Paragon Banking Group PLC

2019 Half-Year Financial Report

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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 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 these forward-looking statements. 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. There are 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. Nothing in this document should be construed as a profit forecast.

OVERVIEW AND OUTLOOK

1. OVERVIEW

Our strategy to build a specialist bank has delivered another strong set of results for the period to March 2019. We have achieved good growth in operating profits and underlying earnings, supported by strong lending volumes, a growing loan book and improving net interest margin ('NIM'). The concentration on specialist markets enables us to utilise our competitive strengths supported by the deployment of our through-the-cycle experience and a robust approach to credit risk, and mitigates the competitive pressures in the wider, more commoditised banking sector.

2. FINANCIAL PERFORMANCE

Underlying profits for the half year were 8.7% higher than the same period in 2018 at £79.8 million with strong performances from both the Mortgage and Commercial Lending divisions, each of which delivered loan and margin growth. Structural benefits from the portfolio mix, with new buy-to-let and commercial lending margins wider than those achieved on the legacy buy-to-let portfolio, underpinned an 8 basis-point improvement in NIM to 224 basis points. This was achieved despite maintaining cautious liquidity levels in the face of Brexit-related market uncertainties and disposing of a high-yielding Idem Capital loan portfolio just before the period began.

In addition to strong new business flows, we have seen lower levels of buy-to-let redemption activity in the period, most notably on the new book, where annualised redemption rates fell to 11.3% from the 18.2% reported at the last half year, contributing to a 10.4% year-on-year increase in the loan book, which had reached £12.5 billion at the period end.

Operating costs were 15.3% higher than in the first half of 2018, reflecting full-period expenses for the Iceberg and Titlestone businesses acquired in December 2017 and July 2018 respectively. The Group continues to increase its technology investments and has also incurred significant project costs during the period, most notably in respect of professional costs to support its pending IRB application.

As expected, the cost of risk rose slightly, to 8 basis points, reflecting the introduction of the IFRS 9 accounting approach. Provision charges within the Mortgage segment fell period-on-period, whereas the charge in the Commercial Lending segment rose, reflecting its relative growth rate and higher through-the-cycle provisioning expectation.

Statutory earnings per share were 5.1% lower year-on-year at 22.5 pence per share, despite the improved underlying performance. An anomalous movement in swap rates during March, fuelled by Brexit-related uncertainties, resulted in a fair value charge of £7.8 million for the period. This reduced statutory reported profit, but will revert to zero over the lives of the underlying instruments.

Removing the impact of this fair value movement, underlying earnings per share rose 11.1% to 25.0 pence per share, and the underlying Return on Tangible Equity ('RoTE') increased to 14.4% from the 13.3% reported in the first half of 2018.

3. NEW BUSINESS ACTIVITY

New business growth was strong in both the Mortgage and Commercial Lending segments.

Within the Mortgage division, our focus continues to be to support the needs of professional landlords. Complex lending comprised 91.5% of the period-end pipeline and completions rose 44.0% from their first half 2018 level. Total new lending in the Mortgage segment was 15.7% higher in the first half of 2019 compared to the first half of 2018.

As a consequence of this strong new business flow and slower redemption rates, the net loan book in the Mortgage segment rose 6.6% from March 2018 to March 2019.

Following the acquisitions in 2018, the Commercial Lending segment has seen the greatest rate of change, with new loans and advances up 69.1% at £455.3 million and the net loan book 88.8% higher at £1.28 billion. Total new advances were £186.0 million higher, with development finance up £125.6 million, asset finance up £47.2 million, structured lending up £17.6 million and motor finance down £4.4 million, where volume growth has been strategically sacrificed for margin enhancement. Our existing development finance business has now been fully integrated with the Titlestone business, now rebranded as Paragon Development Finance.

Our deposit-taking franchise has continued to develop, with balances rising 37.2% year-on-year to £5.9 billion. Our traditional online distribution has been augmented during the half year via a relationship with Hargreaves Lansdown, and further platform partnerships are under development. The average cost of our deposit book has increased by 6 basis points over the year to 1.81% at the end of March 2019, despite the increase in base rates since March 2018.

4. CAPITAL MANAGEMENT

Capital ratios remain strong, with a CET1 ratio of 13.7%. Capital resources exceed our regulatory requirements and are in line with our risk appetites. The UK leverage ratio remains strong, at 6.5%.

We indicated a formulaic approach to determining the level of interim dividend with our 2018 results. The move from a dividend cover ratio of 2.75 to 2.5 times during 2018 has led to a particularly strong interim dividend in 2019 (the interim dividend being half of the prior year final) increasing 27.3% to 7.0 pence per share.

5. DIVERSIFICATION, GROWTH AND CAPITAL OPTIMISATION

The diversification of the Group's loan books and funding sources has been a core part of our strategy in recent years. Operating as a specialist bank, we aim to differentiate our offerings through a greater understanding of our markets, our customers, the products we offer and the associated risks of running such strategies, allowing us to optimise the balance between growth, returns and risk.

During 2018 we demonstrated our ability to recycle capital towards growth opportunities. Capital discipline, while maintaining prudent capital ratios, will remain a feature of our strategy going forward.

In the half year to March 2019 we initiated a thorough review of the risk weights we use to assess capital requirements, which confirmed our approach. We have made significant progress in the development of our second generation buy-to-let IRB models. Once these have been through their final governance reviews we will be ready to submit the first module in our IRB application process.

6. OUTLOOK

Our strategy is to provide outstanding products and service to British consumers and SMEs. We deliver these through a deep understanding of the sectors in which we trade and the customers we serve, ensuring that the products we offer and the services which we provide are appropriate and delivered with a high standard of excellence whilst maintaining our strong credit standards. This specialisation and our through-the-cycle experience enable us to understand our target markets better than our competitors, providing a significant competitive advantage.

Our diversification strategy will support future business growth, delivering further value for our customers, employees and shareholders over the coming years. Economic uncertainties persist in the UK, but our disciplined approach to risk management leaves us well placed to withstand any potential stresses. We remain confident in our future prospects.

We have delivered a strong first half, with increased profits benefiting from good growth in lending and improved margins. This reflects our strategic transformation to become a more broadly based banking group focussed on supporting British SMEs and consumers in specialist lending markets.

In buy-to-let, we have continued to grow lending adapting to the changing market dynamics. Professional landlords are becoming the backbone of the UK private rented sector, where we are well placed to address their complex needs.

The successful integration of the Titlestone development finance business, together with strong growth in the wider Commercial Lending division means that we now offer a stronger and broader proposition to our SME customers. This, together with the changing mix of buy-to-let business, has helped to create a structural improvement in the Group's net interest margin which will continue during the rest of the year and beyond.

The half year performance provides further evidence of the success of Paragon's five-year transformation into a specialist banking group. Our diversification will enable us to continue to grow our customer base and deliver improving returns to shareholders.

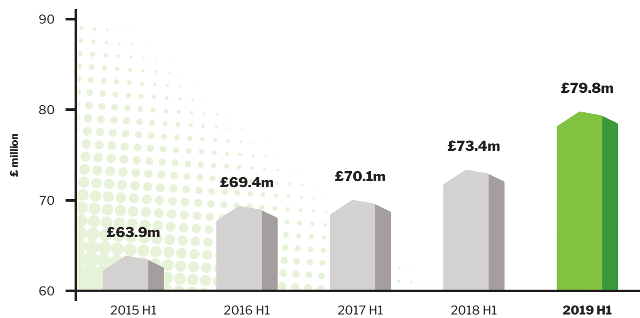
Nigel Terrington

Chief Executive

FINANCIAL HIGHLIGHTS

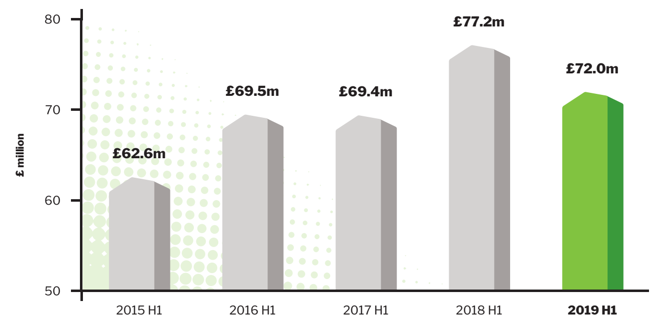
UNDERLYING PROFIT BEFORE TAX
£79.8 million

8.7% higher (2018 H1: £73.4 million)



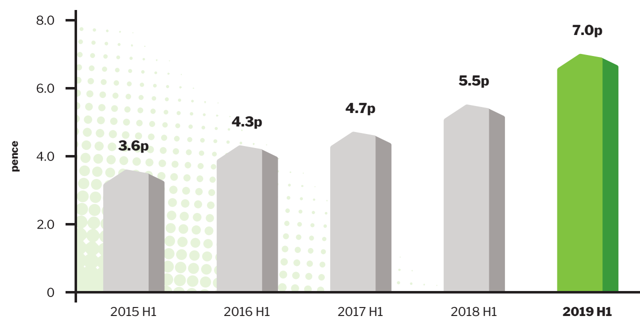
PROFIT BEFORE TAX
£72.0 million

6.7% lower (2018: £77.2 million)



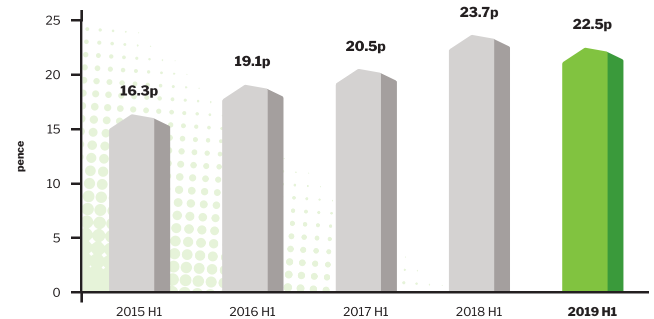
DIVIDEND PER SHARE
7.0 pence

27.3% higher (2018: 5.5 pence)



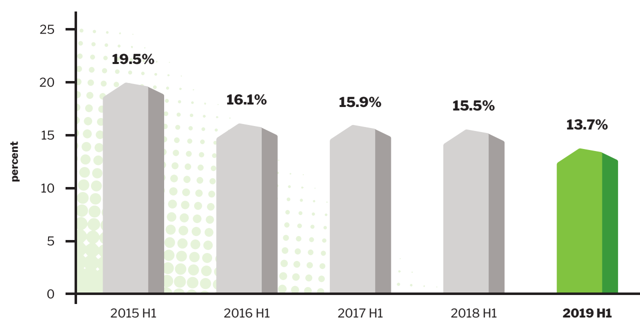
BASIC EARNINGS PER SHARE
22.5 pence

5.1% lower (2018: 23.7 pence)



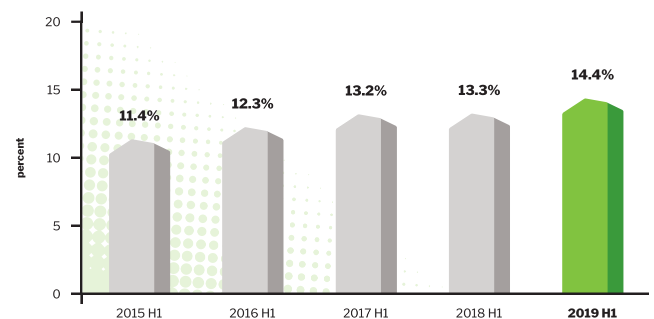
CAPITAL - CET 1 ratio
13.7%

Remains strong (2018: 15.5%)



UNDERLYING RETURN ON TANGIBLE EQUITY
14.4%

(2018: 13.3%)



INTERIM MANAGEMENT REPORT

1. STRATEGY REVIEW

During the six months ended 31 March 2019 the Group has maintained its specialist lending strategy, growing its loan books and improving margins whilst integrating new operations acquired or developed in the previous year.

Lending

Strong lending growth was achieved across the Group's businesses, with total lending of £1,289.2 million, an increase of 30.2% on the first half of 2018 (2018 H1: £990.3 million). Overall these lending levels generated a 10.4% increase in the loan book to £12,525.6 million at 31 March 2019, from £11,346.7 million a year earlier.

Volumes within the Mortgage segment increased by 15.7% to £833.9 million (31 March 2018: £721.0 million), with a 17.4% increase in buy-to-let lending and a reduction in other business lines as the Group increasingly focusses on the professional buy-to-let market. Overall the mortgage segment loan book increased by 6.6% year-on-year to £10,783.9 million (31 March 2018: £10,119.5 million), including the impact of IFRS 9 transition, with the post-2010 buy-to-let portfolio growing by 25.5% to £4,998.5 million.

Within the buy-to-let business the strategic focus remains on the professional landlord subset who are becoming the core investors in the UK private rented sector. The proportion of completions where the customers were 'complex' (i.e. operating through corporate structures and / or running large portfolios) increased from 71.8% to 88.0% of the total with a corresponding fall in simple completions. This effect is also seen in the pipeline at 31 March 2019, with 91.1% of the £711.1 million total representing complex cases (31 March 2018: £787.6 million with 86.3% complex).

Commercial Lending advances increased by 69.1%, to £455.3 million, compared to the first half of 2018 (2018 H1: £269.3 million). Within this, the Group's development finance operation, incorporating the Titlestone business acquired in July 2018, advanced £160.7 million (2018 H1: £35.1 million). Structured lending, launched in the second half of 2018 made £17.6 million of new loans, while the asset finance businesses advanced £211.0 million, 28.8% up on the £163.8 million for the first half of 2018, at improved margins. Motor finance lending reduced from £70.4 million to £66.0 million following a strategic focus on margin improvement. Overall, the Commercial Lending portfolio increased by 88.8% year-on-year to £1,283.9 million (31 March 2018: £680.1 million), including the impact of the Titlestone acquisition.

The increase in lending balances was funded principally through an increase in the Group's retail deposit balances to £5,878.0 million, 37.2% higher than the £4,285.8 million balance at 31 March 2018. This included the initial deposits accepted through the Hargreaves Lansdown platform, representing the first diversification in the savings operation's route to market. Average pricing in the portfolio at 31 March 2019 was 1.81%, slightly higher than the 1.76% reported at 30 September 2018, still representing a highly cost-effective and stable funding source.

Results

Underlying profits (before the effect of fair value movements on hedging items) increased by 8.7% to £79.8 million, from £73.4 million in the first half of 2018. Net interest income was 13.8% higher than for the same period in 2018 at £138.1 million driven upwards by both a higher net interest margin ('NIM') and year on year increases in loan balances.

The Group's new mortgage lending delivers higher margins than its legacy, pre-2010 portfolio. Therefore the run-off of the legacy assets and their replacement with new loans enhances margins overall. Together with wider margins earned through the businesses within the Commercial Lending segment, the Group's new lending activities create a structurally improving margin. NIM in the period was 2.24%, compared to 2.16% in the first half of 2018, despite absorbing the income lost following the sale of a portion of the Idem Capital portfolio in September 2018.

The Group has continued to hold strong levels of liquidity, both actual and contingent, during the period in response to the economic uncertainties inherent in the UK's Brexit process. This has had a negative impact on sentiment across the Group's markets during the period and appears set to continue throughout the remainder of the financial year and beyond.

The Mortgage segment saw underlying profit increasing by 17.0% to £84.6 million (2018 H1: £72.3 million). NIM increased to 1.69% (2018 H1: 1.55%) reflecting the improving mix in the portfolio between the post-2010 lending and lower yielding legacy assets. The redemption rate on the portfolio fell from 10.5% to 8.7% per annum, reflecting retention of customers reaching the end of fixed rate periods and lower absolute levels of maturing accounts, given the movement in the market towards longer-term products in recent years.

In Commercial Lending, underlying profits increased from £6.2 million in the first half of 2018 to £19.5 million for the period. This includes the impact of the Titlestone acquisition, with the acquired loan portfolio contributing approximately 83 basis points of the 106 basis point improvement in the segment's NIM in the period.

Underlying profits of the Idem Capital division fell to £22.8 million (2018 H1: £37.5 million), reflecting the run-off of the book, the asset sale at the end of the 2018 financial year and the particularly high level of lump sum settlements in 2018 which contributed to that period's earnings. NIM in the division reduced to 10.8% from 14.3% in the first half of 2018, a result of these mix changes.

The Group's cost:income ratio in the period was 42.8%, compared to 42.2% in the first half of 2018. The cost base increased by £8.4 million year-on-year, including a full six months of costs from 2018 acquisitions, the increased outsourced costs of the larger savings book and significant project-related costs (including expenses associated with the Group's IRB application). The Group continued to make significant investments in developing systems to provide improved service offerings to its customers and enhance operational resilience, which contributed to the increase in costs in the period.

The Group's loan impairment costs are now reported under IFRS 9. The overall effect of the transition to the new standard was to increase the opening provisions on the Group's loan assets by £27.2 million and reduce equity by £22.2 million, net of tax, although these changes do not impact on the Group's results for the period. IFRS 9 accelerates provision for losses, increasing profit and loss charges on growing books, such as many of the Group's portfolios. Despite this, the bad debt charge only increased to £4.9 million in the period, compared to £1.8 million in the first half of 2018 and less than £5.6 million recorded for the second half of that year. The bad debt charge was lower in the Mortgage division, but rose in Commercial Lending, reflecting its relative growth rate.

Buy-to-let credit performance remained strong with arrears at 31 March 2019 at 0.12%, significantly less than market averages (31 March 2018: 0.09%). Commercial Lending bad debt rates increased slightly, although still represent a very small number of cases. Overall, our behavioural scoring models, which act as a lead indicator of financial stress in the loan books, were stronger in all significant portfolios across the period.

During March 2019 the UK capital markets were affected by Brexit-led macro-economic uncertainties impacting on fair value exercises carried out for accounting purposes at the period end. This created a charge of £7.8 million in respect of the revaluation of derivatives held for hedging (2018 H1: gain of £3.8 million) in the income statement and an increase in the pension scheme liability in the balance sheet of £12.4 million since 30 September 2018, with a consequential reduction of capital. Indications in April 2019 showed interest rates stabilising, suggesting that these movements will reverse, to some extent in the second half of the financial year.

This fair value adjustment led to statutory profit before tax decreasing to £72.0 million from £77.2 million in the first half of 2018, with profit after tax reducing from £62.0 million to £58.1 million after provision for tax at a rate of 19.3% (2018 H1: 19.7%).

This result translates to basic earnings per share ('EPS') on an underlying basis (excluding fair value movements) of 25.0 pence per share, a year-on-year increase of 11.1% (2018 H1: 22.5 pence per share) (Appendix B). On the statutory basis basic EPS reduced by 5.1% to 22.5 pence per share as a result of the fair value losses (2018 H1: 23.7 pence per share). Underlying return on tangible equity ('RoTE') at 14.4% (2018 H1: 13.3%) continued to make progress towards the Group's long-term target of over 15% (Appendix B).

The Group maintains a strong capital position, even after the reductions in equity from IFRS 9 and the revaluation of the pension liability. On an IFRS 9 transitional basis the Group's CET1 capital ratio was 13.7% and its total capital ratio 16.0% (31 March 2018: 15.5% and 18.2%). The largest part of the year-on-year reduction resulted from the Titlestone acquisition in July 2018, where the purchased goodwill has been deducted from regulatory capital, causing the CET1 and total capital ratios to reduce to 13.8% and 16.2% respectively by 30 September 2018. The fully loaded CET1 and total capital ratios at 31 March 2019, excluding the IFRS 9 transitional capital relief were 13.4% and 15.7% respectively. The UK leverage ratio remained strong at 6.5% on the transitional basis, 6.4% fully loaded (31 March 2018: 6.8%).

In accordance with the previously announced policy, an interim dividend of 7.0 pence per share, 50% of the 2018 final dividend will be paid. This represents an increase of 27.3% from the 2018 interim dividend of 5.5 pence per share.

The business has continued to successfully pursue the strategy set out to investors, focussing on its specialist markets and maintaining a strong capital and funding base. It is well placed to deliver further progress and provide sustainable returns to shareholders. Its operating model and wide experience mean that the Group is positioned to respond quickly to the challenges, and to take advantage of the opportunities that will arise, given changes in the broader operating environment.

A more detailed discussion of the Group's performance is given below covering:

2. Lending review	3. Funding review	4. Capital review	5. Financial review	6. Operational review
Lending, performance and markets	Retail deposits and wholesale funding	Capital management, liquidity and distributions	Results for the period, assets and liabilities	Governance, people, risk and regulation

2. LENDING REVIEW

The Group's operations are organised into three divisions, based on product types and origination and servicing capabilities. Its investments in loans and the amounts invested in the period for each of those divisions are summarised below:

	Advances and investments in the period			Investments in loans at the period end		
	Six months ended 31 March 2019	Six months ended 31 March 2018	Year ended 30 September 2018	**31 March 2019**	31 March 2018	30 September 2018
				IFRS 9	IAS 39	IAS 39
	£m	£m	£m	**£m**	£m	£m
Mortgages	**833.9**	721.0	1,623.2	**10,783.9**	10,119.5	10,473.5
Commercial Lending	**455.3**	269.3	710.0	**1,283.9**	680.1	1,133.2
Idem Capital	**-**	-	83.4	**457.8**	547.1	521.1
	1,289.2	990.3	2,416.6	**12,525.6**	11,346.7	12,127.8

Loan balances and related measures are calculated in accordance with IFRS 9 at 31 March 2019 and in accordance with IAS 39 at 30 September 2018 and 31 March 2018. Therefore they may not be directly comparable (see note 3).

The first half of the year has seen the overall loan balance increase by 3.3%, with advances 30.2% ahead of the same period in 2018. This performance was driven by strong growth in the Commercial Lending segment, particularly in newer business areas and steady, targeted growth in buy-to-let mortgage lending combined with lower rates of redemption.

2.1 MORTGAGES

The Group's Mortgage division offers buy-to-let first charge and owner-occupied first and second charge mortgages on residential property in the UK. In all its offerings, the Group targets niche markets where its focus on detailed case-by-case underwriting and its robust and informed approach to property risk differentiate it from mass market and other specialist lenders. Its core products are buy-to-let residential property mortgages, targeted at professional landlords, a market where it is one of the leading participants.

Over the six-month period the UK housing market has remained subdued in the face of economic concerns arising from Brexit and the wider economy. Research from the Royal Institution of Chartered Surveyors ('RICS') during the period suggested that over 70% of estate agents considered Brexit uncertainty as the biggest challenge affecting the housing market, impacting on both buyers and sellers. Against this background the environment for mortgage lending remained relatively benign, with low interest rates helping affordability and low levels of arrears and forced sales.

New mortgage approvals in the period, reported by the Bank of England, at £123.0 billion increased by 3.5% from the £118.8 billion recorded in the same period in the preceding year, with the split of remortgage and house purchase accounts remaining broadly similar. This key indicator remains far below its 2007 peak, when approvals in the six months to March were £178.5 billion. House prices were also subdued, with the Nationwide Building Society reporting an average decline of 0.8% in the six-month period, although this included significant regional variations. The most recent RICS survey suggested this slight downward trend is likely to continue in the near term before a longer-term recovery begins.

