HALF YEAR FINANCIAL STATEMENTS

2017

Building your future

Principality
Building Society
Cymdeithas Adeiladu

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FORWARD-LOOKING STATEMENTS

This interim 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

It is with great pleasure that I can announce an excellent half-year performance from Principality Building Society. Our total assets have risen to £9.0bn (December 2016: £8.2bn) for the first time and this has been achieved by a strong lending performance. In the first six months of this year our net residential mortgage lending increased by £357.5m (June 2016: £359.0m) and our service focus continues to result in strong feedback from our members, customers and our broker partners.

Overall pre-tax profits increased to £31.8m (June 2016: £23.9m) reflecting robust margin and strong arrears performance and providing resilience and security for our members. Our capital and liquidity remains strong and low arrears levels reflect the prudent nature of the balance sheet.

In order to support the growth in lending we have attracted an additional £366.9m (June 2016: £298.7m) in savings. We are grateful to the loyalty shown by our existing Members as well as welcoming many new savers to the Society. They continue to tell us the importance of our personal service and the great job our colleagues do in meeting their needs. The retail business has delivered a profit of £14.9m (June 2016: £13.7m) reflecting strong balance sheet growth.

Our Commercial lending business together with Nemo, our second charge loans business, are important in delivering financial contribution to our Members. Principality Commercial has been performing strongly in recent years signing a number of high profile deals across Wales and the South East of England, and has recorded a half year pre-tax profit of £8.5m (June 2016: £4.5m). Completions in the first half of the year were £76.2m (June 2016: £85.8m), despite signs of a more cautious market in the light of the uncertainty of Brexit. Nemo has again made a meaningful contribution to the overall results with a pre-tax profit of £8.4m (June 2016: £5.7m).

I have been in post as Chief Executive since March and during that time I have visited every one of our 71 branches and agencies. I have witnessed personally the importance of the personal service we provide and I have had great feedback from our Members on how they value what we do and I can see the important role we play in our local communities.

We are a mutual organisation, owned by our Members and we will continue to run the business for the long-term benefit of our Members. To achieve this we will implement our strategy with appropriate prudency, focus and rigour. Our strategy is ambitious with a clear focus on transforming our core mortgage and savings business. Growing the residential mortgage business is important and benefits our Members through building a sustainable business and providing the scale to allow us to invest for the future.

Strong performance in the first half of the year

The Business has delivered an excellent trading performance in the first half of the year, with the following key highlights;

- Total assets £9.0bn (31 December 2016: £8.2bn)
- Savings balances have increased by £366.9m (30 June 2016: £298.7m)
- Net residential mortgage balances of £6,215.8m (31 December 2016: £5,858.3m)
- Gross residential mortgage lending for the first six months of the year of £814.8m (30 June 2016: £802.4m)
- Pre-tax profits of £31.8m (30 June 2016: £23.9m)
- 88.9% of mortgages funded by savers (31 December 2016: 87.2%)
- Strong capital with a Common Equity Tier 1 ratio of 23.4%[1] (31 December 2016: 23.5%)
- Arrears levels remain consistently low, with the percentage of first charge cases greater than three months in arrears currently standing at 0.59% (31 December 2016: 0.63%)
- Customer Service Net Promoter Score performed strongly at 74.0%[2] (31 December 2016: 72.7%)
- Net interest margin 1.45% (30 June 2016: 1.62%)

1. Excluding unaudited interim profits. The equivalent ratio including interim profits to 30 June 2017 would be 24.6%.
2. Source: Based on internal survey data for 6 months ended 30 June 2017

Chief Executive's review (continued)

Recognition and awards

We have received recognition for the tremendous efforts from our colleagues during these past six months with some notable service awards.

These include:

Principality Commercial – Business Insider Wales Funder of the Year;
Nemo – Business Improvement Strategy at the Welsh Contact Centre Awards, for its excellent customer service;
Age Cymru Large Business Award 2017 for our contribution to the creation of an age-friendly Wales;
FT Adviser Innovation & Online Service 5 Star Award for our Intermediaries and Mortgage teams;
Investors in Customers Award for the great service our teams have provided to our broker network.

We have also seen our brand awareness improve at the mid-year point as a result of the events at the Principality Stadium this year. Our long-term partnership with the Welsh Rugby Union continues to develop successfully.

