

PRINCIPALITY BUILDING SOCIETY

Half-year financial report

For the period ended 30 June 2008

Principality Building Society
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for the period ended 30 June 2008

Contents	Page
Responsibility statement	1
Chief Executive's review	2
Independent review report	4
Consolidated income and expenditure statement	5
Consolidated balance sheet	6
Consolidated cash flow statement	7
Notes to the accounts	8

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:

- the condensed set of financial statements has been prepared in accordance with IAS 34 'Interim Financial Reporting';
- the half year financial report includes a fair review of the information required by:
 - (a) DTR 4.2.7R of the Disclosure and Transparency Rules indicating important events that have occurred in the first half of the financial year and their impact on the financial statements with a description of the principal risks and uncertainties in the remaining 6 months; and
 - (b) DTR 4.2.8R of the Disclosure and Transparency Rules outlining related party transactions that have taken place during the first half of the financial year and that have materially affected the financial position or performance of the organisation during that period.

By order of the Board,

P L Griffiths
Group Chief Executive

W G Thomas
Group Finance Director

11 September 2008

Chief Executive's review

Financial position at the half year

Highlights as at 30 June 2008:

- Group assets increased by £437.0m from 31 December 2007 to £6,289.5m.
- The pre-tax profit for the Group was £8.4m, and net profit after tax was £6.0m.
- 88% of loans funded by customer deposits.
- Liquid assets held in the form of Government stocks, short-term deposits and cash totalled £1,355.8m, equivalent to 23.42% of shares and borrowings.
- From the start of the year mortgage assets increased by 5.24%.
- Shares, member savings, increased by 11.7% during the first 6 months of the year.
- The Group gross capital ratio was 7.20% of total share and deposit liabilities whilst free capital ratio was 6.90% of those liabilities.

Overview

After several years of record growth and record profits for the Society the uncertainty created by events in the global credit markets has resulted in slower growth and lower profitability. Undoubtedly the domestic market is now facing a far more testing economic climate and sentiment is skewed by a lack of cash in the system curtailing the availability of credit. This has led to lower housing transactions and a correction in house prices.

In my summary at the end of 2007 I said that we would be “progressive and prudent” and we have remained true to our word. Anticipating the economic and market risks we repositioned our businesses, becoming more selective in our approach to credit risk. In a period of falling house prices we tightened our lending criteria and deliberately reduced lending volumes, especially in our secured loans business. As a result growth has slowed and the impact on other income lines has been significant. Arrears trends have moved up and house prices have fallen rapidly causing a consequential increase in impairment provisions for some parts of the business. The Society does not have any exposure to US related sub-prime exposures.

It has been a period where the focus has shifted back to a more traditional Mutual model and we have dramatically stepped up our savings activity. Our trusted brand and a new range of medium term savings products attracted record retail savings inflows of £448m to the Society. These inflows represented over 160% of the Group's lending growth allowing us to decrease our non retail funding ratio to 26.56%.

We have welcomed over 28,000 new members to the Society through our attractively priced product range. Our net interest income as a percentage of mean assets across the Group fell to 1.25% which continues to benchmark well in the sector and reflects the value of higher margins from our subsidiary businesses.

It has been a period of tough choices and the trade off for strong liquidity, high levels of retail funding and quality assets has been lower lending growth and lower profitability. This has created spare capacity and an aggressive cost reduction programme regrettably leading to the loss of over 100 jobs in the period. Our embryonic broking arm, Moneypilot, has also experienced a fall in volumes and fee income leading to the closure of the business in July 2008. Strong cost management is being exercised across the Group to counter the cyclical downturn in income.

Profit before impairment provisions was 17% down year on year. Underlying this is a strong performance in the core Society with core profit up 11%. Market factors have adversely affected income in our Estate Agency subsidiary and Survey and valuation business. Our broking arm has also seen a fall off in volumes and fee income. A deliberate tightening of lending criteria and a shift to lower loan to value assets in the secured loans business dramatically reduced volumes resulting in a £5.2m decline in fees and commissions, down 30% year on year.

