

PARAGON BANKING GROUP PLC

Half Year Financial Report

For the six months ended 31 March 2024

Under Stock Exchange embargo until 7.00 a.m. Wednesday 5 June 2024

RNS Announcement
Paragon Banking Group PLC
5 June 2024

Continued delivery through strong financial and operational performance

Paragon Banking Group PLC ('Paragon' or 'the Group'), the specialist banking group, today announces its half-year results for the six months ended 31 March 2024.

Nigel Terrington, Chief Executive of Paragon said:

"The Group has delivered another strong operational and financial performance with underlying profits up 13.5%, driven by good loan growth, improved margins and tight cost control.

There has been a strong recovery in customer demand with new business pipelines materially above the levels seen at the year-end, improving the outlook for lending volumes for the rest of this year. The deposit book saw continued strong growth to £14.8 billion, up 24.4%, outperforming the market.

The transformation of the Group's capabilities continues with the cloud-based technology re-platforming programme which is enhancing our customer experience and improving efficiencies.

The Group's strong capital generation is a core strength, supporting our growth ambitions, and enabling us to announce an increase in our share buy-back programme of up to £100.0 million. Including today's announcement, we have returned in excess of £1 billion to our shareholders since 2015 through dividends and share buy-backs.

The strength of our business model, long-term track record, and improving customer sentiment, means the Group is well placed to continue supporting our customers' ambitions whilst delivering strong returns for our shareholders and capitalising on the opportunities in our chosen specialist markets."

Financial highlights:

- Underlying profit increased 13.5% to £146.3 million (2023 H1: £128.9 million)*
- Statutory profit before tax up 138.4% at £110.6 million (2023 H1: £46.4 million) reflecting lower fair value reversals
- Half-year NIM higher at 3.19% (2023 H1: 2.95%)
- Cost:income ratio further reduced to 36.5% (2023 H1: 38.1%)
- Underlying EPS increased 17.4% to 49.9 pence (2023 H1: 42.5 pence)*, while statutory EPS rose 134.1% to 38.4 pence (2023 H1: 16.4 pence)
- Capital base remains strong – CET1 ratio of 14.7% (31 March 2023: 15.6%)
- Underlying RoTE 20.8% (2023 H1: 18.7%)*

- Interim dividend up 20.0% at 13.2 pence (2023 H1: 11.0 pence)
- Accelerated repayment of £0.9 billion of TFSME funding, reduced drawings to £1.85 billion (30 September 2023: £2.75 billion)

* For underlying basis, see Appendix A

Operational highlights:

- Deposit base grew to £14.8 billion (31 March 2023: £11.9 billion)
- Continuing loan book growth and new lending ahead of expectations – guidance upgraded
- New mortgage lending down 36.2% at £0.65 billion (2023 H1: £1.02 billion), reflecting the much-reduced September 2023 pipeline
- Buy-to-let pipeline stood at £0.87 billion (31 March 2023: £0.81 billion; 30 September 2023: £0.59 billion). Recent application flows have maintained their positive trajectory
- New commercial lending up 2.7% to £0.59 billion (2023 H1: £0.57 billion), with growth in SME lending and structured lending offset by reduced activity in development finance and motor finance, reflecting the reduced level of the opening pipeline
- The development finance pipeline has recovered well to end the period 3.9% higher, year-on-year, at £0.67 billion (2023 H1: £0.64 billion) after a challenging 2023 H2
- Strong customer retention, with annualised buy-to-let redemptions at 6.0% for 2024 H1, representing the lowest rate since 2015 H1 (2023 H1: 10.7%)
- Impairment charge increased by £2.8 million to an annualised rate of 14 basis points (2023 H1: 10 basis points) reflecting impacts of the higher interest rate environment on the legacy variable rate portfolio
- Continued close engagement with the PRA over the Group's IRB accreditation

Guidance summary:

2024 FY metric	Original guidance	Updated guidance
Mortgage Lending advances	£1.3bn – £1.6bn	Increase to £1.4bn – £1.6bn
Commercial Lending advances	£1.0bn – £1.2bn	Increase to £1.1bn – £1.2bn
NIM	3.0% – 3.1% range	Increase to over 3.1%
Operating expenses	Sub £180.0m	Unchanged but includes new PRA Levy
RoTE medium term 15-20%	Towards top end of range	Unchanged
Share buy-backs	Up to £50.0m	Increase to up to £100.0m

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The Group will be holding a results presentation for sell-side analysts on Wednesday 5 June 2024 at 9:30am at UBS, 5 Broadgate, London EC2M 2QS.

This will be webcast live at: <https://secure.emincote.com/client/paragon/half-year-results-2024>

The presentation material will be available on the Group's corporate website at www.paragonbankinggroup.co.uk/investors from 7:00am on the same day, with a webcast replay available from 2:00pm.

Cautionary statement

Your attention is drawn to the cautionary statement set out at the end of this document.

Interim Management Report

1 OVERVIEW

The Group delivered strong results for the six months ended 31 March 2024, with underlying profit before tax rising 13.5% from its HY 2023 position and the loan book growing by 4.8%, despite starting the period with a subdued new lending pipeline.

Net interest margin ('NIM') was up 24 basis points from 2023 H1, at 319 basis points, but down marginally from its 2023 H2 level as interest rates have stabilised and deposit costs have risen through the period. NIM for the full year is expected to be above the top end of initial guidance.

The combination of wider margins, tight cost control and an increased loan book was the main driver of underlying profit growth and, when combined with the favourable effects of the Group's share buy-back programme, generated a 17.4% increase in underlying basic earnings per share ('EPS') from its 2023 H1 level to 49.9p for the period (Appendix A).

Lending activity

Buy-to-let new advances, at £649.3 million, were lower than those reported in the first half of 2023 (2023 H1: £1,018.4 million). This level of advances, coupled with strong customer retention led to the net loan book in the Mortgage Lending division growing by 4.0%, year-on-year, to £13.1 billion at 31 March 2024 (31 March 2023: £12.6 billion). Application flows have been stronger in the period, resulting in the pipeline rising to £874.0 million from the £594.6 million recorded at 30 September 2023. This will support increased volumes for the second half of the year, and guidance for the full year's new business has been upgraded.

Commercial Lending volumes were slightly higher than their 2023 level at £589.8 million (2023 H1: £574.4 million) with growth in SME and structured lending offset by lower flows in both the motor finance and development finance operations. The overall commercial lending book continued its expansion, growing by 9.8% year-on-year, to £2.2 billion (March 2023: £2.0 billion), with increased balances across all principal business lines, with the increased pipeline and improved outlook towards the end of the period leading to upgraded guidance for full year lending volumes.

Credit and costs

Credit performance has remained strong in the period, other than a small volume of legacy loans on variable rates, where the interest rate environment has squeezed affordability. While arrears moved upwards in the buy-to-let book in the period, they remain below market average levels, and performance in other portfolios has remained largely stable.

The general outlook for loan impairment remains little changed from that at September 2023 and weightings applied to the economic scenarios have been maintained. The Group's impairment models have generated results broadly in line with those seen six months earlier, while judgemental adjustments have been maintained at their September 2023 level, given the higher-for-longer interest rate outlook and general geopolitical risk. As a result of this stability, the overall impairment coverage

Interim Management Report (Continued)**1 OVERVIEW**

ratio has increased by only 2 basis points from its 30 September 2023 level to 51 basis points (30 September 2023: 49 basis points).

Operating expenses increased by 7.4% from their 2023 H1 level to £90.0 million (2023 H1: £83.8 million), reflecting balance sheet growth, the inflationary environment, continued investment in digitalising the Group's operations, which is already delivering significant benefits, and the inclusion of the new Bank of England levy (£1.7 million) for the first time. Despite this increase in expenditure, the cost:income ratio reduced to 36.5% from the 38.1% reported for 2023 H1.

The Group's cost guidance for FY24 remains unchanged at around £180.0 million.

Capital and distributions

The level of continuing balance sheet growth, together with strong distributions in the period, took the Group's CET1 ratio at 31 March 2024 to 14.7% (31 March 2023: 15.6%), with the total capital ratio standing at 16.6% (31 March 2023: 17.7%).

Liquidity has been maintained at an enhanced level in the period, which has facilitated the repayment of £900.0 million of TFSME drawings (with more repaid following the period end), de-risking the final TFSME repayment, due in October 2025, and adding material access to contingent liquidity through the release of collateral pledged in respect of these borrowings.

An interim dividend for 2024 of 13.2 pence per share has been declared, representing a half of the 2023 final dividend, in line with policy.

Having completed the £50.0 million share buy-back announced in December 2023, the Board has announced a further buy-back of up to £50.0 million to take place in the second half of the financial year.

Conclusion

The Group has performed robustly in the higher interest rate environment of the last six months, seeing positive levels of demand from its specialist lending customers and continued strong inflows of retail deposits. Pipelines for both the buy-to-let mortgage and development finance businesses have grown from their September 2023 positions, improving the near-term outlook for lending volumes. Whilst continuing to invest in its operational capacity for the future, the Group maintains a focus on business efficiency and cost effectiveness, enabling it to deploy its strong capital generation into future growth and distributions.

Interim Management Report (Continued)

2 BUSINESS REVIEW

The Group reports its results analysed between two segments, Mortgage Lending and Commercial Lending, based on customer type, products and management structure. These segments are the same as those reported on at the previous year end. New business advances in the period and period end loan balances are summarised below, analysed by those segments:

	Advances in the period			Loans to customers at the period end		
	Six months ended 31 March 2024	Six months ended 31 March 2023	Year ended 30 September 2023	Six months ended 31 March 2024	Six months ended 31 March 2023	Year ended 30 September 2023
	£m	£m	£m	£m	£m	£m
Mortgage Lending	649.3	1,018.4	1,879.9	13,094.7	12,593.3	12,902.3
Commercial Lending	589.8	574.4	1,128.7	2,154.3	1,961.6	1,972.0
	<u>1,239.1</u>	<u>1,592.8</u>	<u>3,008.6</u>	<u>15,249.0</u>	<u>14,554.9</u>	<u>14,874.3</u>

The carrying value of Group's loan portfolios increased by 2.5% in the six-month period, despite a challenging operating environment, while the year-on-year growth was 4.8%.

Total new loans advanced decreased by 22.2%, year-on-year, with the reduction primarily reflecting the reduced scale of the new business pipelines brought forward at 1 October 2023, as discussed in the Group's 2023 year end reporting.

2.1 MORTGAGE LENDING

The Group's Mortgage Lending division principally provides buy-to-let mortgages secured on UK residential property to specialist landlords. The Group has operated as a specialist in this market for over twenty-five years. This gives the Group deep data on the market through various economic cycles and strong relationships with business providers, landlords and trade bodies. These provide the Group with an unparalleled understanding of both the buy-to-let market and the specialist landlord customer base it targets.

During the period the Group also offered a limited volume of loans to non-specialist landlords, although this activity is non-core and has diminished over recent periods. The segment also includes legacy assets from discontinued product lines, principally residential first and second charge mortgages, although these form a small fraction of the portfolio and are running off over time.

The Group's focus on the specialist buy-to-let market allows it to apply detailed case-by-case underwriting, tailoring its systems and processes to the needs of this customer group, where its focus on managing property risk and building relationships can add value and differentiate its offerings from those of other participants in the market.

Interim Management Report (Continued)

2 BUSINESS REVIEW**Housing and mortgage market**

Economic uncertainty, high interest rates and cost-of-living pressures in the period have continued to depress activity in the UK housing market. According to HMRC, the number of transactions over the six months ended 31 March 2024 was 490,000, the lowest for any six-month period in the last ten years, other than the period which included the first Covid lockdown. This represents a 14.9% fall in transactions compared to the same period twelve months earlier and a 3.9% fall compared to the immediately preceding half year (2023 H1: 576,000; 2023 H2: 510,000).

Despite predictions to the contrary, and the low level of transactions, UK house prices remained resilient in the period, with the Nationwide House Price Index ending the period 1.3% up over the six months, and up 1.6% year-on-year, with Nationwide suggesting evidence of a gradual recovery in the market. This sentiment was echoed by RICS in their March 2024 UK Residential Market Survey, where they predict an improving market for house sales and a gradual increase in prices towards the end of the calendar year.

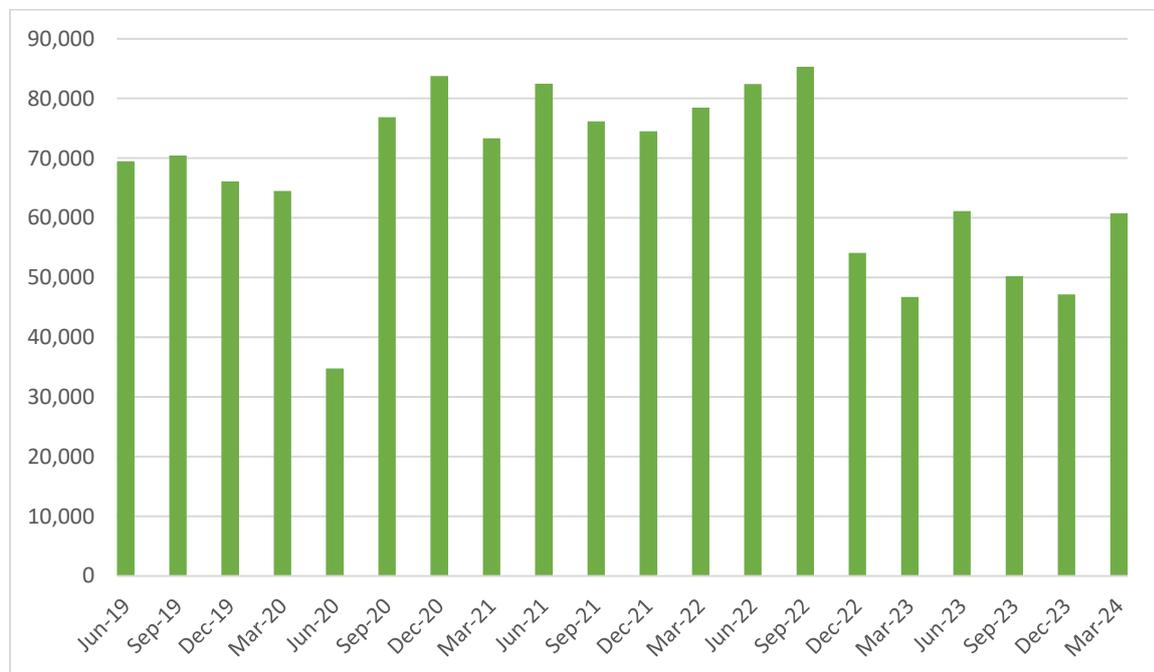
UK house prices have now been broadly static for over a year, although they still remain below their August 2022 peak. Current prices are similar to those seen in February 2022 and higher than those for earlier periods, potentially meaning that only a small proportion of current mortgages have seen security cover reduce below that at the original advance date.

UK mortgage approvals reported by the Bank of England remain significantly lower than the normal levels seen over the last five years (excluding the period of the first Covid lockdown), mirroring activity in the housing market. While the £107.9 billion of new mortgages which were approved in the six-month period represented an increase of 6.9% from the £100.9 billion recorded a year earlier, it represented a fall of 3.1% when compared to the six months ended 30 September 2023. The proportion of the total represented by remortgages remained broadly similar to previous periods at 34.5%, and the number of mortgages refinanced with their original lender declined by 6.9% compared to six months earlier, as borrowers anticipated more favourable interest rates becoming available if they delayed refinancing.

Interim Management Report (Continued)

2 BUSINESS REVIEW

Quarterly Bank of England UK mortgage approval data for the last four financial years is set out below.



Credit performance in the sector as a whole continued to decline, albeit slowly. The UK Finance ('UKF') Arrears and Possessions Report for the quarter ended March 2024 showed arrears moving upwards, with the number of arrears cases increasing by over 10% over the six months since September 2023, although the quarter saw a reduction in light arrears more than compensated by the increase in more serious arrears. Mortgage possessions increased sharply, with over 25% more cases than in the quarter ended 30 September 2023.

The Private Rented Sector ('PRS') and the buy-to-let mortgage market

The Group's target customers in the buy-to-let sector are specialist landlords active in the PRS. Such landlords will typically let out four or more properties, or operate with more complex property types. They will generally run their portfolio as a business and have both a strong understanding of their local lettings market and a high level of personal day-to-day involvement. The Group is amongst a number of mostly small, specialist lenders addressing this sector, which is underserved by many of the larger financial institutions.

Over recent years economic pressures and increasing regulation have caused some landlords to rethink their commitment to the sector, while changing interest rates and house prices have impacted on the attractiveness of property as an investment proposition. However these factors impact most strongly on small scale 'amateur' landlords. The Group's experience is that the specialist portfolio landlords who treat their properties as a business, rather than a simple investment, remain committed to the sector. Landlord survey data from the first quarter of 2024 shows that while more landlords are planning to dispose of properties than to acquire them, most of them plan to buy or sell only one location.

Interim Management Report (Continued)**2 BUSINESS REVIEW**

The experience of the Group's customers, their level of involvement and the diversification of their income streams across properties make them less vulnerable to cash flow shocks in the event of a downturn and better able to cope when faced with an adverse economic situation impacting them or their tenants.

The 2022-2023 English Housing Survey, published by the Department for Levelling Up, Housing and Communities in December 2023, shows that the PRS continues to represent around 19% of English households, as it has consistently done for some time. With recent research conducted by the Nationwide Building Society, published in May 2024, indicating households deferring their first house purchase due to economic pressures, this makes the role of the rented sector particularly important at present.

The importance of the PRS to the UK economy was demonstrated by research into the sector carried out for the Group and the National Residential Landlords Association ('NRLA') by the professional services firm PwC. This concluded that the PRS directly or indirectly supports 390,000 jobs in the UK and contributes £45 billion per year to the country's economy. The full report is available on the Group's corporate website at www.paragonbankinggroup.co.uk.

The residential rental market in the UK remains strong, with the March 2024 RICS UK Residential Market Survey reporting tenant demand rising through the period, albeit with the rate of increase cooling towards the end of the period. Supply remains restricted and RICS anticipate that this will drive rent increases, with 34% of agents expecting rent rises within the second calendar quarter of 2024, and a short-term expectation of rents rising by around 3% per annum, rising to 4% per annum in the longer term.

In its most recent data, published in April 2024, Zoopla reported a 7.2% increase in rents on new lets in the year to February 2024, although it noted that this was the lowest growth rate reported for two years. This is supported by research from Propertymark in its March 2024 Housing Insight Report, where 44% of members reported increasing rents in their area. Propertymark also reported a small increase in available rental properties and gradually reducing rental arrears.

Overall economic research suggests that net immigration to the UK over recent years is contributing to demand in the PRS and the average household in the sector is becoming more affluent. This is helping to mitigate the affordability pressures arising from rising rents.

The development of the regulatory landscape for the PRS has been dominated for some time by the proposed Renters (Reform) Bill, which failed to become law before the dissolution of Parliament in May 2024. The major political parties have all indicated an intention to bring forward new legislation, should they be in government following the forthcoming general election, and it is to be hoped that the significant amount of work already done by organisations representing lenders, tenants and landlords since the publication of the original White Paper in 2022 can be used as a foundation for this. The Group hopes to see proposals which are practical and fully resourced, which balance the needs of both tenants and landlords.

While the most recent UK budget did include some measures addressing rental properties, the main areas of focus, on short-term holiday lets and expatriate landlords, are not heavily represented in the Group's portfolio, and it believes these measures are unlikely to have a material impact on the customer base going forwards.

Interim Management Report (Continued)

2 BUSINESS REVIEW

The Group has continued to engage with the UK Government on these and other matters relating to the PRS, and has also had useful interactions with the Welsh Government on housing topics in the period.

Over 60% of landlords in the PRS fund at least some of their properties through buy-to-let mortgages. However, buy-to-let mortgage activity in the period remained even more subdued than for the general mortgage market, with new advances reported by UKF, at £13.2 billion for the six months ended 31 March 2024 being 41.3% lower than for the same period the previous year (2023 H1: £22.5 billion). Activity in both the new house purchase market and the remortgage market fell by similar amounts. However, some of the downward pressure on remortgaging will be attributable to the expectation of more attractive fixed-rate products becoming available in the short term, coupled with the potential for affordability issues.

The proportion of borrowers transferring to new products offered by their existing lender, which are not recorded as new cases in the data, continued to increase as a proportion of refinancings, with around 70% of landlords adopting this form of refinancing in the period, an increase from around 60% a year earlier. However the absolute number of such transactions declined over the period.

These mixed trends can also be observed in research carried out with the Group's own customers and mortgage brokers in the first quarter of the 2024 calendar year.

In the Group's quarterly landlord market survey for the second quarter of the financial year, 80% of respondents reported strong or very strong tenant demand. The proportion of landlords reporting that their business is profitable in the long term has remained remarkably stable, despite economic headwinds, with the vast majority (78%) reporting rent increases in the last twelve months, rental arrears trending downwards and average yields increasing to their highest level since 2021. Landlords' confidence levels for their own businesses have increased, although there was a low level of confidence for the future of the UK economy overall.

In the Group's biannual survey of specialist mortgage intermediaries, published in February 2024, a clear majority of brokers remained optimistic about the outlook for their own businesses, with 85% stating they were confident or very confident, although this had reduced since the previous survey six months earlier (2023 H2: 94%; 2023 H1: 85%). Confidence in the mortgage industry had also weakened in the six months, at 70% (2023 H2: 79%; 2023 H1: 46%), with sentiment weaker for the buy-to-let market, with only 49% of intermediaries confident (2023 H2: 56%; 2023 H1: 43%) and half either not very, or not at all confident. The principal causes for concern reported were rising interest rates, a slowdown in the housing market and the prospect of a UK economic downturn more generally.

The UKF Arrears and Possession data also reported declining credit quality in the buy-to-let sector, with arrears continuing to grow in the period. However, the number of low-level arrears cases had declined since December 2023, suggesting that a significant proportion of landlords are working their way through the current stressed environment. The number of buy-to-let possessions continued to increase, but only to levels which would have been considered normal in the pre-Covid period.

While the overall picture from this data remains mixed, it would seem to indicate a basic level of underlying strength in the PRS, despite ongoing economic uncertainties and should support both cash flows and affordability for landlord customers. However arrears remain higher than they have been for some time.

Interim Management Report (Continued)

2 BUSINESS REVIEW**Mortgage Lending activity**

The total amounts of the division's lending in the six-month period are set out below. Almost all the Group's mortgage lending in the period was to its target specialist landlord customers.

	Six months ended 31 March 2024 £m	Six months ended 31 March 2023 £m	Year ended 30 September 2023 £m
Specialist buy-to-let	643.4	1,004.5	1,857.6
Non-specialist buy-to-let	5.9	13.9	22.3
Total buy-to-let	<u>649.3</u>	<u>1,018.4</u>	<u>1,879.9</u>

Lending in the segment reduced by 36.2%, year-on-year, in line with the Group's expectations, based on the economic outlook and the level of the opening new business pipeline (the amount of loans passing through the underwriting process), which was 52.7% lower than a year earlier. Over the six months, this position has strengthened considerably, with the pipeline at 31 March growing to £874.0 million (30 September 2023: £594.6 million; 31 March 2023: £810.9 million).

The majority of the Group's mortgage lending products offer fixed interest rates for an initial period, with many customers choosing a new product, either with the Group or elsewhere, at the end of this fixed period. A market shift in 2017 saw five-year fixes become the dominant product and those loans are now reaching the end of the five-year period with customers having to refix their mortgage rates at a higher level.

The Group has well-established, digitally-enabled retention procedures in place to support customers as their fixed rates expire. The Group offers track-to-fixed products as an alternative to fixed-rate loans, allowing customers to delay fixing their interest rates, and this flexibility has helped to support retentions in the period, as well as providing an attractive option for new customers. Over 80% of the specialist landlord customers whose products matured in the past year remained with the Group at the period end.

Specialist intermediaries are the principal source of the Group's buy-to-let applications, and the Mortgage Lending business continues to strategically focus on ensuring that the service offered to them is excellent. The Group's regular intermediary insight surveys in the year showed 97% were satisfied with the ease of obtaining a response from the Group (2023 FY: 95%; 2023 H1: 93%), delivering an net promoter score ('NPS') at offer stage of +58 (2023 FY: +60; 2023 H1: +58).

84% of intermediaries dealing with the Group rated its service as good or better than that provided by other lenders (2023 FY: 75%; 2023 H1: 72%). Paragon Mortgages was also named 'Best Buy-to-Let Lender' at the 2024 Mortgage Strategy Awards and 'Specialist Lender of the Year' at the Mortgage Awards 2024.

Interim Management Report (Continued)**2 BUSINESS REVIEW**

The Group's long-term programme of re-engineering its mortgage business continued through the period. All systems and operational processes are being thoroughly reviewed and refined to align them with the Group's strategy for the division and the overarching plan of digitalising the business.

A major upgrade, covering the process from application to offer, was presented to the broker community during the period. This upgrade will be rolled out from the second half of the financial year, and, as well as being easier to navigate and more intuitive for users, offers enhanced functionality to introducers. The new platform uses API technology to enable brokers to have real-time access to data related to an application, both from the Group and third parties, including credit bureaux and Companies House, enabling significantly more efficient application processing. This will also support more effective assessment processing by the Group, delivering more capacity to its buy-to-let new lending function.

Enhancements already delivered under the programme continue to demonstrate their value to the Group. The redemption and retention process which went live in 2022 continues to underpin the division's success in this area, while the landlord portal introduced in 2023 is now used by 25% of the operation's customers. This gives the Group confidence in the benefits that further stages of the project will bring to the business as they are rolled out.

Environmental impacts

The Group understands the potential for climate change to impact its mortgage business and seeks to mitigate risk through careful consideration of the properties on which it will lend. It also continues to develop systems and refine data to allow its overall position to be measured and the behaviour of its security portfolio under climate-related stresses to be better understood.

As part of its response to climate change, the Group offers a range of green buy-to-let mortgages on all properties within the Group's lending criteria. These products offer lower interest rates for energy efficient properties with EPC ratings of C or higher, the currently accepted benchmark for energy-efficient properties.

The Group recognises the demand from landlords for facilities which would support retrofitting properties to improve energy efficiency, but designing such products is complex without a stable framework defining the standards landlords should be targeting.

The Group, together with other UK banking entities, has been working with the UK Government to develop a more consistent approach to the definition of green activities in the housing market and the housing finance sectors. It is unlikely that significant progress can be made in greening the UK housing stock until all market participants have a shared concept of what that should mean in detail.

Interim Management Report (Continued)

2 BUSINESS REVIEW

The proportion of the Group's new lending volumes secured on properties with an EPC grade C or better continued to increase in the period. These completions accounted for 55.5% of completions in England and Wales, compared to 46.3% in the comparable period a year earlier. The total amount of these advances, which reduced in the period, although by less than the overall decrease in completions, is set out below.

	2024 H1	2023 H1	2023 FY
	£m	£m	£m
New lending on properties with:			
EPC rated A or B	90.2	93.1	184.1
EPC rated C	255.5	364.7	720.5
Total rated A to C	345.7	457.8	904.6
<i>Percentage with available data (England and Wales)</i>	<i>99.8%</i>	<i>99.9%</i>	<i>99.9%</i>

The Group's latest analysis identified EPC grades for 95.2% of its mortgage book in England and Wales by value at 31 March 2024 (30 September 2023: 94.6%; 31 March 2023: 93.8%). Of these 99.3% were graded E or higher (30 September 2023: 99.2%; 31 March 2023: 99.1%) with 42.4% rated A, B or C (30 September 2023: 41.5%; 31 March 2023: 40.3%). This progress results from the continuing improvement in the profile of new lending described above.

Landlords continue to carry out work to upgrade their properties, despite the UK Government's withdrawal of proposals which would have imposed minimum EPC standards on all rental properties. In the Group's most recent survey of buy-to-let landlords, 32% stated that all their properties were at EPC level C or above, and a further 37% said that they planned to upgrade their properties to that level in the short term, regardless of the legislation.

While the Group monitors EPC performance, it is also conscious of the need to avoid unintended consequences by focussing lending solely on this. Although upgrading existing properties is beneficial to overall emissions, the demolition and replacement of properties may be less so.

The Group also monitors the potential physical risks to security values arising from climate change. This includes assessing a property's flood risk as part of the underwriting process. In addition, the exposure of the mortgage book to flood risk from seas, rivers or surface water is monitored on an ongoing basis. The latest data, at 31 March 2024, showed approximately 3.0% (by value) of properties securing the Group's buy-to-let mortgages in England and Wales for which data was available were considered to be at medium or high risk of flooding (30 September 2023: 3.0%; 31 March 2023: 3.0%).

The business is currently working to develop products to support existing customers to make their properties more energy efficient. Given that the majority of properties in the PRS require some form of upgrade to meet the Government targets, this kind of support will be vital to achieving net zero.

Interim Management Report (Continued)

2 BUSINESS REVIEW**Performance**

The outstanding first and second charge mortgage balances in the segment at 31 March 2024 are set out below, analysed by business line.

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m
<i>Post-2010 assets</i>			
Buy-to-let	10,078.8	9,142.8	9,679.5
Owner-occupied	19.1	26.3	22.5
Second charge	66.2	88.6	75.8
	<u>10,164.1</u>	<u>9,257.7</u>	<u>9,777.8</u>
<i>Legacy assets</i>			
Buy-to-let	2,857.8	3,240.5	3,040.6
Owner-occupied	4.5	6.2	5.2
Second charge	68.3	88.9	78.7
	<u>13,094.7</u>	<u>12,593.3</u>	<u>12,902.3</u>

Balances within the mortgage portfolio have continued to increase steadily, reflecting, in particular, the success of the business in retaining existing customers. At 31 March 2024, loan balances in the division were 4.0% higher than a year earlier. Buy-to-let loans represent the overwhelming majority of this balance, and post-2010 originated assets represented 77.6% of the total at the end of the period (30 September 2023: 75.8%; 31 March 2023: 73.5%).

The annualised redemption rate on buy-to-let mortgage assets in the six months to 31 March 2024, at 6.0%, was significantly lower than that seen during the previous financial year (2023 H1: 10.7%; 2023 FY: 9.0%). This figure, which represents the lowest redemption rate since the first six months of the 2015 financial year, resulted partly from market pressures which depressed new lending, and partly from the willingness of customers to remain on reversionary interest rates for longer, in anticipation of fixed interest rates being offered in the market becoming more attractive in future. However, this also reflects the business's strategic priority of managing customer behaviour at the end of fixed-rate periods, with significant operational, product and systems focus placed on customer retention.

Arrears on the Group's buy-to-let mortgage book increased in the period in response to the economic environment. However, at 0.68% of the loan book at 31 March 2024, they remain modest in absolute terms (30 September 2023: 0.34%; 31 March 2023: 0.25%). The Group's buy-to-let arrears also remain low compared to the performance of the national buy-to-let market, as has generally been the case historically. UKF reported arrears of 0.84% for the buy-to-let sector at 31 March 2024 (30 September 2023: 0.69%; 31 March 2023: 0.46%).

Interim Management Report (Continued)

2 BUSINESS REVIEW

The Group's approach to buy-to-let business is focussed on the credit quality and financial capability of its customers, underpinned by a robust assessment of the available security. Relying on a detailed and thorough assessment of the value and suitability of the property as security, this approach to valuation, including the use of a specialist in-house valuation team, provides it with significant security even in times of economic stress.

The loan-to-value coverage in the Group's buy-to-let book, at 63.5%, is similar to that seen at the previous year end, reflecting the largely stable level of house prices in the period (30 September 2023: 62.8%; 31 March 2023: 62.5%). This provides substantial security, while levels of interest cover and stressed affordability also remain good, despite the elevated interest rate environment throughout the period, indicating that the Group's customers are well placed to cope with adverse economic impacts and to continue to develop their businesses.

Arrears on the closed second charge mortgage books increased marginally to 24.61% (30 September 2023: 23.48%; 31 March 2023: 22.59%), while the total balance of such accounts fell by 12.9% over the six months as accounts repaid or redeemed. These arrears levels remain higher than the average for the sector, reflecting the history and seasoning of the balances, with the continuing upward trend reflecting the redemption of performing accounts. This portfolio contains a significant number of accounts which are currently making full monthly payments, but which had missed payments at some point in the past, which inflates the arrears rate. Credit performance in the period is considered to be in line with expectations, and the Group enjoys substantial security on these assets, with an average loan-to-value ratio of 51.9% (30 September 2023: 52.3%; 31 March 2023: 53.1%) providing a significant mitigant to credit risk.

For accounting purposes, 7.7% of the segment's gross balances were considered as having a significant increase in credit risk ('SICR') at the period end (30 September 2023: 6.1%; 31 March 2023: 6.8%), including 1.6% which were credit impaired (30 September 2023: 1.2%; 31 March 2023: 1.2%). This increase resulted from both a higher number of cases identified through probability of default ('PD') modelling, based on credit scores and the economic outlook, and a number of portfolios where a receiver of rent was appointed in the period, which are classified as credit impaired. However, provision coverage was stable, at 35 basis points (30 September 2023: 33 basis points; 31 March 2023: 33 basis points), with coverage on fully performing accounts also broadly stable at 4 basis points (30 September 2023: 4 basis points; 31 March 2023: 5 basis points).

The Group's receiver of rent process for buy-to-let assets helps to reduce the level of loss by giving it direct access to the rental flows from the underlying properties, while allowing tenants to stay in their homes. At 31 March 2024, 741 properties were managed by a receiver on the customer's behalf, an increase of 31.4% (30 September 2023: 564 properties; 31 March 2023: 491 properties). This increase was driven by the appointment of receivers on a number of legacy portfolios, with the resolution of long-standing cases continuing.

Almost all the current receiver of rent arrangements relate to pre-2010 lending, with cases being resolved on a long-term basis to ensure the best outcome for the Group, its landlord customers and their tenants. As part of the receivership process, an up-to-date valuation of the property is obtained, therefore provision on these cases is based on up-to-date security values.

Interim Management Report (Continued)**2 BUSINESS REVIEW****2.2 COMMERCIAL LENDING**

The Group's Commercial Lending division includes four key specialist business streams lending to, or through, commercial organisations, mostly on a secured basis. The development of this division has been a major strategic focus for the Group over recent years and remains fundamental to the success of the Group.

The four business lines address:

- Development finance, funding smaller, mostly residential, property development projects
- SME lending, providing leasing for business assets and unsecured cash flow lending for professional services firms, amongst other products
- Structured lending, providing finance for niche non-bank lenders
- Motor finance, focussed on specialist parts of the market

Each of these businesses is led by a specialist management team, with a strong understanding of their market. The principal competitors for each are small banks and non-bank lenders. The Group operates principally in markets where the largest lenders have little presence, creating both a credit availability issue for customers and significant opportunities for the Group.

The Group's strategy for Commercial Lending is to target niches (either product types or customer groups) where its skill sets and customer service culture can be best applied, and its capital effectively deployed to optimise the relationship between growth, risk and return.

Commercial Lending activity

Total new loans in the Commercial Lending businesses increased by 2.7%, compared to the same period in 2023, with the general economic backdrop impacting customer demand and completion levels. However, the extent and nature of this impact varied across the division's four principal business lines. Performance in the SME lending business was stronger than it had been in the first half of 2023, however advances in both development finance and motor finance continued the downward trend seen in 2023, in response to the pressures of the economic environment and the profile of the opening new business pipelines in these businesses.

Interim Management Report (Continued)

2 BUSINESS REVIEW

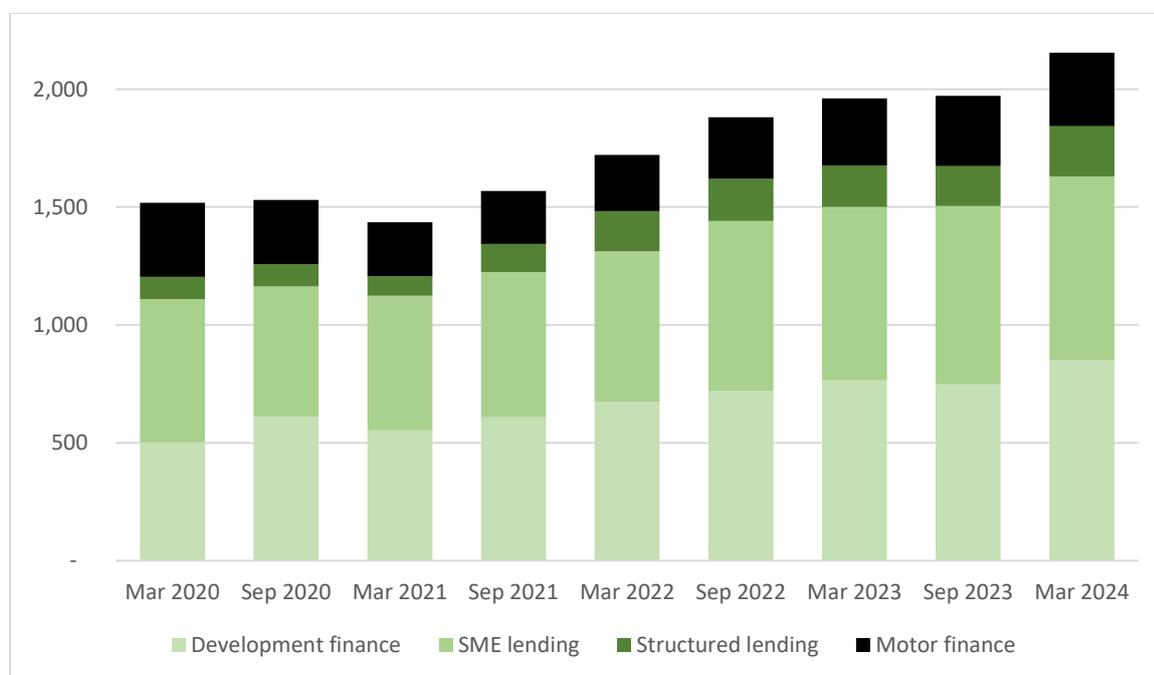
The new lending activity in the segment during the period is set out below, analysed by principal business line. As the structured lending portfolio comprises revolving credit facilities, for this business the amount shown below is the net movement in the period.

	Six months ended 31 March 2024 £m	Six months ended 31 March 2023 £m	Year ended 30 September 2023 £m
Development finance	243.8	273.1	528.1
SME lending	230.2	220.0	447.9
Structured lending	44.2	(4.9)	(9.5)
Motor finance	71.6	86.2	162.2
	<u>589.8</u>	<u>574.4</u>	<u>1,128.7</u>

These advances increased the Commercial Lending loan book by 9.2% in the six months, to a total of £2,154.3 million, its highest level to date (31 March 2023: £1,961.6 million; 30 September 2023: £1,972.0 million). The increase in the portfolio over the most recent five financial years is illustrated by the chart below.

Commercial Lending segment

Outstanding loan balances (£m)



Interim Management Report (Continued)

2 BUSINESS REVIEW*Development finance*

The level of new advances in the Group's development finance business was impacted by the levels of economic and political uncertainty in the UK, which resulted in developers taking a more cautious approach to the timing of phased drawings on existing facilities, and had led to a low new business pipeline entering the period.

The Group's customer base comprises primarily smaller scale property developers, whose business model relies on a continuing flow of new projects, and customers are now bringing forward proposals that are economically feasible in spite of the prevailing conditions. There has also been some reduction in levels of concern over the availability of labour and supplies, which has helped boost confidence in the sector. For the Group this resulted in a level of enquiries in the period which was 20% higher than that seen in the comparable period a year earlier, and the commitment value of new facilities which made their first drawing in the period reaching £304.4 million (2023 H1: £156.4 million; 2023 FY: £365.0 million).

During the period the Group has also expanded its product range to include projects under the Build-to-Rent ('BTR') initiative. This proposition supports the full lifecycle of BTR schemes in established residential locations in cities and large towns across the UK, including site acquisition, development, the letting of a completed scheme and a short-term stabilisation facility, before the property can be refinanced or sold as a buy-to-let investment.

The financial year began with both undrawn balances on agreed facilities, and cases in the process of underwriting, at a historically low level. Unsurprisingly, this led to a reduced level of lending, with advances for the six months 10.7% lower than those seen in the first six months of the 2023 financial year, although only 4.4% less than those in the second half of that year. However, the nearer-term prospects for future lending are stronger than at 30 September 2023, with increasing numbers of proposals coming into the system. The proportion of high-quality proposals has also risen, leading to a rising conversion rate in the period.

Undrawn balances on projects in progress had increased by 19.2% since the year end, to £481.5 million (31 March 2023: £459.9 million; 30 September 2023: £404.1 million), while the new business pipeline had recovered to £186.4 million, 20.8% higher than its September 2023 low point (31 March 2023: £182.7 million; 30 September 2023: £154.3 million). A significant amount of these balances, particularly those related to projects which have already started, would be expected to be drawn in the second half of the financial year providing a stronger base for lending in this period.

The business has extended its Green Homes Initiative Fund by a further £100.0 million, to £300.0 million. This scheme provides beneficial terms for projects which focus on the development of energy-efficient properties with an EPC A grade, and by 31 March 2024, £204.8 million of new lending facilities had been agreed under this initiative (30 September 2023: £175.2 million), with drawings in the period of £28.4 million (2023 H1: £15.8 million; 2023 FY: £46.2 million) and several major projects completed. This initiative rewards energy-efficiency, improving the environment and reducing fuel bills for the ultimate residents, while providing financial benefits to the Group's customers.

Interim Management Report (Continued)**2 BUSINESS REVIEW**

The regional spread of the Group's lending has continued to gradually broaden. While the proportion of the portfolio located in London and the South-East of England increased to 49.4% from the 45.8% recorded at 30 September 2023, it was still less than the 53.7% recorded twelve months earlier. During the period the business also appointed a new relationship director for Yorkshire and the Northeast of England, to increase its presence in this under-represented area.