Members, Communities and Colleagues

Supporting our local communities and helping them prosper at every stage of their lives is what we do as a mutual building society. Our colleagues have yet again put in considerable effort to raise £63,000 for our three chosen charity partners (Llamau, School of Hard Knocks and Cancer Research Wales). They have also volunteered more than 450 hours to help us achieve our Corporate Social Responsibility objectives of helping people live and stay in a home for longer, health and wellbeing and financial education. The Society has also invested £60,000 to support 95 community groups and school projects across Wales.

Outlook

Our outlook for the second half of the year looks robust. However, headline profitability will fall in the coming years as we consciously invest in the business to improve further the propositions and service we provide for Members and customers. This will involve significant investment in technology, processes and our colleagues, and in developing our branch network to meet the changing demands of our Members. Political and economic uncertainty has undoubtedly affected the financial landscape but the Principality balance sheet is strong and is well positioned to deal with any impacts this might have. We will continue to provide a stand out experience for our members and customers whilst investing in our business for the long term.

Stephen Hughes
Chief Executive
2 August 2017

Business review
for the six months ended 30 June 2017

Key Financial Performance Indicators

The Business monitors a number of key financial performance indicators (KPIs) to measure progress towards its strategic objectives. The following table details these KPIs:

	30.06.17	30.06.16	31.12.16
Financial Performance			
Profit Before Tax	£31.8m	£23.9m	£50.3m
Retail Mortgage Balances	£6,215.8m	£5,603.8m	£5,858.3m
Net Interest Margin	1.45%	1.62%	1.57%
Management Expense Ratio (underlying cost basis)[1]	0.92%	1.01%	1.00%
Financial stability			
Common Equity Tier 1 (CET1) Ratio[2]	23.4%	20.3%	23.5%
Liquidity Ratio	18.9%	16.0%	14.6%

1. Further details contained under the heading 'Operating expenses' on the following page
2. Excluding unaudited interim profits. The equivalent ratios including interim profits for June 2017 would be 24.6% for CET1.

Financial Performance

Income Statement

The Business has performed strongly in the first half of the year, with pre-tax profit of £31.8m (30 June 2016: £23.9m) and an underlying profit, adjusting for factors not reflective of current trading performance of £31.9m (30 June 2016: £28.2m). Both measures reflect the ongoing strong performance of the Business, which support the ability to invest for the longer term.

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

	30.06.17 £m	30.06.16 £m	31.12.16 £m
Statutory profit before tax	31.8	23.9	50.3
Adjusted for:			
Nemo strategic review and restructuring costs	-	2.4	2.4
Provisions for other liabilities and charges	0.1	1.9	6.5
Underlying profit	31.9	28.2	59.2

Net Interest Margin

Net interest margin for the period remained strong at 1.45%, albeit lower than the comparative period (30 June 2016: 1.62%). The change in net interest margin is driven by the reduction to £350.1m (31 December 2016: £404.1m) in the total assets held in Nemo due to the decision taken last year to cease new business. This reduction is expected to continue as the Nemo portfolio reduces further in the coming years.

Business review (continued)

for the six months ended 30 June 2017

Operating Expenses

Operating expenses remain a key focus for the Business. On a statutory basis, operating expenses reduced in the period to £39.6m (30 June 2016: £42.1m), driven by a reduction in costs within secured personal lending following the decision to cease writing new business and the associated restructuring costs in the comparative period. As a result of this restructuring, ongoing operating expenses within this business unit are substantially lower. Operating expenses for Retail financial services increased by £1.9m, driven largely by expenditure on strategic programmes, including the Business's investment programme.

Total operating expenses are set out in the table below:

		30.06.17 £m	30.06.16 £m	31.12.16 £m
Retail financial services		35.0	33.1	67.7
Commercial lending		1.8	1.8	3.7
Secured personal lending		2.8	4.8	8.3
Underlying operating expenses		39.6	39.7	79.7
Nemo strategic review and restructuring costs		-	2.4	2.4
Total operating expenses		39.6	42.1	82.1
Management expense ratio	Underlying cost basis	0.92%	1.01%	1.00%
	Statutory cost basis	0.92%	1.07%	1.04%
Cost/Income ratio	Underlying cost basis	57.6%	57.5%	58.5%
	Statutory cost basis	57.6%	61.0%	60.3%

On the basis of underlying cost, the management expense ratio (cost as a proportion of mean assets) was 0.92% (30 June 2016: 1.01%), reflecting the continued focus on cost management within the Business.

