Newcastle Building Society

Half-Yearly Report 2019

Cover photo: Alnwick Castle, Northumberland

Connecting communities in the North East with a better Financial Future.

Newcastle Building Society

2019 Performance Highlights

25,000
Increase in customer base

96 %
Customer satisfaction

£82m
Invested in Lifetime ISAs

£220m
Net Core Residential Lending

0.36%
Mortgage arrears

500
First-Time Buyers

65
Project groups supported via volunteering

18
Industry awards

1,143
Colleagues

£8.5m
Operating profit increased by 18 %

15.5 %
Liquidity

15.1 %
Common Equity Tier 1 Capital

Chief Executive's Review

> I am pleased to report a strong business performance which is providing a sound foundation for further investment into our Society.
>
> **Andrew Haigh,** Chief Executive

We have delivered record levels of new mortgages and savings, high customer satisfaction and welcomed thousands of new Members to our Society in the first half of the year. In relation to our financial performance our profits have improved, we have strong capital ratios, a robust liquidity position and continue to report low levels of arrears, demonstrating the excellent credit quality of our residential mortgage book. We have improved our service and facilities for Members with upgraded branches and new locations.

Some highlights of the first half of 2019 are:

- Operating profit before impairment and provisions increased by 18% to £8.5m (2018: £7.2m);
- Profit before tax was up 18% to £8.2m (2018: £6.9m);
- Gross lending up 65% to £380m (2018: 229m);
- Net core residential lending for the first half of the year was £220m, which exceeded the 2018 full year equivalent by £60m (Full year 2018: £160m);
- We grew our customer base by over 25,000 during the first six months of 2019;
- Three new branches announced to address the reduction in face to face financial services in rural locations:
- Half way point reached in multi-million pound branch investment programme;
- Customer satisfaction at 96%;
- Mortgage arrears remain at low levels at 0.36% (2018: 0.36%);
- Capital ratios remain robust with Total Capital Ratio (Solvency) at 16.9%, Tier 1 Ratio at 15.6%, Common Equity Tier 1 Ratio at 15.1% and Leverage Ratio at 5.0%; and
- Liquidity as a percentage of shares, deposits and liabilities (excluding encumbered assets) was 15.5%.

Building authentic, lasting customer relationships

The interests of our customers and communities are at the heart of our building society. Despite challenging market conditions we are creating real impact in our region helping more people own their own home by delivering an excellent range of competitive products and excellent customer service.

For the first half of 2019 our gross lending was up 65% at £380m and our net core residential lending was £220m, more than our net core residential lending for the whole of 2018, which was £160m.

Our run of industry awards has continued into 2019. In addition to award recognition from L&G Mortgage Club's Best Smaller Lender, we were voted What Mortgage Awards' Best Regional Building Society for the third year in a row.

As well as helping customers own their home, we also believe that it is important that we encourage people to save and help them plan their finances.

We are committed to being present in towns and cities across our region and to the provision of face to face local financial services and advice. We are now past the half way point in our multi-million pound branch investment programme. This sees us investing in new locations for some of our branches and refurbishing existing branches to create new, modern, open plan environments. Face to face, friendly personal service remains at the heart of our offering, supported by in branch digital technology that creates more opportunities for conversations with our customers. As part of the refurbishment programme and where space allows, we are creating community spaces for local people and community groups as a place to go to meet.

At a time when many banks are withdrawing from our high streets, we are re-imagining our branch formats, adapting our design to continue to meet local customer needs, and are increasing the size and impact of our branch network.

In March we announced that we would be opening a new branch in Barnard Castle. More recently, we were very proud to flag our intention to create two new community branches - in Hawes in North Yorkshire and in Wooler in Northumberland. Both deeply rural locations, with a vibrant, community 'can do' attitude, Hawes and Wooler were left without access to financial services when the last bank left their town. In partnering with such well led and determined communities, we believe we can add real value and grow a bright and sustainable future together.

We have also established collaborative relationships with a number of volunteer and local authority libraries in Cumbria, Gateshead and North Yorkshire, providing important financial support to the running of these vital community meeting places, alongside access to financial information for local people.

We anticipate additional announcements over the course of this year as we continue to respond to the needs of those facing challenges in accessing financial services and advice.

Whether it's saving for the future, a lump sum to invest or setting up a new savings account for a child, we have a broad range of savings accounts on offer including bonds and ISAs.

Late last year we launched our Newcastle Cash Lifetime ISA, which enables customers to save for a deposit for their first home or for their retirement, attracting a 25% UK Government bonus on amounts saved each tax year. This product has been very successful with over 27,000 customers opening an account to save for their future with us so far this year.

We were very pleased to announce a five year household insurance partnership with Legal and General, offering a range of SmartQuote home insurance products. SmartQuote uses market leading technology to provide customers with a full home insurance quote by answering only five questions.