With the volume of pipeline business increasing into the second half of the year and the fundamental long-term soundness of the Group's proposition, prospects appear positive. The business continues to develop, extending the types of opportunity it can address.

The underprovision of new homes in the UK, based on the requirements set out in government forecasts, will remain a challenge for whatever administration is in place following the forthcoming general election. Meeting this will offer significant expansion opportunities for smaller developers and for the Group to support them, while delivering strong returns on capital and other stakeholder benefits.

SME lending

The Group's SME lending business has a focus towards the transport and construction sectors and therefore is exposed to UK sentiment around capital investment. The ongoing political uncertainties in the UK and the heightened interest rate environment served to increase levels of caution around committing to major capital projects, particularly asset leasing, which is essentially a longer-term fixed interest rate commitment. This provides a testing operating environment for the operation and its customers, and activity levels in the period reflect that. However, despite these external pressures, new lending in the SME lending business grew by 4.6% compared to the first six months of the 2023 financial year.

Asset leasing volumes for the six months, excluding government-backed loans, increased by 15.0% to £152.9 million compared to the same period twelve months earlier (2023 H1: £133.0 million; 2023 FY: £286.4 million). In contrast, total asset finance lending, excluding cars and high value items, reported by the Finance and Leasing Association ('FLA') fell by 3.4% in the same period, with a similar sized fall (2.1%) for new SME business. Investment in operating leases has also continued, with £4.7 million of assets being acquired (2023 H1: £6.4 million; 2023 FY: £15.3 million).

The Group continues to closely monitor the government-guaranteed portfolio for any adverse indications, particularly in view of the performance issues with such loans reported by other lenders, which have principally focussed on Bounce Back Loans Scheme ('BBLS') lending. However, it has yet to encounter such problems in its own portfolio.

Short-term lending to professional services firms outside the government supported schemes totalled £70.5 million in the period, which was 8.9% less than the comparable period in 2023 (2023 H1: £77.4 million; 2023 FY: £137.7 million). These loans are often used to spread the impact of tax payments, and the level of take-up will be influenced by both the confidence and the profitability levels of the underlying customer base, both of which are likely to have been adversely affected by the economic climate.

Interim Management Report (Continued)**2 BUSINESS REVIEW**

The Group monitors the potential impact on climate of the industries it does business with, and supports UK SMEs with green propositions, initially with funding for alternative fuelled assets in the transport, manufacturing and construction sectors, as they transition their businesses towards net zero. These types of initiatives are expected to increase going forward as such considerations are prioritised by customers.

Following the major update to its front-end IT systems two years ago, the business has continued to rollout incremental changes, delivering operational efficiencies to the Group and an enhanced experience to its business partners. Auto-decisioning systems, which can give a quick response to a proposal have been extended and refined in the period. However, the division's business support team remains fundamental to ensuring the process delivers good outcomes to customers and brokers. This increased level of automation has also facilitated the efficient handling of the increased number of applications for smaller value arrangements dealt with in the period.

The most recent outlook survey conducted by the FLA amongst its members in the early months of 2024, showed little expectation of change in the market during 2024. Over 90% of respondents felt that economic conditions would stay the same, improve slightly or worsen slightly, with those predicting slight improvement significantly outnumbering those favouring slight worsening. A similar pattern was seen in FLA members' expectations for both business investment and market conditions generally. However, a majority were predicting some increase in arrears levels, particularly in the asset finance market.

This level of confidence is confirmed by several other confidence tracking surveys for the SME sector published in the period, which generally show little movement in the six months.

Overall, the situation remains mixed, with some SMEs becoming more confident, especially for the longer term, whilst significant numbers still have a more negative outlook. This is confirmed by other published SME surveys, which show confidence levels little changed over the last six months.

While the operating environment remains challenging in theory, the Group's customer base continues to respond robustly. The outlook for SMEs in the UK, while more stable than six months ago, still presents significant threats, with short-term pessimism likely to impact near-term volume growth in the division, although the decision announced in the 2024 budget to extend full expensing for tax purposes to leased assets, which was welcomed by the Group, may encourage some growth in new business.

Ultimately, the level of customer understanding in the SME lending business, supported by its ongoing programme of systems and process enhancements, positions it well to deal with customer requirements going forward, building on the reputation which won it Leasing World's 2023 Gold award for 'SME Specialist'.

Interim Management Report (Continued)

2 BUSINESS REVIEW*Structured lending*

Activity in the structured lending business stream was positive in the six months, despite economic pressures. The total amount of drawn facilities, at £212.8 million, was 25.9% greater than at 30 September 2023 (30 September 2023: £169.0 million; 31 March 2023: £174.2 million), with total available facilities increasing 16.7% over the six months to £275.0 million (30 September 2023: £235.7 million; 31 March 2023: £220.7 million), a result of two new facilities totalling £40.0 million coming on stream in the period, and a positive retention performance on maturing facilities.

These facilities generally fund non-bank lenders of various kinds, providing the Group with increased product diversification. The facilities are constructed to provide a buffer for the Group in the event of default in the ultimate customer population. The Group's experienced account managers receive regular reporting on the performance of the security assets, and maintain a high level of contact with clients to safeguard its position. To date the Group has recorded no losses on structured lending facilities.

The Group is currently examining further potential facilities which would broaden the range of products and industries supported. In the current economic climate these evaluations have a significant focus on the viability of the underlying customer activity. The Group continues to seek new opportunities in this field, which would extend the range of asset classes covered and dilute the concentration risk inherent in such lending.

Motor finance

The Group's motor finance business is a focussed operation targeting propositions not addressed by mass-market lenders, including specialist makes and vehicle types, such as light commercial vehicles, motorhomes and caravans, including static caravans, with the business extending its criteria for motorhomes in the period, as it marked five years serving that market.

During the six months volumes were constrained as a result of market conditions, which continued to be impacted by the elevated level of interest rates, with new lending falling by 16.9% to £71.6 million compared to the same period in 2023 (2023 FY: £162.2 million; 2023 H1: £86.2 million), although this was only 5.8% below the volume achieved in the second half of the 2023 financial year. This result exceeded expectations, as the Group focussed on managing its margins, despite some aggressive pricing in the market, which also impacted short-term volumes. Car finance volumes across the industry were also depressed, with the FLA reporting a 3.2% decline in new consumer car finance lending in the six months to March 2024 compared to the comparable period twelve months earlier and a 6.3% decline compared to the preceding period.

The Group's expansion of lending on battery-powered electric vehicles ('BEVs') continued in the period, with the Society of Motor Manufacturers and Traders reporting that such vehicles comprise 15% of all new registrations and that one in forty cars on the road is now a BEV, resulting in the average car on the road in 2023 generating 2.1% less CO₂ emissions than a year earlier. The Group advanced £4.9 million of loans on BEVs in the period, 2.1% greater than the lending in the same period in the previous year, despite the fall in overall volumes in the business (2023 FY: £7.8 million; 2023 H1: £4.8 million).

Interim Management Report (Continued)

2 BUSINESS REVIEW

With the business' focus on used car finance, the proportion of BEV lending will lag the growth in new registrations, however, good progress has been made with over 5% of new motor finance business related to these products and around 10% relating to electric vehicles more broadly. The Group is well placed to support the green aspirations of its customers, as electric vehicles become a more widely viable and popular option and increasing numbers enter the used car market.

The Group's motor finance business remains a stable, specialist franchise, which is well placed to continue to develop into the future.

Performance

The size of the Commercial Lending book increased by 9.2% in the six months, despite the restricted growth in new business, as a result of the Group's strategic focus on developing this part of its business over recent years. The loans within the Commercial Lending division, analysed by product type, are set out below.

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m
Asset leasing	615.0	551.6	586.0
Professions finance	57.8	65.4	52.2
CBILS, BBLS and RLS	54.8	76.3	67.2
Invoice finance	29.7	24.4	31.7
Unsecured business lending	22.7	17.6	20.4
Total SME lending	780.0	735.3	757.5
Development finance	849.9	765.8	747.8
Structured lending	212.8	174.2	169.0
Motor finance	311.6	286.3	297.7
	2,154.3	1,961.6	1,972.0

The UK economic environment continued to create trading issues for property developers, mostly relating to costs and project timescales. These issues inevitably impact on credit and accounts are regularly monitored for project progress and credit quality and graded on a case-by-case basis by the Group's Credit Risk function. At 31 March 2024, 14 accounts were identified as at risk of loss, a largely similar position to that seen at the previous year end (30 September 2023: 13; 31 March 2023: 8), however the number of accounts identified with significantly increased risk has continued to increase in the face of economic pressure.

These accounts have been carefully examined and projections stressed for the purposes of the Group's IFRS 9 provisioning. Security across the portfolio more generally remains strong. The average loan to gross development value for the portfolio at the period end, a measure of security cover, was 62.7% (30 September 2023: 63.1%; 31 March 2023: 62.0%). This gives the Group a significant credit buffer if any of the projects encounter issues. No significant write-offs were recognised in the period.

Interim Management Report (Continued)

2 BUSINESS REVIEW

Arrears metrics in the division's originated finance leasing portfolios remain stable, despite the economic pressures on UK consumers and businesses. Arrears on asset leasing business at 31 March 2024 remained very low at 0.13% (30 September 2023: 0.23%; 31 March 2023: 0.17%) and motor finance arrears remained stable at 1.08% (30 September 2023: 1.08%; 31 March 2023: 1.44%). Despite the positive trends so far, the Group continues to carefully monitor performance in these areas, and has processes in place to support any customers facing difficulties.

In January 2024 the FCA announced a review of discretionary commission arrangements across the motor finance industry. While the Group offered products which might fall within the scope of the review, principally between 2014 and 2020, it does not, at this stage, believe its exposure to be material. The FCA has undertaken to make its position clear before the end of September 2024, and the Group will report on how it is impacted at the time of its annual results announcement.

Whilst some lenders have reported significant issues with their CBILS, BBLs and RLS lending related to either credit quality or fraud, the Group is yet to see any significant impacts. The portfolio at 31 March 2024 contained only £2.8 million of Stage 2 accounts at gross carrying value and only £1.0 million of credit impaired cases, and the overall exposure on such loans has reduced by 18.5% in the period as loans pay down.

The Group has so far made claims against the government guarantee on £3.9 million of loans, out of the £131.3 million advanced since the schemes began, with £3.8 million of this balance already settled and the remainder still being processed by the guarantor. The majority of the Group's government-backed lending was to existing customers, which contributed to the credit quality of this lending and has enabled it to avoid the issues seen elsewhere.

For structured lending accounts, the Group carefully monitors the performance of the underlying asset pool on a monthly basis, to ensure its security is adequate. The Group relies on its data monitoring and verification processes to ensure that these reviews are able to detect any credit issues. Performance issues have been identified on one facility, but these are being carefully managed with no losses expected.

In terms of the Group's impairment procedures, 11.3% of the segment's gross balances were considered as having an SICR, a little higher than seen in previous periods, with the rise mostly driven by additional cases in the development finance business (30 September 2023: 9.5%; 31 March 2023: 8.0%). This included 3.3% which were credit impaired (30 September 2023: 3.5%; 31 March 2023: 1.5%), a broadly similar level to six months earlier.

Provision coverage remained around the levels seen at the previous the year end, at 146 basis points (30 September 2023: 156 basis points, 31 March 2023: 136 basis points) although coverage on fully performing accounts had reduced a little from 82 basis points at 30 September 2023 to 73 basis points at the period end (31 March 2023: 86 basis points), mostly as a result of the mix of loan types making up the balances.

Interim Management Report (Continued)

3 FUNDING REVIEW

The Group's retail deposit-taking operation, which operates under the Paragon Bank brand, is central to its funding strategy. This is supplemented with other forms of central bank and wholesale funding, including repurchase agreements, creating an adaptable and sustainable funding model which can respond to developments in the business, its operating environment and the economic landscape.

The Group's debt has an investment grade credit rating, confirmed by Fitch in February 2024, which supports its status as a debt issuer. The Group is therefore able to access cost-effective wholesale funding, across various markets, as well as raising finance for strategic initiatives on a timely basis.

During the six-month period the Group's retail deposit book continued to increase, supporting the growing loan portfolio and facilitating the repayment of some of its central bank borrowings at more attractive pricing. The recent increase in demand for term deposits by households has generated a flow of funds from clearing banks to smaller deposit takers, including the Group, whose market strength is focussed on these products.

The Group continued to pay down wholesale facilities in the period, including £900.0 million of Bank of England TFSME funding.

The Group's funding at 31 March 2024 is summarised below.

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m
Retail deposit balances	14,768.5	11,875.9	13,265.3
Securitised and warehouse funding	17.1	631.6	28.0
Central bank facilities	1,850.0	2,750.0	2,750.0
Tier-2 and retail bonds	261.1	261.6	258.2
Repurchase agreements	100.0	-	50.0
	<hr/>	<hr/>	<hr/>
Total on balance sheet funding	16,996.7	15,519.1	16,351.5
Other off balance sheet liquidity facilities	150.0	150.0	150.0
	<hr/>	<hr/>	<hr/>
	17,146.7	15,669.1	16,501.5

The make-up of the Group's funding balance has continued its long-term movement towards retail savings, with an increase of 11.3% in deposit balances. At the end of the period retail deposits represented 86.9% of all on balance sheet funding (30 September 2023: 81.1%; 31 March 2023: 76.5%).

At 31 March 2024, the proportion of easy access deposits, which are repayable on demand, was 35.2% of total on-balance sheet funding, an increase on the position at the start of the period (30 September 2023: 25.7%; 31 March 2023: 25.1%). However, this percentage remains low compared with the rest of the banking sector and is likely to increase further in future periods.

Interim Management Report (Continued)**3 FUNDING REVIEW**

The Group has continued to build its liquidity balance during the six months, in part to facilitate TFSME repayments in the period. £2,922.7 million of cash was available for liquidity purposes at 31 March 2024 (30 September 2023: £2,907.7 million; 31 March 2023: £2,165.8 million), with additional liquid investments in the form of £98.1 million of UK Government securities ('gilts') being acquired in the period, diversifying the nature of the Group's liquidity base (30 September 2023 and 31 March 2023: £nil).

The level of cash reserves is monitored and managed on an ongoing basis as part of the Group's capital and liquidity strategy, and continues to be based on a conservative view of the economic outlook, allowing for the developing needs of the business and the medium-term requirement to refinance its central bank borrowings by October 2025.

The Group's hedging strategy includes the use of derivative financial instruments to protect its income and operating model from the effects of fluctuations in market interest rates. This strategy continued to develop in the period, with an extension of balance sheet hedging, providing protection to returns in a falling base rate scenario.

3.1 RETAIL FUNDING

The UK savings market provides reliable, liquid, scalable and cost-effective funding for the Group. The savings operation is principally focussed on offering sterling deposits to UK households, through a streamlined online presence, supported by an outsourced administration function, with additional routes to market through third party platforms.

The Group's retail deposit proposition is based on generating and retaining customer accounts by providing competitive interest rates, attractive and innovative products and high-quality customer service. Products offered include cash ISAs, term and notice deposits, and easy access accounts, with the substantial majority of balances insured by the Financial Services Compensation Scheme ('FSCS'). The Group enjoys a significant market position in the cash ISA market, developed over eight years, which has benefitted the Group as interest rates have increased in recent periods.

The protection provided to depositors by the FSCS both incentivises larger savers to divide their deposits between several institutions and reduces the risk perceived by customers in using less familiar institutions, supporting the Group's proposition. At 31 March 2024, this FSCS protection covered over 95% of the Group's deposit balances.

The Group's retail deposit franchise continued to perform strongly in the six-month period, with balances increasing by 11.3%, meeting the Group's funding needs at an attractive cost, compared to other alternatives. Customers continued the preference for fixed product offerings seen towards the end of the last financial year, but market pricing remained volatile with different deposit takers responding to changes in interest rate expectations in different ways and over differing time frames.

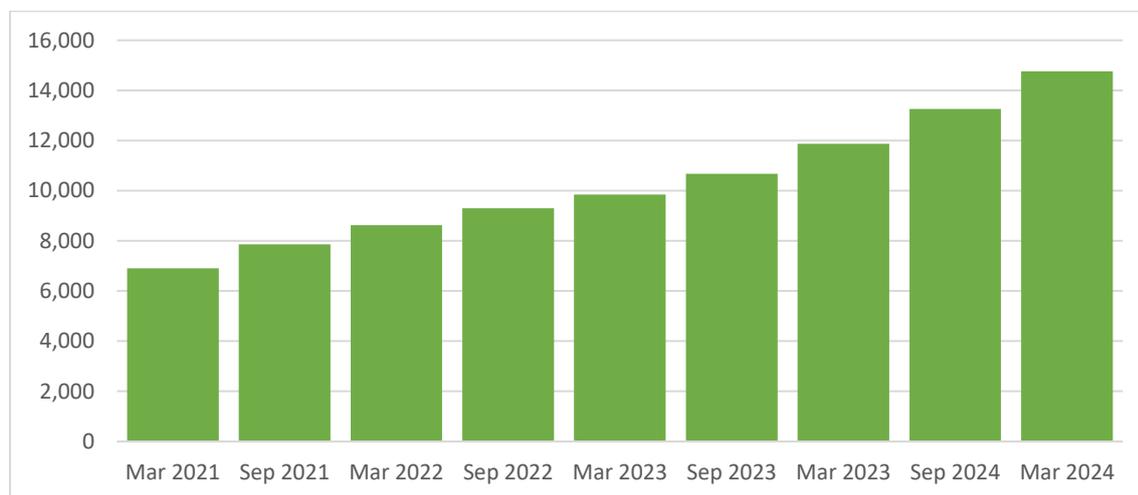
Interim Management Report (Continued)

3 FUNDING REVIEW

The growth in the Group's total retail funding over recent years is set out below.

Retail deposits (£m)

2021 – 2024



During the six months, UK household savings balances reported by the Bank of England remained broadly stable, reflecting the pressure on household budgets from the cost-of-living crisis. Balances at 31 March 2024 reached £1.71 trillion, an increase of 2.7% in the period and an increase of 3.2% year-on-year (30 September 2023: £1.67 trillion; 31 March 2023: £1.66 trillion). While, given the rate of inflation in the period, this represents a real-terms decline in total savings, it is not so marked as might have been expected from the pressure on household incomes.

Against this relatively static background the Group's customer deposits increased much faster than the overall market, with a 24.4% year-on-year increase in balances. This reflects both the attractiveness of the Group's proposition and the impact of its continuing focus on developing its systems and customer service proposition.

Within the savings market the strong move towards fixed-term and notice deposits seen during the last financial year began to level off, although the Bank of England still reported a 5.1% (£11.9 billion) increase in such deposits from individuals over the half year, significantly in excess of the growth in the overall savings base. Total National Savings ('NS&I') deposits by individuals, which fulfil a similar function to term deposits, remained at a similar level as at the beginning of the period, representing £230.5 billion of individual savings at 31 March 2024. Cash ISAs, a product where the Group's offering has historically been strong, also saw increases of 16.4% year-on-year and 6.2% in the six-month period.

These increases are attributable to the increasing opportunity cost to consumers of leaving excess savings in current accounts or low yielding deposit accounts as interest rates rise. As many of these fixed-term products are offered on a fixed-rate basis, this market shift also increased the proportion of the market represented by these products.

Interim Management Report (Continued)

3 FUNDING REVIEW

Despite the broader market trend, the Group has also seen strong growth in its variable interest rate products over the past six months, as fixed rates on offer began to anticipate future falls in base rates, and as it has increased its appetite for easy access deposits in the period.

Increasing diversification and the FSCS guarantee are likely to reduce the potential for liquidity impacts and the Group's profiling of its target customers suggests they may be more resilient than average in the event of future economic stresses.

The Group's savings balances at the period end are analysed below.

	Average interest rate		Proportion of deposits	
	31 March 2024	30 September 2023	31 March 2024	30 September 2023
	%	%	%	%
Fixed rate deposits	4.70	4.07	57.2	65.5
Variable rate deposits	4.25	3.74	42.8	34.5
All balances	<u>4.51</u>	<u>3.95</u>	<u>100.0</u>	<u>100.0</u>

Average interest rates for savings products have continued to move up during the period, as base rate rises in the 2023 financial year worked their way through the system, although market savings rates remained below the SONIA benchmark rate throughout the six months. The Bank of England reported average interest rates for easy access accounts increasing from 2.68% to 2.74% over the six months ended 31 March 2024, whereas the rate for two-year deposits fell from 5.50% to 4.08%.

The average initial term of the Group's fixed rate deposits at 31 March 2024 remained stable at 21 months (30 September 2023: 20 months). At the same time the proportion of the Group's deposit portfolio represented by these products reduced, as more variable rate balances were sought.

The Group's presence on third party investment platforms and digital banks' savings marketplaces provides almost a quarter of the Group's savings base, complementing its direct offering. These channels provide access to a different customer demographic to the Group's mainstream customers, with the more diversified sourcing offering enhanced opportunities to manage inflows and costs. These customer groups demonstrate differing levels of price sensitivity, reflecting their different investing needs and objectives, and also tend to have average deposit balances far lower than seen on direct business.

The Group currently has nine such relationships (30 September 2023: nine), representing 23% of the total deposit base (30 September 2023: 22%; 31 March 2023: 18%), and continues to explore potential developments in this area. It has the necessary systems capacity and control framework to further increase its reach through these channels, if appropriate and cost-effective.

The Group's strategy in the savings market relies on providing a high-quality customer offering and it conducts insight surveys throughout the customer journey.

Interim Management Report (Continued)

3 FUNDING REVIEW

For customers opening a savings account with the Group in the period, 88% of those who provided data stated that they would ‘probably’ or ‘definitely’ take a second product (2023 H1: 89%; 2023 FY: 88%). The net promoter score for new customers in the period was stable at +63 (2023 H1: +62; 2023 FY: +62), a significantly positive position.

Of customers with maturing savings balances in the period, 90% stated that they would ‘probably’ or ‘definitely’ consider taking out a replacement product with the Group (2023 H1: 88%; 2023 FY: 88%) with a substantially improved net promoter score at maturity of +63, compared to +53 for the first half of the 2023 financial year (2023 FY: +59).

The results of this research maintained the strongly positive position previously reported, demonstrating that the quality of the Group’s customer interaction operations position it well to retain customers and deposits in an active and competitive market.

The Group’s service standards were also recognised when it won the 2024 Award for Customer Service at the Savings Champion Awards. Other recognition came in the MoneyComms Top Performers list, where Paragon Bank was recognised as both ‘Best Easy Access Savings Provider’ and ‘Cash ISA provider of the Year’.

The Group’s retail savings franchise continues to grow, providing a stable foundation for its funding strategy, allowing volumes and interest rates to be effectively and flexibly managed. The Group will continue to develop the business on a strategic basis, focussing on enhancing its service proposition, broadening its product range, addressing wider demographics and expanding its presence on third party platforms. It will also continue to develop its systems to ensure it is able to address the increasingly sophisticated needs of savers.

3.2 CENTRAL BANK FACILITIES

The Group’s wholesale funding comprises principally Bank of England facilities, introduced to support SME lending during the Covid pandemic. The Group also has access to other facilities offered by the Bank, which it utilises from time-to-time as part of its overall funding strategy.

The Term Funding scheme for SMEs (‘TFSME’) is the main wholesale funding source, with borrowings under this scheme at 31 March 2024 of £1,850.0 million (31 March 2023: £2,750.0 million; 30 September 2023: £2,750.0 million). Interest is payable on these drawings at the Bank of England base rate, which is currently less attractive than rates available on retail deposits and during the period the Group has strategically reduced the outstanding balance by £900.0 million, ahead of the October 2025 due date for most of these borrowings.

The Group retains access to other Bank of England funding channels, including the Indexed Long-Term Repo (‘ILTR’) and Short-Term Repo (‘STR’) schemes, for liquidity purposes but made no drawings in the period.

Interim Management Report (Continued)

3 FUNDING REVIEW

The Group expects to make use of central bank facilities from time-to-time, where using them is appropriate and cost-effective, or to test operational access. Mortgage loans pre-positioned with the Bank of England are available to act as collateral for drawings, if and when required. This provides access to potential liquidity or funding at 31 March 2024 of up to £2,672.2 million (30 September 2023: £1,715.4 million; 31 March 2023: £944.5 million). Additionally, the Group's retained asset-backed notes and holdings of gilts can be used to access Bank of England funding arrangements.

3.3 WHOLESALE FUNDING

The Group's potential sources of wholesale institutional borrowing include securitisation funding, warehouse bank debt and bond issuance, including senior and subordinated corporate bonds, each of which it can access from time-to-time as appropriate.

The Group's Long-Term Issuer Default Rating, a measure of its strength as an issuer, was confirmed at BBB+ by Fitch in February 2024, with a stable outlook, with Paragon Bank PLC, its principal operating subsidiary, also given a BBB+ rating for the first time as part of this rating exercise. This additional rating will allow more flexibility in funding options in future.

During the period the Group issued its Paragon Mortgages (No. 29) PLC securitisation. This transaction is secured on buy-to-let mortgages and comprises £855.0 million of rated notes, denominated in sterling and bearing interest at a SONIA-linked floating rate. All these notes were retained by the Group and can be used as security against future borrowing and liquidity transactions.

While historically the Group has been one of the principal issuers of UK residential mortgage-backed securities ('RMBS'), its reliance on this funding source has been significantly reduced over recent years, with the most recent issuance held internally as contingent funding, rather than placed in the market.

The Group also accesses the short-term, repo market from time-to-time, with £100.0 million of short-term sale and repurchase transactions with financial institutions outstanding at the period end (30 September 2023: £50.0 million; 31 March 2023: £nil). During the period the Group has broadened the range of counterparties it has used for such transactions, increasing its liquidity options.

The Group's wholesale funding position currently satisfies only a small part of its overall requirements, with the proportion of its funding supplied by wholesale debt the lowest since it received its banking licence in 2014. This will reduce further with the repayment of its remaining retail bonds, due in August 2024, and by further repayments of its TFSME funding. However, wholesale funding capacity remains available for use on a tactical basis, when interest rates and conditions are attractive, and to provide contingent funding and support liquidity.

Interim Management Report (Continued)**3 FUNDING REVIEW**

While capital markets in the UK remained volatile in the period, influenced by speculation over the likely direction of interest rates, the outlook towards the period end was more positive than for some time, with demand solid across most classes of debt, and margins tightening. Coupled with movements in retail deposit rates, this has served to make wholesale funding relatively more attractive than it has been for some time, and the Group's strategy is to maintain as wide a range of funding options as possible.

3.4 DERIVATIVES AND HEDGING

Derivative assets and liabilities continue to be used to hedge interest rate risk arising from fixed rate loans and deposits. The Group undertakes no trading in derivatives. A proportion of the Group's lending pipeline is pre-hedged, resulting in derivative positions being established before the related loans are completed.

While this strategy has not materially changed over recent financial periods, movements in interest rate expectations have resulted in large derivative asset balances being carried on the balance sheet at fair value, although the 31 March 2024 position was reduced from the previous financial year end, as the position unwound, while swap rates remained generally stable overall.

The size of these balances and the volatility in rates has also led to significant profit and loss account impacts. However, any such gains or losses, which tend to zero over time, are ancillary to the Group's lending and deposit-taking activities.

The Group also hedges its tier-2 fixed interest rate borrowings, and has hedged the interest rate risk on the investments in gilts acquired as part of the Group's liquidity buffer in the period.

During the six-month period the Group has continued to develop its balance sheet hedging strategy. This is intended to protect net interest margins from the impact of future falls in interest rates on equity, which otherwise would cause a fixed / floating mismatch between the asset and liability sides of the balance sheet.

In order to mitigate this risk, an amount of the Group's fixed rate mortgage lending has been attributed to provide natural equity hedging. At 31 March 2024, £1,200.0 million had been attributed in this way (30 September 2023: £313.0 million; 31 March 2023: £nil). The hedge at 31 March 2024 represents the Group's target hedging level, covering the majority of the equity balance. However, this form of hedging has no direct accounting impact.

Interim Management Report (Continued)**4 CAPITAL AND LIQUIDITY REVIEW**

The Group's strong financial foundations form one of its three strategic pillars, with building and maintaining strong levels of core capital through the economic cycle a key strategic priority. The Group manages its balance sheet to maintain capital strength, ensure that its regulatory capital and liquidity positions are sufficient to safeguard depositors and provide capacity to meet its strategic objectives and other opportunities going forward.

In the face of economic and political uncertainties in the period, and with the regulatory position on future capital requirements under the 'Basel 3.1' reforms still not finalised, the Group has maintained a largely stable capital position, ensuring that its capital strength is sufficient to withstand potential pressures and address any future changes in requirements.

Despite this, the Group has been able to continue its distribution policy, completing the share buy-back programme announced in the most recent annual accounts, and announcing an interim dividend for the period in line with policy and a further share buy-back programme for the second half of the financial year.

For regulatory purposes the Group's capital comprises shareholders' equity and its Tier-2 bond. It has no outstanding AT1 issuance, but has the capacity to issue such securities, if considered appropriate, under an authority renewed by shareholders at the Annual General Meeting held in March 2024.

4.1 REGULATORY CAPITAL

During the half year, the Group continued to maintain strong regulatory capital ratios, with capital balances being carefully managed. The Group is subject to supervision by the Prudential Regulation Authority ('PRA') and as part of this supervision the regulator sets a Total Capital Requirement ('TCR'), the minimum amount of regulatory capital which the Group must hold. The TCR is defined under the international Basel 3 rules, which are implemented through the PRA Rulebook.

The TCR is held to safeguard depositors in the event of severe losses being incurred by the Group and includes elements determined on the basis of the Group's Total Risk Exposure ('TRE') together with fixed elements. The TCR is specific to the Group and is set on the basis of periodic supervisory reviews carried out by the regulator, the most recent of which took place in 2021. The Group's TCR at 31 March 2024 represents 8.8% of TRE, the same figure as calculated at 30 September and 31 March 2023.

Transitional relief on the adoption of IFRS 9 was granted to the Group, along with most other UK banks. Additional relief was granted in 2020 for the impact on capital of provisions created in response to the Covid pandemic. This relief is being phased out year-by-year, while any reversal of Covid-related provisions will generate a corresponding reduction in relief. These reliefs now have a minimal impact on the Group's capital measures and will be phased out entirely from 1 October 2024.

Interim Management Report (Continued)

4 CAPITAL AND LIQUIDITY REVIEW

The PRA requires firms to disclose capital measures both on the regulatory basis and as if these reliefs had not been given, referred to as the ‘fully loaded’ basis. As the reliefs taper over time, the regulatory and fully loaded bases will converge. The Group’s principal capital measures, CET1 and Total Regulatory Capital (‘TRC’) are set out below on both bases.

	Regulatory basis			Fully loaded basis		
	31 March 2024	31 March 2023	30 September 2023	31 March 2024	31 March 2023	30 September 2023
	£m	£m	£m	£m	£m	£m
Capital						
CET1 capital	1,174.9	1,170.4	1,188.9	1,171.6	1,157.1	1,175.4
TRC	1,324.9	1,320.4	1,338.9	1,321.6	1,307.1	1,325.4
Exposure						
TRE	7,974.7	7,479.9	7,668.7	7,971.4	7,466.6	7,665.2
Requirement						
TCR	698.8	657.7	673.4	698.5	656.6	672.2
Capital buffers	358.9	261.8	345.1	358.7	261.3	344.9

The Group’s CET1 capital comprises its equity shareholders’ funds, adjusted as required by the Regulatory Capital Rules of the PRA, and can be used for all capital purposes. TRC, in addition, includes tier 2 capital in the form of the Group’s Tier-2 Bond. This tier 2 capital can be used to meet up to 25% of TCR. Capital levels on both measures in the period have remained broadly stable, with positive operational performance continuing to support the capital position, even after allowing for paid and proposed distributions.

The year-on-year increase in TCR requirements shown above relates principally to the growth in the Group’s asset base over the period, mitigated, in the most recent six months, by a reduction in derivative exposures.

The Group’s CET1 capital must also cover the CRD IV buffers, the Counter-Cyclical Buffer (‘CCyB’) and Capital Conservation Buffer (‘CCoB’). These apply to all firms and are based on a percentage of TRE. During the period the CCoB remained at 2.5%, its long-term rate, while the UK CCyB was 2.0% throughout the period (30 September 2023: 2.0%; 31 March 2023: 1.0%). The Financial Policy Committee of the Bank of England has announced that it expects this to be the long-term rate of the UK CCyB in normal circumstances. Further buffers may be set by the PRA on a firm-by-firm basis, but may not be disclosed.

The Group’s capital ratios, after allowing for proposed dividends and any irrevocably committed elements of share buy-back programmes, are set out below.

	Regulatory basis			Fully loaded basis		
	31 March 2024	31 March 2023	30 September 2023	31 March 2024	31 March 2023	30 September 2023
CET1 Ratio	14.7%	15.6%	15.5%	14.7%	15.5%	15.4%
Total Capital Ratio	16.6%	17.7%	17.5%	16.6%	17.5%	17.3%
UK Leverage Ratio	7.3%	7.6%	7.6%	7.3%	7.6%	7.6%

Interim Management Report (Continued)

4 CAPITAL AND LIQUIDITY REVIEW

The Group's capital ratios remained stable, with a small downward move in the period mostly a function of the impact of the product mix in the lending books on TRE. As the IFRS 9 reliefs gradually phase out, the measures on the fully loaded basis are converging to those on the regulatory basis, with little difference remaining at 31 March 2024.

The PRA has announced that it intends to implement changes in its Rulebook to reflect the impact of the revisions to the Basel 3 framework made by the Basel Committee on Banking Supervision ('BCBS'), referred to as Basel 3.1. While the majority of these changes have been published, final proposals for those relating to capital requirements for credit risk are not expected to be announced until later in 2024. These changes would affect both firms applying Internal Ratings Based ('IRB') approaches to capital and those using the Standardised Approach. The new requirements are likely to be phased in over a five-year period, currently expected to commence from 1 July 2025.

The Group has evaluated the initial PRA proposals and engaged with the regulator on its results. Certain of the proposals might adversely affect buy-to-let lending and lending to small businesses, notwithstanding the PRA's stated intention that the overall impact of the reforms should be broadly neutral. However, the Group's capital planning has allowed for a range of potential outcomes, and sufficient capital is being held to address the most negative scenarios, which would reduce the Group's CET 1 ratio by 2.1 percentage points.

The Group continues to refine its IRB submission with close engagement with the PRA. In addition to the submission for its buy-to-let approach, which is currently being processed, the Group has also prepared much of the documentation to support an IRB approach for development finance, which represents the next stage of the Group's IRB roadmap.

The PRA has also set out the first stages of its future approach to the supervision of UK institutions, following the UK's exit from the EU. The regulator has defined a category of 'Small Domestic Deposit Takers' (SDDTs) which will be subject to a lighter regulatory touch in some areas. To qualify as an SDDT an institution must operate only in the UK, have limited trading activities and less than £20.0 billion of assets, and must not operate an IRB approach to credit risk.

Although the PRA has issued its proposed liquidity and reporting requirements for SDDTs, it has yet to publish its proposals for the capital regime which will apply to such entities. While the Group would meet the criteria to qualify as an SDDT as at 31 March 2024, it is unlikely to continue to do so in the longer term, and the Group is reviewing the implications of the new SDDT approach as it emerges.

The Group is also hopeful that the PRA might clarify its future regulatory intentions for those firms outside the major banks which do not qualify as SDDTs, to ensure that any regulatory framework remains proportionate.

Interim Management Report (Continued)

4 CAPITAL AND LIQUIDITY REVIEW**4.2 LIQUIDITY**

The Group's policy is to hold sufficient liquidity in the business to meet its long and short-term cash needs, as well as to provide a buffer under stress, while operating at all times within regulatory requirements. It continues to be the Group's policy to maintain strong levels of liquidity cover, and this policy impacts the Group's operational capital and funding requirements.

The Group holds liquidity principally in the form of deposits at the Bank of England, although during the period the position was diversified with the purchase of highly rated gilts.

The Board regularly reviews liquidity risk appetite and closely monitors a number of key internal and external measures. The most significant of these, which are calculated for the Paragon Bank regulatory group on a basis which is standardised across the banking industry, are the Liquidity Coverage Ratio ('LCR') and Net Stable Funding Ratio ('NSFR').

The LCR measures short-term resilience comparing available highly liquid assets to forecast short-term outflows with a 30-day horizon, calculated according to a regulatory formula. The rolling twelve-month average of the Bank's LCR at 31 March 2024 was 218.2% compared to 148.8% at 31 March 2023, and 193.7% for the 2023 financial year. These movements reflect a strategic increase in deposit levels over time to provide flexibility over the repayment of wholesale debt, with the repayments of TFSME borrowings being made throughout the period, and the Group's retail bonds falling due in August 2024.

The NSFR is a longer-term measure of liquidity with a one-year horizon, supporting the management of balance sheet maturities. At 31 March 2024, the Bank's NSFR stood at 132.9% (30 September 2023: 123.4%; 31 March 2023: 128.6%), reflecting a marginal strengthening of the position in the year.

4.3 DIVIDENDS AND DISTRIBUTION POLICY

The Group prioritises maintaining a strong capital position, coupled with providing a proportionate level of return to its shareholders. The positive operating result in the period and the capital outlook support the ongoing return of capital to investors, both in the form of dividends and through share buy-backs.

The Group's stated dividend policy is to distribute approximately 40% of each year's underlying earnings, split between the interim and final dividends, with the interim dividend, in normal circumstances, being equal to 50% of the preceding final dividend. Following its half-yearly review of the capital position and forecasts, the Board determined that an interim dividend in line with policy was appropriate for the current year, and also endorsed this policy on an ongoing basis.

It therefore declared an interim dividend for the year ending 30 September 2024 of 13.2 pence per share (2023 H1: 11.0 pence). This dividend will absorb £27.6 million of capital and will be paid on 26 July 2024 to shareholders on the register on 5 July 2024.

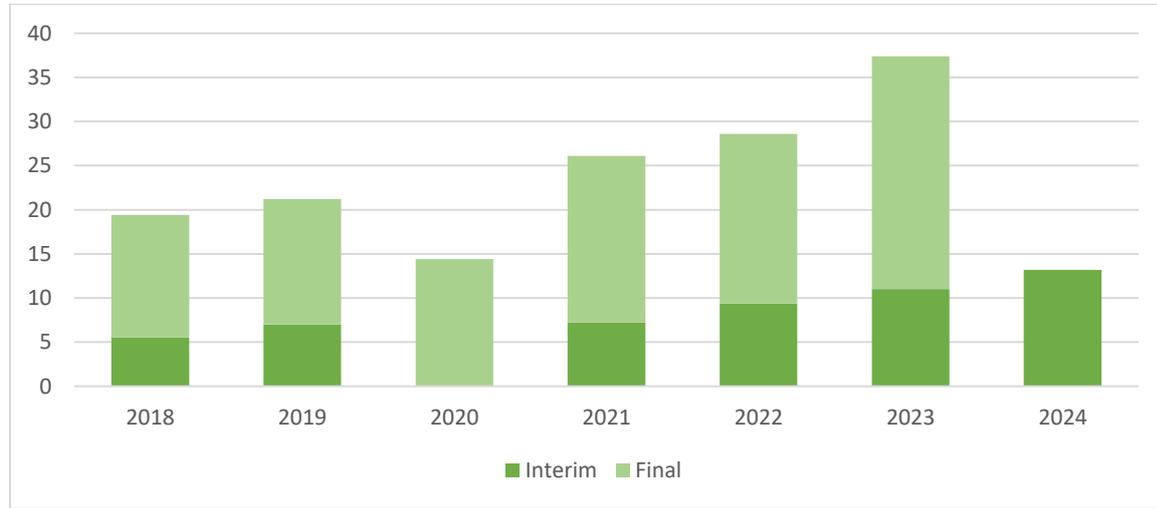
Interim Management Report (Continued)

4 CAPITAL AND LIQUIDITY REVIEW

The progress of the dividend for the year is shown in the chart below.

Dividend for the year (pence)

In respect of the financial years 2018 –2024



The directors have considered the distributable reserves and cash position of the Company and concluded that such a dividend is appropriate.

At the time of publication of the Group's 2023 full year results it announced that the Board had authorised a share buy-back of up to £50.0 million of shares, which was completed on 30 April 2024, after the end of the period.

During the six-months ended 31 March 2024, the Group had expended £39.9 million (including costs) on the acquisition of its own equity, acquiring 5.9 million shares. Shortly before the end of the period, the Group gave an irrevocable instruction to its brokers for the completion of the share buy-back programme, and the remaining balance, £10.4 million, was accrued at the period end and deducted from equity at 31 March 2024.

Given the strength of the capital position at 31 March 2024 and the robust trading performance, the Board has authorised an extension to the programme of up to £50.0 million.

The Group has the authority to make such purchases under a resolution approved by shareholders at the Annual General Meeting in March 2023 and renewed in March 2024. All purchases made under this programme will be announced through the Regulatory News Service ('RNS') of the London Stock Exchange on the day of the transaction. All shares purchased are initially to be held in treasury.

Interim Management Report (Continued)

5 FINANCIAL REVIEW

The financial results for the Group for the six months ended 31 March 2024 have been very positive, with enhanced net interest margin ('NIM') and growth in profit and earnings per share ('EPS') on both an underlying and statutory basis.

Operating profit before impairment provisions on the underlying basis, which excludes fair value movements related to hedging, increased by 14.8% compared to the first half of the 2023 financial year, to £156.6 million (2023 H1: £136.4 million), with a broadly similar growth in underlying profit of 13.5% to £146.3 million (2023 H1: £128.9 million) (Appendix A).

