PRINCIPALITY

Half-year financial report

2010

Principality Building Society

Half-year financial report

for the period ended 30 June 2010

Contents	**Page**

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 parties transactions and changes therein).

The information for the period ended 30 June 2010 does not constitute statutory accounts as defined in section 435 of the Companies Act 2006. The auditor's report on the 2009 Annual Report and Accounts was not qualified, did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying the report and did not contain statements under section 498(2) or (3) of the Companies Act 2006.

By order of the Board,

P L Griffiths	W G Thomas
Chief Executive	Group Finance Director

Chief Executive's review

The Society has performed strongly in the first half of the year as the UK economy emerged from recession. The sector continues to face significant challenges and uncertainty. We anticipate that the risks remain on the downside and we will persist with our strategy of "keeping our members' money safe" whilst trying to deliver the best possible deal for our members in a low base rate environment.

The sector remains burdened by increasing regulatory pressure, particularly on capital and liquidity, and expensive funding which is likely to remain a battle-ground in the months ahead. Margin squeeze appears inevitable and growth will be constrained.

The Society has delivered a good set of half year results taking advantage of improved margins in both our Nemo and Commercial businesses. The Property Services business has delivered on plan and the core Society continues to build its strong regional franchise and increase its retail deposit base. Costs and income have been tightly managed and benchmark well in the sector. Our diversified model has delivered on commitments to key stakeholders.

Trading highlights:-

- Strong half year pre-tax profits of £13.2m
- Reserves increased by £9.6m
- A robust net interest margin of 1.72%
- Balance sheet loan loss provisions of £57.9m
- A cost/income ratio of 50.3%
- Savings growth of £477.6m in the last 12 months

The Group businesses have performed entirely as predicted and we are particularly pleased with:-

- Improved returns from our Nemo business;
- Strong funding capability from within the Society to attract the required amounts of retail savings;
- Strong cross sales performance;
- High quality service levels and strong customer advocacy and;
- Group impairment provisions in line with expectations.

It is difficult to predict the next move in house prices as the "age of austerity" bites. We do not anticipate substantial "double-dip" impacts on residential pricing but recognise the potential for future affordability risk as pressures increase on both the personal and corporate borrower.

Our Commercial book is underpinned by strong client and cash flow covenants. However, continuing economic uncertainty has increased pressure on certain commercial sectors. In light of this we have increased provisions against our commercial book in the first half of the year.

Across our businesses we have utilised sophisticated underwriting techniques and this should provide resilience to our lending portfolios and help contain future impairment levels. We therefore remain optimistic that all our businesses will show a positive performance by the end of the year.

Consolidation in the sector is likely to continue especially if interest rates remain lower for longer. The Society is not exposed to life-time tracker problems and we believe our business model and profitability to be sustainable.

As ever we rely on our strong brand, loyal members and committed workforce and as we celebrate our 150th Anniversary, we do so with pride in our past and confidence in our future.

P L Griffiths
Chief Executive
27 July 2010

Business review for the six months ended 30 June 2010

Income statement

The Group's profit before tax for the 6 months ended 30 June 2010 was £13.2m (30 June 2009: £5.8m) after recognising a gain of £3.1m on the repurchase of £10.0m of subordinated liabilities and after a write-back on the Financial Services Compensation Scheme (FSCS) provision of £1.4m. Excluding this, operating profit before tax for the Group was £8.7m (30 June 2009: £7.2m), an increase of over 20% on last year's profit for the same period and reflecting a strong performance under difficult market and economic conditions. We continue to balance the challenge of a low interest environment against our commitment to provide members with products and services which deliver long-term value.

Profit

Net interest margin
At 1.72% (30 June 2009: 1.58%) the Group's net interest margin remains strong benefitting from higher margins earned in the commercial lending and secured personal lending businesses. Net interest margin has been enhanced by gains of £4.4m (30 June 2009: £2.6m), equivalent to 8bps (30 June 2009: 5bps) arising from the profit on the sale of gilts.

Other income
The Group's non-interest income includes insurance income, property services income and income generated from a number of other complementary activities. The strong performance of sales in life, investment and general insurance products observed in the second half of 2009 has been maintained during the first half of the year. Property services income is 34% ahead of the same period last year as we seek to increase our market share in the lettings arena. The recovery in the housing market and its impact on new instructions observed during the second half of last year has continued into 2010 albeit at slightly lower levels however there has been a notable increase in the number of new instructions in the Estate Agency since the abolition of HIPS in May.