Within this larger market buy-to-let lending remained strong with new advances of £18.9 billion in the six months reported by UK Finance ('UKF'), compared to £18.4 billion in the same period in the previous year. Much of this activity represents refinancing by landlords, with 73.0% of new advances by value representing remortgages (2018 H1: 70.7%). The trend in favour of longer-term fixed interest rates has also continued, with the proportion of new loans with interest rates fixed for five years or more reaching 57.3% (2018 H1: 46.2%, 2017 H1: 25.6%). This trend has been seen in the Group's own lending and is expected to reduce remortgage activity especially in the short-term as product maturity terms increase.

Professional landlords form the largest part of the Group's target market. Recent years have seen lenders' strategies for buy-to-let polarising, with many large lenders not offering buy-to-let loans. This has left the Group amongst a small number of specialist lenders addressing the professional buy-to-let mortgage market.

The lettings market remains robust with RICS reporting both demand and rental levels increasing due to restricted supply, partially as a result of amateur landlords seeking to exit the market in response to fiscal and regulatory changes over recent years. However, the English Housing Survey for 2018, published in January 2019 still shows the private rented sector representing around 19-20% of households, as it has for the past five years. These factors have led to an expectation of increasing rents, with RICS members predicting a 2% increase over the next twelve months accelerating to 3% per annum up to 2024, which should benefit the Group's customers and the affordability of their loans. However, reduced supply and increased rents may present difficulties for tenants and those seeking rented accommodation.

Lending activity

The Group's activity in the six months has been centred on its professional buy-to-let lending proposition, with other products carefully targeted to ensure that yields and risk profiles were appropriate. The new lending activity in the division during the six months is set out below:

	Six months ended 31 March 2019	Six months ended 31 March 2018	Year ended 30 September 2018
	£m	£m	£m
First charge buy-to-let	**787.5**	670.5	1,495.5
First charge owner-occupied	**8.6**	22.6	56.5
Second charge	**37.8**	27.9	71.2
	833.9	721.0	1,623.2

Total mortgage lending increased by 15.7% in the six months compared to the same period in the previous year.

Buy-to-let

The majority of the increase arose in the division's core buy-to-let business, where activity increased by 17.4%, compared to the same period in 2018. The new business pipeline, the loans passing through the underwriting process, was £711.1 million at the period end (30 September 2018: £778.9 million, 31 March 2018: £787.6 million).

In the professional buy-to-let market the Group's strategy of focussing on complex customers (corporate customers and those with larger portfolios) has delivered positive results. These are the customers best suited to the Group's service model and this targeting, coupled with a disciplined approach to underwriting and valuation, has enabled margins and retention rates to be increased while providing the customers with a high standard of support for their business needs.

	Six months to 31 March 2019		Six months to 31 March 2018		Year to 30 September 2018	
	£m	**%**	£m	%	£m	%
Buy-to-let advances						
Corporate customers	**405.9**	**51.5%**	248.0	37.0%	656.7	43.9%
Other complex customers	**287.2**	**36.5%**	233.4	34.8%	528.8	35.4%
Total corporate and complex	**693.1**	**88.0%**	481.4	71.8%	1,185.5	79.3%
Non-complex customers	**94.4**	**12.0%**	189.1	28.2%	310.0	20.7%
	787.5	**100.0%**	670.5	100.0%	1,495.5	100.0%

These advances show the continuing move towards the concentration of buy-to-let activity among more professional investors, many operating through corporate structures. This trend is set to continue in the second half of the year, with 91.5% of pipeline cases being either corporate or complex (31 March 2018: 86.3%).

The Group sources the majority of its new buy-to-let lending through specialist intermediaries and significant investment has been made to ensure the service offered to them is excellent. It was therefore gratifying that in feedback from intermediaries in the period, 93% were satisfied with the ease of obtaining a response from the Group, delivering a net promoter score (the excess of positive over negative feedback per 100 respondents) at offer stage of +55.

Other lending

The division's other lending has been carefully managed to ensure that only lending with appropriate risks and returns is undertaken.

Lending in the Group's second charge mortgage operation at £37.8 million was in line with plan, 35.5% up on the comparable period in 2018. While the second charge market comprises some £1.12 billion per annum, according to data for the year ended 31 March 2019 released by the Finance and Leasing Association ('FLA'), a large part of this lending is to lower credit quality customers, who do not match the Group's credit risk appetite, limiting potential lending in this field.

In residential mortgage lending, margins have been generally compressed and the Group has maintained discipline on acceptable yields, meaning that the amount of new business has fallen. The opportunities for the Group in this area principally relate to highly specialised propositions, where the Group's operational approach can be beneficial, including lending to the existing professional landlord customer base.

Performance

The outstanding loan balances in the segment are set out below, analysed by business line.

	31 March 2019	31 March 2018	30 September 2018
	IFRS 9	IAS 39	IAS 39
	£m	£m	£m
Post 2010 assets			
First charge buy-to-let	**4,998.5**	3,982.0	4,481.8
First charge owner-occupied	**67.0**	26.6	59.4
Second charge	**159.1**	113.8	141.3
	5,224.6	4,122.4	4,682.5
Legacy assets			
First charge buy-to-let	**5,549.5**	5,984.7	5,779.8
First charge owner-occupied	**9.8**	12.4	11.2
	10,783.9	10,119.5	10,473.5

At 31 March 2019 the balance on the Group's mortgage portfolio was 6.6% higher than a year earlier, even after allowing for the £23.2 million reduction in balances on the introduction of IFRS 9. The buy-to-let portfolio had increased year-on-year by 5.8% to £10,548.0 million, including an IFRS 9 reduction of £23.1 million (31 March 2018: £9,966.7 million). Within the buy-to-let portfolio, the value of the post-2010 assets had grown by 25.5%, representing 47.3% of the total (31 March 2018: 40.0%).

The annualised redemption rate on post-2010 buy-to-let mortgage assets was 11.3% in the six months to 31 March 2019 (2018 H1: 18.2%). The annualised redemption rate on pre-2010 legacy assets, at 6.6%, rose slightly from the 5.7% experienced in the six months ended 31 March 2018.

The reduction in post-2010 redemption rates reflects both operational initiatives, which have led to a greater proportion of the Group's customers opting to re-fix their loans during the period, and a lower absolute level of maturing products, resulting from the increased proportion of five-year fixed rate business written in recent years.

Arrears on the buy-to-let book have remained stable in the six months at 0.12% (30 September 2018: 0.11%, 31 March 2018: 0.09%), with arrears on post-2010 lending standing at 0.01% (30 September 2018: 0.01%, 31 March 2018: 0.01%). These arrears remain very low compared to performance in the national buy-to-let market, with UKF reporting arrears of 0.41% across the sector at 31 March 2019 (31 March 2018: 0.41%, 30 September 2018: 0.41%). This exemplary performance reflects the Group's experience through-the-cycle in focussing underwriting on the credit quality and financial capability of its customers, underpinned by a detailed and thorough assessment of the value and suitability of the property as security.

Second charge mortgage arrears increased to 0.41% as the portfolio becomes more seasoned (31 March 2018: zero), with performance remaining strong despite the book's increased maturity. The Group's lending in this field is targeted towards stronger credit propositions and therefore the differential between this performance and the FLA averages for all second charge mortgage loans is expected.

The Group's receiver of rent process for buy-to-let assets helps to reduce the level of loss incurred by both it and, in turn, its landlord customers by giving direct access to the rental flows from the underlying properties. At the period end 751 properties were managed by a receiver on the customer's behalf, a year-on-year reduction of 5.2% (31 March 2018: 792 properties) as cases on the old book resolve and relatively low numbers of post-2010 cases enter receivership.

Outlook

The Group has established a significant market position in professional buy-to-let which offers good prospects for future development and profitability.

While the economic outlook remains uncertain, the Group is confident that its robust approach to valuation and the loan to value coverage in its buy-to-let book, at 67.8% (31 March 2018: 66.6%) provide it with significant security in the event of a downturn. The levels of interest cover and stressed affordability in the portfolio, coupled with continuing strong rental demand suggest that its customers should also prove resilient.

Looking forward, the Group intends to develop its offerings to its core professional landlord customers and the intermediaries supporting them to provide both an enhanced service and additional products tailored to their needs. Despite the political uncertainties, professional landlords are carrying on with their businesses and continuing to develop and expand their portfolios. With the private rented sector representing a fifth of households, professional landlords are vital to the UK's housing provision and the Group sees significant business opportunities in providing them with the financial support that they require.

2.2 COMMERCIAL LENDING

The Group's Commercial Lending division brings together various streams of mostly asset backed lending to, or through, commercial organisations and has seen material levels of Group investment since 2015, for both acquisition activity and organic business development. The principal customer focus of the division is on lending to SME and mid-sized corporate customers, which is an important differentiator from the rest of the Group's business. It includes equipment leasing operations and also the Group's development finance, structured lending and professions finance operations.

The corporate asset finance market in the UK is substantial, covering some £79.4 billion of outstanding balances at 31 March 2019 (30 September 2018: £75.1 billion) and £16.1 billion of advances in the six months then ended (year ended 30 September 2018: £32.1 billion). However, much of this volume is commodity lending by bulk lenders. It is the Group's strategy to target niches (either product types or customer groups) within this market where its particular skill sets can be best applied, and its capital effectively deployed to optimise the relationship between growth, risk and return.

Other offerings in the segment target markets where there has historically been a shortage of credit, such as the Group's development finance business which primarily supports smaller housebuilders and the structured lending business which funds small non-bank lending operations.

In each of these markets the Group's competitors are other smaller banks and similar sized lenders. They are markets in which the largest lenders have little presence, creating a credit availability issue for customers and significant opportunities for the Group.

The division relies heavily on specialist teams to address the separate business lines, either sourced externally or internally developed. This was highlighted when the asset finance business was named as 'SME Specialist of the Year' at the 2018 Leasing World Awards and 'Best Specialist Finance Solutions Provider' in the SME News Magazine's 2019 UK Legal Awards.

The Consumer Lending businesses are building on this success, increasingly developing technological solutions to assist in customer procuration processes, enabling potential borrowers or the brokers they use to access appropriate finance.

The common themes of these diverse business lines are a reliance on understanding and engaging with the customer and the valuation of any security, together with expertise in collections and security realisation. In common with the rest of the Group, the division's focus is on the maintenance of strong credit standards and it does not pursue business volumes at the expense of margins.

Lending activity

During the period the focus across all of the division's business lines has been on growing the scope of the operations to address a wider range of funding propositions for SME customers, while maintaining credit discipline and improving yields.

Within the leasing operations a wider range of assets has been considered, including both hard and soft assets, providing funding to a broader range of small business operations, while the Group's development finance and structured lending have also increased their scope.

Economic factors have led to some nervousness in the Group's market, with macro-economic indicators generally flat, but this has not yet led to any significant downward impact on volumes. The construction sector, which is a significant target market for the asset finance operation, has held up well so far, supported, to some extent, by the impact of large infrastructure projects.

Commercial Lending exposure has increased overall by 13.3% in the six-month period to £1,283.9 million (30 September 2018: £1,133.2 million). This has been driven by particularly strong performances in development finance (up £73.2 million), asset finance (up £47.4 million) and structured lending (up £17.4 million).

The new lending activity in the segment during the period is set out below.

	Six months ended 31 March 2019	Six months ended 31 March 2018	Year ended 30 September 2018
	£m	£m	£m
Asset finance	**150.6**	121.4	259.2
Motor finance	**66.0**	70.4	177.9
Development finance	**160.7**	35.1	136.8
Structured lending	**17.6**	-	40.6
Professions finance	**60.4**	42.4	95.5
	455.3	269.3	710.0

The Commercial Lending segment has seen a 69.1% growth in new advances compared to the corresponding period in 2018. A significant part of this increase comes from the acquisition of Titlestone, which now forms part of the development finance business, in July 2018, and the Iceberg professions finance business in December 2017, which only contributed to three months of the comparator period.

Development finance

The Group's development finance business was significantly expanded by the acquisition of Titlestone in July 2018. The nine months since then have been positive for the business, with Titlestone integrated with the Group's organically developed operation and the focus of the new combined business refined.

The Group's target customer is a small to medium sized developer of UK residential property. The typical types of projects funded have an average size of approximately £4.5 million and are generally focussed on the more liquid parts of the residential market, avoiding developments with high unit values. While the business has been concentrated in the South-East of England so far, with 67% of balances at 31 March 2019 located in London and the South East, the Group's strategic objective is to lend more widely across the UK and this shift continued in the period. Central London property hot-spots have been largely avoided.

Activity in the Group's target market has held up well in the half year, with numbers of enquiries consistent with previous periods. However, some developers have taken longer to get projects under way and there has been additional caution amongst larger scale developers, evidenced in lengthening periods between facility agreement and the first drawdown.

Prospects for the second half of the year remain encouraging, with undrawn amounts on live facilities at 31 March 2019 of £276.9 million and a post-offer pipeline of £149.8 million, a large proportion of which would be expected to flow in to second half completions. Market fundamentals remain strong, albeit tempered by short-term economic anxieties, and the Group's extensive property experience can be used to leverage future growth.

Asset finance

The asset finance operation has retained its position in its core 'hard asset' market during the period. It has maintained its focus on margins and sought to support its business levels through strong customer relationships and service standards.

Volumes have benefitted from an enhanced core proposition and operational efficiencies arising from increasing centralisation of operations at the Group's asset finance hub in Southampton. New asset finance loan volumes have grown by 24.1% compared to the comparative period in 2018, reaching £150.6 million (2018 H1: £121.4 million). As part of the centralisation process significant investments have been made in technology, while the sales teams have also been strengthened across the various specialist areas of the business.

Investment in operating lease assets has also continued with £11.9 million of assets acquired in the period (2018 H1: £19.3 million).

Structured lending

The Group's structured lending business, which made its first loans in the second half of 2018 has made significant progress in the six months. The team, which has built a solid reputation in the market, has expanded in the period, allowing more prospects to be addressed. The structured lending business generally has a longer pipeline than other operations, with detailed negotiations required before a new loan can be agreed. There are now five transactions in place, with more prospects at various stages of development. The deals currently in progress are expected to provide further lending in the second half of the year, while the business as a whole has good prospects for further expansion.

Other lending

The Group continues to carefully target its motor finance offerings on those specialist propositions which are not addressed by mass-market lenders. This limits its ability to grow market share and the level of advances in the first half of 2019 has been below that achieved in 2018, in part due to a continued level of new business pricing discipline. The short-term professions finance business, which includes the Iceberg operation acquired in December 2017, grew broadly in line with expectations during the period.

Performance

The outstanding loan balances in the division are set out below, analysed by business line.

	31 March 2019	31 March 2018	30 September 2018
	IFRS 9	IAS 39	IAS 39
	£m	£m	£m
Asset finance	**451.4**	364.8	403.4
Motor finance	**262.4**	195.4	256.6
Development finance	**426.0**	57.0	352.8
Structured lending	**56.1**	-	38.7
Invoice factoring	**20.9**	15.3	21.8
Professions finance	**48.4**	36.7	42.6
Unsecured business lending	**14.5**	7.3	13.1
Other loans	**4.2**	3.6	4.2
	1,283.9	680.1	1,133.2

Margins in the segment have remained strong, reflecting both the acquisition of Titlestone in 2018 and an underlying increase on a like-for-like basis.

Credit quality in the development finance book has been good, and the overall performance of the projects has been in line with expectations. These accounts are monitored on a case-by-case basis by the Credit Risk function. At 31 March 2019 no accounts had been identified by the monitoring process as being likely to result in a loss, other than three Titlestone accounts identified on acquisition and allowed for in the purchase price, where refinements in fair values at the acquisition date have been reflected in the goodwill valuation.

The average loan to gross development value for the portfolio at the period end, a measure of security cover, was 63.9% (31 March 2018: 60.1%). This increase reflects the initially cautious launch of the Paragon proposition and the higher risk appetite of the Titlestone business.

Arrears in Commercial Lending remain low with arrears in the asset finance business at 1.66% and motor finance at 1.27% (31 March 2018: 0.97% and 0.78% respectively), comparable to those in the wider sector, with the FLA reporting average arrears for asset finance at 1.10% and car finance at 2.70% at 31 March 2019 (31 March 2018: 0.80% and 2.50% respectively).

Performance in the structured lending operation has been in line with expectations with satisfactory pricing and no serious concerns with the operation of the deals.

Outlook

The Commercial Lending segment has seen the greatest level of investment by the Group in the recent past, most notably through its acquisition activity in the asset and development finance markets. The first half of the 2019 financial year has demonstrated the Group's ability to support the needs of underserved customers in these important parts of the UK economy. Whilst further bolt-on acquisitions to enhance existing operations remain a possibility, the Group's focus is now to invest in technological, distribution and servicing enhancements for its commercial activities, having integrated and embedded the acquired elements into its core risk, operational and systems processes.

2.3 IDEM CAPITAL

The Idem Capital segment contains the Group's acquired portfolios, together with its pre-2010 legacy consumer accounts. Its strategic focus is on the acquisition of more specialist loan portfolios where it can enhance value through its collections process and access to funding, and which will augment the organic origination activities of the Group. It uses its analytical skills base, which it sees as a core differentiator, to identify and evaluate portfolios brought to market against these criteria.

As part of the banking group it is able to deploy expertise in a wide variety of asset classes and access the systems development resource and support functions of the wider business, enabling more complex portfolios to be addressed. It also has significant experience in working in partnership, either as an investor or administrator, giving it access to transactions which may be unattractive on a standalone basis.

Overall Idem Capital's success rests on understanding assets, strong analytics, advanced servicing capabilities and the efficient use of funding.

New Business

The UK loan portfolio purchase market remains active despite the current levels of economic uncertainty, and the Group has participated in all the significant tender processes in the period, to some extent. However, conditions in the market have become more difficult with levels of demand and prices remaining high, with several very large investors active in the market.

In the face of these conditions the Group has maintained its disciplined approach. It continues to target only those deals where its wider capabilities in administration and funding can provide a real benefit to the project and where the projected return is attractive in comparison to the other opportunities for the deployment of its capital.

During the period no new deals were completed (2018 H1: none) although, as noted above, the division undertook a limited number of reviews of opportunities that were ultimately not progressed. Aside from these, the main focus of the business was on monitoring the performance of the extant portfolio and the integration of the motor finance portfolio purchased towards the end of the previous financial year.

Performance

The values of the loan balances in the segment are set out below, analysed by business line.

	31 March 2019	31 March 2018	30 September 2018
	IRFS 9	IAS 39	IAS 39
	£m	£m	£m
Second charge mortgage loans	**245.8**	357.5	274.6
Unsecured consumer loans	**158.4**	189.6	173.7
Motor finance	**53.6**	-	72.8
	457.8	547.1	521.1

The reduction in balances from March 2018 is a result of the scale of realisations from the brought forward portfolio. These were both organically from customer repayments and through a portfolio sale, of £54.7 million of assets, completed in the second half of the 2018 financial year. 120 month Estimated Remaining Collections on acquired consumer assets reduced from £615.2 million at 31 March 2018 to £446.5 million at the period end (note 7).

Overall collections from customers have held up well in the period, despite the generally negative economic forecasts for the UK. However, this position will be monitored carefully going forward as the portfolios contain a number of customers who might be more at risk in a downturn. Cash flow from the portfolio remains robust, however, following very high lump sum settlement receipts in 2018 which contributed to income recognition, the current year has seen a more normal level of settlements. Instalment payments remain strong, reflecting the improving behavioural scores seen across the business.

Arrears on the segment's secured lending business remain in line with recent performance at 15.5% (30 September 2018: 15.8%, 31 March 2018: 19.9%). While this is higher than the average for the sector it reflects the seasoning of the balances, which are mostly more than ten years old. Average arrears for secured lending of 9.1% at 31 March 2019 were reported by the FLA (30 September 2018: 9.4%).

The division's consumer lending portfolio has performed well during the period, with strong cash generation. The Group monitors actual cash receipts from acquired portfolios against those forecast in the evaluation which informed the purchase price. Up to 31 March 2019 such collections were 109.8% of those forecast to that point (30 September 2018: 109.7%, 31 March 2018: 109.4%).

The motor finance book acquired at the end of the previous financial year has been bedded in successfully, with collections currently ahead of plan. The success of this acquisition reflects the Group's strategy of targeting more specialist portfolios.

Operational improvements have continued to be made in systems, processes and employment patterns which are expected to generate operational efficiencies in future periods.

Outlook

The loan purchase market continues to offer significant opportunities for Idem Capital to invest in portfolios, either by itself or with partners, where its ability to leverage the skill base of the wider group can generate good returns. These deals are likely to be larger, more idiosyncratic and less frequently available than the average, which leads to an irregular flow of new accounts to the division.

However, it is the Group's firm belief that the maintenance of strict discipline in this area is the best route to delivering an appropriate return on its investments and that the division is well placed to continue the effective management of its asset base and to address appropriate business opportunities as they arise.

3. FUNDING REVIEW

The Group's strategic funding objective is to maintain a diversified and sustainable funding base. It manages a variety of funding options to ensure that pricing and availability issues in any particular funding market can be mitigated, while maintaining the flexibility to fund new business opportunities when required.

During the period this strategy has seen the Group focus on retail deposits, with the capital markets relatively inactive and pricing relatively unattractive for much of the period.

In the uncertain economic climate which has continued through the past six months, the Group continued its policy of increasing contingent liquidity and of holding larger cash balances than might otherwise be the case, with £759.7 million of cash available for liquidity and other purposes at 31 March 2019 (30 September 2018: £962.9 million, 31 March 2018: £690.7 million). The contingent liquidity policy will be kept under review in the light of the emerging economic and political environment.

The Group has also explored new routes to the savings market in the period in order to broaden its distribution and create the capacity for more flexibility in its funding.

The Group's funding at 31 March 2019 is summarised as follows:

	31 March 2019	31 March 2018	30 September 2018
	£m	£m	£m
Retail deposit balances	**5,878.0**	4,285.8	5,296.6
Securitised and warehouse funding	**6,064.8**	6,471.2	6,490.3
Central bank facilities	**984.4**	974.4	1,024.4
Tier 2 and retail bonds	**445.7**	445.1	445.4
Total on balance sheet funding	**13,372.9**	12,176.5	13,256.7
Off balance sheet central bank facilities	**108.5**	108.9	108.7
	13,481.4	12,285.4	13,365.4

The Group's present medium-term strategic funding objective is principally focussed on raising retail deposits, while optimising the use of central bank facilities. Securitisation is used tactically if market conditions are favourable, or where it is appropriate for particular transactions and the Group's present expectation is that one securitisation per year is likely, if conditions are right.

3.1 RETAIL FUNDING

The Group's retail savings proposition provides customers with a range of deposit options, offering competitive rates and value for money, combined with the protection provided by the Financial Services Compensation Scheme ('FSCS'). Such deposits represent a reliable, cost-effective and scalable source of finance for the Group. Over recent years there have been a number of new entrants to this sector of the banking market and competition for internet-sourced deposits has increased. However, the Group's competitive pricing, attractive products and good customer service have meant that it has been able to achieve its required funding levels at an appropriate price.