This result, coupled with the Group's share buy-back programme, generated an increase in underlying EPS of 17.4% to 49.9 pence per share (2023 H1: 42.5 pence) (Appendix A)

As in other recent periods, the Group's statutory results have been significantly affected by the accounting treatment required for pipeline hedging. The Group's policy is to hedge a substantial part of its lending pipeline with interest rate derivatives, and these can lead to substantial fair value gains being recorded in a rapidly changing interest rate environment, notably in the 2022 financial year, in the period before an accounting hedge can be recognised before the relevant loans complete.

The actual cash flows from hedging will impact on net margin through the fixed rate period of the hedged loan, which can be up to five years, and the fair value gains will unwind at the same time. The current year has seen the continuation of the unwinding process which began in the 2023 financial year. The level of these unwinding losses, and other hedging fair value movements, decreased profit before tax on the statutory basis to £110.6 million (2023 H1: £46.4 million), with earnings per share at 38.4 pence per share (2023 H1: 16.4 pence per share).

The Group has consistently excluded these fair value items from underlying results as the timing of their recognition does not reflect that of their economic impact on the business.

Interim Management Report (Continued)

5 FINANCIAL REVIEW**5.1 CONSOLIDATED RESULTS****CONSOLIDATED RESULTS**

For the six months ended 31 March 2024

	2024	2023
	H1	H1
	£m	£m
Interest receivable	641.8	437.6
Interest payable and similar charges	(401.9)	(225.2)
Net interest income	239.9	212.4
Other operating income	6.7	7.8
Total operating income	246.6	220.2
Operating expenses	(90.0)	(83.8)
Provisions for losses	(10.3)	(7.5)
	146.3	128.9
Fair value net (losses)	(35.7)	(82.5)
Operating profit being profit on ordinary activities before taxation	110.6	46.4
Tax charge on profit on ordinary activities	(28.7)	(8.5)
Profit on ordinary activities after taxation	81.9	37.9
	2024	2023
	H1	H1
Basic earnings per share	38.4p	16.4p
Diluted earnings per share	36.9p	15.7p
Dividend – rate per share for the period	13.2p	11.0p

Interim Management Report (Continued)

5 FINANCIAL REVIEW**Income**

Total operating income for the six months increased by 12.0% to £246.6 million (2023 H1: £220.2 million), with loan net interest continuing to form the largest part of the balance.

NIM increased by 24 basis points (Appendix B) compared to the first half of 2023, and by 10 basis points compared to the figure for the 2023 financial year. However, the improvement was not consistent across the business, with the mortgage lending division driving growth. NIM continues to be supported by tight retail funding costs, with changes in product and product mix delivering improved yield. With a 4.7% increase in the average loan book to £15,061.7 million (2023 H1: £14,382.6 million), this NIM enhancement increased net interest income by 12.9% to £239.9 million compared to the first half of 2023 (2023 H1: £212.4 million).

The progression of the Group's annualised NIM over the first half of each of the past five years is set out below.

	Total
	Basis points
<i>Six months ended 31 March</i>	
2024	319
2023	295
2022	257
2021	232
2020	229

The improvement in the Group's NIM position represents the careful long-term management of yields across the Group's businesses and improvements in the average cost of funds as the funding strategy has developed, particularly the sub-SONIA cost of retail deposit funding over recent years. This has been supported by the careful strategic allocation of capital and lending appetites between the Group's businesses to generate the optimum overall return.

Interest income from the Group's loan assets is accounted for using the effective interest rate method set out in IFRS 9. This spreads the impact of initial and terminal fees received from the customer, or paid to third parties, through the life of the account and, where an account has different interest charging bases during its life, such as the majority of the Group's buy-to-let mortgage accounts which have a fixed initial interest rate, attempts to spread this effect. The pattern of income recognition is therefore based on estimates of customer settlement behaviour and future charging rates, and where the economic environment is likely to cause these to vary, as in the current period, the rates at which income is included in profit are adjusted.

Other operating income was £6.7 million for the six-month period, reduced from the £7.8 million reported in the six months ended 31 March 2023. The decrease arose principally as a result of a decline in third party servicing income, as contracts came to an end.

Interim Management Report (Continued)

5 FINANCIAL REVIEW**Costs**

Operating expenses increased by 7.4% in the period, reaching £90.0 million (2023 H1: £83.8 million). The largest part of this increase was driven by payroll costs, with employment-related costs, at £57.6 million (2023 H1: £54.9 million) comprising 64.0% of total operating costs, a similar level to that in the comparable period in the previous year (2023 H1: 65.5%).

The Group's average headcount in the six months was 1,462, 3.9% fewer than in the comparable period in 2023 (2023 H1: 1,522). However, the market-based pay increases for most employees at the beginning of the period, resulted in a 4.9% increase in people costs in the period.

From 1 March 2024 the PRA introduced a new funding levy to replace the cash ratio deposit ('CRD') scheme. This levy gives rise to a charge against profit, unlike the CRD, with the Group's cost base inflated by £1.7 million in the period as a result.

Excluding this additional levy the Group's non-employment cost base has increased by 6.2% to £30.7 million (2023 H1: £28.9 million), impacted by the heightened levels of inflation in the UK economy in recent periods, particularly in professional services. Spend on the Group's digitalisation programme continues to have a significant impact on cost, with non-employment related IT costs increasing by 10.3%, to £6.4 million (2023 H1: £5.8 million). In addition, £2.1 million of software costs were capitalised in the period (2023 H1: £1.3 million). As described in the operations section (Section 6.1), the digitalisation programme has continued to deliver operational enhancements during the period, with more due to come on line in the second half of the year.

The progress of the Group's cost:income ratio (Appendix C) over the first half of each of the last five years is set out below.

	%
<i>Six months ended 31 March</i>	
2024	36.5
2023	38.1
2022	41.2
2021	42.5
2020	41.8

Total cost:income has continued the gradual improvement seen over recent periods, despite the levels of expenditure incurred to develop the business for the future, principally as a function of widening margins.

Cost control remains a strategic priority for the Group, but it manages the cost base in the short term with a focus on delivering its business priorities and meeting regulatory expectations as efficiently as possible. A sustainably lower cost:income ratio remains a longer-term aspiration, rather than a short-term priority, particularly in the face of continuing inflationary pressures in the UK and competitive markets for specialist people and services.

Interim Management Report (Continued)

5 FINANCIAL REVIEW**Impairment provisions**

The Group's impairment charge for the six months ended 31 March 2024 was £10.3 million, an increase of 37.3% (2023 H1: £7.5 million). This increase is largely a result of an increased number of receiver of rent appointments on legacy buy-to-let mortgage accounts, but also results from the forecast economic environment which features ongoing pressures on the cost of living and doing business for customers.

In the six-month period UK bank rates have remained at higher absolute levels than have been seen for some time, after rising rapidly through the 2023 financial year to a level not previously reached since April 2008. While inflation has decreased gradually in the period, it remains at a relatively high level and the impacts of the higher levels seen in the previous years on customers' financial positions are still being felt. It is considered likely by commentators that these pressures may have a serious impact on credit quality, but the arrears levels seen by the Group, amongst other lenders, to date are more minor than some had anticipated.

The Group's recognition of credit losses is governed by the accounting standard IFRS 9, which requires the directors to take a view on the future performance of the Group's loan assets and to base provisioning on expected credit losses ('ECL'). Where the economic outlook is complex, or where there is little relevant historical data to base loss predictions upon, this can be a challenging exercise.

The progress of the impairment charge and annualised cost-of-risk (Appendix B) in the first six months of each of the last five years is set out below.

	Charge	Cost-of-risk
	£m	%
<i>Six months ended 31 March</i>		
2024	10.3	0.14
2023	7.5	0.10
2022	1.3	0.02
2021	6.0	0.09
2020	30.0	0.49

The fluctuating charges set out above show the impacts of successive different sources of uncertainty on credit as they arise and resolve over time. The half year ended 31 March 2020 saw the outbreak of the Covid pandemic and the largest part of the provisions made by the Group in response to Covid were booked in that period. Some of this provision was unwound in subsequent periods, reducing the provision charges, particularly in the first half of 2022.

In the second half of 2022 provision charges increased again, based on expectations as the UK cost-of-living crisis took hold, with the level of charge rising in 2023 and 2024 as the economic forecasts continued to be negative and effects began to be demonstrated in account performance.

Interim Management Report (Continued)

5 FINANCIAL REVIEW*Multiple economic scenarios and impacts*

The Group has developed models to support management's estimation of ECLs, which are regularly monitored, reviewed and updated. These models project losses in its largest books based on customer performance to the reporting date and anticipated future economic conditions. They therefore requires the input of a range of forward-looking economic scenarios which are each evaluated and then weighted to form an overall projection.

For portfolios where detailed models cannot be used the Group will also consider the potential impact of these economic scenarios where this might be significant. In the current period this applied in particular to the Group's development finance portfolio, where the potential impacts of higher build costs, falling development values and longer project timescales were factored into the assessment of accounts.

At 31 March 2024, there was generally more consensus on the UK's economic outlook than at the previous year end. However, the dominant theme of these forecasts is generally pessimistic, with a significant potential for interest rates to remain high for some time, inflation to decline from current levels only slowly, house prices to remain subdued and growth to remain minimal. This, however, is an unfamiliar position for the UK economy, and the consequences for longer-term prospects remain an area of significant disagreement amongst experts.

The potential for wider geopolitical events, including those in Eastern Europe and the Middle East, to impact further on the UK economy remains significant, while the results of elections being held this year in both the UK and the USA may alter expectations fundamentally.

The Group has constructed the scenarios for its ECL modelling based on a number of forecasts from public and private bodies, synthesised to produce internally coherent sets of data. The central scenario is largely aligned with the current Bank of England forecast. It assumes minimal growth in the UK, restrictive monetary policy, unemployment remaining low and falling inflation, with bank rates only reducing slowly. This scenario is used for the Group's planning process, and is only slightly more optimistic than the central scenario adopted in September 2023.

The upside and downside scenarios have been derived from the central scenario, with the upside assuming inflation reducing more quickly, which enables base rates to fall faster, while the downside scenario represents inflation beginning to rise again, leading to a further tightening of monetary policy with the consequent adverse impacts on confidence affecting unemployment and house prices.

As in previous years, the severe downside scenario is based on the most recent Bank of England stress testing scenario published in September 2022. This has, however, been adjusted to allow for the differences between the opening position assumed in the Bank's scenario and the actual position at 31 March 2024. This scenario is included to represent the range of highly stressed outcomes for the UK and the Group's customers, and includes a significant fall in property prices.

Given the continuing divergence of opinion on the direction of the economy, and the potential for significant impact from UK and worldwide geopolitical factors, the Group has retained the weightings applied to each scenario in its modelling at 30 September 2023, including the 20% weighting for the severe stress scenario, to represent the potential for plausible severe outturns for the UK.

Interim Management Report (Continued)

5 FINANCIAL REVIEW

The forecast economic assumptions within each scenario, and the weightings applied, are set out in more detail in note 16.

To illustrate the impact of these scenarios on the Group's IFRS 9 models, the impairment provision at 31 March 2024 before judgemental adjustments has been recalculated, weighting each of the central scenario and the severe scenario at 100%, with the results shown below.

	31 March 2024		30 September 2023		31 March 2023	
	Unadjusted Provision £m	Cover ratio	Unadjusted Provision £m	Cover ratio	Unadjusted Provision £m	Cover ratio
Weighted average	71.6	0.47%	67.1	0.44%	58.2	0.40%
Central scenario	62.5	0.41%	60.9	0.41%	50.8	0.35%
Severe scenario	100.2	0.65%	89.3	0.60%	79.2	0.54%

There is little recent historical evidence of the impact of a sustained period of high interest rates and inflation on customer credit, and both products and regulatory expectations have evolved significantly since interest rates last reached current levels. This means the Group's models will have been derived from datasets which include very few observations representative of this type of economic environment and little evidence on which to base conclusions on how rapidly customer behaviour might respond to sharp, rather than gradual, changes in economic factors.

The distribution of gross balances by IFRS 9 stage (defined in note 14) produced by the Group's impairment methodology at the three most recent six-month period ends is set out below.

	31 March 2024	30 September 2023	31 March 2023
Stage 1	91.8%	93.5%	93.1%
Stage 2	6.3%	5.0%	5.7%
Stage 3	1.8%	1.3%	1.0%
POCI	0.1%	0.2%	0.2%
Total	100.0%	100.0%	100.0%

The levels of cases in Stage 2 and particularly Stage 3 demonstrate that while some level of credit impacts has been seen from the recent economic pressures during the period, this impact remains modest, and will be mitigated in the modelling by the beneficial impacts of falling inflation, particularly in the short term. However, the economic outlook remains challenging, and this may result in a short-term increase in these levels, if impacts on customers intensify. This indicates that the Group needs to consider whether these levels of provision require additional judgemental adjustments.

Interim Management Report (Continued)

5 FINANCIAL REVIEW*Judgemental adjustments*

Where key economic measures are at materially different levels to those which existed when the Group's impairment models were created, management may add judgemental overlays to calculated impairment levels. These are required where it is considered, taking account of all available evidence, that current or anticipated levels of delinquency and / or loss in the modelled portfolios could exceed those implied by the model outputs.

Examples of such circumstances include the period of the Covid pandemic and its aftermath, and the recent period of rapid growth in interest rates and inflation. Whilst the economic outlook at 31 March 2024 appears more stable than was seen in those periods, the cumulative effects of a longer period of elevated interest rates are also potentially challenging for the effectiveness of the provisioning models. Consequently the Group has maintained its judgemental overlays at their September 2023 position, £6.5 million, at the 2024 interim (30 September 2023: £6.5 million; 31 March 2023: £10.0 million).

The judgemental adjustments generated by this process, analysed by division, are set out below.

	31.03.2024 £m	30.09.2023 £m	31.03.2023 £m	30.09.2022 £m
Mortgage Lending	3.0	3.0	4.0	5.0
Commercial Lending	3.5	3.5	6.0	10.0
	6.5	6.5	10.0	15.0

The Group will continue to monitor the appropriateness and scale of each of these overlays and consider the extent to which any of the elements giving rise to them can or should be incorporated into models and standard processes.

Interim Management Report (Continued)

5 FINANCIAL REVIEW*Ratios and trends*

The results of the Group's ECL modelling, including the impact of the economic scenarios described above, together with judgemental adjustments adopted to address uncertainties over the future performance of accounts, have resulted in the overall provision amounts and coverage ratios set out below.

	31 March 2024	30 September 2023	31 March 2023	30 September 2022
	£m	£m	£m	£m
Calculated provision	71.6	67.1	58.2	48.5
Judgemental adjustments	6.5	6.5	10.0	15.0
Total	78.1	73.6	68.2	63.5
Cover ratio				
Mortgage Lending	0.35%	0.33%	0.33%	0.31%
Commercial Lending	1.46%	1.56%	1.36%	1.34%
Total	0.51%	0.49%	0.47%	0.44%

Following the application of judgemental adjustments, the coverage levels at 31 March 2024 remain broadly similar to those seen at the previous financial year end, with judgemental adjustments remaining static, and no material change in the overall level of economic optimism for the UK.

These levels remain higher than the 0.34% coverage ratio seen at 30 September 2019, before the outbreak of the Covid pandemic. Further, that level was recorded when security cover in the buy-to-let book was lower, with an average loan-to-value of 67.4% compared to the 63.5% recorded at 31 March 2024 (30 September 2023: 62.8%; 31 March 2023: 62.5%), although interest cover was higher at that time, and interest rates were lower.

Future coverage levels will depend on future performance of the UK economy and its impact on the Group's customers and markets.

Fair value movements

The fair value line in the Group's profit and loss account primarily reports fair value movements arising from the Group's interest rate hedging arrangements. These are put in place to protect the Group's margins when offering fixed interest rate products in either its savings or lending markets while continuing to honour offers to customers in the event of significant interest rate movements. The Group also hedges certain fixed-rate balance sheet assets and liabilities. The Group maintains a cautious approach to interest rate risk and considers its exposures to be appropriately economically hedged. The Group does not engage in any form of speculative derivative trading and all fair value movements relate to banking book exposures.

Interim Management Report (Continued)

5 FINANCIAL REVIEW

The accounting entries included in this balance are primarily non-cash items and will reverse over the life of the hedging arrangement, and the Group regards these movements as essentially the anticipation of gains or losses belonging economically to later accounting periods, and their subsequent unwinding. They are therefore excluded from underlying results.

During the 2022 financial year, particularly in the second half, there was a significant level of volatility in UK benchmark interest rate expectations which resulted in a gain of £191.9 million for that year being recorded. The impact of market volatility was amplified by the Group's approach to pipeline hedging and the retention strategy applying to maturing five-year fixed loans, which meant that the pipeline was larger and of longer duration (and hence more exposed to movements in interest rates) than in earlier periods.

In the six months ended 31 March 2024 the unwinding of this large gain continued to impact the fair value line. Coupled with the accounting hedge ineffectiveness in the period and the impact of new pipeline hedges, this resulted in a loss on fair value items of £35.7million (2023 H1: loss of £82.5 million) being recorded in the period.

The Group has a net derivative position of £9.1 million (at notional value) at 31 March 2024 (30 September 2023: £14.6 million; 31 March 2023: £863.4 million), which is unmatched for hedge accounting, although forming part of the economic hedging position. These derivatives must be carried at a fair value based on expected cash flows over their contractual lives. As a substantial proportion of this balance has a lifetime of two to five years, volatility in the interest rate markets can generate substantial month-to-month fluctuations in this valuation which have to be included in the Group's profit.

Tax charge

The effective tax rate of the Group in the period on the statutory basis was 25.9%, with the increase from the rate in the comparable period in the previous year (2023 FY: 23.0%; 2023 H1: 18.3%) principally a result of the higher rate of UK corporation tax applying in the period and the impact of deferred tax changes accounted for in the 2023 comparator period.

The Group operates in the UK only and materially all its profit falls within the scope of UK taxation. The standard rate of UK corporation tax applicable in the period was 25.0% (2023 H1: 22.0%), with the surcharge applicable to Paragon Bank profits at 3.0% (2023 H1: 5.5%), with the impact of the increase in the standard rate of corporation tax from 19.0% from 1 April 2023 offset, to some extent, by the reduction in the surcharge from 8.0% to 3.0% as well as the increase in the level from which the surcharge applies (note 8).

As the bulk of the fair value movements arose in Paragon Bank, the surcharge meant that these were subject to a higher rate of tax than the overall effective rate for the Group. This meant that the effective tax rate on underlying profit was 27.3% (2023 FY: 23.9%; 2023 H1: 23.7%), with the increase principally driven by the 2.5% increase in the applicable basic rate of tax (Appendix A).

Interim Management Report (Continued)

5 FINANCIAL REVIEW**Result**

The Group's overall consolidated profit before tax on the statutory basis for the six-month period was £110.6 million (2023 H1: £46.4 million) an increase of 138.4%, principally resulting from the impact of derivative fair values. Profit after tax increased by 116.1% to £81.9 million (2023 H1: £37.9 million). In addition, other comprehensive income of £2.1 million was recorded (2023 H1: £1.3 million) related to valuation gains on the Group's defined benefit pension plan (the 'Plan').

Total consolidated accounting equity at the period end, after accounting for dividends and share buy-backs, was £1,382.0 million (31 March 2023: £1,360.4 million) and consolidated tangible equity £1,212.4 million (31 March 2023: £1,189.9 million), representing a tangible net asset value ('NAV') of £5.80 per share (31 March 2023: £5.35 per share) and a NAV on the statutory basis of £6.62 (31 March 2023: £6.11) (Appendix D).

The information on related party transactions required by DTR 4.2.8(1) of the Disclosure Guidance and Transparency Rules is given in note 33.

5.2 ASSETS AND LIABILITIES

The principal driver of movements in the Group's balance sheet is the size and composition of its loan book. This, together with policies on capital and liquidity, determines the Group's funding requirements and the level of its liabilities.

The Group's loan portfolio increased by 4.8% year-on-year, with increases in both the Mortgage Lending and Commercial Lending divisions. These movements are discussed in more detail in the business review (Section 2 above).

Interim Management Report (Continued)

5 FINANCIAL REVIEW

The Group's assets and liabilities at the period end are summarised in the balance sheet below.

SUMMARY BALANCE SHEET**31 March 2024**

	31 March 2024	31 March 2023	30 September 2023
	£m	£m	£m
Loans to customers			
Mortgage Lending	13,094.7	12,593.3	12,902.3
Commercial Lending	2,154.3	1,961.6	1,972.0
	<u>15,249.0</u>	<u>14,554.9</u>	<u>14,874.3</u>
Hedging adjustment	(196.5)	(318.9)	(379.3)
Derivative financial assets	511.7	511.2	615.4
Cash and investment securities	3,137.1	2,275.4	2,994.3
Pension surplus	16.6	10.4	12.7
Intangible assets	169.6	170.5	168.2
Other assets	93.3	116.9	134.6
	<u>18,980.8</u>	<u>17,320.4</u>	<u>18,420.2</u>
Total assets	<u>18,980.8</u>	<u>17,320.4</u>	<u>18,420.2</u>
Equity	1,382.0	1,360.4	1,410.6
Retail deposits	14,768.5	11,875.9	13,265.3
Hedging adjustment	(1.4)	(37.8)	(30.9)
Other borrowings	2,229.4	3,643.4	3,086.4
Derivative financial liabilities	95.1	51.3	39.9
Other liabilities	507.2	427.2	648.9
	<u>18,980.8</u>	<u>17,320.4</u>	<u>18,420.2</u>
Total equity and liabilities	<u>18,980.8</u>	<u>17,320.4</u>	<u>18,420.2</u>

Funding structure and cash resources

Overall, the Group's retail and wholesale debt funding increased by 9.5% year-on-year, a higher rate than loan book growth as liquidity continued to be increased through the period. Cash and investment balances increased 37.9% over the last twelve months. The period end liquidity buffer for the first time also included a £98.1 million investment in government securities (30 September 2023 and 31 March 2023: £nil) as the Group sought to diversify its liquidity balances.

The funding mix continued to move towards retail funding with 86.9% of debt funding represented by savings balances at 31 March 2024 compared to 76.5% at 31 March 2023. These movements are discussed in more detail in Section 3 above.

Interim Management Report (Continued)

5 FINANCIAL REVIEW**Derivatives**

The derivative assets and liabilities shown in the table above relate almost entirely to arrangements for hedging interest rate risk on fixed rate mortgage and savings products. These assets and liabilities are held at fair value, with the valuation based on future expectations of interest rates. The size of the balances is driven by the difference between current expectations for variable rates and the fixed rates applicable to the hedged items, set at the point of origination, meaning that where market rates move sharply, large balances will be carried.

During the six-month period interest rate expectations began to turn downwards, to some extent, with asset swap valuations falling back, and in some cases turning negative. This resulted in an asset position of £511.7 million at 31 March 2024, reduced by £103.7 million in the six months (31 March 2023: £511.2 million; 30 September 2023: £615.4 million). Interest rate expectations also impacted derivative liabilities, which increased by £55.2 million to £95.1 million (31 March 2023: £51.3 million; 30 September 2023: £39.9 million).

While these movements do contribute to the fair value accounting adjustments, they are offset, to a large extent, by movements in the hedging adjustments to loan assets and deposit liabilities, with the adjustment in assets reducing by £182.8 million in the six months and that in liabilities reducing by £29.5 million.

Pension obligations

The IAS 19 valuation surplus on the Group's defined benefit pension scheme increased to £16.6 million at 31 March 2024 (31 March 2023: £10.4 million; 30 September 2023: £12.7 million). The assumptions for this valuation are based on market-derived interest and bond rates and can be subject to fluctuations where different market measures do not move in parallel.

The principal inputs to the valuation were largely similar to those used at 30 September 2023. The discount rate used in evaluating scheme liabilities, which is based on long-term corporate bond yields, reduced by 65 basis points, from 5.55% to 4.90%, while the assumed rate of RPI inflation, based on gilt yields, decreased by only 10 basis points from 3.25% to 3.15%. These movements led to a pre-tax valuation gain of £2.8 million being recognised in other comprehensive income (2013 H1: £1.9 million; 2023 FY: £2.4 million).

While the IAS 19 valuation is required to be used in the Group's accounts, pension trustees generally use the technical provisions basis set out in the Pensions Act 2004, to measure scheme liabilities. On this basis, the Plan had a surplus of £14.9 million at 31 March 2024 (31 March 2023: £3.8 million; 30 September 2023: £11.9 million), meaning that the scheme was fully funded on this basis.

Interim Management Report (Continued)

5 FINANCIAL REVIEW**Other assets and liabilities**

Other assets were £93.3 million (31 March 2023: £116.9 million; 30 September 2023: £134.6 million), with the reduction principally a result of the replacement of the Cash Ratio Deposit ('CRD') scheme, which required regulated banks to place a designated non-interest-bearing deposit with the Bank of England, the income from which would fund the central bank's activities. This was replaced during the period by the funding levy described above. The Group's CRD balance at 30 September 2023 was £38.0 million.

Other liabilities reduced over the half year to £507.2 million (31 March 2023: £427.2 million; 30 September 2023: £648.9 million), with the principal movement being a reduction in collateral received from counterparties to derivative asset positions resulting from the changes described in the derivatives section above.

5.3 SEGMENTAL RESULTS

The underlying operating profits of the two segments described in the Business Review in Section 2 are detailed fully in note 2 and are summarised below.

	Six months to 31 March 2024	Six months to 31 March 2023	Year to 30 September 2023
	£m	£m	£m
Segmental profit			
Mortgage Lending	128.1	118.9	246.6
Commercial Lending	50.7	56.7	113.2
	<u>178.8</u>	<u>175.6</u>	<u>359.8</u>
Unallocated central costs	(32.5)	(46.7)	(82.2)
	<u>146.3</u>	<u>128.9</u>	<u>277.6</u>

The Group's central administration and funding costs, principally the costs of service areas, establishment costs and interest on excess liquidity and bonds, have not been allocated.

Interim Management Report (Continued)

5 FINANCIAL REVIEW**Mortgage Lending**

NIM in the Group's core Mortgage Lending operation continued to improve in the period, increasing by 12 basis points year-on-year to 226 basis points (Appendix B). This was driven by the continuing gradual replacement of legacy assets by new business and tighter funding costs in the period. Combined with a 4.3% increase in the segment's average mortgage book to £12,998.5 million (31 March 2023: £12,461.0 million) this generated a 9.9% increase in net interest for the segment to £146.7 million (2023 H1: £133.5 million).

Overall credit performance of the book has worsened slightly in the period, with an increase in properties placed under the control of a receiver of rent, although significant adverse credit impacts have yet to be seen. Only 1.6% of the gross loan book by value at the period end was considered to be credit impaired (31 March 2023: 1.2%; 30 September 2023: 1.2%).

The impairment charge for the period was £8.7 million for the six months, with the increase in charge principally relating to additional receiver of rent cases (2023 H1: £5.4 million). This gives a cost-of-risk for the period of 13 basis points (2023 H1: 9 basis points), with the impact of credit performance mitigated by the high levels of security cover in the division's portfolios.

Overall the contribution made by the segment to group profit increased by 7.7% to £128.1 million for the six months compared to the corresponding period in 2023 (2023 H1: £118.9 million).

Commercial Lending

Net interest for the Commercial Lending portfolio decreased to £60.7 million, a reduction of 9.9% compared to the first half of 2023 (2023 H1: £67.4 million). This was despite a 7.4% increase in the average loan book to £2,063.2 million (31 March 2023: £1,921.6 million). NIM declined 113 basis points between the two periods (Appendix B), a result of changes in the proportion of segmental income generated in each of the division's operations.

Impairment charges for the period, at £1.6 million (2023 H1: £2.1 million), were reduced by 23.8% compared to the first half of 2023, with the division's credit position largely remaining stable at a similar position to that reported at the previous year end, and only a limited number of accounts moving to write-off. At 31 March 2024, 3.3% by gross value of cases in the segment's portfolio were considered to be credit impaired, a small improvement compared to 3.5% at the previous year end (31 March 2023: 1.5%). However, a substantial amount of this balance relates to development finance projects, where security cover is generally high.

As a result, segmental profit in the Commercial Lending division decreased to £50.7 million, a reduction of 10.6% compared to the first half of 2023 (2023 H1: £56.7 million).

Interim Management Report (Continued)

6 OPERATIONAL REVIEW

The Group's strategy relies on sector knowledge, specialist systems and the careful management of risk across all its operations to meet its goals. This is recognised by defining a customer-focused culture and a dedicated team, amongst its strategic pillars, highlighting the importance of its experienced, skilled and engaged workforce facilitated by systems and analytics in delivering its purpose.

In the period the Group has continued to progress its long-term programme to enhance processes and technology, with significant elements either completed in the period or nearing completion. These enhancements address both internal systems and those facing its customers and business partners, and enhance its risk management framework to support the digitalised vision of its future operating model. In parallel the Group has continued to invest in its people and processes to ensure the effectiveness of its operations going forward.

This continuing prioritisation ensures that the Group maintains a firm foundation on which to build its business and deliver its strategy in the future.

6.1 OPERATIONS

The Group has a workforce of around 1,450 people, most of whom work on a hybrid basis, splitting their time between home-based working and one of the Group's office locations. The delivery of the Group's strategy requires that its IT and physical infrastructure is optimised to provide the best level of service to customers, and working experience for its people.

Over recent years the Group has been undertaking a major project of re-engineering its IT infrastructure and its loan origination and administration systems to support its digitalised strategic vision.

During the six months this project continued with several major milestones being achieved. The Group's migration of its mainframe systems to a cloud-based solution was completed in December, with around 90% of the Group's major IT applications now cloud-based. In the operational areas, a major upgrade to the mortgage lending platform was launched with the Group's business partners, in readiness for it to go live in the second half of the financial year. Customer take-up of the buy-to-let self-service portal, introduced in 2023 has increased in the period. This enables customers to generate customised statements and update their personal details, amongst other tasks, and has resulted in a reduction of approximately 25% in calls to the operation's contact centre.

Further enhancements were also rolled out to the new SME lending system, enabling a more seamless application process and swifter decisions, while further improvements to telephony, financial crime, payments and customer self-service applications were also put in place, enhancing efficiency and the experience for internal and external users.

As progress is made on the digitalisation roadmap, work continues to deliver further major enhancements for loan and savings customers, business partners and employees, which will come on line in the coming periods.

Interim Management Report (Continued)

6 OPERATIONAL REVIEW

The hybrid working model has continued to evolve over the six-month period, with learnings being used to refine the approach. The Group recognises that for a specialised business there is unlikely to be a single preferred approach and business areas continue to develop working methods to suit the needs of their operations and customers, investing in appropriate system enhancements as required.

Office occupancy has remained at similar levels to previous periods and a programme has been put in place to ensure that the Group's premises are aligned with the requirements of this model of working.

The Group's offices remain valuable hubs to foster collaboration, communication, development and the growth of its culture and identity. During the period the Group continued to review its physical footprint, particularly where buildings are approaching the end of their lease terms, to ensure best use is being made of the estate. As a result plans are in progress to move out of one building near Solihull, while improving the functionality and working environment of the Solihull headquarters.

As well as providing an enhanced working environment for the Group's people, these developments should provide both financial and sustainability benefits and, alongside the Group's relatively modern London and Southampton sites, deliver facilities well-suited to the Group's approach to hybrid working.

The operational resilience of the business remains an important area of focus for the Group and its regulators. During the period the second formal self-assessment required by regulators was successfully completed, providing an opportunity to evaluate developments in this area since the exercise was first completed.

The Group has maintained its focus on high-quality customer service throughout the period. Regular surveys are conducted with customers and business introducers to monitor satisfaction, which have remained positive in the period.

The Financial Conduct Authority ('FCA') Consumer Duty began to come into force in July 2023, and will expand to cover those of the Group's legacy products which are within the scope of the Duty from July 2024. Building on the successful first phase introduction, which involved significant work to embed the Duty's requirements into systems and processes, the further work carried out in the period means that the Group can be confident that it will comply with the wider scope requirements by the FCA deadline.

The Group focusses on FOS complaints data as a high-level satisfaction metric, and incident levels remained low throughout the period. Consolidated information for the two group companies that are required to report complaints to FOS, for the four most recent FOS reporting periods, is set out below. In the most recent period neither company met the threshold for the publication of its data by FOS, with only one of the companies meeting the threshold in the preceding period.

	Six months ended			
	31 December 2023	30 June 2023	31 December 2022	30 June 2022
Cases reported	48	57	44	46
Uphold rate	26.1%	36.2%	15.2%	34.4%

Interim Management Report (Continued)**6 OPERATIONAL REVIEW**

The number of cases reported is broadly in line with the Group's long-term average, while the uphold rate in the second half of the year was positive when compared with industry averages.

The overall uphold rate across all companies reported by FOS for the six months ended 31 December 2023 was 36%, compared to 37% in the previous six months. FOS data across the financial services industry is published on the ombudsman's website at www.financial-ombudsman.org.uk.

The Group is carefully monitoring the progress of the FCA's review of discretionary commission arrangements in the motor finance sector, announced in January 2024. The Group offered products that might fall within the scope of the review, principally between 2014 and 2020, but does not, at this stage believe its exposure to be material or accurately quantifiable.

6.2 GOVERNANCE

The Group believes that high standards of corporate governance are fundamental to the effective execution of its strategy. There have been no significant changes in the Group's governance framework during the period, and the procedures described in Section B of the Annual Report and Accounts for the year ended 30 September 2023 remain in place. The Group is subject to the 2018 UK Corporate Governance Code (the 'Code') and it has continued to comply with the Code's principles and provisions throughout the period.

A new edition of the Code, most of which will apply to the Group from its year ending 30 September 2026 (with the provisions relating to financial control applicable from the 2027 financial year) was published in January 2024. The Group notes the revisions made by the FRC to its original proposals, and is planning its response to the changes.

The Group's annual general meeting ('AGM') was held on 6 March 2024. All resolutions were carried comfortably with at least 95% of votes in favour, and the Board extends its thanks to those shareholders who participated. Detailed results can be found on the Group's corporate website.

In the period, the Audit Committee began a tender process in respect of the appointment of external auditors with effect from the financial year commencing on 1 October 2025. The intention is to make an appointment before the signing of the 2024 accounts, subject to shareholder approval. If shareholders, or other stakeholders, have any views they wish to share with the Audit Committee, they are invited to contact the Committee's Chair through the office of the Company Secretary.

Interim Management Report (Continued)

6 OPERATIONAL REVIEW**Board of directors and senior management**

As previously announced, Tanvi Davda, an independent non-executive director succeeded Hugo Tudor as Chair of the Remuneration Committee on 7 December 2023. Hugo remains on the Board of Directors and has been considered a non-independent director with effect from the conclusion of the AGM on 6 March 2024. Hugo resigned from the Audit, Nomination and Risk and Compliance Committees on this date. The Board currently comprises two executive directors, six independent non-executive directors, one non-independent non-executive director and the Chair, who was considered independent on appointment.

At 31 March 2024 the Board included four female directors, comprising 40% of the Board, with one of the senior roles designated by the FCA held by a woman, Alison Morris, the Senior Independent Director. Half of the Board's principal committees were also chaired by female directors.

Following the period end Derek Sprawling, the Group's Savings Director, was appointed Managing Director of the Group's savings operation, and joined the Executive Performance Committee and Executive Risk Committee. This increases the membership of both committees to twelve.

6.3 PEOPLE

At 31 March 2024, the Group employed 1,440 people, a reduction of 9% in the half year period. The reduction followed a review and restructuring which streamlined the Group's organisational structure, predominantly focused on reducing layers of management whilst ensuring it remains resourced to deliver on strategy and support its customers.

Conditions and culture

The Group continues to operate a hybrid model promoting a healthy work life balance with flexibility around how and where its people work where possible. The Group understands the benefits that flexible working brings in retaining skills and experience and the part it can play in developing a more diverse and engaged workforce.

The Group maintains its accreditation from the UK Living Wage Foundation and minimum hourly pay continues to meet the 'Real Living Wage' levels set by the Foundation, last updated in October 2023. It is the Group's policy to ensure that all employees, including apprentices, are paid in line with the Foundation's hourly rate, currently £12.00 per hour outside London.

In December 2023, the all-employee three-year share award, granted in 2020 to reward employees for their efforts in the Covid pandemic, matured, with the cash value of the shares received being approximately £1,200 per person, on a full-time equivalent basis. In addition to this a dividend equivalent payment was also made.

In the same month, the 87% of employees who were eligible received the Group's profit related pay for the 2023 financial year, which provided an additional £2,400 on a full-time equivalent basis.

Interim Management Report (Continued)

6 OPERATIONAL REVIEW

Holiday entitlement for employees remains at a maximum of 31 days and a minimum of 26 days, in addition to two additional company closure days over the Christmas period and all UK public holidays. This means that all full-time employees will enjoy at least 36 days of paid holiday this year.

Voluntary staff attrition at 31 March 2024 remains in line with the position twelve months earlier, at 10.5% (31 March 2023: 10.0%), despite the continued strength of the labour market. The Group continues to retain long-serving employees, with 33.6% of employees having achieved ten years' service, of whom 12% had been with the Group for over twenty years.

The Group's People Forum continues as one of the main channels for employee opinions to be fed back to the Board and Executive Committee. Hugo Tudor and Tanvi Davda, the outgoing and new Chair of the Remuneration Committee respectively, met with the People Forum in November 2023 to discuss the Group's remuneration arrangements. Meetings between the Forum and various executive and non-executive directors continue on a regular basis.

Supporting the wellbeing of employees is central to the Group's people strategy, and the Wellbeing Team remains the cornerstone of the approach. Sponsored by the Chief People Officer, the Wellbeing Team comprises employees from across the business who are trained as mental health first aiders, supporting employees with their emotional, social, financial, and physical wellbeing. As well as supporting individual employees the network also supports business continuity planning to ensure our workforce remains resilient; this has been further strengthened in the period with the roll-out of trauma and bereavement training to Wellbeing team members.

Equality and diversity

The Group has made significant progress with Equality, Diversity and Inclusion ('EDI') initiatives over recent years. As well as setting targets for female representation, it has made progress to raise awareness and understanding of EDI matters through its employee-led EDI Network, and has also made significant progress in capturing data on the composition of the workforce of employees through diversity monitoring profiles, which have now been completed by 76% of employees.

The most recent phase of work in this area has focused on developing a formal EDI strategy based on the initiatives so far in place, which was approved by the Nomination Committee, the designated board committee responsible for EDI matters, in February. The strategy sets out three areas of focus:

Ensuring that the Group:

1. Continues to attract, develop and retain talent from diverse pools, with particular focus on gender, ethnicity and socio-economic background
2. Continues to be an inclusive place to work
3. Continually improves the availability of data and measures and monitors the diversity of the workforce and experiences of our employees

Interim Management Report (Continued)

6 OPERATIONAL REVIEW

The EDI Network continues to play an integral part in raising awareness, through organising and participating in virtual events, employee listening circles, podcasts and campaign events. These events will continue throughout the second half of the year to drive support for the EDI strategy across the business at all levels.

The Group continues to provide dedicated development opportunities for those employees from under-represented groups through 'Ignite' an internal development programme, and the cross-company mentoring programmes 'Mission Include' and 'Mission Gender Equity', run by Moving Ahead in conjunction with the 30% Club. There have also been recent enrolments in the 'Executive Accelerator Programme', also run by Moving Ahead, which aims to facilitate women's advancement into, and representation in, executive leadership roles, with two senior female employees and two female non-executive directors joining the programme as mentees and mentors, respectively.

The Group continues to promote socio-economic diversity in the financial sector as a founding member of "Progress Together".

The Group published its Gender Pay Gap report in March 2024 and reported a mean pay gap of 35.0% at 5 April 2023 (2022: 36.3%) and median gap of 33.5% (2022: 32.5%). Whilst the Group's 2023 mean gender pay gap has improved slightly since 2022, the measures remain larger than senior management would like. The marginally positive movement in results is attributable to the recruitment of a number of women in senior roles, increasing female representation in the top pay quartile. These included recruits in several important IT and customer-facing roles.

The Group continues to meet the FTSE Women Leaders target of 40% female representation on the Board. It also remains committed to HM Treasury's Women in Finance Charter and has set the target of achieving 40% female representation in senior management roles (executive committee members and their direct reports) by December 2025. At 31 March 2024, 38.2% of senior management roles were held by women, a similar level to that a year earlier (31 March 2023: 39.0%).

Preparations are also well in hand to announce the Group's aspirations for representation of minority ethnic groups in senior management, as requested by the Parker Review. These will be included in the Group's reporting for the year ending 30 September 2024.

Learning and development

Development programmes across the Group have continued to deliver results, with 27 employees successfully completing the Team Leader Academy Programme, 28 employees completing a High Potential Programme and 9 employees successfully completing the Ignite Programme during the first six months of this financial year.

The success of these development programmes, in support of the Group's overall succession plans, has been seen with 39% of graduates from the High Potential Programme, 37% from the Team Leader Academy Programme and 50% from the Ignite Programme securing an internal promotion or change in role. As already described, learning and development remains core to the Group's EDI strategy, with the sixth cohort of the Mission Gender Equity and Mission Include programmes beginning in the period.

Interim Management Report (Continued)

6 OPERATIONAL REVIEW

The Group continues to make use of the Apprenticeship Levy scheme, with 5 employees graduating from their apprenticeships so far this year. There are currently 22 apprentices and Interns working in the Group. As well as dedicated apprenticeship programmes, the Group utilises the levy through its Team Leader Academy programme. The Group utilised 23.7% of its available levy pot in the past twelve months (31 March 2023: 24%). This spend is consistent with the previous year. It also continues to donate 10% of its levy pot to support apprenticeships in SMEs.

