of £100,000 and (b) will only be printed in denominations equal to or in excess of £100,000. No Definitive Bonds will be issued with a denomination above £199,000. If Definitive Bonds are required to be issued, the Issuer will inform the Central Bank of Ireland of all denominations which are in issue.

Taxes: All payments of principal and interest in respect of the Bonds by or on behalf of the Issuer shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatsoever nature, unless such withholding or deduction is required by law. In that event, the Issuer shall account to the relevant authorities for the amount to be withheld or deducted and shall make such payment of principal or interest as the case may be, after such withholding or deduction has been made. The Issuer will not be obliged to make any additional payments to Bondholders, Receiptholders or Couponholders (as defined below in the section entitled "*Terms and Conditions of the Bonds*") in respect of any such withholding or deduction. To the extent that the Issuer is obliged to make any such deduction or withholding, there is no obligation on Financial Guarantors to make good any such amount so deducted or withheld under the Financial Guarantees.

All payments by Financial Guarantors under the Financial Guarantees will be made without withholding or deduction for, or on account of, any Taxes (as defined therein) unless the withholding or deduction of such Taxes is required by law, regulation or administrative practice of any jurisdiction. If any withholding or deduction is so required, Financial Guarantors will make payments under the Financial Guarantees after such withholding or deduction. Financial Guarantors will not be obliged to make any additional payments to Bondholders, Receiptholders or Couponholders in respect of any such withholding or deduction.

Governing Law: The Bonds and the Financial Guarantees will each be governed by the laws of England and Wales.

3. COLLATERAL DEED

The following is an overview of certain of the provisions of the Collateral Deed. It is not exhaustive and is subject to the detailed provisions of the Collateral Deed, copies of which are available for inspection by Bondholders during normal business hours at the specified offices (as set out below) of each of the Paying Agents.

The provisions of the collateral deed (the "**Collateral Deed**") are collateral to the provisions of the Proceeds Onloan Agreements.

The Obligors, the Security Trustee, the Bond Trustee and Financial Guarantors, will on or before the Issue Date enter into the Collateral Deed in which the Obligors will give certain representations and covenants to the Security Trustee, the Bond Trustee and the Financial Guarantors.

Definitions

The following terms shall where used in the Collateral Deed have the following meanings:

"**Accelerated Payment**" means, following an Acceleration, any payment in full or in part by the Financial Guarantor or AGE, at the Financial Guarantor's or AGE's absolute option, of all or part of the Scheduled Principal (as defined below, see the section entitled "*Terms and Conditions of the Bonds*") in advance of the final Scheduled Payment Date together with accrued but unpaid Scheduled Interest (as defined below, see the section entitled "*Terms and Conditions of the Bonds*") on such Scheduled Principal to the date of such payment (but excluding any amounts referred to in items (a) to (d) of the definition of "Guaranteed Amount").

"**Acceleration**" means, in relation to the Guaranteed Bonds, the giving of notice by the Bond Trustee to the Issuer that the Guaranteed Bonds are immediately due and repayable pursuant to Condition 9 (Events of Default) of the Terms and Conditions of the Bonds, and "**Accelerated**" will be construed accordingly.

"**Building Contract Direct Agreement**" means the direct agreement in relation to the Building Contract between ProjectCo, the Majority Creditor(s), the Security Trustee, the Building Contractor and the Construction Contractor Guarantor.

"**Building Contractor Letter of Credit**" means any letter of credit provided by an acceptable building contractor letter of credit provider to ProjectCo in form and substance satisfactory to the Majority Creditor(s).

"**Building Contractor Performance Bond**" means any performance bond provided by an acceptable building contractor performance bond provider to ProjectCo in form and substance satisfactory to the Majority Creditor(s).

"**Construction Document**" means:

(i) the Building Contract;

(ii) the Building Contract Guarantees;

(iii) the Building Contractor Performance Bond;

(iv) the Building Contractor Letter of Credit;

(v) the PFI Interface Agreement;

(vi) an independent certifier's deed of appointment;

(vii) any professional appointment;

(viii) any collateral warranty or direct agreement (other than any Direct Agreement) entered into in favour of the Security Trustee in connection with any of the above or sub-contract thereto; and

(ix) a parallel loan agreement between the Building Contractor, ProjectCo and Keepmoat Limited (the "**Building Contractor Parallel Loan Provider**") (the "**Building Contractor Parallel Loan Agreement**").

"**Direct Agreement**" means:

(i) the Funders' Direct Agreement;

(ii) the Building Contract Direct Agreement;

(iii) the FM Direct Agreement ; and

(iv) any other document designated as such by the Majority Creditor(s) (as defined below) and ProjectCo.

"**Equity Document**" means:

(i) the Issuer Loan Notes;

(ii) the loan note instrument under which the Issuer Loan Notes are constituted;

(iii) the HoldCo Loan Notes (as defined below, see sub section entitled "*Collateral Deed*");

(iv) the loan note instrument under which the HoldCo Loan Notes are constituted;

(v) the Equity Subscription Agreement;

(vi) the Management Services Agreement;

(vii) the Shareholders' Agreement (as defined below, see subsection entitled "*HoldCo Shareholders' Contributions to Financing*"); and

(viii) any other document designated as such by the Majority Creditor(s) and ProjectCo.

"**Financial Guarantor Default**" means any of the following events:

(i) any Guaranteed Amount which is due for payment by AGM in accordance with the terms of the AGM Financial Guarantee and is not paid by AGM on the date stipulated in the AGM Financial Guarantee;

(ii) AGM disclaims, disaffirms, repudiates and/or challenges the validity of any of its obligations under the AGM Financial Guarantee or seeks to do so (in each case, in writing);

(iii) AGM (i) files a petition or commences a case or proceeding under any provision or chapter of the United States Bankruptcy Code or any other similar federal or state law relating to insolvency, bankruptcy, liquidation or reorganisation; (ii) makes a general assignment for the benefit of its creditors; or (iii) has a final and nonappealable order for relief entered against it under the United States Bankruptcy Code or any other similar federal or state law relating to insolvency, bankruptcy, liquidation or reorganisation; or

(iv) court of competent jurisdiction, the New York Department of Insurance or other competent regulatory Council enters a final and nonappealable order, judgment or decree (i) appointing a custodian, trustee, agent or receiver for AGM or for all or any material portion of its property or (ii) authorising the taking of possession by a custodian, trustee, agent or receiver of AGM or of all or any material portion of its property).

"**Finance Document**" means:

(i) the Collateral Deed;

(ii) the Bonds;

(iii) the Bond Trust Deed;

(iv) the Paying Agency Agreement;

(v) the Subscription Agreement (as defined below, see section entitled "*Subscription and Sale*")

(vi) the Financial Guarantees;

(vii) the Reimbursement and Indemnity Deed;

(viii) the Bond Proceeds Onloan Agreement;

(ix) the GIC and any guarantees issued pursuant to the GIC;

(x) the Account Bank Agreement;

(xi) the letter dated on or about the Issue Date between AGE and the Issuer relating to the payment of certain fees in connection with the issuance of the AGE Financial Guarantee (as defined below, see section entitled "*Terms and Conditions of the Bonds*") (the "**AGE Financial Guarantee Fee Letter**");

(xii) the letter dated on or about the Issue Date between AGM and the Issuer relating to the payment of certain fees in connection with the issuance of the AGM Financial Guarantee (as defined below, see section entitled "*Terms and Conditions of the Bonds*") (the "**AGM Financial Guarantee Fee Letter**");

(xiii) the Security Documents;

(xiv) the Security and Intercreditor Trust Deed (as defined below, see sub section entitled "*Security Arrangements*"));

(xv) the Account Bank Agreement;

(xvi) each Direct Agreement ;

(xvii) the Equity Subscription Agreement;

(xviii) the fee letter(s) between the Issuer, the Bond Trustee, the Paying Agent and the Security Trustee in relation to the fees payable to these parties in their capacities as such;

(xix) the fee letter(s) between among others, the Issuer and the Rating Agencies;

(xx) the fee letter entered into between the Obligors and the Lead Manager setting out the amount of certain fees referred to in the Finance Documents;

(xxi) each request for a release of money from the Escrow Account made pursuant to the Collateral Deed; and

(xxii) any other document designated as such by the Majority Creditor(s) (as defined below) and ProjectCo.

"FM Contractor Parallel Loan Provider" means the provider of any FM Contractor Parallel Loan Agreement as approved by the Majority Creditor(s) and who continues to meet the specified requirements of the Majority Creditor(s) from time to time including, without limitation, with respect to the credit rating assigned to such person by the Rating Agencies.

"**FM Direct Agreement**" means the direct agreement in relation to the Facilities Management Contract between ProjectCo, the Majority Creditor(s), the Security Trustee, the Facilities Management Contractor and the Facilities Management Contractor Guarantor.

"**FM Document**" means:

(i) the Facilities Management Contract;

(ii) the FM Guarantee;

(iii) the PFI Interface Agreement;

(iv) a parallel loan agreement between the Facilities Management Contractor, ProjectCo and Keepmoat Limited (the "**FM Contractor Parallel Loan Agreement**"); and

(v) any collateral warranty or direct agreement (other than any Direct Agreement) entered into in favour of the Security Trustee in connection with any of the above or sub-contract thereto.

"**FM Guarantee**" means the guarantee provided by the Facilities Management Contractor Guarantor to ProjectCo in respect of the Facilities Management Contractor's obligations under the Facilities Management Contract.

"**Funders' Direct Agreement**" means the direct agreement in relation to the Project Agreement between, among others, the Authority, the Security Trustee and ProjectCo.

"**Guaranteed Amount**" means, with respect to a Scheduled Payment Date (as defined below, see the section entitled "*Terms and Conditions of the Bonds*"):

(i) an amount equal to scheduled interest due for payment on the Guaranteed Bonds on such Scheduled Payment Date; plus

(ii) an amount equal to the scheduled principal due for payment on the Guaranteed Bonds on such Scheduled Payment Date,

but excluding in each case any amounts due in respect of the Guaranteed Bonds:

(i) attributable to any increase in interest margin, penalty or other sum payable by the Issuer for whatever reason;

(ii) attributable to any present or future taxes, withholding, deduction, assessment or other charge (including interest and penalties in respect of such taxes, withholding, deduction, assessment or other charge) imposed by England or any other sovereign state, or any political subdivision or governmental or taxing council thereof, with respect to any payment by the Issuer due under the Guaranteed Bonds or any gross-up or make whole payment payable by the Issuer in respect of any such taxes, withholding, deduction, assessment or other charge;

(iii) attributable to any default interest;

(iv) attributable to any amount relating to prepayment, early redemption, broken-funding indemnities, penalties, premium, "spens", any make-whole amount or similar types of payments payable in respect of the Guaranteed Bonds; or

(v) in respect of which either of the Financial Guarantors has made an Accelerated Payment on or prior to such Scheduled Payment Date.

"Guaranteed Bonds" means the Bonds.

"**PFI Interface Agreement**" means the interface agreement between, amongst others, ProjectCo, the Facilities Management Contractor and the Building Contractor.

"**Project Document**" means:

(i) the Project Agreement;

(ii) each Construction Document;

(iii) each FM Document;

(iv) each Equity Document;

(v) any guarantee given by any person or any letters of credit issued in respect of any obligations of any person (other than ProjectCo) under any agreement listed above;

(vi) any collateral warranty or direct agreement (other than any Direct Agreement) entered into in relation to any agreement listed above; or

(vii) any other agreement designated as a Project Document by ProjectCo and the Majority Creditor(s).

"**Majority Creditor(s)**" means at any time, the Financial Guarantors unless and until such time as:

(i) both of the Financial Guarantees have been terminated in accordance with Condition 2.3; or

(ii) the Security Trustee has received notice from the Bond Trustee that a Financial Guarantor Default has occurred,

in which case it shall be the Bond Trustee, unless such Financial Guarantor Default has been cured or waived.

"**Major Project Party**" means:

(i) the Building Contractor, until the end of the 12 year latent defects period;

(ii) the Facilities Management Contractor;

(iii) the Building Contract Guarantor, in its capacity as a guarantor of the Building Contract, for so long as it has any outstanding obligations under or as guarantor of the Building Contract;

(iv) each Facilities Management Contractor Guarantor, in its capacity as a guarantor of the Facilities Management Agreement, for so long as it has any outstanding obligations under or as guarantor of the Facilities Management Agreement;

(v) any HoldCo Shareholder (as defined below, see subsection entitled "*HoldCo Shareholders' Contributions to Financing*") and any Sponsor (as defined below, see subsection entitled "*Security Arrangements*"), for so long as it has any outstanding subscription obligations under the Equity Subscription Agreement;

(vi) the Management Services Provider;

(vii) Building Contractor Parallel Loan Provider, for so long as it has any outstanding obligations under the Building Contractor Parallel Loan Agreement; and

(viii) FM Contractor Parallel Loan Provider, for so long as it has any outstanding obligations under the FM Contractor Parallel Loan Agreement.

"**Management Services Agreement**" means the management services agreement between, among others, ProjectCo, and the **Management Services Provider**.

"Management Services Provider" means Keepmoat Limited.

"**Operating Account**" means the account designated as such under the terms of the Account Bank Agreement.

"**Potential Event of Default**" means any event which would (with the passage of time, the giving of notice, the making of any determination hereunder or any combination thereof) if not remedied or waived become an Event of Default (as defined below).

"**Security Documents**" means:

(i) the ProjectCo First Ranking Debenture (as defined below, see sub section entitled "*Security Arrangements*");

(ii) the ProjectCo Second Ranking Debenture (as defined below, see sub section entitled "*Security Arrangements*");

(iii) the Issuer Debenture (as defined below, see sub section entitled "*Security Arrangements*");

(iv) the HoldCo Debenture (as defined below, see sub section entitled "*Security Arrangements*");

(v) the Equity Subscription Agreement;

(vi) the Security Trust and Intercreditor Deed;

(vii) any deed of accession entered into in respect of any document referred to above; and

(viii) any other document evidencing or creating security over any asset of an Obligor to secure any obligation of the Obligors to a Finance Party (as defined below, see subsection entitled "*Security Arrangements*") under the Finance Documents.

"**Transaction Documents**" means a Finance Document or a Project Document

Covenants by the Obligors

The covenants contained in the Collateral Deed will, *inter alia*, require each Obligor:

(i) to comply with the terms of the Transaction Documents to which it is a party;

(ii) not to create or permit to subsist any encumbrance over any of its present or future rights, claims, assets or revenues other than permitted encumbrances;

(iii) not to incur, assume or permit to exist any financial indebtedness except permitted indebtedness;

(iv) not to make any loans or provide other forms of credit or make any deposit with any person except as permitted under the Collateral Deed;

(v) not to dispose of assets other than as contemplated and permitted by the Transaction Documents or, in the case of ProjectCo on arm's length terms in certain restrictive circumstances;

(vi) not to enter into any transaction or series of transactions except as expressly provided in the Transaction Documents;

(vii) not to enter voluntarily into liquidation or dissolution nor undertake or permit any merger, consolidation or reconstruction;

(viii) not to carry out any other business save for the following:

    (a) in respect of ProjectCo, the Project or any business permitted by the Transaction Documents;

    (b) in respect of Holdco the owning of shares in the Issuer and ProjectCo; and

    (c) in respect of the Issuer, issuing the Bonds in accordance with the Transaction Documents and entering into the Proceeds Onloan Agreements; and,

(ix) not make any investments in any business or activity other than as expressly permitted by the Finance Documents.

Covenants by the Issuer

The covenants contained in the Collateral Deed will, *inter alia*, require the Issuer:

(i) to use all reasonable endeavours to procure the admission of the Bonds to the Official List of the Irish Stock Exchange and to maintain the same until none of the Bonds are outstanding, or if it is unable to do so having used all reasonable endeavours or if it is unduly burdensome to maintain such listing, it shall obtain and maintain the listing on such other recognised stock exchange as may be approved by the Bond Trustee and Financial Guarantors (if the Financial Guarantors are then the Majority Creditor(s)); and

(ii) not to carry on any business other than acting as Issuer of the Bonds, issuer of the Issuer Loan Notes, lender of the bond proceeds to ProjectCo pursuant to the Bond Proceeds Onloan Agreement, lender of the equity proceeds to ProjectCo pursuant to the Equity Proceeds Onloan Agreement and carrying out the limited treasury and management support trading functions permitted by the Finance Documents.

Covenants by ProjectCo

The covenants contained in the Collateral Deed will, *inter alia*, require ProjectCo:

(i) to maintain specified levels of insurance;

(ii) not to carry on any business other than the Project or any business other than permitted by the Transaction Documents; and

(iii) not to pay any dividends or make any distributions or payments to the Issuer or to HoldCo, except, in each case, as permitted in the Finance Documents.

Covenants by HoldCo

The covenants contained in the Collateral Deed will, *inter alia*, require HoldCo:

(i) not to carry on any business other than acting as the holding company of ProjectCo and the Issuer and the issuer of loan notes to its shareholders (the "**HoldCo Loan Notes**"), subscribing for Issuer Loan Notes or otherwise as expressly permitted by the Finance Documents; and

(ii) not to form or have any subsidiary other than the Issuer and ProjectCo or make any investments in any business or activity other than as expressly permitted by the Finance Documents.

Trigger Events

Upon the occurrence of any of the trigger events ("**Trigger Events**") specified in the Collateral Deed and at any time thereafter until such Trigger Event has been waived or deemed to have been remedied in accordance with the Collateral Deed or otherwise remedied to the satisfaction of the Majority Creditor(s) (acting reasonably), the Majority Creditor(s) will have certain additional rights to investigate, monitor, require relevant reports from and influence certain of the activities of ProjectCo (as more particularly provided in the Collateral Deed) and ProjectCo will not be permitted to pay any dividends or make any distributions to HoldCo or any payments to the Issuer pursuant to the Equity Proceeds Onloan Agreement.

Events of Default

The occurrence and continuance of any of the following events will, *inter alia*, constitute an event of default (an "**Event of Default**") unless and until such Event of Default has been remedied or waived to the satisfaction of the Majority Creditor(s) in accordance with the Collateral Deed:

(i) failure by any Obligor to make any payment when due under any of the Finance Documents, within specified grace periods (if applicable);

(ii) failure by any Obligor to comply with any of its obligations in the Transaction Documents, subject in some cases to specified grace periods and cure periods;

(iii) an event occurs which would allow either or both of the Authority or ProjectCo to terminate the Project Agreement or the termination of the Project Agreement;

(iv) failure to complete the Works or achieve completion of various phases under the Building Contract within specified time periods after the relevant scheduled completion date;

(v) insolvency, winding-up or an analogous event occurring with respect to ProjectCo, the Issuer, HoldCo and certain material Project parties or a distress or execution is levied in respect thereof and is not discharged within a specified period (except, with respect to those other Material Project Parties (other than the Obligors), if such event if capable of remedy is remedied accordingly to certain cure proposal as approved by the Majority Creditor(s));

(vi) transfers of ownership of the equity share capital in ProjectCo, the Issuer or HoldCo in breach of the restrictions set out in the Collateral Deed;

(vii) specified financial coverage ratios are not met by ProjectCo; and

(viii) specified events related to poor performance by ProjectCo of its obligations under the Project Agreement.

If an Event of Default has occurred and has not been waived by, or remedied to the satisfaction of the Majority Creditor(s) (acting reasonably), this could lead to:

(i) the Majority Creditor(s) instructing the Security Trustee (or the Issuer) to perfect or enforce the Security granted by the Obligors;

(ii) the Majority Creditor(s) directing the Security Trustee to exercise its rights under the Direct Agreements;

(iii) the Majority Creditor(s) directing the Bond Trustee to declare that the Bonds, or any part thereof, are immediately due and payable in accordance with their terms and conditions;

(iv) the Majority Creditor(s) directing the Issuer to declare any amounts outstanding under the Proceeds Onloan Agreements (as defined below, see the sub section entitled "*Security Arrangements*") to be immediately due and payable in accordance with their terms;

(v) the Majority Creditor(s) requiring ProjectCo to pay an amount equal to all outstanding amounts due or owing under or relating to the Bonds and the Reimbursement and Indemnity Deed; and/or

(vi) the Majority Creditor(s) directing ProjectCo to take such steps as regards the management of the Project as are set out in the Collateral Deed.

Notwithstanding the above, none of the Bond Trustee or Security Trustee shall be required to act pursuant to any instruction given by the Majority Creditors unless it is indemnified and/or secured to its satisfaction (including, if so required by the Bond Trustee or Security Trustee, by way of pre-funding).

Accounts

The Collateral Deed regulates payments into and out of each of the accounts maintained by each of the Obligors with the Account Bank (in addition to the provisions in the Account Bank Agreement) (together the "**Accounts**"), *inter alia*, to ensure the paying of the relevant debt service amounts and the prevention of certain prohibited payments.

Any income of ProjectCo will be paid into the Escrow Account, including from under the Project Agreement. Sums withdrawn from the Escrow Account will, in summary, be applied to pay construction costs and permitted operating costs (following transfer to the Operating Account), to pay debt service, to fund relevant reserves to the required levels, and to allow permitted distributions.

ProjectCo may only make distributions to the Issuer (in respect of payments under the Equity Proceeds Onloan Agreement) and/or to HoldCo (in respect of dividends) where, *inter alia*, the following conditions (the "**Distribution Conditions**") are satisfied:

(i) the amounts standing to the credit of each of the reserve accounts are at the required levels;

(ii) certain financial ratios are satisfied;

(iii) no Trigger Event has occurred and is continuing; and

(iv) no Event of Default has occurred and is continuing and no Event of Default or Potential Event of Default would result from the making of such payments.

Costs and Permitted Expenditure

Pursuant to clauses 23 of the Security Trust and Intercreditor Deed and clause 13 of the Collateral Deed, the Obligors will be required to reimburse any Finance Party on demand any costs, charges and expenses together with any irrecoverable VAT thereon incurred upon, amongst others, the exercise of any of the rights, remedies and powers conferred on the Finance Parties by the Finance Documents or in respect of the perfection, preservation or enforcement of the Security (as defined below) on a full indemnity basis, any costs incurred in respect of the negotiation, preparation, execution and registration of the Transaction Documents, the payment of any stamp duty and registration or other document taxes, and within 5 Business Days (as defined below, see sub-section entitled "*Terms and Conditions*") of demand all costs and out of pocket expenses incurred by any Finance Party in connection, *inter alia*, with the monitoring of the Project.

4. PROCEEDS ONLOAN AGREEMENTS

The Issuer and ProjectCo will enter into two Proceeds Onloan Agreements, the Bond Proceeds Onloan Agreement and the Equity Proceeds Onloan Agreement. The Proceeds Onloan Agreements are subject to the terms of the Collateral Deed and Security Trust and Intercreditor Deed (see sub-section below entitled "*Security Trust and Intercreditor Deed*"). The basis of payment of principal and interest under each such agreement is referred to below.

Bond Proceeds Onloan Agreement

Repayment and Prepayment

ProjectCo shall repay the principal of the loan in line with the principal payments due on the Bonds and on the dates that such payments of principal are due.

Interest

ProjectCo shall pay interest on the loan in line with the interest due on the Bonds and on the date that such payments of interest are due.

Equity Proceeds Onloan Agreement

Repayment and Prepayment

ProjectCo shall repay the principal of the loan as set out in the agreement which in relation to the amounts funded by the loan note proceeds shall be in line with the principal payments due under the loan notes as are specified to be paid by the Issuer to HoldCo.

Interest

ProjectCo shall pay interest on the loan as set out in the agreement which in relation to the amounts funded by the loan note proceeds shall be in line with the interest due under the loan notes as are specified to be paid by the Issuer to HoldCo.

5. SECURITY ARRANGEMENTS

The Bonds will have the benefit of the security arrangements summarised below. However, attention is drawn to the section entitled "*Security Trust and Intercreditor Deed*" below. The ability of the Bond Trustee and/or the Security Trustee to exercise rights in respect of such security arrangements will be restricted by the Security Trust and Intercreditor Deed (as defined below in this sub section) and Bondholders will have no independent entitlement to exercise such rights.

In this section:

"**Finance Party**" means:

(i) AGE;

(ii) AGM;

(iii) the Bond Trustee for itself and for and on behalf of the Bondholders;

(iv) each Bondholder each represented by the Bond Trustee on the terms set out in the Bond Trust Deed; and

(v) the Security Trustee for itself and for and on behalf of the Finance Parties,

and, in each case any successor or assignee of any of them.

"**Receiver**" means an administrative receiver, a receiver and manager or a receiver, in each case, appointed under the ProjectCo First Ranking Debenture, ProjectCo Second Ranking Debenture, the HoldCo Debenture, and/or the Issuer Debenture.

"Senior Creditors" means the Finance Parties and any Receiver or delegate.

Security from ProjectCo

(i) Pursuant to a first ranking debenture to be granted by ProjectCo in favour of the Security Trustee on or before the Issue Date (the "**ProjectCo First Ranking Debenture**"), the obligations of ProjectCo to the Senior Creditors under the Finance Documents will be secured by charges and assignments in favour of the Security Trustee over all the assets of ProjectCo which will be expressed to include (*inter alia*):

   (a) fixed charges over certain assets of ProjectCo;

   (b) assignments by way of security of all rights of ProjectCo under, *inter alia*, specified Transaction Documents to which it is a party and all rights to which ProjectCo may be entitled from time to time in relation to the proceeds of any insurance policies; and

   (c) a floating charge over all the property, assets and undertaking of ProjectCo which have not been effectively secured by way of fixed charge or assignment.

(ii) Pursuant to a second ranking debenture to be granted by ProjectCo in favour of the Issuer on or before the Issue Date (the "**ProjectCo Second Ranking Debenture**"), the obligations of ProjectCo to the Senior Creditors under the Finance Documents will be secured by charges and assignments in favour of the Issuer over all the assets of ProjectCo which will be expressed to include (*inter alia*):

(a) fixed charges over certain assets of ProjectCo;

(b) assignments by way of security of all rights of ProjectCo under, *inter alia*, specified Transaction Documents to which it is a party and all rights to which ProjectCo may be entitled from time to time in relation to the proceeds of any insurance policies; and

(c) a floating charge over all the property, assets and undertaking of ProjectCo which have not been effectively secured by way of fixed charge or assignment.

Security from HoldCo

Pursuant to a debenture to be granted by HoldCo in favour of the Security Trustee on or before the Issue Date (the "**HoldCo Debenture**"), the obligations of HoldCo to the Senior Creditors under the Finance Documents will be secured by charges and assignments in favour of the Security Trustee over all the assets of HoldCo which will be expressed to include (*inter alia*):

(i) fixed charges over *inter alia*, the issued shares in ProjectCo and the Issuer;

(ii) assignments by way of security of all rights of HoldCo under, *inter alia*, the Transaction Documents to which it is a party and all rights to which HoldCo may be entitled from time to time in relation to the proceeds of any insurance policies; and

(iii) a floating charge over all the assets of HoldCo which have not been effectively secured by way of fixed charge or assignment.

Security from the Issuer

Pursuant to a debenture to be granted by the Issuer in favour of the Security Trustee on or before the Issue Date (the "**Issuer Debenture**"), the obligations of the Issuer to Senior Creditors under the Finance Documents will be secured by charges and assignments in favour of the Security Trustee over all the assets of the Issuer which will be expressed to include (*inter alia*):

(i) fixed charges over certain assets of the Issuer;

(ii) assignments by way of security of all rights of the Issuer under, *inter alia*, the Transaction Documents to which it is a party and all rights to which the Issuer may be entitled from time to time in relation to the proceeds of any insurance policies; and

(iii) a floating charge over all the property, assets and undertaking of the Issuer which have not been effectively secured by way of fixed charge or assignment.

Joint and Several Guarantee

Pursuant to the terms of the Collateral Deed, the Obligors guarantee each other's obligations to the Finance Parties. HoldCo will also guarantee ProjectCo's obligations to the Issuer under the Bond Proceeds Onloan Agreement.

Security Trust and Intercreditor Deed

The following is an overview of certain provisions of the Security Trust and Intercreditor Deed. It is not exhaustive and is subject to the detailed provisions of the Security Trust and

Intercreditor Deed. Copies of the Security Trust and Intercreditor Deed are available for inspection by Bondholders during normal business hours at the specified offices (as set out below) of each of the Paying Agents.

The Obligors, the HoldCo Shareholders, the Security Trustee, the Bond Trustee and Financial Guarantors will on or before the Issue Date enter into a security trust and intercreditor deed pursuant to which the claims of the Bond Trustee (for itself and for the Bondholders) and Financial Guarantors in respect of the security created or contemplated by the Security Documents (the "**Security**") and under the Finance Documents will be regulated (the "**Security Trust and Intercreditor Deed**").

The claims of the Sponsor Creditors will be subordinated to the claims of the Finance Parties.

The Majority Creditor(s) may instruct the Security Trustee to issue a step-in notice in accordance with the applicable Direct Agreement and the Security Trust and Intercreditor Deed. Until the step-out date or other date, if earlier, on which the step-in period ends, each Finance Party will waive its respective entitlement to exercise rights to accelerate payment under any of the Finance Documents.

Each of the Senior Creditors will appoint the Security Trustee to act as trustee in connection with the Security. In such capacity the Security Trustee will agree in the Security Trust and Intercreditor Deed that it will exercise any right which it may have in respect of the Security Documents only as directed by the Majority Creditor(s) and provided the Security Trustee has been indemnified and/or secured to its satisfaction (including, if required by the Security Trustee, by way of pre-funding).

Definitions

See the sub-section entitled "*Collateral Deed*", above, for definitions used in this section. In addition:

"**Authorised Investment**" means, subject to the terms of the Account, an investment denominated in Pounds Sterling in any of the following:

(i) freely transferable and marketable debt securities issued by H.M. Government which constitute direct, primary and unsubordinated obligations having an outstanding maturity of less than six months from the date of purchase;

(ii) bank debt obligations in the form of certificates of deposit, time deposits or banker's acceptances with a long term senior debt rating of A+ or better by S&P or A1 or better by Moody's issued in the United Kingdom by a bank which is an authorised institution (for the purposes of the Financial Services and Markets Act 2000) or a building society (which is an authorised institution under the Building Societies Act 1986) and having an outstanding maturity less than six months from the date of purchase; or

(iii) other investments agreed between ProjectCo, the Issuer and the Majority Creditor(s).

"**Bond Liabilities**" means all present and future sums, liabilities and obligations whatsoever (actual or contingent) payable, owing, due or incurred by (a) any Obligor to any of the Bond Trustee and the Bondholders under and in respect of the Bonds, the Bond Trust Deed or the Collateral Deed or (b) ProjectCo to the Issuer pursuant to the Bond Proceeds Onloan Agreement.

"**Compensation on Termination**" means any payment made by the Authority to the Senior Creditors and / or the Sponsor Creditors (as applicable) in accordance with the terms of the Project Agreement following a termination of the Project Agreement.

"**Distribution**" means any payment by ProjectCo to any Equity Party or any person connected with any of them other than payments in accordance with the terms of any Project Document (excluding any Equity Document other than the Management Services Agreement) in force as at the date of this Agreement or as otherwise amended in accordance with the terms of this Agreement but provided always that: (a) remuneration properly paid to the directors of the Obligors in accordance with the Shareholders' Agreement; and (b) management fees properly paid in accordance with the Management Services Agreement, shall not be Distributions.

"**Equity Element**" means, at the relevant date, the proportion (expressed as a percentage) that the outstanding amounts described in paragraph (b) of the definition of Debt to Equity Ratio bears to the aggregate of (i) outstanding amounts described in paragraph (a) of the definition of Debt to Equity Ratio; and (ii) outstanding amounts described in paragraph (b) of the definition of Debt to Equity Ratio.

"**Equity Party**" means HoldCo, each HoldCo Shareholder and each Sponsor.

"**Financial Guarantee Fee Letters**" means the AGM Financial Guarantee Letter and the AGE Financial Guarantee Letter.

"**Financial Guarantor Liabilities**" means all present and future sums, liabilities and obligations whatsoever (actual or contingent) payable, owing, due or incurred by (a) any Obligor to either Financial Guarantor (by way of subrogation or otherwise) in respect of the Bonds, the Bond Trust Deed, the Financial Guarantees, the Financial Guarantee Fee Letters, the Account Bank Agreement, the Collateral Deed or under the Reimbursement and Indemnity Deed; or (b) ProjectCo to the Issuer pursuant to the Bonds Proceeds OnLoan Agreement.

"**Financing Rights**" means, in respect of the Security Trustee or any other Senior Creditor, all rights which it has the benefit of pursuant to any Finance Document or any Project Document including:

(i) the right, or the right to direct the Security Trustee or another Senior Creditor, to consent to any amendment, waiver, modification and/or extension of any provision of any Finance Document;

(ii) the right, or the right to direct the Security Trustee or another Senior Creditor, to exercise any right, power and discretion of or under any of the provisions of the Finance Documents (including, without limitation, the right to refuse to advance sums upon non-satisfaction of, or to waive, any conditions precedent contained in any Finance Document);

(iii) the right, or the right to direct the Security Trustee or another Senior Creditor, to bring any litigation, arbitration, administrative or other proceedings arising from or in connection with the Finance Documents; and

(iv) the exercise of any right expressed to be in favour of the Majority Creditor(s) under the Collateral Deed.

"**Instalment Date**" has the meaning given to it in Schedule 1 of the Project Agreement.

"**Security Trustee Liabilities**" means all present and future sums, liabilities and obligations whatsoever (actual or contingent) payable, owing, due or incurred by the Obligors to the Security Trustee for its own account under or in respect of the Finance Documents and Project Documents.

"**Senior Liabilities**" means the Financial Guarantor Liabilities, the Bond Liabilities and the Security Trustee Liabilities.

"**Sponsor Creditors**" means:

(i) HoldCo;

(ii) the Issuer;

(iii) each HoldCo Shareholder;

(iv) each Sponsor; and

(v) any guarantor of any of ProjectCo's obligations,

and, in each case, any successor or assignee of any of them.

"**Sponsors**" means:

(i) Uberior Infrastructure Investments (No.6) Limited;

(ii) Equitix Housing 2 Limited; and

(iii) Keepmoat Leeds PFI Limited.

"**Step-In Creditor**" means the Majority Creditor(s) at such time.

The provisions of the Security Trust and Intercreditor Deed (and the terms of the Proceeds Onloan Agreements), ProjectCo First Ranking Debenture, ProjectCo Second Ranking Debenture, HoldCo Debenture, Issuer Debenture and the joint and several guarantee granted by the Obligors) will allow the Majority Creditor(s) (and no other Finance Party) to instruct the Security Trustee to enforce the security under the Security Documents in accordance with the terms thereof (an "**Enforcement**"). The Majority Creditor(s) will also be entitled to instruct the Security Trustee to enforce the Security granted by ProjectCo, HoldCo and the Issuer only in respect of ProjectCo's obligations to the Issuer under the Proceeds Onloan Agreements (a "**Project Enforcement**"). Proceeds of a Project Enforcement will be retained by the Security Trustee and held on trust by the Security Trustee for the Finance Parties (a) for investment in Authorised Investments in accordance with the terms of the Security Trust and Intercreditor Deed, (b) following an Enforcement (other than a Project Enforcement) for application in accordance with the payment waterfall described below.

Proceeds of enforcement

Sums available to the Security Trustee following an Enforcement (other than a Project Enforcement) will be applied in payment in the following order:

(i) Subject to the rights of any creditor with prior security or a preferential claim, the proceeds of enforcement of the security under the Security Documents must be paid to the Security Trustee.

(ii) Any proceeds of enforcement of the security under the Security Documents and any amount paid to the Security Trustee under any Security Trustee Document, or at any time when the Authority has elected by to pay Compensation on Termination in instalments in the circumstances more fully described in clauses 22.8(a)(i) or 22.8(a)(ii) (*Payment by Instalments under the Project Agreement*) of the Security Trust and Intercreditor Deed, any amount received by the Authority must be applied in the following order of priority (after taking into account payments made to the Principal Paying Agent in accordance with the Paying Agency Agreement on the business day preceding any Scheduled Payment Date (and which are due to be distributed to Bondholders) where corresponding payments ranking in priority thereto or pari passu therewith which are due and payable on such Payment Date have not been made in full):

(a) in or towards payment of or provision for any liability of the Obligors in respect of any unpaid remuneration referred to in the Security Trust and Intercreditor Deed and all fees, costs, expenses, charges, liabilities, legal fees and disbursements or other amounts expended or incurred by the Security Trustee or any Receiver appointed under the Transaction Documents and of all remuneration due to any Receiver under or in connection with the Security Documents;

(b) in or towards payment (in the following order of priority):

   (I) any liability of the Obligors in respect of any unpaid remuneration and all fees, costs, expenses, charges, liabilities, legal fees and disbursements or other amounts expended or incurred by the Bond Trustee;

   (II) any liability of the Obligors in respect of any fees, costs and expenses of the Principal Paying Agent pursuant to the Paying Agency Agreement and of the Account Bank pursuant to the Account Bank Agreement; and

   (III) payment pro rata to each other Senior Creditor, all costs and expenses incurred by or on behalf of that Senior Creditor in connection with such enforcement, in so far as the same relates to the Senior Liabilities (including but not limited to, legal fees and disbursements);

(c) in payment to the Step-In Creditor of any unpaid expenses incurred by the Step-In Creditor;

(d) in payment, pro rata, to the Financial Guarantors in respect of all costs, fees or expenses due under the Reimbursement and Indemnity Deed (other than pursuant to clauses 3.2.4, 3.3.1 or 3.9 of the Reimbursement and Indemnity Deed);

(e) if and for so long as the Financial Guarantors are not the Majority Creditor(s) and to the extent not paid already pursuant to the clauses above, in payment, pro rata, to the Senior Creditors in respect of costs and expenses due pursuant to the Finance Documents;

(f) in payment, pro rata, to the Financial Guarantors until they have received all amounts due under clause 3.2.4 of the Reimbursement and Indemnity Deed and / or the Financial Guarantee Fee Letters (as such term is defined in the Reimbursement and Indemnity Deed);

(g) in payment to the Bond Trustee (on behalf of the Bondholders) of the interest due on the Bonds to the extent to which such amounts have not been paid by the Financial Guarantors under the Financial Guarantees, provided that, the amount payable pursuant to clause 22.7(b)(vii) of the Security Trust and Intercreditor Deed as referred to in this paragraph on any date shall be limited to the Scheduled Interest Liability as at that date. For this purpose, "**Scheduled Interest Liability**" means the amount in respect of interest on the Bonds which the Financial Guarantors have become actually and presently liable to pay on or prior to that date pursuant to the Financial

Guarantees or would be or become so liable subject only to a claim being made in accordance with the Financial Guarantees;

(h) in payment, pro rata, to the Financial Guarantors until the Financial Guarantors have received all amounts then due and payable to them under clauses 3.3.1 and 3.9 of the Reimbursement and Indemnity Deed with respect to interest on the Bonds (including pursuant to any right of subrogation the Financial Guarantors have acquired in respect of any payments made by the Financial Guarantors under the Financial Guarantees);

(i) in payment to the Bond Trustee (on behalf of the Bondholders) of principal due on the Bonds to the extent to which such amounts have not been paid by the Financial Guarantors under the Financial Guarantees provided that, the amount payable pursuant to clause 22.7(b)(ix) of the Security Trust and Intercreditor Deed (as referred to in this paragraph) on any date shall be limited to the Scheduled Principal Liability as at that date. For this purpose, "**Scheduled Principal Liability**" means the amount in respect of principal of the Bonds which the Financial Guarantors have become actually and presently liable to pay on or prior to that date pursuant to the Financial Guarantees or would be or become so liable subject only to a claim being made in accordance with the Financial Guarantees;

(j) in payment, pro rata, to the Financial Guarantors until the Financial Guarantors have received all amounts then due and payable to them under clauses 3.3.1 and 3.9 of the Reimbursement and Indemnity Deed with respect to principal on the Bonds (including pursuant to any right of subrogation the Financial Guarantors have acquired in respect of any payments made by the Financial Guarantors under the Financial Guarantees);

(k) if the Bonds have been accelerated in accordance with Condition 9 of the Bonds, in payment to the Bond Trustee on behalf of Bondholders of any and all outstanding Default Amount (as defined in the Bond Conditions) due and payable on the Bonds;

(l) following discharge in full of all Financial Guarantor Liabilities and payment in full of all outstanding principal of the Bonds, in or towards payment, pro rata, of all remaining sums or liabilities due or owed to the Senior Creditors in respect of the Senior Liabilities and the Account Bank pursuant to the Account Bank Agreement;

(m) at any time when the Authority has elected to pay Compensation on Termination in instalments, provided that on the relevant Instalment Date: (i) no claim has been or will be made under the Financial Guarantees in respect of principal and / or interest on the Bonds; (ii) the Senior Creditors have no fees, costs or expenses due and owing and no such fees, costs or expenses are reasonably expected to become payable at any time prior to the next Instalment Date; (iii) all amounts payable in relation to clauses 22.7(b)(i) to 22.7(b)(xiii) of the Security Trust and Intercreditor Deed (inclusive) ((a) to (l) above) have been fully and irrevocably paid; and (iv) there is no restriction on Distributions outstanding under clause 7.2 (*Distributions*) of the Collateral Deed, in payment on each Instalment Date paid an amount equal to the Equity Element of the amount paid on such scheduled Instalment Date in respect of the principal amount paid to the Bondholders in accordance with clause 22.7(b)(ix) of the Security Trust and Intercreditor Deed ((i) above);

(n) if the Bonds have not been accelerated pursuant to Condition 9 of the Bonds, any and all amounts remaining after application of clauses 22.7 (i) to (xiii) of the Security Trust and Intercreditor Deed ((a) to (l) above) shall be held on trust by the Security Trustee on behalf of the Senior Creditors and invested in Authorised Investments as instructed by the Majority Creditor(s) and, unless otherwise instructed by the Majority Creditor(s), applied by the Security Trustee in payment of amounts becoming due and payable under clauses 22.7 (i)(a) to (xiii) of the Security Trust and Intercreditor Deed ((a) to (l) above) as and when such amounts become so due and payable; and

(o) following discharge in full of all Senior Liabilities (and, for the avoidance of doubt, not at a time when payments are being made in instalments in accordance with clause 22.8 (*Payment by Instalments under the Project Agreement*)) of the Security Trust and Intercreditor Deed, to the payment of any surplus (if any) to the Issuer or any other person entitled to it.

Costs and Permitted Expenditure

Pursuant to clauses 23 of the Security Trust and Intercreditor Deed and clause 13 of the Collateral Deed, the Obligors will be required to reimburse any Finance Party on demand any costs, charges and expenses together with any irrecoverable VAT thereon incurred upon, amongst others, the exercise of any of the rights, remedies and powers conferred on the Finance Parties by the Finance Documents or in respect of the perfection, preservation or enforcement of the Security (as defined below) on a full indemnity basis, any costs incurred in respect of the negotiation, preparation, execution and registration of the Transaction Documents, the payment of any stamp duty and registration or other document taxes, and within 5 Business Days of demand all costs and out of pocket expenses incurred by any Finance Party in connection, *inter alia*, with the monitoring of the Project.

The exercise of Financing Rights and Entrenched Rights and Reserved Matters

Pursuant to clause 9 of the Security Trust and Intercreditor Deed, each Senior Creditor agrees that it will exercise its Financing Rights (other than Entrenched Right or Reserved Matters) as directed by, or with the consent of, the Majority Creditor(s). Subject as otherwise set out in the Security Trust and Intercreditor Deed, the Majority Creditor(s) have the full right, power, and authority to exercise its Financing Rights or to direct the exercise of such rights without regard to the interest of any other person, and will not be a fiduciary or owe any fiduciary duties to any person under the Security Trust and Intercreditor Deed (except where the Majority Creditor is the Bond Trustee, who will have regard solely to its interests and those of the Bondholders).

The Financial Guarantors, the Bond Trustee and the Security Trustee each have a scheduled list of rights which are entrenched rights (the "**Entrenched Rights**") and no Financing Right which includes an Entrenched Right of the Senior Creditors can be exercised if the relevant party does not provide its consent.

The Financial Guarantors, the Bond Trustee and the Security Trustee each have a scheduled list of reserved matters (the "**Reserved Matters**") which are matters personal to them which can be exercised in their discretion without the consent of the Majority Creditor(s).

When exercising the Financing Rights, the Security Trustee and the Bond Trustee (except where the Bond Trustee is the Majority Creditor) shall not be required to have regard to the interests of the Beneficiaries in relation to the exercise of such rights and will have no liability to the Bondholders as a consequence of so acting.

6. HOLDCO SHAREHOLDERS' CONTRIBUTIONS TO FINANCING

Equity

As at the date of this Prospectus (i) Equitix Housing 2 Limited holds 20,400 ordinary shares of £1 each in HoldCo; (ii) Uberior Infrastructure Investments (No.5) Limited holds 25,500 ordinary shares of £1 each in HoldCo; and (iii) Keepmoat Leeds PFI Limited holds 5,100 ordinary shares of £1 each in HoldCo (together the "**HoldCo Shareholders**"), and HoldCo holds 1,000 ordinary shares of £1 each in ProjectCo (the "**ProjectCo Shares**") and 50,000 ordinary shares of £1 each in the Issuer. The share capital of each of HoldCo, ProjectCo and the Issuer is fully paid up.

The relationship between the HoldCo Shareholders, the Issuer, ProjectCo and HoldCo in respect of the management of the HoldCo Shareholders' investment in the Project will substantially be governed by an agreement between those parties to be dated on or around the Issue Date (the "**Shareholders' Agreement**") and by the terms of the Equity Subscription Agreement.

Subordinated Debt

The HoldCo Shareholders have agreed in the Equity Subscription Agreement to subscribe for the HoldCo Loan Notes in the following approximate aggregate amounts:

Party	**HoldCo Loan Notes**
Equitix Housing 2 Limited	£5,072,000
Uberior Infrastructure Investments (No.6) Limited	£6,340,000
Keepmoat Leeds PFI Limited	£1,268,000
Total	£12,680,000

HoldCo has agreed to invest in the Issuer Loan Notes to be issued by the Issuer in the same amounts and on the same dates as the HoldCo Shareholders subscribe for HoldCo Loan Notes. The proceeds of subscription for the Issuer Loan Notes will be on-lent by the Issuer to ProjectCo pursuant to the Equity Proceeds Onloan Agreement at close.

The ability of the Bond Trustee to exercise rights under the Security Trust and Intercreditor Deed in connection with the Issuer Loan Notes will, however, be restricted by the terms of the Security Trust and Intercreditor Deed and Bondholders will have no independent entitlement to exercise such rights.

None of the Bond Trustee, the Security Trustee, or the Principal Paying Agent will be required to monitor or supervise the performance of or compliance with any party's obligations under the Security Trust and Intercreditor Deed in connection with the HoldCo Loan Notes or the Issuer Loan Notes. None of the Bond Trustee, Security Trustee or the Principal Paying Agent is obliged to monitor the credit ratings of any other party to the Transaction Documents or to ascertain whether any such party has defaulted in its obligations under such Transaction Documents.

HoldCo Shareholder Distributions

The HoldCo Shareholders will, subject to various constraints placed by the Collateral Deed upon ProjectCo's ability to make payments to the Issuer and HoldCo, extract payments derived from the project revenues by way of dividends to HoldCo in respect of the shares in ProjectCo and payments of interest and principal from ProjectCo to the Issuer in respect of the Equity

Proceeds Onloan Agreement and consequent payments of interest and principal from the Issuer to HoldCo in respect of the Issuer Loan Notes.

7. FUNDERS' DIRECT AGREEMENT

The Authority will enter into the Funders' Direct Agreement with the Security Trustee, ProjectCo and the Issuer in connection with the Project Agreement pursuant to which the Authority, following service of a notice of termination for a ProjectCo event of default under the Project Agreement or the occurrence of an Event of Default, will agree for a limited period not to terminate the Project Agreement. To the extent instructed to do so by the Majority Creditor(s), the Security Trustee will be entitled to step-in and appoint a representative which shall assume jointly with ProjectCo the rights of ProjectCo under, *inter alia*, the Project Agreement, however neither the Security Trustee or any of its affiliates, agents, delegates of sub-delegates will be bound to act as a representative under the Funders' Direct Agreement. To the extent instructed by the Majority Creditor(s), the Security Trustee will also be entitled to propose a substitute entity to undertake the obligations of ProjectCo under the Project Agreement, which entity will, subject to demonstration of its technical and financial capacity and its agreeing to accede to the terms of the Funders' Direct Agreement, assume such obligations in place of ProjectCo.

8. ACCOUNT BANK AGREEMENT

The Obligors, Financial Guarantors, the Security Trustee, the Bond Trustee and The Bank of New York Mellon, London Branch as account bank (the "**Account Bank**") will enter into an account bank agreement (the "**Account Bank Agreement**") on or before the Issue Date which will regulate the setting up and operation of the Accounts.

Sums standing to the credit of certain of the accounts may be invested (subject to certain restrictions) in certain approved authorised investments in accordance with the provisions of the Account Bank Agreement.

9. GUARANTEED INVESTMENT CONTRACT

In order to mitigate its exposure to interest rate movements on its cash deposits during the period of construction, ProjectCo will enter into a guaranteed investment contract on or about the Issue Date (the "**GIC**") with Lloyds TSB Bank Plc (the "**GIC Provider**") under which, in return for a single up front deposit by ProjectCo (to be funded on the issue date from amounts received by the Issuer and on-lent to ProjectCo), the GIC Provider will make certain scheduled payments during the anticipated construction period.

In the event of a non-scheduled withdrawal under the GIC by ProjectCo, the amount repaid to ProjectCo will be the lower of the amount deposited with the GIC Provider under the GIC and the amount which, if placed on deposit with an appropriately rated guaranteed investment contract provider, would be sufficient to provide ProjectCo with the remaining scheduled payments under the GIC.

In the event that the credit rating of the GIC Provider from either of the Rating Agencies is reduced below a certain level, and the GIC Provider does not (i) obtain an acceptable guarantee of its obligations from an appropriately rated entity, (ii) novate or transfer the GIC to an appropriately rated entity on the same terms or (iii) provide collateral in relation to ProjectCo's deposit with the GIC Provider then the GIC Provider may be required by ProjectCo to pay to ProjectCo an amount (which may be less than the amount deposited with the GIC Provider under the GIC) which, if placed on deposit with an appropriately rated alternative guaranteed investment contract provider, would be sufficient to provide ProjectCo with the remaining scheduled payments under the GIC.

TERMS AND CONDITIONS OF THE BONDS

The following is the text, subject to completion and amendment and save for the text in italics (other than headings), of the terms and conditions which will be endorsed on each Bond in definitive form. Bonds in definitive form will only be issued in certain limited circumstances. For an overview of the provisions of the Bonds in global form, see the section below entitled "Overview of Provisions relating to the Bonds while in Global Form".

The issue of the £101,833,000 5.069 per cent. Fixed Rate Guaranteed Secured Bonds due September 2032 (the "**Bonds**") was authorised by a resolution of the board of directors of Sustainable Communities for Leeds (Finance) plc (the "**Issuer**") passed on 5 July 2013. The Bonds are subject to, and have the benefit of, a bond trust deed dated on or around 11 July 2013 (as amended or supplemented from time to time, the "**Bond Trust Deed**") between the Issuer, Sustainable Communities for Leeds Limited ("**ProjectCo**"), Sustainable Communities for Leeds (Holdings) Limited ("**HoldCo**" and, together with the Issuer and ProjectCo, the "**Obligors**"), Assured Guaranty (Europe) Ltd. ("**AGE**"), Assured Guaranty Municipal Corp. ("**AGM**", and together with AGE, the "**Financial Guarantors**" and each a "**Financial Guarantor**")) and BNY Mellon Corporate Trustee Services Limited as bond trustee (in such capacity the "**Bond Trustee**", which expression includes all persons for the time being appointed bond trustee or bond trustees under the Bond Trust Deed). These terms and conditions include summaries of and are subject to the detailed provisions of the Bond Trust Deed, which includes the form of the Bonds, Receipts and the Coupons (as defined below) relating to them, and a security trust and intercreditor deed dated on or around 11 July 2013 (as amended, supplemented, restated, novated or replaced from time to time, the "**Security Trust and Intercreditor Deed**") between, *inter alia*, the Issuer, ProjectCo, HoldCo, the HoldCo Shareholders (as defined in Condition 2.9), BNY Mellon Corporate Trustee Services Limited as security trustee (the "**Security Trustee**", which expression includes all persons for the time being appointed security trustee or security trustees under the Security Trust and Intercreditor Deed), the Bond Trustee (for itself and on behalf of the Bondholders), the Financial Guarantors and the Sponsors (as defined in Condition 2.9).

The Bonds (excluding those held by or on behalf of the Issuer Group (as defined in Condition 2.9) are unconditionally and irrevocably guaranteed as to scheduled payments of principal and interest in respect of the Bonds (in the proportions set out in Condition 2.2) but excluding any amounts that are not Guaranteed Amounts (as defined in the relevant Financial Guarantee), pursuant to a financial guarantee dated on 11 July 2013 by AGE (the "**AGE Financial Guarantee**") and a financial guarantee dated on 11 July 2013 by AGM (the "**AGM Financial Guarantee**", and together with the AGE Financial Guarantee, the "**Financial Guarantees**" and each a "**Financial Guarantee**") in respect of which the Issuer agrees to indemnify each of AGE and AGM pursuant to the terms of a reimbursement and indemnity deed between the Issuer, ProjectCo, HoldCo, AGE and AGM (the "**Reimbursement and Indemnity Deed**").

Payments in respect of the Bonds will be made pursuant to a paying agency agreement dated on or around 11 July 2013 (as amended or supplemented from time to time, the "**Paying Agency Agreement**") between the Issuer, the Bond Trustee and The Bank of New York Mellon, London branch as principal paying agent (the "**Principal Paying Agent**", which expression includes any successor principal paying agent appointed under the Paying Agency Agreement, and together with any successor or additional paying agents appointed thereunder the "**Paying Agents**").

The holders for the time being of one or more Bonds (the "**Bondholders**"), the holders of the related principal receipts (the "**Receiptholders**" and the "**Receipts**" respectively) and the holders of the related interest coupons (the "**Couponholders**" and the "**Coupons**", respectively) will be entitled to the benefit of, will be bound by, and are deemed to have notice of, all the provisions of the Bond Trust Deed, the Financial Guarantees, the Collateral Deed (as defined in Condition 2.6), the Security Documents (as defined in Condition 2.6), the Security Trust and Intercreditor Deed and the Paying Agency Agreement applicable to them.

Copies of the Bond Trust Deed, the Financial Guarantees, the Collateral Deed, the Security Documents and the Paying Agency Agreement are available for inspection by Bondholders, during normal business hours at the specified offices of each of the Paying Agents.

1. FORM, DENOMINATION AND TITLE

Form and Denomination

1.1 The Bonds are in bearer form, serially numbered, in denominations of £100,000 and integral multiples of £1,000 in excess thereof up to and including £199,000, with Receipts for principal, Coupons for interest, and talons (each a "**Talon**") for further Receipts and Coupons attached at the time of issue. Bonds of one denomination will not be exchangeable for Bonds of any other denomination. No Definitive Bonds will be issued with a denomination above £199,000.

Title

1.2 Title to the Bonds, the Receipts, the Coupons and the Talons will pass by delivery. The holder of any Bond, Receipt, Coupon or Talon shall (except as otherwise required by law) be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any other interest therein, any writing thereon or any notice of any previous loss or theft thereof) and no person shall be liable for so treating such holder.

2. STATUS, FINANCIAL GUARANTEES AND SECURITY

Status of the Bonds

2.1 The Bonds constitute direct, unconditional and secured obligations of the Issuer which rank pari passu and rateably without any preference or priority among themselves and will rank in priority to all unsecured obligations of the Issuer, save for such obligations as may be preferred by provisions of law that are both mandatory and of general application.

Financial Guarantees

2.2 The Bonds (except any Bonds to the extent that they are then held by or on behalf of any of the Issuer Group) have the benefit of the Financial Guarantees. Pursuant to the AGE Financial Guarantee, AGE has unconditionally and irrevocably guaranteed to pay to the Bond Trustee 6 per cent. of all sums due and payable but unpaid by the Issuer in respect of scheduled principal and interest in respect of the Bonds, but excluding any amounts that are not Guaranteed Amounts (as defined in the AGE Financial Guarantee), all as more particularly described in the AGE Financial Guarantee. Pursuant to the AGM Financial Guarantee, AGM has unconditionally and irrevocably guaranteed to pay to the Bond Trustee 94 per cent. of all sums due and payable but unpaid by the Issuer in respect of scheduled principal and interest in respect of the Bonds, but excluding any amounts that are not Guaranteed Amounts (as defined in the AGM Financial Guarantee) and all sums due and payable but unpaid by AGE under the AGE Financial Guarantee, all as more particularly described in the AGM Financial Guarantee.

The terms of each Financial Guarantee provide that amounts of principal and interest on any Bonds (except any Bonds to the extent they are held by or on behalf of the Issuer Group) which have become immediately due and payable (whether by virtue of prepayment, acceleration, mandatory or optional redemption or otherwise) other than on the relevant Scheduled Payment Date (as defined in Condition 4) will not be treated as Guaranteed Amounts (as defined in the Financial Guarantees) which are Due for Payment (as defined in the Financial Guarantees) unless the Financial Guarantors in their sole discretion elect so to do by notice in writing to the Bond Trustee. If no such election is made, the Financial Guarantors will continue to be liable to make payments in respect of the Bonds pursuant to the Financial Guarantees on the dates on which such payments would have been required to be made if such amounts had not become immediately due and payable.

To the extent that the Early Redemption Price (as defined in Condition 6.2) exceeds the Outstanding Principal Amount) to be redeemed, payment of such excess is not guaranteed by the Financial Guarantors under the Financial Guarantees.

Termination of the Financial Guarantees

2.3 If at any time while the Bonds remain outstanding both: (i) AGM's insurer financial strength rating by Moody's ceases to be at least "Baa3"; and (ii) AGM's insurer financial strength rating by S&P ceases to be at least "BBB-" (a "**Financial Guarantor Downgrade Event**"), the Issuer shall: (a) notify the Bondholders and the Bond Trustee that a Financial Guarantor Downgrade Event has occurred and of their rights pursuant to and in accordance with the Bond Trust Deed and the Conditions; and (b) shall convene a meeting of Bondholders for the purpose of considering the Extraordinary Resolution referred to below.

If directed by Bondholders acting by way of an Extraordinary Resolution at any time after the occurrence of a Financial Guarantor Downgrade Event, the Bond Trustee, subject to being indemnified and/or secured to its satisfaction (including, if required by the Bond Trustee, by way of pre-funding), shall issue a notice (the "**Financial Guarantor Removal Notice**") to AGM and AGE specifying that, unless the Financial Guarantor Downgrade Event has been remedied or waived by the Bond Trustee acting in accordance with an Extraordinary Resolution of the Bondholders by the date that is three calendar months after the date of delivery of the Financial Guarantor Removal Notice, each of the Financial Guarantees shall be unconditionally and irrevocably cancelled in whole and not in part effective on the date (such date the "**Financial Guarantor Removal Effective Date**") on which the Financial Guarantors have been (i) reimbursed in full for any payments made under the Financial Guarantees and (ii) paid any and all then-outstanding financial guarantee fees and other amounts owed under the Reimbursement and Indemnity Deed and the Financial Guarantee Fee Letters. The Financial Guarantors may remedy any Financial Guarantor Removal Notice by transferring the AGM Financial Guarantee to an affiliate of AGM that is rated at least "Baa3" by Moody's or "BBB-" by S&P prior to the occurrence of a Financial Guarantor Removal Effective Date and providing a legal opinion addressed to the Bond Trustee and satisfactory to the Bond Trustee (acting reasonably) in relation to the assumption by such affiliate of the obligations of AGM under the AGM Financial Guarantee (including with respect to the portion of the Guaranteed Amounts which are guaranteed by AGE).

After the Financial Guarantor Removal Effective Date has occurred, financial guarantee fees shall cease to be paid to AGM and AGE and the Bondholders may elect by Extraordinary Resolution to use such financial guarantee fees:

(i) to pay a replacement financial guarantor (if available);

(ii) to pay a monitoring adviser to act as Majority Creditor(s) (if available);

(iii) to increase the aggregate amount of interest payable on the Bonds by the amount of such financial guarantee fees (such amount the "**Additional Interest Amount**"); or

(iv) for such other purpose as such Extraordinary Resolution may specify, or any combination of the above and, in the absence of any such election within 30 days of the Financial Guarantor Removal Effective Date, such financial guarantee fees shall be used to fund Additional Interest Amounts.

The Issuer will immediately notify the Bond Trustee (who shall inform the Bondholders) upon: (i) any remedy or waiver of a Financial Guarantor Downgrade Event (including by way of transfer of the AGM Financial Guarantee); or (ii) termination of the Financial Guarantees pursuant to this Condition 2.3, of such occurrence in accordance with Condition 15.

Status of Financial Guarantees

2.4 The Financial Guarantee provided by each Financial Guarantor in respect of the Bonds constitutes a direct, unsecured obligation of such Financial Guarantor which will rank at least *pari passu* with all other unsecured obligations of such Financial Guarantor, save for such obligations as may be preferred by provisions of law that are both mandatory and of general application.

Subrogation of the Financial Guarantors

2.5 The Bond Trust Deed and the Financial Guarantees provide that the Financial Guarantors shall be subrogated to any rights of the Bond Trustee and the Bondholders against the Issuer in respect of amounts due in respect of the Bonds which have been paid by the Financial Guarantors under the Financial Guarantees.

Security

2.6 The obligations of the Issuer under the Bonds are secured by:

(i) the security agreement dated on or before the Issue Date between the Issuer and the Security Trustee (the "**Issuer Debenture**");

(ii) the security agreement dated on or before the Issue Date between ProjectCo and the Security Trustee (the "**ProjectCo Debenture**");

(iii) the security agreement dated on or before the Issue Date between HoldCo and the Security Trustee (the "**HoldCo Debenture**");

(iv) a joint and several guarantee by ProjectCo and HoldCo of the Issuer's obligations *inter alia* under the Bonds pursuant to the terms of a collateral deed (the "**Collateral Deed**") dated on or about the Issue Date between inter alios, the Obligors, the Financial Guarantors, the Security Trustee and the Bond Trustee;

(v) the Equity Subscription Agreement dated on or about the Issue Date between ProjectCo, HoldCo, the HoldCo Shareholders, the Sponsors, the Security Trustee and the Majority Creditor(s);

(vi) any deed of accession entered into in respect of any document referred to above;

(vii) the Direct Agreements; and

(viii) any other document evidencing or creating security over any asset of an Obligor to secure any obligation of the Obligors to a Secured Finance Party under the Finance Documents, (together the "**Security Documents**" and "**Direct Agreements**", has the meaning given in the Collateral Deed).

Collateral Deed

2.7 The Bond Trustee has the benefit of certain representations and covenants set out in the Collateral Deed.

Security Trust and Intercreditor Deed

2.8 The Bonds are subject to the Security Trust and Intercreditor Deed, pursuant to which the exercise by the Bond Trustee of its rights under the Bond Trust Deed and of the rights of the Bondholders under the Bonds on behalf of the Bondholders may in certain circumstances be directed by, and is in most circumstances subject to the prior consent of, other parties to the Security Trust and Intercreditor Deed. Bondholders, Receiptholders and Couponholders are bound by, and deemed to have notice of, all the provisions of the Security Trust and Intercreditor Deed.

The Majority Creditor(s) have the exclusive right, power and authority to direct, or to refrain from directing, each Senior Creditor (as defined in the Security Trust and Intercreditor Deed) and the Security Trustee in the exercise of the Financing Rights subject to Entrenched Rights and Reserved Rights, in each case without regard to the interests of any other person and the Majority Creditor(s) will not owe fiduciary duties to any person.

When exercising the Financing Rights in accordance with the instructions of the Majority Creditor(s), neither the Bond Trustee nor the Security Trustee is required to have regard to the interests of the Bondholders in relation to the exercise of such rights and neither has any liability to the Bondholders as a consequence of so acting.

The Bond Trustee also has the benefit of certain covenants set out in the Security Trust and Intercreditor Deed.

Definitions

2.9 In these Conditions:

"**Entrenched Rights**" has the meaning given to it in the Security Trust and Intercreditor Deed;

"**Financing Rights**" has the meaning given to it in the Security Trust and Intercreditor Deed;

"**Guaranteed Amount**" has the meaning given to it with respect to a Financial Guarantor in the Financial Guarantee given by such Financial Guarantor;

"**HoldCo Shareholders**" means each of Equitix Housing 2 Limited, Keepmoat Leeds PFI Limited and Uberior Infrastructure Investments (No.5) Limited;

"**Issuer Group**" means the Obligors, the HoldCo Shareholders and the Sponsors;

"**Majority Creditor(s)**" means, at any time, the Financial Guarantors unless and until such time as (i) both of the Financial Guarantees have been terminated in accordance with Condition 2.3 as a result of a Financial Guarantor Downgrade Event or (ii) the Security Trustee has received notice from the Bond Trustee that a Financial Guarantor Default (as defined in the Security Trust and Intercreditor Deed) has occurred, in which case, the Bond Trustee shall be the Majority Creditor(s) unless such Financial Guarantor Default has been cured or waived;

"**Moody's**" means Moody's Investors Services, Inc. or any successor to its rating agency function.

"**Outstanding Principal Amount**" means the aggregate principal amount of the Bonds (or, as the context may require, of the relevant number of Bonds or of an individual Bond) outstanding for the time being as reduced by payments of Scheduled Principal or other amounts in respect of principal, including such amounts paid in accordance with Condition 6.

"**Reserved Rights**" has the meaning given to it in the Security Trust and Intercreditor Deed;

"**S&P**" means Standard and Poor's Rating Services, a division of The McGraw-Hill Companies, Inc., or any successor to its rating agency function; and

"**Sponsors**" means each of Equitix Housing 2 Limited, Keepmoat Leeds PFI Limited and Uberior Infrastructure Investments (No.6) Limited.

3. COVENANTS OF THE ISSUER

The Issuer shall perform all its obligations under and in accordance with the Transaction Documents (as defined in the Collateral Deed) to which it is party.

4. INTEREST

Fixed Rate Interest

4.1 The Bonds bear interest on their Outstanding Principal Amount ("**Scheduled Interest**") from the Issue Date at the rate of 5.069 per cent. per annum (the "**Rate of Interest**"). Scheduled Interest will be payable semi-annually in arrear on each scheduled payment date listed in Condition 7.1 (each, a "**Scheduled Payment Date**"). Each period beginning on (and including) the 11 July 2013 (the "**Issue Date**") or any Scheduled Payment Date and ending on (but excluding) the next Scheduled Payment Date is in these Conditions called an "**Interest Period**". The first Scheduled Payment Date will be 30 September 2013 in respect of the Interest Period from (and including) the Issue Date to (but excluding) 30 September 2013. The amount of Scheduled Interest payable on each Scheduled Payment Date shall be the amount set out in Condition 7.1.

If interest is required to be paid in respect of a Bond for a period which is not an Interest Period (other than the Interest Period ending on 30 September 2013 the interest payable in respect of which shall be calculated in accordance with this paragraph), it shall be calculated by applying the Rate of Interest to the Outstanding Principal Amount of such Bond and multiplying the product by the relevant Day Count Fraction (as defined below).

In these conditions:

"**Calculation Period**" means the period for which interest is to be calculated, from (and including) the first day of such period to (but excluding) the last day of such period;

"**Day Count Fraction**" means:

(i) if the relevant Calculation Period is equal to or shorter than the Regular Period during which it falls, the number of days in the Calculation Period divided by the product of (1) the number of days in such Regular Period and (2) two; and

(ii) if the Calculation Period is longer than one Regular Period, the sum of:

(a) the number of days in such Calculation Period falling in the Regular Period in which it begins divided by the product of (1) the number of days in such Regular Period and (2) two; and

(b) the number of days in such Calculation Period falling in the next Regular Period divided by the product of (1) the number of days in such Regular Period and (2) two.

"**Regular Period**" means each period from (and including) 31 March or 30 September in any year to (but excluding) the next 31 March or 30 September respectively.

Additional Interest Amount

4.2 In the event that the Financial Guarantees are terminated by the Bond Trustee on behalf of the Bondholders as a result of a Financial Guarantor Downgrade Event and the Bondholders elect in accordance with Condition 2.3(iii) to increase the amount of interest payable on the Bonds (or the amount of interest payable in respect of the Bonds is otherwise increased in accordance with such Condition), an Additional Interest Amount shall be payable to Bondholders (pro rata to their respective holdings of Bonds) on each Scheduled Payment Date equal to the aggregate amount available to the Issuer which would otherwise have been used to fund the payment of financial guarantee fees under the Reimbursement and Indemnity Deed, the AGE Financial Guarantee Fee Letter and the AGM Financial Guarantee Fee Letter.

5. DEFAULT INTEREST

Default Interest

5.1 The Outstanding Principal Amount (or, where applicable, the relevant part thereof) of each Bond will cease to bear interest from the Scheduled Payment Date for the payment of such principal amount (or part thereof) unless, upon due presentation, payment is improperly withheld or refused, in which case the unpaid amount will bear default interest ("**Default Interest**"), after as well as before judgment, at the Rate of Interest until whichever is the earlier of:

(i) the day on which all principal sums due in respect of such Bond up to that day are received by or on behalf of the relevant Bondholder; and

(ii) the day which is seven days after the Principal Paying Agent or the Bond Trustee has notified the Bondholders that it has received all principal sums due in respect of the Bonds up to such seventh day (except to the extent that there is any subsequent default in payment, in which case interest shall continue to accrue on any unpaid principal amount until such principal amounts are received by or on behalf of the relevant Bondholders).

Default Interest Payment

5.2 Accrued Default Interest arising prior to the final Scheduled Payment Date shall be payable on each date (each a "**Default Interest Payment Date**") on which any amount of Scheduled Principal remains unpaid and which is an integral multiple of six calendar months after the due date for payment of such Scheduled Principal. Any amounts of

Default Interest arising on or after the final Scheduled Payment Date shall be immediately due and payable. Each period beginning on (and including) the date on which the relevant payment is improperly withheld or refused or, as the case may be, any Default Interest Payment Date and ending on (but excluding) the next Default Interest Payment Date is in these Conditions called a "**Default Interest Period**".

Default Interest Calculation

5.3 The amount of Default Interest payable in respect of each Bond for any Default Interest Period shall be calculated on the day count basis set out in Condition 4.1 in respect of Scheduled Interest.

Default Interest does not accrue on Scheduled Interest or Default Interest. The payment of Default Interest is not guaranteed by the Financial Guarantors under the Financial Guarantees.

6. REDEMPTION AND PURCHASE

Scheduled Redemption

6.1 Unless previously redeemed, or purchased and cancelled, the Issuer will redeem the Bonds in instalments by the payment in respect of each Bond on each Scheduled Payment Date of the scheduled principal thereof (which in respect of each £1,000 in principal amount in excess of £100,000 will be the relevant amount determined in accordance with Condition 7.1 and in respect of each Bond in the denomination of £100,000 will be the corresponding amount of scheduled principal calculated on the basis of such amount) (the "**Scheduled Principal**"). The first instalment of Scheduled Principal will be payable on the Scheduled Payment Date falling on 30 September 2013. The final Scheduled Payment Date is the Scheduled Payment Date falling on 30 September 2032. For the avoidance of doubt, the Outstanding Principal Amount of each Bond will be reduced for each payment of principal on the Scheduled Payment Dates as provided in Condition 7 and such payment will not result in a reduction of the number of Bonds in issue.

Issuer Optional Redemption

6.2 Subject to the Issuer satisfying the Financial Guarantors that the Issuer has sufficient available funds to redeem the Bonds in whole and meet all other amounts ranking in priority thereto (in accordance with the priority of payments set out in clause 22.7 (Proceeds of Enforcement) of the Security Trust and Intercreditor Deed) and any other amounts outstanding under the Finance Documents, the Issuer may at any time having given not less than 30 nor more than 60 days' notice of redemption to the Bondholders in accordance with Condition 15 (which notice shall be irrevocable) redeem the Bonds in whole, but not in part, on the date specified for redemption in such notice in an amount (the "**Early Redemption Price**") in respect of each Bond equal to the higher of the following:

(i) the Outstanding Principal Amount of such Bond together with: (a) any payment of principal and interest due but unpaid on or prior to the Reference Date; and (b) any interest (other than under (a)) accrued up to and including the date of redemption; and

(ii) the Outstanding Principal Amount of such Bond multiplied by price (as reported to the Bond Trustee and the Issuer by an Adviser (as defined below)) expressed as a percentage and rounded up to four decimal places at which the Gross Redemption Yield (as defined below) of such Bond on the Reference Date (as defined below) would be equal to the Gross Redemption Yield (determined by the middle-market price) at 3.00 p.m. GMT on the Reference Date of the Reference Gilt (as defined below),

together with (a) any payment of principal and interest due but unpaid on or prior to the Reference Date (as defined below) and (b) any interest (other than under (a)) accrued up to and including the date of redemption.

For the purposes of this Condition 6.2 and Condition 9:

"**Adviser**" means, in respect of a Reference Gilt (or any matter pertaining to the Bonds) a fixed coupon gilt edged market maker (or any other appropriate party) selected by the Issuer and approved by the Majority Creditor(s) or, in the event that the Issuer fails to appoint such person within a reasonable period of time, such fixed coupon gilt edged market maker (or any other appropriate party) selected by the Majority Creditor(s);

"**Business Day**" means a day on which banks are generally open for business in London;

"**Gross Redemption Yield**" means a yield (expressed as a percentage) calculated on a basis consistent with the basis indicated by the United Kingdom Debt Management Office publication

"**Formulae for Calculating Gilt Prices from Yields**" published 8 June 1998 and updated on 15 January 2002 and 16 March 2005, as further updated, supplemented, amended or replaced from time to time. Such method requires the adoption of an assumed inflation rate which shall be such rate as the Bond Trustee has been advised by the Adviser as being appropriate. For the avoidance of doubt the assumed inflation rate shall be a long term inflation rate for the life of the Bonds;

"**Irish Stock Exchange**" means the Irish Stock Exchange;

"**Official List**" means the official list maintained by the Irish Stock Exchange;

"**Reference Date**" means the date which is two Business Days prior to the despatch of the notice of redemption under this Condition 6.2; and

"**Reference Gilt**" means the sterling obligation of the United Kingdom Government listed on the official list maintained by and traded on the London Stock Exchange plc whose duration most closely matches that of the Bonds on the Reference Date, as determined by an Adviser.

To the extent that the amount calculated pursuant to Condition 6.2(ii) exceeds the amount specified in Condition 6.2(i), payment of the excess is not guaranteed by the Financial Guarantors under the Financial Guarantees.

Mandatory Redemption

6.3

(i) If:

(a) any Spens (Full) Acceleration Event or any Spens (Modified) Acceleration Event (as defined below) occurs;

(b) an amount equal to at least the aggregate Outstanding Principal Amount in respect of the Bonds together with any amounts ranking in priority thereto (in accordance with the priority of payments set out in clause 22.7 of the Security Trust and Intercreditor Deed) and any accrued interest thereon, is paid into an account designated by the Issuer (or failing designation by the Issuer, designated by Security Trustee acting on the instructions of the Majority Creditor(s)) which is secured in favour of the Security Trustee under the Issuer Debenture;

(c) the Bond Trustee receives a Sufficiency Certificate (as defined in the Security Trust and Intercreditor Deed) from the Security Trustee confirming receipt of: (1) the proceeds from an Enforcement (in liquid form, including in the form of Authorised Investments); or (2) Compensation on Termination, in each case equal to or in excess of the sum of each Senior Creditor's Claim Certificate (as defined in the Security Trust and Intercreditor Deed) in accordance with the terms of the Security Trust and Intercreditor Deed; and

(d) the Bonds have not previously been declared due and payable pursuant to Condition 9,

then (including in the circumstances described in Condition 6.3(ii)(I) where paragraphs (a) to (d) above apply) each Bond shall be redeemed by the Issuer immediately at the Default Amount.

(ii) If: (a) following the service of an Election Notice, the occurrence of a Leeds City Council Instalment Default; or (b) a termination of the Project Agreement where Leeds City Council has not chosen, or is not entitled, to exercise the Instalment Option, the amount paid by Leeds City Council into an account designated by, and secured in favour of, the Security Trustee pursuant to the Issuer Debenture (the "**Compensation on Termination**") is greater than or equal to the Outstanding Principal Amount together with any amounts ranking in priority thereto (in accordance with the priority of payments set out in clause 22.7 (Proceeds of Enforcement) of the Security Trust and Intercreditor Deed) and any accrued interest thereon then:

(I) if the Compensation on Termination is sufficient to pay the Default Amounts and the Bond Trustee has received a Sufficiency Certificate (as defined in the Security Trust and Intercreditor Deed), then each Bond will, subject to the priority of payments set out in clause 22.7 (Proceeds of Enforcement) of the Security Trust and Intercreditor Deed, be redeemed at the Default Amount for the Bonds on the date falling ten days after deposit of the Compensation on Termination by Leeds City Council into such account;

(II) if the Compensation on Termination is not sufficient to pay the Default Amount, but is greater than or equal to the Outstanding Principal Amount together with any amounts ranking in priority thereto (in accordance with the priority of payments set out in clause 22.7 (Proceeds of Enforcement) of the Security Trust and Intercreditor Deed) and any accrued interest thereon, then, without prejudice to the obligation of the Issuer to pay the Default Amount and the obligations of Leeds City Council to pay Compensation on Termination in accordance with the Project Agreement, each Bond will, subject to the priority of payments set out in clause 22.7 (Proceeds of Enforcement) of the Security Trust and Intercreditor Deed, be redeemed at its Par Amount plus its pro rata share of the difference between (1) the Compensation on Termination; and (2) the Outstanding Principal Amount together with any amounts ranking in priority thereto (in accordance with the priority of payments set out in clause 22.7 (Proceeds of Enforcement) of the Security Trust and Intercreditor Deed) and any accrued interest thereon (the "**Above Par Redemption Amount**") on the date that is ten days after the date of deposit of the Compensation on Termination by Leeds City Council into such account.

Neither AGE nor AGM shall be liable to pay the difference between the Default Amount for Bonds and the Above Par Redemption Amount.

(iii) If: (a) following the service of an Election Notice, the occurrence of a Leeds City Council Instalment Default; or (b) a termination of the Project Agreement where Leeds City Council has not chosen, or is not entitled to exercise, the Instalment Option, the Compensation on Termination is less than the Outstanding Principal Amount together with any amounts ranking in priority thereto (in accordance with the priority of payments set out in clause 22.7 (Proceeds of Enforcement) of the Security Trust and Intercreditor Deed) and any accrued interest thereon then, without prejudice to the obligation of the Issuer to pay the Default Amount and the obligations of Leeds City Council to pay Compensation on Termination in accordance with the Project Agreement, each Bond will, subject to the priority of payments set out in clause 22.7 (Proceeds of Enforcement) of the Security Trust and Intercreditor Deed, be redeemed at its Below Par Redemption Amount on the date (the "**BP Redemption Date**") that is ten days after the date of deposit of the Compensation on Termination by Leeds City Council into such account.

Payment of the Below Par Redemption Amount on the BP Redemption Date does not accelerate AGE and/or AGM's payment obligation under the Financial Guarantees. AGE and/or AGM shall only be liable to make payments in respect of the Bonds (pursuant to the Financial Guarantees) in the amounts and on the dates on which such payments would have been required to be made if such amounts had not become immediately due and payable.

(iv) For the purposes of these Conditions:

"**Below Par Redemption Amount**" means, in respect of each Bond, its pro rata share of the Compensation on Termination which pro rata share will be applied on the BP Redemption Date to reduce the Outstanding Principal Amount of each Bond pro rata and the payments of Scheduled Principal due on the Bonds set out in column B of the table set in out in Condition 7.1 shall be adjusted to reflect such reduction by applying such reduction to the payments of Scheduled Principal due on the Bonds sequentially, commencing with the Scheduled Payment Date occurring immediately after the BP Redemption Date, until the Below Par Redemption Amount is applied in full.

"**Corrupt Gifts**" means the carrying out of a Prohibited Act (as defined in the Project Agreement) by ProjectCo or any of its related parties leading to termination of the Project Agreement pursuant to clause 37.7 (Termination for Corrupt Gifts and Fraud) of the Project Agreement.

"**Default Amount**" means, in respect of each Bond:

(a) in the case of a mandatory redemption or an Event of Default triggered by a Spens (Full) Acceleration Event the higher of:

(I) the Outstanding Principal Amount of such Bond; and

(II) the Outstanding Principal Amount of such Bond multiplied by price (as reported to the Bond Trustee and the Issuer by an Adviser) expressed as a percentage and rounded up to four decimal places at which the Gross Redemption Yield of such Bond on the Reference Date would be equal to the Gross Redemption Yield (determined by the middle-market price) at 3.00 p.m. GMT on the Reference Date of the Reference Gilt,

(b) in the case of a mandatory redemption or an Event of Default triggered by a Spens (Modified) Acceleration Event the higher of:

(I) the Outstanding Principal Amount of such Bond; and

(II) the Outstanding Principal Amount of such Bond multiplied by price (as reported to the Bond Trustee and the Issuer by an Adviser) expressed as a percentage and rounded up to four decimal places at which the Gross Redemption Yield of such Bond on the Reference Date would be equal to the sum of (a) the Gross Redemption Yield (determined by the middle-market price) at 3.00 p.m. GMT on the Reference Date of the Reference Gilt; and (b) 25 basis points,

(c) in all other circumstances, the Outstanding Principal Amount of the relevant Bond.

To the extent that the Default Amount exceeds the Outstanding Principal Amount, such excess is not guaranteed by the Financial Guarantors under the Financial Guarantees.

On the termination of the Project Agreement, Leeds City Council will pay compensation in an amount and at times which will vary according to the circumstances of termination and which may not be sufficient or sufficiently timely to enable the Issuer to pay the Default Amount.

"**Election Notice**" means a notice served by Leeds City Council pursuant to clause 49.4 (Payment of Outstanding Element) of the Project Agreement whereby Leeds City Council elects to accelerate the payment of any termination sum due under the Project Agreement in lieu of continuing to pay under the Instalment Option.

"**Event of Default**" has the meaning given in the Collateral Deed.

"**Force Majeure**" means the occurrence of a Force Majeure Event (as defined in the Project Agreement) leading to termination of the Project Agreement pursuant to clause 39 (Termination on Force Majeure) of the Project Agreement.

"**Instalment Option**" means the provision of the Project Agreement whereby Leeds City Council may elect to pay the termination sum payable upon termination of the Project Agreement in instalments pursuant to clause 49.2 (Instalments) of the Project Agreement.

"**Leeds City Council Event of Default**" means an event of default in relation to Leeds City Council leading to termination of the Project Agreement pursuant to clause 37.3 (Termination on City Council Default) of the Project Agreement.

"**Leeds City Council Instalment Default**" means Leeds City Council defaulting on its instalment payments leading to deemed termination of the Instalment Option.

"**Leeds City Council Voluntary Termination**" means Leeds City Council choosing to terminate the Project Agreement in accordance with clause 37.1 (Voluntary Termination by the City Council) of the Project Agreement.

"**Project Agreement**" means the project agreement dated on or about the date of the Collateral Deed between ProjectCo and the Authority.

"**ProjectCo Default**" means the occurrence of a Default Event (as defined in the Project Agreement) leading to termination of the Project Agreement pursuant to clause 37.4 (Termination on Contractor Default) of the Project Agreement.

"**Spens (Full) Acceleration Event**" means any of:

(i) ProjectCo terminating the Project Agreement as a result of a Leeds City Council Event of Default;

(ii) Leeds City Council terminating the Project Agreement as a result of ProjectCo Default; or

(iii) the occurrence of a Leeds City Council Instalment Default (including, without limitation, where termination of the Project Agreement was originally as a result of Leeds City Council Voluntary Termination, Uninsurable Risks, Force Majeure, ProjectCo Default or Corrupt Gifts).

"**Spens (Modified) Acceleration Event**" means:

(i) Leeds City Council serving an Election Notice (including, without limitation, where termination of the Project Agreement was originally as a result of Leeds City Council Voluntary Termination, Uninsurable Risks, Force Majeure, ProjectCo Default or Corrupt Gifts); or

(ii) Leeds City Council terminating the Project Agreement as a result of Leeds City Council Voluntary Termination.

"**Uninsurable Risks**" means a risk usually covered by insurances in each case required under the Project Agreement becomes Uninsurable (as defined in the Project Agreement) leading to termination of the Project Agreement pursuant to clause 61 (Risks that become Uninsurable) of the Project Agreement.

(v) If the Bonds are redeemed pursuant to Condition 6.3(ii)(II) or 6.3(iii) and the Issuer receives any further payment from Leeds City Council, then within ten Business Days of receipt, the Issuer shall apply the proceeds of such payment (less any amount required to pay or provide for any amount ranking in priority thereto (in accordance with the priorities of payment set out in Clause 22.7 (*Proceeds of Enforcement*) of the Security Trust and Intercreditor Deed)), in making a further payment to each Bondholder pro-rata to its holding of Bonds until the balance of the Default Amount has been paid in full. For the avoidance of doubt, the Bondholders shall not be entitled to receive any such further payment to the extent in that it would result in Bondholders receiving any amount in excess of the Default Amount.

Default Amount

6.4 Notwithstanding any other Condition, upon any redemption of the Bonds following:

(i) a Spens (Full) Acceleration Event, the Issuer shall pay the amount specified in paragraph (a) of the definition of Default Amount; and

(ii) a Spens (Modified) Acceleration Event, the Issuer shall pay the amount specified in paragraph (b) of the definition of Default Amount.

To the extent that the Default Amount exceeds the Outstanding Principal Amount of such Bond, payment of the excess is not guaranteed by the Financial Guarantors under the Financial Guarantees.

No other Redemption

6.5 Without prejudice to Condition 9, neither the Issuer nor any person in the Issuer Group shall be entitled to redeem, to purchase or to cancel the Bonds in whole or in part or to cause any such action to occur otherwise than as provided in Conditions 6.1 to 6.6 (inclusive).

Purchase

6.6 The Issuer or any person in the Issuer Group may at any time purchase Bonds in the open market or otherwise and at any price in individually negotiated transactions, provided that all unmatured Receipts or Coupons and unexchanged Talons appertaining thereto are purchased therewith. Any purchase by tender by the Issuer or any person in the Issuer Group (which shall not include any purchase by the Issuer or any person in the Issuer Group within 5 business days of the Issue Date) shall be made available to all Bondholders alike. Any Bonds so purchased may not be resold and prior to their cancellation in accordance with Condition 6.7, will not be treated as outstanding for purposes of determining a quorum for voting at meetings of Bondholders (save as provided otherwise in the Bond Trust Deed) and will not have the benefit of the Financial Guarantees. In this Condition 6.6 "**business day**" means a day on which banks are open for business in London.

Cancellation

6.7 All Bonds redeemed or purchased by the Issuer pursuant to Condition 6.6 and any unmatured Receipts and Coupons or unexchanged Talons attached to or surrendered with them shall be cancelled and may not be reissued or resold.

7. PAYMENTS AND EXCHANGE OF TALONS

Scheduled Payments

7.1 Unless previously redeemed, or purchased and cancelled, the Issuer will, in respect of each £1,000 in original principal amount of Bonds then outstanding on each Scheduled Payment Date, make a total payment, comprising the relevant payment of Scheduled Interest and, if applicable, the relevant payment of Scheduled Principal payable on each Scheduled Payment Date.

Without prejudice to either Condition 4 or Condition 6, the figures for "**Scheduled Interest**" and "**Total Payment**" set out below are intended to illustrate the Scheduled Interest and the total payment in respect of each £1,000 in original principal amount of the Bonds. The figures for Outstanding Principal Amount and Scheduled Principal set out below provide the Outstanding Principal Amount (assuming all payments are made on the due date in full) and Scheduled Principal in respect of each £1,000 in original principal amount of the Bonds.

A Scheduled Payment Date	B Scheduled Principal per £1,000 (£)	C Scheduled Interest per £1,000 (£)	D Total Payment per £1,000 (£)	E Outstanding Principal Amount per £1,000 (£)
30/09/13	-	11.17	11.17	1,000.00
31/03/14	-	25.35	25.35	1,000.00
30/09/14	-	25.35	25.35	1,000.00
31/03/15	-	25.35	25.35	1,000.00
30/09/15	-	25.35	25.35	1,000.00
31/03/16	-	25.35	25.35	1,000.00
30/09/16	-	25.35	25.35	1,000.00
31/03/17	-	25.35	25.35	1,000.00
30/09/17	3.63	25.35	28.98	996.37
31/03/18	41.81	25.25	67.06	954.56
30/09/18	23.79	24.19	47.98	930.77
31/03/19	28.92	23.59	52.51	901.85
30/09/19	28.67	22.86	51.53	873.19
31/03/20	29.48	22.13	51.61	843.70
30/09/20	30.27	21.38	51.65	813.43
31/03/21	30.68	20.62	51.29	782.76
30/09/21	31.59	19.84	51.43	751.16
31/03/22	31.64	19.04	50.68	719.52
30/09/22	32.70	18.24	50.94	686.82
31/03/23	31.33	17.41	48.73	655.50
30/09/23	32.66	16.61	49.27	622.84
31/03/24	29.86	15.79	45.65	592.97
30/09/24	31.47	15.03	46.50	561.50
31/03/25	28.50	14.23	42.73	533.00
30/09/25	30.10	13.51	43.61	502.90
31/03/26	28.77	12.75	41.52	474.13
30/09/26	29.59	12.02	41.60	444.55
31/03/27	29.69	11.27	40.96	414.85
30/09/27	30.22	10.51	40.73	384.64
31/03/28	30.66	9.75	40.40	353.98
30/09/28	31.46	8.97	40.43	322.52
31/03/29	34.36	8.17	42.54	288.16
30/09/29	33.84	7.30	41.15	254.31
31/03/30	35.91	6.45	42.36	218.40
30/09/30	36.33	5.54	41.87	182.06
31/03/31	43.28	4.61	47.90	138.78
30/09/31	43.03	3.52	46.54	95.76
31/03/32	47.79	2.43	50.21	47.97
30/09/32	47.97	1.22	49.19	-

For the avoidance of doubt, the number of Bonds in issue will not be reduced by the payments of Scheduled Principal set out in Column B, save for any final such payment made on redemption of the Bonds. Payments of Scheduled Principal will reduce the Outstanding Principal Amount of each Bond.

Method of Payment

7.2 Payments in respect of the Bonds by the Issuer will be made only against:

(i) presentation and surrender of the appropriate Receipts and Coupons; and

(ii) in the case of final redemption (provided that payment is made in full) surrender of the relevant Bonds,

in each case at the specified office of any Paying Agent outside the United States by transfer to a sterling account maintained by the payee with or, at the request of the Bondholder, by sterling cheque drawn on, a bank in London.

