Interim Report and Accounts | 2015

At the heart of our communities

PRINCIPALITY BUILDING SOCIETY

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FORWARD-LOOKING STATEMENTS

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

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

Chief Executive's review

Residential mortgage lending exceeds £5bn

I am delighted to report another very strong set of results for the Principality Group for the first six months of 2015, where we have seen our strategy of growing the core business continuing to deliver.

In the first half of the year we have once again grown our lending to customers buying their own home, contributing to the overall increase in lending to home owners which now exceeds £5bn for the first time in the Society's 155 year history. Crucial to this and to the market as a whole, has been lending to first-time buyers where we have consistently supported people onto the housing ladder. As house prices have stabilised and low interest rates have been seen across the market a greater level of affordability has returned, enabling us to help over 1,100 first-time buyers move into their first home in the first six months of the year.

Savers have continued to see interest rates fall which is an outcome of how the market is currently operating. Despite ongoing interest rate reductions from many of our competitors, we at Principality have done our best to try and support our loyal customers by minimising the impact of these wherever we can. Our lending programme continues to be funded by our savers and whilst we may have to take advantage of some of the wholesale funding opportunities that exist in the market to remain competitive, we do not envisage our model changing substantially. At the end of June our savers provided 87.4% of our funds that we lent to borrowers.

The Group's trading performance has been strong in the first half of the year. Excluding the impact of the pension changes last year[1], profit before tax has increased by £2.7m. Our profit for the first six months of the year has meant that we have been able to continue to grow our capital base, which provides vital protection for our Members from any severe market downturns, as well as providing us with important funding for our investment programme as we seek to transform our business into an organisation that will be relevant for both current and future members.

Key Performance Highlights

- Residential mortgage lending exceeds £5bn for the first time in the Society's history
- Continuous support to homeowners has led to a growth in residential mortgage lending in the first six months of the year of £233.4m (30 June 2014: £161.2m)
- Principality was the recipient of Wales' Responsible Large Business Award for 2015 in the Business in the Community Wales Responsible Business Awards 2015
- 87.4% of mortgages funded by savers (31 December 2014: 91.4%)
- Pre-tax profits of £23.2 million (30 June 2014: £30.6m including £10.1m one off benefit from a change in the pension inflation assumption)
- Strong capital ratios with a Common Equity Tier 1 ratio of 19.0% (31 December 2014: 18.2%)
- Net interest margin 1.84% (30 June 2014: 1.84%)
- Arrears levels remain consistently low, with the percentage of cases currently standing at 0.53% (31 December 2014: 0.74%)[2]

Group Performance

Within the Principality Group we have three key businesses; the Building Society, Nemo Personal Finance and our Commercial lending division.

I am delighted that all three businesses have made significant contributions to the Group's performance in 2015. The personal finance sector is seeing increased competition with new entrants and existing businesses competing for trade in a way that has not been previously experienced. Despite this, the Nemo business has performed well and delivered consistent growth in profits compared to the same period in 2014. Arrears levels remain low and the business is very well placed to respond to changes in regulation in the early part of 2016 with significant investment in technology, people and processes. We have strengthened the management team in the business and I have been delighted with the way that Nemo has responded to the challenges.

Our Commercial lending division has also had a very successful first six months with improving profitability. This has been a challenging market for a number of years which we have weathered well and as the economy continues to show signs of recovery I would expect a good business outturn for the remainder of this year.

Supporting our Communities

Our attention remains on our people: our Members and our colleagues. We strive for the highest possible levels of service and in the first half of this year we have seen our highest customer satisfaction index score[3] to date, which is testament to the fantastic personal levels of service that can be seen in our branches, agencies, call centre and head office.

Chief Executive's review (continued)

Supporting our Communities (continued)

Throughout our history our local communities have been at the heart of Principality and we are extremely proud to have been named Wales' Responsible Large Business 2015 for our volunteer and sponsorship projects around Wales and the borders this year. We have also been recognised at the Arts and Business Cymru Awards winning the Arts, Business & Brand Identity Award for the fifth year, this time for extending our partnership with Only Boys Aloud to North Wales.

I am proud of this recognition for our sponsorships, which provide substantial benefits to our Members and local communities as well as brand exposure, which benefits the Society. We have also volunteered hundreds of hours of employee time to help communities and we have invested over £20,000 in our local branch sponsorships to ensure our money is helping people in Wales and the borders.