The fall in house prices has impacted impairment provisions. At a Group level arrears of more than 3 months were 1.51% (Society 0.75%) and the average loan to current valuation across the Group remains below 50%. The Commercial lending book continues to perform strongly with low arrears levels.

Clearly it has been a very testing first half. The results continue to demonstrate that even in the most severe markets the Society can still generate adequate profits, provide good products and build on our strong base. We are in good shape to deal with current market conditions and remain confident that we can come out of this unique economic cycle leaner but fitter.

Capital and profit

The Group's capital position is measured by two capital ratios - gross capital and free capital. The gross capital ratio stands at 7.2% and is a measure of the Group's reserves, subscribed capital and subordinated liabilities as a percentage of total assets. The free capital ratio is the same capital but adds in provision for impairment for losses and deducts intangible and fixed assets resulting in a ratio of 6.9%.

The Group's profit after tax position for the period to 30 June 2008 is down on the comparative period, primarily due to increased provisions and reduction in other income. The impairment provision in Nemo Finance has increased by £6.4m in the period and has had a significant detrimental effect on profit. The drop in other income reflects the slowdown in the mortgage market, affecting the Group's lending, surveying and estate agency activities. This is illustrated in the ratio, other income as a percentage of net operating income, which has fallen from the year-end position of 34.45% to 20.38%.

The ratio of management expense as a percentage of total mean assets is one indication of how efficiently the Society is managing its assets. The ratio has decreased since the year-end from 1.27% to 1.16% which shows the Society are managing costs down to preserve profit, this has been achieved without compromising operational efficiency, customer service or product quality.

The profit was impacted by a fair value adjustment of £2.6m which will unwind as liquid asset and derivative positions mature over the next 10 months.

The Board completed a review of the Group's capital adequacy concluding that the Group is expected to maintain its strong capital position in spite of current uncertainties in the Group's operating environment.

Funding and liabilities

The Society continues to show record growth and inflows of its savings products, with strong up take of fixed rate bonds and the maintained high level of inflows through the Society's e-SAVER channel resulting in an increase of loans funded by customer deposits to 88%.

The other element of funding is the borrowings from wholesale or money market sources. In spite of the general worsening in these markets, observed since the start of the "credit crunch" the Society has continued to be able to raise funds successfully from this source.

The overall high levels of retail savings inflows has helped reduce the Society's funding limit to 26.74% from a year-end position of 29.03%. This ratio shows the proportion of Group funding which is from wholesale or money market sources.

Assets

Total assets have grown for the period to over £6 billion and the Society continues to deliver value for members. To enable the Society to do this the Board applies controls to the Group's lending criteria, which reflect the continuing challenges in the business environment.

Liquid assets give protection against the sudden risk of unexpected outflow of funds and they have been increased since the year-end by £159.1m to £1,355.8m. The Society has increased the level of liquid assets in line with the growth of the book as well as to enhance protection during this demanding time. This is illustrated in the increase in the Society's liquidity ratio, which has risen by 1.02% since the end of the year to 23.42%.

Liquid assets can be readily turned into cash should the need arise and over 90% of the Group's liquid asset investments continue to be invested in AAA/AA rated businesses.

Principal risks and uncertainties

The Group's principal inherent risks are described in the Risk Management report on pages 9 to 11 of the Annual Report and Accounts for 2007. The risks fall into the following categories:

- Credit risk;
- Market risk;
- Liquidity risk; and
- Operational risk.

Trading conditions are likely to remain challenging for at least the rest of the year. The inter-bank markets remain difficult and there is likely to be strong competition for retail funds. Our emphasis will continue to be on prudent lending in these testing times.

Independent review report

We have been engaged by the Group to review the condensed set of financial statements in the half-year financial report for the six months ended 30 June 2008 which comprises the condensed consolidated income and expenditure statement, the condensed consolidated balance sheet, the condensed consolidated statement of total recognised income and expense, the condensed consolidated cash flow statement and related notes 1 to 11. We have read the other information contained in the half-year 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 Group in accordance with International Standard on Review Engagements (UK and Ireland) 2410 issued by the Auditing Practices Board. Our work has been undertaken so that we might state to the Group those matters we are required to state to them 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 Group, for our review work, for this report, or for the conclusions we have formed.