Our subsidiary, Newcastle Financial Advisers Limited, is supporting the development of new talent into the advice sector to help address the decline in numbers of financial advisers. Six new financial adviser trainees were appointed this year, four of them joining via the Society's graduate programme. They will all undertake the industry's professional diploma with a view to joining our existing 27 financial advisers to ensure we can continue to meet the need for face to face advice on the high street across our branch network.

Helping our colleagues realise their potential

As a significant employer in the region we appreciate the responsibility of creating an environment where our colleagues can drive their own development and achieve their potential.

Whether through a comprehensive range of learning and development opportunities, improvements in our reward and benefits package, or empowering our colleagues to use their skills, experience and personal passions to connect with our communities, we continue to work hard to create an outstanding working life experience.

Our increasing success in this area was recently recognised when we were named second in the top 50 "Best Places to Work in the North East" "Best Large Company" category. The awards celebrate businesses in the region that do the most in this area.

We currently employ over 1,140 colleagues across Newcastle Building Society Group, and are delighted that we have achieved growth in headcount of 41 so far this year. We anticipate further growth in the second half of 2019. We believe in the potential of young people and that we play a key role in developing talent and supporting employability across the region.

Through our partnership with the Prince's Trust we are engaging with young people across the North East to help them learn new skills, achieve qualifications and future employment. Our financial support of the Prince's Trust Team programme is backed by a commitment from colleagues across the Society to provide an engaging and rewarding experience for Team participants.

As part of our Prince's Trust involvement over the course of the past 12 months we have supported 56 young people on the Team programme. Earlier this year we also welcomed five young people into the Society for a dedicated two week work experience programme. They spent time finding out about the world of work in a building society and what it might offer for them. We were then delighted to be able to offer two of these young people an apprenticeship with the Society.

So far this year our colleagues have delivered around 39 Prince's Trust volunteering opportunities across the North East, both with Team and other programmes – engaging hundreds more young people.

Our early talent programme for graduates, undergraduate placements and apprenticeships offers opportunities across a range of business areas in the Society. We have welcomed six apprentices in the first half of 2019 and in the second half of the year will welcome a further nine apprentices along with seven graduates and six undergraduate placements to the Society in September.

A great testament to our apprentice programme is that we feature on the "RateMyApprenticeship Top 100 Employers" list. RateMyApprenticeship aims to educate young people about their career options, and inspire them to take an exciting next step after they leave school or college. This is especially pleasing as all listings come from authentic reviews, based on apprentices sharing their experiences of employers.

Connecting with our Communities

The Newcastle Building Society Community Fund at the Community Foundation was launched by the Society in 2016 and over the past three years has helped hundreds of charities, community groups and good causes through its grants programme. Last year we introduced Building Improvement Grants (BIGs), providing between £10,000 and £50,000 grants for community groups and charities in the region who need to make improvement to their community buildings. In 2019 we have doubled our donations available for BIGs to £100,000.

Earlier this year we were the first building society to announce that we were joining the Reclaim Fund's Dormant Accounts Alternative Scheme. The Alternative Scheme provides welcome flexibility for us to direct any funding released as unclaimed assets to causes across our North East region including our partnership with the Community Foundation Tyne & Wear and Northumberland, while protecting the rights of customers to reclaim their money should they re-engage at any point in the future. With this additional funding, alongside our continued Society donations, we expect to see our Community Fund total more than £2m by the end of the year, further accelerating its work, and ensuring that we have the capacity to make grants for generations to come.

The Dementia Friends initiative aims to change the way people act, think and talk about dementia at a time when the age profile of the UK population is rising and the disease is becoming ever more common. In addition to our commitment that every colleague will become a Dementia Friend we also run Dementia Friends awareness sessions across our branch network and in the local community. Sessions are attended by colleagues and customers, as well as local people and high street businesses. In February we delivered our 100th session - to Newcastle Eagles Community Foundation staff at the Eagles' Community Arena.

We have complemented our Dementia Friends work by becoming the first, and currently only, financial organisation to support "Slow Shopping" - initially through a pilot in our Gosforth branch. Slow Shopping aims to provide a safe, welcoming and calm environment for those who need a little more time to conduct their shopping and financial affairs.

At the half year point, our colleagues have so far cumulatively volunteered nearly three months' of equivalent working days to causes they care about and which are close to their hearts, in our local communities, supporting over 65 local project groups via our volunteering programme.

Improving financial capability through sharing money management skills and providing access to financial information continues to be an important contribution our Society makes to its local communities. Our regular financial Big Talk events held across our region continue to be in demand.

We supplement this with our Boardroom Charity Challenge programme for local school children and this year focused our efforts on Gateshead, working with Gateshead Council to involve eight schools in a financial awareness skills and technology challenge that culminated at Proto, the Emerging Technology Centre in Gateshead.