Payments subject to Fiscal Laws

7.3 All payments in respect of the Bonds are subject in all cases to any applicable fiscal or other laws and regulations, but without prejudice to the provisions of Condition 8. No commissions or expenses shall be charged to the Bondholders, Receiptholders or Couponholders in respect of such payments.

Unmatured Receipts, Coupons and Talons Void

7.4 On the early redemption in full of any Bond pursuant to any of Conditions 6.2 or 9, all unmatured Receipts, Coupons and Talons relating thereto (whether or not still attached) shall become void and no payment will be made in respect thereof.

Payments on Business Days

7.5 If the due date for payment of any amount in respect of any Bond, Receipt or Coupon is not a business day in the place of presentation, the holder shall not be entitled to payment in such place of the amount due until the next following business day, and shall not be entitled to any further interest or other payment in respect of any such delay. In this paragraph, "**business day**" means, in respect of any place of presentation, any day on which banks are open for business in such place of presentation.

Payments otherwise than against the Surrender of Receipts or Coupons

7.6 If a Paying Agent makes a payment in respect of any Bond in circumstances where no Receipt or Coupon is surrendered, such Paying Agent will endorse on such Bond a statement indicating the amount and date of such payment.

Fractions

7.7 In respect of any payments to Bondholders any fractions of one pound will be rounded in accordance with Condition 18.

Exchange of Talons

7.8 On or after the maturity date of the final Coupon or Receipt which is (or was at the time of issue) part of a coupon sheet or sheet of Receipts relating to the Bonds (each a "**Coupon Sheet**"), the Talon forming part of such Coupon Sheet may be exchanged at the specified office of the Principal Paying Agent for a further Coupon Sheet excluding any Coupons or Receipts in respect of which claims have already become void pursuant to Condition 10. Upon the due date for redemption of any Bond, any unexchanged Talon relating to such Bond shall become void and no Coupon or Receipt will be delivered in respect of such Talon.

8. TAXATION

8.1 All payments of principal and interest in respect of the Bonds by or on behalf of the Issuer shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatsoever nature, unless such withholding or deduction is required by law. In that event, the Issuer shall account to the relevant authorities for the amount to be withheld or deducted and shall make such payment of principal or interest, as the case may be, after such withholding or deduction has been made.

8.2 The Issuer shall notify the Bond Trustee and the Financial Guarantors of any such withholding or deduction and shall take reasonable measures available to it to avoid such obligation, including the replacement of the Principal Paying Agent, the addition, replacement or removal of a Paying Agent or changing the specified office of any Paying Agent. Should the Issuer still be obliged to make the withholding or deduction, it will, on written request from any Bondholder, provide to the Bondholder copies of any documentation or correspondence with the tax authority regarding the deduction or withholding as the Bondholder may reasonably require to assist it to claim repayment of some or all of the amounts so withheld or deducted.

8.3 The Issuer will not be obliged to make any additional payments to Bondholders, Receiptholders or Couponholders in respect of any such withholding or deduction.

To the extent that the Issuer is obliged to make any such deduction or withholding, there is no obligation on the Financial Guarantors to make good under the Financial Guarantees any such amount so deducted or withheld.

9. EVENTS OF DEFAULT

9.1 If any Event of Default pursuant to the terms of the Collateral Deed occurs and is continuing, then, subject as provided below:

(i) if and for so long as the Financial Guarantors are the Majority Creditor(s), the Bond Trustee shall, upon being (i) so directed by the Financial Guarantors in accordance with the Security Trust and Intercreditor Deed; and (ii) indemnified and/or secured to its satisfaction (including, if required by the Bond Trustee, by way of pre-funding), declare by written notice to the Issuer that the Bonds are immediately due and payable; and

(ii) if and for so long as the Financial Guarantors are not the Majority Creditor(s), the Bond Trustee may at any time and shall, upon being (i) so requested in writing by the holders of at least 25 per cent. in Outstanding Principal Amount of the outstanding Bonds or so directed by a resolution passed at any meeting of the Bondholders by a majority of not less than three quarters of the votes cast (an "**Extraordinary Resolution**") and (ii) indemnified and/or secured to its satisfaction (including, if required by the Bond Trustee, by way of pre-funding), declare by written notice to the Issuer that the Bonds are immediately due and payable,

whereupon each Bond shall become immediately due and payable at the Default Amount (as defined above) together with accrued interest thereon, without further action or formality.

Such an acceleration of sums due on the Bonds does not accelerate the Financial Guarantors's payment obligation under the Financial Guarantees. The Financial Guarantors shall only be liable to make payments in respect of the Bonds (pursuant to the Financial Guarantees) on the dates on which such payments would have been required to be made if such amounts had not become immediately due and payable.

9.2 While the Financial Guarantors are the Majority Creditor(s), save in the circumstances set out in Condition 6.3, neither the Bondholders nor the Bond Trustee will have any rights to call for acceleration of the Bonds following the occurrence of an Event of

Default or for any enforcement of the security for the Bonds unless instructed or directed by the Financial Guarantors.

10. PRESCRIPTION

Claims for principal and interest shall become void unless the relevant Receipts or Coupons and/or the relevant Bonds (as the case may be) are presented for payment within ten years (in the case of principal) and five years (in the case of interest) of the later of (i) the date on which the payment in question first becomes due and (ii) if the full amount payable has not been received in London by the Principal Paying Agent or the Bond Trustee on or prior to such due date, the date on which (the full amount having been so received) notice to that effect has been given to the Bondholders.

11. REPLACEMENT OF BONDS, COUPONS, RECEIPTS AND TALONS

If any Bond, Coupon, Receipt or Talon is lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Principal Paying Agent, subject to all applicable laws and the requirements of any stock exchange on which the Bonds are listed (or other relevant authority), upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the Issuer may reasonably require. Mutilated or defaced Bonds, Coupons, Receipts or Talons must be surrendered before replacements will be issued.

12. BOND TRUSTEE, SECURITY TRUSTEE AND PAYING AGENTS

Bond Trustee and Security Trustee

12.1 Under the Bond Trust Deed, the Bond Trustee is entitled to be indemnified and relieved from responsibility in certain circumstances and certain monies received by the Bond Trustee will be applied to pay its fees, costs, liabilities and expenses in priority to the claims of the Bondholders. In addition, the Bond Trustee is entitled to enter into business transactions with the Obligors, the Financial Guarantors, the Bondholders, the Couponholders, the Receiptholders and any entity related to the Issuer, ProjectCo, HoldCo or the Financial Guarantors or any other party to the Transaction Documents without accounting for any profit.

12.2 In the exercise of its powers and discretions under these Conditions, the Financial Guarantees and the Bond Trust Deed, the Bond Trustee will have regard to the interests of the Bondholders as a class and will not have regard to the consequences of such exercise for individual Bondholders, Receiptholders or Couponholders whether resulting from their being resident or domiciled in any particular jurisdiction or otherwise, and the Bond Trustee shall not be entitled to require from any Obligor, the Financial Guarantors, or the Security Trustee, nor shall any Bondholder, Receiptholder or Couponholder be entitled to claim from any Obligor, the Financial Guarantors, the Bond Trustee or the Security Trustee, any indemnification or other payment in respect of any consequence (including without limitation, any tax consequence) for individual Bondholders, Receiptholders or Couponholders of any such exercise.

12.3 Under the Security Trust and Intercreditor Deed, the Security Trustee is entitled to be indemnified and relieved from responsibility in certain circumstances and to be paid its fees, costs, liabilities and expenses in priority to the claims of the Bondholders. In addition the Security Trustee is entitled to enter into business transactions with the Obligors, the Financial Guarantors, the Bondholders, the Receiptholders, the Couponholders and any entity related to the Issuer, ProjectCo, HoldCo or the Financial Guarantors or any other party to the Transaction Documents without accounting for any profit.

12.4 Neither the Bond Trustee nor the Security Trustee has investigated, nor is either of them responsible or liable for any loss arising as a result of any failure to investigate, the validity, value, sufficiency or enforceability of the security created by the Security Documents or the validity or enforceability of any contracts over which such security is created and both the Bond Trustee and the Security Trustee shall accept without investigation, requisition or objection and without any responsibility or liability for doing so such right and title as the Issuer, ProjectCo and HoldCo have to the property, assets and rights over which security is created pursuant to the Security Documents.

The Bond Trustee has no responsibility for the validity or enforceability of the Financial Guarantees against the Financial Guarantors or any permitted assignee of the Financial Guarantors under the Financial Guarantees, and nor will it be liable to Bondholders for any loss they may suffer as a result of any vitiation of the Financial Guarantees resulting from any act or omission on the part of the Bond Trustee except as a result of its gross negligence or wilful default.

Neither the Bond Trustee nor the Security Trustee will be responsible for or liable for loss which results should any deficiency arise between the amount realised in respect of the property assets and rights over which security is given by the Security Documents and sums due in respect of the Bonds because the Security Trustee or the Bond Trustee is liable to tax in respect of the property assets and rights over which such security is created.

Neither the Security Trustee nor the Bond Trustee shall be responsible for monitoring the obligations of any person to the Issuer and each of them shall, until they have actual knowledge to the contrary, assume that all persons are duly performing the same.

Neither the Security Trustee nor the Bond Trustee will be obliged to take any action under the Bond Trust Deed or the Security Trust and Intercreditor Deed unless either or each is indemnified and/or secured to its satisfaction (including, if required, by way of pre-funding) in respect of any personal liability or expense which it may in its opinion incur. Protection and realisation of the security may be prevented or delayed as a result.

Neither the Security Trustee nor the Bond Trustee is responsible for monitoring compliance by the Issuer with any matter set out in the Collateral Deed including whether an Event of Default has occurred and, if the Bond Trustee is the Majority Creditor(s), and is for whatever reason required to make any determination of material adverse change, or like matter, pursuant to the terms of the Collateral Deed, it may, in its absolute discretion, seek directions from the Bondholders by means of an Extraordinary Resolution or seek advice from an expert, both in accordance with the Bond Trust Deed, and the Bond Trustee will not be responsible for the consequences of any delay involved in so doing.

Paying Agent

12.5 In acting under the Paying Agency Agreement and in connection with the Bonds, Receipts, Coupons and the Talons, the Paying Agents act solely as agents of the Issuer and (to the extent provided in these Conditions) the Bond Trustee and do not assume any obligations towards or relationship of agency or trust for or with any of the Bondholders, Receiptholders or Couponholders.

12.6 The initial Paying Agent and its initial specified office are listed below. The Issuer reserves the right (with the prior approval of the Bond Trustee) at any time to vary or terminate the appointment of any Paying Agent and to appoint a successor principal paying agent and additional or successor paying agents; provided, however, that the Issuer shall at all times maintain (i) a Principal Paying Agent; (ii) so long as the Bonds are admitted to the Official List of the Irish Stock Exchange and to trading on the regulated market of the Irish Stock Exchange, at least one Paying Agent with a specified office in Dublin; and (iii) a paying agent in a member state of the European Union that will not be obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council Meeting of 26-27 November 2000 or any law implementing or complying with, or introduced to conform to, such Directive. Notice of any change in any of the Paying Agents or in their specified offices shall promptly be given by the Issuer to the Bondholders in accordance with Condition 15.

12.7 The Issuer has covenanted in the Bond Trust Deed (i) to make available for inspection by Bondholders at the specified offices of the Paying Agents copies of its annual report shortly after its publication; and (ii) to provide annually a written report to the Financial Guarantors (if it is then the Majority Creditor(s)) and the Bond Trustee (such report to be made available to Bondholders at the specified offices of the Paying Agents upon production by any such Bondholders of evidence satisfactory to the relevant Paying Agent as to its holding of the Bonds and its identity) containing certain information relating to its business.

13. MEETINGS OF BONDHOLDERS: MODIFICATION AND WAIVER

Meetings of Bondholders

13.1

(i) The Bond Trust Deed contains provisions for convening meetings of Bondholders to consider matters affecting their interests, including the modification of these Conditions, the Bond Trust Deed, the Financial Guarantees, the Security Documents and the Collateral Deed. Any such modification may, subject to the prior written consent of the Financial Guarantors if they are the Majority Creditor(s), be made if sanctioned by an Extraordinary Resolution of the Bondholders. A meeting of Bondholders will also have the power (exercisable by Extraordinary Resolution) to advise or instruct the Bond Trustee in connection with the exercise by the Bond Trustee, subject to Condition 14.1, of any of its rights, powers and discretions under the Finance Documents to terminate the Financial Guarantees as a result of a Financial Guarantor Downgrade Event, to remove or approve the appointment of a new Bond Trustee and to appoint any persons (whether Bondholders or not) as a committee to represent the interests of the Bondholders and to confer upon such committee any powers which the Bondholders could themselves exercise by Extraordinary Resolution.

(ii) The quorum at any meeting convened to vote on an Extraordinary Resolution will be one or more persons holding or representing 50 per cent. in outstanding principal amount of the Bonds or, at any adjourned meeting, one or more persons being or representing Bondholders whatever the principal amount of the Bonds held or represented; provided, however, that certain proposals including any proposal to:

(a) change any date fixed for payment of principal or interest in respect of the Bonds, to reduce the amount of principal or interest payable on any date in respect of the Bonds, to alter the method of calculating the amount of any payment in respect of the Bonds or the date for any such payment;

(b) effect any exchange of the Bonds for, or the conversion of the Bonds into shares, bonds or other obligations of the Issuer, the Financial Guarantors or any other person or to approve the substitution of any person for the Issuer as principal obligor under the Bonds or the substitution of any person for the Financial Guarantors as guarantor under the Financial Guarantees;

(c) change the currency of payments under the Bonds other than any change made pursuant to Condition 16;

(d) modify any provisions of the Financial Guarantees in a way which, in the opinion of the Bond Trustee, is materially prejudicial to the Bondholders;

(e) change the quorum required at any meeting of the Bondholders or the majority required to pass an Extraordinary Resolution;

(f) release all or part of the security other than in accordance with the Collateral Deed or the Security Documents or alter the rights of priority and enforcement of the Financial Guarantors or the Bond Trustee on behalf of the Bondholders under the Security Trust and Intercreditor Deed or the Collateral Deed; or

(g) amend any of the above reserved rights,

(each a "**Reserved Matter**" and together the "**Reserved Rights**") may only be sanctioned by an Extraordinary Resolution passed at a meeting of Bondholders at which one or more persons holding or representing not less than three-quarters or, at any adjourned meeting, at least 25 per cent. in outstanding principal amount of the Bonds form a quorum. Any Extraordinary Resolution duly passed at any such meeting shall be binding on all the Bondholders, the Receiptholders and Couponholders whether present or not.

The majority required for an Extraordinary Resolution is at least 75 per cent. of the votes cast at any meeting of the Bondholders. In addition, a resolution in writing signed by or on behalf of all Bondholders who for the time being are entitled to receive notice of a meeting of Bondholders under the Bond Trust Deed will take effect as if it were an Extraordinary Resolution. Such a resolution in writing may be contained in one document or several documents in the same form, each signed by or on behalf of one or more Bondholders.

Modification and Waiver

13.2 The Bond Trustee may, without the consent of the Bondholders, Receiptholders or Couponholders, (and shall, if so directed by the Majority Creditor(s)) concur with the Issuer, the Financial Guarantors (so long as they are the Majority Creditors(s)) or any other relevant parties in making:

(i) any modification to these Conditions, the Bond Trust Deed, the Financial Guarantees, the Security Documents, the Collateral Deed and the Senior Finance Documents (as defined in the Collateral Deed) which is of a formal, minor or technical nature or is made to correct a manifest error; and

(ii) except in the case of Reserved Rights, any other modification of any such document which is in the opinion of the Bond Trustee not materially prejudicial to the interests of the Bondholders.

Any such modification shall be binding on all Bondholders, Receiptholders and Couponholders and, unless the Bond Trustee otherwise agrees, notice thereof shall be given by the Issuer to the Bondholders as soon as practicable thereafter in accordance with Condition 15.

In addition, the Bond Trustee may, without the consent of the Bondholders, Receiptholders or Couponholders authorise or waive any breach or proposed breach of the Bonds, the Bond Trust Deed or any other Finance Document (other than a proposed breach or breach relating to the subject of a Reserved Right) if, in the opinion of the Bond Trustee, the interests of the Bondholders will not be materially prejudiced thereby.

Any such authorisation or waiver shall be binding on all Bondholders, Couponholders and Receiptholders and, if the Bond Trustee so requires, the Issuer shall (unless the Bond Trustee agrees otherwise) cause any such authorisation or waiver to be notified to the Bondholders as soon as practicable thereafter in accordance with Condition 15.

14. EXERCISE AND ENFORCEMENT

Exercise and Enforcement

14.1 As more particularly provided in the Security Trust and Intercreditor Deed, the Bond Trustee will be obliged to take action to exercise or enforce its rights under the Bond Trust Deed or the Security Documents or in respect of the Bonds if required to do so by the Majority Creditor(s) (as defined in the Security Trust and Intercreditor Deed) except in relation to certain specified rights of the Bond Trustee (provided that the Bond Trustee has been indemnified and/or secured to its satisfaction (including, if required by the Bond Trustee, by way of pre-funding)) but will not in most circumstances be entitled to take any such action without the prior written consent of the Majority Creditor(s). Subject as aforesaid, the Bond Trustee shall not be bound as against the Bondholders to take any such action or any action to enforce the Financial Guarantees unless:

(i) it has been so requested in writing by the holders of at least 25 per cent. in outstanding principal amount of the outstanding Bonds or has been so directed by an Extraordinary Resolution; and

(ii) it has been indemnified and/or secured to its satisfaction (including, if required by the Bond Trustee, by way of pre-funding).

The Bond Trustee is entitled to exercise certain rights reserved for the Bond Trustee's exercise in its sole discretion.

Action by Bondholders

14.2 No Bondholder, Receiptholder or Couponholder may take any action against the Issuer, any other Obligor or any Financial Guarantor to enforce its rights in respect of the Bonds or to enforce all or any of the security constituted by the Security Documents or to enforce the Financial Guarantees unless the Bond Trustee having become bound so to proceed fails to do so within a reasonable time and such failure is continuing.

15. NOTICES

Notices to the Bondholders shall be valid if published in a leading English language daily newspaper published in the United Kingdom (which is expected to be the Financial Times). Any such published notice shall be deemed to have been given on the date of first publication. Receiptholders, Couponholders and holders of Talons shall be deemed for all purposes to have notice of the contents of any notice given to the Bondholders. A copy of every published notice to Bondholders will be supplied to Euroclear Bank S.A./N.V. and Clearstream Banking, société anonyme, Luxembourg for so long as the Bonds are cleared and settled through those clearing systems or to any additional or substitute clearing system from time to time nominated by the Issuer or the Bond Trustee and approved by the Financial Guarantors (so long as they are the Majority Creditors(s)) through which the Bonds are cleared and settled.

16. EUROPEAN ECONOMIC AND MONETARY UNION

Notice of Redenomination

16.1 The Issuer may, without the consent of the Bondholders, Receiptholders and Couponholders, on giving at least 30 days' prior notice to the Financial Guarantors (so long as they are the Majority Creditors(s)), the Bondholders, the Bond Trustee and the Paying Agents, designate a date (the "**Redenomination Date**"), being a Scheduled Payment Date under the Bonds falling on or after the date on which the United Kingdom becomes a Participating Member State (as defined below).

Redenomination

16.2 Notwithstanding the other provisions of these Conditions, with effect from the Redenomination Date:

(i) the Bonds shall be deemed to be redenominated into euro in denominations which are integral multiples of euro 0.01 with an Outstanding Principal Amount for each Bond equal to the Outstanding Principal Amount of that Bond in sterling, converted into euro at the rate for conversion of sterling into euro established by the Council of the European Union pursuant to the Treaty (including compliance with rules relating to rounding in accordance with European Community regulations); provided, however, that if the Issuer determines that the then market practice in respect of the redenomination into euro 0.01 of internationally offered securities is different from that specified above, such provisions shall be deemed to be amended so as to comply with such market practice and the Issuer shall promptly notify the Financial Guarantors, the Bond Trustee, the Bondholders, Receiptholders and Couponholders, each stock exchange (if any) on which the Bonds are then listed and the Paying Agents of such deemed amendments;

(ii) if Bonds have been issued in definitive form:

(a) all unmatured Bonds, Receipts and Coupons denominated in sterling (whether or not attached to the Bonds) will become void with effect from the date (the "**Euro Exchange Date**") on which the Issuer gives notice (the "**Euro Exchange Notice**") to the Bondholders and the Bond Trustee that replacement Bonds, Receipts and Coupons denominated in euro are available for exchange (provided that such Bonds, Receipts and Coupons are available) and no payments will be made in respect thereof;

(b) the payment obligations in respect of all Bonds denominated in sterling will become void on the Euro Exchange Date but all other obligations of the Issuer thereunder (including the obligation to exchange such Bonds in accordance with this Condition 18) shall remain in full force and effect; and

(c) new Bonds, Receipts and Coupons denominated in euro will be issued in exchange for Bonds, Receipts and Coupons denominated in sterling in such manner as the Principal Paying Agent may specify and as shall be notified to the Bondholders in the Euro Exchange Notice;

(iii) all payments in respect of the Bonds (other than, unless the Redenomination Date is on or after such date as the sterling ceases to be a sub-division of the euro, payments of interest in respect of periods commencing before the Redenomination Date) will be made solely in euro by credit or transfer to a euro account (or any other account to which euro may be credited or transferred) maintained by the payee with or, at the request of the Bondholder, by cheque drawn on, a bank in the principal financial centre of any Member State of the European Communities; and

(iv) a Bond, Receipt or Coupon may only be presented for payment on a day which is a business day in the place of presentation. In this Condition 16, "**business day**" means, in respect of any place of presentation, any day which is a day on which banks are open for business in such place of presentation and which is also a day on which the TARGET2 system is operating.

Interest

16.3 Following redenomination of the Bonds pursuant to this Condition 16:

(i) where Bonds have been issued in definitive form, the amount of interest due in respect of the Bonds will be calculated by reference to the aggregate outstanding principal amount of the Bonds presented (or, as the case may be, in respect of which Receipts or Coupons are presented) for payment by the relevant holder and the amount of such payment shall be rounded down to the nearest euro 0.01; and

(ii) the amount of interest payable in respect of each Bond for any Scheduled Payment Date shall be calculated by applying the Rate of Interest to the outstanding principal amount of such Bond, dividing the product by two and rounding the resulting figure in accordance with Condition 18. If interest is required to be calculated for any other period, it will be calculated on the basis of the actual number of days elapsed divided by 365 (or, if any of the days elapsed fall in a leap year, the sum of (x) the number of those days falling in a leap year divided by 366 and (y) the number of those days falling in a non-leap year divided by 365); provided, however, that, if the Issuer determines, with the agreement of the Bond Trustee, that the market practice in respect of internationally offered euro denominated securities is different from that specified above, the above shall be deemed to be amended so as to comply with such market practice and the Issuer shall promptly notify the Bondholders in accordance with Condition 15, each stock exchange (if any) on which the Bonds are then listed and the Paying Agents of such deemed amendment.

Interpretation

16.4 In these Conditions:

"**euro**" means the single currency which was introduced at the start of the third stage of European Economic and Monetary Union pursuant to the Treaty;

"**Participating Member State**" means a Member State of the European Communities which adopts the euro as its lawful currency in accordance with the Treaty;

the "**TARGET2 system**" means the Trans-European Automated Real-time Gross Settlement Express Transfer (TARGET2) system; and

the "**Treaty**" means the Treaty establishing the European Communities, as amended.

17. GOVERNING LAW AND JURISDICTION

Governing law

17.1 Each of the Bond Trust Deed, the Bonds, the Receipts and the Coupons, the Financial Guarantees and, in each case, any non-contractual obligations arising out of or in connection with the relevant document, are governed by, and shall be construed in accordance with, the laws of England and Wales.

English courts

17.2 The courts of England have exclusive jurisdiction to settle any dispute (a "**Dispute**"), arising from or connected with the Bonds, the Bond Trust Deed and the Financial Guarantees.

Appropriate forum

17.3 The Issuer agrees and the Financial Guarantors have each agreed in the Bond Trust Deed that the courts of England are the most appropriate and convenient courts to settle any Dispute and, accordingly, that it will not argue to the contrary.

Rights of the Bondholders to take proceeding outside England

17.4 Condition 17.2 is for the benefit of the Bond Trustee and the Bondholders only. As a result, nothing in this Condition 17 prevents the Bond Trustee or any Bondholder from taking proceedings relating to a Dispute ("**Proceedings**") in any other courts with jurisdiction. To the extent allowed by law, the Bond Trustee and the Bondholders may take concurrent Proceedings in any number of jurisdictions.

18. ROUNDING

For the purposes of any calculations referred to in these Conditions (unless otherwise specified in these Conditions) (a) all percentages resulting from such calculations will be rounded, if necessary, to the nearest one hundred-thousandth of a percentage point (with 0.000005 per cent. being rounded up to 0.00001 per cent.), (b) all sterling amounts used in or resulting from such calculations will be rounded to the nearest penny (with one half penny being rounded up), and (c) all amounts denominated in any other currency used in or resulting from such calculations will be rounded to the nearest two decimal places in such currency, with 0.005 being rounded upwards.

19. RIGHTS OF THIRD PARTIES

No person shall have any right to enforce any term or condition of the Bonds or the Bond Trust Deed under the Contracts (Rights of Third Parties) Act 1999.

OVERVIEW OF PROVISIONS RELATING TO THE BONDS WHILE IN GLOBAL FORM

The Temporary Global Bond and the Permanent Global Bond contain provisions which apply to the Bonds while they are in global form, some of which modify the effect of the terms and conditions of the Bonds set out in this Prospectus. The following is an overview of certain of those provisions:

1. EXCHANGE AND DENOMINATIONS

The Bonds will initially be represented by a Temporary Global Bond which will be deposited on or around the Issue Date with a common depositary for Euroclear and Clearstream, Luxembourg. The Temporary Global Bond will be exchangeable in whole or in part for interests in a Permanent Global Bond not earlier than 40 days after the Issue Date upon certification as to non-US beneficial ownership. No payments will be made under the Temporary Global Bond unless exchange for interests in the Permanent Global Bond is improperly withheld or refused. In addition, interest payments in respect of the Bonds cannot be collected without such certification of non-US beneficial ownership.

For so long as the Bonds are represented by a Global Bond and the relevant clearing system(s) so permit, the Bonds will be tradable only in the minimum authorised denomination of £100,000 and higher integral multiples of £1,000, notwithstanding that no Definitive Bonds (as defined below) will be issued with a denomination above £199,000.

The Permanent Global Bond will become exchangeable in whole, but not in part, for Definitive Bonds in denominations of £100,000 and integral multiples of £1,000 in excess thereof up to and including £199,000, each at the request of the bearer of the Permanent Global Bond against presentation and surrender of the Permanent Global Bond to the Principal Paying Agent if either of the following events (each an "**Exchange Event**") occurs: (a) Euroclear or Clearstream, Luxembourg or any additional or substitute clearing system (an "**Additional or Substitute Clearing System**") from time to time nominated by the Issuer or the Bond Trustee and approved by the Financial Guarantors (if it is the Majority Creditor(s)) through which the Bonds are cleared is closed for business for a continuous period of 14 days (other than by reason of legal holidays) or announces an intention permanently to cease business or (b) the Bonds become due and payable pursuant to Condition 9. No Definitive Bonds will be issued with a denomination above £199,000.

The Permanent Global Bond will also become exchangeable, in whole but not in part only and at the option of the Issuer, for Definitive Bonds if, by reason of any change in the laws of the United Kingdom, the Issuer is or will be required to make any withholding or deduction from any payment in respect of the Bonds which would not be required if the Bonds were in definitive form.

Whenever the Permanent Global Bond is to be exchanged for Definitive Bonds, the Issuer shall procure the prompt delivery (free of charge to the bearer) of such Definitive Bonds, duly authenticated and with Receipts, Coupons and Talons attached, in an aggregate principal amount equal to the principal amount of the Permanent Global Bond to the bearer of the Permanent Global Bond against the surrender of the Permanent Global Bond at the specified office of the Principal Paying Agent within 40 days of the occurrence of the relevant Exchange Event.

In addition, the Temporary Global Bond and the Permanent Global Bond will contain provisions which modify the Terms and Conditions of the Bonds as they apply to the

Temporary Global Bond and the Permanent Global Bond. The following is an overview of certain of those provisions:

2. ADDITIONAL PROVISIONS

Payments

All payments in respect of the Temporary Global Bond and the Permanent Global Bond will be made against presentation and (in the case of payment of principal in full with all interest accrued thereon) surrender of the Temporary Global Bond or (as the case may be) the Permanent Global Bond at the specified office of any Paying Agent and will be effective to satisfy and discharge the corresponding liabilities of the Issuer in respect of the Bonds.

Notices

Notwithstanding Condition 15, while all the Bonds are represented by the Permanent Global Bond (or by the Permanent Global Bond and/or the Temporary Global Bond) and the Permanent Global Bond is (or the Permanent Global Bond and/or the Temporary Global Bond are) deposited with a common depositary for Euroclear and Clearstream, Luxembourg or any Additional or Substitute Clearing System from time to time nominated by the Bond Trustee and approved by the Financial Guarantors (if it is the Majority Creditor(s)), notices to Bondholders may be given by delivery to Euroclear and Clearstream, Luxembourg or any such Additional or Substitute Clearing System and such notices shall be deemed to have been given to the Bondholders in accordance with Condition 15 on the date of delivery to Euroclear and Clearstream, Luxembourg or any such Additional or Substitute Clearing System.

Meetings

The holder of, or a proxy for the holder of, the Temporary Global Bond or the Permanent Global Bond will be treated as being two persons for the purposes of any quorum requirements of a meeting of the Bondholders. For the purposes of any such meeting, the holder of any such Global Bond shall be treated as having one vote in respect of each £1,000 in principal amount of the Bonds represented by such Global Bond.

Cancellation

Cancellation of any Bond represented by the Temporary Global Bond or the Permanent Global Bond will be effected by reduction in the principal amount of the Temporary Global Bond or the Permanent Global Bond (as the case may be).

Bond Trustee's Powers

In considering the interests of Bondholders while the Temporary Global Bond or the Permanent Global Bond is held on behalf of Euroclear and/or Clearstream, Luxembourg or any Additional or Substitute Clearing System from time to time nominated by the Bond Trustee and approved by the Financial Guarantors (if it is the Majority Creditor(s)), the Bond Trustee may have regard to any information provided to it by such clearing system(s) as to the identity (either individually or by category) of its accountholders with entitlement to the Temporary Global Bond or the Permanent Global Bond and may consider such interests as if such accountholders were the holders of the Bonds represented by the Temporary Global Bond or the Permanent Global Bond (as the case may be).

USE OF PROCEEDS

The proceeds of the Bonds (net of issue costs and expenses comprising the Lead Manager's fees and the Financial Guarantors' fees) are expected to amount to approximately £98,557,856 and are to be advanced by the Issuer to ProjectCo pursuant to the Bond Proceeds On-Loan Agreement. The amounts to be paid by HoldCo to the Issuer under the Equity Subscription Agreement are to be advanced by the Issuer to ProjectCo under the Equity Proceeds On-Loan Agreement.

The advances under the Proceeds On-Loan Agreements referred to above will be paid into the Escrow Account in the name of ProjectCo maintained with the Account Bank (as described in more detail in the sub-section entitled *"Accounts"* below) (the "**Escrow Account**") and the net proceeds, invested in the GIC (as defined in the sub-section below entitled "Guaranteed Investment Contract" in the section *"The Financing of the Project"*).

ProjectCo may apply amounts deposited into the Escrow Account and/or invested in the GIC only for the purposes set out in the Collateral Deed.

YIELD

On the basis of the issue price of the Bonds of 100 per cent, the Gross Redemption Yield of the Bonds is 5.069 per cent. on a semi-annual basis.

FORM OF AGE FINANCIAL GUARANTEE

Dated 11 July 2013

ASSURED GUARANTY (EUROPE) LTD.

FINANCIAL GUARANTEE No. 80169-U

in respect of

£101,833,000 5.069 per cent. Fixed Rate Guaranteed Secured Bonds due September 2032

This Financial Guarantee is dated on 11 July 2013 and given by Assured Guaranty (Europe) Ltd. whose registered office is at 1 Finsbury Square, London EC2A 1AE (the "**Financial Guarantor**") in favour of BNY Mellon Corporate Trustee Services Limited as trustee for the holders of the Guaranteed Bonds (as defined below) (the "**Bond Trustee**", which expression shall, whenever the context admits, include such Persons for the time being the trustee or trustees of the Bond Trust Deed for the Guaranteed Bondholders).

1 Interpretation

1.1 Definitions

Any capitalised terms used in this Financial Guarantee and not otherwise defined shall have the meaning given to such terms in the Bond Trust Deed (as defined below) unless the context otherwise requires. In the event of any inconsistency between the provisions of this Financial Guarantee and the provisions of the Bond Trust Deed, this Financial Guarantee shall prevail. For the purposes of this Financial Guarantee, the following terms will have the following meanings:

"**Accelerated Payment**" means, following an Acceleration, any payment in full or in part by the Financial Guarantor or AGM, at the Financial Guarantor's or AGM's absolute option, of all or part of the Scheduled Principal in advance of the final Scheduled Payment Date together with accrued but unpaid Scheduled Interest on such Scheduled Principal to the date of such payment (but excluding any amounts referred to in items (i) to (iv) of the definition of "Guaranteed Amount").

"**Acceleration**" means, in relation to the Guaranteed Bonds, the giving of notice by the Bond Trustee to the Issuer that the Guaranteed Bonds are immediately due and repayable pursuant to Condition 9 (*Events of Default*) of the Conditions, and "**Accelerated**" will be construed accordingly.

"**Account**" has the meaning set out in Clause 3.4 (*Payments by the Financial Guarantor*).

"**AGE Proportion**" means the proportion of the Financial Guarantees provided by AGE, which proportion is 6 per cent.

"**Agent**" means each Paying Agent, the Security Trustee and the Fiscal Agent (if any) and the term Agent shall include any successor to each such Agent.

"**AGM**" has the meaning given to it in the Bond Trust Deed.

"**AGM Financial Guarantee**" means the financial guarantee dated on or about the date hereof, provided by AGM as financial guarantor, without regard to any amendment, modification or supplement thereto other than any such amendment, modification or supplement made in accordance with Clause 12.3 (*Termination and Amendment*) thereof.

"**AGM Proportion**" means the proportion of the Financial Guarantees provided by the Financial Guarantor, which proportion is 94 per cent.

"**Avoided Payment**" means any amount that is paid, credited, transferred or delivered to or to the order of the Bond Trustee or a Guaranteed Bondholder by or on behalf of the Issuer in accordance with the terms of the Bond Trust Deed and/or the Guaranteed Bonds in respect of any Guaranteed Amount, which amount has been recovered from, or is otherwise required to be returned or repaid by, the Bond Trustee or a Guaranteed Bondholder as a result of Insolvency Proceedings by or against the Issuer.

"**Bond Trust Deed**" means the bond trust deed dated on or about the date hereof between the Issuer, the Bond Trustee, the Financial Guarantor and AGM, without regard to any amendment, modification or supplement thereto other than any such amendment, modification or supplement made in accordance with the provisions of such bond trust deed with the prior written consent of the Financial Guarantor and AGM.

"**Business Day**" means any day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealings in foreign exchange and foreign currency deposits) in London and New York.

"**Conditions**" means the terms and conditions of the Guaranteed Bonds as set out in Schedule 4 (Terms and Conditions of the Bonds) of the Bond Trust Deed, and "**Condition**" when used herein means such Condition as set out in Schedule 4 of the Bond Trust Deed and referred to herein.

"**Defaulted Amount**" means the portion of a Guaranteed Amount that is Due for Payment and unpaid by reason of Non-payment by the Issuer, including any portion of any Guaranteed Amount that has become an Avoided Payment.

"**Due for Payment**" means, with respect to:

(i) Scheduled Interest on a Scheduled Payment Date, the amount of Scheduled Interest that is due and payable by the Issuer on such Scheduled Payment Date; and

(ii) Scheduled Principal on a Scheduled Payment Date, the amount of Scheduled Principal that is due and payable by the Issuer on such Scheduled Payment Date,

in each case as each such Scheduled Payment Date occurs or would have occurred in accordance with the original terms of the Guaranteed Bonds and without regard to any prepayment, Acceleration or mandatory or optional redemption of the Guaranteed Bonds or any subsequent amendment or modification of the Guaranteed Bonds that has not been consented to in writing by the Financial Guarantor and AGM in accordance with the provisions of the Bond Trust Deed. For the avoidance of doubt, "Due for Payment" does not refer to any earlier date upon which payment of any Guaranteed Amounts may become due under the Guaranteed Bonds, by reason of prepayment, Acceleration, mandatory or optional redemption or otherwise.

"**Financial Guarantee**" means this Financial Guarantee No. 80169-U, without regard to any amendment, modification or supplement hereto other than any such amendment, modification or supplement made in accordance with Clause 12.3 (*Termination and Amendment*).

"**Financial Guarantees**" means this Financial Guarantee and the AGM Financial Guarantee.

"**Financial Guarantee Fee**" has the meaning given to it in the Financial Guarantee Fee Letter.

"**Financial Guarantee Fee Letter**" means the fee letter dated as of on or around 11 July 2013 between the Financial Guarantor and the Obligors, without regard to any amendment, modification or supplement thereto other than any such amendment, modification or supplement made in accordance with the provisions of such fee letter with the prior written consent of the Financial Guarantor.

"**Financial Guarantor Default**" has the meaning given to it in the Security Trust and Intercreditor Deed.

"**Fiscal Agent**" has the meaning assigned thereto in Clause 9 (*Fiscal Agent*).

"**Force Majeure Event**" means any unforeseeable event outside the control of the Financial Guarantor that renders the Financial Guarantor's performance under this Financial Guarantee impossible (and not merely impracticable or more onerous).

"**Guaranteed Amount**" means, with respect to a Scheduled Payment Date:

(a) an amount equal to Scheduled Interest Due for Payment on the Guaranteed Bonds on such Scheduled Payment Date; plus

(b) an amount equal to the Scheduled Principal Due for Payment on the Guaranteed Bonds on such Scheduled Payment Date;

but excluding in each case any amounts due in respect of the Guaranteed Bonds:

(i) attributable to any increase in interest margin, penalty or other sum payable by the Issuer for whatever reason;

(ii) attributable to any present or future taxes, withholding, deduction, assessment or other charge (including interest and penalties in respect of such taxes, withholding, deduction, assessment or other charge) imposed by England or any other sovereign state, or any political subdivision or governmental or taxing authority thereof, with respect to any payment by the Issuer due under the Guaranteed Bonds or any gross-up or make whole payment payable by the Issuer in respect of any such taxes, withholding, deduction, assessment or other charge;

(iii) attributable to any default interest;

(iv) attributable to any amount relating to prepayment, early redemption, broken-funding indemnities, penalties, premium, "spens", any make-whole amount or similar types of payments payable in respect of the Guaranteed Bonds; or

(v) in respect of which the Financial Guarantor or AGM has made an Accelerated Payment on or prior to such Scheduled Payment Date.

"**Guaranteed Bondholder**" means a holder of Guaranteed Bonds.

"**Guaranteed Bonds**" means the £ 101,833,000 5.069 per cent. Fixed Rate Guaranteed Secured Bonds due September 2032 issued by the Issuer but excluding any such bonds that are held by or for the account of any Person included in the Issuer Group.

"**HoldCo**" means Sustainable Communities For Leeds (Holdings) Limited, a company incorporated in England and Wales under registered number 08319372.

"**Insolvency Proceedings**" means the commencement after the date hereof of any bankruptcy, insolvency or similar proceedings by or against the Issuer, or the commencement after the date hereof of any proceedings by or against the Issuer for the winding up or the liquidation of its affairs, or the consent after the date hereof to the appointment of a trustee-in-bankruptcy, conservator, administrator, receiver or liquidator in any bankruptcy, insolvency or similar proceedings relating to the Issuer.

"**Issuer**" means Sustainable Communities for Leeds (Finance) PLC, a company incorporated in England and Wales under registered number 08594721.

"**Issuer Group**" has the meaning given to it in Condition 2.9.

"**Moody's**" means Moody's Investors Service, Inc.

"**Non-payment by the Issuer**" means, with respect to a Guaranteed Amount at a time when such Guaranteed Amount is Due for Payment, that the funds, if any, remitted to any Agent or the Bond Trustee under the terms of the Guaranteed Bonds or the Bond Trust Deed for payment to Guaranteed Bondholders are insufficient for payment in full of such Guaranteed Amount. In addition to and without limiting the foregoing, "Non-payment by the Issuer" applies to any portion of any Guaranteed Amount that has become an Avoided Payment.

"**Notice of Demand**" means a notice of demand in the form of the Annex hereto.

"**Obligors**" means the Issuer, ProjectCo and HoldCo.

"**Order**" means a final, non-appealable order of a court or other body exercising jurisdiction in an Insolvency Proceeding by or against the Issuer, to the effect that the Bond Trustee, any Agent or any Guaranteed Bondholder is required to return or repay all or any portion of an Avoided Payment.

"Paying Agents" means the paying agents identified in the Paying Agency Agreement.

“**ProjectCo**” means Sustainable Communities For Leeds Limited, a company incorporated in England and Wales under registered number 08320624.

“**Rating Agencies**” means Moody’s and S&P and such rating agencies as may be substituted for either such rating agency from time to time in accordance with the provisions of the Bond Trust Deed with the prior written consent of the Financial Guarantor and AGM.

“**Receipt**” and “**Received**” shall mean actual delivery to the Financial Guarantor prior to 12:00 noon, London time, on a Business Day; provided, however, that delivery either on a day that is not a Business Day, or after 12:00 noon, London time, on a Business Day, shall be deemed to be “**Received**” on the next succeeding Business Day. For purposes of this definition, “**actual delivery**” to the Financial Guarantor shall mean (i) the delivery of the original Notice of Demand, notice or other applicable documentation to the Financial Guarantor’s address for notices in accordance with Clause 11 (*Notices*); or (ii) fax transmission of the original Notice of Demand, notice or other applicable documentation to the Financial Guarantor’s fax number for notices in accordance with Clause 11 (*Notices*). If presentation is made by fax transmission, the Bond Trustee (a) shall promptly confirm transmission by telephone to the Financial Guarantor at its telephone number referred to in Clause 11 (*Notices*), and (b) as soon as is reasonably practicable, shall deliver the original Notice of Demand, notice or other applicable documentation to the Financial Guarantor’s address for notices in accordance with Clause 11 (*Notices*). If any Notice of Demand, notice or other documentation actually delivered (or attempted to be delivered) under the Financial Guarantee by the Bond Trustee is not in proper form or is not properly completed, executed or delivered, “**Receipt**” by the Financial Guarantor shall be deemed not to have occurred, and the Financial Guarantor shall so advise the Bond Trustee of such deficiency and the nature of the deficiency within one Business Day of receipt of such deficient Notice of Demand. In such case, the Bond Trustee may submit an amended or corrected Notice of Demand, notice or other documentation, as the case may be, to the Financial Guarantor.

“**Recovery**” has the meaning set out in Clause 3.2 (*Payments by the Financial Guarantor*).

“**S&P**” means Standard and Poor’s Ratings Services.

“**Scheduled Interest**” means, in respect of a Scheduled Payment Date, the amount of scheduled interest on the Guaranteed Bonds then payable in accordance with the original terms of the relevant Conditions without regard to any amendment or modification of such terms other than any amendment or modification of such terms made in accordance with the provisions of the Bond Trust Deed with the prior written consent of the Financial Guarantor and AGM, after giving effect to each amount of principal repaid or prepaid by the Issuer pursuant to the relevant Conditions or otherwise paid following enforcement of the Collateral in accordance with Condition 14 (*Exercise and Enforcement*).

“**Scheduled Payment Date**” has the meaning given to it in the Conditions.

“**Scheduled Principal**” means, in respect of a Scheduled Payment Date, the amount of scheduled principal payable on the Guaranteed Bonds on such Scheduled Payment Date in accordance with Condition 7.1 (*Scheduled Payments*), in accordance with the original terms of the Conditions without regard to any amendment or modification of such terms other than any amendment or modification of such terms made in accordance with the provisions of the Bond Trust Deed with the prior written consent of the Financial Guarantor and AGM, as reduced by each amount of principal repaid or prepaid by the Issuer pursuant to the relevant Conditions or otherwise paid following enforcement of the Collateral in accordance with Condition 14 (*Exercise and Enforcement*).

"**Security Trust and Intercreditor Deed**" means the security trust and intercreditor deed made on or about the date hereof between the Obligors, the other Sponsor Creditors (as defined in that agreement), the Security Trustee, the Bond Trustee, the Financial Guarantor and AGM, without regard to any amendment, modification or supplement thereto other than any such amendment, modification or supplement made in accordance with the provisions of such security trust and intercreditor deed with the prior written consent of the Financial Guarantor and AGM.

"**Security Trustee**" means BNY Mellon Corporate Trustee Services Limited, a company, incorporated with registered number 02631386 under the laws of England and Wales and having its registered office at 1 Canada Square, London E14 5AL, or any other Person(s) for the time being the trustee or trustees under the Security Trust and Intercreditor Deed for itself and as trustee for the beneficiaries under the Security Trust and Intercreditor Deed.

"**Term of the Financial Guarantee**" means the period from and including the date hereof to and including the earlier of:

(A) the termination of the Financial Guarantee in accordance with Condition 2.3 (*Termination of the Financial Guarantees*); and

(B) the last to occur of the following:

(i) the date on which all Guaranteed Amounts have been paid under the Guaranteed Bonds;

(ii) the date on which any period during which any Guaranteed Amount could have become, in whole or in part, an Avoided Payment has expired; and

(iii) if the Issuer becomes subject to any Insolvency Proceedings before the occurrence of (i) and (ii), the later of (a) the date of the conclusion or dismissal of the Insolvency Proceedings without continuing jurisdiction by the court in such Insolvency Proceedings and (b) if the Bond Trustee or any Guaranteed Bondholder is required to return any payment (or portion thereof) in respect of a Guaranteed Amount that is avoided as a result of such Insolvency Proceedings, the date on which the Financial Guarantor has made all payments required to be made under this Financial Guarantee to or to the order of the Bond Trustee in respect of all such Avoided Payments.

1.2 Construction

In this Financial Guarantee, a reference to:

1.2.1 a statutory provision includes a reference to the statutory provision as modified or re-enacted or both from time to time whether before or after the date of this Financial Guarantee and any subordinate legislation made or other thing done under the statutory provision whether before or after the date of this Financial Guarantee;

1.2.2 the singular includes the plural and vice versa (unless the context otherwise requires);

1.2.3 a time of day is a reference to the time in London, unless a contrary indication appears;

1.2.4 each reference to "Clause" or to "Annex", unless the context otherwise requires, is a reference to a clause of or an annex to this Financial Guarantee;

1.2.5 a "**Person**" includes any individual, company, corporation, unincorporated association or body (including a partnership, trust, joint venture or consortium), government, state, agency, organisation or other entity whether or not having separate legal personality; and

1.2.6 a provision of law is a reference to that provision as extended, applied, amended or re-enacted and includes any subordinate legislation.

1.3 Headings

The headings in this Financial Guarantee do not affect its construction or interpretation.

2 Guarantee

2.1 In consideration of the payment by the Issuer of the Financial Guarantee Fee and subject to the terms of this Financial Guarantee, the Financial Guarantor unconditionally and irrevocably guarantees to the Bond Trustee during the Term of the Financial Guarantee the full and complete payment of the AGE Proportion of:

(a) Guaranteed Amounts that are Due for Payment but are unpaid by reason of Non-payment by the Issuer, and

(b) Avoided Payments;

provided that any payment by AGM under the AGM Financial Guarantee in respect of the AGE Proportion of any Defaulted Amount shall constitute a discharge of the Financial Guarantor's obligation to make such payment to the Bond Trustee.

2.2 This Financial Guarantee does not guarantee any prepayment or other accelerated payment which at any time may become due in respect of any Guaranteed Amount, other than at the sole option of the Financial Guarantor as specified in Clause 4 (*Acceleration*) of this Financial Guarantee, nor against any risk other than Non-payment by the Issuer, including failure of the Bond Trustee or any Agent to make any payment due to the Guaranteed Bondholders or any diminution in the market or fair value of the Guaranteed Bonds.

3 Payments by the Financial Guarantor

3.1 Following Receipt by the Financial Guarantor of a Notice of Demand in accordance with Clause 8 (*Notice of Demand*) from the Bond Trustee for any Defaulted Amount, the Financial Guarantor will pay the AGE Proportion of the Defaulted Amount to the Bond Trustee no later than 10:00 a.m., London time, subject to Clause 7.5, on the later of:

(a) the date such Defaulted Amount becomes Due for Payment; and

(b) the fourth Business Day following the day on which the Financial Guarantor Received such Notice of Demand.

3.2 In the event that any amount shall be received by the Bond Trustee or the Bond Trustee has actual notice that any Guaranteed Bondholder has received any amount in respect of a Defaulted Amount forming the basis of a claim specified in a Notice of Demand submitted hereunder, which amount had not been received by the Bond Trustee, or which the Bond Trustee did not have actual notice had been received by a Guaranteed Bondholder when the Notice of Demand was prepared but which is received by the Bond Trustee or the Bond Trustee has actual notice has been received by such Guaranteed Bondholder prior to the receipt of payment from the Financial Guarantor as contemplated by this Financial Guarantee (each such amount, a "**Recovery**"), the Bond Trustee shall promptly so notify the Financial Guarantor (which notice shall include the amount of any such Recovery). The fact that a Recovery has been received by the Bond Trustee or the Bond Trustee has actual notice has been received by such Guaranteed Bondholder shall be deemed to be incorporated in the applicable Notice of Demand as of the date such Notice of Demand was originally prepared, without the need for any further action by any Person, and the Financial Guarantor shall pay the amount of the claim against the Financial Guarantor specified in paragraph (ii) of the Notice of Demand less the sum of the AGE Proportion of all such Recoveries.

3.3 The Financial Guarantor shall be entitled to elect, in its absolute discretion, to pay part or all of any Defaulted Amount to such bank account as is specified by the Bond Trustee without the need for the Financial Guarantor to have Received, and irrespective of whether the Financial Guarantor shall have Received, a Notice of Demand therefor. Any such payment shall be considered a payment by the Financial Guarantor under this Financial Guarantee for all purposes. If requested by the Financial Guarantor, the Bond Trustee shall promptly deliver to the Financial Guarantor a properly completed and executed Notice of Demand in respect of any such payment made or to be made by the Financial Guarantor.

3.4 Payments due hereunder in respect of Guaranteed Amounts will be disbursed to or to the order of the Bond Trustee and credited (in immediately available funds) to the bank account (the "**Account**") specified by the Bond Trustee in the applicable Notice of Demand or pursuant to Clause 3.3 or Clause 4.2. Payment in full to the Account shall discharge the obligations of the Financial Guarantor under this Financial Guarantee to the extent of such payment, whether or not such payment is properly applied by or on behalf of the Bond Trustee or any Agent.

3.5 Once payment by or on behalf of the Financial Guarantor of an amount in respect of any Guaranteed Amount (whether on a Scheduled Payment Date or on an accelerated basis pursuant to Clause 4.2) has been made to the Account, the Financial Guarantor shall have no further obligations under this Financial Guarantee in respect of such Guaranteed Amount to the extent of such payment.

4 Acceleration

4.1 At any time or from time to time following Acceleration, the Financial Guarantor may decide, in its absolute discretion, to make an Accelerated Payment under this Financial Guarantee without the need for the Financial Guarantor to have Received, and irrespective of whether the Financial Guarantor shall have Received, a Notice of Demand.

4.2 The Financial Guarantor shall notify the Bond Trustee in writing of its intention to make any Accelerated Payment and the proposed date of such payment, no later than two Business Days prior to such proposed date of payment. Any such Accelerated Payment shall be considered a payment by the Financial Guarantor under this Financial Guarantee for all purposes. If so requested by the Financial Guarantor at the time the Financial Guarantor gives such written notice, the Bond Trustee shall deliver to the Financial Guarantor a corresponding Notice of Demand.

5 Withholding Tax

All payments by the Financial Guarantor to or to the order of the Bond Trustee under this Financial Guarantee shall be made without withholding or deduction for, or on account of, any taxes, duties, assessments or other governmental charges of whatever nature imposed, levied, collected, withheld or assessed by any sovereign state, or any political subdivision or governmental or taxing authority therein or thereof unless such withholding or deduction is required by law. If any withholding or deduction is so required by law, the Financial Guarantor shall pay such amounts net of such withholding or deduction and shall account to the appropriate tax authority for the amount required to be withheld or deducted. If the Financial Guarantor makes any such withholding or deduction, it shall promptly notify the Bond Trustee and promptly forward to the Bond Trustee any official receipt or other evidence of payment that the Financial Guarantor has received in connection with such payment. The Financial Guarantor shall not be obliged to pay any amount to or to the order of the Bond Trustee in respect of the amount of such withholding or deduction.

6 Subrogation

6.1 The Financial Guarantor will be fully, immediately and automatically subrogated to the Guaranteed Bondholders' and the Bond Trustee's rights to payment of any Guaranteed Amounts paid by or on behalf of the Financial Guarantor, and to any rights relating thereto, to the fullest extent permitted by applicable law to the extent and at the time any such payments are made by or on behalf of the Financial Guarantor under this Financial Guarantee, including, for the avoidance of doubt, any Accelerated Payment.

6.2 Any payment made by or on behalf of the Issuer to or for the benefit of the Bond Trustee or any Guaranteed Bondholder in respect of any Guaranteed Amount paid by or on behalf of the Financial Guarantor hereunder (and a corresponding claim under this Financial Guarantee and/or the AGM Financial Guarantee, which claims shall have been paid in full by the Financial Guarantor and AGM respectively) shall be received and held on trust by the recipient for the benefit of the Financial Guarantor and AGM and shall be paid by the recipient over to the Financial Guarantor and AGM *pro rata* in proportion to the respective amounts paid:

(a) by the Financial Guarantor in respect of a claim made pursuant to this Financial Guarantee, and

(b) by AGM in respect of the related claim made pursuant to the AGM Financial Guarantee.

6.3 The Bond Trustee shall cooperate in all reasonable respects, and at the expense of the Financial Guarantor, with any request by the Financial Guarantor for action necessary to preserve or enforce the Financial Guarantor's rights and remedies, any related security arrangements or otherwise in relation to such subrogation including, without limitation, any request to assign to the Financial Guarantor the Bond Trustee's rights in respect of any Guaranteed Amount which has been paid by the Financial Guarantor.

7 Waiver of Defences

7.1 The obligations of the Financial Guarantor under this Financial Guarantee will continue and will not be terminable other than in accordance with Clause 12 (*Termination and Amendment*) of this

Financial Guarantee notwithstanding failure to receive payment of the Financial Guarantee Fee or any other amount due in respect of this Financial Guarantee. The Financial Guarantee Fee is not refundable for any reason.

7.2 The Financial Guarantor acknowledges that there is no duty of disclosure by the Bond Trustee under this Financial Guarantee but nonetheless, to the fullest extent permitted by applicable law, hereby waives for the benefit of the Bond Trustee and the Guaranteed Bondholders and agrees not to assert any and all rights (whether by counterclaim, rescission, set-off or otherwise) and any and all equities and defences howsoever arising (including, without limitation, any right, equity or defence based on: (a) any right to require the Bond Trustee or any Guaranteed Bondholder first to proceed against or to enforce any other rights or security against, or to claim payment from, any Person before the Bond Trustee may claim from the Financial Guarantor under this Financial Guarantee; (b) fraud on the part of any Person (including fraud on the part of any agent for the Bond Trustee, but excluding fraud by the Bond Trustee itself); (c) misrepresentation, breach of warranty or non-disclosure of information by any Person; (d) any lack of validity or enforceability of the Guaranteed Bonds or the Bond Trust Deed; (e) any modification or any amendment to the Guaranteed Bonds or the Bond Trust Deed; (f) the granting of any time, indulgence or concession by any Person to the Issuer; (g) any insolvency or similar proceedings in respect of the Issuer or any other Person; (h) any lack of capacity, power or authority or any change in status of the Issuer or any other Person; or (i) the refusal or failure to take up, to hold, to perfect or to enforce by any Person any rights under or in connection with any guarantee, indemnity, security or other document) to the extent such rights, equities and defences may be available to the Financial Guarantor to avoid payment of its obligations under this Financial Guarantee in accordance with the express provisions hereof.

7.3 No warranties are given and nothing in this Financial Guarantee is intended to constitute a warranty or a condition precedent to payment under the Financial Guarantee other than Receipt of a Notice of Demand in accordance with Clause 8 (*Notice of Demand*) of this Financial Guarantee.

7.4 Nothing in this Financial Guarantee shall be construed in any way to limit or otherwise affect the Financial Guarantor's right to pursue recovery or claims (based on contractual or other rights, including such rights resulting from the Bond Trustee's or such other Person's fraud, negligence or breach of any agreement to which it is a party) for reimbursement against any Persons for any liabilities, losses, damages, costs and expenses incurred by the Financial Guarantor or to exercise at any time any other remedies that may be available to the Financial Guarantor at law or in equity.

7.5 Nothing in this Financial Guarantee shall be construed to require payment by the Financial Guarantor so long as a Force Majeure Event is continuing, in which event the Financial Guarantor agrees to perform its obligations under this Financial Guarantee promptly following cessation of such Force Majeure Event.

8 Notice of Demand

8.1 Subject to Clauses 2.2, 3.3 and 4 of this Financial Guarantee, payments of Guaranteed Amounts (including Avoided Payments) will only be made after presentation of a properly completed Notice of Demand signed by the Bond Trustee and Received by the Financial Guarantor.

8.2 Notices of Demand can only be given by the Bond Trustee in the manner set out in Clause 11 (*Notices*).

8.3 Without limitation to the Financial Guarantor's obligations under Clause 8.5, if any Notice of Demand is not in the proper form or is not properly completed, executed or delivered, the Financial Guarantor will not be deemed to have Received such Notice of Demand.

8.4 Any Notice of Demand in respect of an Avoided Payment will not be deemed properly completed unless it is accompanied by:

8.4.1 a copy of the Order;

8.4.2 a certificate of the Bond Trustee that the Order has been entered and is not subject to any stay and specifying the Guaranteed Amounts that are Avoided Payments; and

8.4.3 an assignment duly executed by the Bond Trustee, irrevocably assigning to the Financial Guarantor and AGM all rights and claims of the Bond Trustee relating to or arising out of such Avoided Payments against the estate of the Issuer or otherwise.

8.5 The Financial Guarantor will advise the Bond Trustee if a Notice of Demand is not in the proper form or has not been properly completed, executed or delivered within one Business Day of receipt of such deficient Notice of Demand and the Bond Trustee may submit an amended Notice of Demand to the Financial Guarantor.

9 Fiscal Agent

9.1 At any time during the Term of the Financial Guarantee, the Financial Guarantor may appoint a fiscal agent situated in the United Kingdom (the "**Fiscal Agent**") for purposes of this Financial Guarantee by written notice to the Bond Trustee, specifying the name and notice address of such Fiscal Agent. From and after the date of receipt of such notice by the Bond Trustee:

9.1.1 copies of all notices (including Notices of Demand) and other documents required to be delivered to the Financial Guarantor pursuant to this Financial Guarantee shall be simultaneously delivered to the Fiscal Agent and to the Financial Guarantor; and

9.1.2 all payments required to be made by the Financial Guarantor under this Financial Guarantee may be made directly by the Financial Guarantor or by the Fiscal Agent on behalf of the Financial Guarantor.

9.2 The Fiscal Agent is the agent of the Financial Guarantor only, and the Fiscal Agent shall in no event be liable to the Bond Trustee for any acts of the Fiscal Agent or any failure of the Financial Guarantor to deposit, or cause to be deposited, sufficient funds to make payments due under this Financial Guarantee.

10 Transfer

10.1 The rights and obligations of the Financial Guarantor under this Financial Guarantee may be assigned or transferred to or assumed by any affiliate of the Financial Guarantor provided that:

10.1.1 no Financial Guarantor Default has occurred and is continuing at the time of such assignment, transfer or assumption or would occur as a result of such assignment, transfer or assumption;

10.1.2 the Financial Guarantor or such assignee, transferee or party assuming such rights and obligations delivers to the Bond Trustee written confirmation from the Rating Agencies that, at the time of and immediately following any such assignment, transfer or assumption, the financial strength or claims paying ability of such affiliate will be rated at least equal to the financial strength or claims paying ability of the Financial Guarantor at that time;

10.1.3 the Financial Guarantor or such assignee, transferee or party assuming such rights and obligations thereafter delivers to the Bond Trustee written notice of any such assignment, transfer or assumption;

10.1.4 such transferee assumes the obligations of the Financial Guarantor under this Financial Guarantee and accedes to the relevant Finance Documents; and

10.1.5 the location of the transferee does not result in any withholding or deduction for any taxes, duties, assessments, or other governmental charges of whatever nature in respect of any payment by such transferee hereunder, which withholding or deduction is not at the time of the relevant transfer applicable to any such payment by the Financial Guarantor hereunder, and does not otherwise prevent payment being made or result in any deduction being made in respect of any Guaranteed Amount.

10.2 The Bond Trustee may not transfer, assign, sub-participate, declare a trust over or otherwise dispose (other than in favour of the Guaranteed Bondholders) of any of its rights under this Financial Guarantee except to a Person as to whom the Financial Guarantor has given its prior written consent. However, if the Bond Trustee transfers or assigns its rights and obligations under the Bond Trust Deed to a new or additional trustee which has been appointed in accordance with the Bond Trust Deed, no such consent shall be required and such new or additional trustee will be able to enforce this Financial Guarantee and references in this Financial Guarantee to "Bond Trustee" shall be construed as including such new trustee or such additional trustee, as applicable.

11 Notices

11.1 All notices given under this Financial Guarantee shall be in writing (except as otherwise specifically provided herein) and shall be mailed by registered mail or personally delivered or faxed as follows:

To the Financial Guarantor:

Assured Guaranty (Europe) Ltd.
1 Finsbury Square
London EC2A 1AE

Re:	Leeds Social Housing PFI Project
Telephone:	+44 20 7562 1900
Fax:	+44 20 7562 1901

with a copy to the General Counsel at the above address and fax number. Each Notice of Demand shall be marked to indicate "URGENT MATERIAL ENCLOSED".

To the Bond Trustee:

BNY Mellon Corporate Trustee Services Limited
1 Canada Square
London E14 5AL

Attention:	Sustainable Communities for Leeds (Finance) plc – Trustee Administration Manager
Fax:	+44 20 7964 4637

If presentation to the Bond Trustee is made by fax transmission, the Financial Guarantor shall as soon as is reasonably practicable deliver the original notice or other applicable documentation to the Bond Trustee's address for notices in accordance with this Clause 11 (*Notices*).

11.2 The Financial Guarantor or the Bond Trustee may designate an additional or different address, or telephone or fax number, by prior written notice. Each notice, presentation, delivery and communication to the Financial Guarantor or the Bond Trustee shall be effective only upon Receipt by the Financial Guarantor or actual receipt by the Bond Trustee, as the case may be.

12 Termination and Amendment

12.1 This Financial Guarantee is not cancellable by the Financial Guarantor for any reason, including, without limitation, the failure of the Financial Guarantor to receive payment of any Financial Guarantee Fee due in respect of this Financial Guarantee.

12.2 This Financial Guarantee and the obligations of the Financial Guarantor hereunder shall terminate upon the expiration of the Term of the Financial Guarantee.

12.3 This Financial Guarantee may not be amended, modified or supplemented without the prior written consent of the Bond Trustee.

13 Miscellaneous

No waiver of any rights or powers of the Financial Guarantor or the Bond Trustee, or any consent by either of them, shall be valid unless in writing and signed by an authorised officer or agent of the Financial Guarantor or the Bond Trustee, as applicable. The waiver of any right by the Financial Guarantor or the Bond Trustee, or the failure promptly to exercise any such right, shall not be construed as a waiver of any right to exercise the same or any other right at any time thereafter.

14 Redenomination

The obligations of the Financial Guarantor under this Financial Guarantee shall not be affected by any redenomination of the Guaranteed Bonds into Euro pursuant to Condition 16 (*European Economic and Monetary Union*), save that following such redenomination, payments of Guaranteed Amounts hereunder shall be made in Euro.

15 Law and Jurisdiction

15.1 This Financial Guarantee, and any non-contractual obligations arising out of or in connection with it, shall be governed by, and construed in accordance with, the laws of England and Wales.

15.2 With respect to any suit, action or proceedings relating to this Financial Guarantee ("**Proceedings**"), each of the Financial Guarantor and the Bond Trustee irrevocably submits to the jurisdiction of the English courts and waives any objection which it may have at any time to the laying of venue of any Proceedings brought in any such court, waives any claim that such Proceedings have been brought in an inconvenient forum and further waives the right to object, with respect to such Proceedings that such court does not have any jurisdiction over such party.

16 Entire Agreement

This Financial Guarantee constitutes the entire agreement between the Financial Guarantor and the Bond Trustee in relation to the Financial Guarantor's obligation to make payments to the Bond Trustee for the benefit of the Guaranteed Bondholders in respect of the Guaranteed Amounts which become Due for Payment but shall be unpaid by reason of Non-payment by the Issuer, and supersedes any previous agreement between the Financial Guarantor and the Bond Trustee in relation thereto.

17 Third Party Rights

No Person other than the Bond Trustee shall have rights under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Financial Guarantee but this shall not affect any such right any Person may have otherwise than by virtue of such Act.

18 Surrender of Financial Guarantee

The Bond Trustee shall deliver its original engrossment of this Financial Guarantee to the Financial Guarantor upon expiration of the Term of this Financial Guarantee.

In Witness Whereof, this Financial Guarantee has been executed as a deed and delivered on the date inserted above.

EXECUTED as a DEED for and on behalf of
ASSURED GUARANTY (EUROPE) LTD. by:

Authorised signatory

in the presence of

Witness:

ANNEX
NOTICE OF DEMAND

Assured Guaranty (Europe) Ltd.
1 Finsbury Square
London EC2A 1AE

Assured Guaranty Municipal Corp.
31 W. 52nd Street
New York, NY 10019

Attention:

Chief Surveillance Officer

and

General Counsel

The undersigned, duly authorised officers of BNY Mellon Corporate Trustee Services Limited, a company, incorporated with registered number 02631386 under the laws of England and Wales and having its registered office at 1 Canada Square, London E14 5AL in its capacity as bond trustee for the holders of the Guaranteed Bonds (the "**Bond Trustee**"), hereby certify to each of Assured Guaranty (Europe) Ltd. ("**AGE**") and Assured Guaranty Municipal Corp. ("**AGM**" and, together with AGE, the "**Financial Guarantors**") with reference to Financial Guarantee No. 80169-U (the "**AGE Financial Guarantee**") and Financial Guarantee No. 51911-N (the "**AGM Financial Guarantee**" and, together with the AGE Financial Guarantee, the "**Financial Guarantees**") that:

(i) [The Guaranteed Amount[s] that [is/are] due and payable on the Scheduled Payment Date falling on [*insert applicable payment date*] [is/are] [●][*insert applicable amount*]./The Guaranteed Amount[s] that [was/were] paid, credited, transferred or delivered to or to the order of the Bond Trustee or the Guaranteed Bondholders by or on behalf of the Issuer in accordance with the terms of the Bond Trust Deed and/or the Guaranteed Bonds on [*insert applicable payment date*] of [●][*insert applicable amount*] [was/were] recovered from, or was otherwise required to be returned or repaid by, the Bond Trustee or [a/the] Guaranteed Bondholder[s] as a result of Insolvency Proceedings by or against the Issuer on [*insert applicable repayment date*].]

(ii) [The deficiency with respect to the Guaranteed Amount Due for Payment and unpaid by reason of Non-payment by the Issuer on the Scheduled Payment Date falling on [*insert applicable payment date*] is [●][*insert applicable amount*] (the "**Defaulted Amount**"), the AGE Proportion of such Defaulted Amount is [●] and the AGM Proportion of such Defaulted Amount is [●]]/[The Bond Trustee has been notified by the Account Bank that the deficiency in respect of the Guaranteed Amount[s] which [is/are] Due for Payment on the Scheduled Payment Date falling on [*insert applicable payment date*] will be [●] [*insert applicable amount*] (the "**Defaulted Amount**"). The AGE Proportion of such Defaulted Amount is [●] and the AGM Proportion of such Defaulted Amount is [●]].

(iii) The Bond Trustee is making (a) a claim against AGE under the AGE Financial Guarantee for the AGE Proportion of the Defaulted Amount, and (b) a claim against AGM under the AGM Financial Guarantee for the AGM Proportion of the Defaulted Amount, with each such amount to be applied to the payment of the above-described Guaranteed Amount[s].

(iv) To the extent that AGE does not pay the AGE Proportion of any Defaulted Amount when due and payable by AGE in accordance with the terms of the AGE Financial Guarantee, the Bond Trustee is making a claim against AGM under Clause 3.1.2 of the AGM Financial Guarantee for such amount. The Bond Trustee agrees that any payment by AGM of such amount shall discharge AGE from any obligation to make such payment under the AGE Financial Guarantee.

(v) The Bond Trustee agrees that following any payment by the Financial Guarantors made with respect to the Defaulted Amount which is the subject of this Notice of Demand, it (a) will cause such amounts to be applied directly to the payment of the applicable Guaranteed Amount[s]; (b) will ensure that such funds are not applied for any other purpose; and (c) will cause an accurate record of such payment to be maintained with respect to the appropriate Guaranteed Amount(s), the corresponding claim on each Financial Guarantee, and the proceeds of such claim.

(vi) Payments should be made by credit to the following account:

[*(insert details of bank account)*] (the "**Account**").

Capitalised terms used in this Notice of Demand and not otherwise defined herein shall have the respective meanings ascribed thereto in or pursuant to the applicable Financial Guarantee.

This Notice of Demand may be revoked at any time by written notice of such revocation by the Bond Trustee to each Financial Guarantor, if and only to the extent that moneys are actually received by the Bond Trustee prior to any such revocation from a source other than the Financial Guarantors with respect to the Defaulted Amount set forth herein. The Bond Trustee will withdraw this Notice of Demand, or submit a restated Notice of Demand reducing the amount of the claim hereunder, if the required amount of the Defaulted Amount and accordingly each of the AGE Proportion and the AGM Proportion thereof has been reduced (including reduction to zero) on or prior to the date the Financial Guarantors are required to make payment under the Financial Guarantees.

If the Bond Trustee has received, or the Bond Trustee has actual notice that one or more Guaranteed Bondholders has received, from the Issuer or the Financial Guarantors an amount in excess of a Defaulted Amount, the Bond Trustee shall immediately return to each Financial Guarantor the lesser of (i) such Financial Guarantor's proportionate share in such excess amount (such share being calculated by a fraction equal to the amount of the Defaulted Amount paid by the relevant Financial Guarantor to or to the order of the Bond Trustee divided by the total Defaulted Amount paid by both Financial Guarantors to or to the order of the Bond Trustee) and (ii) the amount of the Defaulted Amount paid by the relevant Financial Guarantor to or to the order of the Bond Trustee and not previously distributed by the Bond Trustee to the Guaranteed Bondholders or to any insolvency official appointed in respect of the Issuer. For the avoidance of doubt the Bond Trustee shall only be required to repay any such amounts to the Financial Guarantors that are in the Bond Trustee's possession and under its control, at the time it becomes aware of the requirement to repay such amounts, and the Bond Trustee shall have no liability to any Person for any amounts received by the Bond Trustee from the Financial Guarantors but distributed by the Bond Trustee in accordance with the preceding sentence.

The Bond Trustee acknowledges that as of the date on which any payment by the relevant Financial Guarantor towards a Defaulted Amount is credited to the Account, the relevant Financial Guarantor shall be deemed fully, immediately and automatically subrogated, to the fullest extent permitted by applicable law, to the rights (including, without limitation, any rights and benefits attached thereto, and any security granted at law, by contract or otherwise) of the Guaranteed Bondholders to payment of the Guaranteed Amounts paid by the relevant Financial Guarantor at the time of such payment by the relevant Financial Guarantor towards the Defaulted Amount.

The Bond Trustee hereby (i) assigns to each Financial Guarantor its rights to receive any payment for the account of the Guaranteed Bondholders from the Issuer in respect of the Guaranteed Bonds to the extent of any payments made to (or to the order of) the Bond Trustee by the relevant Financial Guarantor under the applicable Financial Guarantee, including without limitation its right to receive payments of principal and interest on the Guaranteed Bonds (including Recoveries) and, without limitation to the foregoing, any amounts due to the Bond Trustee in respect of securities law violations arising from the offer or sale of the Guaranteed Bonds and (ii) confirms that it has taken all steps reasonably requested by the Financial Guarantor and necessary to effect and perfect such assignments to the Financial Guarantors. Furthermore, the Bond Trustee agrees that it shall exercise or refrain from exercising its voting rights or similar rights and all rights to take legal or other action against the Issuer or any other Person in such manner as either Financial Guarantor may direct. The Bond Trustee further agrees that at either Financial Guarantor's request it shall appoint each Financial Guarantor to act severally as the Bond Trustee's agent in relation to such legal or other action against the Issuer or with respect to its voting or similar right. The foregoing assignments are in addition to, and not in limitation of, rights of subrogation otherwise available to each Financial Guarantor in respect of such payments. Payments to each Financial Guarantor in respect of the foregoing assignment shall in all cases be subject to and subordinate to the rights of the Bond Trustee and the Guaranteed Bondholders to receive all Guaranteed Amounts in respect of the Guaranteed Bonds. The Bond Trustee shall cooperate in all reasonable respects, and at the expense of the Financial Guarantors, with any request by either Financial Guarantor for action necessary to preserve or enforce such Financial Guarantor's rights and remedies, any related security arrangements or otherwise in relation to such subrogation including, without limitation, any request to assign to such Financial Guarantor the Bond Trustee's rights in respect of any Guaranteed Amount which has been paid by the Financial Guarantor, or take such action and deliver such instruments as may be reasonably requested or required by the Financial Guarantor to effectuate the purpose or provisions of this paragraph.

Any payment made by or on behalf of the Issuer to or for the benefit of the Bond Trustee in respect of any Guaranteed Amount forming the basis of a claim hereunder (which claim shall have been paid in full by the Financial Guarantors) shall be received and held on trust for the benefit of the Financial Guarantors and shall be paid over to each Financial Guarantor *pro rata* in proportion to the respective amounts each Financial Guarantor paid in respect of the Defaulted Amount.

The Bond Trustee hereby agrees that so long as no Financial Guarantor Default shall have occurred and be continuing, each Financial Guarantor may at any time during the continuation of any Insolvency Proceeding by or against the Issuer under any applicable law direct all matters relating thereto, including without limitation, (a) all matters relating to any claim in connection with an Insolvency Proceeding by or against the Issuer seeking the avoidance as a preferential transfer of any payment made with respect to the Guaranteed Bonds (a "**Preference Claim**"); (b) the direction of any appeal of any order relating to any Preference Claim at the expense of the Financial Guarantors; and (c) the posting of any surety or performance bond pending any such appeal.

[Pursuant to Clause 8.4 of the Financial Guarantee, the following documents are attached:

- a copy of the Order;
- a certificate of the Bond Trustee that the Order has been entered and is not subject to any stay and specifying the Guaranteed Amounts that are Avoided Payments; and
- an assignment duly executed by the Bond Trustee, irrevocably assigning to the Financial Guarantor and AGM all rights and claims of the Bond Trustee relating to or arising out of such Avoided Payments against the estate of the Issuer or otherwise*.

* To be inserted if demand relates to Avoided Payments.]

This Notice of Demand, and any non-contractual obligations arising out of or in connection with it, shall be governed by, and construed in accordance with, the laws of England and Wales.

No Person, other than each Financial Guarantor, shall have any right under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Notice of Demand but this shall not affect any such right any Person may have otherwise than by virtue of such Act.

In Witness Whereof, the undersigned has executed and delivered this Notice of Demand as a deed on the __ day of _________ of 2__.

Title:

Authorised Signatory

For the Financial Guarantor or
Fiscal Agent Use Only
Wire transfer sent on   By:
Confirmation Number:

FORM OF AGM FINANCIAL GUARANTEE

Dated 11 July 2013

ASSURED GUARANTY MUNICIPAL CORP.

FINANCIAL GUARANTEE No. 51911-N

in respect of

£101,833,000 5.069 per cent. Fixed Rate Guaranteed Secured Bonds due September 2032

This Financial Guarantee is dated 11 July 2013 and given by Assured Guaranty Municipal Corp. with its principal place of business at 31 W. 52nd Street, New York, NY 10019 (the "**Financial Guarantor**") in favour of BNY Mellon Corporate Trustee Services Limited as trustee for the holders of the Guaranteed Bonds (as defined below) (the "**Bond Trustee**", which expression shall, whenever the context admits, include such Persons for the time being the trustee or trustees of the Bond Trust Deed for the Guaranteed Bondholders).

1 Interpretation

1.1 Definitions

Any capitalised terms used in this Financial Guarantee and not otherwise defined shall have the meaning given to such terms in the Bond Trust Deed (as defined below) unless the context otherwise requires. In the event of any inconsistency between the provisions of this Financial Guarantee and the provisions of the Bond Trust Deed, this Financial Guarantee shall prevail. For the purposes of this Financial Guarantee, the following terms will have the following meanings:

"**Accelerated Payment**" means, following an Acceleration, any payment in full or in part by the Financial Guarantor or AGE, at the Financial Guarantor's or AGE's absolute option, of all or part of the Scheduled Principal in advance of the final Scheduled Payment Date together with accrued but unpaid Scheduled Interest on such Scheduled Principal to the date of such payment (but excluding any amounts referred to in items (i) to (iv) of the definition of "Guaranteed Amount").

"**Acceleration**" means, in relation to the Guaranteed Bonds, the giving of notice by the Bond Trustee to the Issuer that the Guaranteed Bonds are immediately due and repayable pursuant to Condition 9 (*Events of Default*) of the Conditions, and "**Accelerated**" will be construed accordingly.

"**Account**" has the meaning set out in Clause 3.4 (*Payments by the Financial Guarantor*).

"**AGE**" has the meaning given to it in the Bond Trust Deed.

"**AGE Financial Guarantee**" means the financial guarantee dated on or about the date hereof, provided by AGE as financial guarantor, without regard to any amendment, modification or supplement thereto other than any such amendment, modification or supplement made in accordance with Clause 12.3 (*Termination and Amendment*) thereof.

"**AGE Proportion**" means the proportion of the Financial Guarantees provided by AGE, which proportion is 6 per cent.

"**Agent**" means each Paying Agent, the Security Trustee and the Fiscal Agent (if any), and the term Agent shall include any successor to each such Agent.

"**AGM Proportion**" means the proportion of the Financial Guarantees provided by the Financial Guarantor, which proportion is 94 per cent.

"**Avoided Payment**" means any amount that is paid, credited, transferred or delivered to or to the order of the Bond Trustee or a Guaranteed Bondholder by or on behalf of the Issuer in accordance with the terms of the Bond Trust Deed and/or the Guaranteed Bonds in respect of any Guaranteed Amount, which amount has been recovered from, or is otherwise required to be returned or repaid by, the Bond Trustee or a Guaranteed Bondholder as a result of Insolvency Proceedings by or against the Issuer.

"**Bond Trust Deed**" means the bond trust deed dated on or about the date hereof between the Issuer, the Bond Trustee, AGE and the Financial Guarantor, without regard to any amendment, modification or supplement thereto other than any such amendment, modification or supplement made in accordance with the provisions of such bond trust deed with the prior written consent of AGE and the Financial Guarantor.

"**Business Day**" means any day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealings in foreign exchange and foreign currency deposits) in London and New York.

"**Conditions**" means the terms and conditions of the Guaranteed Bonds as set out in Schedule 4 (Terms and Conditions of the Bonds) of the Bond Trust Deed, and "**Condition**" when used herein means such Condition as set out in Schedule 4 of the Bond Trust Deed and referred to herein.

"**Defaulted Amount**" means the portion of a Guaranteed Amount that is Due for Payment and unpaid by reason of Non-payment by the Issuer, including any portion of any Guaranteed Amount that has become an Avoided Payment.

"**Due for Payment**" means, with respect to:

(i) Scheduled Interest on a Scheduled Payment Date, the amount of Scheduled Interest that is due and payable by the Issuer on such Scheduled Payment Date; and

(ii) Scheduled Principal on a Scheduled Payment Date, the amount of Scheduled Principal that is due and payable by the Issuer on such Scheduled Payment Date,

in each case as each such Scheduled Payment Date occurs or would have occurred in accordance with the original terms of the Guaranteed Bonds and without regard to any prepayment, Acceleration or mandatory or optional redemption of the Guaranteed Bonds or any subsequent amendment or modification of the Guaranteed Bonds that has not been consented to in writing by AGE and the Financial Guarantor in accordance with the provisions of the Bond Trust Deed. For the avoidance of doubt, "Due for Payment" does not refer to any earlier date upon which payment of any Guaranteed Amounts may become due under the Guaranteed Bonds, by reason of prepayment, Acceleration, mandatory or optional redemption or otherwise.

"**Financial Guarantee**" means this Financial Guarantee No. 51911-N, without regard to any amendment, modification or supplement hereto other than any such amendment, modification or supplement made in accordance with Clause 12.3 (*Termination and Amendment*).

"**Financial Guarantees**" means this Financial Guarantee and the AGE Financial Guarantee.

"**Financial Guarantee Fee**" has the meaning given to it in the Financial Guarantee Fee Letter.

"**Financial Guarantee Fee Letter**" means the fee letter dated as of on or around 11 July 2013 between the Financial Guarantor and the Obligors, without regard to any amendment, modification or supplement thereto other than any such amendment, modification or supplement made in accordance with the provisions of such fee letter with the prior written consent of the Financial Guarantor.

"**Financial Guarantor Default**" has the meaning given to it in the Security Trust and Intercreditor Deed.

"**Fiscal Agent**" has the meaning assigned thereto in Clause 9 (*Fiscal Agent*).

"**Force Majeure Event**" means any unforeseeable event outside the control of the Financial Guarantor that renders the Financial Guarantor's performance under this Financial Guarantee impossible (and not merely impracticable or more onerous).

"**Guaranteed Amount**" means, with respect to a Scheduled Payment Date:

(a) an amount equal to Scheduled Interest Due for Payment on the Guaranteed Bonds on such Scheduled Payment Date; plus

(b) an amount equal to the Scheduled Principal Due for Payment on the Guaranteed Bonds on such Scheduled Payment Date;

but excluding in each case any amounts due in respect of the Guaranteed Bonds:

(i) attributable to any increase in interest margin, penalty or other sum payable by the Issuer for whatever reason;

(ii) attributable to any present or future taxes, withholding, deduction, assessment or other charge (including interest and penalties in respect of such taxes, withholding, deduction, assessment or other charge) imposed by England or any other sovereign state, or any political subdivision or governmental or taxing authority thereof, with respect to any payment by the Issuer due under the Guaranteed Bonds or any gross-up or make whole payment payable by the Issuer in respect of any such taxes, withholding, deduction, assessment or other charge;

(iii) attributable to any default interest;

(iv) attributable to any amount relating to prepayment, early redemption, broken-funding indemnities, penalties, premium, "spens", any make-whole amount or similar types of payments payable in respect of the Guaranteed Bonds; or

(v) in respect of which the Financial Guarantor or AGE has made an Accelerated Payment on or prior to such Scheduled Payment Date.

"**Guaranteed Bondholder**" means a holder of Guaranteed Bonds.

"**Guaranteed Bonds**" means the £101,833,000 5.069 per cent. Fixed Rate Guaranteed Secured Bonds due September 2032 issued by the Issuer but excluding any such bonds that are held by or for the account of any Person included in the Issuer Group.

"**HoldCo**" means Sustainable Communities For Leeds (Holdings) Limited, a company incorporated in England and Wales under registered number 08319372.

"**Insolvency Proceedings**" means the commencement after the date hereof of any bankruptcy, insolvency or similar proceedings by or against the Issuer, or the commencement after the date hereof of any proceedings by or against the Issuer for the winding up or the liquidation of its affairs, or the consent after the date hereof to the appointment of a trustee-in-bankruptcy, conservator, administrator, receiver or liquidator in any bankruptcy, insolvency or similar proceedings relating to the Issuer.

"**Issuer**" means Sustainable Communities for Leeds (Finance) PLC, a company incorporated in England and Wales under registered number 08594721.

"**Issuer Group**" has the meaning given to it in Condition 2.9.

"**Moody's**" means Moody's Investors Service, Inc.

"**Non-payment by the Issuer**" means, with respect to a Guaranteed Amount at a time when such Guaranteed Amount is Due for Payment, that the funds, if any, remitted to any Agent or the Bond Trustee under the terms of the Guaranteed Bonds or the Bond Trust Deed for payment to Guaranteed Bondholders are insufficient for payment in full of such Guaranteed Amount. In addition to and without limiting the foregoing, "Non-payment by the Issuer" applies to any portion of any Guaranteed Amount that has become an Avoided Payment.

"**Notice of Demand**" means a notice of demand in the form of the Annex hereto.

"**Obligors**" means the Issuer, ProjectCo and HoldCo.

"**Order**" means a final, non-appealable order of a court or other body exercising jurisdiction in an Insolvency Proceeding by or against the Issuer, to the effect that the Bond Trustee, any Agent or any Guaranteed Bondholder is required to return or repay all or any portion of an Avoided Payment.

"Paying Agents" means the paying agents identified in the Paying Agency Agreement.

"**ProjectCo**" means Sustainable Communities For Leeds Limited, a company incorporated in England and Wales under registered number 08320624.

"**Rating Agencies**" means Moody's and S&P and such rating agencies as may be substituted for either such rating agency from time to time in accordance with the provisions of the Bond Trust Deed with the prior written consent of AGE and the Financial Guarantor.

"**Receipt**" and "**Received**" shall mean actual delivery to the Financial Guarantor prior to 12:00 noon, London time, on a Business Day; provided, however, that delivery either on a day that is not a Business Day, or after 12:00 noon, London time, on a Business Day, shall be deemed to be "**Received**" on the next succeeding Business Day. For purposes of this definition, "**actual delivery**" to the Financial Guarantor shall mean (i) the delivery of the original Notice of Demand, notice or other applicable documentation to the Financial Guarantor's address for notices in accordance with Clause 11 (*Notices*); or (ii) fax transmission of the original Notice of Demand, notice or other applicable documentation to the Financial Guarantor's fax number for notices in accordance with Clause 11 (*Notices*). If presentation is made by fax transmission, the Bond Trustee (a) shall promptly confirm transmission by telephone to the Financial Guarantor at its telephone number referred to in Clause 11 (*Notices*), and (b) as soon as is reasonably practicable, shall deliver the original Notice of Demand, notice or other applicable documentation to the Financial Guarantor's address for notices in accordance with Clause 11 (*Notices*). If any Notice of Demand, notice or other documentation actually delivered (or attempted to be delivered) under the Financial Guarantee by the Bond Trustee is not in proper form or is not properly completed, executed or delivered, "**Receipt**" by the Financial Guarantor shall be deemed not to have occurred, and the Financial Guarantor shall so advise the Bond Trustee of such deficiency and the nature of the deficiency within one Business Day of receipt of such deficient Notice of Demand. In such case, the Bond Trustee may submit an amended or corrected Notice of Demand, notice or other documentation, as the case may be, to the Financial Guarantor.

"**Recovery**" has the meaning set out in Clause 3.2 (*Payments by the Financial Guarantor*).

"**S&P**" means Standard and Poor's Ratings Services.

"**Scheduled Interest**" means, in respect of a Scheduled Payment Date, the amount of scheduled interest on the Guaranteed Bonds then payable in accordance with the original terms of the relevant Conditions without regard to any amendment or modification of such terms other than any amendment or modification of such terms made in accordance with the provisions of the Bond Trust Deed with the prior written consent of AGE and the Financial Guarantor, after giving effect to each amount of principal repaid or prepaid by the Issuer pursuant to the relevant Conditions or otherwise paid following enforcement of the Collateral in accordance with Condition 14 (*Exercise and Enforcement*).

"**Scheduled Payment Date**" has the meaning given to it in the Conditions.

"**Scheduled Principal**" means, in respect of a Scheduled Payment Date, the amount of scheduled principal payable on the Guaranteed Bonds on such Scheduled Payment Date in accordance with Condition 7.1 (*Scheduled Payments*), in accordance with the original terms of the Conditions without regard to any amendment or modification of such terms other than any amendment or modification of such terms made in accordance with the provisions of the Bond

Trust Deed with the prior written consent of AGE and the Financial Guarantor, as reduced by each amount of principal repaid or prepaid by the Issuer pursuant to the relevant Conditions or otherwise paid following enforcement of the Collateral in accordance with Condition 14 (*Exercise and Enforcement*).

"**Security Trust and Intercreditor Deed**" means the security trust and intercreditor deed made on or about the date hereof between the Obligors, the other Sponsor Creditors (as defined in that agreement), the Security Trustee, the Bond Trustee, AGE and the Financial Guarantor, without regard to any amendment, modification or supplement thereto other than any such amendment, modification or supplement made in accordance with the provisions of such security trust and intercreditor deed with the prior written consent of AGE and the Financial Guarantor.

"**Security Trustee**" means BNY Mellon Corporate Trustee Services Limited, a company, incorporated with registered number 02631386 under the laws of England and Wales and having its registered office at 1 Canada Square, London E14 5AL, or any other Person(s) for the time being the trustee or trustees under the Security Trust and Intercreditor Deed for itself and as trustee for the beneficiaries under the Security Trust and Intercreditor Deed.

"**Term of the Financial Guarantee**" means the period from and including the date hereof to and including the earlier of:

(A) the termination of the Financial Guarantee in accordance with Condition 2.3 (*Termination of the Financial Guarantees*); and

(B) the last to occur of the following:

(i) the date on which all Guaranteed Amounts have been paid under the Guaranteed Bonds;

(ii) the date on which any period during which any Guaranteed Amount could have become, in whole or in part, an Avoided Payment has expired; and

(iii) if the Issuer becomes subject to any Insolvency Proceedings before the occurrence of (i) and (ii), the later of (a) the date of the conclusion or dismissal of the Insolvency Proceedings without continuing jurisdiction by the court in such Insolvency Proceedings and (b) if the Bond Trustee or any Guaranteed Bondholder is required to return any payment (or portion thereof) in respect of a Guaranteed Amount that is avoided as a result of such Insolvency Proceedings, the date on which the Financial Guarantor has made all payments required to be made under this Financial Guarantee to or to the order of the Bond Trustee in respect of all such Avoided Payments.