Directors' responsibilities

The half-year financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-year financial report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

As disclosed in Note 1, the annual financial statements of the Group are prepared in accordance with IFRS as adopted by the European Union. The condensed set of financial statements included in this half-year 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 Group a conclusion on the condensed set of financial statements in the half-year 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 enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is 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-year financial report for the six months ended 30 June 2008 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 Services Authority.

Deloitte & Touche LLP
Chartered Accountants and
Registered Auditors
Cardiff, United Kingdom

11 September 2008

Consolidated income and expenditure statement
Group interim results for six months to 30 June 2008

	Notes	6 months to 30.06.08 £m (Unaudited)	6 months to 30.06.07 £m (Unaudited)	Year ended 31.12.07 £m (Audited)
Interest receivable and similar income	3	191.9	149.0	327.4
Interest payable and similar charges	4	(153.9)	(116.0)	(258.8)
Net interest income		<u>38.0</u>	<u>33.0</u>	<u>68.6</u>
Fees and commission receivable	5	13.6	20.1	41.6
Fees and commission payable	6	(1.8)	(3.1)	(6.3)
Net fee and commission income		<u>11.8</u>	<u>17.0</u>	<u>35.3</u>
Other operating income		0.5	0.7	1.1
Other fair value (losses)/gains	7	<u>(2.6)</u>	<u>0.2</u>	<u>(0.3)</u>
Net operating income		47.7	50.9	104.7
Administrative expenses	8	(29.2)	(29.7)	(62.0)
Depreciation and amortisation		(3.1)	(2.6)	(5.6)
Operating expenses		<u>(32.3)</u>	<u>(32.3)</u>	<u>(67.6)</u>
Impairment losses on loans and advances		<u>(7.0)</u>	<u>(2.4)</u>	<u>(6.5)</u>
Profit before taxation		8.4	16.2	30.6
Taxation expense		(2.4)	(4.9)	(10.1)
Profit for the period		<u>6.0</u>	<u>11.3</u>	<u>20.5</u>
Consolidated statement of total recognised income and expense				
Profit for the period		6.0	11.3	20.5
Actuarial loss on retirement benefit obligations		-	-	(1.5)
Movement in deferred tax relating to retirement benefit obligations		-	-	0.5
		<u>6.0</u>	<u>11.3</u>	<u>19.5</u>

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

The accounting policies and notes on pages 8 to 12 form part of these accounts.

Consolidated balance sheet
As at 30 June 2008

	Notes	As at 30.06.08 (Unaudited) £m	As at 30.06.07 (Unaudited) £m	As at 31.12.07 (Audited) £m
Assets				
Liquid assets:				
Cash in hand and balances with the Bank of England		6.6	7.2	6.3
Loans and advances to credit institutions		42.6	73.1	149.0
Debt securities		1,306.6	858.8	1,041.4
		1,355.8	939.1	1,196.7
Derivative financial instruments		29.2	22.6	10.8
Loans and advances to customers:				
Loans fully secured on residential property		4,189.9	3,613.1	3,986.4
Other loans fully secured on land		578.3	467.5	526.6
Other loans		69.4	61.3	71.0
	9	4,837.6	4,141.9	4,584.0
Investment in joint venture		1.8	1.3	1.3
Intangible fixed assets		3.9	3.9	4.0
Property, plant and equipment		39.4	36.8	39.8
Deferred tax assets		1.2	2.9	2.1
Other assets		4.6	2.1	5.5
Prepayments and accrued income		16.0	10.2	8.3
Total assets		6,289.5	5,160.8	5,852.5
Liabilities				
Shares		4,251.0	3,493.3	3,804.3
Deposits and debt securities:				
Amounts owed to credit institutions		70.2	22.5	41.0
Amounts owed to other customers		1,081.8	674.8	1,063.9
Debt securities in issue		385.3	482.0	435.1
		1,537.3	1,179.3	1,540.0
Derivative financial instruments		12.5	10.7	9.9
Current tax liabilities		2.3	6.0	4.0
Other liabilities		16.4	17.4	12.3
Provision for liabilities and charges		2.0	2.0	2.0
Accruals and deferred income		11.2	11.3	20.0
Deferred tax liabilities		2.0	3.3	2.8
Retirement benefit obligations		2.0	0.6	1.9
Subordinated liabilities		114.4	113.2	120.9
Subscribed capital		57.6	55.8	57.6
Total liabilities		6,008.7	4,892.9	5,575.7
General reserve	10	283.3	269.1	277.3
Other reserves		(2.5)	(1.2)	(0.5)
Total equity and liabilities		6,289.5	5,160.8	5,852.5