Outlook

Everyone understands that the current low rates of interest are unlikely to continue. The impact is both positive and negative. The positive impact is being felt by borrowers who are benefitting from some of the lowest interest rates ever offered on mortgages and this in turn is ensuring that our need to put aside profit for potential bad debts has reduced significantly. We have, for a number of years, assessed borrowers on their ability to repay our loans in a higher interest rate environment and so we are confident that, even when interest rates do undoubtedly start to rise gradually, borrowers will be able to cope.

But the negative impact is being felt by savers who are seeing little return on their investment. The connectivity between the Bank of England Base Rate and savings rates has been well and truly broken and whilst increasing interest rates are likely to be good news for savers, it will take a number of years of rising interest rates to restore the relationship.

For savers, rates are likely to lag behind any base rate rises. At Principality we are committed to our well tested model of our savers being the principle funders of our lending programmes and we know that in order to achieve this we will have to ensure that not only do our rates remain competitive but that we continue to offer the outstanding level of service that our Members have come to expect and deserve to receive.

We still face many global uncertainties, as well as economic concerns in Europe which have not completely gone away, and whilst we have no direct exposure we have to be mindful of the wider impact of these on the UK economy and the challenges that they may uncover along the way.

Principality is well placed to deal with these issues and I am very confident in a continuing bright future for the organisation as we remain focussed on delivering strong results backed up with excellent service and an investment programme in the business that will ensure that it is relevant now and for many years to come.

Graeme H. Yorston
Group Chief Executive
4 August 2015

1. Changes to the inflation assumptions within the Group's defined benefit pension scheme generated a one-off credit of £10.1m in the comparative period in 2014.
2. The percentage of retail lending cases fully secured by a first charge currently with arrears greater than 2.5% of the total outstanding balance.
3. Source: Score of 87.6 in The Leadership Factor survey of 506 customers. April-June 2015.

Business review

for the six months ended 30 June 2015

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:

	30.06.15	30.06.14	31.12.14
Financial performance			
Group profit before tax from continuing operations	£23.2m	£30.6m	£53.5m
Group net interest margin	1.84%	1.84%	1.87%
Management expense ratio	1.11%	0.97% [3]	1.05% [3]
Retail mortgage balances	£5,017.3m	£4,667.1m	£4,783.9m
Financial stability			
Common equity tier 1 (CET1) ratio [1]	19.0%	14.8%	18.2%
Leverage ratio [1,2]	5.1%	4.2%	5.0%
Liquidity ratio	14.0%	18.1%	15.7%

1. excluding unaudited interim profits. The equivalent ratios including interim profits for June 2015 would be 19.9% for CET1 and 5.4% for Leverage.
2. calculated using quarter end values without taking into account Basel III transitional provisions for capital.
3. excludes the impact of a £10.1m credit in H1 2014 in relation to changes to the inflation assumptions for the Group's defined benefit pension scheme. Further details can be found in the Annual Report and Accounts for the year ended 31 December 2014.

Income Statement

The Group has recorded another half year of strong financial performance, with pre-tax profit from continuing operations of £23.2m (30 June 2014: £30.6m) and an underlying profit, adjusting for factors not reflective of current trading performance, of £27.3m (30 June 2014: £27.0m).

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

	30.06.15 £m	30.06.14 £m	31.12.14 £m
Profit before tax from continuing operations	23.2	30.6	53.5
RPI/CPI pension inflation assumption change	-	(10.1)	(10.1)
Gain on the sale of Gilts	-	(0.2)	(0.2)
Provisions for other liabilities and charges	4.1	6.7	8.7
Underlying profit	**27.3**	**27.0**	**51.9**

Interest margin

Net interest income increased to £66.8m (30 June 2014: £66.3m), whilst the net interest margin was in line with the comparative period at 1.84% (30 June 2014: 1.84%). The competitive market for both first and second charge lending has led to reduced rates for new business and, in the second charge portfolio, to increased levels of attrition for existing business in the period. However this has been offset by reducing cost of retail funding in the market, a higher proportion of lower cost secured wholesale funding as a result of the Society's continued strategy of diversifying the funding base, and effective management of liquidity.