Helping our clients and partners succeed

Newcastle Strategic Solutions Limited, the Society's Fintech subsidiary, is the UK's leading provider of outsourced savings management services. We are delighted to see further growth in savings balances under administration and our clients have won 16 industry awards in the first 6 months of 2019, underpinned by the excellent service provided by our dedicated team in North Tyneside. We also marked ten years of partnership with one of our multi award-winning clients in June.

Financial Performance

Profitability

Operating profit before impairment and provisions increased by 18% to £8.5m from £7.2m. Profit before tax was £8.2m for the six months ended 30 June 2019 compared to £6.9m for the first half of 2018.

Net interest income increased by £2.6m to £18.6m reflecting increased income from mortgage lending. Our net interest margin improved to 97bps at 30 June 2019. (30 June 2018: 86bps and 31 December 2018: 92bps).

Other income and charges increased by £2.7m to £17.5m (30 June 2018: £14.8m) through increased income from Newcastle Strategic Solutions, which includes our savings management outsourcing subsidiary and our IT and property subsidiary. Member income, which includes our financial services subsidiary, maintained momentum in a difficult UK and global economic environment.

Our cost to income ratio was comparable to H1 2018 at 76.4%, whilst investing an additional £4.0m in our growing business. Management expenses (comprising administration expenses and depreciation) increased by £4.0m from £23.6m to £27.6m. The increase reflecting the additional costs incurred in relation to increased business volumes, ongoing investment in our people through our Pay and Grading project and the creation of additional roles throughout the Society.

Credit Risk

The percentage of mortgages in arrears by 3 months or more remain at low levels at 0.36% (0.36%: 30 June 2018 and 0.30%: 31 December 2018). Possession cases remain at very low levels. Gross lending for the first half of the year was £380m (First half of 2018: £229m). Total lending has increased by £208m, which includes a £12m reduction in our exposure to the legacy lending book. (First half of 2018: £14m). The Society's core residential mortgage book grew by £220m during the first half of 2019 (First half of 2018: £61m).

Liquidity

Liquid assets as a percentage of Shares, Deposits and Liabilities at 30 June 2019 were 22.5% (30 June 2018: 23.9%). Excluding encumbered liquid assets the ratio was 15.5% at 30 June 2019 (17.3% at 30 June 2018). The quality of liquidity continues to be excellent, comprising assets held in cash or that can easily be converted to cash through treasury markets (repo) or via the various Bank of England liquidity schemes. We expect to carefully manage liquidity levels over the second half of the year.

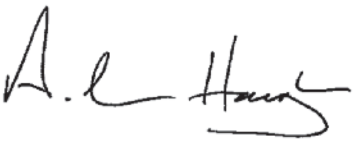
Capital

The Total Capital Ratio (Solvency) decreased to 16.9% from 18.9% at the prior comparable period (31 December 2018: 17.7%) with the reduction reflecting our significant lending growth coupled with the amortisation of Tier 2 capital as it approaches maturity later this year. The Tier 1 ratio was 15.6% (30 June 2018: 16.7%) and Common Equity Tier 1 ratio was 15.1% (30 June 2018: 15.7%). The Society's Basel III leverage ratio (transitional basis) was 5.0% at 30 June 2019 (30 June 2018: 5.3%). Capital ratios disclosed include half year retained profits.

Summary

The Society continues to make excellent progress in the face of very strong competition in the mortgage and savings markets. Putting our Members first and supporting our communities is at the very heart of our strategy as we encourage people to save, help them to plan their finances and own their homes.

Our Purpose is to 'Connect our Communities with a better Financial Future' and I am pleased that there is a great deal of evidence within these results that we continue to take significant steps towards that aim.



Andrew Haigh
Chief Executive
24th July 2019

Forward-looking statements

Certain statements in this half-yearly information are forward-looking. These statements are made in good faith based on the information available up to the time of approval of this report and such statements should be treated with caution due to the inherent uncertainties, including both economic and business risk factors, underlying any such forward-looking information. Therefore actual results may differ materially from those expressed or implied by these forward-looking statements. The Directors undertake no obligation to update any forward-looking statements whether as a result of new information, future events or otherwise.

SUMMARY CONSOLIDATED INCOME STATEMENT

	Unaudited 6 months to 30 Jun 19 £m	Unaudited 6 months to 30 Jun 18 £m	Audited 12 months to 31 Dec 18 £m
Interest receivable and similar income	40.8	36.0	75.2
Interest payable and similar charges	(22.2)	(20.0)	(41.0)
Net interest income	**18.6**	**16.0**	**34.2**
Other income and charges	17.5	14.8	30.3
Total operating income	**36.1**	**30.8**	**64.5**
Administrative expenses	(25.6)	(22.1)	(46.9)
Depreciation	(2.0)	(1.5)	(2.9)
Operating profit before impairments and provisions	**8.5**	**7.2**	**14.7**
Impairment charges on loans and advances to customers	(0.3)	(0.2)	(1.5)
Provisions for liabilities and charges	-	(0.1)	0.1
Profit before taxation	**8.2**	**6.9**	**13.3**
Taxation expense	(1.6)	(1.3)	(2.5)
Profit after taxation for the financial period	**6.6**	**5.6**	**10.8**

The Notes on pages 12 to 19 form an integral part of this condensed consolidated half-yearly financial information.