Impairment

The Business experienced a release of impairment provisions for loans and advances to customers of £2.8m (30 June 2016: £1.1m charge). This was driven by the continued low levels of arrears and moderate house price growth in the period. Impairment charges against commercial loans have decreased in the period, reflecting the work undertaken in recent years to bring to resolution the remaining historic impaired or low credit quality loans. The low overall levels reflect the prudent approach to lending and robust affordability, credit quality and underwriting standards. These standards mean the Business is well positioned to deal with any potential future volatility associated with the current uncertain political and economic environment.

Arrears performance remains strong across all portfolios, with arrears of more than three months of just 0.59% in the retail mortgage portfolio (31 December 2016: 0.63%).

Total impairment provisions held are as follows:

	30.06.17 £m	30.06.16 £m	31.12.16 £m
Retail mortgages	6.0	7.0	5.6
Secured personal lending	13.6	16.8	15.3
Commercial lending	22.6	26.0	24.5
Total	42.2	49.8	45.4

Provisions for liabilities and charges

The provisions charge for other liabilities for the period was £0.1m (30 June 2016: £1.9m), with the majority of charges relating to the Financial Services Compensation Scheme. The fall in provision charge was driven by the significant reduction in expected FSCS future interest payments following the sale in the period of a significant proportion of the Bradford & Bingley legacy assets.

Business review (continued)
for the six months ended 30 June 2017

Statement of Financial Position

Loans and advances to customers
Total assets have increased to £9,011.7m (31 December 2016: £8,281.2m), driven by strong growth in retail mortgage lending. The residential mortgage portfolio increased to £6,215.8m (31 December 2016: £5,858.3m), and the quality of the loans remains strong with an average indexed loan to value of 57.4% (31 December 2016: 56.8%). The Commercial Lending portfolio remained broadly flat at £760.3m (31 December 2016: £772.1m), and the Nemo portfolio has decreased to £350.1m (31 December 2016: £404.1m).

Funding
Retail savings increased to £6,532.1m (31 December 2016: £6,165.2m) reflecting the continued focus on providing competitive products to Members in the current low interest rate environment. In June 2017 the Business entered into its fourth Residential Mortgage Backed Security (RMBS) issuance, securing £475m of further funding to support the Business's growth plans.

Capital and Liquidity
The capital position remains robust, with a CET1 ratio of 23.4% (31 December 2016: 23.5%) and a leverage ratio of 5.2% (31 December 2016: 5.5%), both well above the minimum regulatory requirements.

The Business continues to hold a prudent buffer of high quality liquid assets, with a liquidity ratio of 18.9% (31 December 2016: 14.6%). The Liquidity Coverage Ratio (LCR) is 229.8% as 30 June 2017 (31 December 2016: 161.2%), which is above the current regulatory minimum of 90%. The regulatory minimum increased from 80% on 1 January 2017 and is expected to increase to 100% from 1 January 2018.

Principal Risks and Uncertainties
The principal risks and uncertainties affecting the Business were set out on pages 36 to 44 of the Annual Report and Accounts for the year ended 31 December 2016. These risks are categorised as: credit, market, liquidity and funding, conduct, operational, business, and pension risk, which are common to most financial services firms in the UK. These risks continue to affect the Business at 30 June 2017 and there have been no material changes to the approach to risk management during the first half of the year.

The outlook for the UK economy remains uncertain. This uncertainty is driven by various factors such as: the recent general election, the ongoing Brexit negotiations, higher inflation coupled with weak wage growth and apparently slowing growth within the UK economy.

The Bank of England has set out its concerns over increased growth in consumer borrowing and higher indebtedness within the UK. It has increased the level of capital buffers required to be held by financial services organisations.

The Business is very well placed to meet these challenges and the surrounding uncertainty, with a diversified and flexible funding base, and strong levels of both capital and liquidity. Whilst the current lower interest rates are good news for borrowers, with record low rates on offer in the mortgage market, the Business recognises the challenges that lower interest rates present for our savers. We will continue to look for ways to support Members whilst making the right decisions for the long-term safety and stability of Principality Building Society.