Administrative expenses

The ratio of costs to mean total assets increased to 1.11% (30 June 2014: 0.97%), driven by continuing investment in the Group to meet current regulatory requirements and to ensure the Group is well placed to meet future challenges. Cost management remains a key focus for the Group with a number of initiatives in place, including the continuous improvement programme, to achieve a more efficient business and mitigate cost increases.

Impairment charges

Impairment charges for loans and advances to customers has decreased to £2.7m (30 June 2014: £8.6m), driven by an increase in residential house prices which has led to reduced impairment charges in the second charge portfolio, together with the improvement in the Commercial property market and subsequent increase in the value of collateral in the Commercial Lending portfolio.

Arrears performance remains strong across all portfolios, with arrears greater than 2.5% of the outstanding balance of 0.53% in the retail mortgage portfolio (31 December 2014: 0.74%).

Provisions for other liabilities

The provisions charge for other liabilities for the period was £4.1m (30 June 2014: £6.7m), relating to charges under the Financial Services Compensation Scheme.

Business review (continued)

for the six months ended 30 June 2015

Balance Sheet

Loans and advances to customers

Total assets have increased to £7,341.5m (31 December 2014: £7,265.0m), driven by strong growth in retail mortgage lending. The retail mortgage portfolio increased to £5,017.3m (31 December 2014: £4,783.9m), and the quality of the loans remains strong with an average indexed loan to value of 59.2% (31 December 2014: 58.3%). The Commercial Lending portfolio decreased to £759.1m (31 December 2014: £790.6m), and the second charge portfolio was broadly stable at £522.6m (31 December 2014: £528.4m).

Retail savings decreased to £5,530.7m (31 December 2014: £5,613.0m) reflecting the continued diversification of the Group's funding base following its second RMBS issuance in June 2014.

Impairment

Total impairment provisions are as follows:

	30.6.2015 £m	31.12.2014 £m
Retail mortgages	6.4	6.1
Secured personal lending	19.7	25.5
Commercial lending	27.1	31.1
Total	**53.2**	**62.7**

Retail provisions are broadly in line with the comparative period, with the impact of the growth in the portfolio offset by an increase in collateral value as a result of the increase in residential house prices over the period. Secured personal lending provision levels have decreased significantly driven by the increase in house prices and continued low levels of arrears. Commercial provisions have decreased reflecting the continuing increase in quality of the portfolio as the Group successfully resolves legacy issues.

Capital and Liquidity

The Group's capital position remains robust, with a CET1 ratio of 19.0% (31 December 2014: 18.2%) and a leverage ratio of 5.1% (31 December 2014: 5.0%), all well above the minimum regulatory requirements. The Group anticipates that its second charge mortgage portfolio will, subject to regulatory approval, adopt the Internal Ratings Based (IRB) approach during the second half of 2015. Were the Group to have adopted an IRB approach for these assets at 30 June 2015 based on current models, the CET1 ratio for the Group would have been 14.9%.

The Group continues to hold a prudent buffer of high quality liquid assets, with a liquidity ratio of 14.0% (31 December 2014: 15.7%). The Group continues to monitor the development of the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) metrics. Uncertainty remains over the final form of the NSFR but, based on the Group's own internal monitoring, both ratios are well above regulatory requirements.

Principal Risks and Uncertainties

The principal risks and uncertainties affecting the Group were set out on pages 17 to 24 of the Annual Report and Accounts for the year ended 31 December 2014. These risks are categorised as: credit, liquidity, market, conduct, foreign currency, operational, pension obligation and interest rate risk, which are common to most financial services firms in the UK. Other than foreign currency risk, these risks continue to affect the Group at 30 June 2015 and there have been no material changes to the Group's approach to risk management during the first half of the year.

The mortgage market remains highly competitive, and a rise in interest rates is widely forecast within the next year. A combination of static mortgage rates and rising cost of funds would increase the risk of margin compression. This risk is mitigated by ensuring that a significant proportion of administered rate savings and mortgages are maintained. There remains a risk to the macroeconomic environment from the situation in Greece and its impact on the Eurozone. Whilst the Group has no direct exposure to Greece or other Eurozone economies, a deterioration in the situation has the potential to adversely impact on funding markets and the UK economic outlook, and the Group continues to monitor the situation. The Group also continues to monitor all relevant legal and regulatory developments, both prudential and conduct related, which could impact on the Group.

