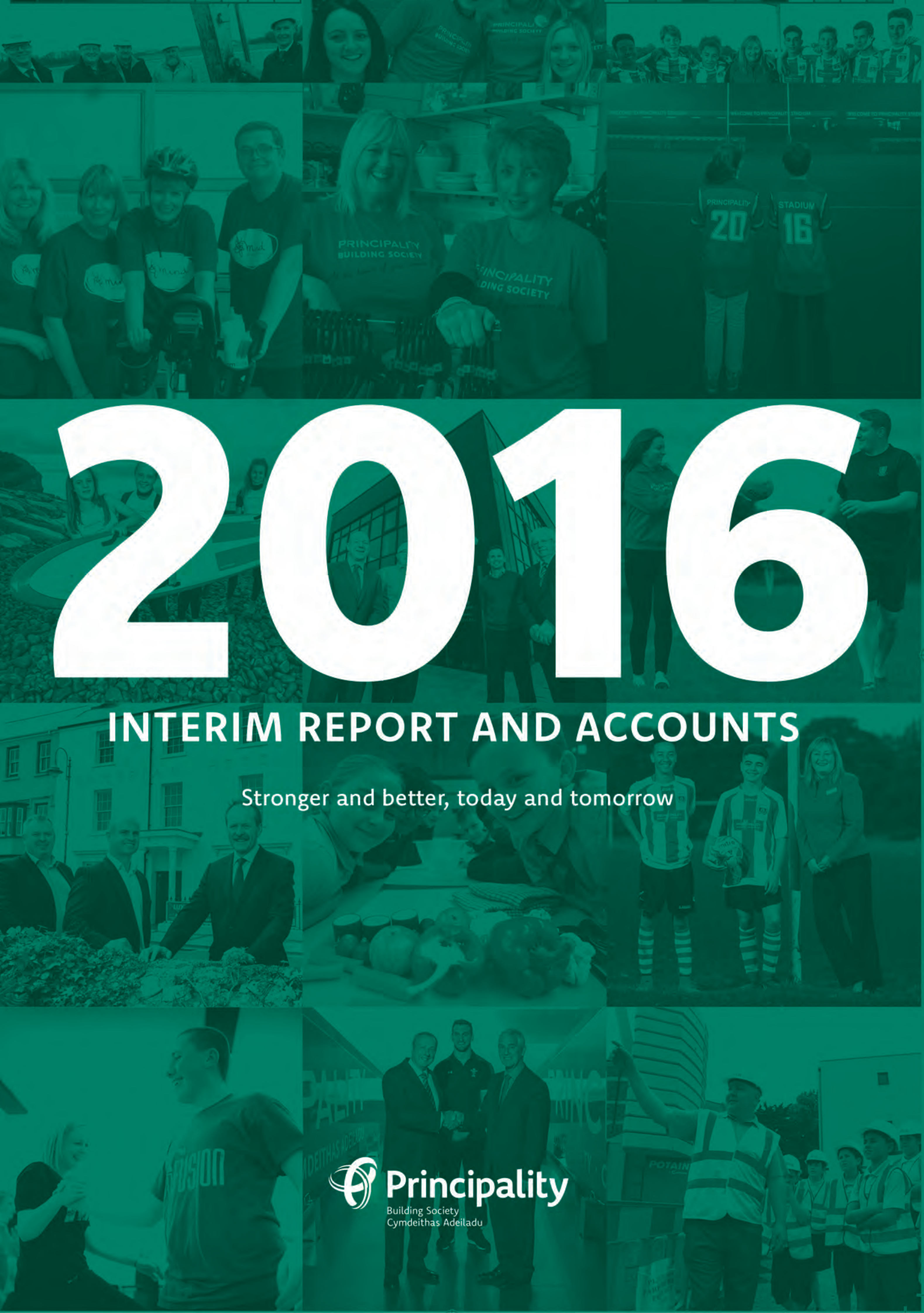

2016

INTERIM REPORT AND ACCOUNTS

Stronger and better, today and tomorrow

Principality
Building Society
Cymdeithas Adeiladu

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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.

Chief Executive's review

Securing our future with a very strong start to the year

I am delighted that our continued delivery of the strategy we set about implementing in 2012 has enabled us to deliver a very strong first half performance for the Principality Group. This strategy has been particularly important in creating a robust platform for further transformation and to be able to cope with some of the uncertainties we now face as we respond to the vote to leave the EU. The strength of the Principality balance sheet puts us in a strong position and places us very well to cope with any downturn in markets that might follow the EU vote. We are in a stronger position than we were when we entered the last downturn in 2009 and therefore I remain confident about the future and our ability to protect and serve our loyal savers as well as continuing to support the housing market. The transformation of the core Building Society will continue as we reshape the business for future generations whilst enhancing the service and products for our existing members.

The greatest uncertainty is interest rates. Whilst the Governor of the Bank of England has indicated the steps he might have to take to protect sterling and the wider economy, we will continue to do all that we can to remain competitive in the savings market, which is the lifeblood of our lending programme. In order to support the growth of our lending we have attracted an additional £298.7m in savings and we are grateful to the loyalty shown by our existing members as well as welcoming many new savers to the Society.