Administrative expenses
We have already demonstrated our commitment and ability to manage our cost base and at 0.97%, the ratio of operating expense as a percentage of total mean assets remain strong despite deteriorating slightly since the year end as we seek to invest more to increase diversity in our income streams.

Impairment provisions for losses on loans and advances
The charge for impairment provisions of £16.4m for the Group was £6.9m less than the same period last year. A decrease in arrears growth and a modest recovery in house prices has resulted in a lower impairment charge in the secured personal lending business with provisions remaining broadly flat in first charge residential lending. The underlying quality and average loan-to-value ratio of 62.8% (31 December 2009: 68.4%) remains strong in residential and commercial lending. Accumulated impairment on our mortgages secured on commercial property is 1.63%.

Provisions for other liabilities and charges
The Society has reviewed the level of provision in light of information published by the FSCS in the period and has released £1.4m. Other provisions of £6.0m have been made in respect of various customer claims, including claims in relation to previous sales of payment protection insurance.

Balance sheet

Loans and advances to customers
Lending criteria remain tight and lending volumes, whilst deliberately low, are showing some signs of improvement with residential mortgage completions during the first half of the year up on the same period last year. The Board remains committed to the sustainability of the business so that it can deliver value to members well into the future. Mortgage assets have increased by 2.6% to £4,858.6m since the year end however management will continue to prudently apply controls to the Group's lending reflecting the uncertain business environment.

Business review for the six months ended 30 June 2010 (continued)

Treasury and liquid assets
Liquid assets have remained broadly flat since the year end and represent 23.9% of shares and borrowings (31 December 2009: 24.5%). Asset quality remains strong with 51.2% of the portfolio being held in sovereign exposures (31 December 2009: 36.8%). Other than sovereign exposures, liquidity is held in the form of investments with other financial institutions with 98.0% (31 December 2009: 96.8%) of these exposures rated between A and AAA under Fitch IBCA credit ratings.

Funding
The Society has a strong and diversified funding base, predominately represented by retail savings. As a result, less reliance is placed on wholesale markets. The savings environment is increasingly competitive as institutions who have previously relied on wholesale funds continue to take a larger share of the retail market and savers choose to pay down their debts or seek higher returns from equity-linked investment products. Management's focus has been to retain the growth of savings balances achieved in 2008 and 2009, compensating for the restriction on access to the wholesale markets as a result of industry-wide downgrades.

This retention strategy continues to be underpinned by a strong take-up of fixed rate bonds which represent 56.7% of all savings balances (31 December 2009: 54.1%). Savings balances have seen a modest increase since the year end of 1.1% to £4,988.1m (31 December 2009: £4,933.2m) representing over 102.7% (31 December 2009: 104.1%) of all mortgage balances.

Borrowings from wholesale ('money market') sources, administered by the Group's treasury function, have remained broadly flat since the year end. At 13.0% (31 December 2009: 12.8%) of all shares, deposits and loans, the Group's borrowings represent a low dependence on wholesale markets. Principality's strong retail brand and reputation has allowed choice over funding sources during a period when wholesale markets remain subdued. Balancing the mix of funding through wholesale markets and retail remains a key focus and the Board is committed to maintaining a prudent position.

Defined benefit pension scheme
The defined benefit scheme will close to future accruals on 31 July 2010 and will be replaced with an enhanced defined contribution scheme, the Group Flexible Retirement Plan (GFRP). The Group will inject £1.0m into the defined benefit scheme on closure and has committed to a further injection of £1.0m on the first anniversary of the closure to help reduce the current deficit.

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. Notwithstanding the repurchase of £10.0m of subordinated liabilities, total capital has increased from £480.4m at the year end to £486.1m.

Regulatory capital stands at £462.6m. The Group's total solvency ratio, a measure of the Group's total capital as a proportion of the Group's risk weighted assets at the balance sheet date, decreased by 0.82% to 16.31% since the year end as a result of the repurchase of the subordinated liabilities. This is still well in excess of the minimum established by the FSA.

Going concern

As presented in the consolidated statement of financial position, the Group meets its funding requirements mainly from retail sources supplemented by wholesale sources. The Group's forecasts and projections include scenario testing which is carried out in accordance with the Internal Capital Adequacy Assessment Process (ICAAP), which is a process required by our regulator to demonstrate appropriate levels of capital under stressed conditions. This takes account of reasonably possible changes in trading performance, and shows that the Group will be able to operate within the sources of funding currently available to it. In addition to these sources, additional contingency funding plans are in place, in particular the Covered Bond Programme.

