PARAGON BANKING GROUP PLC

Half Year Financial Report

For the six months ended 31 March 2022

Under Stock Exchange embargo until 7.00 a.m. Tuesday 14 June 2022

Volume and margin growth deliver record profits

Paragon Banking Group PLC ('Paragon' or 'the Group'), the specialist banking group, today announces its half-year results for the six months ended 31 March 2022.

Nigel Terrington, Chief Executive of Paragon said:

"These excellent results demonstrate the considerable progress we have made in fulfilling our strategic ambitions. Strong growth in new lending at attractive margins has supported the Group's earnings and return on tangible equity progression while capital levels remain comfortably in excess of our regulatory requirements, providing the foundation for further growth and additional capital returns in the future. Whilst the UK economy faces headwinds, we have a high quality loan book and we are confident in our momentum, and have upgraded our guidance for the full year.

Good progress has been made in delivering our multi-year digitalisation plans, which will enhance customer experience and drive greater operational efficiency over time.

Given the Group's strong profit performance and capital position we have extended this year's share buy-back by an additional £25 million."

Financial highlights:

- Underlying profits increased 27.3% to £105.5 million (2021 H1: £82.9 million)*
- Statutory profit before tax up 49.0% at £143.6 million (2021 H1: £96.4 million)
- Structural NIM enhancement to 2.57% accelerated by rate environment (2021 H1: 2.32%)
- Cost:income ratio reduced to 41.2% (2021 H1: 42.5%)
- Underlying EPS increased 29.4% to 32.6 pence (2021 H1: 25.2 pence)*, while statutory EPS increased 51.5% to 44.4 pence (2021 H1: 29.3 pence)
- Capital base remains strong – CET1 15.4% (31 March 2021: 16.0%)
- Underlying RoTE 14.9% (2021 H1: 12.8%)*
- Interim dividend up 30.6% at 9.4p (2021 H1: 7.2p), in line with policy

Operational highlights:

- New lending levels up 32.2% from 2021 H1 to £1.49 billion (2021 H1: £1.13 billion)
- Strong new business pipelines support momentum into the second half:
    - Buy-to-let pipeline up 44.4% from March 2021 at £1.34 billion
    - Development finance pipeline and undrawn commitments up 30.7% from March 2021 at £0.80 billion

- Retail savings deposits up 14.2% to £9.9 billion (2021 H1: £8.6 billion)
- Good progress in multi-business cloud-based digital re-platforming programme
- Platinum Investors in People status achieved, held by only 3% of employers assessed

Guidance summary:

2022 FY metric	Original guidance	Updated guidance
Mortgage Lending advances	£1.7bn+	Increase to £1.8bn +
Commercial Lending advances	£1.1bn+	Increase to £1.2bn +
NIM expansion	5bp+	Increase to 20bp+
Operating expenses	Low £150ms	Unchanged
Buy-back	Up to £50m	Increase to up to £75m

* For underlying basis, see Appendix A

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The Group will be holding a results presentation for sell-side analysts on Tuesday 14 June 2022 at 9:30am at UBS, 5 Broadgate, London EC2M 2QS. A webcast replay will be available on the Group's website from 2:00pm that day. The presentation material will be available on its website at www.paragonbankinggroup.co.uk/investors from 7:00am on the same day.

Cautionary statement

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

Interim Management Report

1 OVERVIEW

In the first six months of its 2022 financial year the Group has continued to deliver on its strategic priorities, leveraging its strong capital base and increasingly digital footprint to drive sustainable growth and diversification.

The Group's buy-to-let mortgage operation saw activity exceed pre-Covid levels with landlord confidence remaining high, despite growing uncertainties in the UK economy, while research carried out for the Group highlighted the continuing importance of the private rented sector to housing provision in the UK. The new business pipeline ended the period at a record level, customer retention levels were strong and green lending continued to grow.

Commercial Lending saw continued growth in the development finance operation, with an increasing focus on greener projects and a new core banking model replacing existing platforms. SME lending operations remained solid, with the benefits of the rollout of new technology offset by increasing economic caution amongst UK SMEs. The Group's motor finance arm launched products across the specialist battery electric vehicle market, helping to support this rapidly growing market.

On 8 June 2022, after the end of the reporting period, the Group disposed of the remaining unsecured loan assets within its Idem Capital division at a small profit, significantly reducing the assets of that segment.

The post-Covid performance of the Group's loan books remains encouraging, with little evidence of credit issues as the direct impact of UK government support schemes recedes. The Group, however, remains cautious in its assessment of future credit losses, with the prospects of UK interest rates and inflation reaching levels not seen for many years generating uncertainty on likely credit impacts.

The Group's retail savings offering continues to form the backbone of its funding strategy, with a strong performance in the first six months which saw the deposit book increasing by 5.9%. Funding costs continue to be closely managed in a competitive environment.

Digitalisation of the Group's key business lines continued apace. Cloud-based technology, designed to improve the experience of our customers, our business partners and our people, has either been rolled out, or is in the late stages of testing, increasing access to open banking application programme interfaces ('API's) in SME lending, development finance and the mortgage business. Further improvements are in the pipeline.

The Group's focus on the development of its employees was recognised in the period with the award of Platinum Investors in People status, the highest grading, held only by 3% of the over 50,000 companies assessed. This focus on people and culture is fundamental to the Group's strategy.

Overall this performance generated a substantial increase in profitability at both the statutory and the underlying level, which excludes the effect of fair value gains which will reverse over time. NIM was enhanced, costs were controlled, and new impairment provisions were minimal.

The Group's regulatory capital and liquidity both remained well in excess of regulatory requirements and are more than sufficient to meet the requirements of the Group's strategy. This has enabled the Board to declare an interim dividend of 9.4 pence per share in line with policy, and also to increase the current £50.0 million share buy-back programme to £75.0 million. Since 2015 the Group has declared £339.5 million of dividends, supplemented by £335.2 million of share buy-backs.

Overall the result for the half year has been exceptionally strong and, although the UK economic outlook may not be as positive as might have been expected six months ago, the Group's prudential strength, high quality loan portfolio and highly resilient and developing technology platforms leave it well placed to face any potential challenges ahead, while building its sustainability credentials.

Interim Management Report (Continued)

2 BUSINESS REVIEW

The Group's operations are organised into three divisions, based on product types, origination and servicing capabilities. Customer loan balances at 31 March 2022 and advances in the period for each of those divisions are summarised below:

	Advances in the period			Loans to customers at the period end		
	Six months ended 31 March 2022 £m	Six months ended 31 March 2021 £m	Year ended 30 September 2021 £m	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m
Mortgage Lending	855.3	724.6	1,630.0	11,999.2	11,130.6	11,608.7
Commercial Lending	634.2	401.7	971.5	1,719.7	1,427.1	1,568.8
Idem Capital	-	-	-	196.0	258.6	225.2
	1,489.5	1,126.3	2,601.5	13,914.9	12,816.3	13,402.7

The half year period has seen a 3.8% growth in the total loan book with an 8.6% year-on-year increase. Excluding legacy first and second mortgage balances the portfolio grew by 17.2%, year-on-year.

2.1 MORTGAGE LENDING

The Group's Mortgage Lending division principally provides buy-to-let mortgages secured on UK residential property to specialist landlords. The Group has a wealth of experience in this market, built up over more than a quarter of a century, giving it an unparalleled understanding of both this form of mortgage and the landlord customer base it targets.

During the period the Group also offered loans to non-specialist landlords and limited numbers of owner-occupied first charge mortgages on residential property. However, these form a minor part of its operations. 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 both mass market lenders and other specialists.

Housing and mortgage market

The UK housing market has continued its strength of recent years through the first six months of the financial year. An increase in the demand for housing and a structural lack of supply means that, house prices have continued upwards, although in the face of lower levels of residential mortgage transactions than seen in previous periods.

2 BUSINESS REVIEW

House prices continued their post-Covid pattern of strong increases, with the Nationwide House Price Index recording a year-on-year improvement of 14.3% to March 2022, 6.7% in the six month period. Research by Nationwide attributes the continuing increases to supply side issues, with the number of people seeking to move exceeding the number of properties becoming available.

Mortgage approvals reported by the Bank of England were broadly similar to those in the first half of the 2021 financial year. £154.2 billion of new mortgages were approved in the period, compared to £157.7 billion a year earlier. However, the proportion of remortgages increased significantly, representing 37.7% of approvals in the first half of 2022 against 24.9% in the comparable period in 2021, reflecting the fall in house purchase activity.

Across the mortgage market, arrears and possessions reported by UK Finance ('UKF') remained at low levels, with the numbers of customers in arrears reducing in the first quarter of the calendar year. Whilst possessions had increased, this included an element of catch-up following the moratorium during the omicron outbreak. Based on its research, published in May 2022, UKF has concluded, despite potentially adverse economic headwinds, the position on mortgage performance remains positive, with the number of households in arrears 10% less than a year previously and also less than before the outbreak of the pandemic.

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

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

The Group considers that this level of experience, the level of the customer's involvement in day-to-day letting activities and the diversification of their income streams across properties make them less vulnerable to cash flow shocks in the event of a downturn and therefore better able to cope when faced with an adverse economic situation.

The PRS continues to provide homes for around 19% of UK households. With supply and pricing issues impacting first-time buyers and the potential for incomes to become more constrained, the sector will continue to be crucial in national housing provision.

The Group has commissioned research on the future of the sector with the Social Market Foundation. This exercise found that, contrary to some widely held beliefs, most people renting their home in the private rented sector are happy with both their property and their landlord, and value the flexibility renting offers to them.

The research also concluded that the attention of policy makers, the media and society more generally, focuses on the minority of PRS tenants who have had particularly bad experiences with renting. However 81% of private renters expressed their contentment with their current property, and 85% say they are satisfied with their landlord.

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The full report on this research – "*Where Next for the Private Rented Sector?*" – is available on the Group's website at www.paragonbankinggroup.co.uk.

Volumes of new buy-to-let mortgages followed the trend in the wider mortgage market, responding to the property market as a whole. New advances reported by UKF, at £23.4 billion for the six months ended 31 March 2022, were broadly similar to those for the previous half year (2021 H2: £23.6 billion), but with a much increased level of remortgage activity. Remortgages comprised 66.2% of new mortgage activity, compared to 55.9% in the six months ended 30 September 2021.

For rental property, RICS, in its March 2022 UK Residential Market Survey, reports increasing levels of tenant demand, putting upward pressure on rents, with an expectation of rents increasing by 4% in the coming year and average increases of 5% per annum over the next five years. This is supported by research from Propertymark, in its March 2022 survey, where 71% of members reported increasing rents. This strength in the market should support both cash flows and affordability for landlord customers, even in the face of interest rate increases and other inflationary pressures.

These national trends are supported by research carried out with the Group's customers and mortgage brokers in the first months of 2022. 62% of landlords reported increased tenant demand, the highest figure reported to date in the Group's research. Landlords also reported rising rents and growing portfolios.

Mortgage intermediaries reported brisk business, with over half operating at or near capacity. Looking forward, strong demand for remortgage products was predicted and over a third of intermediaries had already facilitated green products. Intermediary net confidence for the future of the mortgage market in general was +85%, with confidence in the buy-to-let market at +67%.

The UKF analysis of arrears and possessions published in May 2022 provided analysis of buy-to-let cases, showing a similar picture to the wider mortgage market, with arrears remaining low and the number of arrears cases 5% less than a year earlier.

Overall, current research shows the buy-to-let market in a healthy state, notwithstanding any longer-term impacts of the pandemic, or other, more recent economic issues.

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Mortgage Lending activity

The primary focus of the Group's Mortgage Lending division continues to be the provision of buy-to-let mortgages to specialist landlord customers. The total amounts of the division's lending in the six month period are set out below.

	Six months ended 31 March 2022 £m	Six months ended 31 March 2021 £m	Year ended 30 September 2021 £m
Specialist buy-to-let	838.8	686.2	1,562.2
Simple buy-to-let	15.8	28.7	52.2
Total buy-to-let	854.6	714.9	1,614.4
Owner-occupied	0.7	1.0	1.5
Second charge	-	8.7	14.1
	855.3	724.6	1,630.0

Total lending in the segment increased by 18.0% compared to the same period in the previous financial year, continuing the strong performance seen towards the end of the 2021 financial year.

Buy-to-let

Overall buy-to-let lending continued to increase, building on the momentum established in the second half of 2021. Total completions in the six months were 19.5% higher than in the first half of the 2021 financial year with specialist business up by 22.2%. The pipeline of new business at the period end had increased to £1,337.8 million, 44.4% higher than a year earlier (30 September 2021: £1,008.1 million, 31 March 2021: £926.7 million). Restrictions in lending imposed during the pandemic had all been reversed by the end of the period, with further developments introduced, helping to drive volumes.

The majority of the Group's mortgage lending products offer fixed rates for an initial period, with many customers choosing a new product, either with the Group or elsewhere, at the end of this fixed period. A market shift in 2017 saw five-year fixes become the dominant product and the first tranche of that lending is now coming to the end of the five-year period. The Group has well established retention procedures to address accounts as their fixed rates expire and, in common with the wider market, has also seen a marked shift in new business flows in favour of remortgages. This is in contrast to the emphasis on house purchases seen during 2021, which was partly driven by stamp duty incentives, since withdrawn.

Interim Management Report (Continued)

2 BUSINESS REVIEW

Specialist intermediaries are the principal source of the Group's buy-to-let business, and it continues to develop its service proposition to ensure its business partners receive the service levels that they deserve. The Group continues to monitor satisfaction levels amongst its brokers, with 66% of those surveyed in the period saying that the Group provided better service than other lenders (2021 H1: 66% ,2021 FY: 66%).

This research also showed that 89% of brokers were satisfied with the ease of obtaining a response from the Group (2021 H1: 88%, 2021 FY: 91%), delivering a net promoter score at offer stage of +36 (2021 H1: +46, 2021 FY: +43). The Group was also named 'Best Professional Buy-to-Let Mortgage Lender' at the 2021/22 Your Mortgage Awards, further underlining its customer service credentials.

The Group's long-term programme of reengineering its mortgage business continued through the period. This includes a thorough review of all systems and operational processes to align them with the Group's strategy for the division and the overarching plan of digitalising the business. Initially, particular focus has been on those areas which can deliver immediate impact, such as customer retention, and on enhancing service to mortgage brokers. Improvements which went live in the period are already playing an important role in managing retention risk as five-year fixed rate mortgages start to mature.

The Group continues to expand its range of green buy-to-let mortgages. These products have a maximum 80% loan-to-value ratio and offer lower interest rates for energy efficient properties with Energy Performance Certificate ('EPC') ratings of C or higher. While initially limited to certain property types, this lending was extended to all properties within the Group's lending criteria in October 2021.

The UK Government has identified the provision of more energy efficient housing as a prime objective in its response to climate change, with EPC levels selected as one of the principal benchmarks to be used. It has announced a target of upgrading as many homes as possible in the PRS to an EPC rating of C or higher.

The Group's new lending volumes on green buy-to-let products in the six months ended 31 March 2022, which increased by 38.4% compared to the same period in 2021, are set out below.

	2022 H1	2021 H1	2021 FY
	£m	£m	£m
EPC rated A or B	78.4	64.4	134.3
EPC rated C	274.6	190.7	443.4
Total rated A to C	353.0	255.1	577.7
Coverage (England and Wales)	*99%*	*91%*	*93%*

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The Group's latest analysis identified EPC grades for 90.8% of its mortgage book by value at 31 March 2022 (31 March 2021: 87.6%, 30 September 2021: 88.3%). Of these 98.7% were graded E or higher (31 March 2021: 98.0%, 30 September 2021: 98.4%) with 38.2% rated A, B or C (31 March 2021: 36.8%, 30 September 2021: 37.6%). This steady improvement results from the new lending described above, with 43.2% of new originations in the year having one of the top three grades (99% coverage).

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

The Group also monitors the potential physical risks to security values arising from climate change. This includes assessing a property's flood risk as part of the underwriting process. At 31 March 2022, approximately 2.5% by number of properties securing the Group's buy-to-let mortgages in England and Wales were considered to be at medium or high risk of flooding from the sea or rivers, based on data from the Environment Agency (31 March 2021: 2.3%, 30 September 2021: 2.5%).

In addition, a more detailed analysis was carried out in the period, using data which was more location specific, and also included risk of flooding from surface water. This showed 3.2% of properties securing buy-to-let mortgages were at higher risk.

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

Other lending

The Group makes only a limited number of owner-occupied mortgage loans, normally as an extension of its relationship with its professional landlord customers. Mass-market mortgage lending does not currently offer the levels of return on capital which would be attractive to the Group. The Group no longer offers second charge mortgages, and all its second charge mortgage books are currently in run-off.

Interim Management Report (Continued)

2 BUSINESS REVIEW

Performance

The outstanding first and second charge mortgage balances in the segment at 31 March 2022 are set out below, analysed by business line.

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m
Post-2010 assets			
Buy-to-let	7,992.8	6,702.9	7,379.0
Owner-occupied	31.3	42.0	35.6
Second charge	124.5	168.6	148.1
	8,148.6	6,913.5	7,562.7
Legacy assets			
Buy-to-let	3,850.6	4,216.1	4,045.3
Owner-occupied	-	1.0	0.7
	11,999.2	11,130.6	11,608.7

Balances within the mortgage portfolio have continued to increase steadily, a result of lending volumes and successfully retaining existing customers. At 31 March 2022 loan balances in the division were 7.8% higher than a year earlier. Within this balance, the overall buy-to-let portfolio increased 8.5% year-on-year to £11,843.4 million (30 September 2021: £11,424.3 million, 31 March 2021: £10,919.0 million), with post-2010 originated assets representing 67.5% of the total at the end of the period (31 March 2021: 61.4%).

Despite the levels of activity in the mortgage market, the annualised redemption rate on buy-to-let mortgage assets remained stable in the six months to 31 March 2022 at 6.9% (2021 H1: 6.8%, 2021 FY: 6.9%). As the first wave of five-year fixed term mortgage accounts, a product not widely available before 2017, have begun to mature, the Group has put significant effort into managing these customers and ensuring that, as far as possible, an appropriate new product is made available to them. The increase in the scale of product maturities may, however, see higher absolute redemption levels going forward despite the strong retention performance.

Arrears on the buy-to-let book remained low and broadly stable in the six months at 0.15% (30 September 2021: 0.21%, 31 March 2021: 0.22%). The Group's buy-to-let arrears remain very low compared to performance in the national buy-to-let market, as they have been through the life of the product. In comparison, UKF reported arrears of 0.46% across the buy-to-let sector at 31 March 2022 (30 September 2021: 0.47%, 31 March 2021: 0.57%), highlighting the Group's asset quality.

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The performance metrics of the buy-to-let portfolio have remained generally strong across the period, despite the economic headwinds generated first by Covid, and then by growing uncertainties in the UK economy. However, the extent to which underlying issues have yet to manifest themselves remains uncertain. No payment holidays were given on mortgage accounts in the period, but while there is no evidence of accounts previously given such holidays performing differently on average to other accounts, there is evidence of more erratic payment profiles, particularly for those who were granted extended relief. The Group therefore continues to monitor these accounts closely.

The Group's approach focusses its underwriting on the credit quality and financial capability of its customers, underpinned by its assessment of the available security. It relies on a detailed and thorough assessment of the value and suitability of the property as security, including the use of a specialist in-house valuation team covering the whole country, and this robust approach to valuation, not just at inception, but through the life of the loan, provides it with significant security even in times of economic stress.

The loan-to-value coverage in the Group's buy-to-let book, at 59.2% (30 September 2021: 61.2%, 31 March 2021: 64.4%) is at the lowest level seen in over a decade, as a result of increasing house prices, which have continued to grow despite Covid. The resilience and value of the collateral underlying the Group's buy-to-let mortgage book, alongside its careful approach to provisioning underpins the strength of the Group balance sheet, and is subjected to a systematic programme of stress testing. The levels of interest cover and stressed affordability in the portfolio suggest that its customers are also well placed to manage Covid-related and other economic impacts on their businesses in the longer-term.

Second charge mortgage arrears increased marginally to 1.50% (31 March 2021: 1.00%, 30 September 2021: 1.18%) as the book continued to season, with performance remaining satisfactory. These metrics remain significantly better than those for the second mortgage market as a whole, reported by the Finance and Leasing Association ('FLA').

The Group continues to operate a receiver of rent process for buy-to-let assets, which helps to reduce the level of loss incurred by both it and, in turn, its landlord customers. This process gives the Group direct access to the rental flows from the underlying properties, while allowing tenants to stay in their homes. At 31 March 2022, 558 properties were managed by a receiver on the customer's behalf, broadly stable year-on-year (31 March 2021: 557 properties). Almost all the current receivership arrangements relate to pre-2010 lending, with cases being resolved on a long-term basis to ensure the best outcome for the Group, its customers and their tenants. There were relatively low numbers of cases entering receivership in the period.

Outlook

The mortgage business is well placed to continue to develop into the future. It has the capacity and the systems to continue to deliver the service which brokers and customers require, and to support landlord customers and the PRS going forward.

2 BUSINESS REVIEW

2.2 COMMERCIAL LENDING

The Group's Commercial Lending division includes four key specialist business streams lending to, or through, commercial organisations, mostly on a secured basis. The growth of this division represents a major strategic focus for the Group in the post-Covid environment.

The four major strands of the business comprise:

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

Within these sectors the Group's strategy is to target niches (either product types or customer groups) where its operating model and capital deployment can combine to optimise the relationship between growth and risk, to deliver long-term sustainable returns.

In each of its markets the division's competitors are principally small banks and similarly sized lenders. They are markets in which the largest lenders have little presence, reducing credit availability for customers and creating significant opportunities for the Group. The division operates through specialist teams in each business area, with a common focus on credit standards, customer service, asset appraisal, and collections and recovery linking the operations strategically.

The SME sector was a particular target of UK Government support during the Covid pandemic, resulting in an increase in cash reserves held in businesses across the sector. This makes it difficult to gauge the extent of Covid-related scarring and the future trajectory of the sector. This is complicated further by recent economic developments with increasing borrowing costs, inflationary pressures and supply chain issues all having potential impacts going forward. The requirement for SMEs to start repaying loans made under the Coronavirus Business Interruption Loan Scheme ('CBILS') and other government-backed loans also has the potential to impact investment appetites.

The Group's ongoing project to enhance digital capabilities across the division has continued in the period, with major investment in both its development finance and SME lending platforms. The Group's agile approach to development has resulted in a number of enhancements going live, including a new broker portal for SME lending, which provides a more streamlined and effective process for business providers, while improving operational efficiency by providing the capability for increased process automation.

The division continues to expand its green initiatives with the motor finance operation launching its electric vehicle proposition in the period and the development finance business incentivising developers to provide more energy-efficient properties. At the same time the division continues to support local authorities in 'greening' their refuse collection operations, with the first contracts signed during the period.

Interim Management Report (Continued)

2 BUSINESS REVIEW

Commercial Lending activity

New business in the sector increased by 57.9%, compared to the same period in 2021, as the UK economy continued to emerge from Covid, with growth across all the division's business lines. Growth compared to the first half of 2021 was particularly marked in motor finance and parts of the SME lending business, where market transactions in the first half of 2021 had been at historically low levels.

New business increased by 11.3% compared with the second half of 2021, where the impact of lockdowns had started to recede, with strong growth in the development finance operation, but a flatter position in SME lending, as the growth in asset leasing and loans to professionals was offset by the decline in CBILS and Recovery Loan Scheme ('RLS') lending.

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

	Six months ended 31 March 2022 £m	Six months ended 31 March 2021 £m	Year ended 30 September 2021 £m
Development finance	323.7	229.5	510.4
SME lending	181.8	155.5	336.9
Structured lending	53.0	(12.1)	24.0
Motor finance	75.7	28.8	100.2
	634.2	401.7	971.5

These advances increased the Commercial Lending loan book by 9.6% in the six months, to a total of £1,719.7 million (31 March 2021: £1,427.1 million, 30 September 2021: £1,568.8 million). This is 15.1% larger than the division's £1,494.3 million portfolio at 31 March 2020, before the impact of the pandemic.

Development finance

The growth of the Group's development finance operation had continued throughout the pandemic, laying the foundations for a positive performance in the period, with advances increasing 41.0% compared to the first six months on the 2021 financial year. The UK continues to provide fewer new homes than government forecasts suggest are necessary, offering significant opportunities for the Group's customer base.

The business has now launched its first major green finance option. Projects developing energy-efficient properties, those with an EPC A grade, can receive beneficial funding terms. By 31 March 2022, £23.5 million of new lending facilities had been agreed under the green initiative, with drawings commencing in the period. With a developing pipeline, this will be an area of focus for the Group going forward, as developers increasingly factor these discounts into their project planning.

2 BUSINESS REVIEW

The regional spread of the Group's lending has broadened, with the proportion of the portfolio located in London and the South-East of England falling to 58.2% from 63.6% at 30 September 2021. Activity increased particularly in the East and West Midlands, with funding provided for a number of flagship projects. The business has also increased the range of specialist developments it has funded, including a heightened focus on the later living sector.

The short-term prospects for future lending in the business remain strong. Undrawn balances on current facilities had increased to £596.4 million, a significant amount of which would be expected to be drawn in the second half of the financial year (31 March 2021: £402.0 million, 30 September 2021: £500.4 million). The new business pipeline stood at £266.7 million (31 March 2021: £318.4 million, 30 September 2021 £366.6 million), with the reduction partly attributable to projects delayed by supply chain issues.

The Group's investment in systems for this business has continued through this period, with enhancements being delivered on a regular basis to improve process efficiency and customer service. This drive towards digitalisation will continue, providing a solid platform for the growth of the business and supporting the transition to an internal ratings based approach to capital management.

The current state of the UK house building market gives a significant opportunity for smaller developers to expand and for the Group to support them. The Group's proposition is strong and attractive and continues to provide healthy returns for the capital invested and opportunities for growth.

SME lending

Compared to the first six months of 2021 new lending in the SME lending business grew by 16.9%. Growth compared to the second half of 2021, after lockdowns had mostly ended, was more modest at 0.2%, but this result includes significantly different performances across product types. In particular, lending backed by Covid-related government guarantees formed a far smaller part of the business' activity in the period. Generally SME businesses have remained cautious on their investment decisions, given the economic uncertainties in the current UK environment, constraining all capital goods related activity.

In the asset leasing business volumes excluding government backed loans, at £90.3 million, were broadly similar to the £91.3 million achieved in the second half of the 2021 financial year (2021 H1: £106.9 million, 2021 FY: £198.2 million). This reflects overall market pressures in the asset finance market with the FLA reporting new business, excluding cars and high value items, in the six months to 31 March 2022 4.1% lower than in the previous six months. The FLA's regular survey of members, carried out in the first quarter of 2022 attributed this partly to supply issues affecting the availability of new equipment for leasing. Investment in operating leases has also continued with £9.7 million of assets being acquired (2021 H1: £4.6 million, 2021 FY: £13.0 million).

Interim Management Report (Continued)

2 BUSINESS REVIEW

The Group continued to provide loans under the UK Government-sponsored British Business Bank's RLS programme to support SMEs potentially affected by the Covid pandemic. Initially these loans had the benefit of an 80% government guarantee (after the proceeds of any business assets are applied for leasing balances), but after 31 December 2021, this was reduced to 70%. The reduction in the guarantee and the general emergence from Covid saw take-up of the new scheme drop off markedly. However, the Group expects to offer these loans to SME customers until the scheme closes. The Group's lending in this area has been primarily focussed on its existing customers, with the majority of its lending on asset-secured products.

The first half of 2022 saw £23.8 million advanced under schemes backed by government guarantees (2021 H1: £26.3 million, 2021 FY: £64.2 million), of which £23.3 million was asset leasing business. The Group continues to closely monitor the portfolio for any adverse indications, particularly as the majority of CBILS and Bounce Back Loan Scheme ('BBLS') customers are now obliged to meet their own interest payments, rather than having them met by the UK Government.

Short-term lending to professional services firms outside the government supported schemes reached £57.1 million in the period, double that in the comparable period in 2021 and 71.0% up on the second half of 2021 (2021 H1: £28.6 million, 2021 FY: £62.0 million). These loans are often used to spread the impact of tax payments, and the availability of tax deferrals, together with the availability of CBILS and similar loans amongst this customer group had seriously depressed demand. However the underlying requirement for this form of finance remains for the longer-term, and performance has continued to move back towards pre-Covid levels.

The division is seeing more green lending propositions over recent months, with many businesses in the transportation field and beyond seeking to reduce their carbon footprints. The division also has a strong presence in waste management, supporting local authorities as they transition to greener refuse collection activities and providing funding for the development of recycling plants. It is a strategic priority of the Group to support UK SMEs, whose journey towards net zero may require significant capital investment over time, and these types of initiatives are expected to increase going forward.

The Group's investment in the technology of its SME lending systems has continued to make significant improvements in internal efficiency and service to brokers and customers. Agile and modular delivery enables individual improvements to go into the live system as they are completed, providing incremental enhancements, rather than waiting for a complex 'big bang'.

At the beginning of the period a new broker portal was rolled out. This was developed based on extensive research amongst the broker community and enables brokers to upload applications and receive rapid feedback on the progress of the potential loan. Take-up has been good with over 60% of standard SME lending applications now being received through the portal. Importantly, this interface is designed as an additional service to brokers, and the division's business support team remains fundamental to ensuring brokers and customers receive the standard of service they deserve.

2 BUSINESS REVIEW

While the FLA Outlook Survey for the first quarter of the calendar year, conducted in January 2022, presents a more nuanced view of the outlook for the leasing industry than in some recent surveys, with concerns raised about inflation, consumer spending, funding costs and a potential resurgence of Covid, respondents expected the economic position to improve in the longer-term. 86% of firms were expecting lending volumes to increase over a twelve month horizon, with 55% expecting increases of over 10%.

It is clear that the SME lending market continues to offer good growth prospects to a lender which can provide an efficient, streamlined offering focussed on customers and their advisers and the Group continues to focus on meeting that requirement.

Structured lending

Activity in the structured lending business stream has continued its process of post-Covid normalisation. Drawings generally increased and a further facility came on stream, taking the drawn balance to £171.7 million at the end of March. This is the operation's thirteenth facility to date, with five having paid down, and with no losses incurred.

These facilities generally fund non-bank lenders of various kinds, providing the Group with increased product diversification. The facilities are constructed to provide a buffer for the Group in the event of default in the ultimate customer population. This business line is important both as a direct source of lending, but also as a way to explore new markets and routes to market.

The Group has a number of further facilities in the pipeline, broadening the range of products and industries supported. As each of these arrangements is constructed on a bespoke basis, the throughput of the pipeline tends to be slower than for other products, and hence the post-Covid bounce-back cannot be as rapid.

Motor finance

During the first half of the 2021 financial year the Group's motor finance operation was largely suspended, a response to the low levels of automotive transactions through the initial Covid lockdown periods. The business was relaunched in the spring of 2021, and has rebounded significantly since that time. The £75.7 million advanced in the period is over twice the amount loaned in the comparative period in 2021, and 6.0% greater than the value in the second half of 2021 (2021 H1: £28.8 million, 2021 FY: £100.2 million), despite growing economic uncertainties and inflationary pressures impacting consumers.

The half year saw the Group's first loans on static caravans, a product which delivers strong yields and capacity for expansion and fits with the Group's specialist vision for the business.

The Group also launched its first products for financing battery-powered electric vehicles. £2.7 million of such loans were made, reflecting the recent growth in availability of such vehicles, with the pipeline building significantly as the half year closed. The Group is therefore well placed to support the green aspirations of its customers, as electric vehicles become a more widely viable and popular option.