1.2 Construction

In this Financial Guarantee, a reference to:

1.2.1 a statutory provision includes a reference to the statutory provision as modified or re-enacted or both from time to time whether before or after the date of this Financial Guarantee and any subordinate legislation made or other thing done under the statutory provision whether before or after the date of this Financial Guarantee;

1.2.2 the singular includes the plural and vice versa (unless the context otherwise requires);

1.2.3 a time of day is a reference to the time in London, unless a contrary indication appears;

1.2.4 each reference to "Clause" or to "Annex", unless the context otherwise requires, is a reference to a clause of or an annex to this Financial Guarantee;

1.2.5 a "**Person**" includes any individual, company, corporation, unincorporated association or body (including a partnership, trust, joint venture or consortium), government, state, agency, organisation or other entity whether or not having separate legal personality; and

1.2.6 a provision of law is a reference to that provision as extended, applied, amended or re-enacted and includes any subordinate legislation.

1.3 Headings

The headings in this Financial Guarantee do not affect its construction or interpretation.

2 Guarantee

2.1 In consideration of the payment by the Issuer of the Financial Guarantee Fee and subject to the terms of this Financial Guarantee, the Financial Guarantor unconditionally and irrevocably guarantees to the Bond Trustee during the Term of the Financial Guarantee the full and complete payment of:

2.1.1 the AGM Proportion of:

(a) Guaranteed Amounts that are Due for Payment but are unpaid by reason of Non-payment by the Issuer, and

(b) Avoided Payments; and

2.1.2 the AGE Proportion of:

(a) Guaranteed Amounts that are Due for Payment but are unpaid by reason of Non-payment by the Issuer to the extent that AGE has not paid such amounts when due and payable by AGE under the terms of the AGE Financial Guarantee, and

(b) Avoided Payments to the extent that AGE has not paid such amounts when due and payable by AGE under the terms of the AGE Financial Guarantee,

and any payment by the Financial Guarantor under Clause 2.1.2 shall constitute a discharge of AGE's obligation to make such payment under the AGE Financial Guarantee.

2.2 This Financial Guarantee does not guarantee any prepayment or other accelerated payment which at any time may become due in respect of any Guaranteed Amount, other than at the sole option of the Financial Guarantor as specified in Clause 4 (*Acceleration*) of this Financial Guarantee, nor against any risk other than Non-payment by the Issuer, including failure of the Bond Trustee or any Agent to make any payment due to the Guaranteed Bondholders or any diminution in the market or fair value of the Guaranteed Bonds.

3 Payments by the Financial Guarantor

3.1 Following Receipt by the Financial Guarantor of a Notice of Demand in accordance with Clause 8 (*Notice of Demand*) from the Bond Trustee for any Defaulted Amount, the Financial Guarantor will, subject to Clause 7.5, pay:

3.1.1 the AGM Proportion of the Defaulted Amount to the Bond Trustee by no later than 10:00 a.m., London time, on the later of:

(a) the date such Defaulted Amount becomes Due for Payment; and

(b) the fourth Business Day following the day on which the Financial Guarantor Received such Notice of Demand; and

3.1.2 if:

(a) the Bond Trustee has made a claim against AGE under the AGE Financial Guarantee by delivering a Notice of Demand that has been Received (as defined in the AGE Financial Guarantee) by AGE;

(b) such claim has not been paid by AGE in accordance with the terms of the AGE Financial Guarantee;

(c) the AGE Financial Guarantee has not been terminated; and

(d) the Financial Guarantor has Received notice from the Bond Trustee that AGE has failed to pay such claim,

the AGE Proportion of the Defaulted Amount to the Bond Trustee no later than the Business Day following the day on which such amount was due and payable by AGE in accordance with the terms of the AGE Financial Guarantee.

3.2 In the event that any amount shall be received by the Bond Trustee or the Bond Trustee has actual notice that any Guaranteed Bondholder has received any amount in respect of a Defaulted Amount forming the basis of a claim specified in a Notice of Demand submitted hereunder, which amount had not been received by the Bond Trustee, or which the Bond Trustee did not have actual notice had been received by a Guaranteed Bondholder when the Notice of Demand was prepared but which is received by the Bond Trustee or the Bond Trustee has actual notice has been received by such Guaranteed Bondholder prior to the receipt of payment from the Financial Guarantor as contemplated by this Financial Guarantee (each such amount, a "**Recovery**"), the Bond Trustee shall promptly so notify the Financial Guarantor (which notice shall include the amount of any such Recovery). The fact that a Recovery has been received by the Bond Trustee or the Bond Trustee has actual notice has been received by such Guaranteed Bondholder shall be deemed to be incorporated in the applicable Notice of Demand as of the date such Notice of Demand was originally prepared, without the need for any further action by any Person, and the Financial Guarantor shall pay the amount of the claim against the Financial Guarantor specified in paragraph (ii) of the Notice of Demand less the sum of the AGM Proportion of all such Recoveries or, in the case of any payment by the Financial Guarantor under Clause 2.1.2, the claim against AGE specified in paragraph (ii) of the Notice of Demand less the sum of the AGE Proportion of all such Recoveries.

3.3 The Financial Guarantor shall be entitled to elect, in its absolute discretion, to pay part or all of any Defaulted Amount to such bank account as is specified by the Bond Trustee without the need for the Financial Guarantor to have Received, and irrespective of whether the Financial Guarantor shall have Received, a Notice of Demand therefor. Any such payment shall be considered a payment by the Financial Guarantor under this Financial Guarantee for all purposes. If requested by the Financial Guarantor, the Bond Trustee shall promptly deliver to the Financial Guarantor a properly completed and executed Notice of Demand in respect of any such payment made or to be made by the Financial Guarantor.

3.4 Payments due hereunder in respect of Guaranteed Amounts will be disbursed to or to the order of the Bond Trustee and credited (in immediately available funds) to the bank account (the "**Account**") specified by the Bond Trustee in the applicable Notice of Demand or pursuant to Clause 3.3 or Clause 4.2. Payment in full to the Account shall discharge the obligations of the Financial Guarantor under this Financial Guarantee to the extent of such payment, whether or not such payment is properly applied by or on behalf of the Bond Trustee or any Agent.

3.5 Once payment by or on behalf of the Financial Guarantor of an amount in respect of any Guaranteed Amount (whether on a Scheduled Payment Date or on an accelerated basis pursuant to Clause 4.2) has been made to the Account, the Financial Guarantor shall have no further obligations under this Financial Guarantee in respect of such Guaranteed Amount to the extent of such payment.

4 Acceleration

4.1 At any time or from time to time following Acceleration, the Financial Guarantor may decide, in its absolute discretion, to make an Accelerated Payment under this Financial Guarantee without the need for the Financial Guarantor to have Received, and irrespective of whether the Financial Guarantor shall have Received, a Notice of Demand.

4.2 The Financial Guarantor shall notify the Bond Trustee in writing of its intention to make any Accelerated Payment and the proposed date of such payment, no later than two Business Days prior to such proposed date of payment. Any such Accelerated Payment shall be considered a payment by the Financial Guarantor under this Financial Guarantee for all purposes. If so requested by the Financial Guarantor at the time the Financial Guarantor gives such written notice, the Bond Trustee shall deliver to the Financial Guarantor a corresponding Notice of Demand.

5 Withholding Tax

All payments by the Financial Guarantor to or to the order of the Bond Trustee under this Financial Guarantee shall be made without withholding or deduction for, or on account of, any taxes, duties, assessments or other governmental charges of whatever nature imposed, levied, collected, withheld or assessed by any sovereign state, or any political subdivision or governmental or taxing authority therein or thereof unless such withholding or deduction is required by law. If any withholding or deduction is so required by law, the Financial Guarantor shall pay such amounts net of such withholding or deduction and shall account to the appropriate tax authority for the amount required to be withheld or deducted. If the Financial Guarantor makes any such withholding or deduction, it shall promptly notify the Bond Trustee and promptly forward to the Bond Trustee any official receipt or other evidence of payment that the Financial Guarantor has received in connection with such payment. The Financial Guarantor shall not be obliged to pay any amount to or to the order of the Bond Trustee in respect of the amount of such withholding or deduction.

6 Subrogation

6.1 The Financial Guarantor will be fully, immediately and automatically subrogated to the Guaranteed Bondholders' and the Bond Trustee's rights to payment of any Guaranteed Amounts paid by or on behalf of the Financial Guarantor, and to any rights relating thereto, to the fullest extent permitted by applicable law to the extent and at the time any such payments are made by or on behalf of the Financial Guarantor under this Financial Guarantee, including, for the avoidance of doubt, any Accelerated Payment.

6.2 Any payment made by or on behalf of the Issuer to or for the benefit of the Bond Trustee or any Guaranteed Bondholder in respect of any Guaranteed Amount paid by or on behalf of the Financial Guarantor hereunder (and a corresponding claim under this Financial Guarantee and/or the AGE Financial Guarantee, which claims shall have been paid in full by the Financial Guarantor and AGE respectively) shall be received and held on trust by the recipient for the benefit of the Financial Guarantor and AGE and shall be paid by the recipient over to the Financial Guarantor and AGE *pro rata* in proportion to the respective amounts paid:

(a) by the Financial Guarantor in respect of a claim made pursuant to this Financial Guarantee, and

(b) by AGE in respect of the related claim made pursuant to the AGE Financial Guarantee.

6.3 The Bond Trustee shall cooperate in all reasonable respects, and at the expense of the Financial Guarantor, with any request by the Financial Guarantor for action necessary to preserve or enforce the Financial Guarantor's rights and remedies, any related security arrangements or otherwise in relation to such subrogation including, without limitation, any request to assign to the Financial Guarantor the Bond Trustee's rights in respect of any Guaranteed Amount which has been paid by the Financial Guarantor.

7 Waiver of Defences

7.1 The obligations of the Financial Guarantor under this Financial Guarantee will continue and will not be terminable other than in accordance with Clause 12 (*Termination and Amendment*) of this Financial Guarantee notwithstanding failure to receive payment of the Financial Guarantee Fee or any other amount due in respect of this Financial Guarantee. The Financial Guarantee Fee is not refundable for any reason.

7.2 The Financial Guarantor acknowledges that there is no duty of disclosure by the Bond Trustee under this Financial Guarantee but nonetheless, to the fullest extent permitted by applicable law, hereby waives for the benefit of the Bond Trustee and the Guaranteed Bondholders and agrees not to assert any and all rights (whether by counterclaim, rescission, set-off or otherwise) and any and all equities and defences howsoever arising (including, without limitation, any right, equity or defence based on: (a) any right to require the Bond Trustee or any Guaranteed Bondholder first to proceed against or to enforce any other rights or security against, or to claim payment from, any Person (except in the case only of the guarantee set out in Clause 2.1.2, to the extent of the conditions set out in Clause 3.1.2) before the Bond Trustee may claim from the Financial Guarantor under this Financial Guarantee; (b) fraud on the part of any Person (including fraud on the part of any agent for the Bond Trustee, but excluding fraud by the Bond Trustee itself); (c) misrepresentation, breach of warranty or non-disclosure of information by any Person; (d) any lack of validity or enforceability of the Guaranteed Bonds or the Bond Trust Deed; (e) any modification or any amendment to the Guaranteed Bonds or the Bond Trust Deed; (f) the granting of any time, indulgence or concession by any Person to the Issuer; (g) any insolvency or similar proceedings in respect of the Issuer or any other Person; (h) any lack of capacity, power or authority or any change in status of the Issuer or any other Person; or (i) the refusal or failure to take up, to hold, to perfect or to enforce by any Person any rights under or in connection with any guarantee (except in the case only of the guarantee set out in Clause 2.1.2, to the extent of the conditions set out in Clause 3.1.2), indemnity, security or other document) to the extent such rights, equities and defences may be available to the Financial Guarantor to avoid payment of its obligations under this Financial Guarantee in accordance with the express provisions hereof.

7.3 No warranties are given and nothing in this Financial Guarantee is intended to constitute a warranty or a condition precedent to payment under the Financial Guarantee other than Receipt of a Notice of Demand in accordance with Clause 8 (*Notice of Demand*) of this Financial Guarantee and, in the case only of the guarantee set out in Clause 2.1.2, the conditions set out in Clause 3.1.2.

7.4 Nothing in this Financial Guarantee shall be construed in any way to limit or otherwise affect the Financial Guarantor's right to pursue recovery or claims (based on contractual or other rights, including such rights resulting from the Bond Trustee's or such other Person's fraud, negligence or breach of any agreement to which it is a party) for reimbursement against any Persons for any liabilities, losses, damages, costs and expenses incurred by the Financial Guarantor or to exercise at any time any other remedies that may be available to the Financial Guarantor at law or in equity.

7.5 Nothing in this Financial Guarantee shall be construed to require payment by the Financial Guarantor so long as a Force Majeure Event is continuing, in which event the Financial Guarantor agrees to perform its obligations under this Financial Guarantee promptly following cessation of such Force Majeure Event.

8 Notice of Demand

8.1 Subject to Clauses 2.2, 3.3 and 4 of this Financial Guarantee, payments of Guaranteed Amounts (including Avoided Payments) will only be made after presentation of a properly completed Notice of Demand signed by the Bond Trustee and Received by the Financial Guarantor.

8.2 Notices of Demand can only be given by the Bond Trustee in the manner set out in Clause 11 (*Notices*).

8.3 Without limitation to the Financial Guarantor's obligations under Clause 8.5, if any Notice of Demand is not in the proper form or is not properly completed, executed or delivered, the Financial Guarantor will not be deemed to have Received such Notice of Demand.

8.4 Any Notice of Demand in respect of an Avoided Payment will not be deemed properly completed unless it is accompanied by:

8.4.1 a copy of the Order;

8.4.2 a certificate of the Bond Trustee that the Order has been entered and is not subject to any stay and specifying the Guaranteed Amounts that are Avoided Payments; and

8.4.3 an assignment duly executed by the Bond Trustee, irrevocably assigning to the Financial Guarantor and AGE all rights and claims of the Bond Trustee relating to or arising out of such Avoided Payments against the estate of the Issuer or otherwise.

8.5 The Financial Guarantor will advise the Bond Trustee if a Notice of Demand is not in the proper form or has not been properly completed, executed or delivered within one Business Day of receipt of such deficient Notice of Demand and the Bond Trustee may submit an amended Notice of Demand to the Financial Guarantor.

9 Fiscal Agent

9.1 At any time during the Term of the Financial Guarantee, the Financial Guarantor may appoint a fiscal agent situated in the United Kingdom (the "**Fiscal Agent**") for purposes of this Financial Guarantee by written notice to the Bond Trustee, specifying the name and notice address of such Fiscal Agent. From and after the date of receipt of such notice by the Bond Trustee:

9.1.1 copies of all notices (including Notices of Demand) and other documents required to be delivered to the Financial Guarantor pursuant to this Financial Guarantee shall be simultaneously delivered to the Fiscal Agent and to the Financial Guarantor; and

9.1.2 all payments required to be made by the Financial Guarantor under this Financial Guarantee may be made directly by the Financial Guarantor or by the Fiscal Agent on behalf of the Financial Guarantor.

9.2 The Fiscal Agent is the agent of the Financial Guarantor only, and the Fiscal Agent shall in no event be liable to the Bond Trustee for any acts of the Fiscal Agent or any failure of the Financial Guarantor to deposit, or cause to be deposited, sufficient funds to make payments due under this Financial Guarantee.

10 Transfer

10.1 The rights and obligations of the Financial Guarantor under this Financial Guarantee may be assigned or transferred to or assumed by any affiliate of the Financial Guarantor provided that:

10.1.1 no Financial Guarantor Default has occurred and is continuing at the time of such assignment, transfer or assumption or would occur as a result of such assignment, transfer or assumption;

10.1.2 the Financial Guarantor or such assignee, transferee or party assuming such rights and obligations delivers to the Bond Trustee written confirmation from the

Rating Agencies that, at the time of and immediately following any such assignment, transfer or assumption, the financial strength or claims paying ability of such affiliate will be rated at least equal to the financial strength or claims paying ability of the Financial Guarantor at that time;

10.1.3 the Financial Guarantor or such assignee, transferee or party assuming such rights and obligations thereafter delivers to the Bond Trustee written notice of any such assignment, transfer or assumption;

10.1.4 such transferee assumes the obligations of the Financial Guarantor under this Financial Guarantee and accedes to the relevant Finance Documents; and

10.1.5 the location of the transferee does not result in any withholding or deduction for any taxes, duties, assessments, or other governmental charges of whatever nature in respect of any payment by such transferee hereunder, which withholding or deduction is not at the time of the relevant transfer applicable to any such payment by the Financial Guarantor hereunder, and does not otherwise prevent payment being made or result in any deduction being made in respect of any Guaranteed Amount.

10.2 The Bond Trustee may not transfer, assign, sub-participate, declare a trust over or otherwise dispose (other than in favour of the Guaranteed Bondholders) of any of its rights under this Financial Guarantee except to a Person as to whom the Financial Guarantor has given its prior written consent. However, if the Bond Trustee transfers or assigns its rights and obligations under the Bond Trust Deed to a new or additional trustee which has been appointed in accordance with the Bond Trust Deed, no such consent shall be required and such new or additional trustee will be able to enforce this Financial Guarantee and references in this Financial Guarantee to "Bond Trustee" shall be construed as including such new trustee or such additional trustee, as applicable.

11 Notices

11.1 All notices given under this Financial Guarantee shall be in writing (except as otherwise specifically provided herein) and shall be mailed by registered mail or personally delivered or faxed as follows:

To the Financial Guarantor:

Assured Guaranty Municipal Corp.
31 W. 52nd Street
New York, NY 10019

Re:	Leeds Social Housing PFI Project
Telephone:	+ 1 212 974 0100
Fax:	+ 1 212 581 3268

with a copy to the General Counsel at the above address and fax number. Each Notice of Demand shall be marked to indicate "URGENT MATERIAL ENCLOSED".

To the Bond Trustee:

BNY Mellon Corporate Trustee Services Limited
1 Canada Square
London E14 5AL

Attention:	Sustainable Communities for Leeds (Finance) plc – Trustee Administration Manager
Fax:	+44 20 7964 4637

If presentation to the Bond Trustee is made by fax transmission, the Financial Guarantor shall, as soon as is reasonably practicable, deliver the original notice or other applicable documentation to the Bond Trustee's address for notices in accordance with this Clause 11 (*Notices*).

11.2 The Financial Guarantor or the Bond Trustee may designate an additional or different address, or telephone or fax number, by prior written notice. Each notice, presentation, delivery and communication to the Financial Guarantor or the Bond Trustee shall be effective only upon Receipt by the Financial Guarantor or actual receipt by the Bond Trustee, as the case may be.

12 Termination and Amendment

12.1 This Financial Guarantee is not cancellable by the Financial Guarantor for any reason, including, without limitation, the failure of the Financial Guarantor to receive payment of any Financial Guarantee Fee due in respect of this Financial Guarantee.

12.2 This Financial Guarantee and the obligations of the Financial Guarantor hereunder shall terminate upon the expiration of the Term of the Financial Guarantee.

12.3 This Financial Guarantee may not be amended, modified or supplemented without the prior written consent of the Bond Trustee.

13 Miscellaneous

No waiver of any rights or powers of the Financial Guarantor or the Bond Trustee, or any consent by either of them, shall be valid unless in writing and signed by an authorised officer or agent of the Financial Guarantor or the Bond Trustee, as applicable. The waiver of any right by the Financial Guarantor or the Bond Trustee, or the failure promptly to exercise any such right, shall not be construed as a waiver of any right to exercise the same or any other right at any time thereafter.

14 Redenomination

The obligations of the Financial Guarantor under this Financial Guarantee shall not be affected by any redenomination of the Guaranteed Bonds into Euro pursuant to Condition 16 (*European Economic and Monetary Union*), save that following such redenomination, payments of Guaranteed Amounts hereunder shall be made in Euro.

15 Law and Jurisdiction

15.1 This Financial Guarantee, and any non-contractual obligations arising out of or in connection with it, shall be governed by, and construed in accordance with, the laws of England and Wales.

15.2 With respect to any suit, action or proceedings relating to this Financial Guarantee ("**Proceedings**"), each of the Financial Guarantor and the Bond Trustee irrevocably submits to the jurisdiction of the English courts and waives any objection which it may have at any time to the laying of venue of any Proceedings brought in any such court, waives any claim that such Proceedings have been brought in an inconvenient forum and further waives the right to object, with respect to such Proceedings that such court does not have any jurisdiction over such party.

16 Entire Agreement

This Financial Guarantee constitutes the entire agreement between the Financial Guarantor and the Bond Trustee in relation to the Financial Guarantor's obligation to make payments to the Bond Trustee for the benefit of the Guaranteed Bondholders in respect of the Guaranteed Amounts which become Due for Payment but shall be unpaid by reason of Non-payment by the

Issuer, and supersedes any previous agreement between the Financial Guarantor and the Bond Trustee in relation thereto.

17 Third Party Rights

No Person other than the Bond Trustee shall have rights under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Financial Guarantee but this shall not affect any such right any Person may have otherwise than by virtue of such Act.

18 THIS POLICY IS NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.

19 Surrender of Financial Guarantee

The Bond Trustee shall deliver its original engrossment of this Financial Guarantee to the Financial Guarantor upon expiration of the Term of this Financial Guarantee.

In Witness Whereof, this Financial Guarantee has been executed as a deed and delivered on the date inserted above.

EXECUTED as a DEED for and on behalf of
ASSURED GUARANTY MUNICIPAL CORP. by:

Authorised signatory

ANNEX
NOTICE OF DEMAND

Assured Guaranty (Europe) Ltd.
1 Finsbury Square
London EC2A 1AE

Assured Guaranty Municipal Corp.
31 W. 52nd Street
New York, NY 10019

Attention:

Chief Surveillance Officer

and

General Counsel

The undersigned, duly authorised officers of BNY Mellon Corporate Trustee Services Limited, a company, incorporated with registered number 02631386 under the laws of England and Wales and having its registered office at 1 Canada Square, London E14 5AL in its capacity as bond trustee for the holders of the Guaranteed Bonds (the "**Bond Trustee**"), hereby certify to each of Assured Guaranty (Europe) Ltd. ("**AGE**") and Assured Guaranty Municipal Corp. ("**AGM**" and, together with AGE, the "**Financial Guarantors**") with reference to Financial Guarantee No. 80169-U (the "**AGE Financial Guarantee**") and Financial Guarantee No. 51911-N (the "**AGM Financial Guarantee**" and, together with the AGE Financial Guarantee, the "**Financial Guarantees**") that:

(i) [The Guaranteed Amount[s] that [is/are] due and payable on the Scheduled Payment Date falling on [*insert applicable payment date*] [is/are] [●][*insert applicable amount*]./The Guaranteed Amount[s] that [was/were] paid, credited, transferred or delivered to or to the order of the Bond Trustee or the Guaranteed Bondholders by or on behalf of the Issuer in accordance with the terms of the Bond Trust Deed and/or the Guaranteed Bonds on [*insert applicable payment date*] of [●][*insert applicable amount*] [was/were] recovered from, or was otherwise required to be returned or repaid by, the Bond Trustee or [a/the] Guaranteed Bondholder[s] as a result of Insolvency Proceedings by or against the Issuer on [*insert applicable repayment date*].]

(ii) [The deficiency with respect to the Guaranteed Amount Due for Payment and unpaid by reason of Non-payment by the Issuer on the Scheduled Payment Date falling on [*insert applicable payment date*] is [●][*insert applicable amount*] (the "**Defaulted Amount**"), the AGE Proportion of such Defaulted Amount is [●] and the AGM Proportion of such Defaulted Amount is [●]]/[The Bond Trustee has been notified by the Account Bank that the deficiency in respect of the Guaranteed Amount[s] which [is/are] Due for Payment on the Scheduled Payment Date falling on [*insert applicable payment date*] will be [●] [*insert applicable amount*] (the "**Defaulted Amount**"). The AGE Proportion of such Defaulted Amount is [●] and the AGM Proportion of such Defaulted Amount is [●]].

(iii) The Bond Trustee is making (a) a claim against AGE under the AGE Financial Guarantee for the AGE Proportion of the Defaulted Amount, and (b) a claim against AGM under the AGM Financial Guarantee for the AGM Proportion of the Defaulted Amount, with each such amount to be applied to the payment of the above-described Guaranteed Amount[s].

(iv) To the extent that AGE does not pay the AGE Proportion of any Defaulted Amount when due and payable by AGE in accordance with the terms of the AGE Financial Guarantee, the Bond Trustee is making a claim against AGM under Clause 3.1.2 of the AGM Financial Guarantee for such amount. The Bond Trustee agrees that any payment by AGM of such amount shall discharge AGE from any obligation to make such payment under the AGE Financial Guarantee.

(v) The Bond Trustee agrees that following any payment by the Financial Guarantors made with respect to the Defaulted Amount which is the subject of this Notice of Demand, it (a) will cause such amounts to be applied directly to the payment of the applicable Guaranteed Amount[s]; (b) will ensure that such funds are not applied for any other purpose; and (c) will cause an accurate record of such payment to be maintained with respect to the appropriate Guaranteed Amount(s), the corresponding claim on each Financial Guarantee, and the proceeds of such claim.

(vi) Payments should be made by credit to the following account:

[*(insert details of bank account)*] (the "**Account**").

Capitalised terms used in this Notice of Demand and not otherwise defined herein shall have the respective meanings ascribed thereto in or pursuant to the applicable Financial Guarantee.

This Notice of Demand may be revoked at any time by written notice of such revocation by the Bond Trustee to each Financial Guarantor, if and only to the extent that moneys are actually received by the Bond Trustee prior to any such revocation from a source other than the Financial Guarantors with respect to the Defaulted Amount set forth herein. The Bond Trustee will withdraw this Notice of Demand, or submit a restated Notice of Demand reducing the amount of the claim hereunder, if the required amount of the Defaulted Amount and accordingly each of the AGE Proportion and the AGM Proportion thereof has been reduced (including reduction to zero) on or prior to the date the Financial Guarantors are required to make payment under the Financial Guarantees.

If the Bond Trustee has received, or the Bond Trustee has actual notice that one or more Guaranteed Bondholders has received, from the Issuer or the Financial Guarantors an amount in excess of a Defaulted Amount, the Bond Trustee shall immediately return to each Financial Guarantor the lesser of (i) such Financial Guarantor's proportionate share in such excess amount (such share being calculated by a fraction equal to the amount of the Defaulted Amount paid by the relevant Financial Guarantor to or to the order of the Bond Trustee divided by the total Defaulted Amount paid by both Financial Guarantors to or to the order of the Bond Trustee) and (ii) the amount of the Defaulted Amount paid by the relevant Financial Guarantor to or to the order of the Bond Trustee and not previously distributed by the Bond Trustee to the Guaranteed Bondholders or to any insolvency official appointed in respect of the Issuer. For the avoidance of doubt the Bond Trustee shall only be required to repay any such amounts to the Financial Guarantors that are in the Bond Trustee's possession and under its control, at the time it becomes aware of the requirement to repay such amounts, and the Bond Trustee shall have no liability to any Person for any amounts received by the Bond Trustee from the Financial Guarantors but distributed by the Bond Trustee in accordance with the preceding sentence.

The Bond Trustee acknowledges that as of the date on which any payment by the relevant Financial Guarantor towards a Defaulted Amount is credited to the Account, the relevant Financial Guarantor shall be deemed fully, immediately and automatically subrogated, to the fullest extent permitted by applicable law, to the rights (including, without limitation, any rights and benefits attached thereto, and any security granted at law, by contract or otherwise) of the Guaranteed Bondholders to payment of the Guaranteed Amounts paid by the relevant Financial Guarantor at the time of such payment by the relevant Financial Guarantor towards the Defaulted Amount.

The Bond Trustee hereby (i) assigns to each Financial Guarantor its rights to receive any payment for the account of the Guaranteed Bondholders from the Issuer in respect of the Guaranteed Bonds to the extent of any payments made to (or to the order of) the Bond Trustee by the relevant Financial Guarantor under the applicable Financial Guarantee, including without limitation its right to receive payments of principal and interest on the Guaranteed Bonds (including Recoveries) and, without limitation to the foregoing, any amounts due to the Bond Trustee in respect of securities law violations arising from the offer or sale of the Guaranteed Bonds and (ii) confirms that it has taken all steps reasonably requested by the Financial Guarantor and necessary to effect and perfect such assignments to the Financial Guarantors. Furthermore, the Bond Trustee agrees that it shall exercise or refrain from exercising its voting rights or similar rights and all rights to take legal or other action against the Issuer or any other Person in such manner as either Financial Guarantor may direct. The Bond Trustee further agrees that at either Financial Guarantor's request it shall appoint each Financial Guarantor to act severally as the Bond Trustee's agent in relation to such legal or other action against the Issuer or with respect to its voting or similar right. The foregoing assignments are in addition to, and not in limitation of, rights of subrogation otherwise available to each Financial Guarantor in respect of such payments. Payments to each Financial Guarantor in respect of the foregoing assignment shall in all cases be subject to and subordinate to the rights of the Bond Trustee and the Guaranteed Bondholders to receive all Guaranteed Amounts in respect of the Guaranteed Bonds. The Bond Trustee shall cooperate in all reasonable respects, and at the expense of the Financial Guarantors, with any request by either Financial Guarantor for action necessary to preserve or enforce such Financial Guarantor's rights and remedies, any related security arrangements or otherwise in relation to such subrogation including, without limitation, any request to assign to such Financial Guarantor the Bond Trustee's rights in respect of any Guaranteed Amount which has been paid by the Financial Guarantor, or take such action and deliver such instruments as may be reasonably requested or required by the Financial Guarantor to effectuate the purpose or provisions of this paragraph.

Any payment made by or on behalf of the Issuer to or for the benefit of the Bond Trustee in respect of any Guaranteed Amount forming the basis of a claim hereunder (which claim shall have been paid in full by the Financial Guarantors) shall be received and held on trust for the benefit of the Financial Guarantors and shall be paid over to each Financial Guarantor *pro rata* in proportion to the respective amounts each Financial Guarantor paid in respect of the Defaulted Amount.

The Bond Trustee hereby agrees that so long as no Financial Guarantor Default shall have occurred and be continuing, each Financial Guarantor may at any time during the continuation of any Insolvency Proceeding by or against the Issuer under any applicable law direct all matters relating thereto, including without limitation, (a) all matters relating to any claim in connection with an Insolvency Proceeding by or against the Issuer seeking the avoidance as a preferential transfer of any payment made with respect to the Guaranteed Bonds (a "**Preference Claim**"); (b) the direction of any appeal of any order relating to any Preference Claim at the expense of the Financial Guarantors; and (c) the posting of any surety or performance bond pending any such appeal.

[Pursuant to Clause 8.4 of the Financial Guarantee, the following documents are attached:

- a copy of the Order;
- a certificate of the Bond Trustee that the Order has been entered and is not subject to any stay and specifying the Guaranteed Amounts that are Avoided Payments; and
- an assignment duly executed by the Bond Trustee, irrevocably assigning to the Financial Guarantor and AGM all rights and claims of the Bond Trustee relating to or arising out of such Avoided Payments against the estate of the Issuer or otherwise*.

* To be inserted if demand relates to Avoided Payments.]

This Notice of Demand, and any non-contractual obligations arising out of or in connection with it, shall be governed by, and construed in accordance with, the laws of England and Wales.

No Person, other than each Financial Guarantor, shall have any right under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Notice of Demand but this shall not affect any such right any Person may have otherwise than by virtue of such Act.

In Witness Whereof, the undersigned has executed and delivered this Notice of Demand as a deed on the __ day of _________ of 2__.

Title:

Authorised Signatory

For the Financial Guarantor or
Fiscal Agent Use Only
Wire transfer sent on By:
Confirmation Number:

DESCRIPTION OF THE FINANCIAL GUARANTORS

The information appearing in this section has been prepared by the Financial Guarantors and has not been independently verified by the Issuer or the Lead Manager. Neither the Issuer nor the Lead Manager assumes any responsibility for the accuracy, completeness or applicability of such information; except the Issuer assumes responsibility for the accurate reproduction in this Prospectus of such information provided by the Financial Guarantors and confirms that such information has been accurately reproduced and that as far as the issuer is aware and is able to ascertain from information published by the Financial Guarantors that no facts have been omitted which would render the reproduced information inaccurate or misleading.

1. ASSURED GUARANTY (EUROPE) LTD.

General

Assured Guaranty (Europe) Ltd. ("**AGE**") is a direct wholly-owned subsidiary of Assured Guaranty Municipal Insurance Company, an insurance company organised under the laws of the State of New York, United States of America ("**AGMIC**"), which, in turn, is a direct wholly-owned subsidiary of Assured Guaranty Municipal Corp. ("**AGM**" and together with AGE, "**Assured Guaranty**"), an insurance company also organised under the laws of the State of New York, United States of America AGM is a wholly- owned indirect subsidiary of Assured Guaranty Ltd. ("**AGL**"), a Bermuda based holding company that, through its operating subsidiaries, provides credit protection products to the public finance, infrastructure and structured finance markets. AGL's shares are publicly listed on the New York Stock Exchange under the symbol "AGO". AGL applies its credit underwriting judgment, risk management skills and capital markets experience to offer insurance that protects holders of debt instruments and other monetary obligations from defaults in scheduled payments of interest and principal. AGL's operating subsidiaries market their credit protection products directly to issuers and underwriters of public finance, infrastructure and structured finance securities, as well as to investors in such debt obligations. AGL's operating subsidiaries guarantee debt obligations issued in many countries, although their principal focus is the United States, the United Kingdom, Europe and Australia.

AGE was incorporated with limited liability in England on 8 June 1990 pursuant to the Companies Acts 1985 and *Companies Acts* 1989 with registered number 02510099. AGE was authorised from 29 April 1994, originally by the UK Department of Trade and Industry and subsequently by the UK Financial Services Authority (the "**FSA**"), to carry out and effect "credit", "suretyship" and "miscellaneous financial loss" insurance business in the United Kingdom (firm reference number 202896). From 1 April 2013, AGE is authorised by the PRA and regulated by the PRA and the Financial Conduct Authority (the "**FCA**"). These permissions are sufficient for AGE to provide financial guarantees in the UK. In addition, pursuant to the EC third non-life insurance directive (No. 92/49/EEC), AGE is able to provide financial guarantees in twenty European countries, subject to certain conditions.

AGE's registered office is located at 1 Finsbury Square, London EC2A 1AE, United Kingdom, Telephone: +44-20-7562-1900. AGE has no subsidiaries. AGE's legal and commercial name is Assured Guaranty (Europe) Ltd.

AGE is dependent on AGM in that AGM supports AGE through certain contractual arrangements (see "Material Contracts" below).

Ratings

AGE's financial strength is rated "AA-" (stable outlook) by S&P and "A2" (stable outlook) by Moody's , respectively. Neither S&P nor Moody's is established in the European Community and neither is registered in accordance with Regulation (EC) No 1060/2009 (as amended).

On June 12, 2013, S&P published a report in which it affirmed AGE's "AA-" (stable outlook) financial strength rating. The report is available at www.standardandpoors.com. On January 17, 2013, Moody's issued a press release stating that it had downgraded AGE's insurance financial strength rating to "A2" (stable outlook) from "Aa3". The press release is available at www.moodys.com.

Each rating of AGE should be evaluated independently. An explanation of the significance of the above ratings may be obtained from the applicable rating agency. The above ratings are not recommendations to buy, sell or hold any bond or other security, and such ratings are subject to revision or withdrawal at any time by the Rating Agencies, including withdrawal initiated at the request of AGE in its sole discretion. In addition, the rating agencies may at any time change AGE's long-term ratings outlooks or place AGE's ratings on a watch list for possible downgrade in the near term. Any downward revision or withdrawal of any of the above ratings, the assignment of a negative outlook to such ratings or the placement of such ratings on a negative watch list may have an adverse effect on the market price of any bond or other security guaranteed by AGE. AGE only guarantees scheduled principal and scheduled interest payments payable by the issuer of bonds or other securities guaranteed by AGE on the date(s) when such amounts were initially scheduled to become due and payable (subject to and in accordance with the terms of the relevant financial guarantee), and does not guarantee the market price or liquidity of the bonds or other securities it insures, nor does it guarantee that the ratings on such bonds or other securities will not be revised or withdrawn.

Overview of AGE's Business

AGE provides financial guarantees in the United Kingdom and other European countries for public finance, structured finance and other project and infrastructure finance transactions.

Financial guarantees generally guarantee to the holder of the guaranteed obligation the timely payment of principal of and interest on such obligation in accordance with such obligation's original payment schedule. Accordingly, in the case of a default on the guaranteed obligation, payments under the financial guarantee may not be accelerated without AGE's consent.

Financial guarantees on public infrastructure finance transactions are typically issued in connection with transactions in which the bonds or other securities being issued are secured by or payable from cash flows coming either from a government or quasi-governmental entity or from users of the relevant asset (e.g., passengers on a light rail system or drivers on a toll road). Projects financed under the UK government's PPP based model typically involve the construction of an asset (e.g., hospital, school, court buildings) and its ongoing management and maintenance for an agreed duration in return for which a performance-based fee is paid by the relevant public sector body; this fee is used to pay interest on and amortise the debt that is guaranteed by the relevant financial guarantor.

Financial guarantees on structured finance or asset-backed obligations are typically issued in connection with transactions in which the bonds or other securities being issued are secured by or payable from a specific pool of assets having an ascertainable cash flow or market value and held by a special purpose issuing entity.

New business written by AGE will be guaranteed using a co-guarantee structure pursuant to which AGE will co-guarantee municipal and infrastructure transactions with AGM and structured finance transactions with its affiliate Assured Guaranty Corp. ("**AGC**"). As described elsewhere in this Prospectus with respect to the Bonds and below under "*Material Contracts*", AGE will cover a proportionate share of the total exposure (expected to be between 3 and 10 per cent.), and AGM (or AGC for structured finance transactions) will guarantee the remaining exposure under the transaction (subject to compliance with European Economic Area (the "**EEA**") licensing requirements). In the AGM Financial Guarantee, AGM (or AGC for structured finance transactions) also will provide a second-to-pay guarantee to cover AGE's share of the total exposure.

Information

Copies of the annual financial statements filed with the Registrar of Companies in the United Kingdom are available upon request to AGE at its registered office.

Recent Developments

Since 31 December 2012, the date as at which its latest audited accounts were prepared, AGE has continued to conduct its financial guarantee business in the United Kingdom and the other European countries into which it is passported to provide financial guarantees.

There are no governmental, legal or arbitration proceedings (pending or threatened) of which AGE is aware during the previous 12 months which may have, or have had in the recent past, significant effects on AGE's financial position or profitability.

Directors of AGE

The following is a list of the members of the board of directors of AGE by name and function and sets forth any principal activities of such members outside of AGE:

Name	**Function**	**Principal Activities Outside of AGE**
Dominic Frederico	Executive	Chief Executive Officer and President, Assured Guaranty Ltd.
Simon Leathes (Chairman)	Non-Executive	Director of Assurance Guaranty Ltd., non-executive director of various other financial institutions, charitable organisations and trusts
James Michener	Executive	General Counsel and Secretary, Assured Guaranty Ltd.
Robert Mills	Executive	Chief Operating Officer, Assured Guaranty Ltd.
Anthony Monro-Davies	Non-Executive	Director (Chairman of the Board) of Assured Guarantee Ltd., non-executive director of various other financial institutions, charitable organisations and trusts
Dominic Nathan	Executive	None
Nick Proud	Executive	None

The business address of Messrs. Nathan and Proud is 1 Finsbury Square, London EC2A lAE, United Kingdom. The business address of Messrs. Leathes and Monro-Davies in their capacity as non- executive directors is 1 Finsbury Square, London EC2A 1AE, United Kingdom. The business address of Messrs. Frederico, Mills and Michener is 30 Woodbourne Avenue, Hamilton, Bermuda HM 08.

As at the date of this Prospectus, the above-mentioned board members of AGE do not have potential conflicts of interests between any duties to AGE and their private interests or other duties that are material to the Bonds.

Insurance Regulation

AGE is authorised by the PRA and regulated by the PRA for prudential regulation and the FCA for conduct of business regulation in the conduct of its financial guarantee business in the United Kingdom.

The PRA has regulatory objectives specific to insurance which are (1) to promote insurers' safety and soundness, thereby supporting the stability of the UK financial system and (2) to contribute to securing an appropriate degree of protection for those who are or may become policyholders. The PRA applies new threshold conditions (Threshold Conditions), which insurers must meet, and against which the PRA will assess them on a continuous basis. These conditions are that (a) an insurer's head office, and in particular its mind and management, has to be in the United Kingdom if it is incorporated in the United Kingdom; (b) an insurer's business must be conducted in a prudent manner - in particular that the insurer maintains appropriate financial and non-financial resources; (c) the insurer must be fit and proper, and be appropriately staffed; and (d) the insurer and its group must be capable of being effectively supervised.

Solvency

Under United Kingdom regulations, AGE is subject to certain limits and requirements, including the maintenance of a minimum margin of solvency (which depends on the type and amount of insurance business a company writes) and the establishment of loss and unearned premium reserves.

To the extent that the amount of premiums for such classes exceed certain specified minimum thresholds, each insurance company writing property, credit and other specified categories of insurance or reinsurance business is required by the General Prudential Sourcebook ("**GENPRU**"), the Interim Prudential Sourcebook for Insurers ("**IPRU-INS**") and the Prudential Sourcebook for Insurers ("**INSPRU**") (collectively, the Prudential Sourcebooks) to maintain an equalisation reserve calculated in accordance with the provisions of INSPRU. Because of the amount of premiums that AGE has earned, AGE must maintain an equalization reserve.

The Prudential Sourcebooks also require that AGE calculate and share with the PRA its "enhanced capital requirement" based on risk-weightings applied to assets held and lines of business written. In 2007, the FSA replaced the individual capital assessment for financial guarantee insurers with a "benchmarker" capital adequacy model devised by the FSA. Should the level of capital of AGE fall below the capital requirement as indicated by the benchmarker, the PRA may require AGE to undertake further work, following which Individual Capital Guidance may result. Failure to maintain capital at least equal to the minimum capital requirement in the benchmarker model is one of the grounds on which the wide powers of intervention conferred upon the PRA may be exercised.

The European Union's Solvency II Directive (Directive 2009/13 8/EC), which itself is to be amended by the proposed Omnibus II Directive (collectively, Solvency II), is currently not expected to be implemented before 2015 at the earliest. The solvency requirements described above are expected to be replaced by Solvency II. Among other things, Solvency II introduces a revised risk-based prudential regime which includes the following features: (1) assets and liabilities are generally to be valued at their market value; (2) the amount of required economic capital is intended to ensure, with a probability of 99.5 per cent., that regulated firms are able to meet their obligations to policyholders and beneficiaries over the following 12 months; and (3) reinsurance recoveries will be treated as a separate asset (rather than being netted off the underlying insurance liabilities). In many instances, Solvency II is expected to require insurers to maintain an increased amount of capital to satisfy the new solvency capital requirements.

In addition, an insurer (which includes a company conducting only reinsurance business) is required to perform and submit to the PRA a group capital adequacy return in respect of its ultimate insurance parent. The calculation at the level of the ultimate EEA insurance parent is required to show a positive result. There is no such requirement in relation to the report at the level of the ultimate insurance parent, although if the report at that level raises concerns, the PRA may take regulatory action. Public disclosure of the EEA group calculation will be required.

Financial Services Compensation Scheme

The beneficiaries of AGE's Financial Guarantee are not protected by the Financial Services Compensation Scheme.

Financial Information

The audited accounts of AGE for the years ended 31 December 2011 and 31 December 2012 are included at Appendix 1 and Appendix 2 hereto. There has been no material adverse change in AGE's prospects and no significant change in AGE's financial or trading position since 31 December 2012, the date to which AGE's most recent audited accounts have been prepared.

Auditors

AGE's auditors are PricewaterhouseCoopers LLP ("**PwC**"), 7 More London Riverside, London SE1 2RT. PwC is a member of the Institute of Chartered Accountants in England and Wales.

PwC's report on the audited accounts of AGE for the years ended 31 December 2012 and 31 December 2011 is included with such accounts, which are included at Appendix 1 and Appendix 2 hereto, respectively.

Material Contracts

Except as discussed below, AGE has not entered into contracts outside the ordinary course of business that could result in AGE being under an obligation or entitlement that is material to AGE's ability to meet its obligations to the Bond Trustee under its Financial Guarantee.

AGM provides support to AGE through an amended and restated quota share and stop loss reinsurance agreement (the "**Reinsurance Agreement**") and an amended and restated net worth maintenance agreement (the "**Net Worth Agreement**"). For transactions closed prior to 2011, AGE typically guaranteed all of the guaranteed obligations directly and AGM reinsured approximately 92 per cent, of the Company's retention after cessions to other reinsurers under the quota share cover of the reinsurance agreement. In 2011, AGE implemented a co-guarantee structure pursuant to which AGE directly guarantees a portion of the guaranteed obligations in an amount equal to what would have been AGE's pro rata retention percentage under the quota share cover. AGM directly guarantees the balance of the guaranteed obligations and also provides a second-to-pay guarantee for AGE's portion of the guaranteed obligations.

Under the stop loss cover of the reinsurance agreement, AGM is required to make payments to AGE when AGE's annual net incurred losses and expenses exceeds the AGE's annual net earned premium plus any amounts deducted from AGE's equalisation reserve during the year. The stop loss cover has an annual limit of liability equal to 20 per cent. of AGE's guaranteed net principal amount outstanding at the prior year-end, plus AGE's guaranteed net principal outstanding at the prior year-end of AGE's two largest transactions.

The quota share and stop loss covers each exclude transactions guaranteed by AGE on or after July 1, 2009 that are not municipal, utility, project finance or infrastructure risks or similar types of risks.

Under the Net Worth Agreement, AGM is obligated to cause AGE to maintain capital resources equal to 110 per cent of the greatest of the amounts as may be required by the PRA as a condition for maintaining its authorisation to carry on a financial guarantee business in the U.K., provided that contributions (a) do not exceed 35 per cent of AGM's policyholders' surplus as determined by the laws of the State of New York; and (b) are in compliance with a provision of the New York Insurance Law requiring notice to or approval by the New York State Department of Financial Services for transactions between affiliates that exceed certain thresholds. AGM has never been required to make any contributions to AGE's capital under the current Net Worth Agreement or its prior net worth maintenance agreement.

On the basis of the support provided by the Reinsurance Agreement and the Net Worth Agreement, AGE has the same ratings as AGM. Holders of the Bonds should note that AGE's ability to perform its obligations under its Financial Guarantee and to maintain its current rating substantially depends on the ability of AGM to perform its obligations under the Assured Guaranty Agreements.

The holders of the Bonds should note that the Reinsurance Agreement and the Net Worth Agreement (together, the "**Assured Guaranty Agreements**") are entered into for the benefit of AGE and are not, and should not be regarded as, guarantees by AGM of the payment of any indebtedness, liability or obligations of the Issuer or AGE, including the Bonds or the Financial Guarantee. The Assured Guaranty Agreements are not guarantees for the benefit of the holders of the Bonds. Neither the Bond Trustee nor holders of the Bonds have any recourse to AGM in respect of the Assured Guaranty Agreements.

Payment of Guaranteed Amounts that are due for payment on the Bonds and unpaid by reason of non-payment by the Issuer will be guaranteed by the Financial Guarantors pursuant to the Financial Guarantees but will not be additionally covered by the Assured Guaranty Agreements.

2. ASSURED GUARANTY MUNICIPAL CORP.

General

AGM is an insurance company organised under the laws of the State of New York, U.S.A. AGM is a wholly-owned indirect subsidiary of AGL, a Bermuda based holding company that, through its operating subsidiaries, provides credit protection products to the public finance, infrastructure and structured finance markets. AGL's shares are publicly listed on the New York Stock Exchange under the symbol "AGO". AGL applies its credit underwriting judgment, risk management skills and capital markets experience to offer insurance that protects holders of debt instruments and other monetary obligations from defaults in scheduled payments of interest and principal. AGL's operating subsidiaries market their credit protection products directly to issuers and underwriters of public finance, infrastructure and structured finance securities, as well as to investors in such debt obligations. AGL's operating subsidiaries guarantee debt obligations issued in many countries, although their principal focus is the United States, the United Kingdom, Europe and Australia.

AGM was organised in the State of New York, U.S.A. as an insurance company on 16 March 1984 and commenced operations in 1985.

AGM maintains its principal executive offices at 31 West 52nd Street, New York, New York 10019, U.S.A. The telephone number of AGM is +1 212 974 0100. AGM owns 100 per cent. of AGMIC, which primarily provides reinsurance to AGM. AGM and AGMIC together own AGB, a Bermuda insurance company that also provides reinsurance to AGM and previously provided insurance for transactions outside the U.S. and European markets. AGMIC in turn owns 100 per cent. of AGE. AGM's legal and commercial name is Assured Guaranty Municipal Corp.

Ratings

AGM's financial strength is rated "AA-" (stable outlook) by S&P and "A2" (stable outlook) by Moody's. Neither S&P nor Moody's is established in the European Community and neither is registered in accordance with Regulation (EC) No 1060/2009 (as amended).

On June 12, 2013, S&P published a report in which it affirmed AGM’s “AA-” (stable outlook) financial strength rating. The report is available at www.standardandpoors.com. On January 17, 2013, Moody’s issued a press release stating that it had downgraded AGM’s insurance financial strength rating to “A2” (stable outlook) from “Aa3”. The press release is available at www.moodys.com.

Each rating of AGM should be evaluated independently. An explanation of the significance of the above ratings may be obtained from the applicable rating agency. The above ratings are not recommendations to buy, sell or hold any bond or other security, and such ratings are subject to revision or withdrawal at any time by the Rating Agencies, including withdrawal initiated at the request of AGM in its sole discretion. In addition, the rating agencies may at any time change AGM's long-term ratings outlooks or place AGM's ratings on a watch list for possible downgrade in the near term. Any downward revision or withdrawal of any of the above ratings, the assignment of a negative outlook to such ratings or the placement of such ratings on a negative watch list may have an adverse effect on the market price of any bond or other security guaranteed by AGM. AGM only guarantees scheduled principal and scheduled interest payments payable by the issuer of bonds or other securities guaranteed by AGM on the date(s) when such amounts were initially scheduled to become due and payable (subject to and in accordance with the terms of the relevant financial guarantee), and does not guarantee the market price or liquidity of the bonds or other securities it insures, nor does it guarantee that the ratings on such bonds or other securities will not be revised or withdrawn.

Overview of AGM's business

AGM provides financial guarantees to issuers both within and outside the U.S.A. providing co-insurance on public finance and other project and infrastructure finance transactions in Europe with AGE (see “*Assured Guaranty (Europe) Ltd. Overview of AGE's Business*” above). Since mid-2008, AGM has only provided insurance that protects against principal and interest payment defaults on debt obligations in the U.S. public finance and global infrastructure market. Previously, AGM also offered insurance and reinsurance in the global structured finance market. Like AGE, AGM's financial guarantees generally guarantee to the holder of the guaranteed obligation the timely payment of principal of and interest on such obligation in accordance with such obligation's original payment schedule. Accordingly, in the case of a default on the guaranteed obligation, payments under the financial guarantee may not be accelerated without AGM's consent.

Municipal obligations and municipal bonds include taxable and tax-exempt bonds, notes and other evidences of indebtedness issued by states, political subdivisions (cities, counties, towns and villages), water, sewer and other utility districts, higher educational institutions, hospitals, transportation and housing authorities and other similar agencies. Municipal obligations are supported by the taxing authority of the issuer or the issuer's or underlying obligor's ability to collect fees or assessments for certain projects or public services. References herein to “municipal bonds” and “municipal obligations” are to debt obligations of states and other political subdivisions in the U.S.A.

Information

Copies of the statutory quarterly and annual statements filed by AGM in the U.S.A. are available upon request to AGM at its principal place of business.

Recent Developments

Since 31 December 2012, the date as at which its latest audited financial statements were prepared, AGM has continued to conduct its financial guarantee business in the U.S.A. and the other states and countries in which it is permitted to provide financial guarantees.

There are no governmental, legal or arbitration proceedings (pending or threatened) of which AGM is aware during the previous 12 months which may have, or have had in the recent past, significant effects on AGM's financial position or profitability.

AGM (and various other financial guarantors) are defendants in several actions in the State of California. The plaintiffs in these actions alleged various antitrust and equitable claims against the financial guarantor defendants. Several of plaintiffs' claims against the monoline defendants have been dismissed and the remaining claims are breach of contract and violation of California's unfair competition statute. The complaints in these lawsuits generally seek unspecified monetary damages, interest, attorneys' fees, costs and other expenses. AGM cannot reasonably estimate the possible loss or range of loss, if any, that may arise from these lawsuits.

On 21 June 2013, AGM entered into a settlement agreement with Flagstar Bank ("**Flagstar**") in connection with AGM's litigation for breach of contract against Flagstar on the Flagstar Home Equity Loan Trust, Series 2005-1 and Series 2006-2 second lien transactions. The settlement follows judgments by the court in February and April 2013 in favor of AGM, which judgments Flagstar intended to appeal. As part of the settlement, AGM will receive a cash payment of $105 million and Flagstar will withdraw its appeal. Flagstar also will reimburse AGM in full for all future claims on AGM's financial guaranty insurance policies for such transactions. This settlement resolves all RMBS claims that AGM has asserted against Flagstar and each party has agreed to release the other from any and all other future RMBS-related claims between them.

On March 26, 2013, AGM filed a lawsuit against RBS Securities Inc., RBS Financial Products Inc. and Financial Asset Securities Corp. (collectively, "**RBS**") in the United States District Court for the Southern District of New York on the alleging fraudulent misrepresentations with respect to the quality of the underlying mortgage loans backing a securitisation transaction, which AGM guaranteed.

On May 6, 2013, AGM, its parent AGL and, together with its subsidiaries, and its affiliate AGC entered into an agreement (the "**UBS Agreement**") with UBS and a third party that resolved AGM's and AGC's claims related to specified residential mortgage-backed securities (**"RMBS"**) transactions that were issued, underwritten or sponsored by UBS and insured by AGM or AGC under financial guarantee insurance policies. Under the UBS Agreement, AGM received a cash payment of $358 million and UBS agreed to reimburse AGM for 85% of future losses on certain first lien RMBS transactions under a collateralised loss-sharing reinsurance agreement, which arrangement is expected to be put in place by the third quarter of 2013. As of April 30, 2013, the aggregate par outstanding on the subject transactions was approximately $276.7 million. The UBS Agreement resolves all RMBS claims that AGM and AGC have asserted against UBS in connection with these transactions and certain other UBS RMBS transactions. The effect of the UBS Agreement on AGM's economic loss development in the U.S. RMBS sector was a favourable $141.6 million in the first quarter of 2013.

Directors of AGM

The following is a list of the members of the board of directors of AGM by name and function and sets forth any principal activities of such members outside of AGM:

Name	**Function**	**Principal Activities Outside of AGM**
Howard W. Albert	Executive	Chief Risk Officer, Assured Guaranty Ltd.
Robert A. Bailenson	Executive	Chief Financial Officer, Assured Guaranty Ltd
Russell B. Brewer II	Executive	Chief Surveillance Officer, Assured Guaranty Ltd.

Name	Function	Principal Activities Outside of AGM
Stephen Donnarumma	Executive	None.
Dominic Frederico (Chairman)	Executive	Chief Executive Officer and President, Assured Guaranty Ltd.
James M. Michener	Executive	General Counsel and Secretary, Assured Guaranty Ltd.
Robert B. Mills	Executive	Chief Operating Officer, Assured Guaranty Ltd.
Donald H. Paston	Executive	None.
Andrew Pickering	Executive	Deputy Chief Risk Officer, Assured Guaranty Ltd.
Bruce E. Stern	Executive	None.

The business address of Messrs. Albert, Bailenson, Brewer, Donnarumma, Paston, Pickering and Stern is 31 West 52nd Street, New York, New York, U.S.A. The business address of Messrs. Frederico, Mills and Michener is 30 Woodbourne Avenue, Hamilton, Bermuda HM 08.

As at the date of this Prospectus, the above-mentioned board members of AGM do not have potential conflicts of interests between any duties to AGM and their private interests or other duties that are material to the Bonds.

Insurance Regulation

AGM is licensed to do business as an insurance company in all fifty states of the United States, the District of Columbia and Puerto Rico. It is subject to the insurance laws and regulations of the State of New York, its state of incorporation, which has a comprehensive financial guarantee insurance law, and the insurance laws and regulations of other states in which it is licensed to transact business. These laws and regulations, as well as the level of supervisory authority that may be exercised by the various state insurance departments, vary by jurisdiction, but generally require insurance companies to maintain minimum standards of business conduct and solvency, meet certain financial tests, including single risk limits and minimum policyholders surplus and reserve levels, file certain reports with regulatory authorities, including information concerning their capital structure, ownership and financial condition, and require prior approval of certain changes in control of domestic insurance companies and their direct and indirect parents and the payment of certain dividends and distributions. In addition, these laws and regulations require approval of certain intercorporate transfers of assets and certain transactions between insurance companies and their direct and indirect parents and affiliates, and generally require that all such transactions have terms no less favourable than terms that would result from transactions between parties negotiating at arm's length.

U.S. State insurance laws and regulations (as well as the rating agencies) impose minimum capital requirements on financial guarantee insurance companies, limiting the aggregate amount of insurance which may be written and the maximum size of any single risk exposure which may be assumed. Such companies can use reinsurance to diversify risk, increase underwriting capacity, reduce additional capital needs, stabilize shareholder returns and strengthen financial ratios.

As a primary insurer, AGM is required to honour its obligations to its policyholders whether or not its reinsurers perform their obligations under the various reinsurance agreements with AGM.

AGM has excess of loss treaties with various reinsurers, which provide for a program of reinsurance with respect to losses that exceed certain levels, as specified in the treaties. AGM has a quota share treaty with its affiliate, Assured Guaranty Re Ltd. ("**AGR**"), which provides for AGR to share a percentage of premiums and losses with AGM.

AGM has entered into municipal bond and structured and international finance facultative reinsurance agreements. These agreements allow AGM to reduce its large risks, to manage its portfolio of insurance by bond type and geographic distribution, and to provide additional capacity for frequent municipal bond issuers. Under these agreements, portions of AGM's interests and liabilities can be ceded on an issue-by-issue basis. A ceding commission is withheld to defray AGM's underwriting expenses.

AGM is required to file quarterly and annual statutory financial statements in the United States of America, and is subject to single and aggregate risk limits and other statutory restrictions concerning the types and quality of investments and the filing and use of policy forms and premium rates. In addition, AGM's accounts and operations are subject to periodic examination by the New York Department of Financial Services and its market conduct is subject to review by other state insurance regulatory authorities.

The beneficiaries of AGM's Financial Guarantee are not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the Insurance Law of the State of New York, U.S.A.

AGM is not authorised or regulated by the PRA or the FCA in the United Kingdom.

Financial Information

The consolidated balance sheets of AGM as of 31 December 2011 and 31 December 2012 and the related consolidated statements of operations and comprehensive income, of shareholder's equity and of cash flows for each of the two years in the period ended 31 December, 2012, prepared in accordance with US GAAP are included at Appendix 3 hereto.

There has been no material adverse change in AGM's prospects and no significant change in its financial or trading position since 31 December 2012, the date to which AGM's most recent audited financial statements have been prepared.

Total shareholder's equity for AGM as of March 31, 2013 was $3,313 million, compared to $3,219 million as of December 31, 2012. The primary cause of the change was net income of $155 million for the first quarter of 2013, which was driven by a court decision in favour of AGM in its litigation against Flagstar Bank, FSB, Flagstar Capital Markets Corporation and Flagstar ABS, LLC (collectively, "**Flagstar**"); a settlement AGM entered into with UBS Real Estate Securities Inc. and certain other affiliates ("**UBS**"); the acceleration of premium after AGM entered into another settlement over claims of breaches of representations and warranties in a residential mortgage-backed securities ("**RMBS**") transaction it had insured; and transactions AGM insured that were refunded or terminated on a consensual basis; offset in part by unrealised losses on credit derivative transactions; and other recurring items. The settlement with UBS and the Flagstar decision are discussed in more detail above.

Under the insurance laws of the State of New York, AGM may pay dividends out of earned surplus, provided that, together with all dividends declared or distributed by AGM during the preceding 12 months, the dividends do not exceed the lesser of (a) 10% of policyholders' surplus as of its last statement filed with the Superintendent of Insurance of the State of New York (the "**New York Superintendent**"); or (b) adjusted net investment income (net investment income at the preceding December 31 plus net investment income that has not already been paid out as dividends for the three calendar years prior to the preceding calendar year) during this period. Based on AGM's statutory statements to be filed for the first quarter 2013, the maximum amount available for payment of dividends by AGM without regulatory approval over the 12 months following March 31, 2013 is approximately $186 million.

AGM has exposure to long-term infrastructure transactions with refinancing risk as to which AGM may need to make claim payments that it did not anticipate paying when its financial guarantee insurance policies were issued; the aggregate amount of the claim payments may be substantial and reimbursement may not occur for an extended time, if at all. Total liabilities for the three largest transactions with significant refinancing risk may amount to as much as $3.6 billion, payable in varying amounts over the next 13 years. Of this liability, as much as approximately $3.0 billion may be payable between 2014 and 2020. While the cash flows from these projects were expected to be sufficient to repay all of the debt over the life of the project concession, in order to pay the principal on the early maturing debt, AGM expected it to be refinanced in the market at or prior to its maturity. Due to market dislocation and increased credit spreads, AGM may have to pay a claim at the maturity of the securities, and then recover its payment from cash flows produced by the project in the future. AGM generally projects that in most scenarios it will be fully reimbursed for such payments. However, the recovery of the payments may take from 10-35 years and is uncertain. For the three largest transactions, AGM estimates that it may pay claims of $1.4 billion substantially between 2014 and 2018, without giving effect to any payments that AGM may receive from reinsurers to which it has ceded a portion of this exposure. This estimate is based on certain assumptions AGM has made as to the performance of the transactions, including the refinancing of a certain portion of the debt, the payment of certain anticipated contributions, and AGM prevailing in certain litigation proceedings.

Auditors

AGM's auditors are PricewaterhouseCoopers LLP ("**PwC US**"), 300 Madison Avenue, New York, New York 10017 U.S.A. PwC US is a member of the American Institute of Certified Public Accountants.

PwC-US's report on the audited financial statements of AGM for the years ended 31 December 2012 and 31 December 2011 is included with such accounts, which are included at Appendix 3 hereto.

Material Contracts

AGM has not entered into contracts outside the ordinary course of business that could result in AGM being under an obligation or entitlement that is material to AGM's ability to meet its obligations to the Bond Trustee under its Financial Guarantee. See "*Description of the Financial Guarantors — Assured Guaranty (Europe) Ltd. — Material Contracts*" above.

DESCRIPTION OF THE ISSUER, PROJECTCO, HOLDCO, AND THE SHAREHOLDERS AND STAKEHOLDERS

1. THE ISSUER

History and Development of the Issuer

The Issuer was incorporated in England and Wales on 2 July 2013 as a public limited company under the Companies Act 2006 with registered number 08594721.

Relationship to HoldCo

The Issuer is a wholly owned subsidiary of HoldCo. In the Shareholders Agreement, HoldCo and the other parties thereto have entered in to certain covenants in relation to the ongoing management of the Issuer which are intended, in part, to mitigate any risk that HoldCo's position of control in relation to the Issuer may be abused. In particular, the parties have agreed that the primary business of the Issuer will be to finance the Project, that that business shall be conducted in the best interests of the Issuer and that the board of directors of the Issuer shall be responsible for the overall direction and control of the management of the Issuer.

Registered Office

The Issuer's registered office is at c/o K&L Gates LLP, One New Change, London EC4M 9AF.

Principal Activities

The Issuer has not, since its date of incorporation, carried on any business or activities other than those incidental to its registration, the financing of the Project and other matters described or contemplated in this Prospectus. The Issuer is a special purpose company established to issue the Bonds and the Issuer Loan Notes and to on-lend the proceeds to ProjectCo. The Issuer has no employees.

As at the date of this Prospectus, the Issuer is wholly owned by HoldCo.

Board of Directors

As at the date of this Prospectus, the directors of the Issuer and their other principal activities, are as follows:

Director Name	***Function***	***Addresses***	***Principal Activities***
Fabio D'Alonzo	Director	91-93 Charterhouse Street, London EC1M 6HR	Director: Sustainable Communities for Leeds (Holdings) Limited, Sustainable Communities for Leeds Limited, Bristol Active Holdings Limited, E4I Holdings Limited and Miller E4I Investments Limited
Sion Jones	Director	91-93 Charterhouse Street, London EC1M 6HR	Director: Sustainable Communities for Leeds (Holdings) Limited, Sustainable Communities for Leeds Limited, Bradford & Airedale Community Solutions Fundco 1 Limited, Bradford & Airedale Community Solutions Fundco 2 Limited, Bradford & Airedale Community Solutions Fundco 3 Limited, Bradford & Airedale Community Solutions Fundco 4 Limited, Bradford & Airedale Community Solutions Holdco 1 Limited, Bradford & Airedale Community Solutions Holdco 2 Limited, Bradford & Airedale Community Solutions Holdco 3 Limited, Bradford & Airedale Community Solutions Holdco

Director Name	*Function*	*Addresses*	*Principal Activities*
			4 Limited, Bradford & Airedale Community Solutions Limited, Community Solutions Investment Partners Limited, Community Ventures Company (No 1) Limited, Community Ventures Midco (No 1) Limited, Derbyshire Learning and Community Partnerships Ltd., Durham & Tees Community Ventures Fundco (No.1) Limited, Durham & Tees Community Ventures Fundco (No.2) Limited, Durham & Tees Community Ventures Fundco (No.3) Limited, Durham & Tees Community Ventures Fundco (No.4) Limited, Durham & Tees Community Ventures Holdco (No.1) Limited, Durham & Tees Community Ventures Holdco (No.2) Limited, Durham & Tees Community Ventures Holdco (No.3) Limited, Durham & Tees Community Ventures Holdco (No.4) Limited, Durham & Tees Community Ventures Limited, Equitix Derbyshire Limited, Equitix Education (Derbyshire) Holdings Ltd., Equitix Education (Derbyshire) Ltd., Equitix Healthcare (Lancaster) Limited, Equitix Healthcare (Leeds) Holdings Limited, Equitix Healthcare (Surrey) Limited, Kent Vanwall Limited, KMC (Pembroke) Limited, Leeds PFI SPV 2 Limited, Primaria (Leeds) Limited, Roehampton Hospital Holdings Limited and Roehampton Hospital Limited.
David Joyce	Director	Level 6, 33 Old Broad Street, London EC2N 1HZ	Director: Sustainable Communities for Leeds (Holdings) Limited and Sustainable Communities for Leeds Limited
William Haughey	Director	Level 6, 33 Old Broad Street, London EC2N 1HZ	Director: Sustainable Communities for Leeds (Holdings) Limited, Sustainable Communities for Leeds Limited, Amey Birmingham Highways Holdings Limited, Amey Birmingham Highways Limited, Uberior Infrastructure Investments (No 5) Limited, Uberior Infrastructure Investments (No 6) Limited, Amey Hallam Highways Holdings Limited, Amey Hallam Highways Limited, Uberior Infrastructure Investments (No 7) Limited, Uberior Infrastructure Investments (No 8) Limited and Uberior Infrastructure Investments (Southmead) Limited
David Taylor	Director	Keepmoat Limited, The Waterfront, Lakeside Boulevard, Doncaster, South Yorkshire DN4 5PL	Director: Sustainable Communities for Leeds (Holdings) Limited and Sustainable Communities for Leeds Limited
Colin Rossiter	Director	Keepmoat Limited, The Waterfront, Lakeside Boulevard, Doncaster, South Yorkshire DN4 5PL	Director: Sustainable Communities for Leeds (Holdings) Limited, Sustainable Communities for Leeds Limited, Beswick (Block B) Management Company Limited

Conflicts of Interest:

William Haughey is an officer of entities within the Lloyds Bank Infrastructure Partners Group. All directors are officers in entities which are part of the Shareholders' groups, entities which will subscribe for the HoldCo Loan Notes thus providing funds which are passed on to the

Issuer through the subscription by HoldCo to the Issuer Loan Notes. All directors are also directors of Project Co and HoldCo. Otherwise there are no potential conflicts of interest between any duties to the Issuer owed by the persons listed under ''Board of Directors'' above and their private interests or other duties.

David Joyce is an officer of entities within the Lloyds Bank Infrastructure Partners Group. All directors are officers in entities which are part of the Shareholders' groups, entities which will subscribe for the HoldCo Loan Notes thus providing funds which are passed on to the Issuer through the subscription by HoldCo to the Issuer Loan Notes. All directors are also directors of Project Co and HoldCo. Otherwise there are no potential conflicts of interest between any duties to the Issuer owed by the persons listed under ''Board of Directors'' above and their private interests or other duties.

All directors are officers or employees of entities which are part of the HoldCo Shareholders' respective groups and such groups include entities which will subscribe for shares in HoldCo and for the HoldCo Loan Notes thus providing funds which are passed on to the Issuer through the subscription by HoldCo for shares in the Issuer and for the Issuer Loan Notes. All directors are also directors of ProjectCo and HoldCo. Keepmoat Limited, Keepmoat Regeneration Limited and Keepmoat Leeds PFI Limited are companies within the same group. Colin Rossiter and David Taylor are employees of companies within that group. Otherwise there are no potential conflicts of interest between any duties to the Issuer owed by the persons listed under "Board of Directors" above and their private interests or other duties.

Financial information concerning the Issuer's assets and liabilities, financial position and profits and losses

Historical financial information

The Issuer has not traded, or been in operation since 2 July 2013, being the date of its incorporation. As at the date of this Prospectus no financial statements have been prepared by the Issuer.

Capitalisation Statement

The following table shows the capitalisation of the Issuer as at the date of this Prospectus:

	£
Issued share capital	
50,000 ordinary shares, all fully paid	50,000.00

In accordance with Article 41.6(c) of Directive 2006/43/EC of the European Parliament and of the Authority and any relevant implementing measures of the United Kingdom, the Issuer does not consider it appropriate to have either an audit committee or an administrative or supervisory body entrusted to carry out the functions of an audit committee, because the Issuer's principal business consists of the issue of the Bonds and the Issuer Loan Notes and the lending of amounts to ProjectCo and paying certain fees, expenses and other related amounts and as such, the Issuer is not conducting an operating business.

2. PROJECTCO

History and Development of ProjectCo

ProjectCo was incorporated in England and Wales on 6 December 2012 under the Companies Act 2006 as a private limited company with registered number 08320624.

Registered Office

ProjectCo's registered office is at c/o K&L Gates LLP, One New Change, London EC4M 9AF.

Principal Activities

ProjectCo has not, since its date of incorporation, carried on any business or activities other than those incidental to its registration, the financing of the Project and other matters described or contemplated in this Prospectus. ProjectCo is a special purpose company established to carry out the Project.

Board of Directors

As at the date of this Prospectus, the directors of ProjectCo are the same as the directors of the Issuer. Their principal activities and their business addresses are referred to in section 1 above entitled "The Issuer".

Conflicts of Interest

All directors are officers or employees of entities which are part of the HoldCo Shareholders' respective groups and such groups include entities which will subscribe for shares in HoldCo and for the HoldCo Loan Notes thus providing funds which are passed on to the Issuer through the subscription by HoldCo for shares in the Issuer and for the Issuer Loan Notes. All directors are also directors of the Issuer and HoldCo. Keepmoat Limited, Keepmoat Regeneration Limited and Keepmoat Leeds PFI Limited are companies within the same group. Colin Rossiter and David Taylor are employees of companies within that group. Otherwise there are no potential conflicts of interest between any duties to ProjectCo owed by the persons listed under "Board of Directors" above and their private interests or other duties.

Share Capital and HoldCo Shareholders

As at the date of this Prospectus, ProjectCo is wholly-owned by HoldCo. The issued share capital of ProjectCo is £1,000 divided into 1,000 ordinary shares of £1 each, all of which are fully paid up.

3. HOLDCO

History and Development of HoldCo

HoldCo was incorporated in England and Wales on 5 December 2012 under the Companies Act 2006 as a private limited company with registered number 08319372.

Registered Office

HoldCo's registered office is at c/o K&L Gates LLP, One New Change, London EC4M 9AF.

Principal Activities

HoldCo has not, since its date of incorporation, carried on any business or activities other than those incidental to its registration, the financing of the Project and other matters described or contemplated in this Prospectus. HoldCo is a special purpose company established to act as holding company to the Issuer and ProjectCo.

HoldCo is the parent company of the Issuer and ProjectCo.

Board of Directors

As at the date of this Prospectus, the directors of HoldCo are the same as the directors of the Issuer. Their principal activities and their business addresses are referred to in section 1 above entitled *"The Issuer"*.

Conflicts of Interest

All directors are officers or employees of entities which are part of the HoldCo Shareholders' respective groups and such groups include entities which will subscribe for shares in HoldCo and for the HoldCo Loan Notes. All directors are also directors of the Issuer and ProjectCo. Keepmoat Limited, Keepmoat Regeneration Limited and Keepmoat Leeds PFI Limited are companies within the same group. Colin Rossiter and David Taylor are employees of companies within that group. Otherwise there are no potential conflicts of interest between any duties to HoldCo owed by the persons listed under "Board of Directors" above and their private interests or other duties.

Share Capital and HoldCo Shareholders

The issued share capital of HoldCo is £51,000 divided into 51,000 ordinary shares of £1 each, all of which are fully paid up.

4. SHAREHOLDERS AND STAKEHOLDERS

Equitix Housing 2 Limited

Equitix Housing 2 Limited was incorporated in England and Wales on 28 November 2012 under the Companies Act 2006 as a private company with registered number 08311229. Its registered office is at 91-93 Charterhouse Street, London EC1M 6HR. Equitix Housing 2 Limited is wholly owned by Equitix Fund II LP.

Equitix Housing 2 Limited ("**Equitix**") is a limited partnership established in England and Wales, with its principal place of business being 91-93 Charterhouse Street, London, EC1M 6HR (registered number LP14200). Equitix Investment Management Limited, a FSA regulated company, was appointed as the Manager to Equitix on 9 December 2010. Equitix Investment Management Limited is responsible for the operation and management of Equitix. Equitix invests in social and economic infrastructure projects in the UK.

Uberior Infrastructure Investments (No 5) Limited

Uberior Infrastructure Investments (No 5) Limited was incorporated in England and Wales on 9 May 2012 under the Companies Act 2006 as a private company with registered number 08063001. Its registered office is at 33 Old Broad Street, London EC2N 1HZ. Uberior Infrastructure Investments (No 5) Limited was established to invest in primary social and economic infrastructure projects in the UK. It will invest in projects (including health, defence, education, social housing, government accommodation, custodial facilities, roads, bridges, rail and waste management) underpinned by long term secure government contracts characterised by stable, predictable, availability based cash flows. Uberior Infrastructure Investments (No 5) Limited operates as an investment holding company for its parent, Lloyds Bank UK Infrastructure Partners L.P. (the "**Fund**") and holds the Fund's equity portfolio of high quality, PFI / Public Private Partnerships ("**PPP**") assets.

Uberior Infrastructure Investments (No 6) Limited

Uberior Infrastructure Investments (No 6) Limited was incorporated in England and Wales on 9 May 2012 under the Companies Act 2006 as a private company with registered number 08062999. Its registered office is at 33 Old Broad Street, London EC2N 1HZ. Uberior Infrastructure Investments (No 6) Limited operates as an investment holding company for its parent, the Fund and holds the Fund's debt portfolio in high quality, PFI / PPP assets. This portfolio will be ultimately funded by the Fund and through the issuance of a Eurobond acquired by the Fund. As at 31 December 2012, Uberior Infrastructure Investments (No 6) Limited had committed to subscribe a total of £75,690,103 to three PFI projects.

Keepmoat Leeds PFI Limited

Keepmoat Leeds PFI Limited was incorporated in England and Wales on 29 November 2012 under the Companies Act 2006 as a private company with registered number 08313538. Its registered office is at The Waterfront, Lakeside Boulevard, Doncaster DN4 5PL. Keepmoat Leeds PFI Limited was established as a special purpose company specifically to act as the vehicle for Keepmoat's investment in the Leeds, Little London, Beeston Hill and Holbeck project procured under the UK government PFI.

Keepmoat invests in such social housing projects, in what is its core business, underpinned by long term secure government contracts characterised by stable, predictable, availability based cash flows. Keepmoat Leeds PFI Limited operates as an investment holding company for its parent, Keepmoat Limited, and will hold the investment to earn returns or until such investment is sold.

OVERVIEW OF PROJECT DOCUMENTS

1. PROJECT AGREEMENT

General

This section describes and analyses the principal terms of the Project Agreement. This analysis is not exhaustive, but focuses on issues of particular interest to prospective Bondholders. The Project Agreement is the principal agreement between the Authority and the Contractor to give effect to the arrangements described under the section "*Overview of the Project*".

Parties and Duration

The parties to the Project Agreement are the Authority and the Contractor. The Project Agreement comes into effect on the Issue Date and (subject to earlier termination) continues for twenty (20) years and three (3) months.

Change in Control

No "**Change in Ownership**" (as defined below) is permitted in the shares of the Contractor, the Issuer or HoldCo during the lock in period which is the period expiring on the date which is one year after the Independent Certifier has certified all Dwellings in the Project in accordance with the Project Agreement).

Change in Ownership is defined in the Project Agreement as any transfer or disposal of any of the shares in the Contractor, the Issuer or HoldCo (including control over the exercise of voting rights conferred on those shares or the control over the right to appoint or remove directors or the rights to dividends); or any arrangement which has the same effect.

Any Change in Ownership arising as a consequence of:

(i) the grant or enforcement of security in favour of the Senior Funders in relation to the shares of the Contractor or HoldCo provided that any document conferring security over any shares has been approved by the Authority;

(ii) any change in legal or beneficial ownership of shares listed on a recognised investment exchange; or

(iii) a specific Change in Ownership expressly sanctioned by the Authority under the Project Agreement in relation to one of the equity sponsors,

will not trigger a Change in Ownership for the Project Agreement.

Completion of the Works

The Contractor is required to procure the Works, so that once complete, they comply with, amongst other things, the output specification set out in the Project Agreement. The Works will comprise:

(i) new build works consisting of 388 new buildings to be designed and constructed as part of the Contractor's Works located in three areas of Leeds consisting of Little London, Beeston Hill and Holbeck;

(ii) refurbishment works consisting of the refurbishment of 1,296 existing Authority dwellings. There are two standards that apply to the Refurbishment Dwellings. The first is the interim availability standard. The second is the full availability standard. On and from the commencement date, all Refurbishment Properties are to at least meet the interim availability standard. There is a "bedding-in period" during which the full level of Deductions will not be applied when there is a failure to meet the interim availability standard (please refer to the overview of the Payment Mechanism for further details about this);

(iii) environmental works which generally consists of landscaping and upgrading of areas within Little London, Beeston Hill and Holbeck;

(iv) communal works which comprise of upgrading the communal areas within the estates such as the community playgrounds and facilities available for use by the Tenants; and

(v) early demolition works, which the Authority is responsible for carrying out in relation to certain sites in accordance with the standards specified in the Project Agreement. Such works are required to be completed on or before the date specified in the Project Agreement.

The required specification for each Dwelling in terms of the interim availability standard and the full availability standard is set out in the output specification attached to the Project Agreement. The manner in which the Contractor will deliver the Works is set out in the contractor's proposals which is also a schedule to the Project Agreement. Preliminary designs have been produced by the Contractor and submitted as part of its bid for the Project. These will be developed further in accordance with the project agreement and endorsed in accordance with the Review Procedure. The review procedure forms a schedule of the Project Agreement.

Construction programme and delay

The programme for completion of the Works covers a period of 45 months including a "bedding in period" of three months. Completion is certified by a qualified and experienced consultant ("**Independent Certifier**") appointed jointly by AGE, AGM and any other person providing finance pursuant to the Collateral Deed, the Bonds and any other Finance Document, the Contractor and the Authority.

Progress of the Works is measured by way of Milestones. Milestones are divided into both new build milestones and refurbishment milestones. A certain number of New Build Properties and a certain number of Refurbishment Properties are required to be completed by each of the Milestone Dates. Milestone Dates are set three months apart, with the first Milestone Date falling 12 months after the Initial Services Commencement Date (Refurbishment). A failure to achieve a Milestone by the relevant Milestone Date results in the awarding of a Default Termination Point. A default by the Contractor occurs if five Default Termination Points are outstanding in respect of either New Build Properties or five Default Termination Points are outstanding in respect of Refurbishment Properties. Where however a Milestone for which a Default Termination Point has been awarded is achieved by a later Milestone Date, then the relevant Default Termination Point which was previously awarded is then removed.

Certification occurs on a monthly basis whereby the Independent Certifier is required to certify the number of Dwellings that have achieved the full availability standard.

Note that there is a deeming provision which provides that if full certification has not been issued in relation to a Refurbishment Dwelling by the applicable commencement date specified in the Project Agreement as a consequence of certain events occurring (defined as a Work or Services Denial Event in the Project Agreement) then full certification may be deemed to be issued in respect of that Dwelling. This is intended to take into account where refurbishment works cannot be carried out by the Contractor due to certain factors that are outside of the Contractor's control (for example where a tenant will not grant access for the refurbishment works to be carried out).

The Project Agreement provides that where either works in respect of the New Build Properties or Refurbishment Properties are not complete such that the relevant Certificate of Availability is not awarded on or before the planned services commencement date specified in the Project Agreement then liquidated damages are payable to the Authority at a rate of £15 per dwelling per week. The Project Agreement provides for a process by which if a Compensation Event occurs, such that the Contractor is unable to commence the Works on the date specified in the Project Agreement, achieve a Milestone, or commence services by the planned services commencement date then each of those dates (including future Milestone Dates) can be extended. The costs that can be claimed by the Contractor in relation to such delay include both additional costs that are incurred by the Contractor and/or lost revenue which could not reasonably be expected to be mitigated or recovered.

Given the nature of the mechanism for tracking the progress of the Works through the achievement of Milestones, the Project Agreement does not use the traditional concept of a "long stop date". Instead, as a Contractor default occurs on the awarding of five Default Termination Points in respect of either the work carried out on the New Build Properties or the Refurbishment Properties, there is an effective rolling long stop date of 12 months which represents the amount by which the program would need to be delayed before the relevant default event is triggered.

Snagging and Defects

(i) Snagging

Within five (5) working days of the issue of the relevant certificate of availability to the Contractor, the Independent Certifier is required to issue a list of snagging items and within a further five (5) working days, the Contractor is required to provide to the Authority and the Independent Certifier, a program for making good of such snagging items set out in the snagging list provided that each snagging item is to be made good within twenty (20) working days. If the snagging items have not been made good in accordance with the snagging program to the satisfaction of the Independent Certifier, then the Authority is entitled to affect such repairs as is necessary and recover the costs of doing so from the Contractor.

(ii) Defects

(a) The Contractor is liable for defects in the New Build Dwellings.

(b) In relation to Refurbishment Dwellings, the Authority is liable for any defects in a Refurbishment Dwelling which is not revealed by data contained in the stock condition survey as a reasonable and prudent contractor would interpret such data in the context of the Project (including by reference to any disclosed survey data and any matter relating to a specific Dwelling archetype reasonably and generally known to contractors carrying out similar works). However, the Contractor is liable for defects which would have been revealed by data in a stock condition survey had the stock condition survey been undertaken in accordance with the surveyor's appointment or with the level of skill and care reasonably expected from competent professionals carrying out such stock condition survey or had the stock condition survey included all the Refurbishment Properties or the Contractor had carried out such additional surveys as a reasonable and prudent contractor exercising reasonable skill and care have carried out in such circumstances. The reason for this particular risk profile is because the Contractor elected to carry out a sample stock condition survey of a particular percentage of the Refurbishment Properties, that is, not all the properties were the subject of the stock conditions survey. The Contractor accepted that there is a residual risk in this approach, but that the risk is manageable.

Supervening Events

The Contractor is entitled to relief from its obligations under the Project Agreement to the extent that performance is prevented by the occurrence of a Compensation Event, Force Majeure Event or a Relief Event.

"**Compensation Event**" means a breach by the Authority of any of its obligations under this Agreement.

Compensation Events only apply during the Works Period and are summarised at *Completion of the Works* above.

Relief Events

"**Relief Event**" means:

(i) fire, explosion, lightning, storm, tempest, flood, bursting or overflowing of water tanks, apparatus or pipes, ionising radiation (to the extent it does not constitute a Force Majeure Event), earthquakes, riots and civil commotion;

(ii) failure by any statutory undertaker, utility company, local authority or other like body to carry out works or provide services;

(iii) any accidental loss or damage to the Sites or any roads servicing them;

(iv) any failure or shortage of power, fuel or transport;

(v) any blockade or embargo which does not constitute a Force Majeure Event;

(vi) any:

  (a) official or unofficial strike;

  (b) lockout;

  (c) go slow; or

  (d) other dispute,

  generally affecting the construction, housing or housing management industry or a significant sector of it;

(vii) occurrence of a works or services denial event as defined in the Project Agreement;

(viii) tenant damage or third party damage; and

(ix) the provision by the Authority of data in respect of a Tenant pursuant to the terms of this Agreement to the extent such data is inaccurate;

unless any of the events listed in paragraphs (i) to (ix) inclusive arise (directly or indirectly) as a direct result of any wilful default or wilful act of the Contractor or any of its sub-contractors.

The occurrence of a Relief Event which is the direct cause of delay to a planned services commencement date specified in the Project Agreement or failure to achieve a Milestone and/or adversely affects the ability of the Contractor to perform any obligations entitles the Contractor to relief from termination and the obligation to pay liquidated damages.

Excusing Event

"**Excusing Event**" means:

to the extent that such impacts upon the availability of a Dwelling/or the performance of the services, any of the following:

(i) a default by the Authority;

(ii) Compensation Event;

(iii) the implementation of any change by the Authority or Contractor;

(iv) an emergency (which is not a breach of the obligations of the Contractor under the Project Agreement);

(v) the carrying out of cyclical maintenance and renewal works;

(vi) the carrying out of Works or services in accordance with the specification set out in the Project Agreement to remedy any matters that are the subject of a disrepair action brought by a tenant in accordance with the Project Agreement;

(vii) any event of tenant damage or third party damage provided the Contractor has complied with the Tenant and Third Party Damage Protocol;

(viii) as a result of the Contractor acting in accordance with a written instruction of the Authority issued in accordance with the Project Agreement; and

(ix) the occurrence of a works or services denial event as specified in the Project Agreement"

No Deductions will apply if a failure arises from an Excusing Event.

Force Majeure

"**Force Majeure Event**" is given the following meaning in the Project Agreement;

means the occurrence after the date of this Agreement of:

(i) war, civil war, armed conflict or terrorism;

(ii) nuclear, chemical or biological contamination unless the source or cause of the contamination is as the result of the actions or breach of the Contractor or its sub-contractors of any tier; or

(iii) pressure waves caused by devices travelling at supersonic speeds, which directly causes either party to be unable to comply with all or a material part of its obligations under this Agreement.

Upon the occurrence of a Force Majeure Event, both the Authority and the Contractor will be relieved from liability to the extent that either of them are unable to perform their obligations. There is a requirement to use reasonable endeavours to mitigate the consequences of the Force Majeure Event and continue to perform each of their obligations under the Project Agreement. Payments of the Unitary Charge by the Authority are only made to the extent that the services are actually performed by the Contractor.

If a Force Majeure Event occurs, there are the following key consequences:

(i) relief from obligations;

(ii) the entitlement to make Deductions as a result of the operation of the payment mechanisms set out in the Project Agreement is not affected;

(iii) the parties seek to agree how to mitigate the effects of the Force Majeure Event and facilitate the continued performance of the Project Agreement;

(iv) if the parties are unable to comply with their obligations under the Project Agreement for a period of more than 120 working days then either party may terminate the Project Agreement by giving 30 working days written notice to the other Party; and

(v) if a notice of termination is issued by the Contractor, then the Authority is not obliged to accept that notice of termination or issue a notice to continue. If a notice to continue is issued by the Authority, the Authority is required to pay the Unitary Charge and any contribution payments due from the Authority to the Contractor from the date that termination would have occurred as if the Works and services were being fully provided by the Contractor.

Notwithstanding the above, there is a continuing requirement for the parties to mitigate the affect of the Force Majeure Event.

Services

(i) Services

The Contractor's obligation to provide services will include both "hard FM" services and "soft FM" services. The services will include repairs, maintenance and re-servicing of properties, planned, programmed, preventative and cyclical maintenance; caretaking and cleaning to communal areas and facilities; estate and environmental maintenance; customer access and liaison; contract management, reporting and information; continuous improvement; mobilisation and initial services; hand-back on termination or expiry; criminal record bureau checks; health & safety and risk assessments; staff conduct & training; and quality assurance.

In relation to the retention of risk, the Contractor will be passing all "lifecycle risk" down to the Facilities Management Contractor. The Facilities Management Contractor will be retaining the obligation to carry out the lifecycle works, but will be passing through the risk in relation to the balance of the services to Keepmoat Property Services Limited, which is a wholly owned subsidiary of Keepmoat Limited.

The Contractor is required to perform each of the services in accordance with the output specification, the method statement and the works delivery plan (as defined in the Project Agreement). The performance and delivery of the services is to be measured against the key performance indicators set out in the payments mechanism. If the Contractor fails to provide the services in accordance with the key performance indicators and the output specifications, then the payment mechanism provides that deductions will be levied against the Unitary Charge.

(ii) Market Testing

The first date for marketing testing as required by the Project Agreement is the fifth anniversary following the Initial Services Commencement Date (Refurbishment) and the subsequent marketing testing review dates fall on each fifth anniversary of that date. The Initial Services Commencement Date (Refurbishment) under the Project Agreement is 30 September 2013.

During market testing, there is a competition and if the competition shows that a winning tenderer provides the most economically advantageous tender then the Unitary Charge is adjusted to reflect the cost difference.

Under the Project Agreement, there are only three services that are subject to market testing. These are grounds maintenance, cleaning and caretaking.

Authority Payment

The Authority is making a contribution to the capital cost of the Works totalling £42.6m. The Authority makes such Capital Contribution, on a monthly basis (based on the number of Dwellings having been certified by the Independent Certifier as being complete).

In addition to the Capital Contribution, the Project Agreement requires the Authority to pay the Contractor the monthly unitary payment in respect of each payment period in accordance with the calculations set out in the payment mechanism. The monthly unitary payment is calculated based on a combination of the number of Dwellings that meet the interim availability standard and the number of Dwellings that meet the Full Availability Standard.