SUMMARY CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Unaudited 6 months to 30 Jun 19 £m	Unaudited 6 months to 30 Jun 18 £m	Audited 12 months to 31 Dec 18 £m
Profit for the period	**6.6**	**5.6**	**10.8**
Other comprehensive income/(expense):			
Items that may be reclassified to income statement			
Movement on fair value through other comprehensive income debt securities	1.0	(0.1)	(1.7)
Income tax on items that may be reclassified to income statement	(0.1)	-	0.3
Total items that may be reclassified to income statement	**0.9**	**(0.1)**	**(1.4)**
Items that will not be reclassified to income statement			
Derecognition of pension surplus	(0.4)	-	(1.1)
Total items that will not be reclassified to the income statement	**(0.4)**	**-**	**(1.1)**
Total other comprehensive income/(expense)	**0.5**	**(0.1)**	**(2.5)**
Total comprehensive income for the financial period	**7.1**	**5.5**	**8.3**

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SUMMARY CONSOLIDATED BALANCE SHEET

	Unaudited 30 Jun 19 £m	Unaudited 30 Jun 18 £m	Audited 31 Dec 18 £m
ASSETS			
Liquid assets	803.1	791.5	692.4
Derivative financial instruments	1.7	5.0	3.5
Loans and advances to customers	2,980.0	2,721.5	2,772.2
Fair value adjustments for hedged risk	192.1	183.0	175.9
Property, plant and equipment and other assets	59.8	53.2	53.8
TOTAL ASSETS	**4,036.7**	**3,754.2**	**3,697.8**

	Unaudited 30 Jun 19 £m	Unaudited 30 Jun 18 £m	Audited 31 Dec 18 £m
LIABILITIES			
Shares	2,925.6	2,775.1	2,713.7
Fair value adjustments for hedged risk	0.1	0.8	0.4
Deposits and debt securities	651.6	529.9	552.4
Derivative financial instruments	192.9	186.6	178.3
Other liabilities	20.3	14.5	12.9
Subordinated liabilities	25.0	25.0	25.0
Subordinated capital	20.0	30.0	20.0
Reserves	201.2	192.3	195.1
TOTAL LIABILITIES	**4,036.7**	**3,754.2**	**3,697.8**

The Notes on pages 12 to 19 form an integral part of this condensed consolidated half-yearly financial information.

SUMMARY CONSOLIDATED STATEMENT OF MOVEMENT IN MEMBERS' INTERESTS

For the 6 months ended 30 June 2019 (unaudited)

	General reserve £m	Fair Value through Other Comprehensive Income £m	Total £m
At 1 January 2019	193.7	0.4	194.1
Movement in the period	6.2	0.9	7.1
At 30 June 2019	**199.9**	**1.3**	**201.2**

For the 6 months ended 30 June 2018 (unaudited)

	General reserve £m	Fair Value through Other Comprehensive Income £m	Total £m
At 1 January 2018	185.0	1.8	186.8
Movement in the period	5.6	(0.1)	5.5
At 30 June 2018	**190.6**	**1.7**	**192.3**

For the year ended 31 December 2018 (audited)

	General reserve £m	Fair Value through Other Comprehensive Income £m	Total £m
At 1 January 2018	185.0	1.8	186.8
Movement in the year	9.7	(1.4)	8.3
At 31 December 2018	**194.7**	**0.4**	**195.1**
IFRS 16 transitional provisions	(1.0)	-	(1.0)
At 1 January 2019	**193.7**	**0.4**	**194.1**

The Notes on pages 12 to 19 form an integral part of this condensed consolidated half-yearly financial information.

SUMMARY CONSOLIDATED CASH FLOW STATEMENT

	Unaudited 6 months to 30 Jun 19 £m	Unaudited 6 months to 30 Jun 18 £m	Audited 12 months to 31 Dec 18 £m
Net cash flows from operating activities	80.8	26.0	(50.6)
Payment into defined benefit pension scheme	(0.4)	(0.6)	(1.5)
Net cash flows from investing activities	13.2	52.7	45.8
Net cash flows from financing activities	(2.0)	(2.2)	(14.3)
Net increase / (decrease) in cash and cash equivalents	**91.6**	**75.9**	**(20.6)**
Cash and cash equivalents at the start of period	163.0	183.6	183.6
Cash and cash equivalents at the end of the period	**254.6**	**259.5**	**163.0**