We have exceeded £8bn in assets for the first time in the Society's history and this has been achieved by again increasing our lending to people to buy homes. In the first six months of this year Group net lending increased by £364.5m.

Our strategy of growing and transforming the Building Society has resulted in some difficult decisions, one of which we announced with our 2015 results in February of this year: the decision to cease accepting new business into our subsidiary Nemo Personal Loans. This impacted on 67 people in the business but I am delighted to say that not only does the Nemo business continue to perform very well, but more importantly some 95% of the people affected by the decision have secured alternative employment, either in the Principality Group or outside. Our people are very important to us and I am delighted with the approach we have taken in supporting those impacted into new roles.

Excellent trading performance in the first half of the year

The Group has delivered a very good trading performance in the first half of the year, with profit before tax increasing to £23.9m. This means we have also been able to grow our capital base, and continue to have a solid balance sheet with net assets now up to over £8bn, supporting our priority to be a strong, resilient and safe home for our members.

- Group assets exceed £8bn
- Savings balances have increased by £298.7m
- Net retail mortgage balances of £5,603.8m (31 December 2015: £5,244.9m)
- Gross residential mortgage lending for the first six months of the year of £802.4m (30 June 2015: £554.7m)
- Pre-tax profits of £23.9m (30 June 2015: £23.2m)
- 85.7% of mortgages funded by savers (31 December 2015: 85.9%)
- Strong capital with a Common Equity Tier 1 ratio of 20.3%* (31 December 2015: 21.0%)
- Arrears levels remain consistently low, with the percentage of first charge cases greater than 3 months in arrears currently standing at 0.62% (31 December 2015: 0.62%)

*Excluding unaudited interim profits. The equivalent ratio including interim profits to 30 June 2016 would be 21.2%.

Chief Executive’s review (continued)

Group Businesses

The Principality Group consists of three key businesses: the Building Society, which has 53 branches and 18 agencies around Wales and the borders, Nemo Personal Finance and our commercial lending division, Principality Commercial. All three businesses have performed well in the first half of the year and made meaningful contributions to the Group's profit.

Principality Commercial has delivered its strongest performance for several years, signing a number of high profile deals across Wales and in the South East. Completions in the first half were £85.8m, up from £52.2m in 2015. Principality Commercial continues to support our mutual ethos of helping people into homes and often by adopting innovative approaches to funding is able to support the housing agenda in Wales and beyond. The team are working on some exciting projects including the continuation of the work at Ely Mill, bringing much needed affordable housing to Cardiff; a new aged-restricted development in Dinas with Portabella Group, aimed at providing suitable new housing for older people; and we're working on several projects with Waterstone Homes including the Bible College in Sketty and a new scheme on South Beach Tenby.

Although the commercial market has been improving steadily over the last year, the impact of the uncertainty around Brexit has the potential to cause a slowdown as we see market uncertainty cause decisions to be delayed particularly in this sector. The division is very well placed to cater for this.

Nemo has again made a meaningful contribution to the overall results and I am very pleased to report this business is performing well and in line with our plans. The reshaping of Nemo which took place earlier in the year has been executed to a very high standard as we focus the business on providing excellent customer service to its existing customers.

Supporting our Members, Communities and Colleagues

At Principality we take the vital role we play in the Welsh economy very seriously indeed. Whilst we continue to grow our business both in Wales and beyond, we remain aware of the challenges faced by the communities in Wales which may, given recent events, increase in the months and years ahead. We passionately believe in the cultural heritage of Wales and through our continued support of important areas such as the Eisteddfod, the Only Boys Aloud initiative and the Royal Welsh Show we will do what we can to protect what is held so dear to many in Wales.

Our communities will continue to receive our support through our Branch and Agency Network, providing outstanding service to the majority of our savers, and we will continue to support our teams in community volunteering where already they have given over 500 hours of their time as well as supporting over 70 local groups with more than £40,000 of support for this year.

Chief Executive's review (continued)

For the first time we have decided to support not one but three local charities who will benefit from our teams' charity fund raising activities. Our chosen charities, selected by our employees are Llamau, School of Hard Knocks and Cancer Research Wales.

We have also reset our goals and ambitions for our Corporate Social Responsibility agenda, working and supporting three key areas in line with the challenges faced by many people in Wales today, namely helping people get and, importantly with an ageing population, stay in their homes for longer, Health and Wellbeing and Financial Education.

Finally we are committed to making Principality a great place to work and we know that in doing so the business will be well positioned to support the whole of Wales to continue to prosper.

All of this work is equally as important as the financial results and I am grateful to all of our employees for their support in delivering this important yet challenging agenda as well as their day job. This is what makes Principality unique in financial services today.

Outlook

I have indicated before that a slight reduction in headline numbers is to be expected over the coming years as we see continuing pressure on margins as well as increasing investment being made in the Principality business to transform it for the future. This is likely to start in 2017 with the outlook for the rest of 2016 remaining stable. This was always planned as part of our strategic direction. However the recent decision to exit from the EU has added further challenges to this and we must, and will, be prepared to review our strategy in light of any emerging issues. The fact remains that the Principality balance sheet is strong and is more than able to withstand a severe downturn in the unlikely event that this should occur.

Overall Principality, is well placed to be able to cope with any potential downturns in markets and we will need to work through the challenges as they emerge over the coming months and years. We have already planned for a number of potential scenarios and remain vigilant and well placed to manage our way through this with an experienced Executive team and Board.