(i) Unitary Charge

A monthly invoice in respect of the monthly unitary payment will be submitted by the Contractor on the first Working Day of each payment period along with a monthly monitoring report. This monthly monitoring report is required to set out the information identified in Part H of the payment mechanism which essentially includes a calculation of the monthly unitary payment itself, the Unavailability Deductions, and the Performance Deductions. The monthly unitary payment is subject to a detailed unavailability regime and performance regime, for which non-compliance results in Deductions against the monthly Unitary Charge.

The monthly unitary payment for each month is calculated based on the monthly Unitary Charge. The monthly Unitary Charge is calculated based on the Interim Services Fee and the Full Services Fee. The interim services fee is calculated based on the number of leasehold dwellings and the number of rented dwellings that meet the interim availability standard. Likewise, the full services fee is calculated based on the number of leasehold dwellings and number of rented dwellings that have achieved the full availability standard for that particular month.

The ramp up in the monthly Unitary charge payable under the Project Agreement is subject to a maximum monthly certification cap as specified in the Project Agreement, whereby if Dwellings are completed and certified, and therefore achieve the full availability standard, on a cumulative basis, earlier than the profile established by the maximum monthly certification cap, those additional Dwellings that are certified earlier, will be deemed to not have been so certified. These additional Dwelling will then subsequently be deemed certified at time at which the profile allows this.

Furthermore, 24% of the interim base rented dwelling charge and the full base rented dwelling charge are indexed. The indexation is based on the all items retail prices index excluding mortgage interest payments ("**RPIx**") (as defined in the Project Agreement) published in February each year, as against the RPIx at April 2010. The same indexation formula applies to the interim base leasehold dwelling charge and the full base leasehold dwelling charge (as defined in the Project Agreement).

(ii) Unavailability Deductions

Where a Dwelling fails to achieve either the interim availability standard or the full availability standard (whichever relevant), the Contractor is required to rectify the Unavailability during the period required for rectification, as set out in the Project

Agreement. If the Contractor fails to rectify the Unavailability within the period required for rectification then the Dwelling will be deemed to be Unavailable from the date of receipt of notification by the Contractor of the Unavailability.

There is provision for temporary rectification measures to be carried out by the Contractor to rectify Unavailability on a temporary basis (**"Temporary Rectification"**). If the output specification permits Temporary Rectification, then the Contractor will nevertheless need to rectify the Unavailability during the Period required for rectification.

The total Unavailability Deduction is a sum of the interim Unavailability Deduction and the full Unavailability Deduction (for the Dwellings), the facility Unavailability Deduction and the environmental and communal works Unavailability Deduction, where such deductions are specified in the Project Agreement.

The monthly unitary payment is subject to Unavailability Deductions. Essentially the Unavailability Deduction involves the deduction of the amount of the Services Fee in respect of Dwellings which fails to meet the relevant availability. When a Dwelling is Unavailable but still used, then only 70% of the Dwelling Charge is paid.

The facility Unavailability Deductions are calculated in a similar way with the facility charge deducted from the monthly Unitary Charge if the facility is Unavailable whilst also subject to the Ratchet Factor (the "**Ratchet Factor**") if there are multiple instances of Unavailability. Twenty four percent (24%) of the Facility Base Charge is subject to indexation based on RPIx.

Environmental and communal works Unavailability Deductions operate the same way but there is the base charge for each environmental and communal area which is used for the purpose of the calculation.

The Ratchet Factor is calculated based on the number of days within one month for which a Rented Dwelling, Leasehold Dwelling or Facility is Unavailable or Unavailable but still used. The Ratchet Factor varies from 1.0 to 4.5 depending on the number of days of Unavailability.

There is a requirement for the Contractor to find temporary alternative accommodation that complies with Annex 13 of the output specification. If such temporary alternative accommodation is found then relief from Deduction is given pursuant to Annex 13. It should be noted that where the Authority finds temporary alternative accommodation for the tenant or leaseholder in the event of Unavailability, the Authority is entitled to charge that cost back to the Contractor (if greater than the Unavailability Deduction).

No Unavailability Deductions will apply if the Unavailability arises directly from an Excusing Event, is not the result of breach by the Contractor or a Contractor Related Party and the Contractor is taking reasonable steps to mitigate the effect of the Excusing Event.

(iii) Performance Deductions

Performance Deductions will apply where the Contractor is failing to provide the services in accordance with the key performance indicators standard. Where the Contractor is failing to provide the service in accordance with the key performance indicators standard then a performance calibration factor is calculated. The performance deduction is calculated by multiplying the performance calibration factor, and the performance factor with the Monthly Unitary Charge. The performance factor is capped at 100%. The performance factor for a month is calculated based on the weighting factor, the failure type, the number of key performance indicator standards in respect of the service performance failures occurring in that month and the relevant Ratchet Factor.

No Performance Deductions will apply if the service performance failure arises directly from an Excusing Event, is not the result of breach by the Contractor or a Contractor related party and the Contractor is taking reasonable steps to mitigate the effect of the Excusing Event.

Where there is a mistake made in respect of the Contractor's reporting obligations then a reporting Deduction of £50 (indexed) will apply.

There are three qualifying factors in relation to the application of Deductions. These are:

(a) An overall cap – There is an overall cap that applies in relation to the application of Deductions in any given month equal to the Monthly Unitary Charge. Any excess Unavailability or Performance Deductions will be permanently disregarded.

(b) Performance Deductions - Performance Deductions which are greater than 24% of the Monthly Unitary Charge in any given month. Any excess Performance Deductions will be permanently disregarded.

(c) 'Bedding in' period – During the 'Bedding in' period there is a ramp up of the Deduction profile, from Month 1, when Deductions will not apply, to Month 4 when 100% of Deductions will apply.

Authority Step-In

The Authority has step-in rights to take action in connection with the services (or the Works in respect of Refurbishment Properties) if there is a serious risk in relation to health or safety of persons or property or to the environment, or to discharge a statutory duty or where a Dwelling has been Unavailable for a period of five months except if the Authority reasonably believes that the Contractor is likely to complete or have completed the relevant Works within one month. If the Authority exercises step-in right then the Contractor is required to give reasonable assistance to the Authority while the Authority is exercising its step-in rights. If the Authority steps-in where there is no breach by the Contractor, it must take action in accordance with good industry practice and is required to indemnify the Contractor against all direct losses. If the Authority steps in without a Contractor breach, the Authority will pay the Contractor the Unitary Charge that the Contractor would have received if it were satisfying all of its obligations in carrying out the Works and or services. If the Authority steps in on a Contractor breach, then the Authority will pay the Contractor the Unitary Charge that it would have received if it had been carrying out all of the Works and services less an amount equal to all the Authority's costs of operating and taking action during the step-in period.

TUPE and Pensions

Certain of the employees engaged by the Authority and their contractors who are engaged in services corresponding to the services that are required to be provided by the Contractor will transfer into the employment of the Contractor's sub-contractor – Keepmoat Property Services Limited. These employees in total are six (6). The Project Agreement sets out the details of the employees who will transfer from the Authority to Keepmoat Property Services Limited including the pay and benefits of those employees who will transfer.

If at any time (including, after the submission of the **"Final Employee List"** – the list of all Authority employees and their details that is provided after an employee transfers to the employment of Keepmoat Property Services) the employment and/or reorganisation costs related to the transferring employees are required to be adjusted on account of any differences between the information contained in the **"First Employee List"** (the list of Authority employees who it is expected will be transferred to Keepmoat Property Services) and that contained in the Final Employee List, or on account of any inaccuracies in or omissions from the information contained in the First Employee List or the Final Employee List then there will be a corresponding adjustment to the Unitary Charge to compensate for any such difference.

The Authority will remain responsible, after transfer, for employment related liabilities of the transferring employees which relates to the period prior to the date on which an employee transfers to the employment of Keepmoat Property Services. The Contractor, and ultimately Keepmoat Property Services Limited, will be responsible for all employment related liabilities arising on and from the date of employee transfer.

The Contractor must prove that any Transferring Employee who is an active member of (or eligible to join) the pension scheme offered by Local Government is offered membership of such scheme and that Keepmoat Property Services Limited has become an admission body. The Authority shall procure that once an admission body, Keepmoat Property Services Limited is credited with a notional transfer of each relevant employees' assets equal to the value of the liabilities attributed to their pensionable service.

Once an admission body, Keepmoat Property Services Limited must pay the required pensions contributions for the relevant employees.

For the purpose of the financial model, a contribution rate into the pension scheme has been assumed at 13.4%. To the extent that employer contributions are greater or less than the agreed 13.4%, the Authority takes the risk and also retains the benefit through an adjustment to the next Monthly Unitary Payment.

Change of Law

The Authority will compensate the Contractor in respect of certain Change of Laws enacted after the execution of the Project Agreement which were not reasonably foreseeable prior to the execution of the Project Agreement and which:

(i) impact only on the Project and not similar projects procured under PFI, impact the Contractor and not other persons, or PFI Contractors not other persons;

(ii) affect the provision of housing or tenant management services to housing owned by a local housing authority or a registered social landlord, the provision of construction and maintenance or housing services to residential tenanted accommodation, a tenant or leaseholder or other lawful occupiers of housing owned by a local housing authority or a registered social landlord, the holding of shares in companies or industrial and provident societies whose main business is providing any of the aforementioned services;

(iii) a General Change of Law that comes into effect during the Service Period which involves capital expenditure.

The above are **"Qualifying Changes of Law"**. Changes of Law which are not a Qualifying Change of Law are a Contractor risk.

Usually in a PFI project, a certain percentage of the costs in relation to limb (iii) of the above is funded by the Contractor, through a "change of law facility". In this case, the Authority will be taking the entire risk

The costs in relation to a Qualifying Change of Law, and any postponement of relevant dates, are calculated in accordance with the provisions of the Project Agreement.

Changes to the Works or Services

Procedures (in accordance with the drafting approved by Infrastructure UK and the Homes and Communities Agency) will apply for the instruction, valuation and payment of Changes during the performance of the Works and Changes to any services. The Project Agreement includes a Change protocol which governs these aspects of a Change. A **"Change"** means any change, variation, extension or reduction in the Works and/or the Dwellings and/or the services.

There are specific limitations on the circumstances as to when a Change will be permitted.

In particular, the drafting provides that neither party may issue a Change:

(i) which requires the Works or services to be performed or carried out in a way that infringes any legislation or guidance or is inconsistent with good industry practice;

(ii) which would result in the revoking of an existing consent, or requires the obtaining of a new consent and the Contractor would not be able to obtain such new consent using reasonable efforts;

(iii) which would materially and adversely affect the Contractor's ability to perform the Works or services in a manner which is not compensated pursuant to the Change protocol;

(iv) which would materially and adversely affect the health and safety of any person;

(v) which would require the Contractor to implement the Change in an unreasonable period of time;

(vi) which would increase the Contractor's capital cost by more than 20% in the aggregate;

(vii) which would materially and adversely change the nature of the Project;

(viii) whereby the Authority does not have the legal power or capacity to require the implementation of such Change; or

(ix) which would if, implemented, adversely affect enforceability of priority held by or on behalf of the Senior Funders.

The Change protocol provides for three levels of Changes. These are:

(i) **"Low Value Changes"** which are Changes that are generally listed in a catalogue of Low Value Changes or Works of a minor nature or the provision of plant or equipment which is valued at or less than £10,000, or such Change in services the implementation of which does not exceed £10,000. Furthermore, where such Low Value Changes are aggregated together in a period of six months proceeding such Change, and the sum exceeds £60,000, then such Change is then to be regarded as a Medium Value Change rather than a Low Value Change.

(ii) **"Medium Value Changes"** are Changes that are not Low Value Change, and cost less than £500,000 to implement, or require an adjustment to the Unitary Charge that is less than 5% of the annual Unitary Charge in the relevant year.

(iii) **"High Value Changes"** are Changes that exceed the threshold for a Medium Value Change.

The key difference between the three levels of Changes are that for Low Value Changes, pricing is generally in accordance with the catalogue. Furthermore, the time for implementation of a Low Value Change is also set out in the catalogue, including an extension to the relevant dates as the planned services commencement date. Furthermore, the Contractor is not entitled to any additional charge for the processing, implementing or managing of a Low Value Change, except other than the cost set out in the catalogue.

If the Authority requires a Medium Value Change, the Authority will issue an Authority Change Notice to the Contractor setting out the details of the Change required (**"Authority Change Notice"**). The Contractor is required to respond to that Authority Change Notice with a Contractor response including, amongst other things, an estimated change in the Contractor's costs which results from the Medium Value Change. This requires the Contractor to take into account the whole of life costs in relation to such Medium Value Change. If after receipt of the Authority Change Notice, the Contractor reasonably believes the Contractor response is unlikely to meet the Project Agreement approval criteria, the Contractor can circumvent the process by issuing a Contractor objection. Once the Contractor response is received, the Authority may either confirm or withdraw the Authority Change Notice or reject the Contractor response.

If the Authority withdraws the Authority Change Notice then the Authority is required to pay the Contractor the reasonable additional third party costs incurred by the Contractor in preparing such Contractor response (unless the Contractor response does not meet the approval criteria). If the Authority is entitled to implement the Change itself then the Authority is required to do so using the same skill and care that is required of the Contractor under the Project Agreement. If the Authority fails to do so then there is a deemed Compensation Event. The Contractor is entitled to extensions to the planned services commencement date and any Milestones as a consequence of a Medium Value Change.

The negotiation and implementation of a High Value Change is essentially a two stage process. If the Authority requires the Contractor to carry out a High Value Change, the Authority initiates the process by issuing a Authority Change Notice setting out the details of the required High Value Change. The Contractor is then required to respond with a "**Contractor Stage One Response**". The Authority then considers in good faith the Contractor Stage One Response. The Authority will then confirm the Contractor Stage One Response (in which case the Contractor then proceeds to develop the Contractor Stage Two Response), and confirm the agreed project management fee, the approval criteria and set out a date by which the Contractor Stage Two Response is to be submitted.

If the Contractor Stage One Response does not meet the approval criteria then the Authority may withdraw the Authority Change Notice and the Contractor is not entitled to any compensation. If the Contractor Stage One Response meets the approval criteria but the Authority withdraws the Authority Change Notice, the Contractor is to be reimbursed its third party costs reasonably incurred in preparing the Contractor Stage One Response. The Contractor Stage Two Response essentially consists of a detailed design solution to the Authority Change Notice.

If the Authority accepts the Contractor Stage Two Response then the Authority will issue a confirmation. Alternatively the Authority may withdraw the Authority Change Notice or reject the Contractor Stage Two Response in which case the Authority shall not be responsible for any costs incurred by the Contractor in preparing the Contractor Stage Two Response (except for third party costs which are explained below).

There is however a restriction on the Authority's ability to reject the Contractor Stage Two Response which may only be on the grounds that the Contractor Stage Two Response has failed to meet one or more of the approval criteria or The Contractor has failed to comply with any material requirement of the Change Protocol. If the Authority Change Notice is withdrawn the Authority is required to pay the reasonable third party costs incurred by the Contractor in preparing the Stage Two Response together with outstanding balance of the project management fees. Similar to a Medium Value Change, if the Authority is entitled to implement the change itself, then similar provisions apply.

In respect of both Medium Value Changes and High Value Changes, the Contractor is required to use reasonable endeavours to obtain funding for the whole of the estimated capital expenditure. If the Contractor is unable to do so, the Contractor may inform the Authority and request the Authority provide such funding. If the Authority is unable to provide funding for the capital expenditure then the Contractor will have no obligation to carry out the Authority Change.

Insurance

Uninsurable risks:

Where a relevant risk becomes Uninsurable then the relevant provision of the Project Agreement will apply. **"Uninsurable"** is given the following meaning in the Project Agreement "means in relation to a risk, either that:

(i) insurance is not available to the Contractor in respect of the Project in the worldwide insurance market with reputable insurers of good standing in respect of that risk; or

(ii) the insurance premium payable for insuring that risk is at such a level that the risk is not generally being insured against in the worldwide insurance market with reputable insurers of good standing by contractors in the United Kingdom.

If the risk is Uninsurable and the Contractor can demonstrate to the Authority that a contractor in similar circumstances acting reasonably would resolve to cease to operate such a business as a result of such risk becoming, among other things, Uninsurable, then the parties are required to meet to discuss how the risk is to be managed. Also, the parties are required to discuss self insurance by either party.

If the parties cannot agree how to share the risks then the Authority can either pay an amount equivalent to the amount payable for Compensation on Termination for a Force Majeure Event in respect of third party liability insurance (and the Project Agreement will terminate), or elect to require that the Project Agreement continue.

If the Project Agreement continues, then in respect of contractors all risk, property damage insurance, third party liability insurance, delay in start up and business interruption insurance or statutory insurances the Project Agreement is required to continue and on the occurrence of the risk the Authority is required to pay the Contractor an amount equal to the insurance proceeds that would have been payable had the relevant insurance been in place or an amount equal to the amount calculated in accordance with the Compensation on Termination for a Force Majeure Event, and the Project Agreement will then terminate.

While the Project Agreement is continuing, the Contractor is required to approach the insurance market at least once every four months to establish whether the risk remains uninsurable.

The Project Agreement also includes a self insurance model whereby the Authority and the Contractor agree to explore in good faith (but save for that obligation with no legally binding effect) a model for the Authority to self insure the following insurances:

(i) property damage insurance (but not when Contractor's all risk insurance is in force) and business interruption insurance;

(ii) delay in start up insurance that applies during the design and construction phase.

If the parties agree that the Authority will self insure, there is a reduction to the Unitary Charge to reflect the self insurance model agreed upon, and the insurance premium savings that arise. Pre-agreed due diligence costs in relation to consideration of the self insurance model being legal, technical, financial and insurance due diligence will be covered by the Authority.

Termination Events

The Project Agreement will incorporate early termination rights for the Contractor and the Authority. Compensation will be payable by the Authority upon termination of the Project Agreement. The amount of termination compensation payable will depend on the reason for termination and other circumstances.

Early termination rights fall into the following categories.

(i) Authority Default – this is defined in the Project Agreement as follows:

(a) "an expropriation, sequestration or requisition of a material part of the assets and/or shares of the Contractor by the Authority or other relevant authority;

(b) a failure by the Authority to make payment of any amount of money exceeding one month's Unitary Charge (indexed) that is due and payable by the Authority under this Agreement within twenty (20) working days of service of a formal written demand by the Contractor, where the amount fell due and payable two (2) (or more) months prior to the date of service of the written demand;

(c) a breach by the Authority of its obligations under this Agreement which substantially frustrates or renders it impossible for the Contractor to perform its obligations under this Agreement for a continuous period of two (2) (or more) months;

(d) a breach by the Authority of clause 65.1 (Restrictions on Transfer of the Project Agreement by the Authority) occurs; or

(e) a failure by the Authority to make a payment in excess of £100,000) of the contribution pursuant to clause 10.3.6 that is due and payable by the Authority under this Agreement within twenty (20) working days of service of a formal written demand by the Contractor, where the amount fell due and payable at least twenty (20) working days prior to the date of service of the written demand."

Where termination is due to the Authority Default, or voluntary termination by the Authority, the amount of compensation is intended to enable the Contractor to meets its obligations to the Issuer and to enable the Issuer to meet its obligations under the Bonds including the Bonds Spens amounts. The "**Bonds Spens**" amount is the amount by which any default amount payable under the Bonds exceeds the indexed par amount.

The amount of compensation payable by the Authority in other termination scenarios namely an Uninsurable Risk or a Force Majeure Event, corrupt gifts and fraud and wilful breach of the refinancing provisions, have been structured so as to enable the Contractor to meets its obligations to the Issuer and to enable the Issuer to meet its obligations under the Bonds (but excluding the Bonds Spens amount).

(ii) Contractor Default - – this is defined in the Project Agreement as follows:

(a) "a breach by the Contractor of any of its obligations and/or warranties under this Agreement which materially and adversely affects the performance of the services;

(b) a Persistent breach occurs;

(c) a court makes an order that the Contractor or HoldCo be wound up or a resolution for a voluntary winding-up of the Contractor or HoldCo is passed;

(d) any receiver or manager in respect of the Contractor or HoldCo is appointed or possession is taken by or on behalf of any creditor of any property of the Contractor or HoldCo that is the subject of a charge;

(e) any voluntary arrangement is made for a composition of debts or a scheme of arrangement is approved under the Insolvency Act 1986 or the Companies Act 2006 in respect of the Contractor or HoldCo;

(f) an administration order is made, or an administrator is appointed in respect of the Contractor or HoldCo;

(g) a breach by the Contractor of its obligations under clause 65.2 (Restriction on the Contractor) occurs;

(h) a breach of clause 66.5 (Change in Ownership) or clauses 66.1 to 66.4 occurs;

(i) the Contractor abandons the Project at any time;

(j) the Contractor has not commenced the Works by one (1) month after the Initial Services Commencement Date (Refurbishment);

(k) five (5) Default Termination Points are outstanding in respect of the New Build Properties or five (5) Default Termination Points are outstanding in respect of the Refurbishment Works;

(l) in any four (4) month period the Authority has been entitled to reduce the amount of the Unitary Charge by more than or equal to twenty (20)% through Unavailability Deductions;

(m) in each and every month of any nine (9) month period the Authority has been entitled to reduce the amount of the Unitary Charge by more than or equal to eight (8) % through Performance Deductions;

(n) a breach by the Contractor of its obligations to take out and maintain any of the required insurances;

(o) failure to replace the Sub-contractor or sub-sub contractor following the occurrence of a public safety incident in accordance with clause 25.3 (**"***Public Safety Incident***"**);

(p) a breach by the Contractor of its obligation under clause 30.1 ("*Contractor to become an admission body*");

(q) non-default (example force majeure, uninsurable risks); and

(r) wilful defaults (example corrupt gifts, wilful breach of refinancing provisions)."

Compensation on Termination for Contractor Default

(i) Calculation of Compensation on Termination

For termination by reason of default by the Contractor, the amount of compensation payable by the Authority will be calculated by a reference to the market value of the unexpired term of the Project Agreement. This is by way of an election made by the Authority to either retender the provision of the Project or require an expert determination to value the unexpired project term.

The objective of the retendering procedure is to establish and to pay to the Contractor the highest compliant tender price, as a result of the tender process. If the adjusted highest compliant tender price is less than 0, then the Contractor is required to pay that amount to the Authority on the date of the new contract.

If the Authority is not entitled to retender the provision of the Project or the Authority elects to require an expert determination, then resulting the estimated fair value of the contract is to be determined in accordance with the principles set out in the Project Agreement. To the extent of the adjusted estimated fair value of the contract (as defined in the Project Agreement) is less than 0, then the Contractor is required to pay the authority on the compensation date, the amount of the adjusted estimated fair value of the contract.

(ii) Additional Permitted Borrowing

The provisions for payment of compensation on termination in the Project Agreement also take account of any Additional Permitted Borrowings. If required, the Contractor is entitled to raise further borrowings ("**Additional Permitted Borrowings**") without the consent of the Authority up to a limit ("**Additional Permitted Borrowings Limit**"). Any borrowings in excess of the Additional Permitted Borrowings Limit shall only be raised by the Contractor with the consent of the Authority.

If a Distribution is made while any Additional Permitted Borrowing is outstanding, and the Contractor wilfully or through gross negligence fails to comply with its obligation under the Funders Direct Agreement to notify the Authority of that Distribution, then in addition to the deduction of the Distribution made pursuant to the definition of revised senior debt termination amount set out in the Project Agreement, the Authority shall be entitled to set off the value of the Distribution a second time against the Force Majeure Event termination sum provided that the amount of the Authority default termination sum shall not be less than the revised senior debt termination amount.

Contamination and Unforeseen Ground Conditions

Generally the Contractor is responsible for unforeseen ground conditions and contamination as follows:

(i) New Build Properties – the Contractor is taking the risk of Site conditions and contamination which are not under existing buildings and is deemed to have carried out ground physical and geo physical investigations and examined all the Project Sites and be aware of the nature of the site conditions at the Project Sites including the presence or absence of contamination. Furthermore, the Contractor is required to hold the Authority harmless from and cleaning up and otherwise dealing with contamination at the Project Sites.

(ii) Refurbishment Properties – the Contractor is responsible for site conditions and contamination to the extent that such site conditions and contamination have been or could have been revealed from surveys carried out or from such surveys that would have been carried out by a reasonably experienced contractor using the level of skill and care of competent professionals carrying out such surveys or would have been identified by surveys carried out by a reasonably experienced contractor exercising reasonably skill and care in such circumstances or otherwise would have been revealed by a non-intrusive inspection. Furthermore, the Contractor is required to indemnify the Authority in respect of all direct losses and hold the Authority harmless from cleaning up and otherwise dealing with any contamination within the project sites and/or properties to the extent that the Contractor is responsible for such contamination of site conditions.

(iii) Asbestos

Asbestos risk and liability for defects is divided depending on the types of property. The risk profile for the Refurbishment Properties is as follows: representative sample stock condition surveys were carried out in relation to refurbishment properties. It is accepted that the Contractor takes a risk of carrying out representative sample stock condition surveys.

Accordingly, the Authority takes the risk in relation to asbestos not identified in the disclosed survey data or any asbestos which is not revealed by data contained in the asbestos survey as a reasonable and prudent contractor would interpret such data in the context of the Project and such asbestos would not have been revealed if the asbestos survey had been carried out using the level of skill and care reasonably to have been expected from a competent professional carrying out asbestos surveys, and the asbestos survey would have covered all the refurbishment properties.

The Contractor had carried out such additional surveys as would have been reasonable to expect a reasonably experienced contractor exercising the reasonable skill and care to have carried out in the circumstances or otherwise would have been revealed by non-intrusive inspections.

Indemnities and Exclusive Remedies

The following heads of indemnity are contained in the Project Agreement:

(i) death or personal injury;

(ii) loss of or damage to property, including property belonging to the Authority or for which the Authority is responsible;

(iii) third party actions claims, demands costs, charges and expenses;

(iv) direct losses and indirect losses arising from third party actions claims or demands for breach of statutory duty which arise as a consequence of a breach by the Contractor of its obligations under the Project Agreement.

Specific caps on liability that apply to the general indemnity include:

(i) where the amount of any claim for damage to Authority property or third party claims is in excess of the level of cover required by the Project Agreement in respect of such liability (excluding liability for any excess or deductible which is required to be paid under the policy of insurance);

(ii) in respect of any liability for third party claims or breach of statutory duty and aggregated over the previous five years to the extent that it is a Contractor's uninsured loss, exceeds £750,000.

Subject to express rights under the Project Agreement, the Authority's remedy for non-compliant provision of the services will be confined to its rights under the payment mechanism, which can ultimately result in termination of the relevant sub-contract or part of the sub-contract or the Project Agreement (as the case may be).

Authority's Obligations

The Authority has quite limited obligations under the Project Agreement. Some of the main obligations under the Project Agreement include the following:

(i) payment of the Unitary Charge and Capital Contribution;

(ii) providing access to the Sites;

(iii) obtaining particular consents that cannot be obtained by the Contractor;

(iv) making decant dwellings available, as defined in the Project Agreement;

(v) carrying out early demolition works; and

(vi) eradicating Japanese knotweed in the Japanese knotweed infestation areas.

Dispute Resolution

The Project Agreement contains dispute resolution procedures which will be applicable whenever there is a dispute between the parties. The Authority and the Contractor are required to consult in good faith in an attempt to come to an agreement in relation to the disputed matter. Notwithstanding the right to proceed to consultation, either party may give the other notice of intention to refer the dispute to adjudication and the adjudicator shall be selected in accordance with the relevant provisions of the Project Agreement.

Either party within 90 calendar days of receipt of the adjudicator's decision or where the adjudicator fails to give a decision, may give notice to the other party of its intention to refer the dispute to English courts for final determination.

The Project Agreement also includes provisions dealing with the inclusion of Building Contract disputes and **"Responsive Repairs and Cyclical Maintenance and Renewal Contract Disputes"** (as defined in the Project Agreement) should be heard at the same time as a Project Agreement Dispute.

It should be noted that the adjudicator does not have jurisdiction to determine the Building Contract dispute nor the Responsive Repairs and Cyclical Maintenance and Renewal Contract Dispute but the adjudicator's decision shall be binding on the Contractor and the Building Contractor and the Facilities Management Contractor in so far as it determines issues that relate to their respective contracts.

Corrupt Gifts

The Project Agreement provides that the Authority has the right to terminate the Project Agreement where the Contractor or any of its employees or those of its sub-contractors have made a corrupt gift to the Authority or to any person employed by or on behalf of the Authority and the Contractor has not taken appropriate action, for example by dismissing the relevant sub-contractor, director or employee. If the Corrupt Gift is made by the Contractor or an employee acting with the authority or knowledge of one or more of the Contractor's directors, the Authority has an immediate right to terminate the Project Agreement. The amount of compensation payable by the Authority on such termination has been structured to enable the Contractor to pay the Issuer to enable it to meet its obligations under the Bonds.

Assignment by the Contractor

The Contractor may not assign its interest in the Project Agreement. The Project Agreement prohibits the sub-contract, assignment, under letting, charge, selling or bargaining or otherwise dealing with any benefit of the Project Agreement in whole or in part except with the prior written consent of the Authority. Certain exceptions apply which are:

(i) the grant of any security for any loan made to the Contractor under the Finance Documents;

(ii) the provision of the Works or services from a sub-contractor whose identity has been notified to the Authority prior to the appointment of such sub-contractor.

Refinancing

The Project Agreement sets out the Contractor's obligations in relation to any refinancing of the Project. Wilful default of the refinancing provisions by the Contractor constitutes a Contractor Default under the Project Agreement. Where refinancing occurs (unless it is exempt from the provisions), the Contractor is under an obligation to share with the Authority, the gains (if any) derived from such refinancing.

Title risk

Adverse Rights that could impede on the Contractor's ability to properly carry out the Works or the services, is at the Contractor's risk if it was discoverable by the Contractor by way of:

(i) entries in any public register;

(ii) inspection of the Project Sites;

(iii) all utility equipment and apparatus situated in, on, over, under or through the Project Sites including (without limitation) telegraph poles, drains and sewers and all service media and all rights to use the same;

(iv) all such public rights of way; and

(v) all rights of light and air which affect any of the Project Sites.

Tenant and third party damage

The risk of tenant and third party damage largely sits with the Authority. These costs are passed through to the Contractor to the extent that the costs are direct costs resulting from tenant damage or third party damage (but subject to the tenant and third party damage protocol) (**"Qualifying Costs"**). Importantly, costs that could be recovered under a required insurance, or costs which are already covered by the Unitary Charge, are not Qualifying Costs.

Rent Collection Risk

Housing management such as rent collection, management of void Dwellings and allocation of tenants is retained by the Authority, and will continue to be performed by the ALMOs. Rent collection risk sits with the Authority.

Protocols

The Project Agreement includes the following protocols which govern some of the project specific issues that the Contractor is likely to deal with:

(i) access protocol;

(ii) tenant waiver protocol;

(iii) tenant improvements protocol;

(iv) decant protocol;

(v) disrepair actions protocol;

(vi) adaptations protocol

(vii) tenant and third party damage protocol;

(viii) litigation protocol;

(ix) trees protocol;

(x) marketing and media protocol; and

(xi) ICT protocol.

2. KEY TERMS OF THE BUILDING CONTRACT

General Terms

The parties to the Building Contract, which will be dated on or before the Issue Date, are the Contractor and the Building Contractor. Pursuant to the Building Contract, the Building Contractor will demolish certain buildings, design and construct 388 new build dwellings and carry out improvement and refurbishment works to 1,245 existing dwellings. The Building Contract will reflect the construction provisions of the Project Agreement with the intention that the Contractor's risks and obligations in relation to the Works are passed down to the Building Contractor under the Building Contract.

Completion of Construction Works

(i) Liquidated damages for delay

The Building Contractor will be liable to the Contractor for liquidated damages for delay in completing the relevant Works on or before the relevant planned services commencement date. Liquidated damages are not carved out of the project cap in the Building Contract.

Liquidated damages are payable based on two different triggers:

(a) First, as a direct flowdown of clause 21 (Indemnity) of the Project Agreement. That is, payment at a rate of £15 per dwelling per week for a failure to achieve a planned full services commencement date (Refurbishment) or planned full services commencement date (New Build) until the relevant services commencement date is achieved or Certificate of Availability is issued;

(b) Secondly, and in addition to clause 21, where the relevant Certificate of Availability in respect of the Works has not occurred by the relevant date specified for completion of such Works in the construction programme, then the Building Contractor is required to pay liquidated damages in accordance with the rates specified in Schedule 32 (Liquidated Damages) from the relevant date specified for completion of Works in the construction programme until the relevant Certificate of Availability is issued. The purpose of this tranche of liquidated damages is to cover the revenue shortfall that will be incurred by the Contractor for the late completion of the Dwellings and accordingly loss of the increase in the Monthly Services Payment, where liquidated damages are not levied under the Project

Agreement, but the Authority does not cover the costs associated with the delay in completion (e.g. if a Relief Event occurs).

If the Building Contractor pays liquidated damages and the delay in completion is due to an event that is the subject of the delay in start up insurance, then the Contractor is required to reimburse the Building Contractor an amount no greater than the amount of liquidated damages paid by or deducted from the Building Contractor in respect of such delay to the extent of the Contractor's recovery.

(ii) Delay and compensation

The Building Contract will permit the Building Contractor to obtain extensions of time and compensation for breach and other acts of prevention by the Contractor, and in respect of Changes requested by either the Contractor under the Building Contract or the Authority under the Project Agreement. The benefit of the provisions relating to Compensation Events under the Project Agreement have effectively been passed down to the Building Contractor under the Building Contract, but are subject to the Equivalent Project Relief (**"EPR"**) provisions.

If delay is caused by an event not being a compensation event, liquidated damages will be payable by the Building Contractor to the Contractor and the amount of such liquidated damages will be calculated to be adequate to replace the Contractor's lost revenue attributable to the delay. Where the delay is caused by specific breaches or acts of prevention by the Contractor, liquidated damages will not be payable by the Building Contractor.

Maximum liability

The maximum aggregate liability of the Building Contractor to the Contractor pursuant to and arising out of the Building Contract is limited to 60% percentage of the Contract Sum.

Matters that fall outside the project cap (and therefore are uncapped liability) include the following:

(i) any liability in relation to death or personal injury caused by the Building Contractor or any Building Contractor related party including liability for such under the general indemnity provision in both the Project Agreement and the Building Contract;

(ii) any liability caused or contributed to by:

(a) wilful default by the Building Contractor or a Building Contractor related party;

(b) fraud (including prohibited acts) or fraudulent misrepresentation of the Building Contractor or any Building Contractor related party;

(c) abandonment by the Building Contractor of the Works;

(iii) liability under either the general indemnity provision or the intellectual property indemnity in the Building Contract;

(iv) any liability in respect of the costs of enforcement or defence, incurred by the Contractor which requires the Contractor to enforce or defend claims or actions or to take any claimed EPR through the relevant EPR provision or parallel claims provision of the Building Contract;

(v) any liability of the Building Contractor for indemnifying the Contractor for EPR costs incurred by the Contractor where the Building Contractor pursues its own rights in relation to a Contractor Claim or Authority Claim;

(vi) any claim by the Contractor to the extent arising out of a matter notified to the Building Contractor, and the Building Contractor is entitled to, and elected to, proceed at its own risk pursuant to the parallel claims procedure;

(vii) any liability, where and to the extent that the Building Contractor makes recovery (or is entitled to, but fails to do so) from a Building Contractor Related Party, the Facilities Management Contractor or any other third party;

(viii) any amount that the Building Contractor recovers, or which the Building Contractor is entitled to recover, but fails to do so, as a result of the Building Contractor or any Building Contractor related party causing any insurance policy to become void, from insurance to be maintained by either party, but not exceeding the amount of such relevant insurance cover to be maintained in respect of the relevant loss or claim;

(ix) any payment of interest by the Building Contractor to the Contractor on sums payable;

(x) any liability incurred as a consequence of the Building Contractor repudiating the Building contract;

(xi) liability incurred as a consequence of gross negligence of the Building Contractor;

(xii) any Domestic Liability;

(xiii) any costs or liability of the Building Contractor arising out of clause 18.2, 18.3(d) and 18.4(d) (Project Sites); and

(xiv) any liability arising out of a breach of statutory duty occasioned by an act or omission of the Building Contractor, but subject to such limitations as applied by virtue of the cap on liability in respect of an uninsured breach of a statutory duty.

The Building Contractor is entitled at any time to request a refresh in the project cap. Any cap refreshed is required to be accompanied by a rectification plan by the Building Contractor.

Payment

(i) Payment

The Building Contractor will be paid monthly in arrears but the amount of such payments will be limited by agreed payment schedules and monitored by the Independent Certifier and the technical adviser to the Senior Funder.

The Authority will make a Capital Contribution payment to the cost of carrying out the Works. The receipt of the equivalent amount by the Building Contractor is subject to EPR. Accordingly, the risk of a delay in payment by the Authority of the Capital Contribution amount is a risk passed down to the Building Contractor.

Liability for Building Defects

The Building Contractor will be responsible for the cost of rectifying design and construction defects and for any Deductions arising due to such defects until the date that is 12 years after the date of the last Certificate of Availability save in respect of any action or proceedings commenced prior to the expiry of such 12 year period.

Termination

The Building Contract will terminate on early termination of the Project Agreement.

The termination provisions of the Project Agreement (to the extent relevant to the Works) have been generally passed down to the Building Contract, but with appropriate headroom with the intention of allowing the Contractor an opportunity to manage the Building Contract. There are additional events of default including the guarantee provided by the Building Contractor's parent company ceasing to be in full force and effect; the liability of the Building Contractor reaching prescribed portions of the liability cap; and failure to pay amounts owed under the Building Contract.

Events of default entitling the Building Contractor to terminate the Building Contract include non-payment of sums due from the Contractor to the Building Contractor in excess of an agreed threshold, and material breach by the Contractor which materially and adversely affects the Building Contractor's ability to perform its obligations under the Building Contract.

The Building Contract will also allow for certain non-default events of termination including force majeure and termination of the Project Agreement (where the same is due to Authority default or exercise of the Authority's voluntary termination rights). Compensation on termination will be payable by or to the Building Contractor, depending on the reason for the termination of the Building Contract. If the Building Contractor has defaulted, it will be required to pay compensation to the Contractor.

Supporting Documents

(i) Parent Company Guarantee

The Building Contract guarantors will guarantee the performance of the obligations of the Building Contractor under the Building Contract. There are two Building Contractor guarantors and the guarantee provided is on a joint and several basis.

(ii) Performance Bond

The Building Contractor's obligation under the Building Contract will be supported by two forms of security. One of these is a performance bond in the form of an adjudication bond, of an initial value of £17 million. The performance bond will be issued by Liberty Mutual.

Costs arising under, out of or in respect of the funding agreement and costs that are financing costs are excluded liabilities under the performance bond, i.e. they are not covered by the bond amount.

For the purposes of clarity however the drafting provides that liquidated damages, actual net loss, any interim account, cost to complete, delay damages, any initial statement amount and any compensation shortfall are not to be construed as financing costs or arising under a funding agreement.

The expiry date of the performance bond is on the first to occur of (a) the date of issue of the relevant Certificate of Availability demonstrating that a cumulative total of 1,530 Dwellings have been completed in accordance with the Building Contract; (b) three months after the date of termination of the Building Contract; and (c) the date five years less one day after the date of the performance bond.

The performance bond has four step-downs being on the certification of 826 Dwellings, 1,242 Dwellings, 1,437 Dwellings and lastly 1,631 Dwellings. For the surety to make a payment to the Contractor, a valid claim must be issued to the surety. Before a valid claim can be issued to the surety and a claim be paid by the surety, the Contractor must have made written demand on the Building Contractor guarantors under the guarantee provided by the parent company of the Building Contractor for payment of the claim amount and the Building Contractor guarantors have failed to pay such claim amount.

(iii) Letter of Credit

The initial value of the Letter of Credit is £7.5m and will be issued by Lloyds TSB Bank plc. There are five step downs of the Letter of Credit with an expiry date of 31 March 2017 subject to receipt of the final Certificate of Availability. The step down dates for the Letter of Credit are the following:

(a) first step down is on the later of month 24 or certification of the 744th Dwelling;

(b) second step down is on the later of month 36 or certification of the 1,535th Dwelling;

(c) third step down is on the later of month 39 or certification of the 1,631st Dwelling;

(d) fourth step down is on the later of month 42 or certification of the 1,654th Dwelling; and

(e) final step down is the completion of 1,684th Dwelling or the final dwelling if the total number of Dwellings has been reduced.

(iv) Retention

The Contractor will be entitled to retain and deduct the retention percentage of the gross valuation (as certified by Faithful+Gould) under the Building Contract as follows:

(a) from the date of the Building Contract to month 10 or certification of the 40th Dwelling, the sum equal to 13.75% of the gross valuation of Works executed;

(b) then to month 28 or certification of the 1,071st Dwelling, the sum equal to 10% of the gross valuation of Works executed;

(c) then to month 46 or certification of the 1,684th Dwelling, a sum equal to 5% of the gross valuation of Works executed;

(d) then and until the last day of the defects liability period a sum equal to 2.5% of the gross valuation of Works executed.

(v) Credit enhancement

Under a construction reserve financial guarantee, AGM and AGE will provide additional credit enhancement of £2.5m for two (2) years from the commencement of the Project Agreement, on the occurrence of an event of termination under the

Building Contract and exhaustion of the Performance Bond, Letter of Credit and construction retention detailed above.

3. KEY TERMS OF THE FACILITIES MANAGEMENT CONTRACT

General

The parties to the Facilities Management Contract are the Contractor and the Facilities Management Contractor, which will be dated on or before the Issue Date. Under the Facilities Management Contract, the Facilities Management Contractor will provide Facilities Management Services to 1,684 dwellings (including 51 leaseholder dwellings). The Facilities Management Contract will reflect the services provisions of the Project Agreement with the intention that the Contractor's risks and obligations in relation to those services are passed down to the Facilities Management Contractor under the Facilities Management Contract.

Facilities Management Services and Lifecycle

(i) Facilities Management Services

The Facilities Management Contractor is required to provide the Facilities Management Services in accordance with the output specification, sub-contractor's services, and more generally the terms and conditions of the "**Facilities Management Contract**". The Facilities Management Services are as follows:

(a) repairs, maintenance and re-servicing of void properties;

(b) plan programmed and preventative and cyclical maintenance;

(c) caretaking and cleaning to communal areas and facilities;

(d) estate and environmental maintenance;

(e) customer access and liaison;

(f) contract management, reporting and information;

(g) continuous improvement;

(h) mobilisation and initial services;

(i) handback on termination or expiry;

(j) criminal record bureau checks;

(k) health and safety and risk assessments;

(l) staff conduct and training;

(m) quality assurance.

The Facilities Management Services will be subject to the same performance measurement/availability regime which is set out in the Project Agreement. However, the Facilities Management Contract will contain lower default thresholds than those set out in the Project Agreement, with the intention of permitting the Contractor to terminate the Facilities Management Contractor for poor performance before the Contractor can be terminated for poor performance under the Project Agreement.

Where the occurrence of a Relief Event would either result in the Facilities Management Contractor failing to perform or cause a delay in the performance of the Facilities Management Services, the Facilities Management Contractor will be entitled to relief from termination in an equivalent manner to that enjoyed by the Contractor under the Project Agreement, but the Facilities Management Contractor will not be entitled to any further compensation.

Similar to Relief Events, Excusing Events are also passed down from the Project Agreement to the Facilities Management Contract so that where there is an Excusing Event under the Project Agreement and the Contractor is relieved from Deductions being applied under the payment mechanism, then likewise the Contractor will not apply those Deductions under the Facilities Management Contract.

(ii) Lifecycle

Under the Project Agreement, the Contractor is responsible for performing the Lifecycle Works. This obligation is passed down to the Facilities Management Contractor under the Facilities Management Contract. The Facilities Management Contractor does not pass this down to Keepmoat Property Services Limited under its sub-contract. In relation to payment for the Lifecycle Works, the Facilities Management Contractor is assuming risks for the sufficiency of the Lifecycle Account. On a monthly basis, the Contractor pays into the Lifecycle Account, the lifecycle costs amounts as set out in the Project Agreement. The Facilities Management Contractor invoices the Contractor for the Lifecycle Works actually carried out on a monthly basis. The Facilities Management Contractor's invoices for Lifecycle Works are paid out of the Lifecycle Account as defined in the Project Agreement. The Facilities Management Contractor takes the risk of insufficiency in the Lifecycle Account to meet the invoice.

On the tenth and fifteenth anniversaries of the Full Services Commencement Date, the Facilities Management Contractor is required to review the balance of the Lifecycle Account, and produce a report based on the amount in the Lifecycle Account, the future expenditure on Lifecycle Works, and future payment of lifecycle costs amounts.

If a shortfall is reported, then the Facilities Management Contractor is required to pay an amount into the Lifecycle Account to prevent future shortfalls (either by way of a single instalment or two instalments, if the latter is permitted by the Contractor, the Senior Funder and the technical advisor to the Senior Funder).

To the extent that there is an excess in the Lifecycle Account having regard to the report produced by the Facilities Management Contractor, then the Facilities Management Contractor is paid the lesser of (a) the total amount of monies in the lifecycle account and (b) 75% of the excess identified in the report. At the end of the contract period, any balance outstanding to credit of the Lifecycle Account belongs to the sub-contractor.

Maximum liability

There are two caps on the Facilities Management Contractor's liability.

First is the **"Annual Operational Liability Cap"**, which is the maximum aggregate liability of the Facilities Management Contractor in any contract year. This is not to exceed the sum of :

(i) one hundred percent (100%) of the total monthly services payments in that contract year (before any Deductions are made to the same); and

(ii) one hundred percent (100 %) of the annual lifecycle costs.

Secondly is the **"Termination Liability Cap"**, which is the maximum aggregate liability of the Facilities Management Contractor pursuant to termination of the Facilities Management Contract which is set at:

(i) two hundred percent (200%) of the sum of the total monthly services payments (before any Deductions are made to the same) payable in the contract year immediately preceding the contract year in which termination occurs; and

(ii) one hundred percent (100%) of the average annual lifecycle costs; and

(iii) one hundred percent (100%) of the annual lifecycle costs; and

(iv) any remaining unused liability within the Annual Operational Liability Cap at the time of termination; and

(v) any remaining unutilised part of the Domestic Liability Cap reallocated pursuant to the relevant clause in the Interface Agreement.

Liabilities that are outside the above caps, are generally the same as that for the Building Contract.

Payment

The Facilities Management Contractor's right to monthly services payments together with any other payments relating to the performance of the services is predicated upon the Contractor receiving similar payments or benefits under the Project Agreement. Accordingly, the Facilities Management Contractor will be paid monthly and will be required to submit detailed invoices setting out the base of calculation for each monthly services payment. It is proposed that the monthly services payments to a certain extent tracks the monthly unitary payment in that it will reflect the number of dwellings for which the interim services are provided and the number of dwellings for which the full services are provided. Accordingly, the monthly services payments will step up on the relevant Full Services Commencement Date. Any deductions that are applied by the Authority against the Contractor under the Project Agreement are flowed down to the Facilities Management Contractor under the Facilities Management Contract and will be applied against the monthly services payment. The performance regime and availability criteria which will mirror that of the Project Agreement will determine the level of deductions which will be made from payments from the provision of the services.

Termination

The duration of the Facilities Management Contract will be the same as the duration of the Project Agreement, subject to early termination as set out below. Events of default that relate to the services under the Project Agreement, have been flowed down under the Facilities Management Contract entitling the Contractor to terminate, but with a degree of headroom. This allows first, the Contractor to properly manage the Facilities Management Contract before a Contractor default arises under the Project Agreement from the same event. Secondly, it gives the Senior Funders an opportunity to step in and rectify the default (including replacing the Facilities Management Contractor). In addition, the Facilities Management Contract will be terminated where:

(i) the Facilities Management Contractor's liability cap will be reduced by more than a stipulated threshold and the Facilities Management Contractor fails to comply with the provisions regarding the refresh of the same; or

(ii) the guarantee provided by Keepmoat Limited and Keepmoat Regeneration Limited ceases to be in full force and effect and the Facilities Management Contractor fails to provide a replacement equivalent guarantee.

Events of default entitling the Facilities Management Contractor to terminate the Facilities Management Contract will include performance by the Contractor of certain acts that materially and adversely affect the ability of the Facilities Management Contractor to perform its contractual obligations, non-payments of monthly services payment due from the Contractor to the Facilities Management Contractor where such failure continues for 30 working days following notification of such non-payment and the insolvency of the Contractor.

The Facilities Management Contract will also allow for certain non-default events of termination including force majeure and termination of the Project Agreement (where the same is due to Authority default or exercise of the Authority's voluntary termination rights). Compensation on termination will be payable by or to the Facilities Management Contractor, depending on the reason for the termination of the Facilities Management Contract. If the Facilities Management Contractor has defaulted, it will be required to pay compensation to the Contractor.

Supporting Documents

The guarantors for the Facilities Management Contract will guarantee the performance of the obligations of the Facilities Management Contractor under the Facilities Management Contract. There are two Facilities Management Contract Guarantors and the guarantee provided is on a joint and several basis.

4. DIRECT AGREEMENTS

The Contractor and the Security Trustee will enter into Direct Agreements with each of the sub-contractors and the guarantors of each of the sub-contractors respectively, pursuant to which the sub-contractors will agree that, where they have a right to terminate their respective contracts, they will not for a limited period exercise such right of termination.

5. INTERFACE AGREEMENT

The Interface Agreement will grant each sub-contractor direct rights of recourse against the other sub-contractor where: (a) pass-down liability (i.e. liability passed down from the Contractor to the sub-contractor under the relevant sub-contract) ("**Pass-Down Liability**") arose (wholly or in part) by reason of the other sub-contractor's breach of either their sub-contract or the Interface Agreement; or (b) the Pass-Down Liability arose (wholly or in part) from the sub-contractor's breach of either their sub-contract or the Interface Agreement but such breach or the incidence of such risk was in turn caused or contributed to by or arose from the other sub-contractor's breach..

Furthermore if a sub-contractor is in breach of its obligations under the Interface Agreement, then the sub-contractor in breach is required to compensate the other sub-contractor for direct losses, costs, liabilities, expenses or damages.

These direct rights of recourse are required because under each sub-contract the sub-contractor waives certain rights against the Contractor, and agrees to pursue any such claims under the Interface Agreement.

The Interface Agreement will enable sub-contractors to claim directly against each other without having to require the Contractor to take such action on their behalf through the operation of the sub-contracts. The Interface Agreement will also cap each sub-contractor's liability to the other in respect of Domestic Liability incurred by the sub-contractor.

6. MANAGEMENT SERVICES AGREEMENT

The Contractor will enter into a Management Services Agreement ("**MSA**") with Keepmoat Limited for the provision of management services. These management services are essentially the services required for the day to day operations of the Contractor (as well as HoldCo and the

Issuer) (including general corporate and administrative obligations), as well as the administration of the two sub-contracts. Obligations covered include the serving of notices, receiving of information from the sub-contractors, as well as management of changes by the Authority and changes by the Contractor.

The involvement of Keepmoat Limited, and its affiliates as the exclusive provider of all the Works and services means that there is a need to recognize the possibility of a general failure to perform in relation to both sub-contracts and also the need to mitigate such risk, by introducing the concept of cross default under the Building Contract, Facilities Management Contract and MSA. Hence both sub-contracts contain a cross default provision such that it is an event of default where the sub-contractor in either sub-contract is in breach of its respective sub-contract provided that such breach is either (i) not capable of remedy, or (ii) capable of remedy but not remedied within the prescribed timescales in the respective sub-contract.

THE SOCIAL HOUSING SECTOR

1. ORIGINS OF SOCIAL HOUSING AND HISTORY OF ITS DEVELOPMENT TO DATE

Social housing in Britain started with almshouses which were established from the 10th century to provide a place of residence for "poor, old and distressed folk". Social housing is housing that is let at lower than market rent, mainly on a secure basis to people in housing need. It is generally provided by councils and not-for-profit organisations such as registered providers.

Local authority social housing expanded greatly after World War I. Two million houses were built before 1939, initially for general needs but later to ease slum clearance. After World War II, replacement of the housing stock, particularly through clearances, became council social housing's main role via mass building programmes.

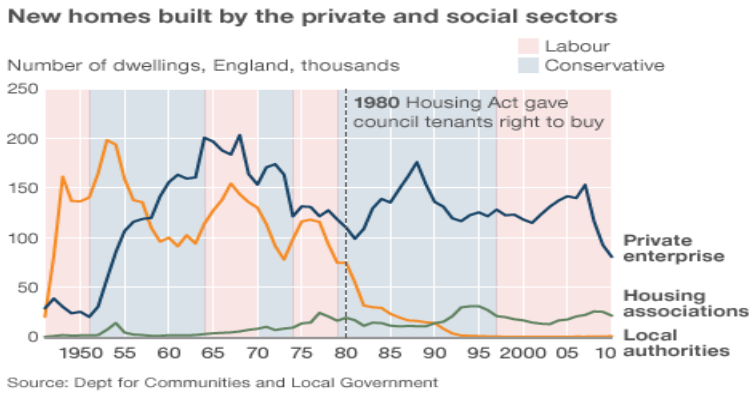
During the 1950s and 1960s, the number of high-rise social dwellings rose significantly. The argument was advanced that more generously sized dwellings could be provided this way, that communities could be re-housed close to existing employment opportunities and suit consumption and leisure patterns. In the early 1950s just 23% of public-sector approvals were for flats, with only 3% high-rise, but by 1966 high-rise housing accounted for 26% of all homes started. Government provided subsidies for local authorities to build such housing. Many such dwellings have since suffered problems, especially poor protection from damp and weather ingress, as well as other design defects and poor management.

After 1970, council social housing acquired a more residual role, more concerned with welfare issues and special needs. Housing Benefit replaced general subsidies for many tenants. Since 1979, the sector of social housing has changed through introduction of tenant rights under the Housing Act 1985 to buy a Dwelling (**"Right to Buy"**) legislation and emphasis on the development of new social housing by housing associations. Although some are much older, the modern non-profit housing associations emerged in the 1960s, 70s and 80s – there was a quantitative growth in the number and percentage of units owned and managed by housing associations through large scale voluntary transfers and other methods. Approximately 40% of the country's social housing stock is owned by local authorities, 15% is managed by arm's length management organisations and 45% by housing associations.

Policy changes and spending cuts are having a material impact on the social housing sector, altering the financial models that have operated since the 1980s. The government's drive to cut the £21 billion housing benefit bill while reducing development grants has cut budgets and shapes future strategies.

2. CURRENT MARKET

Although the recent falls in affordable housing starts have been nothing like as significant as for private house building, the housing market today remains depressed. There has not been the growth in social housing that was hoped for despite strong increases in demand. As at 31 March 2012 there were an estimated 23.1 million dwellings in England. In 2011 there were 19 million private dwellings (owner occupied plus private rented tenures) and four million social rented (private registered providers plus local authority tenures). Between March 2011 and March 2012 the social rented stock increased by 12,000 dwellings and the private stock increased by 113,000 dwellings.



2011-12 NEW SUPPLY OF AFFORDABLE HOUSING

57,950 gross additional affordable homes were supplied in England in 2011-12. 37,540 new affordable homes were provided for social rent in 2011-12. A further 930 new affordable homes were provided for affordable rent in 2011-12 (the first year for which this scheme has run).

52,880 new build affordable homes were provided in 2011-12, representing 91% of all affordable homes provided in 2011-12, compared to 88% of total supply in 2010-11. This was the highest percentage reported since before 1991-92.

In 2011-12, 88% of affordable homes were in receipt of funding through the Homes and Communities Agency (excluding homes delivered under Section 106 of the Town and Country Planning Act 1990 without grant), a reduction from 92% in 2010-11. Around 92% of these were new build homes.

There are approximately 1.8 million households on waiting lists for social housing.

The market of the social housing offer is becoming more diverse. Housing associations are now offering tenancies at ‘affordable’ rents as well as ‘social’ rents to general needs applicants, not just to defined groups of ‘moderate income’ households. Registered providers and local authorities both have powers under the Localism Act 2011 to offer fixed-term tenancies. The impact of these changes will vary from area to area and depend to some extent on local housing market pressures, but also on the policies of local councils and social landlords.

A revitalised private rented sector is now firmly established in the UK, and with more households remaining in the sector for prolonged periods. As social sector fixed-term tenancies are more widely used, there will be less difference between the offer of a social and private sector tenancy, especially where the social tenancy is at an ‘affordable’ rent. In time these policy developments could also reduce the differences in the way households make use of the two sectors, with the average length of time in social sector tenancies shortening.

3. GOVERNMENT INITIATIVES

The Government’s policy is aiming to improve the quality and quantity of properties for rent, both in the private and social sector. Their main initiatives include:

(i) providing more affordable housing, including through a new model of affordable rent that allows registered providers to charge no more than 80% of local market rent;

(ii) supporting innovation and new ways of delivering affordable homes;

(iii) allowing local flexibility on waiting lists, the types of tenancies and social tenants' and landlords' rights and responsibilities;

(iv) helping social landlords stop tenancy fraud and anti-social behaviour;

(v) changing the housing revenue account ("**HRA**") subsidy system to a new, fair, locally controlled system where local authorities are responsible and accountable for their housing services funding local authorities to refurbish their housing stock;

(vi) re-invigorating Right to Buy;

(vii) supporting tenants to play a bigger role in managing their accommodation through the tenant empowerment programme; and

(viii) encouraging more investment in the private rented sector through schemes like new loan guarantees and the Build to Rent Fund.

Affordable Rent represents a major shift in the approach to delivering affordable housing – Government is monitoring its success and its ability to attract future private investment. The key principles of the Affordable Rent model are flexibility, innovation and efficient use of existing assets. In addition, the Localism Act 2011 is designed to strengthen the economic regulation role of the social housing regulator and includes the aims of promoting new supply and supporting value for money from public investment.

"**Laying the Foundations**" **(2011)** is the national housing strategy for England and establishes the government's actions to address the housing shortage, boost the economy, create jobs, and give people the opportunity to get on the housing ladder. It states that social housing can improve people's life chances and it sets out the goal to implement a radical programme of reform to make better use of social housing to support those who need it most.

The Homes and Communities Agency ("**HCA**") is the national housing and regeneration agency for England (other than in London) and works closely with the Government on social and affordable housing. It was established as a non-departmental government body on 1 December 2008 to:

(i) work with partners to create homes, economic growth and jobs;

(ii) provide and manage investment, including the Affordable Homes Programme; and

(iii) regulate housing associations, safeguarding £43 billion of taxpayer investment in the sector and helping to secure more private investment for affordable housing.

4. FUTURE DEVELOPMENTS AND CHALLENGES

In 2013 with large scale reductions in capital subsidy, sweeping welfare reforms and shifts in national housing policy away from the provision of traditional low-rent social housing there are major challenges being faced by the sector. The social and affordable housing sector is debating its purposes and objectives. Many providers (particularly registered providers) are reviewing their strategies and business plans in order to ensure a workable balance between their social and commercial aspirations. All social landlords aspire to improve customer satisfaction and performance, but they have tough decisions to make in order to ensure value for money and on rent levels and arrears.

Some of the key challenges include:

(i) **Prolonged austerity and House building remains fragile**

The Office for Budget Responsibility forecasts that the UK economy will grow slowly over the next few years, with greater concentrations of unemployment, under – employment and in-work poverty in deprived areas. At a time when the Government is set to cut public spending still further, this places more demands on scarce resources, not least housing benefit and housing welfare and an overall pressure to reduce revenue subsidy for housing.

(ii) **Localism and flexibility**

The Localism Act 2011 contained wide-ranging changes that will affect the way social housing operates for some time to come. These include new powers to grant fixed-term tenancies, more control over local waiting lists, reform of homelessness duties to allow councils to discharge homeless people into the private rented sector, and reform of the housing revenue account system. Other relevant changes include the granting of new freedoms to enable registered providers to dispose of their stock and changes to planning law.

(iii) **Private rented sector and pressure on tenants**

There will be increased difficulty for tenants in meeting rental payments caused not only by the reduction of welfare support but also by falling real wages and the growth of underemployment. At the same time, social housing is likely to be in even greater demand, especially if rents in the private sector continue to rise. Savills estimates that by 2016 one in five households in England will be in the private rented sector.

(iv) **Welfare reforms**

Welfare reforms have included reducing the nation's benefits bill, particularly in relation to housing benefit, simplifying the benefits system as a whole and "making work pay". The Government's assessment is that the average household will lose £83 per week:

(a) Phased introduction (2013-17) of Universal Credit - a single benefit to replace most of the current working-age benefits; and

(b) An under-occupation "Bedroom tax" and a limit on the amount that households and individuals can claim in social security – a benefit cap of £350 per week for a single person and £500 for a family.

Many social landlords say that paying housing benefit direct to tenants rather than to landlords will have the biggest impact with more than 80% saying this will affect them significantly. 22% said the changes will make it harder for them to meet their loan covenants, with 10% of those involved in the affordable homes programme saying that direct payment will make it harder for them to deliver their house-building commitments (Smith Institute Survey, 2013).

(v) **Development grant post-2015**

Many are planning for a low- or no-grant future. Developing social housing organisations are expected to benefit directly and indirectly from other schemes to boost housing supply, such as the Get Britain Building fund, the Build Now Pay Later scheme, the New Homes Bonus and the Growing Places fund, although there is some expectation that a future government might revert to a form of grant model, albeit on a much smaller scale. A further round of grant funding based on the affordable rent model is a possibility.

(vi) **Borrow to build**

There are mixed views on the scope for higher gearing. Registered providers alone have £27 billion of unutilised security to cover future borrowing – it is hoped the latest plans to underwrite the debt of housing associations will boost borrowing (through the recent Affordable Homes Guarantee Scheme). Some investors in social housing bonds are reported to have warned the government that a guarantee scheme could in fact be counterproductive as it could drive down yields, thus making the bonds less attractive.

(vii) **Uncertainty of the next Spending Review**

Government may seek further savings on the housing benefit bill. It may seek to replicate the changes made in other welfare benefits (tax credits, state benefits and public-sector pensions in 2011) by shifting rent increase inflation linkage from RPI to the Consumer Price Index. There is concern in the sector that such a change in the rent settlement could adversely affect business planning and loan agreements.

(viii) **Council Building**

The self-financing of council housing under the recently reformed HRA system is widely considered to be a positive development by most. There could be new investment in affordable housing where local authorities take a commercial approach. Some local authorities (especially those that are major landlords) could borrow to build, provided they have sufficient borrowing headroom and land. This could make more collaboration between local authorities and registered providers the next logical step to deliver a refreshed council building programme.

LEEDS CITY COUNCIL

The Authority is the second largest Metropolitan Council in the UK and, at 217 square miles, covers the largest area in the north of England, and is also the third largest and one of the fastest growing, greenest cities in the UK. The Authority was created as a Metropolitan District Council under the provisions of the Local Government Act 1972 and has responsibility for local authority functions within its area, including as a local Housing Authority.

Leeds is situated in the middle of the United Kingdom, with a diverse and growing population of 751,500 (as at the last census in 2011). By 2021 the population is projected to grow 11.8% to 840,000. With over 24,000 VAT/PAYE registered businesses, the REIU forecasting model indicates 445,000 people working in Leeds in 2012, growing by over 10% over the next 10 years.

Leeds' GVA was £18.0bn in 2011. It is around 44% of West Yorkshire's, 20% of Yorkshire and the Humber's, and 1.4% of GB's. Compared with other major GB cities and conurbations, its GVA is exceeded only by London (£283bn), Greater Manchester South (£32.5bn) and Birmingham (£20.9bn).

A thriving economy boasting strengths in financial services, legal, manufacturing, health and retail, Leeds has excellent road, rail and air links, providing a gateway for tourist and business visitors to the region.

Two major schemes completed in 2013: Trinity Leeds (£350m) which opened in Spring and the 13,500 seat Leeds Arena, opening in September. Currently almost £500m of developments are under construction, with a further £5.4bn proposed or on hold.

The Vision for Leeds sets the Authority's ambition to be the best City in the UK.

Best city ambition is framed through the following five outcomes in the City Priority Plan 2011 – 2015:

(i) Best city…for business

(ii) Best city…to live

(iii) Best city…for communities

(iv) Best city…for children and young people

(v) Best city…for health and wellbeing

The Authority operates under a Constitution, and the people of Leeds elect 99 Councillors to run the Authority. The Authority's area is divided into 33 wards, and there are 3 Councillors for each ward. They are usually elected for a four year term of office. The current political composition of the council is made up of five political parties, Labour, Conservative, Liberal Democrat, Morley Borough Independents, and the Green Party. The Constitution also provides the basis for decision-making on the Little London Beeston Hill and Holbeck PFI project, with all approvals now in place to enable the project to reach close.

The Authority has agreed to issue certificates under the Local Government (Contracts) Act 1997 in respect of the Project Agreement and the Funders Direct Agreement certifying that the Authority has the statutory power to enter into such agreements.

TAXATION

1. UNITED KINGDOM

The following is a general overview of the United Kingdom law and United Kingdom Her Majesty's Revenue & Customs ("**HMRC**") practice at the date of this Prospectus regarding withholding taxation in relation to payments of principal and interest in respect of the Bonds. The overview does not purport to be a complete analysis and does not deal with other United Kingdom tax aspects of acquiring, holding or disposing of Bonds. The overview relates only to the position of persons who are absolute beneficial owners of the Bonds and may not apply to certain classes of persons such as dealers or certain professional investors. Prospective Bondholders or Couponholders should be aware that the particular terms of issue of any further bonds may affect the tax treatment of that and other series of bonds. The following is a general guide and should be treated with appropriate caution. Bondholders or Couponholders who are in any doubt as to their tax position should consult their professional advisers.

Bondholders or Couponholders who may be liable to taxation in jurisdictions other than the United Kingdom in respect of their acquisition, holding or disposal of the Bonds are particularly advised to consult their professional advisers as to whether they are so liable (and if so under the laws of which jurisdictions), since the following overview relates only to certain United Kingdom taxation aspects of payments in respect of the Bonds. In particular, Bondholders and Couponholders should be aware that they may be liable to taxation under the laws of other jurisdictions in relation to payments in respect of the Bonds even if such payments may be made without withholding or deduction for or on account of taxation under the laws of the United Kingdom.

UK Withholding Tax On UK Source Interest

(i) Payments of interest on the Bonds may be made without withholding or deduction for or on account of United Kingdom income tax provided that the Bonds are and continue to be listed on a recognised stock exchange within the meaning of section 1005 of the Income Tax Act 2007. The Main Securities Market of the Irish Stock Exchange is a recognised stock exchange for these purposes. On the basis of HMRC published interpretation of the relevant legislation, securities will be treated as listed on the Main Securities Market of the Irish Stock Exchange if they are officially listed in accordance with the applicable provisions in Ireland and are admitted to trading on the Main Securities Market of the Irish Stock Exchange. Provided, therefore, that the Bonds remain so listed, payments of interest on the Bonds may be made without withholding or deduction for or on account of United Kingdom income tax.

(ii) If the Bonds cease to be listed, interest on the Bonds will generally be paid under deduction of United Kingdom income tax at the basic rate (currently 20 per cent.) unless an alternative exemption from withholding tax is available. In general terms, other exemptions which may be available include where:

   (a) the interest on the Bonds is paid to a company which is resident in the United Kingdom for United Kingdom tax purposes or a company not resident in the United Kingdom which carries on a trade in the United Kingdom through a permanent establishment and which is subject to UK corporation tax on that interest, and, at the time the payment is made, the Issuer reasonably believes that the person beneficially entitled to the interest is within the charge to United Kingdom corporation tax as regards the payment of interest, provided that HMRC has not given a direction (in circumstances where it has reasonable grounds to believe that it is likely that the above exemption is not available in respect of such payment of interest at the time the payment is made) that the interest should be paid under deduction of tax; or

(b) the Issuer has received a direction from HMRC in respect of such relief as may be available pursuant to the provisions of any applicable double taxation treaty.

Payments by a Guarantor

If a guarantor (including, for example, AGE or AGM under the Financial Guarantees) makes any payments in respect of interest on the Bonds (or other amounts due under the Bonds other than the repayment of amounts subscribed for the Bonds) such payments may be subject to United Kingdom withholding tax at the basic rate (currently 20 per cent.) subject to such relief as may be available under the provisions of any applicable double taxation treaty or to any other exemption which may apply. Such payments by a Financial Guarantor may not be eligible for the exemptions from withholding tax described in paragraph 1 (i) above.

Provision of Information

Bondholders or Couponholders should note that where any interest on the Bonds is paid to them (or to any person acting on their behalf) by the Issuer or any person in the United Kingdom acting on behalf of the Issuer (a "**paying agent**"), or is received by any person in the United Kingdom acting on behalf of the relevant Bondholder or Couponholder, as the case may be (other than solely by clearing or arranging the clearing of a cheque) (a "**collecting agent**"), then the Issuer, the paying agent or the collecting agent (as the case may be) may, in certain cases, be required to supply to HMRC details of the payment and certain details relating to the Bondholder or Couponholder, as the case may be (including the Bondholder's or Couponholder's name and address). These provisions will apply whether or not the interest has been paid subject to withholding or deduction for or on account of United Kingdom income tax and whether or not the Bondholder or Couponholder, as the case may be, is resident in the United Kingdom for United Kingdom taxation purposes. Where the Bondholder or Couponholder is not so resident, the details provided to HMRC may, in certain cases, be passed by HMRC to the tax authorities of the jurisdiction in which the Bondholder or Couponholder is resident for taxation purposes.

For the above purposes, "interest" should be taken, for practical purposes, as including payments made by a guarantor (including either AGM or AGE) in respect of interest on Bonds.

The provisions referred to above may also apply, in certain circumstances, to payments made on redemption of any Bonds where the amount payable on redemption is greater than the issue price of the Bonds.

Other Rules Relating to United Kingdom Withholding Tax

(i) Where Bonds are issued at an issue price of less than 100 per cent. of their principal amount, any discount element on any such Bonds will not be subject to any United Kingdom withholding tax pursuant to the provisions mentioned above, but may be subject to reporting requirements, as also outlined above.

(ii) Where Bonds are to be, or may fall to be, redeemed at a premium, as opposed to being issued at a discount, then any such element of premium may constitute a payment of interest. Payments of interest are subject to United Kingdom withholding tax and reporting requirements as outlined above.

(iii) Where interest has been paid under deduction of United Kingdom income tax. Bondholders or Couponholders who are not resident in the United Kingdom may be able to recover all or part of the tax deducted if there is an appropriate provision in any applicable double taxation treaty.

(iv) The references to "interest" in this section entitled "United Kingdom Taxation" mean "interest" as understood in United Kingdom tax law. The statements in this section do not take any account of any different definitions of "interest" or "principal" which may prevail under any other law or which may be created by the terms and conditions of the Bonds or any related documentation.

(v) The above description of the United Kingdom withholding tax position assumes that there will be no substitution of the Issuer as principal obligor under the Bonds and does not consider the tax consequences of any such substitution.

2. IRELAND

The following is an overview of the Irish withholding tax treatment of the Bonds. The overview does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a decision to purchase, own or dispose of the Bonds. The overview relates only to the position of Irish withholding taxes on the Bonds.

The overview is based upon Irish tax laws and the practice of the Revenue Commissioners of Ireland as in effect on the date of this Prospectus. Prospective investors in the Bonds should consult their own advisers as to the Irish or other tax consequences of the purchase, beneficial ownership and disposition of the Bonds including, in particular, the effect of any state or local law taxes.

Irish Withholding Tax

Irish withholding tax applies to certain payments including payments of:

(i) Irish source yearly interest (i.e. interest that is capable of arising for a period in excess of one year);

(ii) Irish source annual payments (annual payments are payments that are made over a period in excess of one year and are pure income-profit in the hands of the recipient); and

(iii) Distributions (including interest that is treated as a distribution under Irish law) made by Irish resident companies, at the standard rate of income tax (currently 20 per cent.).

On the basis that the Issuer is not resident in Ireland for the purposes of Irish tax, nor does the Issuer operate in Ireland through a branch or agency with which the issue of the Bonds is connected, nor are the Bonds held in Ireland through a depository, or otherwise located in Ireland, then to the extent that payments of interest or annual payments arise on the Bonds, such payments would not be regarded as payments having an Irish source for the purposes of Irish taxation.

Accordingly, the Issuer should not be obliged to deduct any amount on account of Irish tax from payments made in connection with the Bonds.

Irish Encashment Tax

Payments on any Bonds paid by a paying agent in Ireland or to an agent in Ireland may be subject to Irish encashment tax at the standard rate of Irish tax (currently 20 per cent.), unless it is proved, on a claim made in the required manner to the Revenue Commissioners of Ireland, that the beneficial owner of the Bonds entitled to the interest or distribution is not resident in Ireland for the purposes of Irish tax and such interest or distribution is not deemed, under the provisions of Irish tax legislation, to be income of another person that is resident in Ireland.

3. UNITED STATES

Hiring Incentives to Restore Employment Act

The U.S. Hiring Incentives to Restore Employment Act 2010 introduced Section 871(m) of the U.S. Internal Revenue Code of 1986 (the "**Code**") which treats a "dividend equivalent" payment as a dividend from sources within the United States. Under Section 871(m), such payments generally would be subject to a 30% U.S. withholding tax that may be reduced by an applicable tax treaty, eligible for credit against other U.S. tax liabilities or refunded, provided that the beneficial owner timely claims a credit or refund from the U.S. Internal Revenue Service (the "**IRS**"). A "dividend equivalent" payment is (i) a substitute dividend payment made pursuant to a securities lending or a sale-repurchase transaction that (directly or indirectly) is contingent upon, or determined by reference to, the payment of a dividend from sources within the United States, (ii) a payment made pursuant to a "specified notional principal contract" that (directly or indirectly) is contingent upon, or determined by reference to, the payment of a dividend from sources within the United States, and (iii) any other payment determined by the IRS to be substantially similar to a payment described in (i) and (ii). Proposed U.S. Treasury regulations expand the definition of "specified notional principal contract" beginning 1 January 2014.

While significant aspects of the application of Section 871(m) to the Bonds are uncertain, if the Issuer or any withholding agent determines that withholding is required, neither the Issuer nor any withholding agent will be required to pay any additional amounts with respect to amounts so withheld.

Prospective investors should consult their tax advisers regarding the potential application of Section 871(m) to the Bonds.

4. FOREIGN ACCOUNT TAX COMPLIANCE ACT

Sections 1471 through 1474 of the U.S. Internal Revenue Code of 1986 ("**FATCA**") impose a new reporting regime and potentially a 30% withholding tax with respect to certain payments to any non-U.S. financial institution (a "**foreign financial institution**", or "**FFI**" (as defined by FATCA)) that does not become a "**Participating FFI**" by entering into an agreement with the IRS to provide the IRS with certain information in respect of its account holders and investors or is not otherwise exempt from or in deemed compliance with FATCA. The Issuer is classified as an FFI.

The new withholding regime will be phased in beginning 1 January 2014 for payments from sources within the United States and will apply to "**foreign passthru payments**" (a term not yet defined) no earlier than 1 January 2017. This withholding would potentially apply to payments in respect of (i) any Bonds characterized as debt (or which are not otherwise characterized as equity and have a fixed term) for U.S. federal tax purposes that are issued on or after the later of (a) 1 January 2014 and (b) the date that is six months after the date on which final U.S. Treasury regulations define the term foreign passthru payments (the "**grandfathering date**"), or which are materially modified on or after the grandfathering date and (ii) any Bonds characterized as equity or which do not have a fixed term for U.S. federal tax purposes, whenever issued. If Bonds are issued before the grandfathering date, and additional Bonds of the same series are issued on or after that date, the additional Bonds may not be treated as grandfathered, which may have negative consequences for the existing Bonds, including a negative impact on market price.

The United States and a number of other jurisdictions have announced their intention to negotiate intergovernmental agreements to facilitate the implementation of FATCA (each, an "**IGA**"). Pursuant to FATCA and the "Model 1" and "Model 2" IGAs released by the United States, an FFI in an IGA signatory country could be treated as a "**Reporting FI**" not subject to withholding under FATCA on any payments it receives. Further, an FFI in a Model 1 IGA jurisdiction would not be required to withhold under FATCA or an IGA (or any law implementing an IGA) (any such withholding being "**FATCA Withholding**") from payments it makes (unless it has agreed to do so under the U.S. "qualified intermediary," "withholding foreign partnership," or "withholding foreign trust" regimes).

The Model 2 IGA leaves open the possibility that a Reporting FI might in the future be required to withhold as a Participating FFI on foreign passthru payments. Under each Model IGA, a Reporting FI would still be required to report certain information in respect of its account holders and investors to its home government or to the IRS. The United States and the United Kingdom have entered into an agreement (the "**US-UK IGA**") based largely on the Model 1 IGA.

The Issuer expects to be treated as a Reporting FI pursuant to the US-UK IGA and does not anticipate being obliged to deduct any FATCA Withholding. There can be no assurance, however, that the Issuer will be treated as a Reporting FI, or that it would in the future not be required to deduct FATCA Withholding from payments it makes. Accordingly, the Issuer and financial institutions through which payments on the Bonds are made may be required to withhold FATCA Withholding if any FFI through or to which payment on such Bonds is made is not a Participating FFI, a Reporting FI, or otherwise exempt from or in deemed compliance with FATCA.

If an amount in respect of FATCA Withholding were to be deducted or withheld from interest, principal or other payments made in respect of the Bonds, neither the Issuer nor any paying agent nor any other person would, pursuant to the conditions of the Bonds, be required to pay additional amounts as a result of the deduction or withholding. As a result, investors may receive less interest or principal than expected.

FATCA is particularly complex and its application is uncertain at this time. The above description is based in part on regulations, official guidance and model IGAs, all of which are subject to change or may be implemented in a materially different form. Prospective investors should consult their tax advisers on how these rules may apply to the Issuer and to payments they may receive in connection with the Bonds.

TO ENSURE COMPLIANCE WITH IRS CIRCULAR 230, EACH TAXPAYER IS HEREBY NOTIFIED THAT: (A) ANY TAX DISCUSSION IN THIS PROSPECTUS IS NOT INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED BY THE TAXPAYER FOR THE PURPOSE OF AVOIDING U.S. FEDERAL INCOME TAX PENALTIES THAT MAY BE IMPOSED ON THE TAXPAYER; (B) ANY SUCH TAX DISCUSSION WAS WRITTEN TO SUPPORT THE PROMOTION OR MARKETING OF THE TRANSACTIONS OR MATTERS ADDRESSED HEREIN; AND (C) THE TAXPAYER SHOULD SEEK ADVICE BASED ON THE TAXPAYER'S PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISER.

EUROPEAN UNION SAVINGS DIRECTIVE

Under EC Council Directive 2003/48/EC on the taxation of savings income, member states are required to provide to the tax authorities of another member state details of payments of interest or similar income paid by a person within its jurisdiction to or collected by such a person for, an individual resident in that other member state. However, for a transitional period, Luxembourg and Austria are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have agreed to adopt similar measures (a withholding system in the case of Switzerland).

SUBSCRIPTION AND SALE

1. SUBSCRIPTION

The Lead Manager has, in a subscription agreement dated on or around 11 July 2013 (the "**Subscription Agreement"**) between the Issuer, ProjectCo, HoldCo, Lead Manager, and the Financial Guarantors upon the terms and subject to the conditions contained therein, agreed to subscribe and pay for the Bonds at their issue price of 100 per cent. of their principal amount less the combined management and underwriting commission agreed therein. In addition, such amount as may be agreed in writing between the Issuer and the Financial Guarantors in respect of the Financial Guarantees. Fees and other expenses payable to the Financial Guarantors shall be deducted from the issue price of the Bonds and paid by the Lead Manager to the Financial Guarantors, on behalf of the Issuer. The Issuer has also agreed to reimburse the Lead Manager for expenses incurred by it in connection with the management of the issue of the Bonds. The Lead Manager is entitled in certain circumstances to be released and discharged from its respective obligations under the Subscription Agreement prior to the closing of the issue of the Bonds.

2. SELLING RESTRICTIONS – UNITED STATES

The Lead Manager has acknowledged to the Issuer that the Bonds have not been and will not be registered under the United States Securities Act of 1933, as amended (the "**Securities Act**"), and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except in certain transactions exempt from or not subject to the registration requirements of the Securities Act. The Lead Manager has agreed that it will not offer, sell or deliver the Bonds within the United States or to, or for the account or benefit of, U.S. persons.

In connection with sales outside the United States, the Lead Manager has agreed under the Subscription Agreement that it will not offer, sell or deliver the Bonds to, or for the account or benefit of U.S. persons (a) as part of the Lead Manager's distribution at any time or (b) otherwise prior to the date that is 40 days after the later of the commencement of the offering and the issue date of the Bonds (the "**Distribution Compliance Period**") and, accordingly, that neither it, its affiliates nor any person acting on their behalf has engaged or will engage in any directed selling efforts (within the meaning of Regulation S ("**Regulation S**")) with respect to the Bonds and it and its affiliates and any person acting on its or their behalf has complied with and will comply with the offering restriction requirements of Regulation S under the Securities Act to the extent applicable.

The Lead Manager under the Subscription Agreement has also agreed that, at or prior to confirmation of sales of any Bonds, it will have sent to each distributor, dealer or other person receiving a selling concession, fee or other remuneration to which it sells any Bonds during the Distribution Compliance Period a confirm or other notice setting forth the restrictions on offers and sales of such Bonds within the United States or to, or for the account or benefit of, U.S. persons.

3. SELLING RESTRICTIONS – UNITED KINGDOM

The Lead Manager has represented and agreed that:

(i) *Financial Promotion*: It has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000 ("**FSMA**")) received by it in connection with the issue or sale of any Bonds in circumstances in which section 21(1) of the FSMA does not apply to the Issuer, ProjectCo, HoldCo or the Financial Guarantors.

(ii) *General Compliance*: It has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to any Bonds in, from or otherwise involving the United Kingdom.

4. SELLING RESTRICTIONS - IRELAND

The Lead Manager has represented, warranted and agreed that it has not offered, sold, placed or underwritten and will not offer, sell, place or underwrite the Bonds, or do anything in Ireland in respect of the Bonds, otherwise than in conformity with the provisions of:

(i) any rules issued by the Central Bank of Ireland under section 51 of the Investment Funds, Companies and Miscellaneous Provisions Act, 2005 of Ireland, as amended, (the "2005 Act");

(ii) the Irish Companies Acts 1963 to 2012;

(iii) the Irish Central Bank Acts, 1942 to 2011;

(iv) the European Communities (Markets in Financial Instruments) Regulations 2007 (No.s 1 to 3), as amended, of Ireland and it will conduct itself in accordance with any rules or codes of conduct and any conditions or requirements, or any other enactment, imposed or approved by the Central Bank of Ireland; and

(v) the Irish Market Abuse (Directive 2003/6/EC) Regulations 2005 and any rules issued by the Central Bank of Ireland under section 34 of the 2005 Act.

General

The Lead Manager has agreed with the Issuer and the Financial Guarantors that it will observe all applicable laws and regulations in any jurisdiction in which it may offer, sell or deliver Bonds and that it will not, directly or indirectly, offer, sell or deliver Bonds or distribute or publish this document, any prospectus, circular, advertisement or other offering material (including, without limitation, any supplement to this document) in relation to the Bonds in or from any country of jurisdiction except under circumstances that will to best of its knowledge and belief result in compliance with any applicable laws and regulations, and all offers, sales and deliveries of Bonds by it will be made on the foregoing terms.

None of the Issuer, the Financial Guarantors and the Lead Manager represents by virtue of the Prospectus that Bonds may at any time lawfully be sold in compliance with any applicable registration or other requirements in any jurisdiction, or pursuant to any exemption available thereunder, or assumes any responsibility for facilitating such sale.

Disclaimer

As a result of the foregoing restrictions, purchasers of Bonds are advised to consult legal counsel prior to making any purchase, offer, sale, resale or other transfer of such Bonds.

5. EUROPEAN ECONOMIC AREA

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a "**Relevant Member State**"), the Issuer and the Lead Manager have represented and agreed that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the "**Relevant Implementation Date**") it has not made and will not make an offer of the Bonds which are the subject of the offering contemplated by this Prospectus to the public in that Relevant Member State other than:

(i) to any legal entity which is a qualified investor as defined in the Prospectus Directive;

(ii) to fewer than 100 or, if the Relevant Member State has implemented the relevant provision of the 2010 PD Amending Directive, 150, natural or legal persons (other than qualified investors as defined in the Prospectus Directive), as permitted under the Prospectus Directive, subject to obtaining the prior consent of the Issuer for any such offer; or

(iii) in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of the Bonds will require the Issuer, and the Lead Manager to publish a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive.

For the purposes of this provisions, the expression of an offer of Bonds to the public in relation to any Bonds in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Bonds to be offered so as to enable an investor to decide to purchase or subscribe for the Bonds, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State. The expression Prospectus Directive means Directive 2003/71/EC (and amendments thereto, including the 2010 PD Amending Directive, to the extent implemented in the Relevant Member State), and includes any relevant implementing measure in the Relevant Member State and the expression 2010 PD Amending Directive means Directive 2010/73/EU.

6. SELLING RESTRICTIONS – GENERAL

Other than the approval by the Central Bank of Ireland of this Prospectus as a prospectus in accordance with the requirements of the Prospectus Directive and implementing measures in Ireland, application having been made for the Bonds to be admitted to the Official List of the Irish Stock Exchange and to trading on its regulated market and the filing of this Prospectus as a prospectus with the Companies Registration Office in Ireland, no action is being taken in any jurisdiction that would or is intended to permit a public offering of the Bonds, or the possession, circulation or distribution of this Prospectus or any other material relating to the Issuer or the Bonds in any jurisdiction where action for that purpose is required. This Prospectus does not constitute, and may not be used for the purpose of, an offer or solicitation in or from any jurisdiction where such an offer or solicitation is not authorised. Accordingly, the Bonds may not be offered or sold, directly or indirectly, and neither this Prospectus nor any other offering material or advertisement in connection with the Bonds may be distributed or published in or from any country or jurisdiction, except under circumstances that will result in compliance with any applicable rules and regulations of any such country or jurisdiction.

The Lead Manager has undertaken not to offer or sell any of the Bonds, or to distribute this document or any other material relating to the Bonds, in or from any jurisdiction except under circumstances that will result in compliance with applicable law and regulations.

GENERAL INFORMATION

1. AUTHORISATION

The creation and issue of the Bonds has been authorised by a resolution of the board of directors of the Issuer dated 5 July 2013.

The issue of the AGE Financial Guarantee has been duly authorised by AGE, in accordance with its underwriting procedures.

The issue of the AGM Financial Guarantee has been duly authorised by AGM in accordance with its underwriting procedures.

2. LISTING AND ADMISSION TO TRADING

Transactions will normally be effected for settlement in Pound Sterling and for delivery on the third business day after the date of the transaction. It is expected that the Bonds will be admitted to the Official List of the Irish Stock Exchange and admitted to trading on its regulated market on 11 July 2013, subject only to the issue of the Global Notes. The listing of the Bonds will be cancelled if the Global Notes are not issued.

The estimated aggregate cost of the foregoing applications for admission to the Official List of the Irish Stock Exchange and admission to trading on its regulated market is approximately Pound Sterling 5,000.

Arthur Cox Listing Services Limited is acting solely in its capacity as listing agent for the Issuer in connection with the Bonds and is not itself seeking admission of the Bonds to the Official List of the Irish Stock Exchange or to trading on its regulated market for the purposes of the Prospectus Directive.

For so long as the Bonds are admitted to the Official List of the Irish Stock Exchange and admitted to trading on its regulated market, the Issuer shall maintain a Paying Agent in the United Kingdom.

3. DOCUMENTS AVAILABLE

So long as the Bonds are admitted to trading on its regulated market and the rules of the Irish Stock Exchange so require, physical copies of the following documents may be inspected during normal business hours at the registered office of the Issuer (being, as at the date of this Prospectus, c/o K&L Gates LLP, One New Change, London EC4M 9AF) from the date of this Prospectus:

(i) this Prospectus;

(ii) memorandum and articles of association of the Issuer, ProjectCo and HoldCo;

(iii) memorandum and articles of association of AGE and AGM;

(iv) accounts of AGE for the financial years ended 31 December 2011 and 31 December 2012;

(v) consolidated accounts of AGM for the financial years ended 31 December 2011 and 31 December 2012;

(vi) the AGE Financial Guarantee;

(vii) the AGM Financial Guarantee; and

(viii) the Bond Trust Deed.

4. CLEARING

The Bonds have been accepted for clearance through Euroclear and Clearstream, Luxembourg. The ISIN and Common Code for the Bonds are XS0951467249 and 095146724, respectively.

5. SIGNIFICANT/MATERIAL CHANGE

There has been no material adverse change in the prospects of the Issuer since 2 July 2013 (being the date of incorporation of the Issuer).

There has been no significant change in the financial or trading position of the Issuer since the date of its incorporation.

There has been no material adverse change in the prospects of AGE since 31 December 2012.

There has been no significant change in the financial or trading position of AGE since 31 December 2012.

There has been no material adverse change in the prospects of AGM since 31 December 2012.

There has been no significant change in the financial or trading position of AGM since 31 December 2012.

6. CONTRACTS/ARRANGEMENTS

Since the date of its incorporation, the Issuer has not entered into any contracts or arrangements not being in the ordinary course of business.

7. ACCOUNTS

No statutory or non-statutory accounts within the meaning of Section 434 of the Companies Act 2006 in respect of any financial year of the Issuer have been prepared. So long as the Bonds are admitted to the Official List of the Irish Stock Exchange and the Notes are admitted to trading on its regulated market, the most recently published audited annual accounts of the Issuer from time to time shall be available at the specified office of the Principal Paying Agent. The Issuer does not publish interim accounts.

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

8. NO LITIGATION

The Issuer is not, and has not been, involved in any governmental, legal or arbitration proceedings including any such proceedings which are pending or threatened of which it is aware) since the date of its incorporation, which may have, or have had in the recent past, a significant effect on its financial position or profitability.

9. AUDITORS

The auditors of the Issuer, ProjectCo and HoldCo are BDO LLP, of 55 Baker Street, London W1U 7EU. The auditors of the Issuer, ProjectCo and HoldCo have no material interest in any of the Issuer, ProjectCo or HoldCo.

The auditors of the AGE are PricewaterhouseCooper LLP, of Southwark Towers, 32 London Bridge Street, London SE1 9SY. The auditors of AGE have no material interest in AGE.

The auditors of AGM are PricewaterhouseCoopers LLP, of 300 Madison Avenue, New York, New York 10017 U.S. the auditors of AGM have no material interest in AGM.