Other percentages

	6 months 30 Jun 19 %	6 months 30 Jun 18 %	12 months 31 Dec 18 %
Gross capital as a % of shares and borrowings	6.9	7.5	7.4
Liquid assets as a % of shares and borrowings	22.5	23.9	21.2
Wholesale deposits as a % of shares and borrowings	18.2	16.0	16.9
Liquid assets as a % of shares and borrowings excluding encumbered assets	15.5	17.3	14.6
Net interest receivable as a % of mean total assets (“NIM”)	0.97	0.86	0.92
Cost to income ratio	76.4	76.5	77.0
Profit after tax as a % of mean total assets	0.34	0.30	0.29
Management expenses as a % of mean total assets*	1.44	1.26	1.33
Common Equity Tier 1 Ratio	15.1	15.7	15.7
Tier 1 Ratio	15.6	16.7	16.3
Total Capital Ratio (Solvency)	16.9	18.9	17.7
Leverage Ratio (Basel III - end point)	4.9	5.0	5.2
Leverage Ratio (Basel III - transitional)	5.0	5.3	5.4

* Expressed on an annualised basis

The above percentages are unaudited. Capital ratios disclosed include half year retained profits. The figures for the 12 months ended 31 December 2018 are extracted from the audited 2018 Annual Report and Accounts. The Notes on pages 12 to 19 form an integral part of this condensed consolidated half-yearly financial information.

NOTES

1. General information

1.1. The half-yearly financial information set out above, which was approved by the Board of Directors, does not constitute accounts within the meaning of the Building Societies Act 1986.

1.2. The financial information for the 12 months to 31 December 2018 has been extracted from the financial statements for that year, and on which the auditors gave an unqualified opinion, and which have been filed with the Financial Conduct Authority and Prudential Regulation Authority.

1.3. The half-yearly financial information for the 6 months to 30 June 2019 and the 6 months to 30 June 2018 is unaudited.

1.4. The announcement will be sent to holders of the Society's permanent interest bearing shares. Copies are available from the Society's Principal Office at Portland House, Newcastle upon Tyne NE1 8AL.

2. Basis of preparation

The condensed consolidated financial information for the half-year ended 30 June 2019 has been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority and with IAS 34, 'Interim financial reporting' as adopted by the European Union. The half-yearly financial information should be read in conjunction with the annual financial statements for the year ended 31 December 2018, which have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union.

The Board has assessed the viability of the Group by reviewing medium and long term plans over a 3 year horizon with particular emphasis on examining forecast capital, liquidity and profitability of the Group and the risks to those forecasts through a variety of stress testing scenarios. This horizon is considered appropriate through alignment to the Group's usual forecasting and management reporting allowing robust and continuous assessment of the Group's expected position and principal risks over this time-frame. Active risk management is undertaken to mitigate the Group's principal risks.

The outcome of this review is that the Directors are satisfied that the Group has adequate resources to continue in business and meet its liabilities as they fall due throughout the period of assessment. Accordingly the financial statements of the Group have been prepared on a going concern basis with no material uncertainties that the going concern basis of accounting is appropriate.

3. Accounting policies

The half-yearly financial information has been prepared on the basis of the accounting policies adopted for the year ended 31 December 2018, as described in those financial statements, except for the following key developments: IFRS 16 Leases (see note 9).

4. Principal Risks and Uncertainties

The Group's activities expose it to a variety of risks: market risk (predominantly interest rate risk), credit risk, liquidity risk and operational risk. There have been no changes in the principal risks and uncertainties facing the Group and no significant changes to these risks are currently expected in the second half of the year.

The interim condensed consolidated financial information does not include all risk management information and disclosures required in the annual financial statements, and should be read in conjunction with the Group's 2018 Annual Report and Accounts.

There have been no material changes to the Group's risk appetite since publication of the Group's 2018 Annual Report and Accounts.

The Group does not trade outside of the UK and Gibraltar and does not rely on non-UK resident EU employees. As such, the direct impact of Brexit is expected to be limited with the Group continuing to monitor the UK's Brexit progress. Depending on the terms of the UK's exit, the Group may be impacted indirectly through, for example, the wider economic impacts of property valuations, UK unemployment and interest rate movements.

5. Taxation

The effective tax rate is **19.0%** (2018: 19.0%). The tax charge has been calculated to approximate to the expected full year tax rate and includes an adjustment to deferred tax assets, and to current tax for changes in the enacted corporation tax rate.

NOTES

6. Related Party Transactions

During the 6 months to 30 June 2019 the Society purchased **£2.3m** (2018: £8.3m) of Business Support Services from Newcastle Strategic Solutions Limited (NSSL) and **£2.4m** (2018: £2.0m) of Managed IT and Property Services from Newcastle Systems Management Limited (NSML), both wholly owned subsidiary companies. The Society received **£4.7m** (2018: £11.8m) from NSSL and **£0.5m** (2018: £0.5m) from NSML for the provision of financial and administrative services during the same period. For further detail see Note 31 of the Group's 2018 Annual Report and Accounts.