The volume of retail deposits has continued to grow during the period, with balances at 31 March 2019, at £5,878.0 million, 11.0% higher than at the previous year end (30 September 2018: £5,296.6 million, 31 March 2018: £4,285.8 million).

The Group's share of the overall UK savings market remains small, with household savings balances reported by the Bank of England increasing by 1.6% in the six months ended 31 March 2019 to £1,194.5 billion (30 September 2018: £1,175.6 billion), although these deposits remain overwhelmingly with clearing banks and building societies. While this market position enhances the Group's flexibility, it does mean that rates may be influenced by the funding needs of other, larger, participants in the market, which are beyond the Group's control.

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

	Average interest rate		**Average initial balance**		**Proportion of deposits**	
	31.03.19	30.09.18	**31.03.19**	30.09.18	**31.03.19**	30.09.18
	%	%	**£000**	£000	**%**	%
Fixed rate deposits	**1.99%**	1.94%	**18**	19	**69.6%**	68.8%
Variable rate deposits	**1.41%**	1.36%	**16**	16	**30.4%**	31.2%
All balances	**1.81%**	1.76%	**18**	18	**100.0%**	100.0%

The average initial term of fixed rate deposits at 31 March 2019 was 27 months (30 September 2018: 27 months).

At 31 March 2019 the proportion of easy access deposits, which are repayable on demand, at 23.6% was broadly similar to its level at the beginning of the period (30 September 2018: 25.5%), and represented £1,384.7 million of the balance. This percentage can be expected to rise going forward as the Group generates richer behavioural data to support its liquidity requirement assumptions for easy access business.

The core route to market for the deposit proposition is through its online presence, with traffic driven by strong repeat business flows, a presence on price comparison websites and recommendations from industry savings experts. This has been enhanced in the period by the launch of alternative deposit sources, such as investment platforms outside the main business flow.

The first of these alternative sources came on line in the period, with the Group's launch on the Hargreaves Lansdown Active Savings platform in November 2018. Further such projects are under development and are expected to be launched in the second half of the year.

The Group's products, process and approach continue to be well regarded, both in the industry and by customers. During the period Paragon Bank won the 'Best Monthly Interest Provider' award in the 2019 Moneynet awards, repeating its 2018 success, was named 'Online Savings Provider of the Year' in the Moneyfacts Consumer Awards 2019 and was named as the 'Best Savings Provider for Existing Customers' in the 2019 Savings Champion awards.

In customer feedback 89% of those opening a savings account with the Group in the period, who provided data, stated that they would 'probably' or 'definitely' take a second product (2018 H1: 91%, 2018 full year: 90%). The net promoter score in the same survey was +63, up from +62 in the first half of the preceding financial year (2018 full year: +61).

When customers with maturing savings balances in the year were surveyed 92% stated that they would 'probably' or 'definitely' consider taking out a replacement product with the Group (2018 H1: 90%) with a net promoter score at maturity of +58, up from +44 for the first half of the 2018 financial year (2018 full year: +50). This performance is particularly valuable to the Group, given the benefits of customer and deposit retention.

The Group's outsourced deposit administration platform continues to meet its needs and provides a cost-effective, stable and scalable solution in the medium to long term. Overall, the savings proposition provides the Group with a stable funding platform, with a focus on term funding to manage interest rate risk and the ability to limit product availability to short periods of time, giving the funding channel flexibility and manageability.

The Group expects its deposit base to increase with the business, developing greater diversity and exploring new channels to market and products. The FSCS guarantee is likely to reduce the potential for an economic downturn to impact liquidity and the Group's profiling of its target customers suggests they may be more resilient than average in such circumstances.

3.2 WHOLESALE FUNDING

The Group's wholesale funding comprises securitisation funding, warehouse debt and retail and corporate bonds. It has been one of the principal issuers of residential mortgage backed securities ('RMBS') in the UK over many years. Its Long-Term Issuer Default Rating was affirmed at BBB by Fitch in the period, albeit with a negative outlook which was applied to all the major UK banks as a result of the uncertainty in the Brexit process. Fitch have stated that, all other things being equal, this would be removed in the event of a resolution.

The capital markets have been largely quiet in the six months with rates less appealing than in previous periods. This is attributable to two factors, the general economic environment in the UK and the impending withdrawal of the LIBOR reference rate, which has formed the basis for interest charging on the majority of asset backed securities since the inception of that market.

LIBOR is due to be withdrawn in 2021, within the lifetime of a newly issued four-year security, and UK regulators have mandated the Bank of England Sterling Overnight Index Average ('SONIA') to replace it. However, up until April 2019 no significant SONIA-linked bonds have been issued, with much of the market waiting for a standard approach to emerge.

During the period three mature transactions have been refinanced. These included two pre-2010 deals, First Flexible No. 5 PLC and Paragon Secured Funding (No. 1) PLC, which between them had £83.4 million of principal outstanding at the previous year end and some of the highest funding costs amongst the legacy funding arrangements. The third transaction, Paragon Mortgages (No. 21) PLC, had reached its expected maturity date and was paid down in accordance with market expectations.

While rates have been unattractive for new RMBS issuance throughout the period, with most deals pricing at 100 basis points above LIBOR or more, the Group has been working with its legal and professional advisers to ensure that it is in a position to issue new SONIA linked RMBS when it believes market conditions are right.

At the same time the Group continues to carefully monitor emerging regulatory and market developments so that it suffers no disruption in connection with legacy LIBOR-linked borrowings when the reference rate is withdrawn.

A further funding option is provided by wholesale warehouse funding, which provides standby capability, particularly in the event of market disruption elsewhere, where funds need to be deployed rapidly or as an alternative to retail deposit funding for liquidity purposes. During the period a new £200.0 million facility was agreed with Bank of America Merrill Lynch. This has an interest rate of LIBOR plus 0.95%, providing a source of cost-effective standby funding and an effective means of funding assets ahead of their inclusion in public securitisation structures.

3.3 CENTRAL BANK FACILITIES

The Group has continued to make use of facilities offered by the Bank of England to support its lending to households and businesses. Its drawings under the Term Funding Scheme ('TFS') remain in place and provide £944.4 million of the Group's funding (30 September 2018: £944.4 million, 31 March 2018: £944.4 million), with all drawings remaining in place until at least 2021. The Group also utilised the Indexed Long-Term Repo scheme ('ILTR') for six-month borrowings, with £40.0 million outstanding at the period end (30 September 2018: £80.0 million, 31 March 2018: £30.0 million).

The Group's liquidity drawdown under the Funding for Lending Scheme ('FLS'), which provides liquidity of £108.5 million (30 September 2018: £108.7 million, 31 March 2018: £108.9 million) remained in place throughout the period. The terms of this facility are such that neither the drawing nor the liquidity provided appear on the Group's balance sheet.

The Group has also pre-positioned further mortgage loans and certain other assets with the Bank of England to act as collateral for further drawings on central bank funding lines, if and when required, providing access to liquidity of up to £1,149.6 million.

The Group will continue to access these facilities in future, as part of its overall funding framework.

3.4 SUMMARY

The Group's diversified sources of funding, supporting its retail deposit franchise, give it a strong position, reducing its exposure to issues affecting any particular funding source and allowing it the flexibility to raise funds in accordance with its own market assessments, rather than being forced into sub-optimal transactions for short term reasons. This base delivers a robust and adaptable position going forward, supporting the Group's overall strategic objectives.

Further information on the Group's borrowings is given in note 23.

4. CAPITAL REVIEW

The Group's capital policy aims to provide appropriate returns to shareholders, while ensuring the strength of its balance sheet is preserved and sufficient capital is available to meet its strategic objectives going forward. The maintenance of strong regulatory capital and liquidity positions to safeguard its depositors is also a principal strategic objective.

For regulatory purposes the Group's capital comprises shareholders equity and tier 2 bonds and may be supplemented, if appropriate, by the issue of further qualifying liabilities.

4.1 DIVIDEND AND DISTRIBUTION POLICY

The Company's previously announced dividend policy of paying out 40% of consolidated earnings to shareholders, remains in place, achieving a dividend cover ratio of 2.5 times, in ordinary circumstances.

The interim dividend has been determined, in accordance with policy, as 50% of the previous year's final dividend and has therefore been set at 7.0 pence per share, an increase of 27.3% from the 5.5 pence per share declared in 2018. This will be paid on 26 July 2019 to shareholders on the register on 5 July 2019.

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

The Group's operational capital and funding requirements are also influenced by the need to retain sufficient liquidity in the business to meet its cash requirements in the short and long term, as well as to provide a buffer under stress. There is also a regulatory requirement to hold liquidity in Paragon Bank. The Board regularly reviews its 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 set out below.

Indicator	**31 March 2019**	31 March 2018	30 September 2018	Regulatory minimum
LCR – Liquidity coverage ratio	**134%**	170%	144%	100%
NSFR – Net stable funding requirement	**112%**	112%	113%	100%*

* not yet a binding requirement

This shows the available liquidity at the period end to be well in excess of regulatory minimums.

4.2 REGULATORY CAPITAL

The Group is subject to supervision by the PRA on a consolidated basis, as a group containing an authorised bank. As part of this supervision, the regulator issues individual capital guidance setting an amount of regulatory capital, defined under the international Basel III rules, implemented through the Capital Requirements Regulation and Directive ('CRD IV'), which the Group is required to hold relative to its risk weighted assets in order to safeguard depositors in the event of severe losses being incurred by the Group.

The Group maintains extremely strong capital and leverage ratios, with a total capital ratio of 16.0% at 31 March 2019 and a UK leverage ratio of 6.5%. The CET1 ratio, 13.7% at 31 March 2019, reduced during the period, reflecting the growth in the balance sheet, goodwill on acquisitions and dividends paid to shareholders.

The Group's principal capital measures are set out below. It has been granted transitional relief on the adoption of IFRS 9, with the impact on capital being phased in over a five-year period, with only 5% of the effect being recognised in the first year. However, firms are also required to disclose capital measures as if the relief has not been given (referred to as the 'fully loaded' basis).

		31 March 2019	31 March 2018	1 October 2018	30 September 2018
		IFRS 9	IAS 39	IFRS 9	IAS 39
		£m	£m	£m	£m
CET 1 Capital	Basic	**918.7**	886.1	889.6	890.8
	Fully loaded	**897.5**	886.1	868.4	890.8
Total Regulatory Capital ('TRC')	Basic	**1,068.7**	1,039.9	1,039.6	1,045.7
	Fully loaded	**1,047.5**	1,039.9	1,018.4	1,045.7

The Group's CET1 Capital comprises its equity shareholders' funds, adjusted as required by the CRD IV rules. TRC, in addition, includes tier 2 capital representing the Tier 2 Bonds. Additional tier 2 capital arising from credit loss allowances is no longer included in regulatory capital following the introduction of IFRS 9.

The Group's capital requirements include the Pillar 1 + 2a amount which is specific to the Group and is set by the regulator. This may include both variable and fixed components. At 31 March 2019 this requirement was £747.4 million on the transitional basis and £746.4 million on the fully loaded basis (31 March 2018: £659.7 million – both bases), with the increased requirement principally driven by the growth in the Group's asset base.

The Group's capital must also cover the CRD IV buffers, the Counter-Cyclical ('CCyB') and Capital Conservation ('CCoB') buffers. These apply to all firms and are based on a percentage of risk weighted assets. These buffers were both increased in the period, with the CCoB increasing from 1.875%, to 2.500%, its long-term rate, from January 2019 and the CCyB increasing from 0.5% to 1.0%, from November 2018. These increases in standard CRD IV buffers have added over £75.0 million to the Group's capital requirement. Further buffers may be set by the PRA on a firm by firm basis, but may not be disclosed.

The Group continues to maintain a healthy capital surplus, although this has been eroded by the 1.125 percentage point increase in the CRD IV buffers in the period, the introduction of IFRS 9 and the increase in the deficit on the Group's pension plan.

Capital ratios are set out below.

		31 March 2019	31 March 2018	1 October 2018	30 September 2018
		IFRS 9	IAS 39	IFRS 9	IAS 39
CET 1 Ratio	Basic	**13.7%**	15.5%	13.8%	13.8%
	Fully loaded	**13.4%**	15.5%	13.5%	13.8%
Total Capital Ratio	Basic	**16.0%**	18.2%	16.2%	16.2%
	Fully loaded	**15.7%**	18.2%	15.8%	16.2%
UK Leverage Ratio	Basic	**6.5%**	6.8%	6.4%	6.4%
	Fully loaded	**6.4%**	6.8%	6.3%	6.4%

Capital ratios remain largely in line with previous performance, with IFRS 9 transition not having a major impact. The Group's current CET1 appetite is consistent with its previously stated target of 13.0%.

During the period the Group has undertaken a thorough review of the risk weightings applied to its assets for capital purposes, partly in response to market concerns across the sector. This exercise confirmed the weightings being applied under the Standardised Approach and the appropriateness of the Group's risk weighted assets values and hence its capital measures.

The Group's project to develop an Internal Ratings Based ('IRB') approach to credit risk for capital adequacy purposes continues. A considerable amount of work has been completed during the period, using both internal and external resources, and submission of the first applications, in respect of the Group's buy-to-let mortgage assets is expected in the second half of the current financial year.

4.3 CAPITAL OUTLOOK

While the Group's strong businesses and its flexible funding provide the foundations to grow its capital base to sustain future strategic growth, the Board keeps the appropriate level and form of capital required for the Group under review.

This ensures that, in the light of the Group's strategic objectives and, more specifically where there are changes in the business or in regulatory expectations, the capital position will always be prudent and sustainable, for the benefit of all stakeholders.

5. FINANCIAL REVIEW

Over the half year period the Group's results were impacted by market interest rate movements. These generated significant fair value volatility in the profit and loss account and increased the deficit on the Group's pension scheme, although both measures showed strong signs of recovery after the period end. However, the underlying position continued the positive trends seen in previous periods, driven by Group's long-term strategy.

The six months ended 31 March 2019 saw the Group's underlying profit (appendix B) increase by 8.7% to £79.8 million (2018 H1: £73.4 million) while on the statutory basis profit before tax decreased by 6.7% to £72.0 million (2018 H1: £77.2 million) as a result of the fair value losses on hedging instruments.

Earnings per share decreased by 5.1% to 22.5p (2018 H1: 23.7p) on the statutory basis, and increased by 11.1% to 25.0p excluding the effect of the fair value gains (2018 H1: 22.5p) (appendix B).

5.1 RESULTS FOR THE PERIOD

CONSOLIDATED RESULTS

For the six months ended 31 March 2019

	2019 H1	2018 H1
	IFRS 9	IAS 39
	£m	£m
Interest receivable	**249.2**	213.3
Interest payable and similar charges	**(111.1)**	(92.0)
Net interest income	**138.1**	121.3
Other operating income	**9.9**	8.8
Total operating income	**148.0**	130.1
Operating expenses	**(63.3)**	(54.9)
Provisions for losses	**(4.9)**	(1.8)
	79.8	73.4
Fair value net (losses) / gains	**(7.8)**	3.8
Operating profit being profit on ordinary activities before taxation	**72.0**	77.2
Tax charge on profit on ordinary activities	**(13.9)**	(15.2)
Profit on ordinary activities after taxation	**58.1**	62.0

	2019 H1	2018 H1
Basic earnings per share	**22.5p**	23.7p
Diluted earning per share	**22.0p**	23.0p
Dividend - rate per share for the period	**7.0p**	5.5p

Income

Total operating income increased by 13.8% to £148.0 million (2018 H1: £130.1 million). Within this, net interest income in the period increased by 13.8% to £138.1 million from £121.3 million for the six months ended 31 March 2018. The increase principally reflects the growth in the size of the average loan book, which rose by 9.6% to £12,313.1 million (2018 H1: £11,235.4 million) (appendix C).

Annualised net interest margin ('NIM') was improved in the six months to 31 March 2019 to 2.24% from the 2.16% achieved in the corresponding period last year (appendix C). This increase reflects the changes in product mix in the Group's balance sheet, with new buy-to-let margins exceeding those achieved on the legacy book and the growing Commercial Lending division operating on still wider margins. The net impact of the Titlestone development finance acquisition and the Idem Capital portfolio disposal in the second half of 2018 was also positive for net interest.

Other operating income was £9.9 million for the six months, compared with £8.8 million in the corresponding period in 2018. The increase arises principally from increased operating lease income, following investment in leasing assets over recent years.

Costs

Operating expenses for the period increased by 15.3% to £63.3 million from £54.9 million for the six months ended 31 March 2018. These costs include a full six months of costs relating to both the Titlestone business, acquired in the second half of the last financial year and the Iceberg business, acquired in December 2017. The Group's average number of employees also increased to 1,364 for the period, an increase of 1.1% over the comparable period in 2018 (2018 H1: 1,349). The increase in the Group's savings balance in the period (37.2% between 31 March 2018 and 31 March 2019) also impacts operating costs, with the outsourced servicing fee set by reference to the balance outstanding.

The achievement of the Group's strategy is dependent on its IT infrastructure and during the period it invested heavily in developments to improve efficiency and to provide an enhanced experience to its customers, particularly in the SME market. These initiatives were ongoing at the period end and will be rolled out in the future. Further systems effort was deployed to enhance cyber-security and operational resilience. The period's costs also include expenditure of over £1.0 million on the development of the Group's IRB approach, both in internal resources and external advice, which should generate material future benefits to the Group's capital position. Overall the Group estimates that these project costs comprise over £2.0 million of the cost base for the period.

This investment for the future increased the Group's cost:income ratio in the period to 42.8% (appendix A) from the 42.2% recorded in the first half of 2018, although without the additional project costs and the impact of the acquisitions, this would have reduced. The control of operating costs remains a principal strategic priority of the Group and it applies a rigorous budgeting and monitoring process. Over the medium term, the Group targets improvements in the cost:income ratio, from scale and efficiency gains, but increases in regulatory burdens, IT investments and the impact of new operations means that progress to a lower ratio is unlikely to be linear.

Impairment provisions

With effect from the current financial year, the Group is required to use the new financial instruments accounting standard, IFRS 9, to calculate its impairment provisions in place of IAS 39. This changes the basis of provision from incurred loss to expected loss, which means that although a broadly similar bad debt charge will be posted over the life of a credit impaired account, it will be recognised earlier. The consequence of this is that a growing portfolio, such as most of the Group's loan books, will attract a higher provision charge than it would have done under the previous methodology.

On transition to IFRS 9 an additional £27.2 million of impairment was identified and recognised in opening reserves. The total reduction in equity was £22.2 million after recognising a deferred tax asset. Comparative results for 2018 are not restated, so the impairment charges in the 2019 and 2018 periods are not strictly comparable.

The charge of £4.9 million for loan impairment in the first half year has increased from that for the previous year principally due to the introduction of IFRS 9 (2018 H1: £1.8 million). However, this was less than the £5.6 million recorded in the second half of 2018 under IAS 39. The cost of risk (the impairment charge as an annualised percentage of average loans to customers) increased to 0.08% from 0.03% during the six months ended 31 March 2018 (appendix C), but the level remains low, reflecting the strong credit performance delivered by the Group's underwriting approach in its various operating businesses.

During the period the largest part of the provision charge was attributable to the Commercial Lending segment, with a charge of £3.7 million for the half year, compared to the £0.3 million charge in the first half of 2018 under IAS 39. This was expected under the new standard as this division includes the Group's fastest growing portfolios, where the expected loss basis accelerates provision. In contrast, the Group's mortgage books, where the outstanding balance changed less, had a half year charge of £0.7 million, compared to the £1.9 million IAS 39 charge in the first half of 2018.

Operationally, the Group has continued to see favourable trends in arrears performance over the period, both in terms of new cases reducing and customers correcting past arrears. Careful management of all of the Group's loan books continues to be a strategic priority, for both retention and credit purposes. The credit performance of the books continues to be pleasing, with that of the buy-to-let book remaining exemplary, compared to market averages, and credit metrics on the Group's newer portfolios also strong and in line with expectations.

Fair value movements

Yield curve movements during the period resulted in hedging instrument fair value net losses of £7.8 million (2018 H1: £3.8 million net gain), which do not affect cash flow. The size of the movement in the period is mostly a result of market turbulence at the valuation date, with the 31 March 2019 yield curve showing large fluctuations from longer-term levels, and the March month generating almost two thirds of the charge for the entire period. Commentators have ascribed some of this to heightened political uncertainties in the UK over Brexit at that time. A significant part of this loss was reversed in early April as the yield curve returned to its more normal shape.

The fair value movements of hedged assets or liabilities are expected to trend to zero over time. As such this item represents a timing difference which is consistently excluded from the Group's definition of its underlying profit. The Group remains appropriately economically hedged.

Tax

Tax has been charged at an effective rate of 19.3%, compared with 19.7% for the corresponding period last year. Materially all of the Group's operations fall within the scope of UK taxation and the standard rate of corporation tax applying to the Group in both periods was 19.0%.

Profits after taxation of £58.1 million (2018 H1: £62.0 million) have been transferred to equity, which totalled £1,087.0 million at the period end (31 March 2018: £1,020.6 million). This represents a tangible net asset value of £3.54 per share (31 March 2018: £3.47) and a net asset value on the statutory basis of £4.21 per share (31 March 2018: £3.94) (appendix D).

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

5.2 SEGMENTAL RESULTS

The Group continues to manage its business through three divisions, which are the principal segments for which performance is monitored:

- Mortgages, including the Group's buy-to-let and owner-occupied first and second charge mortgage 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
- Idem Capital, including loan assets acquired from third parties and legacy assets which share certain credit characteristics with them

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

The underlying operating profits of these divisions are detailed fully in note 9 and are summarised below.

	Six months to 31 March 2019	Six months to 31 March 2018
	£m	£m
Segmental profit		
Mortgages	**84.6**	72.3
Commercial Lending	**19.5**	6.2
Idem Capital	**22.8**	37.5
	126.9	116.0
Unallocated central costs	**(47.1)**	(42.6)
	79.8	73.4

Mortgages

The Mortgage division continues to maintain a strong market position in its core professional buy-to-let loan market. Strategically targeted operational initiatives have improved retention and enhanced NIM, while provisions remain low. As a result, the segmental profit increased by 17.0% to £84.6 million, from the corresponding period in the previous year (2018 H1: £72.3 million) on a mortgage book which itself had increased by 6.6% between 31 March 2018 and 31 March 2019. The increasing volume of new buy-to-let lending and the run-off of the legacy portfolio, together with reductions in the redemption rate in the post-2010 book contributed to a 14 basis point improvement in segmental NIM in the period.

Commercial Lending

The Commercial Lending segment achieved a segmental profit of £19.5 million in the period (2018 H1: £6.2 million). This is attributable to the contribution of new business lines, together with growth and enhanced focus in the ongoing sectors. NIM in the division rose by 106 basis points compared with the six months ended 31 March 2018, 23 basis points of which represented like-for-like growth with the remaining 83 basis points relating to assets acquired with the Titlestone business.