10. OTHER

The Bonds, Receipts and any Coupons and Talons appertaining thereto will bear a legend to the following effect: "Any United States person (as defined in the U.S. Internal Revenue Code 1986) who holds this obligation will be subject to limitations under the United States income tax laws, including the limitations provided in Section 165(j) and 1287(a) of the Internal Revenue Code." The sections referred to in such legend provide that a United States person who holds a Bond, Coupon or Talon will generally not be allowed to deduct any loss realised on the sale, exchange or redemption of such Bond, Coupon or Talon and any gain (which might otherwise be characterised as capital gain) recognised on such sale, exchange or redemption will be treated as ordinary income.

The Issuer does not intend to provide post-issuance information in the United Kingdom.

INDEX OF DEFINED TERMS

APPENDIX 1
ANNUAL REPORT AND FINANCIAL STATEMENTS OF AGE
FOR THE YEARS ENDED 31 DECEMBER 2011 AND 31 DECEMBER 2012

Assured Guaranty (Europe) Ltd.

Registered Number: 2510099

Annual report and financial statements
For the year ended 31 December 2011

Assured Guaranty (Europe) Ltd.
Registered in England No. 2510099

Annual report and financial statements
For the year ended 31 December 2011

Contents

Company information

Directors

Executive directors
Sean Wallace McCarthy (resigned effective 31 March 2011)
Dominic John Frederico
Nicholas James Proud
James Michael Michener
Robert Bruce Mills
Andrew Hoyt Pickering (resigned effective 31 March 2011)
Dominic James Brian Nathan (appointed effective 12 August 2011)

Non-executive directors
William Peter Cooke
Anthony Robin Dominic Monro-Davies
Simon William de Mussenden Leathes (appointed effective 4 January 2012)

Company secretary
Bernadine Shaw

Registered office
1 Finsbury Square
London
EC2A 1AE

Independent auditors
PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
7 More London Riverside
London
SE1 2RT

Directors' report for the year ended 31 December 2011

The directors present their report and the audited financial statements of the Company for the year ended 31 December 2011.

Principal activity

The principal activity of Assured Guaranty (Europe) Ltd. (formerly, Financial Security Assurance (U.K.) Limited) ("the Company") is providing financial guarantees for European Union public finance and asset backed obligations. Financial guarantee insurance written by the Company generally guarantees scheduled payments on an issuer's obligations when there is a payment default by the obligor.

The Company is a wholly owned subsidiary of Assured Guaranty Municipal Insurance Company ("AGMIC") (formerly, FSA Insurance Company), which in turn is wholly owned by Assured Guaranty Municipal Corp. ("AGM").

The Company is authorised to effect and carry out certain classes of general insurance, specifically: classes 14 (credit), 15 (suretyship) and 16 (miscellaneous financial loss). This scope of permission is sufficient to enable the Company to effect and carry out financial guarantee insurance and reinsurance. The insurance and reinsurance businesses of the Company are subject to authorisation and close supervision by the Financial Services Authority ("the FSA"). The Company also has permission to arrange and advise on deals in financial guarantees which it underwrites.

Obligations insured by the Company are generally awarded ratings on the basis of the financial strength ratings given by the major securities rating agencies.

The Company has been assigned the following insurance financial strength ratings as of 29th March, 2012. These ratings are subject to continuous review:

S&P: AA- / Stable Outlook

Moody's: Aa3 / (On Review for Possible Downgrade)

Review of business and future developments

The results of the Company for the year are as set out on pages 14 and 15.

During 2011, the Company faced continued challenges in re-establishing its market position. This was primarily due to uncertainty over the Company's financial strength ratings. On 24 January 2011, S&P released a publication entitled "Request for Comment: Bond Insurance Criteria," in which it requested comments on proposed changes to its bond insurance ratings criteria. Although S&P had assigned the Company, AGM and their affiliate, Assured Guaranty Corp. ("AGC") financial strength ratings of AA+ (Stable Outlook) in October 2010, it noted in the Request for Comment that it could lower the financial strength ratings on existing investment grade bond insurers (which included the Company) by one or more rating categories if the proposed bond insurance ratings criteria were adopted - unless those bond insurers raised additional capital or reduced risk. Over the course of 2011, considerable uncertainty existed as market participants provided comments on the proposed criteria, and awaited the issuance of the new criteria. When S&P released its final criteria in August 2011, the criteria contained a new "largest obligor test" that had not been included in the Request for Comment. The largest obligor test had the effect of significantly reducing the Assured Guaranty group's allowed single risk limits and limiting its financial strength rating levels. Then, in September 2011, S&P placed the financial strength ratings of the Company, AGM and AGC on CreditWatch negative. It was not until November 2011 that S&P assigned the

Directors' report for the year ended 31 December 2011 (continued)

Company, AGM and AGC financial strength ratings of AA- (Stable Outlook). In addition, the Company, AGM and AGC have been rated Aa3 (Negative Outlook) by Moody's since December 2009. In addition to the lack of stability of the Company's financial strength ratings, the financial crisis and the continued seizing up of the capital markets, particularly for infrastructure related financings, had a major impact on the Company's ability to secure new transactions.

Notwithstanding these uncertainties, during 2011 the Company succeeded in closing its first transaction since 2008. The Company and AGM replaced Ambac Assurance UK Limited. as financial guarantor on bonds issued by Worcestershire Hospital SPC PLC (formerly Catalyst Healthcare (Worcester) PLC) ("Worcestershire Hospital"). Investors in the transaction agreed to payment for the replacement through a reduction in coupon. Management believes that the Worcestershire Hospital transaction provides important evidence of investor support for the Company's product. This fact, combined with willingness on the part of issuers, sponsors and arranger to work with the Company, suggests that the Company is well positioned to close new transactions in the coming year.

The Company expects the pipeline of European infrastructure transactions to remain robust. Historically, financial guarantees had been an essential component of capital markets financings for European infrastructure projects. Because of the difficulties experienced by the financial guarantee industry since the onset of the credit crisis, these financings have been largely funded with relatively short-term bank loans. The Company expects that its European infrastructure opportunities will increase as the global economic environment stabilises and issuers return to the public markets for financings and that institutional investors will utilise financial guarantees again, as they value the Company's underwriting skills and surveillance functions as well as the value of the Company's guarantees.

At 31st December 2011, gross outstanding par insured was £19,716.4m and net par after reinsurance was £361.2m. Of this, 85.3% related to public finance exposures and 14.7% to structured finance exposures.

Several European countries are experiencing significant economic, fiscal and/or political strains such that the likelihood of default on obligations with a nexus to those countries may be higher than the Company anticipated when such factors did not exist. The Company is closely monitoring its exposures in European countries where it believes heightened uncertainties exist: specifically, Greece, Hungary, Ireland, Italy and Spain. The company has exposures in these countries as follows:

Country	Gross exposure £'million	Net exposure £'million
Greece	261.7	3.5
Ireland	58.1	1.2
Italy	1,460.6	35.4
Hungary	328.7	6.5
Spain	423.2	7.4

The Company is closely monitoring the ability and willingness of obligors in these countries to make timely payments on their obligations.

At 31st December 2011, the Company had exposure to sovereign debt of the Hellenic Republic of Greece through financial guarantees of €200.0m of debt (€4.0m on a net basis) due in 2037 ("2037 Bonds") with a 4.5% fixed coupon and €113.9m of inflation-linked debt (€1.4m on a net basis) due in 2057 ("2057 Bonds") with a 2.085% coupon. Greece, as obligor, has been paying interest on such notes on a timely basis. On 23 February 2012, the Greek Parliament enacted legislation that introduces collective action clauses into eligible Greek law governed bonds to permit the terms of such bonds to be amended with the consent of less than all the holders of those bonds. On 24 February 2012, Greece announced the terms of exchange offers and consent solicitations that requested the voluntary participation by holders of certain Greek bonds in an exchange that would result in the reduction of 53.5% of the notional amount of such bonds, and requested the consent of holders to amendments of the bonds that could be used to effectively impose the same terms on holders that do not voluntarily participate in the exchange. The bonds guaranteed under the financial guarantees were included in the list of Greek bonds covered by the exchange offers and consent solicitations. In March 2012, the Company took delivery of the 2037 Bonds and 2057 Bonds that it guarantees. On the 8 March 2012 Greece announced that 85.8% of the holders of eligible Greek-law governed bonds tendered in the exchange and/or voted in favour of the consent solicitation and that they would invoke the collective action clauses on the remaining eligible Greek-law governed bonds. As holder of the 2037 Bonds, the Company received or will receive the exchanged securities. Having evaluated the exchange offer and consent solicitation on the 2057 Bonds, the Company has agreed to participate voluntarily in the exchange for these bonds. As of year-end the Company held a gross unexpired risk provision of £30.0m (net £0.4m) on both the 2037 Bonds and 2057 Bonds. The Company currently does not have enough information to determine the financial effect of these post balance sheet events.

During 2011, the Company was party to a reinsurance agreement and a net worth maintenance agreement with AGM. Under the quota share cover of the reinsurance agreement relating to transactions closed prior to 2011, AGM reinsured approximately 92% of the Company's retention after cessions to other reinsurers. Under the stop loss cover of the reinsurance agreement, AGM is required to make payments to the Company when the Company's annual net incurred losses and expenses exceeds the Company's annual net earned premium plus any amounts deducted from the Company's equalisation reserve during the year. The stop loss cover has an annual limit of liability equal to 20% of the net principal insured outstanding at the prior year-end, plus the net principal insured outstanding at last year-end of the Company's two largest transactions. Under the net worth maintenance agreement, AGM is obligated to cause the Company to maintain free assets of £10m or such greater amount as may be required by the FSA, provided that contributions do not exceed more than 35% of AGM's policyholders' surplus, do not jeopardise AGM's insurer financial strength rating from Moody's or S&P, and comply with Article 15 of the New York Insurance Law.

It has been agreed between management and the FSA that any new business written by the Company will be guaranteed using a co-insurance structure pursuant to which the Company will co-insure municipal and infrastructure transactions with AGM, and structured finance transactions with AGC. The Company's financial guarantee will guarantee a proportionate share (expected to be approximately 3 to 10%) of the total exposure, and AGM or AGC, as the case may be, will guarantee the remaining exposure under the transaction (subject to compliance with EEA licensing requirements). AGM or AGC, as the case may be, also will issue a second-to-pay guarantee covering AGE's financial guarantee. The Worcestershire Hospital transaction was the first transaction to be executed under the co-insurance arrangement.

In 2007, the FSA supplemented the individual capital assessment for financial guarantee insurers with a "benchmarker" capital adequacy model. The Company has filed an individual capital adequacy submission with the FSA. The FSA elected not to issue Individual Capital Guidance but rather to continue with the use of the benchmarker tool to set the level of capital required. In the third quarter of 2011, management and the FSA conducted a review of the benchmarker model. Should the level of capital at AGE fall below the capital requirement as indicated by the benchmarker, the FSA may require the Company to undertake further work, following which Individual Capital Guidance may result.

During the year the FSA conducted an ARROW review of the Company. Following this review the FSA provided the Company with a Risk Mitigation Programme ("RMP") which required the Company to take certain actions. The Company has agreed an Action Plan with the FSA in order to address all of the points raised in the RMP.

The Company has invested significant financial and management resources into conforming with the requirements established by the European Union's "Solvency II" directive (Directive 2009/138/EC). The Company has been accepted by the FSA into the pre-application process and has begun the process to apply for approval from the FSA for use of the "Partial Internal Model" methodology for calculation of its solvency capital requirement, which combines standard formulas developed by the European Insurance and Occupational Pensions Authority, under the direction of the European Commission, for calculation of certain capital requirements with an internally developed model for calculation of other capital requirements.

Principal risks and uncertainties

The principal risks in the Company's financial guarantee business include insurance risk, credit risk, market risk, liquidity risk, operational risk and systems and control risk.

Insurance risk means the basic risk that the losses associated with the business will not be adequately covered by the Company's revenues and other resources. Insurance risk includes the risk of unanticipated losses, including catastrophic losses, due to the Company's management failing to understand the loss potential of obligations insured by the Company or unexpected third party events, inappropriate policy wording, unexpected legal judgments or legal change with retroactive effect, as well as the risk of revenues and other resources being below expectations due to inadequate premium rates based on ultimate loss experience or expense levels, inadequate reserves and capital resources and other factors.

Credit risk means the risk of loss if another party fails to perform its obligations. The Company faces credit risk as a result of its transactions with a variety of counterparties, including reinsurers, issuers of securities held in its investment portfolio, servicers of asset pools supporting insured structured transactions and other counterparties within the structures of insured transaction. The Company is exposed to the credit risk of its indirect parent company, AGM, in respect of the intra-group reinsurance and other support arrangements between AGM and the Company, which are material to the ability of the Company to engage in its financial guarantee business. The Company's business is dependent on maintaining its ratings and its ratings are dependent on these intra-group agreements and the ratings of AGM.

Market risk means the risk of a decline in value of the Company's assets as a consequence of market movements, such as interest rates and foreign exchange rates, which are not matched by corresponding movements in the value of the liabilities. Please see the discussion of recent adverse loss developments under "Review of business and future developments" above for more information on market risk.

Liquidity risk means the risk that the Company may have insufficient liquid assets to fund the debt services requirements of a defaulted, insured obligation and that losses will be realised in liquidating assets to fund the portions of claims retained by the Company following reinsurance.

Directors' report for the year ended 31 December 2011 (continued)

Operational risk means the risk of unanticipated losses relating to error or failure associated with the administrative aspects of the Company's business, failure to comply with applicable laws and internal Company requirements, the impact of significant events such as a financial system crisis or natural disaster, fraud, corporate governance failure, failure to implement appropriate business plans or conduct effective strategic planning and failures associated with the Company's technology.

Systems and control risk is related to operational risk and means the risk that the Company's systems and controls do not include appropriate plans and procedures for dealing adequately with adverse scenarios.

The Company's management seeks to mitigate the foregoing risks by various means and to assure the availability of adequate capital to cover any liabilities or losses which eventuate notwithstanding the implementation of risk mitigants.

Key performance indicators ("KPIs")

The Board monitors the progress of the Company by reference to the following KPIs:

(i) Net written premium
Net written premium comprises of total gross premium written during the year less the proportion of those premiums that are ceded to its reinsurers. We believe that net written premium is a useful financial measure which permits the evaluation of the value of premiums written and retained by the business during the year.

(ii) Solvency
Solvency, which is a FSA regulatory financial measure, is defined as the excess of capital resources over the capital resources requirement. We believe this is a useful measure as it measures the adequacy of the capital resources of the Company and monitors compliance with the FSA capital requirements.

(iii) Number of new transactions
Number of new transactions is the number of new contracts of insurance incepted during the year.

(iv) Loss ratio
The ratio of net claims incurred to net earned premiums.

The KPIs at the end of the year are as follows:

	2011	2010
	£'000	£'000
Net written premium	**602**	(11,735)
Capital in excess of capital resources requirement	**133,762**	130,164
Loss ratio	**Nil**	Nil
Number of new transactions	**1**	Nil

Results and dividends

The Company's profit after taxation for the year is £2.3m (2010: £25.4m). The directors do not recommend the payment of dividends (2010: Nil).

Directors' report for the year ended 31 December 2011 (continued)

Directors

The following were the directors at the end of the year:

Executive directors
Dominic John Frederico
James Michael Michener
Robert Bruce Mills
Nicholas James Proud
Dominic James Brian Nathan (appointed effective 12 August 2011)

Non-Executive directors
William Peter Cooke
Anthony Robin Dominic Monro-Davies

Financial risk management objectives

The Company is exposed to financial risk through its financial investments, reinsurance assets, liabilities to holders of its financial guarantees and financial investments held within the underlying structures of contracts guaranteed. The key financial risk in its financial investments is that the proceeds from its financial investments are not sufficient to fund the obligations arising from financial guarantees as they fall due. The key financial risk in financial investments held within the underlying structure of contracts guaranteed is that the proceeds from those investments are not sufficient to meet obligations inherent in those contracts, and thus trigger defaults. The most important components of this financial risk are interest rate, currency, credit and liquidity risk.

The Company manages its exposures using a range of risk management techniques. Investment policy is set with reference to the overall risks faced by the Company, with the primary objective to conserve and accumulate capital to cover future obligations and to support the Company's business objectives.

Interest rate risk
Interest rate risk arises primarily from investments in fixed interest securities. Interest rate risk is monitored by comparing the average duration of the investment portfolio. The Company's investment guidelines require the portfolio to have an average duration within two years of the market value weighted average of the relevant benchmark index.

Currency risk
The Company is exposed to currency risk in respect of liabilities under financial guarantees denominated in currencies other than pounds sterling. The most significant currency to which the Company is exposed is the Euro.

The Company seeks to mitigate this risk by matching the estimated foreign currency denominated liabilities with assets denominated in the same currency.

Credit risk
Credit risk is the risk that a counterparty will be unable to pay amounts in full when due. The main areas where the Company is exposed to credit risk are:

- Reinsurer's shares of insurance liabilities
- Amounts due from financial guarantee holders

Directors' report for the year ended 31 December 2011 (continued)

Reinsurance is used to manage risk. This does not, however, discharge the Company's liability as primary financial guarantor. If a reinsurer fails to pay a claim, the Company remains liable for the payment to the policyholder. The creditworthiness of a reinsurer is considered before it is used and strict criteria are applied (including the financial strength of the reinsurer) before a reinsurer is approved.

To manage the risk of non-recoverability of premiums from financial guarantee holders, the Company undertakes extensive due diligence prior to underwriting a contract with its counterparties.

Liquidity risk
Liquidity risk is the risk that cash may not be available to pay obligations as they fall due at a reasonable cost. The Company maintains holdings in short term deposits to ensure there are sufficient funds available to cover anticipated liabilities and unexpected levels of demand. Furthermore, the Company's investment managers are mandated to invest only in debt securities traded on recognised exchanges with the objective of maintaining a high degree of liquidity within the financial resources of the Company. Additionally, in the event of claims arising over a threshold amount, the Company may make claims for reinsurance payments under its reinsurance agreements in advance of paying claims.

Statement of disclosure of information to auditors

Each of the persons who is a director at the date of this report confirms that:

1) so far as each of them is aware, there is no information relevant to the audit of the Company's financial statements for the year ended 31 December 2011 of which the auditors are unaware; and
2) the director has taken all steps that he ought to have taken in his duty as a director in order to make him aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Directors' responsibilities statement

Company law requires the directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the Company and of the profit or loss for that period. The directors are required to prepare the financial statements on a going concern basis, unless it is inappropriate to presume that the Company will continue in business.

The directors confirm that suitable accounting policies have been used and applied consistently. They also confirm that reasonable and prudent judgements and estimates have been made in preparing the financial statements for the year ended 31 December 2011 and that applicable accounting standards have been followed.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to 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.

Directors' report for the year ended 31 December 2011 (continued)

Independent auditors

The auditors PricewaterhouseCoopers LLP continued in office during the year and have expressed their willingness to continue in office. A resolution concerning their reappointment was approved at the meeting of the Company's Board of Directors on 29 March 2012.

On behalf of the Board of Directors

Nicholas James Proud
Director
29 March 2012

Independent Auditors' Report to the Members of Assured Guaranty (Europe) Ltd.

We have audited the financial statements of Assured Guaranty (Europe) Ltd. for the year ended 31 December 2011 which comprise the Profit and Loss Account, the Balance Sheet, and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 10, 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 and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members 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. In addition, we read all the financial and non-financial information in the Annual Report and Financial Statements to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

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 2011 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the 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 Members of Assured Guaranty (Europe) Ltd. (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.

MNichols

Matthew Nichols (Senior Statutory Auditor)
For and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
30 March 2012

Profit and loss account for the year ended 31 December 2011

	Note	**2011 £'000**	2010 £'000
Technical Account – General Business			
Earned premiums, net of reinsurance			
Gross premiums written	*3*	**4,463**	10,022
Outward reinsurance premiums		**(3,861)**	(21,757)
Net premiums written		**602**	(11,735)
Change in the gross provision for unearned premiums		**30,084**	24,331
Change in the provision for unearned premiums, reinsurer's share		**(32,757)**	(12,819)
		(2,673)	11,512
Earned premiums, net of reinsurance		**(2,071)**	(223)
Other technical income	*21*	**-**	11,120
Total technical income		(2,071)	10,897
Changes in technical provisions, net of reinsurance		**400**	-
Net operating expenses / (income)	*4*	**1,754**	(153)
Total technical charges		**2,154**	(153)
Balance on the technical account for general business		**(4,225)**	11,050

Profit and loss account for the year ended 31 December 2011

	Note	**2011 £'000**	2010 £'000
Non-Technical Account			
Balance on the general business technical account		**(4,225)**	11,050
Investment income	*8*	**7,110**	7,016
Unrealised gain on investments	*8*	**781**	1,622
Investment expenses and charges	*8*	**(230)**	(136)
Other income / (charges)	*22*	**121**	(1,711)
Profit on ordinary activities before tax		**3,557**	17,841
Tax on profit on ordinary activities	*10*	**(1,281)**	8,022
Profit for the financial year		**2,276**	25,863

The notes on pages 18 to 30 form part of the financial statements.

All of the results set out are derived from continuing activities.

The Company has no material recognised gains and losses other than the profit above and therefore no separate statement of total recognised gains and losses has been presented.

Neither gains/losses of an insurance company arising on the holding or disposal of investments, nor the effect of fair value accounting for financial instruments are required to be included in a note of historical profits and losses. There are no other differences between the profit on ordinary activities before tax or the profit for the financial year stated above and their historical cost equivalents.

Balance sheet as at 31 December 2011

	Note	2011 £'000	2010 £'000
Assets			
Investments			
Financial investments	*13*	**166,591**	169,649
Reinsurer's share of technical provisions			
Provision for unearned premiums		**618,365**	651,122
Other technical provisions	*20*	**29,598**	-
		647,963	651,122
Debtors			
Debtors arising out of direct insurance operations		**380,789**	402,796
Other debtors		**113,838**	129,202
	12	**494,627**	531,998
Other Assets			
Cash at bank and on hand		**9,194**	8,372
Other assets		**155**	140
Deferred tax	*11*	**27,297**	28,618
		36,646	37,130
Prepayments and accrued income			
Accrued interest		**2,167**	2,182
Deferred acquisition costs		**43,559**	44,948
		45,726	47,130
Total assets		**1,391,553**	1,437,029

Balance sheet as at 31 December 2011

	Note	**2011 £'000**	2010 £'000
Liabilities and shareholder's fund			
Capital and reserves			
Called up share capital	*18*	**55,000**	55,000
Capital contribution	*19*	**62,985**	62,985
Profit and loss account		**59,716**	57,440
Total shareholder's funds		**177,701**	175,425
Technical provisions			
Provision for unearned premium		**622,452**	652,536
Other technical provisions	*20*	**29,998**	-
		652,450	652,536
Creditors			
Creditors arising out of reinsurance operations	*14*	**375,755**	412,593
Other creditors	*14*	**3,916**	8,074
		379,671	420,667
Accruals and deferred income	*15*	**181,731**	188,401
Total liabilities		**1,213,852**	1,261,604
Total liabilities and shareholder's fund		**1,391,553**	1,437,029

The notes on pages 18 to 30 form part of the financial statements.

The financial statements were approved by the Board of Directors on 29 March 2012 and were signed on its behalf by:

Nicholas James Proud
Director

Notes to the financial statements
For the year ended 31 December 2011

1 Statement of significant accounting policies

The accounts have been prepared in accordance with the applicable Accounting Standards in the United Kingdom. The financial statements have been prepared under the provision of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ("SI2008/410") relating to insurance groups and in accordance with the Companies Act 2006 and the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers ("the ABI SORP") dated December 2005 and amended December 2006. The financial statements are prepared on the going concern basis and under the historical cost convention. The principal accounting policies, which have been applied consistently throughout the year, are set out below.

Basis of accounting

(a) Premiums written
Premiums written relate to business incepted during the year, together with any differences between booked premiums for prior years and those previously accrued, and include estimates of premiums receivable but not yet due.

The policy for premium recognition is dependent on the timing of the collection of premiums and the contractual terms of the policy.

(i) Where the premium on a policy is received up front, the premium is recognised as written on the date of inception, and earned in the technical account over the period of the policy having regard to the incidence of risk.

(ii) Where a premium is received in instalments and the underlying bonds are callable, management considers the nature of the call provision(s) and the likelihood of exercise of those provisions, and determines whether it is reasonably certain that the contract will run its full term. The full expected premium is recorded when it is reasonably certain that the contract will run its full term. When the contract is not expected to run its full term, the premium that is recognised as written is either the premium amount to the first call point under the contract and guaranteed minimum premium (where such a clause exists in the policy documents) or where the contract is callable without any notice period, the Company records the instalments as they fall due. When the underlying bonds are non-callable, the premium recognised as written is the full expected premium that is reasonably certain to be received over the life of the contract. Written premiums are recognised as earned income over the period of the policy having regard to the incidence of risk.

When instalment premiums to be received under the policy are linked to an outstanding debt that could be paid down faster than anticipated, or where a premium is linked to an index, the Company recognises premiums written based upon an analysis of the premium it is reasonably certain to receive. Any anticipated change in the expected premium receivable is recognised as an adjustment to premium, in the case of decreases in premium, as soon as it is foreseen and in the case of increases, when such an adjustment is assessed as reasonably certain.

(b) Unearned premiums
Unearned premiums represent the proportion of premiums written in the current or prior years that relate to unexpired terms of policies in force at the balance sheet date, calculated on a time apportionment basis.

Notes to the financial statements (continued)
For the year ended 31 December 2011

1 Statement of significant accounting policies (continued)

(c) Claims and claims expenses
Claims incurred comprise claims and related claims expenses paid in the year and the change in provisions for outstanding claims. When applicable, deductions are made for salvage and subrogation. The provision for unpaid claims and direct claims expenses is recorded when there is a significant deterioration on specific insured obligations and the obligations are in default at the balance sheet date, or when, in management's opinion, the likelihood of default is probable and determinable at the balance sheet date. When appropriate, the provision is discounted to its present value. Provisions are calculated gross of any reinsurance recoveries.

A substantial measure of experience and judgment is involved in assessing outstanding losses, the ultimate cost of which cannot be known with certainty at a balance sheet date. The gross insurance provisions and related reinsurance recoveries are determined on the basis of information currently available; however, it is inherent in the nature of business written that the ultimate liabilities may vary as a result of subsequent developments.

(d) Reinsurance
Contracts entered into by the Company with reinsurers, under which the Company is compensated for losses on one or more contracts issued by the Company and that meet the classification requirements for insurance contracts are classified as reinsurance contracts.

The amounts that will be recoverable from reinsurers are estimated based upon the gross provisions, having due regard to collectability. The recoverability of reinsurance recoveries is assessed having regard to market data on the financial strength of each of the reinsurance companies. The reinsurers' share of claims incurred, in the profit and loss account, reflects the amounts received or receivable from reinsurers in respect of those claims incurred during the period. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised in the profit and loss account as "outward reinsurance premiums" when due.

(e) Acquisition costs and ceding commission income
Acquisition costs incurred, which represent expenses related to the production of business and ceding commission income to be received are deferred, subject to recoverability, and amortised over the period in which the related premiums are earned. These costs include direct and indirect expenses such as the cost of underwriting and marketing personnel. Management uses its judgment in determining what types of costs should be deferred, as well as what percentage of these costs should be deferred. The Company annually conducts a study to determine which operating costs vary with, and are directly related to, the acquisition of new business and qualify for deferral.

(f) Investments
The fair values of investments traded in active markets are based on quoted bid prices on the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The fair values of financial instruments that are not traded in an active market, are established by the directors using valuation techniques which seek to arrive at the price at which an orderly transaction would take between market participants, including broker prices and, if applicable, models.

1 Statement of significant accounting policies (continued)

(g) Investment return
Investment return comprises all investment income, realised investment gains and losses and movements in unrealised gains and losses, net of investment expenses and charges.

(h) Foreign currencies
Transactions in foreign currencies are translated to sterling at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities expressed in foreign currencies at the balance sheet date are translated into sterling at the rates of exchange ruling at that date. Differences arising on exchange are reflected in the non-technical account.

(i) Deferred taxation
Deferred taxation has been recognised as a liability or an asset if transactions have occurred at the balance sheet date that give rise to an obligation to pay more taxation in the future, or a right to pay less taxation in the future. Deferred income tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred tax assets recognised have not been discounted.

(j) Operating leases
Leases of assets where a significant portion of the risk and rewards of ownership are effectively retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the profit and loss account on a straight-line basis over the period of the lease.

(k) Pension costs
In prior years, the Company maintained defined contribution pension plans for the benefit of eligible employees. The maintenance of the pensions plans were transferred to an affiliate, Assured Guaranty (UK) Services Ltd. ("AG UKS"), during the year ended 31 December 2010.

(l) Unexpired risks provision
Provision has been made for any deficiencies arising when unearned premiums, net of associated acquisition costs, are insufficient to meet expected claims and expenses after taking into account future investment return on the investments supporting the unearned premiums provision and unexpired risks provision. The expected claims are calculated based on information available at the balance sheet date. The unexpired risks provision is included in Other technical provisions.

2 Cash flow statement and related party disclosures

The Company is a wholly-owned subsidiary of Assured Guaranty Ltd. ("AGL"). The cash flows of the Company are included in the financial statements of AGL, which are publicly available. Consequently, the Company has taken advantage of the exemption from preparing a cash flow statement under the terms of FRS 1 (revised 1996). The Company is also exempt under the terms of FRS 8 from disclosing related party transactions with entities that are wholly owned subsidiaries of AGL.

Notes to the financial statements (continued)
For the year ended 31 December 2011

3 Segmental analysis

There is only one business segment that of financial guarantee business. The net assets and the business written by the Company are predominantly based in the United Kingdom, with business underwriting decisions made in the United Kingdom.

(a) Gross written premium by geographical segment

	2011	2011	2010	2010
	£'000	£'000	£'000	£'000
- UK	4,205		3,815	
- Europe, excluding UK	193		5,395	
- US	105		764	
- Canada	-		31	
- Japan	(40)		17	
Total gross premiums written		4,463		10,022
Gross earned premium		34,548		34,353
Gross operating income		33,158		31,802
Reinsurance balance		28,048		25,184

Total gross premiums written relate to new business written in the year and in-force business written in prior periods. The Company does not measure profit and loss by geographical segment.

4 Net operating expenses / (income) – technical account

	2011	2010
	£'000	£'000
Movement in deferred acquisition costs	1,389	2,551
Administration expenses	8,936	6,688
Reinsurance commission receivable	(8,571)	(9,392)
	1,754	(153)

Notes to the financial statements (continued)
For the year ended 31 December 2011

5 Auditors' remuneration

During the year, the Company obtained the following services from the auditor at costs as detailed below:

	2011	2010
	£'000	£'000
Audit services	162	3
Other services not covered above	880	153
	1,042	156

2010 audit fee includes release of prior period accrual totalling £145,244.

6 Directors' emoluments

	2011	2010
	£'000	£'000
Aggregate emoluments	390	200
Sums paid to non-executive directors	50	50
Company contributions to defined contributions scheme	28	17
	468	267

Highest paid director

	2011	2010
	£'000	£'000
Total amount of emoluments	336	200
Company contributions to defined contributions scheme	25	17
	361	217

All of the 2011 salaries and emoluments are paid by an affiliate, AG UKS, and charged back to the Company as part of the management fee.

One director is eligible to receive deferred cash and shares under the long-term incentive scheme of the ultimate parent company, AGL. The total value of the long-term incentive award during the year was £66,426. In addition, retirement benefits are accruing for the director under a money purchase pension scheme.

Notes to the financial statements (continued)
For the year ended 31 December 2011

7 Employees

There were no people (including executive directors) employed directly by the Company during the year.

All employees' salaries and benefits were paid by AG UKS, Assured Guaranty Finance Overseas Limited and Assured Guaranty Corp.. In consideration for this service, management service fees were levied on the Company. The total amount levied during the year was £5,444,321 (2010: £3,297,367).

8 Investment return

	2011	2010
	£'000	£'000
Investment Income		
Income from Investments	**6,850**	6,814
Realised gain on investments	**260**	202
	7,110	7,016
Unrealised gain on investments	**781**	1,622
Investment expenses and charges		
Investment management expenses	**(154)**	(136)
Realised loss on investments	**(76)**	
	(230)	
Total investment return	**7,661**	8,502

9 Profit on ordinary activities before taxation

	2011	2010
	£'000	£'000
Profit on ordinary activities before taxation is stated after charging		
Operating lease charges	**536**	770
Foreign exchange gain / (loss)	**121**	(1,711)

The Company has an agreement with AGM for cooperative and joint use of property, and as such was allocated operating lease charges. The amounts allocated during 2011 and 2010 are as included in the above table.

10 Tax on profit on ordinary activities

The Company has made an election with the Internal Revenue Service pursuant to Section 953(d) of the Internal Revenue Code. Section 953(d) allows certain foreign insurance companies to elect to be treated as a U.S. corporation for federal income tax purposes. The impact of the election is that the Company will be taxed as a U.S. corporation subject to tax on its worldwide income, subject to a credit for any taxes paid to a foreign jurisdiction. The current US federal tax rate is 35% (2010: 35%) as compared with an average 26.5% (2010: 28%) rate in the UK.

	2011	2010
	£'000	£'000
UK corporation tax		
- Current	**(1,081)**	(5,076)
- Deferred	**198**	75
Overseas corporation tax		
- Current	**1,258**	(555)
- Deferred	**(1,656)**	13,578
	(1,281)	8,022

The tax assessed for the year is lower than the standard rate of corporation tax in the UK. A reconciliation between the current tax provision and that expected from the standard UK tax rate of 26.5% (2010: 28%) is as follows:

	2011	2010
	£'000	£'000
Tax expense at statutory rate	**(945)**	(4,995)
Effects of:		
Temporary differences		
Employee benefits	**(130)**	(77)
UK and US tax differences		
Permanent		
Net foreign exchange (loss) / gain on translation	**717**	(63)
Tax rate differential	**43**	(1,126)
Timing / temporary		
Unrealised gain / (loss)	**207**	454
Deferred acquisition costs	**(1,879)**	(570)
Timing difference on revenue recognition	**1,929**	401
Other timing differences	**235**	345
Provision for current income taxes	**177**	(5,631)

During the year, as a result of the changes in the UK main corporation tax rate to 26% that was substantively enacted on 29 March 2011 and that was effective from 1 April 2011 and to 25% that was substantively enacted on 5 July 2011 and that will be effective from 1 April 2012, the relevant deferred tax balances have been remeasured at 25%.

Further reductions to the UK corporation tax rate were announced in the March 2012 Budget. The

10 Tax on profit on ordinary activities (continued)

changes, which are expected to be enacted separately each year, propose to reduce the rate by 1% per annum to 22% by 1 April 2014. The changes had not been substantively enacted at the balance sheet date and therefore are not recognised in these financial statements. Had they been substantively enacted they would not have had a material impact on the net deferred tax asset at the period end. The impact of these changes in future periods will be dependent on the level of taxable profits in those periods.

During 2010 Dexia, the previous ultimate parent of the Company, filed an amended U.S. tax return for the 2008 tax year. Based on the amended filing, the Company booked additional foreign tax credits in deferred tax assets of £14.3m. For post acquisition periods, the Company is limited by the U.S. tax code on the annual amount it could benefit from these foreign tax credits. The foreign tax credits expire in 2018 through 2021.

11 Deferred tax (liabilities) / assets

Based on its projections for continued future taxable income, the Company believes that its deferred tax assets are more likely than not to be realised. The items that gave rise to the Company's net deferred tax asset are noted below:

	UK Corporation Deferred Taxes		Overseas Corporation Deferred Taxes		Total Deferred Taxes	
	2011	2010	**2011**	2010	**2011**	2010
Description	**£'000**	£'000	**£'000**	£'000	**£'000**	£'000
UK and US tax differences						
Unrealised gains	-	-	**(1,158)**	(568)	**(1,158)**	(568)
Timing differences on revenue recognition	-	-	**(1,414)**	(1,134)	**(1,414)**	(1,134)
Total deferred tax liabilities	-	-	**(2,572)**	(1,702)	**(2,572)**	(1,702)

	UK Corporation Deferred Taxes		Overseas Corporation Deferred Taxes		Total Deferred Taxes	
	2011	2010	**2011**	2010	**2011**	2010
Description	**£'000**	£'000	**£'000**	£'000	**£'000**	£'000
Timing differences on revenue recognition	-	-	-	-	-	-
Deferred acquisition costs	-	-	**15,445**	15,761	**15,445**	15,761
Employee benefits	**123**	75	**116**	26	**239**	101
Tax credits for UK tax paid	-	-	**13,019**	14,274	**13,019**	14,274
Other temporary timing differences	-	-	**1,166**	184	**1,166**	184
Total deferred tax assets	**123**	75	**29,746**	30,245	**29,869**	30,320
Net deferred tax asset	**123**	75	**27,174**	28,543	**27,297**	28,618

**Notes to the financial statements (continued)
For the year ended 31 December 2011**

11 Deferred tax liabilities / (assets) (continued)

The movement in the net deferred tax asset is as follows:

	UK Corporation Deferred Taxes		Overseas Corporation Deferred Taxes		Total Deferred Taxes	
	2011	2010	**2011**	2010	**2011**	2010
Description	**£'000**	£'000	**£'000**	£'000	**£'000**	£'000
As of 1 January	**75**	-	**28,543**	14,108	**28,618**	14,108
Movement in year	**48**	75	**(1,505)**	13,578	**(1,457)**	13,653
Translation Adjustment	**-**	-	**136**	857	**136**	857
	123	75	**27,174**	28,543	**27,297**	28,618

12 Debtors

	2011	2010
	£'000	£'000
Arising out of direct insurance operations	**380,789**	402,796
Reinsurance commission receivable from group undertaking	**111,858**	116,889
Other debtors including taxation and social security	**1,980**	-
Amounts owed by group undertakings	**-**	12,313
At 31 December	**494,627**	531,998

13 Investments

	2011	2010
	£'000	£'000
Financial investments		
- UK government bonds	**152,694**	161,456
- Non-UK government bonds	**796**	808
- Corporate bonds	**11,684**	6,098
- Asset-backed securities	**126**	-
- Short-term investments	**1,291**	1,287
At 31 December	**166,591**	169,649

Notes to the financial statements (continued)
For the year ended 31 December 2011

13 Investments (continued)

The bonds are shown at market value. The book cost of these is £155,408,860 (2010: £159,276,912). Of the above investments, £165,298,484 were listed investments (2010: £168,362,409).

14 Creditors

	2011	2010
	£'000	£'000
Arising out of reinsurance operations	**375,755**	412,593
Amounts owed to group undertakings	**2,646**	-
Amounts due under pension plan obligations	**3**	4
Other creditors including taxation and social security	**1,267**	8,070
At 31 December	**379,671**	420,667

Amounts owed to group undertakings are unsecured, interest free and have no fixed date for repayment.

15 Accruals and deferred income

	2011	2010
	£'000	£'000
Other liabilities	**152**	-
Reinsurance commission deferred	**181,579**	188,401
At 31 December	**181,731**	188,401

16 Other financial commitments and guarantees

The Company has guaranteed the obligations of Assured Guaranty Credit Protection Limited ("AGCPL"), a fellow group company. AGCPL sells credit protection to counterparties through credit default swaps and may incur a loss in the event of payment default by the obligor. The Company is not aware of any actual or potential liabilities in relation to this guarantee. In 2011 and 2010, the transaction fees incurred by the Company totalled approximately £28,4973 and £27,060, respectively. The Company, in turn, was paid an administrative fee of £15,000 and £15,000 in 2011 and 2010, respectively, by AGCPL in connection with a cooperative agreement between the two companies for AGCPL's use of Company personnel, property and services.

17 Significant risk management activities

The Company relies on the following committees and functions for its risk management policies and procedures: Audit and Risk Oversight Committee of the Board of Directors, Compliance Function, Credit Committee, Executive Committee, Reserve Committee, Risk Management Function and Surveillance Function. Within the limits established by the board committees, specific risk policies and limits are set by the Portfolio Risk Management Committee, which includes members of senior management and senior Credit and Surveillance officers. As part of its risk management strategy, the Company may seek to obtain third party reinsurance and may also periodically enter into other arrangements to alleviate all or a portion of this risk.

Surveillance personnel are responsible for monitoring and reporting on all transactions in the insured portfolio. The primary objective of the surveillance process is to monitor trends and changes in transaction credit quality, detect any deterioration in credit quality, and recommend to management such remedial actions as may be necessary or appropriate. All transactions in the insured portfolio are assigned internal credit ratings, and surveillance personnel are responsible for recommending adjustments to those ratings to reflect changes in transaction credit quality. Risk Management and Surveillance personnel are also responsible for managing work-out and loss situations when necessary. For transactions where a loss is considered probable, surveillance personnel and the Actuarial Function make recommendations on case loss reserves to a Reserve Committee.

The Surveillance Function may request that the Group's workout committee develop and implement loss mitigation strategies when the Surveillance Function identifies transactions that would benefit from active loss mitigation.

The Company segregates its insured portfolio of investment grade and below investment grade risks into surveillance categories to facilitate the appropriate allocation of resources to monitoring and loss mitigation efforts and to aid in establishing the appropriate cycle for periodic review for each exposure. Below investment grade credits include all credits internally rated lower than BBB-. The Company's internal credit ratings are based on the Company's internal assessment of the likelihood of default. The Company's internal credit ratings are expressed on a ratings scale similar to that used by the rating agencies and are generally reflective of an approach similar to that employed by the rating agencies.

The Company monitors its investment grade credits to determine whether any new credits need to be internally downgraded to below investment grade. Quarterly procedures include qualitative and quantitative analysis on the Company's insured portfolio to identify potential new below investment grade credits. The Company refreshes its internal credits ratings on individual credits in cycles based on the Company's view of the credit's quality, loss potential, volatility and sector. Ratings on credits and in sectors identified as under the most stress or with the most potential volatility are reviewed every quarter. Credits identified through this process as below investment grade are subjected to further review by surveillance personnel to determine the various probabilities of a loss. Surveillance personnel present analysis related to potential loss scenarios to a reserve committee. The reserve committee consider the information provided by surveillance personnel when setting reserves.

Notes to the financial statements (continued)
For the year ended 31 December 2011

18 Called up share capital

	2011	2010
	£'000	£'000
Authorised		
500,000,000 ordinary shares of £1 each	**500,000**	500,000
Allotted and fully paid		
55,000,000 ordinary shares of £1 each	**55,000**	55,000

19 Reconciliation of movements in shareholders' funds

	Called up share capital	Profit and loss account	Capital contribution	2011	2010
	£'000	£'000	£'000	£'000	£'000
At 1 January	**55,000**	**57,440**	**62,985**	**175,425**	149,562
Profit for the financial year	-	**2,276**	-	**2,276**	25,863
At 31 December	**55,000**	**59,716**	**62,985**	**177,701**	175,425

20 Other technical provisions

	2011	2010
	£'000	£'000
Unexpired risks provision	**29,998**	-
Reinsurer's share of unexpired risks provision	**(29,598)**	-
At 31 December	**400**	-

The discount rate used in calculating the unexpired risk provision is a rate of 3.5%

21 Other technical income

	2011	2010
	£'000	£'000
Other technical income	-	11,120
At 31 December	-	11,120

Other technical income relates to settlements received on the cancellation of reinsurance contracts.

Notes to the financial statements (continued)
For the year ended 31 December 2011

22 Other income / charges

	2011	2010
	£'000	£'000
Foreign exchange gain / (loss)	121	(1,711)
At 31 December	121	(1,711)

23 Financial commitments

The Company has arrangements with its indirect parent AGM whereby it pays lease rentals on behalf of AGM in respect of office space previously occupied by the Company. The commitment under the uncancellable operating lease is to pay annual rentals of £0.9m (2010: £0.9m). As a result of vacating the building, the Company has made a lease provision for the unexpired portion of the lease, taking into account anticipated future sub-lease income from parties not yet identified. The total amount of lease provision provided for is £0.8m (2010: £1.2m). This lease will expire on 24 September 2013.

24 Subsequent events

AGE has €313.9m of outstanding gross exposure and €5.4m of outstanding net exposure to the Greek government at year-end. This exposure consists of bilateral guarantees on €200m of bonds with a fixed rate coupon of 4.5% due in 2037 and €113.9m of inflation linked bonds with a fixed rate coupon of 2.085% due in 2057, both with bullet maturities. In March 2012, under the terms of its financial guarantees, the Company took delivery of these bonds. Subsequently, the 2037 bonds were exchanged under a Greek government exchange offer, and the Company has tendered the 2057 notes under the same offer. The purpose of the exchange offer is to reduce Greece's obligation by 53.5% of the notional amounts of the original securities. The Company's original obligation on these securities remains unchanged. As of year-end the Company held a gross unexpired risk provision of £30.0m (net £0.4m). The Company currently does not have enough information to determine financial effect of these post balance sheet events.

25 Ultimate and immediate parent company

The immediate parent undertaking is Assured Guaranty Municipal Insurance Company ("AGMIC") (formerly, FSA Insurance Company), a United States company. The ultimate parent undertaking and controlling party is AGL, a Bermuda incorporated insurance holding company.

AGL is the parent undertaking of the largest group of undertakings to consolidate these financial statements at 31 December 2011. The consolidated financial statements of AGL can be obtained from 30 Woodbourne Avenue, Hamilton HM 08, Bermuda.

AGMIC is the parent undertaking of the smallest group of undertakings to consolidate these financial statements. The consolidated financial statements of AGMIC can be obtained from 31 West 52nd Street, New York, NY 10019, United States of America.

Assured Guaranty (Europe) Ltd.

Registered Number: 2510099

Annual report and financial statements
For the year ended 31 December 2012

Annual report and financial statements
For the year ended 31 December 2012

Contents

Company information

Directors

Executive directors
Dominic John Frederico
Nicholas James Proud
James Michael Michener
Robert Bruce Mills
Dominic James Brian Nathan

Non-executive directors
William Peter Cooke (resigned effective 4 December 2012)
Anthony Robin Dominic Monro-Davies
Simon William de Mussenden Leathes (appointed effective 4 January 2012)

Company secretary
Bernadine Shaw (resigned effective 11 September 2012)
Ruth Cove (appointed effective 11 September 2012)

Registered office
1 Finsbury Square
London
EC2A 1AE

Independent auditors
PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
7 More London Riverside
London
SE1 2RT

Directors' report for the year ended 31 December 2012

The directors present their report and the audited financial statements of the Company for the year ended 31 December 2012.

Principal activity

The principal activity of Assured Guaranty (Europe) Ltd. (formerly, Financial Security Assurance (U.K.) Limited) ("the Company") is providing financial guarantees for European Union public finance and asset backed obligations. Financial guarantee insurance written by the Company generally guarantees scheduled payments on an issuer's obligations when there is a payment default by the obligor.

The Company is a wholly owned subsidiary of Assured Guaranty Municipal Insurance Company ("AGMIC") (formerly, FSA Insurance Company), which in turn is wholly owned by Assured Guaranty Municipal Corp. ("AGM").

The Company is authorised to effect and carry out certain classes of general insurance, specifically: classes 14 (credit), 15 (suretyship) and 16 (miscellaneous financial loss). This scope of permission is sufficient to enable the Company to effect and carry out financial guarantee insurance and reinsurance. The insurance and reinsurance businesses of the Company are subject to authorisation and close supervision by the Financial Services Authority ("the FSA"). The Company also has permission to arrange and advise on deals in financial guarantees which it underwrites.

Obligations insured by the Company are generally awarded ratings on the basis of the financial strength ratings given by the major securities rating agencies.

The Company has been assigned the following insurance financial strength ratings as of 26 March, 2013. These ratings are subject to continuous review:

S&P: AA- / Stable Outlook

Moody's: A2 / Stable Outlook

Review of business and future developments

The results of the Company for the year are as set out on pages 13 and 14.

In 2012, the Company continued to be affected by a negative perception of financial guaranty insurers arising from the financial distress suffered by other companies in the industry during the financial crisis. In November 2011, S&P downgraded the financial strength ratings of the Company to AA- (Stable Outlook) under its revised criteria. In January 2013, after a ten month review, Moody's assigned the Company an A2 (Stable) rating. Because the financial strength ratings of the Company were under review for possible downgrade by Moody's throughout most of 2012, the Company believes the demand for the Company's insurance product was negatively impacted.

The Company expects the pipeline of European infrastructure transactions to remain robust. Historically, financial guarantees had been an essential component of capital markets financings for European infrastructure projects. Because of the difficulties experienced by the financial guarantee industry since the onset of the financial crisis, these financings have been largely funded with relatively short-term bank loans. The Company expects that its European infrastructure opportunities will increase as the global economic environment stabilises and issuers return to the public markets for financings and that institutional investors will utilise financial guarantees again, as they value the Company's underwriting skills and surveillance functions as well as the value of the Company's guarantees.

Directors' report for the year ended 31 December 2012 (continued)

At 31st December 2012, gross outstanding par insured was £17,975.1m and net par after reinsurance was £317.8m. Of this, 85.87% related to public finance exposures and 14.13% to structured finance exposures.

The Company's economic exposure to the selected European countries listed below (based on par for financial guaranty contracts and notional amount for financial guaranty contracts accounted for as derivatives) is shown in the following tables, both gross and net of ceded reinsurance:

Country	Gross exposure £'million	Net exposure £'million
Hungary	306.6	6.1
Ireland	42.8	0.9
Italy	1,379.4	33.2
Spain	401.6	7.0

As of December 31, 2012, the Company has not guaranteed any sovereign bonds of the Selected European Countries. The exposure shown in the above table is from transactions primarily backed by receivable payments from sub-sovereigns in Italy, Spain and Hungary. The Company understands that Moody's recently had undertaken a review of redenomination risk in selected countries in the Eurozone, including some of the selected European countries listed above. No redenomination from the Euro to another currency has yet occurred and it may never occur. Therefore, it is not possible to be certain at this point how a redenomination of an issuer's obligations might be implemented in the future and, in particular, whether any redenomination would extend to the Company's obligations under a related financial guarantee. At June 30, 2012, the Company had £3.2m of net exposure to the sovereign debt of Greece. The Company paid claims under its financial guaranties during the 2012 paying off in full its liabilities with respect to the Greek sovereign bonds it guaranteed. At December 31, 2012, the Company no longer had any direct exposure to Greece.

During 2012, the Company was party to a reinsurance agreement and a net worth maintenance agreement with AGM. Under the quota share cover of the reinsurance agreement transactions closed prior to 2011, AGM reinsured approximately 92% of the Company's retention after cessions to other reinsurers for transactions closed prior to 2011. The quota share cover does not apply to business under a co-guaranty, co-insurance or co-reinsurance structure implemented by the Company in 2011, where such co-guaranty, co-insurance or co-reinsurance is with an affiliate and where the amount guarantied, co-insured or co-guarantied by the Company is equal to approximately its pro rata retention percentage under the quota share cover. Under the stop loss cover of the reinsurance agreement, AGM is required to make payments to the Company when the Company's annual net incurred losses and expenses exceeds the Company's annual net earned premium plus any amounts deducted from the Company's equalisation reserve during the year. The stop loss cover has an annual limit of liability equal to 20% of the net principal insured outstanding at the prior year-end, plus the net principal insured outstanding at last year-end of the Company's two largest transactions. The quota share and stop loss covers exclude transaction guarantied by the Company on or after July 1, 2009 that are not municipal, utility, project finance or infrastructure risks or similar types of risks. Under the net worth maintenance agreement, AGM is obligated to cause the Company to maintain capital resources equal to 110% of the greatest of the amounts as may be required by the FSA as a condition for maintaining its authorisation to carry on an insurance business in the U.K., provided that contributions do not exceed more than 35% of AGM's policyholders' surplus on an accumulated basis and are made in accordance with Article 15 of the New York Insurance Law.

It has been agreed between management and the FSA that any new business written by the Company will be guaranteed using a co-insurance structure pursuant to which the Company will co-insure municipal and infrastructure transactions with AGM, and asset backed transactions with Assured Guaranty Corp. ("AGC"). The Company's financial guarantee will guarantee a proportionate share (expected to be approximately 3 to 10%) of the total exposure, and AGM or AGC, as the case may be, will guarantee the remaining exposure under the transaction (subject to compliance with EEA licensing requirements). AGM or AGC, as the case may be, also will issue a second-to-pay guarantee covering the Company's financial guarantee.

The Company has invested significant financial and management resources into conforming with the requirements established by the European Union's "Solvency II" directive (Directive 2009/138/EC). The Company had been accepted by the FSA into the pre-application process and had begun the process to apply for approval from the FSA for use of the "Partial Internal Model" methodology for calculation of its solvency capital requirement, which combines standard formulas developed by the European Insurance and Occupational Pensions Authority, under the direction of the European Commission, for calculation of certain capital requirements with an internally developed model for calculation of other capital requirements. However, the date for the scheduled adoption of Solvency II has been delayed and the FSA has asked the Company to delay making its submission until mid 2014.

Prior to the adoption of Solvency II the FSA will supplement the individual capital assessment for the Companies with a "benchmarker" capital adequacy model. Should the level of capital at the Company fall below the capital requirement as indicated by the benchmarker, the FSA may require the Company to undertake further work, following which Individual Capital Guidance may result.

During 2011 the FSA conducted an ARROW review of the Company. Following this review the FSA provided the Company with a Risk Mitigation Programme ("RMP") which required the Company to take certain actions. The Company has agreed to an Action Plan with the FSA in order to address all of the points raised in the RMP.

Principal risks and uncertainties

The principal risks in the Company's financial guarantee business include insurance risk, credit risk, market risk, liquidity risk, operational risk and systems and control risk.

Insurance risk means the basic risk that the losses associated with the business will not be adequately covered by the Company's revenues and other resources. Insurance risk includes the risk of unanticipated losses, including catastrophic losses, due to the Company's management failing to understand the loss potential of obligations insured by the Company or unexpected third party events, inappropriate policy wording, unexpected legal judgments or legal change with retroactive effect, as well as the risk of revenues and other resources being below expectations due to inadequate premium rates based on ultimate loss experience or expense levels, inadequate reserves and capital resources and other factors.

Credit risk means the risk of loss if another party fails to perform its obligations. The Company faces credit risk as a result of its transactions with a variety of counterparties, including reinsurers, issuers of securities held in its investment portfolio, servicers of asset pools supporting insured structured transactions and other counterparties within the structures of insured transaction. The Company is exposed to the credit risk of its indirect parent company, AGM, in respect of the intra-group reinsurance and other support arrangements between AGM and the Company, which are material to the ability of the Company to engage in its financial guarantee business. The Company's business is dependent on maintaining its ratings and its ratings are dependent on these intra-group agreements and the ratings of AGM.

Market risk means the risk of a decline in value of the Company's assets as a consequence of market movements, such as interest rates and foreign exchange rates, which are not matched by corresponding movements in the value of the liabilities. Please see the discussion of recent adverse loss developments under "Review of business and future developments" above for more information on market risk.

Liquidity risk means the risk that the Company may have insufficient liquid assets to fund the debt services requirements of a defaulted, insured obligation and that losses will be realised in liquidating assets to fund the portions of claims retained by the Company following reinsurance.

Operational risk means the risk of unanticipated losses relating to error or failure associated with the administrative aspects of the Company's business, failure to comply with applicable laws and internal Company requirements, the impact of significant events such as a financial system crisis or natural disaster, fraud, corporate governance failure, failure to implement appropriate business plans or conduct effective strategic planning and failures associated with the Company's technology.

Systems and control risk is related to operational risk and means the risk that the Company's systems and controls do not include appropriate plans and procedures for dealing adequately with adverse scenarios.

The Company's management seeks to mitigate the foregoing risks by various means and to assure the availability of adequate capital to cover any liabilities or losses which eventuate notwithstanding the implementation of risk mitigants.

Key performance indicators ("KPIs")

The Board monitors the progress of the Company by reference to the following KPIs:

(i) Present value of new business written ("PVP") of transactions written by Company.
PVP, which is a non-GAAP ("Generally Accepted Accounting Principle") financial measure, is defined as gross upfront and instalment premiums received and the present value of gross estimated future instalment premiums, on contracts written in the current period, discounted at 6% per year. We believe PVP is a useful measure for management and other users of the financial statement because it enables the evaluation of the value of new business production by the Company by taking into account the value of estimated future instalment premiums on all new contracts underwritten in a reporting period, which GAAP gross premiums written do not adequately measure

(ii) Solvency
Solvency, which is a FSA regulatory financial measure, is defined as the excess of capital resources over the capital resources requirement. We believe this is a useful measure as it measures the adequacy of the capital resources of the Company and monitors compliance with the FSA capital requirements.

(iii) Number of new transactions
Number of new transactions is the number of new contracts of insurance incepted during the year.

(iv) Loss ratio
The ratio of net claims incurred to net earned premiums.

The KPIs at the end of the year are as follows:

	2012	2011
	£'000	£'000
PVP	**Nil**	94
Capital in excess of capital resources requirement	**135,238**	133,762
Loss ratio	**589%**	Nil
Number of new transactions	**Nil**	1

The increase in the loss ratio during 2012 is related to the company's exposure to Greece.

Results and dividends

The Company's profit after taxation for the year is £0.9m (2011: £2.3m). The directors do not recommend the payment of dividends (2011: Nil).

Directors

The following were the directors at the end of the year:

Executive directors
Dominic John Frederico
James Michael Michener
Robert Bruce Mills
Nicholas James Proud
Dominic James Brian Nathan

Non-Executive directors
Anthony Robin Dominic Monro-Davies
Simon William de Mussenden Leathes (appointed effective 4 January 2012)

Financial risk management objectives

The Company is exposed to financial risk through its financial investments, reinsurance assets, liabilities to holders of its financial guarantees and financial investments held within the underlying structures of contracts guaranteed. The key financial risk in its financial investments is that the proceeds from its financial investments are not sufficient to fund the obligations arising from financial guarantees as they fall due. The key financial risk in financial investments held within the underlying structure of contracts guaranteed is that the proceeds from those investments are not sufficient to meet obligations inherent in those contracts, and thus trigger defaults. The most important components of this financial risk are interest rate, currency, credit and liquidity risk.

The Company manages its exposures using a range of risk management techniques. Investment policy is set with reference to the overall risks faced by the Company, with the primary objective to conserve and accumulate capital to cover future obligations and to support the Company's business objectives.

Directors' report for the year ended 31 December 2012 (continued)

Interest rate risk
Interest rate risk arises primarily from investments in fixed interest securities. Interest rate risk is monitored by comparing the average duration of the investment portfolio. The Company's investment guidelines require the portfolio to have an average duration within two years of the market value weighted average of the relevant benchmark index.

Currency risk
The Company is exposed to currency risk in respect of liabilities under financial guarantees denominated in currencies other than pounds sterling. The most significant currency to which the Company is exposed is the Euro.

The Company seeks to mitigate this risk by matching the estimated foreign currency denominated liabilities with assets denominated in the same currency.

Credit risk
Credit risk is the risk that a counterparty will be unable to pay amounts in full when due. The main areas where the Company is exposed to credit risk are:

- Reinsurer's shares of insurance liabilities
- Amounts due from financial guarantee holders

Reinsurance is used to manage risk. This does not, however, discharge the Company's liability as primary financial guarantor. If a reinsurer fails to pay a claim, the Company remains liable for the payment to the policyholder. The creditworthiness of a reinsurer is considered before it is used and strict criteria are applied (including the financial strength of the reinsurer) before a reinsurer is approved.

To manage the risk of non-recoverability of premiums from financial guarantee holders, the Company undertakes extensive due diligence prior to underwriting a contract with its counterparties.

Liquidity risk
Liquidity risk is the risk that cash may not be available to pay obligations as they fall due at a reasonable cost. The Company maintains holdings in short term deposits to ensure there are sufficient funds available to cover anticipated liabilities and unexpected levels of demand. Furthermore, the Company's investment managers are mandated to invest only in debt securities traded on recognised exchanges with the objective of maintaining a high degree of liquidity within the financial resources of the Company. Additionally, in the event of claims arising over a threshold amount, the Company may make claims for reinsurance payments under its reinsurance agreements in advance of paying claims.

Statement of disclosure of information to auditors

Each of the persons who is a director at the date of this report confirms that:

1) so far as each of them is aware, there is no information relevant to the audit of the Company's financial statements for the year ended 31 December 2012 of which the auditors are unaware; and

2) the director has taken all steps that he ought to have taken in his duty as a director in order to make him aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Directors' report for the year ended 31 December 2012 (continued)

Directors' responsibilities statement

Company law requires the directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the Company and of the profit or loss for that period. The directors are required to prepare the financial statements on a going concern basis, unless it is inappropriate to presume that the Company will continue in business.

The directors confirm that suitable accounting policies have been used and applied consistently. They also confirm that reasonable and prudent judgements and estimates have been made in preparing the financial statements for the year ended 31 December 2012 and that applicable accounting standards have been followed.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to 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.

Independent auditors

The auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office. A resolution concerning their reappointment was approved at the meeting of the Company's Board of Directors on 26 March 2013.

On behalf of the Board of Directors

Nicholas James Proud
Director
26 March 2013

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF ASSURED GUARANTY (UK) LIMITED

We have audited the financial statements of Assured Guaranty (UK) Limited for the year ended 31 December 2012 which comprise the Profit and Loss Account, the Balance Sheet and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 10 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 and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members 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. In addition, we read all the financial and non-financial information in the Annual Report and Financial Statements to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

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 2012 and of its profit for the year then ended;

- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and

- have been prepared in accordance with the 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.

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.

Matthew Nichols (Senior Statutory Auditor)
For and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
27 March 2013

Profit and loss account for the year ended 31 December 2012

	Note	**2012 £'000**	2011 £'000
Technical Account – General Business			
Earned premiums, net of reinsurance			
Gross premiums written	*3*	**838**	4,463
Outward reinsurance premiums		**(814)**	(3,861)
Net premiums written		**24**	602
Change in the gross provision for unearned premiums		**54,118**	30,084
Change in the provision for unearned premiums, reinsurer's share		**(53,601)**	(32,757)
		517	(2,673)
Earned premiums, net of reinsurance		**541**	(2,071)
Net operating income	*4*	**2,847**	-
Total technical income		**3,388**	(2,071)
Claims incurred, net of reinsurance			
Claims paid			
- gross amount		**195,405**	-
- reinsurer's share		**(192,221)**	-
Claims incurred, net of reinsurance		**3,184**	-
Changes in technical provisions, net of reinsurance		**(31)**	400
Net operating expenses	*4*	**-**	1,754
Total technical charges		**3,153**	2,154
Balance on the technical account for general business		**235**	(4,225)

Profit and loss account for the year ended 31 December 2012

	Note	**2012** **£'000**	2011 £'000
Non-Technical Account			
Balance on the general business technical account		**235**	(4,225)
Investment income	*8*	**6,510**	7,110
Unrealised (loss) / gain on investments	*8*	**(1,282)**	781
Investment expenses and charges	*8*	**(8,147)**	(230)
Other income	*21*	**4,107**	121
Profit on ordinary activities before tax		**1,423**	3,557
Tax on profit on ordinary activities	*10*	**(546)**	(1,281)
Profit for the financial year		**877**	2,276

The notes on pages 17 to 29 form part of the financial statements.

All of the results set out are derived from continuing activities.

The Company has no material recognised gains and losses other than the profit above and therefore no separate statement of total recognised gains and losses has been presented.

Neither gains/losses of an insurance company arising on the holding or disposal of investments, nor the effect of fair value accounting for financial instruments are required to be included in a note of historical profits and losses. There are no other differences between the profit on ordinary activities before tax or the profit for the financial year stated above and their historical cost equivalents.

Assured Guaranty (Europe) Ltd.

Registered in England No. 2510099

Balance sheet as at 31 December 2012

	Note	2012 £'000	2011 £'000
Assets			
Investments			
Financial investments	*13*	**163,313**	166,591
Reinsurer's share of technical provisions			
Provision for unearned premiums		**564,763**	618,365
Other technical provisions	*20*	**23,314**	29,598
		588,077	647,963
Debtors			
Debtors arising out of direct insurance operations		**354,526**	380,789
Other debtors		**99,583**	113,838
	12	**454,109**	494,627
Other Assets			
Cash at bank and on hand		**12,241**	9,194
Other assets		**77**	155
Deferred tax	*11*	**26,698**	27,297
		39,016	36,646
Prepayments and accrued income			
Accrued interest		**2,555**	2,167
Deferred acquisition costs		**39,557**	43,559
		42,112	45,726
Total assets		**1,286,627**	1,391,553

Balance sheet as at 31 December 2012

	Note	**2012 £'000**	2011 £'000
Liabilities and shareholder's fund			
Capital and reserves			
Called up share capital	*18*	**55,000**	55,000
Capital contribution	*19*	**62,985**	62,985
Profit and loss account		**60,593**	59,716
Total shareholder's funds		**178,578**	177,701
Technical provisions			
Provision for unearned premium		**568,333**	622,452
Other technical provisions	*20*	**23,667**	29,998
		592,000	652,450
Creditors			
Creditors arising out of reinsurance operations		**345,528**	375,755
Other creditors		**4,353**	3,916
	14	**349,881**	379,671
Accruals and deferred income	*15*	**166,168**	181,731
Total liabilities		**1,108,049**	1,213,852
Total liabilities and shareholder's fund		**1,286,627**	1,391,553

The notes on pages 17 to 29 form part of the financial statements.

The financial statements were approved by the Board of Directors on 26 March 2013 and were signed on its behalf by:

Nicholas James Proud
Director

1 Statement of significant accounting policies

The accounts have been prepared in accordance with the applicable Accounting Standards in the United Kingdom. The financial statements have been prepared under the provision of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ("SI2008/410") relating to insurance groups and in accordance with the Companies Act 2006 and the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers ("the ABI SORP") dated December 2005 and amended December 2006. The financial statements are prepared a going concern basis. The principal accounting policies, which have been applied consistently throughout the year, are set out below.

Basis of accounting

(a) Premiums written
Premiums written relate to business incepted during the year, together with any differences between booked premiums for prior years and those previously accrued, and include estimates of premiums receivable but not yet due.

The policy for premium recognition is dependent on the timing of the collection of premiums and the contractual terms of the policy.

(i) Where the premium on a policy is received up front, the premium is recognised as written on the date of inception, and earned in the technical account over the period of the policy having regard to the incidence of risk.

(ii) Where a premium is received in instalments and the underlying bonds are callable, management considers the nature of the call provision(s) and the likelihood of exercise of those provisions, and determines whether it is reasonably certain that the contract will run its full term. The full expected premium is recorded when it is reasonably certain that the contract will run its full term. When the contract is not expected to run its full term, the premium that is recognised as written is either the premium amount to the first call point under the contract and guaranteed minimum premium (where such a clause exists in the policy documents) or where the contract is callable without any notice period, the Company records the instalments as they fall due. When the underlying bonds are non-callable, the premium recognised as written is the full expected premium that is reasonably certain to be received over the life of the contract. Written premiums are recognised as earned income over the period of the policy having regard to the incidence of risk.

When instalment premiums to be received under the policy are linked to an outstanding debt that could be paid down faster than anticipated, or where a premium is linked to an index, the Company recognises premiums written based upon an analysis of the premium it is reasonably certain to receive. Any anticipated change in the expected premium receivable is recognised as an adjustment to premium, in the case of decreases in premium, as soon as it is foreseen and in the case of increases, when such an adjustment is assessed as reasonably certain.

(b) Unearned premiums
Unearned premiums represent the proportion of premiums written in the current or prior years that relate to unexpired terms of policies in force at the balance sheet date, calculated on a time apportionment basis.

1 Statement of significant accounting policies (continued)

(c) Claims and claims expenses
Claims incurred comprise claims and related claims expenses paid in the year and the change in provisions for outstanding claims. When applicable, deductions are made for salvage and subrogation. The provision for unpaid claims and direct claims expenses is recorded when there is a significant deterioration on specific insured obligations and the obligations are in default at the balance sheet date, or when, in management's opinion, the likelihood of default is probable and determinable at the balance sheet date. When appropriate, the provision is discounted to its present value. Provisions are calculated gross of any reinsurance recoveries.

A substantial measure of experience and judgment is involved in assessing outstanding losses, the ultimate cost of which cannot be known with certainty at a balance sheet date. The gross insurance provisions and related reinsurance recoveries are determined on the basis of information currently available; however, it is inherent in the nature of business written that the ultimate liabilities may vary as a result of subsequent developments.

(d) Reinsurance
Contracts entered into by the Company with reinsurers, under which the Company is compensated for losses on one or more contracts issued by the Company and that meet the classification requirements for insurance contracts are classified as reinsurance contracts.

The amounts that will be recoverable from reinsurers are estimated based upon the gross provisions, having due regard to collectability. The recoverability of reinsurance recoveries is assessed having regard to market data on the financial strength of each of the reinsurance companies. The reinsurers' share of claims incurred, in the profit and loss account, reflects the amounts received or receivable from reinsurers in respect of those claims incurred during the period. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised in the profit and loss account as "outward reinsurance premiums" when due.

(e) Acquisition costs and ceding commission income
Acquisition costs incurred, which represent expenses related to the production of business and ceding commission income to be received are deferred, subject to recoverability, and amortised over the period in which the related premiums are earned. These costs include direct and indirect expenses such as the cost of underwriting and marketing personnel. Management uses its judgment in determining what types of costs should be deferred, as well as what percentage of these costs should be deferred. The Company annually conducts a study to determine which operating costs vary with, and are directly related to, the acquisition of new business and qualify for deferral.

(f) Investments
The fair values of investments traded in active markets are based on quoted bid prices on the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The fair values of financial instruments that are not traded in an active market, are established by the directors using valuation techniques which seek to arrive at the price at which an orderly transaction would take between market participants, including broker prices and, if applicable, models.

1 Statement of significant accounting policies (continued)

(g) Investment return
Investment return comprises all investment income, realised investment gains and losses and movements in unrealised gains and losses, net of investment expenses and charges.

(h) Foreign currencies
Transactions in foreign currencies are translated to sterling at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities expressed in foreign currencies at the balance sheet date are translated into sterling at the rates of exchange ruling at that date. Differences arising on exchange are reflected in the non-technical account.

(i) Deferred taxation
Deferred taxation has been recognised as a liability or an asset if transactions have occurred at the balance sheet date that give rise to an obligation to pay more taxation in the future, or a right to pay less taxation in the future. Deferred income tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred tax assets recognised have not been discounted.

(j) Operating leases
Leases of assets where a significant portion of the risk and rewards of ownership are effectively retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the profit and loss account on a straight-line basis over the period of the lease.

(k) Unexpired risks provision
Provision has been made for any deficiencies arising when unearned premiums, net of associated acquisition costs, are insufficient to meet expected claims and expenses after taking into account future investment return on the investments supporting the unearned premiums provision and unexpired risks provision. The expected claims are calculated based on information available at the balance sheet date. The unexpired risks provision is included in Other technical provisions.

2 Cash flow statement and related party disclosures

The Company is a wholly-owned subsidiary of Assured Guaranty Ltd. ("AGL"). The cash flows of the Company are included in the financial statements of AGL, which are publicly available. Consequently, the Company has taken advantage of the exemption from preparing a cash flow statement under the terms of FRS 1 (revised 1996). The Company is also exempt under the terms of FRS 8 from disclosing related party transactions with entities that are wholly owned subsidiaries of AGL.

3 Segmental analysis

There is only one business segment that of financial guarantee business. The net assets and the business written by the Company are predominantly based in the United Kingdom, with business underwriting decisions made in the United Kingdom.

(a) Gross written premium by geographical segment

	2012	2012	2011	2011
	£'000	£'000	£'000	£'000
- UK	1,308		4,205	
- Europe, excluding UK	53		193	
- US	(481)		105	
- Japan	(42)		(40)	
Total gross premiums written		838		4,463
Gross earned premium		54,956		34,548
Gross operating income		50,955		33,158
Reinsurance balance		153,633		28,048

Total gross premiums written relates to in-force business written in prior periods. The Company does not measure profit and loss by geographical segment.

(b) Gross claim incurred by geographical segment

	2012	2012	2011	2011
	£'000	£'000	£'000	£'000
- Europe, excluding UK	195,405		-	-
Total gross claim incurred		195,405		-

4 Net operating income / (expense) – technical account

	2012	2011
	£'000	£'000
Movement in deferred acquisition costs	(4,002)	(1,389)
Administration expenses	(8,978)	(8,936)
Reinsurance commission receivable	15,827	8,571
	2,847	(1,754)

Notes to the financial statements (continued)
For the year ended 31 December 2012

5 Auditors' remuneration

During the year, the Company obtained the following services from the auditor at costs as detailed below:

	2012	2011
	£'000	£'000
Audit services	**144**	162
Other services not covered above	**324**	880
	468	1,042

6 Directors' emoluments

	2012	2011
	£'000	£'000
Aggregate emoluments	**686**	390
Sums paid to non-executive directors	**73**	50
Company contributions to defined contributions scheme	**54**	28
	813	468

Highest paid director

	2012	2011
	£'000	£'000
Total amount of emoluments	**343**	336
Company contributions to defined contributions scheme	**30**	25
	373	361

All of the 2012 salaries and emoluments are paid by an affiliate, Assured Guaranty (UK) Services Limited ("AG UKS"), and charged back to the Company as part of the management fee.

Five directors are eligible to receive deferred cash and shares under the long-term incentive scheme of the ultimate parent company, AGL. The amount charged to the Company in relation to long-term incentive award during the year was £117,000. In addition, retirement benefits are accruing for the directors under a money purchase pension scheme.

Notes to the financial statements (continued)
For the year ended 31 December 2012

7 Employees

There were no people (including executive directors) employed directly by the Company during the year.

All employees' salaries and benefits were paid by AG UKS, Assured Guaranty Finance Overseas Limited and Assured Guaranty Corp.. In consideration for this service, management service fees were levied on the Company. The total amount levied during the year was £5,934,000 (2011: £5,444,000).

8 Investment return

	2012	2011
	£'000	£'000
Investment Income		
Income from Investments	**6,235**	6,850
Realised gain on investments	**275**	260
	6,510	7,110
Unrealised (loss) / gain on investments	**(1,282)**	781
Investment expenses and charges		
Investment management expenses	**(146)**	(154)
Realised loss on investments	**(8,001)**	(76)
	(8,147)	(230)
Total investment return	**(2,919)**	7,661

9 Profit on ordinary activities before taxation

	2012	2011
	£'000	£'000
Profit on ordinary activities before taxation is stated after charging		
Operating lease charges	**413**	536
Foreign exchange (loss) / gain	**(3,387)**	121

The Company has arrangements with an affiliate Assured Guaranty Finance Overseas Limited ("AGFOL") whereby operating expenses including operating lease charges were paid by AGFOL. These expenses are subsequently recharged to the Company at a mark-up of 10% and these have also been included in Operating lease charges in the above table.

10 Tax on profit on ordinary activities

The Company has made an election with the Internal Revenue Service pursuant to Section 953(d) of the Internal Revenue Code. Section 953(d) allows certain foreign insurance companies to elect to be treated as a U.S. corporation for federal income tax purposes. The impact of the election is that the Company will be taxed as a U.S. corporation subject to tax on its worldwide income, subject to a credit for any taxes paid to a foreign jurisdiction. The current US federal tax rate is 35% (2011: 35%) as compared with an average 24.5% (2011: 26.5%) rate in the UK.

	2012	2011
	£'000	£'000
UK corporation tax		
- Current	**(355)**	(1,081)
- Deferred	**-**	198
Overseas corporation tax		
- Current	**(1,225)**	1,258
- Deferred	**1,034**	(1,656)
	(546)	(1,281)

The tax assessed for the year is lower than the standard rate of corporation tax in the UK. A reconciliation between the current tax provision and that expected from the standard UK tax rate of 24.5% (2011: 26.5%) is as follows:

	2012	2011
	£'000	£'000
Tax expense at statutory rate	**(352)**	(945)
Effects of:		
Temporary differences		
Employee benefits	**-**	(130)
UK and US tax differences		
Permanent		
Expenses not deductible for tax purposes	**(3)**	(6)
Overseas corporation tax	**(1225)**	1258
Provision for current income taxes	**(1,580)**	177

For periods subsequent to April 1, 2012, the U.K. corporation tax rate has been reduced to 24%, for the period April 1, 2011 to April 1, 2012 the U.K. corporation tax rate was 26% resulting in a blended tax rate of 24.5% in 2012 and prior to April 1, 2011, the U.K. corporation tax rate was 28% resulting in a blended tax rate of 26.5% in 2011.

10 Tax on profit on ordinary activities (continued)

Further reductions to the UK corporation tax rate were announced in the March 2013 Budget. The changes, which are expected to be enacted separately each year, propose to reduce the rate by 1% per annum to 20% by 1 April 2015. The changes had not been substantively enacted at the balance sheet date and therefore are not recognised in these financial statements. Had they been substantively enacted they would not have had a material impact on the net deferred tax asset at the period end. The impact of these changes in future periods will be dependent on the level of taxable profits in those periods.

During 2010 Dexia, the previous ultimate parent of the Company, filed an amended U.S. tax return for the 2008 tax year. Based on the amended filing, the Company booked additional foreign tax credits in deferred tax assets of £14.3m. For post acquisition periods, the Company is limited by the U.S. tax code on the annual amount it could benefit from these foreign tax credits. The foreign tax credits expire in 2018 through 2021.

11 Deferred tax (liabilities) / assets

Based on its projections for continued future taxable income, the Company believes that its deferred tax assets are more likely than not to be realised. The items that gave rise to the Company's net deferred tax asset are noted below:

	UK Corporation Deferred Taxes		Overseas Corporation Deferred Taxes		Total Deferred Taxes	
Description	**2012**	2011	**2012**	2011	**2012**	2011
UK and US tax differences	**£'000**	£'000	**£'000**	£'000	**£'000**	£'000
Unrealised gains	-	-	**(435)**	(1,158)	**(435)**	(1,158)
Market discounts	-	-	**(250)**	-	**(250)**	-
Timing differences on revenue recognition	-	-	**(1260)**	(1,414)	**(1260)**	(1,414)
Total deferred tax liabilities	-	-	**(1945)**	(2,572)	**(1945)**	(2,572)

	UK Corporation Deferred Taxes		Overseas Corporation Deferred Taxes		Total Deferred Taxes	
	2012	2011	**2012**	2011	**2012**	2011
Description	**£'000**	£'000	**£'000**	£'000	**£'000**	£'000
Deferred acquisition costs	-	-	**9,523**	15,445	**9,523**	15,445
Employee benefits	-	123	**532**	116	**532**	239
Tax credits for UK tax paid	-	-	**18,589**	13,019	**18,589**	13,019
Other temporary timing differences	-	-	-	1,166	-	1,166
Total deferred tax assets	-	123	**28,644**	29,746	**28,644**	29,869
Net deferred tax asset	-	123	**26,699**	27,174	**26,699**	27,297

Notes to the financial statements (continued)
For the year ended 31 December 2012

11 Deferred tax liabilities / (assets) (continued)

The movement in the net deferred tax asset is as follows:

	UK Corporation Deferred Taxes		Overseas Corporation Deferred Taxes		Total Deferred Taxes	
	2012	2011	**2012**	2011	**2012**	2011
Description	**£'000**	£'000	**£'000**	£'000	**£'000**	£'000
As of 1 January	**123**	75	**27,174**	28,543	**27,297**	28,618
Movement in year	**(123)**	48	**(1,335)**	(1,505)	**(1,458)**	(1,457)
Translation Adjustment	-	-	**859**	136	**859**	136
	-	123	**26,698**	27,174	**26,698**	27,297

12 Debtors

	2012	2011
	£'000	£'000
Arising out of direct insurance operations	**354,526**	380,789
Arising out of reinsurance operations	**99,263**	111,858
Other debtors including taxation and social security	**320**	1,980
At 31 December	**454,109**	494,627

13 Investments

	2012	2011
	£'000	£'000
Financial investments		
- UK government bonds	**122,817**	152,694
- Non-UK government bonds	**742**	796
- Corporate bonds	**38,405**	11,684
- Asset-backed securities	**111**	126
- Short-term investments	**1,238**	1,291
At 31 December	**163,313**	166,591

13 Investments (continued)

The bonds are shown at market value. The book cost of these is £153,339,000 (2011: £155,409,000). Of the above investments, £162,075,000 were listed investments (2011: £165,298,000).

14 Creditors

	2012	2011
	£'000	£'000
Arising out of reinsurance operations	**345,528**	375,755
Amounts owed to group undertakings	**3,878**	2,646
Amounts due under pension plan obligations	**10**	3
Other creditors including taxation and social security	**465**	1,267
At 31 December	**349,881**	379,671

Amounts owed to group undertakings are unsecured, interest free and have no fixed date for repayment.

15 Accruals and deferred income

	2012	2011
	£'000	£'000
Other liabilities	**191**	152
Reinsurance commission deferred	**165,977**	181,579
At 31 December	**166,168**	181,731

16 Other financial commitments and guarantees

The Company has guaranteed the obligations of Assured Guaranty Credit Protection Limited ("AGCPL"), a fellow group company. AGCPL sells credit protection to counterparties through credit default swaps and may incur a loss in the event of payment default by the obligor. The Company is not aware of any actual or potential liabilities in relation to this guarantee. In 2012 and 2011, the transaction fees incurred by the Company totalled approximately £28,000 and £28,000, respectively. The Company, in turn, was paid an administrative fee of £15,000 and £15,000 in 2012 and 2011, respectively, by AGCPL in connection with a cooperative agreement between the two companies for AGCPL's use of Company personnel, property and services. The Company does not intend to sell credit default swaps in the future.

17 Significant risk management activities

The Company relies on the following committees and functions established by the Board of Directors for its risk management policies and procedures: Audit and Risk Oversight Committee, Compliance Function, Credit Committee, Executive Committee, Reserve Committee, Risk Management Function and Surveillance Function. Within the limits established by the Portfolio Risk Management Committee for the Group, which includes the Company's Chief Executive Officer, specific risk policies and limits are set by the Executive Committee. As part of its risk management strategy, the Company may seek to obtain third party reinsurance and may also periodically enter into other arrangements to alleviate all or a portion of this risk.

Surveillance personnel are responsible for monitoring and reporting on all transactions in the insured portfolio. The primary objective of the surveillance process is to monitor trends and changes in transaction credit quality, detect any deterioration in credit quality, and recommend to management such remedial actions as may be necessary or appropriate. All transactions in the insured portfolio are assigned internal credit ratings, and surveillance personnel are responsible for recommending adjustments to those ratings to reflect changes in transaction credit quality. Risk Management and Surveillance personnel are also responsible for managing work-out and loss situations when necessary. For transactions where a loss is considered probable, surveillance personnel and the Actuarial Function make recommendations on case loss reserves to a Reserve Committee.

The Surveillance Function may request that the Group's workout committee develop and implement loss mitigation strategies when the Surveillance Function identifies transactions that would benefit from active loss mitigation.

The Company segregates its insured portfolio of investment grade and below investment grade risks into surveillance categories to facilitate the appropriate allocation of resources to monitoring and loss mitigation efforts and to aid in establishing the appropriate cycle for periodic review for each exposure. Below investment grade credits include all credits internally rated lower than BBB-. The Company's internal credit ratings are based on the Company's internal assessment of the likelihood of default. The Company's internal credit ratings are expressed on a ratings scale similar to that used by the rating agencies and are generally reflective of an approach similar to that employed by the rating agencies except for a Super Senior category which is not generally used by rating agencies. The Company uses the Super Senior Category on transactions where it is considered that additional credit enhancement exists and such credit enhancement, in management's opinion, causes the Company's attachment point to be materially above the AAA attachment point.

The Company monitors its investment grade credits to determine whether any new credits need to be internally downgraded to below investment grade. Quarterly procedures include qualitative and quantitative analysis on the Company's insured portfolio to identify potential new below investment grade credits. The Company refreshes its internal credits ratings on individual credits in cycles based on the Company's view of the credit's quality, loss potential, volatility and sector. Ratings on credits and in sectors identified as under the most stress or with the most potential volatility are reviewed every quarter. Credits identified through this process as below investment grade are subjected to further review by surveillance personnel to determine the various probabilities of a loss. Surveillance personnel present analysis related to potential loss scenarios to a reserve committee. The reserve committee consider the information provided by surveillance personnel when setting reserves.

18 Called up share capital

	2012	2011
	£'000	£'000
Authorised		
500,000,000 ordinary shares of £1 each	**500,000**	500,000
Allotted and fully paid		
55,000,000 ordinary shares of £1 each	**55,000**	55,000

19 Reconciliation of movements in shareholders' funds

	Called up share capital	Profit and loss account	Capital contribution	2012	2011
	£'000	£'000	£'000	£'000	£'000
At 1 January	**55,000**	**59,716**	**62,985**	**177,701**	175,425
Profit for the financial year	**-**	**877**	**-**	**877**	2,276
At 31 December	**55,000**	**60,593**	**62,985**	**178,578**	177,701

20 Other technical provisions

	2012	2011
	£'000	£'000
Unexpired risks provision	**23,667**	29,998
Reinsurer's share of unexpired risks provision	**(23,314)**	(29,598)
At 31 December	**353**	400

The discount rate used in calculating the unexpired risk provision is a rate of 3.5%

21 Other income / (charges)

	2012	2011
	£'000	£'000
Foreign exchange (loss) / gain	**(3,387)**	121
Other income	**7,494**	-
At 31 December	**4,107**	121

Other income includes £7.44m of reinsurance recoveries in relation a to realised investment loss on disposal of Greek bonds which were received by the Company in accordance with reinsurance contracts in place.

22 Financial commitments

The Company has arrangements with its indirect parent AGM whereby it pays lease rentals on behalf of AGM in respect of office space previously occupied by the Company. The commitment under the uncancellable operating lease is to pay rentals of £0.6m (2011: £0.9m). As a result of vacating the building, the Company has made a lease provision for the unexpired portion of the lease, taking into account anticipated future sub-lease income from parties not yet identified. The total amount of lease provision provided for is £0.1m (2011: £0.8m). This lease will expire on 24 September 2013.

23 Ultimate and immediate parent company

The immediate parent undertaking is Assured Guaranty Municipal Insurance Company ("AGMIC") (formerly, FSA Insurance Company), a United States company. The ultimate parent undertaking and controlling party is AGL, a Bermuda incorporated insurance holding company.

AGL is the parent undertaking of the largest group of undertakings to consolidate these financial statements at 31 December 2012. The consolidated financial statements of AGL can be obtained from 30 Woodbourne Avenue, Hamilton HM 08, Bermuda.

AGMIC is the parent undertaking of the smallest group of undertakings to consolidate these financial statements. The consolidated financial statements of AGMIC can be obtained from 31 West 52nd Street, New York, NY 10019, United States of America.

APPENDIX 2
CONSOLIDATED FINANCIAL STATEMENTS OF AGM
FOR THE YEARS ENDED 31 DECEMBER 2011 AND 31 DECEMBER 2012

Exhibit 99.1

Assured Guaranty Municipal Corp.

Consolidated Financial Statements

December 31, 2012 and 2011

ASSURED GUARANTY MUNICIPAL CORP.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Independent Auditor's Report

To the Board of Directors and Shareholder of Assured Guaranty Municipal Corp.:

We have audited the accompanying consolidated financial statements of Assured Guaranty Municipal Corp. and its subsidiaries (the "Company"), which comprise the consolidated balance sheets as of December 31, 2012 and December 31, 2011, and the related consolidated statements of operations, of comprehensive income, of shareholder's equity and of cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Assured Guaranty Municipal Corp. and its subsidiaries at December 31, 2012 and December 31, 2011, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 2 to the consolidated financial statements, the Company changed the manner in which it accounts for the costs associated with acquiring or renewing insurance contracts in 2012. Our opinion is not modified with respect to this matter.

/s/ PricewaterhouseCoopers LLP

New York, New York
April 23, 2013

Assured Guaranty Municipal Corp.

Consolidated Balance Sheets

(dollars in millions except per share and share amounts)

	As of December 31, 2012	As of December 31, 2011
Assets		
Investment portfolio:		
Fixed maturity securities, available-for-sale, at fair value (amortized cost of $4,473 and $4,674)	$ 4,831	$ 4,916
Short-term investments, at fair value	473	412
Other invested assets (including note receivable from affiliate of $300 for 2012 and 2011)	444	422
Total investment portfolio	5,748	5,750
Loan receivable from affiliate	83	—
Cash	47	59
Premiums receivable, net of ceding commissions payable	653	645
Ceded unearned premium reserve	1,187	1,373
Reinsurance recoverable on unpaid losses	75	79
Salvage and subrogation recoverable	383	316
Credit derivative assets	131	140
Deferred tax asset, net	409	631
Current income tax receivable	0	131
Financial guaranty variable interest entities' assets, at fair value	1,870	2,057
Other assets	127	149
Total assets	**$ 10,713**	**$ 11,330**
Liabilities and shareholder's equity		
Unearned premium reserve	$ 3,866	$ 4,515
Loss and loss adjustment expense reserve	230	297
Reinsurance balances payable, net	292	248
Notes payable	66	104
Credit derivative liabilities	414	456
Financial guaranty variable interest entities' liabilities with recourse, at fair value	1,605	1,926
Financial guaranty variable interest entities' liabilities without recourse, at fair value	678	704
Other liabilities	343	276
Total liabilities	**7,494**	**8,526**
Commitments and contingencies (See Note 16)		
Preferred stock ($1,000 par value, 5,000.1 shares authorized; 0 shares issued and outstanding)	—	—
Common stock ($45,455 par value, 330 shares authorized; issued and outstanding)	15	15
Additional paid-in capital	1,092	1,142
Retained earnings	1,880	1,491
Accumulated other comprehensive income, net of tax of $125 and $84	232	156
Total shareholder's equity	**3,219**	**2,804**
Total liabilities and shareholder's equity	**$ 10,713**	**$ 11,330**

The accompanying notes are an integral part of these consolidated financial statements.

Assured Guaranty Municipal Corp.

Consolidated Statements of Operations

(in millions)

	Year Ended December 31,	
	2012	**2011**
Revenues		
Net earned premiums	$ 590	$ 661
Net investment income	233	216
Net realized investment gains (losses):		
Other-than-temporary impairment losses	(19)	(79)
Less: portion of other-than-temporary impairment loss recognized in other comprehensive income	(14)	(41)
Other net realized investment gains (losses)	0	20
Net realized investment gains (losses)	(5)	(18)
Net change in fair value of credit derivatives:		
Realized gains and other settlements	11	70
Net unrealized gains (losses)	41	92
Net change in fair value of credit derivatives	52	162
Fair value gain (loss) on committed capital securities	(8)	15
Fair value gains (losses) on financial guaranty variable interest entities	115	(61)
Other income	103	47
Total revenues	1,080	1,022
Expenses		
Loss and loss adjustment expenses	397	382
Amortization of deferred ceding commissions	(12)	(8)
Interest expense	7	6
Other operating expenses	105	95
Total expenses	497	475
Income (loss) before income taxes	583	547
Provision (benefit) for income taxes:		
Current	23	(157)
Deferred	141	306
Total provision (benefit) for income taxes	164	149
Net income (loss)	**$ 419**	**$ 398**

The accompanying notes are an integral part of these consolidated financial statements.