The Group is also currently supporting 73 individuals with funding to complete professional qualifications (31 March 2023: 137). Students for the London Institute of Banking and Finance CeMap mortgage qualification continue to account for the majority, followed closely by individuals undertaking accounting qualifications.

6.4 SUSTAINABILITY

Sustainability, including resilience in the face of climate change risks, is core to the Group's strategy - focussing on specialist customers, to deliver long-term sustainable growth and returns through a low risk and robust business model. Sustainability influences every aspect of the Group's business and means:

- Reducing the impact of its operations on the environment
- Ensuring that it has a positive effect on its stakeholders and communities
- Delivering sustainable products in appropriate markets

The overall response to climate change and other sustainability issues is coordinated by the Sustainability Committee, which is chaired by the External Relations Director, and reports to the Executive Committee. This ensures that information on initiatives within business areas is shared across the Group and facilitates the development of a coordinated and proactive approach.

Since its formation in 2021 the committee has increased the profile of sustainability-related risks and opportunities within the Group and driven improved reporting and understanding of these matters, which in turn has enhanced the approach to identifying and managing climate-related risks and opportunities.

During the six months ended 31 March 2024 the Sustainability Committee has:

- Approved the climate change principal risk policy and an internal framework for labelling sustainable loans
- Measured and assessed progress across key sustainability focus areas
- Reviewed the Group's ESG landscape and prioritised key topics

The Group publishes an annual sustainability report, the Responsible Business Report, each December. This provides more detailed information on sustainability initiatives and demonstrates how sustainability is embedded throughout the Group. It is available on the corporate website at www.paragonbankinggroup.co.uk, alongside other information and documentation relevant to ESG issues.

Interim Management Report (Continued)

6 OPERATIONAL REVIEW**Climate change**

The Group has made a commitment to achieve net zero by 2050 in line with, and in support of, UK Government commitments. In doing so the Group recognises that net zero cannot be achieved by any entity in isolation and that this commitment is therefore dependent on appropriate government and industry support and action. It is therefore disappointing that, at a national level, little has emerged in terms of firm policy during the period.

As members of Bankers for Net Zero ('B4NZ') the Group aims to provide input into the wider efforts of the financial service industry in creating a clear pathway for the decarbonisation of the UK economy.

Climate change has been designated as a principal risk within the Group's Enterprise Risk Management Framework. As a result, the Group's responses to climate change are considered within the Board's overall strategy. These risks fall into two main groups:

- Physical risks (which arise from weather-related events)
- Transitional risks (which come from the adoption of a low-carbon economy)

Information and measures on climate-related risks and opportunities are considered at board level, with information and metrics on sustainability included in the CEO's monthly board report. Developments in sustainable products and climate-related exposures are considered for each business line as part of strategy deep dives which feed into the annual board strategy event and the Corporate Plan.

During the six months ended 31 March 2024 the Group has engaged with external consultants to benchmark its response to climate change to date, including the sustainability governance framework and its progress on compiling its emissions balance sheet to date. The output was largely positive, and the Group considers itself well placed for the next stages of this journey.

In-depth risk and business model reviews have also been carried out with the key business areas in the period. These identified no new material climate-related risks. In addition, a climate change scenario analysis exercise was delivered which assessed the mortgage lending and motor finance portfolios under higher transition risk scenarios. The exercise considered outputs of the Climate Financial Risk Forum ('CFRF') scenario analysis working group, of which the Group is a member. The results will be escalated up to the Board and integrated within the 2024 ICAAP.

Developments within business lines which contribute towards the Group's climate risk strategy are set out in the relevant business reviews, with highlights over the last six-months including:

- Expansion of the funding available through the Green Homes Initiatives in the development finance operation from £200 million to £300 million to increase the number of projects that can be funded through the scheme, following the initial positive uptake
- Establishing Green Champions across the SME lending division to begin targeting more sustainable lending

Interim Management Report (Continued)

6 OPERATIONAL REVIEW

- Increasing levels of new business on energy efficient EPC A-C properties within the buy-to-let mortgage operation. Over the last six months over 55% of new buy-to-let mortgage business, where data was available, had an EPC rating of A-C
- Continued expansion of motor finance lending to battery electric and hybrid vehicles

Additional information on these initiatives is included in the business reviews in Section 2 of this report.

As a financial services provider the direct environmental impact of the Group's operations is considered low. However, it recognises the importance of reducing the impact these operations do have on the environment. The Group has committed to reduce its operational footprint to net zero by 2030 and now reports its operational footprint on a quarterly basis at the Sustainability Committee with a summary report escalated to the Board.

In support of the Group's net zero operational footprint target, for the 2023 financial year the Group purchased certified carbon offsets equivalent to its operational footprint for the twelve months, and will repeat that exercise for the current financial year and each year going forward. However, it acknowledges that, ideally, reducing impacts is preferable to offsetting.

Group initiatives to reduce operational environmental impacts during the last six months include:

- Commencing a project which will result in the closure of a large office site and relocation of staff to our nearby head office which has available capacity following the shift to hybrid working. The office closure will reduce our office-based footprint.
- Roll-out of an ESG supplier survey to critical suppliers to better understand the maturity of suppliers' sustainability approaches. The results of the survey will be used to inform the development of processes to manage the environmental impact of the Group's supply chain.
- Enhancing employee vehicle data collection across the company car fleet to facilitate more accurate monitoring and assessment of emissions attributable to business travel.
- Progressing the Energy Savings Opportunity Scheme ('ESOS') submission due later in the year. ESOS requires independent energy audits to assess usage and identify energy-saving opportunities. This will complement actions already taken in identifying the potential for further reductions, where appropriate.

The Group is required by the UK Listing Rules to report on climate change risk and exposures using the Taskforce on Climate-Related Financial Disclosure ('TCFD') framework. The 2023 Annual Report and Accounts contains disclosures for the Group which are consistent with the recommendations of the TCFD and the expectations set out in the Listing Rules. These disclosures set out the Group's approach to the management of climate risk in greater detail than this Half-Yearly Report and is available on its corporate website at www.paragonbankinggroup.co.uk.

While the TCFD itself has been disbanded, these disclosures will continue to develop in light of emerging market practice, the UK legislative framework and regulatory expectations. The Group will carefully monitor developments in these areas, including the UK Government's consultation on non-financial reporting requirements, launched in March 2024, as they emerge.

Interim Management Report (Continued)

6 OPERATIONAL REVIEW**Social engagement**

The Group's charity for the 2024 financial year, chosen by employees, is Molly Ollys, which supports disabled and terminally ill children and their families. At the half-way point of the year the amount raised through events organised by the Group's Charity Committee had reached £26,000 with further fundraising events already planned for the rest of the year.

Employees are also entitled to an annual paid volunteering day. So far this year, employees have already contributed 161 days, supporting projects in the community, with a focus on those which provide education, help those experiencing poverty or which benefit the local environment. The Group is targeting 450 volunteer days for 2024 with a large number of events already planned for the second half of the financial year.

The Group has joined a 'community parenting' scheme organised by Solihull Council, which supports young people leaving the care system and venturing into independent adulthood. This initiative has involved the donation of laptops and webcams to aid young adults with their studies, job applications or arranging accommodation. Additionally the Group has worked with Future First, a UK social mobility and education charity which connects state school pupils to former students they can relate to, helping equip them for the world of work.

6.5 RISK MANAGEMENT

The effective management of risk remains crucial to the achievement of the Group's strategic objectives. It operates a risk governance framework, designed around a formal three lines of defence model (business areas, Risk and Compliance function and Internal Audit) supervised at board level.

Risk environment

The Group continues to assess the nature of the varied and dynamic challenges it faces, using its Enterprise Risk Management Framework ('ERMF') as a key enabler to ensure it remains agile and resilient in its responses. The ERMF continues to provide a robust and effective mechanism which ensures that new and developing risks are promptly identified, assessed and managed, with appropriate oversight from a risk governance perspective. The role of the ERMF has been critical both in the early identification of risk issues, and in providing a mechanism to manage them, as the risk landscape continues to evolve.

At 31 March 2024, the risk agenda remains largely dominated by geopolitical and economic threats, manifesting themselves in the UK through continued cost-of-living challenges and high costs of doing business, against a background of general global economic uncertainty. However, the level of cautious optimism for the economic prospects for the UK has increased in the period, as prospects of a prolonged recession diminish.

Interim Management Report (Continued)

6 OPERATIONAL REVIEW

2024 will see a number of major elections globally, which will undoubtedly have an impact on the world economy. The Group is closely monitoring the possible consequences of a potential change of UK government following July's general election, and the impact this may have on the broader economic landscape.

In addition, the Group continues to review the impact of conflicts in the Middle East and Ukraine. The development of the potential consequences of these situations is ongoing, but they could be wide-ranging and varied, including global economic impacts such as supply chain disruption, and physical and cyber security threats.

Despite these macro-economic and political headwinds, the Group has performed positively, whilst remaining vigilant to the uncertainties that have remained throughout the six-month period, and which are expected to continue to pose certain challenges for the foreseeable future:

- Interest rates are generally considered to have broadly peaked, and the prevailing view is that the outlook is more stable than at the start of the period. However, given political uncertainties and ongoing inflationary pressures, the Group continues to closely monitor potential impacts on its customers and employees:

- The Group continues to focus on high-quality lending. Credit policy is intended to be prudent, and the Group continues to assess actual and projected arrears trends in setting lending criteria. The wider economic challenges of recent years have yet to translate into significant adverse performance across the lending portfolios

Whilst the credit performance of the buy-to-let lending book saw some movement as landlords adjusted to higher interest rates, default rates have remained broadly static, with the principal exception of a few legacy portfolios. The sustained property valuations seen in the period, coupled with very strong rental demand, provide a sound basis for buy-to-let lending. Together with the prospects of lower interest rates towards the end of the year, this provides a more positive outlook

Similarly, arrears on Motor Finance loans, the main bank exposure to the consumer credit market, have remained largely stable over the period

- Whilst the current risk profile of loans across the Group's portfolios does not indicate any noticeable signs of significantly increased financial stress, the Group continues to take a forward-looking, as well as current, view of affordability, and will adjust credit policy to ensure loan repayments are sustainable for customers as appropriate
- The Group takes its responsibilities in respect of customers with reducing financial resilience, and those in vulnerable circumstances, extremely seriously. It continues to ensure that where forbearance solutions are appropriate, they are tailored to individual customer circumstances and aligned to regulatory guidance and expectations

The Group continues to monitor closely the impacts of government policy and how such interventions may influence the broader economic landscape

Interim Management Report (Continued)

6 OPERATIONAL REVIEW

- Embedding the Group's operational resilience capability continues, reflecting regulatory and industry practice. The objective is to deliver continuous improvement, implementing the findings of the cycles of self-assessment carried out over the last two years. The Group is focussed on ensuring that operational resilience remains a critical driver and a priority in the design and execution of its strategic transformation programme, particularly given the increasing reliance on third parties to deliver core services

Over the last six months the Group has continued to refine and test its stated impact tolerances through its scenario testing programme and to address any enhancement requirements identified. It therefore remains well-placed to meet the 2025 regulatory deadline, to demonstrate it can consistently operate within stated impact tolerances

- Prioritising focus on climate change, given the associated risks, remains an ever-present challenge. The UK Government has confirmed its goal of net zero carbon by 2050 and the Group, together with the wider financial services industry, have a vital role to play in that commitment. The Group considers the impacts of climate change risk through both its own operations and its lending activities, and continues to evolve its approach to measuring and mitigating the transition and physical risks potentially caused by climate change

These issues are expected to continue to affect the risk landscape through the second half of the financial year, and will continue to be carefully monitored. Despite a more positive economic outlook in the UK there still remains a high degree of uncertainty and the political situation following the General Election in July will be critical in determining the direction of the economy and the sector.

Risk management processes

During the six-month period the Group has continued to make good progress in embedding its ERMF to ensure that its principles are adopted into business practice, and it is well-placed to manage all categories of risk and respond to the changing business environment in a proportionate manner. It is recognised that this is an ongoing journey and will necessitate continuous improvement, however, robust foundations and practices have been established over the last few years, which are driving effective risk management throughout the organisation.

Key elements underpinning the ERMF include a comprehensive set of policies addressing all principal risks, which are reviewed, enhanced where appropriate and approved annually by the board-level Risk and Compliance Committee; and ongoing education and training to ensure that understanding and management of risk pervades all levels of the Group, reinforced by a strong and visible risk culture. The Group continues to review its risk approach to ensure it remains effective and proportionate in terms of both maturity and operation, and adoption is supported through regular business-wide risk maturity and risk culture assessments.

The ERMF will continue to evolve as it matures and the business grows and changes. The Group remains committed to ensuring that risk processes and resources remain appropriate, allowing all risks to be managed within stated appetites. Key to this vision is ensuring that the correct tools are in place to further improve the analysis and reporting of risk-related data, providing better insight into the risk profile at all levels within the Group.

Interim Management Report (Continued)

6 OPERATIONAL REVIEW

Despite the geopolitical, economic and sectoral challenges, the Group remains committed to delivering key risk management initiatives to build further on the good progress made to date. Enhancements since the previous financial year end include:

- **FCA Consumer Duty** – Continuing the ongoing implementation of the Consumer Duty's requirements across in-scope closed products, and enhancing activities already completed for open products, ensuring the Group's culture is driving good outcomes for retail customers
- **Operational resilience** – Continuous embedding of operational resilience capabilities including addressing actions and vulnerabilities identified in the regular self-assessment process. This includes ongoing refinement of critical business services and tolerances, ensuring these considerations are embedded as both part of day-to-day operations, and as a core principle within the Group's digital strategy and technology roadmap
- **Climate change** – Addressing the financial risks of climate change through key risk driver assessments, and consideration of the impacts of the wider ESG agenda across the Group's operations
- **Financial Crime** – Ongoing initiatives to ensure the Group's financial crime risk framework is robust and continues to mature, with investment in technology and resources to support the Group's operations
- **IRB** – Continuing to develop IRB model methodologies for the buy-to-let and development finance portfolios, while embedding the overarching model risk framework to enhance credit risk management and support the IRB application process
- **Stress testing** – Enhancing stress testing procedures to ensure the robustness of capital and liquidity positions. This also incorporates the Group's IRB models for the buy-to-let and development finance portfolios
- **Cyber-security** – Effective cyber-security controls and a robust data protection approach remain a key focus for the Group. With the increasingly sophisticated nature of cyber threats the Group remains vigilant to the evolving threats, particularly with the growing use of artificial intelligence, and is committed to investing in cyber-defences as a priority

The Group continues to review its exposure to emerging developments in the Brexit process as further clarity is received regarding the UK's future relationship with the EU, and the process of embedding EU legislation into UK law and regulations continues. However, it is clear this will take time to manifest itself fully and the long-term impact continues to emerge. In the shorter term the Group is considering how any changes in government later in the year may impact this and wider national policy and priorities.

The Group has further continued to focus on the management and oversight of outsourcing arrangements and its relationships with important suppliers. This remains a key pillar in the Group's operational resilience approach.

Interim Management Report (Continued)

6 OPERATIONAL REVIEW**Principal risks and uncertainties**

A summary of the principal risks and uncertainties faced by the Group, required by DTR 4.2.7(2) of the Disclosure and Transparency Rules, is set out on pages 176 to 177. These risks have not changed significantly since those disclosed at the 2023 financial year end.

6.6 REGULATORY CHANGES

Paragon Bank, which, for regulatory purposes, includes most of the Group's activities, is authorised by the PRA and regulated by the PRA and the FCA. The Group is subject to consolidated supervision by the PRA and a number of its subsidiaries are authorised and regulated by the FCA. As a result, current and projected regulatory changes continue to pose a significant risk for the Group, arising from both their impacts and the pace of change. Therefore, the Group monitors the regulatory landscape on an ongoing basis with a particular focus on new and emerging regulations to ensure it is well-placed to respond to such changes in an agile manner.

The governance and control structures within the Group provide a robust mechanism to ensure that the impacts of all new regulatory requirements on the business are clearly understood and that appropriate preparations are made before implementation. Regular reports on key regulatory developments are received at both executive and board risk committees, assessing the potential implications for the Group, along with necessary actions.

Given the nature of its operations the Group is affected by a broad range of prudential and conduct regulations. The Group engages in regular dialogue with its regulators and responds to all requests promptly.

The volume of requests for information from the FCA has continued to increase over recent periods, and this trend is expected to continue, focussing on the exercise of forbearance for customers as well as monitoring Consumer Duty implementation. The Group responds to such requests in a timely fashion and maintains robust controls to support the delivery of good customer outcomes.

The following recent and current developments have the greatest potential impact on the Group:

- **Consumer Duty** – In July 2022, the FCA issued its final rules and guidance on 'A new Consumer Duty', which seeks to set higher expectations for the standard of support provided to customers, and challenges firms to evidence the customer outcomes that they are delivering. The Group successfully implemented the new rules for open products by the July 2023 deadline and remains on track to implement the requirements for closed products by July 2024. This activity continues to be championed and overseen by the Board, with a designated non-executive director having been assigned specific responsibility for oversight

Interim Management Report (Continued)

6 OPERATIONAL REVIEW

- **Customers in vulnerable circumstances** – The treatment of customers in vulnerable circumstances continues to be a strong focus for the FCA, demonstrated by its intention to review firms’ treatment of customers in vulnerable circumstances, which was referenced in its 2024/2025 business plan. The Group takes its responsibilities in this regard very seriously, with significant work continuing to be undertaken to revise existing procedures, controls and training provisions to meet regulatory and industry expectations
- **Motor finance commissions** – The FCA’s announcement in January 2024 that it would be conducting a review of historical motor finance commission sales practices has relevance to the Group’s motor finance loans, advanced between 2014 and 2020. Whilst exposure remains low due to the comparatively small size of the portfolio from this period, the Group remains vigilant in monitoring the FCA’s progress
- **Basel 3.1** – In December 2023, the PRA published Part 1 of its Basel 3.1 implementation standards. This covered a range of areas such including Counterparty Credit Risk (‘CCR’), Credit Valuation Adjustment (‘CVA’) and Operational Risk that, while important, are not critical drivers of the Group’s capital requirement

Part 2, which will address Credit Risk, is expected to be published in 2024, at some point after the UK General Election. The expected implementation date for all Basel 3.1 measures in the UK remains 1 July 2025, although some changes may be phased in. However, the PRA has stated that firms will be given a twelve month period to implement the reforms following the publication of Part 2, meaning that implementation may be delayed. Before implementation the PRA intends to rebase and adjust all firms’ Pillar 2A requirements and PRA buffers. The Group proactively monitors and manages its capital, assessing the implications of a range of different possible impacts including potential worse case scenarios as part of its capital planning activities

- **Regulatory framework** – The PRA’s approach to Small Domestic Deposit Takers (‘SDDT’) continues to be developed. The PRA published its approach to liquidity and reporting for SDDTs in December 2023 and is expected to publish a Consultation Paper on the capital regime at a similar time to the Part 2 statement on Basel 3.1 referred to above.

The proposed implementation date for the SDDT capital regime is currently expected to be in the first half of 2026. A transitional capital regime has been proposed for in-scope SDDTs for the period between implementation of the Basel 3.1 reforms for larger firms and implementation of the new SDDT regime

The development of these proposals is being monitored closely, and while the Group would currently qualify to be designated as an SDDT, it is not certain whether the new regime would be applied

Interim Management Report (Continued)

6 OPERATIONAL REVIEW

- **Solvent Exit planning** – In the early part of 2024, the PRA published a final policy on solvent exit plans for non-systemic banks and building societies (PS5/24), which would include the Group. It requires firms to undertake a Solvent Exit Analysis and, when the circumstances require it, develop a Solvent Exit Execution Plan. The Group is fully aware of the requirements, which will complement existing work undertaken on recovery planning, and expects to be compliant by the deadline of 1 October 2025
- **Enhancing the Special Resolution Regime** – In January 2024, HM Treasury published a consultation proposing the extension of some powers under the Special Resolution Regime (for example the use of partial sale, transfer, or bridge bank) to small firms. The proposals also include a greater role for the FSCS in the provision of funds to support recapitalisation. These proposals are, to some extent, a response to issues identified following the failure of Silicon Valley Bank in March 2023. The Group is tracking developments closely and has provided feedback to HM Treasury
- **Operational Resilience** – The Group remains firmly on track to meet all requirements of the final rules and guidance on ‘building operational resilience in financial services’ published in 2021 by the FCA, PRA and Bank of England. The Group has successfully completed the 2024 iteration of its self-assessment enabling it to validate progress in addressing any gaps identified by the 2023 assessment, and to help set clear objectives for further refining its approach

The Group is committed to a programme of continuous improvement in its resilience capability. Important business services are mapped and tested using severe but plausible scenarios to push the boundaries on the ability of the infrastructure, key dependencies and third parties to recover from disruption. The scenario library was enhanced for the 2024 testing programme, and the groupwide disaster recovery testing plan helps support the ongoing scenario testing programme, with clear focus on recovery of important business services. This approach should ensure the Group can meet the regulatory deadline of 2025, by when it will need to be able to demonstrate its ability to stay consistently within impact tolerances

- **Climate change** – The Group continues to work towards embedding its approach to managing climate-related financial risks. The Sustainability Committee, alongside the executive level risk committees, ensures comprehensive consideration of such risks across all aspects of the business, and that the Group is well-positioned to address emerging challenges.

Managing the impacts of climate change is seen as a key strategic priority for the Group with board-agreed commitments and a detailed plan of work, which has been developed reflecting regulatory and wider requirements. This is reviewed on an ongoing basis to ensure it reflects new thinking and developing expectations as they emerge

- **MREL** – Although the Group is not subject to MREL (Minimum Requirement for own funds and Eligible Liabilities) requirements currently, given its potential for growth it may be required to issue MREL eligible instruments at some point in the future and therefore continues to closely monitor developments and potential impacts

Interim Management Report (Continued)**6 OPERATIONAL REVIEW**

Certain regulations applying in the financial services sector only affect entities over a certain size, which the Group might meet within its current planning horizon. The Group considers whether and when these regulations might apply to it in light of the growth implicit in its business plans and puts appropriate arrangements in place to ensure it would be able to comply at that point.

The Group continues to assess how the result of the UK general election being held in July 2024, and a potential consequent change of government in Westminster, may impact its operations and the policy and regulatory regimes to which it and its customers are subject.

The governance and risk management framework within the Group continues to mature and provides a critical mechanism to ensure that the impacts of all new regulatory requirements are clearly understood and mitigated as far as possible. Regular reports on key regulatory developments are received at both executive and board risk committees.

Overall, the Group considers that it is well placed to address all the regulatory changes to which it is presently exposed.

Statement of Directors' Responsibilities

The directors confirm that, to the best of their knowledge:

- The condensed financial statements have been prepared in accordance with International Accounting Standard 34 – 'Interim Financial Reporting', issued by the IASB and as contained in UK-adopted IFRS
- The Interim Management Report includes a fair review of the information required by Section 4.2.7R of the Disclosure Guidance and Transparency Rules, issued by the Financial Conduct Authority (that being an indication of important events that have occurred during the first six months of the current financial year and their impact on the condensed financial statements and a description of the principal risks and uncertainties for the remaining six months of the financial year)
- The Interim Management Report includes a fair review of the information required by Section 4.2.8R of the Disclosure Guidance and Transparency Rules, issued by the Financial Conduct Authority (that being disclosure of related party transactions that have taken place in the first six months of the current financial year and that have materially affected the financial position or the performance of the enterprise during that period; and any changes in the related party transactions described in the last annual report which could do so)

Approved by the Board of Directors and signed on behalf of the Board as the persons responsible within the Company.

CIARA MURPHY

Company Secretary

5 June 2024

Board of Directors

R D East <i>(Chair of the Board and Chair of the Nomination Committee)</i>	H R Tudor <i>(Non-executive director)</i>
B A Ridpath <i>(Non-executive director)</i>	G H Yorston <i>(Non-executive director)</i>
A C M Morris <i>(Non-executive director, Chair of the Audit Committee and Senior Independent Director)</i>	P A Hill <i>(Non-executive director and Chair of the Risk and Compliance Committee)</i>
T P Davda <i>(Non-executive director and Chair of the Remuneration Committee)</i>	Z L Howorth <i>(Non-executive director)</i>
N S Terrington <i>(Chief Executive Officer)</i>	R J Woodman <i>(Chief Financial Officer)</i>

Independent review report to Paragon Banking Group PLC

Conclusion

We have been engaged by Paragon Banking Group PLC (the 'Company') to review the condensed set of financial statements in the half-yearly financial report for the six months ended 31 March 2024 which comprises the consolidated statement of profit or loss, consolidated statement of comprehensive income, consolidated balance sheet, consolidated cash flow statement, consolidated statement of movements in equity and the related explanatory notes.

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 31 March 2024 is not prepared, in all material respects, in accordance with IAS 34 Interim Financial Reporting as adopted for use in the UK and the Disclosure Guidance and Transparency Rules (the 'DTR') of the UK's Financial Conduct Authority (the 'UK FCA').

Basis for conclusion

We conducted our review in accordance with International Standard on Review Engagements (UK) 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity ('ISRE (UK) 2410') issued for use in the UK. 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. We read the other information contained in the half-yearly financial report and consider whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

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.

Conclusions relating to going concern

Based on our review procedures, which are less extensive than those performed in an audit as described in the 'Basis for conclusion' section of this report, nothing has come to our attention that causes us to believe that the directors have inappropriately adopted the going concern basis of accounting, or that the directors have identified material uncertainties relating to going concern that have not been appropriately disclosed.

This conclusion is based on the review procedures performed in accordance with ISRE (UK) 2410. However, future events or conditions may cause the Group to cease to continue as a going concern, and the above conclusions are not a guarantee that the Group will continue in operation.

Independent review report to Paragon Banking Group PLC

Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the DTR of the UK FCA.

As disclosed in note 36, the annual financial statements of the Group are prepared in accordance with UK-adopted international accounting standards.

The directors are responsible for preparing the condensed set of financial statements included in the half-yearly financial report in accordance with IAS 34 as adopted for use in the UK.

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

Our responsibility

Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review. Our conclusion, including our conclusions relating to going concern, are based on procedures that are less extensive than audit procedures, as described in the Basis for conclusion section of this report.

The purpose of our review work and to whom we owe our responsibilities

This report is made solely to the Company in accordance with the terms of our engagement to assist the Company in meeting the requirements of the DTR of the UK FCA. Our review has been undertaken so that we might state to the Company those matters we are required to state to it in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company for our review work, for this report, or for the conclusions we have reached.

MICHAEL McGARRY

for and on behalf of KPMG LLP
Chartered Accountants

15 Canada Square
London
E14 5GL

5 June 2024

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

For the six months ended 31 March 2024 (Unaudited)

	Note	Six months to 31 March 2024 £m	Six months to 31 March 2023 £m	Year to 30 September 2023 £m
Interest receivable	3	641.8	437.6	1,010.6
Interest payable and similar charges	4	(401.9)	(225.2)	(561.7)
Net interest income		<u>239.9</u>	<u>212.4</u>	<u>448.9</u>
Other leasing income		14.9	13.6	27.4
Related costs		(12.2)	(10.9)	(21.8)
Net leasing income		<u>2.7</u>	<u>2.7</u>	<u>5.6</u>
Other income	5	4.0	5.1	11.5
Other operating income		<u>6.7</u>	<u>7.8</u>	<u>17.1</u>
Total operating income		<u>246.6</u>	<u>220.2</u>	<u>466.0</u>
Operating expenses		(90.0)	(83.8)	(170.4)
Provisions for losses	6	(10.3)	(7.5)	(18.0)
Operating profit before fair value items		<u>146.3</u>	<u>128.9</u>	<u>277.6</u>
Fair value net (losses)	7	(35.7)	(82.5)	(77.7)
Operating profit being profit on ordinary activities before taxation		<u>110.6</u>	<u>46.4</u>	<u>199.9</u>
Tax charge on profit on ordinary activities	8	(28.7)	(8.5)	(46.0)
Profit on ordinary activities after taxation		<u>81.9</u>	<u>37.9</u>	<u>153.9</u>
	Note	Six months to 31 March 2024	Six months to 31 March 2023	Year to 30 September 2023
Basic earnings per share	9	38.4p	16.4p	68.7p
Diluted earnings per share	9	36.9p	15.7p	66.3p
Dividend – rate per share for the period	29	13.2p	11.0p	37.4p

The results for the periods shown above relate entirely to continuing operations.

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the six months ended 31 March 2024 (Unaudited)

	Note	Six months to 31 March 2024 £m	Six months to 31 March 2023 £m	Year to 30 September 2023 £m
Profit for the period		81.9	37.9	153.9
Other comprehensive income				
<i>Items that will not be reclassified subsequently to profit or loss</i>				
Actuarial gain on pension scheme	25	2.8	1.9	2.4
Tax thereon		(0.7)	(0.6)	(0.8)
Other comprehensive income for the period net of tax		2.1	1.3	1.6
Total comprehensive income for the period		84.0	39.2	155.5

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEET

31 March 2024 (Unaudited)

	Note	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m	30 September 2022 £m
Assets					
Cash – central banks	10	2,739.5	2,087.1	2,783.3	1,612.5
Cash – retail banks	10	299.5	188.3	211.0	318.4
Investment securities	11	98.1	-	-	-
Loans to customers	12	15,052.5	14,236.0	14,495.0	13,650.4
Derivative financial assets	18	511.7	511.2	615.4	779.0
Sundry assets	19	16.2	44.9	51.0	39.2
Current tax assets		6.5	-	8.9	5.4
Retirement benefit obligations	25	16.6	10.4	12.7	7.1
Property, plant and equipment		70.6	72.0	74.7	71.4
Intangible assets	20	169.6	170.5	168.2	170.2
Total assets		18,980.8	17,320.4	18,420.2	16,653.6
Liabilities					
Short-term bank borrowings		1.2	0.2	0.2	0.4
Retail deposits	21	14,767.1	11,838.1	13,234.4	10,569.5
Derivative financial liabilities	18	95.1	51.3	39.9	102.1
Asset-backed loan notes	22	17.1	289.8	28.0	409.3
Secured bank borrowings	22	-	341.8	-	586.0
Retail bond issuance	22	112.5	112.3	112.4	112.3
Corporate bond issuance	22	148.6	149.3	145.8	149.2
Central bank facilities	22	1,850.0	2,750.0	2,750.0	2,750.0
Repurchase agreements	22	100.0	-	50.0	-
Sundry liabilities	23	499.1	410.6	631.2	513.1
Current tax liabilities		-	0.2	-	-
Deferred tax liabilities		8.1	16.4	17.7	44.4
Total liabilities		17,598.8	15,960.0	17,009.6	15,236.3
Called-up share capital	26	216.6	241.5	228.7	241.4
Reserves	27	1,224.3	1,220.5	1,257.5	1,223.9
Own shares	28	(58.9)	(101.6)	(75.6)	(48.0)
Total equity		1,382.0	1,360.4	1,410.6	1,417.3
Total liabilities and equity		18,980.8	17,320.4	18,420.2	16,653.6

The condensed financial statements for the half year were approved by the Board of Directors on 5 June 2024.

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED CASH FLOW STATEMENT

For the six months ended 31 March 2024 (Unaudited)

	Note	Six months to 31 March 2024 £m	Six months to 31 March 2023 £m	Year to 30 September 2023 £m
Net cash flow generated by operating activities	30	1,115.6	825.9	2,171.7
Net cash (utilised) by investing activities	31	(100.5)	(1.8)	(3.1)
Net cash (utilised) by financing activities	32	(971.4)	(479.4)	(1,105.0)
Net increase in cash and cash equivalents		43.7	344.7	1,063.6
Opening cash and cash equivalents		2,994.1	1,930.5	1,930.5
Closing cash and cash equivalents		3,037.8	2,275.2	2,994.1
Represented by balances within				
Cash	10	3,039.0	2,275.4	2,994.3
Short-term bank borrowings		(1.2)	(0.2)	(0.2)
		3,037.8	2,275.2	2,994.1

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF MOVEMENTS IN EQUITY

For the six months ended 31 March 2024 (Unaudited)

Six months ended 31 March 2024

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m
Transactions arising from							
Profit for the period	-	-	-	-	81.9	-	81.9
Other comprehensive income	-	-	-	-	2.1	-	2.1
Total comprehensive income	-	-	-	-	84.0	-	84.0
Transactions with owners							
Dividends paid (note 29)	-	-	-	-	(56.1)	-	(56.1)
Shares cancelled	(12.1)	-	12.1	-	(68.5)	68.5	-
Capital reorganisation	-	-	-	-	-	-	-
Own shares purchased	-	-	-	-	-	(52.8)	(52.8)
Irrevocable instruction accrual	-	-	-	-	-	(10.4)	(10.4)
Exercise of share awards	-	-	-	-	(11.5)	11.4	(0.1)
Charge for share-based remuneration	-	-	-	-	4.5	-	4.5
Tax on share-based remuneration	-	-	-	-	2.3	-	2.3
Net movement in equity in the period	(12.1)	-	12.1	-	(45.3)	16.7	(28.6)
Opening equity	228.7	71.4	12.9	(70.2)	1,243.4	(75.6)	1,410.6
Closing equity	216.6	71.4	25.0	(70.2)	1,198.1	(58.9)	1,382.0

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF MOVEMENTS IN EQUITY

For the six months ended 31 March 2024 (Unaudited) (Continued)

Six months ended 31 March 2023

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m
Transactions arising from							
Profit for the period	-	-	-	-	37.9	-	37.9
Other comprehensive income	-	-	-	-	1.3	-	1.3
Total comprehensive income	-	-	-	-	39.2	-	39.2
Transactions with owners							
Dividends paid (note 29)	-	-	-	-	(43.7)	-	(43.7)
Shares cancelled	-	-	-	-	-	-	-
Capital reorganisation	-	-	(71.8)	-	71.8	-	-
Own shares purchased	-	-	-	-	-	(70.1)	(70.1)
Irrevocable instruction accrual	-	-	-	-	-	10.8	10.8
Exercise of share awards	0.1	0.3	-	-	(6.2)	5.7	(0.1)
Charge for share-based remuneration	-	-	-	-	4.6	-	4.6
Tax on share-based remuneration	-	-	-	-	2.4	-	2.4
Net movement in equity in the period	0.1	0.3	(71.8)	-	68.1	(53.6)	(56.9)
Opening equity	241.4	71.1	71.8	(70.2)	1,151.2	(48.0)	1,417.3
Closing equity	241.5	71.4	-	(70.2)	1,219.3	(101.6)	1,360.4

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF MOVEMENTS IN EQUITY

For the six months ended 31 March 2024 (Unaudited) (Continued)

Year ended 30 September 2023

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m
Transactions arising from							
Profit for the year	-	-	-	-	153.9	-	153.9
Other comprehensive income	-	-	-	-	1.6	-	1.6
Total comprehensive income	-	-	-	-	155.5	-	155.5
Transactions with owners							
Dividends paid (note 29)	-	-	-	-	(67.9)	-	(67.9)
Shares cancelled	(12.9)	-	12.9	-	(67.3)	67.3	-
Capital reorganisation	-	-	(71.8)	-	71.8	-	-
Own shares purchased	-	-	-	-	-	(120.5)	(120.5)
Irrevocable instruction accrual	-	-	-	-	-	10.8	10.8
Exercise of share awards	0.2	0.3	-	-	(11.4)	14.8	3.9
Charge for share-based remuneration	-	-	-	-	9.6	-	9.6
Tax on share-based remuneration	-	-	-	-	1.9	-	1.9
Net movement in equity in the year	(12.7)	0.3	(58.9)	-	92.2	(27.6)	(6.7)
Opening equity	241.4	71.1	71.8	(70.2)	1,151.2	(48.0)	1,417.3
Closing equity	228.7	71.4	12.9	(70.2)	1,243.4	(75.6)	1,410.6

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS

For the six months ended 31 March 2024 (Unaudited)

1. GENERAL INFORMATION

The condensed financial statements are prepared for Paragon Banking Group PLC ('the Company') and its subsidiary companies (together 'the Group') on a consolidated basis.

The condensed financial statements for the six months ended 31 March 2024 and for the six months ended 31 March 2023 have not been audited, as defined in section 434 of the Companies Act 2006.

The figures shown above for the year ended 30 September 2023 and the year ended 30 September 2022 are not statutory accounts. A copy of the statutory accounts for each year has been delivered to the Registrar of Companies. The auditors reported on those statutory accounts and their reports were unqualified, did not draw attention to any matters by way of emphasis and did not contain an adverse statement under sections 498 (2) or 498 (3) of the Companies Act 2006.

This half-yearly financial report is also available on the Group's corporate website at www.paragonbankinggroup.co.uk. As previously advised, the half-yearly financial report is available online only, to help to reduce the environmental impact of shareholder communication.

The remaining notes to the accounts are organised in to three sections:

- Analysis – providing further analysis and information on the amounts shown in the primary financial statements
- Capital and Financial Risk – providing information on the Group's management of operational and regulatory capital and its principal financial risks
- Basis of preparation – providing details of the Group's accounting policies and of how they have been applied in the preparation of the condensed financial statements

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS

For the six months ended 31 March 2024 (Unaudited)

The notes set out below give more detailed analysis of the balances shown in the primary financial statements and further information on how they relate to the operations, results and financial position of the Group.

2. SEGMENTAL INFORMATION

The Group analyses its operations, both for internal management information and external financial reporting, on the basis of the markets from which its assets are generated.

The segments used are described below:

- Mortgage Lending, including the Group's buy-to-let, and owner-occupied first and second charge lending and related activities
- Commercial Lending, including the Group's equipment leasing activities, development finance, structured lending and other offerings targeted towards SME customers, together with its motor finance business

These segments are the same as those used at 30 September 2023.

Dedicated financing and administration costs of each of these businesses, including the interest impacts of fair value hedging, are allocated to the segment. Shared central costs are not allocated between segments, nor is income from central cash balances or the carrying costs of unallocated savings balances.

Loans to customers and operating lease assets are allocated to segments as are dedicated securitisation funding arrangements and their related cash balances.

Other assets are not allocated between segments.

All the Group's operations are conducted in the UK, all revenues arise from external customers and there are no inter-segment revenues. No customer contributes more than 10% of the revenue of the Group.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****2. SEGMENTAL INFORMATION (Continued)**

Financial information about these business segments, prepared on the same basis as used in the consolidated accounts of the Group, is shown below.

Six months ended 31 March 2024

	Mortgage Lending £m	Commercial Lending £m	Unallocated items £m	Total £m
Interest receivable	453.8	113.0	75.0	641.8
Interest payable	(307.1)	(52.3)	(42.5)	(401.9)
Net interest income	146.7	60.7	32.5	239.9
Other operating income	1.7	5.0	-	6.7
Total operating income	148.4	65.7	32.5	246.6
Operating expenses	(11.6)	(13.4)	(65.0)	(90.0)
Provisions for losses	(8.7)	(1.6)	-	(10.3)
	128.1	50.7	(32.5)	146.3

Six months ended 31 March 2023

	Mortgage Lending £m	Commercial Lending £m	Unallocated items £m	Total £m
Interest receivable	310.6	96.5	30.5	437.6
Interest payable	(177.1)	(29.1)	(19.0)	(225.2)
Net interest income	133.5	67.4	11.5	212.4
Other operating income	3.1	4.7	-	7.8
Total operating income	136.6	72.1	11.5	220.2
Operating expenses	(12.3)	(13.3)	(58.2)	(83.8)
Provisions for losses	(5.4)	(2.1)	-	(7.5)
	118.9	56.7	(46.7)	128.9

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS**

For the six months ended 31 March 2024 (Unaudited)

2. SEGMENTAL RESULTS (Continued)*Year ended 30 September 2023*

	Mortgage Lending £m	Commercial Lending £m	Unallocated Items £m	Total Segments £m
Interest receivable	713.6	207.4	89.6	1,010.6
Interest payable	(436.0)	(71.7)	(54.0)	(561.7)
Net interest income	277.6	135.7	35.6	448.9
Other operating income	5.6	11.5	-	17.1
Total operating income	283.2	147.2	35.6	466.0
Direct costs	(26.2)	(26.4)	(117.8)	(170.4)
Provisions for losses	(10.4)	(7.6)	-	(18.0)
	<u>246.6</u>	<u>113.2</u>	<u>(82.2)</u>	<u>277.6</u>

The segmental profits disclosed above reconcile to the consolidated results as set out below.

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m
Results shown above	146.3	128.9	277.6
Fair value items	(35.7)	(82.5)	(77.7)
Operating profit	<u>110.6</u>	<u>46.4</u>	<u>199.9</u>

The assets of the segments were:

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m	30 September 2022 £m
Mortgage Lending	13,210.9	12,702.5	12,988.4	12,569.2
Commercial Lending	2,195.6	2,016.7	2,016.3	1,923.2
Total segment assets	15,406.5	14,719.2	15,004.7	14,492.4
Unallocated assets	3,574.3	2,601.2	3,415.5	2,161.2
Total assets	<u>18,980.8</u>	<u>17,320.4</u>	<u>18,420.2</u>	<u>16,653.6</u>

An analysis of the Group's loan assets by type and segment is shown in note 12.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****3. INTEREST RECEIVABLE**

Interest receivable is analysed as follows.

