Half Year Financial Statements 2014

PRINCIPALITY
BUILDING SOCIETY

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FORWARD-LOOKING STATEMENTS

This half-year report contains certain forward-looking statements. These statements are made by the directors in good faith based on the information available to them up to the time of their approval of this report, and such statements should be treated with caution due to the inherent uncertainties, including both economic and business risk factors, underlying any such forward-looking information. Therefore, actual results may differ materially from those expressed or implied by these forward-looking statements.

The directors undertake no obligation to update any forward-looking statements whether as a result of new information, future events or otherwise.

Responsibility statement

We confirm that to the best of our knowledge:

(a) the condensed set of financial statements has been prepared in accordance with IAS 34 *Interim Financial Reporting*;

(b) the interim management report includes a fair review of the information required by DTR 4.2.7 (indication of important events during the first six months and the description of principal risks and uncertainties for the remaining six months of the year); and

(c) the interim management report includes a fair review of the information required by DTR 4.2.8 (disclosure of related party transactions and changes therein).

The information for the period ended 30 June 2014 does not constitute statutory accounts as defined in the Building Societies Act 1986. The auditor's report on the 2013 Annual Report and Accounts was not qualified and did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying the report.

By order of the Board,

Graeme H. Yorston
Group Chief Executive

Stephen Hughes
Group Finance Director

Chief Executive's review

I am pleased to report another successful and well-balanced first half performance, and we remain on track to deliver our strategic growth. Since we launched our mortgage growth strategy at the start of 2012 we have become the UK's 6th largest building society and increased net residential mortgage lending by over £1 billion. As a result of this strong growth our profit levels have also increased in the first six months of 2014, which in turn has strengthened our balance sheet as demand for capital increases from both our regulators and the wider European capital requirements.

We are in a strong position and our increased profitability further ensures that we can continue with our strategy to deliver long-term value and security to our Members, customers, staff and local communities.

Key Performance Highlights

- Pre-tax profits of £30.6 million (30 June 2013: £11.8m restated) for continuing operations
- Strong capital ratios with a Common Equity Tier 1 ratio of 14.81% (31 December 2013: 14.75% restated*)
- Most recommended savings provider in Wales**
- Assets increased to £7.4bn (30 June 2013: £7.0bn)
- 92.8% of mortgages funded by savers (30 June 2013: 98.6%)

As part of our strategy to focus on the core Society and grow retail mortgage lending, we regularly review our businesses to ensure that they are prospering in our ownership. Through this review we have determined that Peter Alan and our surveyors business would be better supported within a group of similar businesses to ensure the potential is optimised. The profit generated on the sale of Peter Alan and outsourcing of our surveying business also provides further capital to the core business as well as providing further investment opportunities. For these reasons, as we continue to focus on our strategy for the building society to benefit our Members both now and in the future, we approached potential buyers and interested parties. We are delighted that we have agreed the sale of the Peter Alan business and the surveying business to the Connells Group, one of the largest estate agency businesses in the UK, for consideration of £16.4m. As the deal was completed in July any profits from the sale will be reflected in Principality's full year results for 2014.

All Peter Alan and surveying staff will transfer over to the new business. We are confident that with Connells' expertise, scale and values, Peter Alan and the surveying business will continue to prosper and that they will be able to maximise the potential of these excellent businesses.

Mortgage Growth

During the first six months of this year we have continued to focus on helping people to own their own home, particularly in our heartland of Wales and the borders. We have increased new mortgage lending by 7% compared to the same period last year, highlighting our commitment to deliver accessible mortgage products for new homebuyers and those moving home or re-mortgaging.

Along with the continuation of our 95% mortgage product to help people get onto and move up the housing ladder we also signed up to the Help to Buy equity loan scheme in Wales, as part of our efforts to help the housing market move forward.

Our focus remains on prudent growth for the Society and we will continue to work with all of our stakeholders to help to stimulate first-time buyer activity, create new models for financing affordable housing and develop alternatives to home ownership that will help ensure a sustainable housing market. We continue to see strong arrears performance with the percentage of arrears cases at 0.79% (31 December 2013: 0.78%) which compares favourably with the industry average of 1.24%. ***

***In order to provide a more meaningful comparator, the Common Equity Tier 1 ratio as at 31 December 2013 has been restated to reflect the Basel III rules which came into effect on 1 January 2014.**

****Source: GfK NOP Financial Research Survey (FRS), 12 months ending June 2014, NPS score of savings customers in Wales, answering likelihood to recommend, c. 2,400 adults. Competitor list includes the following: Barclays, Halifax, HSBC, Lloyds TSB, NatWest, Nationwide, NS&I, Santander**

*****The percentage of retail lending cases fully secured by a first charge currently with arrears greater than 2.5% of the total outstanding balance. CML arrears and possession data as at March 2014.**

Chief Executive's review

Delivering value for our savers

Demand for savers' funds has been reduced significantly over the past two years and this has forced down interest rates that are paid to savers across the market. Recognising this, we are doing all we can to protect our savers and have stayed committed to rewarding loyalty, providing consistent rates in the market coupled with excellent service levels. We will continue to look for further opportunities to reward the loyalty of our Members and ensure that we are giving them the best rates we can.

Key highlights include:

- £148m growth in Welsh savings balances during January to June 2014
- Average pay rate Wales 1.81% vs. a market average of 1.53% ****
- Members holding a Promise Saver are benefiting from a rate of 2.00% AER, one of the best rates on the high street for this type of product
- Members holding Promise ISA are benefiting from a tax-free rate of 2.30% AER 18 month Members' ISA proposition launched in April paying the top rate in the fixed term ISA market (when compared to 1 and 2 year fixed term ISA products)
- Members benefited from the tax-free Members only ISA (2.10%), investing balances of just over £20m – we're also providing the additional benefit of allowing top-ups in to this account in line with the £15,000 ISA limit increase

Group Businesses

Nemo has once again delivered strong levels of profitability for the Group and remains one of the leading second charge loan businesses in the market. We continue to manage this business prudently and we are making sure that Nemo is well-positioned to cope with the challenges of the future.

Within a challenging commercial environment, our own commercial book is also performing well and we have supported several development projects this year, helping to support the economy within our heartland, boost employment and supply homes where they are needed.

Outlook

The UK economy is showing continued signs of recovery with house prices returning to positive levels in many areas and reducing unemployment. However, there are many geopolitical risks, as well as UK specific risks, which could impact recovery at any stage. The Society remains prudent in its assumptions over the medium-term and recognises the potential impact of rising interest rates in 2014/2015 on our borrowers.

Every part of our business is focused on protecting and creating value for our Members and customers and I am confident that Principality is well-placed to meet their needs both now and in the long-term.

Graeme H. Yorston
Group Chief Executive
30 July 2014

**** Source: CACI Limited as at March 2014

Business review
for the six months ended 30 June 2014

Discontinued operations

On 30 July 2014, the Group entered into and completed on a sale agreement to sell Peter Alan Limited, its subsidiary businesses and the Group's Surveyors business (together 'Peter Alan'), which together carried out all of the Group's estate agency, lettings and surveying operations. At the date of completion control of Peter Alan passed to the acquirer.

Upon completion, in exchange for the sale of its 100% shareholding, the Group received consideration of £16.4m. The consideration generated a gain in the region of £10.5m, being the sale proceeds less costs, less the carrying amount of Peter Alan's net assets and attributable goodwill at the time of completion. This will be recognised in the Group's results for the second half of the year.

The sale is in line with the Group strategy of focusing on the core business of the building society. The Board considered that significant investment would be required to maximise the potential of Peter Alan, and the focus on the core Society has reduced the strategic rationale for maintaining an estate agency and letting business within the Group.

The performance of Peter Alan saw increased estate agency income of £3.0m (30 June 2013: £2.5m) and lettings income of £1.6m (30 June 2013: £1.2m). This performance contributed to overall income for the discontinued operations of £5.8m (30 June 2013: £4.8m) and profit before tax of £0.2m (30 June 2013: £0.1m loss).

In line with the requirements of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, the consolidated income statement has been restated for the comparative periods to include only items relating to continuing activities, and to separately disclose the profit from discontinued operations. The assets and liabilities held by Peter Alan are classified in the statement of financial position as a disposal group as at 30 June 2014.

Accordingly, to allow meaningful comparison, all ratios and comparators included within the Business Review exclude the impact of discontinued operations unless stated otherwise.

Continuing operations

Income statement

The Group's profit before tax from continuing operations for the six months ended 30 June 2014 was £30.6m (30 June 2013: £11.8m restated), this includes a £10.1m gain in relation to pension past service costs. This is explained in more detail in the administrative expenses section on page 5.