2 BUSINESS REVIEW

Performance

The loans within the Commercial Lending division, analysed by product type are set out below.

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m
Asset leasing	457.0	467.8	468.7
Professions finance	49.5	27.9	33.1
CBILS, BBLS and RLS	94.3	50.1	83.8
Invoice finance	24.1	14.3	20.9
Unsecured business lending	14.0	11.7	10.3
Total SME lending	638.9	571.8	616.8
Development finance	672.9	552.3	608.2
Structured lending	171.7	82.6	118.9
Motor finance	236.2	220.4	224.9
	1,719.7	1,427.1	1,568.8

The size of the Commercial Lending book increased by 9.6% in the six months, as activity amongst the Group's SME customer base began to increase following the pandemic.

Credit quality in the development finance book remained excellent. Accounts are regularly monitored for project progress and credit quality and graded on a case-by-case basis by the Credit Risk function. At 31 March 2022 only three accounts were identified as at risk of loss. The average loan to gross development value for the portfolio at the period end, a measure of security cover, was 62.1% (30 September 2021: 61.7%, 31 March 2021: 62.4%). This gives the Group a significant credit buffer if any of the projects encounter issues. No write-offs were recognised in the period.

Arrears in the division's finance leasing portfolios remain stable, even with the cessation of the majority of payment reliefs. Arrears on asset leasing business at 31 March 2022 stood at 0.21% (30 September 2021: 0.27%, 31 March 2021: 0.86%) and those on the motor finance book at 2.20% (30 September 2021: 2.30%, 31 March 2021: 2.25%). Write-offs in SME Lending were limited to a small number of cases where special conditions applied, and which had been provided for at 30 September 2021.

Whilst some lenders have reported issues with their CBILS, BBLS and RLS lending related to either credit quality or fraud, the Group is yet to see any significant impacts, even though the majority of customers are now in a position where they have to fund repayments, rather than these being met by the UK Government. The portfolio at 31 March 2022 contained only £1.4 million Stage 2 accounts at gross carrying value and only £0.4 million of credit impaired cases. The Group has so far had to make claims on £1.8 million of loans, out of the £113.9 million advanced since the schemes began. The majority of the Group's government-backed lending was to its existing customers, which contributed to the credit quality of this lending.

2 BUSINESS REVIEW

For structured lending accounts, the Group carefully monitors the performance of the underlying asset pool on a monthly basis, to ensure its security is adequate. Performance in the half year has been in line with expectations, with a number of facilities showing improved metrics. Of the two facilities assigned to IFRS 9 Stage 2 at 30 September 2021, one had returned to Stage 1, with the other redeeming at par.

Outlook

Overall the prospects for the Commercial Lending division appear strong, underpinning the Group's diversification strategy. While economic uncertainty is growing, the Group's positioning and sector exposures, coupled with its use of enhanced technology, mean it is well placed to support the aspirations of its customers in the coming periods.

2.3 IDEM CAPITAL

The Idem Capital segment contains the Group's acquired loan portfolios, together with its pre-2010 legacy consumer accounts. These include mostly second charge and unsecured consumer loans. The Group regards the operation as essentially opportunistic, with portfolios acquired only where these fit within its existing capabilities and operations and where the projected return is attractive in comparison to the other opportunities for the deployment of its capital.

After the period end the Group sold the majority of its unsecured portfolios, considerably reducing the size of the Idem Capital division. As a result it is considering whether it is appropriate to report Idem Capital as a separate segment in future. However it will still consider portfolio acquisitions where these meet its strategic requirements.

The Idem Capital back book includes consumer lending portfolios where customers may have historically rescheduled their debt repayments and its processes aim to generate fair outcomes for all customers, recognising any vulnerabilities, which are also considered carefully in any asset disposals. The implementation of the new FCA Consumer Duty in the Group's relationships with all its customers, particularly those who may be vulnerable, is a strategic priority for the division, particularly in light of the mounting financial pressures on UK households.

2 BUSINESS REVIEW

New business

The UK market for loan portfolio sales in the period remained restrained, with bidding highly competitive for those loan books coming to market. The Group considered a number of opportunities in the mortgage finance, consumer lending and asset finance spaces, but none of these ultimately met its criteria and they were not progressed. Therefore, in the six month period, no new portfolio acquisitions were completed (2021 H1: none).

The main focus of the business throughout the half year was the careful management of its existing loan portfolios and ensuring that appropriate processes and systems were in place to address both the longer-term impacts of the Covid outbreak and the more general impacts of rising living costs on its customers. This is particularly important where those customers might be vulnerable or may develop vulnerabilities as a result of the ongoing situation.

Performance

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

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m
Second charge mortgage loans	117.4	151.6	133.6
Unsecured consumer loans	76.8	98.1	87.3
Motor finance	1.8	8.9	4.3
	196.0	258.6	225.2

With no portfolios acquired in the period, the Idem Capital loan book has continued to decline in the period as a result of customer collections. 120 month Estimated Remaining Collections on the segment's acquired consumer assets, which measures forecast undiscounted receipts, reduced to £209.3 million at 31 March 2022 from £260.1 million a year earlier and payment performance in the segment remained in line with historic experience.

On 8 June 2022, after the end of the period, the Group disposed of unsecured loan assets with a carrying value of £76.8 million at 31 March 2022. A small profit is expected to be realised against these assets, which will be finalised following post-completion procedures and reported with the year end results.

2 BUSINESS REVIEW

Arrears on the segment's secured lending business continued to move higher as overall numbers of cases declined. Arrears cases represented 25.4% of Idem Capital second charge mortgage assets at 31 March 2022 (30 September 2021: 24.3%, 31 March 2021: 20.2%). However the absolute number of arrears cases reduced by 6.6% to 2,048 from 2,193 at the start of the period (31 March 2021: 1,945). This shows the increase in percentage arrears to be a result of the structure of these portfolios, which include accounts which were making full payments in the period but may have missed payments in the past, remaining in arrears long-term, and the propensity of fully up-to-date accounts to redeem more quickly than these long-term arrears cases.

None of the individual Idem Capital purchased loan portfolios were considered as underperforming in the period. The Group monitors actual cash receipts from acquired portfolios against those forecast in the evaluation which informed the purchase price. Up to 31 March 2022, such collections were 109.7% of those forecast to that point (30 September 2021: 109.8%, 31 March 2021: 110.0%), demonstrating the stability in cash flow from these portfolios.

The Group continues to invest in its systems and people to ensure that these loans are serviced efficiently and effectively, and that appropriate customer outcomes are achieved, particularly for vulnerable customers.

Outlook

The Group continues to view the ability to acquire appropriate loan portfolios on an opportunistic basis as a useful adjunct to its strategic objectives, however this is not a primary strategic focus. The disposal of most of the division's unsecured loan book after the period end will further reduce its contribution to group profit, but the prospects for the remaining income streams remain positive.

The Group will continue to ensure that all Idem Capital customers, including those whose accounts are disposed of, receive appropriate outcomes and fair treatment.

3 FUNDING REVIEW

The Group's principal source of funding is its retail deposit-taking operation, but it is able to access a variety of other funding sources, including central bank funding lines. This ensures that its funding position is both adaptable and sustainable as the business and its operating environment change over time. Cost-effective funding can be accessed despite issues in any particular funding market, and funding for strategic initiatives sourced on a timely basis.

During the period the Group's deposit book has grown, despite the increasing normalisation of economic activity and high-profile new entrants to the market, with additional channels to market also being added. In addition, the Group's status as a debt issuer was enhanced when its credit rating was upgraded by Fitch during March 2022.

The Group's funding at 31 March 2022 is summarised below.

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m
Retail deposit balances	9,853.7	8,631.2	9,300.4
Securitised and warehouse funding	1,348.4	2,767.0	1,246.0
Central bank facilities	2,850.0	2,244.4	2,819.0
Tier-2 and retail bonds	261.3	405.3	386.1
Repurchase agreements	-	50.0	-
Total on balance sheet funding	14,313.4	14,097.9	13,751.5
Other off balance sheet liquidity facilities	150.0	150.0	150.0
	14,463.4	14,247.9	13,901.5

The Group's funding balance has continued to move towards the retail savings market in the period, with an increase of 5.9% in retail deposits. At the end of the period retail deposits represented 68.8% of all on balance sheet funding (30 September 2021: 67.6%, 31 March 2021: 61.2%).

At 31 March 2022 the proportion of easy access deposits, which are repayable on demand, was 25.2% of total on-balance sheet funding, similar to the position at the start of the period (30 September 2021: 24.1%, 31 March 2021: 20.0%). This percentage remains low compared to the rest of the banking sector and can be expected to rise going forward.

The Group's stance on liquidity remains prudent, with £1,342.5 million of cash available at 31 March 2022 (30 September 2021: £1,236.5 million, 31 March 2021: £1,895.1 million). The appropriate level of cash reserves continues to be monitored as part of the Group's capital and liquidity strategy, which will continue to take a conservative view of the economic outlook, including the long-term impacts of the pandemic, UK interest rates, the cost of living and wider geopolitical concerns.

Derivative assets and liabilities continue to be used to hedge interest rate risk arising from fixed rate loans and deposits. While this strategy has not materially changed in the period, the movements in interest rate expectations over the six months, coupled with the increased mortgage pipeline have resulted in larger swap balances on the balance sheet at 31 March 2022. However, the Group still undertakes no trading in derivatives.

3 FUNDING REVIEW (Continued)

The Group successfully executed the plans to transition all LIBOR-linked assets and exposures to alternative rates set out in the 2021 Annual Report before the cessation of LIBOR in December 2021.

3.1 RETAIL FUNDING

The Group's retail savings operation forms the principal plank of its funding platform. The UK savings market provides a funding channel which is reliable, liquid, scalable and cost-effective, with activity little impacted by the ongoing pandemic.

The main focus of the business has been on offering sterling deposits to UK households, through a streamlined online presence, supported by an outsourced administration function, although this has become more diversified over recent periods. Products offered include cash ISAs, term and notice deposits, and easy access accounts.

The Group's strategy in the retail deposit market is to generate and retain customer accounts by providing competitive interest rates, attractive and innovative products and high quality customer service. The protection provided to depositors by the Financial Services Compensation Scheme ('FSCS') both incentivises larger savers to split their deposits, and reduces the perceived risk for customers in using less familiar institutions, providing market opportunities for the Group's offering.

During the six months UK household savings balances reported by the Bank of England continued to increase with balances at 31 March 2022 reaching £1,424.6 billion, an increase of 1.4% in the period and an increase of 4.4% year-on-year. The Covid pandemic reduced the levels of discretionary spending by households, and hence an increase in savings. Some of this increase may be reversed as the UK economy returns to a more normal footing, potentially mitigating inflationary pressures to some degree.

The Group's customer deposits continued to increase faster than the overall market, with a 5.9% increase in balances over the six month period, reflecting the soundness of the Group's proposition and its continuing programme of business and systems development. This was achieved despite some high-profile new entrants to the market, together with high levels of competition, producing upward pressure on rates.

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

	Average interest rate		Proportion of deposits	
	31 March 2022 %	**30 September 2021 %**	**31 March 2022 %**	**30 September 2021 %**
Fixed rate deposits	1.26	1.25	58.0	58.8
Variable rate deposits	0.63	0.42	42.0	41.2
All balances	0.99	0.91	100.0	100.0

3 FUNDING REVIEW (Continued)

The increase in funding costs is driven by market movements, where savings rates have begun to move upwards, following the increase in the Bank of England base rate, after a period of stability. The average initial term of fixed rate deposits at 31 March 2022 remained stable at 25 months (30 September 2021: 26 months), although easy access products have continued to dominate the savings market, with customers expecting rate increases in the near term.

During the period the Group broadened its in-house product range with the launch of its first green savings product, a market-leading three year fixed rate bond, with the proceeds used to fund buy-to-let mortgages on properties with EPC levels of C or above. This enables the Group's customers to support the process of enhancing the sustainability of the UK's housing stock. The Group aims to build on this green savings initiative going forward.

Offerings through third party channels also provide an increasing part of the Group's savings base. These channels, which include investment platforms and savings marketplaces operated by digital banks, provide access to a different customer demographic to the Group's mainstream customers. This more diversified sourcing offers enhanced opportunities to manage inflows and costs. The Group now has nine such relationships, compared to seven at 30 September 2021. These channels now represent around 14% of the total deposit base (30 September 2021: 12%) and the Group has the systems and control framework in place to further increase its reach through these channels, if appropriate.

The Group's strategy in the savings market relies on providing a high quality customer offering and conducts insight surveys throughout the customer journey. The results of this research in the period maintained the strongly positive position previously reported.

For customers opening a savings account with the Group in the period, 88% of those who provided data stated that they would 'probably' or 'definitely' take a second product (2021 H1: 86%, 2021 FY: 88%). The net promoter score for new customers in the period was +58, an improvement from the +50 achieved in the first half of the preceding financial year, and in line with 2021's full year result (2021 H1: +50, 2021 FY: +58), remaining significantly positive.

Of customers with maturing savings balances in the period, 86% stated that they would 'probably' or 'definitely' consider taking out a replacement product with the Group (2021 H1: 89%, 2021 FY: 89%) with a net promoter score at maturity of +50, compared to +52 for the first half of the 2021 financial year (2021 FY: +52).

These responses show that the quality of the Group's customer interaction operations position it well to retain customers and deposits in an active and competitive market.

The Group continues to be successful in industry awards, being named 'Best Fixed Rate Cash ISA Provider' at the 2022 Moneynet.co.uk awards, an endorsement of one of the business' key products.

3 FUNDING REVIEW (Continued)

Retail deposits continue to provide a stable foundation for the Group's funding strategy allowing volumes and rates to be effectively and flexibly managed. The Group will continue to develop the business on a strategic basis, expanding its product range, addressing wider demographics and expanding its presence on third party platforms. It will also continue to develop its systems to ensure it is able to address the increasingly sophisticated needs of savers.

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

3.2 CENTRAL BANK FACILITIES

The Group has access to facilities offered by the Bank of England from time to time, which it utilises as part of its overall funding strategy.

The largest part of the Group's central bank funding relates to the Bank of England Term Funding scheme for SMEs ('TFSME'). TFSME closed for new drawings during the period, but before closure the Group repaid and redrew all its existing TFSME borrowings, ensuring that this cost-effective funding continues to be available for as long as possible. The Group's TFSME borrowings at 31 March 2022 were £2,750.0 million (31 March 2021: £2,025 million, 30 September 2022: £2,750.0 million) with interest payable at the Bank of England base rate.

The Group's remaining drawings under the Bank of England's original Term Funding Scheme ('TFS') were repaid during the period, further improving the maturity profile of the Group's borrowings.

While these long-term funding solutions are no longer available, the Group retains access to other Bank of England funding channels for liquidity purposes and has drawn on the Indexed Long-Term Repo ('ILTR') scheme in the period.

The Group expects to continue to make use of facilities offered by the Bank of England from time to time where this is appropriate and cost-effective, and mortgage loans have been pre-positioned with the Bank of England to be available to act as collateral for future drawings, if and when required. This provides access to potential to be liquidity or funding of up to £2,066.2 million (30 September 2021: £1,424.2 million).

3 FUNDING REVIEW (Continued)

3.3 WHOLESALE FUNDING

The Group's wholesale funding, its borrowings from other institutions, includes securitisation funding, warehouse bank debt and retail and Tier-2 corporate bonds, each of which are issued from time to time where appropriate and cost-effective. The Group's Long-Term Issuer Default Rating, a measure of its strength as an issuer, was upgraded from BBB to BBB+ by Fitch in March 2022, with a stable outlook.

Capital markets remained strong in the period with demand for new issuance high in the securitisation, tier-2 and AT1 markets, although conditions weakened after the period end.

The Group renegotiated its £400.0 million warehouse funding facility during the period, extending the maximum drawing to £450.0 million and transitioning the interest margin from 0.60% above LIBOR to 0.50% over SONIA, reducing the cost of funds drawn. This facility is used to provide additional funding capacity, as well as providing an alternative funding route in the event of market disruption elsewhere, where funds need to be deployed rapidly or where an alternative to retail deposit funding is preferred.

Historically the Group has been one of the principal issuers of UK residential mortgage backed securities ('RMBS'), however its reliance on this funding source has been significantly reduced over recent years, with the most recent issuance held internally rather than placed in the market. No new issues have been made in the period, but securitisation remains a key part of the Group's funding strategy.

The Group's retail bond issued in 2015 was repaid at maturity in January 2022.

While the wholesale part of the Group's funding remained largely stable in the period, these initiatives improved the maturity profile and enhanced the overall cost of funds.

3.4 FUNDING OUTLOOK

The Group's funding base remains strong and flexible, with the retail savings business continuing to develop, including through the issue of its first green products, and the tenor and rates of its wholesale and central bank borrowings improved. Together these delivered benefits to the Group's cost of funds in the period. The continued close management of funding costs in a period of base rate volatility will be key to the Group's future margin progression.

The business is well placed to continue to maintain and enhance this diverse, robust and adaptable funding strategy, to support the growth, sustainability and strategic development of the Group into the future.

4 CAPITAL AND LIQUIDITY REVIEW

The Group's capital policy is designed to provide attractive returns to shareholders, preserve the strength of its balance sheet, maintain strong regulatory capital and liquidity positions that safeguard its depositors, and to ensure sufficient capital is available to meet strategic objectives and opportunities going forward.

Over recent periods the Group has strengthened its capital and liquidity positions as a safeguard against the risks of the Covid pandemic. As the impacts from the virus have become clearer and the immediate impacts on the economy have receded, those positions have been cautiously unwound, whilst remaining mindful of other emerging risks.

The Group has continued its distribution policy, pursuing the buy-back programmes described in the most recent annual accounts and proposing an interim dividend for the period of half the 2021 final dividend in line with policy.

For regulatory purposes the Group's capital comprises shareholders' equity and its Tier-2 green bond. It has no outstanding AT1 issuance, but has the capacity to issue such securities, if considered appropriate, under an authority renewed by shareholders at the Annual General Meeting held in March 2022.

4.1 REGULATORY CAPITAL

During the half year the Group has continued to maintain strong regulatory capital ratios, with capital balances being carefully managed in response to the developing progress of the Covid pandemic and its aftermath, along with other economic developments.

The Group is subject to supervision by the Prudential Regulation Authority ('PRA') and as part of this supervision the regulator sets a Total Capital Requirement ('TCR'), the minimum amount of regulatory capital which the Group must hold. The TCR is defined under the international Basel III rules, which are implemented through the PRA Rulebook.

The TCR includes elements determined based on the Group's Total Risk Exposure ('TRE') together with fixed elements and is held in order to safeguard depositors in the event of severe losses being incurred by the Group.

Transitional relief on the adoption of IFRS 9 was granted to the Group, along with most other UK banks. Additional relief was granted in 2020 for the impact on capital of provisions created in response to the Covid pandemic. This relief is being phased out year by year, while any reversal of Covid-related provisions will generate a corresponding reduction in relief.

Interim Management Report (Continued)

4 CAPITAL AND LIQUIDITY REVIEW (Continued)

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

	Regulatory basis			Fully loaded basis		
	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m
Capital						
CET1 capital	1,092.4	1,057.3	1,055.8	1,070.5	1,015.9	1,026.1
TRC	1,242.4	1,203.8	1,205.8	1,220.5	1,161.5	1,176.1
Requirement						
TCR	625.8	585.9	604.2	623.9	582.4	601.8

The Group's CET1 capital comprises its equity shareholders' funds, adjusted as required by the Regulatory Capital Rules of the PRA, and can be used for all capital purposes. TRC, in addition, includes tier 2 capital in the form of Tier-2 Bonds, including the Group's green bond. This tier 2 capital can be used to meet up to 25% of the Group's TCR. The increase in both capital measures is driven by the positive trading performance over the six months and the reduction in the Group's pension deficit, which outweighed the impact of the proposed dividend and the share buy-backs in the period.

The TCR is specific to the Group and is set by the regulator, based on its supervisory reviews. The increase in requirements shown above relates principally to the growth in the Group's asset base over the periods shown. The TCR at 31 March 2022 represents 8.8% of TRE, in line with the 8.8% calculated at 30 September 2021 and the 8.9% at 31 March 2021, and the regulatory minimum of 8.0%.

The Group's CET1 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 TRE. During the period the CCoB remained at 2.5%, its long-term rate, while the CCyB remained at 0.0%, the rate set by regulators in response to the Covid pandemic. The long-term rate of the CCyB in normal circumstances is expected to be 2.0% and the Bank of England has announced an increase to 1.0% from December 2022.

The capital requirement in respect of these CRD IV buffers increased in the period to £177.4 million at 31 March 2022 (30 September 2021: £170.9 million) on the regulatory basis.

Further buffers may be set by the PRA on a firm-by-firm basis but may not be disclosed.

Interim Management Report (Continued)

4 CAPITAL AND LIQUIDITY REVIEW (Continued)

The Group's capital ratios, after allowing for the proposed interim dividend and the irrevocably committed element of the buy-back programme, are set out below.

	Regulatory basis			Fully loaded basis		
	31 March 2022	31 March 2021	30 September 2021	31 March 2022	31 March 2021	30 September 2021
CET1 Ratio	15.4%	16.0%	15.4%	15.1%	15.5%	15.1%
Total Capital Ratio	17.5%	18.2%	17.6%	17.3%	17.7%	17.3%
UK Leverage Ratio	7.4%	7.7%	7.5%	7.3%	7.4%	7.3%

The Group's capital ratios remained relatively stable over the period, with the additional capital generated from profitable trading required to support the asset growth in the period. As the IFRS 9 reliefs gradually phase out, the measures on the fully loaded basis are converging to those on the regulatory basis.

The Basel Committee on Banking Supervision ('BCBS') originally set the implementation date for its revisions to the Basel III framework (Basel 3.1) as 1 January 2023. This was, however, subject to those revisions being enacted in the relevant jurisdiction, a process which has been delayed by the pandemic. In the UK these rules are expected to be enacted through the PRA Rulebook and the regulator has indicated a delay to its target implementation date to 1 January 2025. The regulator has also announced its intention to publish a consultation paper on the implementation of Basel 3.1 in the UK in the fourth quarter of the 2022 calendar year.

The PRA has also launched a more extensive consultation on its approach to regulating non-systemically important banks without international activities, although the initial focus of this exercise is to be on banks with assets of less than £15 billion. The Group is monitoring these developments and will respond through its capital planning as appropriate.

The Group submitted the second stage of its application for the accreditation of its Internal Ratings Based ('IRB') approach to buy-to-let credit risk for capital adequacy purposes to the PRA in March 2021. The project continues to progress to plan, albeit the PRA are still developing their requirements based on work they are currently undertaking on existing IRB banks' hybrid models. The overall application process is therefore likely to take longer than originally anticipated to allow for the inclusion of these revised requirements in the Group's models and their consequent review by the PRA as part of the application process.

4 CAPITAL AND LIQUIDITY REVIEW (Continued)

4.2 LIQUIDITY

The Group's policy is to hold sufficient liquidity in the business to meet its long and short-term cash requirements, as well as to provide a buffer under stress, at all times operating within regulatory requirements. This policy has a consequent effect on the Group's operational capital and funding requirements.

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

The LCR is a measure of short-term resilience which compares available highly liquid assets to forecast short-term outflows, calculated according to a prescribed formula, with a 30-day horizon. The monthly average of the Bank's LCR for the period was 148.8% compared to 175.8% during the first six months of the 2021 financial year, and 165.6% during the 2021 financial year as a whole. These movements reflect the Group's build-up of liquidity buffers in response to Covid during 2020, and the relaxation of these buffers as the effects of the pandemic became clearer.

The NSFR is a longer-term measure of liquidity with a one-year horizon, supporting the management of balance sheet maturities. At 31 March 2022 the Bank's NSFR stood at 121.2% (30 September 2021: 119.6%, 31 March 2021: 119.3%), reflecting a marginal strengthening of the position.

4.3 DIVIDENDS AND DISTRIBUTION POLICY

The Group manages its capital cautiously and has a strong cash position at 31 March 2022. Coupled with the operating profit in the period this means that it remains appropriate for the Group to return capital to its investors, both in the form of dividends and through share buy-backs.

The Group's policy is that the interim dividend should, in normal circumstances, be equal to 50% of the preceding final dividend. Following a review of the capital position and forecasts, and considering the capital impacts of the stress testing carried out as part of the ICAAP and forecasting processes, the Board determined that a distribution in accordance with the Group's normal policy was appropriate.

It therefore declared an interim dividend for the year ending 30 September 2022 of 9.4 pence per share (2021 H1: 7.2 pence), 50% of the 18.9p final dividend declared for 2021. This dividend will absorb £22.7 million of capital and will be paid on 29 July 2022 to shareholders on the register on 8 July 2022.

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

At the time of publication of the Group's 2021 results it announced that the Board had authorised a share buy-back of up to £50.0 million of shares in the market, in addition to the completion of the remaining small element of the June 2021 buy-back programme.

4 CAPITAL AND LIQUIDITY REVIEW (Continued)

In the six month period the Group had expended £27.2 million (including costs) on the acquisition of its own equity, acquiring 5.0 million shares. The Group gave an irrevocable authority for the acquisition of further shares under this programme during the half year closed period, leaving £12.5 million still to be disbursed at the date of approval of this report.

Given the strength of the capital position at 31 March 2022 and the robust trading performance, the Board has authorised a £25.0 million extension to the programme, which is expected to be completed in the second half of the financial year.

The Group has the authority to make such purchases under a resolution approved by shareholders at the Annual General Meeting in February 2021 and renewed in March 2022. All purchases made under this programme are announced through the Regulatory News Service ('RNS') of the London Stock Exchange on the day of the transaction. All shares purchased are initially to be held in treasury.

4.4 CAPITAL OUTLOOK

The Group has a strong capital base and liquidity and has demonstrated the strength of its processes for forecasting and managing its position. Its requirements are kept under regular review, in light of the level and form of capital required by the current business, its strategic priorities and the regulatory and economic outlook.

The Group's position allows for a strong level of return to shareholders, both in the form of dividends and share buy-backs, even after the return of CCyB requirements and the withdrawal of IFRS 9 reliefs are factored in. This position remains both prudent and sustainable and helps ensure the viability of the business for the benefit of all stakeholders.

Interim Management Report (Continued)

5 FINANCIAL RESULTS

The Group's results for the six months ended 31 March 2022 reflect a continuation of the momentum reported at the 2021 year end. Operating profit before impairment provisions increased by 20.1% compared to the first half of the 2021 financial year, to £106.8 million (2021 H1: £88.9 million). The easing of Covid pressures and continued strong growth in UK house prices saw the reversal of impairment provisions and an increase of 27.3% in underlying profit to £105.5 million (2021 H1: £82.9 million) (Appendix A).

Upward pressures on market interest rates resulted in significant fair value gains being booked on derivatives held to hedge the Group's new lending pipeline. While the impact of these gains increased profit before tax on the statutory basis by 49.0% to £143.6 million (2021 H1: £96.4 million), operationally these represent timing differences which will reverse in future periods, rather than core income to the Group and they are therefore excluded from underlying performance in the Group's disclosures.

These results, coupled with the Group's share buy-back programme, generated an increase in underlying earnings per share ('EPS') of 29.4% to 32.6 pence per share (2021 H1: 25.2 pence) (Appendix A), while EPS on the statutory basis increased 51.5% to 44.4 pence per share (2021 H1: 29.3 pence).

5.1 CONSOLIDATED RESULTS

CONSOLIDATED RESULTS
For the six months ended 31 March 2022

	2022 H1 £m	2021 H1 £m
Interest receivable	254.7	238.6
Interest payable and similar charges	(79.5)	(91.1)
Net interest income	175.2	147.5
Other operating income	6.5	7.2
Total operating income	181.7	154.7
Operating expenses	(74.9)	(65.8)
Provisions for losses	(1.3)	(6.0)
	105.5	82.9
Fair value net gains	38.1	13.5
Operating profit being profit on ordinary activities before taxation	143.6	96.4
Tax charge on profit on ordinary activities	(34.5)	(22.2)
Profit on ordinary activities after taxation	109.1	74.2

5 FINANCIAL RESULTS (Continued)

	2022 H1	2021 H1
Basic earnings per share	44.4p	29.3p
Diluted earnings per share	43.0p	28.3p
Dividend – rate per share for the period	9.4p	7.2p

Income

Total operating income for the six months increased by 17.5% to £181.7 million (2021 H1: £154.7 million), with loan interest continuing to form the largest part of the balance.

The Group increased its net interest margin ('NIM') by 25 basis points (Appendix B) compared to the first half of 2021, with tighter retail funding costs and changes in product mix delivering improved yield. When coupled with a 7.3% increase in the average loan book to £13,658.8 million (2021 H1: £12,723.9 million), this generated an increase of 18.8% in net interest income to £175.2 million compared to the first half of 2021 (2021 H1: £147.5 million).

The progression of the Group's annualised NIM, including and excluding the Idem Capital division, over the first half of each of the past five years is set out below.

	Total Basis points	Excluding Idem Capital Basis points
Six months ended 31 March		
2022	**257**	**248**
2021	232	220
2020	229	214
2019	224	189
2018	216	150

This demonstrates the improvement in the Group's NIM over the period, despite the rundown of the Idem Capital books, which had historically generated higher NIM than other parts of the business. This represents the careful long-term management of yields across the Group's businesses and improvements in the average cost of funds as the funding strategy has developed.

Other operating income was £6.5 million for the six month period, reduced from the £7.2 million reported for the first six half of the 2021 financial year. The reduction arises principally from a reduction in third party servicing income from non-core activities.

5 FINANCIAL RESULTS (Continued)

Costs

Operating expenses increased by 13.8% in the period, reaching £74.9 million (2021 H1: £65.8 million). The majority of this increase is driven by payroll costs, with employment-related costs comprising 66.9% of total operating costs.

The Group's average headcount in the period was 1,480, 4.7% greater than in the comparable period in 2021 (2021 H1: 1,413). Combined with an average 5% pay increase at the beginning of the period and a focus on specialist roles amongst new positions, this saw a 12.3% increase in people costs in the period.

The Group's wider cost base has also been impacted by increasing levels of inflation in the UK economy. The Group's digitalisation programme has also had a significant impact on cost, with major projects taking place across all the Group's principal business lines. Much of this work is carried out in-house, impacting on employment costs, but significant external expenditure is also being incurred. The reliance on internal resource means that the Group capitalises relatively little in respect of software developments, taking costs in current expenditure. Only £0.6 million of such costs were capitalised in the period (2021 H1: £1.4 million).

The Group's IRB programme has continued through the period, as described in section 4 above. While the benefits of the programme will be long-term, costs of developing the approach are expensed as they arise.

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

	As disclosed %	**Idem excluded %**
Six months ended 31 March		
2022	**41.2**	**41.7**
2021	42.5	44.1
2020	41.8	43.5
2019	42.8	49.1
2018	42.2	56.8

Total cost:income has remained broadly stable, despite the levels of expenditure incurred to develop the business for the future, and the falling away of Idem Capital income.

The efficiency of the Group's operations remains a key focus of its strategy. The Group continues to invest in digitalising the business and to develop its people and risk management processes. It has also transitioned to a new hybrid working model post-pandemic. Control of costs remains a priority, particularly in the current inflationary environment. Against this backdrop, the reduction in the cost:income ratio in the period is encouraging, however the achievement of a sustainably lower cost:income ratio remains a longer-term aspiration, rather than a short-term priority.