Steve Hughes	Tom Denman
Chief Executive	Chief Financial Officer
2 August 2017	2 August 2017

Condensed consolidated income statement
Group interim results for six months to 30 June 2017

	Notes	6 months to 30.06.17 £m (Unaudited)	6 months to 30.06.16 £m (Unaudited)	Year ended 31.12.16 £m (Audited)
Interest receivable and similar income	3	105.8	117.5	229.1
Interest payable and similar charges	4	(43.7)	(54.3)	(104.2)
Net interest income		62.1	63.2	124.9
Fees and commission receivable	5	3.9	5.9	9.0
Fees and commission payable		(0.4)	(0.5)	(0.9)
Net fee and commission income		3.5	5.4	8.1
Other operating income		0.7	0.8	1.6
Other fair value gains/(losses)	6	2.4	(0.4)	1.6
Net operating income		68.7	69.0	136.2
Administrative expenses	7	(36.4)	(38.9)	(74.2)
Depreciation and amortisation		(3.2)	(3.2)	(7.9)
Operating expenses		(39.6)	(42.1)	(82.1)
Impairment credit/(charge) for losses on loans and advances		2.8	(1.1)	2.7
Provisions for liabilities and charges	11	(0.1)	(1.9)	(6.5)
Operating profit and profit before taxation		31.8	23.9	50.3
Taxation expense	9	(7.2)	(5.9)	(11.2)
Profit for the period/year		24.6	18.0	39.1

Condensed consolidated statement of other comprehensive income
Group interim results for six months to 30 June 2017

	Notes	6 months to 30.06.17 £m (Unaudited)	6 months to 30.06.16 £m (Unaudited)	Year ended 31.12.16 £m (Audited)
Profit for the period/year		24.6	18.0	39.1
Items that will not be reclassified subsequently to profit and loss:				
Actuarial gain/(loss) on retirement benefit obligations		1.3	(5.8)	(12.6)
Tax on retirement benefit obligations	9	(0.8)	1.2	2.5
Items that may be reclassified subsequently to profit and loss:				
(Loss)/gain on available-for-sale assets		(1.3)	1.2	0.6
Tax on available-for-sale assets	9	0.2	(0.2)	(0.1)
Total comprehensive income for the period/year		24.0	14.4	29.5

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 10 to 20 form part of these accounts.

Condensed consolidated statement of financial position

Group interim results as at 30 June 2017

	Notes	6 months to 30.06.17 £m (Unaudited)	6 months to 30.06.16 £m (Unaudited)	Year to 31.12.16 £m (Audited)
Assets				
Liquid assets:				
Cash in hand and balances with the Bank of England		1,173.4	656.9	585.7
Loans and advances to credit institutions		157.6	214.0	141.5
Debt securities		244.3	319.5	389.6
		1,575.3	1,190.4	1,116.8
Derivative financial instruments		29.7	39.0	30.4
Loans and advances to customers:				
Loans fully secured on residential property		7,052.5	6,576.0	6,766.7
Other loans		296.2	333.4	307.2
	10	7,348.7	6,909.4	7,073.9
Intangible fixed assets		1.0	1.2	1.3
Property, plant and equipment		43.2	46.6	44.5
Deferred tax assets		3.3	3.3	4.4
Other assets		1.6	3.5	1.7
Prepayments and accrued income		8.9	8.1	8.2
Total Assets		9,011.7	8,201.5	8,281.2
Liabilities				
Shares		6,532.1	5,920.5	6,165.2
Deposits and debt securities:				
Amounts owed to credit institutions		605.3	512.9	611.2
Amounts owed to other customers		198.0	239.0	226.5
Debt securities in issue		1,018.8	790.0	631.1
		1,822.1	1,541.9	1,468.8
Derivative financial instruments		33.9	68.0	45.7
Current tax liabilities		6.3	6.4	5.3
Other liabilities		6.3	2.3	6.8
Provisions for liabilities	11	6.8	5.5	7.1
Accruals and deferred income		19.8	20.1	18.8
Deferred tax liabilities		0.2	0.7	0.5
Retirement benefit obligations	8	14.0	9.2	15.3
Subordinated liabilities		-	92.3	-
Subscribed capital		67.8	71.2	69.3
Total liabilities		8,509.3	7,738.1	7,802.8
General reserve		501.0	460.9	476.0
Other reserves		1.4	2.5	2.4
Total equity and liabilities		9,011.7	8,201.5	8,281.2