Prior year comparatives have been restated where appropriate following the implementation of International Financial Reporting Interpretations Committee (IFRIC) 21 *Levies.* More information relating to this restatement can be found on pages 60 and 81 of the 2013 Annual Report and Accounts:

http://www.principality.co.uk/~/media/Files/PDF/Financial%20Reports/2013/ANNUAL%20REPORT%202013.ashx

Profit

Net interest margin
At 1.84% (30 June 2013: 1.52% restated) the Group's net interest margin has increased as a result of the continued market-wide impact of the Funding for Lending Scheme (FLS), which together with a significant decrease in wholesale funding costs, continues to drive down the Group's average cost of funds. Maturing higher priced savings products have been replaced with products which are priced based on current market conditions. The net interest margin has also benefited from the growth in mortgage balances during the last 12 months.

The Group continues to benefit from higher margins earned in the secured personal lending business. However, increased competition in the second charge market is likely to result in some margin compression during the second half of the year and into 2015.

Net interest margin has been enhanced by gains of £0.2m (30 June 2013: £0.5m), equivalent to 0.2bps (30 June 2013: 0.8bps) arising from the disposal of gilts.

Business review

for the six months ended 30 June 2014 (continued)

Other income

The Group's non-interest income from continuing activities at £3.8m (30 June 2013: £7.4m) includes insurance income and income generated from a number of other complementary activities. These together generated 5.3% (30 June 2013: 12.3% restated) of net operating income. Commissions on sales of insurance and related financial service products in the Society have declined by 38.8% on the same period last year, which together with significant one-off profit share income during the prior year of £2.2m has driven the decrease in non-interest income.

Administrative expenses

Ongoing strategic investments to enhance the Society's capabilities and operational infrastructure have resulted in an increase for continuing operations in the ratio of operating expense to total mean assets to 0.97% (30 June 2013: 0.95% restated) excluding a gain in 2014 of £10.1m on pension past service cost described in the defined benefit pension scheme section below. The cost to income ratio for continuing operations was 49.5% (30 June 2013: 54.2% restated) also excluding the gain on pension past service cost.

A significant element of this investment is necessary to meet regulatory requirements, such as technological and operational changes required to meet the requirements of the Financial Conduct Authority's Mortgage Market Review regulations, which came into force on 26 April 2014. The Society continues to invest in improving customer service, the results of which can be seen in the outcome of external industry benchmarking exercises. The Board continues to drive a continuous improvement programme to achieve medium term cost efficiencies.

During the first half of 2014, the trustees agreed to change the basis for the inflation assumption used in the actuarial calculation of the scheme's liability from the Retail Price Index (RPI) to the Consumer Price Index (CPI). This change has recently been adopted by a large number of pension plans in both the public and private sectors throughout the UK. The effect of this change has been to decrease the scheme liability by £10.1m, which has been recognised in the first half of 2014 and, as a past service cost, is reflected as an increase to profit for the period in the consolidated income statement.

Impairment provisions for losses on loans and advances

The charge for impairment provisions of £8.6m for the Group's continuing operations is £2.6m lower than that for the same period last year.

	June 2014 £m	June 2013 £m
Retail financial services	1.9	1.2
Commercial lending	4.5	6.3
Secured personal lending	2.2	3.7
Total	8.6	11.2

Consistent quality of lending, increasing house prices, a low interest rate environment and prudent arrears management policies have contained arrears levels in both first and second charge residential lending.

The performance of the commercial lending book remains robust, with only 8 exposures greater than three months in arrears (31 December 2013: 7). Whilst the commercial lending market remains challenging, the generally more positive economic outlook for the UK and increased stability in capital values provide grounds for cautious optimism.

There are no arrears in respect of lending to Registered Social Landlords (30 June 2013: Nil).

Business review

for the six months ended 30 June 2014 (continued)

Provisions for other liabilities and charges
Provisions of £2.1m (30 June 2013: £0.4m) have been made in respect of various customer claims and redress. Additionally, the Group has recognised an FSCS interest charge of £2.4m in respect of scheme year April 2014 to March 2015 and the second instalment of the capital repayment of £2.2m.

During 2013, the IASB issued IFRIC 21 *Levies*, which is effective for periods beginning on or after 1 January 2014. The IFRIC clarifies when a liability should be recognised for a levy, defining when the obliging event occurs. The change to the PRA handbook combined with the IFRIC changes how the industry has recognised FSCS for both capital and interest, changing the trigger for recognition in the financial statements from the year end to 1 April of the subsequent year in line with the start of the FSCS scheme year. The Group has adopted IFRIC 21, and the comparatives for the six month period ended 30 June 2013 and the statement of financial position as at 30 June 2013 have been restated.

More information regarding the uncertainties associated with the level of the provision can be found in note 17a.

Taxation
The statutory rate of corporation tax was reduced to 21.0% from 1 April 2014. The Group is subject to corporation tax at a rate of 23.0% for the period 1 January to 31 March 2014, and 21.0% for the period 1 April to 31 December 2014, resulting in an effective statutory rate of corporation tax of 21.5% for the full year in 2014.

The actual effective tax rate for the Group is expected to be 22.1% (30 June 2013: 25.2% restated) compared with the statutory rate of tax of 21.5% (30 June 2013: 23.3%). The rate differential is mainly due to disallowable expenditure. At the half year, taxation expense as a proportion of profit before tax is 17.5% as the £10.1m credit to the consolidated income statement in respect of the pension past service cost (as described in the Defined benefit pension scheme section below and in Note 17c) which is not chargeable to corporation tax, was recognised in full during the period.

Statement of Financial Position

Loans and advances to customers
The Group continues to focus on the quality of business written, concentrating on affordability and LTV ratios in underwriting loans and mortgages. The Society continues to execute its growth strategy for residential first charge mortgages, which have increased since the end of the year to £4,667.1m.

The Society is committed to supporting the housing market, with gross lending of £612.5m in the first half of the year (30 June 2013: £572.4m). The Society continues to support first time buyers, and has continued to support the Welsh housing market through the provision of products such as the 95% LTV mortgage.

The average LTV of the residential first and second charge portfolios stands at 62.6% (31 December 2013: 63.2%), with 79.5% of the portfolio under 80% LTV and 3.9% in negative equity based on indexed property values. Buy-to-let mortgages make up 24.0% of mortgages in the retail financial services division.

We continue to support our Members and customers who are experiencing financial difficulties and agree the most appropriate course of action. Short-term temporary actions could include revised payment schedules, payment holidays or a switch to 'interest only' lending. Our approach to dealing with Members and customers in financial difficulties means that we only take possession of a property as a last resort having considered all Member and customer outcomes and the customer's best interests. During the first half of the year, the Group took 48 properties into possession (30 June 2013: 30).

The group continues to adopt a prudent strategy for the second charge and commercial lending portfolios underpinned by robust underwriting policies.

Liquidity

Liquid assets typically comprise cash deposits held with central banks and unencumbered securities that may be sold or pledged through a repurchase agreement (repo) either directly with the central banks to which the Group has access or with other market counterparties.

Since the end of the year, liquid assets have increased by 17.3% to £1,222.5m, largely as a result of proceeds from the Society's second Residential Mortgage Backed Security issuance in June 2014. This is discussed in more detail in the Funding section below. This will support mortgage lending during the second half of the year. The liquid asset buffer includes highly liquid assets which typically comprise cash held with central banks and gilts. The proportion of liquid assets assigned to the buffer is 81.5% (31 December 2013: 75.8%) and represents a surplus of 77.5% of the Group's buffer liquidity requirement. Of the other liquid assets not assigned to the liquid assets buffer, which typically comprise investments with other financial institutions, none (31 December 2013: 6.7%) are less than A rated under Fitch credit ratings. The Group's core liquidity ratio was 16.76% (31 December 2013: 13.18%).

A package of new capital and liquidity regulations (referred to as Basel III or CRD4) was implemented in the UK from 1 January 2014. The objective of the reform package is to improve the financial services sector's ability to absorb shocks arising from financial and/or economic stress, thus reducing the potentially destabilising impact on the financial sector into the real economy. Basel III includes a short-term liquidity stress metric, the Liquidity Coverage Ratio (LCR), and a longer-term stable funding metric, the Net Stable Funding Ratio (NSFR). The Group monitors compliance against these metrics, and they are estimated at 222% and 143% respectively against proposed regulatory requirements of 100% for both measures (31 December 2013: 156% and 126% respectively). Estimations are made using the Society's interpretation of the directive which was incorporated into the European and UK regulatory framework on 1 January 2014.