5 FINANCIAL RESULTS (Continued)

Impairment provisions

The gradual retreat of the Covid pandemic in the six months, and the unwinding of the effects of some of the UK Government's interventions in response to it, have increased the level of visibility around the drivers of expected credit loss ('ECL'). However, the Group has maintained a cautious, evidence-based approach to any potential revisions in its credit predictions. While there has yet to be significant utilisation of Covid-related provisions, except in a limited number of cases, the amount of excess cash balances in both the consumer and SME lending sectors is still providing a near-term cushion against default. There are increasing pressures on both consumers and businesses from interest rates and prices, both rising at rates not seen in many years, and the full impact of the present conflict in Ukraine on the UK economy is also uncertain.

The balancing of these factors has led to a charge of £1.3 million being reported in the half year (2021 H1: £6.0 million). The progress of the impairment charge and annualised cost of risk (Appendix B) in the first six months of each of the four years since the introduction of IFRS 9 in 2019 is set out below.

	Charge £m	**Cost of risk %**
Six months ended 31 March		
2022	**1.3**	**0.02**
2021	6.0	0.09
2020	30.0	0.49
2019	4.9	0.08

The half year ended 31 March 2020 saw the outbreak of the Covid pandemic and the largest part of the provisions made by the Group in response to Covid were booked in that period.

The absolute level of provision in the Group's balance sheet remains elevated. £55.2 million of provision was held at 31 March 2022, providing a coverage ratio of 40 basis points. This compares to £82.4 million (64 basis points) at 31 March 2021 and £65.4 million at 30 September 2021 (49 basis points), although remains higher than the £41.9 million (34 basis points) carried at 30 September 2019, before the onset of the virus.

With the Group's buy-to-let mortgage portfolio representing the largest part of its exposure, coverage ratios would normally be expected to fall as house prices rise, increasing the value of security held. Over the period between 30 September 2019 and 31 March 2022 the average loan-to-value ratio on the buy-to-let portfolio reduced from 67.4% to 59.2%.

Multiple economic scenarios and impacts

The calculation of ECL for IFRS 9 purposes requires the consideration of multiple economic scenarios. While the immediate impacts of Covid had begun to recede during the period, the uncertainties surrounding its longer-term effects continued to pose difficulties for economic forecasters, even before the beginning of conflict in Ukraine. The impacts of rising interest rates and inflation are also uncertain, especially given the prospects of changes on a scale not seen for some years.

5 FINANCIAL RESULTS (Continued)

The Group's approach to setting economic scenarios at 31 March 2022 is similar to that used at the previous year end. The Group's approach can be summarised as:

- A central scenario was derived based on public forecasts. This is somewhat less optimistic than the central scenario used at 30 September 2021, reflecting market expectations of higher interest rates and increased inflation.
- The upside and downside scenarios were derived from the central scenario, being more benign or severe variants of this, but broadly similar in trajectory.
- The severe scenario has been set to represent the population of potential negative outturns, whether through an economic downturn, a resurgence of the pandemic, or the effects of the conflict in Ukraine. As such it represents a radically different outcome for the UK to the other scenarios. This is largely based on the Bank of England's stress testing scenarios, but with a less optimistic outlook on house prices, the variable which has the most significant impact on the value of the Group's ECLs.

The weightings applied to each scenario have been held at those used at both 30 September 2021 and 31 March 2021. While the fading impacts of the pandemic might have led to a more benign reweighting of scenarios, the mounting headwinds from other directions militate against such a move. The forecast economic assumptions within each scenario, and the weightings applied, are set out in more detail in note 11.

To illustrate the impact of these scenarios on the Group's IFRS 9 models, the impairment provision at 31 March 2022 before post-model adjustments ('PMA's) has been recalculated, weighting each of the central scenario and the severe scenario at 100%, with the results shown below.

	Provision before PMAs £m	Cover ratio
Weighted average	41.1	0.29%
Central scenario	34.3	0.25%
Severe scenario	82.6	0.59%

The calculated provisions remain lower than might be expected, given the uncertain economic outlook. It is clear that this must relate, in part, to the model build process. The data on which the Group's ECL models were based includes relatively few observations under scenarios similar to those predicted, which will make any resulting model less reliable.

It is also clear that the additional cash reserves of businesses and households will delay the manifestation of underlying credit issues in the normal metrics, which will have the effect of reducing calculated ECLs.

To compensate for these effects, the Group calculates post-model adjustments ('PMA's) to ensure the adequacy of its ECLs.

5 FINANCIAL RESULTS (Continued)

Post-model adjustments

In order to ensure that its loan portfolios are adequately provisioned, the Group considers whether there are factors not fully captured by the modelling process, including economic conditions more generally which indicate a need for PMAs. Information considered includes credit data, customer and broker feedback received, the results of insight surveys, industry intelligence and expert knowledge within the business lines.

In the six month period, the dominance of Covid in these considerations reduced as the short-term impact of the pandemic receded and other economic factors such as the UK cost of living, rising interest rates and the conflict in the Ukraine became more significant.

The Group's impairment models rely on the historically observed linkage between actual credit indicators at the reporting date, such as credit bureau data and arrears metrics, and future credit being reliable in current circumstances. Where this is likely not to be the case, the predictive power of the models is diminished.

The derivation of these models is based on historic credit data and, as with all such models, their inherent reliability is higher when operating over scenarios similar to those previously observed than when dealing with novel situations.

In the present situation there is evidence that the availability of cash reserves in the economy, either built up over the Covid period or as a result of Government support, may be delaying the manifestation of credit issues and causing models to predict a lower ECL than is strictly appropriate. There is also no mechanism whereby the models can evaluate the long-term effects of 'scarring' from the pandemic on particular customers or industries.

It is also notable that the economic scenarios discussed above include variables such as inflation increasing more rapidly than historically observed, and to higher levels than seen for many years. This will inevitably reduce the effectiveness of the models.

To compensate for these effects, which would tend to understate ECLs, the Group applies PMAs, based on its experience and its understanding of current customer and market positions, to allow for the potential shortfall.

The requirement for PMAs relates primarily to two concerns: the extent to which ongoing Covid impacts are delaying defaults across the books, and supressing ECLs in the models; and the divergence of present economic forecasts from recent history, which potentially impacts on the ability of models to fully capture future uncertainties.

In order to size the requirement for PMAs across the loan book the Group has considered, on a portfolio-by-portfolio basis, the extent to which modelled provisions diverge from long-run experience and the appropriateness of such differences given the underlying economic environment at the period end. All available external information on general customer performance was analysed and the impact of the potential take-up of government support and other reliefs was assessed. The Group also considered whether there were any issues of post-Covid scarring applying to any particular industry.

Interim Management Report (Continued)

5 FINANCIAL RESULTS (Continued)

In conjunction with this analysis, the Group considered the potential for apparently well-performing accounts to default, for the reasons set out above, applying the market understanding and credit judgement of its experienced team. The SME lending business was a particular area of focus, given the prevalence of CBILS / BBLS funding in the customer base and the occurrence of a limited number of these types of default in the period.

The Group additionally considered the need for an uplift to ECLs to allow for the potential for cost of living, affordability and employment issues inherent in its economic forecasts.

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

	31.03.2022 £m	30.09.2021 £m	31.03.2021 £m	30.09.2020 £m
Mortgage Lending	7.8	8.9	19.2	14.0
Commercial Lending	6.3	10.2	7.3	5.8
Idem Capital	-	0.3	1.0	-
	14.1	19.4	27.5	19.8

These broader assessments were then allocated amongst accounts, focussing on higher risk segments, or accounts where sufficient data existed to identify any issues. In particular, Covid-related PMAs in the mortgage book were focussed on accounts previously having been granted payment holidays, which still show signs of increased payment volatility compared to other loans. Any accounts identified as being at significant risk by the PMA process were restaged appropriately.

The PMAs described above align the overall reported provision with current loss expectations, given the inherent uncertainties on a macro and micro level and based on the Group's internal monitoring of credit risk and customer contact metrics. The Group maintains a cautious approach, and will require more evidence of post-Covid customer behaviour, and of the effects of the new economic environment on defaults and model behaviour, before significantly amending its approach to PMAs.

5 FINANCIAL RESULTS (Continued)

Ratios and trends

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

	31 March 2022 £m	30 September 2021 £m	31 March 2021 £m	30 September 2020 £m
Calculated provision	41.1	46.0	54.9	62.0
PMAs	14.1	19.4	27.5	19.8
Total	55.2	65.4	82.4	81.8
Cover ratio				
Mortgage Lending	0.27%	0.30%	0.43%	0.44%
Commercial Lending	1.18%	1.74%	2.00%	1.85%
Idem Capital	1.01%	1.27%	1.79%	1.62%
Total	**0.40%**	**0.49%**	**0.64%**	**0.64%**

The coverage ratios continue to demonstrate the movement in the Group's overall provisioning back towards more normal levels, although remaining higher than the 0.34% coverage ratio seen at 30 September 2019, before the outbreak of the pandemic. This level was recorded when security cover in the buy-to-let book was lower, with an average loan to value of 67.4% compared to the 59.2% recorded at 31 March 2022. The extent to which coverage levels revert to these levels will depend on future performance of the UK economy and on the emergence of reliable evidence on the underlying credit quality of the Group's loan assets.

Fair value movements

The fair value gains reported in the profit and loss account relate entirely to the Group's hedging operations. No speculative derivative trading is undertaken. The Group hedges against its pipeline of fixed rate mortgage business to ensure that desired yield levels are achieved on completed loans. However accounting standards require that while such derivatives form an economic hedge, they must be fair valued for accounting purposes and any gain taken to profit. Where market interest rate expectations move significantly, this leads to the recording of large gains or losses, which will ultimately reverse over the lives of the loans being hedged.

During the period there was a high level of volatility in interest rate expectations, which has created a fair value gain of £38.1 million for the six months (2021 H1: £13.5 million). These gains are non-cash movements, and the Group has consistently excluded them from its definition of operating profit as distortive and unhelpful in assessing the Group's true performance.

5 FINANCIAL RESULTS (Continued)

Taxation

The effective tax rate of the Group in the period was 24.0%, with the increase from the rate in the comparable period in the previous year principally a result of a higher proportion of the Group's profit, including the majority of fair value gains, arising in Paragon Bank. The Group operates in the UK only and materially all its profit falls within the scope of UK taxation. The standard rate of UK corporation tax applicable in the period was 19.0%, with the surcharge applicable to Paragon Bank profits at 8.0%, both as in the previous year.

While the standard rate of taxation applicable to the Group will rise to 25.0% from April 2023, this will be mitigated, to some extent, by a reduction of the bank surcharge to 3.0% and an increase in the profit threshold over which it becomes chargeable, both enacted in the period.

Result

The Group's overall consolidated profit before tax for the six month period was £143.6 million (2021 H1: £96.4 million) an increase of 49.0%. Profit after tax increased by 47.0% to £109.1 million (2021 H1: £74.2 million). In addition, other comprehensive income of £10.6 million was recorded (2021 H1: £4.0 million) mostly related to valuation gains on the Group's defined benefit pension plan (the 'Plan').

As a result of these, total consolidated equity increased to £1,279.7 million (31 March 2021: £1,203.8 million) and consolidated tangible equity to £1,109.6 million (31 March 2021: £1,033.3 million), representing a tangible net asset value ('NAV') of £4.59 per share (31 March 2021: £4.07 per share) and a NAV on the statutory basis of £5.30 (31 March 2021: £4.74) (Appendix D).

The information on related party transactions required by DTR 4.2.8(1) of the Disclosure Guidance and Transparency Rules is given in note 25.

5 FINANCIAL RESULTS (Continued)

5.2 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 2022

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m
Loans to customers			
Mortgage Lending	11,999.2	11,130.6	11,608.7
Commercial Lending	1,719.7	1,427.1	1,568.8
Idem Capital	196.0	258.6	225.2
	13,914.9	12,816.3	13,402.7
Derivative financial assets	201.7	180.7	44.2
Cash	1,500.4	2,103.0	1,360.1
Pension surplus	4.4	-	-
Intangible assets	170.1	170.5	170.5
Other assets *	(40.5)	218.3	159.5
Total assets	15,751.0	15,488.8	15,137.0
Equity	1,279.7	1,203.8	1,241.9
Retail deposits	9,853.7	8,631.2	9,300.4
Other borrowings	4,460.1	5,466.8	4,451.4
Derivatives financial liabilities	32.5	76.2	43.9
Pension deficit	-	11.8	10.3
Other liabilities *	125.0	99.0	89.1
Total equity and liabilities	15,751.0	15,488.8	15,137.0

* *Other assets and other liabilities include fair value hedging adjustments on loans to customers and retail deposits respectively (note 12).*

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

Despite the continuing uncertainties in the UK economy, the portfolio increased by 8.6%, year-on-year, with particularly strong growth in the Commercial Lending division, and continuing amortisation of the Idem Capital books. These movements are discussed in more detail in the lending review (Section 2 above).

5 FINANCIAL RESULTS (Continued)

Funding structure and cash resources

Overall the Group's retail and wholesale debt funding increased by 1.5% year-on-year, with the impact of the loan book growth offset by a relaxation of liquidity policy which saw cash balances reducing 28.7% over the last twelve months. The funding mix continued to move towards retail funding with 68.8% of debt funding represented by savings balances at 31 March 2022 compared to 61.2% at 31 March 2021. These movements are discussed in more detail in Section 3 above.

Derivatives

All the Group's derivative assets and liabilities relate to hedging arrangements for fixed rate mortgage and savings products. These are shown on the balance sheet at fair value, which is a function of movements in market expectations of interest rates. Increased expectations of interest rate rises generated growth in such assets from £27.7 million at 31 March 2021 to £201.7 million at 31 March 2022 (30 September 2021: £44.2 million). Derivative assets at 31 March 2021 includes £153.0 million of cross-currency basis swaps, relating to securitisation transactions paid down in 2021. Interest rate expectations also impacted derivative liabilities, which reduced to £32.5 million (31 March 2021: £76.2 million, 30 September 2021: £43.9 million).

While the element of these movements relating to pipeline hedging contributed towards the fair value movements in the profit and loss account described above, they were largely offset by movements in the balance hedge accounting adjustments, with the adjustment to loans to customers (included in sundry assets above) credited by £157.0 million in the six months and that to retail deposits (included in sundry liabilities) debited by £27.9 million (note 12).

Pension obligations

The valuation basis prescribed by IAS 19 for pension exposures requires the underlying assumptions to be based on market interest and bond rates at the period end, and can be subject to fluctuations where different market measures do not move at the same rate. During the period corporate bond yields, used to derive the discount rate, increased faster than long-term gilt yields, used to model inflation, eliminating the accounting deficit on the Plan and generating a surplus of £4.4 million at the period end (31 March 2021: £11.8 million, 30 September 2021: £10.3 million).

While the IAS 19 valuation is required to be used in the Group's accounts, pension trustees generally use the technical basis set out in the Pensions Act 2004. On this basis, which includes the effect of a charge given over the Group's head office building, the Plan had a surplus of £1.5 million at 31 March 2022 (31 March 2021: £5.8 million, 30 September 2021: deficit of £1.0 million), meaning that the scheme was fully funded on this basis. A full triennial valuation of the Plan is taking place as of 31 March 2022, and the Group's future levels of contribution will be agreed with the Trustee following the completion of the exercise.

5 FINANCIAL RESULTS (Continued)

Other assets and liabilities

The movements in sundry assets and sundry liabilities relate principally to the movements in fair value adjustments described above. Excluding these movements sundry assets were £111.0 million (31 March 2021: £160.2 million, 30 September 2021: £154.0 million), driven by a reduced requirement to post collateral deposits against derivative liability positions, a further result of the movements described above.

Sundry liabilities excluding fair value adjustments increased significantly to £155.9 million (31 March 2021: £95.9 million, 30 September 2021: £92.1 million), with the principal movement being a substantial increase in collateral received from counterparties to derivative asset positions.

5.3 SEGMENTAL RESULTS

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

	Six months to 31 March 2022 £m	Six months to 31 March 2021 £m	Year to 30 September 2021 £m
Segmental profit			
Mortgage Lending	116.6	92.4	213.8
Commercial Lending	41.6	37.6	75.7
Idem Capital	6.6	8.7	17.1
	164.8	138.7	306.6
Unallocated central costs and other one-off items	(59.3)	(55.8)	(112.4)
	105.5	82.9	194.2

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

5 FINANCIAL RESULTS (Continued)

Mortgage Lending

NIM in the Group's core Mortgage Lending operation continued to improve in the period, increasing by 19 basis points to 207 basis points. This was driven by the gradual replacement of legacy assets by new business and a tightening of funding costs. Coupled with a 7.6% increase in the average mortgage book to £11,804.0 million (31 March 2021: £10,975.0 million) this generated an 18.4% increase in net interest for the segment to £122.1 million (2021 H1: £103.1 million).

Credit performance in the mortgages books has remained strong, even as the impacts of Covid-related government support initiatives diminishes. This has driven a net release of £1.0 million of impairment provision in the six months (2021 H1: charge of £4.9 million).

Together these created an increase of 26.2% in contribution made by the segment to group profit to £116.6 million for the six months compared to the corresponding period in 2021 (2021 H1: £92.4 million).

Commercial Lending

Segmental profit in the Commercial Lending division increased to £41.6 million, an increase of 10.6% compared to the first half of 2021 (2021 H1: £37.6 million).

Net interest for the portfolio increased by 15.9% compared to the first half of 2021. This was largely driven by an 11.8% increase in the average loan book to £1,644.2 million (31 March 2021: £1,471.0 million), but also reflects a 24 basis point improvement in NIM between the two periods, generated through product mix changes, yield management and tighter funding costs.

Impairment charges for the period, at £3.2 million were increased by 146.2% compared to the first half of 2021 (2021 H1: £1.3 million). Impairments in this division, particularly for SME lending balances have reversed more slowly following the Covid pandemic, compared to the Group's other portfolios. The UK Government's RLS, CBILS and BBLS initiatives supplied significant cash liquidity into the SME sector and there is evidence that some part of this cash remains available to satisfy finance liabilities in the short term, potentially deferring defaults in the sector. The charge was also impacted by a significant one-off external fraud case, which also affected a significant number of other lenders in the sector, in many cases relatively more severely.

Idem Capital

The contribution from the Idem Capital division continues to reduce as the loan portfolio amortises. Segmental profit was reduced by 24.1% to £6.6 million, compared to the first half of 2021 (2021 H1: £8.7 million), broadly in line with the 24.2% decline in the average loan balance.

6 OPERATIONAL REVIEW

The success of the Group's strategy is based on the strength of its people, systems and controls and the continuing development of these alongside the evolution of its business is an ongoing focus at senior management levels. The Covid pandemic demonstrated the Group's agility and flexibility in resource deployment, which are fundamental to the execution of this strategy.

It was very pleasing that the Group's commitment to its people was recognised by the award of Platinum Investors in People ('IiP') status, the highest level available, achieved by only 3% of employers assessed.

The easing of Covid restrictions during the six months has seen a continual development of working arrangements as employees increasingly returned to the Group's premises, and hybrid working methods were trialled and then adopted on an ongoing basis. At the same time IT and process developments continued to progress, supporting the Group's digitalised vision of its future operating model, while the enterprise risk management framework has further evolved to ensure that the business remains robust.

All these streams combine to give the Group an operational structure on which it can rely to deliver its business strategy.

6.1 OPERATIONS

The Group now has over 1,500 people, the majority of whom have a base in one of its office buildings, which they use as part of a hybrid working model. In order for the Group to provide the best possible service to customers and remain successful, individual business areas have taken different approaches to implementing the flexibility this offers. This approach was adopted in the period, building on the experience of people working from home during the Covid pandemic.

The Group's success in continuing to progress the development of new systems, processes and products during the Covid pandemic meant that it entered the half year well positioned to deliver enhancements in the period.

During the six months the Group was able to complete or progress a significant number of technological, operational and regulatory projects. Long-term projects to provide better technology for the development finance, SME lending and savings operations continued in the period, with enhancements becoming available to support customers and intermediaries, while shorter term projects provided enhancements to surveyors' administration, treasury systems, video conferencing, email and cyber security and interactions with vulnerable customers.

The operational resilience of the business remains an important area of focus for the Group. During the period the formal self-assessment required by regulators was successfully completed, endorsing the Group's investment of time and resources in this area over recent periods.

6 OPERATIONS (Continued)

The Group considers that its offices remain valuable in the new era of hybrid working. Offices will play a significant role in fostering collaboration, collegiality, creativity and the growth of the Group's culture and identity. The Group continues to review its locations to ensure they are optimised for new working methods and to manage their energy efficiency. As part of that process the Group's SME lending hub was relocated within the Southampton area, to a more suitable building with a better environmental impact. The Group's premises in Cardiff and Poole were also replaced with more appropriate facilities.

The Group has maintained its focus on high quality customer service throughout the period and is currently working to embed the new FCA Customer Duty requirements in its systems and processes. The Group focusses on FOS complaints data as a high level satisfaction metric, and incident levels remained low throughout the period.

Consolidated information for the two group companies required to report to FOS, for the four most recent FOS reporting periods, is set out below.

	Six months ended			
	31 December 2021	30 June 2021	31 December 2020	30 June 2020
Cases reported	35	50	60	40
Uphold rate	34.2%	34.0%	43.3%	41.3%

FOS data across the financial services industry is published on the ombudsman's website at www.financial-ombudsman.org.uk. However, the Group's complaint level has regularly been below the threshold for publication.

6.2 GOVERNANCE

The period has seen the further normalisation of the Group's governance, following Covid, with more in-person interaction and face-to-face meetings. However, the continuing impact of the pandemic has continued to be a major focus for the Board, as well as newer threats to the UK economy, including those relating to events in Ukraine and wider pressures on the costs of living and doing business.

The Group continues to be subject to the 2018 UK Corporate Governance Code ('the Code') and the Group's procedures for compliance with the Code are set out in the Annual Report and Accounts for 2021. The Group continued to comply with the principles of the Code during the period. The Group adopted the 'comply and explain' approach under Provision 19 of the Code to extend the Chair's tenure past nine years for succession planning purposes and to ensure the appointment of a suitable replacement Chair, as set out below.

6 OPERATIONS (Continued)

Board of Directors

As announced in the Group's 2021 year end results, Fiona Clutterbuck intends to step down as Chair once a suitable candidate is appointed, and after an appropriate handover period. During the period the Group has been progressing the search for a new Chair and the result will be announced once an appointment is finalised and regulatory approval received.

The Group is conscious of the need to ensure that the Board contains an appropriate balance of skills, experiences and diversities. It has noted the recent comments on diversity and governance from the PRA and the FCA, as well as in the corporate world more generally and is in the process of appointing an additional non-executive director, bearing this thinking in mind. Once finalised this appointment will be announced to the market.

As at 31 March 2022, the Board had three female directors out of a total of eight board members, forming 37.5% of the Board. This included the Chair of the Board, one of the four most senior board positions, as defined by the FCA.

Remuneration policy

The PRA remuneration rules applicable to the Group were changed with effect from the current financial year as it now qualifies as a Proportionality Level 2 ('Level 2') bank, bringing it within the scope of more onerous rules. This is a result of both the reduction in the asset threshold defining a Level 2 bank from £15 billion to £13 billion, announced by the PRA in December 2020, and of the development of the rules themselves. Affected employees have been determined and the changes required identified. The principal changes relate to the arrangements for the provision of variable remuneration to such people and the introduction of clawback and malus provisions to a larger group of employees. Changes relating to executive directors' remuneration arrangements were described in the 2021 Directors' Remuneration Report.

The Group's triennial review of its Directors' Remuneration policy will be progressed during the second half of the financial year, for presentation at the 2023 Annual General Meeting. Consultations will be held with shareholders, investor bodies and other stakeholder groups, and we would urge such persons to participate if invited.

6.3 PEOPLE

At 31 March 2022, the Group employed 1,507 people, an increase of 5.7% from March 2021, and of 4.5% in the half year period. Most of these new roles are in customer facing areas of the business. These people, and the way they embody the Group's values in their working lives, are fundamental to the achievement of the business strategy and it was particularly pleasing to be recognised as a Platinum Standard employer in the recent Investors in People reassessment.

6 OPERATIONS (Continued)

Conditions and culture

The Group has adopted hybrid working across the business on a permanent basis, following trials of various hybrid models over a number of months. The Board and executive team are confident that employees can work effectively, meeting business needs, and serving customers whilst working in different locations.

The Group promotes flexibility around how and where its people work, so that a healthy work life balance can be achieved. No single approach will be optimal for all roles and work continues at all levels of the business to identify the most effective work patterns for people, teams and functions. The Group understands the benefits that more flexible ways of working bring for many of its employees, and a project is underway to ensure that the technological, environmental, cultural and wellbeing needs of both the employees and the business are addressed as the process of embedding this new way of working continues.

The Group's triennial reaccreditation review process for IiP took place in March 2022 resulting in an upgrade to Platinum Standard, the highest available. This represents an endorsement of the Group's high performance culture and focus on its people. This accreditation is only held by around 1,500 employers, 3% of the over 50,000 firms assessed. In the IiP assessors' feedback they noted that:

"Achieving this level of maturity during a global pandemic is exceptional and reflects the high levels of resilience, collaboration and empowerment established within Paragon's people. Paragon ensures that everyone has a clear focus on outcomes-based high performance and enables people to take responsibility for their performance, talent development and continuous improvement. Consequently employees outperform expectations with passion and a strong sense of pride interlaced with a pinch of humour and clear integrity."

The Group maintains its accreditation from the UK Living Wage Foundation and minimum pay continues to meet the levels set by the Foundation, last updated in November 2021. Holiday entitlement was enhanced during the year, with all employees receiving an extra day's holiday, increasing the maximum to 31 days. The Group also allowed employees to carry over an additional five days holiday into the 2022 / 23 holiday year and increased the amount of holiday which could be sold as temporary measures to support employees who had been unable to make use of their full holiday entitlements due to the impact of the Covid pandemic.

Despite the unprecedented labour turnover in the UK, the Group's annual attrition rate is running lower than pre-pandemic levels; 12.5% (March 2022) compared to 15.3% in March 2020 (March 2021: 6.9%). The Group continues to retain long-serving employees, with 30.2% of employees having achieved 10 years' service, of whom 12.6% had been with the Group for over 20 years. Despite these levels of talent retention, the growth of the Group means that vacancy numbers remain consistently higher than pre-pandemic and further investment is being made in technology to streamline the recruitment and on-boarding processes.

The Group's People Forum remains one of the main channels for employee opinions to be fed back to the Board and Executive Committee. Both the Chair of the Board and Chief Executive have met with the People Forum in the past six months, and discussions have covered topics including the Group's strategy; its approach to climate change and other ESG issues; and hybrid working.

6 OPERATIONS (Continued)

The wellbeing of the Group's employees remains central to its people strategy, and the Wellbeing Team remain the cornerstone of the approach. The Wellbeing Team is sponsored by the People Director and comprises a group of employees who have been trained as mental health first aiders. The team provide a source of support to employees and are there to signpost people to additional resources and avenues of support in relation to emotional, social, financial and physical wellbeing.

Equality and diversity

The Group remains focused on its equality, diversity, and inclusion ('EDI') agenda, with oversight from the Board. The EDI Network continues to lead campaigns to raise awareness and understanding of the importance of workforce diversity and an inclusive culture. Activities have included the launch of Executive Listening Circles, where members of the Executive Committee meet with employees from underrepresented groups to listen to their experiences and gain a different perspective, and the continued delivery of training including a new Inclusive Leadership course which has been attended by over 60% of managers.

The Group published its Gender Pay Gap report in March 2022 and reported a mean pay gap of 38.4% at 5 April 2021 (2020: 40.7%) and median gap of 36.6% (2020: 36.9%). Whilst the Group's 2021 gender pay gaps have improved slightly since 2020, the measures remain larger than senior management would like. The positive movement in results is attributable to the number of senior female hires in the period and the number of successful candidates for senior roles in sales and customer-facing roles was particularly pleasing. However, men still continue to occupy the majority of senior roles in the organisation.

The Group continues to meet the FTSE Women Leaders target of boards having 33% female representation (37.5% as at March 2022). The Group remains committed to HM Treasury's Women in Finance Charter; the Group set itself the target of achieving 35% of women in senior positions, using the FTSE Women Leaders definition by January 2022 and as at this date achieved 36.4% female representation. As of 31 March 2022, this position had improved further to 37.5% (34.6% as at March 2021). The first five-year phase of the Group's Women in Finance initiative ended in January 2022, with all targets met and it is now in the process of setting targets for the second phase to build on the progress to date.

The Group remains committed to developing female talent, particularly in specialisms where women have historically been under-represented. The latest cohort of the Group's senior leadership development programme has 56% female representation, and the Group continues to have mentors and mentees involved in the 'Women Ahead 30% Club', a cross-company mentoring scheme.

A lack of socio-economic diversity at senior level in UK financial services has been a concern for some time, and the Group is proud to have been part of the foundation of Progress Together, a new nationwide membership body focussed on addressing this, becoming a founder member at its launch in May 2022.

6 OPERATIONS (Continued)

Training and development

Developing the managers and leaders of the Group has continued to be an area of focus over the period. Training on Change Leadership, Leading Performance, Inclusive Leadership, Transformational Leadership and Leading a Customer Centric Culture continues to be delivered and well attended by the Group's management population. The Group's well established Team Leader and Management Academies also continue to run, with 45 employees currently enrolled on these programmes and plans to enrol more later in the year. Two cohorts of employees have passed through the High Potential Programme since its launch in 2021 with 33% of delegates having secured an internal promotion or change in role, supporting succession at senior management levels.

The Group continues to make use of the Apprenticeship Levy scheme, with four employees graduating from their apprenticeships and securing permanent roles in the business so far this year. There are currently ten full time apprentices working in the Group, with plans to recruit a further ten later in the financial year. As well as dedicated apprenticeship programmes, the Group utilises the levy through its Team Leader Academy programme. The Group utilised 29% of its available levy pot in the past twelve months (34% as at March 2021). The Group is also currently supporting 105 individuals with funding to complete professional qualifications (31 March 2021: 135). Students for the London Institute of Banking and Finance CeMap mortgage qualification continue to be the most numerous amongst these.

6.4 SUSTAINABILITY

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

- Reducing the impact of the Group's operations on the environment
- Ensuring that the Group has a positive effect on our stakeholders and communities
- Delivering sustainable lending through the design of products offered and the choices of sectors in which to operate
- Offering green savings products to facilitate customers' sustainable investment goals

Since 2021 the Group's overall response to climate change and other sustainability issues has been coordinated by the Sustainability Committee, which reports directly to the Executive Committee. This provides a forum for sharing information on initiatives within business areas and helps to develop the Group's overall response.

The Group published its first sustainability report, the 2021 Responsible Business Report, in December 2021. This provides more detailed information on its sustainability initiatives and demonstrates how sustainability is embedded throughout the Group. It is available on the Group's corporate website at www.paragonbankinggroup.co.uk.

6 OPERATIONS (Continued)

Climate change

Climate change is designated as a principal risk within the Group's Enterprise Risk Management Framework. As a result information and measures on climate change risks are considered at board level and the Group's responses are considered within the Board's overall strategy. These risks fall into two main groups:

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

The Green Bond Framework reflects the Group's commitment to embed sustainability throughout its strategy, operations, and product offerings including funding and capital raising activities. The Sustainability Committee is responsible for the Framework.