The accounting policies and notes on pages 8 to 12 form part of these accounts.

**Consolidated cash flow statement
for the period ended 30 June 2008**

	6 months to 30.06.08 (Unaudited) £m	6 months to 30.06.07 (Unaudited) £m	Year ended 31.12.07 (Audited) £m
Net cash inflow from operating activities (see below)	233.2	102.4	331.7
Cash flows from investing activities			
Purchase of intangible assets and property, plant and equipment	(0.4)	(4.7)	(11.2)
Proceeds from sale of intangible assets and property, plant and equipment	(1.4)	-	0.1
Purchase of investment securities	(2,678.6)	(939.1)	(2,288.7)
Proceeds from sale and maturity of investment securities	2,410.6	824.0	1,991.9
(Decrease)/increase in cash and cash equivalents	(36.6)	(17.4)	23.8
Cash and cash equivalents at beginning of year	70.9	47.1	47.1
Cash and cash equivalents at end of year	34.3	29.7	70.9
Represented by:			
Cash and balances with the Bank of England	6.6	5.7	6.3
Loans and advances to credit institutions repayable on demand	27.7	24.0	64.6
	34.3	29.7	70.9
Net cash inflow from operating activities			
Profit before taxation	8.4	16.2	30.6
Adjusted for:			
Depreciation and amortisation	3.1	2.6	5.6
Loss on sale of property, plant and equipment	-	-	0.3
Increase in impairment provisions on loans and advances to customers	6.8	2.3	5.4
Change in fair values	8.5	4.9	(9.2)
Other non cash movements	0.1	0.7	0.1
Changes in net operating assets			
Decrease in loans and advances to credit institutions	62.9	33.2	6.0
Increase in loans and advances to customers	(287.3)	(269.4)	(692.9)
Increase/(decrease) in other assets	6.6	1.0	(2.1)
Decrease/(increase) in prepayments and accrued income	(7.3)	(0.6)	0.9
Decrease in derivative financial instruments	(15.9)	(5.1)	5.9
Increase in shares	448.3	86.2	397.8
Increase in deposits and debt securities	4.3	233.0	586.3
Increase in other liabilities	3.6	5.0	3.6
Increase in accruals and deferred income	(6.0)	(5.6)	(0.1)
Decrease/(increase) in retirement benefit obligations	0.1	0.1	(0.1)
Taxation	(3.0)	(2.1)	(6.4)
	233.2	102.4	331.7

**Notes to the accounts
for the period ended 30 June 2008**

1. Accounting policies

Basis of preparation

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 Services Authority and with International Accounting Standard (“IAS”) 34 ‘Interim Financial Reporting’, as adopted by the European Union.

The same accounting policies and judgements are followed in this condensed set of financial statements as applied in the Group’s latest annual audited financial statements, which have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as adopted by the European Union.

The information for the year ended 31 December 2007 does not constitute statutory accounts as defined in section 240 of the Companies Act 1985. A copy of the statutory accounts for that year has been published. The auditors’ report on those accounts was not qualified and did not contain statements under section 237(2) or (3) of the Companies Act 1985.