Together with organic growth, the acquired Titlestone business generated a substantial increase in loan assets, with the segment's loans to customers at 31 March 2019, at £1,283.9 million increasing 88.8% from the position twelve months earlier (31 March 2018: £680.1 million).

Idem Capital

The Idem Capital division's portfolios continued to perform well in the six months ended 31 March 2019. No new deals were completed and hence the outstanding loan balance reduced through run-off in the period, falling by 16.3% in the last twelve months (31 March 2018: £547.1 million). NIM reduced in the segment, a result of the strategic focus on acquiring performing books, which may have lower yields; the impact of the portfolio sale of higher yielding assets in September 2018; natural portfolio amortisation; and a more normal level of lump sum settlements than the strong levels that enhanced earnings in the prior year. This impacted on segment profit, which fell by 39.2% to £22.8 million (2018 H1: £37.5 million).

5.3 ASSETS AND LIABILITIES

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

SUMMARY BALANCE SHEET

31 March 2019

	31 March 2019	31 March 2018	1 October 2018	30 September 2018
	IFRS 9	IAS 39	IFRS 9	IAS 39
	£m	£m	£m	£m
Free cash	**204.2**	141.2	238.0	238.0
Other cash	**867.8**	921.4	1,072.6	1,072.6
Loans to customers	**12,525.6**	11,346.7	12,100.6	12,127.8
Derivative financial assets	**751.3**	763.4	855.7	855.7
Other assets	**133.7**	53.7	51.7	51.7
Intangible assets	**171.4**	120.3	169.3	169.3
Total assets	**14,654.0**	13,346.7	14,487.9	14,515.1
Retail deposits	**5,878.0**	4,285.8	5,296.6	5,296.6
Borrowings	**7,495.6**	7,891.7	7,961.2	7,961.2
Derivative liabilities	**30.9**	6.2	4.7	4.7
Sundry liabilities	**130.6**	112.6	132.0	137.2
Pension deficit	**31.9**	29.8	19.5	19.5
Equity	**1,087.0**	1,020.6	1,073.9	1,095.9
Total equity and liabilities	**14,654.0**	13,346.7	14,487.9	14,515.1

The change in the balance sheet in the period has been driven by the increase in the Group's loan books reported in the lending review section, with the portfolio increasing on a like-for-like basis by 3.5% since the year end to £12,525.6 million (1 October 2018 (IFRS 9): £12,100.6 million). This increase, together with the Group's liquidity policy, determines its funding requirements and hence the level of its liabilities.

Loan assets

The Group's loan assets include:

- Buy-to-let and owner-occupied first mortgage assets in the Mortgage segment
- Second charge mortgages, with new originations in the Mortgage segment and purchased and similar legacy assets in Idem Capital
- Other unsecured consumer lending in Idem Capital
- Asset finance and motor finance loans in the Commercial Lending segment, with similar purchased accounts in the Idem Capital segment
- Development finance loans in the Commercial Lending segment
- Structured lending loans in the Commercial Lending segment
- Professions finance, invoice finance and other funding solutions for SME businesses in the Commercial Lending segment

The allocation of these loan assets between segments is set out below.

	31 March 2019	31 March 2018	1 October 2018	30 September 2018
	IFRS 9	IAS 39	IFRS 9	IAS 39
	£m	£m	£m	£m
Mortgages	**10,783.9**	10,119.5	10,449.5	10,473.5
Commercial Lending	**1,283.9**	680.1	1,131.3	1,133.2
Idem Capital	**457.8**	547.1	519.8	521.1
	12,525.6	11,346.7	12,100.6	12,127.8

An analysis of the Group's financial assets by type is shown in note 18. Movements in the Group's loan asset balances are discussed in the Lending Review (Section 2) above.

Derivatives

Movements in derivative financial assets and liabilities arise principally as a result of the effect of changes in exchange rates on instruments forming cash flow hedges for the Group's floating rate notes. These movements do not impact the Group's results while the exchange movements have a broadly equal and opposite impact on borrowings.

The impact of the yield curve changes already mentioned has also driven significant changes in the valuation of derivatives held for hedging fixed rate loan assets or deposit liabilities, with the net carrying value switching from a £21.3 million asset at 30 September 2018 to a £20.0 million liability at the period end. For those derivatives forming part of a hedge for accounting purposes this movement is offset by the movement in the fair value adjustments against loans to customer and retail deposits.

Funding

Movements in the Group's funding, including retail deposit balances and wholesale borrowings, are discussed in the funding review section. The Group has pursued a conservative liquidity policy in the period, resulting in strong levels of liquid assets being held throughout the period.

Pension obligations

The IAS 19 valuation of the Group's pension scheme deficit increased significantly in the period, with the impact of the Group's contributions under the recovery plan being offset by a reduction in the bond yields which drive the discounting used in this valuation. These yields fell by 50 basis points in the period to record low levels, a result of the same market disruption which affected swap fair values. This caused the £12.4 million increase in the deficit to £31.9 million (30 September 2018: £19.5 million, 31 March 2018: £29.8 million).

While the valuation under IAS 19 is that which is required to be disclosed in the accounts, pension trustees generally use the technical provisions basis as provided in the Pensions Act 2004 to measure scheme liabilities. On this basis, the valuation at 31 March 2019 was £26.7 million, an increase of £11.5 million in the period (30 September 2018: £15.2 million, 31 March 2018: £19.6 million), representing a 79.3% funding level (30 September 2018: 87.0%).

Discount rates increased after the period end, with the valuation on the technical basis having reduced to £20.7 million by 30 April 2019. An approximately proportionate impact on the IAS 19 valuation would be expected.

Other assets and liabilities

Sundry assets have increased significantly as a result of the Group's deferred tax balance becoming an asset (a result of IFRS 9 transition adjustments and the movement in the pension plan liability), together with the inclusion of £26.0 million of collateral which was required to be posted in respect of credit swap balances (30 September 2018: £3.8 million).

Within sundry liabilities, the transfer of deferred tax to assets has been offset by the increase in interest accruals on deposits.

6. OPERATIONS REVIEW

Over the period the Group has continued to generate operational efficiencies. The Group's development finance operations have been integrated with the acquired Titlestone business, in terms of location, systems and management structure while the rationalisation of the asset finance business on to fewer sites has also progressed.

Strategically the Group continues to operate a centralised operational structure, with a consolidated governance and risk management framework covering all of its operations and ensuring effective oversight.

6.1 MANAGEMENT AND PEOPLE

The Group relies on the strength of its governance and management processes and the quality of its people to achieve its strategic objectives. With over 1,350 employees, split between the head office in Solihull and satellite offices, the Group recognises the importance of its strengths in this area and its participation in a number of external initiatives to enhance them.

Governance and management

During the period the Company continued to comply with the principles of the UK Corporate Governance Code (the 'Code'). On 31 December 2018 Alan Fletcher and Patrick Newberry stepped down from the Board. Alan served as a director from 2009, including a lengthy term as Chairman of the Remuneration Committee, ceasing to be independent for corporate governance purposes in February 2018. Pat served first as an independent director of Paragon Bank PLC from its earliest months of operation in 2014, serving as chairman of its audit committee, and joined the Board of Paragon Banking Group in 2017. They leave with the thanks of the Group and their fellow directors for their support and dedication in the development of both the Group and Paragon Bank PLC, and the best wishes of their colleagues for the future.

Peter Hartill, a non-executive director since 2011, and Chairman of the Audit Committee and Senior Independent Director, will be retiring at the 2020 Annual General Meeting having served on the Board for nine years. The Group has commenced the process of identifying a new non-executive director and a further announcement will be made when appropriate.

John Heron, Director of Mortgages, has also signalled his intention to retire and will be leaving in early 2020. John joined the Group in 1986 and, as well as being the Group's longest-serving employee, he has been instrumental in establishing and building our buy-to-let mortgage offering. A recruitment process has commenced.

During the period the Group has continued its review of the requirements of the new edition of the Code, which will come into force for the Group from 1 October 2019. At the same time the Group has considered the forthcoming changes in UK rules for the disclosure of Chief Executive remuneration and the director's consideration of wider stakeholder interests ('section 172') and new requirements for corporate governance and other new disclosures in subsidiary entities.

No significant implementation issues have been identified and the Group expects to be able to meet the new requirements as of the implementation dates.

The Board has also considered the governance and committee structures in preparation for the Group's IRB application, as well as providing oversight to that development more generally.

Equality and diversity

Diversity has continued to be a focus for the Board and the Group as a whole, and in September 2018 the second progress report on the Group's internal targets under the Women in Finance Charter was published on its website. The targets include female representation in senior management roles reaching 35% by January 2022, increasing from 26% at the time the targets were set. The Group was pleased to report this target had been achieved by 31 December 2018 and remained at 35% at 31 March 2019.

The Group reported its full Gender Pay Gap information at the end of March 2019, having included the headline numbers in its Annual Report for the year ended 30 September 2018. These results, based on the April 2018 pay date, can be found on the 'Corporate Responsibility' section of the Group's website.

The Group's published data covered all its operations, going beyond the requirements of the legislation to provide a more complete view of its position. The median gender pay gap for the whole Group at 5 April 2018, reported in March 2019, at 30.7% was not dissimilar to those for other smaller financial entities (5 April 2017: 30.4%). Analysis of the data confirmed the Group's view that its gap arose primarily from the low numbers of women in higher paying positions, rather than unequal pay for similar jobs, emphasising the importance of the Women in Finance initiative to generate improvements over the medium term.

The Group welcomes the interest in this issue generated by the public reporting of gender pay but would favour a review of the detail of the legislation in the light of experience to date to ensure all disclosures required are comparable and understandable.

During the period the Group joined the Women Ahead 30% Club cross-company mentoring scheme, providing ten trained mentors to support female mentees from other companies, whilst nominating ten female mentees to receive external mentoring support at the same time. This is an annual programme and feedback from mentors and mentees has been very positive.

The Group provides annual diversity awareness training for managers and additional communication events are planned in the coming months. The Group carries out an annual voluntary and anonymous diversity survey of its employees with the 2018 survey producing a response rate of 72%, significantly above industry average. The 2019 survey will be conducted during the second half of 2019 and results will be reported at the year end. Actions to promote equal opportunities within recruitment, learning and career development continue to be an important element of the Group's people strategy.

The Nomination Committee, as the Board Committee responsible for diversity issues across the Group, oversees policies and performance on diversity. While the Group is confident that there is no systematic gender bias in its recruitment or remuneration practices, it is conscious of the underrepresentation of women at senior levels in the financial services sector and it anticipates that one of the effects of its Women in Finance initiative will be to erode the gender pay gap over time by increasing female representation at senior levels.

Whilst the Group is pleased with progress to date in improving diversity, relative to other similar organisations, it recognises that there is still much work to do. It is confident, however, that the measures put in place will help provide individuals with the opportunities they deserve and the Group with the workforce it needs to achieve its strategic goals. A full list of the Group's diversity targets can be found on the 'Corporate Responsibility' section of the Group's website.

People and development

The Group has managed an efficient operation over the past six months, increasing average employee numbers by 1.1% compared to the first half of 2018. It maintains its accreditation from the UK Living Wage Foundation and minimum pay continues to meet the levels set by the Foundation.

The Group prides itself on the high retention rate of its workforce. Its annual employee attrition rate of 16.1% (2018 H1: 8.7%) is below the national average. 26.4% of its people have been with the Group for more than ten years, with 11.2% having achieved over 20 years' service. We believe this is due to the provision of quality development opportunities and ensuring the Group remains a place where people want to work. This in turn has meant that through-the-cycle knowledge and experience have been retained in all the Group's specialist areas, which form the foundation of its strategic focus on specialist lending.

The Group has continued to draw down on Apprenticeship Levy funds to support its development objectives and the internal Management Academy was certified with the Chartered Management Institute ('CMI') to facilitate this. There are typically over 100 people completing professional qualifications at any one time across the Group. The Group currently has 43 apprentices registered under the levy scheme, utilising 28% of its levy pot in the past 12 months. Whilst a higher take up would be desirable, the requirement for apprentices to spend 20% of their time out of the business makes identifying suitable roles challenging.

Regulatory and other training programmes have also taken place internally to ensure employees remain competent to deliver good customer outcomes. The Group has continued to work with local secondary schools, colleges and universities, with industrial placements becoming a feature for some of the Group's specialist areas. The Group has introduced a volunteering day linked to local and regional charitable activities which is available to all employees, with the first initiative piloted between January and March 2019 by nine employees. Feedback has been very positive and there are plans to extend the volunteering scheme across local communities in the second half of this year.

Management development has been a core focus to support the Group's wider succession planning strategy, as well as developing more female employees to increase the pool of available internal candidates. During the period work has continued to embed the internal mentoring programme, accredited by the CMI, which helps to support succession planning strategy and develop future leaders. The Group held a senior leadership conference in January 2019 and two senior leadership development centres have been held during the period.

The health and wellbeing of the Group's employees is an important element of its people strategy. An internal team of emotional wellbeing volunteers, identified and trained with the support of the charity Mind during 2018, is now embedded and provides support to individuals experiencing issues within their personal life or at work, which may impact on their emotional, psychological or social wellbeing.

6.2 RISK

The effective management of risk is 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.

In the last six months, the Group has continued to enhance its ability to manage all categories of risk. In particular it has focussed on:

- The development of advanced models to enhance credit risk management and support the Group's IRB application process
- The enhancement of operational risk capabilities, including the assessment of critical business services and tolerances
- The continuing evolution and embedding of its risk appetite framework
- Ongoing embedding of its operational risk management system in business areas for use on a day-to-day basis
- The maintenance and further development of effective cyber-security controls
- The integration of the businesses acquired in the previous year to ensure they are fully captured by the risk management framework
- Continuing the embedding of robust data protection processes and controls to ensure compliance with the Data Protection Act 2018

The principal challenges in the risk environment faced by the Group during the six-month period and going forward include:

- The impact of continuing uncertainty as to the timing and terms on which the UK will leave the EU and their impact on the Group's businesses and the regulatory regimes it operates under
- The impact of fiscal and regulatory changes introduced in preceding periods on the scope and nature of the demand for buy-to-let mortgages in the UK
- Heightened cyber-security risks as a result of the increasing sophistication and frequency of cyber-attacks affecting the financial services sector

The Group is carefully monitoring and responding to these risks as they develop and considers itself well placed to mitigate their impact.

A summary of the principal risks and uncertainties faced by the Group is given on page 30.

6.3 REGULATION

Paragon Bank, which encompasses the majority of the Group's activities for regulatory purposes, 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 other subsidiaries are authorised and regulated by the FCA. As a result, current and projected regulatory changes, particularly revisions to the Basel supervisory regime, continue to pose a significant risk for the Group, both as a result of their impact and of the pace of change.

The governance and control structures within the Group continue to be developed to ensure that the impacts of all new regulatory requirements on the business are clearly understood and that appropriate preparations are made before these requirements are implemented. 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.

Whilst the Group is impacted by a broad range of prudential and conduct regulations, given the nature of its operations, the following recent and current developments are of particular note:

- A discussion paper was published by the Bank of England, PRA and FCA in July 2018 focussing on the need for greater operational resilience in the UK financial system and the individual firms and market infrastructures within it. The Group is actively working to ensure it has the necessary arrangements in place to meet the best practice expectations of the paper
- Extensions to the Senior Managers and Certification Regime ('SMCR') to cover a wider section of persons employed in financial services come into force in December 2019. This will increase the number of the Group's employees within the SMCR and the oversight activities required to ensure compliance with the extended rules. These systems have been developed in the period and training modules for all impacted people have taken place across the Group
- The policy statement issued by the FCA in March 2017 regarding Payment Protection Insurance ('PPI'), setting a deadline of 29 August 2019 for any new PPI complaints and new rules and guidance on the handling of such matters. Impacts from this process have, so far, been minimal and this is expected to remain the case
- The development of proposals, led by the Bank of England and the FCA, to establish SONIA as the primary sterling interest rate benchmark by the end of 2021, in place of LIBOR, continues to be monitored to assess any potential impact on the Group and its customers. This is discussed further in the funding section
- The FCA proposals to make changes to the responsible lending rules and guidance in respect of mortgage customers, issued in March 2019. The Group is in the process of assessing their impact and determining what action may be required
- The results of the FCA multi-firm review on motor finance, published in March 2019. The Group has completed a detailed gap analysis against this and is currently considering any policy and procedural changes which may be required

The Group, along with the rest of the UK corporate sector, does not yet have clear visibility on potential regulatory changes that may be introduced following the UK's decision to leave the EU. However, given its current business model and activities, it does not have any EU passporting issues that need to be considered.

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

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

7. CONCLUSION

The Group has continued to make strong progress in its strategy to provide focussed specialist lending products to UK small businesses and consumers, while offering competitive deposit rates to savers.

The Group remains well placed in those specialist markets where it has targeted its activity. It has maintained its leading position in the professional buy-to-let mortgage market, helping to support the UK's vital private rented sector. It has also continued to focus its product range on underserved areas of consumer and SME lending, providing these consumers with better access to finance.

During the period the integration of the acquired Titlestone development finance business has been successfully completed giving the Group a significant presence in that market, supporting smaller house builders. Investing in the development of delivery processes has also continued across all business lines to enhance the experience of both customers and business partners.

These developments leave the Group well placed to continue to support its customer base in the face of economic uncertainty in the UK and to deliver sustainable returns to its shareholders.

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 these have not changed materially from those described in section A2.2 of the last annual report and accounts of the Group for the year ended 30 September 2018. These are summarised below.

Category	Risk	Description
Business	Economic	The Group could be materially affected by a severe downturn in the UK economy given its income is wholly derived from activities within the UK. This is more difficult to forecast given current uncertainties on the date and terms on which the UK will leave the EU and the potential for economic turbulence and negative short-term consequences. This could reduce demand for the Group's loan products, increase the number of customers that default on their loans and cause security asset values to fall.
	Concentration	The Group's business plans could be particularly affected by any downturn in the performance of the UK private rented sector and/or further regulatory intervention to control buy-to-let lending.
	Transition	Failure to manage major internal reorganisations or integrate acquired businesses safely and effectively could adversely affect the Group's business plans and damage its reputation.
Credit	Customer	Inaccurate targeting and underwriting of credit decisions could result in customers becoming less able to service debt, exposing the Group to unexpected material losses.
	Counterparty	Failure of an institution holding the Group's cash deposits or providing hedging facilities for risk mitigation could expose the Group to loss or liquidity issues.
Conduct	Fair outcomes	If the Group fails to deliver fair outcomes for its customers this could impact both on its reputation and on its financial performance through loss of business or regulatory sanction.
Operational	Systems and IT Security	The risk that the Group's systems may be unable to support its operational requirements or that the Group fails to adequately protect itself and its customers against cyber-crime.
	People	Failure to attract or retain appropriately skilled key employees at all levels could impact upon the Group's ability to deliver its business plans and strategic objectives.
	Regulation	The risk that the Group's strategic plans could be materially impacted by any significant regulatory or legal changes and that it might suffer loss or reputational damage if it fails to identify and respond to such changes effectively.
Liquidity and Capital	Funding	If access to funding became restricted, either through market movements or regulatory intervention, this might result in the scaling back or cessation of some business lines.
	Capital	Changes in capital requirements for lending secured on residential property currently in progress could have adverse financial implications for the Group.
Market	Interest rates	Reduction in margins between market lending and borrowing rates or mismatches in the Group balance sheet could impact profits.
Pension Obligation	Pensions	The obligation to support the Group's defined benefit pension plan might deplete resources.

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.

DIRECTORS' RESPONSIBILITES

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 adopted and endorsed by the European Union
- 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 UK Listing 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 UK Listing 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.

Pandora Sharp
Company Secretary

22 May 2019

Board of Directors
F J Clutterbuck
N S Terrington
R J Woodman
J A Heron
P J N Hartill
H R Tudor
B A Ridpath
F F Williamson
G H Yorston

Consolidated Income Statement

For the six months ended 31 March 2019 (Unaudited)

	Note	**Six months to 31 March 2019**	Six months to 31 March 2018	Year to 30 September 2018
		IFRS 9	IAS 39	IAS 39
		£m	£m	£m
Interest receivable	10	**249.2**	213.3	451.9
Interest payable and similar charges	11	**(111.1)**	(92.0)	(197.3)
Net interest income		**138.1**	121.3	254.6
Other leasing income		**9.0**	7.4	16.3
Related costs		**(7.0)**	(6.0)	(12.5)
Net leasing income		**2.0**	1.4	3.8
Gain on disposal of financial assets		**-**	-	28.0
Other income	12	**7.9**	7.4	15.5
Other operating income		**9.9**	8.8	47.3
Total operating income		**148.0**	130.1	301.9
Operating expenses		**(63.3)**	(54.9)	(114.2)
Provisions for losses		**(4.9)**	(1.8)	(7.4)
Operating profit before fair value items		**79.8**	73.4	180.3
Fair value net (losses) / gains	13	**(7.8)**	3.8	1.2
Operating profit being profit on ordinary activities before taxation		**72.0**	77.2	181.5
Tax charge on profit on ordinary activities	14	**(13.9)**	(15.2)	(35.7)
Profit on ordinary activities after taxation		**58.1**	62.0	145.8

	Note	**Six months to 31 March 2019**	Six months to 31 March 2018	Year to 30 September 2018
Basic earnings per share	15	**22.5p**	23.7p	55.9p
Diluted earnings per share	15	**22.0p**	23.0p	54.2p
Dividend - rate per share for the period	29	**7.0p**	5.5p	19.4p

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

Consolidated Statement of Comprehensive Income

For the six months ended 31 March 2019 (Unaudited)

	Note	**Six months to 31 March 2019**	Six months to 31 March 2018	Year to 30 September 2018
		IFRS 9	IAS 39	IAS 39
		£m	£m	£m
Profit for the period		**58.1**	62.0	145.8
Other comprehensive income / (expenditure)				
Items that will not be reclassified subsequently to profit or loss				
Actuarial (loss) / gain on pension plan	*25*	**(12.9)**	(0.6)	8.9
Tax thereon		**1.8**	0.1	(1.7)
		(11.1)	(0.5)	7.2
Items that may be reclassified subsequently to profit or loss				
Cash flow hedge (losses) / gains taken to equity		**(0.9)**	0.6	1.0
Tax thereon		**0.2**	(0.1)	(0.2)
		(0.7)	0.5	0.8
Other comprehensive income / (expenditure) for the period net of tax		**(11.8)**	-	8.0
Total comprehensive income for the period		**46.3**	62.0	153.8

Consolidated Balance Sheet

31 March 2019 (Unaudited)

	Note	**31 March 2019**	31 March 2018	1 October 2018	30 September 2018	30 September 2017
		IFRS 9	IAS 39	IFRS 9	IAS 39	IAS 39
		£m	£m	£m	£m	£m
Assets						
Cash – central banks	*16*	**704.0**	628.5	895.9	895.9	615.0
Cash – retail banks	*16*	**368.0**	434.1	414.7	414.7	881.9
Short-term investments	*17*	**-**	10.0	-	-	-
Loans to customers	*18*	**12,544.4**	11,325.1	12,076.5	12,103.7	11,115.4
Derivative financial assets	*20*	**751.3**	763.4	855.7	855.7	906.6
Sundry assets		**45.9**	13.1	19.0	19.0	12.7
Deferred tax assets		**5.4**	-	-	-	-
Property, plant and equipment		**63.6**	52.2	56.8	56.8	46.2
Intangible assets	*21*	**171.4**	120.3	169.3	169.3	104.4
Total assets		**14,654.0**	13,346.7	14,487.9	14,515.1	13,682.2
Liabilities						
Short-term bank borrowings		**0.6**	1.0	1.1	1.1	0.6
Retail deposits	*22*	**5,878.7**	4,278.8	5,292.4	5,292.4	3,611.9
Derivative financial liabilities	*20*	**30.9**	6.2	4.7	4.7	7.1
Asset backed loan notes	*23*	**5,143.0**	5,457.7	5,554.7	5,554.7	6,475.8
Secured bank borrowings	*23*	**921.9**	1,013.5	935.6	935.6	1,306.0
Retail bond issuance	*23*	**296.3**	295.9	296.1	296.1	295.7
Corporate bond issuance	*23*	**149.4**	149.2	149.3	149.3	149.1
Central bank facilities	*23*	**984.4**	974.4	1,024.4	1,024.4	700.0
Sundry liabilities	*24*	**112.4**	99.1	114.4	114.4	74.6
Current tax liabilities		**17.5**	15.5	21.4	21.4	17.4
Deferred tax liabilities		**-**	5.0	0.8	5.6	4.8
Retirement benefit obligations	*25*	**31.9**	29.8	19.5	19.5	29.8
Total liabilities		**13,567.0**	12,326.1	13,414.4	13,419.2	12,672.8
Called up share capital	*26*	**281.8**	281.5	281.6	281.6	281.5
Reserves	*27*	**908.1**	837.1	895.9	918.3	811.0
Own shares	*28*	**(102.9)**	(98.0)	(104.0)	(104.0)	(83.1)
Total equity		**1,087.0**	1,020.6	1,073.5	1,095.9	1,009.4
Total liabilities and equity		**14,654.0**	13,346.7	14,487.9	14,515.1	13,682.2

The condensed financial statements for the half year were approved by the Board of Directors on 22 May 2019.

