NEWCASTLE BUILDING SOCIETY ANNOUNCES 2017 FINANCIAL RESULTS

Key Highlights

- Profit before tax of £13.1m compared to £8.1m for 2016
- Strong Capital ratios - Common Equity Tier 1 ratio of 15.3% and Leverage ratio of 5.2%
- Robust liquidity ratio of 17.0%
- Gross mortgage lending up 8% to £535m
- The number of mortgages in 3 months arrears or more at a record low of 0.34%
- "What Mortgage Awards 2017" Winner for Best Regional Building Society
- Achievement of Gold Investors in People status and launch of apprenticeship programme
- Increased contribution to the Community Fund and over £133,000 in grants awarded to 76 charities across our heartland
- Purchase of our flagship office building at Cobalt Park
- Newly refurbished branches in Darlington and Durham in better locations
- Further increase in customer satisfaction rating to 96%

Chief Executive's Statement

In 2017 we have made great progress, with higher levels of lending, more new savers, increased levels of ongoing financial advice business, and delivery of major regulatory and investment programmes to improve service and support growth. In terms of financial performance we are reporting increased profits, strong capital ratios, a robust liquidity position and record low levels of arrears, reflecting the excellent credit quality of our residential mortgage book.

For over 150 years Newcastle Building Society has been bringing communities in the North East together and connecting them with a better financial future. Our Members can rely on us to help save and plan their finances, buy their own home, make positive changes to local communities and of course be a great place for our colleagues to work and develop.

A few of the highlights of 2017 include: Achievement of Gold Investors in People status; significantly expanding our programme of grant giving from the Newcastle Building Society Community Fund; relocation and refurbishment of branches in Darlington and Durham; purchase of our flagship offices on Cobalt Business Park; delivery of critical projects covering regulatory, accounting and information technology enhancements; major investment in colleagues through leadership programmes; a new apprenticeship programme; and last but not least – a record customer satisfaction score of 96%.

Financial Performance

Profit before tax improved to £13.1m for the year ended 31 December 2017 compared to £8.1m for 2016, an increase of 62%. This significant improvement was due mainly to a reduction in charges for impairment provisions and a non-recurring credit related to the purchase of our Cobalt office of £2.2m. Operating profit before provisions and exceptional items increased by £0.2m to £12.1m with overall growth in income of £3.3m, being offset by an increase in costs of £3.1m associated with the significant ongoing investment into the business.

Net interest margin improved from 0.77% to 0.79% reflecting increased levels of residential mortgage lending despite a very competitive mortgage market and pressure on margins. Funding costs were slightly lower as the Society utilised the Bank of England Term Funding Scheme to provide cost effective 4 year financing.

Income from Newcastle Strategic Solutions, our savings management outsourcing business, increased by 3.5% while underlying profitability was lower reflecting a significant investment into the infrastructure. This included a strengthened senior management team, an enhanced project support team and a higher depreciation charge reflecting increased capital expenditure to upgrade and enhance infrastructure. The Solutions business provides a diversified income stream, based on core competencies within the building society business. All of the profits from this business are ploughed back into the Society and support increased investment in services for Members as well as providing capital to support and grow the business.

In 2017 we continued our significant investment programme in IT systems and supporting processes, particularly around cyber security, enhancing resilience and information security, reflecting the latest regulatory and accounting developments and improving functionality.

Mortgage impairment charges have fallen, as we expected, reducing from £1.8m to £0.2m and for the first time in 10 years, the Society had no charge in the period in relation to legacy commercial lending exposures with the book now representing only 1.5% of the total mortgage portfolio.

Provisions for liabilities and charges increased by £0.4m from £0.6m to £1.0m. The charge for the Financial Services Compensation Scheme levy reduced from £0.6m to £0.1m reflecting a lower expected interest levy for the 2017/18 Scheme year. Offsetting this reduction was an increase in the provision for consumer redress of £0.9m reflecting increased costs of dealing with claims.

In February 2017 we purchased our office building at Cobalt Park in North Tyneside, a site that we have occupied for the last nine years, securing our future occupancy of the building. During the lease period the Society spread the effective cost of the lease over what was a 15 year term and built up a significant creditor for costs recognised but not billed during the rent free period. On purchase of the building this credit has been released, as it is no longer required, generating a £2.2m one-off profit in the year.