Other than £84.7m of AAA rated Supranational Bonds issued by the European Investment Bank, and effectively guaranteed by the European Union member states, the Group does not hold any direct bank exposures to the Eurozone. The Group has indirect exposures through bank counterparties that themselves have direct exposures to Greece, Italy, Portugal, Spain, Ireland and Cyprus. Based on available information, an assessment has been made of the Society's key counterparties regarding the potential levels of indirect exposure to distressed Eurozone economies. After such an assessment, the Board has concluded that no impairment provisions are required for indirect exposures to Eurozone sovereign debt.

During the year the Group continued to perform internal stress tests on its liquidity which consistently demonstrates a strong position after allowing for a range of extreme stress scenarios and mitigating actions. The results of these scenarios are brought together into the Group's Individual Liquidity Adequacy Assessment (ILAA) document, which is reviewed at least annually by the Board.

A weekly review is undertaken by the Treasury Committee, a sub-committee of the Asset and Liability Committee, on current and expected credit risk, liquidity risk and interest rate risk of all treasury assets with a view to highlighting the likelihood of any future performance difficulties and losses based on emerging published data and intelligence.

Business review
for the six months ended 30 June 2014 (continued)

Funding
The Society has a strong funding base, predominantly represented by retail savings. Savings balances represent 92.8% (31 December 2013: 94.2%) of all mortgage balances. The Board's focus has been to balance funding from available sources retaining funds at economic rates whilst providing value to Members.

In June the Society entered into its second Residential Mortgage Backed Security (RMBS) issue, the first being in 2011. The RMBS issue involved the formation of a Special Purpose Entity (SPE), Friary No. 2 Plc, which provides security to a £520.5m amortising bond. As at 30 June 2014, £519.1m of loans issued by the Society had been transferred to the SPE, which remain on the statement of financial position of the Society as it retains the risks and rewards of the assets. The amortised value of the bond was £520.5m, with £45.5m retained by the Group.

As at 30 June 2014, £429.8m of loans issued by the Society had been transferred to the SPE in relation to the Society's first RMBS, Friary No. 1 Plc. These assets remain on the statement of financial position of the Society as it retains the risks and rewards. The amortised value of the bond was £459.7m, with £328.3m retained by the Group.

As at 30 June 2014, the Society had drawn down additional funding of £207.0m (31 December 2013: £350.0m) under the Bank of England's Funding for Lending (FLS) scheme. This funding has been used primarily to support mortgage growth and supplement maturing wholesale funding. No further draw-downs are planned under the scheme.

Asset encumbrance is 20.2% (31 December 2013: 16.8%) of total assets which is well within the Board approved limit of 30.0%.

The Society's long-term debt ratings with Fitch and Moody's, at BBB+ and Ba1 respectively, remain unchanged since the end of the year.

Defined benefit pension scheme
On 3 April 2014 the Trustees of the Group's defined benefit pension plan decided to adopt the Consumer Prices Index (CPI), rather than the Retail Prices Index (RPI), as the basis for determining the rate of inflation in actuarial calculations of the scheme liability. The use of CPI as the inflationary assumption brings the pension scheme in line with wider market practice. The pension scheme liability as at 30 June was £8.6m (31 December 2013: £17.1m), which is reflected in the statement of financial position. The change in inflation assumptions caused a credit to the consolidated income statement of £10.1m in the period in relation to a reduction of the estimated future liability arising as a result of past service costs.

Business review

for the six months ended 30 June 2014 (continued)

Capital

Capital comprises the Group's general reserve, permanent interest-bearing shares (subscribed capital) and subordinated liabilities. This capital is held to support the development of the business, to protect Members' deposits and provide a buffer against unexpected losses.

During 2013 the Group obtained approval from the PRA to adopt an Internal Ratings Based (IRB) approach for capital calculations. This allows the Group to use its own internal information to estimate risk weightings, rather than standard risk weightings prescribed by the PRA and will further enhance the Group's risk management processes. As at 30 June 2014 and 31 December 2013 the Society's first charge retail and commercial mortgage assets had adopted the IRB approach.

Excluding unaudited 2014 interim profits, key capital ratios include:

	Basel III Basis		Basel II Basis
	30 June 2014	31 December 2013 (restated*)	31 December 2013
	%	%	%
Common Equity Tier 1	14.81	14.75	16.85
Tier 1	17.05	16.95	18.73
Solvency ratio	19.33	19.31	20.20
Leverage ratio	4.20	4.53	4.74

The Group's second charge mortgage assets will adopt IRB in the second half of 2014, subject to regulatory approval. The Group currently estimates that, had the second charge mortgage assets adopted IRB at 30 June 2014, the Common Equity Tier 1 Ratio would be 10.57%.

The Leverage ratio is calculated using quarter end values without taking account of Basel III transitional provisions for Capital. The Leverage ratio on a Basel II basis as at 31 December has been restated to take into account further guidance included within the "Basel III Leverage Ratio Framework and Disclosure Requirement" document issued by the Bank of International Settlements in January 2014.

From 1 January 2014 the Group has been subject to Basel III regulations. The impact on capital and capital ratios can be found in the Group's 2013 Pillar 3 disclosure, published on the Society's website (www.principality.co.uk).

The key elements of Basel III for capital requirements are as follows:

- Reduced capital resources through changes to the definition of capital and grandfathering of old instruments. Permanent Interest Bearing Shares (PIBS) will be phased out over nine years from 2014. Over the period 2014-18, there will be changes and additions to capital deductions from Common Equity Tier 1 and Tier 2 capital including pension deficit and AFS reserve;
- Increased capital requirements through Credit Valuation Adjustments and the treatment of deferred tax assets;
- New limits and capital buffers. Higher thresholds for all forms of capital with an increased focus on Common Equity Tier 1; and
- Introduction of the Leverage Ratio. The Basel Committee is using a period to 2017 to test a minimum Tier 1 leverage ratio of 3.0%.

A glossary of terms can be found on pages 102 to 105 of the 2013 Annual Report and Accounts.

***In order to provide more meaningful comparators, the Common Equity Tier 1, Tier 1, Solvency and Leverage ratios as at 31 December 2013 have been restated to reflect the Basel III rules which came into effect on 1 January 2014.**

Business review

for the six months ended 30 June 2014 (continued)

Going concern

The Group meets its funding requirements, which include the need to maintain a sufficient liquidity buffer, mainly from retail sources supplemented by RMBS, FLS and other wholesale funding.

The Group's forecasts and projections include scenario testing as carried out in accordance with the Internal Capital Adequacy Assessment Process (ICAAP) and Individual Liquidity Adequacy Assessment (ILAA), which are processes required by the PRA to demonstrate appropriate levels of capital and liquidity respectively under stressed scenarios reflecting the directors' views of different risks that might arise under varying economic conditions. These scenarios take account of severe but plausible impacts on trading performance, and show that the Group will be able to operate within the sources of funding currently available to it, even under stressed scenarios. In addition to these sources, contingency funding plans are in place.

The assets held for liquidity purposes are assessed and regularly reviewed for counterparty risks, and the Board consider that the Group is not exposed to losses on those assets that would affect the decision to adopt the basis of going concern. The Board consider that the overall level of capital, including Tier 1 capital of £365.3m (17.05% as a percentage of risk-weighted assets) and a solvency ratio of 19.33% is adequate.

Having considered the plans and forecasts for the Group, the Board are satisfied that there are adequate resources and no material uncertainties that lead to significant doubt on the Group's ability to continue in business for the foreseeable future. Accordingly, the financial statements continue to be prepared on a going concern basis.

Principal risks and uncertainties

The Group Risk Committee (GRC), which meets at least quarterly, is responsible for reviewing strategic, operational and financial risks and ensuring that appropriate action is taken to mitigate those risks. Further information on the outlook for the second half of the year is detailed in the Chief Executive's review on page 2. Additional information on risk is also provided in the Pillar 3 disclosure available at:

http://www.principality.co.uk/en/About-Us/About-Principality/Financial-Reports.aspx

The principal risks and uncertainties which have an impact on the Group's long-term performance remain those outlined on pages 15 to 20 of the 2013 Annual Report and Accounts. These risks include:

Credit risk

This is the risk that a customer or counterparty will fail to meet their financial obligations to the Group as they become due. Notwithstanding the improving economic environment in the UK, significant risks remain, including the impact of future base rate rises on mortgage affordability, and the risk presented by volatility within the housing market. These risks, together with the continued fragility of Eurozone economies, have the potential to impact arrears and loan loss provision levels.

Each business area, residential first and second charge lending, commercial lending and treasury, has its own individual Credit Risk Policy Statement setting out its risk appetite including policy scope, structures and responsibilities, definitions of risk and risk measurement and approach to monitoring. In addition, each business area maintains a detailed procedures manual setting out operating rules and standards.