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m
<i>Interest receivable in respect of</i>			
Loans and receivables	395.9	294.0	642.9
Finance leases	35.1	27.5	59.6
Factoring income	2.8	1.7	4.3
	<hr/>	<hr/>	<hr/>
Interest on loans to customers	433.8	323.2	706.8
Effect of fair value hedging of loan assets	130.8	81.4	210.0
	<hr/>	<hr/>	<hr/>
Interest on loans to customers after hedging	564.6	404.6	916.8
On pension scheme surplus (note 25)	0.4	0.2	0.4
On investment securities	0.5	-	-
Other interest receivable	76.3	32.8	93.4
	<hr/>	<hr/>	<hr/>
Total interest on financial assets	<u>641.8</u>	<u>437.6</u>	<u>1,010.6</u>

The above interest arises from:

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m
Financial assets held at amortised cost	475.5	328.5	740.6
Finance leases	35.1	27.5	59.6
Pension scheme surplus	0.4	0.2	0.4
Derivative instruments held at fair value	130.8	81.4	210.0
	<hr/>	<hr/>	<hr/>
	<u>641.8</u>	<u>437.6</u>	<u>1,010.6</u>

Other interest receivable relates principally to cash deposits at central and retail banks.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****4. INTEREST PAYABLE AND SIMILAR CHARGES**

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m
<i>On financial liabilities</i>			
Retail deposits	299.8	127.5	334.1
Effect of fair value hedging of deposits	21.5	20.5	54.4
	<hr/>	<hr/>	<hr/>
Interest on retail deposits after hedging	321.3	148.0	388.5
Asset-backed loan notes	1.5	7.7	10.9
Bank loans and overdrafts	8.3	16.0	34.8
Corporate bonds	3.3	3.3	6.6
Effect of fair value hedging of bonds	1.0	-	0.6
Retail bonds	3.1	3.2	6.5
Central bank facilities	61.9	45.7	111.9
Sale and repurchase agreements	1.1	0.7	0.7
	<hr/>	<hr/>	<hr/>
Total interest on financial liabilities	401.5	224.6	560.5
Discounting on lease liabilities	0.1	0.1	0.3
Other finance costs	0.3	0.5	0.9
	<hr/>	<hr/>	<hr/>
	401.9	225.2	561.7

The above amounts relate to

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m
Financial liabilities held at amortised cost	379.0	204.1	505.5
Derivative financial instruments held at fair value	22.5	20.5	55.0
Other items	0.4	0.6	1.2
	<hr/>	<hr/>	<hr/>
	401.9	225.2	561.7

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****5. OTHER INCOME**

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m
Loan account fee income	2.7	2.8	4.8
Broker commissions	0.8	1.1	2.1
Third party servicing	0.4	1.2	4.3
Other income	0.1	-	0.3
	<u>4.0</u>	<u>5.1</u>	<u>11.5</u>

All loan account fee income arises from financial assets held at amortised cost.

6. LOAN IMPAIRMENT PROVISIONS CHARGED TO INCOME

The amounts charged to the profit and loss account in the period are analysed as follows:

	Mortgage Lending £m	Commercial Lending £m	Total £m
Six months ended 31 March 2024			
Provided in period (note 15)	9.0	2.1	11.1
Recovery of written off amounts	(0.3)	(0.5)	(0.8)
	<u>8.7</u>	<u>1.6</u>	<u>10.3</u>
Six months ended 31 March 2023			
Provided in period (note 15)	5.4	3.3	8.7
Recovery of written off amounts	-	(1.2)	(1.2)
	<u>5.4</u>	<u>2.1</u>	<u>7.5</u>
Year ended 30 September 2023			
Provided in period (note 15)	10.8	8.3	19.1
Recovery of written off amounts	(0.4)	(0.7)	(1.1)
	<u>10.4</u>	<u>7.6</u>	<u>18.0</u>

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****7. FAIR VALUE NET (LOSSES)**

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m
Ineffectiveness of fair value hedges			
Portfolio hedges of interest rate risk			
Deposit hedge	5.3	1.5	7.8
Loan hedge	0.9	(1.9)	(23.7)
	<u>6.2</u>	<u>(0.4)</u>	<u>(15.9)</u>
Individual hedges of interest rate risk	-	-	-
	6.2	(0.4)	(15.9)
Other hedging movements	(23.9)	(38.5)	(53.5)
Net (losses) on other derivatives	(18.0)	(43.6)	(8.3)
	<u>(35.7)</u>	<u>(82.5)</u>	<u>(77.7)</u>

The fair value net (loss) represents the accounting volatility on derivative instruments which are matching risk exposure on an economic basis generated by the requirements of IAS 39. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting has not been adopted or is not achievable on certain items. The losses and gains are primarily due to timing differences in income recognition between the derivative instruments and the economically hedged assets and liabilities. Such differences will reverse over time and have no impact on the cash flows of the Group.

The impact of hedging arrangements on the Group's balance sheet is summarised in note 18 and a full description of the Group's use of derivative financial instruments for hedging purposes is set out in note 26 to the financial statements for the year ended 30 September 2023.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****8. TAX CHARGE ON PROFIT ON ORDINARY ACTIVITIES**

The Group's income tax charge for the six months ended 31 March 2024 represents an effective rate of 25.9% (six months ended 31 March 2023: 18.3%; year ended 30 September 2023: 23.0%). This is based on the Group's best estimate of the annual effective rate of income tax expected for the full year ending 30 September 2024, derived from UK statutory rates, applied to the pre-tax income of the period.

The standard rate of corporation tax in the UK applicable to the Group in the period was 25% (six months ended 31 March 2023: 22.0%), based on currently enacted legislation. During the year ended 30 September 2021, the UK Government enacted legislation increasing the standard rate of corporation tax in the UK from 19.0% to 25.0% from April 2023. The effect of these changes on deferred tax balances was accounted for in the year ended 30 September 2021.

The Bank Corporation Tax Surcharge subjects any taxable profits arising in the Group's banking subsidiary, Paragon Bank PLC (and no other group entity) to an additional rate of tax applied to any amounts of taxable profit in excess of a threshold.

In the financial year ended 30 September 2022, the UK Government enacted legislation reducing the rate of the Banking Surcharge from 8.0% to 3.0%, also from April 2023, while increasing the profit threshold at which the surcharge applies to £100.0m from £25.0m. This has resulted in the surcharge applying to Paragon Bank in the current year reducing to 3.0% on earnings over £100.0m. The impact of this change on deferred tax balances was accounted for in the year ended 30 September 2023. The combination of the standard rate of tax and the surcharge results in taxable profits in excess of the annual threshold arising in Paragon Bank being taxed at 28.0% in the current period (2023: 27.5%).

9. EARNINGS PER SHARE

Earnings per ordinary share is calculated as follows:

	31 March 2024	31 March 2023	30 September 2023
Profit for the period (£m)	81.9	37.9	153.9
Basic weighted average number of ordinary shares ranking for dividend during the period (m)	213.2	231.7	224.1
Dilutive effect of the weighted average number of share options and incentive plans in issue during the period (m)	8.7	9.2	8.0
Diluted weighted average number of ordinary shares ranking for dividend during the period (m)	221.9	240.9	232.1
Earnings per ordinary share - basic	38.4p	16.4p	68.7p
- diluted	36.9p	15.7p	66.3p

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****10. CASH AND CASH EQUIVALENTS**

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m	30 September 2022 £m
Balances with central banks	2,739.5	2,087.1	2,783.3	1,612.5
Balances with other banks	299.5	188.3	211.0	318.4
	<u>3,039.0</u>	<u>2,275.4</u>	<u>2,994.3</u>	<u>1,930.9</u>

Not all the Group's cash is immediately available for its general purposes, including liquidity management. Cash received in respect of loan assets funded through warehouse facilities and securitisations is not immediately available, due to the terms of those arrangements. This cash is shown as 'securitisation cash' below.

Cash held by the Trustees of the Paragon Employee Share Ownership Plans may only be used to invest in the shares of the Company, pursuant to the aims of those plans. This is shown as 'ESOP cash' below.

The total 'Cash and Cash Equivalents' balance may be analysed as shown below.

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m	30 September 2022 £m
Available cash	2,922.7	2,165.8	2,907.7	1,689.1
Securitisation cash	116.2	109.2	86.1	240.5
ESOP cash	0.1	0.4	0.5	1.3
	<u>3,039.0</u>	<u>2,275.4</u>	<u>2,994.3</u>	<u>1,930.9</u>

Cash and cash equivalents are classified as Stage 1 exposures (see note 14) for the purposes of impairment provisioning. The probabilities of default have been assessed to be so low as to require no significant impairment provision.

11. INVESTMENT SECURITIES

Investment securities represent securities issued by the UK Government and held as part of the Group's liquidity buffer. The nominal value of the securities is £100.0m (30 September 2023 and 31 March 2023: £nil), and they bear fixed rate interest and have been assigned a credit rating of AA- by Fitch.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****12. LOANS TO CUSTOMERS**

The Group's loans to customers at 31 March 2024, analysed between the segments described in note 2 are as follows:

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m	30 September 2022 £m
First mortgages	12,960.2	12,415.8	12,747.8	12,122.4
Second charge mortgages	134.5	177.5	154.5	206.3
Total Mortgage Lending	13,094.7	12,593.3	12,902.3	12,328.7
Motor finance	311.6	286.3	297.7	261.3
Asset finance	626.4	575.6	609.6	563.9
Finance lease receivables	938.0	861.9	907.3	825.2
Development finance	849.9	765.8	747.8	719.9
Other secured commercial lending	272.2	231.1	227.6	238.1
Other commercial loans	94.2	102.8	89.3	98.4
Total Commercial Lending	2,154.3	1,961.6	1,972.0	1,881.6
Loans to customers	15,249.0	14,554.9	14,874.3	14,210.3
Fair value adjustments from hedge accounting (note 18)	(196.5)	(318.9)	(379.3)	(559.9)
	15,052.5	14,236.0	14,495.0	13,650.4

13. LOAN IMPAIRMENT - BASIS OF PROVISION*Provisioning approach*

IFRS 9 requires that impairment is evaluated on an expected credit loss ('ECL') basis. ECLs are based on an assessment of the probability of default ('PD') and loss given default ('LGD'), discounted to give a net present value. The estimation of ECL should be unbiased and probability weighted, considering all reasonable and supportable information, including forward looking economic assumptions and a range of possible outcomes. Provision may be based on either twelve-month or lifetime ECL, dependant on whether an account has experienced a significant increase in credit risk ('SICR').

The Group's approach to impairment provision on loans to customers, in accordance with IFRS 9, is set out in detail in note 21 to the 2023 annual accounts. This includes an outline of the calculations used and definitions of relevant terms, and the information in this half year report should be read in conjunction with it.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****13. LOAN IMPAIRMENT - BASIS OF PROVISION (CONTINUED)**

The methodologies used to derive the Group's ECL provisions at 31 March 2024 are analysed below.

	Gross £m	Impairment £m	Net £m
31 March 2024			
Modelled portfolios	14,059.5	(51.6)	14,007.9
Judgemental adjustments thereon	-	(6.5)	(6.5)
	<u>14,059.5</u>	<u>(58.1)</u>	<u>14,001.4</u>
Non-modelled portfolios	1,267.6	(20.0)	1,247.6
Total	<u>15,327.1</u>	<u>(78.1)</u>	<u>15,249.0</u>
31 March 2023			
Modelled portfolios	13,473.2	(44.7)	13,428.5
Judgemental adjustments thereon	-	(10.0)	(10.0)
	<u>13,473.2</u>	<u>(54.7)</u>	<u>13,418.5</u>
Non-modelled portfolios	1,149.9	(13.5)	1,136.4
Total	<u>14,623.1</u>	<u>(68.2)</u>	<u>14,554.9</u>
30 September 2023			
Modelled portfolios	13,825.4	(48.3)	13,777.1
Judgemental adjustments thereon	-	(6.5)	(6.5)
	<u>13,825.4</u>	<u>(54.8)</u>	<u>13,770.6</u>
Non-modelled portfolios	1,122.5	(18.8)	1,103.7
Total	<u>14,947.9</u>	<u>(73.6)</u>	<u>14,874.3</u>

There have been no significant changes in overall approach since the 2023 year end. At that time, as discussed in the 2023 annual accounts, it was necessary for the Group to make various judgemental adjustments to model-generated provisions to allow for factors related to the uncertain economic outlook for the UK at that time, which had not been reflected by the Group's models. While the position at 31 March 2024 is more stable, the continuing economic and political uncertainties in the UK, and the economic risks to the UK inherent in the wider geopolitical situation, mean that the Group has taken a broadly similar approach in determining provision at 31 March 2024 to that used at the year end.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS

For the six months ended 31 March 2024 (Unaudited)

13. LOAN IMPAIRMENT - BASIS OF PROVISION (CONTINUED)

Significant Increase in Credit Risk ('SICR')

Under IFRS 9, SICR is not defined solely by account performance, but on the basis of the customer's overall credit position, and this evaluation should include consideration of external data. The Group's aim is to define SICR to correspond, as closely as possible, to that population of accounts which are subject to enhanced administrative and monitoring procedures operationally. The Group assesses SICR in its modelled portfolios primarily on the basis of the relative difference in an account's lifetime PD between origination and the reporting date. The levels of difference required to qualify as an SICR may differ between portfolios and will depend, to some extent, on the level of risk originally perceived and are monitored on an ongoing basis to ensure that this calibrates with actual experience.

It should be noted that the use of the current PD, which includes external factors such as credit bureau data, means that all relevant information in the Group's hands concerning the customers' present credit position is included in the evaluation, as well as the impact of future economic expectations.

For non-modelled portfolios, the SICR assessment is based on the credit monitoring position of the account in question and for all portfolios a number of qualitative indicators which might provide evidence of SICR have been considered

As part of its determination of whether model outputs form a reliable basis for impairment provisioning, the Group considered if it had any evidence of groups of accounts which demonstrated factors indicating that they had a higher level of credit risk than other accounts in the same portfolios. No such evidence was noted at 31 March 2024, 31 March 2023 or 30 September 2023, and hence no additional accounts were identified as having an SICR.

Judgemental Adjustments

To ensure that the Group's loan portfolios are properly provisioned, the Group considers factors might impact on customers, but which may either not be reflected in its provision models, be only partially reflected or not be reflected sufficiently quickly. These may include consideration of the likely impact of the broad economic environment, customer and market sentiment and expert knowledge within the Group's businesses.

In the six months ended 31 March 2024 the most significant factors in this exercise were the uncertainties inherent in the current economic and geopolitical outlook and the extent to which these were being fully addressed by the Group's provision modelling.

While the economic position in the UK was rather more settled at the balance sheet date than at 30 September 2023, the impacts of inflation, which remains higher than it has been for some years, and increased interest rates on the cost of living and doing business in the UK still present significant issues to customers, and may not have been fully reflected in performance metrics as yet. The geopolitical effects of conflicts, including those in Eastern Europe and the Middle East, continue to have the potential to impact on the UK, while the elections being held in 2024 in both the UK and USA have the potential to impact economic policy.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****13. LOAN IMPAIRMENT - BASIS OF PROVISION (CONTINUED)**

The divergence of the current economic environment from those experienced over much of recent history inevitably weakens the ability of any experience-based model to predict credit performance accurately, and means that management have to consider carefully the requirement for the mechanically generated provision to be adjusted.

Where management has identified a requirement to amend the calculated provision as a result of either model deficiencies or idiosyncratic behaviour in part of the portfolio, judgemental adjustments are applied to the modelled outputs so that the ECL recognised corresponds to expert judgement, taking into account the widest possible range of current information, which might not be factored into the modelling process.

The Group's approach to impairment modelling is based on the analysis of historical credit data. In normal circumstances the Group's objective is to develop its models to the point where the level of judgemental adjustments required is minimal, but in economic conditions where previous relevant experience is limited or non-existent, some form of judgemental adjustment is always likely to be necessary. While scenarios including high interest rates, cost-of-living issues and fluctuating inflation have occurred in the UK in the past, market conditions, products and regulatory expectations have moved on considerably in the meantime, and most such observations would pre-date the existence of buy-to-let mortgages as a distinct asset class. This means that the value of past history as a guide to future credit performance is reduced.

The current model behaviour and the potential for unobserved credit issues have meant that the requirement for such adjustments over recent periods has been significant. Evidence considered by management in order to assess the size of adjustments required included internal performance data, customer and broker feedback, insight surveys, industry intelligence, evidence on the wider economy and quantitative and qualitative data and statements from industry, government and regulatory bodies. These were combined with the expert knowledge within the business to form a broad estimate of the level of provision required across the Group.

As part of this exercise, the potential for climate related issues to impact on customer business models or security values over the timescales for ECL calculation required by IFRS 9 was considered. No specific requirement for additional impairment provisions over the amounts already determined was identified.

The requirement for judgemental adjustments is considered on a portfolio-by-portfolio basis, and the potential for the existence of significant groups of assets within those portfolios being particularly exposed to credit risk in the expected economic scenarios is also considered.

The total amounts of judgemental adjustments provided across the Group are set out below by segment.

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m
Mortgage Lending	3.0	4.0	3.0
Commercial Lending	3.5	6.0	3.5
	6.5	10.0	6.5

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For the six months ended 31 March 2024 (Unaudited)

13. LOAN IMPAIRMENT - BASIS OF PROVISION (CONTINUED)

The position at 31 March 2024 is unchanged from that at 30 September 2023, representing the extent to which the concerns over future customer performance and the potential for future economic headwinds which gave rise to the original adjustments remain in place. While some adverse trends in performance have been noted in the portfolios, these have been offset, to some extent, by the impact of forecast downward trends in future inflation and interest rates in the scenarios underlying the impairment models.

The movements seen in the 2023 financial year mostly arose from the extent to which anticipated customer behaviour became observable in the period, couple with the impacts of a more stable, but still adverse, economic environment and the introduction of an updated SME lending impairment mode, reducing the need for judgemental overlays in that book.

The adjustment in the Mortgage Lending book at 30 September 2023 represented the level to which the credit metrics and other model inputs did not produce a result for the buy-to-let portfolio which accorded with the credit expectations of management, brokers and customers. While there has been some upward movement in arrears metrics, both for the Group and the buy-to-let market more generally, future expectations remain broadly in line with those six months earlier. In response to these factors, management decided that it was appropriate to maintain the level of overlay at 31 March 2024.

The Group's SME lending portfolio performed generally strongly in the period, with a consequent impact on the calculated provision. However, the level of pessimism in the broader outlook for UK SMEs in the current economic climate has not significantly reduced, and there remain concerns as to the effectiveness of the Group's provisioning model in a high interest rate environment. On this basis the judgemental adjustment from 30 September 2023 has been retained.

For the motor finance portfolio, the £1.0m overlay to the modelled provision, first included at 30 September 2023, has been maintained (31 March 2023: £nil; 30 September 2023: £1.0m). This is intended allow for difficulties noted in that model with responding to a period of falling inflation rapidly following a period of sharp price rises. As at the previous year end, the 31 March 2024 economic scenarios depressed the calculated provision below a level management considered reasonable, given other portfolio data, justifying the additional provision. The Group is currently working on the development of an updated motor finance provision model, which may reduce some of these impacts in future.

The Group's analysis found no evidence of particular concentrations of credit risk below portfolio level. Given this, and the high-level nature of the exercise undertaken, the judgemental adjustments have been apportioned across the respective portfolios to individual performing cases. As such they are included in the credit risk disclosures required by IFRS 7.

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SELECTED NOTES TO THE ACCOUNTS – ANALYSIS

For the six months ended 31 March 2024 (Unaudited)

13. LOAN IMPAIRMENT - BASIS OF PROVISION (CONTINUED)

The Group will continue to monitor the requirement for these adjustments as the economic situation develops and its impacts are further reflected in model outputs. It will also consider the extent to which future model enhancements will reduce the need for overlays. It is anticipated that a more normal economic situation would require a lower value of adjustments, but the timescale in which such a scenario might be reached appears uncertain, given present levels of economic and political uncertainty.

The Group has adopted the terminology for impairment adjustments proposed by the Taskforce on Disclosures about Expected Credit Loss ('DECL') which restricts the use of the term 'Post Model Adjustment' ('PMA') to those adjustments calculated on an account-by-account basis and therefore no longer uses that term for other judgemental adjustments.

14. LOAN IMPAIRMENTS BY STAGE AND DIVISION

IFRS 9 calculations and related disclosures require loan assets to be divided into three stages, with accounts which were credit impaired on initial recognition representing a fourth class.

The three classes comprise: those where there has been no SICR since advance or acquisition (Stage 1); those where there has been an SICR (Stage 2); and loans which are impaired (Stage 3).

- On initial recognition, and for assets where there has not been an SICR, provisions will be made in respect of losses resulting from the level of credit default events expected in the twelve months following the balance sheet date
- Where a loan has experienced an SICR, whether or not the loan is considered to be credit impaired, provisions are made based on the ECLs over the full life of the loan
- For credit impaired assets, provisions are made on the basis of lifetime ECLs

For assets which are 'Purchased or Originated as Credit Impaired' ('POCI') accounts (those considered as credit impaired at the point of first recognition), such as certain of the Group's acquired assets in the Mortgage Lending segment, the carrying valuation is based on expected cash flows discounted by the EIR determined at the point of acquisition.

The recommendations of the taskforce on Disclosures about Expected Credit Loss ('DECL') suggest standard categories for analysis of firms' loan books. In the context of the DECL categorisation the Group's Mortgage Lending balances are classified as 'UK retail mortgage' business while its Commercial Lending balances, being advanced primarily to SME entities correspond with the 'UK other retail' business classification.

The Group defines coverage as the value of the ECL provision divided by the gross carrying value of the related loans.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****14. LOAN IMPAIRMENTS BY STAGE AND DIVISION (Continued)**

An analysis of the Group's loan portfolios between the stages defined above is set out below.

	Stage 1 £m	Stage 2 * £m	Stage 3 * £m	POCI £m	Total £m
31 March 2024					
Gross loan book					
Mortgage Lending	12,126.6	797.5	204.8	11.9	13,140.8
Commercial Lending	1,938.2	175.9	65.9	6.3	2,186.3
Total	14,064.8	973.4	270.7	18.2	15,327.1
Impairment provision					
Mortgage Lending	(5.2)	(3.6)	(37.3)	-	(46.1)
Commercial Lending	(14.1)	(4.0)	(9.3)	(4.6)	(32.0)
Total	(19.3)	(7.6)	(46.6)	(4.6)	(78.1)
Net loan book					
Mortgage Lending	12,121.4	793.9	167.5	11.9	13,094.7
Commercial Lending	1,924.1	171.9	56.6	1.7	2,154.3
Total	14,045.5	965.8	224.1	13.6	15,249.0
Coverage ratio					
Mortgage Lending	0.04%	0.45%	18.21%	-	0.35%
Commercial Lending	0.73%	2.27%	14.11%	73.02%	1.46%
Total	0.14%	0.78%	17.21%	25.27%	0.51%

* Stage 2 and 3 balances are analysed in more detail below.

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SELECTED NOTES TO THE ACCOUNTS – ANALYSIS

For the six months ended 31 March 2024 (Unaudited)

14. LOAN IMPAIRMENTS BY STAGE AND DIVISION (Continued)

	Stage 1 £m	Stage 2 * £m	Stage 3 * £m	POCI £m	Total £m
31 March 2023					
Gross loan book					
Mortgage Lending	11,779.6	701.8	134.5	18.6	12,634.5
Commercial Lending	1,828.7	130.1	23.0	6.8	1,988.6
Total	13,608.3	831.9	157.5	25.4	14,623.1
Impairment provision					
Mortgage Lending	(5.9)	(4.4)	(30.9)	-	(41.2)
Commercial Lending	(15.7)	(2.6)	(3.9)	(4.8)	(27.0)
Total	(21.6)	(7.0)	(34.8)	(4.8)	(68.2)
Net loan book					
Mortgage Lending	11,773.7	697.4	103.6	18.6	12,593.3
Commercial Lending	1,813.0	127.5	19.1	2.0	1,961.6
Total	13,586.7	824.9	122.7	20.6	14,554.9
Coverage ratio					
Mortgage Lending	0.05%	0.63%	22.97%	-	0.33%
Commercial Lending	0.86%	2.00%	16.96%	70.59%	1.36%
Total	0.16%	0.84%	22.10%	18.90%	0.47%

* Stage 2 and 3 balances are analysed in more detail below.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS

For the six months ended 31 March 2024 (Unaudited)

14. LOAN IMPAIRMENTS BY STAGE AND DIVISION (Continued)

	Stage 1 £m	Stage 2 * £m	Stage 3 * £m	POCI £m	Total £m
30 September 2023					
Gross loan book					
Mortgage Lending	12,159.7	625.0	142.2	17.7	12,944.6
Commercial Lending	1,812.6	119.8	63.8	7.1	2,003.3
Total	13,972.3	744.8	206.0	24.8	14,947.9
Impairment provision					
Mortgage Lending	(4.8)	(6.1)	(31.4)	-	(42.3)
Commercial Lending	(14.8)	(3.3)	(8.4)	(4.8)	(31.3)
Total	(19.6)	(9.4)	(39.8)	(4.8)	(73.6)
Net loan book					
Mortgage Lending	12,154.9	618.9	110.8	17.7	12,902.3
Commercial Lending	1,797.8	116.5	55.4	2.3	1,972.0
Total	13,952.7	735.4	166.2	20.0	14,874.3
Coverage ratio					
Mortgage Lending	0.04%	0.98%	22.08%	-	0.33%
Commercial Lending	0.82%	2.75%	13.17%	67.61%	1.56%
Total	0.14%	1.26%	19.32%	19.35%	0.49%

* Stage 2 and 3 balances are analysed in more detail below.

In terms of the Group's credit management processes, Stage 1 cases will fall within the appropriate customer servicing functions and Stage 2 cases will be subject to account management arrangements. Stage 3 cases will include both those subject to recovery or similar processes and those which, though being managed on a long-term basis, are included with defaulted accounts for regulatory purposes. However, these broad categorisations may vary between different product types.

POCI balances included in the Commercial Lending segment arise from acquired businesses, where those assets were identified as credit impaired at the point of acquisition when the acquired portfolios as a whole were evaluated. Additional provision arising on these assets post-acquisition is shown as 'Impairment provision' above.

The Group's acquired secured consumer loans are included in the Mortgage Lending segment together with its closed second charge mortgage portfolio. Acquired loans which were performing on acquisition are included in the staging analysis above. These balances reduce as the customers make repayments.

Acquired portfolios of second charge mortgage assets, which were largely non-performing at acquisition and which were purchased at a deep discount to face value, are shown as POCI assets above. Although no provision is shown above for such assets, the effect of the discount on purchase is included in the gross value, ensuring that the carrying value is substantially less than the total of the current balances due from customers and that the level of cover is considerable.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS

For the six months ended 31 March 2024 (Unaudited)

14. LOAN IMPAIRMENTS BY STAGE AND DIVISION (Continued)

Analysis of Stage 2 loans

The tables below analyse the accounts in Stage 2 between those not more than one month in arrears where an SICR has nonetheless been identified from other information, and accounts more than one month in arrears.

Cases which have been greater than one month in arrears in the last three months, but which are not at the balance sheet date are shown as ‘recent arrears’ in the tables below.

In all cases accounts which are more than one month in arrears, where this is a meaningful measure, are considered to have an SICR. However, in certain loan portfolios, regular monthly payments of pre-set amounts are not required and hence this criterion cannot be used.

The Group uses arrears multiples as a proxy for days past due, as this measure is commonly used in its arrears reporting. A loan will generally be one month in arrears from the point at which a payment is one day past due until it is thirty days past due.

The Stage 2 balance across the portfolio, representing cases where the risk of loss has increased significantly since advance, has increased markedly across the portfolio in the period, as customer resilience was impacted by higher costs of living and doing business over time. However, the level of provision coverage for Stage 2 accounts has reduced, compared to that at 30 September 2023, reflecting the value of security available on the assets entering the Stage.

The value of Stage 2 accounts in the Mortgage Lending segment has continued to increase in the six months, as the current economic conditions impact on customers. However, the majority of this increase is due to accounts which were not more the one month in arrears at the period end, but identified as having an SICR as a result of recent performance or credit scoring through the PD model. While arrears performance has generally worsened over the period, the value of accounts identified as Stage 2 as a result of having arrears at the balance sheet date has actually reduced, indicating that, while some cases have flowed through to Stage 3, the Group’s focus on careful management of higher risk accounts is currently stabilising the position.

The absolute value of Stage 2 provision and Stage 2 coverage levels in the Mortgage Lending segment have reduced, although this is principally a result of lower coverage on arrears cases, with coverage on cases identified by the PD model broadly similar to that at 30 September 2023. The reduction in cover on arrears accounts is a result of a change in the make-up of that balance, with some substantial balances with high provision having moved to Stage 3 in the period.

In the Commercial Lending division, the Stage 2 balance has also increased significantly, although accounts which are not demonstrating arrears in excess of one month continue to form the great majority of cases in this category. The majority of the increase relates to development finance cases, where additional scrutiny of more cases has been required in what has been a difficult period for the construction industry. However, these cases enjoy secure security over real estate assets, meaning that the overall level of impairment provision required is lower than for other commercial lending accounts. This has resulted in a small decrease in the Stage 2 impairment coverage, compared to 30 September 2023, although the absolute level of provision is greater.

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For the six months ended 31 March 2024 (Unaudited)

14. LOAN IMPAIRMENTS BY STAGE AND DIVISION (CONTINUED)

	< 1 month arrears	Recent arrears	> 1 <= 3 months arrears	Total
	£m	£m	£m	£m
31 March 2024				
Gross loan book				
Mortgage Lending	729.8	16.4	51.3	797.5
Commercial Lending	170.3	1.6	4.0	175.9
Total	900.1	18.0	55.3	973.4
Impairment provision				
Mortgage Lending	(2.9)	(0.1)	(0.6)	(3.6)
Commercial Lending	(3.4)	(0.1)	(0.5)	(4.0)
Total	(6.3)	(0.2)	(1.1)	(7.6)
Net loan book				
Mortgage Lending	726.9	16.3	50.7	793.9
Commercial Lending	166.9	1.5	3.5	171.9
Total	893.8	17.8	54.2	965.8
Coverage ratio				
Mortgage Lending	0.40%	0.61%	1.17%	0.45%
Commercial Lending	2.00%	6.25%	12.50%	2.27%
Total	0.70%	1.11%	1.99%	0.78%

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SELECTED NOTES TO THE ACCOUNTS – ANALYSIS

For the six months ended 31 March 2024 (Unaudited)

14. LOAN IMPAIRMENTS BY STAGE AND DIVISION (Continued)

	< 1 month arrears	Recent arrears	> 1 <= 3 months arrears	Total
	£m	£m	£m	£m
31 March 2023				
Gross loan book				
Mortgage Lending	631.5	13.5	56.8	701.8
Commercial Lending	126.3	1.4	2.4	130.1
Total	757.8	14.9	59.2	831.9
Impairment provision				
Mortgage Lending	(3.2)	-	(1.2)	(4.4)
Commercial Lending	(2.2)	(0.1)	(0.3)	(2.6)
Total	(5.4)	(0.1)	(1.5)	(7.0)
Net loan book				
Mortgage Lending	628.3	13.5	55.6	697.4
Commercial Lending	124.1	1.3	2.1	127.5
Total	752.4	14.8	57.7	824.9
Coverage ratio				
Mortgage Lending	0.51%	-	2.11%	0.63%
Commercial Lending	1.74%	7.14%	12.50%	2.00%
Total	0.71%	0.67%	2.53%	0.84%

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SELECTED NOTES TO THE ACCOUNTS – ANALYSIS

For the six months ended 31 March 2024 (Unaudited)

14. LOAN IMPAIRMENTS BY STAGE AND DIVISION (Continued)

	< 1 month arrears	Recent arrears	> 1 <= 3 months arrears	Total
	£m	£m	£m	£m
30 September 2023				
Gross loan book				
Mortgage Lending	518.1	15.8	91.1	625.0
Commercial Lending	116.3	0.4	3.1	119.8
Total	634.4	16.2	94.2	744.8
Impairment provision				
Mortgage Lending	(2.3)	(0.1)	(3.7)	(6.1)
Commercial Lending	(2.9)	-	(0.4)	(3.3)
Total	(5.2)	(0.1)	(4.1)	(9.4)
Net loan book				
Mortgage Lending	515.8	15.7	87.4	618.9
Commercial Lending	113.4	0.4	2.7	116.5
Total	629.2	16.1	90.1	735.4
Coverage ratio				
Mortgage Lending	0.44%	0.63%	4.06%	0.98%
Commercial Lending	2.49%	-	12.90%	2.75%
Total	0.82%	0.62%	4.35%	1.26%

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SELECTED NOTES TO THE ACCOUNTS – ANALYSIS

For the six months ended 31 March 2024 (Unaudited)

14. LOAN IMPAIRMENTS BY STAGE AND DIVISION (Continued)

Analysis of Stage 3 loans

The tables below analyse the accounts in Stage 3 between those:

- In the process of sale or other enforcement procedures ('Realisations')
- Where a receiver of rent ('RoR') has been appointed by the Group to manage the property on the customers' behalf
- Which are being managed on a long-term basis and where full recovery is possible, but which are considered to meet regulatory default criteria at the balance sheet date ('>3 month arrears')
- which no longer meet regulatory default criteria, but which are being retained in Stage 3 for a probationary period ('Probation')

Where an account meets two of the criteria, it will be assigned to the category shown first in the list above.

RoR accounts in Stage 3 may be fully up-to-date with full recovery possible. These accounts are included in Stage 3 as they are classified as defaulted for regulatory purposes.

The value of Stage 3 cases has increased in the six months ended 31 March 2024, with the level of provision also increasing. The growth is concentrated in the Mortgage Lending segment, although the value of such cases remains a very small part of the overall balance.

The increase in the Mortgage Lending segment is concentrated in the receiver of rent category. While the values of such balances have been generally decreasing over recent years, the current level of economic pressures on a few landlords has seen the Group appoint a receiver as the best way of ensuring the best possible outcome for itself, the customer and their tenants. While such cases are classified as Stage 3 for IFRS 9 purposes, the rental flows may be such that no loss will be made.

The Stage 3 position for Mortgage Lending also shows an increased level of volatility in performance, also observed operationally by the Group, with a similar level of cases moving towards possession as that seen at 30 September 2023, but also a substantially increased number of cases which had been in arrears moving back to a performing status.

Coverage levels in the Mortgage Lending segment for Stage 3 cases are a little reduced, but this is largely an impact of the individual accounts in the receiver of rent and possessions categories, where the provision amount will generally be based on a recent valuation of the security property, carried out as part of the receivership or enforcement process.

The level of Stage 3 cases in the Commercial Lending division is broadly similar to that observed at 30 September 2023. The majority of these cases relate to the development finance division and enjoy the benefit of substantial security over the development properties. The value of Stage 3 impairments and coverage levels also remained broadly similar to those provided at the previous year end.

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For the six months ended 31 March 2024 (Unaudited)

14. LOANS IMPAIRMENTS BY STAGE AND DIVISION (Continued)

	Probation £m	> 3 month arrears £m	RoR managed £m	Realisations £m	Total £m
31 March 2024					
Gross loan book					
Mortgage Lending	20.6	49.0	80.0	55.2	204.8
Commercial Lending	0.7	58.7	-	6.5	65.9
Total	21.3	107.7	80.0	61.7	270.7
Impairment provision					
Mortgage Lending	-	(2.2)	(20.5)	(14.6)	(37.3)
Commercial Lending	(0.3)	(6.0)	-	(3.0)	(9.3)
Total	(0.3)	(8.2)	(20.5)	(17.6)	(46.6)
Net loan book					
Mortgage Lending	20.6	46.8	59.5	40.6	167.5
Commercial Lending	0.4	52.7	-	3.5	56.6
Total	21.0	99.5	59.5	44.1	224.1
Coverage ratio					
Mortgage Lending	-	4.49%	25.63%	26.45%	18.21%
Commercial Lending	42.86%	10.22%	-	46.15%	14.11%
Total	1.41%	7.61%	25.63%	28.53%	17.21%

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For the six months ended 31 March 2024 (Unaudited)

14. LOANS IMPAIRMENTS BY STAGE AND DIVISION (Continued)

	Probation £m	> 3 month arrears £m	RoR managed £m	Realisations £m	Total £m
31 March 2023					
Gross loan book					
Mortgage Lending	9.8	45.7	49.1	29.9	134.5
Commercial Lending	0.3	17.8	-	4.9	23.0
Total	10.1	63.5	49.1	34.8	157.5
Impairment provision					
Mortgage Lending	(0.5)	(1.8)	(19.6)	(9.0)	(30.9)
Commercial Lending	-	(1.6)	-	(2.3)	(3.9)
Total	(0.5)	(3.4)	(19.6)	(11.3)	(34.8)
Net loan book					
Mortgage Lending	9.3	43.9	29.5	20.9	103.6
Commercial Lending	0.3	16.2	-	2.6	19.1
Total	9.6	60.1	29.5	23.5	122.7
Coverage ratio					
Mortgage Lending	5.10%	3.94%	39.92%	30.10%	22.97%
Commercial Lending	-	8.99%	-	46.94%	16.96%
Total	4.95%	5.35%	39.92%	32.47%	22.10%

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS

For the six months ended 31 March 2024 (Unaudited)

14. LOANS IMPAIRMENTS BY STAGE AND DIVISION (Continued)

	Probation £m	> 3 month arrears £m	RoR managed £m	Realisations £m	Total £m
30 September 2023					
Gross loan book					
Mortgage Lending	8.8	40.4	50.3	42.7	142.2
Commercial Lending	1.1	57.8	-	4.9	63.8
Total	9.9	98.2	50.3	47.6	206.0
Impairment provision					
Mortgage Lending	-	(1.2)	(16.6)	(13.6)	(31.4)
Commercial Lending	(0.3)	(5.5)	-	(2.6)	(8.4)
Total	(0.3)	(6.7)	(16.6)	(16.2)	(39.8)
Net loan book					
Mortgage Lending	8.8	39.2	33.7	29.1	110.8
Commercial Lending	0.8	52.3	-	2.3	55.4
Total	9.6	91.5	33.7	31.4	166.2
Coverage ratio					
Mortgage Lending	-	2.97%	33.00%	31.85%	22.08%
Commercial Lending	27.27%	9.52%	-	53.06%	13.17%
Total	3.03%	6.82%	33.00%	34.03%	19.32%

The security values available to reduce exposure at default in the calculation shown above for Stage 3 accounts are set out below. The estimated value of the security represents, for each account, the lesser of the valuation estimate and the exposure at default in the central scenario. Security values are based on the most recent valuation of the relevant asset held by the Group, indexed or depreciated as appropriate.

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m
First mortgages	141.5	80.5	89.5
Second mortgages	9.4	11.1	10.2
Asset finance	1.1	2.1	1.6
Motor finance	2.9	1.0	1.2
	154.9	94.7	102.5

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For the six months ended 31 March 2024 (Unaudited)

14. LOANS IMPAIRMENTS BY STAGE AND DIVISION (Continued)

The RoR managed accounts are being managed to ensure the optimal resolution for landlords, tenants and lenders and have largely reached a long-term, stable position, but the existence of the RoR arrangement causes the accounts to be treated as defaulted for regulatory purposes. The Group's RoR arrangements are described in more detail below.

Mortgage Lending balances with over three months arrears include second charge mortgage accounts originated over ten years ago which have been over three months in arrears for some time. These accounts are generally making regular payments and have significant levels of equity in the underlying property which reduces the required provision to the value shown above. It is expected that a high proportion of these accounts will eventually redeem naturally, either on the sale of the property or by the satisfaction of the amount due through instalment payments.

Buy-to-let receiver of rent cases (Stage 3)

Where a buy-to-let mortgage customer in England or Wales falls into arrears on their account the Group has the power to appoint a receiver of rent under the Law of Property Act. The receiver will then manage the property on behalf of the customer, collecting rents and remitting them to make payments on the account. While the receiver has the power to sell the property, in many cases they will operate it as a buy-to-let on at least a short to medium term basis, potentially longer, depending on the individual circumstances of the case. This causes less disruption to the tenants and may result in the mortgage account returning to performing status and the property being handed back to the customer.

While legacy cases continued to be resolved in the period, economic pressures in the period have led to an increasing number of new receiver of rent appointments in the period, including some larger portfolio cases. These overwhelmingly relate to legacy cases advanced before 2009 and will therefore have a long rental history, with tenants in place in many cases.

The following table analyses the number and gross carrying value of RoR managed accounts shown above by the date of the receivers' appointment, illustrating this position.

	31 March 2024		31 March 2023		30 September 2023	
	Number	£m	Number	£m	Number	£m
Managed accounts						
<i>Appointment date</i>						
2010 and earlier	110	16.9	177	27.5	135	20.1
2011 to 2015	25	3.6	41	5.7	31	4.5
2014 to 2020	11	1.5	22	3.0	15	2.0
2021 and later	338	58.0	89	12.9	154	23.7
Total managed accounts	484	80.0	329	49.1	335	50.3
Accounts in the process of realisation	254	41.9	162	28.6	225	41.0
	738	121.9	491	77.7	560	91.3

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SELECTED NOTES TO THE ACCOUNTS – ANALYSIS

For the six months ended 31 March 2024 (Unaudited)

14. LOANS IMPAIRMENTS BY STAGE AND DIVISION (Continued)

Receiver of rent accounts in the process of realisation at the period end are included under that heading in the Stage 3 tables above. In addition to the cases analysed above there were 3 other receiver of rent cases in acquired mortgage books classified as POCI (31 March 2023: nil; 30 September 2023: 4), meaning that the Group's total receiver of rent cases at 31 March 2024 were 741 (31 March 2023: 491; 30 September 2023: 564).

15. LOAN IMPAIRMENTS - PROVISION MOVEMENTS IN THE PERIOD

The movements in the impairment provision calculated under IFRS 9, analysed by business segments, are set out below.