The Group monitors its liquidity levels in accordance with the FSA's liquidity rules and has completed an Individual Liquidity Adequacy Assessment (ILAA) in May 2010 so as to ensure that an appropriate level of resource is maintained to meet the requirements of the business. These are assessed under a number of stressed scenarios reflecting the different risks that might arise under current economic conditions. The assets held for liquidity purposes are assessed and reviewed for counterparty risks, and the directors consider that the Group is not exposed to such losses on those assets that would affect the decision to adopt the basis of going concern.

Business review for the six months ended 30 June 2010 (continued)

Having considered the plans and forecasts for the Group for the next 12 months, the directors believe that there are no material uncertainties that lead to significant doubt on the Group's ability to continue in business for our members as a mutual building society for the foreseeable future. In addition, the directors consider that the overall level of capital, including Tier 1 capital of £344.6m (12.42% as a percent of risk-weighted assets) and a solvency ratio of 16.31% is adequate. Accordingly, the half year financial statements continue to be prepared on a going concern basis.

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 2009. Additional information on risk is also provided in the Pillar 3 disclosure available at http://www.principality.co.uk/default.aspx?page=1899. The Chief Executive's Review comments on the principal risks and uncertainties affecting the Group for the remaining six months of the year.

W G Thomas
Group Finance Director
27 July 2010

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-year financial report for the six months ended 30 June 2010 which comprises the condensed consolidated statement of comprehensive income, the condensed consolidated statement of financial position, the condensed consolidated statement of recognised income and expense, the condensed consolidated statement of cash flows and related notes 1 to 17. 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 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 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 Society, 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 IFRSs as adopted by the European Union. The condensed set of financial statements included in this half-year 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-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 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-year financial report for the six months ended 30 June 2010 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 LLP
Chartered Accountants and Statutory Auditors
Cardiff, United Kingdom
27 July 2010

Condensed consolidated statement of comprehensive income
Group Interim results for six months to 30 June 2010

	Notes	6 months to 30.06.10 £m (Unaudited)	6 months to 30.06.09 £m (Unaudited)	Year ended 31.12.09 £m (Restated*)
Interest receivable and similar income	3	105.8	120.3	226.7
Interest payable and similar charges	4	(52.3)	(68.0)	(120.3)
Net interest income		53.5	52.3	106.4
Fees and commission receivable	5	9.4	7.6	18.6
Fees and commission payable	6	(0.7)	(0.5)	(1.3)
Net fee and commission income		8.7	7.1	17.3
Other operating income		0.5	0.4	0.5
Other fair value gains and losses	7	(0.1)	0.1	(6.5)
Net operating income		62.6	59.9	117.7
Administrative expenses	8	(28.6)	(26.4)	(54.0)
Depreciation and amortisation		(2.9)	(3.0)	(6.0)
Total operating expenses		(31.5)	(29.4)	(60.0)
Impairment provision for losses on loans and advances		(16.4)	(23.3)	(39.5)
Provision for other liabilities and charges	9	(4.6)	(1.4)	(3.9)
Operating profit		10.1	5.8	14.3
Other gains	10	3.1	-	-
Profit before tax		13.2	5.8	14.3
Taxation expense	11	(3.1)	(1.7)	(3.5)
Profit for the period/year		10.1	4.1	10.8

Condensed consolidated statement of recognised income and expense

Profit for the period/year	10.1	4.1	10.8
Actuarial loss on retirement benefit obligations	(0.7)	(5.3)	(8.9)
Movement in deferred tax relating to retirement benefit obligations	0.2	1.6	2.5
	9.6	0.4	4.4

* Other provisions of £2.5m have been reclassified from fees and commission receivable to provision for other liabilities and charges in the period. There was no effect on profit for the year as a result of the reclassification.

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

The accounting policies and notes on pages 10 to 18 form part of these accounts.