Assured Guaranty Municipal Corp.

Consolidated Statements of Comprehensive Income

(in millions)

	Year Ended December 31,	
	2012	2011
Net income (loss)	**$ 419**	**$ 398**
Unrealized holding gains (losses) arising during the period:		
Investments with no other-than-temporary impairment, net of tax provision (benefit) of $29 and $63	54	118
Investments with other-than-temporary impairment, net of tax provision (benefit) of $6 and $5	10	9
Unrealized holding gains (losses) arising during the period, net of tax	64	127
Less: reclassification adjustment for gains (losses) included in net income (loss), net of tax provision (benefit) of $(6) and $(8)	(12)	(15)
Other comprehensive income (loss)	76	142
Comprehensive income (loss)	**$ 495**	**$ 540**

The accompanying notes are an integral part of these consolidated financial statements.

Assured Guaranty Municipal Corp.

Consolidated Statements of Shareholder's Equity

(dollars in millions, except share data)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholder's Equity
	Shares	Amount				
Balance at December 31, 2010 (as originally reported)	**330**	**$ 15**	**$ 1,192**	**$ 1,100**	**$ 14**	**$ 2,321**
Cumulative effect of accounting change - deferred acquisition costs (Note 5)	—	—	—	(7)	—	(7)
Balance at December 31, 2010 (as adjusted)	330	15	1,192	1,093	14	2,314
Net income	—	—	—	398	—	398
Other comprehensive income	—	—	—	—	142	142
Return on capital	—	—	(50)	—	—	(50)
Balance at December 31, 2011	330	15	1,142	1,491	156	2,804
Net income	—	—	—	419	—	419
Dividends	—	—	—	(30)	—	(30)
Other comprehensive income	—	—	—	—	76	76
Return of capital	—	—	(50)	—	—	(50)
Balance at December 31, 2012	**330**	**$ 15**	**$ 1,092**	**$ 1,880**	**$ 232**	**$ 3,219**

The accompanying notes are an integral part of these consolidated financial statements.

Assured Guaranty Municipal Corp.

Consolidated Statements of Cash Flows

(in millions)

	Year Ended December 31, 2012	Year Ended December 31, 2011
Operating activities		
Net income (loss)	$ 419	$ 398
Net amortization of premium (discount) on fixed maturity securities	(13)	10
Provision (benefit) for deferred income taxes	141	306
Net realized investment (gains) losses	5	18
Net unrealized gains (losses) on credit derivatives	(41)	(92)
Fair value (gain) loss on committed capital securities	8	(15)
Change in deferred ceding commissions, net	11	5
Change in premiums receivable	29	31
Change in deferred premium revenue net of ceded deferred premium revenue	(463)	(685)
Change in net loss and loss adjustment expense reserve and salvage and subrogation, net	(221)	409
Change in current income taxes	171	(335)
Changes in financial guaranty variable interest entities assets and liabilities, net	(10)	282
(Purchases) sales of trading securities, net	(37)	(5)
Other	64	(40)
Net cash flow provided by (used in) operating activities	63	287
Investing activities		
Fixed maturity securities:		
Sales	298	573
Maturities	492	283
Purchases	(526)	(1,036)
Net sales (purchases) of short-term investments	(26)	200
Net proceeds from paydowns on financial guaranty variable interest entities' assets	468	677
Loan to affiliate	(83)	—
Other investments	36	20
Net cash flow provided by (used in) investing activities	**659**	**717**
Financing activities		
Dividends paid	(30)	—
Repayment of notes payable	(36)	(22)
Paydown of financial guaranty variable interest entities' liabilities	(618)	(918)
Return of capital	(50)	(50)
Net cash provided by (used in) financing activities	**(734)**	**(990)**
Effect of exchange rate changes	0	1
Increase (decrease) in cash	**(12)**	**15**
Cash at beginning of period	59	44
Cash at end of period	**$ 47**	**$ 59**
Supplemental cash flow information		
Cash paid (received) during the period for:		
Income taxes	$ (108)	$ 158
Interest	$ 8	$ 7

The accompanying notes are an integral part of these consolidated financial statements.

Assured Guaranty Municipal Corp.

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

1. Business and Basis of Presentation

Business

Assured Guaranty Municipal Corp., formerly known as Financial Security Assurance Inc. ("AGM," or together with its direct and indirect owned subsidiaries, the "Company"), a New York domiciled insurance company, is a wholly owned subsidiary of Assured Guaranty Municipal Holdings Inc. ("AGMH"). AGMH is an indirect and wholly owned subsidiary of Assured Guaranty Ltd. ("AGL" and, together with its subsidiaries, "Assured Guaranty"). AGL is a Bermuda based holding company that provides, through its operating subsidiaries, credit protection products to the United States ("U.S.") and international public finance (including infrastructure) and structured finance markets.

The Company applies its credit underwriting judgment, risk management skills and capital markets experience to offer insurance that protects holders of debt instruments and other monetary obligations from defaults in scheduled payments, including scheduled interest and principal payments. The Company markets its credit protection products directly to issuers and underwriters of public finance securities as well as to investors in such obligations. The Company guarantees obligations issued in many countries, although its principal focus is on the U.S., as well as Europe and Australia. The Company had previously offered insurance and reinsurance in the global structured finance market, but has not done so since mid-2008.

Financial guaranty insurance policies provide an unconditional and irrevocable guaranty that protects the holder of a financial obligation against non-payment of principal and interest ("Debt Service") when due. Upon an obligor's default on scheduled principal or interest payments due on the obligation, the Company is required under the financial guaranty policy to pay the principal or interest shortfall. The Company has issued financial guaranty insurance policies on public finance obligations and, prior to mid-2008, structured finance obligations. Public finance obligations insured by the Company consist primarily of general obligation bonds supported by the taxing powers of U.S. state or municipal governmental authorities, as well as tax-supported bonds, revenue bonds and other obligations supported by covenants from state or municipal governmental authorities or other municipal obligors to impose and collect fees and charges for public services or specific infrastructure projects. The Company also includes within public finance obligations those obligations backed by the cash flow from leases or other revenues from projects serving substantial public purposes, including utilities, toll roads, health care facilities and government office buildings. Structured finance obligations insured by the Company are generally issued by special purpose entities and backed by pools of assets such as residential or commercial mortgage loans, consumer or trade receivables, securities or other assets having an ascertainable cash flow or market value. While AGM has ceased insuring new originations of asset-backed securities, a significant portfolio of such obligations remains outstanding and its wholly owned subsidiary Assured Guaranty (Europe) Ltd. ("AGE") provides financial guarantees in both the international public finance and structured finance markets.

In the past, the Company had sold credit protection by issuing policies that guaranteed payment obligations under credit derivatives. Financial guaranty contracts accounted for as credit derivatives are generally structured such that the circumstances giving rise to the Company's obligation to make loss payments are similar to those for financial guaranty insurance contracts and only occurs upon one or more defined credit events such as failure to pay or bankruptcy, in each case, as defined within the transaction documents, with respect to one or more third party referenced securities or loans. Financial guaranty contracts accounted for as credit derivatives are primarily comprised of credit default swaps ("CDS"). The Company's credit derivative transactions are governed by International Swaps and Derivative Association, Inc. ("ISDA") documentation.

The Company has not entered into any new CDS in order to sell credit protection since 2008. In addition, regulatory guidelines issued in 2009 that limited the terms under which such protection could be sold, and capital and margin requirements applicable under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), also contributed to the decision of the Company not to enter into new CDS in the foreseeable future. The Company actively pursues opportunities to terminate existing CDS. These actions have the effect of reducing future fair value volatility in income and/or reducing rating agency capital charges.

Basis of Presentation

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") and, in the opinion of management, reflect all adjustments that are of a normal recurring nature, necessary for a fair statement of the financial condition, results of operations and cash flows of the Company and its consolidated financial guaranty variable interest entities ("FG VIEs") for the periods presented. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The consolidated financial statements include the accounts of AGM and its direct and indirect subsidiaries (collectively, the "Subsidiaries"), and its consolidated FG VIEs. Intercompany accounts and transactions between and among all consolidated entities have been eliminated. Certain prior year balances have been reclassified to conform to the current year's presentation.

In June 2011, the Financial Accounting Standards Board ("FASB") issued guidance that eliminates the option to report other comprehensive income and its components in the statement of changes in shareholder's equity and requires an entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement or in two separate but consecutive statements. Upon adoption, the Company expanded the Consolidated Statements of Comprehensive Income to include the other comprehensive income items now presented in the Consolidated Statement of Shareholder's Equity, with retrospective application. In February 2013, the FASB issued authoritative guidance which will require the disclosure of information about the amounts reclassified out of accumulated other comprehensive income by component. The nature of the disclosure will depend on whether the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. If the reclassification is required in its entirety to net income, the guidance will require the disclosure of significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income, either on the face of the statement where net income is presented or in the notes. If reclassification to net income is not required under U.S. GAAP, the guidance will require a cross reference to other required disclosures that provide additional detail about the reclassified amount. This guidance will impact the disclosures relating to other comprehensive income in the Company's financial statements and will have no impact on the results of operations, financial position or cash flows.

In December 2011, the FASB issued guidance which will require disclosures for entities with financial instruments and derivatives that are either offset on the balance sheet or subject to a master netting arrangement. The guidance is effective for interim and annual periods beginning on or after January 1, 2013. The guidance is not applicable to the Company as the Company does not have financial instruments that are either offset on the balance sheet or subject to a master netting arrangement.

Significant Accounting Policies

The Company's significant accounting policies include when and how to measure fair value of assets and liabilities, when to consolidate an entity, and when and how to recognize premium revenue and loss expense. All other significant accounting policies are either discussed below or included in the following notes.

Significant Accounting Policies

Premium revenue recognition on financial guaranty contracts accounted for as insurance	Note 4
Policy acquisition costs	Note 5
Expected loss to be paid	Note 6
Loss and loss adjustment expense on financial guaranty contracts accounted for as insurance	Note 7
Fair value measurement	Note 8
Credit derivatives	Note 9
Variable interest entities	Note 10
Investments	Note 11
Income taxes	Note 13
Reinsurance and Other Monoline Exposures	Note 14

The Company revalues assets, liabilities, revenue and expenses denominated in non-U.S. currencies into U.S. dollars using applicable exchange rates. Gains and losses relating to AGM's foreign currency transactions are reported in the consolidated statement of operations.

2. Business Changes, Risks, Uncertainties and Accounting Developments

Summarized below are updates of the most significant recent events that have had, or may have in the future, a material effect on the financial position, results of operations or business prospects of the Company.

Market Conditions

The overall economic environment in the U.S. has improved over the last few years and indicators such as lower delinquency rates and more stable housing prices point toward improvement in the housing market. However, unemployment rates remain too high for a robust general economic recovery to have taken hold and concerns over the fiscal cliff may have hampered the recovery towards the end of 2012. The low interest rate environment has also negatively affected new business opportunities. The Company's business and its financial condition will continue to be subject to the risk of global financial and economic conditions that could materially and negatively affect the demand for its products, the amount of losses incurred on transactions it guarantees, future profitability, financial position, investment portfolio, cash flow, statutory capital, financial strength ratings and stock price.

The financial crisis that began in 2008 has caused many state and local governments that issue some of the obligations the Company insures to experience significant budget deficits and revenue collection shortfalls that require them to significantly raise taxes and/or cut spending in order to satisfy their obligations. While the U.S. government has provided some financial support to state and local governments, significant budgetary pressures remain. If the issuers of the obligations in the Company's public finance portfolio do not have sufficient funds to cover their expenses and are unable or unwilling to raise taxes, decrease spending or receive federal assistance, the Company may experience increased levels of losses or impairments on its public finance obligations, which would materially and adversely affect its business, financial condition and results of operations. Additionally, future legislative, regulatory or judicial changes in the jurisdictions regulating the Company may adversely affect its ability to pursue its current mix of business, materially impacting its financial results.

Internationally, several European countries are experiencing significant economic, fiscal and /or political strains. The European countries where it believes heightened uncertainties exist are: Greece, Hungary, Ireland, Italy, Portugal and Spain (the “Selected European Countries”). See Note 3, Outstanding Exposure.

Rating Actions

When a rating agency assigns a public rating to a financial obligation guaranteed by AGM or its subsidiary AGE, it generally awards that obligation the same rating it has assigned to the financial strength of AGM or AGE. Investors in products insured by AGM and guaranteed by AGE frequently rely on ratings published by nationally recognized statistical rating organizations (“NRSROs”) because such ratings influence the trading value of securities and form the basis for many institutions’ investment guidelines as well as individuals’ bond purchase decisions. Therefore, AGM and AGE manage their business with the goal of achieving high financial strength ratings. If the financial strength ratings were reduced below current levels, the Company expects it could have adverse effects on its future business opportunities as well as the premiums or fees it could charge for its insurance policies or guarantees and consequently, a further downgrade could harm the Company’s new business production and results of operations in a material respect. However, the models used by NRSROs differ, presenting conflicting goals that may make it inefficient or impractical to reach the highest rating level. The models are not fully transparent, contain subjective data (such as assumptions about future market demand for the Company’s products) and change frequently. Ratings reflect only the views of the respective NRSROs and are subject to continuous review and revision or withdrawal at any time.

In the last several years, Standard and Poor’s Ratings Services (“S&P”) and Moody’s Investors Service, Inc. (“Moody’s”) have downgraded the financial strength ratings of AGM and AGE. On January 17, 2013, Moody’s downgraded the Insurance Financial Strength ("IFS") rating of AGM and AGE to A2 from Aa3. While the outlook for the ratings from S&P and Moody's is stable, there can be no assurance that S&P and Moody's will not take further action on the Company’s ratings. For a discussion of the effect of rating actions on the Company, see the following:

- Note 6, Expected Loss to be Paid

- Note 14, Reinsurance and Other Monoline Exposures

- Note 17, Notes Payable and Credit Facilities (regarding the impact on the Company's insured leveraged lease transactions)

In addition, a rating downgrade may cause AGM to pay claims in respect of the former financial products business of its parent AGMH. When Assured Guaranty purchased AGMH and its subsidiaries from Dexia SA and certain of its affiliates (collectively, "Dexia") on July 1, 2009, Assured Guaranty did not purchase AGMH's guaranteed investment contracts ("GIC") business, its medium term notes business or the equity payment agreements associated with AGMH's leveraged lease business (collectively, the "former financial products business"). Instead, Assured Guaranty entered into agreements with Dexia in order to transfer to Dexia the credit and liquidity risks associated with AGMH's former financial products business. If Dexia does not comply with its obligations following a downgrade of the financial strength rating of AGM, AGM may be required to pay claims on GICs insured by AGM, most of which allow for the termination of the GIC contract and the withdrawal of GIC funds at the option of the GIC holder in the event of a downgrade of AGM, unless the relevant GIC issuer posts collateral or otherwise enhances its credit. The relevant rating thresholds are specified in the transaction documents; below A- by S&P or A3 by Moody's, the GIC issuer generally has no right to avoid withdrawal by posting collateral or otherwise enhancing its credit. Each GIC contract stipulates the thresholds below which the GIC issuer must post eligible collateral, along with the types of securities eligible for posting and the collateralization percentage applicable to each security type. These collateralization percentages range from 100% of the GIC balance for cash posted as collateral to, typically, 108% for asset-backed securities. The January 2013 Moody's downgrade of AGM could result in withdrawal of $226.5 million of GIC funds and the need to post collateral on GICs with a balance of $1.9 billion. A further downgrade of AGM to below AA- by S&P could result in an incremental withdrawal or require collateral posting on GICs with a balance of $882.7 million. In the event of such a downgrade, assuming collateral posting on all transactions potentially impacted as a result of any additional rating action, with an average margin of 105%, the market value as of December 31, 2012 that the GIC issuers would be required to post in order to avoid withdrawal of any GIC funds would be $2.9 billion. There are sufficient eligible and liquid assets within the GIC business to satisfy the withdrawal and collateral posting obligations that arose as a result of the January 2013 AGM downgrade and would be expected to arise as a result of potential future rating action.

Accounting Changes

There has been significant GAAP rule making activity which has affected the accounting policies and presentation of the Company's financial information, particularly:

- adoption of new guidance that restricted the types and amounts of financial guaranty insurance acquisition costs that may be deferred, (see Note 5, Financial Guaranty Insurance Acquisition Costs),

- adoption of guidance that changed the presentation of other comprehensive income ("OCI"), (see "Consolidated Statements of Comprehensive Income)," and

- adoption of guidance requiring additional fair value disclosures (see Note 8, Fair Value Measurement).

In July 2012, the FASB issued Accounting Standards Update ("ASU") 2012-02, "Intangibles-Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment" ("ASU 2012-02"). ASU 2012-02 amends prior indefinite-lived intangible asset impairment testing guidance. Under ASU 2012-02, the Company has the option to first assess qualitative factors to determine whether it is more likely than not (a likelihood of more than 50%) that an indefinite-lived intangible asset is impaired. If, after considering the totality of events and circumstances, an entity determines it is more likely than not that an indefinite-lived intangible asset is not impaired, then calculating the fair value of such asset is unnecessary. The Company adopted ASU 2012-02 at December 31, 2012. There was no cumulative effect upon the adoption of ASU 2012-02 on the Company's consolidated financial position, results of operations or cash flows.

Significant Transactions

- There have been four settlements of representation and warranty claims over the past three years. See Note 6, Expected Loss to be Paid.

- The Company has entered into several agreements with reinsurers, including re-assumption agreements with Radian Asset Assurance Inc. ("Radian"), a re-assumption agreement with Tokio Marine & Nichido Fire

Insurance Co., Ltd. ("Tokio") and a $435 million excess of loss reinsurance facility. See Note 14, Reinsurance and Other Monoline Exposures.

3. Outstanding Exposure

The Company's financial guaranty contracts are written in different forms, but collectively are considered financial guaranty contracts. The Company seeks to limit its exposure to losses by underwriting obligations that are investment grade at inception, diversifying its insured portfolio and maintaining rigorous subordination or collateralization requirements on structured finance obligations. The Company also has utilized reinsurance by ceding business to third-party reinsurers. The Company provides financial guaranties with respect to debt obligations of special purpose entities, including VIEs. Some of these VIEs are consolidated as described in Note 10, Consolidation of Variable Interest Entities. The outstanding par and Debt Service amounts presented below include outstanding exposures on VIEs whether or not they are consolidated.

Debt Service Outstanding

	Gross Debt Service Outstanding		Net Debt Service Outstanding	
	December 31, 2012	December 31, 2011	December 31, 2012	December 31, 2011
	(in millions)			
Public finance	$ 537,810	$ 598,712	$ 391,826	$ 412,016
Structured finance	60,926	76,049	53,449	67,202
Total financial guaranty	$ 598,736	$ 674,761	$ 445,275	$ 479,218

Summary of Public Finance and Structured Finance Insured Portfolio

Sector	Gross Par Outstanding As of December 31, 2012	Gross Par Outstanding As of December 31, 2011	Ceded Par Outstanding As of December 31, 2012	Ceded Par Outstanding As of December 31, 2011	Net Par Outstanding As of December 31, 2012	Net Par Outstanding As of December 31, 2011
			(in millions)			
Public finance:						
U.S.:						
General obligation	$ 137,601	$ 147,855	34,217	$ 42,726	$ 103,384	$ 105,129
Tax backed	57,512	64,466	14,001	18,462	43,511	46,004
Municipal utilities	50,017	55,184	10,119	13,131	39,898	42,053
Transportation	24,997	28,944	5,862	9,541	19,135	19,403
Healthcare	12,880	15,941	4,375	7,160	8,505	8,781
Higher education	10,146	10,314	2,668	2,961	7,478	7,353
Housing	4,621	6,041	676	1,350	3,945	4,691
Infrastructure finance	2,389	2,352	1,163	1,140	1,226	1,212
Other public finance-U.S.	2,060	2,183	339	400	1,721	1,783
Total public finance-U.S.	302,223	333,280	73,420	96,871	228,803	236,409
Non-U.S.:						
Infrastructure finance	17,045	16,510	5,482	5,287	11,563	11,223
Regulated utilities	14,314	14,454	7,758	7,611	6,556	6,843
Other public finance-non-U.S.	7,184	9,072	1,919	2,738	5,265	6,334
Total public finance-non-U.S.	38,543	40,036	15,159	15,636	23,384	24,400
Total public finance obligations	$ 340,766	$ 373,316	88,579	$ 112,507	$ 252,187	$ 260,809
Structured finance:						
U.S.:						
Pooled corporate obligations	27,148	$ 32,967	1,718	$ 2,554	$ 25,430	$ 30,413
Residential Mortgage-Backed Securities ("RMBS")	9,409	11,745	1,228	1,442	8,181	10,303
Financial products	3,653	5,217	—	—	3,653	5,217
Insurance securitizations	383	476	77	107	306	369
Consumer receivables	247	993	15	186	232	807
Structured credit	175	176	86	97	89	79
Commercial receivables	56	61	3	3	53	58
Other structured finance-U.S.	1,620	1,769	1,242	1,279	378	490
Total structured finance-U.S.	42,691	53,404	4,369	5,668	38,322	47,736
Non-U.S.:						
Pooled corporate obligations	8,500	11,648	1,478	2,014	7,022	9,634
Residential Mortgage-Backed Securities	1,455	1,552	152	157	1,303	1,395
Structured credit	361	531	78	118	283	413
Insurance securitizations	—	56	—	18	—	38
Other structured finance- non-U.S.	401	402	28	29	373	373
Total structured finance- non-U.S.	10,717	14,189	1,736	2,336	8,981	11,853
Total structured finance obligations	$ 53,408	$ 67,593	6,105	8,004	$ 47,303	$ 59,589
Total	$ 394,174	$ 440,909	94,684	120,511	$ 299,490	$ 320,398

Unless otherwise noted, ratings disclosed herein on Assured Guaranty's insured portfolio reflect Assured Guaranty's internal ratings. Assured Guaranty's ratings scale is similar to that used by the NRSROs; however, the ratings in these financial statements may not be the same as those assigned by any such rating agency. For example, the super senior category, which is not generally used by rating agencies, is used by Assured Guaranty in instances where Assured Guaranty's AAA-rated exposure on its internal rating scale (which does not take into account Assured Guaranty's financial guaranty) has additional credit enhancement due to either (1) the existence of another security rated AAA that is subordinated to Assured Guaranty's exposure or (2) Assured Guaranty's exposure benefiting from a different form of credit enhancement that would pay any claims first in the event that any of the exposures incurs a loss, and such credit enhancement, in management's opinion, causes Assured Guaranty's attachment point to be materially above the AAA attachment point.

Financial Guaranty Portfolio by Internal Rating
As of December 31, 2012

	Public Finance U.S.		Public Finance Non-U.S.		Structured Finance U.S.		Structured Finance Non-U.S.		Total	
Rating Category	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%
					(dollars in millions)					
Super senior	$ —	—%	$ —	—%	$ 8,658	22.6%	$ 2,493	27.8%	$ 11,151	3.7%
AAA	3,521	1.5%	508	2.2%	15,758	41.1%	4,133	46.0%	23,920	8.0%
AA	82,798	36.2%	789	3.4%	6,833	17.8%	469	5.2%	90,889	30.3%
A	118,867	52.0%	5,946	25.4%	1,155	3.0%	586	6.6%	126,554	42.3%
BBB	21,795	9.5%	14,506	62.0%	215	0.6%	676	7.5%	37,192	12.4%
Below-investment-grade ("BIG")	1,822	0.8%	1,635	7.0%	5,703	14.9%	624	6.9%	9,784	3.3%
Total net par outstanding	$ 228,803	100.0%	$ 23,384	100.0%	$ 38,322	100.0%	$ 8,981	100.0%	$ 299,490	100.0%

Financial Guaranty Portfolio by Internal Rating
As of December 31, 2011

	Public Finance U.S.		Public Finance Non-U.S.		Structured Finance U.S.		Structured Finance Non-U.S.		Total	
Rating Category	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%	Net Par Outstanding	%
					(dollars in millions)					
Super senior	$ —	—%	$ —	—%	$ 9,574	20.0%	$ 3,414	28.8%	$ 12,988	4.1%
AAA	3,869	1.6%	1,317	5.4%	20,272	42.5%	5,590	47.2%	31,048	9.7%
AA	91,476	38.7%	949	3.9%	8,937	18.8%	665	5.6%	102,027	31.8%
A	118,922	50.3%	7,290	29.9%	1,045	2.2%	474	4.0%	127,731	39.9%
BBB	20,251	8.6%	13,240	54.3%	346	0.7%	1,126	9.5%	34,963	10.9%
BIG	1,891	0.8%	1,604	6.5%	7,562	15.8%	584	4.9%	11,641	3.6%
Total net par outstanding	$ 236,409	100.0%	$ 24,400	100.0%	$ 47,736	100.0%	$ 11,853	100.0%	$ 320,398	100.0%

Beginning in the first quarter 2012, the Company decided to classify those portions of risks benefiting from reimbursement obligations collateralized by eligible assets held in trust in acceptable reimbursement structures as the higher of 'AA' or their current internal rating. The Company applied this policy to the Bank of America Agreement and the Deutsche Bank Agreement (see Note 6, Expected Loss to be Paid). The Bank of America Agreement was entered into in April 2011 and the reclassification in the first quarter 2012 resulted in a decrease in BIG net par outstanding as of December 31, 2011 of $980 million from that previously reported.

Securities purchased for loss mitigation purposes represented $703 million and $988 million of gross par outstanding as of December 31, 2012 and 2011, respectively. In addition, under the terms of certain credit derivative contracts, the Company has obtained the obligations referenced in such contracts and recorded it in invested assets in the consolidated balance sheets. Such amounts totaled $219 million and $221 million in gross par outstanding as of December 31, 2012 and 2011, respectively.

Actual maturities of insured obligations could differ from contractual maturities because borrowers have the right to call or prepay certain obligations with or without call or prepayment penalties. The expected maturities of structured finance obligations are, in general, considerably shorter than the contractual maturities for such obligations.

**Expected Amortization of
Net Par Outstanding of Financial Guaranty Insured Obligations
As of December 31, 2012**

Terms to Maturity	Public Finance	Structured Finance	Total
		(in millions)	
0 to 5 years	$ 74,215	$ 39,496	$ 113,711
5 to 10 years	54,154	3,749	57,903
10 to 15 years	49,071	1,238	50,309
15 to 20 years	34,827	1,314	36,141
20 years and above	39,920	1,506	41,426
Total net par outstanding	$ 252,187	$ 47,303	$ 299,490

In addition to amounts shown in the tables above, at December 31, 2012, AGM had outstanding commitments to provide guaranties of $197 million for structured finance and $763 million for public finance obligations, of which up to $336 million can be used together with Assured Guaranty Corp. ("AGC"), an affiliate of the Company. The structured finance commitments include the unfunded component of pooled corporate and other transactions. Public finance commitments typically relate to primary and secondary public finance debt issuances. The expiration dates for the public finance commitments range between January 15, 2013 and February 25, 2017; up to $625 million of public finance commitments will expire by December 31, 2013. All the commitments are contingent on the satisfaction of all conditions set forth in them and may expire unused or be canceled at the counterparty's request. Therefore, the total commitment amount does not necessarily reflect actual future guaranteed amounts.

The Company seeks to maintain a diversified portfolio of insured obligations designed to spread its risk across a number of geographic areas.

Geographic Distribution of Financial Guaranty Portfolio
As of December 31, 2012

	Number of Risks	Net Par Outstanding	Percent of Total Net Par Outstanding
		(dollars in millions)	
U.S.:			
Public finance:			
California	1,162	$ 34,912	11.7%
Pennsylvania	935	19,634	6.6%
New York	869	18,478	6.2%
Illinois	699	16,025	5.3%
Texas	956	15,105	5.0%
Florida	277	13,409	4.5%
Michigan	597	10,486	3.5%
New Jersey	579	9,916	3.3%
Georgia	129	6,635	2.2%
Washington	249	6,145	2.0%
Other states	3,774	78,058	26.1%
Total U.S. public finance	10,226	228,803	76.4%
Structured finance (multiple states)	343	38,322	12.8%
Total U.S.	10,569	267,125	89.2%
Non-U.S.:			
United Kingdom	81	12,140	4.0%
Australia	21	4,765	1.6%
Canada	11	3,646	1.2%
France	14	1,782	0.6%
Italy	10	1,717	0.6%
Other	61	8,315	2.8%
Total non-U.S.	198	32,365	10.8%
Total	10,767	$ 299,490	100.0%

Economic Exposure to the Selected European Countries

Several European countries are experiencing significant economic, fiscal and/or political strains such that the likelihood of default on obligations with a nexus to those countries may be higher than the Company anticipated when such factors did not exist. The Company is closely monitoring its exposures in Selected European Countries where it believes heightened uncertainties exist. Published reports have identified countries that may be experiencing reduced demand for their sovereign debt in the current environment. The Company selected these European countries based on these reports and its view that their credit fundamentals are deteriorating. The Company's economic exposure to the Selected European Countries (based on par for financial guaranty contracts and notional amount for financial guaranty contracts accounted for as derivatives) is shown in the following table net of ceded reinsurance.

Net Economic Exposure to Selected European Countries(1)
December 31, 2012

	Hungary	Ireland	Italy	Portugal	Spain (2)	Total
			(in millions)			
Sovereign and sub-sovereign exposure:						
Public finance	$ —	$ —	$ 827	$ 96	$ 219	$ 1,142
Infrastructure finance	324	—	218	—	144	686
Total sovereign and sub-sovereign exposure	324	—	1,045	96	363	1,828
Non-sovereign exposure:						
Regulated utilities	—	—	135	—	7	142
RMBS	211	—	479	—	—	690
Pooled corporate obligations	—	76	59	12	108	255
Total non-sovereign exposure	211	76	673	12	115	1,087
Total	$ 535	$ 76	$ 1,718	$ 108	$ 478	$ 2,915
Total BIG	$ 535	$ 7	$ 207	$ 96	$ 362	$ 1,207

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(1) While the Company's exposures are shown in U.S. dollars, the obligations the Company insures are in various currencies, including U.S. dollars, Euros and British pounds sterling. One of the RMBS included in the table above includes residential mortgages in both Italy and Germany, and only the portion of the transaction equal to the portion of the original mortgage pool in Italian mortgages is shown in the table.

(2) See Note 6, Expected Loss to be Paid.

When the Company directly insures an obligation, it assigns the obligation to a geographic location or locations based on its view of the geographic location of the risk. For direct exposure this can be a relatively straight-forward determination as, for example, a debt issue supported by availability payments for a toll road in a particular country. The Company may also assign portions of a risk to more than one geographic location.

The Company has included in the exposure tables above its indirect economic exposure to the Selected European Countries through exposure it provides on pooled corporate obligations. The Company considers economic exposure to a selected European Country to be indirect when the exposure relates to only a small portion of an insured transaction that otherwise is not related to a Selected European Country. In most instances, the trustees and/or servicers for such transactions provide reports that identify the domicile of the underlying obligors in the pool (and the Company relies on such reports), although occasionally such information is not available to the Company. The Company has reviewed transactions through which it believes it may have indirect exposure to the Selected European Countries that is material to the transaction and included in the tables above the proportion of the insured par equal to the proportion of obligors so identified as being domiciled in a Selected European Country.

The Company no longer guarantees any sovereign bonds of the Selected European Countries. The exposure shown in the “Public Finance Category” is from transactions backed by receivable payments from sub-sovereigns in Italy, Spain and Portugal. Sub-sovereign debt is debt issued by a governmental entity or government backed entity, or supported by such an entity, that is other than direct sovereign debt of the ultimate governing body of the country. As of December 31, 2012, the Company no longer had any direct exposure to Greece. In 2012, the Company paid claims under its guarantees of €146 million in net exposure to the sovereign debt of Greece, paying off in full its liabilities with respect to the Greek sovereign bonds.

The Company understands that Moody's recently had undertaken a review of redenomination risk in selected countries in the Eurozone, including some of the Selected European Countries. No redenomination from the Euro to another currency has yet occurred and it may never occur. Therefore, it is not possible to be certain at this point how a redenomination of an issuer's obligations might be implemented in the future and, in particular, whether any redenomination would extend to the Company's obligations under a related financial guarantee.

Significant Risk Management Activities

The Risk Oversight and Audit Committees of the Board of Directors of AGL oversee the Company's risk management policies and procedures. With input from the board committees, specific risk policies and limits are set by the Portfolio Risk Management Committee, which includes members of senior management and senior Credit and Surveillance officers. The Company's Risk Management function encompasses enterprise risk management, establishing the Company's risk appetite, credit underwriting of new business, surveillance and work-out.

Surveillance personnel are responsible for monitoring and reporting on all transactions in the insured portfolio. The primary objective of the surveillance process is to monitor trends and changes in transaction credit quality, detect any deterioration in credit quality, and recommend to management such remedial actions as may be necessary or appropriate. All transactions in the insured portfolio are assigned internal credit ratings, and Surveillance personnel are responsible for recommending adjustments to those ratings to reflect changes in transaction credit quality.

Work-out personnel are responsible for managing work-out and loss mitigation situations, working with surveillance and legal personnel (as well as outside vendors) as appropriate. They develop strategies for the Company to enforce its contractual rights and remedies and to mitigate its losses, engage in negotiation discussions with transaction participants and, when necessary, manage (along with legal personnel) the Company's litigation proceedings.

Since the onset of the financial crisis, the Company has shifted personnel to loss mitigation and work-out activities and hired new personnel to augment its efforts. Although the Company's loss mitigation efforts may extend to any transaction it has identified as having loss potential, much of the activity has been focused on RMBS.

Surveillance Categories

The Company segregates its insured portfolio into investment grade and BIG surveillance categories to facilitate the appropriate allocation of resources to monitoring and loss mitigation efforts and to aid in establishing the appropriate cycle for periodic review for each exposure. BIG exposures include all exposures with internal credit ratings below BBB-. The Company's internal credit ratings are based on internal assessments of the likelihood of default and loss severity in the event of default. Internal credit ratings are expressed on a ratings scale similar to that used by the rating agencies and are generally reflective of an approach similar to that employed by the rating agencies.

The Company monitors its investment grade credits to determine whether any new credits need to be internally downgraded to BIG. The Company refreshes its internal credit ratings on individual credits in quarterly, semi-annual or annual cycles based on the Company's view of the credit's quality, loss potential, volatility and sector. Ratings on credits in sectors identified as under the most stress or with the most potential volatility are reviewed every quarter.

Credits identified as BIG are subjected to further review to determine the probability of a loss (see Note 6, Expected Loss to be Paid). Surveillance personnel then assign each BIG transaction to the appropriate BIG surveillance category based upon whether a lifetime loss is expected and whether a claim has been paid. The Company expects “lifetime losses” on a transaction when the Company believes there is at least a 50% chance that, on a present value basis, it will pay more claims over the life of that transaction than it ultimately will have reimbursed. For surveillance purposes, the Company calculates present value using a constant discount rate of 5%. (A risk-free rate is used for recording of reserves for financial statement purposes.)

More extensive monitoring and intervention is employed for all BIG surveillance categories, with internal credit ratings reviewed quarterly. The three BIG categories are:

- BIG Category 1: Below-investment-grade transactions showing sufficient deterioration to make lifetime losses possible, but for which none are currently expected. Transactions on which claims have been paid but are expected to be fully reimbursed (other than investment grade transactions on which only liquidity claims have been paid) are in this category.

- BIG Category 2: Below-investment-grade transactions for which lifetime losses are expected but for which no claims (other than liquidity claims which is a claim that the Company expects to be reimbursed within one year) have yet been paid.

- BIG Category 3: Below-investment-grade transactions for which lifetime losses are expected and on which claims (other than liquidity claims) have been paid. Transactions remain in this category when claims have been paid and only a recoverable remains.

Financial Guaranty Exposures
(Insurance and Credit Derivative Form)
As of December 31, 2012

	BIG Net Par Outstanding				Net Par	BIG Net Par as a % of Total Net Par
	BIG 1	BIG 2	BIG 3	Total BIG	Outstanding	Outstanding
			(in millions)			
First lien U.S. RMBS:						
Prime first lien	$ —	$ —	$ —	$ —	$ 77	—%
Alt-A first lien	26	285	571	882	1,104	0.3
Option ARM	—	—	525	525	762	0.2
Subprime	78	934	583	1,595	3,313	0.5
Second lien U.S. RMBS:						
Closed end second lien	—	205	98	303	461	0.1
Home equity lines of credit ("HELOCs")	72	—	1,967	2,039	2,464	0.7
Total U.S. RMBS	176	1,424	3,744	5,344	8,181	1.8
Other structured finance	678	216	89	983	39,122	0.3
U.S. public finance	1,633	—	189	1,822	228,803	0.6
Non-U.S. public finance	1,635	—	—	1,635	23,384	0.6
Total	$ 4,122	$ 1,640	$ 4,022	$ 9,784	$ 299,490	3.3%

Financial Guaranty Exposures
(Insurance and Credit Derivative Form)
As of December 31, 2011

	BIG Net Par Outstanding				Net Par	BIG Net Par as a % of Total Net Par
	BIG 1	BIG 2	BIG 3	Total BIG	Outstanding	Outstanding
			(in millions)			
First lien U.S. RMBS:						
Prime first lien	$ —	$ —	$ —	$ —	$ 89	—%
Alt-A first lien	39	434	602	1,075	1,239	0.3
Option ARM	—	99	832	931	1,440	0.3
Subprime (including net interest margin securities)	681	907	131	1,719	3,566	0.5
Second lien U.S. RMBS:						
Closed end second lien	—	450	367	817	967	0.3
HELOCs	409	—	2,061	2,470	3,002	0.8
Total U.S. RMBS	1,129	1,890	3,993	7,012	10,303	2.2
Other structured finance	615	233	286	1,134	49,286	0.3
U.S. public finance	1,739	—	152	1,891	236,409	0.6
Non-U.S. public finance	1,415	189	—	1,604	24,400	0.5
Total	$ 4,898	$ 2,312	$ 4,431	$ 11,641	$ 320,398	3.6%

Below-Investment-Grade Credits
By Category
As of December 31, 2012

Description	Net Par Outstanding			Number of Risks(2)		
	Financial Guaranty Insurance(1)	Credit Derivative	Total	Financial Guaranty Insurance(1)	Credit Derivative	Total
	(dollars in millions)					
BIG:						
Category 1	$ 3,723	$ 399	$ 4,122	71	6	77
Category 2	1,640	—	1,640	21	—	21
Category 3	3,892	130	4,022	50	9	59
Total BIG	$ 9,255	$ 529	$ 9,784	142	15	157

Below-Investment-Grade Credits
By Category
As of December 31, 2011

Description	Net Par Outstanding			Number of Risks(2)		
	Financial Guaranty Insurance(1)	Credit Derivative	Total	Financial Guaranty Insurance(1)	Credit Derivative	Total
	(dollars in millions)					
BIG:						
Category 1	$ 4,637	$ 261	$ 4,898	77	4	81
Category 2	2,312	—	2,312	26	—	26
Category 3	4,070	361	4,431	47	10	57
Total BIG	$ 11,019	$ 622	$ 11,641	150	14	164

(1) Includes net par outstanding for FG VIE.

(2) A risk represents the aggregate of the financial guaranty policies that share the same revenue source for purposes of making Debt Service payments.

Superstorm Sandy

On October 29, 2012, Superstorm Sandy made landfall in New Jersey and caused significant loss of life and property damage in New Jersey, New York and Connecticut. The Company does not expect any significant losses as a direct result of the superstorm at this time.

4. Financial Guaranty Insurance Premiums

The portfolio of outstanding exposures discussed in Note 3, Outstanding Exposure, includes financial guaranty contracts that meet the definition of insurance contracts as well as those that meet the definition of a derivative under GAAP. Amounts presented in this note relate only to financial guaranty insurance contracts. See Note 9, Financial Guaranty Contracts Accounted for as Credit Derivatives for a discussion of credit derivative revenues.

Accounting Policies

Accounting for financial guaranty contracts that meet the scope exception under derivative accounting guidance are subject to industry specific guidance which prescribes revenue recognition methodologies. Contracts that meet the definition of a derivative are accounted for at fair value and discussed separately in these financial statements. The accounting for contracts that fall under the financial guaranty insurance definition are consistent whether the contract was written on a direct basis, assumed from another financial guarantor under a reinsurance treaty, ceded to another insurer under a reinsurance treaty or acquired in a business combination.

“Unearned premium reserve” or “unearned premium revenue” represents “deferred premium revenue” net of paid claims that have not yet been expensed, or “contra-paid.” The following discussion relates to the deferred premium revenue component of the unearned premium reserve, while the contra paid is discussed in Note 7, Financial Guaranty Insurance Losses.

The amount of deferred premium revenue at contract inception is determined as follows:

- For premiums received upfront on financial guaranty insurance contracts that were originally underwritten by the Company, deferred premium revenue is equal to the amount of cash received. Upfront premiums typically relate to public finance transactions.

- For premiums received in installments on financial guaranty insurance contracts that were originally underwritten by the Company, deferred premium revenue is the present value of either (1) contractual premiums due or (2) premiums expected to be collected over the life of the contract. For financial guaranty insurance contracts where the underlying collateral is comprised of homogeneous pools of assets, the expected premiums to be collected over the life of the contract is used to estimate the present value of future premiums. To be considered a homogeneous pool of assets prepayments must be contractually prepayable, the amount of prepayments must be probable, and the timing and amount of prepayments can be reasonably estimated. When the Company makes a significant adjustment to prepayment assumptions, or expected premium collections, it recognizes a prospective change in premium revenues. When the Company adjusts prepayment assumptions, an adjustment is recorded to the deferred premium revenue, with a corresponding adjustment to the premium receivable. For all other contracts, the present value of contractual premiums due is used. Premiums receivable are discounted at the risk-free rate at inception and such discount rate is updated only when significant changes to prepayment assumptions are made.Installment premiums typically relate to structured finance transactions, where the insurance premium rate is determined at the inception of the contract but the insured par is subject to prepayment throughout the life of the deal.

- For financial guaranty insurance contracts acquired in a business combination, deferred premium revenue is equal to the fair value of the insurance contract at the date of acquisition based on what a hypothetical similarly rated financial guaranty insurer would have charged for the contract at that date and not the actual cash flows under the insurance contract. The amount of deferred premium revenue differs significantly from cash collections due primarily to fair value adjustments recorded in connection with a business combination.

The Company recognizes deferred premium revenue as earned premium over the contractual period or expected period of the contract in proportion to the amount of insurance protection provided.

As premium revenue is recognized, a corresponding decrease to the deferred premium revenue is recorded. The amount of insurance protection provided is a function of the insured principal amount outstanding. Accordingly, the proportionate share of premium revenue recognized in a given reporting period is a constant rate calculated based on the relationship between the insured principal amounts outstanding in the reporting period compared with the sum of each of the insured principal amounts outstanding for all periods. When an insured financial obligation is retired before its maturity, the financial guaranty insurance contract is extinguished. Any nonrefundable deferred premium revenue related to that contract is recognized as premium revenue. When a premium receivable balance is deemed uncollectible, it is written off to a bad debt expense.

Deferred premium revenue ceded to reinsurers is recorded as an asset in the line item "ceded unearned premium reserve". Direct, assumed and ceded premium revenue are presented net in the income statement line item, net earned premiums.

Net earned premiums comprise the following:

Net Earned Premiums

	Year Ended December 31,	
	2012	2011
	(in millions)	
Scheduled net earned premiums	$ 403	$ 569
Acceleration of premium earnings	174	79
Accretion of discount on net premiums receivable	13	13
Total net earned premiums(1)	$ 590	$ 661

(1) Excludes $150 million and $74 million for the year ended December 31, 2012 and 2011, respectively, related to consolidated FG VIEs.

Components of Unearned Premium Reserve

	As of December 31, 2012			As of December 31, 2011		
	Gross	Ceded	Net(1)	Gross	Ceded	Net(1)
			(in millions)			
Deferred premium revenue	$ 4,016	$ 1,224	$ 2,792	$ 4,607	$ 1,398	$ 3,209
Contra-paid	(150)	(37)	(113)	(92)	(25)	(67)
Total	$ 3,866	$ 1,187	$ 2,679	$ 4,515	$ 1,373	$ 3,142

(1) Excludes $251 million and $398 million deferred premium revenue and $98 million and $133 million of contra-paid related to FG VIEs as of December 31, 2012 and December 31, 2011, respectively.

Net Deferred Premium Revenue Roll Forward

	Year Ended December 31,	
	2012	2011
	(in millions)	
Balance beginning of period, December 31	$ 3,209	$ 3,941
Premium written, net	51	106
Net premium earned, excluding accretion	(577)	(648)
Commutations of reinsurance contracts	(28)	(20)
Change in expected premium	142	(8)
Consolidation of FG VIEs	(5)	(162)
Balance, end of period, December 31	$ 2,792	$ 3,209

Gross Premium Receivable, Net of Ceding Commissions Roll Forward

	Year Ended December 31, 2012	Year Ended December 31, 2011
	(in millions)	
Balance beginning of period, December 31	$ 645	$ 729
Premium written, net	143	172
Premium payments received, net	(222)	(256)
Adjustments:		
Changes in the expected term of financial guaranty insurance contracts	50	(3)
Accretion of discount	30	21
Foreign exchange translation	13	(5)
Consolidation of FG VIEs	(5)	(7)
Other adjustments	(1)	(6)
Balance, end of period, December 31(1)(2)	$ 653	$ 645

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(1) Represents elimination of premium receivable related to the consolidation of FG VIEs.

(2) Excludes $16 million and $17 million as of December 31, 2012 and 2011, respectively, related to consolidated FG VIEs.

Gains or losses due to foreign exchange rate changes relate to installment premium receivables denominated in currencies other than the U.S. dollar. Approximately 66% and 68% of installment premiums at December 31, 2012 and 2011, respectively, are denominated in currencies other than the U.S. dollar, primarily in Euro and British Pound Sterling.

The timing and cumulative amount of actual collections may differ from expected collections in the tables below due to factors such as foreign exchange rate fluctuations, counterparty collectability issues, accelerations, commutations and changes in expected lives.

Expected Collections of Gross Premiums Receivable, Net of Ceding Commissions (Undiscounted)

	December 31, 2012
	(in millions)
2013 (January 1 - March 31)	$ 23
2013 (April 1 - June 30)	25
2013 (July 1- September 30)	16
2013 (October 1 - December 31)	19
2014	65
2015	62
2016	59
2017	55
2018-2022	210
2023-2027	134
2028-2032	97
After 2032	114
Total	$ 879

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(1) Excludes expected cash collections on FG VIEs of $19 million.

Scheduled Net Earned Premiums
Financial Guaranty Insurance Contracts

	As of December 31, 2012
	(in millions)
2013 (January 1 - March 31)	$ 87
2013 (April 1 - June 30)	83
2013 (July 1- September 30)	78
2013 (October 1 - December 31)	74
Subtotal 2013	322
2014	273
2015	238
2016	213
2017	188
2018-2022	686
2023-2027	405
2028-2032	233
After 2032	234
Total present value basis(1)	2,792
Discount	142
Total future value	$ 2,934

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(1) Excludes scheduled net earned premiums on consolidated FG VIEs of $251 million.

Selected Information for Policies Paid in Installments

	As of December 31,	
	2012	2011
	(dollars in millions)	
Premiums receivable, net of ceding commission payable	$ 653	$ 645
Gross deferred premium revenue	1,562	1,832
Weighted-average risk-free rate used to discount premiums	3.46%	3.6%
Weighted-average period of premiums receivable (in years)	10.0	10.3

5. Financial Guaranty Insurance Acquisition Costs

Accounting Policy

Policy acquisition costs that are directly related and essential to successful insurance contract acquisition are deferred for contracts accounted for as insurance. Amortization of deferred policy acquisition costs includes the accretion of discount on ceding commission income and expense. Acquisition costs associated with derivative contracts are not deferrable.

In October 2010, the FASB adopted Accounting Standards Update (“Update”) No. 2010-26. The Company adopted this guidance January 1, 2012, with retrospective application. As of January 1, 2011, the effect of retrospective application of Update No. 2010-26 was a reduction to deferred acquisition costs ("DAC") of $10 million and a reduction to retained earnings of $7 million. DAC is netted with deferred ceding commission income and recorded in "other liabilities" on the consolidated balance sheets. There was no impact to cash flow. The Update specifies that certain costs incurred in the successful acquisition of new and renewal insurance contracts should be capitalized. These costs include direct costs of contract acquisition that result directly from and are essential to the contract transaction. These costs include expenses such as ceding commissions and the cost of underwriting personnel. Ceding commission income on ceded reinsurance contracts that are associated with premiums received in installments are calculated at their contractually defined rates and included in deferred ceding commissions, with a corresponding offset to net premiums receivable or reinsurance balances payable. Management uses its judgment in determining the type and amount of cost to be deferred. The Company conducts an annual study to determine which operating costs qualify for deferral. Costs incurred by the insurer for soliciting potential customers, market research, training, administration, unsuccessful acquisition efforts, and product development as well as all overhead type costs are charged to expense as incurred. DAC is amortized in proportion to net earned premiums. When an insured obligation is retired early, the remaining related DAC is expensed at that time.

Effect of Retrospective Application of New Deferred Acquisition Cost Guidance
On Consolidated Statements of Operations

	As Reported Year Ended 2011	Retroactive Application Adjustment	As Revised Year Ended 2011
		(in millions)	
Amortization of DAC	$ (7)	$ (1)	$ (8)
Other operating expenses	86	9	95
Net income (loss)	404	(6)	398

The effect of retrospective application of Update No. 2010-26 was an increase to other liabilities of $20 million as of December 31, 2011.

Rollforward of Deferred Ceding Commissions, Net of DAC
With Retrospective Application of Change in Accounting Principle(1)

	Year Ended December 31,	
	2012	2011
	(in millions)	
Balance, beginning of period	$ (99)	$ (93)
Costs deferred during the period:		
Ceded and assumed commissions	(29)	(24)
Premium taxes	3	4
Compensation and other acquisition costs	7	6
Total	(19)	(14)
Costs amortized during the period	8	8
Balance, end of period	$ (110)	$ (99)

(1) The balances are included in other liabilities on the consolidated balance sheets.

6. Expected Loss to be Paid

Accounting Policy

The insured portfolio includes policies accounted for under three separate accounting models depending on the characteristics of the contract and the Company's control rights. The Company has paid and expects to pay future losses on policies which fall under each of the three accounting models. The following provides a summarized description of the three accounting models required under GAAP for each type of contract with references to additional information provided throughout this report. The three models are insurance, derivative and VIE consolidation.

However, in order to effectively evaluate and manage the economics and liquidity of the entire insured portfolio, management compiles and analyzes loss information for all policies on a consistent basis because loss payments must be made regardless of accounting model. That is, management monitors and assigns ratings and calculates expected losses in the same manner for all its exposures regardless of form or differing accounting models. Management also considers contract specific characteristics that affect the estimates of expected loss. The discussion of expected loss to be paid within this note encompasses expected losses on all policies in the insured portfolio, whatever the accounting treatment. Net expected loss to be paid in the tables below consists of the present value of future: expected claim and loss and loss adjustment expenses ("LAE") payments, expected recoveries of excess spread in the transaction structures, cessions to reinsurers, and expected recoveries for breaches of representations and warranties ("R&W") and other loss mitigation strategies. Assumptions used in the determination of the net expected loss to be paid presented below, such as delinquency, severity, and discount rates and expected timeframes to recovery in the mortgage market were consistent by sector regardless of the accounting model used.

Accounting Models:

The following is a summary of each of the accounting models prescribed by GAAP with a reference to the notes that describe the accounting polices and required disclosures. This note provides information regarding expected claim payments to be made under all insured contracts regardless of form of execution.

Insurance Accounting

For contracts accounted for as financial guaranty insurance, loss and LAE reserve is recorded only to the extent and for the amount that expected losses to be paid exceed unearned premium reserve. As a result, the Company has expected losses that have not yet been expensed but will be expensed in future periods. Such amounts will be expensed in future periods as deferred premium revenue amortizes into income. Expected loss to be paid is important from a liquidity perspective in that it represents the present value of amounts that the Company expects to pay or recover in future periods. Expected loss to be expensed is important because it presents the Company's projection of incurred losses that will be recognized in future periods as deferred premium revenue amortizes into income. See Note 7, Financial Guaranty Insurance Losses.

Derivative Accounting, at Fair Value

For contracts that do not meet the financial guaranty scope exception in the derivative accounting guidance (primarily due to the fact that the insured is not required to be exposed to the insured risk throughout the life of the contract), the Company records such credit derivative contracts at fair value on the consolidated balance sheet with changes in fair value recorded in the consolidated statement of operations. Expected loss to be paid is an important measure used by management to analyze the net economic loss on credit derivatives. The fair value recorded on the balance sheet represents an exit price in a hypothetical market because the Company does not trade its credit derivative contracts. The fair value is determined using significant Level 3 inputs in an internally developed model while the expected loss to be paid (which represents the present value of expected cash outflows) uses methodologies and assumptions consistent with financial guaranty insurance expected losses to be paid. See Note 8, Fair Value Measurement and Note 9, Financial Guaranty Contracts Accounted for as Credit Derivatives.

VIE Consolidation, at Fair Value

For financial guaranty insurance contracts issued on the debt of variable interest entities over which the Company is deemed to be the primary beneficiary due to its control rights, as defined in accounting literature, the Company consolidates the FG VIE. The Company's expected loss to be paid is reflected in the fair value of the FG VIEs liabilities. The Company carries the assets and liabilities of the FG VIEs at fair value under the fair value option election. Management assesses the losses on the insured debt of the consolidated FG VIEs in the same manner as other financial guaranty insurance and credit derivative contracts. Expected loss to be paid for FG VIEs pursuant to AGM's financial guaranty insurance policies is calculated in a manner consistent with the Company's other financial guaranty insurance contracts.

Expected Loss to be Paid

The expected loss to be paid is equal to the present value of expected future cash outflows for claim and LAE payments, net of inflows for expected salvage and subrogation (i.e. excess spread on the underlying collateral, and estimated and contractual recoveries for breaches of representations and warranties), using current risk-free rates. When the Company becomes entitled to the cash flow from the underlying collateral of an insured credit under salvage and subrogation rights as a result of a claim payment or estimated future claim payment, it reduces the expected loss to be paid on the contract. Net expected loss to be paid is defined as expected loss to be paid, net of amounts ceded to reinsurers.

The current risk-free rate is based on the remaining period of the contract used in the premium revenue recognition calculation (i.e., the contractual or expected period, as applicable). The Company updates the discount rate each quarter and records the effect of such changes in economic loss development. Expected cash outflows and inflows are probability weighted cash flows that reflect the likelihood of all possible outcomes. The Company estimates the expected cash outflows and inflows using management's assumptions about the likelihood of all possible outcomes based on all information available to it. Those assumptions consider the relevant facts and circumstances and are consistent with the information tracked and monitored through the Company's risk-management activities.

Economic Loss Development

Economic loss development represents the change in expected loss to be paid attributable to all factors other than loss and LAE payments. It includes the effects of changes in assumptions based on observed market trends, changes in discount rates, accretion of discount and the economic effects of loss mitigation efforts.

Loss Mitigation

Expected loss to be paid and economic loss development include the effects of loss mitigation strategies and other contractual rights to mitigate losses such as: negotiated and estimated recoveries for breaches of representations and warranties, and purchases of insured debt obligations. Additionally, in certain cases, issuers of insured obligations elected, or the Company and an issuer mutually agreed as part of a negotiation, to deliver the underlying collateral or insured obligation to the Company. In circumstances where the Company has acquired its own insured obligations that have expected losses, either as part of loss mitigation strategy or via delivery of underlying collateral, expected loss to be paid is reduced by the proportionate share of the insured obligation that was purchased. The difference between the purchase price of the obligation and the fair value excluding the value of the Company's insurance, is treated as a paid loss for both purchased bonds and delivered collateral or insured obligations. Assets that are purchased or put to the Company are recorded in the investment portfolio, at fair value, excluding the value of the Company's insurance or credit derivative contract. See Note 11, Investments and Cash and Note 8, Fair Value Measurement.

Loss Estimation Process

The Company's loss reserve committees estimate expected loss to be paid for all contracts. Surveillance personnel present analyses related to potential losses to the Company's loss reserve committees for consideration in estimating the expected loss to be paid. Such analyses include the consideration of various scenarios with potential probabilities assigned to them. Depending upon the nature of the risk, the Company's view of the potential size of any loss and the information available to the Company, that analysis may be based upon individually developed cash flow models, internal credit rating assessments and sector‑driven loss severity assumptions or judgmental assessments. In the case of its assumed business, the Company may conduct its own analysis as just described or, depending on the Company's view of the potential size of any loss and the information available to the Company, the Company may use loss estimates provided by ceding insurers. The Company's loss reserve committees review and refresh the estimate of expected loss to be paid each quarter. The Company's estimate of ultimate loss on a policy is subject to significant uncertainty over the life of the insured transaction due to the potential for significant variability in credit performance as a result of economic, fiscal and financial market variability over the long duration of most contracts. The determination of expected loss to be paid is an inherently subjective process involving numerous estimates, assumptions and judgments by management.

The following table presents a roll forward of the present value of net expected loss to be paid for all contracts, whether accounted for as insurance, credit derivatives, or FG VIEs, by sector before and after the benefit for estimated and contractual recoveries for breaches of R&W. The Company used weighted average risk-free rates for U.S. dollar denominated obligations, which ranged from 0.0% to 3.28% as of December 31, 2012 and 0.0% to 3.27% as of December 31, 2011.

Net Expected Loss to be Paid,
Before Recoveries for Breaches of R&W
Roll Forward by Sector
Year Ended December 31, 2012

	Net Expected Loss to be Paid as of December 31, 2011(2)	Economic Loss Development	(Paid) Recovered Losses(1)	Net Expected Loss to be Paid as of December 31, 2012(2)
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 274	$ 43	$ (36)	$ 281
Option ARM	754	92	(507)	339
Subprime	256	44	(31)	269
Total first lien	1,284	179	(574)	889
Second lien:				
Closed end second lien	86	(8)	(12)	66
HELOCs	76	61	(140)	(3)
Total second lien	162	53	(152)	63
Total U.S. RMBS	1,446	232	(726)	952
Other structured finance	62	(37)	3	28
U.S. public finance	(35)	15	(38)	(58)
Non-U.S. public finance	38	195	(195)	38
Total	$ 1,511	$ 405	$ (956)	$ 960

Net Expected Loss to be Paid,
Before Recoveries for Breaches of R&W
Roll Forward by Sector
Year Ended December 31, 2011

	Net Expected Loss to be Paid as of December 31, 2010	Economic Loss Development	(Paid) Recovered Losses(1)	Net Expected Loss to be Paid as of December 31, 2011(2)
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 213	$ 122	$ (61)	$ 274
Option ARM	751	442	(439)	754
Subprime	207	61	(12)	256
Total first lien	1,171	625	(512)	1,284
Second lien:				
Closed end second lien	190	(65)	(39)	86
HELOCs	117	192	(233)	76
Total second lien	307	127	(272)	162
Total U.S. RMBS	1,478	752	(784)	1,446
Other structured finance	72	(9)	(1)	62
U.S. public finance	8	3	(46)	(35)
Non-U.S. public finance	1	37	—	38
Total	$ 1,559	$ 783	$ (831)	$ 1,511

(1) Net of ceded paid losses, whether or not such amounts have been settled with reinsurers. Ceded paid losses are typically settled 45 days after the end of the reporting period. Such amounts are recorded in reinsurance recoverable on paid losses included in other assets.

(2) Includes expected LAE to be paid for mitigating claim liabilities of $19 million as of December 31, 2012 and $21 million as of December 31, 2011. The Company paid $30 million and $29 million in LAE for the years ended December 31, 2012 and 2011, respectively.

Net Expected Recoveries from
Breaches of R&W Rollforward
Year Ended December 31, 2012

	Future Net R&W Benefit as of December 31, 2011	R&W Development and Accretion of Discount During 2012	R&W Recovered During 2012(1)	Future Net R&W Benefit as of December 31, 2012(2)
		(in millions)		
Alt-A first lien	$ 181	$ 19	(68)	$ 132
Option ARM	619	78	(216)	481
Subprime	101	6	—	107
Closed end second lien	118	3	(6)	115
HELOC	151	35	(61)	125
Total	$ 1,170	$ 141	$ (351)	$ 960

Net Expected Recoveries from Breaches of R&W Rollforward Year Ended December 31, 2011

	Future Net R&W Benefit at December 31, 2010	R&W Development and Accretion of Discount During 2011	R&W Recovered During 2011(1)	Future Net R&W Benefit at December 31, 2011
		(in millions)		
Alt-A first lien	$ 68	$ 113	—	$ 181
Option ARM	291	395	(67)	619
Subprime	27	74	—	101
Closed end second lien	98	28	(8)	118
HELOC	738	101	(688)	151
Total	$ 1,222	$ 711	$ (763)	$ 1,170

(1) Gross amounts recovered are \$383 million and \$956 million for year ended December 31, 2012 and 2011, respectively.

(2) Includes excess spread that the Company will receive as salvage as a result of a settlement agreement with a R&W provider.

Net Expected Loss to be Paid, After Net Expected Recoveries for Breaches of R&W Roll Forward Year Ended December 31, 2012

	Net Expected Loss to be Paid as of December 31, 2011	Economic Loss Development	(Paid) Recovered Losses(1)	Net Expected Loss to be Paid as of December 31, 2012
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 93	$ 24	$ 32	$ 149
Option ARM	135	14	(291)	(142)
Subprime	155	38	(31)	162
Total first lien	383	76	(290)	169
Second lien:				
Closed end second lien	(32)	(11)	(6)	(49)
HELOCs	(75)	26	(79)	(128)
Total second lien	(107)	15	(85)	(177)
Total U.S. RMBS	276	91	(375)	(8)
Other structured finance	62	(37)	3	28
U.S. public finance	(35)	15	(38)	(58)
Non-U.S. public finance	38	195	(195)	38
Total	$ 341	$ 264	$ (605)	$ 0

Net Expected Loss to be Paid,
After Net Expected Recoveries for Breaches of R&W
Roll Forward
Year Ended December 31, 2011

	Net Expected Loss to be Paid as of December 31, 2010	Economic Loss Development	(Paid) Recovered Losses(1)	Net Expected Loss to be Paid as of December 31, 2011
	(in millions)			
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 145	$ 9	$ (61)	$ 93
Option ARM	460	47	(372)	135
Subprime	180	(13)	(12)	155
Total first lien	785	43	(445)	383
Second lien:				
Closed end second lien	92	(93)	(31)	(32)
HELOCs	(621)	91	455	(75)
Total second lien	(529)	(2)	424	(107)
Total U.S. RMBS	256	41	(21)	276
Other structured finance	72	(9)	(1)	62
U.S. public finance	8	3	(46)	(35)
Non-U.S. public finance	1	37	—	38
Total	$ 337	$ 72	$ (68)	$ 341

(1) Net of ceded paid losses, whether or not such amounts have been settled with reinsurers. Ceded paid losses are typically settled 45 days after the end of the reporting period. Such amounts are recorded in reinsurance recoverable on paid losses included in other assets.

The following tables present the present value of net expected loss to be paid for all contracts by accounting model, by sector and after the benefit for estimated and contractual recoveries for breaches of R&W.

Net Expected Loss to be Paid
By Accounting Model
As of December 31, 2012

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives	Total
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 131	$ 18	$ —	$ 149
Option ARM	(106)	(36)	—	(142)
Subprime	112	50	—	162
Total first lien	137	32	—	169
Second lien:				
Closed end second lien	(62)	23	(10)	(49)
HELOCs	39	(167)	—	(128)
Total second lien	(23)	(144)	(10)	(177)
Total U.S. RMBS	114	(112)	(10)	(8)
Other structured finance	23	—	5	28
U.S. public finance	(58)	—	—	(58)
Non-U.S. public finance	38	—	—	38
Total	$ 117	$ (112)	$ (5)	$ 0

Net Expected Loss to be Paid
By Accounting Model
As of December 31, 2011

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives	Total
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 103	$ (10)	$ —	$ 93
Option ARM	111	24	—	135
Subprime	88	42	25	155
Total first lien	302	56	25	383
Second lien:				
Closed end second lien	(59)	33	(6)	(32)
HELOCs	75	(150)	—	(75)
Total second lien	16	(117)	(6)	(107)
Total U.S. RMBS	318	(61)	19	276
Other structured finance	42	—	20	62
U.S. public finance	(34)	—	(1)	(35)
Non-U.S. public finance	38	—	—	38
Total	$ 364	$ (61)	$ 38	$ 341

(1) Refer to Note 10, Consolidation of Variable Interest Entities.

The following tables present the net economic loss development for all contracts by accounting model, by sector and after the benefit for estimated and contractual recoveries for breaches of R&W.

Net Economic Loss Development
By Accounting Model
Year Ended December 31, 2012

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives(2)	Total
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 25	$ (1)	$ 0	$ 24
Option ARM	13	1	0	14
Subprime	29	9	—	38
Total first lien	67	9	—	76
Second lien:				
Closed end second lien	(3)	(8)	—	(11)
HELOCs	7	19	—	26
Total second lien	4	11	—	15
Total U.S. RMBS	71	20	—	91
Other structured finance	(23)	—	(14)	(37)
U.S. public finance	(9)	—	24	15
Non-U.S.Public finance	220	—	(25)	195
Total	$ 259	$ 20	$ (15)	$ 264

Net Economic Loss Development
By Accounting Model
Year Ended December 31, 2011

	Financial Guaranty Insurance	FG VIEs(1)	Credit Derivatives(2)	Total
		(in millions)		
U.S. RMBS:				
First lien:				
Alt-A first lien	$ 10	$ (1)	$ —	$ 9
Option ARM	(38)	85	—	47
Subprime	(43)	33	(3)	(13)
Total first lien	(71)	117	(3)	43
Second lien:				
Closed end second lien	(106)	36	(23)	(93)
HELOCs	172	(81)	—	91
Total second lien	66	(45)	(23)	(2)
Total U.S. RMBS	(5)	72	(26)	41
Other structured finance	18	—	(27)	(9)
U.S. public finance	4	—	(1)	3
Non-U.S.Public finance	37	—	—	37
Total	$ 54	$ 72	$ (54)	$ 72

(1) Refer to Note 10, Consolidation of Variable Interest Entities.

(2) Refer to Note 9, Financial Guaranty Contracts Accounted for as Credit Derivatives.

Approach to Projecting Losses in U.S. RMBS

The Company projects losses on its insured U.S. RMBS on a transaction-by-transaction basis by projecting the performance of the underlying pool of mortgages over time and then applying the structural features (i.e., payment priorities and tranching) of the RMBS to the projected performance of the collateral over time. The resulting projected claim payments or reimbursements are then discounted using risk-free rates. For transactions where the Company projects it will receive recoveries from providers of R&W, it projects the amount of recoveries and either establishes a recovery for claims already paid or reduces its projected claim payments accordingly.

The further behind a mortgage borrower falls in making payments, the more likely it is that he or she will default. The rate at which borrowers from a particular delinquency category (number of monthly payments behind) eventually default is referred to as the “liquidation rate.” Liquidation rates may be derived from observed roll rates, which are the rates at which loans progress from one delinquency category to the next and eventually to default and liquidation. The Company applies liquidation rates to the mortgage loan collateral in each delinquency category and makes certain timing assumptions to project near-term mortgage collateral defaults from loans that are currently delinquent.

Mortgage borrowers that are not more than one payment behind (generally considered performing borrowers) have demonstrated an ability and willingness to pay throughout the recession and mortgage crisis, and as a result are viewed as less likely to default than delinquent borrowers. Performing borrowers that eventually default will also need to progress through delinquency categories before any defaults occur. The Company projects how many of the currently performing loans will default and when they will default by first converting the projected near term defaults of delinquent borrowers derived from liquidation rates into a vector of conditional default rates ("CDR"), then projecting how the conditional default rates will develop over time. Loans that are defaulted pursuant to the conditional default rate after the liquidation of currently delinquent loans represent defaults of currently performing loans. A conditional default rate is the outstanding principal amount of defaulted loans liquidated in the current month divided by the remaining outstanding amount of the whole pool of loans (or "collateral pool balance"). The collateral pool balance decreases over time as a result of scheduled principal payments, partial and whole principal prepayments, and defaults.

In order to derive collateral pool losses from the collateral pool defaults it has projected, the Company applies a loss severity. The loss severity is the amount of loss the transaction experiences on a defaulted loan after the application of net proceeds from the disposal of the underlying property. The Company projects loss severities by sector based on its experience to date. Further detail regarding the assumptions and variables the Company used to project collateral losses in its U.S. RMBS portfolio may be found below in the sections *"U.S. Second Lien RMBS Loss Projections: HELOCs and Closed-End Second Lien"* and *"U.S. First Lien RMBS Loss Projections: Alt-A First Lien, Option ARM, Subprime and Prime."*

The Company is in the process of enforcing claims for breaches of R&W regarding the characteristics of the loans included in the collateral pools. The Company calculates a credit from the RMBS issuer for such recoveries where the R&W were provided by an entity the Company believes to be financially viable and where the Company already has access or believes it will attain access to the underlying mortgage loan files. Where the Company has an agreement with an R&W provider (e.g., the Bank of America Agreement or the Deutsche Bank Agreement) or where it is in advanced discussions on a potential agreement, that credit is based on the agreement or potential agreement. In second lien RMBS transactions where there is no agreement or advanced discussions, this credit is based on a percentage of actual repurchase rates achieved across those transactions where material repurchases have been made. In certain scenarios included in the probability weighted R&W estimates for first lien RMBS transactions where there is no agreement or advanced discussions, this credit is estimated by reducing collateral losses projected by the Company to reflect a percentage of the recoveries the Company believes it will achieve, based on a percentage of actual repurchase rates achieved or based on the Company's two largest settlements with Bank of America Agreement and Deutsche Bank Agreement. The first lien approach is different from the second lien approach because the Company's first lien transactions have multiple tranches and a more complicated method is required to correctly allocate credit to each tranche. In each case, the credit is a function of the projected lifetime collateral losses in the collateral pool, so an increase in projected collateral losses generally increases the R&W credit calculated by the Company for the RMBS issuer. Further detail regarding how the Company calculates these credits may be found under *"Breaches of Representations and Warranties"* below.

The Company projects the overall future cash flow from a collateral pool by adjusting the payment stream from the principal and interest contractually due on the underlying mortgages for (a) the collateral losses it projects as described above, (b) assumed voluntary prepayments and (c) recoveries for breaches of R&W as described above. The Company then applies an individual model of the structure of the transaction to the projected future cash flow from that transaction's collateral pool to project the Company's future claims and claim reimbursements for that individual transaction. Finally, the projected claims and reimbursements are discounted using risk-free rates. As noted above, the Company runs several sets of assumptions regarding mortgage collateral performance, or scenarios, and probability weights them.

The ultimate performance of the Company's RMBS transactions remains highly uncertain, may differ from the Company's projections and may be subject to considerable volatility due to the influence of many factors, including the level and timing of loan defaults, changes in housing prices, results from the Company's loss mitigation activities and other variables. The Company will continue to monitor the performance of its RMBS exposures and will adjust its RMBS loss projection assumptions and scenarios based on actual performance and management's view of future performance.

Year-End 2012 Compared to Year-End 2011 U.S. RMBS Loss Projections

The Company's RMBS loss projection methodology assumes that the housing and mortgage markets will eventually improve. Each quarter the Company makes a judgment as to whether to change the assumptions it uses to make RMBS loss projections based on its observation during the quarter of the performance of its insured transactions (including early stage delinquencies, late stage delinquencies and, for first liens, loss severity) as well as the residential property market and economy in general, and, to the extent it observes changes, it makes a judgment as whether those changes are normal fluctuations or part of a trend. Based on such observations, the Company chose to use essentially the same assumptions and scenarios to project RMBS loss as of December 31, 2012 as it used as of December 31, 2011, except that as compared to December 31, 2011:

- in its most optimistic scenario, it reduced by three months the period it assumed it would take the mortgage market to recover; and
- in its most pessimistic scenario, it increased by three months the period it assumed it would take the mortgage market to recover.

The Company's use of essentially the same assumptions and scenarios to project RMBS losses as of December 31, 2012 as at December 31, 2011 was consistent with its view at December 31, 2012 that the housing and mortgage market recovery is occurring at a slower pace than it anticipated at December 31, 2011. The Company's changes during 2012 to the period it would take the mortgage market to recover in its most optimistic scenario and its most pessimistic scenario allowed it to consider a wider range of possibilities for the speed of the recovery. Since the Company's projections for each RMBS transaction are based on the delinquency performance of the loans in that individual RMBS transaction, improvement or deterioration in that aspect of a transaction's performance impacts the projections for that transaction. The methodology and assumptions the Company uses to project RMBS losses and the scenarios it employs are described in more detail below under "- U.S. Second Lien RMBS Loss Projections: HELOCs and Closed-End Second Lien" and " - U.S. First Lien RMBS Loss Projections: Alt A First Lien, Option ARM, Subprime and Prime".

Year-End 2011 Compared to Year-End 2010 U.S. RMBS Loss Projections

During 2011 the Company made a judgment as to whether to change the assumptions it used to make RMBS loss projections based on its observation of the performance of its insured transactions (including early stage delinquencies, late stage delinquencies and, for first liens, loss severity) as well as the residential property market and economy in general, and, to the extent it observed changes, it made a judgment as whether those changes were normal fluctuations or part of a trend. Based on such observations, the Company chose to use essentially the same assumptions and scenarios to project RMBS loss as of December 31, 2011 as it used as of December 31, 2010, except that as compared to December 31, 2010:

- based on its observation of the slow mortgage market recovery, the Company increased its base case expected period for reaching the final conditional default rate in second lien transactions and adjusted the probability weightings it applied to second lien scenarios from year-end 2010 to reflect the changes to those scenarios;

- also based on its observation of the slow mortgage market recovery the Company added a more stressful first lien scenario at year-end 2011 reflecting an even slower potential recovery in the housing and mortgage markets, making what had prior to that been a stress scenario its base scenario;

- based on its observation of increased loss severity rates, the Company increased its projected loss severity rates in various of its first lien scenarios; and

- based on its observation of liquidation rates, the Company decreased the liquidation rates it applied to non-performing loans.

The Company's use of essentially the same assumptions and scenarios to project RMBS losses as of December 31, 2011 as at December 31, 2010 was consistent with its view at December 31, 2011 that the housing and mortgage market recovery was occurring at a slower pace than it anticipated at December 31, 2010. Since the Company's projections for each RMBS transaction are based on the delinquency performance of the loans in that individual RMBS transaction, improvement or deterioration in that aspect of a transaction's performance impacts the projections for that transaction. The methodology and assumptions the Company uses to project RMBS losses and the scenarios it employs are described in more detail below under "– U.S. Second Lien RMBS Loss Projections: HELOCs and Closed-End Second Lien" and " – U.S. First Lien RMBS Loss Projections: Alt A First Lien, Option ARM, Subprime and Prime".

U.S. Second Lien RMBS Loss Projections: HELOCs and Closed End Second Lien

The Company insures two types of second lien RMBS: those secured by HELOCs and those secured by closed end second lien mortgages. HELOCs are revolving lines of credit generally secured by a second lien on a one to four family home. A mortgage for a fixed amount secured by a second lien on a one to four family home is generally referred to as a closed end second lien. Second lien RMBS sometimes include a portion of loan collateral with a different priority than the majority of the collateral. The Company has material exposure to second lien mortgage loans originated and serviced by a number of parties, but the Company's most significant second lien exposure is to HELOCs originated and serviced by Countrywide, a subsidiary of Bank of America. See "—Breaches of Representations and Warranties."

The delinquency performance of HELOC and closed end second lien exposures included in transactions insured by the Company began to deteriorate in 2007, and such transactions continue to perform below the Company's original underwriting expectations. While insured securities benefit from structural protections within the transactions designed to absorb collateral losses in excess of previous historically high levels, in many second lien RMBS projected losses now exceed those structural protections.

The Company believes the primary variables affecting its expected losses in second lien RMBS transactions are the amount and timing of future losses in the collateral pool supporting the transactions and the amount of loans repurchased for breaches of R&W (or agreements with R&W providers related to such obligations). Expected losses are also a function of the structure of the transaction; the voluntary prepayment rate (typically also referred to as conditional prepayment rate ("CPR") of the collateral); the interest rate environment; and assumptions about the draw rate and loss severity. These variables are interrelated, difficult to predict and subject to considerable volatility. If actual experience differs from the Company's assumptions, the losses incurred could be materially different from the estimate. The Company continues to update its evaluation of these exposures as new information becomes available.

The following table shows the range of key assumptions for the calculation of expected loss to be paid for individual transactions for direct vintage 2004 - 2008 second lien U.S. RMBS.

Key Assumptions in Base Case Expected Loss Estimates
Second Lien RMBS(1)

HELOC key assumptions	As of December 31, 2012	As of December 31, 2011
Plateau CDR	3.8% - 15.9%	4.0% - 27.4%
Final CDR trended down to	0.4% - 3.2%	0.4% - 3.2%
Expected period until final CDR	36 months	36 months
Initial CPR	2.9% - 14.6%	1.4% - 25.8%
Final CPR	10%	10%
Loss severity	98%	98%
Initial draw rate	0.0% - 4.8%	0.0% - 15.3%

Closed end second lien key assumptions	As of December 31, 2012	As of December 31, 2011
Plateau CDR	10.6% - 20.7%	17.9% - 29.5%
Final CDR trended down to	3.5% - 8.6%	3.5% - 8.6%
Expected period until final CDR	36 months	36 months
Initial CPR	2.3% - 5.0%	2.2% - 5.1%
Final CPR	10%	10%
Loss severity	98%	98%

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(1) Represents variables for most heavily weighted scenario (the "base case").

In second lien transactions the projection of near-term defaults from currently delinquent loans is relatively straightforward because loans in second lien transactions are generally "charged off" (treated as defaulted) by the securitization's servicer once the loan is 180 days past due. Most second lien transactions report the amount of loans in five monthly delinquency categories (*i.e.*, 30-59 days past due, 60-89 days past due, 90-119 days past due, 120-149 days past due and 150-179 days past due). The Company estimates the amount of loans that will default over the next five months by calculating current representative liquidation rates (the percent of loans in a given delinquency status that are assumed to ultimately default) from selected representative transactions and then applying an average of the preceding twelve months' liquidation rates to the amount of loans in the delinquency categories. The amount of loans projected to default in the first through fifth months is expressed as a CDR. The first four months' CDR is calculated by applying the liquidation rates to the current period past due balances (i.e., the 150-179 day balance is liquidated in the first projected month, the 120-149 day balance is liquidated in the second projected month, the 90-119 day balance is liquidated in the third projected month and the 60-89 day balance is liquidated in the fourth projected month). For the fifth month the CDR is calculated using the average 30-59 day past due balances for the prior three months. The fifth month CDR is then used as the basis for the plateau period that follows the embedded five months of losses.

As of December 31, 2012, for the base case scenario, the CDR (the "plateau CDR") was held constant for one month. Once the plateau period has ended, the CDR is assumed to gradually trend down in uniform increments to its final long-term steady state CDR. In the base case scenario, the time over which the CDR trends down to its final CDR is 30 months. Therefore, the total stress period for second lien transactions is 36 months, comprising five months of delinquent data, a one month plateau period and 30 months of decrease to the steady state CDR. This is the same as December 31, 2011, but 12 months longer than the total stress period of 24 months (comprising five months of delinquent data, a one month plateau period and 18 months of decrease to the steady state CDR) it used for December 31, 2010. The long-term steady state CDR is calculated as the constant CDR that would have yielded the amount of losses originally expected at underwriting. When a second lien loan defaults, there is generally a very low recovery. Based on current expectations of future performance, the Company assumes that it will only recover 2% of the collateral, the same as December 31, 2011 and December 31, 2010.

The rate at which the principal amount of loans is prepaid may impact both the amount of losses projected (which is a function of the CDR and the loan balance over time) as well as the amount of excess spread (which is the excess of the interest paid by the borrowers on the underlying loan over the amount of interest and expenses owed on the insured obligations). In the base case, the current CPR (based on experience of the most recent three quarters) is assumed to continue until the end of the plateau before gradually increasing to the final CPR over the same period the CDR decreases. For transactions where the initial CPR is higher than the final CPR, the initial CPR is held constant. The final CPR is assumed to be 10% for both HELOC and closed-end second lien transactions. This level is much higher than current rates for most transactions, but lower than the historical average, which reflects the Company's continued uncertainty about the projected performance of the borrowers in these transactions. This pattern is consistent with how the Company modeled the CPR at December 31, 2011 and December 31, 2010. To the extent that prepayments differ from projected levels it could materially change the Company's projected excess spread and losses.

The Company uses a number of other variables in its second lien loss projections, including the spread between relevant interest rate indices, and HELOC draw rates (the amount of new advances provided on existing HELOCs expressed as a percentage of current outstanding advances). For HELOC transactions, the draw rate is assumed to decline from the current level to a final draw rate over a period of three months. The final draw rates were assumed to range from 0.0% to 2.4%.

In estimating expected losses, the Company modeled and probability weighted three possible CDR curves applicable to the period preceding the return to the long-term steady state CDR. The Company believes that the level of the elevated CDR and the length of time it will persist is the primary driver behind the likely amount of losses the collateral will suffer (before considering the effects of repurchases of ineligible loans). The Company continues to evaluate the assumptions affecting its modeling results.

As of December 31, 2012, the Company's base case assumed a one month CDR plateau and a 30 month ramp-down (for a total stress period of 36 months). The Company also modeled a scenario with a longer period of elevated defaults and another with a shorter period of elevated defaults and weighted them the same as of December 31, 2011. Increasing the CDR plateau to four months and increasing the ramp-down by three months to 33-months (for a total stress period of 42 months) would increase the expected loss by approximately $36 million for HELOC transactions and $2 million for closed-end second lien transactions. On the other hand, keeping the CDR plateau at one month but decreasing the length of the CDR ramp-down to 21 months (for a total stress period of 27 months) would decrease the expected loss by approximately $37 million for HELOC transactions and $2 million for closed-end second lien transactions. The length of the total stress period the Company used in its pessimistic scenario December 31, 2012 was three months longer than the total stress period it used at December 31, 2011 and 15 months longer than the total stress period it used at December 31, 2010. On the other hand, the total stress period the Company used in its optimistic scenario at December 31, 2012 was three months shorter than the total stress period it used at December 31, 2011 but nine months longer than the total stress period it used at December 31, 2010.

U.S. First Lien RMBS Loss Projections: Alt-A First Lien, Option ARM, Subprime and Prime

First lien RMBS are generally categorized in accordance with the characteristics of the first lien mortgage loans on one-to-four family homes supporting the transactions. The collateral supporting "subprime RMBS" transactions consists of first-lien residential mortgage loans made to subprime borrowers. A "subprime borrower" is one considered to be a higher risk credit based on credit scores or other risk characteristics. Another type of RMBS transaction is generally referred to as "Alt-A first lien." The collateral supporting such transactions consists of first-lien residential mortgage loans made to "prime" quality borrowers who lack certain ancillary characteristics that would make them prime. When more than 66% of the loans originally included in the pool are mortgage loans with an option to make a minimum payment that has the potential to amortize the loan negatively (*i.e*., increase the amount of principal owed), the transaction is referred to as an "Option ARM." Finally, transactions may be composed primarily of loans made to prime borrowers. First lien RMBS sometimes include a portion of loan collateral that differs in priority from the majority of the collateral.

The performance of the Company's first lien RMBS exposures began to deteriorate in 2007 and such transactions, continue to perform below the Company's original underwriting expectations. The Company currently projects first lien collateral losses many times those expected at the time of underwriting. While insured securities benefited from structural protections within the transactions designed to absorb some of the collateral losses, in many first lien RMBS transactions, projected losses exceed those structural protections.

The majority of projected losses in first lien RMBS transactions are expected to come from non-performing mortgage loans (those that are delinquent or in foreclosure or where the loan has been foreclosed and the RMBS issuer owns the underlying real estate). Changes in the amount of non-performing loans from the amount projected in the previous period are one of the primary drivers of loss development in this portfolio. In order to determine the number of defaults resulting from these delinquent and foreclosed loans, the Company applies a liquidation rate assumption to loans in each of various delinquency categories. The Company arrived at its liquidation rates based on data purchased from a third party, and assumptions about how delays in the foreclosure process may ultimately affect the rate at which loans are liquidated. The liquidation rate is a standard industry measure that is used to estimate the number of loans in a given aging category that will default within a specified time period. The Company projects these liquidations to occur over two years. For both year-end 2012 and year-end 2011 the Company reviewed the data supplied by the third-party provider. Based on its review of that data, the Company maintained the same liquidation assumptions at December 31, 2012 as it had used at December 31, 2011, but these were updated from December 31, 2010. The following table shows liquidation assumptions for various delinquency categories.

First Lien Liquidation Rates

	December 31, 2012	December 31, 2011
30 - 59 Days Delinquent		
Alt-A and Prime	35%	35%
Option ARM	50	50
Subprime	30	30
60 - 89 Days Delinquent		
Alt-A and Prime	55	55
Option ARM	65	65
Subprime	45	45
90 + Days Delinquent		
Alt-A and Prime	65	65
Option ARM	75	75
Subprime	60	60
Bankruptcy		
Alt-A and Prime	55	55
Option ARM	70	70
Subprime	50	50
Foreclosure		
Alt-A and Prime	85	85
Option ARM	85	85
Subprime	80	80
Real Estate Owned		
All	100	100

While the Company uses liquidation rates as described above to project defaults of non-performing loans, it projects defaults on presently current loans by applying a CDR trend. The start of that CDR trend is based on the defaults the Company projects will emerge from currently nonperforming loans. The total amount of expected defaults from the non-performing loans is translated into a constant CDR (*i.e.*, the CDR plateau), which, if applied for each of the next 24 months, would be sufficient to produce approximately the amount of defaults that were calculated to emerge from the various delinquency categories. The CDR thus calculated individually on the delinquent collateral pool for each RMBS is then used as the starting point for the CDR curve used to project defaults of the presently performing loans.

In the base case, after the initial 24-month CDR plateau period, each transaction's CDR is projected to improve over 12 months to an intermediate CDR (calculated as 20% of its CDR plateau); that intermediate CDR is held constant for

36 months and then trails off in steps to a final CDR of 5% of the CDR plateau. Under the Company's methodology, defaults projected to occur in the first 24 months represent defaults that can be attributed to loans that are currently delinquent or in foreclosure, while the defaults projected to occur using the projected CDR trend after the first 24 month period represent defaults attributable to borrowers that are currently performing. The CDR trend the Company used in its base case for December 31, 2012 was the same as it used for December 31, 2011 but had small differences from the one it used for December 31, 2010 (for example, for December 31, 2010 the intermediate CDR was calculated as 15% of the plateau CDR).

Another important driver of loss projections is loss severity, which is the amount of loss the transaction incurs on a loan after the application of net proceeds from the disposal of the underlying property. Loss severities experienced in first lien transactions have reached historic high levels, and the Company is assuming that these high levels generally will continue for another year (in the case of subprime loans, the Company assumes the unprecedented 90% loss severity rate will continue for six months then drop to 80% for six months before following the ramp described below). The Company determines its initial loss severity based on actual recent experience. The Company's loss severity assumptions for December 31, 2012 were the same as it used for December 31, 2011 but, as shown in the table below, higher than the loss severity assumptions it used for December 31, 2010. The Company then assumes that loss severities begin returning to levels consistent with underwriting assumptions beginning in June 2013, and in the base case scenario, decline over two years to 40%.

The following table shows the range of key assumptions used in the calculation of expected loss to be paid for individual transactions for direct vintage 2004 - 2008 first lien U.S. RMBS.

Key Assumptions in Base Case Expected Loss Estimates
First Lien RMBS(1)

	As of December 31, 2012	As of December 31, 2011
Alt-A First Lien		
Plateau CDR	6.8% - 23.2%	5.7% - 41.3%
Intermediate CDR	1.4% - 4.6%	1.1% - 8.3%
Final CDR	0.3% - 1.2%	0.3% - 2.1%
Initial loss severity	65%	65%
Initial CPR	0.0% - 14.3%	0.0% - 15.2%
Final CPR	15%	15%
Option ARM		
Plateau CDR	7.0% - 26.1%	11.7% - 31.5%
Intermediate CDR	1.4% - 5.2%	2.3% - 6.3%
Final CDR	0.4% - 1.3%	0.6% - 1.6%
Initial loss severity	65%	65%
Initial CPR	0.4% - 3.8%	0.3% - 10.8%
Final CPR	15%	15%
Subprime		
Plateau CDR	7.3% - 21.2%	10.3% - 29.9%
Intermediate CDR	1.5% - 4.2%	2.1% - 6.0%
Final CDR	0.5% - 1.3%	0.5% - 1.5%
Initial loss severity	90%	90%
Initial CPR	0.0% - 9.2%	0.0% - 10.6%
Final CPR	15%	15%

(1) Represents variables for most heavily weighted scenario (the "base case").

The rate at which the principal amount of loans is prepaid may impact both the amount of losses projected (since that amount is a function of the conditional default rate, the loss severity and the loan balance over time) as well as the amount of excess spread (the amount by which the interest paid by the borrowers on the underlying loan exceeds the amount of interest owed on the insured obligations). The assumption for the CPR follows a similar pattern to that of the conditional default rate.

The current level of voluntary prepayments is assumed to continue for the plateau period before gradually increasing over 12 months to the final CPR, which is assumed to be either 10% or 15% depending on the scenario run. For transactions where the initial CPR is higher than the final CPR, the initial CPR is held constant. These assumptions are the same as those it used for December 31, 2011 and December 31, 2010.