Graeme H. Yorston
Group Chief Executive
2 August 2016

Business review
for the six months ended 30 June 2016

Key Financial Performance Indicators
The Group monitors a number of key financial performance indicators to assess progress towards the strategic objectives of the business. These are summarised in the following table:

	30.06.16	30.06.15	31.12.15
Financial performance			
Group profit before taxation from continuing operations	£23.9m	£23.2m	£49.0m
Group net interest margin	1.62%	1.84%	1.81%
Management expense ratio (underlying cost basis) [3]	1.01%	1.08%	1.07%
Retail mortgage balances	£5,603.8m	£5,017.3m	£5,244.9m
Financial stability			
Common equity tier 1 (CET1) ratio [1]	20.3%	19.0%	21.0%
Leverage ratio [1,2]	5.1%	5.1%	5.5%
Liquidity ratio	16.0%	14.0%	13.9%

1. excluding unaudited interim profits. The equivalent ratios including interim profits for June 2016 would be 21.2% for CET1 and 5.3% for Leverage.
2. calculated using quarter end values without taking into account Basel III transitional provisions for capital.
3. further details contained under the heading 'Operating expenses' below

Strategic Review of Nemo
As set out in the 2015 Annual Report and Accounts, during 2015 the Group undertook a comprehensive review of the options for the future of Nemo. The outcome of this review was that the Board took the decision to cease new lending at Nemo and focus the Group's investment on the core retail and commercial businesses. The Group will continue to maintain and service its existing secured lending customers through a reshaped Nemo business, which will focus on providing excellent service to its customers.

The decision to cease origination was put into effect from February 2016. As a result of the associated business restructuring, the Group has incurred exceptional costs of £2.4m in the period. The Nemo portfolio continues to perform well, generating strong profit and with decreasing levels of arrears. As at 30 June 2016 the portfolio balance was £466.5m (31 December 2015: £517.2m).

Income Statement
The Group has performed strongly in the first half of the year, with pre-tax profit from continuing operations of £23.9m (30 June 2015: £23.2m) and an underlying profit, adjusting for factors not reflective of current trading performance, in line with the comparative period at £28.2m (30 June 2015: £28.2m).

The table below details the adjustments made to statutory profit to arrive at underlying profit:

	30.06.16 £m	30.06.15 £m	31.12.15 £m
Profit before taxation	23.9	23.2	49.0
Nemo strategic review and restructuring costs	2.4	0.9	4.5
Provisions for other liabilities and charges	1.9	4.1	4.3
Underlying profit	28.2	28.2	57.8

Business review (continued)
for the six months ended 30 June 2016

Interest margin
Net interest margin for the period remained strong at 1.62%, albeit lower than the comparative period (30 June 2015: 1.84%). The reduction in interest receivable reflects the ongoing competitiveness of the mortgage market, leading to reduced rates for new business, and the reduction in the size of the Nemo portfolio. This has been offset by a lower cost of retail funding in the market, and a higher proportion of lower cost secured wholesale funding following the Group's third Residential Mortgage Backed Security issuance in February 2016, continuing the strategy of maintaining a diversified funding base.

Operating expenses

The Group incurred exceptional costs of £2.4m in the period in respect of the restructuring of the Nemo business as described above. Excluding these costs, the underlying operating expenses comparison is set out in the table below:

		30.06.16 £m	30.06.15 £m	31.12.15 £m
Underlying operating expenses		39.7	39.4	79.2
Nemo strategic review and restructuring costs		2.4	0.9	4.5
Total statutory operating expenses		42.1	40.3	83.7
Management expense ratio	Underlying cost basis	1.01%	1.08%	1.07%
	Statutory cost basis	1.07%	1.11%	1.13%

On the basis of underlying cost, the Group's management expense ratio (cost as a proportion of mean assets) was 1.01% (30 June 2015: 1.08%), reflecting the continued focus on cost management within the Group. The Group has a clear view of the business it is building through its ongoing strategic investment programme. This will see significant investment in people, processes, brand and technology capability.

Impairment
Impairment charges for loans and advances to customers have decreased to £1.1m (30 June 2015: £2.7m), driven by lower impairment charges in both the Nemo and Commercial Lending portfolios. The lower charge in the Nemo portfolio was due to reduced levels of arrears, together with an increase in collateral values in the period. The reduced charge for Commercial Lending reflected the stronger position of the commercial lending market in the first half of the year, prior to the referendum vote, together with the resolution during 2015 of a significant proportion of the remaining impaired or lower credit quality loans.

Arrears performance remains strong across all portfolios, with arrears of more than three months of just 0.62% in the retail mortgage portfolio (31 December 2015: 0.62%).

Total impairment provisions are as follows:

	30.06.16 £m	30.06.15 £m	31.12.15 £m
Retail mortgages	7.0	6.4	6.3
Secured personal lending	16.8	19.7	18.2
Commercial lending	26.0	27.1	24.7
Total	49.8	53.2	49.2

Business review (continued)
for the six months ended 30 June 2016

Provisions for other liabilities
The provisions charge for other liabilities for the period was £1.9m (30 June 2015: £4.1m), relating to charges under the Financial Services Compensation Scheme.