	Mortgage Lending £m	Commercial Lending £m	Total £m
At 30 September 2023	42.3	31.3	73.6
Provided in period (note 6)	9.0	2.1	11.1
Amounts written off	(5.2)	(1.4)	(6.6)
At 31 March 2024 (note 14)	46.1	32.0	78.1
At 30 September 2022	38.0	25.5	63.5
Provided in period (note 6)	5.4	3.3	8.7
Amounts written off	(2.2)	(1.8)	(4.0)
At 31 March 2023 (note 14)	41.2	27.0	68.2
At 30 September 2022	38.0	25.5	63.5
Provided in period (note 6)	10.8	8.3	19.1
Amounts written off	(6.5)	(2.5)	(9.0)
At 30 September 2023 (note 14)	42.3	31.3	73.6

Accounts are considered to be written off for accounting purposes if a balance remains once standard enforcement processes have been completed, subject to any amount retained in respect of expected salvage receipts. This has no effect on the net carrying value, only on the amounts reported as gross loan balances and accumulated impairment provisions.

More detailed analyses of these movements by IFRS 9 stage on a consolidated basis for the six months ended 31 March 2024, the six months ended 31 March 2023, and the year ended 30 September 2023 are set out below.

These tables, and the matching tables analysing movements in gross balances, have been compiled by comparing opening and closing balances on each account and analysing the movements between them.

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Changes due to credit risk includes all changes in model parameters whether related to account performance, external credit data or model assumptions, including economic scenarios and weightings.

There have been no changes in models creating significant movements in balances in the period.

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Loss allowance at					
30 September 2023	19.6	9.4	39.8	4.8	73.6
New assets originated or purchased	4.5	-	-	-	4.5
Changes in loss allowance					
Transfer to Stage 1	1.1	(0.9)	(0.2)	-	-
Transfer to Stage 2	(1.1)	1.8	(0.7)	-	-
Transfer to Stage 3	(0.1)	(3.9)	4.0	-	-
Changes on stage transfer	(0.9)	1.6	10.6	-	11.3
Changes due to credit risk	(3.8)	(0.4)	(0.3)	(0.2)	(4.7)
Write offs	-	-	(6.6)	-	(6.6)
Loss allowance at 31 March 2024	19.3	7.6	46.6	4.6	78.1
	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Loss allowance at					
30 September 2022	25.5	8.0	28.5	1.5	63.5
New assets originated or purchased	4.1	-	-	-	4.1
Changes in loss allowance					
Transfer to Stage 1	2.7	(2.6)	(0.1)	-	-
Transfer to Stage 2	(1.1)	1.7	(0.6)	-	-
Transfer to Stage 3	(0.1)	(1.2)	1.3	-	-
Changes on stage transfer	(2.3)	1.3	7.3	-	6.3
Changes due to credit risk	(7.2)	(0.2)	2.4	3.3	(1.7)
Write offs	-	-	(4.0)	-	(4.0)
Loss allowance at 31 March 2023	21.6	7.0	34.8	4.8	68.2

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15. LOAN IMPAIRMENTS - PROVISION MOVEMENTS IN THE PERIOD (CONTINUED)

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Loss allowance at 30 September 2022	25.5	8.0	28.5	1.5	63.5
New assets originated or purchased	9.5	-	-	-	9.5
Changes in loss allowance					
Transfer to Stage 1	2.8	(2.7)	(0.1)	-	-
Transfer to Stage 2	(1.7)	2.0	(0.3)	-	-
Transfer to Stage 3	(0.2)	(1.9)	2.1	-	-
Changes on stage transfer	(2.5)	2.3	14.6	-	14.4
Changes due to credit risk	(13.8)	1.7	4.0	3.3	(4.8)
Write offs	-	-	(9.0)	-	(9.0)
Loss allowance at 30 September 2023	19.6	9.4	39.8	4.8	73.6

During the six months ended 31 March 2024 provision levels increased marginally, with the general stability a reflection of the largely unchanged level of economic confidence in the UK and the non-emergence of significant arrears issues across the portfolios.

The increase in provision was largely concentrated in Stage 3, where the appointment of receivers of rent to a small number of larger legacy buy-to-let portfolios generated a move to stage 3 for all the cases involved and, in some cases, additional provision once detailed valuations of the properties had been undertaken.

While the value of Stage 2 cases increased, the provision reduced, largely as a result of heavily provided cases moving to Stage 3 and newly recognised cases having higher levels of security, which reduces the provision required. The level of provision on Stage 1 cases was broadly similar to that six months earlier.

During the year ended 30 September 2023 the impairment allowance increased, driven mostly by the increase in Stage 3 and POCI cases, a result of the level of actual defaults in the period, particularly in the development finance business, and by reduced levels of available security through declining house prices in the mortgage segment.

The net reduction in Stage 1 provisions in that year included the effect of changes in judgemental adjustments in the period, with items formerly addressed by these provisions beginning to move through Stage 2 and Stage 3. These movements were driven by both account performance, and by the impact of more severe actual and forecast economic conditions.

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15. LOAN IMPAIRMENTS-PROVISION MOVEMENTS IN THE PERIOD (Continued)

The movements in the Loans to Customers balances in respect of which these loss allowances have been made are set out below.

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Balance at 30 September 2023	13,972.3	744.8	206.0	24.8	14,947.9
New assets originated or purchased	1,868.7	-	-	-	1,868.7
Changes in staging					
Transfer to Stage 1	140.9	(139.2)	(1.7)	-	-
Transfer to Stage 2	(498.3)	516.5	(18.2)	-	-
Transfer to Stage 3	(21.5)	(102.4)	123.9	-	-
Redemptions and repayments	(1,774.5)	(75.0)	(40.5)	(6.5)	(1,896.5)
Write offs	-	-	(6.6)	-	(6.6)
Other changes	377.2	28.7	7.8	(0.1)	413.6
Balance at 31 March 2024	14,064.8	973.4	270.7	18.2	15,327.1
Loss allowance	(19.3)	(7.6)	(46.6)	(4.6)	(78.1)
Carrying value	14,045.5	965.8	224.1	13.6	15,249.0
	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Balance at 30 September 2022	12,157.0	1,963.6	124.4	28.8	14,273.8
New assets originated or purchased	1,593.2	-	-	-	1,593.2
Changes in staging					
Transfer to Stage 1	1,213.4	(1,211.6)	(1.8)	-	-
Transfer to Stage 2	(265.8)	271.9	(6.1)	-	-
Transfer to Stage 3	(12.8)	(50.5)	63.3	-	-
Redemptions and repayments	(1,424.9)	(150.2)	(22.2)	(6.2)	(1,603.5)
Write offs	-	-	(4.0)	-	(4.0)
Other changes	348.2	8.7	3.9	2.8	363.6
Balance at 31 March 2023	13,608.3	831.9	157.5	25.4	14,623.1
Loss allowance	(21.6)	(7.0)	(34.8)	(4.8)	(68.2)
Carrying value	13,586.7	824.9	122.7	20.6	14,554.9

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	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Balance at 30 September 2022	12,157.0	1,963.6	124.4	28.8	14,273.8
New assets originated or purchased	3,128.4	-	-	-	3,128.4
Changes in staging					
Transfer to Stage 1	1,258.9	(1,255.7)	(3.2)	-	-
Transfer to Stage 2	(365.6)	372.9	(7.3)	-	-
Transfer to Stage 3	(28.9)	(104.7)	133.6	-	-
Redemptions and repayments	(2,773.3)	(250.6)	(44.8)	(10.5)	(3,079.2)
Write offs	-	-	(9.0)	-	(9.0)
Other changes	595.8	19.3	12.3	6.5	633.9
Balance at 30 September 2023	13,972.3	744.8	206.0	24.8	14,947.9
Loss allowance	(19.6)	(9.4)	(39.8)	(4.8)	(73.6)
Carrying value	<u>13,952.7</u>	<u>735.4</u>	<u>166.2</u>	<u>20.0</u>	<u>14,874.3</u>

Other changes includes interest and similar charges.

16. LOAN IMPAIRMENTS - ECONOMIC INPUTS TO CALCULATIONS

Impairment provision under IFRS 9 is calculated on a forward-looking ECL basis, based on expected economic conditions in multiple internally coherent scenarios. While the provision calculation is intended to address all possible future economic outcomes, the Group, in common with most other lenders, uses a small number of differing scenarios as representatives of this universe of potential outturns.

The Group uses four distinct economic scenarios chosen to represent the range of possible outcomes and allow for the impact of economic asymmetry in the calculations. Each scenario comprises a number of economic parameters and while models for different portfolios may not use all the variables, the set, as a whole, is defined for the Group and must be internally consistent.

As the Group does not have an internal economics function, in developing its economic scenarios it considers analysis from reputable external sources to form a general market consensus which informs its central scenario. These sources include data and forecasts produced by the Office of Budget Responsibility ('OBR') and the PRA as well as private sector economic research bodies and industry sources. The Group also takes account of public statements from bodies such as the Bank of England and the UK Government to inform its final position.

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For the six months ended 31 March 2024 (Unaudited)

16. LOAN IMPAIRMENTS - ECONOMIC INPUTS TO CALCULATIONS (Continued)

The central scenario used for IFRS 9 impairment purposes is the same scenario which forms the basis for the Group's business planning and forecasting and will therefore generally carry the highest probability weighting. In its March 2024 forecasting cycle (the 'April reforecast') the Group has adopted a central economic scenario derived using a broadly equivalent approach to that used in September 2023, with the starting point of the scenario updated to reflect the actual movements of economic variables in the six months.

The general trend of the Group's central forecast follows that published by the Bank of England in February 2024. Monetary policy remains restrictive and UK GDP growth is minimal. Unemployment remains low and inflation falls in the short term, although picks up slowly towards the end of the forecast period, with bank base rates falling slowly.

Compared with the central forecast adopted at 30 September 2023, this is marginally more optimistic, with unemployment and interest rates at lower levels and a more optimistic outlook for house prices in the short term. However, GDP remains on a similar trajectory and CPI inflation is more marked in the later years. The scenario also begins from the actual March 2024 position, so that variances against the September scenarios in the six-month period are reflected, with house prices at 31 March 2024, especially, starting the forecast period at a higher level than previously modelled.

The upside and downside scenarios are derived from the central forecast, as they have been in previous periods. The shape of the curves representing all three scenarios are similar across the forecast period, but the upside scenario assumes inflation falling more rapidly, enabling the Bank of England to cut the base rate further and faster than in the base case, while house prices remain largely stable. Conversely, the downside case represents a sharp increase in CPI, leading to short-term increases in base rates, with economic confidence impacting on both house prices and unemployment levels.

The severe scenario has been derived from the most recent Annual Cyclical Scenario ('ACS') published by the Bank of England, as in recent periods. As the Bank has not published a new version of this scenario since 2022, for March 2024 impairment modelling the Group has adjusted the ACS to allow for the economic environment at the start of the forecast period, which differs markedly from that seen in 2022. However the scenario still represents a short-term recession, a significant increase in inflation and unemployment and a significant slump in house prices.

Following a review of the weightings of the different scenarios, set against the overall potential for variability in the future economic outlook, the Group decided to maintain the scenario weightings used at 30 September 2023. While the consensus view for the UK economic outlook is both more settled and more benign than it was at 30 September 2023, the potential for significant downside impacts from geopolitical factors, including conflicts in Eastern Europe and the Middle East, remains. The elections being held in July in the UK and in November in the US are both likely to impact economic sentiment, to the extent of producing substantially different outcomes. This supports the maintenance of the September 2023 weightings.

Sensitivities comparing the effect of these weightings with those which might be seen in a more normal economic environment are set out in note 17.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****16. LOAN IMPAIRMENTS - ECONOMIC INPUTS TO CALCULATIONS (Continued)**

The weightings attached to each scenario are set out below

	31 March 2024	30 September 2023	31 March 2023
Central Scenario	40%	40%	40%
Upside Scenario	10%	10%	10%
Downside Scenario	30%	30%	30%
Severe Scenario	20%	20%	20%
	100%	100%	100%

The Group's economic scenarios comprise seven variables based on standard publicly available metrics for the UK. These variables are:

- Year-on-year change in Gross Domestic Product ('GDP') as measured by the Office of National Statistics ('ONS')
- Year-on-year change in the House Price Index ('HPI') as measured by the Nationwide Building Society
- Bank Base Rate ('BBR'), as set by the Bank of England
- Consumer Price Inflation ('CPI') as measured by the ONS
- Unemployment rate, as measured by the ONS
- Annual change in secured lending, as measured by the Bank of England 'mortgage advances' data series
- Annual change in consumer credit, as measured by the Bank of England 'unsecured advances' data series

The projected average values of each of these variables in each of the first five years of the forecast period are set out below. Values are shown for the twelve months ending on 31 March or 30 September in each year as appropriate.

31 March 2024

GDP (year-on-year change)

	2025	2026	2027	2028	2029
	%	%	%	%	%
Central scenario	0.7	0.8	1.3	1.6	1.6
Upside scenario	1.7	2.5	2.4	1.9	1.6
Downside scenario	(0.4)	0.7	1.3	1.6	1.6
Severe scenario	(3.6)	(0.2)	1.2	1.2	1.2

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS

For the six months ended 31 March 2024 (Unaudited)

16. LOAN IMPAIRMENTS - ECONOMIC INPUTS TO CALCULATIONS (Continued)

HPI (year-on-year change)

	2025	2026	2027	2028	2029
	%	%	%	%	%
Central scenario	(4.4)	2.2	4.4	4.0	2.6
Upside scenario	2.4	7.0	5.6	4.9	4.0
Downside scenario	(9.2)	1.7	4.0	3.7	1.5
Severe scenario	(13.1)	(15.1)	-	7.0	5.6

BBR (rate)

	2025	2026	2027	2028	2029
	%	%	%	%	%
Central scenario	4.8	4.1	3.6	3.5	3.5
Upside scenario	4.1	3.2	3.0	3.0	3.0
Downside scenario	5.6	5.0	4.1	3.5	3.5
Severe scenario	6.0	5.8	5.1	4.3	3.6

CPI (rate)

	2025	2026	2027	2028	2029
	%	%	%	%	%
Central scenario	2.4	2.6	2.1	2.0	2.0
Upside scenario	2.0	2.0	1.9	2.0	2.0
Downside scenario	3.7	3.1	2.3	1.8	2.0
Severe scenario	4.6	4.5	2.4	1.7	2.0

Unemployment (rate)

	2025	2026	2027	2028	2029
	%	%	%	%	%
Central scenario	4.6	4.9	5.0	4.4	3.7
Upside scenario	4.1	4.4	4.5	4.1	3.7
Downside scenario	5.1	6.1	6.5	5.3	4.2
Severe scenario	6.9	8.4	7.8	7.2	6.6

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS**

For the six months ended 31 March 2024 (Unaudited)

16. LOAN IMPAIRMENTS - ECONOMIC INPUTS TO CALCULATIONS (Continued)*Secured lending (annual change)*

	2025	2026	2027	2028	2029
	%	%	%	%	%
Central scenario	0.3	0.9	2.6	3.0	3.0
Upside scenario	1.0	1.6	3.2	3.0	3.0
Downside scenario	(0.5)	0.1	2.1	3.0	3.0
Severe scenario	(1.8)	(1.1)	1.1	3.0	3.0

Consumer credit (annual change)

	2025	2026	2027	2028	2029
	%	%	%	%	%
Central scenario	2.3	3.1	4.6	5.0	5.0
Upside scenario	3.0	3.8	5.1	5.0	5.0
Downside scenario	1.5	2.3	4.0	5.0	5.0
Severe scenario	0.3	1.1	3.1	5.0	5.0

31 March 2023*GDP (year-on-year change)*

	2024	2025	2026	2027	2028
	%	%	%	%	%
Central scenario	(0.7)	(0.1)	0.7	1.2	1.2
Upside scenario	1.3	0.7	0.7	1.2	1.2
Downside scenario	(2.3)	0.1	1.4	1.2	1.2
Severe scenario	(3.7)	(0.2)	1.2	1.2	0.8

HPI (year-on-year change)

	2025	2026	2027	2028	2029
	%	%	%	%	%
Central scenario	(8.8)	(0.7)	3.3	4.4	3.7
Upside scenario	(3.9)	5.7	7.1	5.6	4.9
Downside scenario	(14.0)	(6.2)	3.2	4.0	3.7
Severe scenario	(13.1)	(15.1)	-	7.0	5.6

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS**

For the six months ended 31 March 2024 (Unaudited)

16. LOAN IMPAIRMENTS - ECONOMIC INPUTS TO CALCULATIONS (Continued)*BBR (rate)*

	2024	2025	2026	2027	2028
	%	%	%	%	%
Central scenario	4.1	3.9	3.6	3.4	3.1
Upside scenario	4.5	4.5	4.3	3.8	3.2
Downside scenario	3.1	2.1	2.0	2.0	2.0
Severe scenario	5.8	5.8	5.1	4.3	3.5

CPI (rate)

	2024	2025	2026	2027	2028
	%	%	%	%	%
Central scenario	5.6	2.5	1.7	1.9	1.9
Upside scenario	5.5	3.2	2.8	2.1	1.9
Downside scenario	4.1	1.1	0.5	1.2	2.1
Severe scenario	16.7	10.0	3.0	2.3	2.0

Unemployment (rate)

	2024	2025	2026	2027	2028
	%	%	%	%	%
Central scenario	4.2	4.8	5.2	5.2	4.2
Upside scenario	4.0	4.5	4.7	4.6	4.1
Downside scenario	4.7	5.4	6.1	5.7	4.7
Severe scenario	6.8	8.4	7.8	7.2	6.2

Secured lending (annual change)

	2024	2025	2026	2027	2028
	%	%	%	%	%
Central scenario	2.8	2.4	3.0	3.5	3.5
Upside scenario	3.5	3.2	3.8	4.1	3.5
Downside scenario	2.0	1.7	2.3	2.9	3.5
Severe scenario	(0.9)	0.2	2.3	3.4	3.5

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS

For the six months ended 31 March 2024 (Unaudited)

16. LOAN IMPAIRMENTS - ECONOMIC INPUTS TO CALCULATIONS (Continued)

Consumer credit (annual change)

	2024	2025	2026	2027	2028
	%	%	%	%	%
Central scenario	2.8	3.6	3.5	3.5	3.5
Upside scenario	3.5	4.4	4.3	4.1	3.5
Downside scenario	2.0	2.9	2.8	2.9	3.5
Severe scenario	(4.6)	(2.3)	1.6	3.7	3.5

30 September 2023*GDP (year-on-year change)*

	2024	2025	2026	2027	2028
	%	%	%	%	%
Central scenario	0.4	0.9	1.0	1.2	1.2
Upside scenario	1.6	1.4	1.0	1.2	1.2
Downside scenario	(0.4)	0.7	1.0	1.2	1.2
Severe scenario	(3.6)	(0.2)	1.2	1.2	1.2

HPI (year-on-year change)

	2024	2025	2026	2027	2028
	%	%	%	%	%
Central scenario	(6.4)	(1.7)	4.7	4.4	3.2
Upside scenario	(1.1)	5.8	6.8	5.0	4.5
Downside scenario	(10.7)	(2.2)	4.0	4.0	2.6
Severe scenario	(13.1)	(15.1)	-	7.0	5.6

BBR (rate)

	2024	2025	2026	2027	2028
	%	%	%	%	%
Central scenario	5.5	5.4	4.8	4.4	4.1
Upside scenario	5.2	4.4	3.7	3.5	3.5
Downside scenario	5.6	3.8	2.6	2.0	2.0
Severe scenario	6.0	5.8	5.1	4.3	3.4

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS

For the six months ended 31 March 2024 (Unaudited)

16. LOAN IMPAIRMENTS - ECONOMIC INPUTS TO CALCULATIONS (Continued)

CPI (rate)

	2024	2025	2026	2027	2028
	%	%	%	%	%
Central scenario	4.4	2.6	1.6	1.8	2.0
Upside scenario	3.7	2.1	2.1	2.0	2.1
Downside scenario	4.5	1.0	0.7	1.8	2.0
Severe scenario	15.7	12.8	3.7	2.4	2.1

Unemployment (rate)

	2024	2025	2026	2027	2028
	%	%	%	%	%
Central scenario	4.8	5.6	6.0	5.6	4.9
Upside scenario	4.3	4.6	4.8	4.4	3.9
Downside scenario	5.3	6.4	6.7	6.1	5.4
Severe scenario	6.9	8.4	7.8	7.2	6.6

Secured lending (annual change)

	2024	2025	2026	2027	2028
	%	%	%	%	%
Central scenario	0.8	0.3	1.8	3.0	3.0
Upside scenario	1.5	1.0	2.5	3.2	3.0
Downside scenario	-	(0.5)	1.0	2.8	3.0
Severe scenario	(1.3)	(1.8)	(0.3)	2.5	3.0

Consumer credit (annual change)

	2024	2025	2026	2027	2028
	%	%	%	%	%
Central scenario	3.5	2.3	3.9	4.9	5.0
Upside scenario	4.3	3.0	4.7	5.1	5.0
Downside scenario	2.8	1.5	3.2	4.8	5.0
Severe scenario	1.5	0.3	1.9	4.4	5.0

After the end of the initial five-year period, the final rate or rate of change (as appropriate) is assumed to continue into the future in each scenario.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS

For the six months ended 31 March 2024 (Unaudited)

16. LOAN IMPAIRMENTS - ECONOMIC INPUTS TO CALCULATIONS (Continued)

To illustrate the levels of non-linearity in the various scenarios, the maximum and minimum quarterly levels for each variable over the five-year period commencing on the balance sheet date are set out below.

31 March 2024

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max %	Min %	Max %	Min %	Max %	Min %	Max %	Min %
Economic driver								
GDP	1.6	0.1	2.7	0.4	1.6	(0.7)	1.2	(5.0)
HPI	4.4	(5.2)	7.4	(0.8)	4.1	(10.7)	7.2	(16.4)
BBR	5.3	3.5	4.8	3.0	5.8	3.5	6.0	3.5
CPI	2.8	1.9	2.2	1.8	4.0	1.5	5.0	1.5
Unemployment	5.0	3.6	4.5	3.6	6.6	4.1	8.5	5.2
Secured lending	3.0	-	3.8	0.8	3.0	(0.8)	3.0	(2.0)
Consumer credit	5.0	2.0	5.5	2.8	5.0	1.3	5.0	-

31 March 2023

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max %	Min %	Max %	Min %	Max %	Min %	Max %	Min %
Economic driver								
GDP	1.2	(0.8)	2.0	0.2	1.6	(2.5)	1.2	(5.0)
HPI	4.4	(11.3)	7.4	(7.4)	4.1	(15.1)	7.2	(16.4)
BBR	4.3	3.0	4.5	3.0	3.8	2.0	6.0	3.3
CPI	8.5	1.4	7.5	1.7	8.0	0.4	17.0	2.0
Unemployment	5.3	4.0	4.7	3.8	6.3	4.3	8.5	4.8
Secured lending	3.5	2.3	4.3	3.1	3.5	1.6	3.5	(1.2)
Consumer credit	3.8	2.5	4.5	3.3	3.5	1.8	4.2	(5.2)

30 September 2023

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max %	Min %	Max %	Min %	Max %	Min %	Max %	Min %
Economic driver								
GDP	1.2	0.3	2.3	0.9	1.2	(0.8)	1.2	(5.0)
HPI	4.4	(8.2)	7.4	(3.1)	4.1	(13.4)	7.2	(16.4)
BBR	5.5	4.0	5.3	3.5	5.8	2.0	6.0	3.3
CPI	5.0	1.5	4.3	1.8	6.0	0.4	17.0	2.0
Unemployment	6.0	4.5	4.8	3.8	7.0	5.0	8.5	5.2
Secured lending	3.0	-	3.8	0.8	3.0	(0.8)	3.0	(2.0)
Consumer credit	5.0	2.0	5.8	2.8	5.0	1.3	5.0	-

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****16. LOAN IMPAIRMENTS - ECONOMIC INPUTS TO CALCULATIONS (Continued)**

The asymmetry in the models is demonstrated by comparing the calculated impairment provision with that which would have been produced using the central scenario alone, 100% weighted.

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m
<i>Provision using central scenario 100% weighted</i>			
Mortgage Lending	39.0	35.3	38.4
Commercial Lending	30.0	25.5	29.0
	<hr/>	<hr/>	<hr/>
Calculated impairment provision	69.0 78.1	60.8 68.2	67.4 73.6
	<hr/>	<hr/>	<hr/>
Effect of multiple economic scenarios	9.1	7.4	6.2
	<hr/>	<hr/>	<hr/>

17. IMPAIRMENT PROVISION – SENSITIVITY ANALYSIS

The calculation of impairment provisions under IFRS 9 is subject to a variety of uncertainties arising from assumptions, forecasts and expectations about future events and conditions. To illustrate the impact of these uncertainties, sensitivity calculations have been performed for some of the most significant.

These sensitivities are intended as mathematical illustrations of the impacts of the various assumptions of the Group's modelling. They do not necessarily represent alternative potential impairment values as other factors might also need to be considered in arriving at a final provision figure if circumstances differed from those at the balance sheet date.

Economic conditions

To illustrate the potential impact of differing future economic scenarios on the total impairment, the provisions which would be calculated if each of the economic scenarios were 100% weighted are shown below.

Scenarios	31 March 2024		30 September 2023	
	Provision £m	Difference £m	Provision £m	Difference £m
Central	69.0	(9.1)	67.4	(6.2)
Upside	59.9	(18.2)	59.0	(14.6)
Downside	79.0	0.9	73.4	(0.2)
Severe downside	106.7	28.6	95.7	22.1
	<hr/>	<hr/>	<hr/>	<hr/>

The weighted average of these 100% weighted provisions need not equal the weighted average ECL due to the impact of the differing PDs on staging.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****17. IMPAIRMENT PROVISION – SENSITIVITY ANALYSIS (Continued)***Scenario weightings*

In order to illustrate the impact of scenario weightings on the outcomes, the impairment provision requirements were sensitised using alternative weightings. The sensitivity is based on the weightings used at IFRS 9 transition on 1 October 2018. The use of the 2018 weighting is intended to represent a more settled outlook than has been evident at any of the most recent year ends. Judgemental adjustments are assumed to remain constant.

The weightings used, and the results of applying this sensitivity to the 31 March 2024 scenarios are set out below.

	Weighting			Severe	Impairment £m	Difference £m
	Central	Upside	Downside			
As reported	40%	10%	30%	20%	78.1	-
Sensitivity	40%	30%	25%	5%	70.5	7.6

Significant increase in credit risk

The most significant driver of SICR is relative PD. If all PDs across the Group's principal buy-to-let mortgage book were increased by 10%, loans with a gross value of £98.3m would transfer from Stage 1 to Stage 2 (30 September 2023: £68.4m), and the total provision would increase by £0.7m from the combined effects of higher PDs on expected losses and the impact of providing for expected lifetime losses, rather than 12-month losses on the additional Stage 2 cases (30 September 2023: £0.8m).

Value of security

The principal assumptions impacting the LGD are the estimated security values. If the rate of growth in house prices assumed by the model after the forecast minimum were halved, ignoring any PD effects, then the provision for the Group's first and second mortgage assets under the central scenario would increase by £0.4m (30 September 2023: £0.7m).

Receiver of rent

The majority of receiver of rent cases, which are included in Stage 3, are managed long-term and therefore their assumed realisation date has an important impact on the provision calculation. If the assumed rate of realisation was increased by 20%, the impairment provision in the central scenario would increase by £0.6m (30 September 2023: £0.1m).

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****18. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING**

The Group uses derivative financial instruments such as interest rate risk swaps for risk management purposes only. Each such derivative contract is entered into for economic hedging purposes to manage a particular identified risk and any gains or losses arising are incidental to this objective. No trading in derivative financial instruments is undertaken.

A detailed description of the Group's use of derivatives and its accounting for derivatives and hedging is set out in note 26 to the 2023 Group Accounts.

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m	30 September 2022 £m
Derivative financial assets	511.7	511.2	615.4	779.0
Derivative financial liabilities	(95.1)	(51.3)	(39.9)	(102.1)
	<u>416.6</u>	<u>459.9</u>	<u>575.5</u>	<u>676.9</u>
Of which:				
Interest rate swaps in hedging relationships	417.8	433.9	559.4	554.5
Other interest rate swaps	(1.2)	26.0	16.1	121.9
Currency futures	-	-	-	0.5
	<u>416.6</u>	<u>459.9</u>	<u>575.5</u>	<u>676.9</u>

All hedging relationships and strategies at 30 September 2023 described in note 26 to the 2023 Group Accounts have continued in the period.

In addition, the fixed value investment securities described in note 11 have been hedged using interest rate swaps. These hedging arrangements have been designated as fair value micro hedges for IAS 39 hedge accounting purposes.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS

For the six months ended 31 March 2024 (Unaudited)

18. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (Continued)

The balances held on the Group's balance sheet relating to the hedging of interest rate risk on its fixed rate customer loan and deposit balances are summarised below.

	Note	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m	30 September 2022 £m
<i>Derivative financial instruments</i>					
Assets		511.7	511.2	615.4	779.0
Liabilities		(95.1)	(51.3)	(39.9)	(102.1)
		<u>416.6</u>	<u>459.9</u>	<u>575.5</u>	<u>676.9</u>
<i>Fair value hedging adjustments</i>					
On loans to customers	12	(196.5)	(318.9)	(379.3)	(559.9)
On investment securities		1.8	-	-	-
On retail deposits	21	1.4	37.8	30.9	99.7
On borrowings		0.9	-	3.7	-
		<u>(192.4)</u>	<u>(281.1)</u>	<u>(344.7)</u>	<u>(460.2)</u>
Net balance sheet position		<u>224.2</u>	<u>178.8</u>	<u>230.8</u>	<u>216.7</u>
<i>Collateral balances</i>					
Posted (in sundry assets)	19	-	-	-	-
Received (in sundry liabilities)	23	(215.0)	(244.2)	(383.4)	(388.6)
		<u>(215.0)</u>	<u>(244.2)</u>	<u>(383.4)</u>	<u>(388.6)</u>

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****19. SUNDRY ASSETS**

	Note	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m
Current assets				
Accrued interest income		5.9	2.3	4.6
CSA assets	18	-	-	-
CRDs		-	32.9	38.0
Other sundry assets		10.3	9.7	8.4
		<u>16.2</u>	<u>44.9</u>	<u>51.0</u>

Cash Ratio Deposits ('CRD's) were non-interest-bearing deposits which were required to be lodged with the Bank of England, based on the value of Paragon Bank's eligible liabilities. These deposits were required to comply with regulatory rules, but the scheme was terminated by the Bank of England during the period.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****20. INTANGIBLE ASSETS**

Intangible assets at net book value comprise:

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m	30 September 2022 £m
Goodwill	162.8	164.4	162.8	164.4
Computer software	6.0	4.6	4.4	3.9
Other intangibles	0.8	1.5	1.0	1.9
Total assets	<u>169.6</u>	<u>170.5</u>	<u>168.2</u>	<u>170.2</u>

The balance for goodwill at 31 March 2024 shown above includes £113.0m in respect of the SME Lending Cash Generating Unit ('CGU') and £49.8m in respect of the Development Finance CGU.

IAS 36 requires that such balances are tested annually for impairment, or more frequently if there is reason to suggest that an impairment has occurred. The Group last carried out a full impairment review in accordance with IAS 36 at 30 September 2023.

In preparing the financial information at 31 March 2024 the Group has considered whether a further impairment test might be required. The trading performances of the CGUs were compared to those projected in the 30 September 2023 testing and the potential impact of the Group's April 2024 reforecasting exercise on these forecasts was also considered. As a result of this exercise it was concluded that there was no indication of impairment, and no impairment testing was carried out.

The results of the testing carried out at 30 September 2023, including sensitivity analyses relating to that testing, are set out in note 31 to the 2023 Group Accounts. The analysis for each CGU shows movements in the key input assumptions used in testing which would be sufficient to eliminate any headroom. These movements, while not expected by management at the time, were nonetheless considered 'reasonably possible' for the purposes of IAS 36.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS

For the six months ended 31 March 2024 (Unaudited)

21. RETAIL DEPOSITS

The Group's retail deposits, held by Paragon Bank PLC, were received from customers in the UK and are denominated in sterling. The deposits comprise principally term deposits, and notice and easy access accounts. The method of interest calculation on these deposits is analysed below.

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m	30 September 2022 £m
Fixed rate	8,449.0	7,574.4	8,690.2	6,201.3
Variable rates	6,319.5	4,301.5	4,575.1	4,467.9
	<u>14,768.5</u>	<u>11,875.9</u>	<u>13,265.3</u>	<u>10,669.2</u>

The weighted average interest rate on retail deposits at 31 March 2024, analysed by charging method, is set out below.

	31 March 2024 %	31 March 2023 %	30 September 2023 %	30 September 2022 %
Fixed rate	4.70	2.93	4.07	1.74
Variable rates	4.25	2.70	3.74	1.55
All deposits	<u>4.51</u>	<u>2.84</u>	<u>3.95</u>	<u>1.66</u>

The contractual maturity of these deposits is analysed below.

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m	30 September 2022 £m
Amounts repayable				
In less than three months	1,375.0	883.5	1,589.4	929.0
In more than three months but not more than one year	5,063.3	4,832.1	5,193.7	3,732.1
In more than one year, but not more than two years	1,699.7	1,763.0	1,643.0	1,627.3
In more than two years, but not more than five years	650.9	504.0	631.8	421.4
Total term deposits	<u>8,788.9</u>	<u>7,982.6</u>	<u>9,057.9</u>	<u>6,709.8</u>
Repayable on demand	<u>5,979.6</u>	<u>3,893.3</u>	<u>4,207.4</u>	<u>3,959.4</u>
	<u>14,768.5</u>	<u>11,875.9</u>	<u>13,265.3</u>	<u>10,669.2</u>
Fair value adjustments for portfolio hedging (note 18)	(1.4)	(37.8)	(30.9)	(99.7)
	<u>14,767.1</u>	<u>11,838.1</u>	<u>13,234.4</u>	<u>10,569.5</u>

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****22. BORROWINGS**

On 15 February 2024, Fitch Ratings affirmed the Group's Long-Term Issuer Default Rating at BBB+, with a stable outlook. It also affirmed the senior unsecured debt rating at BBB and the rating of the Group's Tier-2 bond at BBB-, with this security therefore enjoying an investment-grade rating.

At the same time Fitch Ratings assigned a BBB+ Long-term Issuer Default Rating to Paragon Bank PLC, the Group's principal operating subsidiary, the first time a company-level rating has been issued for this entity.

All borrowings described in the Group Accounts for the year ended 30 September 2023 remained in place throughout the period.

On 1 November 2023, a group company, Paragon Mortgages (No. 29) PLC, issued £855.0m of sterling mortgage-backed floating rate notes analysed below, at par.

Class	Fitch rating	Moody's rating	Interest margin above compounded SONIA	Principal value £m
A	AAA	Aaa	1.20%	747.0
B	AA	Aa1	1.90%	33.7
C	A-	Aa2	2.75%	29.3
D	B+	A2	3.80%	45.0
				855.0

All the above notes were retained by the Group.

Repayments made in respect of the Group's borrowings are shown in note 32.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****23. SUNDRY LIABILITIES**

Sundry liabilities include:

	Note	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m
Amounts falling due within one year				
Lease liabilities		2.7	2.4	2.6
Accrued interest		179.5	97.3	156.7
CSA liabilities	18	215.0	244.2	383.4
Purchase of own shares	28	10.4	-	-
Other sundry liabilities		41.3	33.9	47.2
		448.9	377.8	589.9
Amounts falling due after more than one year				
Lease liabilities		5.5	6.7	6.3
Accrued interest		40.8	22.4	31.5
Other sundry liabilities		3.9	3.7	3.5
		50.2	32.8	41.3
Total				
Lease liabilities		8.2	9.1	8.9
Other sundry liabilities		490.9	401.5	622.3
		499.1	410.6	631.2

CONDENSED FINANCIAL STATEMENTS

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For the six months ended 31 March 2024 (Unaudited)

24. CONDUCT

The Group, as a participant in the financial services industry, is exposed to a high level of regulatory supervision, which could in the event of conduct failures expose it to financial liabilities. The Group maintains a strong compliance and conduct framework, supervised by the second line compliance function, to mitigate the risk, although it is impossible to eliminate it entirely.

In January 2024 the FCA announced that it was conducting a review of the historical use of discretionary commission arrangements across the motor finance industry, following action taken in this field by the courts and the Financial Ombudsman Service ('FOS'). The FCA has announced its intention to publish its policy on the treatment of such matters before 30 September 2024.

The Group was active in this market, principally from 2014 until 2020, and while it does not believe that it has disadvantaged customers, the extent of any potential exposure will not become clear until after the FCA has made its position clear.

The regulatory environment continues to develop, through regulatory policies, legislative rules and court rulings, and while the Group's assessment is that it currently has no material potential liability for issues relating to motor finance commissions or other conduct issues, this is based on our current interpretation of requirements and hence further liabilities may arise as these develop over time.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS

For the six months ended 31 March 2024 (Unaudited)

25. RETIREMENT BENEFIT OBLIGATIONS

The defined benefit obligation at 31 March 2024 has been calculated on a year-to-date basis. Since the last IAS 19 actuarial valuation at 30 September 2023, there have been movements in financial conditions, requiring an adjustment to the actuarial assumptions underlying the calculation of the defined benefit obligation at 31 March 2024. In particular, over the period since the 30 September 2023 actuarial valuation, the discount rate has decreased by 65 basis points per annum, whereas expectations of long-term inflation have decreased by a lower amount, around 10 basis points.

The net effect of these changes, together with the Group's contributions and the performance of the plan assets, has resulted in the value of the net defined benefit surplus at 31 March 2024 increasing from the position at 30 September 2023. The impact of allowing for the changes in actuarial assumptions has been recognised as an actuarial gain in other comprehensive income.

The Group has recognised the surplus as an asset at the balance sheet date as it anticipates being able to access economic benefits at least as great as the carrying value. However such assets are eliminated from capital for regulatory purposes (note 34).

The movements in the amount recognised in respect of the defined benefit plan during the six-month period ended 31 March 2024 are summarised below.

	Six months to 31 March 2024 £m	Six months to 31 March 2023 £m	Year to 30 September 2023 £m
Opening pension surplus	12.7	7.1	7.1
Employer contributions	1.5	1.9	3.9
<i>Amounts posted to profit and loss</i>			
Current service cost	(0.2)	(0.2)	(0.5)
Net funding cost (note 3)	0.4	0.2	0.4
Administrative expenses	(0.6)	(0.5)	(0.6)
<i>Amounts posted to other comprehensive income</i>			
Return on plan assets not included in interest	7.9	1.8	(7.8)
Experience (loss) on liabilities	(0.1)	(1.1)	(1.8)
Actuarial (loss) / gain from changes in financial assumptions	(7.5)	1.2	11.1
Actuarial gain from changes in demographic assumptions	2.5	-	0.9
Closing pension surplus	16.6	10.4	12.7

Pursuant to the recovery plan agreed with the Trustee of the pension plan, the Group has effectively granted a first charge over its freehold head office building as security for its agreed contributions. No account of this charge is taken in the calculation of the above surplus.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****26. CALLED-UP SHARE CAPITAL**

Movements in the issued share capital in the period were:

	Six months to 31 March 2024 Number	Six months to 31 March 2023 Number	Year to 30 September 2023 Number
Ordinary shares of £1 each			
Opening share capital	228,700,413	241,409,624	241,409,624
Shares issued	-	135,998	160,833
Shares cancelled	(12,095,453)	-	(12,870,044)
	<u>216,604,960</u>	<u>241,545,622</u>	<u>228,700,413</u>

During the period, the Company issued no shares (six months ended 31 March 2023: 135,998; year ended 30 September 2023: 160,833). The share issues in the previous year were made in order to satisfy options granted under Sharesave schemes. Consideration received in respect of these issues in the six months ended 31 March 2023 was £463,863 (year ended 30 September 2023: £534,934).

On 1 June 2023, 12,870,044 of the shares held in treasury at that date were cancelled, with 12,095,453 further shares cancelled on 23 February 2024.

27. RESERVES

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m	30 September 2022 £m
Share premium account	71.4	71.4	71.4	71.1
Capital redemption reserve	25.0	-	12.9	71.8
Merger reserve	(70.2)	(70.2)	(70.2)	(70.2)
Profit and loss account	1,198.1	1,219.3	1,243.4	1,151.2
	<u>1,224.3</u>	<u>1,220.5</u>	<u>1,257.5</u>	<u>1,223.9</u>

On 28 March 2023 the High Court confirmed the cancellation of the Company's capital redemption reserve, following shareholder approval at the AGM on 1 March 2023. This reserve had arisen on the cancellation of ordinary shares which had been purchased in the market and held in treasury. The balance outstanding on the capital redemption reserve was transferred to the profit and loss account.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****28. OWN SHARES**

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m
Treasury shares			
Opening balance	54.0	18.2	18.2
Shares purchased	39.9	61.2	111.5
Options exercised	(2.7)		(8.4)
Shares cancelled	(68.5)	-	(67.3)
Closing balance	<u>22.7</u>	<u>79.4</u>	<u>54.0</u>
ESOP shares			
Opening balance	21.6	19.0	19.0
Shares purchased	12.9	8.9	9.0
Options exercised	(8.7)	(5.7)	(6.4)
Closing balance	<u>25.8</u>	<u>22.2</u>	<u>21.6</u>
Irrevocable authority to purchase			
Opening balance	-	10.8	10.8
Given in period	10.4	-	-
Expiring / utilised in the period	-	(10.8)	(10.8)
Closing balance	<u>10.4</u>	<u>-</u>	<u>-</u>
Total closing balance	<u><u>58.9</u></u>	<u><u>101.6</u></u>	<u><u>75.6</u></u>
Total opening balance	<u><u>75.6</u></u>	<u><u>48.0</u></u>	<u><u>48.0</u></u>
Number of shares held			
Treasury	3,411,017	14,870,044	10,074,002
ESOP	4,277,272	4,126,511	4,009,490
Total own shares	<u><u>7,688,289</u></u>	<u><u>18,996,555</u></u>	<u><u>14,083,492</u></u>

At 31 March 2024 an irrevocable instruction for the purchase of a further £10.4m of shares was in place (note 23).