In estimating expected losses, the Company modeled and probability weighted sensitivities for first lien transactions by varying its assumptions of how fast a recovery is expected to occur. One of the variables used to model sensitivities was how quickly the conditional default rate returned to its modeled equilibrium, which was defined as 5% of the current conditional default rate. The Company also stressed CPR and the speed of recovery of loss severity rates. The Company probability weighted a total of five scenarios (including its base case) as of December 31, 2012. For December 31, 2012 the Company used the same five scenarios and weightings as it used for December 31, 2011 except that for December 31, 2012 it assumed in the most stressful scenario that the recovery would occur three months more slowly and in the most optimistic scenario that it would occur three months more quickly than it had assumed would be the case for December 31, 2011. For December 31, 2010 the Company used only four scenarios, and there were some other differences in the assumptions used for the December 31, 2010 as compared to those used for December 31, 2012. In a somewhat more stressful environment than that of the base case, where the conditional default rate plateau was extended three months (to be 27 months long) before the same more gradual conditional default rate recovery and loss severities were assumed to recover over four rather than two years (and subprime loss severities were assumed to recover only to 60%), expected loss to be paid would increase from current projections by approximately $20 million for Alt-A first liens, $15 million for Option ARM and $96 million for subprime transactions. In an even more stressful scenario where loss severities were assumed to rise and then recover over eight years and the initial ramp-down of the CDR was assumed to occur over 15 months (rather than 12 months as of December 31, 2011) and other assumptions were the same as the other stress scenario), expected loss to be paid would increase from current projections by approximately $56 million for Alt-A first liens, $34 million for Option ARM and $149 million for subprime transactions. The Company also considered two scenarios where the recovery was faster than in its base case. In a scenario with a somewhat less stressful environment than the base case, where conditional default rate recovery was somewhat less gradual and the initial subprime loss severity rate was assumed to be 80% for 12 months and was assumed to recover to 40% over two years, expected loss to be paid would decrease from current projections by approximately $3 million for Alt-A first lien, $26 million for Option ARM and $27 million for subprime transactions. In an even less stressful scenario where the conditional default rate plateau was three months shorter (21 months, effectively assuming that liquidation rates would improve) and the conditional default rate recovery was more pronounced, (including an initial ramp-down of the CDR over nine months rather than 12 months as at December 31, 2011) expected loss to be paid would decrease from current projections by approximately $22 million for Alt-A first lien, $55 million for Option ARM and $56 million for subprime transactions.

Breaches of Representations and Warranties

Generally, when mortgage loans are transferred into a securitization, the loan originator(s) and/or sponsor(s) provide R&W, that the loans meet certain characteristics, and a breach of such R&W often requires that the loan be repurchased from the securitization. In many of the transactions the Company insures, it is in a position to enforce these requirements. The Company uses internal resources as well as third party forensic underwriting firms and legal firms to pursue breaches of R&W. If a provider of R&W refuses to honor its repurchase obligations, the Company may choose to initiate litigation. See "-Recovery Litigation" below.

The Company's success in pursuing R&W claims against a number of counterparties that provided R&W on a loan by loan basis has permitted the Company to pursue reimbursement agreements with R&W providers. Such agreements provide the Company with many of the benefits of pursuing the R&W claims but without the expense and uncertainty of pursuing the R&W claims on a loan by loan basis.

The Company may also employ other strategies as appropriate to avoid or mitigate losses in U.S. RMBS or other areas, including pursuing litigation in areas other than RMBS or entering into other arrangements to alleviate or reduce all or a portion of certain risks.

The Company is pursuing reimbursements for breaches of R&W regarding loan characteristics. Performance of the collateral underlying certain first and second lien securitizations has substantially differed from the Company's original expectations. The Company has employed several loan file diligence firms and law firms as well as devoted internal resources to review the mortgage files surrounding many of the defaulted loans. The Company's success in these efforts has resulted in several negotiated agreements in respect of the Company's R&W claims, including one on April 14, 2011 with Bank of America and one on May 8, 2012 with Deutsche Bank AG.

On April 14, 2011, Assured Guaranty reached a comprehensive agreement with Bank of America Corporation and its subsidiaries, including Countrywide Financial Corporation and its subsidiaries (collectively, “Bank of America”), regarding their liabilities with respect to 29 RMBS transactions insured by Assured Guaranty, including claims relating to reimbursement for breaches of R&W and historical loan servicing issues ("Bank of America Agreement"). Of the 29 RMBS transactions, eight were second lien transactions and 21 were first lien transactions, all of which were financial guaranty insurance except for one first lien in credit derivative form. The Bank of America Agreement covers Bank of America-sponsored securitizations that AGM has insured, as well as certain other securitizations containing concentrations of Countrywide-originated loans that AGM has insured. The AGM-insured transactions covered by the Bank of America Agreement have a gross par outstanding of $2.5 billion ($2.2 billion net par outstanding) as of December 31, 2012.

Bank of America paid $1,043 million (of which $822 million was related to AGM-insured transactions) in 2011 and $57 million in March 2012 (of which $45 million is related to AGM-insured transactions) in respect of Assured Guaranty insured second lien transactions. In consideration of the $1.1 billion, Assured Guaranty has agreed to release its claims for the repurchase of mortgage loans underlying the eight second lien transactions (i.e., Assured Guaranty will retain the risk of future insured losses without further offset for R&W claims against Bank of America).

In addition, Bank of America will reimburse Assured Guaranty 80% of claims Assured Guaranty pays on certain first lien transactions, until aggregate collateral losses on such RMBS transactions reach $6.6 billion. As of December 31, 2012, collateral losses for covered first lien transactions were $3.1 billion (of which $2.8 billion was related to AGM). Assured Guaranty estimates that cumulative projected collateral losses for the covered first lien transactions will be $5.1 billion. Assured Guaranty accounts for the 80% loss sharing agreement with Bank of America as subrogation. As Assured Guaranty calculates expected losses for these first lien transactions, such expected losses will be offset by an R&W benefit from Bank of America for 80% of these amounts. As of December 31, 2012, Bank of America had placed $316 million of eligible assets in trust in order to collateralize the reimbursement obligation relating to the first lien transactions. The amount of assets required to be posted may increase or decrease from time to time, as determined by rating agency requirements. A portion of the covered transactions are insured by the Company. As of December 31, 2012, and before cessions to reinsurers, AGM had collected $291 million, and had invoiced for an additional $17 million in claims paid in December 2012, and expected to collect an additional $254 million, on a discounted basis, for the covered first lien transactions under the Bank of America Agreement.

On May 8, 2012, Assured Guaranty reached a settlement with Deutsche Bank AG and certain of its affiliates (collectively, “Deutsche Bank”), resolving claims related to certain RMBS transactions issued, underwritten or sponsored by Deutsche Bank that were insured by Assured Guaranty under financial guaranty insurance policies and to certain RMBS exposures in re-securitization transactions as to which AGC provides credit protection through CDS. As part of the settlement agreement (the “Deutsche Bank Agreement”), Assured Guaranty settled its litigation against Deutsche Bank on three RMBS transactions.

Assured Guaranty received a cash payment of $166 million from Deutsche Bank upon signing of the Deutsche Bank Agreement, a portion of which partially reimbursed Assured Guaranty for past losses on certain transactions. Assured Guaranty and Deutsche Bank also entered into loss sharing arrangements covering future RMBS related losses, which are described below. Under the Deutsche Bank Agreement, Deutsche Bank AG placed eligible assets in trust in order to collateralize the obligations of a reinsurance affiliate under the loss-sharing arrangements. The Deutsche Bank reinsurance affiliate may be required to post additional collateral in the future to satisfy rating agency requirements. As of December 31, 2012, the balance of the assets held in trust of $44 million was sufficient to fully collateralize Deutsche Bank's obligations, based on the Company's estimate of expected loss for the transactions covered under the agreement.

The settlement includes six AGM and two AGC RMBS transactions (“Covered Transactions”) insured through financial guaranty insurance policies. The Covered Transactions are backed by first lien and second lien mortgage loans. Under the Deutsche Bank Agreement, the Deutsche Bank reinsurance affiliate will reimburse 80% of Assured Guaranty’s future losses on the Covered Transactions until Assured Guaranty’s aggregate losses (including those to date that are partially reimbursed by the $166 million cash payment) reach $319 million. Assured Guaranty currently projects that in the base case the Covered Transactions will not generate aggregate losses in excess of $319 million. In the event aggregate losses exceed $389 million, the Deutsche Bank reinsurance affiliate is required to resume reimbursement at the rate of 85% of Assured Guaranty’s losses in excess of $389 million until such losses reach $600 million. The six AGM Covered Transactions represented $438 million of gross par outstanding ($323 million on a net basis) as of December 31, 2012. AGM and AGC will be reimbursed under the Deutsche Bank Agreement for their respective future losses on the Covered Transactions as they pay claims on such Covered Transactions, and Assured Guaranty quarterly will allocate such reimbursements between the six insurers pro rata based on the cumulative amounts, net of recoveries, paid to date by each insurer with respect to the Covered Transactions.

As of December 31, 2012 and before cessions to reinsurers, the Company collected $4 million and had invoiced for an additional $2 million in claims paid in the fourth quarter 2012.

The settlement does not include AGM's CDS with Deutsche Bank. The parties have agreed to continue efforts to resolve CDS-related claims.

In the fourth quarter of 2012, AGM reached agreement with another R&W provider in an RMBS securitization transaction to repurchase underlying loans in that transaction. Such amount was applied by the securities administrator to the transaction's flow of funds and is available to support the R&W benefit on this transaction, as of December 31, 2012 of $81 million.

The Company has included in its net expected loss estimates as of December 31, 2012 an estimated benefit from loan repurchases related to breaches of R&W of $960 million, which includes $470 million from agreements with and judgments against R&W providers and $490 million in transactions where the Company does not yet have such an agreement or judgment. (Included in $470 million is a credit for amounts awarded in a judgment subject to appeal). Proceeds projected to be reimbursed to the Company on transactions where the Company has already paid claims are viewed as a recovery on paid losses. For transactions where the Company has not already paid claims, projected recoveries reduce projected loss estimates. In either case, projected recoveries have no effect on the amount of the Company's exposure. See "Recovery Litigation" below for a description of the related legal proceedings the Company has commenced.

The Company's success in pursuing breaches of R&W is based upon a detailed review of loan files. The Company reviewed approximately 28,300 second lien and 6,000 first lien loan files (representing approximately $2,173 million and $2,044 million, respectively, of loans) in transactions as to which it eventually reached agreements or won judgment. For the RMBS transactions as to which the Company had not settled its claims or won a judgment for breaches of R&W as of December 31, 2012, the Company had performed a detailed review of approximately 2,800 second lien and 20,800 first lien loan files, representing approximately $203 million in second lien and $6,575 million in first lien outstanding par of loans underlying insured transactions. In the majority of its loan file reviews, the Company identified breaches of one or more R&W regarding the characteristics of the loans, such as misrepresentation of income or employment of the borrower, occupancy, undisclosed debt and non-compliance with underwriting guidelines at loan origination.

Through December 31, 2012 (but including judgments and settlements reached through February 28, 2013) the Company has caused entities providing R&Ws to pay or agree to pay (or has won a judgment requiring them to pay) approximately $2.2 billion (gross of reinsurance) in respect of their R&W liabilities for transactions in which the Company has provided a financial guaranty. Of this, $1.8 billion are payments made or to be made pursuant to agreements with or judgments against R&W providers and approximately $375 million are amounts paid into the relevant RMBS financial guaranty transactions pursuant to the transaction documents in the regular course.

The $1.8 billion of payments made or to be made by R&W providers under agreements with the Company or a judgment against them includes $1.3 billion that has already been received by the Company, as well as $496 million the Company projects receiving in the future pursuant to such currently existing agreements or judgment. Because much of that $496 million is projected to be received through loss-sharing arrangements, the exact amount the Company will receive will depend on actual losses experienced by the covered transactions. This amount is included in the Company's calculated credit for R&W recoveries, described below.

The $375 million paid, by R&W providers were paid in the regular course into the relevant RMBS transactions in accordance with the priority of payments set out in the relevant transaction documents. Because the Company may insure only a portion of the capital structure of a transaction, such payments will not necessarily directly benefit the Company dollar-for-dollar, especially in first lien transactions. However, such payments do reduce collateral pool losses and so usually reduce the Company's expected losses.

The Company did not incorporate any gain contingencies or damages paid from potential litigation in its estimated repurchases. The amount the Company will ultimately recover related to contractual R&W is uncertain and subject to a number of factors including the counterparty's ability to pay, the number and loss amount of loans determined to have breached R&W and, potentially, negotiated settlements or litigation recoveries. As such, the Company's estimate of recoveries is uncertain and actual amounts realized may differ significantly from these estimates. In arriving at the expected recovery from breaches of R&W, the Company considered the creditworthiness of the provider of the R&W, the number of breaches found on defaulted loans, the success rate in resolving these breaches across those transactions where material repurchases have been made and the potential amount of time until the recovery is realized.

The calculation of expected recovery from breaches of R&W involved a variety of scenarios which ranged from the Company recovering substantially all of the losses it incurred due to violations of R&W to the Company realizing limited recoveries. These scenarios were probability weighted in order to determine the recovery incorporated into the Company's estimate of expected losses. This approach was used for both loans that had already defaulted and those assumed to default in the future.

U.S. RMBS Risks with R&W Benefit

	Number of Risks(1) as of		Debt Service as of	
	December 31, 2012	December 31, 2011	December 31, 2012	December 31, 2011
	(dollars in millions)			
Alt-A first lien	10	11	$ 1,023	$ 1,261
Option ARM	7	10	604	1,240
Subprime	5	5	810	892
Closed-end second lien	2	2	120	219
HELOC(2)	5	12	443	2,171
Total	29	40	$ 3,000	$ 5,783

(1) A risk represents the aggregate of the financial guaranty policies that share the same revenue source for purposes of making Debt Service payments.

(2) The decline in number of HELOC risks and Debt Service relates to the final payment from Bank of America for covered HELOC transactions.

The following table provides a breakdown of the development and accretion amount in the roll forward of estimated recoveries associated with alleged breaches of R&W.

	Year Ended December 31,	
	2012	2011
	(in millions)	
Inclusion or removal of deals with breaches of R&W during period	$ 2	$ 80
Change in recovery assumptions as the result of additional file review and recovery success	40	229
Estimated increase (decrease) in defaults that will result in additional (lower) breaches	63	(46)
Results of settlements/judgments	29	433
Accretion of discount on balance	7	15
Total	$ 141	$ 711

The Company assumes that recoveries on second lien transactions that were not subject to the Deutsche Bank Agreement will occur in two to four years from the balance sheet date depending on the scenarios and that recoveries on transactions backed by Alt-A first lien, Option ARM and Subprime loans will occur as claims are paid over the life of the transactions.

The quality of servicing of the mortgage loans underlying an RMBS transaction influences collateral performance and ultimately the amount (if any) of the Company's insured losses. The Company has established a group to mitigate RMBS losses by influencing mortgage servicing, including, if possible, causing the transfer of servicing or establishing special servicing arrangements. “Special servicing” is an industry term referencing more intense servicing applied to delinquent loans aimed at mitigating losses. Special servicing arrangements provide incentives to a servicer to achieve better performance on the mortgage loans it services. As a result of the Assured Guaranty’s efforts, as of February 28, 2013 the servicing of approximately $3.0 billion of mortgage loans had been transferred to a new servicer and another $1.7 billion of mortgage loans were subject to special servicing arrangements. The December 31, 2012 net insured par of the transactions subject to a servicing transfer was $2.7 billion and the net insured par of the transactions subject to a special servicing arrangement was $0.9 billion.

Selected U.S. Public Finance Transactions

U.S. municipalities and related entities have been under increasing pressure over the last few quarters, and a few have filed for protection under the U.S. Bankruptcy Code, entered into state processes designed to help municipalities in fiscal distress or otherwise indicated they may consider not meeting their obligations to make timely payments on their debts. The

Company expects that bondholder rights will be enforced. However, given some of these developments, and the circumstances surrounding each instance, the ultimate outcome cannot be certain. The Company will continue to analyze developments in each of these matters closely. The municipalities whose obligations the Company has insured that have filed for protection under Chapter 9 of the U.S Bankruptcy Code are: Jefferson County, Alabama and Stockton, California. The City Council of Harrisburg, Pennsylvania had also filed a purported bankruptcy petition, which was later dismissed by the bankruptcy court; a receiver for the City of Harrisburg was appointed by the Commonwealth Court of Pennsylvania on December 2, 2011.

The Company has net exposure to Jefferson County, Alabama of $286 million as of December 31, 2012. On November 9, 2011, Jefferson County filed for bankruptcy under Chapter 9 of the U.S. Bankruptcy Code. Part of the Company's net Jefferson County exposure relates to $125 million in sewer revenue exposure. The sewer revenue warrants are secured by a pledge of the net revenues of the sewer system. The bankruptcy court has affirmed that the net revenues constitute a “special revenue” under Chapter 9. Therefore, the lien on net revenues of the sewer system survives the bankruptcy filing and such net revenues are not subject to the automatic stay during the pendency of Jefferson County's bankruptcy case. BNY Mellon, as trustee, had brought a lawsuit regarding the amount of net revenues to which it is entitled. Since its bankruptcy filing, Jefferson County had been withholding estimated bankruptcy-related legal expenses and an amount representing a monthly reserve for future expenditures and depreciation and amortization from the monthly payments it had been making to the trustee from sewer revenues for Debt Service. On June 29, 2012, the Bankruptcy Court ruled that “Operating Expenses” as determined under the bond indenture do not include (1) a reserve for depreciation, amortization, or future expenditures, or (2) an estimate for professional fees and expenses, such that, after payment of Operating Expenses (as defined in the indenture), monies remaining in the Revenue Account created under the bond indenture must be distributed in accordance with the waterfall set forth in the indenture without withholding any monies for depreciation, amortization, reserves, or estimated expenditures that are the subject of this litigation. Whether sufficient net revenues will be available for the payment of regularly scheduled debt service ultimately depends on the bankruptcy court's valuation of the sewer revenue stream. The Company's remaining net exposure of $161 million to Jefferson County relates to obligations that are secured by, or payable from, certain taxes that may have the benefit of a statutory lien or a lien on “special revenues” or other collateral.

On June 28, 2012, the City of Stockton, California filed for bankruptcy under Chapter 9 of the U.S. Bankruptcy Code. The Company's net exposure to Stockton's general fund is $64 million, consisting of pension obligation bonds. As of December 31, 2012, the Company had paid $4 million in net claims.

The Company has $130 million of net par exposure to The City of Harrisburg, Pennsylvania, of which $69 million is BIG. The Company has paid $11 million in net claims as of December 31, 2012, and expects a full recovery.

The Company has $23 million remaining in net par exposure to bonds secured by the excess free cash flow of the Foxwoods Casino, run by the Mashantucket Pequot Tribe. The Company had paid $74 million in net claims as of December 31, 2012, and expects full recovery of such amount.

The Company projects that its total future expected net recovery across its troubled U.S. public finance credits (after projected recoveries of claims already paid) will be $58 million as of December 31, 2012, up from $35 million as of December 31, 2011. This increase was due primarily to the increase in expected recoveries on Foxwoods Casino.

Certain Selected European Country Transactions

The Company insures and reinsures credits with sub-sovereign exposure to various Spanish regions where a Spanish sovereign default causes the regions also to default. The Company's gross exposure to these credits is €435 million and its exposure net of reinsurance is €274 million. During 2012, the Company downgraded most of these exposures to the BB category due to concerns that these regions would not pay under their contractual obligations. As a result the Company estimated a net expected loss of $31 million compared to none as of December 31, 2011. During 2012 the Company paid $183 million in net claims in respect of the €314 million (€146 million net) Greek sovereign bonds it had guaranteed, and no longer has any direct financial guaranty exposure to Greece. Information regarding the Company's exposure to other Selected European Countries may be found under Note 3, Outstanding Exposure, –Economic Exposure to the Selected European Countries.

Manufactured Housing

The Company insures a total of $217 million net par of securities backed by manufactured housing loans, a total of $128 million rated BIG. The Company has expected loss to be paid of $21 million as of December 31, 2012 compared to $18 million as of December 31, 2011.

Infrastructure Finance

The Company has exposure to infrastructure transactions with refinancing risk as to which the Company may need to make claim payments that it did not anticipate paying when the policies were issued; the aggregate amount of the claim payments may be substantial and reimbursement may not occur for an extended time, if at all. For the three largest transactions with significant refinancing risk, the Company may be exposed to, and subsequently recover, payments aggregating $1.4 billion. These transactions generally involve long-term infrastructure projects that are financed by bonds that mature prior to the expiration of the project concession. While the cash flows from these projects were expected to be sufficient to repay all of the debt over the life of the project concession, in order to pay the principal on the early maturing debt, the Company expected it to be refinanced in the market at or prior to its maturity. Due to market dislocation and increased credit spreads, the Company may have to pay a claim at the maturity of the securities, and then recover its payment from cash flows produced by the project in the future. The Company generally projects that in most scenarios it will be fully reimbursed for such payments. However, the recovery of the payments may take a long time and is uncertain. The claim payments are anticipated to occur substantially between 2014 and 2017, while the recoveries could take 20-45 years, depending on the transaction and the performance of the underlying collateral.

Recovery Litigation

RMBS Transactions

As of the date of this filing, AGM has lawsuits pending against a number of providers of representations and warranties in U.S. RMBS transactions insured by them, seeking damages. In all the lawsuits, AGM has alleged breaches of R&W in respect of the underlying loans in the transactions, and failure to cure or repurchase defective loans identified by AGM to such persons. In addition, in the lawsuits against DLJ Mortgage Capital, Inc. (“DLJ”) and Credit Suisse Securities (USA) LLC (“Credit Suisse”) and UBS Real Estate Securities Inc. ("UBS"), AGM has alleged breaches of contract in procuring falsely inflated shadow ratings (a condition to the issuance by AGM of its policies) by providing false and misleading information to the rating agencies:

- **Flagstar**: AGM has sued Flagstar Bank, FSB, Flagstar Capital Markets Corporation and Flagstar ABS, LLC in the United States District Court for the Southern District of New York on the Flagstar Home Equity Loan Trust, Series 2005-1 and Series 2006-2 second lien transactions. On February 5, 2013, the court granted judgment in favor of AGM on its claims for breach of contract plus contractual interest and attorneys' fees and costs to be determined. On April 1, 2013, the court issued a final judgment awarding AGM damages of $90.7 million and pre-judgment interest of $15.9 million, for a total of $106.5 million. The court deferred ruling on AGM's requests for attorneys' fees and expenses until the resolution of any appeal by Flagstar of the final judgment. On April 10, 2013, Flagstar Bank filed a notice of appeal indicating that it appeals both the February 5, 2013 order and the April 1, 2013 final judgment.

- **Deutsche Bank**: AGM has sued Deutsche Bank AG affiliates DB Structured Products, Inc. and ACE Securities Corp. in the Supreme Court of the State of New York on the ACE Securities Corp. Home Equity Loan Trust, Series 2006-GP1 second lien transaction.

- **ResCap**: AGM has sued GMAC Mortgage, LLC (formerly GMAC Mortgage Corporation; Residential Asset Mortgage Products, Inc.; Ally Bank (formerly GMAC Bank); Residential Funding Company, LLC (formerly Residential Funding Corporation); Residential Capital, LLC (formerly Residential Capital Corporation, "ResCap"); Ally Financial (formerly GMAC, LLC); and Residential Funding Mortgage Securities II, Inc. in the United States District Court for the Southern District of New York on the GMAC RFC Home Equity Loan-Backed Notes, Series 2006-HSA3 and GMAC Home Equity Loan-Backed Notes, Series 2004-HE3 second lien transactions. On May 14, 2012, ResCap and several of its affiliates (the “Debtors”) filed for Chapter 11 protection with the U.S. Bankruptcy Court. The automatic stay of Bankruptcy Code Section 362 (a) stays lawsuits (such as the suit brought by AGM) against the Debtors and AGM, the Debtors and the non-Debtor affiliates have filed a stipulation with the court agreeing to extend the stay to the non-Debtor affiliates until April 30, 2013.

- **Credit Suisse**: AGM and its affiliate AGC have sued DLJ and Credit Suisse in the Supreme Court of the State of New York on first lien U.S. RMBS transactions insured by them. The ones insured by AGM are: CSAB Mortgage-Backed Pass Through Certificates, Series 2006-2; CSAB Mortgage-Backed Pass Through Certificates, Series 2006-3; CSAB Mortgage-Backed Pass Through Certificates, Series 2006-4; and CMSC Mortgage-Backed Pass Through Certificates, Series 2007-3. On December 6, 2011, DLJ and Credit Suisse filed a motion to dismiss the cause of action asserting breach of the document containing the condition precedent regarding the rating of the securities and claims for recissionary damages and other relief in the complaint, and on October 11, 2012, the Supreme Court of the State of New York granted the motion to dismiss. AGM and AGC intend to appeal the dismissal of certain of its claims. The causes of action against DLJ for breach of R&W and breach of its repurchase obligations remain.

- **UBS**: AGM has sued UBS in the Supreme Court of the State of New York on the MASTR Adjustable Rate Mortgages Trust 2006-OA2, MASTR Adjustable Rate Mortgages Trust 2007-1 and MASTR Adjustable Rate Mortgages Trust 2007-3 first lien transactions. The case was later removed to the United States District Court for the Southern District of New York. In April 2012, UBS filed a motion to dismiss the complaint and in August 2012, the court rejected the motion to dismiss as to AGM's claims of breach of R&W and for recissory damages. It also upheld AGM's breach of warranty claim related to the shadow ratings issued with respect to the transactions. The motion to dismiss was granted against AGM's claims for breach of the repurchase obligation, which the court held could only be enforced by the trustee of the applicable trusts, and for declaratory judgments that UBS failed to cure breaches and for reimbursement of all insurance payments made to UBS. On September 28, 2012, at the direction of AGM, the trustee of the trusts filed a breach of contract complaint against UBS on behalf of the applicable trusts.

On March 26, 2013, AGM filed a lawsuit against RBS Securities Inc., RBS Financial Products Inc. and Financial Asset Securities Corp. (collectively, “RBS”) in the United States District Court for the Southern District of New York on the Soundview Home Loan Trust 2007-WMC1 transaction. The complaint alleges that RBS made fraudulent misrepresentations to AGM regarding the quality of the underlying mortgage loans in the transaction and that RBS's misrepresentations induced AGM into issuing a financial guaranty insurance policy in respect of the Class II-A-1 certificates issued in the transaction.

AGM also has a lawsuit pending against UBS Securities LLC, as underwriter, as well as several named and unnamed control persons of IndyMac Bank, FSB and related IndyMac entities, that it filed in September 2010 in California state court on the IndyMac IMSC Mortgage Loan Trust, Series 2007-HOA-1a first lien transaction (the "HOA1 Transaction"), seeking damages for alleged violations of state securities laws and breach of contract, among other claims. In addition, on August 9, 2012, AGM filed a complaint in California state court against OneWest Bank, FSB, the servicer of the mortgage loans underlying the HOA1 Transaction and the IndyMac Home Equity Mortgage Loan Asset-Backed Trust, Series 2007-H1 HELOC transaction seeking damages, specific performance and declaratory relief in connection with OneWest failing to properly service the mortgage loans.

Public Finance Transactions

In June 2010, AGM sued JPMorgan Chase Bank, N.A. and JPMorgan Securities, Inc. (together, “JPMorgan”), the underwriter of debt issued by Jefferson County, in the Supreme Court of the State of New York alleging that JPMorgan induced AGM to issue its insurance policies in respect of such debt through material and fraudulent misrepresentations and omissions, including concealing that it had secured its position as underwriter and swap provider through bribes to Jefferson County commissioners and others. In December 2010, the court denied JPMorgan’s motion to dismiss. AGM has filed a motion with the Jefferson County bankruptcy court to confirm that continued prosecution of the lawsuit against JPMorgan will not violate the automatic stay applicable to Jefferson County notwithstanding JPMorgan’s interpleading of Jefferson County into the lawsuit. AGM is continuing its risk remediation efforts for this exposure.

In September 2010, AGM, together with TD Bank, National Association and Manufacturers and Traders Trust Company, as trustees, filed a complaint in the Court of Common Pleas of Dauphin County, Pennsylvania against The Harrisburg Authority, The City of Harrisburg, Pennsylvania, and the Treasurer of the City in connection with certain Resource Recovery Facility bonds and notes issued by The Harrisburg Authority, alleging, among other claims, breach of contract by both The Harrisburg Authority and The City of Harrisburg, and seeking remedies including an order of mandamus compelling the City to satisfy its obligations on the defaulted bonds and notes and the appointment of a receiver for The Harrisburg Authority. Acting on its own, the City Council of Harrisburg filed a purported bankruptcy petition for the City in October 2011, which petition and a subsequent appeal were dismissed by the bankruptcy court in November 2011. The City Council appealed the dismissal of the appeal and such appeal was dismissed as untimely both by the District Court and the Third Circuit Court of Appeals. As a result of the dismissal, the actions brought by AGM and the trustees against The City of Harrisburg and The Harrisburg Authority are no longer stayed. A receiver for The City of Harrisburg (the “City Receiver”) was appointed by the Commonwealth Court of Pennsylvania in December 2011. The City Receiver filed a motion to intervene in the mandamus action and action for the appointment of a receiver for the resource recovery facility. In March 2012, the Court of Common Pleas of Dauphin County, Pennsylvania issued an order granting the motion for the appointment of a receiver for the resource recovery facility, which order has been appealed by The Harrisburg Authority.

7. Financial Guaranty Insurance Losses

Accounting Policies

Loss and LAE Reserve

Loss and LAE reserve reported on the balance sheet relates only to direct and assumed reinsurance contracts that are accounted for as insurance, substantially all of which are financial guaranty insurance contracts. The corresponding reserve ceded to reinsurers is reported as reinsurance recoverable on unpaid losses. As discussed in Note 8, Fair Value Measurement, contracts that meet the definition of a derivative, as well as consolidated FG VIE assets and liabilities, are recorded separately at fair value.

Under financial guaranty insurance accounting, the sum of unearned premium reserve (deferred premium revenue, less claim payments that have not yet been expensed or "contra-paid"), and loss and LAE reserve represents the Company's stand-ready obligation. At contract inception, the entire stand-ready obligation is represented by unearned premium reserve. A loss and LAE reserve for an insurance contract is only recorded when the expected loss to be paid plus contra-paid ("total losses") exceed the deferred premium revenue on a contract by contract basis.

When a claim payment is made on a contract it first reduces any recorded loss and LAE reserve. To the extent a loss and LAE reserve is not recorded on a contract, which occurs when total losses are less than deferred premium revenue, or to the extent loss and LAE reserve is not sufficient to cover a claim payment, then such claim payment is recorded as "contra-paid," which reduces the unearned premium reserve. The contra-paid is recognized in the line item "loss and LAE" in the consolidated statement of operations when and for the amount that total losses exceed the remaining deferred premium revenue on the insurance contract. Loss and LAE in the consolidated statement of operations is presented net of cessions to reinsurers.

Salvage and Subrogation Recoverable

When the Company becomes entitled to the cash flow from the underlying collateral of an insured credit under salvage and subrogation rights as a result of a claim payment or estimated future claim payment, it reduces the expected loss to be paid on the contract. Such reduction in expected to be paid can result in one of the following:

- a reduction in the corresponding loss and LAE reserve with a benefit to the income statement,
- no entry recorded, if "total loss" is not in excess of deferred premium revenue, or
- the recording of a salvage asset with a benefit to the income statement if the transaction is in a net recovery position at the reporting date.

The Company recognizes the expected recovery of claim payments made by an acquired subsidiary, including recoveries from settlement with R&W providers, prior to the date of acquisition consistent with its policy for recognizing recoveries on all financial guaranty insurance contracts. To the extent that the estimated amount of recoveries increases or decreases, due to changes in facts and circumstances, including the examination of additional loan files and our experience in recovering loans put back to the originator, the Company would recognize a benefit or expense consistent with how changes in the expected recovery of all other claim payments are recorded. The ceded component of salvage and subrogation is recorded in the line item reinsurance balances payable.

Expected Loss to be Expensed

Expected loss to be expensed represents past or future net claim payments that have not yet been expensed. Such amounts will be expensed in future periods as deferred premium revenue amortizes into income on financial guaranty insurance policies. Expected loss to be expensed is important because it presents the Company's projection of incurred losses that will be recognized in future periods, based on current expected losses to be paid.

Insurance Contracts' Loss Information

The following table provides balance sheet information on loss and LAE reserves, net of reinsurance and salvage and subrogation recoverable.

Loss and LAE Reserve (Recovery),
Net of Reinsurance and Salvage and Subrogation Recoverable
Insurance Contracts

	As of December 31, 2012			As of December 31, 2011		
	Loss and LAE Reserve, net	Salvage and Subrogation Recoverable, net	Net	Loss and LAE Reserve, net	Salvage and Subrogation Recoverable, net	Net
	(in millions)					
U.S. RMBS:						
First lien:						
Alt-A first lien	$ 52	$ —	$ 52	$ 31	$ 55	$ (24)
Option ARM	29	213	(184)	109	123	(14)
Subprime	78	—	78	42	—	42
Total first lien	159	213	(54)	182	178	4
Second lien:						
Closed-end second lien	—	71	(71)	0	68	(68)
HELOC	—	169	(169)	—	151	(151)
Total second lien	—	240	(240)	0	219	(219)
Total U.S. RMBS	159	453	(294)	182	397	(215)
Other structured finance	10	—	10	40	—	40
U.S. public finance	16	86	(70)	11	56	(45)
Non-U.S. public finance	23	—	23	28	—	28
Subtotal	208	539	(331)	261	453	(192)
Effect of consolidating FG VIEs	(53)	(217)	164	(43)	(191)	148
Total (1)	$ 155	$ 322	$ (167)	$ 218	$ 262	$ (44)

(1) See "Components of Net Reserves (Salvage)" table for loss and LAE reserve and salvage and subrogation recoverable components.

The following table reconciles the loss and LAE reserve and salvage and subrogation components on the consolidated balance sheet to the financial guaranty net reserves (salvage) in the financial guaranty BIG transaction loss summary tables.

Components of Net Reserves (Salvage)
Insurance Contracts

	As of December 31, 2012	As of December 31, 2011
	(in millions)	
Loss and LAE reserve	$ 230	$ 297
Reinsurance recoverable on unpaid losses	(75)	(79)
Subtotal	155	218
Salvage and subrogation recoverable	(383)	(316)
Salvage and subrogation payable(1)	61	54
Subtotal	(322)	(262)
Financial guaranty net reserves (salvage)	$ (167)	$ (44)

(1) Recorded as a component of reinsurance balances payable.

Balance Sheet Classification of
Net Expected Recoveries for Breaches of R&W

	As of December 31, 2012			As of December 31, 2011		
	For all Financial Guaranty Insurance Contracts	Effect of Consolidating FG VIEs	Reported on Balance Sheet (1)	For all Financial Guaranty Insurance Contracts	Effect of Consolidating FG VIEs	Reported on Balance Sheet (1)
			(in millions)			
Salvage and subrogation recoverable	$ 393	$ (170)	$ 223	$ 293	$ (131)	$ 162
Loss and LAE reserve	455	(11)	444	706	(31)	675

(1) The remaining benefit for R&W is not recorded on the balance sheet until the expected loss, net of R&W, exceeds unearned premium reserve.

The table below provides a reconciliation of net expected loss to be paid to net expected loss to be expensed. Expected loss to be paid differs from expected loss to be expensed due to: (1) the contra-paid which represent the payments that have been made but have not yet been expensed, (2) for transactions with a net expected recovery, the addition of claim payments that have been made (and therefore are not included in expected loss to be paid) that are expected to be recovered in the future (and therefore have reduced expected loss to be paid), and (3) loss reserves that have already been established (and therefore expensed but not yet paid).

Reconciliation of Net Expected Loss to be Paid and
Net Expected Loss to be Expensed
Insurance Contracts

	As of December 31, 2012
	(in millions)
Net expected loss to be paid	$ 5
Less: net expected loss to be paid for FG VIEs	(112)
Total	117
Contra-paid, net	113
Salvage and subrogation recoverable, net of reinsurance	322
Loss and LAE reserve, net of reinsurance	(155)
Net expected loss to be expensed (1)	$ 397

(1) Excludes $150 million as of December 31, 2012 related to consolidated FG VIEs.

The following table provides a schedule of the expected timing of net expected losses to be expensed. The amount and timing of actual loss and LAE may differ from the estimates shown below due to factors such as refundings, accelerations, commutations, changes in expected lives and updates to loss estimates. A loss and LAE reserve is only recorded for the amount by which expected loss to be expensed exceeds deferred premium revenue determined on a contract-by-contract basis. This table excludes amounts related to consolidated FG VIEs, which are eliminated in consolidation.

Net Expected Loss to be Expensed
Insurance Contracts

	As of December 31, 2012
	(in millions)
2013 (January 1 - March 31)	$ 18
2013 (April 1 - June 30)	18
2013 (July 1- September 30)	16
2013 (October 1 - December 31)	14
Subtotal 2013	66
2014	43
2015	37
2016	32
2017	32
2018-2022	108
2023-2027	46
2028-2032	20
After 2032	13
Total present value basis(1)	397
Discount	95
Total future value	$ 492

(1) Consolidation of FG VIEs resulted in reductions of $150 million in net expected loss to be expensed.

The following table presents the loss and LAE recorded in the consolidated statements of operations by sector for non-derivative contracts. Amounts presented are net of reinsurance.

Loss and LAE Reported on the Consolidated Statements of Operations

	Year Ended December 31, 2012	Year Ended December 31, 2011
	(in millions)	
U.S. RMBS:		
First lien:		
Alt-A first lien	$ 47	$ 47
Option ARM	112	242
Subprime	40	(9)
Total first lien	199	280
Second lien:		
Closed-end second lien	35	6
HELOC	29	117
Total second lien	64	123
Total U.S. RMBS	263	403
Other structured finance	(21)	25
U.S. public finance	25	14
Non-U.S. public finance	182	29
Subtotal	449	471
Effect of consolidating FG VIEs	(52)	(89)
Total loss and LAE	$ 397	$ 382

The following table provides information on non-derivative financial guaranty insurance contracts categorized as BIG.

Financial Guaranty Insurance
BIG Transaction Loss Summary
December 31, 2012

	BIG Categories								
	BIG 1		BIG 2		BIG 3				
	Gross	Ceded	Gross	Ceded	Gross	Ceded	Total BIG, Net	Effect of Consolidating VIEs	Total
	(dollars in millions)								
Number of risks(1)	71	(66)	21	(21)	50	(50)	142	—	142
Remaining weighted-average contract period (in years)	9.5	9.6	9.3	15.6	5.3	6.8	7.4	—	7.4
Outstanding exposure:									
Principal	$ 6,004	$ (2,281)	$ 1,820	$ (180)	$ 4,680	$ (788)	$ 9,255	$ —	$ 9,255
Interest	2,583	(893)	982	(179)	1,157	(240)	3,410	—	3,410
Total(2)	$ 8,587	$ (3,174)	$ 2,802	$ (359)	$ 5,837	$ (1,028)	$ 12,665	$ —	$ 12,665
Expected cash outflows (inflows)	$ 1,535	$ (900)	$ 733	$ (64)	$ 1,827	$ (250)	$ 2,881	$ (617)	$ 2,264
Potential recoveries(3)	(1,586)	883	(475)	22	(1,818)	209	(2,765)	713	(2,052)
Subtotal	(51)	(17)	258	(42)	9	(41)	116	96	212
Discount	(2)	6	(78)	15	(59)	7	(111)	16	(95)
Present value of expected cash flows	$ (53)	$ (11)	$ 180	$ (27)	$ (50)	$ (34)	$ 5	$ 112	$ 117
Deferred premium revenue	$ 93	$ (36)	$ 211	$ (17)	$ 728	$ (122)	$ 857	$ (244)	$ 613
Reserves (salvage)(4)	$ (100)	$ 6	$ 49	$ (15)	$ (266)	$ (5)	$ (331)	$ 164	$ (167)

Financial Guaranty Insurance
BIG Transaction Loss Summary
December 31, 2011

	BIG Categories								
	BIG 1		BIG 2		BIG 3		Total BIG, Net	Effect of Consolidating VIEs	Total
	Gross	Ceded	Gross	Ceded	Gross	Ceded			
	(dollars in millions)								
Number of risks(1)	77	(73)	26	(26)	47	(47)	150	—	150
Remaining weighted-average contract period (in years)	7.9	9.5	12.3	20.6	6.2	6.6	7.5	—	7.5
Outstanding exposure:									
Principal	$ 6,721	$ (2,084)	$ 2,727	$ (415)	$ 4,914	$ (844)	$ 11,019	$ —	$ 11,019
Interest	2,269	(732)	2,002	(575)	1,337	(234)	4,067	—	4,067
Total(2)	$ 8,990	$ (2,816)	$ 4,729	$ (990)	$ 6,251	$ (1,078)	$ 15,086	$ —	$ 15,086
Expected cash outflows (inflows)	$ 1,590	$ (871)	$ 1,470	$ (141)	$ 1,749	$ (165)	$ 3,632	$ (877)	$ 2,755
Potential recoveries(3)	(1,657)	882	(910)	45	(1,690)	122	(3,208)	892	(2,316)
Subtotal	(67)	11	560	(96)	59	(43)	424	15	439
Discount	17	(6)	(180)	37	8	3	(121)	46	(75)
Present value of expected cash flows	$ (50)	$ 5	$ 380	$ (59)	$ 67	$ (40)	$ 303	$ 61	$ 364
Deferred premium revenue	$ 250	$ (91)	$ 265	$ (15)	$ 962	$ (169)	$ 1,202	$ (386)	$ 816
Reserves (salvage)(4)	$ (92)	$ 14	$ 201	$ (49)	$ (276)	$ 10	$ (192)	$ 148	$ (44)

(1) A risk represents the aggregate of the financial guaranty policies that share the same revenue source for purposes of making Debt Service payments. The ceded number of risks represents the number of risks for which the Company ceded a portion of its exposure.

(2) Includes BIG amounts related to FG VIEs.

(3) Includes estimated future recoveries for breaches of R&W as well as excess spread, and draws on HELOCs.

(4) See table "Components of net reserves (salvage)."

Ratings Impact on Financial Guaranty Business

A downgrade of the Company may result in increased claims under financial guaranties issued by the Company if the insured obligors were unable to pay.

For example, AGM has issued financial guaranty insurance policies in respect of the obligations of municipal obligors under interest rate swaps. Under the swaps, AGM insures periodic payments owed by the municipal obligors to the bank counterparties. Under certain of the swaps, AGM also insures termination payments that may be owed by the municipal obligors to the bank counterparties. If (i) AGM has been downgraded below the rating trigger set forth in a swap under which it has insured the termination payment, which rating trigger varies on a transaction by transaction basis; (ii) the municipal obligor has the right to cure by, but has failed in, posting collateral, replacing AGM or otherwise curing the downgrade of AGM; (iii) the transaction documents include as a condition that an event of default or termination event with respect to the municipal obligor has occurred, such as the rating of the municipal obligor being downgraded past a specified level, and such condition has been met; (iv) the bank counterparty has elected to terminate the swap; (v) a termination payment is payable by the municipal obligor; and (vi) the municipal obligor has failed to make the termination payment payable by it, then AGM would be required to pay the termination payment due by the municipal obligor, in an amount not to exceed the policy limit set forth in the financial guaranty insurance policy. The claim payments would be subject to recovery from the municipal obligor. As a result of the January 2013 Moody's downgrade of the financial strength rating of AGM, if the conditions giving rise to the obligation of AGM to make a payment under the swap policies were all satisfied, then AGM could pay claims in an amount not exceeding $109 million in respect of such termination payments. Taking into consideration whether the rating of the municipal obligor is below any applicable specified trigger, if the financial strength ratings of AGM were further downgraded below "A" by S&P or below "A2" by Moody's, and the conditions giving rise to the obligation of AGM to make a payment under the swap policies were all satisfied, then AGM could pay claims in an additional amount not exceeding $258 million in respect of such termination payments.

As another example, with respect to variable rate demand obligations ("VRDOs") for which a bank has agreed to provide a liquidity facility, a downgrade of AGM may provide the bank with the right to give notice to bondholders that the bank will terminate the liquidity facility, causing the bondholders to tender their bonds to the bank. Bonds held by the bank accrue interest at a "bank bond rate" that is higher than the rate otherwise borne by the bond (typically the prime rate plus 2.00% — 3.00%, and capped at the lesser of 25% and the maximum legal limit). In the event the bank holds such bonds for longer than a specified period of time, usually 90-180 days, the bank has the right to demand accelerated repayment of bond principal, usually through payment of equal installments over a period of not less than five years. In the event that a municipal obligor is unable to pay interest accruing at the bank bond rate or to pay principal during the shortened amortization period, a claim could be submitted to AGM or AGC under its financial guaranty policy. As of December 31, 2012, AGM had insured approximately $8.2 billion net par of VRDOs, of which approximately $338 million of net par constituted VRDOs issued by municipal obligors rated BBB- or lower pursuant to the Company's internal rating. As of the date of this filing, the Company has not been notified that a bank has terminated a liquidity facility as a result of the January 2013 Moody's downgrade, nor has there been a failed remarketing of the AGM VRDOs, although in some cases, VRDOs insured by AGM have remarketed at higher interest rates. The specific terms relating to the rating levels that trigger the bank's termination right, and whether it is triggered by a downgrade by one rating agency or a downgrade by all rating agencies then rating the insurer, vary depending on the transaction.

8. Fair Value Measurement

The Company carries a significant portion of its assets and liabilities at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (i.e., exit price). The price represents the price available in the principal market for the asset or liability. If there is no principal market, then the price is based on a hypothetical market that maximizes the value received for an asset or minimizes the amount paid for a liability (i.e., the most advantageous market).

Fair value is based on quoted market prices, where available. If listed prices or quotes are not available, fair value is based on either internally developed models that primarily use, as inputs, market-based or independently sourced market parameters, including but not limited to yield curves, interest rates and debt prices or with the assistance of an independent third-party using a discounted cash flow approach and the third party's proprietary pricing models. In addition to market information, models also incorporate transaction details, such as maturity of the instrument and contractual features designed to reduce the Company's credit exposure, such as collateral rights as applicable.

Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments include amounts to reflect counterparty credit quality, the Company's creditworthiness and constraints on liquidity. As markets and products develop and the pricing for certain products becomes more or less transparent, the Company may refine its methodologies and assumptions. During 2012, no changes were made to the Company's valuation models that had or are expected to have, a material impact on the Company's consolidated balance sheets or statements of operations and comprehensive income.

The Company's methods for calculating fair value produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. The use of different methodologies or assumptions to determine fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

The fair value hierarchy is determined based on whether the inputs to valuation techniques used to measure fair value are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect Company estimates of market assumptions. The fair value hierarchy prioritizes model inputs into three broad levels as follows, with Level 1 being the highest and Level 3 the lowest. An asset or liability's categorization within the fair value hierarchy is based on the lowest level of significant input to its valuation.

Level 1—Quoted prices for identical instruments in active markets. The Company generally defines an active market as a market in which trading occurs at significant volumes. Active markets generally are more liquid and have a lower bid-ask spread than an inactive market.

Level 2—Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and observable inputs other than quoted prices, such as interest rates or yield curves and other inputs derived from or corroborated by observable market inputs.

Level 3—Model derived valuations in which one or more significant inputs or significant value drivers are unobservable. Financial instruments are considered Level 3 when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. Level 3 financial instruments also include those for which the determination of fair value requires significant management judgment or estimation.

Transfers between Levels 1, 2 and 3 are recognized at the end of the period when the transfer occurs. The Company reviews the classification between Levels 1, 2 and 3 quarterly to determine whether a transfer is necessary. During the periods presented, there were no transfers between Level 1 and Level 2. The committed capital securities ("CCS") were transferred to Level 3 in the fair value hierarchy in the third quarter 2011 because the Company was no longer able to obtain the same level of pricing information as in past quarters. There were no transfers in or out of Level 3 during 2012.

In May 2011, the FASB issued new guidance that develops common requirements for measuring fair value and for disclosing information about fair value measurements to improve the comparability of financial statements prepared in accordance with U.S. GAAP and International Financial Reporting Standards. The new guidance clarifies the application of existing fair value measurement and disclosure requirements, changes certain principles related to measuring fair value, and requires additional disclosures about fair value measurements. The amendments were adopted in the first quarter of 2012. The Company did not have an impact on its financial position and results of operations as a result of these amendments.

Measured and Carried at Fair Value

Fixed Maturity Securities and Short-term Investments

The fair value of bonds in the investment portfolio is generally based on prices received from third party pricing services or alternative pricing sources with reasonable levels of price transparency. The pricing services prepare estimates of fair value measurements using their pricing applications, which include available relevant market information, benchmark curves, benchmarking of like securities, sector groupings, and matrix pricing. Additional valuation factors that can be taken into account are nominal spreads and liquidity adjustments. The pricing services evaluate each asset class based on relevant market and credit information, perceived market movements, and sector news. The market inputs used in the pricing evaluation, listed in the approximate order of priority include: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data and industry and economic events. Benchmark yields have in many cases taken priority over reported trades for securities that trade less frequently. The extent of the use of each input is dependent on the asset class and the market conditions. Given the asset class, the priority of the use of inputs may change or some market inputs may not be relevant. Additionally, the valuation of fixed maturity investments is more subjective when markets are less liquid due to the lack of market based inputs, which may increase the potential that the estimated fair value of an investment is not reflective of the price at which an actual transaction would occur. The vast majority of fixed maturities are classified as Level 2.

Short-term investments, that are traded in active markets, are classified within Level 1 in the fair value hierarchy and are based on quoted market prices. Securities such as discount notes are classified within Level 2 because these securities are typically not actively traded due to their approaching maturity and, as such, their cost approximates fair value.

Prices determined based upon model processes where at least one significant model assumption or input is unobservable, are considered to be Level 3 in the fair value hierarchy. At December 31, 2012, the Company used model processes to price 23 fixed maturity securities, which was 8% or $445 million of the Company's fixed-maturity securities and short-term investments at fair value. Level 3 securities were priced with the assistance of an independent third-party. The pricing is based on a discounted cash flow approach using the third-party's proprietary pricing models. The models use inputs such as projected prepayment speeds; severity assumptions; recovery lag assumptions; estimated default rates (determined on the basis of an analysis of collateral attributes, historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); house price depreciation/appreciation rates based on macroeconomic forecasts and recent trading activity. The yield used to discount the projected cash flows is determined by reviewing various attributes of the bond including collateral type, weighted average life, sensitivity to losses, vintage, and convexity, in conjunction with market data on comparable securities. Significant changes to any of these inputs could materially change the expected timing of cash flows within these securities which is a significant factor in determining the fair value of the securities.

Other Invested Assets

Other invested assets includes certain investments that are carried and measured at fair value on a recurring basis and non-recurring basis, as well as assets not carried at fair value. Within other invested assets, $89 million are carried at fair value on a recurring basis as of December 31, 2012. These assets primarily comprise certain short-term investments and fixed maturity securities classified as trading and are Level 2 in the fair value hierarchy. Also carried at fair value on a recurring basis are $1 million in notes classified as Level 3 in the fair value hierarchy. The fair value of these notes is determined by calculating the present value of the expected cash flows. The unobservable inputs used in the fair value measurement of the notes are discount rate, prepayment speed and default rate.

Within other invested assets, $7 million are carried at fair value on a non-recurring basis as of December 31, 2012. These assets are comprised of mortgage loans which are classified as Level 3 in the fair value hierarchy as there are significant unobservable inputs used in the valuation of such loans. The non-performing portion of these mortgage loans is valued using an average recovery rate. The performing loans are valued using management's determination of future cash flows arising from these loans, discounted at the rate of return that would be required by a market participant. The unobservable inputs used in the fair value measurement of the mortgage loans are discount rate, recovery on delinquent loans, loss severity, prepayment speed and default rate.

Other Assets

Committed Capital Securities

The fair value of CCS, which is recorded in "other assets" on the consolidated balance sheets, represents the difference between the present value of remaining expected put option premium payments under AGM Committed Preferred Trust Securities (the "AGM CPS Securities") agreements, and the estimated present value that the Company would hypothetically have to pay currently for a comparable security (see Note 17, Notes Payable and Credit Facilities). The estimated current cost of the Company's CCS depends on several factors, including broker-dealer quotes for the outstanding securities, the U.S. dollar forward swap curve, London Interbank Offered Rate ("LIBOR") curve projections and the term the securities are estimated to remain outstanding.

In the third quarter 2011, these securities were transferred to Level 3 in the fair value hierarchy because there is a reliance on significant unobservable inputs to the valuation model, including a broker-dealer quote and the Company's estimate of the term the securities will be outstanding. Prior to the third quarter 2011, the significant market inputs used were observable; therefore, the Company classified this fair value measurement as Level 2. The Company is no longer able to obtain the same level of pricing information as in past quarters.

Financial Guaranty Contracts Accounted for as Credit Derivatives

The Company's credit derivatives consist primarily of insured CDS contracts, and also include interest rate swaps that fall under derivative accounting standards requiring fair value accounting through the statement of operations. The Company does not enter into CDS with the intent to trade these contracts and the Company may not unilaterally terminate a CDS contract absent an event of default or termination event that entitles the Company to terminate; however, the Company has mutually agreed with various counterparties to terminate certain CDS transactions. Such terminations generally are completed for an amount that approximates the present value of future premiums, not at fair value.

The terms of the Company's CDS contracts differ from more standardized credit derivative contracts sold by companies outside the financial guaranty industry. Management considers the non-standard terms of its credit derivative contracts in determining the fair value of these contracts. The non-standard terms include the absence of collateral support agreements or immediate settlement provisions. In addition, the Company employs relatively high attachment points and does not exit derivatives it sells or purchases for credit protection purposes, except under specific circumstances such as mutual agreements with counterparties to terminate certain CDS contracts.

Due to the lack of quoted prices for its instruments or for similar instruments, the Company determines the fair value of its credit derivative contracts primarily through modeling that uses various inputs to derive an estimate of the fair value of the Company's contracts in principal markets. Observable inputs other than quoted market prices exist; however, these inputs reflect contracts that do not contain terms and conditions similar to the credit derivative contracts issued by the Company. Management does not believe there is an established market where financial guaranty insured credit derivatives are actively traded. The terms of the protection under an insured financial guaranty credit derivative do not, except for certain rare circumstances, allow the Company to exit its contracts. Management has determined that the exit market for the Company's credit derivatives is a hypothetical one based on its entry market. Management has tracked the historical pricing of the Company's deals to establish historical price points in the hypothetical market that are used in the fair value calculation. These contracts are classified as Level 3 in the fair value hierarchy since there is reliance on at least one unobservable input deemed significant to the valuation model, most importantly the Company's estimate of the value of the non-standard terms and conditions of its credit derivative contracts and of the Company's current credit standing.

The Company's models and the related assumptions are continuously reevaluated by management and enhanced, as appropriate, based upon improvements in modeling techniques and availability of more timely and relevant market information.

The fair value of the Company's credit derivative contracts represents the difference between the present value of remaining net premiums the Company expects to receive or pay for the credit protection under the contract and the estimated present value of premiums that a financial guarantor of comparable credit-worthiness would hypothetically charge or pay the Company for the same protection. The fair value of the Company's credit derivatives depends on a number of factors, including notional amount of the contract, expected term, credit spreads, changes in interest rates, the credit ratings of referenced entities, the Company's own credit risk and remaining contractual cash flows. The expected remaining contractual cash flows are the most readily observable inputs since they are based on the CDS contractual terms. These cash flows include premiums to be received or paid under the terms of the contract. Credit spreads capture the effect of recovery rates and performance of underlying assets of these contracts, among other factors. If credit spreads of the underlying obligations change, the fair value of the related credit derivative changes. Market liquidity also affects valuations of the underlying obligations. Market conditions at December 31, 2012 were such that market prices of the Company's CDS contracts were not available. Since market prices were not available, the Company used proprietary valuation models that used both unobservable and observable market data inputs as described under "Assumptions and Inputs" below. These models are primarily developed internally based on market conventions for similar transactions.

Valuation models include management estimates and current market information. Management is also required to make assumptions of how the fair value of credit derivative instruments is affected by current market conditions. Management considers factors such as current prices charged for similar agreements, when available, performance of underlying assets, life of the instrument, and the nature and extent of activity in the financial guaranty credit derivative marketplace. The assumptions that management uses to determine the fair value may change in the future due to market conditions. Due to the inherent uncertainties of the assumptions used in the valuation models to determine the fair value of these credit derivative products, actual experience may differ from the estimates reflected in the Company's consolidated financial statements and the differences may be material.

Assumptions and Inputs

Listed below are various inputs and assumptions that are key to the establishment of the Company's fair value for CDS contracts.

- How gross spread is calculated.
- The allocation of gross spread among:
  - the profit the originator, usually an investment bank, realizes for putting the deal together and funding the transaction ("bank profit");
  - premiums paid to the Company for the Company's credit protection provided ("net spread"); and
  - the cost of CDS protection purchased by the originator to hedge their counterparty credit risk exposure to the Company ("hedge cost").
- The weighted average life which is based on expected remaining contractual cash flows and Debt Service schedules, which are readily observable inputs since they are based on the CDS contractual terms.
- The rates used to discount future expected cash flows.

The expected future premium cash flows for the Company's credit derivatives were discounted at rates ranging from 0.25% to 2.8% at December 31, 2012 and 0.3% to 2.7% at December 31, 2011.

Gross spread is used to ultimately determine the net spread a comparable financial guarantor would charge the Company to transfer its risk at the reporting date. The Company obtains gross spreads on risks assumed from market data sources published by third parties (e.g. dealer spread tables for the collateral similar to assets within the Company's transactions) as well as collateral-specific spreads provided by trustees or obtained from market sources. If observable market credit spreads are not available or reliable for the underlying reference obligations, then market indices are used that most closely resemble the underlying reference obligations, considering asset class, credit quality rating and maturity of the underlying reference obligations. These indices are adjusted to reflect the non-standard terms of the Company's CDS contracts. Market sources determine credit spreads by reviewing new issuance pricing for specific asset classes and receiving price quotes from their trading desks for the specific asset in question. Management validates these quotes by cross-referencing quotes received from one market source against quotes received from another market source to ensure reasonableness. In addition, the Company compares the relative change in price quotes received from one quarter to another, with the relative change experienced by published market indices for a specific asset class. Collateral specific spreads obtained from third-party, independent market sources are un-published spread quotes from market participants or market traders who are not trustees. Management obtains this information as the result of direct communication with these sources as part of the valuation process.

With respect to CDS transactions for which there is an expected claim payment within the next twelve months, the allocation of gross spread reflects a higher allocation to the cost of credit rather than the bank profit component. In the current market, it is assumed that a bank would be willing to accept a lower profit on distressed transactions in order to remove these transactions from its financial statements.

The following spread hierarchy is utilized in determining which source of gross spread to use, with the rule being to use CDS spreads where available. If not available, the Company either interpolates or extrapolates CDS spreads based on similar transactions or market indices.

- Actual collateral specific credit spreads (if up-to-date and reliable market-based spreads are available).
- Deals priced or closed during a specific quarter within a specific asset class and specific rating.
- Credit spreads interpolated based upon market indices.
- Credit spreads provided by the counterparty of the CDS.
- Credit spreads extrapolated based upon transactions of similar asset classes, similar ratings, and similar time to maturity.

Information by Credit Spread Type

	As of December 31, 2012	As of December 31, 2011
Based on actual collateral specific spreads	0%	0%
Based on market indices	100%	100%
Total	100%	100%

Over time the data inputs can change as new sources become available or existing sources are discontinued or are no longer considered to be the most appropriate. It is the Company's objective to move to higher levels on the hierarchy whenever possible, but it is sometimes necessary to move to lower priority inputs because of discontinued data sources or management's assessment that the higher priority inputs are no longer considered to be representative of market spreads for a given type of collateral. This can happen, for example, if transaction volume changes such that a previously used spread index is no longer viewed as being reflective of current market levels.

The Company interpolates a curve based on the historical relationship between the premium the Company receives when a credit derivative is closed to the daily closing price of the market index related to the specific asset class and rating of the deal. This curve indicates expected credit spreads at each indicative level on the related market index. For transactions with unique terms or characteristics where no price quotes are available, management extrapolates credit spreads based on an alternative transaction for which the Company has received a spread quote from one of the first three sources within the Company's spread hierarchy. This alternative transaction will be within the same asset class, have similar underlying assets, similar credit ratings, and similar time to maturity. The Company then calculates the percentage of relative spread change quarter over quarter for the alternative transaction. This percentage change is then applied to the historical credit spread of the transaction for which no price quote was received in order to calculate the transactions' current spread. Counterparties determine credit spreads by reviewing new issuance pricing for specific asset classes and receiving price quotes from their trading desks for the specific asset in question. These quotes are validated by cross-referencing quotes received from one market source with those quotes received from another market source to ensure reasonableness.

The premium the Company receives is referred to as the "net spread." The Company's pricing model takes into account not only how credit spreads on risks that it assumes affect pricing, but also how the Company's own credit spread affects the pricing of its deals. The Company's own credit risk is factored into the determination of net spread based on the impact of changes in the quoted market price for credit protection bought on the Company, as reflected by quoted market prices on CDS referencing AGM. For credit spreads on the Company's name the Company obtains the quoted price of CDS contracts traded on AGM from market data sources published by third parties. The cost to acquire CDS protection referencing AGM affects the amount of spread on CDS deals that the Company retains and, hence, their fair value. As the cost to acquire CDS protection referencing AGM increases, the amount of premium the Company retains on a deal generally decreases. As the cost to acquire CDS protection referencing AGM decreases, the amount of premium the Company retains on a deal generally increases. In the Company's valuation model, the premium the Company captures is not permitted to go below the minimum rate that the Company would currently charge to assume similar risks. This assumption can have the effect of mitigating the amount of unrealized gains that are recognized on certain CDS contracts. Given the current market conditions and the Company's own credit spreads, approximately 82%, as of December 31, 2012 and approximately 93% as of December 31, 2011 of the Company's CDS contracts are fair valued using this minimum premium. The Company corroborates the assumptions in its fair value model, including the portion of exposure to AGM hedged by its counterparties, with independent third parties each reporting period. The current level of AGM's own credit spread has resulted in the bank or deal originator hedging a significant portion of its exposure to AGM. This reduces the amount of contractual cash flows AGM can capture as premium for selling its protection.

The amount of premium a financial guaranty insurance market participant can demand is inversely related to the cost of credit protection on the insurance company as measured by market credit spreads assuming all other assumptions remain constant. This is because the buyers of credit protection typically hedge a portion of their risk to the financial guarantor, due to the fact that the Company's contracts' contractual terms typically do not require the posting of collateral by the guarantor. The widening of a financial guarantor's own credit spread increases the cost to buy credit protection on the guarantor, thereby reducing the amount of premium the guarantor can capture out of the gross spread on the deal. The extent of the hedge depends on the types of instruments insured and the current market conditions.

A fair value resulting in a credit derivative asset on protection sold is the result of contractual cash inflows on in-force deals in excess of what a hypothetical financial guarantor could receive if it sold protection on the same risk as of the reporting date. If the Company were able to freely exchange these contracts (i.e., assuming its contracts did not contain proscriptions on transfer and there was a viable exchange market), it would be able to realize a gain representing the difference between the higher contractual premiums to which it is entitled and the current market premiums for a similar contract. The Company determines the fair value of its CDS contracts by applying the difference between the current net spread and the contractual net spread for the remaining duration of each contract to the notional value of its CDS contracts.

Example

Following is an example of how changes in gross spreads, the Company's own credit spread and the cost to buy protection on the Company affect the amount of premium the Company can demand for its credit protection. The assumptions used in these examples are hypothetical amounts. Scenario 1 represents the market conditions in effect on the transaction date and Scenario 2 represents market conditions at a subsequent reporting date.

	Scenario 1		Scenario 2	
	bps	% of Total	bps	% of Total
Original gross spread/cash bond price (in bps)	185		500	
Bank profit (in bps)	115	62%	50	10%
Hedge cost (in bps)	30	16%	440	88%
The Company premium received per annum (in bps)	40	22%	10	2%

In Scenario 1, the gross spread is 185 basis points. The bank or deal originator captures 115 basis points of the original gross spread and hedges 10% of its exposure to AGM, when the CDS spread on AGM was 300 basis points (300 basis points × 10% = 30 basis points). Under this scenario the Company received premium of 40 basis points, or 22% of the gross spread.

In Scenario 2, the gross spread is 500 basis points. The bank or deal originator captures 50 basis points of the original gross spread and hedges 25% of its exposure to AGM, when the CDS spread on AGM was 1,760 basis points (1,760 basis points × 25% = 440 basis points). Under this scenario the Company would receive premium of 10 basis points, or 2% of the gross spread. Due to the increased cost to hedge AGM's name, the amount of profit the bank would expect to receive, and the premium the Company would expect to receive decline significantly.

In this example, the contractual cash flows (the Company premium received per annum above) exceed the amount a market participant would require the Company to pay in today's market to accept its obligations under the CDS contract, thus resulting in an asset. This credit derivative asset is equal to the difference in premium rates discounted at the corresponding LIBOR over the weighted average remaining life of the contract.

Strengths and Weaknesses of Model

The Company's credit derivative valuation model, like any financial model, has certain strengths and weaknesses.

The primary strengths of the Company's CDS modeling techniques are:

- The model takes into account the transaction structure and the key drivers of market value. The transaction structure includes par insured, weighted average life, level of subordination and composition of collateral.

- The model maximizes the use of market-driven inputs whenever they are available. The key inputs to the model are market-based spreads for the collateral, and the credit rating of referenced entities. These are viewed by the Company to be the key parameters that affect fair value of the transaction.

- The model is a consistent approach to valuing positions. The Company has developed a hierarchy for market-based spread inputs that helps mitigate the degree of subjectivity during periods of high illiquidity.

The primary weaknesses of the Company's CDS modeling techniques are:

- There is no exit market or actual exit transactions. Therefore the Company’s exit market is a hypothetical one based on the Company’s entry market.

- There is a very limited market in which to validate the reasonableness of the fair values developed by the Company’s model.

- At December 31, 2012 and 2011, the markets for the inputs to the model were highly illiquid, which impacts their reliability.

- Due to the non-standard terms under which the Company enters into derivative contracts, the fair value of its credit derivatives may not reflect the same prices observed in an actively traded market of credit derivatives that do not contain terms and conditions similar to those observed in the financial guaranty market.

As of December 31, 2012 these contracts were classified as Level 3 in the fair value hierarchy because there is a reliance on at least one unobservable input deemed significant to the valuation model, most significantly the Company's estimate of the value of non-standard terms and conditions of its credit derivative contracts and of amount of protection purchased on AGM's name.

Fair Value Option on FG VIEs' Assets and Liabilities

The Company elected the fair value option for all FG VIEs assets and liabilities. See Note 10, Consolidation of Variable Interest Entities.

The FG VIEs that are consolidated by the Company issued securities collateralized by HELOCs, first lien and second lien RMBS, subprime automobile loans, and other loans and receivables. The lowest level input that is significant to the fair value measurement of these assets and liabilities in its entirety was a Level 3 input (i.e. unobservable), therefore management classified them as Level 3 in the fair value hierarchy. Prices were generally determined with the assistance of an independent third-party. The pricing is based on a discounted cash flow approach and the third-party's proprietary pricing models. The models to price the FG VIEs' liabilities used, where appropriate, inputs such as estimated prepayment speeds; market values of the assets that collateralize the securities; estimated default rates (determined on the basis of an analysis of collateral attributes, historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); discount rates implied by market prices for similar securities; house price depreciation/appreciation rates based on macroeconomic forecasts and, for those liabilities insured by the Company, the benefit from the Company's insurance policy guaranteeing the timely payment of principal and interest for the FG VIE tranches insured by the Company, taking into account the timing of the potential default and the Company's own credit rating. These inputs are utilized to project the future cash flows of the security and to evaluate the overall bond profile. The third-party also utilizes an internal model to determine an appropriate yield at which to discount the cash flows of the security, by factoring in collateral types, weighted-average lives, and other structural attributes specific to the security being priced. The expected yield is further calibrated by utilizing algorithm's designed to aggregate market color, received by the third-party, on comparable bonds.

Changes in fair value of the FG VIEs' assets and liabilities are included in fair value gains (losses) on FG VIEs within the consolidated statement of operations. Except for net credit impairment that triggers a claim on the financial guaranty contract (i.e. net expected loss to be paid as described in Note 6), the unrealized fair value gains (losses) related to the consolidated FG VIEs will reverse to zero over the terms of these financial instruments.

The fair value of the Company's FG VIE assets is sensitive to changes related to estimated prepayment speeds; estimated default rates (determined on the basis of an analysis of collateral attributes such as: historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); discount rates implied by market prices for similar securities; and house price depreciation/appreciation rates based on macroeconomic forecasts. Significant changes to some of these inputs could materially change the market value of the FG VIE's assets and the implied collateral losses within the transaction. In general, the fair value of the FG VIE asset is most sensitive to changes in the projected collateral losses, where an increase in collateral losses typically leads to a decrease in the fair value of FG VIE assets, while a decrease in collateral losses typically leads to an increase in the fair value of FG VIE assets. These factors also directly impact the fair value of the Company's FG VIE liabilities.

The fair value of the Company's FG VIE liabilities is also sensitive to changes relating to estimated prepayment speeds; market values of the assets that collateralize the securities; estimated default rates (determined on the basis of an analysis of collateral attributes such as: historical collateral performance, borrower profiles and other features relevant to the evaluation of collateral credit quality); discount rates implied by market prices for similar securities; and house price depreciation/appreciation rates based on macroeconomic forecasts. In addition, the Company's FG VIE liabilities with recourse are also sensitive to changes in the Company's implied credit worthiness. Significant changes to any of these inputs could materially change the timing of expected losses within the insured transaction which is a significant factor in determining the implied benefit from the Company's insurance policy guaranteeing the timely payment of principal and interest for the tranches of debt issued by the FG VIE that is insured by the Company. In general, extending the timing of expected loss payments by the Company into the future typically leads to a decrease in the value of the Company's insurance and a decrease in the fair value of the Company's FG VIE liabilities with recourse, while a shortening of the timing of expected loss payments by the Company typically leads to an increase in the value of the Company's insurance and an increase in the fair value of the Company's FG VIE liabilities with recourse.

Not Carried at Fair Value

Financial Guaranty Insurance Contracts

The fair value of the Company's financial guaranty contracts accounted for as insurance was based on management's estimate of what a similarly rated financial guaranty insurance company would demand to acquire the Company's in-force book of financial guaranty insurance business. This amount was based on the pricing assumptions management has observed for portfolio transfers that have occurred in the financial guaranty market and included adjustments to the carrying value of unearned premium reserve for stressed losses, ceding commissions and return on capital. The significant inputs were not readily observable. The Company accordingly classified this fair value measurement as Level 3.

Other Invested Assets

Other invested assets primarily consist of a surplus note issued by AGC to AGM (see note 15, Related Party Transactions) and assets acquired in refinancing transactions. The fair value of the surplus note was determined by calculating the effect of changes in U.S. Treasury yield adjusted for a credit factor at the end of each reporting period.

The fair value of the assets acquired in refinancing transactions was determined by calculating the present value of the expected cash flows. The Company uses a market approach to determine discounted future cash flows using market driven discount rates and a variety of assumptions, including LIBOR curve projections and prepayment and default assumptions. The fair value measurement was classified as Level 3 in the fair value hierarchy because there is a reliance on significant unobservable inputs to the valuation model, including the discount rates, prepayment and default assumptions, loss severity and recovery on delinquent loans.

Other Assets and Other Liabilities

The Company’s other assets and other liabilities consist predominantly of accrued interest, receivables for securities sold and payables for securities purchased, the carrying values of which approximate fair value.

Notes Payable

The fair value of the notes payable was determined by calculating the present value of the expected cash flows. The Company uses a market approach to determine discounted future cash flows using market driven discount rates and a variety of assumptions, if applicable, including LIBOR curve projections, prepayment and default assumptions, and AGM CDS spreads. The fair value measurement was classified as Level 3 in the fair value hierarchy.

Loan Receivable from Affiliate

The fair value of the Company's loan receivable from affiliate is determined by calculating the effect of changes in U.S. Treasury yield adjusted for a credit factor at the end of each reporting period.

Financial Instruments Carried at Fair Value

Amounts recorded at fair value in the Company's financial statements are included in the tables below.

Fair Value Hierarchy of Financial Instruments Carried at Fair Value
As of December 31, 2012

	Fair Value	Fair Value Hierarchy		
		Level 1	Level 2	Level 3
		(in millions)		
Assets:				
Investment portfolio, available-for-sale:				
Fixed maturity securities				
U.S. government and agencies	$ 93	$ —	$ 93	$ —
Obligations of state and political subdivisions	3,503	—	3,491	12
Corporate securities	230	—	230	—
Mortgage-backed securities:				
RMBS	359	—	175	184
Commercial mortgage-backed security ("CMBS")	103	—	103	—
Asset-backed securities	341	—	92	249
Foreign government securities	202	—	202	—
Total fixed maturity securities	4,831	—	4,386	445
Short-term investments	473	308	165	—
Other invested assets (1)	97	—	89	8
Credit derivative assets	131	—	—	131
FG VIEs' assets, at fair value	1,870	—	—	1,870
Other assets(2)	14	—	—	14
Total assets carried at fair value	$ 7,416	$ 308	$ 4,640	$ 2,468
Liabilities:				
Credit derivative liabilities	$ 414	$ —	$ —	$ 414
FG VIEs' liabilities with recourse, at fair value	1,605	—	—	1,605
FG VIEs' liabilities without recourse, at fair value	678	—	—	678
Total liabilities carried at fair value	$ 2,697	$ —	$ —	$ 2,697

Fair Value Hierarchy of Financial Instruments Carried at Fair Value
As of December 31, 2011

	Fair Value	Fair Value Hierarchy Level 1	Level 2	Level 3
		(in millions)		
Assets:				
Investment portfolio, available-for-sale:				
Fixed maturity securities				
U.S. government and agencies	$ 86	$ —	$ 86	$ —
Obligations of state and political subdivisions	3,597	—	3,587	10
Corporate securities	208	—	208	—
Mortgage-backed securities:				
RMBS	344	—	239	105
CMBS	104	—	104	—
Asset-backed securities	335	—	124	211
Foreign government securities	242	—	242	—
Total fixed maturity securities	4,916	—	4,590	326
Short-term investments	412	135	277	—
Other invested assets (1)	44	—	33	11
Credit derivative assets	140	—	—	140
FG VIEs' assets, at fair value	2,057	—	—	2,057
Other assets(2)	22	—	—	22
Total assets carried at fair value	$ 7,591	$ 135	$ 4,900	$ 2,556
Liabilities:				
Credit derivative liabilities	$ 456	$ —	$ —	$ 456
FG VIEs' liabilities with recourse, at fair value	1,926	—	—	1,926
FG VIEs' liabilities without recourse, at fair value	704	—	—	704
Total liabilities carried at fair value	$ 3,086	$ —	$ —	$ 3,086

(1) Includes mortgage loans that are recorded at fair value on a non-recurring basis. At December 31, 2012 and December 31, 2011, such investments were carried at their market value of $7 million and $9 million, respectively.

(2) Includes fair value of CCS.

Changes in Level 3 Fair Value Measurements

The table below presents a roll forward of the Company's Level 3 financial instruments carried at fair value on a recurring basis during the years ended December 31, 2012 and 2011.

Fair Value Level 3 Rollforward
Recurring Basis
Year Ended December 31, 2012

	Fixed Maturity Securities								
	Obligations of State and Political Subdivisions	RMBS	Asset-Backed Securities	Other Invested Assets	FG VIEs' Assets at Fair Value	Other Assets	Credit Derivative Asset (Liability), net(5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value
					(in millions)				
Fair value as of December 31, 2011	$ 10	$ 105	$ 211	$ 2	$ 2,057	$ 22	$ (316)	$ (1,926)	$ (704)
Total pretax realized and unrealized gains/(losses) recorded in:(1)									
Net income (loss)	— (2)	13 (2)	27 (2)	0	273 (3)	(8) (4)	52 (6)	(233) (3)	(110) (3)
Other comprehensive income (loss)	1	11	20	(1)	—	—	—	—	—
Purchases	1	95	18	—	—	—	—	—	—
Settlements	—	(40)	(27)	—	(468)	—	(19)	482	136
FG VIE consolidations	—	—	—	—	8	—	—	(10)	—
FG VIE elimination	—	—	—	—	—	—	—	82	—
Fair value as of December 31, 2012	$ 12	$ 184	$ 249	$ 1	$ 1,870	$ 14	$ (283)	$ (1,605)	$ (678)
Change in unrealized gains/(losses) related to financial instruments held as of December 31, 2012	$ 1	$ 3	$ 23	$ (1)	$ 459	$ (8)	$ 38	$ (549)	$ 198

Fair Value Level 3 Rollforward
Recurring Basis
Year Ended December 31, 2011

	Fixed Maturity Securities								
	Obligations of State and Political Subdivisions	RMBS	Asset-Backed Securities	Other Invested Assets	FG VIEs' Assets at Fair Value	Other Assets	Credit Derivative Asset (Liability), net(5)	FG VIEs' Liabilities with Recourse, at Fair Value	FG VIEs' Liabilities without Recourse, at Fair Value
	(in millions)								
Fair value as of December 31, 2010	$ —	$ 72	$ 165	$ 2	$ 2,692	$ —	$ (411)	$ (2,511)	$ (842)
Total pretax realized and unrealized gains/(losses) recorded in:(1)									
Net income (loss)	— (2)	(31) (2)	(11) (2)	—	(179) (3)	14 (4)	162 (6)	53 (3)	(8) (3)
Other comprehensive income (loss)	1	(76)	33	0	—	—	—	—	—
Purchases	9	216	47	—	—	—	—	—	—
Settlements	—	(24)	(23)	0	(720)	—	(67)	759	209
FG VIE consolidations	—	(52)	—	—	264	—	—	(227)	(63)
Transfers into Level 3	—	—	—	—	—	8	—	—	—
Fair value as of December 31, 2011	$ 10	$ 105	$ 211	$ 2	$ 2,057	$ 22	$ (316)	$ (1,926)	$ (704)
Change in unrealized gains/(losses) related to financial instruments held as of December 31, 2011	$ 0	$ (76)	$ 33	$ (1)	$ 159	$ 14	$ 83	$ 60	$ (69)

(1) Realized and unrealized gains (losses) from changes in values of Level 3 financial instruments represent gains (losses) from changes in values of those financial instruments only for the periods in which the instruments were classified as Level 3.

(2) Included in net realized investment gains (losses) and net investment income.

(3) Included in fair value gains (losses) on FG VIEs.

(4) Recorded in fair value gains (losses) on CCS.

(5) Represents net position of credit derivatives. The consolidated balance sheet presents gross assets and liabilities based on net counterparty exposure.

(6) Reported in net change in fair value of credit derivatives.

Level 3 Fair Value Disclosures

Quantitative Information About Level 3 Fair Value Inputs
At December 31, 2012

Financial Instrument Description	(in millions)	Valuation Technique	Significant Unobservable Inputs	Range
Assets:				
Fixed maturity securities:				
Obligations of state and political subdivisions	$ 12	Discounted cash flow	Rate of inflation	1.0% - 3.0%
			Cash flow receipts	4.9% - 29.7%
			Discount rates	4.6%
			Collateral recovery period	1 month - 11 years
RMBS	184	Discounted cash flow	CPR	1.0% - 6.9%
			CDR	6.2% - 23.0%
			Severity	51.6% - 102.8%
			Yield	3.5% - 12.5%
Asset-backed securities:				
Whole business securitization	63	Discounted cash flow	Annual gross revenue projections (in millions)	$54 - $96
			Value of primary financial guaranty policy	43.8%
			Liquidity discount	5.0% - 20.0%
Investor owned utility	186	Discounted cash flow	Liquidation value (in millions)	$212 - $242
			Years to liquidation	0 years - 3 years
			Discount factor	15.3%
Other invested assets	8	Discounted cash flow	Discount for lack of liquidity	10.0% - 20.0%
			Recovery on delinquent loans	20.0% - 60.0%
			Default rates	1.0% - 12.0%
			Loss severity	40.0% - 90.0%
			Prepayment speeds	6.0% - 15.0%
FG VIEs’ assets, at fair value	1,870	Discounted cash flow	CPR	0.5% - 9.3%
			CDR	3.6% - 28.6%
			Loss severity	50.6% - 103.8%
			Yield	4.5% - 20.0%

Financial Instrument Description	Fair Value as of December 31, 2012 (in millions)	Valuation Technique	Significant Unobservable Inputs	Range
Other assets	14	Discounted cash flow	Quotes from third party pricing	$45 - $51
			Term (years)	3 years
Liabilities:				
Credit derivative liabilities, net	(283)	Discounted cash flow	Hedge cost (in bps)	64.2 - 536.2
			Bank profit (in bps)	1.0 - 1,312.9
			Internal floor (in bps)	7.0 - 60.0
			Internal credit rating	AAA - BIG
FG VIEs' liabilities, at fair value	(2,283)	Discounted cash flow	CPR	0.5% - 9.3%
			CDR	3.6% - 28.6%
			Loss severity	50.6% - 103.8%
			Yield	4.5% - 20.0%

The carrying amount and estimated fair value of the Company's financial instruments are presented in the following table.

Fair Value of Financial Instruments

	As of December 31, 2012		As of December 31, 2011	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(in millions)			
Assets:				
Fixed maturity securities	$ 4,831	$ 4,831	$ 4,916	$ 4,916
Short-term investments	473	473	412	412
Other invested assets	441	548	420	538
Loan receivable from affiliate	83	82	—	—
Credit derivative assets	131	131	140	140
FG VIEs' assets, at fair value	1,870	1,870	2,057	2,057
Other assets	72	72	81	81
Liabilities:				
Financial guaranty insurance contracts(1)	2,091	2,949	2,651	3,392
Note payable	66	72	104	101
Credit derivative liabilities	414	414	456	456
FG VIEs' liabilities with recourse, at fair value	1,605	1,605	1,926	1,926
FG VIEs' liabilities without recourse, at fair value	678	678	704	704
Other liabilities	25	25	8	8

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(1) Carrying amount includes the assets and liabilities related to financial guaranty insurance contract premiums, losses, and salvage and subrogation and other recoverables net of reinsurance.

9. Financial Guaranty Contracts Accounted for as Credit Derivatives

Accounting Policy

Credit derivatives are recorded at fair value. Changes in fair value are recorded in “net change in fair value of credit derivatives” on the consolidated statement of operations. Realized gains and other settlements on credit derivatives include credit derivative premiums received and receivable for credit protection the Company has sold under its insured CDS contracts, premiums paid and payable for credit protection the Company has purchased, contractual claims paid and payable and received and receivable related to insured credit events under these contracts, ceding commissions expense or income and realized gains or losses related to their early termination. Net unrealized gains and losses on credit derivatives represent the adjustments for changes in fair value in excess of realized gains and other settlements. Fair value of credit derivatives is reflected as either net assets or net liabilities determined on a contract by contract basis in the Company's consolidated balance sheets. See Note 8, Fair Value Measurement, for a discussion on the fair value methodology for credit derivatives.

Credit Derivatives

The Company has a portfolio of financial guaranty contracts that meet the definition of a derivative in accordance with GAAP (primarily CDS). Until the Company ceased selling credit protection through credit derivative contracts in the beginning of 2009, following the issuance of regulatory guidelines that limited the terms under which the credit protection could be sold, management considered these agreements to be a normal part of its financial guaranty business. The potential capital or margin requirements that may apply under the Dodd-Frank Wall Street Reform and Consumer Protection Act contributed to the decision of the Company not to sell new credit protection through CDS in the foreseeable future.

Credit derivative transactions are governed by ISDA documentation and have different characteristics from financial guaranty insurance contracts. For example, the Company’s control rights with respect to a reference obligation under a credit derivative may be more limited than when the Company issues a financial guaranty insurance contract. In addition, while the Company’s exposure under credit derivatives, like the Company’s exposure under financial guaranty insurance contracts, has been generally for as long as the reference obligation remains outstanding, unlike financial guaranty contracts, a credit derivative may be terminated for a breach of the ISDA documentation or other specific events. A loss payment is made only upon the occurrence of one or more defined credit events with respect to the referenced securities or loans. A credit event may be a non-payment event such as a failure to pay, bankruptcy or restructuring, as negotiated by the parties to the credit derivative transactions. If events of default or termination events specified in the credit derivative documentation were to occur, the non-defaulting or the non-affected party, which may be either the Company or the counterparty, depending upon the circumstances, may decide to terminate a credit derivative prior to maturity. The Company may be required to make a termination payment to its swap counterparty upon such termination. The Company may not unilaterally terminate a CDS contract; however, the Company on occasion has mutually agreed with various counterparties to terminate certain CDS transactions.

Credit Derivative Net Par Outstanding by Sector

The estimated remaining weighted average life of credit derivatives was 2.5 years at December 31, 2012 and 2.8 years at December 31, 2011. The components of the Company's credit derivative net par outstanding are presented below.

Credit Derivatives Net Par Outstanding

Asset Type	As of December 31, 2012				As of December 31, 2011			
	Net Par Outstanding	Original Subordination (1)	Current Subordination (1)	Weighted Average Credit Rating	Net Par Outstanding	Original Subordination (1)	Current Subordination (1)	Weighted Average Credit Rating
				(dollars in millions)				
Pooled corporate obligations:								
Collateralized loan obligations/ collateralized bond obligations	$ 15,614	29.1%	30.4%	AAA	$ 18,606	28.7%	29.4%	AAA
Synthetic investment grade pooled corporate	9,089	21.1	19.2	AAA	11,494	19.7	17.9	AAA
Synthetic high yield pooled corporate	3,616	35.0	30.4	AAA	4,901	35.7	30.3	AA+
Trust preferred securities collateralized debt obligations ("TruPS CDOs")	41	55.1	78.8	AAA	63	56.1	70.5	AAA
Market value CDOs of corporate obligations	1,492	17.0	29.9	AAA	1,492	17.0	32.0	AAA
Total pooled corporate obligations	29,852	26.8	27.0	AAA	36,556	26.4	26.1	AAA
U.S. RMBS:								
Subprime first lien (including net interest margin)	72	—	—	AA	102	—	—	A
Closed end second lien and HELOCs	101	—	—	BBB	127	—	—	BBB
Total U.S. RMBS	173	—	—	A	229	—	—	BBB+
Other	3,269	—	—	A-	4,254	—	—	A
Total	$ 33,294			AAA	$ 41,039			AAA

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(1) Represents the sum of subordinate tranches and over-collateralization and does not include any benefit from excess interest collections that may be used to absorb losses.

Except for TruPS CDOs, the Company's exposure to pooled corporate obligations is highly diversified in terms of obligors and industries. Most pooled corporate transactions are structured to limit exposure to any given obligor and industry. The majority of the Company's pooled corporate exposure consists of collateralized loan obligation ("CLO") or synthetic pooled corporate obligations. Most of these CLOs have an average obligor size of less than 1% of the total transaction and typically restrict the maximum exposure to any one industry to approximately 10%. The Company's exposure also benefits from embedded credit enhancement in the transactions which allows a transaction to sustain a certain level of losses in the underlying collateral, further insulating the Company from industry specific concentrations of credit risk on these deals.

The $3.3 billion of exposure in "Other" CDS contracts as of December 31, 2012 comprises numerous deals typically structured with significant underlying credit enhancement and spread across various asset classes, such as commercial receivables, international RMBS, infrastructure, regulated utilities and consumer receivables.

Distribution of Credit Derivative Net Par Outstanding by Internal Rating

Ratings	As of December 31, 2012 Net Par Outstanding	As of December 31, 2012 % of Total	As of December 31, 2011 Net Par Outstanding	As of December 31, 2011 % of Total
	(dollars in millions)			
Super Senior	$ 10,488	31.5%	$ 12,342	30.1%
AAA	17,338	52.1	22,814	55.6
AA	1,839	5.5	1,963	4.8
A	1,781	5.3	1,860	4.5
BBB	1,319	4.0	1,438	3.5
BIG	529	1.6	622	1.5
Total credit derivative net par outstanding	$ 33,294	100.0%	$ 41,039	100.0%

Net Change in Fair Value of Credit Derivatives

Net Change in Fair Value of Credit Derivatives Gain (Loss)

	Year Ended December 31, 2012	Year Ended December 31, 2011
	(in millions)	
Net credit derivative premiums received and receivable	$ 49	$ 89
Net ceding commissions (paid and payable) received and receivable	1	3
Realized gains on credit derivatives	50	92
Net credit derivative losses (paid and payable) recovered and recoverable	(39)	(22)
Total realized gains (losses) and other settlements on credit derivatives	11	70
Net unrealized gains (losses) on credit derivatives	41	92
Net change in fair value of credit derivatives	$ 52	$ 162

In years ended December 31, 2012 and 2011, CDS contracts totaling $1.7 billion and $5.2 billion in net par were terminated, resulting in accelerations of credit derivative revenue of $0.5 million in 2012 and $14 million in 2011.

Changes in the fair value of credit derivatives occur primarily because of changes in interest rates, credit spreads, notional amounts, credit ratings of the referenced entities, expected terms, realized gains (losses) and other settlements, and the issuing company's own credit rating, credit spreads and other market factors. Except for net estimated credit impairments (i.e., net expected loss to be paid as discussed in Note 6), the unrealized gains and losses on credit derivatives are expected to reduce to zero as the exposure approaches its maturity date. With considerable volatility continuing in the market, unrealized gains (losses) on credit derivatives may fluctuate significantly in future periods.

Net Change in Unrealized Gains (Losses) on Credit Derivatives By Sector

Asset Type	Year Ended December 31, 2012	Year Ended December 31, 2011
	(in millions)	
Pooled corporate obligations:		
CLOs/Collateralized bond obligations	$ (1)	$ 3
Synthetic investment grade pooled corporate	19	16
Synthetic high yield pooled corporate	20	(1)
TruPS CDOs	1	(1)
Market value CDOs of corporate obligations	0	0
Total pooled corporate obligations	39	17
U.S. RMBS:		
Alt-A first lien	0	—
Subprime first lien (including net interest margin)	24	6
Closed end second lien and HELOCs	5	11
Total U.S. RMBS	29	17
Other	(27)	58
Total	$ 41	$ 92

In 2012, unrealized fair value gains were generated primarily in the high yield and investment grade synthetic pooled corporate sectors, as well as the subprime first lien sector. The gains in all three sectors were a result of a significant run-off of par outstanding as the transactions in these sectors approach maturity, as well as the expiration of several large transactions. The unrealized gains were partially offset by unrealized losses in the Other sector. The unrealized losses in Other were a result of the decreased cost to buy protection in AGM's name as the market cost of AGM's credit protection decreased during the period. Several transactions were pricing above their floor levels (or the minimum rate at which the Company would consider assuming these risks based on historical experience); therefore when the cost of purchasing CDS protection on AGM, which management refers to as the CDS spread on AGM, decreased the implied spreads that the Company would expect to receive on these transactions increased.