Balance Sheet

Loans and advances to customers
Total assets have increased to £8,201.5m (31 December 2015: £7,584.4m), driven by strong growth in retail mortgage lending. The retail mortgage portfolio increased to £5,603.8m (31 December 2015: £5,244.9m), and the quality of the loans remains strong with an average indexed loan to value of 58.0% (31 December 2015: 57.4%). The Commercial Lending portfolio increased to £778.8m (31 December 2015: £755.8m), and the Nemo portfolio has decreased to £466.5m (31 December 2015: £517.2m).

Funding
Retail savings increased to £5,920.5m (31 December 2015: £5,621.8m) reflecting the continued focus on providing competitive products to Members in the current low interest rate environment. In February 2016 the Group entered into its third Residential Mortgage Backed Security (RMBS) issuance, securing £375m of further funding to support the Group's growth plans for lending.

Capital and Liquidity
The Group's capital position remains robust, with a CET1 ratio of 20.3% (31 December 2015: 21.0%) and a leverage ratio of 5.1% (31 December 2015: 5.5%), all well above the minimum regulatory requirements. The decrease in these ratios was driven by the balance sheet growth in the first half of the year.

The Group continues to hold a prudent buffer of high quality liquid assets, with a liquidity ratio of 16.0% (31 December 2015: 13.9%). The Group's Liquidity Coverage Ratio (LCR) continues to be in excess of 100%, well above the current regulatory minimum of 80% set out by the PRA.

Principal Risks and Uncertainties
The principal risks and uncertainties affecting the Group were set out on pages 27 to 40 of the Annual Report and Accounts for the year ended 31 December 2015. These risks are categorised as: credit, liquidity, market, conduct, business, operational and pension obligation risk, which are common to most financial services firms in the UK. These risks continue to affect the Group at 30 June 2016 and there have been no material changes to the Group's approach to risk management during the first half of the year.

The economic outlook for the UK is uncertain, driven by the outcome of the EU referendum vote. The immediate aftermath of the vote saw a substantial fall in the value of sterling and volatility in the main stock indices, together with liquidity issues in some commercial property investment funds, but the longer term impacts remain unclear. The consensus of economic forecasters predicts that the short to medium term impact will be lower growth, higher inflation and dampened consumer demand driven by the impact of a weaker pound on the price of imported goods, and weaker business investment due to the uncertain political environment.

The Bank of England has been clear that it stands ready to support the economy through the use of monetary policy levers, including quantitative easing and if neccessary a base rate reduction and has reduced the level of capital buffers required to be held by financial services organisations to facilitate lending. The impact of fiscal policy is at this stage unclear.

The Group is well placed to meet these challenges, with a diversified and flexible funding base, and very strong levels of capital and liquidity. The Group exists to serve and protect its Members' interests. Whilst lower interest rates are good news for borrowers, with record low rates on offer in the mortgage market, the Society recognises the challenges that lower interest rates present for savers, and will continue to look for ways to support Members whilst making the right decisions for the long term safety and stability of the Society.

Stephen Hughes
Group Finance Director
2 August 2016

Condensed consolidated income statement

Group interim results for six months to 30 June 2016

	Notes	6 months to 30.06.16 £m (Unaudited)	6 months to 30.06.15 £m (Unaudited)	Year ended 31.12.15 £m (Audited)
Interest receivable and similar income	3	117.5	121.1	243.3
Interest payable and similar charges	4	(54.3)	(54.3)	(109.2)
Net interest income		63.2	66.8	134.1
Fees and commission receivable	5	5.9	3.0	6.5
Fees and commission payable		(0.5)	(0.5)	(1.1)
Net fee and commission income		5.4	2.5	5.4
Other operating income		0.8	0.7	1.4
Other fair value (losses)/gains	6	(0.4)	0.3	0.9
Net operating income		69.0	70.3	141.8
Administrative expenses	7	(38.9)	(37.2)	(77.1)
Depreciation and amortisation		(3.2)	(3.1)	(6.6)
Operating expenses		(42.1)	(40.3)	(83.7)
Impairment provision for losses on loans and advances		(1.1)	(2.7)	(4.8)
Provision for liabilities and charges	11	(1.9)	(4.1)	(4.3)
Operating profit and profit before taxation		23.9	23.2	49.0
Taxation expense	9	(5.9)	(5.0)	(11.3)
Profit for the period/year		18.0	18.2	37.7

Condensed consolidated statement of other comprehensive income

Group interim results for six months to 30 June 2016

	Notes	6 months to 30.06.16 £m (Unaudited)	6 months to 30.06.15 £m (Unaudited)	Year ended 31.12.15 £m (Audited)
Profit for the period/year		18.0	18.2	37.7
Items that will not be reclassified subsequently to profit and loss:				
Actuarial (loss)/gain on retirement benefit obligations		(5.8)	0.3	1.1
Income tax	9	1.2	-	(0.1)
Items that may be reclassified subsequently to profit and loss:				
(Loss)/gain on available-for-sale assets		1.2	(1.1)	(1.3)
Income tax	9	(0.2)	0.2	0.3
Total comprehensive income for the period/year		14.4	17.6	37.7

All items dealt with in arriving at the profit before tax and the profit for the period, and the preceding financial periods, as above, relate to continuing operations.