The Group recognises the importance of reducing the impact that its own operations have on the environment. As a financial services provider the Group's overall environmental footprint across its principal operations is low. The Group is, however, committed to identifying, measuring and managing the impact of its operations on the environment and to find ways to mitigate any negative impacts. During the six months key initiatives included:

- Installing electric vehicle charging points at the Group's head office building for use by employees
- Updating the company car policy so that only hybrid or electric vehicles will be provided on new leases, eliminating diesel and petrol vehicles from the company fleet by 2025. The Group's target is for a completely electric-only fleet by 2031
- Relocating the Group's Southampton, Cardiff and Poole operations to more energy efficient premises
- Continuing the rollout of LED lighting across the Group's principal sites

Developments in sustainable products and climate-related exposures are discussed in the relevant business reviews. Green initiatives launched or expanded in the six months included:

- Expansion of the green mortgage range, providing a green alternative to every product for customers whose properties have an EPC rating of C or higher
- A green homes initiative in the development finance operation to support the provision of new domestic properties with the highest energy performance standards
- Motor finance lending on battery electric vehicles

The Group continues to develop its reporting to manage both its risk management processes and its reporting under the principals set out by the Taskforce on Climate-Related Financial Disclosure ('TCFD'). The Group is required by the UK Listing Rules to report on climate change risk and exposures under the TCFD framework in its 2022 year end accounts, building on the disclosures introduced in 2021.

6 OPERATIONS (Continued)

Social engagement

The Group's Charity Committee raised almost £43,000 for the Alzheimer's Society, the employee's chosen charity for 2021, an outstanding result, given the restrictions imposed on normal fundraising activities by the pandemic. For 2022 employees voted to support Mind and fundraising has continued through the first three months of the year, both in the Group's offices and virtually.

Employees are also using their entitlement to an annual paid volunteering day, particularly as more opportunities become available with the loosening of Covid restrictions. Employees have already supported 15 projects with 10 different community organisations and the Group is targeting 250 volunteer days for 2022.

6.5 RISK MANAGEMENT

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

Risk environment

During the last six months the Group has continued to respond to the challenges posed by the ongoing pandemic, however the vaccine roll-out and the gradual return to pre-Covid society have enabled the Group to develop and implement a hybrid working model. This is seen as key to the Group's overall strategy, enabling it to retain and attract a strong workforce and remaining agile and resilient in its risk management capability. This is coupled with the Group's risk management framework which has provided a robust mechanism to ensure that new risks are promptly identified, assessed, managed and appropriately overseen from a risk governance perspective. However, it is recognised that the wider pandemic is still a global challenge, and the possibility of further waves and subsequent lockdowns may still pose further issues during the coming months.

Whilst Covid has dominated the recent risk landscape, there are a number of strategic risk issues which the Group has identified, or continued to focus on, during the six-month period:

- The impact of the ongoing conflict between Russia and Ukraine is still uncertain and the Group is monitoring the position carefully. In immediate response to the outbreak of the conflict the Group has identified and ringfenced any potential exposures to Russian, Belorussian or Ukrainian customers and suppliers and close oversight is being maintained through ongoing customer due diligence and risk assessment processes. In addition, the Group continues to invest in its cyber controls given heightened threat assessments posed by this situation

6 OPERATIONS (Continued)

- Increasing inflationary pressures in the UK have required the Group to ensure that high standards of prudent lending are maintained, particularly in an environment of rising interest rates and cost pressures for both new and existing borrowers. The Group takes a forward-looking, as well as current view of affordability, and has adjusted policy to ensure loan repayments are sustainable for customers, and will continue to do so
- The continued embedding of the Group's operational resilience capability, given its proven criticality in the handling of the pandemic, and the incorporation of lessons learned into the overarching framework. This will be key as the Russian-Ukrainian situation develops, given uncertainties around how impacts from the conflict may manifest themselves globally
- Prioritising focus on climate change given the associated risks, remains an ever-present challenge. The UK Government has confirmed its goal of net zero carbon by 2050 and the Group, and the rest of the financial services industry, have a vital role to play in that commitment. The Group considers the impacts of climate change risk through both its operations, and its lending activities and continues to evolve its approach to measure and mitigate the transition and physical risks potentially caused by climate change

These issues are expected to continue to dominate the risk landscape through the second half of the year, particularly with the overall levels of economic uncertainty in the UK and the prospect of levels of inflation and interest rates not seen for many years. The Group will carefully monitor the emerging impacts on both credit risk and the wider risk landscape as the situation develops.

The Group continues to review its exposure to emerging developments in the Brexit process as further clarity is received as to the UK's future trading and regulatory relationships with the EU. While the Group does not have operations outside the UK, it has continued to review the capital, liquidity and operational implications of the stresses which might be caused by the process. The Board has kept the situation under ongoing review throughout the period and continues to do so and considers that the Group is well placed to address the challenges.

Risk management processes

During the six-month period the Group has continued to invest in and mature its risk management capability, ensuring it is further developing its ability to manage all categories of risk as the business develops. Significant progress has been made in enhancing the Group's enterprise risk management framework ('ERMF') with the implementation of a revised suite of policies across principal risks, including revisions to risk appetites, and further work on the approach to embedding a robust and pervasive risk culture across the Group.

The continued evolution of the ERMF is a key strategic priority and considerable work has been undertaken to mature and expand risk processes and resources to ensure that all risks are managed within stated appetites. The Group continues to review its risk approach to ensure it remains effective and proportionate in terms of both maturity and operation and is committed to further enhancement of the ERMF over the coming years.

6 OPERATIONS (Continued)

Whilst the pandemic has continued to provide its own unique set of challenges through the half year, including re-deployment of resource and priorities, the Group is committed to continuing to deliver on key risk management initiatives in the period including:

- **Consumer duty** - Assessing the impact of the new FCA Consumer Duty on the products and services offered across the Group ensuring that the Group's culture is driving good outcomes for its customers
- **Operational resilience -** Ongoing embedding of operational resilience capabilities. This has included refinement of critical business services and tolerances, ensuring these considerations are embedded as part of day-to-day operations, together with enhancement of the Group's technology
- **Climate change -** Addressing the financial risks of climate change through key risk driver assessments, and consideration of the impacts of the wider ESG agenda across the Group's operations
- **IRB** - Continuing to develop IRB model methodologies across our buy-to-let and PDF portfolios and embed the overarching model risk framework to enhance credit risk management and support the Group's IRB application process. Phase 2 of the buy-to-let application was submitted to the PRA in March 2021 and PRA interviews are ongoing. Significant progress has been made on Phase 3 documentation for buy-to-let and Phase 2 documentation for development finance.
- **Outsourcing and suppliers** - Continued evolution and further embedding of the Group's approach to managing the risks and oversight of its outsourced relationships and important suppliers
- **Stress testing** - Enhancing stress testing procedures within the Group to ensure the robustness of capital and liquidity positions
- **Cyber security** - Ensuring that the Group's cyber-security controls and data protection approach continue to remain effective in the face of the rapidly evolving challenges in these areas and the current geopolitical risks arising from the conflict in Ukraine

Overall the level of regulatory compliance standards impacting the Group continues to increase, and it is committed to ensuring it remains compliant in all areas of its business, with particular focus on continuing to strengthen financial crime systems and controls, which have been an area of regulatory focus across the sector. Given the importance of ensuring that the Group's financial crime risk mitigation framework remains robust, a comprehensive programme of work has and continues to be undertaken in this area. The implementation of an enhanced anti-money laundering programme has resulted in widespread activity, with significant technological advancements and financial investments being made. Financial crime expertise has also been uplifted with recruitment into both first and second line functions.

6 OPERATIONS (Continued)

Principal risks and uncertainties

A summary of the principal risks and uncertainties faced by the Group, required by DTR 4.2.7(2) of the Disclosure and Transparency Rules, is set out on pages 158 to 163. These risks have not changed significantly since those disclosed at the 2021 year end.

6.6 REGULATORY CHANGES

Paragon Bank, which, for regulatory purposes, includes most of the Group's activities, is authorised by the PRA and regulated by the PRA and the FCA. The Group is subject to consolidated supervision by the PRA and a number of its subsidiaries are authorised and regulated by the FCA. As a result, current and projected regulatory changes, particularly the ongoing programme of 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 provide a robust mechanism to ensure that the impacts of all new regulatory requirements on the business are clearly understood and that appropriate preparations are made before implementation. Regular reports on key regulatory developments are received at both executive and board risk committees, assessing the potential implications for the Group, along with necessary actions.

Whilst the impact of Covid has largely driven the regulatory priorities since 2020, the Group is affected by a broad range of prudential and conduct regulations, given the nature of its operations. The Group therefore engages in regular dialogue with its regulators and continues to respond to regulatory requests in a timely fashion, focussing controls on the delivery of fair customer outcomes.

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

- **Consumer Duty** - The FCA issued draft rules relating to the 'Consumer Duty' in December 2021. This seeks to set higher expectations for the standard of care provided to customers and will result in new rules relating to communications, products and services, customer support and price and value. The Group has initiated a programme of activity to prepare for the final rules and implementation in 2023

- **Vulnerable customers** - The treatment of vulnerable customers continues to be a strong focus for the FCA, further supported by the Consumer Duty proposals. The Group continues to take its responsibilities in this regard seriously. Significant work continues to be undertaken to revise existing procedures, controls and training provisions to meet regulatory and industry expectations, and to enhance management information and analysis in relation to drivers of vulnerability

6 OPERATIONS (Continued)

- **Operational resilience** - Good progress continues to be made in developing and enhancing operational resilience capability across the Group following the publication of the final rules and guidance on this area in 2021. The Group has met the 2022 policy implementation deadline including identifying important business services, setting impact tolerances and embedding a scenario testing approach

  The Group's first self-assessment has been through governance and fully approved by the Board. Focus is now on continuous improvement of the resilience approach and ongoing assessment of vulnerabilities

- **Climate change** - The Group continues to work towards embedding its approach to managing climate-related financial risks in line with the PRA expectations. Managing the impacts of climate change is seen as a key strategic priority for the Group and climate risk considerations are embedded within the Group's ERMF. During 2021 the PRA published a report setting out its intention to begin supervision of climate related financial risks in 2022

  In response to supervisory expectations, the Group's 2022 ICAAP has considered the impact of climate change under a number of scenarios to ensure the Group is adequately capitalised. As the regulatory and wider requirements surrounding climate change risk continue to develop, the Group's approach will evolve to reflect emerging good practice in a manner that is proportionate to its climate exposure

- **MREL** - The Bank of England published a Statement of Policy ('SoP') in December 2021 setting out its expectation on MREL, taking effect from 1 January 2022. Although the Group does not have an MREL requirement currently as it is not a bail-in firm, this could be an area that impacts in future and therefore continues to be closely monitored

  The proposal included a longer transition period (extended from 3 years to 6), a 3-year notice period ahead of transition and the possible use of a 2-year flexible add-on. Additionally, the SoP has amended the transition glide path with the Bank of England now offering the possibility of using a two-step glide path

The consultation process for the incorporation of the prudential regulation regime previously set out in European legislation into UK law and regulation following Brexit continues to progress. While the expectation is that the majority of requirements will be directly transcribed, the PRA has indicated its willingness to depart from the EU text where it believes such a departure would enhance regulatory oversight in the UK. The Group will continue to monitor this process and respond as appropriate.

The Board and Executive Committee receive regular briefings on the progress of all these initiatives and overall, the Group considers it is well placed to respond to upcoming regulatory developments and ensure compliance in line with required timescales.

Statement of Directors' Responsibilities

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

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

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

MARIUS VAN NIEKERK

Company Secretary

14 June 2022

Board of Directors

F J Clutterbuck

(Chair of the Board)

B A Ridpath

(Non-executive director)

A C M Morris

(Non-executive director and Chair of the Audit Committee)

N S Terrington

(Chief Executive Officer)

H R Tudor

(Non-executive director, Chair of the Remuneration Committee and Senior Independent Director)

G H Yorston

(Non-executive director)

P A Hill

(Non-executive director and Chair of the Risk and Compliance Committee)

R J Woodman

(Chief Financial Officer)

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 2022 which comprises consolidated statement of profit or loss, consolidated statement of comprehensive income, consolidated balance sheet, consolidated cash flow statement, consolidated statement of movements in equity and the related explanatory notes.

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 31 March 2022 is not prepared, in all material respects, in accordance with IAS 34 *Interim Financial Reporting* as adopted for use in the UK and the Disclosure Guidance and Transparency Rules ('the DTR') of the UK's Financial Conduct Authority ('the UK FCA').

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.

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 28, the latest annual financial statements of the Group were prepared in accordance with International Financial Reporting Standards adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union and in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006 and the next annual financial statements will be prepared in accordance with UK-adopted international accounting standards. The directors are responsible for preparing the condensed set of financial statements included in the half-yearly financial report in accordance with IAS 34 as adopted for use in the UK.

INDEPENDENT REVIEW REPORT TO PARAGON BANKING GROUP PLC

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 Ryder for and on behalf of KPMG LLP

Chartered Accountants

66 Queen Square
Bristol
BS1 4BE

14 June 2022

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF PROFIT OR LOSS
For the six months ended 31 March 2022 (Unaudited)

	Note	Six months to 31 March 2022 £m	Six months to 31 March 2021 £m	Year to 30 September 2021 £m
Interest receivable	3	254.7	238.6	484.2
Interest payable and similar charges	4	(79.5)	(91.1)	(173.7)
Net interest income		175.2	147.5	310.5
Other leasing income		11.8	9.6	20.4
Related costs		(9.7)	(8.5)	(16.9)
Net leasing income		2.1	1.1	3.5
Other income	5	4.4	6.1	10.9
Other operating income		6.5	7.2	14.4
Total operating income		181.7	154.7	324.9
Operating expenses		(74.9)	(65.8)	(135.4)
Provisions for losses	11	(1.3)	(6.0)	4.7
Operating profit before fair value items		105.5	82.9	194.2
Fair value net gains	6	38.1	13.5	19.5
Operating profit being profit on ordinary activities before taxation		143.6	96.4	213.7
Tax charge on profit on ordinary activities	7	(34.5)	(22.2)	(49.2)
Profit on ordinary activities after taxation		109.1	74.2	164.5

	Note	Six months to 31 March 2022	Six months to 31 March 2021	Year to 30 September 2021
Basic earnings per share	8	44.4p	29.3p	65.2p
Diluted earnings per share	8	43.0p	28.3p	63.0p
Dividend – rate per share for the period	21	9.4p	7.2p	26.1p

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

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
For the six months ended 31 March 2022 (Unaudited)

	Note	Six months to 31 March 2022 £m	Six months to 31 March 2021 £m	Year to 30 September 2021 £m
Profit for the period		109.1	74.2	164.5
Other comprehensive income				
Items that will not be reclassified subsequently to profit or loss				
Actuarial gain on pension scheme	17	13.7	7.8	8.2
Tax thereon		(3.1)	(1.5)	(0.9)
		10.6	6.3	7.3
Items that may be reclassified subsequently to profit or loss				
Cash flow hedge (losses) taken to equity		-	(2.9)	(3.0)
Tax thereon		-	0.6	0.5
		-	(2.3)	(2.5)
Other comprehensive income for the period net of tax		10.6	4.0	4.8
Total comprehensive income for the period		119.7	78.2	169.3

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEET
31 March 2022 (Unaudited)

	Note	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m	30 September 2020 £m
Assets					
Cash – central banks	9	1,265.7	1,832.3	1,142.0	1,637.1
Cash – retail banks	9	234.7	270.7	218.1	287.9
Loans to customers	10	13,763.4	12,874.4	13,408.2	12,741.1
Derivative financial assets	12	201.7	180.7	44.2	463.3
Sundry assets		36.4	88.8	69.2	128.0
Current tax assets		0.7	3.0	-	5.7
Deferred tax assets		-	3.7	14.4	6.2
Retirement benefit obligations	17	4.4	-	-	-
Property, plant and equipment		73.9	64.7	70.4	66.1
Intangible assets	13	170.1	170.5	170.5	170.1
Total assets		15,751.0	15,488.8	15,137.0	15,505.5
Liabilities					
Short-term bank borrowings		0.4	0.1	0.3	0.4
Retail deposits	14	9,822.8	8,634.3	9,297.4	7,867.0
Derivative financial liabilities	12	32.5	76.2	43.9	132.4
Asset backed loan notes	15	477.1	2,011.3	516.0	3,270.5
Secured bank borrowings	15	871.3	755.7	730.0	657.8
Retail bond issuance	15	112.2	237.0	237.1	296.8
Corporate bond issuance	15	149.1	168.3	149.0	149.8
Central bank facilities	15	2,850.0	2,244.4	2,819.0	1,854.4
Repurchase agreements	15	-	50.0	-	-
Sundry liabilities	16	155.8	95.9	90.7	100.0
Current tax liabilities		-	-	1.4	-
Deferred tax liabilities		0.1	-	-	-
Retirement benefit obligations	17	-	11.8	10.3	20.4
Total liabilities		14,471.3	14,285.0	13,895.1	14,349.5
Called-up share capital	18	250.5	262.0	262.5	261.8
Reserves	19	1,075.8	976.9	1,056.1	932.0
Own shares	20	(46.6)	(35.1)	(76.7)	(37.8)
Total equity		1,279.7	1,203.8	1,241.9	1,156.0
Total liabilities and equity		15,751.0	15,488.8	15,137.0	15,505.5

The condensed financial statements for the half year were approved by the Board of Directors on 14 June 2022.

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED CASH FLOW STATEMENT
For the six months ended 31 March 2022 (Unaudited)

	Note	Six months to 31 March 2022 £m	Six months to 31 March 2021 £m	Year to 30 September 2021 £m
Net cash flow generated by operating activities	22	221.1	691.7	878.1
Net cash (utilised) by investing activities	23	(1.2)	(2.3)	(4.3)
Net cash (utilised) by financing activities	24	(79.7)	(511.1)	(1,438.6)
Net increase / (decrease) in cash and cash equivalents		140.2	178.3	(564.8)
Opening cash and cash equivalents		1,359.8	1,924.6	1,924.6
Closing cash and cash equivalents		1,500.0	2,102.9	1,359.8
Represented by balances within				
Cash	9	1,500.4	2,103.0	1,360.1
Short-term bank borrowings		(0.4)	(0.1)	(0.3)
		1,500.0	2,102.9	1,359.8

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF MOVEMENTS IN EQUITY
For the six months ended 31 March 2022 (Unaudited)

Six months ended 31 March 2022

	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	-	-	-	-	-	109.1	-	109.1
Other comprehensive income	-	-	-	-	-	10.6	-	10.6
Total comprehensive income	-	-	-	-	-	119.7	-	119.7
Transactions with owners								
Dividends paid (note 21)	-	-	-	-	-	(46.6)	-	(46.6)
Shares cancelled	(12.1)	-	12.1	-	-	(60.7)	60.7	-
Own shares purchased	-	-	-	-	-	-	(39.7)	(39.7)
Exercise of share awards	0.1	0.3	-	-	-	(9.8)	9.1	(0.3)
Charge for share based remuneration	-	-	-	-	-	4.4	-	4.4
Tax on share based remuneration	-	-	-	-	-	0.3	-	0.3
Net movement in equity in the period	(12.0)	0.3	12.1	-	-	7.3	30.1	37.8
Opening equity	262.5	70.1	50.3	(70.2)	-	1,005.9	(76.7)	1,241.9
Closing equity	250.5	70.4	62.4	(70.2)	-	1,013.2	(46.6)	1,279.7

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF MOVEMENTS IN EQUITY
For the six months ended 31 March 2022 (Unaudited) (Continued)

Six months ended 31 March 2021

	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	-	-	-	-	-	74.2	-	74.2
Other comprehensive income	-	-	-	-	(2.3)	6.3	-	4.0
Total comprehensive income	-	-	-	-	(2.3)	80.5	-	78.2
Transactions with owners								
Dividends paid (note 21)	-	-	-	-	-	(36.5)	-	(36.5)
Shares cancelled	-	-	-	-	-	-	-	-
Own shares purchased	-	-	-	-	-	-	-	-
Exercise of share awards	0.2	0.5	-	-	-	(2.6)	2.7	0.8
Charge for share based remuneration	-	-	-	-	-	4.4	-	4.4
Tax on share based remuneration	-	-	-	-	-	0.9	-	0.9
Net movement in equity in the period	0.2	0.5	-	-	(2.3)	46.7	2.7	47.8
Opening equity	261.8	68.7	50.3	(70.2)	2.5	880.7	(37.8)	1,156.0
Closing equity	262.0	69.2	50.3	(70.2)	0.2	927.4	(35.1)	1,203.8

CONDENSED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF MOVEMENTS IN EQUITY
For the six months ended 31 March 2022 (Unaudited) (Continued)

Year ended 30 September 2021

	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 year	-	-	-	-	-	164.5	-	164.5
Other comprehensive income	-	-	-	-	(2.5)	7.3	-	4.8
Total comprehensive income	-	-	-	-	(2.5)	171.8	-	169.3
Transactions with owners								
Dividends paid (note 21)	-	-	-	-	-	(54.6)	-	(54.6)
Shares cancelled	-	-	-	-	-	-	-	-
Own shares purchased	-	-	-	-	-	-	(42.2)	(42.2)
Exercise of share awards	0.7	1.4	-	-	-	(3.3)	3.3	2.1
Charge for share based remuneration	-	-	-	-	-	8.9	-	8.9
Tax on share based remuneration	-	-	-	-	-	2.4	-	2.4
Net movement in equity in the year	0.7	1.4	-	-	(2.5)	125.2	(38.9)	85.9
Opening equity	261.8	68.7	50.3	(70.2)	2.5	880.7	(37.8)	1,156.0
Closing equity	262.5	70.1	50.3	(70.2)	-	1,005.9	(76.7)	1,241.9

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS
For the six months ended 31 March 2022 (Unaudited)

1. GENERAL INFORMATION

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

The condensed financial statements for the six months ended 31 March 2022 and for the six months ended 31 March 2021 have not been audited, as defined in section 434 of the Companies Act 2006.

The figures shown above for the year ended 30 September 2021 and the year ended 30 September 2020 are not statutory accounts. A copy of the statutory accounts for the year has been delivered to the Registrar of Companies. The auditors reported on those statutory accounts and their report was unqualified, did not draw attention to any matters by way of emphasis and did not contain an adverse statement under sections 498 (2) or 498 (3) of the Companies Act 2006.

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

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

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

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2022 (Unaudited)

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

2. SEGMENTAL INFORMATION

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

- Mortgage Lending, including the Group's buy-to-let, and owner-occupied first and second charge lending and related activities
- Commercial Lending, including the Group's equipment leasing activities, development finance, structured lending and other offerings targeted towards SME customers, together with its motor finance business
- 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, nor is income from central cash balances or the carrying costs of unallocated savings balances.

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

Other assets are not allocated between segments.

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

Following the agreement for the sale of Idem Capital assets described in note 10, concluded after the end of the period, the Group intends to review its segments for future disclosure, given the relatively small size of the ongoing Idem Capital segment compared to the two other divisions.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2022 (Unaudited)

2. SEGMENTAL INFORMATION (Continued)

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

Six months ended 31 March 2022

	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Unallocated items £m	Total £m
Interest receivable	180.9	62.9	9.1	1.8	254.7
Interest payable	(58.8)	(9.0)	(0.8)	(10.9)	(79.5)
Net interest income	122.1	53.9	8.3	(9.1)	175.2
Other operating income	2.8	3.7	-	-	6.5
Total operating income	124.9	57.6	8.3	(9.1)	181.7
Operating expenses	(9.3)	(12.8)	(2.6)	(50.2)	(74.9)
Provisions for losses	1.0	(3.2)	0.9	-	(1.3)
	116.6	41.6	6.6	(59.3)	105.5

Six months ended 31 March 2021

	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Unallocated items £m	Total £m
Interest receivable	168.4	57.1	12.3	0.8	238.6
Interest payable	(65.3)	(10.6)	(1.5)	(13.7)	(91.1)
Net interest income	103.1	46.5	10.8	(12.9)	147.5
Other operating income	2.9	4.1	0.2	-	7.2
Total operating income	106.0	50.6	11.0	(12.9)	154.7
Operating expenses	(8.7)	(11.7)	(2.5)	(42.9)	(65.8)
Provisions for losses	(4.9)	(1.3)	0.2	-	(6.0)
	92.4	37.6	8.7	(55.8)	82.9

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2022 (Unaudited)

2. SEGMENTAL RESULTS (Continued)

Year ended 30 September 2021

	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Unallocated Items £m	Total Segments £m
Interest receivable	345.8	114.2	22.7	1.5	484.2
Interest payable	(126.6)	(19.7)	(2.5)	(24.9)	(173.7)
Net interest income	219.2	94.5	20.2	(23.4)	310.5
Other operating income	6.1	8.0	0.3	-	14.4
Total operating income	225.3	102.5	20.5	(23.4)	324.9
Direct costs	(17.4)	(23.9)	(5.1)	(89.0)	(135.4)
Provisions for losses	5.9	(2.9)	1.7	-	4.7
	213.8	75.7	17.1	(112.4)	194.2

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

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m
Results shown above	105.5	82.9	194.2
Fair value items	38.1	13.5	19.5
Operating profit	143.6	96.4	213.7

The assets of the segments were:

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m	30 September 2020 £m
Mortgage Lending	12,155.9	11,490.8	11,732.0	11,488.2
Commercial Lending	1,762.5	1,466.0	1,608.1	1,554.3
Idem Capital	196.0	258.6	225.2	297.1
Total segment assets	14,114.4	13,215.4	13,565.3	13,339.6
Unallocated assets	1,636.6	2,273.4	1,571.7	2,165.9
Total assets	15,751.0	15,488.8	15,137.0	15,505.5

An analysis of the Group's loan assets by type and segment is shown in note 10.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2022 (Unaudited)

3. INTEREST RECEIVABLE

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m
Interest receivable in respect of			
Loans and receivables	229.9	216.6	440.0
Finance leases	21.5	20.1	40.4
Factoring income	1.5	1.1	2.3
Interest on loans to customers	252.9	237.8	482.7
Other interest receivable	1.8	0.8	1.5
Total interest on financial assets	254.7	238.6	484.2

The above interest arises from:

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m
Financial assets held at amortised cost	233.2	218.5	443.8
Finance leases	21.5	20.1	40.4
	254.7	238.6	484.2

4. INTEREST PAYABLE AND SIMILAR CHARGES

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m
On retail deposits	55.4	63.1	120.5
On asset backed loan notes	5.5	10.0	17.9
On bank loans and overdrafts	5.0	3.8	6.6
On corporate bonds	3.3	5.4	9.3
On retail bonds	5.8	8.2	15.4
On central bank facilities	4.0	0.9	2.2
On repurchase agreements	-	-	0.1
Total interest on financial liabilities	79.0	91.4	172.0
On pension scheme deficit (note 17)	0.1	0.2	0.3
Discounting on contingent consideration	-	0.1	0.3
Discounting on lease liabilities	0.1	0.1	0.2
Other finance costs	0.3	(0.7)	0.9
	79.5	91.1	173.7

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

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2022 (Unaudited)

5. OTHER INCOME

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m
Loan account fee income	2.2	2.8	5.1
Broker commissions	1.1	1.0	1.9
Third party servicing	0.9	2.1	3.5
Other income	0.2	0.2	0.4
	4.4	6.1	10.9

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

6. FAIR VALUE NET GAINS

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m
Ineffectiveness of fair value hedges (note 12)			
Portfolio hedges of interest rate risk			
Deposit hedge	1.6	(0.2)	(0.3)
Loan hedge	10.4	3.9	6.6
	12.0	3.7	6.3
Ineffectiveness of cash flow hedges	-	-	-
Other hedging movements	1.2	6.7	9.9
Net gains / (losses) on other derivatives	24.9	3.1	3.3
	38.1	13.5	19.5

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

The impact of hedging arrangements on the Group's balance sheet is summarised in note 12 and a full description of the Group's use of derivative financial instruments for hedging purposes is set out in note 19 to the financial statements for the year ended 30 September 2021.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2022 (Unaudited)

7. TAX CHARGE ON PROFIT ON ORDINARY ACTIVITIES

The Group's income tax charge for the six months ended 31 March 2022 represents an effective rate of 24.0% (six months ended 31 March 2021: 23.0%, year ended 30 September 2021: 23.0%). This is based on the Group's best estimate of the annual effective rate of income tax expected for the full year ending 30 September 2022, derived UK statutory rates, applied to the pre-tax income of the period.

The standard rate of corporation tax in the UK applicable to the Group in the period was 19% (2021 H1: 19.0%), based on currently enacted legislation. During the year ended 30 September 2021, the UK Government enacted legislation increasing the standard rate of corporation tax in the UK from 19.0% to 25.0% from April 2023. This will increase the standard rate of corporation tax applicable to the Group to 22.0% in the year ending 30 September 2023 and to 25.0% in the year ending 30 September 2024 and thereafter. The effect of these changes on deferred tax balances was accounted for in the year ended 30 September 2021.

In the current financial year the UK Government enacted legislation reducing the rate of the Banking Surcharge from 8.0% to 3.0%, also from April 2023, while increasing the profit threshold at which the surcharge applies to £100.0m from £25.0m. The impact of this change on deferred tax balances has been accounted for in the current period.

8. EARNINGS PER SHARE

Earnings per ordinary share is calculated as follows:

	31 March 2022	31 March 2021	30 September 2021
Profit for the period (£m)	109.1	74.2	164.5
Basic weighted average number of ordinary shares ranking for dividend during the period (m)	245.7	253.3	252.3
Dilutive effect of the weighted average number of share options and incentive plans in issue during the period (m)	8.2	8.8	8.9
Diluted weighted average number of ordinary shares ranking for dividend during the period (m)	253.9	262.1	261.2
Earnings per ordinary share - basic	44.4p	29.3p	65.2p
- diluted	43.0p	28.3p	63.0p

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2022 (Unaudited)

9. CASH AND CASH EQUIVALENTS

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m	30 September 2020 £m
Balances with central banks	1,265.7	1,832.3	1,142.0	1,637.1
Balances with other banks	234.7	270.7	218.1	287.9
	1,500.4	2,103.0	1,360.1	1,925.0

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

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

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

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m	30 September 2020 £m
Available cash	1,342.4	1,895.1	1,236.5	1,701.1
Securitisation cash	156.7	207.2	123.3	223.4
ESOP cash	1.3	0.7	0.3	0.5
	1,500.4	2,103.0	1,360.1	1,925.0

Cash and cash equivalents are classified as Stage 1 exposures (see note 11) for the purposes of impairment provisioning. The probabilities of default have been assessed to be so low as to require no significant impairment provision.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2022 (Unaudited)

10. LOANS TO CUSTOMERS

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m	30 September 2020 £m
Loans to customers	13,914.9	12,816.3	13,402.7	12,631.4
Fair value adjustments from portfolio hedging (note 12)	(151.5)	58.1	5.5	109.7
	13,763.4	12,874.4	13,408.2	12,741.1

The Group's loan assets at 31 March 2022, analysed between the segments described in note 2, are set out below.

	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Total £m
At 31 March 2022				
First mortgages	11,874.7	-	-	11,874.7
Consumer loans	124.5	-	194.2	318.7
Motor finance	-	236.2	1.8	238.0
Asset finance	-	457.0	-	457.0
Development finance	-	672.9	-	672.9
Other commercial loans	-	353.6	-	353.6
Loans to customers	11,999.2	1,719.7	196.0	13,914.9
At 31 March 2021				
First mortgages	10,962.0	-	-	10,962.0
Consumer loans	168.6	-	249.7	418.3
Motor finance	-	220.4	8.9	229.3
Asset finance	-	467.8	-	467.8
Development finance	-	552.3	-	552.3
Other commercial loans	-	186.6	-	186.6
Loans to customers	11,130.6	1,427.1	258.6	12,816.3

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10. LOANS TO CUSTOMERS (Continued)

	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Total £m
At 30 September 2021				
First mortgages	11,460.6	-	-	11,460.6
Consumer loans	148.1	-	220.9	369.0
Motor finance	-	224.9	4.3	229.2
Asset finance	-	468.7	-	468.7
Development finance	-	608.2	-	608.2
Other commercial loans	-	267.0	-	267.0
Loans to customers	11,608.7	1,568.8	225.2	13,402.7
At 30 September 2020				
First mortgages	10,636.9	-	-	10,636.9
Consumer loans	182.6	-	281.6	464.2
Motor finance	-	256.9	15.5	272.4
Asset finance	-	478.0	-	478.0
Development finance	-	609.0	-	609.0
Other commercial loans	-	170.9	-	170.9
Loans to customers	10,819.5	1,514.8	297.1	12,631.4

On 8 June 2022, after the end of the period, the Group entered into an agreement to dispose of unsecured consumer loan assets from its Idem Capital division with a carrying value at 31 March 2022 of £76.8m. The final value of the transaction will be determined in the second half of the financial year, based on the position at the closure of the deal, but a small profit is expected. More information on this transaction will be given with the Group’s year end results.