Condensed consolidated statement of financial position
As at 30 June 2010

	Notes	As at 30.06.10 (Unaudited) £m	As at 30.06.09 (Unaudited) £m	As at 31.12.09 (Audited) £m
Assets				
Liquid assets:				
Cash in hand and balances with the Bank of England		404.3	5.5	136.3
Loans and advances to credit institutions		36.5	190.1	159.5
Debt securities		925.7	948.7	1,084.5
		1,366.5	1,144.3	1,380.3
Derivative financial instruments		43.9	28.1	36.3
Loans and advances to customers:				
Loans fully secured on residential property		4,184.7	4,178.1	4,049.3
Other loans fully secured on land		580.0	590.8	594.6
Other loans		93.9	91.0	93.0
	12	4,858.6	4,859.9	4,736.9
Investment in joint venture		1.9	1.9	1.9
Intangible fixed assets		2.2	2.7	2.5
Property, plant and equipment		36.5	37.4	36.6
Deferred tax assets		4.1	2.4	3.9
Other assets		3.3	5.9	1.5
Prepayments and accrued income		22.6	14.7	19.0
Total assets		6,339.6	6,097.3	6,218.9
Liabilities				
Shares		4,988.1	4,510.5	4,933.2
Deposits and debt securities:				
Amounts owed to credit institutions	13	443.2	440.6	448.0
Amounts owed to other customers		195.0	320.7	172.6
Debt securities in issue		102.6	279.5	93.0
		740.8	1,040.8	713.6
Derivative financial instruments		72.6	35.3	50.6
Current tax liabilities		4.2	2.1	2.0
Other liabilities		9.0	8.0	5.8
Provision for liabilities and charges		14.4	8.2	9.4
Accruals and deferred income		11.9	11.3	12.2
Deferred tax liabilities		1.8	2.6	1.8
Retirement benefit obligations		10.7	6.6	9.9
Subordinated liabilities	10	114.3	125.9	125.6
Subscribed capital		70.4	64.6	65.1
Total liabilities		6,038.2	5,815.9	5,929.2
General reserve	14	297.5	283.9	287.9
Other reserves		3.9	(2.5)	1.8
Total equity and liabilities		6,339.6	6,097.3	6,218.9

The accounting policies and notes on pages 10 to 18 form part of these accounts.

Condensed consolidated statement of cash flows
for the period ended 30 June 2010

	6 months to 30.06.10 (Unaudited) £m	6 months to 30.06.09 (Unaudited) £m	Year ended 31.12.09 (Audited) £m
Net cash inflow/(outflow) from operating activities (see below)	19.2	(220.6)	45.4
Cash flows from investing activities			
Purchase of intangible assets and property, plant and equipment	(2.6)	(1.5)	(3.5)
Purchase of investment securities	(1,355.9)	(1,469.3)	(3,475.6)
Proceeds from sale and maturity of investment securities	1,517.6	1,695.3	3,571.7
Cash flows from financing activities			
Repurchase of subordinated liabilities	(6.9)	-	-
Increase in cash and cash equivalents	171.4	3.9	138.0
Cash and cash equivalents at beginning of period/year	242.7	104.7	104.7
Cash and cash equivalents at end of period/year	414.1	108.6	242.7
Represented by:			
Cash and balances with the Bank of England	404.3	5.5	136.3
Loans and advances to credit institutions repayable on demand	9.8	103.1	106.4
	414.1	108.6	242.7

Net cash inflow/(outflow) from operating activities

Profit before taxation	13.2	5.8	14.3
Adjusted for:			
Depreciation and amortisation	2.9	3.0	6.0
Increase in impairment losses on loans and advances to customers	16.4	8.5	39.4
Change in fair values	(10.2)	11.2	17.9
Other non cash movements	(2.9)	0.3	0.4
Changes in net operating assets			
Decrease in loans and advances to credit institutions	38.9	18.0	52.0
(Increase)/decrease in loans and advances to customers	(116.8)	0.9	81.4
(Increase)/decrease in other assets	(1.8)	0.6	2.0
(Increase)/decrease in prepayments and accrued income	(3.6)	19.5	15.1
Increase/(decrease) in derivative financial instruments	14.5	(22.4)	(15.3)
Increase/(decrease) in shares	47.2	(116.9)	309.8
Increase/(decrease) in deposits and debt securities	15.0	(144.8)	(471.0)
Increase/(decrease) in other liabilities	3.2	0.7	(1.5)
Increase/(decrease) in accruals and deferred income	4.9	(1.6)	0.4
Taxation	(1.7)	(3.4)	(5.5)
	19.2	(220.6)	45.4

Notes to the accounts
for the period ended 30 June 2010

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 are followed in this condensed set of financial statements as applied in the Group's latest annual audited financial statements.