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****29. EQUITY DIVIDEND**

Amounts recognised as distributions to equity shareholders in the period:

	Six months to 31 March 2024 £m	Six months to 31 March 2023 £m	Year to 30 September 2023 £m
Final dividend for the year ended 30 September 2023 of 26.4p per share	56.1	-	-
Final dividend for the year ended 30 September 2022 of 19.2p per share	-	43.7	43.7
Interim dividend for the year ended 30 September 2023 of 11.0p per share	-	-	24.2
	<u>56.1</u>	<u>43.7</u>	<u>67.9</u>

An interim dividend of 13.2p per share is proposed for the period (2023: 11.0p per share), for the reasons set out in note 34(c). This will be paid on 26 July 2024 with a record date of 5 July 2024. The amount expected to be absorbed by this dividend, based on the number of shares in issue at the balance sheet date is £27.6m (31 March 2023: £24.2m). The interim dividend will be recognised in the accounts when it is paid.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****30. NET CASH FLOW FROM OPERATING ACTIVITIES**

	Six months to 31 March 2024 £m	Six months to 31 March 2023 £m	Year to 30 September 2023 £m
Profit before tax	110.6	46.4	199.9
Non-cash items included in profit, and other adjustments			
Depreciation of property, plant and equipment	2.0	1.8	4.0
(Profit) on disposal of property, plant and equipment	(0.1)	-	(0.1)
Amortisation of intangible assets	0.6	1.0	3.6
Non-cash movements on borrowings	3.1	0.8	(2.5)
Impairment losses on loans to customers	10.3	7.5	18.0
Charge for share-based remuneration	4.5	4.6	9.6
Net (increase) / decrease in operating assets			
Assets held for leasing	3.2	(0.7)	(2.7)
Loans to customers	(385.0)	(352.1)	(682.0)
Derivative financial instruments	(182.8)	267.8	163.6
Fair value of portfolio hedges	103.7	(241.0)	(180.6)
Other receivables	33.7	(7.1)	(15.0)
Net increase / (decrease) in operating liabilities			
Retail deposits	1,503.2	1,206.7	2,596.1
Derivative financial instruments	55.2	(50.8)	(62.2)
Fair value of portfolio hedges	29.5	61.9	68.8
Other liabilities	(141.8)	(91.8)	128.3
Cash generated by operations	1,149.9	855.0	2,246.8
Income taxes (paid)	(34.3)	(29.1)	(75.1)
Net cash flow generated by operating activities	1,115.6	825.9	2,171.7

Cash flows relating to plant and equipment held for leasing under operating leases are classified as operating cash flows.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – ANALYSIS****For the six months ended 31 March 2024 (Unaudited)****31. NET CASH FLOW USED IN INVESTING ACTIVITIES**

	Six months to 31 March 2024 £m	Six months to 31 March 2023 £m	Year to 30 September 2023 £m
Investment in securities	(98.1)	-	-
Proceeds from sales of operating property, plant and equipment	0.1	-	0.1
Purchases of operating property, plant and equipment	(0.5)	(0.5)	(1.6)
Purchases of intangible assets	(2.0)	(1.3)	(1.6)
Net cash (utilised) by investing activities	(100.5)	(1.8)	(3.1)

32. NET CASH FLOW FROM FINANCING ACTIVITIES

	Six months to 31 March 2024 £m	Six months to 31 March 2023 £m	Year to 30 September 2023 £m
Shares issued	-	0.4	0.5
Dividends paid (note 29)	(56.1)	(43.7)	(67.9)
Repayment of asset-backed floating rate notes	(11.1)	(120.0)	(382.1)
Movement on central bank facilities	(900.0)	-	-
Movement on other bank facilities	-	(244.4)	(586.0)
Movement on sale and repurchase agreements	50.0	-	50.0
Capital element of lease payments	(1.3)	(1.1)	(2.4)
Purchase of own shares (note 28)	(52.8)	(70.1)	(120.5)
Exercise of share awards	(0.1)	(0.5)	3.4
Net cash (utilised) by financing activities	(971.4)	(479.4)	(1,105.0)

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33. RELATED PARTY TRANSACTIONS

In the six months ended 31 March 2024, the Group has continued the related party relationships described in note 55 on page 274 of the Group's 2023 Annual Report and Accounts. Related party transactions in the period comprise the compensation of the Group's key management personnel, the acceptance of retail deposits from certain non-executive directors, and transactions with the Group Pension Plan.

There have been no changes in these relationships which could have a material effect on the financial position or performance of the Group in the period.

Retail deposits of £740,000 by directors were outstanding at the period end (31 March 2023: £698,000; 30 September 2023: £720,000) and the maximum outstanding in the period was £796,000 (31 March 2023: £797,000; 30 September 2023: £771,000).

Except for the transactions referred to above, there have been no related party transactions in the six months ended 31 March 2024.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK

For the six months ended 31 March 2024 (Unaudited)

The notes below describe the processes and measurements which the Group uses to manage its capital position and its exposure to credit risk. It should be noted that certain capital measures, which are presented to illustrate the Group's position, are not covered by the Independent Review Report. Where this is the case, the relevant disclosures are marked as such.

34. CAPITAL MANAGEMENT

The Group's objectives in managing capital are:

- To ensure that the Group has sufficient capital to meet its operational requirements and strategic objectives
- To safeguard the Group's ability to continue as a going concern, so that it can continue to provide returns to shareholders and benefits for other stakeholders
- To provide an adequate return to shareholders by pricing products and services commensurately with the level of risk
- To ensure that sufficient regulatory capital is available to meet any externally imposed requirements

The protection of the Group's capital base and its long-term viability are key strategic priorities.

The Group sets the amount of capital in proportion to risk, availability and cost. The Group manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets, having particular regard to the relative costs and availability of debt and equity finance at any given time. In order to maintain or adjust the capital structure the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares, issue or redeem other capital instruments, such as retail or corporate bonds, or sell assets to reduce debt.

The Group is subject to regulatory capital rules imposed by the PRA on a consolidated basis as a group containing an authorised bank. This is discussed further below.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK

For the six months ended 31 March 2024 (Unaudited)

34. CAPITAL MANAGEMENT (Continued)

(a) Regulatory Capital

The Group is subject to supervision by the PRA on a consolidated basis, as a group containing an authorised bank. For regulatory purposes the Company is designated as a CRR consolidation entity as defined by the PRA Rulebook. As part of this supervision the regulator will issue a Total Capital Requirement ('TCR') setting an amount of regulatory capital, relative to its risk weighted assets, which the Group is required to hold at all times, in order to safeguard depositors from loss in the event of severe losses being incurred by the Group. This is set in accordance with international Basel 3 rules, issued by the Basel Committee on Banking Supervision ('BCBS') which are implemented in the UK through the PRA Rulebook.

The Group's regulatory capital is monitored by the Board of Directors, its Risk and Compliance Committee and by the Executive Risk Committee ('ERC') and the Asset and Liability Committee, which ensure that appropriate action is taken to ensure compliance with the regulator's requirements. The future regulatory capital requirement is also considered as part of the Group's forecasting and strategic planning process.

The Group took advantage of the transitional reliefs allowing the capital impacts of IFRS 9 transition and Covid-related provisions to be phased in over the financial years up to 30 September 2024. Where such reliefs are taken, firms are also required to disclose their capital positions calculated as if the reliefs were not available (the 'fully loaded' basis).

The tables below demonstrate that at 31 March 2024 the Group's total regulatory capital of £1,324.9m (31 March 2023: £1,320.4m; 30 September 2023: £1,338.9m) was comfortably in excess of the amounts required by the regulator, including £698.8m in respect of its Total Capital Requirement ('TCR') (31 March 2023: £657.7m; 30 September 2023: £673.4m), which is comprised of fixed and variable elements (none of these amounts are covered by the independent review report).

At 31 March 2024 the Group's TCR represented 8.8% of Total Risk Exposure ('TRE') (31 March 2023: 8.8%; 30 September 2023: 8.8%).

The CRR also requires firms to hold additional capital buffers, including a Capital Conservation Buffer ('CCoB') of 2.5% of TRE (at 31 March 2024) and a Counter Cyclical Capital Buffer ('CCyB'), currently 2.0% of TRE (31 March 2023: 1.0%; 30 September 2023: 2.0%), which is expected to be long-term rate in a standard risk environment. Firm specific buffers may also be required.

The Group's regulatory capital differs from its equity as certain adjustments are required by the PRA Rulebook or the regulator. A reconciliation of the Group's equity to its regulatory capital determined in accordance with the PRA Rulebook at 31 March 2024 is set out below.

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SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK

For the six months ended 31 March 2024 (Unaudited)

34. CAPITAL MANAGEMENT (Continued)

	Note	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m	30 September 2022 £m
Total equity	§	1,382.0	1,360.4	1,410.6	1,417.3
<i>Deductions</i>					
Proposed dividend	29	(27.6)	(24.5)	(56.7)	(44.9)
IFRS 9 transitional relief	*	3.3	13.3	13.5	25.8
Intangible assets	20	(169.6)	(170.5)	(168.2)	(170.2)
Pension surplus net of deferred tax	25	(12.5)	(7.8)	(9.6)	(5.3)
Prudent valuation adjustments	β	(0.7)	(0.5)	(0.6)	(0.9)
Insufficient coverage	ψ	-	(0.0)	(0.1)	(0.0)
Common Equity Tier 1 (‘CET1’) capital		1,174.9	1,170.4	1,188.9	1,221.8
Other tier 1 capital		-	-	-	-
Total Tier 1 capital		1,174.9	1,170.4	1,188.9	1,221.8
Corporate bond Eligibility cap	φ	150.0	150.0	150.0	150.0
		-	-	-	-
Total Tier 2 capital		150.0	150.0	150.0	150.0
Total regulatory capital (‘TRC’)		1,324.9	1,320.4	1,338.9	1,371.8

§ Including results for the six months ended 31 March 2024 which have been verified by the Group’s external auditor for regulatory purposes.

* Firms are permitted to phase in the impact of IFRS 9 transition and of the impact of Covid-related IFRS 9 impairment provisions over a five-year period. This is explained more fully in note 61 (a) to the 2023 Group Accounts.

β For capital purposes, assets and liabilities held at fair value, such as the Group’s derivatives, are required to be valued on a more conservative basis than the market value basis set out in IFRS 13. This difference is represented by the prudent valuation adjustment above, calculated using the ‘Simplified Approach’ set out in the PRA Rulebook.

ψ Regulatory deduction where there is insufficient coverage for non-performing exposures required under Article 47(c) of the CRR which remained in force in the UK under the Brexit arrangements but was removed by the PRA with effect from 1 November 2023. The amount required at 31 March 2023 was less than £0.1m.

φ The PRA Rulebook restricts the amount of tier 2 capital which is eligible for regulatory purposes to 25% of TCR.

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For the six months ended 31 March 2024 (Unaudited)

34. CAPITAL MANAGEMENT (Continued)

The TRE amount calculated under the PRA Rulebook framework against which this capital is held, and the proportion of these assets it represents, are calculated as shown below.

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m	30 September 2022 £m
Credit risk				
Balance sheet assets	7,097.6	6,690.6	6,784.2	6,652.1
Off balance sheet	95.8	72.9	87.2	85.4
IFRS 9 transitional relief	3.3	13.3	13.5	25.8
	<hr/>	<hr/>	<hr/>	<hr/>
Total credit risk	7,196.7	6,776.8	6,884.9	6,763.3
Operational risk	740.2	633.1	740.2	633.1
Market risk	-	-	-	-
Other	37.8	70.0	43.6	118.6
	<hr/>	<hr/>	<hr/>	<hr/>
Total risk exposure ('TRE')	7,974.7	7,479.9	7,668.7	7,515.0
	<hr/>	<hr/>	<hr/>	<hr/>
Solvency ratios	%	%	%	%
CET1	14.7	15.6	15.5	16.3
TRC	16.6	17.7	17.5	18.3
	<hr/>	<hr/>	<hr/>	<hr/>

This table is not covered by the Independent Review Report

The risk weightings for credit risk exposures are currently calculated using the Standardised Approach. The Basic Indicator Approach is used for operational risk.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK

For the six months ended 31 March 2024 (Unaudited)

34. CAPITAL MANAGEMENT (Continued)

On a fully loaded basis (excluding the effect of IFRS 9 transitional relief) the Group's capital ratios would be:

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m	30 September 2022 £m
CET1 Capital	1,174.9	1,170.4	1,188.9	1,221.8
Add back: IFRS 9 relief	(3.3)	(13.3)	(13.5)	(25.8)
Fully loaded CET1 Capital	1,171.6	1,157.1	1,175.4	1,196.0
TRC	1,324.9	1,320.4	1,338.9	1,371.8
Add back: IFRS 9 relief	(3.3)	(13.3)	(13.5)	(25.8)
Fully loaded TRC	1,321.6	1,307.1	1,325.4	1,346.0
Total risk exposure	7,974.7	7,479.9	7,668.7	7,515.0
Add back: IFRS 9 relief	(3.3)	(13.3)	(13.5)	(25.8)
Fully loaded TRE	7,971.4	7,466.6	7,655.2	7,489.2
Fully loaded solvency ratios	%	%	%	%
CET1	14.7	15.5	15.4	16.0
TRC	16.6	17.5	17.3	18.0

This table is not covered by the Independent Review Report

The TRC at 31 March 2024 on the fully loaded basis of £1,321.6m (31 March 2023: £1,307.1m; 30 September 2023: £1,325.4m) was in excess of the TCR of £698.5m (31 March 2023: £656.6m; 30 September 2023: £672.2m) on the same basis (amounts not covered by the Independent Review Report).

Leverage ratio

The table below shows the calculation of the UK leverage ratio, based on the consolidated balance sheet assets adjusted as required. The PRA has proposed a minimum UK leverage ratio of 3.25% for UK firms with retail deposits of over £50.0 billion. In addition, in October 2021 the PRA stated its expectation that all other UK firms should manage their leverage risk so that this ratio does not ordinarily fall below 3.25%.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK

For the six months ended 31 March 2024 (Unaudited)

34. CAPITAL MANAGEMENT (Continued)

	Note	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m	30 September 2022 £m
Total balance sheet assets		18,980.8	17,320.4	18,420.2	16,653.6
Add Credit fair value adjustments on loans to customers	12	196.5	318.9	379.3	559.9
Debit fair value adjustments on retail deposits	21	1.4	37.8	30.9	99.7
Adjusted balance sheet assets		19,178.7	17,677.1	18,830.4	17,313.2
Less: Derivative assets	18	(511.7)	(511.2)	(615.4)	(779.0)
Central bank deposits	10	(2,739.5)	(2,087.1)	(2,783.3)	(1,612.5)
Cash Ratio Deposits	19	-	(32.9)	(38.0)	(30.2)
Accrued interest on sovereign exposures		(4.2)	(2.1)	(4.2)	(1.0)
On-balance sheet items		15,923.3	15,043.8	15,389.5	14,890.5
Less: Intangible assets	20	(169.6)	(170.5)	(168.2)	(170.2)
Pension surplus	25	(16.6)	(10.4)	(12.7)	(7.1)
Total on balance sheet exposures		15,737.1	14,862.9	15,208.6	14,713.2
Regulatory exposure for derivatives		183.8	279.1	179.6	434.7
Total derivative exposures		183.8	279.1	179.6	434.7
Post offer pipeline at gross notional amount		1,167.6	986.7	993.3	1,307.9
Adjustment to convert to credit equivalent amounts		(962.2)	(819.9)	(815.7)	(1,094.1)
Off balance sheet items		205.4	166.8	177.6	213.8
Tier 1 capital		1,174.9	1,170.4	1,188.9	1,221.8
Total leverage exposure before IFRS 9 relief		16,126.3	15,308.8	15,565.8	15,361.7
IFRS 9 relief		3.3	13.3	13.5	25.8
Total leverage exposure		16,129.6	15,322.1	15,579.3	15,387.5
UK leverage ratio		7.3%	7.6%	7.6%	7.9%

This table is not covered by the Independent Review Report

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK****For the six months ended 31 March 2024 (Unaudited)****34. CAPITAL MANAGEMENT (Continued)**

The fully loaded leverage ratio is calculated as follows:

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m	30 September 2022 £m
Fully loaded tier 1 capital	1,171.6	1,157.1	1,175.4	1,196.0
Total leverage exposure before IFRS 9 relief	16,126.3	15,308.8	15,565.8	15,361.7
Fully loaded UK leverage exposure	<u>7.3%</u>	<u>7.6%</u>	<u>7.6%</u>	<u>7.8%</u>

This table is not covered by the Independent Review Report

The Group calculates regulatory exposure on derivatives using the Standardised Approach for Counterparty Credit Risk ('SA-CCR'), which includes elements based on the market value of derivative assets adjusted for collateral, amongst other things, and based on potential future exposure in respect of all derivatives held.

This leverage ratio is prescribed by the PRA and differs from that defined by the Basel regime due to the exclusion of central bank deposits from exposures.

Capital requirements in subsidiary entities

The regulatory capital disclosures in these condensed financial statements relate only to the consolidated position for the Group. Individual entities within the Group are also subject to supervision on a standalone basis. All such entities complied with the requirements to which they were subject during the period.

(b) Return on tangible equity ('RoTE')

RoTE is defined by the Group by comparing the profit after tax for the period, adjusted for amortisation charged on intangible assets, to the average of the opening and closing equity positions, excluding intangible assets and goodwill.

It effectively reflects a return on equity as if all intangible assets are eliminated immediately against reserves. As this is similar to the approach used for the capital of financial institutions it is widely used in the sector.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK****For the six months ended 31 March 2024 (Unaudited)****34. CAPITAL MANAGEMENT (Continued)**

The Group's consolidated annualised RoTE for the six months ended 31 March 2024 is derived as follows:

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m	30 September 2022 £m
Profit for the period	81.9	37.9	153.9	313.6
Amortisation of intangible assets	0.6	1.0	3.6	2.0
Adjusted profit	<u>82.5</u>	<u>38.9</u>	<u>157.5</u>	<u>315.6</u>
Divided by				
Opening equity	1,410.6	1,417.3	1,417.3	1,241.9
Opening intangible assets	(168.2)	(170.2)	(170.2)	(170.5)
Opening tangible equity	<u>1,242.4</u>	<u>1,247.1</u>	<u>1,247.1</u>	<u>1,071.4</u>
Closing equity	1,382.0	1,360.4	1,410.6	1,417.3
Closing intangible assets	(169.6)	(170.5)	(168.2)	(170.2)
Closing tangible equity	<u>1,212.4</u>	<u>1,189.9</u>	<u>1,242.4</u>	<u>1,247.1</u>
Average tangible equity	<u>1,227.4</u>	<u>1,218.5</u>	<u>1,244.7</u>	<u>1,159.3</u>
Return on tangible equity	<u>13.4%</u>	<u>6.4%</u>	<u>12.7%</u>	<u>27.2%</u>

This table is not covered by the Independent Review Report

(c) Dividend policy

The Company is committed to a long-term sustainable dividend policy. Ordinarily, dividends will increase in line with earnings, subject to the requirements of the business and the availability of cash resources. The Board reviews the policy at least twice a year in advance of announcing its results, taking into account the Group's strategy, capital requirements, principal risks and the objective of enhancing shareholder value.

In determining the level of dividend for any year, the Board expects to follow the dividend policy, but will also take into account the level of available retained earnings in the Company, its cash resources and the cash and capital requirements inherent in its business plans. In addition to the payment of dividends, the Board may also consider whether it is appropriate to apply excess capital in the market purchase of the Group's shares.

The distributable reserves of the Company comprise its profit and loss account balance and, other than the requirement for Paragon Bank PLC to retain an appropriate level of regulatory capital, there are no restrictions preventing profits elsewhere in the Group from being distributed to the parent.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK

For the six months ended 31 March 2024 (Unaudited)

34. CAPITAL MANAGEMENT (Continued)

Since the year ended 30 September 2018, the Company has adopted a policy of paying out approximately 40% of its basic earnings per share as dividend (a dividend cover ratio of around 2.5 times), in the absence of any idiosyncratic factors which might make such a dividend inappropriate. This policy is reviewed by the Board at least annually. The Company considers it has access to sufficient cash resources to pay dividends at this level and that its distributable reserves are abundant for this purpose.

To provide greater transparency, the Company has also indicated that its interim dividend per share will normally be 50% of the previous final dividend, in the absence of any indicators which might make such a level of payment inappropriate.

To determine whether the application of this policy in the current year was appropriate the Board considered the Group's capital position and forecast capital requirements based on its strategic outlook, supported by the half-yearly reforecasting exercise.

This included considering the capital impacts of stress testing carried out as part of both the forecasting and ICAAP processes, and the potential impact of ongoing developments in the regulatory regime for capital, including the introduction in the UK of Basel 3.1. Based on these considerations the Board concluded that a payment in line with policy was appropriate and declared an interim dividend for the period of 13.2p per share (2023 H1: 11.0p per share) (note 29). It also confirmed that the approach of paying an interim dividend of 50% of the preceding year's final dividend would continue to apply in future years.

A buy-back programme for the current financial year, for up to £50.0m of ordinary shares, was announced at the time of the Group's 2023 results announcement. The amount expended in this programme during the period was £39.9m (2023 H1: £61.2m) (note 28). Shortly before the period end the Group gave its brokers an irrevocable instruction to complete the programme, and the full £50.0 million was utilised by 30 April 2024. The remaining amount of the announced funds was accrued for the period end.

As part of its half year consideration of capital, the Board of Directors authorised an extension of the current year's buy-back programme of up to £50.0m. All shares acquired in buy-back programmes are initially held in treasury.

The directors have considered the distributable reserves of the Company and concluded that these distributions are appropriate.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK

For the six months ended 31 March 2024 (Unaudited)

35. CREDIT RISK

The Group's credit risk is primarily attributable to its loans to customers and its business objectives rely on maintaining a high-quality customer base and place strong emphasis on good credit management, both at the time of acquiring or underwriting a new loan, where strict lending criteria are applied, and throughout the loan's life.

The Group's loan assets at 31 March 2024, 31 March 2023 and 30 September 2023 are analysed below.

	31 March 2024		31 March 2023		30 September 2023	
	£m	%	£m	%	£m	%
Buy-to-let mortgages	12,936.6	84.8%	12,383.3	85.1%	12,720.1	85.6%
Owner occupied mortgages	23.6	0.2%	32.5	0.2%	27.7	0.1%
Total first charge residential mortgages	12,960.2	85.0%	12,415.8	85.3%	12,747.8	85.7%
Second charge mortgage loans	134.5	0.9%	177.5	1.2%	154.5	1.0%
Loans secured on residential property	13,094.7	85.9%	12,593.3	86.5%	12,902.3	86.7%
Development finance	849.9	5.5%	765.8	5.3%	747.8	5.0%
Loans secured on property	13,944.6	91.4%	13,359.1	91.8%	13,650.1	91.7%
Asset finance loans	585.3	3.8%	519.1	3.6%	559.1	3.8%
Motor finance loans	311.6	2.1%	286.3	1.9%	297.7	2.0%
Aircraft mortgages	29.7	0.2%	32.5	0.2%	26.9	0.2%
Secured RLS and CBILS	41.1	0.3%	56.5	0.4%	50.5	0.4%
Structured lending	212.8	1.4%	174.2	1.2%	169.0	1.1%
Invoice finance	29.7	0.2%	24.4	0.2%	31.7	0.2%
Total secured loans	15,154.8	99.4%	14,452.1	99.3%	14,785.0	99.4%
Professions finance	57.8	0.4%	65.4	0.5%	52.2	0.4%
Unsecured RLS, CBILS and BBLS	13.7	0.1%	19.8	0.1%	16.7	0.1%
Other unsecured commercial loans	22.7	0.1%	17.6	0.1%	20.4	0.1%
Total loans to customers	15,249.0	100.0%	14,554.9	100.0%	14,874.3	100.0%

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK****For the six months ended 31 March 2024 (Unaudited)****35. CREDIT RISK (Continued)**

First and second charge mortgages are secured by charges over residential properties in England and Wales, or similar Scottish or Northern Irish securities.

Development finance loans are secured by a first charge (or similar Scottish security) over the development property and various charges over the build.

Asset finance loans and motor finance loans are effectively secured by the financed asset, while aircraft mortgages are secured by a charge on the aircraft funded.

Structured lending and invoice finance balances are effectively secured over the assets of the customer, with security enhanced by maintaining balances at a level less than the total amount of the security (the advance percentage).

Professions finance accounts are generally short-term unsecured loans made to firms of lawyers and accountants for working capital purposes.

Loans made under the Recovery Loan Scheme ('RLS'), the Coronavirus Business Interruption Loan Scheme ('CBILS') and the Bounce Back Loan Scheme ('BBLs') have the benefit of a guarantee underwritten by the UK Government.

There are no significant concentrations of credit risk to individual counterparties due to the large number of customers included in the portfolios. All lending is to customers within the UK. The total gross carrying value of the Group's Loans to Customers due from customers with total portfolio exposures over £10.0m is analysed below by product type.

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m
Buy-to-let mortgages	149.8	167.1	149.6
Development finance	485.3	354.8	390.6
Structured lending	198.3	172.8	160.3
Asset finance	14.5	12.5	24.6
	<u>847.9</u>	<u>707.2</u>	<u>725.1</u>

The threshold of £10.0m is used internally for monitoring large exposures.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK

For the six months ended 31 March 2024 (Unaudited)

35. CREDIT RISK (Continued)

Credit grading

An analysis of the Group's loans to customers by absolute level of credit risk at 31 March 2024 is set out below. The analysed amount represents gross carrying amount.

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
31 March 2024					
Very low risk	11,511.7	174.8	1.8	3.5	11,691.8
Low risk	2,119.9	478.7	39.3	0.7	2,638.6
Moderate risk	169.1	151.5	11.1	1.8	333.5
High risk	106.2	123.0	12.1	2.3	243.6
Very high risk	32.2	43.0	203.4	8.8	287.4
Not graded	125.7	2.4	3.0	1.1	132.2
Total gross carrying amount	14,064.8	973.4	270.7	18.2	15,327.1
Impairment	(19.3)	(7.6)	(46.6)	(4.6)	(78.1)
Total loans to customers	14,045.5	965.8	224.1	13.6	15,249.0
31 March 2023					
Very low risk	11,251.5	164.1	1.6	7.6	11,424.8
Low risk	2,042.5	392.0	55.0	1.5	2,491.0
Moderate risk	132.1	153.9	8.9	2.3	297.2
High risk	35.3	85.9	11.4	3.5	136.1
Very high risk	44.4	34.3	77.5	8.8	165.0
Not graded	102.5	1.7	3.1	1.7	109.0
Total gross carrying amount	13,608.3	831.9	157.5	25.4	14,623.1
Impairment	(21.6)	(7.0)	(34.8)	(4.8)	(68.2)
Total loans to customers	13,586.7	824.9	122.7	20.6	14,554.9
30 September 2023					
Very low risk	11,393.7	23.0	1.9	6.6	11,425.2
Low risk	2,236.4	395.5	73.8	2.5	2,708.2
Moderate risk	157.1	147.3	9.7	1.8	315.9
High risk	34.0	113.3	13.6	3.2	164.1
Very high risk	37.7	63.3	104.1	9.3	214.4
Not graded	113.4	2.4	2.9	1.4	120.1
Total gross carrying amount	13,972.3	744.8	206.0	24.8	14,947.9
Impairment	(19.6)	(9.4)	(39.8)	(4.8)	(73.6)
Total loans to customers	13,952.7	735.4	166.2	20.0	14,874.3

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK****For the six months ended 31 March 2024 (Unaudited)****35. CREDIT RISK (Continued)**

Gradings above are based on credit scorecards or internally assigned risk ratings as appropriate for the individual asset class. These measures are calibrated across product types and used internally to monitor the Group's overall credit risk profile against its risk appetite.

These gradings represent current credit quality on an absolute basis and this may result in assets in higher IFRS 9 stages with low risk grades, especially where a case qualifies through breaching, for example, an arrears threshold but is making regular payments. This will apply especially to Stage 3 cases reported in note 14, other than those shown as 'realisations'.

Examples of these cases include fully up-to-date receiver of rent cases, customers who may be up-to-date on accounts with other lenders creating an overall positive rating, and accounts where the default on the Group's loan has yet to impact on external credit scoring.

A small proportion of the loan book (0.9%) is classed as 'not graded' above. This rating relates to loans that have been fully underwritten at origination but where the customer falls outside the automated assessment techniques used post-completion. This is similar to the 0.8% classified as ungraded at 30 September 2023. This disclosure is expected to be developed further in future periods.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK

For the six months ended 31 March 2024 (Unaudited)

35. CREDIT RISK (Continued)

*Credit characteristic by portfolio**Loans secured on residential property*

An analysis of the indexed loan-to-value ('LTV') ratio for those loan accounts secured on residential property by value at 31 March 2024 is set out below. LTVs for second charge mortgages are calculated allowing for the interest of the first charge holder, based on the most recent first charge amount held by the Group, while for acquired accounts the effect of any discount on purchase is allowed for.

	31 March 2024		31 March 2023		30 September 2023	
	First Mortgages	Second Charge Mortgages	First Mortgages	Second Charge Mortgages	First Mortgages	Second Charge Mortgages
	%	%	%	%	%	%
LTV ratio						
Less than 70%	70.2	94.8	75.0	93.4	72.7	94.6
70% to 80%	25.4	3.3	20.5	4.0	23.8	3.2
80% to 90%	3.3	0.9	3.3	1.1	2.5	0.9
90% to 100%	0.3	0.2	0.3	0.4	0.2	0.3
Over 100%	0.8	0.8	0.9	1.1	0.8	1.0
	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
Average LTV ratio	<u>63.4</u>	<u>51.9</u>	<u>62.4</u>	<u>53.1</u>	<u>62.7</u>	<u>52.3</u>
Buy-to-let	63.5		62.5		62.8	
Owner-occupied	<u>38.8</u>		<u>40.2</u>		<u>39.0</u>	

The regionally indexed LTVs shown above are affected by changes in house prices, with the Nationwide house price index, for the UK as a whole, registering an increase of 1.3% during the six months ended 31 March 2024 and an annual increase of 1.6% in the year ended 31 March 2024 compared to a decrease of 5.3% in the year ended 30 September 2023.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK

For the six months ended 31 March 2024 (Unaudited)

35. CREDIT RISK (Continued)

The geographical distribution of the Group's residential mortgage assets by gross carrying value is set out below.

	First Charge			Second Charge		
	31 March 2024	31 March 2023	30 September 2023	31 March 2024	31 March 2023	30 September 2023
	%	%	%	%	%	%
East Anglia	3.3	3.3	3.3	3.4	3.4	3.4
East Midlands	5.9	5.8	5.9	6.2	6.2	6.2
Greater London	18.2	18.1	18.2	7.7	7.6	7.4
North	3.5	3.5	3.5	4.3	4.2	4.2
North West	10.2	10.3	10.3	7.4	7.6	7.5
South East	30.9	30.7	30.6	37.6	38.1	37.8
South West	8.9	8.8	9.0	8.4	8.3	8.4
West Midlands	6.2	6.2	6.2	7.2	7.3	7.3
Yorkshire and Humberside	7.2	7.7	7.4	6.1	6.1	6.2
Total England	94.3	94.4	94.4	88.3	88.8	88.4
Northern Ireland	-	-	-	2.4	2.1	2.3
Scotland	2.6	2.5	2.5	5.6	5.5	5.5
Wales	3.1	3.1	3.1	3.7	3.6	3.8
	100.0	100.0	100.0	100.0	100.0	100.0

Development finance

Development finance loans generally do not require customers to make payments during the life of the loan, therefore arrears and past due measures cannot be used to monitor credit risk. Instead, cases are monitored on an individual basis by management and Credit Risk. The average loan to gross development value ('LTGDV') ratio for the portfolio at the period end, a measure of security cover, is analysed below.

	31 March 2024		31 March 2023		30 September 2023	
	By value %	By number %	By value %	By number %	By value %	By number %
LTGDV						
50% or less	6.2	7.8	10.3	6.6	8.2	6.1
50% to 60%	19.8	20.5	20.5	22.0	17.3	21.7
60% to 65%	33.5	31.2	39.2	35.1	37.7	33.0
65% to 70%	30.4	30.3	21.6	26.3	25.5	27.4
70% to 75%	4.5	5.3	5.5	7.3	5.8	7.4
Over 75%	5.6	4.9	2.9	2.7	5.5	4.4
	100.0	100.0	100.0	100.0	100.0	100.0

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK****For the six months ended 31 March 2024 (Unaudited)****35. CREDIT RISK (Continued)**

The average LTGDV cover at the period end was 62.7% (31 March 2023: 62.0%, 30 September 2023: 63.1%).

LTGDV is calculated by comparing the current expected end of term exposure with the latest estimate of the value of the completed development based on surveyors' reports.

At 31 March 2024, the development finance portfolio comprised 243 accounts (31 March 2023: 259; 30 September 2023: 230) with a total carrying value of £849.9m (31 March 2023: £765.8m; 30 September 2023: £747.8m). Of these accounts, 20 were included in Stage 2 at 31 March 2024 (31 March 2023: 14; 30 September 2023: 15), with 12 accounts included as Stage 3 (31 March 2023: 7; 30 September 2023: 12). In addition, one acquired account had been classified as POCI (31 March 2023: 1; 30 September 2023: 1). An allowance for these losses was made in the IFRS 3 fair value calculation.

The geographical distribution of the Group's development finance loans by gross carrying value is set out below.

	31 March 2024 %	31 March 2023 %	30 September 2023 %
East Anglia	4.4	2.8	4.4
East Midlands	11.4	12.6	11.8
Greater London	13.4	11.5	11.8
North	0.7	1.0	0.8
North West	0.5	0.3	0.4
South East	36.0	42.2	34.0
South West	18.8	16.1	21.3
West Midlands	5.2	5.4	6.2
Yorkshire and Humberside	6.3	6.6	6.6
Total England	96.7	98.5	97.3
Northern Ireland	-	-	-
Scotland	3.1	1.5	2.7
Wales	0.2	-	-
	100.0	100.0	100.0

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK****For the six months ended 31 March 2024 (Unaudited)****35. CREDIT RISK (Continued)***Asset finance and Motor finance*

Asset finance customers are generally small or medium sized businesses. The nature of the assets underlying the Group's asset finance lending, including loans financed through CBILS and RLS loans, by gross carrying value is set out below.

	31 March 2024	31 March 2023	30 September 2023
	%	%	%
Commercial vehicles	43.8	39.7	41.9
Construction plant	30.3	33.2	30.9
Manufacturing	5.8	5.6	6.3
Technology	4.7	5.0	4.8
Refuse disposal vehicles	3.1	3.1	3.4
Other vehicles	4.6	4.8	4.7
Agriculture	1.9	2.2	2.1
Print and paper	1.3	1.2	1.6
Other	4.5	5.2	4.3
	100.0	100.0	100.0

Motor finance loans are secured over cars, leisure vehicles (motorhomes and caravans) and light commercial vehicles and represent exposure to consumers and small businesses.

Structured lending

The Group's structured lending division provides revolving loan facilities to support non-bank lending businesses. Loans are made to a Special Purpose Vehicle ('SPV') company controlled by the customer and effectively secured on the loans made by the SPV. Exposure is limited to a percentage of the underlying assets, providing a buffer against credit loss.

Summary details of the structured lending portfolio are presented below.

	31 March 2024	31 March 2023	30 September 2023	30 September 2022
Number of transactions	10	8	9	8
Total facilities (£m)	275.0	220.7	235.7	220.5
Carrying value (£m)	212.8	174.2	169.0	178.7

The maximum advance under these facilities was generally 80% of the underlying assets, except where loans secured by residential property form the security for the facility, where 90% is permissible.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK

For the six months ended 31 March 2024 (Unaudited)

35. CREDIT RISK (Continued)

Customers are charged interest on their drawn balance at a rate linked to SONIA, and a commitment fee on the undrawn amount of their facility. However, there is generally no requirement to make regular payments of specific amounts, with the facilities operating on a revolving basis, able to be paid down and redrawn over their term.

The performance of each loan is monitored monthly on a case-by-case basis by the Group's Credit Risk function, assessing compliance with covenants relating to both the customer and the performance and composition of the asset pool. These assessments, which are reported to Credit Committee, are used to inform the assessment of expected credit loss under IFRS 9.

At 31 March 2024 one facility was identified as Stage 2 (31 March 2023: two; 30 September 2023: one), with the remainder identified as Stage 1.

RLS, CBILS and BBLs

Loans under these schemes have the benefit of guarantees underwritten by the UK Government, which launched them as a response to the impact of Covid on UK SMEs.

CBILS and BBLs were launched in 2020 and remained open for new applications until March 2021. RLS was launched in April 2021 as a successor scheme and has subsequently been extended twice. The current scheme is expected to be available until June 2024, and the UK Government has announced a further extension.

The Group offered term loans and asset finance loans under CBIL scheme. Interest and fees are paid by the UK Government for the first twelve months and the government guarantees covers up to 80% of the lender's principal loss after the application of any proceeds from the asset financed (if applicable).

Loans under the BBL scheme are six-year term loans at a standard 2.5% per annum interest rate. The UK Government pays the interest on the loan for the first twelve months and provides lenders with a guarantee covering the whole outstanding balance.

The Group offers term loans and asset finance loans under the RLS. Interest and fees are payable by the customer from inception. The Government guarantee covers up to 80% of the lender's principal loss, after the application of any proceeds from the asset financed (if applicable), on applications received before 1 January 2022 and up to 70% for applications received thereafter.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK****For the six months ended 31 March 2024 (Unaudited)****35. CREDIT RISK (Continued)**

The Group's outstanding RLS, CBILS and BBLS loans at 31 March 2024 were:

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m
RLS			
Term loans	0.9	0.9	1.0
Asset finance	30.1	37.8	36.0
Total RLS	31.0	38.7	37.0
CBILS			
Term loans	10.2	15.4	12.6
Asset finance	11.0	18.7	14.5
Total CBILS	21.2	34.1	27.1
BBLS	2.6	3.5	3.1
Total	54.8	76.3	67.2
Total term loans	13.7	19.8	16.7
Total asset finance	41.1	56.5	50.5
	54.8	76.3	67.2

At 31 March 2024, £0.9m of this balance was considered to be non-performing (31 March 2023: £0.7m; 30 September 2023: £0.7m).

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK

For the six months ended 31 March 2024 (Unaudited)

35. CREDIT RISK (Continued)

Arrears performance

The number of accounts in arrears by asset class, based on the most commonly quoted definition of arrears for the type of asset, at 31 March 2024, 31 March 2023 and 30 September 2023, compared to the industry averages at those dates published by UK Finance ('UKF') and the Finance and Leasing Association ('FLA'), was:

	31 March 2024 %	31 March 2023 %	30 September 2023 %
First mortgages			
Accounts more than three months in arrears			
Buy-to-let accounts including receiver of rent cases	0.68	0.25	0.34
Buy-to-let accounts excluding receiver of rent cases	0.28	0.16	0.15
Owner-occupied accounts	3.41	3.28	2.93
UKF data for mortgage accounts more than three months in arrears			
Buy-to-let accounts including receiver of rent cases	0.84	0.46	0.69
Buy-to-let accounts excluding receiver of rent cases	0.76	0.43	0.64
Owner-occupied accounts	0.98	0.78	0.89
All mortgages	0.94	0.72	0.84
Second charge mortgage loans			
Accounts more than 2 months in arrears			
All accounts	24.61	22.59	23.48
Post-2010 originations	3.21	2.37	2.42
Legacy cases	27.47	25.92	26.58
Purchased assets	31.21	28.98	30.10
FLA data for second mortgages	6.60	6.60	6.30
Motor finance loans			
Accounts more than 2 months in arrears			
All accounts	1.08	1.44	1.08
Originated cases	1.09	1.34	1.07
Purchased assets	-	4.28	1.32
FLA data for consumer point of sale hire purchase	4.30	3.70	3.90
Asset finance loans			
Accounts more than 2 months in arrears	0.13	0.17	0.23
FLA data for business lease/hire purchase loans	0.70	0.60	0.60

No published industry data for asset classes comparable to the Group's other books has been identified. Where revised data at 31 March 2023 or 30 September 2023 has been published by the FLA or UKF, the comparative industry figures above have been amended.

Arrears information is not given for development finance, structured lending or invoice finance activities as the structure of the products means that such a measure is not appropriate.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK

For the six months ended 31 March 2024 (Unaudited)

35. CREDIT RISK (Continued)

The Group calculates its headline arrears measure for buy-to-let mortgages, shown above, based on the numbers of accounts three months or more in arrears, including purchased assets, but excluding those cases in possession and receiver of rent cases designated for sale. This is consistent with the methodology used by UKF in compiling its statistics for the buy-to-let mortgage market as a whole.

The number of accounts in arrears will naturally be higher for legacy books, such as the Group's legacy second charge mortgages and residential first mortgages, as performing accounts tend to redeem earlier than non-performing loans, meaning that the latter gradually become a higher proportion of any closed loan book.

The figures shown above for second charge mortgage loans include purchased portfolios which generally include a high proportion of cases in arrears at the time of purchase, where this level of performance is allowed for in the discount to current balance represented by the purchase price. However, this will lead to higher than average reported arrears.