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS

Provisioning approach

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

The Group's approach to impairment provision on loans to customers, in accordance with IFRS 9, is set out in detail in note 18 to the annual accounts. This includes an outline of the calculations used and a definition of terms, and the information in this half year report should be read in conjunction with it.

There have been no significant changes in overall approach since the 2021 year end. At that time, as discussed in the 2021 annual accounts, it was necessary for the Group to depart from its normal provisioning methodology due to the impact of the Covid crisis, both on the Group's customers and on the metrics used to determine credit quality. The continuing uncertainties surrounding the long term impact of the pandemic, combined with increasing pressures on the UK economy from increases in interest rates, inflation and the cost of living more widely, and the economic risks to the UK inherent in the current conflict in Ukraine, mean that the Group has taken a broadly similar approach in determining provision at 31 March 2022.

Significant Increase in Credit Risk ('SICR')

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

While the immediate economic effects of the Covid pandemic have largely receded, the extent of the underlying long-term damage done to the financial situations of consumers and businesses, so-called Covid scarring, is not yet clear. Neither are such effects necessarily observable, as yet, from either internal or external credit data. Such scarring might be indicative of an SICR on a customer's account, and hence the Group has to carefully consider, using all data available to it, whether any such SICR accounts exist, other than those identified through the normal process.

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

When reviewing the subsequent payment patterns of accounts that have been granted Covid-related reliefs, it has been evident that there is higher payment volatility (both in terms of account improvement and deterioration) in these cases, particularly in cases where an extension to the payment holiday has been granted. This indicates an increased credit risk, though the impact is not significant in scale in all cases. As a result of this analysis the accounts of buy-to-let customers who have been granted extended payment reliefs have been placed in Stage 2, regardless of other indicators.

The effect of this override is to transfer accounts with gross balances of £548.9m (31 March 2021: £661.2m, 30 September 2021: £599.8m) to Stage 2. The additional provision on transfer is included within PMAs.

This overall approach remains broadly consistent with that taken at 30 September 2021. In reviewing account performance during the current period the Group has not yet identified any positive evidence which would cause it to begin to unwind this position. It will be reviewed going forward as other government economic interventions are scaled back and the post-relief credit characteristics of such accounts become more evident.

Post Model Adjustments ('PMA's)

In order to ensure that its loan portfolios are adequately provisioned, the Group considers whether there are factors not fully captured by the modelling process, including economic conditions more generally, which indicate a need for PMAs. Information considered includes credit data, customer and broker feedback received, the results of insight surveys, industry intelligence and expert knowledge within the business lines.

In the six month period, the dominance of Covid in these considerations reduced as the short-term impact of the pandemic receded and other economic factors such as the UK cost of living, rising interest rates and the conflict in the Ukraine became more significant.

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

In normal circumstances the Group's objective is to develop its modelling to the point where the level of PMAs required is minimal, but in economic conditions where previous relevant experience is limited or non-existent, as with Covid or the potential for a high inflation, high interest rate economic climate, some form of PMA is likely to be necessary. While high interest rate and inflation scenarios have occurred in the UK in the past, market conditions, products and regulatory expectations have moved on considerably in the meantime, and most such observations would pre-date the existence of buy-to-let mortgages as a distinct asset class.

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11.IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

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

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

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m
Mortgage Lending	7.8	19.2	8.9
Commercial Lending	6.3	7.3	10.2
Idem Capital	-	1.0	0.3
	14.1	27.5	19.4

Other than the behaviour of extended payment relief cases noted above, this analysis found no evidence of particular concentrations of credit risk below portfolio level. Given this, and the high level nature of the PMA exercise, the PMAs have been allocated across the Group's major portfolios to individual cases.

The Group will continue to monitor the requirement for these PMAs as the economic situation develops and the impact of government interventions recedes.

Impairment by stage and division

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

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

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

For assets which are 'Purchased or Originated as Credit Impaired' ('POCI') accounts (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.

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

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

	Stage 1 £m	Stage 2 * £m	Stage 3 * £m	POCI £m	Total £m
31 March 2022					
Gross loan book					
Mortgage Lending	10,379.0	1,520.7	120.2	12.0	12,031.9
Commercial Lending	1,689.9	34.3	9.3	6.7	1,740.2
Idem Capital	78.9	5.9	23.0	90.2	198.0
Total	12,147.8	1,560.9	152.5	108.9	13,970.1
Impairment provision					
Mortgage Lending	(5.4)	(5.5)	(21.8)	-	(32.7)
Commercial Lending	(14.9)	(0.8)	(4.4)	(0.4)	(20.5)
Idem Capital	-	(0.1)	(1.9)	-	(2.0)
Total	(20.3)	(6.4)	(28.1)	(0.4)	(55.2)
Net loan book					
Mortgage Lending	10,373.6	1,515.2	98.4	12.0	11,999.2
Commercial Lending	1,675.0	33.5	4.9	6.3	1,719.7
Idem Capital	78.9	5.8	21.1	90.2	196.0
Total	12,127.5	1,554.5	124.4	108.5	13,914.9
Coverage ratio					
Mortgage Lending	0.05%	0.36%	18.14%	-	0.27%
Commercial Lending	0.88%	2.33%	47.31%	5.97%	1.18%
Idem Capital	-	1.69%	8.26%	-	1.01%
Total	0.17%	0.41%	18.43%	0.37%	0.40%

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

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SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

	Stage 1 £m	Stage 2 * £m	Stage 3 * £m	POCI £m	Total £m
31 March 2021					
Gross loan book					
Mortgage Lending	10,063.9	980.0	121.3	14.0	11,179.2
Commercial Lending	1,352.0	79.8	17.7	6.7	1,456.2
Idem Capital	107.2	7.4	27.7	121.0	263.3
Total	11,523.1	1,067.2	166.7	141.7	12,898.7
Impairment provision					
Mortgage Lending	(4.5)	(16.0)	(28.1)	-	(48.6)
Commercial Lending	(17.3)	(2.7)	(8.7)	(0.4)	(29.1)
Idem Capital	(0.2)	(0.3)	(4.2)	-	(4.7)
Total	(22.0)	(19.0)	(41.0)	(0.4)	(82.4)
Net loan book					
Mortgage Lending	10,059.4	964.0	93.2	14.0	11,130.6
Commercial Lending	1,334.7	77.1	9.0	6.3	1,427.1
Idem Capital	107.0	7.1	23.5	121.0	258.6
Total	11,501.1	1,048.2	125.7	141.3	12,816.3
Coverage ratio					
Mortgage Lending	0.04%	1.63%	23.17%	-	0.43%
Commercial Lending	1.28%	3.38%	49.15%	5.97%	2.00%
Idem Capital	0.19%	4.05%	15.16%	-	1.79%
Total	0.19%	1.78%	24.60%	0.28%	0.64%

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

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

	Stage 1 £m	Stage 2 * £m	Stage 3 * £m	POCI £m	Total £m
30 September 2021					
Gross loan book					
Mortgage Lending	10,303.7	1,206.4	120.0	13.4	11,643.5
Commercial Lending	1,504.2	66.4	19.0	6.9	1,596.5
Idem Capital	92.5	6.3	25.3	104.0	228.1
Total	11,900.4	1,279.1	164.3	124.3	13,468.1
Impairment provision					
Mortgage Lending	(1.7)	(10.2)	(22.9)	-	(34.8)
Commercial Lending	(12.9)	(1.0)	(13.6)	(0.2)	(27.7)
Idem Capital	(0.4)	(0.1)	(2.4)	-	(2.9)
Total	(15.0)	(11.3)	(38.9)	(0.2)	(65.4)
Net loan book					
Mortgage Lending	10,302.0	1,196.2	97.1	13.4	11,608.7
Commercial Lending	1,491.3	65.4	5.4	6.7	1,568.8
Idem Capital	92.1	6.2	22.9	104.0	225.2
Total	11,885.4	1,267.8	125.4	124.1	13,402.7
Coverage ratio					
Mortgage Lending	0.02%	0.85%	19.08%	-	0.30%
Commercial Lending	0.86%	1.51%	71.58%	2.90%	1.74%
Idem Capital	0.43%	1.59%	9.49%	-	1.27%
Total	0.13%	0.88%	23.68%	0.16%	0.49%

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

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

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

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.

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

Acquired portfolios within the Mortgage Lending and Idem Capital segments 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 an SICR has nonetheless been identified from other information and accounts more than one month in arrears.

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

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

The value of accounts in Stage 2 as a result of arrears is broadly similar to that at 30 September 2021 across all segments. The more negative economic outlook has caused an increased number of non-arrears accounts to be identified as having an SICR in the Mortgage Lending division. However, the impact of house price inflation means that the growth in gross Stage 2 assets is not matched by growth in provision, and the coverage ratios have reduced.

Stage 2 non-arrears accounts in Consumer Lending have fallen significantly though, principally as a result of improvements in the performance of development finance accounts against project plans. This has decreased the average security value of Commercial Lending Stage 2 cases and increased the required coverage.

In the Idem Capital division, Stage 2 assets and provision levels are broadly similar to those at 30 September 2021.

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SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

	< 1 month arrears £m	Recent arrears £m	> 1 <= 3 months arrears £m	Total £m
31 March 2022				
Gross loan book				
Mortgage Lending	1,498.4	6.9	15.4	1,520.7
Commercial Lending	29.3	1.3	3.7	34.3
Idem Capital	3.1	0.6	2.2	5.9
Total	1,530.8	8.8	21.3	1,560.9
Impairment provision				
Mortgage Lending	(5.3)	-	(0.2)	(5.5)
Commercial Lending	(0.6)	-	(0.2)	(0.8)
Idem Capital	-	-	(0.1)	(0.1)
Total	(5.9)	-	(0.5)	(6.4)
Net loan book				
Mortgage Lending	1,493.1	6.9	15.2	1,515.2
Commercial Lending	28.7	1.3	3.5	33.5
Idem Capital	3.1	0.6	2.1	5.8
Total	1,524.9	8.8	20.8	1,554.5
Coverage ratio				
Mortgage Lending	0.35%	-	1.30%	0.36%
Commercial Lending	2.05%	-	5.41%	2.33%
Idem Capital	-	-	4.55%	1.69%
Total	0.39%	-	2.35%	0.41%

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SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

	< 1 month arrears £m	Recent arrears £m	> 1 <= 3 months arrears £m	Total £m
31 March 2021				
Gross loan book				
Mortgage Lending	948.2	12.7	19.1	980.0
Commercial Lending	73.6	1.6	4.6	79.8
Idem Capital	3.4	0.8	3.2	7.4
Total	1,025.2	15.1	26.9	1,067.2
Impairment provision				
Mortgage Lending	(15.1)	(0.6)	(0.3)	(16.0)
Commercial Lending	(2.2)	-	(0.5)	(2.7)
Idem Capital	(0.1)	-	(0.2)	(0.3)
Total	(17.4)	(0.6)	(1.0)	(19.0)
Net loan book				
Mortgage Lending	933.1	12.1	18.8	964.0
Commercial Lending	71.4	1.6	4.1	77.1
Idem Capital	3.3	0.8	3.0	7.1
Total	1,007.8	14.5	25.9	1,048.2
Coverage ratio				
Mortgage Lending	1.59%	4.72%	1.57%	1.63%
Commercial Lending	2.99%	-	10.87%	3.38%
Idem Capital	2.94%	-	6.25%	4.05%
Total	1.70%	3.97%	3.72%	1.78%

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SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2022 (Unaudited)

11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

	< 1 month arrears	Recent arrears	> 1 <= 3 months arrears	Total
	£m	£m	£m	£m
30 September 2021				
Gross loan book				
Mortgage Lending	1,184.8	8.0	13.6	1,206.4
Commercial Lending	61.1	0.2	5.1	66.4
Idem Capital	2.9	0.7	2.7	6.3
Total	1,248.8	8.9	21.4	1,279.1
Impairment provision				
Mortgage Lending	(9.9)	(0.1)	(0.2)	(10.2)
Commercial Lending	(0.9)	-	(0.1)	(1.0)
Idem Capital	-	-	(0.1)	(0.1)
Total	(10.8)	(0.1)	(0.4)	(11.3)
Net loan book				
Mortgage Lending	1,174.9	7.9	13.4	1,196.2
Commercial Lending	60.2	0.2	5.0	65.4
Idem Capital	2.9	0.7	2.6	6.2
Total	1,238.0	8.8	21.0	1,267.8
Coverage ratio				
Mortgage Lending	0.84%	1.25%	1.47%	0.85%
Commercial Lending	1.47%	-	1.96%	1.51%
Idem Capital	-	-	3.70%	1.59%
Total	0.86%	1.12%	1.87%	0.88%

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.

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SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2022 (Unaudited)

11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

Analysis of Stage 3 loans

The table below analyses the accounts in Stage 3 between those:

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

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

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

The gross values of Stage 3 accounts at 31 March 2022 are broadly similar to those at 30 September 2021, except for write-offs of large exposures in the Commercial Lending division which had been fully provided at the year end. These balances were included in the 'arrears > 3 months' category at 30 September 2021.

Other than the impact of the Commercial Lending write-offs, coverage levels remained broadly similar to the year end position. Ratios in Stage 3 will naturally be subject to a wider range of fluctuation than those elsewhere, given the low number of accounts involved, the consequent potential for mix effects and the idiosyncratic nature of some of the cases.

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SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

	Probation	> 3 month arrears	RoR managed	Realisations	Total
	£m	£m	£m	£m	£m
31 March 2022					
Gross loan book					
Mortgage Lending	9.1	19.8	74.3	17.0	120.2
Commercial Lending	1.1	2.3	-	5.9	9.3
Idem Capital	0.4	20.0	-	2.6	23.0
Total	10.6	42.1	74.3	25.5	152.5
Impairment provision					
Mortgage Lending	-	(0.3)	(16.2)	(5.3)	(21.8)
Commercial Lending	(0.3)	(1.4)	-	(2.7)	(4.4)
Idem Capital	-	(0.7)	-	(1.2)	(1.9)
Total	(0.3)	(2.4)	(16.2)	(9.2)	(28.1)
Net loan book					
Mortgage Lending	9.1	19.5	58.1	11.7	98.4
Commercial Lending	0.8	0.9	-	3.2	4.9
Idem Capital	0.4	19.3	-	1.4	21.1
Total	10.3	39.7	58.1	16.3	124.4
Coverage ratio					
Mortgage Lending	-	1.52%	21.80%	31.18%	18.14%
Commercial Lending	27.27%	60.87%	-	45.76%	47.31%
Idem Capital	-	3.50%	-	46.15%	8.26%
Total	2.83%	5.70%	21.80%	36.08%	18.43%

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

	Probation	> 3 month arrears	RoR managed	Realisations	Total
	£m	£m	£m	£m	£m
31 March 2021					
Gross loan book					
Mortgage Lending	3.3	23.1	81.3	13.6	121.3
Commercial Lending	1.3	6.9	-	9.5	17.7
Idem Capital	1.1	23.3	-	3.3	27.7
Total	5.7	53.3	81.3	26.4	166.7
Impairment provision					
Mortgage Lending	(0.2)	(2.1)	(20.4)	(5.4)	(28.1)
Commercial Lending	(0.5)	(3.3)	-	(4.9)	(8.7)
Idem Capital	-	(2.6)	-	(1.6)	(4.2)
Total	(0.7)	(8.0)	(20.4)	(11.9)	(41.0)
Net loan book					
Mortgage Lending	3.1	21.0	60.9	8.2	93.2
Commercial Lending	0.8	3.6	-	4.6	9.0
Idem Capital	1.1	20.7	-	1.7	23.5
Total	5.0	45.3	60.9	14.5	125.7
Coverage ratio					
Mortgage Lending	6.06%	9.09%	25.09%	39.71%	23.17%
Commercial Lending	38.46%	47.83%	-	51.58%	49.15%
Idem Capital	-	11.16%	-	48.48%	15.16%
Total	12.28%	15.01%	25.09%	45.08%	24.60%

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

	Probation £m	> 3 month arrears £m	RoR managed £m	Realisations £m	Total £m
30 September 2021					
Gross loan book					
Mortgage Lending	7.3	20.7	80.9	11.1	120.0
Commercial Lending	0.6	11.4	-	7.0	19.0
Idem Capital	0.7	21.3	-	3.3	25.3
Total	8.6	53.4	80.9	21.4	164.3
Impairment provision					
Mortgage Lending	(0.3)	(0.9)	(17.4)	(4.3)	(22.9)
Commercial Lending	(0.1)	(10.3)	-	(3.2)	(13.6)
Idem Capital	-	(1.0)	-	(1.4)	(2.4)
Total	(0.4)	(12.2)	(17.4)	(8.9)	(38.9)
Net loan book					
Mortgage Lending	7.0	19.8	63.5	6.8	97.1
Commercial Lending	0.5	1.1	-	3.8	5.4
Idem Capital	0.7	20.3	-	1.9	22.9
Total	8.2	41.2	63.5	12.5	125.4
Coverage ratio					
Mortgage Lending	4.11%	4.35%	21.51%	38.74%	19.08%
Commercial Lending	16.67%	90.35%	-	45.71%	71.58%
Idem Capital	-	4.69%	-	42.42%	9.49%
Total	4.65%	22.85%	21.51%	41.59%	23.68%

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

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m
First mortgages	78.0	70.4	74.7
Second mortgages	14.7	17.2	15.4
Asset finance	2.3	4.4	4.7
Motor finance	1.8	1.9	2.0
	96.8	93.9	96.8

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

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

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

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

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

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 2022		31 March 2021		30 September 2021	
	Number	£m	Number	£m	Number	£m
Managed accounts						
Appointment date						
2010 and earlier	313	52.7	350	59.1	333	56.3
2011 to 2013	52	8.5	64	10.7	56	9.1
2014 to 2016	19	2.6	27	3.9	24	3.3
2016 and later	74	10.5	46	7.6	86	12.2
Total managed accounts	458	74.3	487	81.3	499	80.9
Accounts in the process of realisation	100	14.9	69	13.1	54	10.2
	558	89.2	556	94.4	553	91.1

Receiver of rent accounts in the process of realisation at the period end are included under that heading in the Stage 3 tables above.

In addition to the cases analysed above, no POCI accounts had a receiver of rent in place at 31 March 2022 (31 March 2021: 1, 30 September 2021: none), making a total of 558 (31 March 2021: 557, 30 September 2021: 553).

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

Movements in impairment provision

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

	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Total £m
At 30 September 2021	34.8	27.7	2.9	65.4
Provided in period	(1.0)	4.0	(0.6)	2.4
Amounts written off	(1.1)	(11.2)	(0.3)	(12.6)
At 31 March 2022	32.7	20.5	2.0	55.2
At 30 September 2020	48.3	28.6	4.9	81.8
Provided in period	4.9	1.8	-	6.7
Amounts written off	(4.6)	(1.3)	(0.2)	(6.1)
At 31 March 2021	48.6	29.1	4.7	82.4
At 30 September 2020	48.3	28.6	4.9	81.8
Provided in period	(5.9)	4.0	(1.2)	(3.1)
Amounts written off	(7.6)	(4.9)	(0.8)	(13.3)
At 30 September 2021	34.8	27.7	2.9	65.4

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

The difference between the amount shown above and the profit and loss account charge or credit for the period is amounts recovered on previously written off accounts of £1.1m (31 March 2021: £0.7m, 30 September 2021: £1.6m).

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

A more detailed analysis of these movements by IFRS 9 stage on a consolidated basis for the six months ended 31 March 2022, the six months ended 31 March 2021, and the year ended 30 September 2021 are set out below.

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

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

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

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Loss allowance at 30 September 2021	15.0	11.3	38.9	0.2	65.4
New assets originated or purchased	6.6	-	-	-	6.6
Changes in loss allowance					
Transfer to Stage 1	1.0	(0.8)	(0.2)	-	-
Transfer to Stage 2	(0.7)	1.1	(0.4)	-	-
Transfer to Stage 3	(0.1)	(0.5)	0.6	-	-
Changes on stage transfer	(0.9)	0.6	1.8	-	1.5
Changes due to credit risk	(0.6)	(5.3)	-	0.2	(5.7)
Write offs	-	-	(12.6)	-	(12.6)
Loss allowance at 31 March 2022	20.3	6.4	28.1	0.4	55.2

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Loss allowance at 30 September 2020	22.2	15.8	43.4	0.4	81.8
New assets originated or purchased	5.7	-	-	-	5.7
Changes in loss allowance					
Transfer to Stage 1	3.6	(1.5)	(2.1)	-	-
Transfer to Stage 2	(1.0)	2.0	(1.0)	-	-
Transfer to Stage 3	(0.1)	(0.5)	0.6	-	-
Changes on stage transfer	(2.9)	1.8	4.9	-	3.8
Changes due to credit risk	(5.5)	1.4	1.3	-	(2.8)
Write offs	-	-	(6.1)	-	(6.1)
Loss allowance at 31 March 2021	22.0	19.0	41.0	0.4	82.4

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Loss allowance at 30 September 2020	22.2	15.8	43.4	0.4	81.8
New assets originated or purchased	8.1	-	-	-	8.1
Changes in loss allowance					
Transfer to Stage 1	4.7	(2.6)	(2.1)	-	-
Transfer to Stage 2	(1.4)	2.1	(0.7)	-	-
Transfer to Stage 3	(0.2)	(0.7)	0.9	-	-
Changes on stage transfer	(3.8)	1.8	3.1	-	1.1
Changes due to credit risk	(14.6)	(5.1)	7.6	(0.2)	(12.3)
Write offs	-	-	(13.3)	-	(13.3)
Loss allowance at 30 September 2021	15.0	11.3	38.9	0.2	65.4

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

During the six months ended 31 March 2022 the impairment allowance remained relatively stable, due to the opposing effects of the easing of Covid-related pressures on the UK economy and mounting concerns about the nation's economic health more generally, with inflation and interest rates increasing and the potential for impacts from the conflict in Ukraine.

The most significant upward movement in provisions came from new lending, mostly impacting Stage 1 amounts. While the impact of increased PDs moved more accounts from Stage 1 to Stage 2, as the effects of less benign economics worked their way through the Group's models, increased security values, particularly house prices, mitigated the impact of this on provision values. The principal impact on Stage 3 provisions was from write-offs, mostly of accounts in the Commercial Lending division identified as defaults at the 2021 year end.

The principal movements in the impairment provision in the year ended 30 September 2021, particularly in the second half were downwards, with a more benign economic outlook reducing both the estimated likelihood of losses and the expected loss on defaulted cases as security values improved. However coverage levels still remained in excess of those pre-Covid, with PMAs in place to compensate for the potential impact of credit issues not apparent in the data.

While less accounts had been granted payment holiday extensions in that year than in the preceding year, this drove further transfer from Stage 1 to Stage 2. Transfers to Stage 3 reflected principally a small number of realisations cases and other cases identified through credit review. Write offs largely related to the realisation of already provided losses on cases being worked out on a long-term basis.

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

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Balances at 30 September 2021	11,900.4	1,279.1	164.3	124.3	13,468.1
New assets originated or purchased	1,432.3	-	-	-	1,432.3
Changes in staging					
Transfer to Stage 1	124.6	(122.5)	(2.1)	-	-
Transfer to Stage 2	(495.0)	501.2	(6.2)	-	-
Transfer to Stage 3	(13.8)	(12.1)	25.9	-	-
Redemptions and repayments	(1,006.2)	(111.8)	(18.2)	(30.8)	(1,167.0)
Write offs	-	-	(12.6)	-	(12.6)
Other changes	205.5	27.0	1.4	15.4	249.3
Balance at 31 March 2022	12,147.8	1,560.9	152.5	108.9	13,970.1
Loss allowance	(20.3)	(6.4)	(28.1)	(0.4)	(55.2)
Carrying value	12,127.5	1,554.5	124.4	108.5	13,914.9

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Balances at 30 September 2020	11,329.7	1,045.4	176.1	162.0	12,713.2
New assets originated or purchased	1,079.1	-	-	-	1,079.1
Changes in staging					
Transfer to Stage 1	116.9	(109.2)	(7.7)	-	-
Transfer to Stage 2	(215.7)	223.0	(7.3)	-	-
Transfer to Stage 3	(18.3)	(21.2)	39.5	-	-
Redemptions and repayments	(974.8)	(89.2)	(29.6)	(29.0)	(1,122.6)
Write offs	-	-	(6.1)	-	(6.1)
Other changes	206.2	18.4	1.8	8.7	235.1
Balance at 31 March 2021	11,523.1	1,067.2	166.7	141.7	12,898.7
Loss allowance	(22.0)	(19.0)	(41.0)	(0.4)	(82.4)
Carrying value	11,501.1	1,048.2	125.7	141.3	12,816.3

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Balances at 30 September 2020	11,329.7	1,045.4	176.1	162.0	12,713.2
New assets originated or purchased	2,419.4	-	-	-	2,419.4
Changes in staging					
Transfer to Stage 1	158.5	(149.5)	(9.0)	-	-
Transfer to Stage 2	(514.2)	519.6	(5.4)	-	-
Transfer to Stage 3	(23.7)	(21.6)	45.3	-	-
Redemptions and repayments	(1,884.9)	(158.6)	(35.7)	(53.1)	(2,132.3)
Write offs	-	-	(13.3)	-	(13.3)
Other changes	415.6	43.8	6.3	15.4	481.1
Balance at 30 September 2021	11,900.4	1,279.1	164.3	124.3	13,468.1
Loss allowance	(15.0)	(11.3)	(38.9)	(0.2)	(65.4)
Carrying value	11,885.4	1,267.8	125.4	124.1	13,402.7

Other changes includes interest and similar charges.

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

Economic impacts

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

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

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

The central scenario used for IFRS 9 impairment purposes is the same scenario which forms the basis of the Group's business planning and forecasting and will therefore generally carry the highest probability weighting. In its March 2022 forecasting cycle (the 'April reforecast') the Group has adopted a central economic scenario derived using a broadly equivalent approach to that used in September 2021, with the starting point of the scenario updated to reflect the actual movements of economic variables in the six months. The general trend of the Group's central forecasts remains broadly positive in the medium term, though with a period of adverse economic pressures in the short term.

Compared to the central scenario adopted at 30 September 2021, the new central forecast is more pessimistic in the short term with higher inflation and lower growth than the September scenarios, before converging later in the forecast period, reflecting the current pressures on the UK economy. UK interest rates are forecast to be higher than was forecast in September following recent rises and indications of further rises to come. This scenario does, however, start from a generally more positive position than predicted in September as the impacts of the omicron variant of Covid proved less severe than expected, and house price growth in the six months remained strong, contrary to many predictions.

The upside and downside scenarios continue to be derived from the central scenario, as they have been in previous periods. The shapes of these three scenarios are broadly similar across the period, except that house price inflation follows a smoother track in the upside scenario than in the central scenario while the downside scenario includes declining house prices.

The severe scenario has been derived from stress testing scenarios published by the Bank of England, as in previous periods. However, due to the crisis in Ukraine, the Bank of England has delayed publication of its 2022 stress testing parameters. Instead, the Group has reverted to the last stress scenarios published by the Bank before the onset of Covid in 2020. The 'rates up' variant of the stress scenarios was chosen as more representative of likely future stresses than the 'rates down' variant, and the rate of house price recovery was slowed, to ensure an appropriately severe impact on buy-to-let mortgages in the latter part of the forecast period.

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

Following a review of the weightings of the different scenarios, set against the overall potential for variability in the future economic outlook, the Group decided to maintain the scenario weightings used at 30 September 2021. While the direct impacts of the Covid pandemic have begun to recede, fresh uncertainties, particularly around cost of living issues in the UK and the conflict in Ukraine, have arisen in the period, and the Group concluded it was not yet appropriate to move towards a more normal set of weightings. A sensitivity examining the impact of this decision is set out below.