Stephen Hughes
Group Finance Director
4 August 2015

Condensed consolidated income statement

Group interim results for six months to 30 June 2015

	Notes	6 months to 30.06.15 £m (Unaudited)	6 months to 30.06.14 £m (Unaudited)	Year ended 31.12.14 £m (Audited)
Interest receivable and similar income	3	121.1	130.2	258.0
Interest payable and similar charges	4	(54.3)	(63.9)	(124.2)
Net interest income		66.8	66.3	133.8
Fees and commission receivable	5	3.0	3.9	7.6
Fees and commission payable	6	(0.5)	(0.6)	(1.0)
Net fee and commission income		2.5	3.3	6.6
Other operating income		0.7	0.5	1.5
Other fair value gains/(losses)	7	0.3	0.8	(1.5)
Net operating income		70.3	70.9	140.4
Administrative expenses	8	(37.2)	(21.8)	(55.6)
Depreciation and amortisation		(3.1)	(3.2)	(9.1)
Operating expenses		(40.3)	(25.0)	(64.7)
Impairment provision for losses on loans and advances		(2.7)	(8.6)	(13.5)
Provision for liabilities and charges	13	(4.1)	(6.7)	(8.7)
Operating profit & profit before taxation from continuing operations		23.2	30.6	53.5
Taxation expense	10	(5.0)	(5.2)	(11.7)
Profit for the period/year from continuing operations		18.2	25.4	41.8
Profit for the period from discontinued operations		-	0.1	10.5
Profit for the period/year		18.2	25.5	52.3

Condensed consolidated statement of other comprehensive income

	Notes	6 Months to 30.06.15 £m (Unaudited)	6 Months to 30.06.14 £m (Unaudited)	Year ended 31.12.14 £m (Audited)
Profit for the period/year		18.2	25.5	52.3
Items that will not be reclassified subsequently to profit and loss:				
Actuarial gain/(loss) on retirement benefit obligations		0.3	(2.1)	(1.6)
Income tax	10	-	0.3	0.4
Items that may be reclassified subsequently to profit and loss:				
(Loss)/gain on available-for-sale assets		(1.1)	-	7.1
Income tax	10	0.2	-	(1.5)
Total comprehensive income for the period/year		17.6	23.7	56.7

The accounting policies and notes on pages 8 to 17 form part of these accounts.

Condensed consolidated statement of financial position

As at 30 June 2015

	Notes	As at 30.06.15 £m (Unaudited)	As at 30.06.14 £m (Unaudited)	As at 31.12.14 £m (Audited)
Assets				
Liquid assets:				
Cash in hand and balances with the Bank of England		362.5	547.6	432.6
Loans and advances to credit institutions		159.0	125.7	150.7
Debt securities		413.0	549.2	454.1
		934.5	1,222.5	1,037.4
Derivative financial instruments		22.7	36.7	30.9
Loans and advances to customers:				
Loans fully secured on residential property		5,947.0	5,568.2	5,720.4
Other loans fully secured on land		350.9	421.1	370.6
Other loans		27.7	49.6	48.9
	12	6,325.6	6,038.9	6,139.9
Intangible fixed assets		1.5	2.5	1.8
Property, plant and equipment		44.0	45.2	43.9
Deferred tax assets		1.6	3.4	2.0
Other assets		10.1	3.5	3.0
Prepayments and accrued income		1.5	7.1	6.1
Disposal group assets held for sale		-	11.6	-
Total assets		7,341.5	7,371.4	7,265.0
Liabilities				
Shares		5,530.7	5,605.7	5,613.0
Deposits and debt securities:				
Amounts owed to credit institutions		399.9	218.6	227.5
Amounts owed to other customers		242.0	238.9	173.9
Debt securities in issue		510.8	693.1	600.3
		1,152.7	1,150.6	1,001.7
Derivative financial instruments		31.7	24.9	42.8
Current tax liabilities		4.1	5.2	7.0
Other liabilities		6.3	6.6	4.4
Provision for liabilities	13	7.6	15.1	3.9
Accruals and deferred income		10.9	9.6	9.5
Disposal group liabilities held for sale		-	4.3	-
Deferred tax liabilities		0.1	0.3	0.3
Retirement benefit obligations	9	5.9	8.6	6.9
Subordinated liabilities		92.3	92.3	92.3
Subscribed capital		70.3	69.9	71.9
Total liabilities		6,912.6	6,993.1	6,853.7
General reserve	14	427.2	381.3	408.7
Other reserves		1.7	(3.0)	2.6
Total equity and liabilities		7,341.5	7,371.4	7,265.0

The accounting policies and notes on pages 8 to 17 form part of these accounts.