7. Revenue from contracts with customers

	Unaudited 6 months to 30 Jun 19 £m	Unaudited 6 months to 30 Jun 18 £m	Audited 12 months to 31 Dec 18 £m
Revenue from contracts with customers			
Solutions Business:			
Savings management services	13.1	11.4	24.8
Savings management project and change services	0.5	0.7	1.3
IT services	0.3	0.3	0.7
Member Business:			
Regulated advice services	2.1	2.0	4.1
Third party services	0.4	0.4	0.7
Total revenue from contracts with customers	**16.4**	**14.8**	**31.6**

In accordance with IFRS 8, 'Operating Segments', the Group reports the following segments; Member business and Solutions business. When the Group prepares financial information for management, it disaggregates revenue by segment and service type.

The table above illustrates the disaggregation of revenue in scope of IFRS 15, 'Revenue from Contracts with Customers'. Revenue from customers with contracts generated by the Solutions business and the Member business can be seen in "Other income and charges" within the Segment information note.

8. Segment information

The chief operating decision maker has been identified as the Board of Directors. The Board reviews the Group's internal reporting in order to assess performance and allocate resources. Management has determined the operating segments based on these reports. Following the management approach of IFRS 8, operating segments are reported in accordance with the internal reporting provided to the Board of Directors. The operating segments used by the Group meet the definition of a reportable segment under IFRS 8.

The 'Member business' segment provides mortgage, savings, investment and insurance products to Members and customers. The 'Solutions business' segment (that includes subsidiaries Newcastle Strategic Solutions Limited and Newcastle Systems Management Limited) provides business to business services through people, processes and technology. The Board assesses performance based on profit before tax after the allocation of all central costs. Operating profit before impairments and provisions is also assessed as this provides information on underlying business performance.

Income and directly attributable costs are allocated to each segment and support costs are apportioned, based on direct salary costs and detailed allocations by budget holders.

6 months to 30 June 2019	Member Business £m	Solutions Business £m	Total £m
Net interest income	18.6	-	18.6
Other income and charges	2.4	15.1	17.5
Administrative expenses	(14.7)	(10.9)	(25.6)
Depreciation	(1.3)	(0.7)	(2.0)
Operating profit before impairments and provisions	**5.0**	**3.5**	**8.5**
Impairment charges on loans and advances to customers	(0.3)	-	(0.3)
Provisions for liabilities and charges	-	-	-
Profit before taxation	**4.7**	**3.5**	**8.2**
Taxation expense			(1.6)
Profit after taxation for the financial period			**6.6**

6 months to 30 June 2018	Member Business £m	Solutions Business £m	Total £m
Net interest income	16.0	-	16.0
Other income and charges	2.3	12.5	14.8
Administrative expenses	(13.1)	(9.0)	(22.1)
Depreciation	(0.9)	(0.6)	(1.5)
Operating profit before impairments and provisions	**4.3**	**2.9**	**7.2**
Impairment charges on loans and advances to customers	(0.2)	-	(0.2)
Provisions for liabilities and charges	(0.1)	-	(0.1)
Profit before taxation	**4.0**	**2.9**	**6.9**
Taxation expense			(1.3)
Profit after taxation for the financial period			**5.6**

Year to 31 December 2018	Member Business £m	Solutions Business £m	Total £m
Net interest income	34.2	-	34.2
Other income and charges	4.8	25.5	30.3
Administrative expenses	(27.9)	(19.0)	(46.9)
Depreciation	(1.7)	(1.2)	(2.9)
Operating profit before impairments and provisions	**9.4**	**5.3**	**14.7**
Impairment charges on loans and advances to customers	(1.5)	-	(1.5)
Provisions for liabilities and charges	0.1	-	0.1
Profit before taxation	**8.0**	**5.3**	**13.3**
Taxation expense			(2.5)
Profit after taxation for the financial period			**10.8**
Total Assets	**3,681.0**	**16.8**	**3,697.8**

9. IFRS 16 Leases

IFRS 16, Leases, superseded IAS 17, Leases, on 1 January 2019 and sets out new principles for the recognition, measurement, presentation and disclosure of leases. The standard requires a lessee to recognise a right-of-use asset and corresponding lease liability on the Balance Sheet for all leases other than short term leases or leases for which the underlying asset is of low value.

The Group has adopted IFRS 16 retrospectively from 1 January 2019 but has not restated comparatives for the 2018 reporting period, as permitted under the specific transitional provisions in the standard. The reclassifications and the adjustments arising from the new leasing rules are therefore recognised in the opening balance sheet on 1 January 2019.