The weightings attached to each scenario are set out below

	31 March 2022	30 September 2021	31 March 2021
Central Scenario	40%	40%	40%
Upside Scenario	10%	10%	10%
Downside Scenario	35%	35%	35%
Severe Scenario	15%	15%	15%
	100%	100%	100%

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

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

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

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

31 March 2022

GDP (year-on-year change)

	2023 %	2024 %	2025 %	2026 %	2027 %
Central scenario	2.8	2.0	1.1	1.9	1.5
Upside scenario	4.2	2.5	1.4	2.0	1.5
Downside scenario	1.6	1.8	1.1	1.9	1.5
Severe scenario	(1.4)	(2.0)	1.2	1.1	1.0

HPI (year-on-year change)

	2023 %	2024 %	2025 %	2026 %	2027 %
Central scenario	3.2	0.6	3.0	3.5	3.2
Upside scenario	6.8	4.6	4.0	4.9	5.0
Downside scenario	2.5	(3.2)	(2.4)	1.6	3.2
Severe scenario	(4.8)	(15.4)	(14.4)	2.3	3.2

BBR (rate)

	2023 %	2024 %	2025 %	2026 %	2027 %
Central scenario	1.3	1.9	2.0	2.0	2.0
Upside scenario	1.1	1.3	1.3	1.3	1.3
Downside scenario	0.8	0.8	0.8	0.8	0.8
Severe scenario	2.3	4.0	4.0	3.9	3.4

CPI (rate)

	2023 %	2024 %	2025 %	2026 %	2027 %
Central scenario	7.2	3.0	1.7	1.9	2.0
Upside scenario	6.4	2.4	2.0	1.9	2.0
Downside scenario	6.1	3.1	2.0	2.0	2.0
Severe scenario	7.9	4.9	2.9	2.4	2.0

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

Unemployment (rate)

	2023 %	2024 %	2025 %	2026 %	2027 %
Central scenario	4.0	4.3	4.6	4.5	4.3
Upside scenario	3.8	3.8	4.0	3.9	3.8
Downside scenario	4.4	4.7	5.0	4.9	4.7
Severe scenario	6.4	9.2	8.8	8.2	7.5

Secured lending (annual change)

	2023 %	2024 %	2025 %	2026 %	2027 %
Central scenario	2.7	3.9	4.1	4.0	3.5
Upside scenario	3.4	4.6	4.9	4.8	4.3
Downside scenario	1.9	3.1	3.4	3.3	2.8
Severe scenario	1.9	(0.9)	0.2	2.3	3.4

Consumer credit (annual change)

	2023 %	2024 %	2025 %	2026 %	2027 %
Central scenario	4.3	5.0	4.6	4.9	4.5
Upside scenario	5.0	5.8	5.4	5.6	5.3
Downside scenario	3.5	4.3	3.9	4.1	3.8
Severe scenario	(2.8)	(4.6)	(2.3)	1.6	4.0

31 March 2021

GDP (year-on-year change)

	2022 %	2023 %	2024 %	2025 %	2026 %
Central scenario	11.4	4.3	2.0	1.9	2.1
Upside scenario	12.2	3.5	2.0	2.0	2.0
Downside scenario	10.3	4.8	2.5	1.9	2.1
Severe scenario	6.7	7.7	3.6	1.8	1.9

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

HPI (year-on-year change)

	2022 %	2023 %	2024 %	2025 %	2026 %
Central scenario	0.4	1.3	2.8	2.9	3.2
Upside scenario	3.8	3.5	4.7	4.6	2.9
Downside scenario	(4.8)	(6.3)	(0.6)	2.1	2.0
Severe scenario	(15.3)	(11.1)	(6.9)	(0.6)	0.9

BBR (rate)

	2022 %	2023 %	2024 %	2025 %	2026 %
Central scenario	0.1	0.1	0.3	0.6	0.8
Upside scenario	0.1	0.3	0.8	1.0	1.0
Downside scenario	0.1	0.1	0.1	0.3	0.4
Severe scenario	(0.1)	(0.1)	0.0	0.1	0.2

CPI (rate)

	2022 %	2023 %	2024 %	2025 %	2026 %
Central scenario	1.7	2.0	1.9	2.1	2.0
Upside scenario	1.9	2.2	2.2	2.0	2.0
Downside scenario	1.3	1.5	2.0	2.2	2.3
Severe scenario	0.9	0.3	1.1	1.6	1.9

Unemployment (rate)

	2022 %	2023 %	2024 %	2025 %	2026 %
Central scenario	6.9	5.3	4.8	4.4	4.3
Upside scenario	5.8	5.4	4.8	4.4	4.3
Downside scenario	7.9	6.5	5.7	5.0	4.8
Severe scenario	11.8	10.4	7.1	5.2	4.8

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SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

Secured lending (annual change)

	2022 %	2023 %	2024 %	2025 %	2026 %
Central scenario	4.9	3.9	3.4	3.1	3.1
Upside scenario	5.4	5.1	4.5	4.0	3.6
Downside scenario	3.6	3.0	2.7	3.3	3.8
Severe scenario	0.2	(2.3)	(0.4)	1.7	2.5

Consumer credit (annual change)

	2022 %	2023 %	2024 %	2025 %	2026 %
Central scenario	(0.6)	3.9	5.0	5.9	6.1
Upside scenario	0.7	5.8	7.0	7.6	8.2
Downside scenario	(1.8)	2.8	2.0	2.0	2.0
Severe scenario	5.1	3.2	1.0	2.2	4.5

30 September 2021

GDP (year-on-year change)

	2022 %	2023 %	2024 %	2025 %	2026 %
Central scenario	7.2%	2.0%	1.3%	1.6%	1.9%
Upside scenario	8.6%	2.5%	2.1%	1.8%	1.9%
Downside scenario	3.9%	3.4%	2.1%	1.9%	1.9%
Severe scenario	(3.7)%	8.9%	4.9%	2.6%	2.0%

HPI (year-on-year change)

	2022 %	2023 %	2024 %	2025 %	2026 %
Central scenario	0.7%	2.1%	2.7%	3.2%	3.0%
Upside scenario	4.0%	3.9%	4.5%	4.7%	2.6%
Downside scenario	(4.9)%	(5.9)%	-	2.1%	2.1%
Severe scenario	(10.9)%	(11.6)%	(7.9)%	(1.8)%	0.7%

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

BBR (rate)

	2022 %	2023 %	2024 %	2025 %	2026 %
Central scenario	0.1%	0.1%	0.4%	0.7%	0.8%
Upside scenario	0.1%	0.5%	0.9%	1.0%	1.0%
Downside scenario	0.1%	0.1%	0.2%	0.3%	0.5%
Severe scenario	-	(0.1)%	-	-	0.1%

CPI (rate)

	2022 %	2023 %	2024 %	2025 %	2026 %
Central scenario	3.8%	2.3%	1.9%	2.0%	2.0%
Upside scenario	3.0%	2.1%	2.0%	2.0%	2.0%
Downside scenario	4.2%	3.0%	2.1%	2.0%	2.0%
Severe scenario	0.9%	0.4%	0.9%	1.5%	1.9%

Unemployment (rate)

	2022 %	2023 %	2024 %	2025 %	2026 %
Central scenario	5.4%	5.1%	4.7%	4.3%	4.2%
Upside scenario	4.6%	4.3%	4.3%	4.0%	3.8%
Downside scenario	5.8%	5.5%	5.1%	4.7%	4.6%
Severe scenario	9.4%	11.5%	8.7%	5.8%	4.9%

Secured lending (annual change)

	2022 %	2023 %	2024 %	2025 %	2026 %
Central scenario	4.4%	3.6%	3.1%	3.2%	3.3%
Upside scenario	5.3%	4.8%	4.3%	3.8%	3.8%
Downside scenario	3.3%	2.8%	2.9%	3.6%	3.9%
Severe scenario	1.5%	(2.4)%	(1.0)%	1.3%	2.5%

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

Consumer credit (annual change)

	2022 %	2023 %	2024 %	2025 %	2026 %
Central scenario	2.6%	4.4%	5.5%	6.1%	6.2%
Upside scenario	4.3%	6.5%	7.3%	8.0%	8.3%
Downside scenario	2.3%	2.0%	2.0%	2.0%	2.3%
Severe scenario	0.6%	5.1%	1.2%	1.7%	4.0%

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

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

31 March 2022

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max %	Min %	Max %	Min %	Max %	Min %	Max %	Min %
Economic driver								
GDP	3.4	1.1	4.4	1.2	2.4	0.8	2.3	(4.4)
HPI	6.5	0.0	8.2	3.8	6.1	(4.8)	5.1	(17.8)
BBR	2.0	1.0	1.3	1.0	0.8	0.8	4.0	0.8
CPI	8.0	1.6	7.5	1.8	7.0	1.9	8.5	1.9
Unemployment	4.7	3.9	4.1	3.7	5.1	4.3	9.2	4.5
Secured lending	4.5	2.5	5.3	3.3	3.8	1.8	3.7	(1.2)
Consumer credit	5.0	3.0	5.8	3.8	4.3	2.3	4.8	(5.2)

31 March 2021

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max %	Min %	Max %	Min %	Max %	Min %	Max %	Min %
Economic driver								
GDP	18.1	1.9	20.7	1.9	16.5	1.9	14.3	(0.3)
HPI	7.4	(3.8)	8.6	1.1	3.4	(10.0)	3.5	(20.2)
BBR	0.8	0.1	1.0	0.1	0.5	0.1	0.2	(0.1)
CPI	2.1	1.4	2.3	1.6	2.3	1.0	2.0	0.2
Unemployment	7.8	4.2	5.9	4.2	8.5	4.6	11.9	4.5
Secured lending	5.3	3.0	5.5	3.5	4.0	2.5	2.7	(2.5)
Consumer credit	6.1	(3.4)	8.2	(2.5)	4.6	(5.9)	9.2	0.3

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SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

30 September 2021

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max %	Min %	Max %	Min %	Max %	Min %	Max %	Min %
Economic driver								
GDP	11.5	1.1	13.3	1.6	7.3	0.9	14.3	(5.9)
HPI	6.1	(4.0)	7.7	0.6	2.9	(9.8)	2.4	(16.9)
BBR	0.8	0.1	1.0	0.1	0.5	0.1	0.2	(0.1)
CPI	4.0	1.8	3.8	1.8	4.5	1.8	2.0	0.2
Unemployment	5.5	4.1	4.7	3.8	5.9	4.5	11.9	4.8
Secured lending	4.8	3.0	5.5	3.5	4.0	2.5	3.1	(2.5)
Consumer credit	6.4	0.4	8.5	1.9	4.6	(0.1)	9.2	(8.9)

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

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m
Provision using central scenario 100% weighted			
Mortgage Lending	27.7	37.2	24.6
Commercial Lending	19.3	27.6	26.0
Idem Capital	1.4	3.4	2.1
	48.4	68.2	52.7
Calculated impairment provision	55.2	82.4	65.4
Effect of multiple economic scenarios	6.8	14.2	12.7

Sensitivity

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

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

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

Economic conditions

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

	31 March 2022		30 September 2021	
Scenarios	**Provision £m**	**Difference £m**	**Provision £m**	**Difference £m**
Central	48.4	(6.8)	52.7	(12.7)
Upside	41.4	(13.8)	47.1	(18.3)
Downside	51.5	(3.7)	68.1	2.7
Severe downside	96.7	41.5	106.1	40.7

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

Scenario weightings

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

The weightings used, at the results of applying this sensitivity to the 31 March 2022 scenarios are set out below.

	Weighting				Impairment	Difference
	Central	**Upside**	**Downside**	**Severe**	**£m**	**£m**
As reported	40%	10%	35%	15%	55.2	-
Sensitivity	40%	30%	25%	5%	47.4	7.8

Significant increase in credit risk

The most significant driver of SICR is relative PD. If all PDs across the Group's principal buy-to-let mortgage book were increased by 10%, loans with a gross value of £97.5m would transfer from Stage 1 to Stage 2 (30 September 2021: £99.0m), and the total provision would increase by £0.7m from the combined effects of higher PDs on expected losses and the impact of providing for expected lifetime losses, rather than 12-month losses on the additional Stage 2 cases (30 September 2021: £1.1m).

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11. IMPAIRMENT PROVISION ON LOANS TO CUSTOMERS (Continued)

Value of security

The principal assumptions impacting the LGD are the estimated security values. If the rate of growth in house prices assumed by the model after the forecast minimum were halved, ignoring any PD effects, then the provision for the Group's first and second mortgage assets under the central scenario would increase by £2.6m (30 September 2021: £3.3m).

Receiver of rent

The majority of receiver of rent cases, which are included in Stage 3, are managed long-term and therefore their assumed realisation date has an important impact on the provision calculation. If the assumed rate of realisation was increased by 20%, the impairment provision in the central scenario would increase by £0.5m (30 September 2021: £0.6m).

12. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m	30 September 2020 £m
Derivative financial assets	201.7	180.7	44.2	463.3
Derivative financial liabilities	(32.5)	(76.2)	(43.9)	(132.4)
	169.2	104.5	0.3	330.9
Of which:				
Cross-currency basis swaps	-	153.0	-	445.3
Interest rate swaps in hedging relationships	151.7	(51.6)	(3.0)	(115.6)
Other interest rate swaps	17.6	3.0	3.5	1.0
Currency futures	(0.1)	0.1	(0.2)	0.2
	169.2	104.5	0.3	330.9

All hedging relationships and strategies at 30 September 2021 described in note 19 to the 2021 Group Accounts have continued in the period. The Group's remaining LIBOR-linked derivatives transitioned to a SONIA-linked basis during the period, on the basis set out in the 2021 Group Accounts.

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12. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

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

	Note	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m	30 September 2020 £m
Derivative financial instruments					
Assets		201.7	27.7	44.2	18.0
Liabilities		(32.5)	(76.2)	(43.9)	(132.4)
		169.2	(48.5)	0.3	(114.4)
Fair value hedging adjustments					
On loans to customers	10	(151.5)	58.1	5.5	109.7
On retail deposits	14	30.9	(3.1)	3.0	(10.4)
		(120.6)	55.0	8.5	99.3
Net balance sheet position		48.6	6.5	8.8	(15.1)
Collateral balances					
Posted (in sundry assets)		-	61.3	36.6	103.5
Received (in sundry liabilities)	16	(64.2)	(3.1)	(0.2)	-
		(64.2)	58.2	36.4	103.5

Certain of the Group's securitisation borrowings were denominated in euros and US dollars, with the last of these liabilities being repaid in 2021. All such borrowings were swapped at inception so that they had the effect of sterling borrowings. These swaps provided an effective hedge against exchange rate movements, and were accounted for as cash flow hedges, but the requirement to carry them at fair value led, when exchange rates had moved significantly since the issue of the notes, to large balances for the swaps being carried in the balance sheet. The debit balance on such swaps was compensated for by retranslating the borrowings at the current exchange rate.

These compensating differences gave rise to the non-cash items shown in note 22 as 'Movements related to asset backed loan notes denominated in currency.'

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13. INTANGIBLE ASSETS

Intangible assets at net book value comprise:

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m	30 September 2020 £m
Goodwill	164.4	164.4	164.4	164.4
Computer software	3.4	3.0	3.4	2.2
Other intangibles	2.3	3.1	2.7	3.5
Total assets	170.1	170.5	170.5	170.1

The balance for goodwill at 31 March 2022 shown above includes £113.0m in respect of the SME Lending Cash Generating Unit ('CGU') and £49.8m in respect of the Development Finance CGU. Given the changes in the economic outlook for the UK since 30 September 2021, and their potential impact on the outlook for these businesses, these balances have been retested for impairment in accordance with IAS 36 for good order.

These tests were conducted in the same way as those described in note 24 to the 2021 Group Accounts, using updated forecasts. The levels of business activity in these forecasts are considered by management to form a reasonable basis for the assessment of goodwill based on past experience and the current economic environment. The revised key assumptions are set out below.

- The level of business activity in the SME Lending CGU assumes a compound annual growth rate ('CAGR') for new business over the five-year period of 13.8%, a small reduction from the 13.9% assumed at 30 September 2021
- The level of business activity in the Development Finance CGU assumes a CAGR for new commitments over the five-year period of 14.6%, compared with 13.2% used at 30 September 2021
- In both CGUs cash flows beyond the five-year budget are extrapolated using a constant growth rate of 1.6% (30 September 2021: 1.6%) which does not exceed the long-term average growth rates for the markets in which the businesses are active
- The discount rate in both tests is based on third party estimates of the implied industry cost of capital. The pre-tax discount rate applied to the SME Lending cash flow projection is 13.4% (30 September 2021: 13.4%) while that applied to the Development Finance CGU was 13.3% (30 September 2021: 13.2%)

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13. INTANGIBLE ASSETS (Continued)

As an illustration of the sensitivity of these impairment tests to movements in the key assumptions:

- The Group has calculated that a 0.0% growth rate combined with a 4.0% reduction in profit levels in the SME Lending CGU and a stable pre-tax discount rate would eliminate the headroom in the projection. A 0.0% growth rate combined with a 5.0% reduction in profit levels and a 46 basis point increase in the pre-tax discount rate would generate a write down of £10.0m

  In the testing carried out at 30 September 2021, a 0.0% growth rate combined with a 15.0% reduction in profit levels and a 159 basis point increase in the pre-tax discount rate would have eliminated the headroom in the projection. A 0.0% growth rate combined with a 20.7% reduction in profit levels and a 125 basis point increase in the pre-tax discount rate would have generated a write down of £10.0m

- Management believes any reasonably possible change in the key assumptions in the Development Finance CGU would not cause the recoverable amount of the CGU to fall below the balance sheet carrying value. This was also the case in the testing carried out at 30 September 2021

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14. RETAIL DEPOSITS

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

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m	30 September 2020 £m
Fixed rate	5,711.5	5,312.8	5,466.0	4,975.9
Variable rates	4,142.2	3,318.4	3,834.4	2,880.7
	9,853.7	8,631.2	9,300.4	7,856.6

The weighted average interest rate on retail deposits at 31 March 2022, analysed by charging method, is set out below.

	31 March 2022 %	31 March 2021 %	30 September 2021 %	30 September 2020 %
Fixed rate	1.26	1.46	1.25	1.69
Variable rates	0.63	0.46	0.42	0.72
All deposits	0.99	1.08	0.91	1.34

The contractual maturity of these deposits is analysed below.

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m	30 September 2020 £m
Amounts repayable				
In less than three months	1,000.7	670.1	789.0	565.0
In more than three months but not more than one year	3,382.0	2,947.4	3,105.4	2,725.6
In more than one year, but not more than two years	1,457.2	1,599.4	1,580.1	1,541.6
In more than two years, but not more than five years	413.4	596.4	507.4	664.8
Total term deposits	6,253.3	5,813.3	5,981.9	5,497.0
Repayable on demand	3,600.4	2,817.9	3,318.5	2,359.6
	9,853.7	8,631.2	9,300.4	7,856.6
Fair value adjustments for portfolio hedging (note 12)	(30.9)	3.1	(3.0)	10.4
	9,822.8	8,634.3	9,297.4	7,867.0

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15. BORROWINGS

On 4 March 2022 Fitch Ratings upgraded the Group's Long-Term Issuer Default Rating from BBB to BBB+, with a stable outlook. It also upgraded the senior unsecured debt rating to BBB from BBB- and the rating of the Groups Tier-2 bond from BB+ to BBB-, meaning that this security now enjoys an investment-grade rating.

All borrowings described in the Group Accounts for the year ended 30 September 2021 remained in place throughout the period, except as noted below.

On 21 October 2021 all of the Group's drawings under the Bank of England Term Funding Scheme for SME's ('TFSME') were repaid and redrawn, extending the tenor of this borrowing to 21 October 2025. No further amounts were drawn in the period and the TFSME is no longer available for new drawings.

The Group's remaining drawings under the Bank of England Term Funding Scheme ('TFS') were repaid in the year. The Group retains access to the Bank of England Indexed Long-Term Repo scheme ('ILTR') for short term liquidity purposes and £100.0m had been drawn at 31 March 2022 (30 September 2021: £nil, 31 March 2021: £nil) at an interest rate of 0.15% above bank base rate.

On 8 November 2021 revisions were agreed to the Group's warehouse facility, held in Paragon Seventh Funding Limited. This increased the maximum facility to £450.0m and amended the interest rate payable to 0.5% above SONIA. The commitment period was extended for an initial 13-month period with the ability to extend monthly until a potential final maturity date of 24 November 2024.

The Group's £125.0m retail bond was repaid in full at its due date in January 2022.

Repayments made in respect of the Group's borrowings are shown in note 24.

During the period all of the Group's remaining LIBOR linked borrowings were transitioned to SONIA based rates, as described in the 2021 Annual Report and Accounts.

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16. SUNDRY LIABILITIES

Sundry liabilities include:

	Note	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m
Amounts falling due within one year				
Contingent consideration		1.9	5.3	4.6
Lease liabilities		2.2	1.6	1.5
CSA liabilities	12	64.2	3.1	0.2
Other sundry liabilities		66.9	57.9	62.3
		135.2	67.9	68.6
Amounts falling due after more than one year				
Contingent consideration		-	6.2	2.9
Lease liabilities		7.6	3.8	8.0
Other sundry liabilities		13.0	18.0	11.2
		20.6	28.0	22.1
Total				
Contingent consideration		1.9	11.5	7.5
Lease liabilities		9.8	5.4	9.5
Other sundry liabilities		144.1	79.0	73.7
		155.8	95.9	90.7

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17. RETIREMENT BENEFIT OBLIGATIONS

The defined benefit obligation at 31 March 2022 has been calculated on a year-to-date basis. Since the last IAS 19 actuarial valuation at 30 September 2021, 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 2022. In particular, over the period since the 30 September 2021 actuarial valuation, the discount rate has increased by 75 basis points per annum, whereas expectations of long-term inflation have increased by a lower amount, around 20 basis points.

The net effect of these changes, together with the Group's contributions and the performance of the plan assets, has resulted in the value of the net defined benefit obligations at 31 March 2022 moving to a surplus position from a deficit at 30 September 2021. The impact of allowing for the changes in actuarial assumptions has been recognised as an actuarial gain in other comprehensive income.

The Group has recognised the surplus as an asset at the balance sheet date as it anticipates being able to access economic benefits at least as great as the carrying value. However such assets are eliminated from capital for regulatory purposes (note 26).

The movements in the amount recognised in respect of the defined benefit plan during the six month period ended 31 March 2022 are summarised below.

	Six months to 31 March 2022 £m	Six months to 31 March 2021 £m	Year to 30 September 2021 £m
Opening pension (deficit)	(10.3)	(20.4)	(20.4)
Employer contributions	1.9	2.6	4.8
Amounts posted to profit and loss			
Current service cost	(0.4)	(1.1)	(1.8)
Net funding cost (note 4)	(0.1)	(0.2)	(0.3)
Administrative expenses	(0.4)	(0.5)	(0.8)
Amounts posted to other comprehensive income			
Return on plan assets not included in interest	(7.5)	2.7	11.0
Experience gain on liabilities	-	-	-
Actuarial gain / (loss) from changes in financial assumptions	21.2	5.1	(1.7)
Actuarial gain / (loss) from changes in demographic assumptions	-	-	(1.1)
Closing pension surplus / (deficit)	4.4	(11.8)	(10.3)

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

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18. CALLED-UP SHARE CAPITAL

Movements in the issued share capital in the period were:

	Six months to 31 March 2022 Number	Six months to 31 March 2021 Number	Year to 30 September 2021 Number
Ordinary shares of £1 each			
Opening share capital	262,495,185	261,777,972	261,777,972
Shares issued	113,554	219,779	717,213
Shares cancelled	(12,100,834)	-	-
Closing share capital	250,507,905	261,997,751	262,495,185

During the period, the Company issued 113,554 shares (six months ended 31 March 2021: 219,779; year ended 30 September 2021: 717,213) to satisfy options granted under Sharesave schemes for a consideration of £341,517 (six months ended 31 March 2021: £751,254; year ended 30 September 2021: £2,196,934).

On 24 November 2021, 12,100,834 shares held in treasury at 30 September 2021 were cancelled.

19. RESERVES

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m	30 September 2020 £m
Share premium account	70.4	69.2	70.1	68.7
Capital redemption reserve	62.4	50.3	50.3	50.3
Merger reserve	(70.2)	(70.2)	(70.2)	(70.2)
Cash flow hedging reserve	-	0.2	-	2.5
Profit and loss account	1,013.2	927.4	1,005.9	880.7
	1,075.8	976.9	1,056.1	932.0

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For the six months ended 31 March 2022 (Unaudited)

20. OWN SHARES

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m
Treasury shares			
Opening balance	60.7	23.0	23.0
Shares purchased	27.2	-	37.7
Shares cancelled	(60.7)	-	-
Closing balance	27.2	23.0	60.7
ESOP shares			
Opening balance	16.0	14.8	14.8
Shares purchased	12.5	-	4.5
Options exercised	(9.1)	(2.7)	(3.3)
Closing balance	19.4	12.1	16.0
Total closing balance	46.6	35.1	76.7
Total opening balance	76.7	37.8	37.8
Number of shares held			
Treasury	5,025,743	5,218,702	12,100,834
ESOP	4,015,675	3,056,632	3,732,324
Total at own shares	9,041,418	8,275,334	15,833,158

At 31 March 2022 an irrevocable instruction for the purchase of a further £12.7m of shares was in place. This instruction was completed before the approval date of this report.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
For the six months ended 31 March 2022 (Unaudited)

21. EQUITY DIVIDEND

Amounts recognised as distributions to equity shareholders in the period:

	Six months to 31 March 2022 £m	Six months to 31 March 2021 £m	Year to 30 September 2021 £m
Final dividend for the year ended 30 September 2021 of 18.9p per share	46.6	-	-
Final dividend for the year ended 30 September 2020 of 14.4p per share	-	36.5	36.5
Interim dividend for the year ended 30 September 2021 of 7.2p per share	-	-	18.1
	46.6	36.5	54.6

An interim dividend of 9.4p is proposed for the period (2021: 7.2p per share), for the reasons set out in note 26(c). This will be paid on 29 July 2022 with a record date of 8 July 2022. The amount expected to be absorbed by this dividend, based on the number of shares in issue at the balance sheet date is £22.7m (31 March 2021: £18.3m). The interim dividend will be recognised in the accounts when it is paid.

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SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
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22. NET CASH FLOW FROM OPERATING ACTIVITIES

	Six months to 31 March 2022 £m	Six months to 31 March 2021 £m	Year to 30 September 2021 £m
Profit before tax	143.6	96.4	213.7
Non-cash items included in profit, and other adjustments			
Depreciation of property, plant and equipment	1.7	2.0	4.3
(Profit) / loss on disposal of property, plant and equipment	(0.1)	-	0.1
Amortisation of intangible assets	1.0	1.0	2.0
Movements related to asset backed loan notes denominated in currency	-	(289.4)	(442.3)
Other non-cash movements on borrowings	1.0	(1.9)	2.5
Impairment losses on loans to customers	1.3	6.0	(4.7)
Charge for share based remuneration	4.4	4.4	8.9
Net (increase) / decrease in operating assets			
Assets held for leasing	(3.4)	1.7	0.2
Loans to customers	(513.5)	(190.9)	(766.6)
Derivative financial instruments	(157.5)	282.6	419.1
Fair value of portfolio hedges	157.0	51.6	104.2
Other receivables	28.4	39.2	58.8
Net increase / (decrease) in operating liabilities			
Retail deposits	553.3	774.6	1,443.8
Derivative financial instruments	(11.4)	(56.2)	(88.5)
Fair value of portfolio hedges	(27.9)	(7.3)	(13.4)
Other liabilities	68.1	(5.1)	(15.7)
Cash generated by operations	246.0	708.7	926.4
Income taxes (paid)	(24.9)	(17.0)	(48.3)
Net cash flow generated by operating activities	221.1	691.7	878.1

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

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23. NET CASH FLOW USED IN INVESTING ACTIVITIES

	Six months to 31 March 2022 £m	Six months to 31 March 2021 £m	Year to 30 September 2021 £m
Proceeds from sales of operating property, plant and equipment	0.1	-	-
Purchases of operating property, plant and equipment	(0.7)	(0.9)	(1.9)
Purchases of intangible assets	(0.6)	(1.4)	(2.4)
Net cash (utilised) by investing activities	(1.2)	(2.3)	(4.3)

24. NET CASH FLOW FROM FINANCING ACTIVITIES

	Six months to 31 March 2022 £m	Six months to 31 March 2021 £m	Year to 30 September 2021 £m
Shares issued	0.4	0.7	2.1
Dividends paid (note 21)	(46.6)	(36.5)	(54.6)
Repayment of asset backed floating rate notes	(39.3)	(970.3)	(2,313.1)
Issue of Tier-2 bond	-	149.2	148.9
Redemption of Tier-2 bond	-	(130.9)	(153.7)
Redemption of Retail Bonds	(125.0)	(60.0)	(60.0)
Movement on repurchase agreements	-	50.0	-
Movement on central bank facilities	31.0	390.0	964.6
Movement on other bank facilities	140.9	97.8	71.9
Capital element of lease payments	(0.7)	(1.2)	(2.5)
Purchase of own shares (note 20)	(39.7)	-	(42.2)
Sale of shares	(0.7)	0.1	-
Net cash (utilised) by financing activities	(79.7)	(511.1)	(1,438.6)

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SELECTED NOTES TO THE ACCOUNTS – ANALYSIS
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25. RELATED PARTY TRANSACTIONS

In the six months ended 31 March 2022, the Group has continued the related party relationships described in note 47 on page 243 of the Group's 2021 Annual Report and Accounts. Related party transactions in the period comprise the compensation of the Group's key management personnel, the acceptance of retail deposits from certain non-executive directors, and transactions with the Group Pension Plan.

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

Retail deposits of £18,000 by directors were outstanding at the period end (31 March 2021: £51,000, 30 September 2021: £16,000) and the maximum outstanding in the period was £19,000 (31 March 2021: £301,000, 30 September 2021: £301,000).

Except for the transactions referred to above, there have been no related party transactions in the six months ended 31 March 2022.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2022 (Unaudited)

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

26. 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) 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 which, following the implementation of the Financial Services Act 2021 on 1 January 2022, are implemented through the PRA Rulebook.

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.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
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26. CAPITAL MANAGEMENT (Continued)

The tables below demonstrate that at 31 March 2022 the Group's total regulatory capital of £1,242.4m (31 March 2021: £1,203.8m, 30 September 2021: £1,205.8m) was comfortably in excess of the amounts required by the regulator, including £625.8m in respect of its Total Capital Requirement ('TCR') (31 March 2021: £585.9m, 30 September 2021: £604.2m), which is comprised of fixed and variable elements (none of these amounts are covered by the independent review report).

At 31 March 2022 the Group's TCR represented 8.8% of Total Risk Exposure ('TRE') (30 September 2021: 8.8%).

The CRR also requires firms to hold additional capital buffers, including a Capital Conservation Buffer ('CCoB') of 2.5% of TRE (at 31 March 2022) and a Counter Cyclical Buffer ('CCyB'), currently 0.0% of TRE (30 September 2021: 0.0%). The UK CCyB will increase to 1.0% of TRE from December 2022, and its long-term rate in a standard risk environment is expected to be 2.0%. Firm specific buffers may also be required.

The Group's regulatory capital differs from its equity as certain adjustments are required by the PRA Rulebook or the regulator. A reconciliation of the Group's equity to its regulatory capital determined in accordance with the PRA Rulebook at 31 March 2022 is set out below.

	Note	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m	30 September 2020 £m
Total equity	§	1,279.7	1,203.8	1,241.9	1,156.0
Deductions					
Proposed dividend	21	(22.7)	(18.3)	(46.6)	(36.4)
Irrevocable share buy-back instructions	20	(12.7)	-	-	-
IFRS 9 transitional relief	*	21.9	41.4	29.7	42.3
Intangible assets	13	(170.1)	(170.5)	(170.5)	(170.1)
Pension surplus net of deferred tax		(3.5)	-	-	-
Software relief	†	-	1.2	1.4	-
Prudent valuation adjustments	β	(0.2)	(0.3)	(0.1)	(0.6)
Common Equity Tier 1 ('CET1') capital		1,092.4	1,057.3	1,055.8	991.2
Other tier 1 capital		-	-	-	-
Total Tier 1 capital		1,092.4	1,057.3	1,055.8	991.2
Corporate bond		150.0	169.1	150.0	150.0
Eligibility cap	Φ	-	(22.6)	-	-
Total Tier 2 capital		150.0	146.5	150.0	150.0
Total regulatory capital ('TRC')		1,242.4	1,203.8	1,205.8	1,141.2

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SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2022 (Unaudited)

26. CAPITAL MANAGEMENT (Continued)

§ Including results for the six months ended 31 March 2022 which have been verified by the Group's external auditor for regulatory purposes.

* Firms are permitted to phase in the impact of IFRS 9 transition and of the impact of Covid-related IFRS 9 impairment provisions over a five year period. This is explained more fully in note 53 (a) to the 2021 Group Accounts.

† Under a relief enacted by the EU in December 2020 an amount in respect of software assets in intangibles was added back to capital. This was calculated in accordance with Article 36 (1) (b) of the CRR. This relief was rescinded for UK firms from 1 January 2022.

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

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

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

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m	30 September 2020 £m
Credit risk				
Balance sheet assets	6,362.5	5,899.6	6,073.5	6,171.7
Off balance sheet	92.0	111.2	143.9	104.1
IFRS 9 transitional relief	21.9	41.4	29.7	42.3
Total credit risk	6,476.4	6,052.2	6,247.1	6,318.1
Operational risk	576.0	544.3	576.0	544.3
Market risk	-	-	-	-
Other	43.3	19.5	13.7	85.7
Total risk exposure ('TRE')	7,095.7	6,616.0	6,836.8	6,948.1
Solvency ratios	%	%	%	%
CET1	15.4	16.0	15.4	14.3
TRC	17.5	18.2	17.6	16.4

This table is not covered by the Independent Review Report

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

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SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
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26. CAPITAL MANAGEMENT (Continued)

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

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m	30 September 2020 £m
CET1 Capital	1,092.4	1,057.3	1,055.8	991.2
Add back: IFRS 9 relief	(21.9)	(41.4)	(29.7)	(42.3)
Fully loaded CET1 Capital	1,070.5	1,015.9	1,026.1	948.9
TRC	1,242.4	1,203.8	1,205.8	1,141.2
Add back: IFRS 9 relief	(21.9)	(41.4)	(29.7)	(42.3)
Impact on Tier 2 eligibility	-	(0.9)	-	-
Fully loaded TRC	1,220.5	1,161.5	1,176.1	1,098.9
Total risk exposure	7,095.7	6,616.0	6,836.8	6,948.1
Add back: IFRS 9 relief	(21.9)	(41.4)	(29.7)	(42.3)
Fully loaded TRE	7,073.8	6,574.6	6,807.1	6,905.8
Fully loaded solvency ratios	%	%	%	%
CET1	15.1	15.5	15.1	13.7
TRC	17.3	17.7	17.3	15.9

This table is not covered by the Independent Review Report

The TRC at 31 March 2021 on the fully loaded basis of £1,220.5m (31 March 2021: £1,161.5m, 30 September 2021: £1,176.1m) was in excess of the TCR of £623.9m (31 March 2021: £582.4m, 30 September 2021: £601.8m) on the same basis (amounts not covered by the Independent Review Report).