Consolidated Cash Flow Statement

For the six months ended 31 March 2019 (Unaudited)

	Note	**Six months to 31 March 2019**	Six months to 31 March 2018	Year to 30 September 2018
		£m	£m	£m
Net cash flow generated by operating activities	*30*	**177.3**	515.9	1,074.4
Net cash (utilised) by investing activities	*31*	**(1.3)**	(17.2)	(282.8)
Net cash (utilised) by financing activities	*32*	**(414.1)**	(933.4)	(978.4)
Net (decrease) in cash and cash equivalents		**(238.1)**	(434.7)	(186.8)
Opening cash and cash equivalents		**1,309.5**	1,496.3	1,496.3
Closing cash and cash equivalents		**1,071.4**	1,061.6	1,309.5
Represented by balances within:				
Cash	*16*	**1,072.0**	1,062.6	1,310.6
Short-term bank borrowings		**(0.6)**	(1.0)	(1.1)
		1,071.4	1,061.6	1,309.5

Consolidated Statement of Movements in Equity

For the six months ended 31 March 2019 (Unaudited)

Six months ended 31 March 2019 (IFRS 9)

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Cash flow hedging reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m
Transactions arising from								
Profit for the period	-	-	-	-	-	58.1	-	58.1
Other comprehensive income	-	-	-	-	(0.7)	(11.1)	-	(11.8)
Total comprehensive income	-	-	-	-	(0.7)	47.0	-	46.3
Transactions with owners								
Dividends paid (note 29)	-	-	-	-	-	(35.9)	-	(35.9)
Shares cancelled	-	-	-	-	-	-	-	-
Own shares purchased	-	-	-	-	-	-	-	-
Shares issued to ESOP	-	-	-	-	-	-	-	-
Exercise of share awards	0.2	0.3	-	-	-	(1.2)	1.1	0.4
Charge for share based remuneration	-	-	-	-	-	2.8	-	2.8
Tax on share based remuneration	-	-	-	-	-	(0.1)	-	(0.1)
Net movement in equity in the period	0.2	0.3	-	-	(0.7)	12.6	1.1	13.5
Opening equity As previously reported	281.6	65.8	28.7	(70.2)	3.3	890.7	(104.0)	1,095.9
Change of accounting policy (note 3)	-	-	-	-	-	(22.4)	-	(22.4)
As adjusted	281.6	65.8	28.7	(70.2)	3.3	868.3	(104.0)	1,073.5
Closing equity	281.8	66.1	28.7	(70.2)	2.6	880.9	(102.9)	1,087.0

Six months ended 31 March 2018 (IAS 39)

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Cash flow hedging reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m
Transactions arising from								
Profit for the period	-	-	-	-	-	62.0	-	62.0
Other comprehensive income	-	-	-	-	0.5	(0.5)	-	-
Total comprehensive income	-	-	-	-	0.5	61.5	-	62.0
Transactions with owners								
Dividends paid (note 29)	-	-	-	-	-	(28.9)	-	(28.9)
Shares cancelled	-	-	-	-	-	-	-	-
Own shares purchased	-	-	-	-	-	-	(25.2)	(25.2)
Shares issued to ESOP	-	-	-	-	-	-	-	-
Exercise of share awards	-	0.1	-	-	-	(10.3)	10.3	0.1
Charge for share based remuneration	-	-	-	-	-	2.4	-	2.4
Tax on share based remuneration	-	-	-	-	-	0.8	-	0.8
Net movement in equity in the period	-	0.1	-	-	0.5	25.5	(14.9)	11.2
Opening equity	281.5	65.5	28.7	(70.2)	2.5	784.5	(83.1)	1,009.4
Closing equity	281.5	65.6	28.7	(70.2)	3.0	810.0	(98.0)	1,020.6

Year ended 30 September 2018 (IAS 39)

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Cash flow hedging reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m
Transactions arising from								
Profit for the period	-	-	-	-	-	145.8	-	145.8
Other comprehensive income	-	-	-	-	0.8	7.2	-	8.0
Total comprehensive income	-	-	-	-	0.8	153.0	-	153.8
Transactions with owners								
Dividends paid (note 29)	-	-	-	-	-	(43.1)	-	(43.1)
Shares cancelled	-	-	-	-	-	-	-	-
Own shares purchased	-	-	-	-	-	-	(31.4)	(31.4)
Shares issued to ESOP	-	-	-	-	-	-	-	-
Exercise of share awards	0.1	0.3	-	-	-	(10.9)	10.5	-
Charge for share based remuneration	-	-	-	-	-	6.1	-	6.1
Tax on share based remuneration	-	-	-	-	-	1.1	-	1.1
Net movement in equity in the period	0.1	0.3	-	-	0.8	106.2	(20.9)	86.5
Opening equity	281.5	65.5	28.7	(70.2)	2.5	784.5	(83.1)	1,009.4
Closing equity	281.6	65.8	28.7	(70.2)	3.3	890.7	(104.0)	1,095.9

SELECTED NOTES TO THE ACCOUNTS

For the six months ended 31 March 2019 (Unaudited)

1. GENERAL INFORMATION

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

The condensed financial statements for the six months ended 31 March 2019 and for the six months ended 31 March 2018 and the balance sheet information as at 1 October 2018 have not been audited, as defined in section 434 of the Companies Act 2006.

The figures shown above for the years ended 30 September 2018 and 30 September 2017 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.

A copy of the half-yearly financial report will be posted to those shareholders who have requested to receive one and additional copies can be obtained from the Company Secretary, Paragon Banking Group PLC, 51 Homer Road, Solihull, West Midlands, B91 3QJ.

This half-yearly financial report is also available on the Group's website at www.paragonbankinggroup.co.uk. In future years the half-yearly financial report will be available online only, to help to reduce the environmental impact of shareholder communication.

2. ACCOUNTING POLICIES

The condensed financial statements are presented in accordance with the requirements of International Accounting Standard 34 – 'Interim Financial Reporting'.

The Group prepares its annual financial statements in accordance with International Financial Reporting Standards as endorsed by the European Union. The condensed financial statements have been prepared on the basis of the accounting policies set out in the Annual Report and Accounts of the Group for the year ended 30 September 2018 except for the adoption of IFRS 9 – 'Financial Instruments' ('IFRS 9') and IFRS 15 – 'Revenue from Contracts with Customers' ('IFRS 15'), described in note 3. This basis is expected to be used in the preparation of the financial statements of the Group for the year ending 30 September 2019.

The critical accounting estimates and judgements affecting the condensed financial information are the same as those described in note 6 to the accounts of the Group for the year ended 30 September 2018 other than those related to IFRS 9, as described in note 3.

Comparability of information

As described in note 3 below, the balance sheet information at 30 September 2017, 30 September 2018 and 31 March 2018 and the profit and loss information for the periods ended on these dates is not required to be restated on the adoption of IFRS 9. The information presented is derived in accordance with IAS 39 'Financial Instruments: Recognition and Measurement' ('IAS 39'), and therefore may not be directly comparable with the balance sheet at 31 March 2019 and the profit and loss account for the six months then ended which are prepared under IFRS 9.

New and revised reporting standards

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 2018.

3. CHANGES IN ACCOUNTING STANDARDS

The Group is required to adopt IFRS 9 and IFRS 15 in preparing its financial statements for the year ending 30 September 2019. It has therefore applied these standards in the preparation of this half year report.

IFRS 9 – Overview

IFRS 9 'Financial Instruments' replaces IAS 39 'Financial Instruments: Recognition and Measurement' ('IAS 39') and addresses the recognition, classification and measurement of financial assets and liabilities. The Group published a report on its transition to IFRS 9 on 22 March 2019 which gives more details on the new requirements and how the Group has chosen to adopt them. This document is available from the investor section of the Group's website at www.paragonbankinggroup.co.uk.

IFRS 9 – Classification

IFRS 9 changes the classification requirements for financial assets and liabilities. In accordance with the new rules

- Cash balances and loans to customers (other than finance leases), which were classified as 'loans and receivables' under IAS 39 are classified as 'held at amortised cost' under IFRS 9 and continue to be measured on the amortised cost basis
- Retail deposits and external borrowings, which were classified as 'other financial liabilities' under IAS 39 are classified as 'financial liabilities measured at amortised cost' and continue to be measured on the amortised cost basis
- Derivative financial assets and liabilities, which were carried at fair value under IAS 39 are classified as 'financial assets or liabilities at fair value through profit and loss' under IFRS 9 and continue to be measured on the same basis

The amortised cost and fair value measurement methodologies remain broadly the same in IFRS 9 as they were in IAS 39 and no measurement changes in the Group's accounts have arisen as a result of these classification changes

The Group's material financial asset and financial liability balances measured in accordance with IFRS 9 and the preceding standard, IAS 39, at the transition date (1 October 2018) are set out below:

	Post-transition	Pre-transition
	£m	£m
Financial Assets		
Cash – central banks	**895.9**	**895.9**
Cash – retail banks	**414.7**	**414.7**
Loans to customers	**12,100.6**	**12,127.8**
Derivative financial assets	**855.7**	**855.7**
	14,266.9	**14,294.1**
Financial Liabilities		
Retail deposits	**5,296.6**	**5,296.6**
Derivative financial liabilities	**4.7**	**4.7**
Asset backed loan notes	**5,554.7**	**5,554.7**
Secured bank borrowings	**935.6**	**935.6**
Retail bond issuance	**296.1**	**296.1**
Corporate bond issuance	**149.3**	**149.3**
Central bank facilities	**1,024.4**	**1,024.4**
	13,261.4	**13,261.4**

IFRS 9 – Impairment

IFRS 9 changes the basis of impairment provision for all financial assets from an incurred loss to an expected loss basis. Therefore, the provisioning is dependent on an assessment of the probability of future default and the loss which might be incurred at that time. This introduces significant additional areas of estimation to the accounting.

IFRS 9 requires 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 Significant Increase in Credit Risk ('SICR') since advance or acquisition (Stage 1); those where there has been a SICR (Stage 2); and loans which are credit impaired (Stage 3). It is an important feature of the standard that SICR is not defined solely by the performance of the account, but also by other information available about the customer both internally and externally, such as credit bureau information.

- 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. These accounts would be largely unprovided for under IAS 39, although some cases with adverse qualitative indicators might have been addressed by a collective emergence provision. Such provisions under IAS 39 were designed to cover assets where a loss event had occurred before the reporting date, but this event had not yet affected performance
- Where a loan has experienced an SICR, whether or not the loan is considered to be credit impaired, provisions will be made based on the ECLs over the full life of the loan. This is likely to lead to an increase in provision in general, though the IAS 39 emergence provision would have also addressed some of this risk

- For credit impaired assets, provisions will be made on the basis of lifetime expected credit losses, taking account of forward-looking economic assumptions and a range of possible outcomes. Under IAS 39, provisions were based on the asset's carrying value and the present value of the estimated future cash flows. Despite IAS 39 not explicitly taking account of alternative economic scenarios, where loans had attracted a provision under IAS 39, the IFRS 9 provision on transition was, in most cases, broadly similar to the closing IAS 39 position

  Credit impaired assets are identified either through quantitative measures or by operational status. In determining indicators of credit impairment regard is also taken of definitions used for regulatory capital purposes. Assets may also be assigned to Stage 3 if they are identified as credit impaired as a result of management review processes.

- For assets which were purchased or originated as credit impaired ('POCI') accounts (i.e. considered as credit impaired at the point of first recognition), such as certain of the Group's acquired assets in Idem Capital, the required treatment is largely similar under IAS 39 and IFRS 9. This classification also includes credit impaired assets recognised in corporate acquisitions under IFRS 3. Purchased performing accounts are not classified as POCI, but are first recognised in Stage 1

Full details of the approach to these calculations is given in the transition report.

Under IAS 39 the Group treated all accounts as live where they remained open on its administration system. IFRS 9 requires a firm to consider the prospect of future recovery in its write off approach and the Group has adopted a revised accounting policy for write offs following transition.

Accounts are now written off for accounting purposes when standard enforcement processes have been completed, subject to any amount retained in respect of expected salvage receipts. This change has no effect on the net carrying value, only on the amounts reported as gross loan balances and accumulated impairment provisions, but provides a more informative value for the coverage ratio.

All accounts which would have been written off for accounting purposes prior to the transition date under the new policy have been written off at transition. All of these cases were fully provided and therefore this has had no impact on reserves.

As disclosed in the transition report, the introduction of IFRS 9 resulted in an increase in impairment provision of £27.2m at the transition date, 1 October 2018. The impacts by business segment are set out below:

	IAS 39	IFRS 9	Change	Change
	£m	£m	£m	%
Loans to customers				
Mortgages	**10,473.5**	**10,449.5**	**(24.0)**	**(0.2)%**
Commercial Lending	**1,133.2**	**1,131.3**	**(1.9)**	**(0.2)%**
Idem Capital	**521.1**	**519.8**	**(1.3)**	**(0.2)%**
Total	**12,127.8**	**12,100.6**	**(27.2)**	**(0.2)%**

The increase in impairment on transition will be allowed as a deduction for the purposes of UK Corporation Tax under the Change in Accounting Practices Regulations. This is spread over the ten years following transition for loan assets and is allowable in the 2019 tax computations for finance leases. A deferred tax asset of £5.0m has been recognised on transition.

The movement in impairment provisions between the balance disclosed under IAS 39 and the opening balance under IFRS 9 is set out below.

	£m
Loans to customers	
At 30 September 2018 under IAS 39	**107.4**
IFRS 9 transition adjustments	**27.2**
Change in write-off definition	**(80.4)**
At 1 October 2018 under IFRS 9	**54.2**

The reduction due to write off definitions is principally attributable to part redeemed loan balances which remained live on the administration systems of the Group and were therefore treated as live for accounting purposes. Under IFRS 9 these balances may be defined as written off, and the Group's IFRS 9 write off policy considers them to be so, as this provides users with a more useful measure of provision cover.

IFRS 9 – Significant judgements

In addition to the significant judgements disclosed in the Group accounts for the year ended 30 September 2018, the following judgements relating to IFRS 9 are significant in compiling the half year information.

Definition of default	Used in modelling probabilities of default. The Group's definition of default is aligned to its internal operational procedures. IFRS 9 provides a rebuttable presumption of default when an account is 90 days overdue and this was used as the starting point for this exercise. Other factors include account management activities such as appointment of a receiver or enforcement procedures. A combination of qualitative and quantitative measures was considered in developing the definition of default.
Identification of SICR	SICR 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.
Use of forward-looking information	The economic inputs to the model, where the central forecast represents the scenario used in the Group's planning process and the alternative scenarios are based on versions of this as well as the Bank of England's stress scenario. More detail is provided on the Group's use of forward-looking information in note 19.

IFRS 9 – Hedge accounting

The hedge accounting requirements of IFRS 9 do not specifically address portfolio fair value hedges of interest rate risk ('macro hedges') which IAS 39 deals with directly. A separate financial reporting standard is to be developed in this area. IFRS 9 allows the option to continue to apply the existing hedge accounting requirements of IAS 39 until this is implemented.

As the Group's hedging arrangements are either macro hedges, which are not specifically addressed by the new standard, or bespoke cash flow hedges, which would not be affected by the change of standard, the Group has decided to defer application of these rules until the full new hedge accounting regime is in place.

It thus continues to apply the hedge accounting requirements of IAS 39 and all hedging arrangements in place at 30 September 2018 continue to be recognised on 1 October 2018 after IFRS 9 transition.

IFRS 9 – Comparative information

IFRS 9 does not require the restatement of comparative information and therefore all balance sheets and results for periods on or before 30 September 2018 are presented in accordance with IAS 39.

In order to aid users of the accounts additional comparative balance sheet amounts at 1 October 2018, immediately following transition, have been provided where relevant.

IFRS 15 – Impact

IFRS 15 governs the accounting for those of the Group's income streams which are not within the scope of either IFRS 9 or IAS 17 - 'Leases'. These comprise principally third-party servicing income, maintenance income on vehicle leasing, third party commission income and account fee income. The accounting for most of these flows is unchanged as the amounts are charged on an event-by-event basis.

There is a small balance sheet impact from the accounting for maintenance agreements, decreasing reserves at 30 September 2018 by £0.2m. In view of the low level of impact comparative amounts have not been restated for this change.

Summary

The overall impacts of the changes above on equity at 30 September 2018 are set out below.

	£m	£m
At 30 September 2018		**1,095.9**
IFRS 9		
Impairment	**(27.2)**	
Deferred tax thereon	**5.0**	
	(22.2)	
IFRS 15		
Maintenance income	**(0.2)**	
Total adjustments		**(22.4)**
Equity at 1 October 2018		**1,073.5**

All these amendments impacted retained earnings. None of these changes have any impact on the Group's cash flow reporting.

4. GOING CONCERN BASIS

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 7 to 29. The principal risks and uncertainties affecting the Group in the forthcoming six months are described on page 30.

Note 7 to the accounts for the year ended 30 September 2018 includes an analysis of the Group's working capital position and policies, while notes 8 to 11 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, interest rate and liquidity risk. Note 6 to those accounts discusses critical accounting 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 23.

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 Group's retail deposits of £5,878.0m (note 22) are repayable within five years, with 71.0% of this balance (£4,175.3m) 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 2019 Paragon Bank held £555.9m of balance sheet assets for liquidity purposes, all of which comprised central bank deposits (note 16). A further £108.5m of liquidity was provided by the Bank of England Funding for Lending Scheme, bringing the total to £664.4m.

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'). 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 give access to an additional £1,149.6m of further drawings.

The Group's securitisation funding structures ensure that a substantial proportion of its originated loan portfolio is match funded. 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 utilising the Group's available warehouse facilities are refinanced through securitisation or retail deposits from time to time.

The earliest maturity of any of the Group's working capital debt is in December 2020, when the oldest of the Group's retail bond issues matures.

The Group's cash analysis continues to show strong free cash balances, even after allowing for significant discretionary cash outflows, and its securitisation investments produce substantial cash inflows.

The Group has demonstrated its ability to raise retail and corporate bond debt when required through its Euro Medium Term Note Programme and other programmes, while it most recently accessed the UK long-term securitisation debt market in April 2018. The Group's access to debt is also enhanced by its corporate BBB rating affirmed by Fitch Ratings in March 2019 and its status as an issuer is evidenced by the BBB- rating of its £150.0 million Tier-2 bond.

At 31 March 2019 the Group had free cash balances of £204.2m immediately available for use (note 16).

As described in note 6 the Group's capital base is subject to consolidated supervision by the PRA. Its capital at 31 March 2019 was in excess of regulatory requirements and group forecasts show this continuing to be the case.

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 those aspects of 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.

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 it was appropriate for them to continue to adopt the going concern basis in preparing the half-yearly report.

5. FAIR VALUES OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

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 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 2019 or the year ended 30 September 2018 carried at fair value and valued using level 3 measurements, other than contingent consideration amounts (note 24).

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.

a) Assets and liabilities carried at fair value

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 risk adjusted interest rate. The principal inputs to these valuation models are LIBOR benchmark interest rates for the currencies in which the instruments are denominated, being sterling, euros and dollars. The cross-currency basis swaps have a notional principal related to the outstanding currency borrowings and therefore the estimated rate of repayment of these notes also affects the valuation of the swaps. In order to determine the fair values, 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. 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 20.

Contingent consideration

The value of the contingent considerations shown in note 26 are required to be stated at fair value in the accounts. These amounts are valued based on the expected outcomes of the performance tests set out in respective sale and purchase agreements, discounted as appropriate. The most significant inputs to these valuations are the Group's forecasts on future activity relating to the businesses or individuals concerned, which are drawn from the overall Group forecasting model. As such, these are classified as unobservable inputs and the valuations classified as level 3 measurements.

Short-term investments

The short-term investments described in note 17 are freely traded securities for which a market price quotation is available and are classified as level 1 measurements.

b) Assets and liabilities carried at amortised cost

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.

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.

Loan assets

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.

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.

The fair values for financial assets and liabilities held at amortised cost, other than those where carrying values are so low that any difference would be immaterial, determined in accordance with the methodologies set out above are summarised below.

	31 March 2019	**31 March 2019**	31 March 2018	31 March 2018	30 September 2018	30 September 2018
	Carrying amount	**Fair value**	Carrying amount	Fair value	Carrying amount	Fair value
	£m	**£m**	£m	£m	£m	£m
Financial assets						
Loans to customers	**12,525.6**	**12,666.8**	11,346.7	11,424.2	12,127.8	12,222.9
Cash	**1,072.0**	**1,072.0**	1,062.6	1,062.6	1,310.6	1,310.6
	13,597.6	**13,738.8**	12,409.3	12,486.8	13,438.4	13,533.5
Financial liabilities						
Asset backed loan notes	**5,143.0**	**5,143.0**	5,457.7	5,457.7	5,554.7	5,554.7
Corporate and retail bonds	**445.7**	**468.8**	445.1	483.4	445.4	478.3
Retail deposits	**5,878.0**	**5,900.4**	4,285.8	4,281.5	5,296.6	5,301.7
Secured bank borrowings	**921.9**	**921.9**	1,013.5	1,013.5	935.6	935.6
	12,388.6	**12,434.1**	11,202.1	11,236.1	12,232.3	12,270.3

6. 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 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.