Condensed consolidated statement of cash flows

Group interim results for six months to 30 June 2017

	6 months to 30.06.17 £m (Unaudited)	6 months to 30.06.16 £m (Unaudited)	Year ended 31.12.16 £m (Audited)
Net cash inflow from operating activities (see below)	461.4	230.3	252.3
Cash flows from investing activities			
Purchase of intangible assets and property, plant and equipment	(1.7)	(3.1)	(5.7)
Purchase of investment securities	(6.0)	(24.8)	(124.7)
Proceeds from sale and maturity of investment securities	150.1	144.3	173.4
Cash flows from financing activities			
Repayment of subordinated liabilities	-	-	(92.3)
Increase in cash and cash equivalents	603.8	346.7	203.0
Cash and cash equivalents at beginning of period/year	727.2	524.2	524.2
Cash and cash equivalents at end of period/year	1,331.0	870.9	727.2
Represented by:			
Cash and balances with the Bank of England	1,173.4	656.9	585.7
Loans and advances to credit institutions repayable on demand	157.6	214.0	141.5
	1,331.0	870.9	727.2
Net cash outflow from operating activities			
Profit after taxation	24.6	18.0	39.1
Adjusted for:			
Depreciation and amortisation	3.2	3.2	7.9
Impairment credit/(charge) for loans and advances to customers	(2.8)	1.1	(2.7)
Change in fair values	3.2	(18.6)	(6.9)
Taxation charge	7.2	5.9	11.2
Other non-cash movements	0.8	(5.4)	(12.5)
Changes in net-operating assets			
(Increase) in loans and advances to customers	(289.0)	(332.3)	(513.8)
Decrease/(increase) in other assets	0.1	(0.5)	1.1
(Increase) in prepayments and accrued income	(0.7)	(3.9)	(4.0)
Change in derivative financial instruments	(11.1)	19.0	5.3
Increase in shares	373.9	286.2	538.8
Increase in deposits and debt securities	358.4	253.5	179.7
(Decrease) in other liabilities	(0.5)	(5.5)	(1.0)
(Decrease)/increase in provisions for liabilities	(0.3)	1.7	3.2
Increase in accruals and deferred income	1.0	8.3	7.1
(Decrease)/increase in pension fund obligation	(1.3)	4.7	11.2
Taxation paid	(5.3)	(5.1)	(11.4)
	461.4	230.3	252.3

Condensed consolidated statement of changes in members' interests

Group interim results for six months to 30 June 2017

	Six months to 30 June 2017		
	General Reserve £m	Available for Sale Reserve £m	Total Equity Attributable to Members £m
Group			
At 1 January	476.0	2.4	478.4
Comprehensive income for the period/year	25.0	(1.0)	24.0
At 30 June	501.0	1.4	502.4

	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

	Year ended 31 December 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 year	28.6	0.8	29.4
At 31 December	476.0	2.4	478.4

Notes to the accounts
for the six months ended 30 June 2017

1. Accounting policies

Reporting period

The financial statements show the financial performance of the group for the half-year ended 30 June 2017.

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 2017 Interim Financial Report are consistent with those disclosed in the Annual Report and Accounts for the year ended 31 December 2016.

The group launched its IFRS 9 implementation project in 2015, focused on the impairment changes and the revisions to classification and measurement set out in the standard. This project reports progress through a steering group to the nominated oversight committees, and ultimately the Audit Committee.

The group is in the final stages of its assessment of the impact of IFRS 9 on loan loss provisions. Expected credit loss models have been developed for each of the core asset portfolios and are being parallel run alongside IAS 39 models. The output of the parallel run process will be used to review and refine the models throughout the second half of 2017, along with the relevant disclosure requirements, ahead of full implementation.

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. The Directors performed an assessment of the group's long-term viability in January 2017, details of which are included on page 71 of the 2016 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 six months ended 30 June 2017

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 2017			
	Retail financial services £m	Commercial lending £m	Secured personal lending £m	Total £m
Net interest income	45.0	7.4	9.7	62.1
Other income and charges	5.6	0.9	0.1	6.6
Net operating income	50.6	8.3	9.8	68.7
Operating expenses	(35.0)	(1.8)	(2.8)	(39.6)
Impairment provision for losses on loans and advances	(0.6)	2.0	1.4	2.8
Provision for other liabilities and charges	(0.1)	-	-	(0.1)
Operating profit and profit before taxation	14.9	8.5	8.4	31.8
Taxation expense				(7.2)
Profit after taxation				24.6

	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

Notes to the accounts
for the six months ended 30 June 2017

2. Business segments (continued)

	Year ended 31 December 2016			
	Retail financial services £m	Commercial lending £m	Secured personal lending £m	Total £m
Net interest income	87.9	13.8	23.2	124.9
Other income and charges	9.4	1.8	0.1	11.3
Net operating income	97.3	15.6	23.3	136.2
Operating expenses	(67.7)	(3.7)	(10.7)	(82.1)
Impairment provision for losses on loans and advances	(0.2)	0.7	2.2	2.7
Provision for other liabilities and charges	(3.2)	(0.1)	(3.2)	(6.5)
Operating profit and profit before taxation	26.2	12.5	11.6	50.3
Taxation expense				(11.2)
Profit after taxation				39.1