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

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26. CAPITAL MANAGEMENT (Continued)

	Note	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m	30 September 2020 £m
Total balance sheet assets		15,751.0	15,488.8	15,137.0	15,505.5
Add Credit fair value adjustments on loans to customers	10	151.5	-	-	-
Debit fair value adjustments on retail deposits	14	30.9	-	3.0	-
Adjusted balance sheet assets		15,933.4	15,488.8	15,140.0	15,505.5
Less: Derivative assets	12	(201.7)	(180.7)	(44.2)	(463.3)
Central bank deposits	9	(1,265.7)	(1,832.3)	(1,142.0)	(1,637.1)
Cash Ratio Deposits		(27.6)	(19.3)	(23.7)	(15.1)
Accrued interest on sovereign exposures		(0.4)	-	-	-
On-balance sheet items		14,438.0	13,456.5	13,930.1	13,390.0
Less: Intangible assets	13	(170.1)	(170.5)	(170.5)	(170.1)
Pension surplus	17	(4.4)	-	-	-
Software relief		-	1.2	1.4	-
Total on balance sheet exposures		14,263.5	13,287.2	13,761.0	13,219.9
Derivative assets	12	201.7	180.7	44.2	463.3
Potential future exposure on derivatives		29.4	42.7	36.3	92.3
Total derivative exposures		231.1	223.4	80.5	555.6
Post offer pipeline at gross notional amount		1,322.2	1,118.4	1,380.3	949.1
Adjustment to convert to credit equivalent amounts		(1,110.4)	(916.3)	(1,128.3)	(773.8)
Off balance sheet items		211.8	202.1	252.0	175.3
Tier 1 capital		1,092.4	1,057.3	1,055.8	991.2
Total leverage exposure before IFRS 9 relief		14,706.4	13,712.7	14,093.5	13,950.8
IFRS 9 relief		21.9	41.4	29.7	42.3
Total leverage exposure		14,728.3	13,754.1	14,123.2	13,993.1
UK leverage ratio		7.4%	7.7%	7.5%	7.1%

This table is not covered by the Independent Review Report

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2022 (Unaudited)

26. CAPITAL MANAGEMENT (Continued)

The fully loaded leverage ratio is calculated as follows:

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m	30 September 2020 £m
Fully loaded tier 1 capital	1,070.5	1,015.9	1,026.1	948.9
Total leverage exposure before IFRS 9 relief	14,706.4	13,712.7	14,093.5	13,950.8
Fully loaded UK leverage exposure	7.3%	7.4%	7.3%	6.8%

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.

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26. CAPITAL MANAGEMENT (Continued)

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

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

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

The Group's consolidated annualised RoTE for the six months ended 31 March 2022 is derived as follows:

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m	30 September 2020 £m
Profit for the period	109.1	74.2	164.5	91.3
Amortisation of intangible assets	1.0	1.0	2.0	2.0
Adjusted profit	110.1	75.2	166.5	93.3
Divided by				
Opening equity	1,241.9	1,156.0	1,156.0	1,108.4
Opening intangible assets	(170.5)	(170.1)	(170.1)	(171.1)
Opening tangible equity	1,071.4	985.9	985.9	937.3
Closing equity	1,279.7	1,203.8	1,241.9	1,156.0
Closing intangible assets	(170.1)	(170.5)	(170.5)	(170.1)
Closing tangible equity	1,109.6	1,033.3	1,071.4	985.9
Average tangible equity	1,090.5	1,009.6	1,028.7	961.6
Return on tangible equity	20.2%	14.9%	16.2%	9.7%

This table is not covered by the Independent Review Report

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26. CAPITAL MANAGEMENT (Continued)

(c) **Dividend policy**

The Company is committed to a long term sustainable dividend policy. Ordinarily, dividends will increase in line with earnings, subject to the requirements of the business and the availability of cash resources. The Board reviews the policy at least twice a year in advance of announcing its results, taking into account the Group's strategy, capital requirements, principal risks and the objective of enhancing shareholder value. In determining the level of dividend for any year, the Board expects to follow the dividend policy, but will also take into account the level of available retained earnings in the Company, its cash resources and the cash and capital requirements inherent in its business plans.

The distributable reserves of the Company comprise its profit and loss account balance and, other than the requirement for Paragon Bank PLC to retain an appropriate level of regulatory capital, there are no restrictions preventing profits elsewhere in the Group from being distributed to the parent.

Since the year ended 30 September 2018, the Company has adopted a policy of paying out approximately 40% of its basic earnings per share as dividend (a dividend cover ratio of around 2.5 times), in the absence of any idiosyncratic factors which might make such a dividend inappropriate. This policy is reviewed by the Board at least annually. The Company considers it has access to sufficient cash resources to pay dividends at this level and that its distributable reserves are abundant for this purpose.

To provide greater transparency, the Company has also indicated that its interim dividend per share will normally be 50% of the previous final dividend, in the absence of any indicators which might make such a level of payment inappropriate (note 21).

Following a review of the capital position and forecasts, and considering the capital impacts of the stress testing carried out as part of the ICAAP and forecasting processes, the Board determined that an interim distribution in accordance with this policy was appropriate. It therefore declared an interim dividend for the year of 9.4p per share (2021 H1: 7.2p), 50% of the 18.9p final dividend declared for 2021.

In addition, at the time of authorising the 2021 half year report the Board approved a share buy-back of up to £40.0m of shares, which was completed in the period. At the time of the approval of the 2021 year end accounts a further buyback of £50.0m was authorised. This commenced in the period and at 31 March 2021 £27.2m (including costs) had been expended (note 20).

As part of its half year consideration of the Group's capital position, the Board agreed to increase the total amount of this programme from £50.0m to £75.0m. The programme will continue into the second half of the year. All shares acquired are initially held in treasury.

The directors have considered the distributable reserves of the Company and concluded that these distributions are appropriate.

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27. 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. The Group's loan assets at 31 March 2022, 31 March 2021 and 30 September 2021 are analysed below.

	31 March 2022		31 March 2021		30 September 2021	
	£m	%	£m	%	£m	%
Buy-to-let mortgages	11,843.4	85.1%	10,919.0	85.2%	11,424.3	85.2%
Owner occupied mortgages	31.3	0.2%	43.0	0.3%	36.3	0.3%
Total first charge residential mortgages	11,874.7	85.3%	10,962.0	85.5%	11,460.6	85.5%
Second charge mortgage loans	241.9	1.8%	320.2	2.5%	281.7	2.1%
Loans secured on residential property	12,116.6	87.1%	11,282.2	88.0%	11,742.3	87.6%
Development finance	672.9	4.8%	552.3	4.3%	608.2	4.5%
Loans secured on property	12,789.5	91.9%	11,834.5	92.3%	12,350.5	92.1%
Asset finance loans	430.3	3.1%	440.4	3.4%	440.5	3.3%
Motor finance loans	238.0	1.7%	229.3	1.8%	229.2	1.7%
Aircraft mortgages	26.7	0.2%	27.4	0.2%	28.2	0.2%
Structured lending	171.7	1.2%	82.6	0.7%	118.9	0.9%
Invoice finance	24.1	0.2%	14.3	0.1%	20.9	0.2%
Total secured loans	13,680.3	98.3%	12,628.5	98.5%	13,188.2	98.4%
Professions finance	49.5	0.4%	27.9	0.2%	33.1	0.3%
RLS, CBILS and BBLS	94.3	0.7%	50.1	0.4%	83.8	0.6%
Other unsecured commercial loans	14.0	0.1%	11.7	0.1%	10.3	0.1%
Unsecured consumer loans	76.8	0.5%	98.1	0.8%	87.3	0.6%
Total loans to customers	13,914.9	100%	12,816.3	100.0%	13,402.7	100.0%

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SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2022 (Unaudited)

27. CREDIT RISK (Continued)

First and second charge mortgages are secured by charges over residential properties in England and Wales, or similar Scottish or Northern Irish securities.

Development finance loans are secured by a first charge (or similar Scottish security) over the development property and various charges over the build.

Asset finance loans and motor finance loans are effectively secured by the financed asset, while aircraft mortgages are secured by a charge on the aircraft funded.

Structured lending and invoice finance balances are effectively secured over the assets of the customer, with security enhanced by maintaining balances at a level less than the total amount of the security (the advance percentage).

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

Loans made under the Recovery Loan Scheme ('RLS'), the Coronavirus Business Interruption Loan Scheme ('CBILS') and the Bounce Back Loan Scheme ('BBLS') have the benefit of a guarantee underwritten by the UK Government.

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

There are no significant concentrations of credit risk to individual counterparties due to the large number of customers included in the portfolios. All lending is to customers within the UK. The total gross carrying value of the Group's Loans to Customers due from customers with total portfolio exposures over £10.0m is analysed below by product type.

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m
Buy-to-let mortgages	152.0	175.9	163.3
Development finance	231.7	199.3	217.9
Structured lending	166.8	60.7	108.7
Asset finance	-	-	10.4
	550.5	435.9	500.3

The threshold of £10.0m is used internally for monitoring large exposures.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2022 (Unaudited)

27. CREDIT RISK (Continued)

Credit grading

An analysis of the Group's loans to customers by absolute level of credit risk at 31 March 2022 is set out below. The analysed amount represents gross carrying amount.

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
31 March 2022					
Very low risk	10,127.4	678.5	1.4	38.4	10,845.7
Low risk	1,684.4	733.0	81.7	13.9	2,513.0
Moderate risk	160.2	96.0	5.8	18.6	280.6
High risk	41.5	24.0	8.2	18.2	91.9
Very high risk	48.3	28.2	49.2	15.6	141.3
Not graded	86.0	1.2	6.2	4.2	97.6
Total gross carrying amount	12,147.8	1,560.9	152.5	108.9	13,970.1
Impairment	(20.3)	(6.4)	(28.1)	(0.4)	(55.2)
Total loans to customers	12,127.5	1,554.5	124.4	108.5	13,914.9
31 March 2021					
Very low risk	8,954.9	545.2	23.3	44.1	9,567.5
Low risk	1,230.1	89.6	5.7	18.3	1,343.7
Moderate risk	748.0	175.7	10.6	27.5	961.8
High risk	258.0	140.7	48.6	26.3	473.6
Very high risk	44.3	44.4	45.4	19.6	153.7
Not graded	287.8	71.6	33.1	5.9	398.4
Total gross carrying amount	11,523.1	1,067.2	166.7	141.7	12,898.7
Impairment	(22.0)	(19.0)	(41.0)	(0.4)	(82.4)
Total loans to customers	11,501.1	1,048.2	125.7	141.3	12,816.3
30 September 2021					
Very low risk	9,834.5	563.8	1.3	41.9	10,441.5
Low risk	1,716.9	532.2	78.5	16.3	2,343.9
Moderate risk	149.2	130.2	3.8	22.4	305.6
High risk	42.0	23.7	11.6	21.7	99.0
Very high risk	42.0	27.5	62.0	17.4	148.9
Not graded	115.8	1.7	7.1	4.6	129.2
Total gross carrying amount	11,900.4	1,279.1	164.3	124.3	13,468.1
Impairment	(15.0)	(11.3)	(38.9)	(0.2)	(65.4)
Total loans to customers	11,885.4	1,267.8	125.4	124.1	13,402.7

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2022 (Unaudited)

27. CREDIT RISK (Continued)

Gradings above are based on credit scorecards or internally assigned risk ratings as appropriate for the individual asset class. These measures are calibrated across product types and used internally to monitor the Group's overall credit risk profile against its risk appetite.

These gradings represent current credit quality on an absolute basis and this may result in assets in higher IFRS 9 stages with low risk grades, especially where a case qualifies through breaching, for example, an arrears threshold but is making regular payments. This will apply especially to Stage 3 cases reported in note 11, other than those shown as 'realisations'.

Examples of these cases include fully up-to-date receiver of rent cases, customers who may be up-to-date on accounts with other lenders and accounts where the default on the Group's loan has yet to impact on external credit score.

A small proportion of the loan book (0.7%) is classed as 'not graded' above. This rating relates to loans that have been fully underwritten at origination but where the customer falls outside the automated assessment techniques used post-completion. This has been reduced from the 1.0% classified as ungraded at 30 September 2021 partly as a result of updated data methodologies. This disclosure is expected to be developed further in future periods.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2022 (Unaudited)

27. CREDIT RISK (Continued)

Credit characteristic by portfolio

Loans secured on residential property

An analysis of the indexed loan-to-value ('LTV') ratio for those loan accounts secured on residential property by value at 31 March 2022 is set out below. LTVs for second charge mortgages are calculated allowing for the interest of the first charge holder, based on the most recent first charge amount held by the Group, while for acquired accounts the effect of any discount on purchase is allowed for.

	31 March 2022		31 March 2021		30 September 2021	
	First Mortgages	Second Charge Mortgages	First Mortgages	Second Charge Mortgages	First Mortgages	Second Charge Mortgages
	%	%	%	%	%	%
LTV ratio						
Less than 70%	89.0	94.2	69.5	80.0	83.8	88.4
70% to 80%	9.5	3.4	27.7	14.5	14.3	8.5
80% to 90%	0.3	1.0	1.2	2.8	0.5	1.5
90% to 100%	0.3	0.4	0.3	0.9	0.3	0.6
Over 100%	0.9	1.0	1.3	1.8	1.1	1.0
	100.0	100.0	100.0	100.0	100.0	100.0
Average LTV ratio	59.2	53.2	64.3	60.0	61.6	56.1
Buy-to-let	59.2		64.4		61.2	
Owner-occupied	38.9		45.6		42.0	

The regionally indexed LTVs shown above are affected by changes in house prices, with the Nationwide house price index, for the UK as a whole, registering an increase of 6.7% during the six months ended 31 March 2022 and annual increases of 14.3% in the year ended 31 March 2022 and 10.0% in the year ended 30 September 2021.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2022 (Unaudited)

27. CREDIT RISK (Continued)

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

		First Charge			Second Charge	
	31 March 2022	31 March 2021	30 September 2021	31 March 2022	31 March 2021	30 September 2021
	%	%	%	%	%	%
East Anglia	3.3	3.2	3.3	3.3	3.3	3.3
East Midlands	5.5	5.4	5.5	6.2	6.2	6.3
Greater London	18.3	18.8	18.5	7.9	8.2	7.8
North	3.2	3.2	3.1	4.0	4.0	4.0
North West	10.3	10.4	10.3	7.5	7.3	7.4
South East	31.7	31.7	31.8	38.9	39.4	39.3
South West	8.7	8.6	8.7	8.4	8.2	8.3
West Midlands	5.7	5.4	5.5	7.2	7.1	7.1
Yorkshire and Humberside	7.9	8.2	8.1	6.0	5.9	6.0
Total England	94.6	94.9	94.8	89.4	89.6	89.5
Northern Ireland	0.1	0.1	0.1	1.9	1.8	1.8
Scotland	2.2	1.8	2.0	5.3	5.1	5.2
Wales	3.1	3.2	3.1	3.4	3.5	3.5
	100.0	100.0	100.0	100.0	100.0	100.0

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 2022		31 March 2021		30 September 2021	
	By value	By number	By value	By number	By value	By number
	%	%	%	%	%	%
LTGDV						
50% or less	7.9	5.5	5.3	4.9	2.9	5.3
50% to 60%	21.1	21.1	24.4	17.9	27.3	20.6
60% to 65%	43.4	44.0	43.0	46.2	44.3	49.4
65% to 70%	24.3	25.4	23.1	26.9	22.8	21.9
70% to 75%	1.0	2.2	1.9	2.7	1.4	1.6
Over 75%	2.3	1.8	2.3	1.4	1.3	1.2
	100.0	100.0	100.0	100.0	100.0	100.0

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2022 (Unaudited)

27. CREDIT RISK (Continued)

The average LTGDV cover at the period end was 62.1% (31 March 2021: 62.4%, 30 September 2021: 61.7%).

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 2022, the development finance portfolio comprised 275 accounts (31 March 2021: 223, 30 September 2021: 247) with a total carrying value of £672.9m (31 March 2021: £552.3m, 30 September 2021: £608.2m). Of these accounts, only 4 were included in Stage 2 at 31 March 2022 (31 March 2021: 8, 30 September 2021: 10), with 2 accounts included as Stage 3 (31 March 2021: 1, 30 September 2021: none). In addition, one acquired account had been classified as POCI (31 March 2021: 1, 30 September 2021: 1). An allowance for these losses was made in the IFRS 3 fair value calculation.

The geographical distribution of the Group's development finance loans by gross carrying value is set out below.

	31 March 2022 %	31 March 2021 %	30 September 2021 %
East Anglia	2.5	5.0	3.6
East Midlands	9.3	3.3	6.3
Greater London	7.7	8.9	6.1
North	1.2	2.1	2.4
North West	0.9	0.9	1.1
South East	50.5	57.4	57.5
South West	15.2	15.4	13.5
West Midlands	6.6	4.9	4.8
Yorkshire and Humberside	4.9	0.9	3.5
Total England	98.8	98.8	98.8
Northern Ireland	-	-	-
Scotland	1.2	1.2	1.2
Wales	-	-	-
	100.0	100.0	100.0

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2022 (Unaudited)

27. CREDIT RISK (Continued)

Asset finance and Motor finance

Asset finance customers are generally small or medium sized businesses. The nature of the assets underlying the Group's asset finance lending, including loans financed through CBILS, by gross carrying value is set out below.

	31 March 2022 %	31 March 2021 %	30 September 2021 %
Commercial vehicles	35.9	33.2	33.4
Construction plant	33.8	32.8	34.2
Technology	4.6	6.6	7.0
Manufacturing	6.7	6.7	6.2
Refuse disposal vehicles	4.2	5.2	2.3
Other vehicles	4.6	4.1	4.3
Print and paper	1.9	3.1	4.3
Agriculture	2.7	2.9	3.1
Other	5.6	5.4	5.2
	100.0	100.0	100.0

Motor finance loans are secured over cars, motorhomes and light commercial vehicles and represent exposure to consumers and small businesses.

Structured lending

The Group's structured lending division provides revolving loan facilities to support non-bank lending businesses. Loans are made to a Special Purpose Vehicle ('SPV') company controlled by the customer and effectively secured on the loans made by the SPV. Exposure is limited to a percentage of the underlying assets, providing a buffer against credit loss.

Summary details of the structured lending portfolio are presented below.

	31 March 2022	31 March 2021	30 September 2021	30 September 2020
Number of transactions	8	7	8	8
Total facilities (£m)	203.0	121.8	185.5	139.0
Carrying value (£m)	171.7	82.6	118.9	94.9

The maximum advance under these facilities was 90% of the underlying assets.

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SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2022 (Unaudited)

27. CREDIT RISK (Continued)

These accounts do not have a requirement to make regular payments, operating on a revolving basis. The performance of each loan is monitored monthly on a case by case basis by the Group's Credit Risk function, assessing compliance with covenants relating to both the customers and the performance and composition of the asset pool. These assessments, which are reported to Credit Committee, are used to inform the assessment of expected credit loss under IFRS 9.

At 31 March 2022 all of these facilities were identified as Stage 1. At 31 March 2021 two facilities were identified as Stage 2 (30 September 2021: 1) with the remainder in Stage 1.

RLS, CBILS and BBLS

Loans under these schemes have the benefit of guarantees underwritten by the UK Government, which launched them as a response to the impact of Covid on UK SMEs.

CBILS and BBLS were launched in 2020 and remained open for new applications until March 2021. RLS was launched in April 2021 as a successor scheme and is expected to be available until June 2022.

The Group offered term loans and asset finance loans under CBIL scheme. Interest and fees are paid by the UK Government for the first twelve months and the government guarantees covers up to 80% of the lender's principal loss after the application of any proceeds from the asset financed (if applicable).

Loans under the BBL scheme are six year term loans at a standard 2.5% per annum interest rate. The UK Government pays the interest on the loan for the first twelve months and provides lenders with a guarantee covering the whole outstanding balance.

The Group offers term loans and asset finance loans under the RLS. Interest and fees are payable by the customer from inception. The Government guarantee covers up to 80% of the lender's principal loss, after the application of any proceeds from the asset financed (if applicable), on applications received before 1 January 2022 and up to 70% for applications received thereafter.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2022 (Unaudited)

27. CREDIT RISK (Continued)

The Group's outstanding RLS, CBILS and BBLS loans at 31 March 2022 were:

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m
RLS			
Term loans	0.3	-	0.1
Asset finance	39.1	-	20.7
Total RLS	39.4	-	20.8
CBILS			
Term loans	22.1	29.3	28.1
Asset finance	28.3	15.6	29.9
Total CBILS	50.4	44.9	58.0
BBLS	4.5	5.2	5.0
Total	94.3	50.1	83.8

At 31 March 2022, £0.1m of this balance was considered to be non-performing (30 September 2021: £0.2m).

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.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – CAPITAL AND FINANCIAL RISK
For the six months ended 31 March 2022 (Unaudited)

27. CREDIT RISK (Continued)

Arrears performance

The number of accounts in arrears by asset class, based on the most commonly quoted definition of arrears for the type of asset, at 31 March 2022, 31 March 2021 and 30 September 2021, compared to the industry averages at those dates published by UK Finance ('UKF') and the Finance and Leasing Association ('FLA'), was:

	31 March 2022 %	31 March 2021 %	30 September 2021 %
First mortgages			
Accounts more than three months in arrears			
Buy-to-let accounts including receiver of rent cases	0.15	0.22	0.21
Buy-to-let accounts excluding receiver of rent cases	0.11	0.19	0.14
Owner-occupied accounts	4.13	4.06	4.48
UKF data for mortgage accounts more than three months in arrears			
Buy-to-let accounts including receiver of rent cases	0.46	0.57	0.47
Buy-to-let accounts excluding receiver of rent cases	0.42	0.54	0.45
Owner-occupied accounts	0.85	1.01	0.94
All mortgages	0.77	0.92	0.85
Second charge mortgage loans			
Accounts more than 2 months in arrears			
All accounts	20.13	15.74	19.08
Post-2010 originations	1.50	1.00	1.18
Legacy cases	23.89	22.18	23.12
Purchased assets	26.03	19.22	24.76
FLA data for second mortgages	8.10	8.90	8.60
Motor finance loans			
Accounts more than 2 months in arrears			
All accounts	3.37	4.69	4.15
Originated cases	2.20	2.25	2.30
Purchased assets	12.93	13.69	14.07
FLA data for consumer point of sale hire purchase	3.30	*	3.30
Asset finance loans			
Accounts more than 2 months in arrears	0.21	0.86	0.27
FLA data for business lease/hire purchase loans	0.90	1.00	0.70

* No measure published

No published industry data for asset classes comparable to the Group's other books has been identified. Where revised data at 31 March 2021 or 30 September 2021 has been published by the FLA or UKF, the comparative industry figures above have been amended.

Arrears information is not given for development finance, structured lending or factoring activities as the structure of the products means that such a measure is not relevant.

27. CREDIT RISK (Continued)

The Group calculates its headline arrears measure for buy-to-let mortgages, shown above, based on the numbers of accounts three months or more in arrears, including purchased assets, but excluding those cases in possession and receiver of rent cases designated for sale. This is consistent with the methodology used by UKF in compiling its statistics for the buy-to-let mortgage market as a whole.

The number of accounts in arrears will naturally be higher for legacy books, such as the Group's legacy second charge mortgages and residential first mortgages 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 second charge mortgages 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.

Acquired assets

In the debt purchase industry, Estimated Remaining Collections ('ERCs') is commonly used as a measure of the value of a portfolio. This is defined as the sum of the undiscounted cash flows expected to be received over a specified future period. In the Group's view, this measure may be suitable for heavily discounted, unsecured, distressed portfolios (which will be treated as POCI under IFRS 9) but is less applicable for some types of portfolio in which the Group has invested, where cash flows are higher on acquisition, loans may be secured on property and customers may not be in default. In such cases, the IFRS 9 amortised cost balance, at which these assets are carried in the Group balance sheet, provides a better indication of value.

However, to aid comparability, the 84 and 120 month ERCs value for the Group's purchased consumer assets are set out below. These are derived from the same models and assumptions used in the effective interest rate calculations. ERCs are set out both for all purchased consumer portfolios and for those classified as POCI under IFRS 9.

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m	30 September 2020 £m
All purchased consumer assets				
Carrying value	164.3	208.9	185.2	235.3
84 month ERCs	195.3	249.0	221.2	277.8
120 month ERCs	212.3	277.7	245.2	313.7
POCI assets only				
Carrying value	102.2	126.1	113.2	139.8
84 month ERCs	127.8	160.8	143.9	176.9
120 month ERCs	142.3	182.3	163.4	203.7

Amounts shown include loans disclosed as consumer loans and first mortgages (note 10).

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2022 (Unaudited)

The notes set out below describe the accounting basis on which the Group prepares its accounts, the particular accounting policies adopted by the Group and the principal judgements and estimates which were required in the preparation of the condensed financial information.

They also include other information describing how the condensed financial information has been prepared required by legislation and accounting standards.

28. ACCOUNTING POLICIES

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

The condensed financial statements are required to be prepared as the basis of the accounting policies expected to be used in the production of the financial statements for the year.

The Group is required, by the Companies Act 2006 and the Listing Rules of the FCA, to prepare its financial statements for the year ending 30 September 2022 in accordance with international accounting standards' as adopted in the United Kingdom. In the financial years reported on this also means, in the Group's circumstances, that the financial statements also accord with IFRS as approved by the International Accounting Standards Board.

In previous periods financial statements had been prepared under EU endorsed IFRS, however the change of framework does not change the substance of the requirements applying to the Group and no prior-year restatement of the financial statements is required.

The accounting policies adopted in the current year are therefore the same as those set out in the 2021 Annual Report and Accounts of the Group.

The Group has historically chosen to present an additional comparative balance sheet.

New and revised reporting standards

New reporting standards and interpretations in issue but not effective do not address matters relevant to the Group's accounting and reporting.

No new or revised reporting standards significantly affecting the Group's accounting have been issued since the approval of the Group's financial statements for the year ended 30 September 2021.

29. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The critical accounting estimates and judgements affecting the condensed financial information are the same as those described in notes 62 and 63 to the accounts of the Group for the year ended 30 September 2021.

The current state of the UK economy continues to have a significant impact on the reliability of these estimates. The potential for any resurgence in Covid, the building pressures on the cost of living and doing business in the UK from increasing interest rates and inflationary pressures and the global economic effects of the conflict in Ukraine all contribute to the inherent uncertainty surrounding any estimates which attempt to model the future economic behaviour of business and consumers.

(a) **Significant Increase in Credit Risk ('SICR')**

Under IFRS 9, the directors are required to assess where a credit obligation has suffered a Significant Increase in Credit Risk ('SICR'). The directors' assessment is based primarily on changes in the calculated probability of default, 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.

During the Covid pandemic the Group granted certain accounts a period of payment relief, in accordance with government and regulatory expectations. For some of these cases an extension to this relief was granted. While no accounts remain on such reliefs at the period end, the performance of such cases has been more volatile than general, particularly for accounts granted extended reliefs. In consequence buy-to-let accounts which had extended payment relief have been classified as SICR cases.

If additional accounts were determined to have an SICR, these balances would attract additional impairment provision, as such cases are provided on the basis of lifetime expected loss, rather the 12-month expected loss, and the overall provision charge would be higher. Conversely, if cases are incorrectly identified as SICR, impairment provisions will be overstated. Furthermore, adjustments to current PD estimates in the Group's models may also have the effect of identifying more or less accounts as having an SICR.

More information on the definition of SICR adopted is given in note 11.

(b) **Impairment losses on loans to customers**

Impairment losses on loans are calculated based on statistical models, applied to the present status, performance and management strategy for the loans concerned which are used to determine each loan's PD and LGD.

Internal information used will include number of months arrears, qualitative information, such as possession by a first charge holder on a second charge mortgage or where a buy-to-let case is under the control of a receiver of rent, the receiver's present and likely future strategy for the property (which might include keeping current tenants in place, refurbish and relet, immediate sale etc).

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SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2022 (Unaudited)

29. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

External information used includes customer specific data, such as credit bureau information as well as more general economic data.

Key internal assumptions in the models relate to estimates of future cash flows from customers' accounts, their timing and, for secured accounts, the expected proceeds from the realisation of the property or other charged assets. These cash flows will include payments received from the customer, and, for buy-to-let cases where a receiver of rent is appointed, rental receipts from tenants, after allowing for void periods and running costs. These key assumptions are based on observed data from historical patterns and are updated regularly based on new data as it becomes available.

In addition, the directors consider how appropriate past trends and patterns might be in the current economic situation and make any adjustments they believe are necessary to reflect current and expected conditions.

In the current economic situation this process is made more complex by both the elevated level of uncertainties and the lack of recent experience of similar situations against which to benchmark. At the same time, the level to which Covid-related 'scarring' has yet to manifest itself in credit metrics is still unclear.

The accuracy of the impairment calculations will be affected by unexpected changes to the economic situation, variances between the models used and the actual results, or assumptions which differ from the actual outcomes. In particular, if the impact of economic factors such as employment levels on customers is worse than is implicit in the model then the number of accounts requiring provision might be greater than suggested by the model, while falls in house prices, over and above any assumed by the model might increase the provision required in respect of accounts currently provided. Similarly, if the account management approach assumed in the modelling cannot be adopted the provision required may be different.

In order to provide forward looking economic inputs to the modelling of the ECL, the Group must derive a set of scenarios which are internally coherent. The Group addresses these requirements using four distinct economic scenarios chosen to represent the range of possible outcomes. These scenarios at 31 March 2022 have been derived in light of the current economic situation, modelling a variety of possible outcomes as described in note 11. It should be noted, however, that there remains a significant range of differing opinions amongst economists about the longer-term prospects for the UK, which have diverged again over the period since September 2021, with both UK economic and geopolitical uncertainties building.

The variables are used for two purposes in the IFRS 9 calculations:

- They are applied as inputs in the models which generate PD values, where those found by statistical analysis to have the most predictive value are used
- They are used as part of the calculation where the variable has a direct impact on the expected loss calculation, such as the HPI

The economic variables will also inform assumptions about the Group's approach to account management given a particular scenario.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2022 (Unaudited)

29. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

In addition to uncertainty created by the economic scenarios, the Group recognises that economic situations can arise which lie outside the range of situations considered when it originally derived its IFRS 9 approach to impairment and which informed the development of its impairment models. It is considered that the current forecast scenarios, which include higher rates of interest and inflation than in the historically observed data represent situations of this kind. The Group therefore considered, for each class of asset, whether any adjustment to the normal approach was required to ensure sufficient provision was created and also reviewed other available data, both from account performance and customer feedback to form a view of the underlying reasons for observed customer behaviours and of their future intentions and prospects.

The position after considering all these matters is set out in note 11, together with further information on the Group's approach. The economic scenarios referred to above and their impact on the overall provision are set out in that note.

(c) **Effective interest rates**

In order to determine the EIR applicable to loans and borrowings an estimate must be made of the expected life of each asset or liability and hence the cash flows relating thereto, including those relating to early redemption charges. For purchased loan accounts this will involve estimating the likely future credit performance of the accounts at the time of acquisition. For each portfolio a model is in place to ensure that income is appropriately spread.