Day-to-day management of credit risk is undertaken by specialist teams working in each business area using credit risk management techniques adopted as part of the Group's overall approach to measure, mitigate and manage credit risk in a manner consistent with the risk appetite approved by the GRC and the Board. Credit risk portfolios are subject to regular stress testing to simulate outcomes and assess the potential impact on capital requirements.

Business review
for the six months ended 30 June 2014 (continued)

The Group remains cautious with regard to commercial lending which is undertaken on a prudent basis, where management has adopted a strategy geared towards reducing overall exposure to development finance and larger, single counterparty loans. The Commercial Lending Division is managed within a framework of conservative credit criteria, principally focusing on the underlying income stream and debt servicing cover as well as property value.

The impact of the continued economic uncertainty in the Eurozone and the current crises in the Ukraine and Middle East increases the risk of credit default in wholesale markets. A weekly review of counterparty exposures is undertaken by the Treasury Committee in order to identify and mitigate the potential likelihood of any future performance difficulties or losses based on emerging published data and market intelligence.

Liquidity risk
This is the risk that the Group is not able to meet its financial obligations as they fall due, or can do so only at excessive cost. The objective of the Group's liquidity policy is therefore to maintain sufficient liquid assets to cover cash flow imbalances and fluctuations in funding, to maintain full public confidence in the Group and to ensure that all financial obligations are met.

The directors have considered the funding and liquidity risk under the heading 'Going concern' above.

Market risk
The risk that the value of, or income arising from, the Group's assets and liabilities changes as a result of changes in market prices, the principal elements being interest rate risk, including the use of derivatives, and foreign currency risk.

The Group is exposed to interest rate risk, principally arising from the provision of fixed rate mortgage and savings products. The various interest rate features and maturity profiles for these products, and the use of wholesale funds to support their delivery, create interest rate risk exposures due to the imperfect matching of interest rates between different financial instruments and the timing differences on the re-pricing of assets and liabilities.

The continued economic uncertainty in the Eurozone along with the UK Government and Bank of England's response to mortgage lending and other economic and banking sector issues continue to create short-term volatility in market prices. Taking account of this, the Asset and Liability Committee has continued to manage the Group's market risk exposure prudently.

Operational risk
With a diverse business model and a more competitive operating environment, it is recognised that the Group is exposed to increased levels of operational risk, for example in terms of systems capability and staff competencies. The financial services sector also faces growing levels of financial crime, particularly in relation to e-distribution channels, which require increasingly sophisticated monitoring and anti-fraud controls. The Group has adopted The Standardised Approach for the calculation of regulatory capital requirements relating to operational risk. This is supported by a governance structure and risk management framework the purpose of which is to identify, assess and manage existing and emerging operational risks arising from current and planned business activities, and mitigate as far as possible the impact of unknown events.

Business review
for the six months ended 30 June 2014 (continued)

Conduct risk
Conduct risk management ensures that our customers are treated fairly and that we consistently deliver fair customer outcomes.

Governance and oversight of business conduct is structured around a framework which reflects the four pillars of the product lifecycle as listed below:

- Target market, product design and governance
- Sales sustainability and process
- Servicing and arrears management
- Complaints management

The sustainability of the Group's business model and achievement of its longer-term strategy are dependent upon the consistent and fair treatment of customers. The emergence of the separate FCA and PRA regulatory regimes reflects the increasing scrutiny of the measures adopted by firms in relation to business conduct and the Society's approach towards the governance of conduct risk has developed accordingly.

The Group's approach to managing conduct risk is set out in a Board approved Conduct Strategy – this was refreshed at the beginning of 2014 and is reviewed annually. The strategy sets out the Group's Conduct Risk Appetite as well as the activity being undertaken to further develop the Group's approach to managing conduct risk.

Execution of the Group's Conduct Strategy and performance against Conduct Risk Appetite is reviewed regularly at the Group's Customer and Conduct Committee and Customer Experience Forum, both of which form part of the Group's governance and control framework, as well as by the Board. Following recent changes, the Compliance and Conduct function is responsible for advising the Group on conduct matters and overseeing the risks that could lead to the unfair treatment of customers, reporting regularly to the above committees and the Board on findings.

Pension obligation risk
The risk that the value of the Fund's assets, together with ongoing employer and Member contributions, will be insufficient to cover the projected obligations of the Fund over time. To mitigate these risks, management, together with the Trustees of the Scheme, regularly review reports prepared by the Scheme's independent actuaries and take appropriate actions which may, for example, include adjusting the investment strategy and/or contribution levels.

The Group's defined benefit pension scheme is also subject to market risk and this risk is managed by the Trustees of the scheme.

Details of the pension obligations of the Group can be found in note 12 of the 2013 Annual Report and Accounts.

Stephen Hughes
Group Finance Director
30 July 2014

Independent review report
to Principality Building Society

We have been engaged by the Society to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2014 which comprises the condensed consolidated income statement, the condensed consolidated statement of comprehensive income, the condensed consolidated statement of financial position, the condensed consolidated statement of cash flows and related notes 1 to 19. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Society 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. Our work has been undertaken so that we might state to the Society those matters we are required to state to it in an independent review 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 Society, for our review work, for this report, or for the conclusions we have formed.

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 Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

As disclosed in note 1, the annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with International Accounting Standard 34 Interim Financial Reporting, as adopted by the European Union.

Our responsibility

Our responsibility is to express to the Society a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

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 United Kingdom. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) 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.

Conclusion

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 30 June 2014 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Deloitte LLP
Chartered Accountants and Statutory Auditor
Cardiff, United Kingdom
30 July 2014

Condensed consolidated income statement

Group Interim results for six months to 30 June 2014

	Notes	6 months to 30.06.14 £m (Unaudited)	6 months to 30.06.13 £m (Unaudited – restated*)	Year ended 31.12.13 £m (Audited – restated*)
Interest receivable and similar income	3	130.2	127.9	261.6
Interest payable and similar charges	4	(63.9)	(75.7)	(145.2)
Net interest income		66.3	52.2	116.4
Fees and commission receivable	5	3.9	7.4	13.4
Fees and commission payable	6	(0.6)	(0.5)	(1.1)
Net fee and commission income		3.3	6.9	12.3
Other operating income		0.5	0.5	0.9
Other fair value gains/(losses)	7	0.8	0.6	(1.2)
Net operating income		70.9	60.2	128.4
Administrative expenses	8	(21.8)	(29.5)	(58.9)
Depreciation and amortisation		(3.2)	(3.1)	(6.4)
Total operating expenses		(25.0)	(32.6)	(65.3)
Impairment provision for losses on loans and advances		(8.6)	(11.2)	(22.4)
Provision for liabilities and charges	14	(6.7)	(4.6)	(12.5)
Operating profit		30.6	11.8	28.2
Other gains	9	-	-	-
Profit before tax		30.6	11.8	28.2
Taxation expense	10	(5.2)	(2.9)	(6.2)
Profit for the period from continuing operations		25.4	8.9	22.0
Profit/(loss) for the period from discontinued operations	11	0.1	(0.2)	0.2
Profit for the period/year		**25.5**	**8.7**	**22.2**

Condensed consolidated statement of comprehensive income

	Notes	6 Months to 30.06.14 £m (Unaudited)	6 Months to 30.06.13 £m (Unaudited – restated*)	Year ended 31.12.13 £m (Audited)
Profit for the period/year		25.5	8.7	22.2
Actuarial loss on retirement benefit obligations		(2.1)	(1.7)	(4.3)
Loss on available-for-sale assets		-	(3.8)	(8.2)
Taxation expense		0.3	1.1	2.2
Total comprehensive income for the period/year		**23.7**	**4.3**	**11.9**

All items dealt with in arriving at the profit before tax relate to continuing operations.

The accounting policies and notes on pages 17 to 31 form part of these accounts.

*Further information can be found in Note 1. The year ended 31 December 2013 is restated only to show separately the results of discontinued and continuing operations.