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

	6 months to 30.06.17 £m (Unaudited)	6 months to 30.06.16 £m (Unaudited)	Year ended 31.12.16 £m (Audited)
Total assets by business segments			
Retail financial services	7,883.5	6,927.7	7,086.6
Secured personal lending	350.9	467.9	405.2
Commercial lending	777.3	805.9	789.4
Total assets	9,011.7	8,201.5	8,281.2
Total liabilities and equity by business segment			
Retail financial services and Commercial lending	8,660.8	7,733.6	7,876.0
Secured personal lending	350.9	467.9	405.2
Total liabilities and equity	9,011.7	8,201.5	8,281.2

3. Interest receivable and similar income

	Group		
	6 months to 30.06.17 £m (Unaudited)	6 months to 30.06.16 £m (Unaudited)	Year ended 31.12.16 £m (Audited)
On loans fully secured on residential property	106.8	116.9	231.7
On other loans	7.3	6.9	12.3
On debt securities	1.4	1.9	3.9
On other liquid assets	1.0	1.8	2.7
On derivative financial instruments	(10.7)	(10.0)	(21.5)
	105.8	117.5	229.1

Notes to the accounts
for the six months ended 30 June 2017

4. Interest payable and similar charges

	Group		
	6 months to 30.06.17 £m (Unaudited)	6 months to 30.06.16 £m (Unaudited)	Year ended 31.12.16 £m (Audited)
On shares held by individuals	39.8	46.3	91.1
On deposits and debt securities	6.6	9.6	17.2
On subscribed capital	2.1	2.1	4.2
On subordinated liabilities	-	0.7	0.8
On derivative financial instruments	(4.8)	(4.4)	(9.1)
	43.7	54.3	104.2

5. Fees and commission receivable

	Group		
	6 months to 30.06.17 £m (Unaudited)	6 months to 30.06.16 £m (Unaudited)	Year ended 31.12.16 £m (Audited)
Insurance and related financial service products	1.8	3.5	4.4
Mortgage related fees	2.0	2.2	4.2
Other fees and commission	0.1	0.2	0.4
	3.9	5.9	9.0

6. Other fair value gains and losses

	Group		
	6 months to 30.06.17 £m (Unaudited)	6 months to 30.06.16 £m (Unaudited)	Year ended 31.12.16 £m (Audited)
Gains/(losses) on derivatives	8.4	(14.2)	(5.3)
(Losses)/gains on hedged items attributable to the hedged risk	(6.0)	13.8	6.9
	2.4	(0.4)	1.6

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.

Notes to the accounts
for the six months ended 30 June 2017

7. Administrative expenses

	Group		
	6 months to 30.06.17 £m (Unaudited)	6 months to 30.06.16 £m (Unaudited)	Year ended 31.12.16 £m (Audited)
Wages and salaries	19.9	19.0	38.7
Social security costs	2.0	1.9	3.8
Other pension costs	1.0	0.9	1.7
	22.9	21.8	44.2
Other administrative expenses	13.5	14.7	27.6
Nemo strategic review and restructuring costs	-	2.4	2.4
	36.4	38.9	74.2

8. Retirement benefit obligations

	Group		
	6 months to 30.06.17 £m (Unaudited)	6 months to 30.06.16 £m (Unaudited)	Year ended 31.12.16 £m (Audited)
Fair value of plan assets	57.3	55.7	58.1
Present value of funded and unfunded obligations	(71.3)	(64.9)	(73.4)
Pension scheme deficit	(14.0)	(9.2)	(15.3)

9. Taxation

Taxation for the group for 2017 is charged at 22.6% (30 June 2016: 24.7%), 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 was reduced to 19.0% from 6 April 2017. This results in an effective statutory rate of 19.25% for the year ending December 2017. The statutory rate of corporation tax will be reduced to 17.0% from April 2020.