The underlying estimates are based on historical data and reviewed regularly. For purchased accounts historical data obtained from the vendor will be examined. The accuracy of the EIR applied would therefore be compromised by any differences between actual repayment profiles and those predicted, which in turn would depend directly or indirectly (in the case of borrowings) on customer behaviour.

To illustrate the potential impact of variability of the estimate, the amortised cost values were recalculated by changing one factor in the EIR calculation and keeping all others at their current levels. This exercise indicated that:

- A reduction of the assumed average lives of loans secured on residential property by three months would reduce balance sheet assets by £11.9m (30 September 2021: £12.0m), while an increase of the assumed asset lives of such assets by three months would increase balance sheet assets by £12.0m (30 September 2021: £12.1m).
- An increase of 50% in the number of five year fixed rate buy-to-let loan assets assumed to redeem before the end of the fixed rate period, generating additional early redemption charges would increase balance sheet assets by £9.8m (30 September 2021: £11.2m).
- A reduction (or increase) in estimated cash flows from purchased loan assets of 5% would reduce (or increase) balance sheet assets by £6.1m (30 September 2021: £7.1m).

As any of these changes would, in reality, be accompanied by movements in other factors, actual outcomes may differ from these estimates.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2022 (Unaudited)

29. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

(d) **Impairment of goodwill**

The carrying value of goodwill recognised on acquisitions is validated by use of an impairment test based on the projected cash flows for the CGU, based on management forecasts and other assumptions including a discount factor.

The accuracy of this impairment calculation would be compromised by any differences between the forecasts used and the levels of business activity that the CGU is able to achieve in practice. The potential impacts of Covid scarring and wider economic uncertainties in the UK mean that there is a greater risk of inaccuracy in compiling these forecasts. This test will also be affected by the accuracy of the discount factor used.

The sensitivity of the impairment test to reasonably possible movements in these assumptions is discussed in note 13.

30. GOING CONCERN BASIS

The condensed financial information for the half year has been prepared on the going concern basis.

Accounting standards require the directors to assess the Group's ability to continue to adopt the going concern basis of accounting. In performing this assessment, the directors consider all available information about the future, the possible outcomes of events and changes in conditions and the realistically possible responses to such events and conditions that would be available to them, having regard to the 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' published by the Financial Reporting Council in September 2014 applicable to half-yearly reporting.

Particular focus is given to the Group's financial forecasts for this period to ensure the adequacy of resources available for the Group to meet its business objectives on both a short term and strategic basis. The guidance requires that this assessment covers a period of at least twelve months from the date of approval of this half-yearly report.

The business activities of the Group, its current operations and those factors likely to affect its future results and development, together with a description of its financial position and funding position, are described in the Interim Management Report on pages 4 to 57. The principal risks and uncertainties affecting the Group in the forthcoming six months are described on pages 158 to 163.

Note 53 to the 2021 Group Accounts includes an analysis of the Group's regulatory and working capital position and policies, while notes 54 to 57 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. Notes 62 and 63 to those accounts discusses critical accounting judgements and estimates affecting the results and financial position disclosed therein. The position and policies described in these notes remain materially unchanged to the date of this half-yearly report, subject to the changes in funding described in note 15.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2022 (Unaudited)

30. GOING CONCERN BASIS (CONTINUED)

Financial forecasts

The Group has a formalised process of budgeting, reporting and review. The Group's planning procedures forecast its profitability, capital position, funding requirement and cash flows. Detailed plans are produced for two year periods with longer-term forecasts covering a five year period which include detailed income forecasts. These plans provide information to the directors which is used to ensure the adequacy of resources available for the Group to meet its business objectives, both on a short-term and strategic basis.

The Group makes extensive use of stress testing in compiling and reviewing its forecasts. This stress testing approach was recently reviewed in detail as part of the annual Internal Capital Adequacy Assessment Process ('ICAAP') cycle, where testing considered the impact of a number of severe but plausible scenarios. During the planning process, sensitivity analysis was carried out on a number of key assumptions that underpin the forecast to evaluate the impact of the Group's principal risks.

The key stresses modelled in detail to evaluate the forecast were:

- An increase of 20% in buy-to-let volumes. This examined the impact of volumes on profitability and illustrated the extent to which capital resources and liquidity would be stretched due to the higher cash and capital requirements
- Higher funding costs – 25bps higher cost on all new savings deposits throughout. This scenario illustrates the impact of a significant prolonged margin squeeze on profitability and whether this would cause significant impacts on any capital, liquidity or encumbrance ratios
- A 50% reduction in the growth of development finance portfolio coupled with a 50bp reduction in margins. Development finance is the highest yielding product, and this scenario illustrates the effect of product mix on contribution and other ratios
- A doubling of redemption rates for buy-to-let mortgages reaching the end of their fixed rate period. This illustrates the potential risk inherent in the five-year fixed rate business which will mature in 2022 and beyond
- Increased economic stress on customers - as well as modelling the impact of each of the economic scenarios set out in note 11 across the forecast horizon, the severe economic scenario was also modelled over the five year horizon. To ensure this represented a worst-case scenario all other assumptions were held steady, although in reality adjustments to new business appetite and other factors would be made
- Combined downside stress - the half-year IFRS9 downside economic scenario described in note 11 was modelled out for the plan horizon with new business volumes lowered by 15% and the cost of new deposits increased 10 basis points. This presented a plausible set of adverse factors to the business model with a prolonged tail-risk

These stresses did not include management actions which might mitigate the impact of the adverse assumptions used. They were designed to demonstrate how such stresses would affect the Group's financing, capital and liquidity positions and highlight any areas which might impact the Group's going concern assessment. Under all of these scenarios, the Group was able to meet its obligations over the forecast horizon and maintain a surplus over its regulatory requirements for both capital and liquidity through normal balance sheet management activities.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2022 (Unaudited)

30. GOING CONCERN BASIS (CONTINUED)

As part of the ICAAP process the Group also assessed the potential operational risks it could face. This was done through the analysis of the impact and cost of a series of severe but plausible scenarios. This analysis did not highlight any factors which cast doubt on the Group's ability to continue as a going concern.

The Group started the period with a strong capital and liquidity position enabling the management of any significant outflows of deposits and / or reduced inflows from customer receipts. Overall, the forecasts, even under reasonable further levels of stress show the Group retaining sufficient equity, capital, cash and liquidity throughout the forecast period to satisfy its regulatory and operational requirements.

Availability of funding and liquidity

The availability of funding and liquidity is a key consideration, including retail deposit, wholesale funding, central bank and other contingent liquidity options.

The Group's retail deposits of £9,853.7m (note 14) are repayable within five years, with 81.0% (£7,983.1m) of this balance payable within twelve months of the balance sheet date. The liquidity exposure represented by these deposits is closely monitored, a process supervised by the Asset and Liability Committee. The Group is required to hold liquid assets in Paragon Bank to mitigate this liquidity risk. At 31 March 2022, Paragon Bank held £1,257.7m of balance sheet assets for liquidity purposes, all of which comprised central bank deposits (note 9). A further £150.0m of liquidity was provided by the long/short repo arrangement described in the Group's 2021 Annual Report and Accounts. This brings the total available to £1,407.7m.

Paragon Bank manages its liquidity in line with the Board's risk appetite and the requirements of the PRA, which are formally documented in the Board's approved Individual Liquidity Adequacy Assessment Process ('ILAAP') updated annually. The Bank maintains a liquidity framework that includes a short to medium term cash flow requirement analysis, a longer-term funding plan and access to the Bank of England's liquidity insurance facilities, where pre-positioned assets would support further drawings of £2,066.2m. Holdings of the Group's own externally rated mortgage backed loan notes can also be used to access the Bank of England's liquidity facilities or other funding arrangements. At 31 March 2022 the Group had £464.4m (30 September 2021: £529.2m) of such notes available for use, of which £222.3m were rated AAA (30 September 2021: £287.0m). The available AAA notes would give access to £179.1m (30 September 2021: £149.3m) if used to support drawings on Bank of England facilities.

The Group's securitisation funding structures provide match funding for part of the asset base. Repayment of the securitisation borrowings is restricted to funds generated by the underlying assets and there is limited recourse to the Group's general funds. Recent and current loan originations are financed through retail deposits and may be refinanced through securitisation where this is appropriate and cost-effective. While the Group has not accessed the public securitisation market in the period, the market remains active and the Group maintains the infrastructure required to access it.

The earliest maturity of any of the Group's working capital debt is in August 2024, when a retail bond issue of £112.5m matures. All central bank borrowings mature in 2025.

30. GOING CONCERN BASIS (CONTINUED)

The Group's access to debt is also enhanced by its corporate rating, upgraded to BBB+ by Fitch Ratings in March 2022, and its status as an issuer is evidenced by the upgraded BBB-, investment grade, rating of its £150.0m Tier-2 Bonds. It has regularly accessed the capital markets for warehouse funding and corporate and retail bonds over recent years and continues to be able to access these markets.

The Group's cash analysis continues to show strong free cash balances, even after allowing scope for significant discretionary cash outflows and capital distributions.

As described in note 26, the Group's capital base is subject to consolidated supervision by the PRA. Its capital at 31 March 2022 was in excess of regulatory requirements and group forecasts show this continuing to be the case.

Going Concern assessment

In order to assess the appropriateness of the going concern basis the directors considered the Group's financial position, the cash flow requirements laid out in its forecasts, its access to funding, the assumptions underlying the forecasts and potential risks affecting them.

After performing this assessment, the directors concluded that there was no material uncertainty as to whether the Group would be able to maintain adequate capital and liquidity for at least twelve months following the date of approval of this half-yearly report and consequently that it was appropriate for them to continue to adopt the going concern basis in preparing the half-yearly financial information for the Group.

31. FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The Group's financial assets and financial liabilities are valued on one of two bases, defined by IFRS 9:

- Financial assets and liabilities carried at fair value through profit and loss ('FVTPL')
- Financial assets and liabilities carried at amortised cost

IFRS 7 – 'Financial Instruments: Disclosures' requires that, where assets are measured at fair value, these measurements should be classified using a fair value hierarchy reflecting the inputs used and defines three levels.

- Level 1 measurements are unadjusted market prices
- Level 2 measurements are derived from directly or indirectly observable data, such as market prices or rates
- Level 3 measurements rely on significant inputs which are not derived from observable data

As quoted prices are not available for level 2 and 3 measurements, the valuation is derived from cash flow models based, where possible, on independently sourced parameters. The accuracy of the calculation would therefore be affected by unexpected market movements or other variances in the operation of the models or the assumptions used.

CONDENSED FINANCIAL STATEMENTS

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31. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

The Group had no financial assets or liabilities in the period ended 31 March 2022 or the year ended 30 September 2021 carried at fair value and valued using level 3 measurements, other than contingent consideration amounts (note 16).

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**

The following table summarises the Group's financial assets and liabilities which are carried at fair value.

	Note	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m
Financial assets				
Derivative financial assets	12	201.7	180.7	44.2
		201.7	180.7	44.2
Financial liabilities				
Derivative financial liabilities	12	32.5	76.2	43.9
Contingent consideration	16	1.9	11.5	7.5
		34.4	87.7	51.4

Derivative financial assets and liabilities

Derivative financial instruments are stated at their fair values in the accounts. The Group uses a number of techniques to determine the fair values of its derivative assets and liabilities, for which observable prices in active markets are not available. These are principally present value calculations based on estimated future cash flows arising from the instruments, discounted using a market interest rate, adjusted for risk as appropriate.

The principal inputs to these valuation models are SONIA (and formerly LIBOR) benchmark interest rates for the currencies in which the instruments are denominated, being sterling, euros and dollars. The cross-currency basis swaps, which were terminated during 2021, had a notional principal related to the outstanding currency borrowings and therefore the estimated rate of repayment of these notes also affected the valuation of the swaps. However, the variability in this input does not have a significant impact on the valuation, compared to other inputs.

CONDENSED FINANCIAL STATEMENTS

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31. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

In order to determine the fair values, the management applies valuation adjustments to observed data where that data would not fully reflect the attributes of the instrument being valued, such as particular contractual features or the identity of the counterparty. The management reviews the models used on an ongoing basis to ensure that the valuations produced are reasonable and reflect all relevant factors. These valuations are based on market information and they are therefore classified as level 2 measurements. Details of these assets are given in note 12.

Contingent consideration

The contingent considerations shown in note 16 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 business generated by operational units acquired, business derived as a result of the vendor's contacts or other goodwill, and any other new business flows which are or might be attributable to the acquisition agreement, 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.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2022 (Unaudited)

31. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

(b) Assets and liabilities carried at amortised cost

The fair values for financial assets and liabilities held at amortised cost, determined in accordance with the methodologies set out in this note are summarised below.

	31 March 2022		31 March 2021		30 September 2021	
	Carrying amount £m	Fair value £m	Carrying amount £m	Fair value £m	Carrying amount £m	Fair value £m
Financial assets						
Cash	1,500.4	1,500.4	2,103.0	2,103.0	1,360.1	1,360.1
Loans to customers	13,914.9	13,966.9	12,816.3	12,854.9	13,402.7	13,470.6
Sundry financial assets	32.2	32.2	86.0	86.0	65.7	65.7
	15,447.5	15,499.5	15,005.3	15,043.9	14,828.5	14,896.4
Financial liabilities						
Short term bank borrowings	0.4	0.4	0.1	0.1	0.3	0.3
Asset backed loan notes	477.1	477.1	2,011.3	2,011.3	516.0	516.0
Secured bank borrowings	871.3	871.3	755.7	755.7	730.0	730.0
Retail deposits	9,853.7	9,844.1	8,631.2	8,676.6	9,300.4	9,308.5
Corporate and retail bonds	261.3	275.2	405.3	428.3	386.1	411.9
Other financial liabilities	131.7	131.7	72.3	72.3	66.3	66.3
	11,595.5	11,599.8	11,875.9	11,944.3	10,999.1	11,033.0

Cash, bank loans and securitisation borrowings

The fair values of cash and cash equivalents, bank loans and overdrafts and asset backed loan notes, which are carried at amortised cost are considered to be not materially different from their book values. In arriving at that conclusion market inputs have been considered but because all the assets mature within three months of the year end and the interest rates charged on financial liabilities reset to market rates on a quarterly basis, little difference arises.

While the Group's asset backed loan notes are listed, the quoted prices for an individual note may not be indicative of the fair value of the issue as a whole, due to the specialised nature of the market in such instruments and the limited number of investors participating in it.

As these valuation exercises are not wholly market-based, they are considered to be level 2 measurements.

CONDENSED FINANCIAL STATEMENTS

SELECTED NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the six months ended 31 March 2022 (Unaudited)

31. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

Loans to customers

To assess the likely fair value of the Group's loan assets in the absence of a liquid market, the directors have considered the estimated cash flows expected to arise from the Group's investments in its loans to customers based on a mixture of market based inputs, such as rates and pricing and non-market based inputs such as redemption rates. Given the mixture of observable and non-observable inputs these are considered to be level 3 measurements.

Corporate debt

The Group's retail and corporate bonds are listed on the London Stock Exchange and there is presently a reasonably liquid market in the instruments. It is therefore appropriate to consider that the market price of these borrowings constitutes a fair value. As this valuation is based on a market price, it is considered to be a level 1 measurement.

Retail deposits

To assess the likely fair value of the Group's retail deposit liabilities, the directors have considered the estimated cash flows expected to arise based on a mixture of market-based inputs, such as rates and pricing and non-market-based inputs such as withdrawal rates. Given the mixture of observable and non-observable inputs, these are considered to be level 3 measurements.

Sundry assets and liabilities

Fair values of financial assets and liabilities disclosed as sundry assets and sundry liabilities are not considered to be materially different to their carrying values.

These assets and liabilities are of relatively low value and may be settled at their carrying value at the balance sheet date or shortly thereafter.

ADDITIONAL FINANCIAL INFORMATION (APPENDICIES)

For the six months ended 31 March 2022 (not covered by the Independent Review Report)

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

A. UNDERLYING PROFIT

The Group reports underlying profit excluding fair value accounting adjustments arising from its hedging arrangements and certain one-off items of income and costs relating to asset sales and acquisitions.

The fair value adjustments arise principally as a result of market interest rate movements, outside the Group's control. They are profit neutral over time and are not included in operating profit for management reporting purposes. They are also disregarded by many external analysts.

This definition of 'underlying' has been chosen following consideration of the needs of investors and analysts following the Group's shares, and because management feel it better represents the underlying economic performance of the Group's business.

	31 March 2022 £m	31 March 2021 £m	30 September 2021 £m
Profit on ordinary activities before tax	143.6	96.4	213.7
Add back: Fair value adjustments	(38.1)	(13.5)	(19.5)
Underlying profit	105.5	82.9	194.2

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 2022 £m	31 March 2021 £m	30 September 2021 £m
Underlying profit	105.5	82.9	194.2
Tax at effective rate (note 7)	(25.3)	(19.1)	(44.7)
Underlying earnings	80.2	63.8	149.5
Basic weighted average number of shares (note 8)	245.7	253.3	252.3
Underlying earnings per share	32.6p	25.2p	59.3p

ADDITIONAL FINANCIAL INFORMATION (APPENDICIES)

For the six months ended 31 March 2022 (not covered by the Independent Review Report)

A. UNDERLYING PROFIT (CONTINUED)

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

	Six months to 31 March 2022 £m	Six months to 31 March 2021 £m	Year to 30 September 2021 £m
Underlying earnings	80.2	63.8	149.5
Amortisation of intangible assets	1.0	1.0	2.0
Adjusted underlying earnings	81.2	64.8	151.5
Average tangible equity (note 26(b))	1,090.5	1,009.6	1,028.7
Underlying RoTE (annualised)	14.9%	12.8%	14.7%

B. INCOME STATEMENT RATIOS

Net interest margin ('NIM') and cost of risk (impairment charge as a percentage of average loan balance) for the Group and its segments are calculated as shown.

Six months to 31 March 2022

	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Total £m
Opening loans to customers (note 10)	11,608.7	1,568.8	225.2	13,402.7
Closing loans to customers (note 10)	11,999.2	1,719.7	196.0	13,914.9
Average loans to customers	11,804.0	1,644.2	210.6	13,658.8
Net interest	122.1	53.9	8.3	175.2
NIM (annualised)	2.07%	6.56%	7.88%	2.57%
Impairment provision	(1.0)	3.2	(0.9)	1.3
Cost of risk (annualised)	(0.02)%	0.39%	(0.85)%	0.02%

ADDITIONAL FINANCIAL INFORMATION (APPENDICIES)

For the six months ended 31 March 2022 (not covered by the Independent Review Report)

B. INCOME STATEMENT RATIOS (Continued)

Six months to 31 March 2021

	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Total £m
Opening loans to customers (note 10)	10,819.5	1,514.8	297.1	12,631.4
Closing loans to customers (note 10)	11,130.6	1,427.1	258.6	12,816.3
Average loans to customers	10,975.0	1,471.0	277.9	12,723.9
Net interest	103.1	46.5	10.8	147.5
NIM (annualised)	1.88%	6.32%	7.77%	2.32%
Impairment provision	4.9	1.3	(0.2)	6.0
Cost of risk (annualised)	0.09%	0.18%	(0.14)%	0.09%

Year to 30 September 2021

	Mortgage Lending £m	Commercial Lending £m	Idem Capital £m	Total £m
Opening loans to customers (note 10)	10,819.5	1,514.8	297.1	12,631.4
Closing loans to customers (note 10)	11,608.7	1,568.8	225.2	13,402.7
Average loans to customers	11,214.1	1,541.8	261.1	13,017.0
Net interest	219.2	94.5	20.2	310.5
NIM	1.95%	6.13%	7.74%	2.39%
Impairment provision	(5.9)	2.9	(1.7)	(4.7)
Cost of risk	(0.05)%	0.19%	(0.65)%	(0.04)%

Not all net interest is allocated to segments (see note 2).

ADDITIONAL FINANCIAL INFORMATION (APPENDICIES)

For the six months ended 31 March 2022 (not covered by the Independent Review Report)

C. COST:INCOME RATIO

Cost:income ratio is derived as follows:

	31 March 2022	31 March 2021	30 September 2021
Operating expenses (£m)	74.9	65.8	135.4
Total operating income (£m)	181.7	154.7	324.9
Cost / Income	41.2%	42.5%	41.7%

D. NET ASSET VALUE

	Note	31 March 2022	31 March 2021	30 September 2021
Total equity (£m)		1,279.7	1,203.8	1,241.9
Outstanding issued shares (m)	18	250.5	262.0	262.5
Treasury shares (m)	20	(5.0)	(5.2)	(12.1)
Shares held by ESOP schemes (m)	20	(4.0)	(3.1)	(3.7)
		241.5	253.7	246.7
Net asset value per £1 ordinary share		£5.30	£4.74	£5.03
Tangible equity (£m)	26	1,109.6	1,033.3	1,071.4
Tangible net asset value per £1 ordinary share		£4.59	£4.07	£4.34

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. The uncertainties around the longer-term impacts of the pandemic continue to be identified and assessed but overall in the opinion of the directors these have not changed materially from those described in Section A2.2 of the Annual Report and Accounts of the Group for the year ended 30 September 2021.

The pandemic impacts Group's assessment of its exposure under almost all the categories within its risk management framework. The effects on both the Group and the wider UK and global economy continue to be quantified and the Group is monitoring closely how this impacts the overall risk profile. Given the uncertainties about the length of the pandemic, the evolving government and fiscal response and the impacts on customers and staff, the Group continues to assess its principal risks in light of the changing operating environment.

The principal risks are summarised below.

Category	Risk	Description
Capital The risk that there is or will be insufficient capital to operate effectively including meeting minimum regulatory requirements, operating within board-approved risk appetite and supporting the Group's strategic goals	Capital resources	Overall capital resources fail to meet regulatory or business requirements
	Capital requirements	Failure to adequately meet or define overall capital requirements in line with business requirements
Liquidity and Funding The risk that the Group has insufficient financial resources to enable it to meet its obligations as they fall due, cannot raise or maintain sufficient funds to finance its future plans, or can only secure such resources at excessive cost, and / or encumbrance.	Funding concentration	Risk due to concentration of funding in particular products, delivery channels, markets and terms
	Funding tenor	Risk to the maturity structure of the Group's funding due to external, internal or contractual events
Market The risk of changes in the net value of, or net income arising from, the Group's assets and liabilities from adverse movements in market prices. The Group does not have a trading book, but the risk arises in the banking book	Duration	Arises from assets and liabilities being linked to the same interest rate indices, but re-pricing at different dates
	Basis	Arises from assets and liabilities linked to different rate indices which do not move in tandem
	Optionality	Arises as the settlement of assets and liabilities is sometimes different from originally forecast
	Foreign exchange ('FX')	Risk that changes in the relative value of currencies could result in financial loss

PRINCIPAL RISKS AND UNCERTAINTIES

Category	Risk	Description
Credit The risk of financial loss arising from a borrower or counterparty failing to meet their financial obligations to the Group when they fall due	Customer	The risk that the Group is exposed to unexpected material losses from the failure to screen potential borrowers, underwrite new business, and manage repayments effectively
	Concentration	The risk of loss that might occur from higher proportions of exposure within any area of lending or operation. The Group monitors and controls concentrations of loans, to amongst others, business lines, geographic regions, groups of customers and types of collateral
	Collateral	The risk of financial loss occurring as the result of property or assets secured against debt owed to the Group reducing in value beyond expected tolerances
	Wholesale counterparty	The risk of failure of an institution holding the Group's investments or providing hedging facilities for risk mitigation which could expose the bank to loss or liquidity issues
	Outsourcer default	The risk that, as a result of the Group outsourcing material activities to a third-party supplier, the Group is exposed to financial loss on the failure of that provider
Model The risk that the Group may make incorrect decisions based on the output of internal models, due to errors in the development, implementation or use of such models resulting in a loss or misreporting within financial statements	Assumptions	The risk of an error in assumptions made anywhere in the model lifecycle, covering scope, data sourcing, development, testing, validation, implementation and maintenance which results in incorrect decisioning
	Operation	The risk that a model which has been scoped, developed, implemented and executed as expected, may produce incorrect reporting, if its use is not controlled, or it is not operated in a safe, reliable and controlled environment

PRINCIPAL RISKS AND UNCERTAINTIES

Category	Risk	Description
Reputational The risk of negative consequences arising from a failure to meet the expectations and standards of the Group's customers, investors, regulators or other counterparties whilst undertaking business activities	Brand	The risk of deterioration in the inherent value of the Group's brand equity through adverse publicity, which may result in an adverse impact on share price or loss of competitive advantage
	Corporate responsibility	The risk that the Group's corporate responsibility approach does not promote commitment to practice environmental and social sustainability in the environmental and social landscapes in which it operates therefore creating negative consequences to the perception of the Group
Strategic The risk that the corporate plan does not fully align to, and support, the Group's strategic priorities or is not executed effectively as a result of external factors, incorrect planning assumptions or insufficient or inadequate resources	Corporate plan design	The risk that the design of the plan does not reflect the strategic priorities and doesn't adequately take account of and align to the prevailing external environment
	Corporate plan delivery	The risk that the corporate plan is not effectively executed or is not resilient to the changing external environment
	Business	The risk that the Group is adversely exposed to factors either externally and / or by lack of innovation and overambitious targets that lower its profits or cause it to fail
	Political	The risk that political decisions, economic action / inaction, events, or conditions significantly affect the Group or its market sectors, profitability or value
	Acquisition	The failure to target appropriate acquisitions or manage effectively the transition and implementation risks resulting from material corporate acquisitions which may impact adversely on the Group's performance

PRINCIPAL RISKS AND UNCERTAINTIES

Category	Risk	Description
Climate Change The risk of climate changes impacting the Group either directly or indirectly through its third-party relationships. This includes the transitional risk to Paragon's strategy and profile through moving to a low carbon environment and any physical risks arising from changes to the natural environment	Physical	The risk to the Group, its market sectors and supply chain of business disruption and loss caused by more frequent or severe man-made weather events such as flooding, droughts and storms
	Transitional	The risk that the speed of transition towards a greener economy may have a significantly adverse effect on the Group's asset values and / or the cost of doing business
Conduct The risk that the Group's culture drives poor behaviours or decision making in the execution of its business activities which leads to failure to achieve fair outcomes for customers and / or the ability to demonstrate the Group is acting with integrity in the market	Customer fair outcomes	The risk that the Group fails to put customers at the centre of how the business is run, culturally, strategically and operationally, failing to meet their needs and potentially leading to detrimental outcomes
	Market integrity and effective competition	The risk that the Group enters into transactions or new target markets that fail to deliver effective competition for consumers, or the Group fails to implement systems and controls that protect the soundness of financial markets and ensure the integrity of those transactions
Operational The risk of financial and non-financial detriment resulting from inadequate or failed internal procedures, people and systems or from external events	People	Failure of the Group to recruit, retain, develop and effectively lead / manage its people
	Health and safety	Non-adherence to legislation and regulation in order to ensure the health, safety and welfare of employees, contractors, visitors and members of the public
	Property	Property owned or occupied by the Group is subject to unauthorised access, physical damage or loss of services adversely affecting the effective operation of the business
	Third party	Risk associated with the selection, procurement and delivery of goods and services from third party suppliers, and ensuring that their ongoing management is in line with the Group's legal, regulatory and commercial obligations

PRINCIPAL RISKS AND UNCERTAINTIES

Category	Risk	Description
	Information technology	The Group's IT infrastructure and systems are unable to support its operational needs, including failure to adequately protect against the threat of cyber-crime
	End user computing	Risk associated with applications that are not managed and developed in a standard IT development environment
	Change	Poor implementation of business change including projects and programmes delivering new or amended processes, products or IT systems
	Transaction processing	Poorly executed regular business transactions resulting in customer detriment and / or financial loss
	Regulatory compliance	Failure to adhere to the legislation, regulations and guidelines relevant to the Group, leading to regulatory censure, fines, legal recourse and the inability to carry out business as usual
	Legal	Failure to act according to the law, meet contractual obligations, and manage disputes as a Group or with its customers or third parties
	Data Protection	Failure to comply with data protection obligations with respect to confidentiality, integrity and availability leading to large fines and significant reputational damage
	Financial crime	Failure to detect and / or prevent the Group from falling victim to offences of fraud, theft and money laundering across establishments, products and services. Failure to fulfil regulatory and legal obligations on all aspects of financial crime legislation and to prevent any form of potential bribery, corruption or terrorist fundraising through normal business activity

PRINCIPAL RISKS AND UNCERTAINTIES

Category	Risk	Description
	Corporate governance	Failure of the processes and structures by which the Group is directed and controlled by its Board of Directors, executive management, business units and support functions. This results in inappropriate management information to enable effective decision making
	Financial control and reporting	Incorrect accounting, reporting and financial management resulting in financial misstatement, poor decision making and associated losses for the Group

The Group has considered and responded to all these risks, mitigating the exposure as far as is practicable to ensure that its risk profile remains within the Board's stated risk appetite.

CAUTIONARY STATEMENT

Sections of this Half-yearly Report, including but not limited to the Interim Management Report may contain forward-looking statements with respect to certain of the plans and current goals and expectations relating to the future financial condition, business performance and results of the Group. These statements can be identified by the fact that they do not relate strictly to historical or current facts. They use words such as ‘anticipate’, ‘estimate’, ‘expect’, ‘intend’, ‘will’, ‘project’, ‘plan’, ‘believe’, ‘target’ and other words and terms of similar meaning in connection with any discussion of future operating or financial performance but are not the exclusive means of identifying such statements. These have been made by the directors in good faith using information available up to the date on which they approved this report, and the Group undertakes no obligation to update or revise these forward-looking statements for any reason other than in accordance with its legal or regulatory obligations (including under the UK Market Abuse Regulation, UK Listing Rules and the Disclosure Guidance and Transparency Rules of the Financial Conduct Authority (‘FCA’)).

By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of the Group and depend upon circumstances that may or may not occur in the future that could cause actual results or events to differ materially from those expressed or implied by the forward-looking statements. There are also a number of factors that could cause actual future financial conditions, business performance, results or developments to differ materially from the plans, goals and expectations expressed or implied by these forward-looking statements and forecasts. As a result, you are cautioned not to place reliance on such forward-looking statements as a prediction of actual results or otherwise.

These factors include, but are not limited to: material impacts related to foreign exchange fluctuations; macro-economic activity; the impact of outbreaks, epidemics or pandemics, such as the Covid pandemic and ongoing challenges and uncertainties posed by the Covid pandemic for businesses and governments around the world, including the duration, spread and any recurrence of the Covid pandemic and the extent of the impact of the Covid pandemic on overall demand for the Group’s services and products; potential changes in dividend policy; changes in government policy and regulation (including the monetary, interest rate and other policies of central banks and other regulatory authorities in the principal markets in which the Group operates) and the consequences thereof (including, without limitation, actions taken as a result of the Covid pandemic); actions by the Group’s competitors or counterparties; third party, fraud and reputational risks inherent in its operations; the UK’s exit from the EU; unstable economic conditions and market volatility, including currency fluctuations; the risk of a global economic downturn; acts of terrorism and other acts of hostility or war and responses to, and consequences of, those acts; technological changes and risks to the security of IT and operational infrastructure, systems, data and information resulting from increased threat of cyber and other attacks; general changes in government policy that may significantly influence investor decisions (including, without limitation, actions taken in support of managing and mitigating climate change and in supporting the global transition to net zero carbon emissions); societal shifts in customer financing and investment needs; and other risks inherent to the industries in which the Group operates.

Nothing in this Half-yearly Report should be construed as a profit forecast.