2. Business segments

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

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

	Group		
	6 months to 30.06.08	6 months to 30.06.07	Year ended 31.12.07
	£m	£m	£m
Result by business segment	(Unaudited)	(Unaudited)	(Audited)
Net operating income before fair value gains and losses			
Retail financial services	32.7	30.4	61.5
Secured personal lending	10.7	10.0	22.6
Estate agency	3.6	6.0	11.7
Commercial lending	3.3	4.3	9.2
	50.3	50.7	105.0
Administrative expenses	(29.2)	(29.7)	(62.0)
Depreciation and amortisation	(3.1)	(2.6)	(5.6)
Impairment losses on loans and advances	(7.0)	(2.4)	(6.5)
Fair value gains and losses	(2.6)	0.2	(0.3)
Profit before taxation	8.4	16.2	30.6
Total assets by business segments			
Retail financial services	4,618.9	3,810.1	4,281.5
Secured personal lending	719.6	550.8	688.9
Commercial lending	943.6	794.9	874.5
Other segments	7.4	5.0	7.6
Total assets	6,289.5	5,160.8	5,852.5

The allocation of liabilities to business segments is not appropriate. Net proceeds of funding will be used by the Group for the general purposes of its business.

From the 1 January 2008 the divisional funding recharge for Commercial Lending changed from using a Base Rate to LIBOR basis.

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

Notes to the accounts
for the period ended 30 June 2008

3. Interest receivable and similar income

	6 months to 30.06.08 £m (Unaudited)	Group 6 months to 30.06.07 £m (Unaudited)	Year ended 31.12.07 £m (Audited)
On loans fully secured on residential property	128.7	108.8	229.2
On other loans fully secured on land	21.7	13.8	34.8
On debt securities	33.9	21.4	50.4
Profit on realisation of investments	-	-	1.3
On other liquid assets	2.8	2.3	6.2
On derivative financial instruments	4.8	2.7	5.5
	<u>191.9</u>	<u>149.0</u>	<u>327.4</u>

4. Interest payable and similar charges

	6 months to 30.06.08 £m (Unaudited)	Group 6 months to 30.06.07 £m (Unaudited)	Year ended 31.12.07 £m (Audited)
On shares held by individuals	99.8	79.8	172.5
On other shares	0.4	0.5	0.4
On deposits and debt securities	48.1	29.8	73.0
On subscribed capital	2.3	2.1	4.3
On subordinated liabilities	3.2	3.2	6.4
On derivative financial instruments	0.1	0.6	2.2
	<u>153.9</u>	<u>116.0</u>	<u>258.8</u>

5. Fees and commission receivable

	6 months to 30.06.08 £m (Unaudited)	Group 6 months to 30.06.07 £m (Unaudited)	Year ended 31.12.07 £m (Audited)
Insurance and related financial service products	7.4	11.2	23.3
Estate agency	2.9	5.1	9.9
Mortgage related fees	1.8	2.2	5.5
Other fees and commission	1.5	1.6	2.9
	<u>13.6</u>	<u>20.1</u>	<u>41.6</u>

Notes to the accounts
for the period ended 30 June 2008

6. Fees and commission payable

	6 months to 30.06.08 £m (Unaudited)	6 months to 30.06.07 £m (Unaudited)	Year ended 31.12.07 £m (Audited)
Mortgage related fees	1.5	2.9	5.2
Other fees and commission	0.1	0.1	0.7
Bank charges	0.2	0.1	0.4
	<u>1.8</u>	<u>3.1</u>	<u>6.3</u>

7. Other fair value gains and losses

	6 months to 30.06.08 £m (Unaudited)	6 months to 30.06.07 £m (Unaudited)	Year ended 31.12.07 £m (Audited)
Gains less losses on derivatives	15.9	5.1	(5.9)
Gains less losses on hedged items attributable to the hedged risk	(18.5)	(4.9)	5.6
	<u>(2.6)</u>	<u>0.2</u>	<u>(0.3)</u>