(a) 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.

The Board reviewed its dividend policy following the Group's reorganisation in September 2017, concluding that the changes made would make the Group's use of working capital more efficient and that there was, therefore, less need to retain earnings to support future growth. It therefore determined that the targeted dividend cover ratio would be 2.5 times with effect from the year ended 30 September 2018. Subsequent reviews, most recently in May 2019 have confirmed this policy. 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, and the interim dividend for the current year has been set in accordance with this policy (note 29).

(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.

The Group's consolidated annualised RoTE for the six months ended 31 March 2019 is derived as follows:

	31 March 2019	31 March 2018	30 September 2018	30 September 2017
	£m	£m	£m	£m
Profit for the period	**58.1**	62.0	145.8	117.2
Amortisation of intangible assets	**1.3**	0.9	2.1	1.6
Adjusted profit	**59.4**	62.9	147.9	118.8
Divided by				
Opening equity	**1,073.5**	1,009.4	1,009.4	969.5
Opening intangible assets	**(169.3)**	(104.4)	(104.4)	(105.4)
Opening tangible equity	**904.2**	905.0	905.0	864.1
Closing equity	**1,087.0**	1,020.6	1,095.9	1,009.4
Closing intangible assets	**(171.4)**	(120.3)	(169.3)	(104.4)
Closing tangible equity	**915.6**	900.3	926.6	905.0
Average tangible equity	**909.9**	902.6	915.8	884.5
Return on Tangible Equity	**13.1%**	13.9%	16.1%	13.4%

(c) Regulatory capital

The Group is subject to supervision by the PRA on a consolidated basis, as a group containing an authorised bank. As part of this supervision the regulator will issue individual capital guidance setting an amount of regulatory capital, which the Group is required to hold relative to its risk weighted assets in order to safeguard depositors from loss in the event of severe losses being incurred by the Group. This is defined by the international Basel III rules, set by the Basel Committee on Banking Supervision ('BCBS') and currently implemented in UK law by EU Regulation 575/2013, referred to as the Capital Requirements Regulation ('CRR').

The Group's regulatory capital is monitored by the Board of Directors, its Risk and Compliance Committee and the Asset and Liability Committee, who 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 tables below demonstrate that at 31 March 2019 the Group's total regulatory capital of £1,068.7m (31 March 2018: £1,039.9m, 30 September 2018: £1,045.7m) was comfortably in excess of the amounts required by the regulator, including £747.4m in respect of Pillar 1 and Pillar 2a capital (31 March 2018: £659.7m, 30 September 2018: £727.7m), which is comprised of fixed and variable elements (none of these amounts are covered by the independent review report).

The CRR also requires firms to hold additional capital buffers, including a Capital Conservation Buffer ('CCoB') of 2.50% of risk weighted assets (at 31 March 2019) and a Counter Cyclical Buffer ('CCyB'), currently 1.0% of risk weighted assets. These have increased from a CCoB of 1.875% and CCyB of 0.5% at 30 September 2018. Firm specific buffers may also be required.

The Group's regulatory capital differs from its equity as certain adjustments are required by the CRR or the regulator. A reconciliation of the Group's equity to its regulatory capital determined in accordance with CRD IV at 31 March 2019 is set out below.

	Note	**31 March 2019**	31 March 2018	1 October 2018	30 September 2018	30 September 2017
		£m	£m	£m	£m	£m
Total equity	§	**1,087.0**	1,020.6	1,073.5	1,095.9	1,009.4
Deductions						
Proposed dividend	29	**(18.1)**	(14.2)	(35.8)	(35.8)	(28.9)
IFRS 9 transitional relief	*	**21.2**	-	21.2	-	-
Intangible assets	21	**(171.4)**	(120.3)	(169.3)	(169.3)	(104.4)
Common Equity Tier 1 ('CET1') capital		**918.7**	886.1	889.6	890.8	876.1
Other tier 1 capital		**-**	-	-	-	-
Total tier 1 capital		**918.7**	886.1	889.6	890.8	876.1
Corporate bond		**150.0**	150.0	150.0	150.0	150.0
Less: amortisation adjustment	†	**-**	-	-	-	-
		150.0	150.0	150.0	150.0	150.0
Collectively assessed credit impairment allowances	‡	**-**	3.8	-	4.9	4.4
Total tier 2 capital		**150.0**	153.8	150.0	154.9	154.4
Total regulatory capital ('TRC')		**1,068.7**	1,039.9	1,039.6	1,045.7	1,030.5

§ Including results for the six months ended 31 March 2019 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 over a five year period.

† Where tier 2 capital instruments have less than five years to maturity the amount eligible as regulatory capital reduces by 20% per annum on a straight line basis. No such adjustment is required in respect of the Group's Tier 2 Corporate Bond which matures in 2026.

‡ Under IFRS 9 there are no collectively assessed credit impairment allowances which are eligible as tier 2 capital.

The total risk exposure calculated under the CRD IV framework, against which this capital is held, and the proportion of this exposure it represents, are calculated as shown below.

	31 March 2019	31 March 2018	1 October 2018	30 September 2018
	£m	£m	£m	£m
Credit risk				
Balance sheet assets	**6,053.9**	5,066.1	5,756.3	5,767.3
Off balance sheet	**59.5**	79.4	87.8	87.8
IFRS 9 transitional relief	**10.5**	-	10.5	-
Total credit risk	**6,123.9**	5,145.5	5,854.6	5,855.1
Operational risk	**485.1**	464.9	485.1	485.1
Market risk	**-**	-	-	-
Other	**91.1**	103.9	105.1	105.1
Total risk exposure ('TRE')	**6,700.1**	5,714.3	6,444.8	6,445.3
Solvency ratios	**%**	%	%	%
CET1	**13.7**	15.5	13.8	13.8
TRC	**16.0**	18.2	16.2	16.2

This table is not covered by the Independent Review Report

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

	31 March 2019	31 March 2018	1 October 2018	30 September 2018
	£m	£m	£m	£m
CET1 Capital	**918.7**	886.1	889.6	890.8
Add back: IFRS 9 relief	**(21.2)**	-	(21.2)	-
Fully loaded CET1 Capital	**897.5**	886.1	868.4	890.8
TRC	**1,068.7**	1,039.9	1,039.6	1,045.7
Add back: IFRS 9 relief	**(21.2)**	-	(21.2)	-
Fully loaded TRC	**1,047.5**	1,039.9	1,018.4	1,045.7
Total risk exposure	**6,700.1**	5,714.3	6,444.8	6,445.3
Add back: IFRS 9 relief	**(10.5)**	-	(10.5)	-
Fully loaded TRE	**6,689.6**	5,714.3	6,434.3	6,445.3
Fully loaded Solvency ratios	**%**	%	%	%
CET1	**13.4**	15.5	13.5	13.8
Total regulatory capital	**15.7**	18.2	15.8	16.2

This table is not covered by the Independent Review Report

The total regulatory capital at 31 March 2019 on the fully loaded basis of £1,047.5m was in excess of the Pillar 1 & 2a requirement of £746.4m on the same basis (amounts not covered by the Independent Review Report).

The CRD IV risk weightings for credit risk exposures are calculated using the Standardised Approach. Operational risk is calculated using the Basic Indicator Approach.

Risk weighted assets under the Standardised Approach are calculated on the basis of carrying values. Therefore the introduction of IFRS 9 reduces the total risk exposure as a consequence of the increased provision levels.

The following table below shows the calculation of the UK leverage ratio, based on the consolidated balance sheet assets adjusted as shown below:

		Note	**31 March 2019**	31 March 2018	1 October 2018	30 September 2018
			£m	£m	£m	£m
Total balance sheet assets			**14,654.0**	13,346.7	14,487.9	14,515.1
Add:	Credit fair value adjustments on loans to customers	*18*	**-**	21.6	24.1	24.1
	Debit fair value adjustments on retail deposits	*22*	**-**	7.0	4.2	4.2
Adjusted balance sheet assets			**14,654.0**	13,375.3	14,516.2	14,543.4
Less:	Derivative assets	*20*	**(751.3)**	(763.4)	(855.7)	(855.7)
	Central bank deposits	*16*	**(704.0)**	(628.5)	(895.9)	(895.9)
	CRDs		**(9.1)**	(2.4)	(6.2)	(6.2)
	Accrued interest on sovereign exposures		**(0.2)**	-	(0.4)	(0.4)
On-balance sheet items			**13,189.4**	11,981.0	12,758.0	12,785.2
Less: Intangible assets		*21*	**(171.4)**	(120.3)	(169.3)	(169.3)
Total on balance sheet exposures			**13,018.0**	11,860.7	12,588.7	12,615.9
Derivative assets		*20*	**751.3**	763.4	855.7	855.7
Potential future exposure on derivatives			**151.2**	170.7	172.1	172.1
Total derivative exposures			**902.5**	934.1	1,027.8	1,027.8
Post offer pipeline at gross notional amount			**810.4**	492.7	817.7	817.7
Adjustment to convert to credit equivalent amounts			**(674.9)**	(246.3)	(569.2)	(569.2)
Off balance sheet items			**135.5**	246.4	248.5	248.5
Tier 1 capital			**918.7**	886.1	889.6	890.8
Total leverage exposure before IFRS 9 relief			**14,056.0**	13,041.2	13,865.0	13,892.2
IFRS 9 relief			**25.8**	-	25.8	-
Total leverage exposure			**14,081.8**	13,041.2	13,890.8	13,892.2
UK leverage ratio			**6.5%**	6.8%	6.4%	6.4%

This table is not covered by the Independent Review Report

The fully loaded leverage ratio is calculated as follows

	31 March 2019	31 March 2018	1 October 2018	30 September 2018
	£m	£m	£m	£m
Fully loaded Tier 1 capital	**897.5**	886.1	868.4	890.8
Total leverage exposure before IFRS 9 relief	**14,056.0**	13,041.2	13,865.0	13,892.2
Fully loaded UK leverage exposure	**6.4%**	6.8%	6.3%	6.4%

This table is not covered by the Independent Review Report

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.

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

7. CREDIT RISK

The Group's 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 credit risk is primarily attributable to its loans to customers. There are no significant concentrations of credit risk to individual counterparties due to the large number of customers included in the portfolios.

The Group's loan assets at 31 March 2019, 31 March 2018 and 1 October 2018 are analysed as follows:

	31 March 2019		31 March 2018		1 October 2018	
	IFRS 9		IAS 39		IFRS 9	
	£m	**%**	£m	%	£m	%
Buy-to-let mortgages	**10,548.0**	**84.2%**	9,966.7	87.9%	10,227.4	84.5%
Owner-occupied mortgages	**76.8**	**0.6%**	39.0	0.3%	80.9	0.7%
Total first mortgages	**10,624.8**	**84.8%**	10,005.7	88.2%	10,308.3	85.2%
Second charge mortgage loans	**404.8**	**3.2%**	471.3	4.2%	414.4	3.4%
Loans secured on residential property	**11,029.6**	**88.0%**	10,477.0	92.4%	10,722.7	88.6%
Development finance	**426.0**	**3.4%**	57.0	0.5%	352.9	2.9%
Loans secured on property	**11,455.6**	**91.4%**	10,534.0	92.9%	11,075.6	91.5%
Asset finance loans	**433.6**	**3.5%**	361.8	3.2%	389.9	3.3%
Motor finance loans	**316.0**	**2.5%**	195.4	1.7%	329.2	2.7%
Aircraft mortgages	**17.8**	**0.1%**	3.0	-	12.4	0.1%
Structured lending	**56.1**	**0.4%**	-	-	38.7	0.3%
Invoice finance	**20.9**	**0.2%**	15.3	0.1%	21.7	0.2%
Total secured loans	**12,300.0**	**98.1%**	11,109.5	97.9%	11,867.5	98.1%
Professions finance	**48.4**	**0.4%**	36.7	0.3%	42.1	0.4%
Other unsecured commercial loans	**18.7**	**0.2%**	10.9	0.1%	17.2	0.1%
Unsecured consumer loans	**158.5**	**1.3%**	189.6	1.7%	173.8	1.4%
Total loans to customers	**12,525.6**	**100.0%**	11,346.7	100.0%	12,100.6	100.0%

Other consumer loans include unsecured loans either advanced by Group companies or acquired from their originators at a discount.

Professions finance loans are generally short-term unsecured loans made to lawyers and accountants for working capital purposes.

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 2019 is set out below. For acquired accounts the effect of any discount on purchase is allowed for.

	31 March 2019		31 March 2018		30 September 2018	
	First mortgages	**Secured loans**	First mortgages	Secured loans	First mortgages	Secured loans
	%	**%**	%	%	%	%
Loan to value ratio						
Less than 70%	**53.8**	**64.1**	60.0	58.4	60.6	66.1
70% to 80%	**34.3**	**18.5**	27.9	18.1	29.7	17.4
80% to 90%	**9.6**	**10.3**	9.2	11.4	7.1	9.3
90% to 100%	**0.5**	**3.5**	0.9	6.4	0.8	3.5
Over 100%	**1.8**	**3.6**	2.0	5.7	1.8	3.7
	100.0	**100.0**	100.0	100.0	100.0	100.0
Average LTV ratio	**67.7**	**66.6**	66.5	68.8	66.0	65.9
Buy-to-let	**67.8**		66.6		66.1	
Owner-occupied	**53.4**		44.6		51.3	

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 a decrease of 0.8% during the six months ended 31 March 2019 and annual increases of 0.7% in the year ended 31 March 2019 and 2.0% in the year ended 30 September 2018.

The increase in the LTV ratio for owner occupied accounts relates to the greater numbers of new lending accounts, which have higher LTV levels than old legacy cases.

The geographical distribution of the Group's first mortgage assets by gross carrying value is set out below.

	31 March 2019	31 March 2018	30 September 2018
East Anglia	**3.1%**	3.1%	3.0%
East Midlands	**5.3%**	5.2%	5.2%
Greater London	**18.7%**	18.3%	18.6%
North	**3.4%**	3.5%	3.5%
North West	**10.2%**	10.3%	10.2%
South East	**31.4%**	30.9%	31.3%
South West	**9.1%**	9.4%	9.2%
West Midlands	**5.0%**	4.6%	4.8%
Yorkshire and Humberside	**9.1%**	9.7%	9.4%
Total England	**95.3%**	95.0%	95.2%
Northern Ireland	**0.1%**	0.1%	0.1%
Scotland	**1.3%**	1.5%	1.4%
Wales	**3.3%**	3.4%	3.3%
	100.0%	100.0%	100.0%

Unsecured consumer loans

Almost all the Group's unsecured consumer loan assets are part of purchased debt portfolios where the consideration paid will have been based on the credit quality and performance of the loans at the point of the transaction. Collections on purchased accounts have been comfortably in excess of those implicit in the purchase prices.

Development finance

Development finance loans 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 2019		31 March 2018		30 September 2018	
	By value	**By number**	By value	By number	By value	By number
	%	**%**	%	%	%	%
LTGDV						
50% or less	**2.0**	**2.2**	10.5	9.8	3.4	4.4
50% to 60%	**14.2**	**18.0**	24.0	32.8	18.9	22.8
60% to 65%	**46.1**	**48.3**	64.2	55.7	63.3	59.6
65% to 70%	**27.2**	**23.0**	1.3	1.7	7.1	9.6
70% to 75%	**5.0**	**6.8**	-	-	0.7	0.7
Over 75%	**5.5**	**1.7**	-	-	6.6	2.9
	100.0	**100.0**	100.0	100.0	100.0	100.0

The average LTGDV cover at the period end was 63.9% (31 March 2018 60.1%, 30 September 2018 63.2%).

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 2019 the development finance portfolio comprised 178 accounts (31 March 2018: 61, 30 September 2018: 136) with a total carrying value of £426.0m (31 March 2018 £57.0m, 30 September 2018: £352.8m). Of these accounts only three were considered at risk of loss (31 March 2018 none, 30 September 2018: four). These accounts had been acquired in the Titlestone purchase where an allowance for losses was made in the IFRS 3 fair value calculation.

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 set out below.

	31 March 2019	31 March 2018	30 September 2018	30 September 2017
Number of transactions	**5**	-	3	-
Total facilities (£m)	**60.2**	-	52.5	-
Carrying value (£m)	**56.1**	-	38.7	-

The maximum advance under these facilities was 70% to 75% of the underlying assets and the Group's Credit Risk function monitors compliance with agreed covenants relating to both the customer and the asset pool.

At 31 March 2019 there were no significant concerns regarding the credit performance of these facilities and no provisions for impairment had been made.

Arrears measures

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 2019, 31 March 2018 and 30 September 2018, compared to the industry averages at those dates published by UK Finance ('UKF') and the Finance and Leasing Association ('FLA'), was:

	31 March 2019	31 March 2018	30 September 2018
	%	%	%
First mortgages			
Accounts more than three months in arrears			
Buy-to-let accounts including receiver of rent cases	**0.12**	0.09	0.11
Buy-to-let accounts excluding receiver of rent cases	**0.04**	0.02	0.03
Owner-occupied accounts	**2.99**	2.60	3.15
UKF data for mortgage accounts more than three months in arrears			
Buy-to-let accounts including receiver of rent cases	**0.41**	0.41	0.41
Buy-to-let accounts excluding receiver of rent cases	**0.37**	0.38	0.37
Owner-occupied accounts	**0.87**	0.91	0.88
All mortgages	**0.78**	0.82	0.79
Second charge mortgage loans			
Accounts more than 2 months in arrears			
All accounts	**14.04**	18.17	13.64
Post-2010 originations	**0.41**	0.00	0.21
Legacy cases (Pre-2010 originations)	**19.34**	16.94	17.97
Purchased assets	**15.52**	21.06	14.81
FLA data for second mortgages	**9.10**	10.60	9.40
Motor finance loans			
Accounts more than 2 months in arrears			
All accounts	**6.05**	0.78	3.91
Originated cases	**1.27**	0.78	0.93
Purchased assets	**12.01**	-	6.84
FLA data for consumer hire purchase	**2.70**	2.50	2.50
Asset finance loans			
Accounts more than 2 months in arrears	**1.66**	0.97	0.78
FLA data for business lease / hire purchase loans	**1.10**	0.80	0.70

No published industry data for asset classes comparable to the Group's other books has been identified. Where revised data at 31 March 2018 or 30 September 2018 has been published by the FLA or UKF, the comparative industry figures above have been amended.

Arrears information is not given for development finance or factoring activities as the structure of the products means that such a measure is not relevant. Other consumer loans consist primarily of purchased credit impaired assets.

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 than for comparable active ones, as performing accounts pay off their balances, leaving arrears accounts representing a greater proportion of the total.

The figures shown above for secured loans include purchased portfolios which generally include a high proportion of cases in arrears at the time of purchase and 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.

IFRS 9 Analysis

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 a SICR (Stage 2); and loans which are impaired (Stage 3). It is an important feature of the standard that SICR is not defined solely by the performance of the account, but also by other information available about the customer, such as credit bureau information.

- 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 will be made based on the ECLs over the full life of the loan
- For credit impaired assets, provisions will be made on the basis of lifetime expected credit losses, taking account of forward-looking economic assumptions and a range of possible outcomes

Credit impaired assets are identified either through quantitative measures or by operational status. Designations of accounts for regulatory capital purposes are also taken into account. Assets may also be assigned to Stage 3 if they are identified as credit impaired as a result of management review processes.

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

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

	Stage 1	Stage 2*	Stage 3*	POCI	Total
	£m	£m	£m	£m	£m
31 March 2019					
Gross loan book					
Mortgages	**10,280.8**	**384.2**	**138.8**	**11.7**	**10,815.5**
Commercial Lending	**1,231.1**	**38.4**	**8.4**	**14.6**	**1,292.5**
Idem Capital	**234.3**	**18.1**	**38.4**	**178.3**	**469.1**
Total	**11,746.2**	**440.7**	**185.6**	**204.6**	**12,577.1**
Impairment provision					
Mortgages	**(0.4)**	**(2.2)**	**(29.0)**	**-**	**(31.6)**
Commercial Lending	**(4.8)**	**(0.8)**	**(3.0)**	**-**	**(8.6)**
Idem Capital	**(0.3)**	**(0.5)**	**(10.5)**	**-**	**(11.3)**
Total	**(5.5)**	**(3.5)**	**(42.5)**	**-**	**(51.5)**
Net loan book					
Mortgages	**10,280.4**	**382.0**	**109.8**	**11.7**	**10,783.9**
Commercial Lending	**1,226.3**	**37.6**	**5.4**	**14.6**	**1,283.9**
Idem Capital	**234.0**	**17.6**	**27.9**	**178.3**	**457.8**
Total	**11,740.7**	**437.2**	**143.1**	**204.6**	**12,525.6**
Coverage ratio					
Mortgages	**-**	**0.57%**	**20.89%**	**-**	**0.29%**
Commercial Lending	**0.39%**	**2.08%**	**35.71%**	**-**	**0.67%**
Idem Capital	**0.13%**	**2.76%**	**27.34%**	**-**	**2.41%**
Total	**0.05%**	**0.79%**	**22.90%**	**-**	**0.41%**

	Stage 1	Stage 2*	Stage 3*	POCI	Total
	£m	£m	£m	£m	£m
1 October 2018					
Gross loan book					
Mortgages	9,961.6	369.9	142.4	11.7	10,485.6
Commercial Lending	1,106.4	8.2	5.8	17.5	1,137.9
Idem Capital	278.9	19.7	40.0	192.7	531.3
Total	11,346.9	397.8	188.2	221.9	12,154.8
Impairment provision					
Mortgages	(0.3)	(1.7)	(34.1)	-	(36.1)
Commercial Lending	(4.2)	(0.4)	(2.0)	-	(6.6)
Idem Capital	(0.4)	(0.5)	(10.6)	-	(11.5)
Total	(4.9)	(2.6)	(46.7)	-	(54.2)
Net loan book					
Mortgages	9,961.3	368.2	108.3	11.7	10,449.5
Commercial Lending	1,102.2	7.8	3.8	17.5	1,131.3
Idem Capital	278.5	19.2	29.4	192.7	519.8
Total	11,342.0	395.2	141.5	221.9	12,100.6
Coverage ratio					
Mortgages	-	0.46%	23.95%	-	0.34%
Commercial Lending	0.38%	4.88%	34.48%	-	0.58%
Idem Capital	0.14%	2.54%	26.50%	-	2.16%
Total	0.04%	0.65%	24.81%	-	0.45%

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

During the period the Group revised certain of its default definitions for regulatory purposes. Where appropriate, IFRS 9 definitions have been amended to harmonise with the new definition and hence the staging at 1 October 2018 set out above differs from that presented in the Group's transition report.

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 principally 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.

Idem Capital loans include acquired consumer and motor finance loans together with legacy (originated pre-2010) second charge mortgage and unsecured consumer loans. Legacy assets and acquired loans which were performing on acquisition are included in the staging analysis above. Acquired portfolios 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 current balances due from customers and the level of cover is considerable.