Notes to the accounts
for the six months ended 30 June 2017

10. Loans and advances to customers

	Group		
	6 months to 30.06.17 £m (Unaudited)	6 months to 30.06.16 £m (Unaudited)	Year ended 31.12.16 £m (Audited)
Fully secured on residential property	7,046.3	6,535.8	6,744.8
Fully secured on land	311.9	350.5	323.9
	7,358.2	6,886.3	7,068.7
Provision for impairment losses	(42.2)	(49.8)	(45.4)
Unamortised loan origination fees	10.2	12.6	11.2
Fair value adjustment for hedged risk	22.5	60.3	39.4
	7,348.7	6,909.4	7,073.9

11. Provisions for liabilities

	Group		
	6 months to 30.06.17 £m (Unaudited)	6 months to 30.06.16 £m (Unaudited)	Year ended 31.12.16 £m (Audited)
At beginning of the period/year	7.1	3.8	3.8
Additions	0.1	1.9	6.5
Utilisation	(0.4)	(0.2)	(3.2)
At end of the period/year	6.8	5.5	7.1

The provisions balance includes £1.5m for the FSCS levy. This balance is made up of the expected interest charges for scheme years April 2016 to March 2017 and April 2017 to March 2018.

Provision levels are broadly consistent in comparison to the amounts held at 31 December 2016. The group continues to hold provisions in respect of claims in relation to previous sales of Payment Protection Insurance (PPI) and various other customer claims.

On 2 March 2017, the FCA published its Policy Statement (PS17/3) communicating a deadline of 29 August 2019 for consumers to complain about the way they were sold PPI. The Policy Statement also introduced the requirement to proactively contact customers who have previously had their complaints defended. Management views its current provision as appropriate, however complaint trends and the associated provision adequacy will continue to be closely monitored.

Further details are set out in note 19 of the 2016 Annual Report and Accounts.

Notes to the accounts
for the six months ended 30 June 2017

12. Related party transactions

The group had no related party transactions outside the normal course of the business during the half-year to 30 June 2017. Transactions for this period are similar to those for the year to 31 December 2016, details of which can be found on page 134 of the 2016 Annual Report and Accounts.

13. 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 30.06.17		Year ended 31.12.16	
	Carrying Value £m (Unaudited)	Fair Value £m (Unaudited)	Carrying Value £m (Audited)	Fair Value £m (Audited)
Total assets				
Cash in hand and balances with Bank of England	1,173.4	1,173.4	585.7	585.7
Loans and advances to credit institutions	157.6	157.6	141.5	141.5
Debt securities	244.3	244.3	389.6	389.6
Derivative financial instruments	29.7	29.7	30.4	30.4
Loans and advances to customers	7,348.7	7,362.4	7,073.9	7,127.8
	8,953.7	8,967.4	8,221.1	8,275.0
Total liabilities				
Shares	6,532.1	6,565.2	6,165.2	6,215.9
Amounts owed to credit institutions	605.3	605.3	611.2	611.2
Amounts owed to other customers	198.0	198.0	226.5	226.5
Debt securities in issue	1,018.8	1,024.0	631.1	627.3
Derivative financial instruments	33.9	33.9	45.7	45.7
Subscribed capital	67.8	63.9	69.3	59.8
	8,455.9	8,490.3	7,749.0	7,786.4

Further details on the methods and assumptions which have been applied in determining fair value are set out in note 31 of the 2016 Annual Report and Accounts.

Notes to the accounts
for the six months ended 30 June 2017

13. Financial instruments (continued)

Assets measured at fair value

	As at 30.06.17 (Unaudited)			
	£m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets at fair value through profit or loss:				
Derivative financial instruments	29.7	-	27.2	2.5
Available-for-sale financial assets:				
Debt securities	244.3	244.3	-	-
Total	274.0	244.3	27.2	2.5
Financial liabilities at fair value through profit or loss:				
Amounts owed to credit institutions	22.0	-	22.0	-
Derivative financial instruments	33.9	-	31.4	2.5
Total	55.9	-	53.4	2.5

	As at 30.06.16 (Unaudited)			
	£m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets at fair value through profit or loss:				
Derivative financial instruments	39.0	-	33.5	5.5
Available-for-sale financial assets:				
Debt securities	319.5	319.5	-	-
Total	358.5	319.5	33.5	5.5
Financial liabilities at fair value through profit or loss:				
Amounts owed to credit institutions	36.8	-	36.8	-
Derivative financial instruments	68.1	-	62.6	5.5
Total	104.9	-	99.4	5.5

	As at 31.12.16 (Audited)			
	£m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets at fair value through profit or loss:				
Derivative financial instruments	30.4	-	28.3	2.1
Available-for-sale financial assets:				
Debt securities	389.6	389.6	-	-
Total	420.0	389.6	28.3	2.1
Financial liabilities at fair value through profit or loss:				
Amounts owed to credit institutions	37.3	-	37.3	-
Derivative financial instruments	45.7	-	43.6	2.1
Total	83.0	-	80.9	2.1

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. This is detailed on the following page.