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

	6 months to 30.06.08 £m (Unaudited)	6 months to 30.06.07 £m (Unaudited)	Year ended 31.12.07 £m (Audited)
Wages and salaries	16.0	14.8	31.5
Social security costs	1.6	1.5	3.1
Other pension costs	0.7	0.6	1.4
	<u>18.3</u>	<u>16.9</u>	<u>36.0</u>
Other administrative expenses	10.9	12.8	26.0
	<u>29.2</u>	<u>29.7</u>	<u>62.0</u>

9. Loans and advances to customers

	As at 30.06.08 £m (Unaudited)	As at 30.06.07 £m (Unaudited)	As at 31.12.07 £m (Audited)
Maturity analysis of loans and advances to customers from the date of the balance sheet:			
Repayable on demand	87.5	82.6	79.7
Less than three months	100.0	73.5	58.9
Between three months and one year	263.3	152.5	222.2
Between one year and five years	969.5	859.4	932.5
More than five years	3,419.8	2,967.5	3,259.8
	<u>4,840.1</u>	<u>4,135.5</u>	<u>4,553.1</u>
Provision for impairment losses	(26.4)	(15.5)	(19.4)
Unamortised loan origination fees	42.9	40.8	44.5
Fair value adjustment for hedged risk	(19.0)	(18.9)	5.8
	<u>4,837.6</u>	<u>4,141.9</u>	<u>4,584.0</u>

Notes to the accounts
for the period ended 30 June 2008

10. Analysis of general reserve

	As at 30.06.08 (Unaudited) £m	Group As at 30.06.07 (Unaudited) £m	As at 31.12.07 (Audited) £m
Balance at 1 January	277.3	257.8	257.8
Profit for the financial period	6.0	11.3	20.5
Actuarial loss on retirement benefit obligations	-	-	(1.5)
Movement in deferred tax relating to retirement benefit obligations	-	-	0.5
Total recognised income for the year	6.0	11.3	19.5
Balance at end of period	283.3	269.1	277.3
Reserves excluding pension liability	285.2	269.7	279.2
Pension liability	(1.9)	(0.6)	(1.9)
	283.3	269.1	277.3

11. Financial instruments

Loans and advances to credit institutions

The percentage of these exposures that are rated between A- and AAA under Fitch IBCA credit ratings for 2008 is 94.4% (December 2007: 93.0%).

Collateral is not held over loans and advances to credit institutions, debt securities and derivative instruments.

None of these exposures was either past due or impaired and there are no assets that would otherwise be past due or impaired whose terms have been renegotiated.

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.

Loans and advances to customers

(a) Residential

The percentage of these exposures that are fully secured by a first charge on residential property is 73.2% (December 2007: 75.5%), while fully secured by a second charge on residential property is 14.7% (December 2007: 13.2%).

The average loan to value (LTV) in respect of the Group's loans secured on residential property is estimated to be 68.5% (December 2007: 68.5%).

The Group provides loans secured on residential property across England and Wales and does not consider there to be any significant geographical concentration of credit.

The percentage of residential lending cases fully secured by a first charge currently with arrears greater than 2.5% of the total outstanding balance is 0.68% (December 2007: 0.57%). This is lower than the CML figure of 1.10% as at 30 June 2008.

The percentage of residential lending cases fully secured by a second charge currently in arrears by number is 4.10% (December 2007: 2.72%), and by value is 4.88% (December 2007: 3.24%).

The Group has mortgage indemnity guarantee insurance which after a set first value of "excess" provides additional protection against subsequent residential loan impairment up to an agreed level.

**Notes to the accounts
for the period ended 30 June 2008**

11. Financial instruments (continued)

(b) Commercial

The percentage of total exposures that are fully secured by a first charge on land is 12.1% (December 2007: 11.3%).

Loans secured on commercial property are well diversified by industry type with the largest exposure to one counterparty amounting to £64.5m (December 2007: £73.6m) or 7% (December 2007: 9%) of gross balances.

Asset quality remains strong with only 6 commercial cases (December 2007: 1) with arrears of more than three months but less than 12 months. Arrears balances were £1.1m (December 2007: £0.4m).