At 31 December 2018 the Group was committed to minimum payments under non-cancellable operating lease agreements totalling £4.5m. These commitments were recognised on 1 January 2019 under IFRS 16 at the minimum present value of the remaining lease payments, discounted at a rate reflecting the Group's typical borrowing costs. Under IFRS 16, likely lease extensions are factored into the Group's remaining payments and the Group also now includes expected rates and insurance payments on leased properties as part of the discounted remaining lease payments.

The Group discounts its lease payments at the rate it would expect to pay to borrow funding for a similar duration to each lease. The Group's weighted average incremental borrowing rate applied to its lease liabilities on 1 January 2019 was 2.5%.

Reconciliation of operating lease commitments to IFRS 16 lease liability

	£m
Operating lease commitments disclosed at 31 December 2018	**4.5**
If discounted at the Group's incremental borrowing rate of 2.5%	4.0
Less short term operating leases not accounted for under IFRS 16	(0.2)
Plus finance leases recognised on balance sheet at 31 December 2018	0.8
Plus property taxes recognised under IFRS 16	0.5
Plus rates, insurance and extension options	1.8
Plus expected dilapidation expenses	0.4
IFRS 16 lease liability at 1 January 2019	**7.3**

The associated right-of-use assets were measured on a retrospective basis as if the new rules had always been applied. Right-of-use assets of £6.3m were recognised on Balance Sheet at 1 January 2019 including £0.3m of accelerated depreciation on an impaired finance lease with the difference between lease assets and liabilities of £1.0m recognised as an adjustment to the Group's opening reserves, as shown in the Summary Consolidated Statement of Movement in Members' Interests on page 8.

10. Fair value measurement

The following table summarises the fair value measurement basis used for assets and liabilities held on the Balance Sheet at fair value at 30 June 2019.

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Debt securities - Fair value through other comprehensive income	1.6	-	-	1.6
Derivative financial instruments	1.7	-	-	1.7
Fair value adjustments for hedged risk on underlying instruments	-	192.1	-	192.1
Financial liabilities				
Derivative financial instruments	192.9	-	-	192.9
Fair value adjustments for hedged risk on underlying instruments	-	0.1	-	0.1

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

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

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

These definitions have been taken from the March 2009 amendment to IFRS 13 'Improving Disclosures: Financial Instruments'.

There were no transfers between levels in the period.

11. IFRS 9 Financial Instruments

The Group recognises impairment provisons against its loans, liquidity investments and receivable balances under IFRS 9’s forward looking impairment methodology. The Group's IFRS 9 impairment modelling and methodology is unchanged since the previous year.

For detailed information concerning the Group's application of IFRS 9, including its impairment modelling and methodology, see the 2018 Annual Report and Accounts available at www.newcastle.co.uk.

IFRS 9 expects more than one scenario to be considered when calculating expected credit losses. The Group applies this principle by assessing the provisions required under three separate 'macroeconomic forecasts'. These macroeconomic forecasts are forward views towards a selection of key economic variables (being Bank of England base rate, UK Nominal Gross Domestic Product, the rate of UK unemployment, UK Household Income and the UK House Price Index).

The Group prepares a range of economic forecasts by applying a range of stresses to these economic variables. Throughout 2018, the Group calculated three scenarios as follows:

- Base scenario: calculated with reference to the Bank of England’s quarterly forecasts, and in line with budgets;
- Upside scenario: a positively stressed variant to the base scenario; and
- Downside scenario: a negatively stressed variant to the base scenario.

Through much of the first half of 2019 Global and National pressures have led to high levels of market volatility. With particular mind to the UK's exit of the European Union, market 'uncertainty' has been felt keenly. The Group's base scenario is already reflective of the market's future expectations and should therefore inherently reflect a degree of the market's uncertainty.

The Society’s final expected credit losses disclosed are the losses calculated under each discrete scenario multiplied by a ‘likelihood factor’: set to 80% for the base scenario and 10% for each of the upside and downside scenarios at both 30 June 2019 and 31 December 2018.

The impact of IFRS 9's staging and consequent loss provisioning to the Society's closing 30 June 2019 balance sheet was as follows:

IFRS 9 Gross Exposure

	Stage 1 Of which Months in Arrears			Stage 2 Of which Months in Arrears			Stage 3 Of which Months in Arrears			Total
	<1 £m	1-3 £m	>3 £m	<1 £m	1-3 £m	>3 £m	<1 £m	1-3 £m	>3 £m	£m
Prime residential	1,843.1	-	-	165.2	20.1	-	6.1	2.7	7.1	**2,044.3**
Buy-to-Let	243.2	-	-	15.7	2.8	-	0.4	-	5.9	**268.0**
Commercial	23.2	-	-	-	0.1	-	15.1	-	-	**38.4**
Housing Association	420.9	-	-	-	-	-	-	-	-	**420.9**
Serviced Apartments	17.9	-	-	0.7	-	-	-	-	-	**18.6**
Policy Loans	2.7	-	-	-	-	-	0.3	-	-	**3.0**
Total	**2,551.0**	**-**	**-**	**181.6**	**23.0**	**-**	**21.9**	**2.7**	**13.0**	**2,793.2**