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 the calculations of retirement benefit obligations..

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.

Changes to the actuarial assumptions for inflation and the discount rate applied to calculate the present value of future scheme liabilities has resulted in a net charge to the statement of recognised income and expense of £0.5m.

	6 months to 30.06.10 (Unaudited) %	6 months to 30.06.09 (Unaudited) %	Year ended 31.12.09 (Audited) %
Discount rate assumption	5.30	6.00	5.65
Inflation assumption	3.30	3.20	3.60
Rate of increase in pensionable salaries	3.30	3.20	3.60

Notes to the accounts
for the period ended 30 June 2010

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 30.06.10 (Unaudited)					
	Retail financial services £m	Commercial lending £m	Secured personal lending £m	Property services £m	Adjustment for Group transactions £m	Total £m
Interest receivable and similar income	78.7	18.7	28.4	-	(20.0)	105.8
Interest payable and similar charges	(52.3)	(13.1)	(6.9)	-	20.0	(52.3)
Net interest income	26.4	5.6	21.5	-	-	53.5
Net fee and commission income	3.5	0.5	0.1	4.7	(0.1)	8.7
Other operating income	0.6	-	-	-	(0.1)	0.5
Fair value losses	(0.1)	-	-	-	-	(0.1)
Net operating income	30.4	6.1	21.6	4.7	(0.2)	62.6
Administrative expenses	(22.7)	(0.9)	(4.4)	(3.3)	(0.2)	(31.5)
Impairment provision for losses on loans and advances	(1.4)	(7.3)	(7.7)	-	-	(16.4)
Provision for other liabilities and charges	1.4	-	(6.0)	-	-	(4.6)
Operating profit/(loss)	**7.7**	**(2.1)**	**3.5**	**1.4**	**(0.4)**	**10.1**
Other gains	**3.1**	**-**	**-**	**-**	**-**	**3.1**
Profit/(loss) before taxation	**10.8**	**(2.1)**	**3.5**	**1.4**	**(0.4)**	**13.2**

	6 months to 30.06.09 (Unaudited)					
	Retail financial services £m	Commercial lending £m	Secured personal lending £m	Property services £m	Adjustment for Group transactions £m	Total £m
Interest receivable and similar income	95.3	21.7	28.9	-	(25.6)	120.3
Interest payable and similar charges	(68.0)	(15.6)	(10.0)	-	25.6	(68.0)
Net interest income	27.3	6.1	18.9	-	-	52.3
Net fee and commission income	3.1	0.5	-	3.5	-	7.1
Other operating income	0.5	-	-	-	(0.1)	0.4
Fair value gains	0.1	-	-	-	-	0.1
Net operating income	31.0	6.6	18.9	3.5	(0.1)	59.9
Administrative expenses	(20.4)	(1.0)	(4.5)	(3.6)	0.1	(29.4)
Impairment provision for losses on loans and advances	(1.5)	(2.5)	(19.3)	-	-	(23.3)
Provision for other liabilities and charges	(1.4)	-	-	-	-	(1.4)
Operating profit/(loss)	**7.7**	**3.1**	**(4.9)**	**(0.1)**	**-**	**5.8**
Other gains	**-**	**-**	**-**	**-**	**-**	**-**
Profit/(loss) before taxation	**7.7**	**3.1**	**(4.9)**	**(0.1)**	**-**	**5.8**

Notes to the accounts
for the period ended 30 June 2010

2. Business segments (continued)

	Year ended 31.12.09 (Restated)					
	Retail financial services £m	Commercial lending £m	Secured personal lending £m	Property services £m	Adjustment for Group transactions £m	Total £m
Interest receivable and similar income	141.0	40.0	61.6	-	(15.9)	226.7
Interest payable and similar charges	(92.5)	(27.8)	(16.2)	-	16.2	(120.3)
Net interest income	48.5	12.2	45.4	-	0.3	106.4
Net fee and commission income	7.8	2.2	0.6	6.8	(0.1)	17.3
Other operating income	0.8	-	-	-	(0.3)	0.5
Fair value losses	(6.5)	-	-	-	-	(6.5)
Net operating income	50.6	14.4	46.0	6.8	(0.1)	117.7
Administrative expenses	(43.1)	(2.0)	(8.7)	(6.2)	-	(60.0)
Impairment provision for losses on loans and advances	(2.0)	(5.0)	(32.5)	-	-	(39.5)
Provision for other liabilities and charges	(1.4)	-	(2.5)	-	-	(3.9)
Operating profit	**4.1**	**7.4**	**2.3**	**0.6**	**(0.1)**	**14.3**
Other gains	**-**	**-**	**-**	**-**	**-**	**-**
Profit before taxation	**4.1**	**7.4**	**2.3**	**0.6**	**(0.1)**	**14.3**