Condensed consolidated statement of financial position

As at 30 June 2014

	Notes	As at 30.06.14 (Unaudited) £m	As at 30.06.13 (Unaudited – restated*) £m	As at 31.12.13 (Audited) £m
Assets				
Liquid assets:				
Cash in hand and balances with the Bank of England		547.6	479.8	355.6
Loans and advances to credit institutions		125.7	141.8	120.5
Debt securities		549.2	539.9	566.0
		1,222.5	1,161.5	1,042.1
Derivative financial instruments		36.7	36.4	37.6
Loans and advances to customers:				
Loans fully secured on residential property		5,568.2	5,179.7	5,409.0
Other loans fully secured on land		421.1	494.9	446.5
Other loans		49.6	46.0	49.1
	13	6,038.9	5,720.6	5,904.6
Intangible fixed assets		2.5	2.9	4.4
Property, plant and equipment		45.2	47.1	47.8
Deferred tax assets		3.4	4.3	4.3
Other assets		3.5	8.1	6.3
Prepayments and accrued income		7.1	10.4	11.0
Disposal group assets held for sale	11	11.6	-	-
Total assets		**7,371.4**	**6,991.3**	**7,058.1**
Liabilities				
Shares		5,605.7	5,642.0	5,562.6
Deposits and debt securities:				
Amounts owed to credit institutions	15	218.6	209.2	499.7
Amounts owed to other customers		238.9	316.5	225.1
Debt securities in issue		693.1	231.4	178.0
		1,150.6	757.1	902.8
Derivative financial instruments		24.9	33.5	26.2
Current tax liabilities		5.2	2.6	1.9
Other liabilities		6.6	8.8	8.4
Provision for liabilities and charges	14	15.1	10.6	12.7
Accruals and deferred income		9.6	9.2	8.7
Disposal group liabilities held for sale	11	4.3	-	-
Deferred tax liabilities		0.3	0.6	0.5
Retirement benefit obligations		8.6	14.9	17.1
Subordinated liabilities		92.3	92.3	92.3
Subscribed capital		69.9	72.8	70.2
Total liabilities		6,993.1	6,644.4	6,703.4
General reserve	16	381.3	346.5	357.7
Other reserves		(3.0)	0.4	(3.0)
Total equity and liabilities		**7,371.4**	**6,991.3**	**7,058.1**

The accounting policies and notes on pages 17 to 31 form part of these accounts.

*Further information can be found in Note 1.

Condensed consolidated statement of cash flows

Group Interim results for six months to 30 June 2014

	6 months to 30.06.14 (Unaudited) £m	6 months to 30.06.13 (Unaudited – restated*) £m	Year ended 31.12.13 (Audited) £m
Net cash inflow/(outflow) from operating activities (see below)	199.8	79.8	(0.9)
Cash flows from investing activities			
Purchase of intangible assets and property, plant and equipment	(3.3)	(4.7)	(8.7)
Purchase of investment securities	(169.3)	(289.4)	(476.2)
Proceeds from sale and maturity of investment securities	186.1	193.2	349.5
Purchase of companies	-	-	(1.3)
Cash flows from financing activities	-	-	-
Increase/(decrease) in cash and cash equivalents	213.3	(21.1)	(137.6)
Cash and cash equivalents at beginning of period/year	466.0	603.7	603.6
Cash and cash equivalents at end of period/year	**679.3**	**582.6**	**466.0**
Represented by:			
Cash and balances with the Bank of England	547.6	479.8	355.6
Loans and advances to credit institutions repayable on demand	131.7	102.8	110.4
	679.3	582.6	466.0
Net cash outflow from operating activities			
Profit before taxation	30.8	11.6	28.7
Adjusted for:			
Depreciation and amortisation	3.5	3.4	6.9
Increase in impairment losses on loans and advances to customers	8.6	11.2	22.4
Change in fair values	0.3	7.3	18.0
Other non-cash movements	-	0.1	0.3
Changes in net operating assets			
Decrease/(increase) in loans and advances to credit institutions not repayable on demand	10.0	(15.9)	13.1
(Increase) in loans and advances to customers	(147.4)	(158.9)	(372.9)
Decrease/(increase) in other assets	2.5	(1.9)	(0.1)
Decrease in prepayments and accrued income	3.0	5.0	4.4
(Decrease) in derivative financial instruments	(0.4)	(8.8)	(17.2)
Increase in shares	47.8	182.2	108.7
Increase in deposits and debt securities	246.8	47.3	192.5
Increase/(decrease) in other liabilities	2.1	0.3	(0.6)
Increase in provisions for liabilities	2.5	0.6	2.8
Increase/(decrease) in accruals and deferred income	1.1	(0.5)	(1.1)
(Decrease) in pension fund obligations	(10.6)	-	(0.3)
Taxation payments	(0.8)	(3.2)	(6.5)
	199.8	**79.8**	**(0.9)**

*Further information can be found in Note 1

Notes to the accounts
for the period ended 30 June 2014

1. Accounting policies

Basis of preparation

The half-yearly report information set out in this document is unaudited and does not constitute accounts within the meaning of section 73 of the Building Societies Act 1986. The financial information for the year ended 31 December 2013 has been extracted from the Annual Accounts for that year. The Annual Accounts for the year ended 31 December 2013 have been filed with the Financial Conduct Authority (formerly the Financial Services Authority).

The Auditor's report on these Annual Accounts was unqualified and did not include any matters to which the Auditor drew attention by way of emphasis without qualifying their report.

A copy of the half-yearly financial report is placed on Principality Building Society's website. The directors are responsible for the maintenance and integrity of the information on the website. Information published on the internet is accessible in many countries with different legal requirements. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The condensed consolidated set of financial statements included in this half-year financial report has been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority and with International Accounting Standard (IAS) 34 *Interim Financial Reporting*, as adopted by the European Union. The annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union.

The Group adopted IFRIC 21 *Levies* in 2013, which has led to a restatement of the 2013 half year comparatives. The IFRIC amended the trigger point for recognition of the FSCS levy from the year end to the start of the scheme year, which is in April. The effects of the restatement changed the scheme year recognition points for 2011 and 2012, thus decreasing the 2013 brought forward reserves balances by £0.7m and reduced the profit before tax to 30 June 2013 by £3.0m. Additionally, the revision to IAS 19 *Employee Benefits* became effective in 2013, the main impact of which was the change the recognition of the rate of return on assets to the income statement. The 2013 brought forward reserves were decreased by £0.4m, and £0.6m was charged in 2013. For more details, please see page 51 of the 2013 Annual Report and Accounts. The consolidated income statement for the year ended 31 December 2013 is restated only to show separately the results of discontinued and continuing operations.

Changes in accounting policy

In the current financial year, the Group has adopted the amendments to IAS 36 *Impairment of Assets* and IAS 39 *Financial Instruments: Recognition and Measurement.* Otherwise, the same accounting policies, presentation and methods of computation are followed in the condensed set of financial statements as applied in the Group's latest annual audited financial statements.

The amendments to IAS 39 provide an exemption to the requirement to discontinue hedge accounting when the counterparty to a hedging instrument changes if the following criteria are met: the change arises as a consequence of the introduction of laws or regulations; the parties agree that a clearing counterparty will replace the original counterparties; and no other changes to the derivative are made. The Society has adopted the use of clearing counterparties in response to G20 Group of Nations agreements that over the counter (OTC) derivatives should be cleared through a central counterparty (CCP), enacted more specifically in the European Market Infrastructure Regulation (EMIR) in the EU. The adoption by the Society of clearing counterparties meets all of the requirements for the exemption; therefore, there is no impact on the accounts of the Society and the Group.

The amendments to IAS 36 remove the requirement to disclose recoverable amounts of goodwill and other indefinite-lived intangible assets when there is no impairment during the period. The Annual Report and Accounts for the Group have historically included the disclosures required before this amendment, but the interim accounts have not. Therefore, although there may be an impact on the Annual Report and Accounts, there will be no impact on these interim accounts.

Notes to the accounts
for the period ended 30 June 2014

1. Accounting policies (continued)

Judgements in applying accounting policies and critical accounting estimates

The same accounting judgements are followed in this condensed set of financial statements as applied in the Group's latest annual audited financial statements, except for calculations of retirement benefit obligations, and reflect management's current estimates.

Retirement benefit obligation

The Group has to make assumptions on the expected return on pension plan assets, mortality, inflation and future salary rises when valuing its pension liability and the cost of benefits provided. Changes in assumptions could affect the reported liability, service cost and expected return on pension plan assets.

The assumptions used by the actuaries' were:

	6 months to 30.06.14 (Unaudited) %	6 months to 30.06.13 (Unaudited) %	Year ended 31.12.13 (Audited) %
Discount rate assumption	4.20	4.90	4.50
Inflation assumption (RPI)	3.40	3.50	3.50
Inflation assumption (CPI)	2.40	3.00	2.70
Rate of increase in pensionable salaries	2.40	3.50	3.50

As the scheme is closed to new entrants, the assumed rate of increase in pensionable salaries is the same as the inflationary assumption, now linked to the Consumer Price Index as described below. Details of the contingent element of the retirement benefit obligation can be found in Note 17c.