In 2011, unrealized fair value gains were generated primarily in the Other sector due to narrower implied net spreads. The unrealized gain in Other was primarily attributable to price improvements on a XXX life securitization transaction, as well as the run off of par outstanding on several policies. The narrower implied net spreads were primarily a result of the increased cost to buy protection in AGM's name as the market cost of AGM's credit protection increased. Several transactions were pricing above their floor levels (or the minimum rate at which the Company would consider assuming these risks based on historical experience); therefore when the cost of purchasing CDS protection on AGM, which management refers to as the CDS spread on AGM, increased the implied spreads that the Company would expect to receive on these transactions decreased.

The impact of changes in credit spreads will vary based upon the volume, tenor, interest rates, and other market conditions at the time these fair values are determined. In addition, since each transaction has unique collateral and structural terms, the underlying change in fair value of each transaction may vary considerably. The fair value of credit derivative contracts also reflects the change in the Company's own credit cost based on the price to purchase credit protection on AGM. The Company determines its own credit risk based on quoted CDS prices traded on the Company at each balance sheet date. Generally, a widening of the CDS prices traded on AGM has an effect of offsetting unrealized losses that result from widening general market credit spreads, while a narrowing of the CDS prices traded on AGM has an effect of offsetting unrealized gains that result from narrowing general market credit spreads.

Five Year CDS Spread on AGM

	As of December 31, 2012	2011	2010
Quoted price of CDS contract (in basis points)	536	778	650

Components of Credit Derivative Assets (Liabilities)

	As of December 31, 2012	As of December 31, 2011
	(in millions)	
Credit derivative assets	$ 131	$ 140
Credit derivative liabilities	(414)	(456)
Net fair value of credit derivatives	$ (283)	$ (316)

	As of December 31, 2012	As of December 31, 2011
	(in millions)	
Fair value of credit derivatives before effect of AGM credit spread	$ (627)	$ (1,109)
Plus: Effect of AGM credit spread	344	793
Net fair value of credit derivatives	$ (283)	$ (316)

The $0.6 billion liability as of December 31, 2012, which represents the fair value of CDS contracts before considering the implications of AGM's credit spreads, is a direct result of continued wide credit spreads in the fixed income security markets, and ratings downgrades. The asset classes that remain most affected are pooled corporate obligations. Comparing December 31, 2012 to December 31, 2011, there was a narrowing of general market spreads as well as a run-off in net par outstanding, resulting in a gain of approximately $482 million, before taking into account AGM's credit spreads.

Management believes that the trading level of AGM's credit spreads are due to the correlation between AGM's risk profile and the current risk profile of the broader financial markets and to increased demand for credit protection against AGM as the result of its financial guaranty volume, as well as the overall lack of liquidity in the CDS market. Offsetting the benefit attributable to AGM's credit spread were higher credit spreads in the fixed income security markets. The higher credit spreads in the fixed income security market are due to the lack of liquidity in the high yield CDO, Trust- Preferred CDO, and CLO markets as well as continuing market concerns over the most recent vintages of subprime RMBS.

The following table presents the fair value and the present value of expected claim payments or recoveries (i.e. net expected loss to be paid as described in Note 6) for contracts accounted for as derivatives.

Net Fair Value and Expected Losses of Credit Derivatives by Sector

Asset Type	Fair Value of Credit Derivative Asset (Liability), net		Present Value of Expected Claim (Payments) Recoveries (1)	
	As of December 31, 2012	As of December 31, 2011	As of December 31, 2012	As of December 31, 2011
		(in millions)		
Pooled corporate obligations:				
CLOs/Collateralized bond obligations	$ (2)	$ 0	$ —	$ —
Synthetic investment grade pooled corporate	(6)	(25)	—	—
Synthetic high yield pooled corporate	3	(16)	—	(5)
TruPS CDOs	0	(1)	—	—
Market value CDOs of corporate obligations	0	0	—	—
Total pooled corporate obligations	(5)	(42)	—	(5)
U.S. RMBS:				
Option ARM and Alt-A first lien	0	0	—	—
Subprime first lien (including net interest margin)	0	(18)	—	(25)
Closed end second lien and HELOCs	(10)	(15)	10	7
Total U.S. RMBS	(10)	(33)	10	(18)
Other	(268)	(241)	(4)	(14)
Total	$ (283)	$ (316)	$ 6	$ (37)

(1) Represents amount in excess of the present value of future installment fees to be received of $1 million as of December 31, 2012 and $2 million as of December 31, 2011. There is no R&W benefit on credit derivatives as of December 31, 2012 and 2011.

Sensitivity to Changes in Credit Spread

The following table summarizes the estimated change in fair values on the net balance of the Company's credit derivative positions assuming immediate parallel shifts in credit spreads on AGM and on the risks that it assumes.

Effect of Changes in Credit Spread
As of December 31, 2012

Credit Spreads(1)	Estimated Net Fair Value (Pre-Tax)	Estimated Change in Gain/(Loss) (Pre-Tax)
	(in millions)	
100% widening in spreads	$ (537)	$ (254)
50% widening in spreads	(408)	(125)
25% widening in spreads	(343)	(60)
10% widening in spreads	(304)	(21)
Base Scenario	(283)	—
10% narrowing in spreads	(264)	19
25% narrowing in spreads	(243)	40
50% narrowing in spreads	(209)	74

(1) Includes the effects of spreads on both the underlying asset classes and the Company’s own credit spread.

10. Consolidation of Variable Interest Entities

The Company provides financial guaranties with respect to debt obligations of special purpose entities, including VIEs. AGM does not sponsor any VIEs when underwriting third party financial guaranty insurance or credit derivative transactions, nor does it act as the servicer or collateral manager for any VIE obligations that it insures. The transaction structure generally provides certain financial protections to the Company. This financial protection can take several forms, the most common of which are overcollateralization, first loss protection (or subordination) and excess spread. In the case of overcollateralization (i.e., the principal amount of the securitized assets exceeds the principal amount of the structured finance obligations guaranteed by the Company), the structure allows defaults of the securitized assets before a default is experienced on the structured finance obligation guaranteed by the Company. In the case of first loss, the financial guaranty insurance policy only covers a senior layer of losses experienced by multiple obligations issued by special purpose entities, including VIEs. The first loss exposure with respect to the assets is either retained by the seller or sold off in the form of equity or mezzanine debt to other investors. In the case of excess spread, the financial assets contributed to special purpose entities, including VIEs, generate cash flows that are in excess of the interest payments on the debt issued by the special purpose entity. Such excess spread is typically distributed through the transaction's cash flow waterfall and may be used to create additional credit enhancement, applied to redeem debt issued by the special purpose entities, including VIEs (thereby, creating additional overcollateralization), or distributed to equity or other investors in the transaction.

AGM is not primarily liable for the debt obligations issued by the VIEs they insure and would only be required to make payments on these debt obligations in the event that the issuer of such debt obligations defaults on any principal or interest due. AGM's creditors do not have any rights with regard to the assets of the VIEs. Proceeds from sales, maturities, prepayments and interest from VIE assets may only be used to pay Debt Service on VIE liabilities. Net fair value gains and losses on FG VIEs are expected to reverse to zero at maturity of the VIE debt, except for net premiums received and receivable, and claims paid and expected to be paid by AGM under the financial guaranty insurance contract. The Company's estimate of expected loss to be paid for FG VIEs is included in Note 6, Expected Loss to be Paid.

Accounting Policy

For all years presented, the Company has evaluated whether it was the primary beneficiary or control party of its VIEs. If the Company concludes that it is the primary beneficiary it is required to consolidate the entire VIE in the Company's financial statements. The accounting rules governing the criteria for determining the primary beneficiary or control party of VIEs changed effective January 1, 2010.

Effective January 1, 2010, GAAP requires the Company to perform an analysis to determine whether its variable interests give it a controlling financial interest in a VIE. This analysis identifies the primary beneficiary of a VIE as the enterprise that has both 1) the power to direct the activities of a VIE that most significantly impact the entity's economic performance; and 2) the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. This guidance requires an ongoing reassessment of whether the Company is the primary beneficiary of a VIE.

As part of the terms of its financial guaranty contracts, the Company obtains certain protective rights with respect to the VIE that are triggered by the occurrence of certain events, such as failure to be in compliance with a covenant due to poor deal performance or a deterioration in a servicer or collateral manager's financial condition. At deal inception, the Company typically is not deemed to control a VIE; however, once a trigger event occurs, the Company's control of the VIE typically increases. The Company continuously evaluates its power to direct the activities that most significantly impact the economic performance of VIEs that have debt obligations insured by the Company and, accordingly, where the Company is obligated to absorb VIE losses or receive benefits that could potentially be significant to the VIE. The Company obtains protective rights under its insurance contracts that give the Company additional controls over a VIE if there is either deterioration of deal performance or in the financial health of the deal servicer. The Company is deemed to be the control party under GAAP, typically when its protective rights give it the power to both terminate and replace the deal servicer, which are characteristics specific to the Company's financial guaranty contracts. If the Company's protective rights that could make it the control party have not been triggered, then it does not consolidate the VIE. As of December 31, 2012, the Company had issued financial guaranty contracts for approximately 600 VIEs that it did not consolidate.

The FG VIEs' liabilities that are insured by the Company are considered to be with recourse, because the Company guarantees the payment of principal and interest regardless of the performance of the related FG VIEs' assets. FG VIEs' liabilities that are not insured by the Company are considered to be without recourse, because the payment of principal and interest of these liabilities is wholly dependent on the performance of the FG VIEs' assets.

The Company has limited contractual rights to obtain the financial records of its consolidated FG VIEs. The FG VIEs do not prepare separate GAAP financial statements; therefore, the Company compiles GAAP financial information for them based on trustee reports prepared by and received from third parties. Such trustee reports are not available to the Company until approximately 30 days after the end of any given period. The time required to perform adequate reconciliations and analyses of the information in these trustee reports results in a one quarter lag in reporting the FG VIEs' activities. The Company records the fair value of FG VIE assets and liabilities based on modeled prices. The Company updates the model assumptions each reporting period for the most recent available information, which incorporates the impact of material events that may have occurred since the quarter lag date. Interest income and interest expense are derived from the trustee reports and included in "fair value gains (losses) on FG VIEs" in the consolidated statement of operations. The Company has elected the fair value option for assets and liabilities classified as FG VIEs' assets and liabilities because the carrying amount transition method was not practical.

Consolidated FG VIEs

Number of FG VIEs Consolidated

	Year Ended December 31,	
	2012	2011
Beginning of the year	26	24
Consolidated(1)	1	6
Matured	(2)	(4)
End of the year	25	26

(1) Net gain on consolidation and deconsolidation was $5 million in 2012 and $40 million in 2011 and recorded in "fair value gains (losses) on FG VIEs" in the consolidated statement of operations.

The total unpaid principal balance for the FG VIEs' assets that were over 90 days or more past due was approximately $654 million. The aggregate unpaid principal of the FG VIEs' assets was approximately $1,987 million greater than the aggregate fair value at December 31, 2012. The change in the instrument-specific credit risk of the FG VIEs' assets for 2012 was a gain of $320 million. The change in the instrument-specific credit risk of the FG VIEs' assets for 2011 were losses of $565 million.

The aggregate unpaid principal balance was approximately $1,569 million greater than the aggregate fair value of the FG VIEs' liabilities as of December 31, 2012.

The table below shows the carrying value of the consolidated FG VIEs' assets and liabilities in the consolidated financial statements, segregated by the types of assets that collateralize their respective debt obligations:

Consolidated FG VIEs
By Type of Collateral

	As of December 31, 2012					As of December 31, 2011				
	Number of FG VIEs		Assets		Liabilities	Number of FG VIEs		Assets		Liabilities
	(dollars in millions)									
With recourse:										
HELOCs	8	$	525	$	786	8	$	573	$	908
First liens:										
Alt-A first lien	4		131		113	4		128		124
Option ARM	2		42		169	2		50		244
Subprime	6		392		485	5		387		473
Closed-end second lien	3		28		13	3		59		21
Automobile loans	2		39		39	4		156		156
Total with recourse	25		1,157		1,605	26		1,353		1,926
Without recourse	—		713		678	—		704		704
Total	25	$	1,870	$	2,283	26	$	2,057	$	2,630

Gross Unpaid Principal for FG VIEs' Liabilities
With Recourse

	As of December 31, 2012		As of December 31, 2011	
	(in millions)			
Gross unpaid principal for FG VIEs' liabilities with recourse	$	2,087	$	3,030

Contractual Maturity Schedule of FG VIE Liabilities with Recourse

Contractual Maturity	As of December 31, 2012	
	(in millions)	
2013	$	—
2014		39
2015		—
2016		—
2017		—
Thereafter		2,048
Total	$	2,087

The consolidation of FG VIEs has a significant effect on net income and shareholder's equity due to (1) changes in fair value gains (losses) on FG VIE assets and liabilities, (2) the elimination of premiums and losses related to the AGM FG VIE liabilities with recourse and (3) the elimination of investment balances related to the Company's purchase of AGM insured FG VIE debt. Upon consolidation of a FG VIE, the related insurance and, if applicable, the related investment balances, are considered intercompany transactions and therefore eliminated. Such eliminations are included in the table below to present the full effect of consolidating FG VIEs.

Effect of Consolidating FG VIEs on Net Income and Shareholder's Equity

	Year Ended December 31,	
	2012	2011
	(in millions)	
Net earned premiums	$ (150)	$ (74)
Net investment income	(11)	(6)
Net realized investment gains (losses)	4	12
Fair value gains (losses) on FG VIEs	115	(61)
Loss and LAE	52	89
Total pretax effect on net income	10	(40)
Less: tax provision (benefit)	3	(14)
Total effect on net income (loss)	$ 7	$ (26)

	As of December 31, 2012	As of December 31, 2011
	(in millions)	
Total (decrease) increase on shareholder’s equity	$ (321)	$ (325)

Fair value gains (losses) on FG VIEs represent the net change in fair value on the consolidated FG VIEs’ assets and liabilities. For the year ended December 31, 2012, the Company recorded a pre-tax net fair value gain of consolidated FG VIEs of $115 million. The majority of this gain, approximately $59 million, is a result of a R&W settlement with Deutsche Bank that closed during the second quarter 2012. While prices continued to appreciate during the period on the Company's FG VIE assets and liabilities, the remainder of the gains were primarily driven by large principal paydowns made on the Company's FG VIEs.

Year ended December 31, 2011 pre-tax fair value losses on consolidated FG VIEs of $61 million were driven by the unrealized loss on consolidation of six new VIEs, as well as two existing transactions in which the fair value of the underlying collateral depreciated, while the price of the wrapped senior bonds was largely unchanged from the prior year.

Non-Consolidated VIEs

To date, the Company's analyses have indicated that it does not have a controlling financial interest in any other VIEs and, as a result, they are not consolidated in the consolidated financial statements. The Company's exposure provided through its financial guaranties with respect to debt obligations of special purpose entities is included within net par outstanding in Note 3, Outstanding Exposure.

11. Investments and Cash

Accounting Policy

The vast majority of the Company's investment portfolio is fixed maturity and short-term investments, classified as available-for-sale at the time of purchase (approximately 97% based on fair value at December 31, 2012), and therefore carried at fair value. Changes in fair value for other than temporarily impaired ("OTTI") securities are bifurcated between credit losses and non-credit changes in fair value. Credit losses on other-than-temporary impairment securities are recorded in the statement of operations and the non-credit component of OTTI securities are recorded in OCI. For securities where the Company has the intent to sell, declines in fair value are recorded in the consolidated statements of operations. OTTI credit losses adjust the amortized cost of impaired securities and that amortized cost basis is not increased for any subsequent recoveries in fair value. However, the amortized cost basis is adjusted for accretion and amortization using the effective interest method with a corresponding entry recorded in net investment income.

Realized gains and losses on sales of investments are determined using the specific identification method. Realized loss includes amounts recorded for other than temporary impairments on debt securities and the declines in fair value of securities for which the Company has the intent to sell the security or inability to hold until recovery of amortized cost.

For mortgage-backed securities, and any other holdings for which there is prepayment risk, prepayment assumptions are evaluated and revised as necessary. Any necessary adjustments due to changes in effective yields and maturities are recognized in current income.

The Company purchased securities that it has insured, and for which it has expected losses to be paid, in order to mitigate the economic effect of insured losses ("loss mitigation bonds"). These securities were purchased at a discount and are accounted for excluding the effects of the Company's insurance on the securities.

Short-term investments, which are those investments with a maturity of less than one year at time of purchase, are carried at fair value and include amounts deposited in money market funds.

Other invested assets include assets acquired in refinancing transactions which are primarily comprised of franchise loans that are evaluated for impairment by assessing the probability of collecting expected cash flows. Any impairment is recorded in the consolidated statement of operations and any subsequent increases in expected cash flow are recorded as an increase in yield over the remaining life of the loans. Other invested assets also include trading securities and a surplus note issued by AGC to AGM (see Note 15, Related Party Transactions). Trading securities are recorded on a trade date basis and carried at fair value. Unrealized gains and losses on trading securities are reflected in net income. The surplus note is being held to maturity.

Cash consists of cash on hand and demand deposits. As a result of the lag in reporting, FG VIEs and short term investments reported on the consolidated balance sheet does not reflect cash outflow to the holders of the debt issued by the FG VIEs for claim payments made by the Company to the consolidated FG VIEs until the subsequent reporting period.

Assessment for Other-Than Temporary Impairments

Once an OTTI has occurred, the amount of the OTTI recognized in earnings depends on whether an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the OTTI is recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date.

If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the OTTI is separated into (1) the amount representing the credit loss and (2) the amount related to all other factors.

The Company has a formal review process to determine OTTI for securities in its investment portfolio where there is no intent to sell and it is not more likely than not it will be required to sell the security before recovery. Factors considered when assessing impairment include:

- a decline in the market value of a security by 20% or more below amortized cost for a continuous period of at least six months;
- a decline in the market value of a security for a continuous period of 12 months;
- recent credit downgrades of the applicable security or the issuer by rating agencies;
- the financial condition of the applicable issuer;
- whether loss of investment principal is anticipated;
- the impact of foreign exchange rates;
- whether scheduled interest payments are past due; and
- whether we have the intent to sell the security prior to its recovery in fair value.

For these securities, the Company's formal review process includes analyses of the ability to recover the amortized cost by comparing the net present value of projected future cash flows with the amortized cost of the security. If the net present value is less than the amortized cost of the investment, an OTTI loss is recorded. The net present value is calculated by discounting the Company's best estimate of projected future cash flows at the effective interest rate implicit in the debt security prior to impairment. The Company's estimates of projected future cash flows are driven by assumptions regarding probability of default and estimates regarding timing and amount of recoveries associated with a default. The Company develops these estimates using information based on historical experience, credit analysis of an investment, as mentioned above, and market observable data, such as industry analyst reports and forecasts, sector credit ratings and other data relevant to the collectability of the security. For mortgage‑backed and asset backed securities, cash flow estimates also include prepayment assumptions and other assumptions regarding the underlying collateral including default rates, recoveries and changes in value. The determination of the assumptions used in these projections requires the use of significant management judgment.

The Company's assessment of a decline in value included management's current assessment of the factors noted above. The Company also seeks advice from its outside investment managers. If that assessment changes in the future, the Company may ultimately record a loss after having originally concluded that the decline in value was temporary.

Investment Portfolio

Net investment income is a function of the yield that the Company earns on invested assets and the size of the portfolio. The investment yield is a function of market interest rates at the time of investment as well as the type, credit quality and maturity of the invested assets. Net investment income increased primarily due to higher income earned on loss mitigation bonds. Income earned on the general portfolio excluding loss mitigation bonds declined slightly due to lower reinvestment rates. Accrued investment income on fixed maturity, short-term investments and assets acquired in refinancing transactions was $52 million and $55 million as of December 31, 2012 and 2011, respectively.

Net Investment Income

	Year Ended December 31,	
	2012	2011
	(in millions)	
Income from fixed maturity securities	$ 215	$ 200
Income from short-term investments	0	0
Interest income from notes receivable from affiliates (See Note 15, Related Party Transactions)	17	15
Interest from assets acquired in refinancing transactions	5	5
Gross investment income	237	220
Investment expenses	(4)	(4)
Net investment income	$ 233	$ 216

Net Realized Investment Gains (Losses)

	Year Ended December 31,	
	2012	2011
	(in millions)	
Realized gains on investment portfolio	$ 23	$ 25
Realized losses on investment portfolio	(23)	(5)
OTTI:		
Intent to sell	0	(1)
Credit component of OTTI securities	(5)	(37)
OTTI	(5)	(38)
Net realized investment gains (losses)	$ (5)	$ (18)

The following table presents the roll-forward of the credit losses of fixed maturity securities for which the Company has recognized OTTI and where the portion of the fair value adjustment related to other factors was recognized in OCI.

Roll Forward of Credit Losses in the Investment Portfolio

	Year Ended December 31,	
	2012	2011
	(in millions)	
Balance, beginning of period	$ 31	$ 7
Additions for credit losses on securities for which an OTTI was not previously recognized	2	25
Eliminations of securities issued by FG VIEs	—	(13)
Additions for credit losses on securities for which an OTTI was previously recognized	3	12
Balance, end of period	$ 36	$ 31

Fixed Maturity Securities and Short-Term Investments
by Security Type
As of December 31, 2012

Investment Category	Percent of Total(1)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	AOCI (2) Gain (Loss) on Securities with OTTI	Weighted Average Credit Quality(3)
				(dollars in millions)			
Fixed maturity securities:							
U.S. government and agencies	2%	$ 86	$ 8	$ 0	$ 94	$ —	AA+
Obligations of state and political subdivisions	65	3,197	306	0	3,503	6	AA
Corporate securities	4	215	15	0	230	—	AA-
Mortgage-backed securities(4):							
RMBS	8	398	13	(53)	358	(37)	BBB-
CMBS	2	97	6	—	103	—	AAA
Asset-backed securities	6	288	54	—	342	41	BIG
Foreign government securities	3	192	9	0	201	1	AAA
Total fixed maturity securities	90	4,473	411	(53)	4,831	11	AA-
Short-term investments	10	473	0	—	473	—	AAA
Total investment portfolio	100%	$ 4,946	$ 411	$ (53)	$ 5,304	$ 11	AA-

Fixed Maturity Securities and Short-Term Investments
by Security Type
As of December 31, 2011

Investment Category	Percent of Total(1)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	AOCI Gain (Loss) on Securities with OTTI	Weighted Average Credit Quality(3)
			(dollars in millions)				
Fixed maturity securities:							
U.S. government and agencies	1%	$ 78	$ 8	$ —	$ 86	$ —	AA+
Obligations of state and political subdivisions	66	3,357	240	0	3,597	4	AA
Corporate securities	4	200	9	(1)	208	—	AA-
Mortgage-backed securities(4):							
RMBS	8	392	11	(59)	344	(38)	A-
CMBS	2	101	3	—	104	—	AAA
Asset-backed securities	6	302	33	—	335	29	BIG
Foreign government securities	5	244	4	(6)	242	—	AAA
Total fixed maturity securities	92	4,674	308	(66)	4,916	(5)	AA-
Short-term investments	8	412	—	—	412	—	AAA
Total investment portfolio	100%	$ 5,086	$ 308	$ (66)	$ 5,328	$ (5)	AA-

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(1) Based on amortized cost.

(2) Accumulated OCI ("AOCI").

(3) Ratings in the tables above represent the lower of the Moody's and S&P classifications except for bonds purchased for loss mitigation or risk management strategies, which use internal ratings classifications. The Company's portfolio consists primarily of high-quality, liquid instruments.

(4) Government‑agency obligations were approximately 38% of mortgage backed securities as of December 31, 2012 and 52% as of December 31, 2011 based on fair value.

The Company continues to receive sufficient information to value its investments and has not had to modify its valuation approach due to the current market conditions. As of December 31, 2012, amounts, net of tax, in AOCI included a net unrealized gain of $7 million for securities for which the Company had recognized OTTI and a net unrealized gain of $225 million for securities for which the Company had not recognized OTTI. As of December 31, 2011, amounts, net of tax, in AOCI included a net unrealized loss of $4 million for securities for which the Company had recognized OTTI and a net unrealized gain of $160 million for securities for which the Company had not recognized OTTI.

The Company's investment portfolio in tax-exempt and taxable municipal securities includes issuances by a wide number of municipal authorities across the U.S. and its territories. This is a high quality portfolio of municipal securities with an average rating of AA as of December 31, 2012 and 2011. Securities rated lower than A-/A3 by S&P or Moody's are not eligible to be purchased for the Company's portfolio unless acquired for loss mitigation or risk management strategies.

The following tables present the fair value of the Company's available-for-sale municipal bond portfolio as of December 31, 2012 and December 31, 2011 by state, excluding $350 million and $237 million of pre-refunded bonds, respectively. The credit ratings are based on the underlying ratings and do not include any benefit from bond insurance.

Fair Value of Available-for-Sale Municipal Bond Portfolio by State
As of December 31, 2012

State	State General Obligation	Local General Obligation	Revenue	Fair Value	Amortized Cost	Average Credit Rating
			(in millions)			
Texas	$ 47	$ 191	$ 200	$ 438	$ 401	AA
New York	13	21	396	430	399	AA
Florida	34	36	173	243	216	AA-
California	20	27	196	243	215	AA-
Illinois	—	63	130	193	173	A+
Washington	11	39	89	139	126	AA
Arizona	—	8	113	121	110	AA
Michigan	—	29	84	113	102	AA-
Massachusetts	20	4	82	106	95	AA
Pennsylvania	29	32	32	93	86	A+
All others	134	132	768	1,034	949	AA-
Total	$ 308	$ 582	$ 2,263	$ 3,153	$ 2,872	AA-

Fair Value of Available-for-Sale Municipal Bond Portfolio by State
As of December 31, 2011

State	State General Obligation	Local General Obligation	Revenue	Fair Value	Amortized Cost	Average Credit Rating
			(in millions)			
New York	$ 12	$ 24	$ 446	$ 482	$ 453	AA
Texas	47	220	195	462	432	AA
Florida	34	35	176	245	225	AA
Illinois	3	66	159	228	213	AA
California	19	13	170	202	182	AA
Washington	11	53	83	147	136	AA
Michigan	—	37	86	123	116	AA
Arizona	—	8	115	123	116	AA
Massachusetts	21	—	83	104	96	AA
Ohio	—	32	61	93	86	AA
All others	173	203	775	1,151	1,076	AA
Total	$ 320	$ 691	$ 2,349	$ 3,360	$ 3,131	AA

The revenue bond portfolio is comprised primarily of essential service revenue bonds issued by water and sewer authorities and other utilities, transportation authorities, universities and healthcare providers.

Revenue Sources

Type	As of December 31, 2012 Fair Value	As of December 31, 2012 Amortized Cost	As of December 31, 2011 Fair Value	As of December 31, 2011 Amortized Cost
	(in millions)			
Transportation	$ 472	$ 421	$ 510	$ 474
Tax backed	437	400	518	484
Municipal utilities	390	355	369	342
Water and sewer	298	274	299	281
Healthcare	253	229	257	242
Higher education	247	225	195	182
All others	166	156	201	191
Total	$ 2,263	$ 2,060	$ 2,349	$ 2,196

The Company's investment portfolio is managed by four outside managers. As municipal investments are a material portion of the Company's overall investment portfolio, the Company has established detailed guidelines regarding credit quality, exposure to a particular sector and exposure to a particular obligor within a sector. Each of the portfolio managers perform independent analysis on every municipal security they purchase for the Company's portfolio. The Company meets with each of its portfolio managers quarterly and reviews all investments with a change in credit rating as well as any investments on the manager's watch list of securities with the potential for downgrade.

The following tables summarize, for all securities in an unrealized loss position, the aggregate fair value and gross unrealized loss by length of time the amounts have continuously been in an unrealized loss position.

Fixed Maturity Securities
Gross Unrealized Loss by Length of Time
As of December 31, 2012

	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
			(dollars in millions)			
U.S. government and agencies	$ 12	$ 0	$ —	$ —	$ 12	$ 0
Obligations of state and political subdivisions	17	0	—	—	17	0
Corporate securities	5	0	—	—	5	0
Mortgage-backed securities:						
RMBS	76	(17)	97	(36)	173	(53)
Foreign government securities	6	0	—	—	6	0
Total	$ 116	$ (17)	$ 97	$ (36)	$ 213	$ (53)
Number of securities		16		10		26
Number of securities with OTTI		5		4		9

Fixed Maturity Securities
Gross Unrealized Loss by Length of Time
As of December 31, 2011

	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
			(dollars in millions)			
Obligations of state and political subdivisions	$ 6	$ 0	$ 10	$ 0	$ 16	$ 0
Corporate securities	16	(1)	—	—	16	(1)
Mortgage-backed securities:						
RMBS	81	(40)	30	(19)	111	(59)
Foreign government securities	141	(6)	—	—	141	(6)
Total	$ 244	$ (47)	$ 40	$ (19)	$ 284	$ (66)
Number of securities		26		10		36
Number of securities with OTTI		4		3		7

Of the securities in an unrealized loss position for 12 months or more as of December 31, 2012, six securities had unrealized losses greater than 10% of book value. The total unrealized loss for these securities as of December 31, 2012 was $35 million. The Company has determined that the unrealized losses recorded as of December 31, 2012 are yield related and not specific to issuer credit, therefore not OTTI.

The amortized cost and estimated fair value of available-for-sale fixed maturity securities by contractual maturity as of December 31, 2012 are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Distribution of Fixed-Maturity Securities
by Contractual Maturity
As of December 31, 2012

	Amortized Cost	Estimated Fair Value
	(in millions)	
Due within one year	$ 123	$ 124
Due after one year through five years	493	522
Due after five years through 10 years	1,405	1,547
Due after 10 years	1,957	2,177
Mortgage-backed securities:		
RMBS	398	358
CMBS	97	103
Total	$ 4,473	$ 4,831

Under agreements with its cedants and in accordance with statutory requirements, the Company maintains fixed maturity securities in trust accounts for the benefit of reinsured companies, which amounted to $21 million and $21 million as of December 31, 2012 and December 31, 2011, respectively. In addition, to fulfill state licensing requirements, the Company has placed on deposit eligible securities of $15 million and $15 million as of December 31, 2012 and December 31, 2011, respectively, for the protection of policyholders. In connection with an excess of loss reinsurance facility, $17 million were released from the trust to the reinsurers in the first quarter of 2013. See Note 14, Reinsurance and other Monoline Exposures.

No investments of the Company were non-income producing for the years ended December 31, 2012, and 2011.

Loss Mitigation Assets

One of the Company's strategies for mitigating losses has been to purchase insured securities that have expected losses at discounted prices. The Company may also obtain the obligations referenced in CDS transactions that have triggered the insured's obligation to put these bonds to AGM.

Prior to its acquisition, AGM had also purchased assets of certain insured obligations that had triggered rights under the financial guaranty contracts. The Company has rights under certain of its financial guaranty insurance policies and indentures that allow it to accelerate the insured notes and pay claims under its insurance policies upon the occurrence of predefined events of default. To mitigate financial guaranty insurance losses, the Company had elected to purchase the outstanding insured obligation or its underlying collateral. Generally, refinancing vehicles reimburse AGM in whole for its claims payments in exchange for assignments of certain of AGM's rights against the trusts. The refinancing vehicles obtained their funds from the proceeds of AGM-insured GICs issued in the ordinary course of business by former subsidiaries of AGMH that had engaged in its former financial products business (the "Financial Products Companies"). The refinancing vehicles are consolidated with the Company. The accretable yield on the securitized loans was $150 million and $141 million at December 31, 2012 and 2011, respectively.

Loss Mitigation Assets
Carrying Value

	As of December 31,	
	2012	2011
	(in millions)	
Fixed maturity securities:		
Obligations of state and political subdivisions	$ 12	$ 9
RMBS	184	105
Asset-backed securities	249	211
Other invested assets:		
Assets acquired in refinancing transactions	72	107
Other	1	2
Total	$ 518	$ 434

12. Insurance Company Regulatory Requirements

The Company's ability to pay dividends depends, among other things, upon its financial condition, results of operations, cash requirements and compliance with rating agency requirements, and is also subject to restrictions contained in the insurance laws and related regulations of its state of domicile and other states. Financial statements prepared in accordance with accounting practices prescribed or permitted by local insurance regulatory authorities differ in certain respects from GAAP.

The Company prepares statutory financial statements in accordance with accounting practices prescribed or permitted by the National Association of Insurance Commissioners (“NAIC”) and their respective insurance departments. Prescribed statutory accounting practices are set forth in the NAIC Accounting Practices and Procedures Manual. The Company has no permitted accounting practices on a statutory basis.

GAAP differs in certain significant respects from statutory accounting practices, applicable to U.S. insurance companies that are prescribed or permitted by insurance regulatory authorities. The principal differences result from the following statutory accounting practices:

- upfront premiums are earned when related principal and interest have expired rather than earned over the expected period of coverage;
- acquisition costs are charged to operations as incurred rather than over the period that related premiums are earned;

- a contingency reserve is computed based on the following statutory requirements:

    1) for all policies written prior to July 1, 1989, an amount equal to 50% of cumulative earned premiums less permitted reductions, plus

    2) for all policies written on or after July 1, 1989, an amount equal to the greater of 50% of premiums written for each category of insured obligation or a designated percentage of principal guaranteed for that category. These amounts are provided each quarter as either 1/60th or 1/80th of the total required for each category, less permitted reductions;

- certain assets designated as "non-admitted assets" are charged directly to statutory surplus but are reflected as assets under GAAP;

- the amount of deferred tax assets that may be admitted is subject to an adjusted surplus threshold and is generally limited to the lesser of those assets the Company expects to realize within three years of the balance sheet date or fifteen percent of the Company's adjusted surplus. This realization period and surplus percentage is subject to change based on the amount of adjusted surplus;

- insured CDS are accounted for as insurance contracts rather than as derivative contracts recorded at fair value;

- bonds are generally carried at amortized cost rather than fair value;

- VIEs and refinancing vehicles are not consolidated;

- push-down acquisition accounting is not applicable under statutory accounting practices;

- present value of expected losses are discounted at 5% and recorded without consideration of the deferred premium revenue as opposed to discounted at the risk free rate at the end of each reporting period and only to the extent they exceed deferred premium revenue;

- present value of installment premiums are not recorded on the balance sheets.

Insurance Regulatory Amounts Reported

	Policyholders' Surplus		Net Income (Loss)	
	As of December 31,		Year Ended December 31,	
	2012	2011	2012	2011
	(in millions)			
Assured Guaranty Municipal Corp (Consolidated)(1)	$ 1,785	$ 1,227	$ 256	$ 632
Assured Guaranty Municipal Corp (Stand-alone)	1,780	1,209	203	399

(1) Amounts represent the Company's statutory basis amounts on a consolidated basis with all its domestic and foreign subsidiaries.

Dividend Restrictions and Capital Requirements

AGM is a New York domiciled insurance company. Based on AGM's statutory statements filed for the year ended December 31, 2012, the maximum amount available for payment of dividends by AGM without regulatory approval over the 12 months following December 31, 2012, is approximately $178 million. Also in connection with the acquisition of AGMH on July 1, 2009 ("AGMH Acquisition"), the Company committed to the New York Department of Financial Services that AGM would not pay any dividends for a period of two years from the Acquisition Date without written approval of the New York Department of Financial Services.

Dividends Paid
By Insurance Company

	Year Ended December 31,	
	2012	2011
	(in millions)	
Dividends paid by AGM to AGMH	30	—

13. Income Taxes

Accounting Policy

The provision for income taxes consists of an amount for taxes currently payable and an amount for deferred taxes. Deferred income taxes are provided for temporary differences between the financial statement carrying amounts and tax bases of assets and liabilities, using enacted rates in effect for the year in which the differences are expected to reverse. A valuation allowance is recorded to reduce the deferred tax asset to an amount that is more likely than not to be realized.

Non-interest‑bearing tax and loss bonds are purchased to prepay the tax benefit that results from deducting contingency reserves as provided under Internal Revenue Code Section 832(e). The Company records the purchase of tax and loss bonds in deferred taxes.

The Company recognizes tax benefits only if a tax position is “more likely than not” to prevail.

Provision for Income Taxes

The Company's Bermuda subsidiary, Assured Guaranty (Bermuda) Ltd. (formerly Financial Security Assurance International Ltd. (“AGBM”)), is not subject to any income, withholding or capital gains taxes under current Bermuda law. The Company has received an assurance from the Minister of Finance in Bermuda that, in the event of any taxes being imposed, AGBM will be exempt from taxation in Bermuda until March 28, 2035. The Company's U.S. and United Kingdom (“U.K.”) subsidiary are subject to income taxes imposed by U.S. and U.K. authorities and file applicable tax returns.

In conjunction with AGL's purchase of AGMH on July 1, 2009, AGM and its insurance company subsidiaries have joined the consolidated federal tax group of AGUS. A new tax sharing agreement was entered into effective July 1, 2009 whereby each company in the Assured Guaranty US Holdings Inc. ("AGUS") consolidated tax group pays or receives its proportionate share of the consolidated federal tax burden for the group as if each company filed on a separate return basis with current period credit for net losses.

A reconciliation of the difference between the provision for income taxes and the expected tax provision at statutory rates in taxable jurisdictions is presented below:

Effective Tax Rate Reconciliation

	Year Ended December 31,	
	2012	2011
	(in millions)	
Expected tax provision (benefit) at statutory rate	$ 204	$ 192
Tax-exempt interest	(42)	(43)
True-up from tax return filings	0	(2)
Change in liability for uncertain tax positions	—	—
Other	2	2
Total provision (benefit) for income taxes	$ 164	$ 149
Effective tax rate	28.2%	27.2%

Components of Net Deferred Tax Assets

	As of December 31,	
	2012	2011
	(in millions)	
Deferred tax assets:		
Unrealized losses on credit derivative financial instruments, net	$ 98	$ 132
Unearned premium reserve, net	143	356
Losses and LAE reserves	19	—
Tax and loss bonds	6	45
Deferred ceding commission income	38	41
Foreign tax credits	30	30
FG VIEs	145	175
Investment in foreign subsidiary	30	29
Investment basis difference	72	27
Other	3	10
Total deferred income tax assets	584	845
Deferred tax liabilities:		
Contingency reserves	6	45
Losses and LAE reserves	—	62
Unrealized appreciation on investments	125	84
Market discount	33	—
Other	11	23
Total deferred income tax liabilities	175	214
Net deferred income tax asset	$ 409	$ 631

As of December 31, 2012, the Company had foreign tax credits carried forward of $30 million which expire in 2018 through 2021. Internal Revenue Code limits the amounts of foreign tax credits the Company may utilize each year. Management believes sufficient future taxable income exists to realize the full benefit of these foreign tax credits.

Valuation Allowance

The Company came to the conclusion that it is more likely than not that its net deferred tax asset will be fully realized after weighing all positive and negative evidence available as required under GAAP. The positive evidence that was considered included the cumulative operating income the Company has earned over the last three years, and the significant unearned premium income to be included in taxable income. The positive evidence outweighs any negative evidence that exists. As such, the Company believes that no valuation allowance is necessary in connection with this deferred tax asset. The Company will continue to analyze the need for a valuation allowance on a quarterly basis.

Audits

AGUS has open tax years with the U.S. Internal Revenue Service ("IRS") for 2009 forward and is currently under audit for the 2009 tax year. The IRS concluded its field work with respect to tax years 2006 through 2008 without adjustment. On February 20, 2013 the IRS notified AGUS that the Joint Committee on Taxation completed its review and has accepted the results of the IRS examination without exception. AGMH and subsidiaries have separate open tax years with the IRS of 2008 through the July 1, 2009 when they joined the AGUS consolidated group. AGMH and subsidiaries are under audit for 2008 while members of the Dexia Holdings Inc. consolidated tax group. The Company is indemnified by Dexia for any potential liability associated with this audit of any periods prior to the AGMH Acquisition. The Company's U.K. subsidiary is not currently under examination and have open tax years of 2010 forward.

Uncertain Tax Positions

The following table provides a reconciliation of the beginning and ending balances of the total liability for unrecognized tax benefits. The Company does not believe it is reasonably possible that this amount will change significantly in the next twelve months.

	2012	2011
	(in millions)	
Balance as of January 1,	$ 5	$ 5
True-up from tax return filings	—	—
Increase in unrecognized tax benefits as a result of position taken during the current period	—	—
Balance as of December 31,	5	$ 5

The Company's policy is to recognize interest and penalties related to uncertain tax positions in income tax expense. As of December 31, 2012, the Company has accrued $1 million of interest.

The total amount of unrecognized tax benefits as at December 31, 2012, that would affect the effective tax rate, if recognized, is $5 million.

Tax Treatment of CDS

The Company treats the guaranty it provides on CDS as insurance contracts for tax purposes and as such a taxable loss does not occur until the Company expects to make a loss payment to the buyer of credit protection based upon the occurrence of one or more specified credit events with respect to the contractually referenced obligation or entity. The Company holds its CDS to maturity, at which time any unrealized fair value loss in excess of credit-related losses would revert to zero. The tax treatment of CDS is an unsettled area of the law. The uncertainty relates to the IRS determination of the income or potential loss associated with CDS as either subject to capital gain (loss) or ordinary income (loss) treatment. In treating CDS as insurance contracts the Company treats both the receipt of premium and payment of losses as ordinary income and believes it is more likely than not that any CDS credit related losses will be treated as ordinary by the IRS. To the extent the IRS takes the view that the losses are capital losses in the future and the Company incurred actual losses associated with the CDS, the Company would need sufficient taxable income of the same character within the carryback and carryforward period available under the tax law.

14. Reinsurance and Other Monoline Exposures

AGM assumes exposure on insured obligations (“Assumed Business”) and cedes portions of its exposure on obligations it has insured (“Ceded Business”) in exchange for premiums, net of ceding commissions.

Accounting Policy

For business assumed and ceded, the accounting model of the underlying direct financial guaranty contract dictates the accounting model used for the reinsurance contract (except for those eliminated as FG VIEs). For any assumed or ceded financial guaranty insurance premiums and losses, the accounting model described in Note 4 is followed, and for assumed and ceded credit derivative premiums and losses, the accounting model in Note 6 is followed.

Ceded and Assumed Business

The Company has Ceded Business to non-affiliated companies to limit its exposure to risk. Under these relationships, the Company cedes a portion of its insured risk in exchange for a premium paid to the reinsurer. The Company remains primarily liable for all risks it directly underwrites and is required to pay all gross claims. It then seeks reimbursement from the reinsurer for its proportionate share of claims. The Company may be exposed to risk for this exposure if it were required to pay the gross claims and not be able to collect ceded claims from an assuming company experiencing financial distress. A number of the financial guaranty insurers to which the Company has ceded par have experienced financial distress and been downgraded by the rating agencies as a result. In addition, state insurance regulators have intervened with respect to some of these insurers. The Company's ceded contracts generally allow the Company to recapture Ceded Business after certain triggering events, such as reinsurer downgrades.

Over the past several years, the Company has entered into several commutations in order to reassume previously ceded books of business from BIG financial guaranty companies and its other reinsurers. The Company also has cancelled assumed reinsurance contracts. These commutations of ceded and cancellations of Assumed Business resulted in gains of $82 million and $32 million for the years ended December 31, 2012 and 2011, respectively, which were recorded in “other income.” While certain Ceded Business has been reassumed, the Company still has significant Ceded Business with third parties.

Net Effect of Commutations of Ceded and Cancellations of Assumed Reinsurance Contracts

	Year Ended December 31,	
	2012	2011
	(in millions)	
Increase (decrease) in net unearned premium reserve	$ 109	$ (12)
Increase (decrease) in net par outstanding	19,173	(270)

The following table presents the components of premiums and losses reported in the consolidated statement of operations and the contribution of the Company's Assumed and Ceded Businesses.

Effect of Reinsurance on Statement of Operations

	Year Ended December 31,	
	2012	2011
	(in millions)	
Premiums Written:		
Direct	$ 194	$ 170
Ceded	(1)	(71)
Net	$ 193	$ 99
Premiums Earned:		
Direct	$ 809	$ 871
Assumed	1	0
Ceded	(220)	(210)
Net	$ 590	$ 661
Loss and LAE:		
Direct	$ 583	$ 510
Ceded	(186)	(128)
Net	$ 397	$ 382

Reinsurer Exposure

In addition to assumed and ceded reinsurance arrangements, the Company may also have exposure to some financial guaranty reinsurers (i.e., monolines) in other areas. Second-to-pay insured par outstanding represents transactions the Company has insured that were previously insured by other monolines. The Company underwrites such transactions based on the underlying insured obligation without regard to the primary insurer. Another area of exposure is in the investment portfolio where the Company holds fixed maturity securities that are wrapped by monolines and whose value may decline based on the rating of the monoline. At December 31, 2012, based on fair value, the Company had $562 million of fixed maturity securities in its investment portfolio wrapped by National Public Finance Guarantee Corporation, $392 million by Ambac Assurance Corporation ("Ambac"), $84 million by AGC, and $25 million by other guarantors.

Exposure by Reinsurer

Reinsurer	Ratings as of April 22, 2013		Par Outstanding as of December 31, 2012		
	Moody's Reinsurer Rating	S&P Reinsurer Rating	Ceded Par Outstanding(1)	Second-to-Pay Insured Par Outstanding	Assumed Par Outstanding
			(dollars in millions)		
Affiliated Companies	(2)	(2)	$ 64,923	$ 503	$ 26
Non-Affiliated Companies:					
Tokio	Aa3(3)	AA-(3)	8,395	—	933
American Overseas Reinsurance Company Limited (f/k/a Ram Re)	WR(4)	WR	7,672	—	24
Radian	Ba1	B+	5,097	40	—
Syncora Guarantee Inc.	WR	WR	4,156	727	—
Mitsui Sumitomo Insurance Co. Ltd.	A1	A+(3)	2,243	—	—
ACA Financial Guaranty Corp.	NR	WR	810	5	—
Swiss Reinsurance Co.	A1	AA-	430	—	—
CIFG Assurance North America Inc. ("CIFG")	WR	WR	65	119	—
MBIA Inc.	(5)	(5)	—	7,834	—
Ambac	WR	WR	—	3,464	—
Financial Guaranty Insurance Co.	WR	WR	—	1,209	—
Other	Various	Various	893	—	1
Non-Affiliated Companies			29,761	13,398	958
Total			$ 94,684	$ 13,901	$ 984

(1) Includes $3,633 million in ceded par outstanding related to insured credit derivatives.

(2) As of the date of this document, the affiliates of AGM are Assured Guaranty Re Ltd. and its subsidiaries ("AG Re"), rated Baa1 (stable) by Moody's and AA- (stable) by S&P, and AGC and its subsidiaries, rated A3 (stable) by Moody's and AA- (stable) by S&P.

(3) The Company has structural collateral agreements satisfying the triple-A credit requirement of S&P and/or Moody's.

(4) Represents "Withdrawn Rating."

(5) MBIA Inc. includes various subsidiaries which are rated BB, CCC and WR by S&P and Caa2, B3, Baa2, WR and NR by Moody's.

Ceded Par Outstanding by Reinsurer and Credit Rating
As of December 31, 2012

Reinsurer	Super Senior	AAA	AA	A	BBB	BIG	Total
	Internal Credit Rating						
				(in millions)			
Affiliated Companies	$ 68	$ 1,391	$ 21,277	$ 30,697	$ 10,304	$ 1,186	$ 64,923
Tokio	313	1,072	1,421	2,457	2,412	720	8,395
American Overseas Reinsurance Company Limited (f/k/a Ram Re)	52	420	3,098	2,515	1,277	310	7,672
Radian	10	256	374	2,342	1,737	378	5,097
Syncora Guarantee Inc.	—	—	241	761	2,495	659	4,156
Mitsui Sumitomo Insurance Co. Ltd.	7	151	713	865	449	58	2,243
ACA Financial Guaranty Corp.	—	—	474	325	11	—	810
Swiss Reinsurance Co.	—	8	7	261	111	43	430
CIFG	—	—	—	—	—	65	65
Other	—	—	114	741	38	—	893
Total	$ 450	$ 3,298	$ 27,719	$ 40,964	$ 18,834	$ 3,419	$ 94,684

In accordance with U.S. statutory accounting requirements and U.S. insurance laws and regulations, in order for the Company to receive credit for liabilities ceded to reinsurers domiciled outside of the U.S., such reinsurers must secure their liabilities to the Company. All of the unauthorized reinsurers in the table above post collateral for the benefit of the Company in an amount at least equal to the sum of their ceded unearned premium reserve, loss reserves and contingency reserves all calculated on a statutory basis of accounting. CIFG and Radian are authorized reinsurers. Radian's collateral equals or exceeds its ceded statutory loss reserves and CIFG's collateral covers a substantial portion of its ceded statutory loss reserves. Collateral may be in the form of letters of credit or trust accounts. The total collateral posted by all non-affiliated reinsurers as of December 31, 2012 is approximately $977 million.

Second-to-Pay
Insured Par Outstanding by Rating
As of December 31, 2012(1)

	Public Finance				Structured Finance				
	AA	A	BBB	BIG	AAA	AA	A	BIG	Total
					(in millions)				
Affiliated Companies	$ 77	$ —	$ —	$ —	$ —	$ 426	$ —	$ —	$ 503
Radian	—	13	16	11	—	—	—	—	40
Syncora Guarantee Inc.	—	114	312	214	84	—	3	—	727
ACA Financial Guaranty Corp	3	—	2	—	—	—	—	—	5
CIFG	5	17	52	45	—	—	—	—	119
MBIA Inc.	1,941	2,971	1,403	—	—	1,308	—	211	7,834
Ambac	966	1,772	195	207	15	53	1	255	3,464
Financial Guaranty Insurance Co.	26	651	3	241	248	—	—	40	1,209
Total	$ 3,018	$ 5,538	$ 1,983	$ 718	$ 347	$ 1,787	$ 4	$ 506	$ 13,901

(1) Assured Guaranty's internal rating.

Amounts Due (To) From Reinsurers

	As of December 31, 2012	
	Ceded Premium, net of Commissions	Ceded Expected Loss and LAE
	(in millions)	
Affiliated Companies	$ (63)	$ 20
Tokio	(27)	37
American Overseas Reinsurance Company Ltd.	(10)	3
Radian	(20)	(4)
Syncora Guarantee Inc.	(43)	1
Mitsui Sumitomo Insurance Co. Ltd.	(5)	9
Swiss Reinsurance Co.	(3)	2
CIFG	—	3
Other	(59)	—
Total	$ (230)	$ 71

Excess of Loss Reinsurance Facility

On January 22, 2012, AGC and AGM entered into an aggregate excess of loss reinsurance facility, effective as of January 1, 2012. The facility cover losses occurring from January 1, 2013 through December 31, 2020. It terminates on January 1, 2014 unless AGC and AGM choose to extend it. The facility covers U.S. public finance credits insured or reinsured by AGC and AGM as of September 30, 2011, excluding credits that were rated non-investment grade as of December 31, 2011 by Moody's or S&P or internally by AGC or AGM and subject to certain per credit limits. The facility attaches when AGC's or AGM's net losses (net of AGC's and AGM other reinsurance, other than pooling reinsurance provided to AGM by AGM's subsidiaries and net of recoveries) exceed in the aggregate $2 billion and covers a portion of the next $600 million of losses, with the reinsurers assuming pro rata in the aggregate $435 million of the $600 million of losses and AGC and AGM jointly retaining the remaining $165 million of losses. The reinsurers are required to be rated at least AA-(Stable Outlook) through December 31, 2014 or to post collateral sufficient to provide AGM and AGC with the same reinsurance credit as reinsurers rated AA-. AGM and AGC are obligated to pay the reinsurers their share of recoveries relating to losses during the coverage period in the covered portfolio. This obligation is secured by a pledge of the recoveries, which will be deposited into a trust for the benefit of the reinsurers. The Company has paid approximately $17 million of premiums during 2012. The remaining $17 million of premium was released from the trust to the reinsurers in the first quarter of 2013.

Re-Assumption Agreement with Radian Asset Assurance Inc.

On January 24, 2012, AGM entered into an agreement under which it reassumed $12.9 billion of par it had previously ceded to Radian. AGM has received a payment of $86 million from Radian for the re-assumption, which consists 96% of public finance exposure and 4% of structured finance credits. Additionally, the Company projected it will receive an incremental $1.9 million, on a present value basis of future installment premiums. The reassumed portfolio is composed entirely of selected credits that meet the Company's underwriting standards.

Tokio Marine & Nichido Fire Insurance Co., Ltd. Agreement

Effective as of March 1, 2012, AGM and Tokio entered into a Commutation, Reassumption and Release Agreement for a portfolio consisting of approximately $6.2 billion principal amount of U.S. public finance exposures outstanding as of February 29, 2012. Tokio paid AGM the statutory unearned premium outstanding as of February 29, 2012 plus a commutation premium.

15. Related Party Transactions

Guarantees or Contingencies for Related Parties

AGM has executed a net worth maintenance agreement on behalf of Assured Guaranty Municipal Insurance Company

(“AGMIC”) pursuant to which the Company agrees to maintain AGMIC's policyholders' surplus of $66 million as determined under the laws of New York. AGM has entered into a net worth maintenance agreement with AGBM pursuant to which AGM agrees to cause AGBM to maintain the minimum shareholders' equity required under the laws of Bermuda for AGBM to maintain its insurance license. However, under both of these net worth maintenance agreements, any contributions by AGM for such purpose shall not: (a) exceed 35% of AGM's policyholders' surplus on an accumulated basis as determined under the laws of the State of New York, (b) not have the effect of jeopardizing AGM's insurer financial strength rating from Moody's or S&P, and (c) be in compliance with Section 1505 of the New York Insurance Law. AGM has entered into an amended and restated net worth maintenance agreement with AGE pursuant to which the Company agrees to maintain AGE's capital resources at least equal to 110% of the minimum capital requirement as determined under the laws of the United Kingdom or required by the U.K. insurance regulator; provided that any such contributions by AGM shall not: (a) exceed 35% of AGM's policyholders' surplus on an accumulated basis as determined under the laws of the State of New York and (b) be in compliance with Section 1505 of the New York Insurance Law. AGM did not make any contributions under any of these net worth maintenance agreements with AGE in 2012 and 2011.

Management, Service Contracts or Cost Sharing Arrangements

Under a Service Agreement between AGC and AGM dated January 1, 2010, AGC provides insurance and certain support services, including actuarial, claims handling, surveillance, legal, corporate secretarial, information technology, human resources, accounting, tax, financial reporting and investment planning services to AGM. Also under the Service Agreement, AGM makes available office space and equipment to certain of its affiliates. Costs and expenses under the Service Agreement are allocated directly, where possible, and where not possible, allocated between companies according to: employee headcount multiplied by the percentage of employee time allocated to each company.

See Note 18, Employee Benefit Plans for expenses related to Long-Term Compensation Plans of AGL which are allocated to AGM. For the years ended December 31, 2012 and 2011, the Company was allocated expenses of $64 million and $55 million, respectively, under these affiliate expense sharing agreements. The increase in the expenses that AGC allocated to affiliates was a result of an updated time study. The primary driver was an increase in expenses allocated to AGM which guaranteed the majority of new business in 2012.

The following table summarizes the amounts due (to) from affiliate companies under the expense sharing agreements.

Amounts Due (To) From Affiliated Companies

	As of December 31,	
	2012	2011
	(in millions)	
Affiliated companies		
Assured Guaranty Corp.	$ (36)	$ (16)
Assured Guaranty Finance Overseas Ltd.	(1)	(2)
Assured Guaranty Ltd.	(1)	(1)
Other	(3)	(1)
Total	$ (41)	$ (20)

Assured Guaranty Re Ltd.

The Company cedes business to AG Re under certain reinsurance agreements. The following table summarizes the affiliated components of each balance sheet item, where applicable.

	As of December 31,	
	2012	2011
	(in millions)	
Assets:		
Ceded unearned premium reserve (1)	644	679
Reinsurance recoverable on unpaid losses	19	12
Reinsurance recoverable on paid losses(2)	1	8
Profit commission receivable (2)	3	5
Net credit derivative assets	45	41
Liabilities:		
Ceded premium payable, net of ceding commission	63	69
Ceded salvage and subrogation recoverable	17	13
Ceded funds held	36	22
Other liabilities (3)	118	106

(1) Includes $11 million and $5 million of ceded contra-paid on losses at December 31, 2012 and December 31, 2011, respectively.

(2) Included in other assets on the consolidated balance sheets.

(3) Represents deferred ceding commissions.

The table below summarizes ceded activity to AG Re reflected in the consolidated statement of operations.

	Year Ended December 31,	
	2012	2011
	(in millions)	
Revenues:		
Net earned premiums	(92)	(90)
Profit commission income	3	5
Realized gains and other settlements on credit derivatives	(1)	(2)
Net unrealized gains (losses) on credit derivatives	3	(4)
Expenses:		
Loss and loss adjustment expenses (recoveries)	(58)	(26)
Commissions incurred (earned)	(7)	(7)

Other Invested Assets

Surplus Note from AGC

On December 18, 2009, AGC issued a surplus note with a principal amount of $300.0 million to AGM. This note carries a simple interest rate of 5.0% per annum and matures on December 31, 2029. Principal is payable at the option of AGC prior to the final maturity of the note in 2029 and interest is payable on the note annually in arrears as of December 31 of each year, commencing December 31, 2010. Payments of principal and interest are subject to AGC having policyholders' surplus in excess of statutory minimum requirements after such payment and to prior written approval by the Maryland Insurance Administration. AGM recognized $15 million of interest income in each of the years ended December 31, 2012 and 2011. AGM also received $15 million of interest from AGC in each of the years ended December 31, 2012 and 2011. There was no principal paydown on the surplus note by AGC.

Loan Receivable from Affiliate

Loan to Assured Guaranty US Holdings Inc.

In May 2012, AGBM entered into a five-year loan agreement with AGUS which authorizes borrowings up to $172.5 million. On May 31, 2012, AGUS borrowed $82.5 million under such agreement. Interest is accruing on the unpaid principal amount of the loan at a rate of six-month LIBOR plus 3% per annum. The entire outstanding principal balance of the loan, together with all accrued and unpaid interest, will be due and payable on the fifth anniversary of the date the loan is made. AGM recognized $2 million of interest income during the year ended December 31, 2012.

Capital Contribution from AGMH

In the third quarter of 2008, AGM issued a non-interest bearing surplus note with no term to AGMH in exchange for $300 million which, due to the terms of the agreement, is recorded as capital. Principal on the surplus note may be paid at any time at the option of the Company, subject to prior approval of the New York Superintendent and in compliance with the conditions to such payments as contained in the New York Insurance Laws. The Company repaid $50 million in principal on these surplus notes in 2012 and $50 million in 2011. As of December 31, 2012, an aggregate principal of $125 million remains outstanding on the surplus note. In March 2013, AGM obtained approval from the New York Department of Financial Services to repay an additional $25 million of principal of the surplus note.

16. Commitments and Contingencies

Leases

Effective June 2004, the Company entered into a 21-year sublease agreement with Deutsche Bank AG for office space at 31 West 52nd Street, New York, New York. The Company moved to this space in June 2005. The lease contains scheduled rent increases every five years after the 19-month rent-free period, as well as lease incentives for initial construction costs of up to $6 million, as defined in the sublease. The lease contains provisions for rent increases related to increases in the building's operating expenses. The lease also contains a renewal option for an additional ten-year period, and an option to rent additional office space at various points in the future, in each case at then-current market rents. Rent expense was $5.0 million in 2012 and $4.9 million in 2011.

Future Minimum Rental Payments

Year	(in millions)
2013	$ 8.5
2014	7.4
2015	7.1
2016	7.5
2017	7.6
Thereafter	66.3
Total	$ 104.4

Legal Proceedings

Litigation

Lawsuits arise in the ordinary course of the Company's business. It is the opinion of the Company's management, based upon the information available, that the expected outcome of litigation against the Company, individually or in the aggregate, will not have a material adverse effect on the Company's financial position or liquidity, although an adverse resolution of litigation against the Company in a fiscal quarter or year could have a material adverse effect on the Company's results of operations in a particular quarter or year.

In addition, in the ordinary course of its business, the Company asserts claims in legal proceedings against third parties to recover losses paid in prior periods. For example, as described in the "Recovery Litigation" section within Note 6, Expected Loss to be Paid, as of the date of this filing, AGM has filed complaints against certain sponsors and underwriters of RMBS securities that AGM had insured, alleging, among other claims, that such persons had breached R&W in the transaction documents, failed to cure or repurchase defective loans and/or violated state securities laws. The amounts, if any, the Company will recover in proceedings to recover losses are uncertain, and recoveries, or failure to obtain recoveries, in any one or more of these proceedings during any quarter or year could be material to the Company's results of operations in that particular quarter or year.

Proceedings Relating to the Company's Financial Guaranty Business

AGM and AGMH receive subpoenas *duces tecum* and interrogatories from regulators from time to time.

In August 2008, a number of financial institutions and other parties, including AGM and other bond insurers, were named as defendants in a civil action brought in the circuit court of Jefferson County, Alabama relating to the County's problems meeting its sewer debt obligations: *Charles E. Wilson vs. JPMorgan Chase & Co et al* (filed the Circuit Court of Jefferson County, Alabama), Case No. 01-CV-2008-901907.00, a putative class action. The action was brought on behalf of rate payers, tax payers and citizens residing in Jefferson County, and alleges conspiracy and fraud in connection with the issuance of the County's debt. The complaint in this lawsuit seeks equitable relief, unspecified monetary damages, interest, attorneys' fees and other costs. On January, 13, 2011, the circuit court issued an order denying a motion by the bond insurers and other defendants to dismiss the action. Defendants, including the bond insurers, have petitioned the Alabama Supreme Court for a writ of mandamus to the circuit court vacating such order and directing the dismissal with prejudice of plaintiffs' claims for lack of standing. On January 23, 2012, the Alabama Supreme Court entered a stay pending the resolution of the Jefferson County bankruptcy. The Company cannot reasonably estimate the possible loss or range of loss, if any, that may arise from this lawsuit.

Beginning in July 2008, AGM and various other financial guarantors were named in complaints filed in the Superior Court for the State of California, City and County of San Francisco. Since that time, plaintiffs' counsel has filed amended complaints against AGM and AGC and added additional plaintiffs. As of the date of this filing, the plaintiffs with complaints against AGM and AGC, among other financial guaranty insurers, are: (a) *City of Los Angeles, acting by and through the Los Angeles Department of Water and Power*; (b) *City of Sacramento*; (c) *City of Los Angeles*; (d) *City of Oakland*; (e) *City of Riverside*; (f) *City of Stockton*; (g) *County of Alameda*; (h) *Contra Costa County*; (i) *County of San Mateo*; (j) *Los Angeles World Airports;* (k) *City of Richmond;* (l) *Redwood City;* (m) *East Bay Municipal Utility District;* (n) *Sacramento Suburban Water District;* (o) *City of San Jose;* (p) *County of Tulare;* (q) *The Regents of the University of California;* (r) *The Redevelopment Agency of the City of Riverside;* (s) *The Public Financing Authority of the City of Riverside;* (t) *The Jewish Community Center of San Francisco;* (u) *The San Jose Redevelopment Agency;* (v) *The Redevelopment Agency of the City of Stockton;* (w) *The Public Financing Authority of the City of Stockton;* and (x) *The Olympic Club*. Complaints filed by the City and County of San Francisco and the Sacramento Municipal Utility District were subsequently dismissed as to AGM and AGC. These complaints allege that the financial guaranty insurer defendants (i) participated in a conspiracy in violation of California's antitrust laws to maintain a dual credit rating scale that misstated the credit default risk of municipal bond issuers and created market demand for municipal bond insurance, (ii) participated in risky financial transactions in other lines of business that damaged each insurer's financial condition (thereby undermining the value of each of their guaranties), and (iii) failed to adequately disclose the impact of those transactions on their financial condition. In addition to their antitrust claims, various plaintiffs in these actions assert claims for breach of the covenant of good faith and fair dealing, fraud, unjust enrichment, negligence, and negligent misrepresentation. At hearings held in July and October 2011 relating to AGM, AGC and the other defendants' demurrer, the court overruled the demurrer on the following claims: breach of contract, violation of California's antitrust statute and of its unfair business practices law, and fraud. The remaining claims were dismissed. On December 2, 2011, AGM, AGC and the other bond insurer defendants filed an anti-SLAPP ("Strategic Lawsuit Against Public Participation") motion to strike the complaints under California's Code of Civil Procedure. On May 1, 2012, the court ruled in favor of the bond insurer defendants on the first prong of the anti-SLAPP motion as to the causes of action arising from the alleged conspiracy, but denied the motion as to those causes of action based on transaction specific representations and omissions about the bond insurer defendants' credit ratings and financial health. The court held hearings on the second prong of the anti-SLAPP motion on March 21, 2013 and April 22, 2013. At the March 21, 2013 hearing, the court issued an oral ruling that, under the second prong of the anti-SLAPP motion, there has been no showing of an antitrust act claim against the defendants. At the April 22, 2013 hearing the court issued another oral ruling that, under the second prong of the anti-SLAPP motion, plaintiffs had offered sufficient evidence of a claim under California's Unfair Competition Law and denied defendants' motion to strike. The complaints in these lawsuits generally seek unspecified monetary damages, interest, attorneys' fees, costs and other expenses. The Company cannot reasonably estimate the possible loss or range of loss, if any, that may arise from these lawsuits.

On November 19, 2012, Lehman Brothers Holdings Inc. ("LBHI") and Lehman Brothers Special Financing Inc. ("LBSF") commenced an adversary complaint and claim objection in the United States Bankruptcy Court for the Southern District of New York against Credit Protection Trust 283 ("CPT 283"), FSA Administrative Services, LLC, as trustee for CPT 283, and AGM, in connection with CPT 283's termination of a CDS between LBSF and CPT 283. CPT 283 terminated the CDS as a consequence of LBSF failing to make a scheduled payment owed to CPT 283, which termination occurred after LBHI filed for bankruptcy but before LBSF filed for bankruptcy. The CDS provided that CPT 283 was entitled to receive from LBSF a termination payment in that circumstance of approximately $43.8 million (representing the economic equivalent of the future fixed payments CPT 283 would have been entitled to receive from LBSF had the CDS not been terminated), and CPT 283 filed proofs of claim against LBSF and LBHI (as LBSF's credit support provider) for such amount. LBHI and LBSF seek to disallow and expunge (as impermissible and unenforceable penalties) CPT 283's proofs of claim against LBHI and LBSF and recover approximately $67.3 million, which LBHI and LBSF allege was the mark-to-market value of the CDS to LBSF (less unpaid amounts) on the day CPT 283 terminated the CDS, plus interest, attorney's fees, costs and other expenses. On the same day, LBHI and LBSF also commenced an adversary complaint and claim objection against Credit Protection Trust 207 ("CPT 207"), FSA Administrative Services, LLC, as trustee for CPT 207, and AGM, in connection with CPT 207's termination of a CDS between LBSF and CPT 207. Similarly, the CDS provided that CPT 207 was entitled to receive from LBSF a termination payment in that circumstance of $492,555. LBHI and LBSF seek to disallow and expunge CPT 207's proofs of claim against LBHI and LBSF and recover approximately $1.5 million. AGM believes the terminations of the CDS and the calculation of the termination payment amounts were consistent with the terms of the ISDA master agreements between the parties. The Company cannot reasonably estimate the possible loss, if any, that may arise from this lawsuit.

Proceedings Related to AGMH's Former Financial Products Business

The following is a description of legal proceedings involving AGMH's former financial products business. Although Assured Guaranty did not acquire AGMH's former financial products business, which included AGMH's former GIC business, medium term notes business and portions of the leveraged lease businesses, certain legal proceedings relating to those businesses are against entities that Assured Guaranty did acquire. While Dexia SA and Dexia Crédit Local S.A. ("DCL"), jointly and severally, have agreed to indemnify Assured Guaranty against liability arising out of the proceedings described below in the "—Proceedings Related to AGMH's Former Financial Products Business" section, such indemnification might not be sufficient to fully hold Assured Guaranty harmless against any injunctive relief or civil or criminal sanction that is imposed against AGMH or its subsidiaries.

Governmental Investigations into Former Financial Products Business

AGMH and/or AGM have received subpoenas *duces tecum* and interrogatories or civil investigative demands from the Attorneys General of the States of Connecticut, Florida, Illinois, Massachusetts, Missouri, New York, Texas and West Virginia relating to their investigations of alleged bid rigging of municipal GICs. AGMH is responding to such requests. AGMH may receive additional inquiries from these or other regulators and expects to provide additional information to such regulators regarding their inquiries in the future. In addition,

- AGMH received a subpoena from the Antitrust Division of the Department of Justice in November 2006 issued in connection with an ongoing criminal investigation of bid rigging of awards of municipal GICs and other municipal derivatives;

- AGM received a subpoena from the Securities and Exchange Commission ("SEC") in November 2006 related to an ongoing industry-wide investigation concerning the bidding of municipal GICs and other municipal derivatives; and

- AGMH received a “Wells Notice” from the staff of the Philadelphia Regional Office of the SEC in February 2008 relating to the investigation concerning the bidding of municipal GICs and other municipal derivatives. The Wells Notice indicates that the SEC staff is considering recommending that the SEC authorize the staff to bring a civil injunctive action and/or institute administrative proceedings against AGMH, alleging violations of Section 10 (b) of the Exchange Act and Rule 10b-5 thereunder and Section 17(a) of the Securities Act.

Pursuant to the subpoenas, AGMH has furnished to the Department of Justice and SEC records and other information with respect to AGMH’s municipal GIC business. The ultimate loss that may arise from these investigations remains uncertain.

In July 2010, a former employee of AGM who had been involved in AGMH's former financial products business was indicted along with two other persons with whom he had worked at Financial Guaranty Insurance Company. Such former employee and the other two persons were convicted on fraud conspiracy counts. They have appealed the convictions.

Lawsuits Relating to Former Financial Products Business

During 2008, nine putative class action lawsuits were filed in federal court alleging federal antitrust violations in the municipal derivatives industry, seeking damages and alleging, among other things, a conspiracy to fix the pricing of, and manipulate bids for, municipal derivatives, including GICs. These cases have been coordinated and consolidated for pretrial proceedings in the U.S. District Court for the Southern District of New York as *MDL 1950, In re Municipal Derivatives Antitrust Litigation,* Case No. 1:08-cv-2516 ("MDL 1950").

Five of these cases named both AGMH and AGM: (a) *Hinds County, Mississippi v. Wachovia Bank, N.A.*; (b) *Fairfax County, Virginia v. Wachovia Bank, N.A.*; (c) *Central Bucks School District, Pennsylvania v. Wachovia Bank, N.A.*; (d) *Mayor and City Council of Baltimore, Maryland v. Wachovia Bank, N.A.*; and (e) *Washington County, Tennessee v. Wachovia Bank, N.A.* In April 2009, the MDL 1950 court granted the defendants' motion to dismiss on the federal claims, but granted leave for the plaintiffs to file a second amended complaint. In June 2009, interim lead plaintiffs' counsel filed a Second Consolidated Amended Class Action Complaint; although the Second Consolidated Amended Class Action Complaint currently describes some of AGMH's and AGM's activities, it does not name those entities as defendants. In March 2010, the MDL 1950 court denied the named defendants' motions to dismiss the Second Consolidated Amended Class Action Complaint. The complaints in these lawsuits generally seek unspecified monetary damages, interest, attorneys' fees and other costs. The Company cannot reasonably estimate the possible loss, if any, or range of loss that may arise from these lawsuits.

Four of the cases named AGMH (but not AGM) and also alleged that the defendants violated California state antitrust law and common law by engaging in illegal bid-rigging and market allocation, thereby depriving the cities or municipalities of competition in the awarding of GICs and ultimately resulting in the cities paying higher fees for these products: (f) *City of Oakland, California v. AIG Financial Products Corp.*; (g) *County of Alameda, California v. AIG Financial Products Corp.*; (h) *City of Fresno, California v. AIG Financial Products Corp.*; and (i) *Fresno County Financing Authority v. AIG Financial Products Corp*. When the four plaintiffs filed a consolidated complaint in September 2009, the plaintiffs did not name AGMH as a defendant. However, the complaint does describe some of AGMH's and AGM's activities. The consolidated complaint generally seeks unspecified monetary damages, interest, attorneys' fees and other costs. In April 2010, the MDL 1950 court granted in part and denied in part the named defendants' motions to dismiss this consolidated complaint.

In 2008, AGMH and AGM also were named in five non-class action lawsuits originally filed in the California Superior Courts alleging violations of California law related to the municipal derivatives industry: (a) *City of Los Angeles, California v. Bank of America, N.A.*; (b) *City of Stockton, California v. Bank of America, N.A.*; (c) *County of San Diego, California v. Bank of America, N.A.*; (d) *County of San Mateo, California v. Bank of America, N.A.*; and (e) *County of Contra Costa, California v. Bank of America, N.A.* Amended complaints in these actions were filed in September 2009, adding a federal antitrust claim and naming AGM (but not AGMH) and AGUS, among other defendants. These cases have been transferred to the Southern District of New York and consolidated with MDL 1950 for pretrial proceedings.

In late 2009, AGM and AGUS, among other defendants, were named in six additional non-class action cases filed in federal court, which also have been coordinated and consolidated for pretrial proceedings with MDL 1950: (f) City of Riverside, California v. Bank of America, N.A.; (g) Sacramento Municipal Utility District v. Bank of America, N.A.; (h) Los Angeles World Airports v. Bank of America, N.A.; (i) Redevelopment Agency of the City of Stockton v. Bank of America, N.A.; (j) Sacramento Suburban Water District v. Bank of America, N.A.; and (k) County of Tulare, California v. Bank of America, N.A.

The MDL 1950 court denied AGM and AGUS's motions to dismiss these eleven complaints in April 2010. Amended complaints were filed in May 2010. On October 29, 2010, AGM and AGUS were voluntarily dismissed with prejudice from the

Sacramento Municipal Utility District case only. The complaints in these lawsuits generally seek or sought unspecified monetary damages, interest, attorneys' fees, costs and other expenses. The Company cannot reasonably estimate the possible loss, if any, or range of loss that may arise from the remaining lawsuits.

In May 2010, AGM and AGUS, among other defendants, were named in five additional non-class action cases filed in federal court in California: (a) City of Richmond, California v. Bank of America, N.A. (filed on May 18, 2010, N.D. California); (b) City of Redwood City, California v. Bank of America, N.A. (filed on May 18, 2010, N.D. California); (c) Redevelopment Agency of the City and County of San Francisco, California v. Bank of America, N.A. (filed on May 21, 2010, N.D. California); (d) East Bay Municipal Utility District, California v. Bank of America, N.A. (filed on May 18, 2010, N.D. California); and (e) City of San Jose and the San Jose Redevelopment Agency, California v. Bank of America, N.A (filed on May 18, 2010, N.D. California). These cases have also been transferred to the Southern District of New York and consolidated with MDL 1950 for pretrial proceedings. In September 2010, AGM and AGUS, among other defendants, were named in a sixth additional non-class action filed in federal court in New York, but which alleges violation of New York's Donnelly Act in addition to federal antitrust law: Active Retirement Community, Inc. d/b/a Jefferson's Ferry v. Bank of America, N.A. (filed on September 21, 2010, E.D. New York), which has also been transferred to the Southern District of New York and consolidated with MDL 1950 for pretrial proceedings. In December 2010, AGM and AGUS, among other defendants, were named in a seventh additional non-class action filed in federal court in the Central District of California, Los Angeles Unified School District v. Bank of America, N.A., and in an eighth additional non-class action filed in federal court in the Southern District of New York, Kendal on Hudson, Inc. v. Bank of America, N.A. These cases also have been consolidated with MDL 1950 for pretrial proceedings. The complaints in these lawsuits generally seek unspecified monetary damages, interest, attorneys' fees, costs and other expenses. The Company cannot reasonably estimate the possible loss or range of loss that may arise from these lawsuits.

In January 2011, AGM and AGUS, among other defendants, were named in an additional non-class action case filed in federal court in New York, which alleges violation of New York's Donnelly Act in addition to federal antitrust law: Peconic Landing at Southold, Inc. v. Bank of America, N.A. This case has been consolidated with MDL 1950 for pretrial proceedings. The complaint in this lawsuit generally seeks unspecified monetary damages, interest, attorneys' fees, costs and other expenses. The Company cannot reasonably estimate the possible loss or range of loss that may arise from this lawsuit.

In September 2009, the Attorney General of the State of West Virginia filed a lawsuit (Circuit Ct. Mason County, W. Va.) against Bank of America, N.A. alleging West Virginia state antitrust violations in the municipal derivatives industry, seeking damages and alleging, among other things, a conspiracy to fix the pricing of, and manipulate bids for, municipal derivatives, including GICs. An amended complaint in this action was filed in June 2010, adding a federal antitrust claim and naming AGM (but not AGMH) and AGUS, among other defendants. This case has been removed to federal court as well as transferred to the S.D.N.Y. and consolidated with MDL 1950 for pretrial proceedings. The complaint in this lawsuit generally seeks civil penalties, unspecified monetary damages, interest, attorneys' fees, costs and other expenses. The Company cannot reasonably estimate the possible loss, if any, or range of loss that may arise from this lawsuit.

17. Notes Payable and Credit Facilities

Notes Payable

Notes Payable represents debt issued by VIEs consolidated by AGM to one of the Financial Products Companies that were transferred to Dexia Holdings prior to the AGMH Acquisition. The funds borrowed were used to finance the purchase of the underlying obligations of AGM-insured obligations which had breached triggers allowing AGM to exercise its right to accelerate payment of a claim in order to mitigate loss. The assets purchased are classified as assets acquired in refinancing transactions and recorded in "other invested assets." The terms of the notes payable match the terms of the assets acquired in refinancing transactions. On the Acquisition Date, the fair value of these notes payable was $164.4 million, including a premium of $9.5 million that is being amortized over the term of the debt.

The principal and carrying values of the Company's notes payable are presented in the table below.

Principal and Carrying Amounts of Notes Payable

	As of December 31,			
	2012		2011	
	Principal	Carrying Value	Principal	Carrying Value
	(in millions)			
Notes Payable	$ 61	$ 66	$ 97	$ 104

The Company recorded $7 million and $6 million of interest expense on the notes payable for the years ended December 31, 2012, and December 31, 2011, respectively.

Expected Maturity Schedule of Notes Payable

Expected Withdrawal Date	Principal Amount
	(in millions)
2013	$ 22
2014	10
2015	10
2016	6
2017	13
Thereafter	0
Total	$ 61

Recourse Credit Facilities

2009 Strip Coverage Facility

In connection with the AGMH Acquisition, AGM agreed to retain the risks relating to the debt and strip policy portions of the leveraged lease business. The liquidity risk to AGM related to the strip policy portion of the leveraged lease business is mitigated by the strip coverage facility described below.

In a leveraged lease transaction, a tax-exempt entity (such as a transit agency) transfers tax benefits to a tax-paying entity by transferring ownership of a depreciable asset, such as subway cars. The tax-exempt entity then leases the asset back from its new owner.

If the lease is terminated early, the tax-exempt entity must make an early termination payment to the lessor. A portion of this early termination payment is funded from monies that were pre-funded and invested at the closing of the leveraged lease transaction (along with earnings on those invested funds). The tax-exempt entity is obligated to pay the remaining, unfunded portion of this early termination payment (known as the “strip coverage”) from its own sources. AGM issued financial guaranty insurance policies (known as “strip policies”) that guaranteed the payment of these unfunded strip coverage amounts to the lessor, in the event that a tax-exempt entity defaulted on its obligation to pay this portion of its early termination payment. AGM can then seek reimbursement of its strip policy payments from the tax-exempt entity, and can also sell the transferred depreciable asset and reimburse itself from the sale proceeds.

One event that may lead to an early termination of a lease is the downgrade of AGM, as the strip coverage provider, or the downgrade of the equity payment undertaker within the transaction, in each case, generally to a financial strength rating below double-A. Upon such downgrade, the tax exempt entity is generally obligated to find a replacement credit enhancer within a specified period of time; failure to find a replacement could result in a lease default, and failure to cure the default within a specified period of time could lead to an early termination of the lease and a demand by the lessor for a termination payment from the tax exempt entity. However, even in the event of an early termination of the lease, there would not necessarily be an automatic draw on AGM’s policy, as this would only occur to the extent the tax-exempt entity does not make the required termination payment.

As a result of the January 2013 Moody's downgrade of AGM, all the leveraged lease transactions in which AGM acts as strip coverage provider are currently breaching a ratings trigger related to AGM. If early termination of the leases were to occur and the tax-exempt entities do not make the required early termination payments, then AGM would be exposed to possible liquidity claims on gross exposure of approximately $1.7 billion as of December 31, 2012. To date, none of the leveraged lease transactions that involve AGM has experienced an early termination due to a lease default and a claim on the AGM guaranty. It is difficult to determine the probability that the Company will have to pay strip provider claims or the likely aggregate amount of such claims. At December 31, 2012, approximately $947 million of cumulative strip par exposure had been terminated since 2008 on a consensual basis. The consensual terminations have resulted in no claims on AGM.

On July 1, 2009, AGM and DCL, acting through its New York Branch ("Dexia Crédit Local (NY)"), entered into a credit facility (the "Strip Coverage Facility"). Under the Strip Coverage Facility, Dexia Crédit Local (NY) agreed to make loans to AGM to finance all draws made by lessors on AGM strip policies that were outstanding as of November 13, 2008, up to the commitment amount. The commitment amount of the Strip Coverage Facility was $1 billion at closing of the AGMH Acquisition but is scheduled to amortize over time. As of December 31, 2012, the maximum commitment amount of the Strip Coverage Facility has amortized to $960 million. It may also be reduced in 2014 to $750 million, if AGM does not have a specified consolidated net worth at that time.

Fundings under this facility are subject to certain conditions precedent, and their repayment is collateralized by a security interest that AGM granted to Dexia Crédit Local (NY) in amounts that AGM recovers—from the tax-exempt entity, or from asset sale proceeds—following its payment of strip policy claims. The Strip Coverage Facility will terminate upon the earliest to occur of an AGM change of control, the reduction of the commitment amount to $0, and January 31, 2042.

The Strip Coverage Facility's financial covenants require that AGM and its subsidiaries maintain a maximum debt-to-capital ratio of 30% and maintain a minimum net worth of 75% of consolidated net worth as of July 1, 2009, plus, starting July 1, 2014, (i) 25% of the aggregate consolidated net income (or loss) for the period beginning July 1, 2009 and ending on June 30, 2014 or, (2) zero, if the commitment amount has been reduced to $750 million as described above. The Company is in compliance with all financial covenants as of December 31, 2012.

The Strip Coverage Facility contains restrictions on AGM, including, among other things, in respect of its ability to incur debt, permit liens, pay dividends or make distributions, dissolve or become party to a merger or consolidation. Most of these restrictions are subject to exceptions. The Strip Coverage Facility has customary events of default, including (subject to certain materiality thresholds and grace periods) payment default, bankruptcy or insolvency proceedings and cross-default to other debt agreements.

As of December 31, 2012, no amounts were outstanding under this facility, nor have there been any borrowings during the life of this facility.

AGM CPS Securities

In June 2003, $200 million of "AGM CPS Securities", money market preferred trust securities, were issued by trusts created for the primary purpose of issuing the AGM CPS Securities, investing the proceeds in high-quality commercial paper and selling put options to AGM, allowing AGM to issue the trusts non-cumulative redeemable perpetual preferred stock (the "AGM Preferred Stock") of AGM in exchange for cash. There are four trusts, each with an initial aggregate face amount of $50 million. These trusts hold auctions every 28 days, at which time investors submit bid orders to purchase AGM CPS Securities. If AGM were to exercise a put option, the applicable trust would transfer the portion of the proceeds attributable to principal received upon maturity of its assets, net of expenses, to AGM in exchange for AGM Preferred Stock. AGM pays a floating put premium to the trusts, which represents the difference between the commercial paper yield and the winning auction rate (plus all fees and expenses of the trust). If an auction does not attract sufficient clearing bids, however, the auction rate is subject to a maximum rate of one-month LIBOR plus 200 basis points for the next succeeding distribution period. Beginning in August 2007, the AGM CPS Securities required the maximum rate for each of the relevant trusts. AGM continues to have the ability to exercise its put option and cause the related trusts to purchase AGM Preferred Stock. The trusts provide AGM access to new capital at its sole discretion through the exercise of the put options. As of December 31, 2012 the put option had not been exercised. The Company does not consider itself to be the primary beneficiary of the trusts. See Note 8, Fair Value Measurement, –Other Assets–Committed Capital Securities, for a fair value measurement discussion.

18. Employee Benefit Plans

Accounting Policy

AGM participates in AGL's long term incentive plans. AGL follows the fair value recognition provisions for share based compensation expense. The Company is allocated its proportionate share of all compensation expense based on time studies conducted annually.

Assured Guaranty Ltd. 2004 Long-Term Incentive Plan

Under the Assured Guaranty Ltd. 2004 Long-Term Incentive Plan, as amended (the "Incentive Plan"), the number of common shares that may be delivered under the Incentive Plan may not exceed 10,970,000. In the event of certain transactions affecting AGL's common shares, the number or type of shares subject to the Incentive Plan, the number and type of shares subject to outstanding awards under the Incentive Plan, and the exercise price of awards under the Incentive Plan, may be adjusted.

The Incentive Plan authorizes the grant of incentive stock options, non-qualified stock options, stock appreciation rights, and full value awards that are based on AGL's common shares. The grant of full value awards may be in return for a participant's previously performed services, or in return for the participant surrendering other compensation that may be due, or may be contingent on the achievement of performance or other objectives during a specified period, or may be subject to a risk of forfeiture or other restrictions that will lapse upon the achievement of one or more goals relating to completion of service by the participant, or achievement of performance or other objectives. Awards under the Incentive Plan may accelerate and become vested upon a change in control of AGL.

The Incentive Plan is administered by a committee of the Board of Directors of AGL. The Compensation Committee of the Board serves as this committee except as otherwise determined by the Board. The Board may amend or terminate the Incentive Plan. As of December 31, 2012, 2,565,007 common shares of AGL were available for grant under the Incentive Plan.

The Company recognized expenses of $3 million and $2 million for the years ended December 31, 2012 and 2011, respectively, under the Incentive Plan.

Stock Options

Nonqualified or incentive stock options may be granted to employees and directors of Assured Guaranty. Stock options are generally granted once a year with exercise prices equal to the closing price on the date of grant. To date, AGL has only issued nonqualified stock options. All stock options, except for performance stock options, granted to employees vest in equal annual installments over a three-year period and expire seven years or ten years from the date of grant. None of AGL's options, except for performance stock options, have a performance or market condition.

Performance Stock Options

Beginning in 2012, the Company has granted performance stock options under the Incentive Plan. These awards are non-qualified stock options with exercise prices equal to the closing price on the date of grant. These awards vest in full or on a pro-rata basis on the third anniversary of the grant date, if certain target hurdle prices are met. These awards expire seven years from the date of grant.

Restricted Stock Awards

Restricted stock awards are valued based on the closing price of the underlying shares at the date of grant. These Restricted stock awards to employees generally vest in equal annual installments over a four-year period.

Restricted Stock Units

Restricted stock units are valued based on the closing price of the underlying shares at the date of grant. Restricted stock units generally vest in equal installments over a four-year period.

Performance Restricted Stock Units

Beginning in 2012, the Company has granted performance restricted stock units under the Incentive Plan. These awards vest in full or on a pro-rata basis on the third anniversary of grant date, if certain target hurdle prices are met.

Employee Stock Purchase Plan

Assured Guaranty established the AGL Employee Stock Purchase Plan ("Stock Purchase Plan") in accordance with Internal Revenue Code Section 423, and participation is available to all eligible employees. Maximum annual purchases by participants are limited to the number of whole shares that can be purchased by an amount equal to 10% of the participant's compensation or, if less, shares having a value of $25,000. Participants may purchase shares at a purchase price equal to 85% of the lesser of the fair market value of the stock on the first day or the last day of the subscription period. The Company recorded $0.1 million and $0.1 million in share-based compensation, after the effects of DAC, under the Stock Purchase Plan during the years ended December 31, 2012 and 2011, respectively.

Cash-Based Compensation

Performance Retention Plan

Assured Guaranty has established the Assured Guaranty Ltd. Performance Retention Plan (“PRP”) which permits the grant of cash based awards to selected employees. PRP awards may be treated as nonqualified deferred compensation subject to the rules of Internal Revenue Code Section 409A. The PRP is a sub-plan under the Company's Long-Term Incentive Plan (enabling awards under the plan to be performance based compensation exempt from the $1 million limit on tax deductible compensation).

Assured Guaranty granted a limited number of PRP awards in 2007, which vested after four years of continued employment (or if earlier, on employment termination, if the participant's termination occured as a result of death, disability, or retirement). Participants received the designated award in a single lump sum in 2011.

Generally, each PRP award is divided into three installments, with 25% of the award allocated to a performance period that includes the year of the award and the next year, 25% of the award allocated to a performance period that includes the year of the award and the next two years, and 50% of the award allocated to a performance period that includes the year of the award and the next three years. Each installment of an award vests if the participant remains employed through the end of the performance period for that installment. Awards may vest upon the occurrence of other events as set forth in the plan documents. Payment for each performance period is made at the end of that performance period. One half of each installment is increased or decreased in proportion to the increase or decrease of per share adjusted book value during the performance period, and one half of each installment is increased or decreased in proportion to the operating return on equity during the performance period. As of December 31, 2012, a limited number of awards had cliff vesting in five years. Operating return on equity and adjusted book value are defined in each PRP award agreement.

A payment otherwise subject to the $1 million limit on tax deductible compensation, will not be made unless performance satisfies a minimum threshold.

The Company recognized performance retention plan expenses of $6 million and $3 million for the year ended December 31, 2012 and 2011, respectively, representing its proportionate share of the Assured Guaranty expense.

Defined Contribution Plans

Employees receive employer contributions into the AGC Employee Retirement Plan (“AGC ERP”) based on a fixed percentage of the employee's compensation and are eligible to make employee contributions and to receive matching employer contributions based on a percentage of compensation up to limits prescribed by Internal Revenue Code Section 401(k). The Company recognized defined contribution expenses of $4 million and $4 million for the years ended December 31, 2012 and 2011, respectively.

Employees receive employer contributions into the AGC Supplemental Executive Retirement Plan based on a fixed percentage of the employee's compensation and are eligible to make employee contributions and to receive matching employer contributions based on a percentage of compensation.

19. Other Comprehensive Income

Year Ended December 31, 2012

	Net Unrealized Gains (Losses) on Investments	Total Accumulated Other Comprehensive Income
	(in millions)	
Balance, December, 2011	$ 156	$ 156
Other comprehensive income (loss)	76	76
Balance, December 31, 2012	$ 232	$ 232

Year Ended December 31, 2011

	Net Unrealized Gains (Losses) on Investments	Total Accumulated Other Comprehensive Income
	(in millions)	
Balance, December 31, 2010	$ 14	$ 14
Other comprehensive income (loss)	142	142
Balance, December 31, 2011	$ 156	$ 156

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