	6 months to 30.06.10 £m (Unaudited)	6 months to 30.06.09 £m (Unaudited)	Year ended 31.12.09 £m (Audited)
Total assets by business segments			
Retail financial services	4,722.3	4,453.9	4,575.9
Secured personal lending	664.2	688.0	669.7
Commercial lending – fully secured on residential property	368.0	360.2	373.9
Commercial lending – fully secured on commercial property including land	580.0	590.8	594.6
Property services	5.1	4.4	4.8
Total assets	6,339.6	6,097.3	6,218.9
Total liabilities by business segment			
Retail financial services	5,670.3	5,404.2	5,544.4
Secured personal lending	664.2	688.0	669.7
Commercial lending – fully secured on residential property	-	-	-
Commercial lending – fully secured on commercial property including land	-	-	-
Property services	5.1	5.1	4.8
Total liabilities	6,339.6	6,097.3	6,218.9

Net proceeds of funding will be used by the Group for the general purposes of its business.

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

3. Interest receivable and similar income

	Group		
	6 months to 30.06.10 £m (Unaudited)	6 months to 30.06.09 £m (Unaudited)	Year ended 31.12.09 £m (Audited)
On loans fully secured on residential property	104.4	110.6	226.6
On other loans fully secured on land	17.8	12.7	24.4
On debt securities	6.7	14.8	23.1
Profit on realisation of investments	4.4	2.6	3.7
On other liquid assets	0.7	0.8	1.2
On derivative financial instruments	(28.2)	(21.2)	(52.3)
	105.8	120.3	226.7

The derivative arrangements in place for the Group result in a net payment of fixed interest on mortgage related derivatives. Due to the continued low rates of LIBOR over the first half of the year, net interest of £28.2m has been payable.

4. Interest payable and similar charges

	Group		
	6 months to 30.06.10 £m (Unaudited)	6 months to 30.06.09 £m (Unaudited)	Year ended 31.12.09 £m (Audited)
On shares held by individuals	54.7	57.0	112.5
On other shares	0.1	0.1	-
On deposits and debt securities	10.1	16.4	23.0
On subscribed capital	2.1	2.1	4.2
On subordinated liabilities	3.0	3.2	6.5
On derivative financial instruments	(17.7)	(10.8)	(25.9)
	52.3	68.0	120.3

The derivative arrangements in place for the Group result in a net receipt of fixed interest on savings related derivatives. Due to the continued low rates of LIBOR over the first half of the year, net interest of £17.7m has been received.

5. Fees and commission receivable

	Group		
	6 months to 30.06.10 £m (Unaudited)	6 months to 30.06.09 £m (Unaudited)	Year ended 31.12.09 £m (Restated)
Insurance and related financial service products	3.1	2.4	6.0
Estate Agency	2.4	2.1	4.5
Mortgage related fees	2.2	1.7	5.3
Other fees and commission	1.7	1.4	2.8
	9.4	7.6	18.6

6. Fees and commission payable

	Group		
	6 months to 30.06.10 £m (Unaudited)	6 months to 30.06.09 £m (Unaudited)	Year ended 31.12.09 £m (Audited)
Mortgage related fees	0.5	0.3	1.0
Bank charges	0.2	0.2	0.3
	0.7	0.5	1.3

7. Other fair value gains and losses

	Group		
	6 months to 30.06.10 £m (Unaudited)	6 months to 30.06.09 £m (Unaudited)	Year ended 31.12.09 £m (Audited)
(Losses)/gains on derivatives	(14.4)	5.1	7.3
Gains/(losses) on hedged items attributable to the hedged risk	14.3	(5.0)	(13.8)
	(0.1)	0.1	(6.5)