Notes to the accounts
for the six months ended 30 June 2017

13. Financial instruments (continued)

Hierarchy for fair value disclosures

Level	
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.

The items included within level 3 are interest rate swaps, the notional amounts for which track the amortisation profile of the mortgage assets within the Retail Mortgage Backed Securities (RMBS) structures. The valuations are calculated using present value calculations based on market interest rate curves and projected mortgage prepayment amounts. The unobservable inputs relate to the projection of the notional amounts of the swaps, which change over time to match the balance of the underlying mortgage portfolio.

14. 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 30.06.17 £m (Unaudited)	6 months to 30.06.16 £m (Unaudited)	Year ended 31.12.16 £m (Audited)
In respect of loans and advances to customers:			
Secured by a first charge on residential property	6,680.6	6,073.7	6,325.9
Secured by a first charge on land	311.9	332.8	323.9
Secured by a second charge on residential property	365.7	479.8	418.9
	7,358.2	6,886.3	7,068.7
Provisions for impairment losses	(42.2)	(49.8)	(45.4)
Effective interest rate adjustments	10.2	12.6	11.2
Fair value adjustments	22.5	60.3	39.4
	7,348.7	6,909.4	7,073.9

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 30.06.17 £m (Unaudited)	6 months to 30.06.16 £m (Unaudited)	Year ended 31.12.16 £m (Audited)
Retail financial services	6,215.8	5,603.8	5,858.3
Commercial lending	760.3	778.8	772.1
Secured personal lending	350.1	466.5	404.1
Fair value adjustments	22.5	60.3	39.4
	7,348.7	6,909.4	7,073.9

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.

14. Credit risk (continued)

The average index-linked loan to value (LTV) in respect of the group's loans secured by a first or second charge on residential property is 57.4% (31 December 2016: 56.8%).

The percentage of retail lending cases fully secured by a first charge currently with arrears greater than three months is 0.59% (31 December 2016: 0.63%) which compares favourably with the industry average of 0.91% (CML arrears and possession data as at March 2017).

Residential lending cases fully secured by a first charge which were six months or more in arrears had arrears balances of £0.9m (31 December 2016: £0.9m) with 196 (31 December 2016: 184) cases.

The percentage of secured personal loans currently in arrears by two months or more by number is 4.61% (31 December 2016: 5.88%), which by value is 5.53% (31 December 2016: 6.69%).

ii) Commercial

Loans secured on commercial property are diversified by industry type with the largest exposure to one counterparty amounting to £29.6m (31 December 2016: £29.8m) or 2.9% (31 December 2016: 3.7%) of gross balances.

Asset quality remains strong with impaired balances of £25.7m (31 December 2016: £27.7m), or 3.3% of gross balances (31 December 2016: 3.5%). Specific provisions of £9.8m (31 December 2016: £9.7m) are held against impaired exposures to cover management's best estimate of expected losses.

iii) Treasury

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

An assessment has been made of the group's key counterparties which concluded that no impairment provisions were 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;

(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 information required by DTR 4.2.8 (indication of any related party transactions that have taken place or any changes in the related party transactions described in the last annual report).

By order of the Board,

Stephen Hughes
Chief Executive
2 August 2017

Independent review report
to Principality Building Society

We have been engaged by the Company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2017 which comprises the condensed consolidated income statement, the condensed consolidated statement of financial position, the condensed consolidated statement of cash flows, the condensed consolidated statement of changes in members' interests, the condensed consolidated statement of cash flows and related notes 1 to 14. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Company in accordance with International Standard on Review Engagements (UK) 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 company 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 company, for our review work, for this report, or for the conclusions we have formed.

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

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

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

Scope of Review
We conducted our review in accordance with International Standard on Review Engagements (UK) 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 consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion
Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2017 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
Statutory Auditor
Cardiff, United Kingdom
2 August 2017

Other information

The information for the period ended 30 June 2017 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 2016 has been extracted from the Annual Report and Accounts for that year. The annual accounts for the year ended 31 December 2016 have been filed with the Financial Conduct Authority.

The auditor's report on the 2016 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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