During the first half of 2014, the trustees of the pension plan agreed to adopt the Consumer Price Index (CPI) as the inflationary assumption in actuarial calculations of the scheme liability. Previously, the Retail Price Index (RPI) has been used. The liability as calculated using the CPI is currently estimated to be £8.6m, which is reflected in the statement of financial position.

Going concern

The directors are satisfied that the Group has sufficient resources to continue in operation for the foreseeable future, a period of not less than 18 months from the date of this report. Accordingly, they continue to adopt the going concern basis in preparing the condensed financial statements. Further information regarding the directors' assessment of Going Concern can be found in the Business Review on page 10.

Non-current assets held for sale

Non-current assets and disposal groups classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell.

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset or disposal group is available for immediate sale in its present condition. Management must be committed to the sale which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

When the Group is committed to a sale plan involving loss of control of a subsidiary, all of the assets and liabilities of that subsidiary are classified as held for sale when the criteria described above are met, regardless of whether the Group will retain a non-controlling interest in its former subsidiary after the sale.

Notes to the accounts

for the period ended 30 June 2014

2. Business segments

The Group operates four main business segments: retail financial services, commercial lending, secured personal lending, and property services.

Transactions between the business segments are on normal commercial terms and conditions.

	6 months to 30.06.14 (Unaudited) - continuing activities					
	Retail financial services	Commercial lending	Secured personal lending	Property services	Adjustment for Group transactions*	Total
	£m	£m	£m	£m	£m	£m
Net interest income	43.3	6.3	16.7	-	-	66.3
Other income and charges	3.8	0.9	-	-	(0.1)	4.6
Net operating income	47.1	7.2	16.7	-	(0.1)	70.9
Administrative expenses	(28.3)	(2.0)	(5.6)	(0.2)	11.1	(25.0)
Impairment provision for losses on loans and advances	(1.9)	(4.5)	(2.2)	-	-	(8.6)
Provision for other liabilities and charges	(4.3)	(0.6)	(1.8)	-	-	(6.7)
Operating profit/(loss)	**12.6**	**0.1**	**7.1**	**(0.2)**	**11.0**	**30.6**
Other gains	-	-	-	-	-	-
Profit before taxation	**12.6**	**0.1**	**7.1**	**(0.2)**	**11.0**	**30.6**
Tax						(5.2)
Profit for the period from discontinued operations						0.1
Profit after tax and discontinued operations						**25.5**

	6 months to 30.06.13 (Unaudited - restated) - continuing activities					
	Retail financial services	Commercial lending	Secured personal lending	Property services	Adjustment for Group transactions	Total
	£m	£m	£m	£m	£m	£m
Net interest income	29.3	4.7	18.2	-	-	52.2
Other income and charges	4.2	1.0	2.9	-	(0.1)	8.0
Net operating income	33.5	5.7	21.1	-	(0.1)	60.2
Administrative expenses	(26.0)	(2.1)	(5.7)	(0.2)	1.4	(32.6)
Impairment provision for losses on loans and advances	(1.2)	(6.3)	(3.7)	-	-	(11.2)
Provision for other liabilities and charges	(3.8)	(0.6)	(0.1)	(0.1)	-	(4.6)
Operating profit/(loss)	**2.5**	**(3.3)**	**11.6**	**(0.3)**	**1.3**	**11.8**
Other gains	-	-	-	-	-	-
Profit before taxation	**2.5**	**(3.3)**	**11.6**	**(0.3)**	**1.3**	**11.8**
Tax						(2.9)
Profit for the period from discontinued operations						(0.2)
Profit after tax and discontinued operations						**8.7**

*The 30 June 2014 figures include the impact of the pension past service cost relating to the change from RPI to CPI.

2. Business segments (continued)

	Year ended 31.12.13 (Audited – restated*) - continuing activities					
	Retail financial services	Commercial lending	Secured personal lending	Property services	Adjustment for Group transactions	Total
	£m	£m	£m	£m	£m	£m
Net interest income	68.6	11.0	36.8	-	-	116.4
Other income and charges	6.3	2.0	4.0	-	(0.3)	12.0
Net operating income	74.9	13.0	40.8	-	(0.3)	128.4
Administrative expenses	(52.6)	(4.2)	(10.7)	(0.5)	2.7	(65.3)
Impairment provision for losses on loans and advances	(0.4)	(16.7)	(5.3)	-	-	(22.4)
Provision for other liabilities and charges	(3.4)	(0.6)	(8.4)	(0.1)	-	(12.5)
Operating profit/(loss)	**18.5**	**(8.5)**	**16.4**	**(0.6)**	**2.4**	**28.2**
Other gains	-	-	-	-	-	-
Profit before taxation	**18.5**	**(8.5)**	**16.4**	**(0.6)**	**2.4**	**28.2**
Tax						(6.2)
Profit for the period from discontinued operations						0.2
Profit after tax and discontinued operations						**22.2**

	6 months to 30.06.14 £m (Unaudited)	6 months to 30.06.13 £m (Unaudited)	Year ended 31.12.13 £m (Audited)
Total assets by business segments			
Retail financial services	5,986.1	5,521.4	5,653.2
Secured personal lending	561.6	588.2	572.9
Commercial lending	812.1	875.1	822.9
Property services	-	6.6	9.1
Assets classified as held for sale	11.6	-	-
Total assets	**7,371.4**	**6,991.3**	**7,058.1**

The Group operates entirely within the UK, and therefore a geographical segment analysis is not required.

*The 31 December 2013 figures above have been restated only to exclude the effects of discontinued operations.

Notes to the accounts
for the period ended 30 June 2014

3. Interest receivable and similar income

	Group		
	6 months to 30.06.14 £m (Unaudited)	6 months to 30.06.13 £m (Unaudited)	Year ended 31.12.13 £m (Audited)
On loans fully secured on residential property	124.5	124.4	252.1
On other loans fully secured on land	9.1	10.2	20.0
On debt securities	3.1	2.5	5.4
Profit on realisation of investments	0.2	0.5	0.6
On other liquid assets	0.9	1.3	2.1
On derivative financial instruments	(7.6)	(11.0)	(18.6)
	130.2	**127.9**	**261.6**

4. Interest payable and similar charges

	Group		
	6 months to 30.06.14 £m (Unaudited)	6 months to 30.06.13 £m (Unaudited – restated)	Year ended 31.12.13 £m (Audited)
On shares held by individuals	59.0	71.6	137.0
On deposits and debt securities	7.3	8.4	11.1
On subscribed capital	2.1	2.1	4.2
On subordinated liabilities	0.7	0.7	1.4
On derivative financial instruments	(5.2)	(7.1)	(8.5)
	63.9	**75.7**	**145.2**

5. Fees and commission receivable

	Group		
	6 months to 30.06.14 £m (Unaudited)	6 months to 30.06.13 £m (Unaudited)	Year ended 31.12.13 £m (Audited)
Insurance and related financial service products	1.3	4.1	5.8
Estate Agency and lettings income	-	-	-
Mortgage related fees	2.2	2.3	5.1
Other fees and commission	0.4	1.0	2.5
	3.9	**7.4**	**13.4**

6. Fees and commission payable

	Group		
	6 months to 30.06.14 £m (Unaudited)	6 months to 30.06.13 £m (Unaudited)	Year ended 31.12.13 £m (Audited)
Mortgage related fees	0.3	0.3	0.6
Bank charges	0.3	0.2	0.5
	0.6	**0.5**	**1.1**

7. Other fair value gains and losses

	Group		
	6 months to 30.06.13 £m (Unaudited)	6 months to 30.06.13 £m (Unaudited)	Year ended 31.12.13 £m (Audited)
Gains on derivatives	0.4	8.8	17.3
Losses on hedged items attributable to the hedged risk	0.4	(8.2)	(18.5)
	0.8	**0.6**	**(1.2)**

Other fair value gains and losses represent the difference between changes in the fair values excluding interest flows of the hedging derivatives and the changes in the fair values excluding interest flows of the underlying hedged items.

8. Administrative expenses

	Group		
	6 months to 30.06.14 £m (Unaudited)	6 months to 30.06.13 £m (Unaudited – restated)	Year ended 31.12.13 £m (Audited)
Wages and salaries	16.9	15.5	31.8
Social security costs	1.7	1.5	3.1
Other pension costs	(9.1)	0.9	1.8
	9.5	17.9	36.7
Other administrative expenses	12.3	11.6	22.2
	21.8	**29.5**	**58.9**

On 3 April 2014 the Trustees of the Group's defined benefit pension plan decided to adopt the Consumer Prices Index (CPI), rather than the Retail Prices Index (RPI), as the basis for determining the rate of inflation in actuarial calculations of the scheme liability. The change in inflation assumptions caused a credit to administrative expenses of £10.1m in the period in relation to a reduction of the estimated future liability arising as a result of past service costs. This is recognised in 'Other pension costs' above.