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 30.06.10 £m (Unaudited)	6 months to 30.06.09 £m (Unaudited)	Year ended 31.12.09 £m (Audited)
Wages and salaries	15.1	13.8	28.7
Social security costs	1.4	1.3	2.7
Other pension costs	0.7	0.8	1.1
	17.2	15.9	32.5
Other administrative expenses	11.4	10.5	21.5
	28.6	26.4	54.0

9. Provision for other liabilities and charges

	Group		
	6 months to 30.06.10 £m (Unaudited)	6 months to 30.06.09 £m (Unaudited)	Year ended 31.12.09 £m (Restated)
Financial Services Compensation Scheme levy	1.4	(1.4)	(1.4)
Other provisions	(6.0)	-	(2.5)
	(4.6)	(1.4)	(3.9)

Other provisions of £6.0m have been made in respect of various customer claims, including claims in relation to previous sales of payment protection insurance. It is expected that the liability will predominantly crystallise over the next 12 to 24 months.

10. Other gains

Gains of £3.1m were made on the repurchase of £10.0m of 5 3/8% Subordinated Notes due 2016 during the period.

11. Tax

Included in the profit for the period is a gain of £3.1m on the repurchase of £10.0m of subordinated liabilities which has been treated as non-taxable. Excluding this, tax for the six month period is charged at 30.7%, representing the best estimate of the annual effective tax rate expected for the full year, applied to the pre-tax income of the six month period.

12. Loans and advances to customers

	Group 6 months to 30.06.10 £m (Unaudited)	6 months to 30.06.09 £m (Unaudited)	Year ended 31.12.09 £m (Audited)
Maturity analysis of loans and advances to customers from the date of the balance sheet:			
Repayable on demand	58.0	49.9	66.4
less than three months	126.5	103.5	110.2
Between three months and one year	240.1	235.8	218.5
Between one year and five years	1,061.3	1,094.7	1,071.7
More than five years	3,327.6	3,324.4	3,233.0
	4,813.5	4,808.3	4,699.8
Provision for impairment losses	(57.9)	(46.8)	(49.3)
Unamortised loan origination fees	33.2	38.3	38.0
Fair value adjustment for hedged risk	69.8	60.1	48.4
	4,858.6	4,859.9	4,736.9

As at 30 June 2010, £842.7m of loans issued by the Society had been transferred to Principality Covered Bond LLP. These loans secure a £700m AAA rated bond issued by the Society. The loans remain on the balance sheet of the Society as the risks and rewards are retained by the Society.

13. Amounts owed to credit institutions

As part of the Covered Bond Programme, and included in amounts owed to credit institutions, is £398.1m relating to securities sold under short-term agreements to repurchase.

14. Analysis of general reserve

	Group As at 30.06.10 (Unaudited) £m	As at 30.06.09 (Unaudited) £m	As at 31.12.09 (Audited) £m
Balance at 1 January	287.9	283.5	283.5
Profit for the financial period/year	10.1	4.1	10.8
Actuarial loss on retirement benefit obligations	(0.7)	(5.3)	(8.9)
Movement in deferred tax relating to retirement benefit obligations	0.2	1.6	2.5
Total recognised income for the period/year	9.6	0.4	4.4
Balance at end of period/year	297.5	283.9	287.9
Reserves excluding pension liability	308.0	287.6	297.8
Pension liability	(10.5)	(3.7)	(9.9)
	297.5	283.9	287.9

15. Contingent liabilities and commitments

Financial Services Compensation Scheme levy

a) Financial Services Compensation Scheme levy

As described in note 39 to the 2009 Annual Report and Accounts, the Society is required to make payments to the Financial Services Compensation Scheme (FSCS) in relation to the restructuring of a number of failed financial institutions.

The Society has reviewed the level of provision in light of information published by the FSCS in the period and has released £1.4m of the provision. A provision of £3.6m (31 December 2009: £5.0m) is held in respect of these levies and represents the Society's best estimate of total levies payable in September 2010 and 2011. The Society has not 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) Payment protection insurance (PPI)

The FSA has recently published a Consultation Paper (CP10/06) on The Assessment and Redress of PPI Complaints which provides feedback on the earlier Consultation Paper of the same name (CP09/23). The proposals apply to all types of PPI policies, which, in the Group's case, relate to secured personal lending PPI products.

The consultation period closed on 28 April 2010 and the FSA intends to set out its proposals in a Policy Statement later in 2010. Given the current stage of the consultation process, the likely outcome and any adverse impact of this process on the Group or of the need to offer wider redress cannot be reliably estimated.

c) Defined benefit pension scheme

The Group will inject £1.0m into the defined benefit pension scheme on it's closure on 31 July 2010. It has further committed to inject an additional £1.0m into the scheme on 31 July 2011.