The Group's capital ratios continue to strengthen with Common Equity Tier 1 ratio improving from 14.3% to 15.3% and Tier 1 capital ratio increasing from 15.8% to 16.6%. The Group's overall capital ratio (Solvency ratio) was slightly higher at 18.9% compared to 18.7% at the end of 2016. The leverage ratio (on a transitional basis) remained at 5.2%.

Despite the mortgage market being extremely competitive in 2017 we achieved an increase in lending reflecting the investment we have made in distribution, our mortgage product range and online systems capability for brokers. Gross residential mortgage lending increased by 8% from £496m to £535m and net residential lending increased by 11% from £195m to £220m.

The percentage of mortgage loans in arrears of 3 months or more, across our whole mortgage portfolio based on the number of loans, reduced again from 0.42% to 0.34%; lower than the industry average with 2017 seeing a record low since we have been tracking 3 months arrears. Possession cases also continued at very low levels reflecting the excellent credit quality of the Society's residential lending.

Our liquidity at the end of the year was 17.0%, excluding encumbered assets, down slightly compared to the level at the end of 2016 of 17.4% but well above our minimum operating requirements. The Society's liquidity coverage ratio was 180% against a minimum required level of 100% (from 1 January 2018). This significant headroom reflects the quality of the Society's liquidity with the majority of it invested in AAA/AA rated assets, in the UK.

Supporting our Customers

As a building society, helping people own their home is at the heart of our purpose.

In 2017 we have seen record low mortgage rates. We continued to offer a wide range of good value products to help house buyers, from 2 to 10 year fixed periods, variable and discounted rates, and fee free products. We have a range of retention products available on maturity for loyal customers. We also provide mortgages for borrowers with more specialist needs including building their own home and buying a property to let.

We launched an exclusive range of mortgages to help local people buy their own home in the North East which have been very popular particularly for borrowers requiring a 95% LTV mortgage. Whether it's first time buyers taking their first step on the property ladder, supporting existing house buyers move home, or simply helping people save money by re-mortgaging, we are focused on meeting the needs of our borrowers. We were delighted that our efforts were recognized in the "What Mortgage Awards 2017" when we received the award for Best Regional Building Society.

We believe it's important, for individuals and for wider society, that people are encouraged to save for their future and to plan their finances. Against a backdrop of falling individual savings levels, we have launched a range of regular savings products which include Help to Buy ISA and children's savings accounts with this range set to be expanded further in 2018 so we can encourage everyone to get into the regular savings habit.

In November 2017 the Bank of England increased the base rate from 0.25% to 0.5% giving savers the first sign in 10 years that savings rates may start to increase. In advance of the Bank of England announcement we committed to pass on the base rate increase to all of our retail savers with variable rate savings accounts, which was very positively received by customers.

Our financial advice subsidiary, Newcastle Financial Advisers Limited (NFAL), gives customers financial advice regardless of how much they have to invest. NFAL has a significant and growing level of funds under management for people in the region, and continues to invest in growing local financial adviser talent to meet a customer preference for face-to-face service. The subsidiary increased income and profits in 2017 and scores highly for customer satisfaction (currently at 98%). It has been particularly appreciated in areas of our region that have experienced loss of ongoing service from other providers of financial advice.

We are committed to our heartland area and continue to invest in a modern High Street branch network that is fit for the future and designed around the needs of our customers. Darlington branch was relocated to a facility that provides a greatly improved environment for our customers and colleagues, including more private meeting spaces to discuss financial matters with ease.

Durham branch also has a new location, providing modern premises and facilities for our customers. Further plans are in place to invest in the relocation or refurbishment of our Carlisle and Berwick branches, which we expect to be completed in 2018.

Reflecting our strategic focus on our North East heartland, during the second half of the year we made the difficult decision to close our two geographically outlying branches - Dumfries closed in September and Gibraltar closed in October.

We have plans to upgrade all of our remaining branches, which have not already been refurbished, over the next 2-3 years.

Supporting our Colleagues

In 2017 we were delighted to be awarded Investors in People – Gold status. This recognises our commitment to leadership development, our genuine involvement with local communities, our values and behaviours, and our investment in colleague engagement and communication, all of which are driving positive change across the organisation.

We have made significant progress towards our goal to make the Society a great place to work, where people can realise their potential. In 2017 we completed a major review of our pay and grading structures so we can ensure we have fair remuneration, competitive packages and all staff have a clear understanding of their roles. This was aligned with an extensive job evaluation exercise which will ensure we have the right pay and grading structures in place to attract and retain talent. This process will continue in 2018.