The accounting policies and notes on pages 12 to 22 form part of these accounts.

Condensed consolidated statement of financial position

Group interim results for six months to 30 June 2016

	Notes	6 months to 30.06.16 £m (Unaudited)	6 months to 30.06.15 £m (Unaudited)	Year ended 31.12.15 £m (Audited)
Assets				
Liquid assets:				
Cash in hand and balances with the Bank of England		656.9	362.5	357.6
Loans and advances to credit institutions		214.0	159.0	166.6
Debt securities		319.5	413.0	437.8
		1,190.4	934.5	962.0
Derivative financial instruments		39.0	22.7	21.3
Loans and advances to customers:				
Loans fully secured on residential property		6,576.0	5,947.0	6,210.1
Other loans		333.4	378.6	334.8
	10	6,909.4	6,325.6	6,544.9
Intangible fixed assets		1.2	1.5	1.4
Property, plant and equipment		46.6	44.0	46.5
Deferred tax assets		3.3	1.6	1.1
Other assets		3.5	10.1	3.0
Prepayments and accrued income		8.1	1.5	4.2
Total Assets		8,201.5	7,341.5	7,584.4
Liabilities				
Shares		5,920.5	5,530.7	5,621.8
Deposits and debt securities:				
Amounts owed to credit institutions		512.9	399.9	543.1
Amounts owed to other customers		239.0	242.0	280.9
Debt securities in issue		790.0	510.8	463.5
		1,541.9	1,152.7	1,287.5
Derivative financial instruments		68.0	31.7	31.4
Current tax liabilities		6.4	4.1	5.2
Other liabilities		2.3	6.3	7.8
Provision for liabilities	11	5.5	7.6	3.8
Accruals and deferred income		20.1	10.9	11.7
Deferred tax liabilities		0.7	0.1	-
Retirement benefit obligations	8	9.2	5.9	4.1
Subordinated liabilities		92.3	92.3	92.3
Subscribed capital		71.2	70.3	69.8
Total liabilities		7,738.1	6,912.6	7,135.4
General reserve		460.9	427.2	447.4
Other reserves		2.5	1.7	1.6
Total equity and liabilities		8,201.5	7,341.5	7,584.4

Condensed consolidated statement of cash flows

Group interim results for six months to 30 June 2016

	6 months to 30.06.16 £m (Unaudited)	6 months to 30.06.15 £m (Unaudited)	Year ended 31.12.15 £m (Audited)
Net cash (outflow)/inflow from operating activities	230.3	(98.8)	(65.4)
Cash flows from investing activities			
Purchase of intangible assets and property, plant and equipment	(3.1)	(2.9)	(9.1)
Purchase of investment securities	(24.8)	(31.1)	(91.8)
Proceeds from sale and maturity of investment securities	144.3	70.9	106.8
Disposal proceeds of property, plant and equipment	-	-	0.3
Cash flows from financing activities	-	-	-
(Decrease)/increase in cash and cash equivalents	346.7	(61.9)	(59.2)
Cash and cash equivalents at beginning of period/year	524.2	583.4	583.4
Cash and cash equivalents at the end of period/year	870.9	521.5	524.2
Represented by:			
Cash and balances with the Bank of England	656.9	362.5	357.6
Loans and advances to credit institutions repayable on demand	214.0	159.0	166.6
	870.9	521.5	524.2
Net cash outflow from operating activities			
Profit after taxation	18.0	18.2	37.7
Adjusted for:			
Depreciation and amortisation	3.2	3.1	6.6
Impairment losses on loans and advances to customers	1.1	2.7	4.8
Change in fair values	(18.6)	4.6	2.9
Taxation charge	5.9	5.0	11.3
Other non-cash movements	(5.4)	-	1.1
Changes in net operating assets			
Decrease in loans and advances to credit institutions	-	-	-
(Increase) in loans and advances to customers	(332.3)	(198.8)	(419.9)
(Increase)/decrease in other assets	(0.5)	(7.1)	-
(Increase)/decrease in prepayments and accrued income	(3.9)	4.6	1.9
Change in derivative financial instruments	19.0	(2.9)	(1.8)
Increase/(decrease) in shares	286.2	(77.9)	14.5
Increase in deposits and debt securities	253.5	150.7	285.0
(Decrease)/increase in other liabilities	(5.5)	1.9	3.4
Increase/(decrease) in provisions for liabilities	1.7	3.7	(0.1)
Increase in accruals and deferred income	8.3	1.4	2.2
Increase/(decrease) in pension fund obligation	4.7	(0.6)	(2.8)
Taxation paid	(5.1)	(7.4)	(12.2)
	230.3	(98.8)	(65.4)

Statement of changes in members interests

Group interim results for six months to 30 June 2016

	Six months to 30 June 2016		
	General Reserve £m	Available for Sale Reserve £m	Total Equity Attributable to Members £m
Group			
At 1 January	447.4	1.6	449.0
Comprehensive income for the period/year	13.5	0.9	14.4
At 30 June	460.9	2.5	463.4

	Six months to 30 June 2015		
	General Reserve £m	Available for Sale Reserve £m	Total Equity Attributable to Members £m
Group			
At 1 January	408.7	2.6	411.3
Comprehensive income for the period/year	18.5	(0.9)	17.6
At 30 June	427.2	1.7	428.9

	Year end 31 December 2015		
	General Reserve £m	Available for Sale Reserve £m	Total Equity Attributable to Members £m
Group			
At 1 January	408.7	2.6	411.3
Comprehensive income for the period/year	38.7	(1.0)	37.7
At 31 December	447.4	1.6	449.0

Notes to the accounts
for the period ended 30 June 2016

1. Accounting policies

Reporting period

The financial statements show the financial performance of the Group for the half-year ended 30 June 2016.