16. 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.

17. Financial instruments – credit risk

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

Loans and advances to credit institutions, debt securities and derivative financial instruments

	Group		
	6 months to 30.06.10 £m (Unaudited)	6 months to 30.06.09 £m (Unaudited)	Year ended 31.12.09 £m (Audited)
Financial assets:			
Loans and advances to credit institutions:			
Credit Support Annex (CSA) deposits	20.5	21.5	24.5
Other	16.0	190.1	147.0
Debt securities	925.7	948.7	1,084.5
Derivative financial instruments:			
Interest rate swaps	35.8	30.2	24.1
Cross currency interest rate swaps	8.1	10.1	12.2
Loans and advances to customers	4,858.6	4,859.9	4,736.9
	5,864.7	6,060.5	6,029.2

The percentage of these exposures that are rated between A and AAA under Fitch ratings for 2010 is 99.1% (31 December 2009: 96.8%).

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

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.

The International Swaps and Derivatives Association (ISDA) Master Agreement is Principality's preferred agreement for documenting derivative activity. For certain counterparties a Credit Support Annex (CSA) has been executed in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between counterparties to mitigate the market contingent counterparty risk inherent in the outstanding positions. £20.5m was pledged as at 30 June 2010 (31 December 2009: £24.5m pledged).

17. Financial instruments – credit risk (continued)

Loans and advances to customers

The table shows loans and advances to customers disaggregated by security type and by loan type.

	Group		
	6 months to 30.06.10 £m (Unaudited)	6 months to 30.06.09 £m (Unaudited)	Year ended 31.12.09 £m (Audited)
In respect of loans and advances to customers:			
Fully secured by a first charge on residential property	3,616.9	3,586.1	3,475.3
Fully secured by a first charge on commercial property including land	580.0	590.8	594.6
Fully secured by a second charge on residential property	567.8	592.1	574.0
Partially secured by a second charge on residential property	93.9	90.9	93.0
	4,858.6	4,859.9	4,736.9
Retail financial services	3,248.9	3,225.9	3,112.5
Commercial loans – fully secured on residential property	368.0	360.2	362.7
Commercial loans – fully secured on commercial property including land	580.0	590.8	594.6
Secured personal lending	661.7	683.0	667.1
	4,858.6	4,859.9	4,736.9

(a) Retail financial services and secured personal lending
Loans and advances to residential customers account for 88.0% of total loans and advances to customers (31 December 2009: 87.4%). 74.3% of loans and advances to residential customers are secured by a first charge on residential property (31 December 2009: 73.4%), 11.6% are fully secured by a second charge on residential property (31 December 2009: 12.1%) and 11.9% are fully secured by a first charge on land (31 December 2009: 12.6%).

The average index-linked loan to value (LTV) in respect of the Group's loans secured on residential property is estimated to be 62.8% (31 December 2009: 68.4%).

The Group provides loans secured on residential property across England and Wales and the Society, as a regional building society, has a geographical concentration in Wales. As at 30 June 2010, approximately 39.1% of residential exposures by account and 40.8% by value were concentrated in Wales (31 December 2009: 41.2% by account and 41.3% by value).

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 1.14% (31 December 2009: 1.02%) which compares favourably with the industry average of 1.64% (latest available Council of Mortgage Lenders (CML) arrears and possessions data as at 30 June 2010).

The Society holds Excess of Loss Insurance cover which provides additional protection against subsequent residential loan impairment, up to an agreed threshold, after a prescribed level of 'first loss' or excess. Cover is restricted to new owner occupier mortgage loans advanced prior to 30th April 2010, where the original Loan to Value ratio exceeds 75%.

The percentage of residential lending cases fully secured by a second charge currently in arrears by number is 9.3% (31 December 2009: 8.6%), and by value is 11.1% (31 December 2009: 10.1%).

(b) Commercial
Loans secured on commercial property are well diversified by industry type with the largest exposure to one counterparty amounting to £46.3m (31 December 2009: £46.7m) or 4.9% (31 December 2009: 5%) of gross balances.

Asset quality remains strong with total arrears balances of £1.9m (31 December 2009: £1.8m) and only six commercial cases (31 December 2009: three) three months or more in arrears.