9. Other gains

There have been no other gains included in the profit for the 6 months to 30 June 2014 (30 June 2013: Nil).

Notes to the accounts
for the period ended 30 June 2014

10. Taxation expense

Estimated tax for the Group for 2014 is charged at 22.1% (30 June 2013: 25.2%), representing the best estimate of the annual effective tax rate expected for the full year, applied to the forecast pre-tax income for the year and pro-rated for the six month period. The reduction in rate is largely driven by the reduction in the UK Corporation tax rate from 23.0% to 21.0% from 1 April 2014.

11. Discontinued operations

On 30 July 2014, the Group entered into and completed on a sale agreement to sell Peter Alan Limited, its subsidiary businesses and the Group's Surveyors business (together 'Peter Alan'), which together carried out all of the Group's estate agency, lettings and surveying operations. At the date of completion control of Peter Alan passed to the acquirer.

Upon completion, in exchange for the sale of its 100% shareholding, the Group received consideration of £16.4m. The consideration generated a gain in the region of £10.5m, being the sale proceeds less costs, less the carrying amount of Peter Alan's net assets and attributable goodwill at the time of completion. This will be recognised in the Group's results for the second half of the year.

The sale is in line with the Group strategy of focusing on the core business of the building society. The Board considered that significant investment would be required to maximise the potential of Peter Alan, and the focus on the core Society has reduced the strategic rationale for maintaining an estate agency and letting business within the Group.

The results of the discontinued operations, which have been included in the consolidated income statement, were as follows:

	6 months to 30.06.14 £m (Unaudited)	6 months to 30.06.13 £m (Unaudited)	Year ended 31.12.13 £m (Audited)
Revenue	5.8	4.8	10.7
Expenses	(5.6)	(4.9)	(10.2)
Profit before tax	**0.2**	**(0.1)**	**0.5**
Attributable tax expense	(0.1)	(0.1)	(0.3)
Net gain/(loss) attributable to discontinued operations	**0.1**	**(0.2)**	**0.2**

During the period, Peter Alan Limited contributed £1.4m (year to 31 December 2013: £2.4m) to the Group's net operating cash flows, received £0.3m (year to 31 December 2013: paid £3.0m) in respect of investing activities and received £Nil (year to 31 December 2013: £Nil) in respect of financing activities.

The major classes of assets and liabilities comprising the operations classified as a disposal group are as follows:

	As at 30.06.14 £m (Unaudited)
Goodwill	0.3
Other intangibles	1.3
Property, plant and equipment	2.7
Trade and other receivables	1.3
Cash and bank balances	6.0
Total assets classified as held for sale	11.6
Trade and other payables	4.1
Corporation tax payable	0.2
Total liabilities associated with assets classified as held for sale	4.3
Net assets of disposal group	**7.3**

12. Assets measured at fair value

As at 30.06.14 (Unaudited)	Group		
	£m	Level 1 £m	Level 2 £m
Financial assets at fair value through profit or loss:			
Derivative financial instruments	36.7	-	36.7
Available-for-sale financial assets:			
Debt securities	549.2	549.2	-
Total	**585.9**	**549.2**	**36.7**

As at 30.06.13 (Unaudited)	Group		
	£m	Level 1 £m	Level 2 £m
Financial assets at fair value through profit or loss:			
Derivative financial instruments	36.4	-	36.4
Available-for-sale financial assets:			
Debt securities	539.9	539.9	-
Total	**576.3**	**539.9**	**36.4**

As at 30.12.13 (Audited)	Group		
	£m	Level 1 £m	Level 2 £m
Financial assets at fair value through profit or loss:			
Derivative financial instruments	37.6	-	37.6
Available-for-sale financial assets:			
Debt securities	566.0	566.0	-
Total	**603.6**	**566.0**	**37.6**

The tables above provide an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into levels 1 to 3 based on the degree to which the fair value is observable. None of the instruments have transferred between levels during the period.

Level	Hierarchy for fair value disclosures
1.	Quoted prices (unadjusted) in active markets for identical assets or liabilities.
2.	Inputs other than quoted prices included within level 1 that are observable for the asset or liability either directly or indirectly (i.e. derived from prices).
3.	Inputs for the asset or liability that are not based on observable market data. There are no instruments classified as level 3 in 2014 (2013: none).

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for the period ended 30 June 2014

13. Loans and advances to customers

	Group		
	As at 30.06.14 £m (Unaudited)	As at 30.06.13 £m (Unaudited)	As at 31.12.13 £m (Audited)
Maturity analysis of loans and advances to customers from the date of the statement of financial position:			
Less than three months	149.0	192.7	157.7
Between three months and one year	232.0	279.0	245.6
Between one year and five years	1,078.6	984.0	1,036.3
More than five years	4,619.2	4,288.4	4,496.6
	6,078.8	5,744.1	5,936.2
Provision for impairment losses	(61.7)	(72.6)	(59.9)
Unamortised loan origination fees	16.4	20.4	18.4
Fair value adjustment for hedged risk	5.4	28.7	9.9
	6,038.9	**5,720.6**	**5,904.6**

The Society issued its second Residential Mortgage Backed Security (RMBS) in June of this year. The RMBS issue involved the formation of a Special Purpose Entity (SPE) Friary No. 2 Plc, which provides security to an £520.5m amortising bond. As at 30 June 2014, £519.1m of loans issued by the Society had been transferred to the SPE which remain on the statement of financial position of the Society as it retains the risks and rewards of the assets. The amortised value of the bond was £520.5m, with £45.5m retained by the Group.

As at 30 June 2014, £429.8m of loans issued by the Society had been transferred to the SPE in relation to the Society's first RMBS, Friary No. 1 Plc. These assets remain on the statement of financial position of the Society as it retains the risks and rewards. The amortised value of the bond was £459.7m, with £328.3m retained by the Group.

As at 30 June 2014, the Society had drawn down additional funding of £207.0m (31 December 2013: £350.0m) under the Bank of England's Funding for Lending (FLS) scheme. This funding has been used primarily to support mortgage growth and supplement maturing wholesale funding. No further draw-downs are planned under the scheme.

Notes to the accounts
for the period ended 30 June 2014

14. Provision for liabilities and charges

	Group		
	As at 30.06.14 (Unaudited) £m	As at 30.06.13 (Unaudited – restated) £m	As at 31.12.13 (Audited) £m
At beginning of the period/year	12.7	9.9	9.9
Charge for the period/year	6.7	4.6	12.5
Utilisation	(4.3)	(3.9)	(9.7)
At end of the period/year	**15.1**	**10.6**	**12.7**

Provisions for liabilities are analysed as follows:

	Group		
	As at 30.06.14 (Unaudited) £m	As at 30.06.13 (Unaudited – restated) £m	As at 31.12.13 (Audited) £m
PPI	1.1	2.7	1.1
FSCS	6.9	6.3	2.3
Regulatory and other complaints	7.1	1.6	9.3
At end of period/year	**15.1**	**10.6**	**12.7**

Further details of the provisions held and expected timing of payments are set out in note 17 of these Half Year Financial Statements and in note 39 to the 2013 Annual Report and Accounts. Further details of the restatement of the 2013 half year figures are set out in note 1.

15. Amounts owed to credit institutions

Included in amounts owed to credit institutions is £175.4m (31 December 2013:£413.3m) in respect of sale and repurchase agreements.

16. Analysis of general reserve

	Group		
	As at 30.06.14 (Unaudited) £m	As at 30.06.13 (Unaudited – restated) £m	As at 31.12.13 (Audited) £m
Balance at beginning of the period/year	357.7	339.4	339.4
Profit for the financial period/year	25.5	8.7	22.2
Actuarial loss on retirement benefit obligations	(2.1)	(1.7)	(4.3)
Movement in tax relating to retirement benefit obligations	0.2	0.1	0.4
Total recognised income for the period/year	23.6	7.1	18.3
Balance at end of period/year	**381.3**	**346.5**	**357.7**
Reserves excluding pension liability	389.9	361.4	374.8
Pension liability	(8.6)	(14.9)	(17.1)
	381.3	**346.5**	**357.7**

Notes to the accounts
for the period ended 30 June 2014

17. Contingent liabilities and commitments

a) Financial Services Compensation Scheme levy

As described in note 39 to the 2013 Annual Report and Accounts, the Society is required to make payments to the FSCS in relation to the restructuring of a number of failed financial institutions.