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 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.

Accounting policies

The accounting policies adopted by the Group in the preparation of its 2016 Interim Financial Report are consistent with those disclosed in the Annual Report and Accounts for the year ended 31 December 2015.

A number of small changes were made to accounting standards came in to effect for this accounting year which have not had a material impact on the Group.

Going concern

The Directors have reviewed the plans and forecasts for The Group giving due consideration to profitability, liquidity and capital adequacy, together with the outlook for the UK economy and the potential impact of the EU referendum vote. The Directors performed an assessment of the Group's long term viability in January 2016, details of which are included on page 61 of the 2015 Annual Report and Accounts. This long term viability assessment considered the viability of the Group over a three year period taking into account the Group's strategy, business model and principal risks faced. Whilst the full assessment of the period covered by that statement has not been repeated, nothing has come to the attention of the Directors to suggest that that assessment is no longer appropriate.

In this context the Directors consider that the Group has sufficient resources to continue in operational existence for the foreseeable future and, as a result, that it is appropriate to prepare these financial statements on the going concern basis.

Notes to the accounts
for the period ended 30 June 2016

2. Business segments

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

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

	Six months to 30 June 2016			
	Retail financial services £m	Commercial Lending £m	Secured personal lending £m	Total £m
Net interest income	44.4	6.8	12.0	63.2
Other income and charges	4.9	0.9	-	5.8
Net operating income	49.3	7.7	12.0	69.0
Operating expenses	(33.1)	(1.8)	(7.2)	(42.1)
Impairment provision for losses on loans and advances	(0.9)	(1.2)	1.0	(1.1)
Provision for other liabilities and charges	(1.6)	(0.2)	(0.1)	(1.9)
Operating profit and profit before taxation	13.7	4.5	5.7	23.9
Taxation expense				(5.9)
Profit after taxation				18.0

	Six months to 30 June 2015			
	Retail financial services £m	Commercial Lending £m	Secured personal lending £m	Total £m
Net interest income	46.7	6.7	13.4	66.8
Other income and charges	2.7	0.8	-	3.5
Net operating income	49.4	7.5	13.4	70.3
Operating expenses	(31.9)	(2.0)	(6.4)	(40.3)
Impairment provision for losses on loans and advances	(0.8)	(2.5)	0.6	(2.7)
Provision for other liabilities and charges	(3.3)	(0.5)	(0.3)	(4.1)
Operating profit and profit before taxation	13.4	2.5	7.3	23.2
Taxation expense				(5.0)
Profit after taxation				18.2

Notes to the accounts
for the period ended 30 June 2016

2. Business segments (continued)

	Year end 31 December 2015			
	Retail financial services £m	Commercial Lending £m	Secured personal lending £m	Total £m
Net interest income	93.6	13.7	26.8	134.1
Other income and charges	5.8	1.9	-	7.7
Net operating income	99.4	15.6	26.8	141.8
Operating expenses	(66.7)	(4.0)	(13.0)	(83.7)
Impairment provision for losses on loans and advances	(1.2)	(5.0)	1.4	(4.8)
Provision for other liabilities and charges	(2.7)	(0.4)	(1.2)	(4.3)
Operating profit and profit before taxation	28.8	6.2	14.0	49.0
Taxation expense				(11.3)
Profit after taxation				37.7

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

	6 months to 30.06.16 £m (Unaudited)	6 months to 30.06.15 £m (Unaudited)	Year ended 31.12.15 £m (Audited)
Total assets by business segments			
Retail financial services	6,927.7	6,036.5	6,288.5
Secured personal lending	467.9	528.0	522.3
Commercial lending	805.9	777.0	773.6
Total assets	8,201.5	7,341.5	7,584.4
Total liabilities and equity by business segment			
Retail financial services and Commercial lending	7,733.6	6,813.5	7,062.1
Secured personal lending	467.9	528.0	522.3
Total liabilities and equity	8,201.5	7,341.5	7,584.4

Notes to the accounts
for the period ended 30 June 2016

3. Interest receivable and similar income

	Group		
	6 months to 30.06.16 £m (Unaudited)	6 months to 30.06.15 £m (Unaudited)	Year ended 31.12.15 £m (Audited)
On loans fully secured on residential property	116.9	119.2	240.9
On other loans	6.9	7.9	15.1
On debt securities	1.9	2.3	4.6
On other liquid assets	1.8	1.0	2.0
On derivative financial instruments	(10.0)	(9.3)	(19.3)
	117.5	121.1	243.3

4. Interest payable and similar charges

	Group		
	6 months to 30.06.16 £m (Unaudited)	6 months to 30.06.15 £m (Unaudited)	Year ended 31.12.15 £m (Audited)
On shares held by individuals	46.3	49.8	97.9
On deposits and debt securities	9.6	7.2	15.9
On subscribed capital	2.1	2.2	4.3
On subordinated liabilities	0.7	0.7	1.5
On derivative financial instruments	(4.4)	(5.6)	(10.4)
	54.3	54.3	109.2