Part of our purpose of “Connecting Communities in the North East with a Better Financial Future” is delivered through the manner in which we support our colleagues in planning their own future. We were therefore very pleased to announce improved pension contributions for over 500 colleagues going into 2018. A corporate bonus was awarded to colleagues in relation to 2017 performance, which ranged from 0% to 6% of salary, with the majority of colleagues being paid 3%.

In 2017 we were officially accredited by the National Living Wage Foundation as a Real Living Wage employer. This goes further than the Government’s national minimum wage. Real Living Wage Rates are independently calculated and are the only UK rates based on real living costs.

We have continued to invest in our Academy programme for financial advisers, which provides a professional training programme leading to qualified adviser status. Four new internal recruits joined the programme this year. Investing in our talent through this type of opportunity is core to our ongoing commitment to provide accessible, face to face, affordable financial advice for people across our region.

We also increased our investment in nurturing regional talent with the launch of our first ever apprenticeship programme. Five apprentices aged between 17 and 24 joined us to undertake a 12 to 18 month training and development programme resulting in a nationally recognised qualification. This supplements the student placement and undergraduate training programmes that we have already operated for many years. We plan to expand the apprenticeship programme in the years ahead.

Supporting our Communities

As a customer-owned business, supporting our communities and helping them make positive changes is part of our purpose.

Since the launch of our Community Saver accounts, which generate a Society donation to the Newcastle Building Society Community Fund at the Community Foundation, we have provided grants to help local community groups continue, or enhance, their delivery of valuable local services.

In 2017 we awarded £133,823 in grants to 76 charities and community groups, positively impacting an estimated 74,000 people across the North East region. From lunch clubs for the socially isolated, to a talking newspaper for the blind, and the provision of new children’s toys for a local community play group, we have been privileged to play our part in creating a better outcome for a number of communities across the North East and Cumbria.

We have also continued to support the North East-based cancer research charity, the Sir Bobby Robson Foundation through our charity-linked savings accounts, and this year reached an impressive £2.5m in donations since the fund first started. Our support to the Sir Bobby Robson Foundation, combined with the contribution to the Community Foundation to build up the endowment for the Community Fund saw total charitable giving of £770,000 or 6% of our profit before tax.

Our financial education programme continues to deliver memorable opportunities for primary school children, the basis of which is a six week classroom based course of lessons all about money - delivered by our branch staff. The culmination of the programme is the Boardroom Charity Challenge which asks young participants to develop business ideas that will benefit their local community while making a profit. Our 2017 winner was Throckley Primary school in Newcastle.

This programme is supplemented by an ongoing, region-wide series of 'Big Talks' which provide a review of developments in pensions, investments and protection. This year we supplemented our 'Big Talks' with First Time Buyer information events for those who are new to the process of buying a home.

Our colleague volunteering policy encourages all our colleagues to spend two days volunteering to support a range of charities and groups based in our local communities. Colleagues have supported more than 70 causes this year.

Summary

I am very pleased with the Society's progress in 2017 which balances the need for a strong financial performance with investing in the products and services we provide for customers both now and for the longer term.

I would like to thank our colleagues for their fantastic contribution in 2017 and our Members for their ongoing support. While there may be economic uncertainty from global factors outside of our control and it is likely the UK mortgage market will continue to be extremely competitive in 2018, we are well placed to continue our progress in the year ahead.

Regardless of the economic backdrop we will be true to our purpose of "Connecting Communities in the North East with a Better Financial Future", encouraging people to save and plan their finances and helping people own their home. We will strive to be a great place to work where our staff can achieve their potential and help our communities make positive changes.