Analysis of Stage 2 loans

The table below analyses the accounts in stage 2 between those not more than one month in arrears where a significant increase in credit risk ('SICR') has nonetheless been identified from other information and accounts more than one month in arrears, which are automatically deemed to have an SICR.

	< 1 month arrears	> 1 <= 3 months arrears	Total
	£m	£m	£m
31 March 2019			
Gross loan book			
Mortgages	328.6	55.6	384.2
Commercial Lending	33.3	5.1	38.4
Idem Capital	8.7	9.4	18.1
Total	370.6	70.1	440.7
Impairment provision			
Mortgages	(1.0)	(1.2)	(2.2)
Commercial Lending	(0.2)	(0.6)	(0.8)
Idem Capital	(0.2)	(0.3)	(0.5)
Total	(1.4)	(2.1)	(3.5)
Net loan book			
Mortgages	327.6	54.4	382.0
Commercial Lending	33.1	4.5	37.6
Idem Capital	8.5	9.1	17.6
Total	369.2	68.0	437.2
Coverage ratio			
Mortgages	0.30%	2.16%	0.57%
Commercial Lending	0.60%	11.76%	2.08%
Idem Capital	2.30%	3.19%	2.76%
Total	0.38%	3.00%	0.79%

	< 1 month arrears	> 1 <= 3 months arrears	Total
	£m	£m	£m
1 October 2018			
Gross loan book			
Mortgages	306.3	63.6	369.9
Commercial Lending	4.0	4.2	8.2
Idem Capital	8.8	10.9	19.7
Total	319.1	78.7	397.8
Impairment provision			
Mortgages	(0.8)	(0.9)	(1.7)
Commercial Lending	(0.1)	(0.3)	(0.4)
Idem Capital	(0.2)	(0.3)	(0.5)
Total	(1.1)	(1.5)	(2.6)
Net loan book			
Mortgages	305.5	62.7	368.2
Commercial Lending	3.9	3.9	7.8
Idem Capital	8.6	10.6	19.2
Total	318.0	77.2	395.2
Coverage ratio			
Mortgages	0.26%	1.42%	0.46%
Commercial Lending	2.50%	7.14%	4.88%
Idem Capital	2.27%	2.75%	2.54%
Total	0.34%	1.91%	0.65%

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 it is one day past due until it is thirty days past due.

Analysis of Stage 3 loans

The table below analyses the accounts in Stage 3 between accounts in the process of enforcement or where full recovery is considered unlikely ('Realisations' in the table), loans being managed on a long term basis where full recovery is possible but which are considered in default for regulatory purposes and buy-to-let mortgages where a receiver of rent ('RoR') has been appointed by the Group to manage the property on the customer's behalf. RoR accounts in Stage 3 may be fully up to date with full recovery possible, and such accounts would not have been provided for under IAS 39. These accounts are included in Stage 3 as they are classified as defaulted for regulatory purposes.

	> 3 month arrears	RoR managed	Realisations	Total
	£m	£m	£m	£m
31 March 2019				
Gross loan book				
Mortgages	**6.4**	**115.1**	**17.3**	**138.8**
Commercial Lending	**0.6**	**-**	**7.8**	**8.4**
Idem Capital	**28.2**	**-**	**10.2**	**38.4**
Total	**35.2**	**115.1**	**35.3**	**185.6**
Impairment provision				
Mortgages	**(0.5)**	**(22.3)**	**(6.2)**	**(29.0)**
Commercial Lending	**-**	**-**	**(3.0)**	**(3.0)**
Idem Capital	**(1.8)**	**-**	**(8.7)**	**(10.5)**
Total	**(2.3)**	**(22.3)**	**(17.9)**	**(42.5)**
Net loan book				
Mortgages	**5.9**	**92.8**	**11.1**	**109.8**
Commercial Lending	**0.6**	**-**	**4.8**	**5.4**
Idem Capital	**26.4**	**-**	**1.5**	**27.9**
Total	**32.9**	**92.8**	**17.4**	**143.1**
Coverage ratio				
Mortgages	**7.81%**	**19.37%**	**35.84%**	**20.89%**
Commercial Lending	**-**	**-**	**38.46%**	**35.71%**
Idem Capital	**6.38%**	**-**	**85.29%**	**27.34%**
Total	**6.53%**	**19.37%**	**50.71%**	**22.90%**

	> 3 month arrears	RoR managed	Realisations	Total
	£m	£m	£m	£m
1 October 2018				
Gross loan book				
Mortgages	5.0	116.3	21.1	142.4
Commercial Lending	1.1	-	4.7	5.8
Idem Capital	29.0	-	11.0	40.0
Total	35.1	116.3	36.8	188.2
Impairment provision				
Mortgages	-	(26.8)	(7.3)	(34.1)
Commercial Lending	(0.4)	-	(1.6)	(2.0)
Idem Capital	(1.7)	-	(8.9)	(10.6)
Total	(2.1)	(26.8)	(17.8)	(46.7)
Net loan book				
Mortgages	5.0	89.5	13.8	108.3
Commercial Lending	0.7	-	3.1	3.8
Idem Capital	27.3	-	2.1	29.4
Total	33.0	89.5	19.0	141.5
Coverage ratio				
Mortgages	-	23.04%	34.60%	23.95%
Commercial Lending	36.36%	-	34.04%	34.48%
Idem Capital	5.86%	-	80.91%	26.50%
Total	5.98%	23.04%	48.37%	24.81%

The RoR managed accounts are being managed to ensure the optimal resolution for landlords, tenants and lenders and this long-term, stable situation underpinned their treatment as not impaired under IAS 39, but the existence of the RoR arrangement causes the accounts to be treated as defaulted for regulatory purposes.

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 2019		1 October 2018	
	No.	**£m**	No.	£m
Appointment date				
2010 and earlier	**452**	**80.9**	464	83.0
2011 to 2013	**102**	**20.4**	107	21.8
2014 to 2016	**36**	**5.2**	40	5.9
2016 and later	**70**	**8.6**	44	5.6
Total	**660**	**115.1**	655	116.3

Receiver of rent accounts in the process of realisation at the period end are included under that heading.

Idem Capital balances with over three months arrears comprise principally second charge mortgage accounts originated over ten years ago. 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.

Estimated remaining collections

In the debt purchase industry, Estimated Remaining Collections ('ERC') 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 ERC values 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 2019	31 March 2018	30 September 2018	30 September 2017
	£m	£m	£m	£m
All purchased consumer assets				
Carrying value	**331.2**	452.3	364.2	503.5
84 month ERC	**395.5**	543.5	434.9	608.9
120 month ERC	**446.5**	615.2	489.6	688.8
POCI assets only				
Carrying value	**190.0**	272.3	204.4	302.9
84 month ERC	**248.1**	316.2	269.9	317.2
120 month ERC	**283.9**	411.4	306.2	359.9

Amounts shown include loans disclosed as consumer loans and first mortgages (note 18).

Further information relating to comparative information prepared under IAS 39 is included in note 34(a) and (b).

8. ACQUISITIONS

On 3 July 2018 the Group acquired the entire share capital of Titlestone Property Finance Limited together with a portfolio of loans held by companies related to it (together 'Titlestone'). IFRS disclosures in respect of this acquisition were presented on a provisional basis in note 15 to the Group Accounts for the year ended 30 September 2018.

Following the end of the year the circumstances, performance and security value of certain of the Titlestone loans were reviewed in more detail, providing further information on the value of those assets at the acquisition date. As a result of this exercise the initial values of those loans were reduced by £2.8m with a corresponding change in the related deferred tax balances of £0.4m. Consequently the goodwill balance was increased by £2.4m (note 21).

9. SEGMENTAL RESULTS

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:

- Mortgages, 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
- Idem Capital, including loan assets acquired from third parties and legacy assets which share certain credit characteristics with them

Dedicated financing and administration costs of each of these businesses are allocated to the segment. Shared central costs are not allocated between segments, and neither is income from central cash balances nor 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 cross-currency basis swaps and cash balances.

Other assets are not allocated between segments.

All of 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.

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 2019

	Mortgages	Commercial Lending	Idem Capital	Unallocated items	Total
	£m	£m	£m	£m	£m
Interest receivable	**170.9**	**44.7**	**30.2**	**3.4**	**249.2**
Interest payable	**(81.2)**	**(14.3)**	**(3.8)**	**(11.8)**	**(111.1)**
Net interest income	**89.7**	**30.4**	**26.4**	**(8.4)**	**138.1**
Other operating income	**3.3**	**5.7**	**0.9**	**-**	**9.9**
Total operating income	**93.0**	**36.1**	**27.3**	**(8.4)**	**148.0**
Direct costs	**(7.7)**	**(12.9)**	**(4.0)**	**(38.7)**	**(63.3)**
Provision for losses	**(0.7)**	**(3.7)**	**(0.5)**	**-**	**(4.9)**
	84.6	**19.5**	**22.8**	**(47.1)**	**79.8**

Six months ended 31 March 2018

	Mortgages	Commercial Lending	Idem Capital	Unallocated items	Total
	£m	£m	£m	£m	£m
Interest receivable	145.1	19.6	46.8	1.8	213.3
Interest payable	(67.3)	(7.3)	(5.2)	(12.2)	(92.0)
Net interest income	77.8	12.3	41.6	(10.4)	121.3
Other operating income	3.8	4.7	0.3	-	8.8
Total operating income	81.6	17.0	41.9	(10.4)	130.1
Direct costs	(7.4)	(10.5)	(4.8)	(32.2)	(54.9)
Provision for losses	(1.9)	(0.3)	0.4	-	(1.8)
	72.3	6.2	37.5	(42.6)	73.4

Year ended 30 September 2018

	Mortgages	Commercial Lending	Idem Capital	Unallocated items	Total
	£m	£m	£m	£m	£m
Interest receivable	299.1	50.1	97.9	4.8	451.9
Interest payable	(141.5)	(17.9)	(10.1)	(27.8)	(197.3)
Net interest income	157.6	32.2	87.8	(23.0)	254.6
Other operating income	7.6	10.9	0.7	28.1	47.3
Total operating income	165.2	43.1	88.5	5.1	301.9
Direct costs	(14.9)	(21.2)	(10.4)	(67.7)	(114.2)
Provision for losses	(5.5)	(2.0)	0.1	-	(7.4)
	144.8	19.9	78.2	(62.6)	180.3

The segmental profits disclosed above reconcile to the consolidated results as shown below:

	31 March 2019	31 March 2018	30 September 2018
	£m	£m	£m
Results shown above	**79.8**	73.4	180.3
Fair value items	**(7.8)**	3.8	1.2
Operating profit	**72.0**	77.2	181.5

The assets of the segments listed above are:

	31 March 2019	31 March 2018	1 October 2018	30 September 2018	30 September 2017
	IFRS 9	IAS 39	IFRS 9	IAS 39	IAS 39
	£m	£m	£m	£m	£m
Mortgages	**11,833.9**	11,193.1	11,598.2	11,622.2	11,393.2
Commercial Lending	**1,326.6**	710.0	1,166.7	1,168.6	582.2
Idem Capital	**457.8**	581.1	539.6	540.9	642.4
Total segment assets	**13,618.3**	12,484.2	13,304.5	13,331.7	12,617.8
Unallocated assets	**1,035.7**	862.5	1,183.4	1,183.4	1,064.4
Total assets	**14,654.0**	13,346.7	14,487.9	14,515.1	13,682.2

An analysis of the Group's loan assets by type and segment is shown in note 18.

10. INTEREST RECEIVABLE

	31 March 2019	31 March 2018	30 September 2018
	£m	£m	£m
Interest receivable in respect of			
Loans and receivables	**221.3**	198.0	408.9
Finance leases	**22.0**	11.6	34.4
Factoring income	**1.4**	1.2	2.2
Interest on loans to customers	**244.7**	210.8	445.5
Other interest receivable	**4.5**	2.5	6.4
Total interest on financial assets	**249.2**	213.3	451.9

The above interest arises from:

	31 March 2019	31 March 2018	30 September 2018
	£m	£m	£m
Financial assets held at amortised cost	**227.2**	201.7	417.5
Finance leases	**22.0**	11.6	34.4
	249.2	213.3	451.9

11. INTEREST PAYABLE AND SIMILAR CHARGES

	31 March 2019	31 March 2018	30 September 2018
	£m	£m	£m
On retail deposits	**53.9**	37.8	83.1
On asset backed loan notes	**34.6**	27.2	60.3
On bank loans and overdrafts	**2.4**	8.8	16.5
On corporate bonds	**5.5**	5.5	10.9
On retail bonds	**9.3**	9.3	18.6
On central bank facilities	**4.1**	2.1	5.2
Total interest on financial liabilities	**109.8**	90.7	194.6
On pension scheme deficit (note 25)	**0.3**	0.4	0.8
Discounting on contingent consideration	**0.2**	0.2	0.5
Other finance costs	**0.8**	0.7	1.4
	111.1	92.0	197.3

All interest on financial liabilities relates to financial liabilities carried at amortised cost.

12. OTHER INCOME

	31 March 2019	31 March 2018	30 September 2018
	£m	£m	£m
Loan account fee income	**3.9**	4.3	9.0
Broker commissions	**0.9**	1.1	2.1
Third party servicing	**2.7**	1.5	3.4
Other income	**0.4**	0.5	1.0
	7.9	7.4	15.5

13. FAIR VALUE NET (LOSSES) / GAINS

The fair value net (loss) / gain represents the accounting volatility on derivative instruments which are matching risk exposure on an economic basis generated by the hedge accounting requirements of IAS 39, which is still applied by the Group, as permitted by IFRS 9. 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 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.

Foreign exchange gains of £88.2m on asset backed loan notes denominated in US Dollars and Euros (31 March 2018: gains of £158.8m; 30 September 2018: gains of £67.6m) have been offset against movements on the cross-currency basis swaps used to hedge these liabilities as part of the cash flow hedge accounting treatment applied.

14. TAX CHARGE ON PROFIT ON ORDINARY ACTIVITIES

Income tax for the six months ended 31 March 2019 is charged at an effective rate of 19.3% (six months ended 31 March 2018: 19.7%, year ended 30 September 2018: 19.7%), representing the best estimate of the annual effective rate of income tax expected for the full year, 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 19.0% (2018 H1: 19.0%).

15. EARNINGS PER SHARE

Earnings per ordinary share is calculated as follows:

	31 March 2019	31 March 2018	30 September 2018
	£m	£m	£m
Profit for the period (£m)	**58.1**	62.0	145.8
Basic weighted average number of ordinary shares ranking for dividend during the period (m)	**258.1**	262.1	260.8
Dilutive effect of the weighted average number of share options and incentive plans in issue during the period (m)	**6.5**	7.5	8.4
Diluted weighted average number of ordinary shares ranking for dividend during the period (m)	**264.6**	269.6	269.2
Earnings per ordinary share			
- basic	**22.5p**	23.7p	55.9p
- diluted	**22.0p**	23.0p	54.2p

16. CASH AND CASH EQUIVALENTS

	31 March 2019	31 March 2018	30 September 2018	30 September 2017
	£m	£m	£m	£m
Balances with central banks	**704.0**	628.5	895.9	615.0
Balances with other banks	**368.0**	434.1	414.7	881.9
	1,072.0	1,062.6	1,310.6	1,496.9

Only 'Free Cash' is unrestrictedly available for the Group's general purposes. 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.

Balances with central banks includes deposits which form part of the liquidity buffer of Paragon Bank PLC and are therefore not available for the Group's general purposes. Free cash may also be deposited at the Bank of England.

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 2019	31 March 2018	30 September 2018	30 September 2017
	£m	£m	£m	£m
Free cash	**204.2**	141.2	238.0	305.5
Securitisation cash	**309.6**	369.5	338.8	574.0
Liquidity buffer	**555.5**	549.5	724.9	615.0
ESOP cash	**2.7**	2.4	8.9	2.4
	1,072.0	1,062.6	1,310.6	1,496.9

17. SHORT TERM INVESTMENTS

This amount represents treasury bills and other liquid securities held from time to time as part of the liquidity requirement of Paragon Bank PLC. They were designated as 'Available for Sale', under IAS 39 - 'Financial Instruments: Recognition and Measurement' and are consequently shown at market value.

18. LOANS TO CUSTOMERS

	31 March 2019	31 March 2018	1 October 2018	30 September 2018	30 September 2017
	IFRS 9	IAS 39	IFRS 9	IAS 39	IAS 39
	£m	£m	£m	£m	£m
Loans to customers	**12,525.6**	11,346.7	12,100.6	12,127.8	11,124.1
Fair value adjustments from portfolio hedging	**18.8**	(21.6)	(24.1)	(24.1)	(8.7)
	12,544.4	11,325.1	12,076.5	12,103.7	11,115.4

The Group's loan assets at 31 March 2019, analysed between the segments described in note 9 are as follows:

	Mortgages	**Commercial Lending**	**Idem Capital**	**Total**
	£m	**£m**	**£m**	**£m**
At 31 March 2019 (IFRS 9)				
First mortgages	**10,624.8**	**-**	**-**	**10,624.8**
Consumer loans	**159.1**	**-**	**404.2**	**563.3**
Motor finance	**-**	**262.4**	**53.6**	**316.0**
Asset finance	**-**	**451.4**	**-**	**451.4**
Development finance	**-**	**426.0**	**-**	**426.0**
Other commercial loans	**-**	**144.1**	**-**	**144.1**
Loans to customers	**10,783.9**	**1,283.9**	**457.8**	**12,525.6**
At 31 March 2018 (IAS 39)				
First mortgages	10,005.7	-	-	10,005.7
Consumer loans	113.8	-	547.1	660.9
Motor finance	-	195.4	-	195.4
Asset finance	-	364.8	-	364.8
Development finance	-	57.0	-	57.0
Other commercial loans	-	62.9	-	62.9
Loans to customers	10,119.5	680.1	547.1	11,346.7

	Mortgages	Commercial Lending	Idem Capital	Total
	£m	£m	£m	£m
At 1 October 2018 (IFRS 9)				
First mortgages	10,308.3	-	-	10,308.3
Consumer loans	141.2	-	447.0	588.2
Motor finance	-	256.4	72.8	329.2
Asset finance	-	402.3	-	402.3
Development finance	-	352.9	-	352.9
Other commercial loans	-	119.7	-	119.7
Loans to customers	10,449.5	1,131.3	519.8	12,100.6
At 30 September 2018 (IAS 39)				
First mortgages	10,332.2	-	-	10,332.2
Consumer loans	141.3	-	448.3	589.6
Motor finance	-	256.6	72.8	329.4
Asset finance	-	403.4	-	403.4
Development finance	-	352.8	-	352.8
Other commercial loans	-	120.4	-	120.4
Loans to customers	10,473.5	1,133.2	521.1	12,127.8
At 30 September 2017 (IAS 39)				
First mortgages	9,855.5	-	-	9,855.5
Consumer loans	98.4	-	611.4	709.8
Motor finance	-	163.0	-	163.0
Asset finance	-	323.5	-	323.5
Development finance	-	42.3	-	42.3
Other commercial loans	-	30.0	-	30.0
Loans to customers	9,953.9	558.8	611.4	11,124.1

19. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS

The movements in the impairment provision calculated under IFRS 9 are set out below.

	Mortgages	Commercial Lending	Idem Capital	Total
	£m	£m	£m	£m
At transition – 1 October 2018	**36.1**	**6.6**	**11.5**	**54.2**
Provided in the period	**1.1**	**3.7**	**0.8**	**5.6**
Amounts written off	**(5.6)**	**(1.7)**	**(1.0)**	**(8.3)**
At 31 March 2019	**31.6**	**8.6**	**11.3**	**51.5**

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

Impairment provision under IFRS 9 is calculated on a forward-looking expected loss basis, based on expected economic conditions in multiple internally coherent scenarios. 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.

The central scenario is the economic forecast used within the Group for planning purposes and represents its expectation of the most likely outcome. The upside and downside scenarios are less likely variants developed from this base case. The final scenario represents a protracted slump and is derived from the Bank of England's annual stress testing scenarios.

The economic variables comprising each scenario, and their projected average rates of increase (or decrease) for the first five years of the forecast period are set out below.

31 March 2019

	Central scenario	Upside scenario	Downside scenario	Severe downside scenario
Weighting applied	**40%**	**30%**	**25%**	**5%**
Economic driver				
Gross Domestic Product ('GDP') (increase)	1.7%	2.2%	1.0%	(0.1)%
House Price Index ('HPI') (increase)	3.1%	5.3%	(0.5)%	(5.9)%
Bank Base Rate ('BBR')	0.9%	1.8%	0.5%	0.0%
Consumer Price Inflation ('CPI')	2.0%	1.7%	2.5%	3.1%
Unemployment (rate)	4.0%	3.5%	5.6%	8.0%
Secured lending (annual change)	3.2%	3.7%	2.4%	1.3%
Consumer credit (annual change)	8.5%	10.6%	5.1%	0.1%

1 October 2018

	Central scenario	Upside scenario	Downside scenario	Severe downside scenario
Weighting applied	**40%**	**30%**	**25%**	**5%**
Economic driver				
Gross Domestic Product ('GDP') (increase)	1.6%	2.0%	0.9%	(0.1)%
House Price Index ('HPI') (increase)	3.0%	5.1%	(0.3)%	(5.2)%
Bank Base Rate ('BBR')	1.2%	1.7%	0.7%	0.0%
Consumer Price Inflation ('CPI')	2.1%	1.8%	2.6%	3.3%
Unemployment (rate)	3.9%	3.6%	5.7%	8.3%
Secured lending (annual change)	3.2%	3.6%	2.5%	1.5%
Consumer credit (annual change)	8.6%	10.5%	5.3%	0.6%

Further information relating to comparative disclosures under IAS 39 which are no longer relevant under IFRS 9 is included in note 34(c).

20. DERIVATIVE FINANCIAL ASSETS AND LIABILITES

	31 March 2019	31 March 2018	30 September 2018	30 September 2017
	£m	£m	£m	£m
Derivative financial assets	**751.3**	763.4	855.7	906.6
Derivative financial liabilities	**(30.9)**	(6.2)	(4.7)	(7.1)
	720.4	757.2	851.0	899.5
Of which:				
Foreign exchange basis swaps	**740.4**	738.1	829.7	896.3
Other derivatives	**(20.0)**	19.1	21.3	3.2
	720.4	757.2	851.0	899.5

The accounting treatment of these derivative assets and liabilities remain the same under IFRS 9. All hedging relationships and strategies at 30 September 2018 have continued in the period.

The Group's securitisation borrowings are denominated in sterling, euros and US dollars. All currency borrowings are swapped at inception so that they have the effect of sterling borrowings. These swaps provide an effective hedge against exchange rate movements, but the requirement to carry them at fair value leads, when exchange rates have moved significantly since the issue of the notes, to large balances for the swaps being carried in the balance sheet. This is currently the case with both euro and US dollar swaps, although the debit balance is compensated for by retranslating the borrowings at the current exchange rate.