Expected Credit Losses

	Stage 1 Of which Months in Arrears			Stage 2 Of which Months in Arrears			Stage 3 Of which Months in Arrears			Total
	<1 £000	1-3 £000	>3 £000	<1 £000	1-3 £000	>3 £000	<1 £000	1-3 £000	>3 £000	£000
Prime residential	45	-	-	128	43	-	596	78	296	**1,186**
Buy-to-Let	1	-	-	3	1	-	1	-	-	**6**
Commercial	725	-	-	-	-	-	8,724	-	-	**9,449**
Housing Association	-	-	-	-	-	-	-	-	-	**-**
Serviced Apartments	-	-	-	-	-	-	-	-	-	**-**
Policy Loans	-	-	-	-	-	-	319	-	-	**319**
Total	**771**	**-**	**-**	**131**	**44**	**-**	**9,640**	**78**	**296**	**10,960**

The above analysis excludes provisions on liquidity investments and trade debtors which are not material.

The Group's equity release portfolios are not within the scope of IFRS 9 and are accounted as unbundled insurance contracts under IFRS 4.

Sensitivity

The Group's residential mortgage provisions are most sensitive to increases in the downside scenario probability:

In recognition of increasing uncertainty to the Group's economic forecasts, the Group began modelling in June 2019 a high-impact, low probability stressed scenario: a forward view that reflects a prolonged severe and negative stress that is aligned with the Group's key vulnerabilities and benchmarked against the Bank of England's stress testing recommendations.

The Group's sensitivity analysis at 30 June 2019 reflect both adjustments to the scenario likelihood factors and the inclusion of this severe stressed scenario (in each instance at a 1% likelihood factor in recognition of the highly unlikely nature of this severe stress). A likelihood factor of 10% is applied to the Group's upside scenario throughout. The Group does not consider any of the sensitivity based uplifts to be material.

Base %	Downside %	Additional Provision Required* £000s
80	10	48
70	19	160
60	29	320
55	34	384
50	39	446
40	49	586

*Against prime residential and BTL

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors confirm that this condensed consolidated half-yearly financial information has been prepared in accordance with IAS 34 as adopted by the European Union, and that the half-yearly management report herein includes a true and fair review of the information required by the Disclosure and Transparency Rules (DTR 4.2.4, DTR 4.2.7 and DTR 4.2.8).

The Society's Home Member State is the United Kingdom.

The Directors of Newcastle Building Society are listed in the Annual Report for 2018, subject to the following changes. David Buffham retired from the Board on 24 June 2019. Patrick Ferguson resigned from the Board on 21 June 2019. Mick Thompson joined the Board on 29 January 2019. Adam Bennett joined the Board on 24 April 2019. There were no other changes to the Board in the period.

On behalf of the Board

Andrew Haigh
Chief Executive
24th July 2019

INDEPENDENT REVIEW REPORT TO THE DIRECTORS OF NEWCASTLE BUILDING SOCIETY

Report on the half yearly financial information

Our conclusion

We have reviewed Newcastle Building Society's half yearly financial information (the "interim financial statements") for the 6 month period ended 30 June 2019. Based on our review, nothing has come to our attention that causes us to believe that the interim financial statements are not prepared, in all material respects, in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union.

What we have reviewed

The interim financial statements comprise:

- the summary consolidated balance sheet as at 30 June 2019;
- the summary consolidated income statement and summary consolidated statement of comprehensive income for the period then ended;
- the summary consolidated cash flow statement for the period then ended;
- the summary consolidated statement of movement in members' interests for the period then ended; and
- the explanatory notes to the interim financial statements.

The interim financial statements included in the Half-Yearly Report 2019 have been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union.

As disclosed in note 2 to the interim financial statements, the financial reporting framework that has been applied in the preparation of the full annual financial statements of the Group is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Responsibilities for the interim financial statements and the review

Our responsibilities and those of the directors

The Half-Yearly Report 2019, including the interim financial statements, is the responsibility of, and has been approved by, the Directors.

Our responsibility is to express a conclusion on the interim financial statements based on our review. This report, including the conclusion, has been prepared for and only for the directors of the Society as a body, for management purposes, in connection with our review of your half-yearly financial information and for no other purpose. Our report may not be made available to any other party without our prior written consent. We do not, in giving this conclusion, 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.

What a review of interim financial statements involves

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and, consequently, does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

We have read the other information contained in the Half-Yearly Report 2019 for the six months ended 30 June 2019 and considered whether it contains any apparent misstatements or material inconsistencies with the information in the interim financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants
Newcastle upon Tyne
24th July 2019

Connecting communities in the North East
with a better **Financial Future.**

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