5. Fees and commission receivable

	Group		
	6 months to 30.06.16 £m (Unaudited)	6 months to 30.06.15 £m (Unaudited)	Year ended 31.12.15 £m (Audited)
Insurance and related financial service products	3.5	1.0	2.0
Mortgage related fees	2.2	1.7	4.0
Other fees and commission	0.2	0.3	0.5
	5.9	3.0	6.5

6. Other fair value gains and losses

	Group		
	6 months to 30.06.16 £m (Unaudited)	6 months to 30.06.15 £m (Unaudited)	Year ended 31.12.15 £m (Audited)
(Losses)/gains on derivatives	(14.2)	1.6	1.8
Gains/(losses) on hedged items attributable to the hedged risk	13.8	(1.3)	(0.9)
	(0.4)	0.3	0.9

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.

7. Administrative expenses

	Group		
	6 months to 30.06.16 £m (Unaudited)	6 months to 30.06.15 £m (Unaudited)	Year ended 31.12.15 £m (Audited)
Wages and salaries	19.0	17.8	37.1
Social security costs	1.9	1.9	3.9
Other pension costs	0.9	0.9	1.9
	21.8	20.6	42.9
Other administrative expenses	14.7	15.7	29.7
Nemo strategic review and restructuring costs	2.4	0.9	4.5
	38.9	37.2	77.1

8. Retirement benefit obligations

	Group		
	6 months to 30.06.16 £m (Unaudited)	6 months to 30.06.15 £m (Unaudited)	Year ended 31.12.15 £m (Audited)
Fair value of plan assets	55.7	55.8	54.1
Present value of funded and unfunded obligations	(64.9)	(61.7)	(58.2)
Pension scheme deficit	(9.2)	(5.9)	(4.1)

Notes to the accounts
for the period ended 30 June 2016

9. Taxation

Estimated tax for the Group for 2016 is charged at 24.7% (30 June 2015: 21.6%), 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 statutory rate of corporation tax will be reduced to 19% from 1 April 2017 and to 18% from 1 April 2020. In addition an 8% surcharge on banking profits (including those of building societies) was introduced from 1 January 2016. This surcharge will apply to all taxable profits generated by the Society in excess of a £25m statutory allowance.

10. Loans and advances to customers

	Group		
	6 months to 30.06.16 £m (Unaudited)	6 months to 30.06.15 £m (Unaudited)	Year ended 31.12.15 £m (Audited)
Fully secured on residential property	6,535.8	5,962.7	6,198.1
Fully secured on land	332.8	348.1	330.6
Other loans	17.7	27.7	24.6
	6,886.3	6,338.5	6,553.3
Provision for impairment losses	(49.8)	(53.2)	(49.2)
Unamortised loan origination fees	12.6	13.7	13.8
Fair value adjustment for hedged risk	60.3	26.6	27.0
	6,909.4	6,325.6	6,544.9

11. Provision for liabilities

	Group		
	6 months to 30.06.16 £m (Unaudited)	6 months to 30.06.15 £m (Unaudited)	Year ended 31.12.15 £m (Audited)
At beginning of the period/year	3.8	3.9	3.9
Additions	1.9	4.1	4.3
Utilisation	(0.2)	(0.4)	(4.4)
At end of the period/year	5.5	7.6	3.8

The provisions balance includes £3.6m for the FSCS levy. This balance includes the expected interest charges for scheme years April 2015 to March 2016 and April 2016 to March 2017 and the expected capital charge for 2016-17. Further details of the provisions held and expected timing of payments are set out in note 12 of these Interim Financial Statements and in note 30 to the 2015 Annual Report and Accounts.

12. Financial commitments and contingent liabilities

Financial Services Compensation Scheme levy

As described in note 30 to the 2015 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 £3.6m (31 December 2015: £1.7m) is held in respect of these levies and represents the Society's best estimate of total levies payable in July 2016 and 2017. The FSCS levy provision has been calculated with the most up-to-date information with regards to the scheme 2015/2016 and 2016/17 levy year.

It is expected that further interest payments will be made in future years, for which a provision will be recognised in the relevant FSCS scheme year. The Group also has potential exposure to any capital shortfalls arising from the sale of assets in relation to Bradford and Bingley. The Group's share of any further costs cannot be quantified, although the Group's share could be material; no provision has been recognised.

13. Related party transactions

The Group had no related party transactions outside the normal course of the business during the half-year to 30 June 2016. Transactions for this period are similar to those for the year to 31 December 2015, details of which can be found in the 2015 Annual Report and Accounts.

Notes to the accounts
for the period ended 30 June 2016

14. Financial instruments

Carrying values and fair values

The table below compares carrying values and fair values of the Group's financial instruments by category.