Acquired assets

In the debt purchase industry, Estimated Remaining Collections ('ERCs') is commonly used as a measure of the value of a portfolio. This is defined as the sum of the undiscounted cash flows expected to be received over a specified future period. In the Group's view, this measure may be suitable for heavily discounted, unsecured, distressed portfolios (which will be treated as POCI under IFRS 9) but is less applicable for some types of portfolio in which the Group has invested, where cash flows are higher on acquisition, loans may be secured on property and customers may not be in default. In such cases, the IFRS 9 amortised cost balance, at which these assets are carried in the Group balance sheet, provides a better indication of value.

However, to aid comparability, the 84 and 120 month ERCs value for the Group's purchased consumer assets are set out below. These are derived from the same models and assumptions used in the effective interest rate calculations. ERCs are set out both for all purchased consumer portfolios and for those classified as POCI under IFRS 9.

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m	30 September 2022 £m
<i>All purchased consumer assets</i>				
Carrying value	41.9	65.4	58.6	75.3
84 month ERCs	56.8	76.4	68.9	88.6
120 month ERCs	62.1	82.5	73.4	94.2
<i>POCI assets only</i>				
Carrying value	11.9	18.6	17.7	21.4
84 month ERCs	18.1	25.3	24.5	29.9
120 month ERCs	21.7	29.7	27.8	33.0

Amounts shown include loans disclosed as loans to customers (note 12). They include first mortgages and second charge mortgages.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION****For the six months ended 31 March 2024 (Unaudited)**

The notes set out below describe the accounting basis on which the Group prepares its accounts, the particular accounting policies adopted by the Group and the principal judgements and estimates which were required in the preparation of the condensed financial information.

They also include other information describing how the condensed financial information has been prepared required by legislation and accounting standards.

36. ACCOUNTING POLICIES

The condensed financial statements are presented in accordance with the requirements of International Accounting Standard 34 – ‘Interim Financial Reporting’.

The condensed financial statements are required to be prepared on the basis of the accounting policies expected to be used in the production of the financial statements for the year.

The Group is required, by the Companies Act 2006 and the Listing Rules of the FCA, to prepare its financial statements for the year ending 30 September 2024 in accordance with UK-adopted international accounting standards. In the financial years reported on this also means, in the Group’s circumstances, that the financial statements also accord with IFRS as approved by the International Accounting Standards Board.

The requirements of UK-adopted IFRS have not changed for the current year and therefore the accounting policies adopted in the current year are the same as those set out in the 2023 Annual Report and Accounts of the Group.

In addition, the investment securities described in note 11 are held as part of the Group’s liquidity buffer. They are therefore classified as ‘held to collect’, following an example set out in IFRS 9. These securities are carried at amortised cost, with income recognised on an EIR basis.

The Group has historically chosen to present an additional comparative balance sheet.

IFRS 18

On 9 April 2024 the IASB issued IFRS 18 – ‘Presentation and Disclosure in Financial Statements’. This is expected to impact the way in which information is disclosed in financial statements without impacting materially on the underlying accounting.

IFRS 18 is expected to apply to the Group with effect from its financial year ending 30 September 2028 if the standard is endorsed for use in the UK. A detailed exercise to determine the impact of the new Standard on the Group’s annual and half-year reporting will be carried out before the implementation date.

New and revised reporting standards

In the preparation of these consolidated financial statements, no accounting standards are being applied for the first time.

Other than IFRS 18, described above, there are no new reporting standards and interpretations in issue but not effective which address matters relevant to the Group’s accounting and reporting.

No new or revised reporting standards significantly affecting the Group’s accounting have been issued since the approval of the Group’s financial statements for the year ended 30 September 2023, other than IFRS 18.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

For the six months ended 31 March 2024 (Unaudited)

37. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The critical accounting estimates and judgements affecting the condensed financial information are the same as those described in notes 68 and 69 to the accounts of the Group for the year ended 30 September 2023.

Updated commentary on the critical accounting judgements related to significant increase in credit risk, and the critical accounting estimates related to impairment losses on loans to customers and effective interest rates is set out below.

(a) Significant Increase in Credit Risk ('SICR')

Under IFRS 9, the directors are required to assess where a credit obligation has suffered a Significant Increase in Credit Risk ('SICR'). The directors' assessment is based primarily on changes in the calculated PD, but also includes consideration of other qualitative indicators and the adoption of the backstop assumption in the Standard that all cases which are more than 30 days overdue have an SICR, for account types where days overdue is an appropriate measure.

As part of its consideration of the adequacy of its impairment provisioning, management have considered whether there are any factors not reflected in its normal approach which indicate that a group, or groups of accounts should be considered as having SICR. No such accounts were identified.

If additional accounts were determined to have an SICR, these balances would attract additional impairment provision, as such cases are provided on the basis of lifetime expected loss, rather than the 12-month expected loss, and the overall provision charge would be higher. Conversely, if cases are incorrectly identified as SICR, impairment provisions will be overstated. Furthermore, adjustments to current PD estimates in the Group's models may also have the effect of identifying more or less accounts as having an SICR.

More information on the definition of SICR adopted is given in note 13.

(b) Impairment losses on loans to customers

Impairment losses on loans are calculated based on statistical models, applied to the present status, performance and management strategy for the loans concerned which are used to determine each loan's PD and LGD.

Internal information used will include number of months arrears, qualitative information, such as possession by a first charge holder on a second charge mortgage or where a buy-to-let case is under the control of a receiver of rent, the receiver's present and likely future strategy for the property (which might include keeping current tenants in place, refurbish and relet, immediate sale etc).

External information used includes customer-specific data, such as credit bureau information as well as more general economic data.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

For the six months ended 31 March 2024 (Unaudited)

37. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Continued)

Key internal assumptions in the models relate to estimates of future cash flows from customers' accounts, their timing and, for secured accounts, the expected proceeds from the realisation of the property or other charged assets. These cash flows will include payments received from the customer, and, for buy-to-let cases where a receiver of rent is appointed, rental receipts from tenants, after allowing for void periods and running costs. These key assumptions are based on observed data from historical patterns and are updated regularly based on new data as it becomes available.

In addition, the directors consider how appropriate past trends and patterns might be in the current economic situation and make any adjustments they believe are necessary to reflect current and expected conditions.

In evaluating the potential impact of the economic situation at 31 March 2024 there is little recent history against which to benchmark likely customer behaviour. Interest rates in the UK increased rapidly in the preceding year and have remained at elevated levels throughout the period. The UK base rate remained at 5.25% throughout the period, a level it had not touched since April 2008, since when significant regulatory intervention in the UK's lending markets has taken place. There have also been significant changes in product structures in that period, including the growth of longer term fixed-rate mortgage lending in recent years. All these factors make the historical record of behaviours in higher interest rate environments an uncertain guide to the likely impact of current rate levels.

There is also little agreement between economic forecasters as to the future direction of the UK economy, exacerbated by the potential impact of July's general election. At the same time, the level to which economic pressures on customers have yet to manifest themselves in credit metrics is still unclear, with credit performance across the markets in which the Group is active being better than some expected over the past 18 months. However, considerable uncertainty exists as to whether this represents a more benign outcome, or merely a delay in credit issues emerging beyond what was anticipated. Together, these factors make forecasting credit behaviour in current conditions particularly challenging.

The accuracy of the impairment calculations would be affected by unexpected changes to the economic situation, variances between the models used and the actual results, or assumptions which differ from the actual outcomes. In particular, if the impact of economic factors such as employment levels on customers is worse than is implicit in the models then the number of accounts requiring provision might be greater than suggested by the models, while falls in house prices, over and above any assumed by the models might increase the provision required in respect of accounts currently provided. Similarly, if the account management approach assumed in the modelling cannot be adopted the provision required may be different.

In order to provide forward looking economic inputs to the modelling of the ECL, the Group must derive a set of scenarios which are internally coherent. The Group addresses these requirements using four distinct economic scenarios chosen to represent the range of possible outcomes. These scenarios at 31 March 2024 have been derived in light of the current economic situation, modelling a variety of possible outcomes as described in note 16.

As noted above, there remains a significant range of different opinions amongst economists about the longer-term prospects for the UK, and while these have converged, to some extent, over recent months, the medium-term political uncertainty over UK economic policy adds inherent complexity to any forecasting exercise.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

For the six months ended 31 March 2024 (Unaudited)

37. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Continued)

The variables are used for two purposes in the IFRS 9 calculations:

- They are applied as inputs in the models which generate PD values, where those found by statistical analysis to have the most predictive value are used
- They are used as part of the calculation where the variable has a direct impact on the expected loss calculation, such as the HPI

The economic variables will also inform assumptions about the Group's approach to account management given a particular scenario.

In addition to uncertainty created by the economic scenarios, the Group recognises that economic situations can arise which lie outside the range of potential positions considered as a basis for its IFRS 9 approach to impairment when the current models were built. The current forecast scenarios, which include higher rates of interest and inflation than in the historically observed data, represent situations where these models may not be able to fully allow for potential economic impacts on the loan portfolios. The Group therefore assessed, for each class of asset, whether any adjustment to the normal approach was required to ensure sufficient provision was created and also reviewed other available data, both from account performance and customer feedback to form a view of the underlying reasons for observed customer behaviours and of their future intentions and prospects.

As a result of this exercise additional requirements for provision were identified, to compensate for potential model weakness and to allow for economic pressures in the wider economy which cannot be identified by a modelled approach. By their nature such adjustments are less systematic and therefore subject to a wider range of outturns. The nature and amounts of these judgemental adjustments are set out in note 13.

The position after considering all these matters is set out in notes 13 to 15, together with further information on the Group's approach. The economic scenarios referred to above and their impact on the overall provision are set out in note 16, while sensitivity analyses on impairment provisioning are set out the note 17.

(c) Effective interest rates

In order to determine the EIR applicable to loans and borrowings an estimate must be made of the expected life of each asset or liability and the cash flows relating thereto, including those relating to early redemption charges together with any initial fees receivable from the customer or procurement fees payable to a mortgage broker or other introducer.

Where an account may have differing interest charging arrangements in different phases of its contractual life, such as the Group's buy-to-let mortgage accounts which have a fixed interest rate for a set period and then revert to a variable rate set by the Group (the 'reversionary rate'), the behavioural life and the expected level of the reversionary rate will have a significant impact on the overall EIR. For each portfolio a model is in place to ensure that income is appropriately spread.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

For the six months ended 31 March 2024 (Unaudited)

37. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Continued)

For loan accounts such as those in the Group's mortgage portfolios where borrowers typically repay their balances before the contractual repayment date, the estimated life of the account will be dependent on customer behaviour. The customer may choose to sell their property and redeem the mortgage at any point, but may also choose to refinance their account, if a more attractive alternative is available, based on the interest rate they are being charged at that point in time, or expect to be charged in the future. The behavioural life of the loan may therefore be influenced by levels of activity in the residential property market, or by the nature and pricing of alternative funding sources, at each point in the loan's life and these are likely to vary over time.

For loans which have a fixed-rate period, the length of that period will have a significant behavioural impact, with many customers choosing to consider their positions at the point at which the fixed rate expires, influenced by the market conditions then prevailing. The forecast future choices of customers currently on fixed-rate products at this point therefore have a significant impact on the EIR modelling for these assets.

Where loans are more likely to run to contractual term, and interest rates are less likely to vary over that term, as is the case for the majority of the Group's motor finance and asset-backed SME lending, the determination of an EIR model is less judgemental, and reflects principally the spreading of known fees and commissions.

The Group models lives for each of its asset classes, based on its current expectation of future borrower behaviour, and uses these profiles, together with its expectations of future reversionary interest rates, to determine the correct EIR to be applied to each account. The underlying estimates are based on historical data, adjusted for expected changes, and reviewed regularly. The accuracy of the EIR applied would therefore be compromised by any differences between actual repayment profiles and charging rates and those predicted, which in turn would depend directly on customer behaviour and market conditions.

The Group therefore keeps its models under review and refines its modelling in the light of any emerging deviations from expected behaviour. These are particularly likely where the current or expected economic environment differs from historic scenarios for which relevant data observations are available. This is currently the case, with market mortgage rates at far higher levels than have been seen in many years. In such cases management consider carefully the impacts which any new conditions may have on customer behaviour and reversionary rates and reflect them in the model as appropriate, revisiting these assumptions regularly as observable data becomes available, with a detailed exercise to analyse any emerging themes taking place every six months as part of the half-year and year-end results processes.

For purchased loans the EIR calculation will involve estimating the likely future credit performance of the accounts at the time of acquisition as well as the customers' payment behaviour. In the initial modelling historical data obtained from the vendor will be examined, with assumptions revisited through the asset lives based on actual and expected customer behaviour.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

For the six months ended 31 March 2024 (Unaudited)

37. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Continued)

The application of these estimates results in an overall decrease in the carrying value of the Group's loans to customers, including POCL accounts, at 31 March 2024 of £0.2m (30 September 2023: increase of £20.5m).

To illustrate the potential variability of the estimate, the amortised cost values were recalculated by changing one factor in the EIR calculation and keeping all others at their current levels.

- Currently the average behavioural life used in the buy-to-let modelling for non-legacy assets, which have an average fixed period of 48 months (30 September 2023: 49 months), was 81 months (30 September 2023: 83 months).

A reduction of the assumed average lives of all loans secured on residential property by three months would reduce balance sheet assets by £9.0m (30 September 2023: £9.3m), while an increase of the assumed asset lives of such assets by three months would increase balance sheet assets by £9.0m (30 September 2023: £9.2m). £8.8m of both the increase and decrease related to non-legacy buy-to-let assets (30 September 2023: £8.8m).

A reduction of the assumed average lives of all loans secured on residential property by six months would reduce balance sheet assets by £18.1m (30 September 2023: £18.5m), while an increase of the assumed asset lives of such assets by six months would increase balance sheet assets by £18.0m (30 September 2023: £18.4m). £17.6m of both the increase and decrease related to non-legacy buy-to-let assets (30 September 2023: £17.5m)

- The EIR calculation is based on management estimates of the reversionary rates which would be charged to customers after the end of their fixed rate periods.

If it was assumed that the maximum reversionary rate which could be charged in future was 6.00%, then the value of the non-legacy buy-to-let loan book would be decreased by £7.2m (30 September 2023: £3.0m).

If it was assumed that the maximum reversionary rate which could be charged in future was 8.00%, then the value of the non-legacy buy-to-let loan book would be increased by £12.7m (30 September 2023: £3.9m)

- Where fixed rate buy-to-let assets redeem before the end of their fixed rate period, an early redemption charge is made, and an estimate for the impact of these charges must be included in the EIR calculation.

An increase of 50% in the number of five-year fixed rate buy-to-let loan assets assumed to redeem before the end of the fixed-rate period would increase balance sheet assets by £7.5m (30 September 2023: £9.6m).

- A reduction (or increase) in estimated cash flows from purchased loan assets (principally buy-to-let first mortgage loans and second charge consumer loan assets) of 5% would reduce (or increase) balance sheet assets by £1.2m (30 September 2023: £1.6m). Such assets now represent only £41.9m of the Group's loan portfolio (30 September 2023: £58.8m).

As any of these changes would, in reality, be accompanied by movements in other factors, actual outcomes may differ from these estimates.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

For the six months ended 31 March 2024 (Unaudited)

38. GOING CONCERN BASIS

The condensed financial information for the half year has been prepared on the going concern basis.

Accounting standards require the directors to assess the Group's ability to continue to adopt the going concern basis of accounting. In performing this assessment, the directors consider all available information about the future, the possible outcomes of events and changes in conditions and the realistically possible responses to such events and conditions that would be available to them, having regard to the 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' published by the Financial Reporting Council in September 2014 applicable to half-yearly reporting.

Particular focus is given to the Group's financial forecasts for this period to ensure the adequacy of resources available for the Group to meet its business objectives on both a short-term and strategic basis. The guidance requires that this assessment covers a period of at least twelve months from the date of approval of this half-yearly report.

The business activities of the Group, its current operations and those factors likely to affect its future results and development, together with a description of its financial position and funding position, are described in the Interim Management Report on pages 5 to 68. The principal risks and uncertainties affecting the Group in the forthcoming six months are described on pages 176 to 177.

Note 61 to the 2023 Group Accounts includes an analysis of the Group's regulatory and working capital position and policies, while notes 62 to 65 include a detailed description of its funding structures, its use of financial instruments, its financial risk management objectives and policies and its exposure to credit, market and liquidity risk. notes 68 and 69 to those accounts discusses critical accounting judgements and estimates affecting the results and financial position disclosed therein. The position and policies described in these notes remain materially unchanged to the date of this half-yearly report, subject to the changes in funding described in note 22.

Financial forecasts

The Group has a formalised process of budgeting, reporting and review. The Group's planning procedures forecast its profitability, capital position, funding requirement and cash flows. Detailed plans are produced for two-year periods with longer-term forecasts covering a five-year period which include detailed income forecasts. These plans provide information to the directors which is used to ensure the adequacy of resources available for the Group to meet its business objectives, both on a short-term and strategic basis.

The forecast is updated every six months, and the directors have based their going concern assessment of the reforecast for the period beginning on 1 April 2024.

The Group makes extensive use of stress testing in compiling and reviewing its forecasts. This stress testing approach was recently reviewed in detail as part of the annual Internal Capital Adequacy Assessment Process ('ICAAP') cycle, where testing considered the impact of a number of severe but plausible scenarios. During the planning process, sensitivity analysis was carried out on a number of key assumptions that underpin the forecast to evaluate the impact of the Group's principal risks.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

For the six months ended 31 March 2024 (Unaudited)

38. GOING CONCERN BASIS (Continued)

The key stresses modelled in detail to evaluate the forecast were:

- An increase in buy-to-let volumes. This examined the impact of higher volumes at a reduced yield on profitability and illustrated the extent to which capital resources and liquidity would be stretched due to the higher cash and capital requirements
- Higher funding costs – higher cost on all new savings deposits, both front book and back book throughout the forecast horizon. This scenario illustrates the impact of a significant, prolonged margin squeeze on profitability, and whether this would cause significant impacts on any capital, liquidity or encumbrance ratios
- Higher buy-to-let redemption rates for buy-to-let mortgages reaching the end of their fixed rate period. This illustrates the potential risk inherent in five-year fixed rate business
- Increased economic stress on customers. As well as modelling the impact of each of the economic scenarios set out in note 16 across the forecast horizon, the severe economic scenario was also modelled over the five-year horizon. To ensure this represented a worst-case scenario all other assumptions were held steady, although in reality adjustments to new business appetite and other factors would be made
- Combined downside stress - the half-year IFRS 9 downside economic scenario described in note 16 was modelled out for the plan horizon along with a plausible set of other adverse factors to the business model, creating a prolonged tail-risk

These stresses did not take account of management actions which might mitigate the impact of the adverse assumptions used. They were designed to demonstrate how such stresses would affect the Group's financing, capital and liquidity positions and highlight any areas which might impact the Group's going concern status. Under all these scenarios, the Group was able to meet its obligations over the forecast horizon and maintain a surplus over its regulatory requirements for both capital and liquidity through normal balance sheet management activities.

As part of the ICAAP process the Group also assessed the potential operational risks it could face. This was done through the analysis of the impact and cost of a series of severe but plausible scenarios. This analysis did not highlight any factors which cast doubt on the Group's ability to continue as a going concern.

The Group began the forecast period with a strong capital and liquidity position enabling the management of any significant outflows of deposits and / or reduced inflows from customer receipts. Overall, the forecasts, even under reasonable further levels of stress show the Group retaining sufficient equity, capital, cash and liquidity throughout the forecast period to satisfy its regulatory and operational requirements.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION****For the six months ended 31 March 2024 (Unaudited)****38. GOING CONCERN BASIS (Continued)****Availability of funding and liquidity**

The availability of funding and liquidity is a key consideration, including retail deposit, wholesale funding, central bank and other contingent liquidity options.

The Group's retail deposits of £14,768.5m (note 21) are repayable within five years, with 84.1% (£12,417.9m) of this balance payable within twelve months of the balance sheet date. The liquidity exposure represented by these deposits is closely monitored, a process supervised by the Asset and Liability Committee. The Group is required to hold liquid assets in Paragon Bank to mitigate this liquidity risk. At 31 March 2024, Paragon Bank held £2,745.4m of balance sheet assets for liquidity purposes, of which £2,647.3m comprised central bank deposits (note 10) and £98.1m was in the form of investment securities (note 11). A further £150.0m of liquidity was provided by the long/short repo arrangement described in the Group's 2023 Annual Report and Accounts. This brings the total available to £2,895.4m.

Paragon Bank manages its liquidity in line with the Board's risk appetite and the requirements of the PRA, which are formally documented in the Board's approved Individual Liquidity Adequacy Assessment Process ('ILAAP') updated annually. The Bank maintains a liquidity framework that includes a short to medium-term cash flow requirement analysis, a longer-term funding plan and access to the Bank of England's liquidity insurance facilities, where pre-positioned assets would support further drawings of £2,672.2m. Holdings of the Group's own externally rated mortgage-backed loan notes can also be used to access the Bank of England's liquidity facilities or other funding arrangements. At 31 March 2024 the Group had £1,937.1m (30 September 2023: £1,205.6m) of such notes available for use, of which £1,615.8m were rated AAA (30 September 2023: £986.9m). The available AAA notes would give access to £813.6m (30 September 2023: £769.8m) if used to support drawings on Bank of England facilities.

The Group's securitisation funding structures provide match funding for part of the asset base. Repayment of the securitisation borrowings is restricted to funds generated by the underlying assets and there is limited recourse to the Group's general funds. Recent and current loan originations are financed through retail deposits and may be refinanced through securitisation where this is appropriate and cost-effective. While the Group has not accessed the public securitisation market in the period, the market remains active and the Group maintains the infrastructure required to access it.

The earliest maturity of any of the Group's working capital debt is in August 2024, when a retail bond issue of £112.5m matures. The majority of central bank borrowings mature in 2025.

The Group's access to debt is enhanced by its BBB+ corporate rating, confirmed by Fitch Ratings in February 2024, and its status as an issuer is evidenced by the BBB-, investment grade, rating of its £150.0m Tier-2 Bonds. It has regularly accessed the capital markets for warehouse funding and corporate and retail bonds over recent years and continues to be able to access these markets. The Group also has access to the short-term repo market which it accesses from time-to-time.

The Group's cash analysis, which includes the impact of all scheduled debt and deposit repayments, continues to show a strong free cash position, even after allowing scope for significant discretionary payments and capital distributions.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

For the six months ended 31 March 2024 (Unaudited)

38. GOING CONCERN BASIS (Continued)

As described in note 34, the Group's capital base is subject to consolidated supervision by the PRA. Its capital at 31 March 2024 was in excess of regulatory requirements and the Group's forecasts indicate that this will continue to be the case.

Going Concern assessment

In order to assess the appropriateness of the going concern basis the directors considered the Group's financial position, the cash flow requirements laid out in its forecasts, its access to funding, the assumptions underlying the forecasts and potential risks affecting them.

After performing this assessment, the directors concluded that there was no material uncertainty as to whether the Group would be able to maintain adequate capital and liquidity for at least twelve months following the date of approval of this half-yearly report and consequently that it was appropriate for them to continue to adopt the going concern basis in preparing the half-yearly financial information for the Group.

39. FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The Group's financial assets and financial liabilities are valued on one of two bases, defined by IFRS 9:

- Financial assets and liabilities carried at fair value through profit and loss ('FVTPL')
- Financial assets and liabilities carried at amortised cost

IFRS 7 – 'Financial Instruments: Disclosures' requires that, where assets are measured at fair value, these measurements should be classified using a fair value hierarchy reflecting the inputs used and defines three levels.

- Level 1 measurements are unadjusted market prices
- Level 2 measurements are derived from directly or indirectly observable data, such as market prices or rates
- Level 3 measurements rely on significant inputs which are not derived from observable data

As quoted prices are not available for level 2 and 3 measurements, the valuation is derived from cash flow models based, where possible, on independently sourced parameters. The accuracy of the calculation would therefore be affected by unexpected market movements or other variances in the operation of the models or the assumptions used.

The Group had no financial assets or liabilities in the period ended 31 March 2024 or the year ended 30 September 2023 carried at fair value and valued using level 3 measurements.

The Group has not reclassified any of its measurements during the period.

The methods by which fair value is established for each class of financial assets and liabilities are set out below.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION**

For the six months ended 31 March 2024 (Unaudited)

39. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (Continued)**(a) Assets and liabilities carried at fair value**

The following table summarises the Group's financial assets and liabilities which are carried at fair value.

	Note	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m
Financial assets				
Derivative financial assets	18	511.7	511.2	615.4
		511.7	511.2	615.4
Financial liabilities				
Derivative financial liabilities	18	95.1	51.3	39.9
		95.1	51.3	39.9

Derivative financial assets and liabilities

Derivative financial instruments are stated at their fair values in the accounts. The Group uses a number of techniques to determine the fair values of its derivative assets and liabilities, for which observable prices in active markets are not available. These are principally present value calculations based on estimated future cash flows arising from the instruments, discounted using a market interest rate, adjusted for risk as appropriate. The principal inputs to these valuation models are SONIA (and formerly LIBOR) sterling benchmark interest rates.

In order to determine the fair values, the management applies valuation adjustments to observed data where that data would not fully reflect the attributes of the instrument being valued, such as particular contractual features or the identity of the counterparty. The management reviews the models used on an ongoing basis to ensure that the valuations produced are reasonable and reflect all relevant factors. These valuations are based on market information and they are therefore classified as level 2 measurements. Details of these assets are given in note 18.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION****For the six months ended 31 March 2024 (Unaudited)****39. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)****(b) Assets and liabilities carried at amortised cost**

The fair values for financial assets and liabilities held at amortised cost, determined in accordance with the methodologies set out in this note are summarised below.

	31 March 2024		31 March 2023		30 September 2023	
	Carrying amount £m	Fair value £m	Carrying amount £m	Fair value £m	Carrying amount £m	Fair value £m
Financial assets						
Cash	3,039.0	3,039.0	2,275.4	2,275.4	2,994.3	2,994.3
Investment securities	98.1	97.8	-	-	-	-
Loans to customers	15,249.0	15,187.6	14,554.9	14,276.6	14,874.3	14,524.0
Sundry financial assets	9.8	9.8	39.9	39.9	46.0	46.0
	<u>18,395.9</u>	<u>18,334.2</u>	<u>16,870.2</u>	<u>16,591.9</u>	<u>17,914.6</u>	<u>17,564.3</u>
Financial liabilities						
Short term bank borrowings	1.2	1.2	0.2	0.2	0.2	0.2
Asset-backed loan notes	17.1	17.1	289.8	289.8	28.0	28.0
Secured bank borrowings	-	-	341.8	341.8	-	-
Retail deposits	14,768.5	14,791.3	11,875.9	11,799.6	13,265.3	13,177.3
Corporate and retail bonds	261.1	250.8	261.6	244.4	258.2	234.8
Sale and repurchase agreements	100.0	100.0	-	-	50.0	50.0
Other financial liabilities	478.7	478.7	393.4	393.4	608.8	608.8
	<u>15,626.6</u>	<u>15,639.1</u>	<u>13,162.7</u>	<u>13,069.2</u>	<u>14,210.5</u>	<u>14,099.1</u>

Cash, bank loans and securitisation borrowings

The fair values of cash and cash equivalents, bank loans and overdrafts and asset-backed loan notes, which are carried at amortised cost, are considered to be not materially different from their book values. In arriving at that conclusion market inputs have been considered but because all the assets mature within three months of the year end and the interest rates charged on financial liabilities reset to market rates on a quarterly basis, little difference arises.

While the Group's asset-backed loan notes are listed, the quoted prices for an individual note may not be indicative of the fair value of the issue as a whole, due to the specialised nature of the market in such instruments and the limited number of investors participating in it.

As these valuation exercises are not wholly market-based, they are considered to be level 2 measurements.

CONDENSED FINANCIAL STATEMENTS**SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION****For the six months ended 31 March 2024 (Unaudited)****39. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)***Investment securities*

The Group's investment securities are of the type for which a liquid market exists and for which quoted prices are available. It is therefore appropriate to consider that the market price of these assets constitutes a fair value. As this valuation is based on a market price it is considered to be a level 1 measurement.

Loans to customers

To assess the likely fair value of the Group's loan assets in the absence of a liquid market, the directors have considered the estimated cash flows expected to arise from the Group's investments in its loans to customers based on a mixture of market-based inputs, such as rates and pricing and non-market-based inputs such as redemption rates. Given the mixture of observable and non-observable inputs these are considered to be level 3 measurements.

Corporate debt

The Group's retail and corporate bonds are listed on the London Stock Exchange and there is presently a reasonably liquid market in the instruments. It is therefore appropriate to consider that the market price of these borrowings constitutes a fair value. As this valuation is based on a market price, it is considered to be a level 1 measurement.

Retail deposits

To assess the likely fair value of the Group's retail deposit liabilities, the directors have considered the estimated cash flows expected to arise based on a mixture of market-based inputs, such as rates and pricing and non-market-based inputs such as withdrawal rates. Given the mixture of observable and non-observable inputs, these are considered to be level 3 measurements.

Sundry assets and liabilities

Fair values of financial assets and liabilities disclosed as sundry assets and sundry liabilities are not considered to be materially different to their carrying values.

These assets and liabilities are of relatively low value and may be settled at their carrying value at the balance sheet date or shortly thereafter.

ADDITIONAL FINANCIAL INFORMATION (APPENDICIES)**For the six months ended 31 March 2024 (not covered by the Independent Review Report)**

Additional financial information supporting the amounts shown in the interim management report but not forming part of the condensed financial statements.

A. UNDERLYING PROFIT

The Group reports underlying profit excluding fair value accounting adjustments arising from its hedging arrangements and certain one-off items of income and costs relating to asset sales and acquisitions.

The fair value adjustments arise principally as a result of market interest rate movements, outside the Group's control. They are profit neutral over time and are not included in operating profit for management reporting purposes. They are also disregarded by many external analysts.

The transactions relating to the asset disposals and acquisitions do not form part of the day-to-day activities of the Group and, therefore, their removal provides greater clarity on the Group's operational performance.

This definition of 'underlying' has been chosen following consideration of the needs of investors and analysts following the Group's shares, and because management feel it better represents the underlying economic performance of the Group's business.

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m
Profit on ordinary activities before tax	110.6	46.4	199.9
Add back: Fair value adjustments	35.7	82.5	77.7
Underlying profit	<u>146.3</u>	<u>128.9</u>	<u>277.6</u>

Underlying basic earnings per share, calculated on the basis of underlying profit adjusted for tax, is derived as follows:

	31 March 2024 £m	31 March 2023 £m	30 September 2023 £m
Underlying profit	146.3	128.9	277.6
Tax on underlying result	(39.9)	(30.5)	(66.4)
Underlying earnings	<u>106.4</u>	<u>98.4</u>	<u>211.2</u>
Basic weighted average number of shares (note 9)	<u>213.2</u>	<u>231.7</u>	<u>224.1</u>
Underlying earnings per share	<u>49.9p</u>	<u>42.5p</u>	<u>94.2p</u>

ADDITIONAL FINANCIAL INFORMATION (APPENDICIES)

For the six months ended 31 March 2024 (not covered by the Independent Review Report)

A. UNDERLYING PROFIT (CONTINUED)

Tax on underlying profit has been calculated based on the effective rate which would result from the exclusion of the adjusting items from the corporation tax calculation. This gives an effective tax rate of 27.3% for the six months ended 31 March 2024 (31 March 2023: 23.7%; 30 September 2023: 23.9%).

Underlying return on tangible equity is derived using underlying earnings calculated on the same basis shown above. Tangible equity is calculated excluding the impacts of fair value hedging.

	Note	Six months to 31 March 2024 £m	Six months to 31 March 2023 £m	Year to 30 September 2023 £m
Underlying earnings		106.4	98.4	211.2
Amortisation of intangible assets		0.6	1.0	3.6
Adjusted underlying earnings		107.0	99.4	214.8
<i>Opening underlying tangible equity</i>				
Equity		1,410.6	1,417.3	1,417.3
Intangible assets	20	(168.2)	(170.2)	(170.2)
Balance sheet impact of fair values	18	(230.8)	(216.7)	(216.7)
Deferred tax thereon		32.8	53.2	53.2
		1,044.4	1,083.6	1,083.6
<i>Closing underlying tangible equity</i>				
Equity		1,382.0	1,360.4	1,410.6
Intangible assets	20	(169.6)	(170.5)	(168.2)
Balance sheet impact of fair values	18	(224.2)	(178.8)	(230.8)
Deferred tax thereon		21.5	31.2	32.8
		1,009.7	1,042.3	1,044.4
Average underlying tangible equity		1,027.1	1,062.9	1,064.0
Annualised underlying RoTE		20.8%	18.7%	20.2%

ADDITIONAL FINANCIAL INFORMATION (APPENDICIES)

For the six months ended 31 March 2024 (not covered by the Independent Review Report)

B. INCOME STATEMENT RATIOS

Net interest margin ('NIM') and cost-of-risk (impairment charge as a percentage of average loan balance) for the Group and its segments are calculated as shown. Not all net interest is allocated to segments and therefore total segment net interest in these tables will not equal net interest for the Group (see note 2).

Six months to 31 March 2024

	Mortgage Lending £m	Commercial Lending £m	Total £m
Opening loans to customers (note 12)	12,902.3	1,972.0	14,874.3
Closing loans to customers (note 12)	13,094.7	2,154.3	15,249.0
Average loans to customers	12,998.5	2,063.2	15,061.7
Net interest (note 2)	146.7	60.7	239.9
NIM (annualised)	2.26%	5.88%	3.19%
Impairment provision charge (note 2)	8.7	1.6	10.3
Cost-of-risk (annualised)	0.13%	0.15%	0.14%

Six months to 31 March 2023

	Mortgage Lending £m	Commercial Lending £m	Total £m
Opening loans to customers (note 12)	12,328.7	1,881.6	14,210.3
Closing loans to customers (note 12)	12,593.3	1,961.6	14,554.9
Average loans to customers	12,461.0	1,921.6	14,382.6
Net interest (note 2)	133.5	67.4	212.4
NIM (annualised)	2.14%	7.01%	2.95%
Impairment provision charge / (release) (note 2)	5.4	2.1	7.5
Cost-of-risk (annualised)	0.09%	0.22%	0.10%

ADDITIONAL FINANCIAL INFORMATION (APPENDICIES)

For the six months ended 31 March 2024 (not covered by the Independent Review Report)

B. INCOME STATEMENT RATIOS (Continued)*Year to 30 September 2023*

	Mortgage Lending £m	Commercial Lending £m	Total £m
Opening loans to customers (note 12)	12,328.7	1,881.6	14,210.3
Closing loans to customers (note 12)	12,902.3	1,972.0	14,874.3
Average loans to customers	<u>12,615.5</u>	<u>1,926.8</u>	<u>14,542.3</u>
Net interest (note 2)	277.6	135.7	448.9
NIM	2.20%	7.04%	3.09%
Impairment provision charge (note 2)	10.4	7.6	18.0
Cost-of-risk	<u>0.08%</u>	<u>0.39%</u>	<u>0.12%</u>

C. COST:INCOME RATIO

Cost:income ratio is derived as follows:

	31 March 2024	31 March 2023	30 September 2023
Operating expenses (£m)	90.0	83.8	170.4
Total operating income (£m)	246.6	220.2	466.0
Cost / Income	<u>36.5%</u>	<u>38.1%</u>	<u>36.6%</u>

ADDITIONAL FINANCIAL INFORMATION (APPENDICIES)

For the six months ended 31 March 2024 (not covered by the Independent Review Report)

D. NET ASSET VALUE

	Note	31 March 2024	31 March 2023	30 September 2023
Total equity (£m)		1,382.0	1,360.4	1,410.6
Outstanding issued shares (m)	26	216.6	241.5	228.7
Treasury shares (m)	28	(3.4)	(14.9)	(10.1)
Shares held by ESOP schemes (m)	28	(4.3)	(4.1)	(4.0)
		208.9	222.5	214.6
Net asset value per £1 ordinary share		£6.62	£6.11	£6.57
Tangible equity (£m)	34	1,212.4	1,189.9	1,242.4
Tangible net asset value per £1 ordinary share		£5.80	£5.35	£5.79

PRINCIPAL RISKS AND UNCERTAINTIES

There are a number of potential risks and uncertainties which could have a material impact on the Group's performance over the remaining six months of the financial year and could cause actual results to differ materially from expected and historical results. In the opinion of the directors, overall, these have not changed materially from those described in Section A2.2 of the Annual Report and Accounts of the Group for the year ended 30 September 2023.

The development of these risks in the six months and the risk areas of greatest concern are described in section 6.5 of this report.

The principal risks are summarised below.

- **Capital risk** – The risk that there is or will be insufficient capital for the Group to operate effectively including meeting minimum regulatory requirements, operating within board approved risk appetite and supporting its strategic goals
- **Liquidity and funding risk** – The risk that the Group has insufficient financial resources to enable it to meet its obligations as they fall due, cannot raise or maintain sufficient funds to finance its future plans, or can only secure such resources at excessive cost, and / or encumbrance
- **Market risk** – The risk of changes in the net value of, or net income arising from, assets and liabilities in the Group's banking book from adverse movements in market prices, including the impact of changes in the interest rates at which the Group lends and those at which it can borrow
- **Credit risk** – The risk of financial loss arising from a customer or financial counterparty failing to meet their obligations to the Group when they fall due or a change in the credit quality of the third party or instrument. This includes the risk of losses arising from customers' inability to make payments on their accounts and the risk of realisations from security assets being less than anticipated
- **Model risk** – The risk that the Group may make incorrect decisions based on the output of internal financial models, due to errors in the development, implementation or use of such models resulting in a loss or misreporting within financial statements. This may relate to the design and operation of models or the selection of input assumptions
- **Reputational risk** – The risk of negative consequences arising from a failure to meet the expectations and standards of the Group's customers, investors, regulators or other counterparties whilst undertaking business activities
- **Strategic risk** – The risk that the corporate plan does not fully align to, and support, the Group's strategic priorities or is not executed effectively as a result of external factors, incorrect planning assumptions or insufficient or inadequate resources
- **Climate change risk** – The risk of climate change impacting the Group either directly or indirectly through its third-party relationships. This includes the transitional risk to its strategy and profile through moving to a low carbon operating environment and any physical risks to the business or its assets arising from physical changes to the natural environment

PRINCIPAL RISKS AND UNCERTAINTIES

- **Conduct risk** – The risk that the Group’s financial products are designed, priced, sold and delivered in a way which fails to deliver good outcomes for customers, or does not demonstrate that the Group is acting with integrity in the market. This includes risks relating to communications with customers, dealing with customers who may be vulnerable, in arrears or dissatisfied, and to the Group’s obligations under the FCA Consumer Duty
- **Operational risk** – The risk of financial and non-financial detriment resulting from inadequate or failed internal procedures, people and systems or from external events. This includes risks relating to the Group’s IT systems, cyber security and data handling; compliance with legal and regulatory requirements; procedures for the prevention and detection of money laundering and other financial crime; and the Group’s resilience planning and business continuity arrangements

The Group has considered and responded to all these risks, mitigating the exposure as far as is practicable to ensure that its risk profile remains within the Board’s stated risk appetite.

CAUTIONARY STATEMENT

Sections of this Half-yearly Report, including but not limited to the Interim Management Report may contain forward-looking statements with respect to certain of the plans and current goals and expectations relating to the future financial condition, business performance and results of the Group. These statements can be identified by the fact that they do not relate strictly to historical or current facts. They use words such as 'anticipate', 'estimate', 'expect', 'intend', 'will', 'project', 'plan', 'believe', 'target' and other words and terms of similar meaning in connection with any discussion of future operating or financial performance but are not the exclusive means of identifying such statements. These have been made by the directors in good faith using information available up to the date on which they approved this report, and the Group undertakes no obligation to update or revise these forward-looking statements for any reason other than in accordance with its legal or regulatory obligations (including under the UK Market Abuse Regulation, UK Listing Rules and the Disclosure Guidance and Transparency Rules of the Financial Conduct Authority ('FCA')).

By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of the Group and depend upon circumstances that may or may not occur in the future that could cause actual results or events to differ materially from those expressed or implied by the forward-looking statements. There are also a number of factors that could cause actual future financial conditions, business performance, results or developments to differ materially from the plans, goals and expectations expressed or implied by these forward-looking statements and forecasts. As a result, you are cautioned not to place reliance on such forward-looking statements as a prediction of actual results or otherwise.

These factors include, but are not limited to: material impacts related to foreign exchange fluctuations; macro-economic activity; the impact of outbreaks, epidemics or pandemics, and the extent of their impact on overall demand for the Group's services and products; potential changes in dividend policy; changes in government policy and regulation (including the monetary, interest rate and other policies of central banks and other regulatory authorities in the principal markets in which the Group operates) and the consequences thereof; actions by the Group's competitors or counterparties; third party, fraud and reputational risks inherent in its operations; the UK's exit from the EU; unstable UK and global economic conditions and market volatility, including currency and interest rate fluctuations and inflation or deflation; the risk of a global economic downturn; acts of terrorism and other acts of hostility or war and responses to, and consequences of, those acts; technological changes and risks to the security of IT and operational infrastructure, systems, data and information resulting from increased threat of cyber and other attacks; general changes in government policy that may significantly influence investor decisions (including, without limitation, actions taken in support of managing and mitigating climate change and in supporting the global transition to net zero carbon emissions); societal shifts in customer financing and investment needs; and other risks inherent to the industries in which the Group operates.

Nothing in this Half-yearly Report should be construed as a profit forecast.