21. INTANGIBLE ASSETS

Intangible assets at net book value comprise:

	31 March 2019	31 March 2018	30 September 2018	30 September 2017
	£m	£m	£m	£m
Goodwill	**164.6**	114.6	162.2	98.1
Computer software	**2.1**	1.6	2.1	2.0
Other intangibles	**4.7**	4.1	5.0	4.3
Total assets	**171.4**	120.3	169.3	104.4

The movements in goodwill shown above include the adjustments to acquisition accounting described in note 8.

22. RETAIL DEPOSITS

The Group's retail deposits, held by Paragon Bank PLC, were received from customers in the United Kingdom and are denominated in sterling. The deposits comprise principally term deposits and 120 day notice accounts. The method of interest calculation on these deposits is analysed as follows:

	31 March 2019	31 March 2018	30 September 2018	30 September 2017
	£m	£m	£m	£m
Fixed rate	**4,092.5**	3,210.6	3,643.1	2,675.9
Variable rates	**1,785.5**	1,075.2	1,653.5	939.5
	5,878.0	4,285.8	5,296.6	3,615.4

The weighted average interest rate on retail deposits, analysed by charging method, was:

	31 March 2019	31 March 2018	30 September 2018	30 September 2017
	%	%	%	%
Fixed rate	**1.99**	1.90	1.94	1.89
Variable rates	**1.41**	1.30	1.36	1.61

The contractual maturity of these deposits is analysed below.

	31 March 2019	31 March 2018	30 September 2018	30 September 2017
	£m	£m	£m	£m
Amounts repayable				
In less than three months	**570.6**	293.8	256.8	211.4
In more than three months but not more than one year	**2,220.0**	1,470.5	2,024.7	1,399.6
In more than one year, but not more than two years	**994.2**	1,081.8	1,010.6	770.0
In more than two years, but not more than five years	**708.5**	698.1	655.3	629.7
Total term deposits	**4,493.3**	3,544.2	3,947.4	3,010.7
Repayable on demand	**1,384.7**	741.6	1,349.2	604.7
	5,878.0	4,285.8	5,296.6	3,615.4
Fair value adjustments for portfolio hedging	**0.7**	(7.0)	(4.2)	(3.5)
	5,878.7	4,278.8	5,292.4	3,611.9

23. BORROWINGS

On 27 March 2019, Fitch Ratings confirmed the Group's Long-Term Issuer Default Rating and its senior unsecured debt rating at BBB. Consequentially the rating of the Group's £150.0m Tier 2 Bond was also maintained at BBB-.

All borrowings described in the Group Accounts for the year ended 30 September 2018 remained in place throughout the period, except as noted below.

During the period the Group continued to access the Indexed Long-Term Repo ('ILTR') scheme provided by the Bank of England.

Of the Group's borrowings at 30 September 2018, the mortgage backed floating rate notes issued by First Flexible No. 5 PLC and Paragon Mortgages (No. 21) PLC were both repaid in December 2018. The asset backed floating rate notes issued by Paragon Secured Funding (No. 1) PLC, the Group's last outstanding non-mortgage securitisation, were repaid in November 2018. In each case this followed the purchase of the entity's loan assets by other group companies.

On 14 November 2018, a new £200.0m warehouse funding facility was agreed between Paragon Seventh Funding Limited and Bank of America Merrill Lynch. The facility is secured over all of the assets of Paragon Seventh Funding Limited, with a 12 month commitment period. Interest is payable at 0.95% over three month LIBOR.

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

24. SUNDRY LIABILITIES

Sundry liabilities include £38.8m of amounts falling due after more than one year (31 March 2018: £43.5m; 30 September 2018: £40.8m). Deferred consideration of £21.3m, falling due after more than one year, is included in the sundry liabilities balance (31 March 2018: £26.1m; 30 September 2018: £25.7m).

25. RETIREMENT BENEFIT OBLIGATIONS

The defined benefit obligation at 31 March 2019 has been calculated on a year-to-date basis. Since the last IAS 19 actuarial valuation at 30 September 2018 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 2019. In particular, over the period since the 30 September 2018 actuarial valuation, the discount rate has decreased by 50 basis points per annum, whereas expectations of long term inflation have remained stable.

The net effect of these changes, together with the Group's contribution and the performance of the plan assets, has resulted in the value of the defined benefit obligation at 31 March 2019 increasing substantially from that at 30 September 2018. The impact of allowing for the change in actuarial assumptions has been recognised as an actuarial loss in other comprehensive income.

The movements in the deficit on the defined benefit plan during the six month period ended 31 March 2019 are summarised below.

	Six months to 31 March 2019	Six months to 31 March 2018	Year to 30 September 2018
	£m	£m	£m
Opening pension deficit	**19.5**	29.8	29.8
Employer contributions	**(2.2)**	(2.2)	(4.5)
Amounts posted to profit and loss			
Service cost	**0.9**	0.9	1.8
Past service cost	**0.2**	-	-
Net funding cost (note 11)	**0.3**	0.4	0.8
Administrative expenses	**0.3**	0.3	0.5
Amounts posted to other comprehensive income			
Return on plan assets not included in interest	**0.2**	0.7	(1.1)
Experience (gain) on liabilities	**-**	-	-
Actuarial loss / (gain) from changes in financial assumptions	**14.1**	(0.1)	(6.0)
Actuarial (gain) from changes in demographic assumptions	**(1.4)**	-	(1.8)
Closing pension deficit	**31.9**	29.8	19.5

Past service cost relates to the cost of GMP equalisation, discussed in note 56 to the group accounts.

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 deficit.

26. CALLED-UP SHARE CAPITAL

Movements in the issued share capital in the period were:

	Six months to 31 March 2019	Six months to 31 March 2018	Year to 30 September 2018
	Number	Number	Number
Ordinary shares of £1 each			
Opening share capital	**281,596,936**	281,489,701	281,489,701
Shares issued	**168,094**	7,583	107,235
Shares cancelled	**-**	-	-
Closing share capital	**281,765,030**	281,497,284	281,596,936

During the period the Company issued 168,094 shares (six months ended 31 March 2018: 7,583; year ended 30 September 2018: 107,235) to satisfy options granted under sharesave schemes for a consideration of £475,660 (six months ended 31 March 2018: £22,548; year ended 30 September 2018: £360,031).

27. RESERVES

	31 March 2019	31 March 2018	1 October 2018	30 September 2018	30 September 2017
	IFRS 9	IAS 39	IFRS 9	IAS 39	IAS 39
	£m	£m	£m	£m	£m
Share premium account	**66.1**	65.6	65.8	65.8	65.5
Capital redemption reserve	**28.7**	28.7	28.7	28.7	28.7
Merger reserve	**(70.2)**	(70.2)	(70.2)	(70.2)	(70.2)
Cash flow hedging reserve	**2.6**	3.0	3.3	3.3	2.5
Profit and loss account	**880.9**	810.0	868.3	890.7	784.5
	908.1	837.1	895.9	918.3	811.0

28. OWN SHARES

	31 March 2019	31 March 2018	30 September 2018
	£m	£m	£m
Treasury shares			
At 1 October 2018	**91.8**	66.6	66.6
Shares purchased	**-**	25.2	25.2
Shares cancelled	**-**	-	-
At 31 March 2019	**91.8**	91.8	91.8
ESOP shares			
At 1 October 2018	**12.2**	16.5	16.5
Shares purchased	**-**	-	6.2
Options exercised	**(1.1)**	(10.3)	(10.5)
At 31 March 2019	**11.1**	6.2	12.2
Total at 31 March 2019	**102.9**	98.0	104.0
Total at 1 October 2018	**104.0**	83.1	83.1
Number of shares held			
Treasury	**20,800,284**	20,800,284	20,800,284
ESOP	**2,517,608**	1,608,146	2,874,825
Total at 31 March 2019	**23,317,892**	22,408,430	23,675,109

29. EQUITY DIVIDEND

Amounts recognised as distributions to equity shareholders in the period:

	Six months to 31 March 2019	Six months to 31 March 2018	Year to 30 September 2018
	£m	£m	£m
Final dividend for the year ended 30 September 2018 of 13.9p per share	**35.9**	-	-
Final dividend for the year ended 30 September 2017 of 11.0p per share	**-**	28.9	28.9
Interim dividend for the year ended 30 September 2018 of 5.5p per share	**-**	-	14.2
	35.9	28.9	43.1

An interim dividend of 7.0p per share is proposed (2018: 5.5p per share), payable on 26 July 2019 with a record date of 5 July 2019. The amount expected to be absorbed by this dividend, based on the number of shares in issue at the balance sheet date is £18.1m (31 March 2018: £14.2m). The interim dividend will be recognised in the accounts when it is paid.

30. NET CASH FLOW FROM OPERATING ACTIVITIES

	Six months to 31 March 2019	Six months to 31 March 2018	Year to 30 September 2018
	£m	£m	£m
Profit before tax	**72.0**	77.2	181.5
Non-cash items included in profit and other adjustments			
Depreciation of property, plant and equipment	**0.8**	0.9	1.9
Profit on disposal of property, plant and equipment	**-**	(0.1)	(0.2)
Amortisation of intangible assets	**1.3**	0.9	2.1
Foreign exchange movement on borrowings	**(88.2)**	(158.8)	(67.6)
Other non-cash movements on borrowings	**0.8**	2.9	6.0
Impairment losses on loans to customers	**4.9**	1.8	7.4
Charge for share based remuneration	**2.8**	2.4	6.1
Net (increase) / decrease in operating assets			
Operating lease assets	**(7.3)**	(6.6)	(12.0)
Loans to customers	**(432.7)**	(222.4)	(781.7)
Derivative financial instruments	**104.4**	143.2	50.9
Fair value of portfolio hedges	**(42.9)**	12.9	15.4
Other receivables	**(26.9)**	(0.4)	(6.1)
Net increase / (decrease) in operating liabilities			
Retail deposits	**581.4**	670.4	1,681.2
Derivative financial instruments	**26.2**	(0.9)	(2.4)
Fair value of portfolio hedges	**4.9**	(3.5)	(0.7)
Other liabilities	**(2.6)**	12.1	24.6
Cash generated by operations	**198.9**	532.0	1,106.4
Income taxes (paid)	**(21.6)**	(16.1)	(32.0)
Net cash flow generated by operating activities	**177.3**	515.9	1,074.4

31. NET CASH FLOW USED IN INVESTING ACTIVITIES

	Six months to 31 March 2019	Six months to 31 March 2018	Year to 30 September 2018
	£m	£m	£m
Proceeds from sales of property, plant and equipment	**-**	0.3	0.5
Purchases of property, plant and equipment	**(0.3)**	(0.5)	(0.8)
Purchases of intangible assets	**(1.0)**	(0.2)	(1.5)
(Increase) / decrease in short term investments	**-**	(10.0)	-
Acquisition of businesses (note 5)	**-**	(6.8)	(281.0)
Net cash (utilised) / generated by investing activities	**(1.3)**	(17.2)	(282.8)

32. NET CASH FLOW FROM FINANCING ACTIVITIES

	Six months to 31 March 2019	Six months to 31 March 2018	Year to 30 September 2018
	£m	£m	£m
Shares issued (note 26)	**0.4**	0.1	0.4
Dividends paid (note 29)	**(35.9)**	(28.9)	(43.1)
Issue of asset backed floating rate notes	**-**	-	432.5
Repayment of asset backed floating rate notes	**(324.8)**	(860.9)	(1,289.7)
Movement on central bank facilities	**(40.0)**	274.4	324.4
Movement on other bank facilities	**(13.8)**	(292.9)	(371.1)
Purchase of shares (note 28)	**-**	(25.2)	(31.8)
Net cash (utilised) by investing activities	**(414.1)**	(933.4)	(978.4)

33. RELATED PARTY TRANSACTIONS

In the six months ended 31 March 2019, the Group has continued the related party relationships described in note 66 on page 226 of the Annual Report and Accounts of the Group for the financial year ended 30 September 2018. Related party transactions in the period comprise the compensation of the Group's key management personnel, transactions with the Group Pension Plan, the acceptance of retail deposits from certain non-executive directors and fees paid to a non-executive director who retired during the year in respect of his appointment as a director of the Corporate Trustee of 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.

Except for the transactions referred to above, there have been no related party transactions in the six months ended 31 March 2019.

34. DISCLOSURES UNDER IAS 39

Certain disclosures made in respect of IAS 39 based amounts are not directly comparable to IFRS 9 disclosures, but still form part of the comparative financial information. To avoid confusion, these are presented below.

a) Analysis of Loans to Customers (Note 7)

The IAS 39 carrying amount of loans to customers is analysed between product types as shown below. The corresponding balances under IFRS 9 at 1 October 2018 are shown in note 7.

	30 September 2018 IAS 39	
	£m	%
Buy-to-let mortgages	10,261.6	84.6%
Owner occupied mortgages	70.6	0.6%
Total first mortgages	10,332.2	85.2%
Second charge mortgage loans	415.9	3.4%
Loans secured on residential property	10,748.1	88.6%
Development finance	352.8	2.9%
Loans secured on property	11,100.9	91.5%
Asset finance loans	391.0	3.3%
Motor finance loans	329.4	2.7%
Aircraft mortgages	12.4	0.1%
Structured lending	38.7	0.3%
Invoice finance	21.8	0.2%
Total secured loans	11,894.2	98.1%
Professions finance	42.6	0.4%
Other unsecured commercial loans	17.3	0.1%
Unsecured consumer loans	173.7	1.4%
Total loans to customers	12,127.8	100.0%

b) Ageing of IAS 39 exposures (Note 7)

The payment status of the carrying balances of the Group's live loan assets, before provision for impairment, at 31 March 2018 and at 30 September 2018 split between those accounts considered as performing and those included in the population for impairment testing, is shown below. This disclosure is not required under IFRS 9, however comparative amounts are still required to be presented. Balances for immaterial asset classes are not shown. Asset finance loans below include other related loan balances. Fully provided non-live accounts, shown in note 34(c), are excluded from the tables below.

Days past due is not a relevant measure for the development finance or invoice discounting businesses, due to their particular contractual arrangements.

First mortgages

	31 March 2018	30 September 2018
	£m	£m
Performing accounts (less than 3 months arrears)	9,986.6	10,312.8
Impairment population	32.6	33.0
	10,019.2	10,345.8

Consumer and asset finance

	Second charge mortgage loans	**Motor finance loans**	**Asset finance loans**	**Total**
	£m	**£m**	**£m**	**£m**
31 March 2018				
Performing accounts (less than 2 months arrears)	403.1	195.1	410.1	1,008.3
Impairment population	68.7	1.5	6.4	76.6
	471.8	196.6	416.5	1,084.9
30 September 2018				
Performing accounts (less than 2 months arrears)	370.1	324.0	402.4	1,096.5
Impairment population	48.3	6.8	3.1	58.2
	418.4	330.8	405.5	1,154.7

Arrears in the tables above are based on the contractual payment status of the customers concerned. Where assets have been purchased, customers may already have been in arrears at the time of acquisition and an appropriate adjustment made to the consideration paid.

c) *Movement in impairment provision (Note 19)*

The following amounts in respect of impairment provisions under IAS 39, net of allowances for recoveries of written off assets, have been deducted from the appropriate assets in the balance sheet. This disclosure has been superseded under IFRS 9, but disclosures for comparator periods are still required.

	First mortgages	Other loans and receivables	Finance leases	Total
	£m	£m	£m	£m
At 30 September 2017	89.1	18.3	3.2	110.6
Provided in the period	2.0	(0.4)	0.3	1.9
Amounts written off	(3.1)	(4.9)	(0.3)	(8.3)
At 31 March 2018	88.0	13.0	3.2	104.2
At 30 September 2017	89.1	18.3	3.2	110.6
Provided in the year	5.6	0.6	2.9	9.1
Amounts written off	(3.7)	(7.6)	(1.0)	(12.3)
At 30 September 2018	91.0	11.3	5.1	107.4

Of the above balances, the following provisions were held in respect of realised losses not charged off, which remained on the balance sheet and are provided for in full.

	First mortgages	Other loans and receivables	Finance leases	Total
	£m	£m	£m	£m
At 31 March 2018	76.2	-	0.5	76.7
At 30 September 2018	78.2	-	0.9	79.1

The amounts charged to the profit and loss account, net of recoveries of previously provided amounts are set out below.

	First mortgages	Other loans and receivables	Finance leases	Total
	£m	£m	£m	£m
Six months ended 31 March 2018				
Amounts provided in the period	2.0	(0.4)	0.3	1.9
Recovery of amounts previously provided	(0.1)	-	-	(0.1)
Net impairment for the period	1.9	(0.4)	0.3	1.8
Year ended 30 September 2018				
Amounts provided in the year	5.6	0.6	2.9	9.1
Recovery of amounts previously provided	(0.1)	(0.5)	(1.1)	(1.7)
Net impairment for the year	5.5	0.1	1.8	7.4

INDEPENDENT REVIEW REPORT

To Paragon Banking Group PLC

Conclusion

We have been engaged by the Company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 31 March 2019 which comprises the consolidated income statement, consolidated statement of comprehensive income, consolidated balance sheet, consolidated cash flow statement, consolidated statement of movements in equity and 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 2019 is not prepared, in all material respects, in accordance with IAS 34 Interim Financial Reporting as adopted by the EU and the Disclosure Guidance and Transparency Rules ('the DTR') of the UK's Financial Conduct Authority ('the UK FCA').

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity issued by the Auditing Practices Board for use in the 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.

The impact of uncertainties due to the UK exiting the European Union on our review

Uncertainties related to the effects of Brexit are relevant to understanding our review of the condensed financial statements. Brexit is one of the most significant economic events for the UK, and at the date of this report its effects are subject to unprecedented levels of uncertainty of outcomes, with the full range of possible effects unknown. An interim review cannot be expected to predict the unknowable factors or all possible future implications for a company and this is particularly the case in relation to Brexit.

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 2, the annual financial statements of the Group are prepared in accordance with International Financial Reporting Standards as adopted by the EU. 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 by the EU.

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.

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.

Simon Clark,
for and on behalf of KPMG LLP
Chartered Accountants
1 Snow Hill Queensway,
Birmingham
B4 6GH
22 May 2019

ADDITIONAL FINANCIAL INFORMATION

For the six months ended 31 March 2019

Additional financial information supporting the amounts shown in the interim management report but not forming part of the condensed financial statements.

A. COST:INCOME RATIO

Cost:income ratio is derived as follows:

	31 March 2019	31 March 2018	30 September 2018
Operating expenses (£m)	**63.3**	54.9	114.2
Total operating income (£m)	**148.0**	130.1	301.9
Cost / Income	**42.8%**	42.2%	37.8%

B. UNDERLYING PROFIT

The Group reports underlying profit excluding fair value accounting adjustments arising from its hedging arrangements. This measure has been chosen as it is one widely used by 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 2019	31 March 2018	30 September 2018
	£m	£m	£m
Profit on ordinary activities before tax	**72.0**	77.2	181.5
Less: Gain on disposal of financial assets	**-**	-	(28.0)
Add back: Acquisition costs and other one-off items	**-**	-	4.2
Add back: Fair value adjustments	**7.8**	(3.8)	(1.2)
Underlying profit	**79.8**	73.4	156.5

Underlying basic earnings per share, calculated on the basis of underlying profit charged at the overall effective tax rate, is derived as follows.

	31 March 2019	31 March 2018	30 September 2018
	£m	£m	£m
Underlying profit	**79.8**	73.4	156.5
Tax at effective rate (note 14)	**(15.4)**	(14.5)	(30.8)
Underlying earnings	**64.4**	58.9	125.7
Basic weighted average number of shares (note 15)	**258.1**	262.1	260.8
Underlying earnings per share	**25.0p**	22.5p	48.2p

Underlying return on tangible equity is derived using underlying earnings calculated on the same basis.

	Six months to 31 March 2019	Six months to 31 March 2018	Year to 30 September 2018
	£m	£m	£m
Underlying earnings	**64.4**	58.9	125.7
Amortisation of intangible assets	**1.3**	0.9	2.1
Adjusted underlying earnings	**65.7**	59.8	127.8
Average tangible equity (note 6(b))	**909.9**	902.6	915.8
Underlying RoTE	**14.4%**	13.3%	14.0%

C. 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 follows:

Six months to 31 March 2019 (IFRS 9)

	Mortgages	**Commercial Lending**	**Idem Capital**	**Total**
	£m	**£m**	**£m**	**£m**
Opening loans to customers (note 18)	**10,449.5**	**1,131.3**	**519.8**	**12,100.6**
Closing loans to customers (note 18)	**10,783.9**	**1,283.9**	**457.8**	**12,525.6**
Average loans to customers	**10,616.7**	**1,207.6**	**488.8**	**12,313.1**
Net interest	**89.7**	**30.4**	**26.4**	**138.1**
Annualised NIM	**1.69%**	**5.03%**	**10.80%**	**2.24%**
Impairment provision	**0.7**	**3.7**	**0.5**	**4.9**
Cost of risk (annualised)	**0.01%**	**0.61%**	**0.20%**	**0.08%**

Six months to 31 March 2018 (IAS 39)

	Mortgages	**Commercial Lending**	**Idem Capital**	**Total**
	£m	**£m**	**£m**	**£m**
Opening loans to customers (note 18)	9,953.9	558.8	611.4	11,124.1
Closing loans to customers (note 18)	10,119.5	680.1	547.1	11,346.7
Average loans to customers	10,036.7	619.4	579.3	11,235.4
Net interest	77.8	12.3	41.6	121.3
Annualised NIM	1.55%	3.97%	14.36%	2.16%
Impairment provision	1.9	0.3	0.4	1.8
Cost of risk (annualised)	0.04%	0.10%	0.14%	0.03%

Year to 30 September 2018 (IAS 39)

	Mortgages £m	Commercial Lending £m	Idem Capital £m	Total £m
Opening loans to customers (note 18)	9,953.9	558.8	611.4	11,124.1
Closing loans to customers (note 18)	10,473.5	1,133.2	521.1	12,127.8
Average loans to customers	10,213.7	846.0	566.3	11,626.0
Net interest	157.6	32.2	87.8	254.6
Annualised NIM	1.54%	3.81%	15.50%	2.19%
Impairment provision	5.5	2.0	(0.1)	7.4
Cost of risk (annualised)	0.05%	0.24%	(0.02)%	0.06%

D. NET ASSET VALUE

	Note	**31 March 2019**	31 March 2018	30 September 2018
Total equity (£m)		**1,087.0**	1,020.6	1,095.9
Outstanding issued shares (m)	*26*	**281.8**	281.5	281.6
Treasury shares (m)	*28*	**(20.8)**	(20.8)	(20.8)
Shares held by ESOP schemes (m)	*28*	**(2.5)**	(1.6)	(2.9)
		258.5	259.1	257.9
Net asset value per £1 ordinary share		**£4.21**	£3.94	£4.25
Tangible equity (£m)	*6*	**915.6**	900.3	926.6
Tangible net asset value per £1 ordinary share		**£3.54**	£3.47	£3.59

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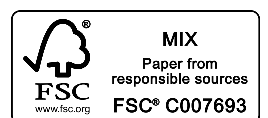
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