A provision of £6.9m (31 December 2013: £2.3m) is held in respect of these levies and represents the Society's best estimate of total levies payable in July 2014 and 2015. The FSCS levy provision has been adjusted to reflect the most up-to-date information with regards to the 2014/2015 levy year, which has resulted in an increase in the provision of £4.6m. The Society has not yet been directly notified of the levies payable as a result of the claims against the FSCS and there are a number of factors that prevent accurate calculation of this future liability. As more information becomes available, the Society will continue to review provision levels as appropriate.

b) Customer and Regulatory Complaints

The Group has undertaken a detailed and comprehensive review of processes and documentation in relation to compliance with consumer credit legislation. As a result of this review, a number of areas requiring remediation were identified. A remediation process has been initiated, and a provision of £5.4m is held against this liability, with £3.5m utilised during the first half of the year. An additional provision of £0.9m was made in the first half of the year.

A provision of £1.1m is held in respect of PPI, with £0.5m being utilised during the first half of the year. An additional provision of £0.5m was made in the first half of the year.

c) Defined benefit pension scheme

The pension scheme was subject to a triennial valuation in September 2013. Additional payments due as part of the recovery plan agreed are £1.5m per plan year (October to September) during the first three years after the valuation with an additional £1.1m to be paid during the fourth year after the valuation. A total of £1.9m is expected to be paid during 2014 as part of the recovery plan.

During the first half of 2014, the trustees agreed to change the basis for the inflation assumption used in the actuarial calculation of the scheme's liability from the Retail Price Index (RPI) to the Consumer Price Index (CPI). This change has recently been adopted by a large number of pension plans in both the public and private sectors throughout the UK. The effect of this change has been to decrease the scheme liability by £10.1m, which has been recognised in the first half of 2014 and, as a past service cost, is reflected as an increase to profit for the period in the Consolidated Income Statement.

18. Related party transactions

Transactions between the Society and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. There were no other significant related party transactions in the current or prior period which require disclosure in the half year financial report.

Notes to the accounts
for the period ended 30 June 2014

19. Financial instruments

a) Carrying values and fair values

The table below compares carrying values and fair values of the Group's financial instruments by category. It is accompanied by an explanation of the methods used to determine fair value.

		6 months to 30.06.14		Year ended 31.12.13	
		Carrying Value (Unaudited) £m	Fair Value (Unaudited) £m	Carrying Value (Unaudited) £m	Fair Value (Audited) £m
Group assets					
Cash in hand and balances with Bank of England		547.6	547.6	355.6	355.6
Loans and advances to credit institutions	i.	125.7	125.7	120.5	120.5
Debt securities	ii.	549.2	549.2	566.0	566.0
Derivative financial instruments	iii.	36.7	36.7	37.6	37.6
Loans and advances to customers	iv.	6,038.9	6,022.6	5904.6	5886.1
		7,298.1	**7,281.8**	**6,984.3**	**6,965.8**
Group liabilities					
Shares	vi.	5,605.7	5,605.7	5,562.6	5,562.6
Amounts owed to credit institutions	vii.	218.6	218.5	499.7	499.7
Amounts owed to other customers	vii.	238.9	238.9	225.1	225.1
Debt securities in issue	vii.	693.1	695.5	178.0	181.7
Derivative financial instruments	iii.	24.9	24.9	26.2	26.2
Subordinated liabilities	viii.	92.3	86.8	92.3	81.1
Subscribed capital	viii.	69.9	57.0	70.2	48.5
		6,943.4	**6,927.4**	**6,654.1**	**6,624.9**

The gross amount of foreign currency swaps held was 20.0m Euro.

19. Financial instruments (continued)

a) Carrying values and fair values (continued)

Fair value is the amount for which an asset could be exchanged, or a liability transferred, between knowledgeable, willing parties in an arm's length transaction. The following methods and assumptions have been applied in determining fair value:

i) The carrying amount of loans and advances to credit institutions with a maturity of under 12 months is assumed to equate to their fair value.
ii) Debt securities classified as available-for-sale are measured at fair value by reference to market prices.
iii) All derivatives are held for economic hedging purposes. The fair value of interest rate swaps is calculated by utilising discounted cash flow valuation models. The fair value of cross currency interest rate swaps is obtained from external counterparties.
iv) The fair value of loans and advances to customers at a variable rate is assumed to approximate to their carrying amounts. The fair value of loans and advances to customers at a fixed rate of interest represents the discounted amount of estimated future cash flows expected to be received after taking account of provisions, expected levels of early repayment and discounting at current market rates.
v) The fair value of loans and advances to subsidiaries at a variable rate is assumed to approximate to their carrying amounts
vi) The fair value of customer accounts is assumed to approximate to the amount payable at the date of the statement of financial position.
vii) The fair values of amounts owed to credit institutions, amounts owed to other customers and debt securities in issue are established by using discounted cash flow valuation models or are assumed to approximate to the amount payable at the date of the statement of financial position.
viii) The fair values of subordinated liabilities and subscribed capital are obtained from market prices.

b) Credit Risk

The table below shows the Group's estimated maximum exposure to credit risk for all financial assets.

i) Loans and advances to customers

The Group's exposure to credit risk relating to loans and advances to customers can be broken down by security as follows:

	Group		
	6 months to 30.06.14 £m (Unaudited)	6 months to 30.06.13 £m (Unaudited)	Year ended 31.12.13 £m (Audited)
In respect of loans and advances to customers:			
Fully secured by a first charge on residential property	5,058.1	4,618.0	4,882.3
Fully secured by a first charge on land	421.1	494.9	446.5
Fully secured by a second charge on residential property	504.7	533.0	516.8
Partially secured by a second charge on residential property	49.6	46.0	49.1
Fair value adjustments	5.4	28.7	9.9
	6,038.9	**5,720.6**	**5,904.6**

19. Financial instruments (continued)

b) Credit Risk (continued)

The Group's exposure to credit risk relating to loans and advances to customers can be broken down by business segments as follows:

	Group		
	6 months to 30.06.14 £m (Unaudited)	6 months to 30.06.13 £m (Unaudited)	Year ended 31.12.13 £m (Audited)
Retail financial services	4,667.1	4,237.8	4,505.9
Commercial loans	812.1	875.1	822.9
Secured personal lending	554.3	579.0	565.9
Fair value adjustments	5.4	28.7	9.9
	6,038.9	**5,720.6**	**5,904.6**

The Group provides loans secured on residential property across England, Scotland and Wales and the Society, as a regional building society, has a geographical concentration in Wales.

As at 30 June 2014, approximately 31.4% (31 December 2013: 31.9%) of first and second charge retail loans by account and 29.1% (31 December 2013: 29.6%) by value were concentrated in Wales.

The average index-linked loan to value (LTV) in respect of the Group's loans secured by first and second charge on residential property is 62.6% (31 December 2013: 63.2%).

The percentage of retail lending cases fully secured by a first charge currently with arrears greater than 2.5% of the total outstanding balance is 0.79% (31 December 2013: 0.78%) which compares favourably with the industry average of 1.24% (CML arrears and possession data as at March 2014).

Total arrears balances on residential lending fully secured by a first charge was £1.5m (31 December 2013: £1.5m) and there are 144 (31 December 2013: 143) residential cases six months or more in arrears.

The percentage of secured personal loans currently in arrears by number 8.50% (31 December 2013: 8.74%), which by value is 10.90% (31 December 2013: 11.68%).

We continue to uphold our mutual values exploring all reasonable and appropriate account management and forbearance options for borrowers experiencing financial difficulty. The Group offers a range of account management and forbearance options for borrowers. In the event of short-term difficulty the Group operates temporary reductions in payments and 'rehabilitation' tools for borrowers in arrears or pre-delinquency. Actions may include granting a revised payment schedule, a temporary transfer to interest-only, arrangements for the borrower to underpay and changing the payment date or payment method.

ii) Commercial

Loans secured on commercial property are diversified by industry type with the largest exposure to one counterparty amounting to £30.0m (31 December 2013: £29.9m) or 3.5% (31 December 2013: 3.5%) of gross balances.

Asset quality remains strong with total arrears balances of £0.1m (31 December 2013: £0.1m) and only 8 commercial cases (31 December 2013: 7) three months or more in arrears.

19. Financial instruments (continued)

iii) Treasury

The treasury risk function monitors exposure concentrations against a variety of criteria including counterparty and country limits, and all exposures are well spread across this risk assessment framework.

An assessment has been made of the Society's key counterparties regarding the potential levels of direct or indirect exposure to distressed Eurozone economies. This assessment concludes that no impairment provisions are required.