	6 months to 30.06.16		Year ended 31.12.15	
	Carrying Value £m (Unaudited)	Fair Value £m (Unaudited)	Carrying Value £m (Audited)	Fair Value £m (Audited)
Group assets				
Cash in hand and balances with Bank of England	656.9	656.9	357.6	357.6
Loans and advances to credit institutions	214.0	214.0	166.6	166.6
Debt securities	319.5	319.5	437.8	437.8
Derivative financial instruments	39.0	39.0	21.3	21.3
Loans and advances to customers	6,909.4	7,011.8	6,544.9	6,628.1
	8,138.8	8,241.2	7,528.2	7,611.4
Group liabilities				
Shares	5,920.5	5,951.9	5,621.8	5,644.7
Amounts owed to credit institutions	512.9	512.9	543.1	543.1
Amounts owed to other customers	239.0	239.0	280.9	280.9
Debt securities in issue	790.0	788.5	463.5	462.8
Derivative financial instruments	68.0	68.0	31.4	31.4
Subordinated liabilities	92.3	92.3	92.3	88.9
Subscribed capital	71.2	59.7	69.8	61.3
	7,693.9	7,712.3	7,102.8	7,113.1

Further details on the methods and assumptions which have been applied in determining fair value are set out in note 31 of the 2015 Annual Report and Accounts.

The subordinated liabilities of £92.3m were repaid on 8 July 2016.

Notes to the accounts
for the period ended 30 June 2016

14. Financial instruments (continued)

Assets measured at fair value

	As at 30.06.16 (Unaudited)		
	£m	Level 1 £m	Level 2 £m
Financial assets at fair value through profit or loss:			
Derivative financial instruments	39.0	-	39.0
Available-for-sale financial assets:			
Debt securities	319.5	319.5	-
Total	358.5	319.5	39.0

	As at 30.06.15 (Unaudited)		
	£m	Level 1 £m	Level 2 £m
Financial assets at fair value through profit or loss:			
Derivative financial instruments	22.7	-	22.7
Available-for-sale financial assets:			
Debt securities	413.0	413.0	-
Total	435.7	413.0	22.7

	As at 31.12.15 (Audited)		
	£m	Level 1 £m	Level 2 £m
Financial assets at fair value through profit or loss:			
Derivative financial instruments	21.3	-	21.3
Available-for-sale financial assets:			
Debt securities	437.8	437.8	-
Total	459.1	437.8	21.3

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 2016 (2015:none).

15. 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 30.06.16 £m (Unaudited)	6 months to 30.06.15 £m (Unaudited)	Year ended 31.12.15 £m (Audited)
In respect of loans and advances to customers:			
Fully secured by a first charge on residential property	6,073.7	5,456.5	5,693.6
Fully secured by a first charge on land	332.8	348.1	330.6
Secured by a second charge on residential property	479.8	533.9	529.1
	6,886.3	6,338.5	6,553.3
Provisions for impairment losses	(49.8)	(53.2)	(49.2)
Unamortised loan origination fees	12.6	13.7	13.8
Fair value adjustments	60.3	26.6	27.0
	6,909.4	6,325.6	6,544.9

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 30.06.16 £m (Unaudited)	6 months to 30.06.15 £m (Unaudited)	Year ended 31.12.15 £m (Audited)
Retail financial services	5,603.8	5,017.3	5,244.9
Commercial lending	778.8	759.1	755.8
Secured personal lending	466.5	522.6	517.2
Fair value adjustments	60.3	26.6	27.0
	6,909.4	6,325.6	6,544.9

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 2016, approximately 31.2% (31 December 2015: 29.9%) of first and second charge retail loans by account and 28.6% (31 December 2015: 27.5%) by value were concentrated in Wales.

15. Credit risk (continued)

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 58.5% (31 December 2015: 58.2%).

The percentage of retail lending cases fully secured by a first charge currently with arrears greater than 3 months is 0.62% (31 December 2015: 0.62%) which compares favourably with the industry average of 1.04% (CML arrears and possession data as at March 2016).

Residential lending fully secured by a first charge which were 6 months or more in arrears had arrears balances of £0.8m (31 December 2015: £0.8m) with 175 (31 December 2015: 159) cases.

The percentage of secured personal loans currently in arrears by two months or more by number is 6.37% (31 December 2015: 6.87%), which by value is 7.06% (31 December 2015: 7.41%).

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 £29.9m (31 December 2015: £29.9m) or 3.7% (31 December 2015: 3.8%) of gross balances.

Asset quality remains strong with impaired balances of £28.8m (31 December 2015: £36.6m), or 3.6% of gross balances (31 December 2015: 4.7%). Specific provisions of £7.9m (31 December 2015: £10.3m) are held against impaired exposures to cover management's best estimate of expected losses.

ii) 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 Group'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.

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 as adopted by the EU; and

(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).

By order of the Board,

Graeme H. Yorston
Group Chief Executive

Stephen Hughes
Group Finance Director

2 August 2016

Independent review report
to Principality Building Society

We have been engaged by the Society to review the condensed set of financial statements in the Interim Financial Report for the six months ended 30 June 2016 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 15. We have read the other information contained in the Interim 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 Interim Financial Report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the Interim 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 Interim 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 Interim Financial Report for the six months ended 30 June 2016 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
2 August 2016

Other information

The information for the period ended 30 June 2016 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 2015 has been extracted from the Annual Report and Accounts for that year. The annual accounts for the year ended 31 December 2015 have been filed with the Financial Conduct Authority.

The auditor's report on the 2015 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.

A copy of the Interim 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.

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