Andrew Haigh
Chief Executive
27th February 2018

NEWCASTLE BUILDING SOCIETY
PRELIMINARY ANNOUNCEMENT
for the year ended 31 December 2017

CONSOLIDATED INCOME STATEMENTS

	2017	2016
	£m	£m
Interest receivable and similar income	**65.6**	69.8
Interest payable and similar charges	**(36.5)**	(42.7)
Net interest income	**29.1**	27.1
Other income and charges	**28.7**	27.4
Gains less losses on financial instruments and hedge accounting	**0.1**	0.1
Administrative expenses	**(43.0)**	(40.3)
Depreciation	**(2.8)**	(2.4)
Operating profit before impairments, provisions and exceptional items	**12.1**	11.9
Impairment charges on loans and advances to customers	**(0.2)**	(3.2)
Provisions for liabilities and charges	**(1.0)**	(0.6)
Exceptional gain on purchase of Cobalt Offices	**2.2**	-
Profit for the year before taxation	**13.1**	8.1
Taxation expense	**(2.2)**	(2.0)
Profit after taxation for the financial year	**10.9**	6.1

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	2017	Restated 2016
	£m	£m
Profit for the financial year	**10.9**	6.1
Other comprehensive income/(expense):		
Items that may be reclassified to income statement		
Movement on available for sale reserve	**1.8**	1.0
Income tax on items that may be reclassified to income statement	**(0.3)**	(0.2)
Total items that may be reclassified to income statement	**1.5**	0.8
Items that will not be reclassified to income statement		
Actuarial remeasurements on retirement benefit obligations	**-**	2.6
Income tax on items that will not be reclassified to income statement	**-**	-
De-recognition of pensions surplus	**(1.7)**	(2.6)
Total items that will not be reclassified to income statement	**(1.7)**	-
Total comprehensive income for the financial year	**10.7**	6.9

CONSOLIDATED BALANCE SHEETS

ASSETS	2017 £m	Restated 2016 £m
Liquid assets	**789.8**	776.5
Derivative financial instruments	**4.9**	6.5
Loans and advances to customers	**2,707.3**	2,563.8
Fair value adjustments for hedged risk	**206.2**	233.8
Property, plant and equipment	**38.8**	22.8
Other assets	**15.1**	15.9
TOTAL ASSETS	**3,762.1**	3,619.3
LIABILITIES		
Shares	**2,788.5**	2,709.2
Fair value adjustments for hedged risk	**1.6**	5.2
Deposits and debt securities	**504.6**	398.4
Derivative financial instruments	**210.2**	234.3
Other liabilities	**15.4**	16.1
Subordinated liabilities	**25.0**	50.0
Subscribed capital	**30.0**	30.0
Reserves	**186.8**	176.1
TOTAL LIABILITIES	**3,762.1**	3,619.3

CONSOLIDATED CASH FLOW STATEMENTS

	2017	2016
	£m	£m
Cash inflows from operating activities	**66.9**	18.1
Payment into defined benefit pension scheme	**(2.0)**	(2.0)
Net cash inflows from operating activities	**64.9**	16.1
Cash (outflows)/inflows from investing activities		
Purchase of property, plant and equipment	**(18.8)**	(2.1)
Sale of property, plant and equipment	**-**	0.2
Purchase of investment securities	**(185.1)**	(133.3)
Sale and maturity of investment securities	**154.9**	137.2
Net cash (outflows)/inflows from investing activities	**(49.0)**	2.0
Cash outflows from financing activities		
Interest paid on subordinated liabilities	**(2.1)**	(2.6)
Interest paid on subscribed capital	**(3.5)**	(3.5)
Repayment of subordinated liabilities	**(25.0)**	-
Repayments under finance lease agreements	**(0.1)**	(0.1)
Net cash outflows from financing activities	**(30.7)**	(6.2)
Net (decrease) / increase in cash	**(14.8)**	11.9
Cash and cash equivalents at start of year	**198.4**	186.5
Cash and cash equivalents at end of year	**183.6**	198.4

		Restated
Summary of key financial ratios	**2017**	2016
	%	%
Gross capital as a percentage of shares and borrowings	**7.36**	8.24
Liquid assets as a percentage of shares and borrowings	**23.94**	24.99
Profit for the year as a percentage of mean total assets	**0.29**	0.17
Management expenses for the year as a percentage of mean total assets	**1.24**	1.21

Notes

1. The financial information set out above, which was approved by the Board of Directors on 27 February 2018, does not constitute accounts within the meaning of the Building Societies Act 1986.
2. The financial information for the years ended 31 December 2017 and 31 December 2016 has been extracted from the Accounts for those years and on which the auditors have given an unqualified opinion.
3. Restated figures reflect retrospective application of the Group's accounting policy, as revised in 2017 to derecognise defined benefit pension surpluses from the balance sheet. The 2016 surplus of £2.6m and associated deferred tax liability of £0.4m have both been restated to £nil.