Condensed consolidated statement of cash flows

Group interim results for six months to 30 June 2015

	6 months to 30.06.15 £m (Unaudited)	6 months to 30.06.14 £m (Unaudited)	Year ended 31.12.14 £m (Audited)
Net cash (outflow)/inflow from operating activities (see below)	(98.8)	199.8	(9.3)
Cash flows from investing activities			
Purchase of intangible assets and property, plant and equipment	(2.9)	(3.3)	(7.6)
Purchase of investment securities	(31.1)	(169.3)	(232.1)
Proceeds from sale and maturity of investment securities	70.9	186.1	351.2
Net proceeds from disposal of discontinued operations		-	15.2
Cash flows from financing activities	-	-	-
(Decrease)/increase in cash and cash equivalents	(61.9)	213.3	117.4
Cash and cash equivalents at beginning of period/year	583.4	466.0	466.0
Cash and cash equivalents at end of period/year	**521.5**	**679.3**	**583.4**
Represented by:			
Cash and balances with the Bank of England	362.5	547.6	432.6
Loans and advances to credit institutions repayable on demand	159.0	131.7	150.8
	521.5	**679.3**	**583.4**
Net cash outflow from operating activities			
Profit after taxation	18.2	25.5	52.3
Adjusted for:			
Depreciation and amortisation	3.1	3.5	6.2
Impairment losses on property, plant and equipment and intangible assets	-	-	3.0
Impairment losses on loans and advances to customers	2.7	8.6	13.5
Change in fair values	4.6	0.3	(20.7)
Taxation charge	5.0	5.2	11.7
Gain on disposal of discontinued operations		-	(10.5)
Other non-cash movements	-	0.1	(10.7)
Changes in net operating assets			
Decrease in loans and advances to credit institutions	-	10.0	10.0
(Increase) in loans and advances to customers	(198.8)	(147.4)	(221.1)
(Increase)/decrease in other assets	(7.1)	2.5	3.2
Decrease in prepayments and accrued income	4.6	3.0	4.8
Change in derivative financial instruments	(2.9)	(0.4)	23.3
(Decrease)/increase in shares	(77.9)	47.8	45.2
Increase in deposits and debt securities	150.7	246.8	99.3
Increase/(decrease) in other liabilities	1.9	2.1	(3.9)
Increase/(decrease) in provisions for liabilities	3.7	2.5	(8.9)
Increase in accruals and deferred income	1.4	1.1	0.8
(Decrease) in pension fund obligations	(0.6)	(10.6)	(1.8)
Taxation	(7.4)	(0.8)	(5.0)
	(98.8)	**199.8**	**(9.3)**

Notes to the accounts
for the period ended 30 June 2015

1. Accounting policies

Reporting period

The financial statements show the financial performance of the Group for the half-year ended 30 June 2015.

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 2015 Interim Financial Report are consistent with those disclosed in the Annual Report and Accounts for the year ended 31 December 2014.

A number of new accounting standards came in to effect for this accounting year which have not had a material impact on the Group. For further details of these accounting standards are available in note 1 of the 2014 Annual Report and Accounts.

Going concern

The directors have reviewed the plans and forecasts for the next 18 months giving due consideration to profitability, liquidity and capital adequacy. In this context the directors consider that the Group has adequate liquidity to meet both normal demands of the business and the requirements which might arise in stressed circumstances for the foreseeable future. The directors also consider that reasonable profits continue to be generated in order to keep capital at an adequate level to meet regulatory requirements. Accordingly, the going concern basis has been adopted in the preparation of the Interim Report and Accounts.

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.

	6 months to 30.06.15 (Unaudited) - continuing activities				
	Retail financial services £m	Commercial lending £m	Secured personal lending £m	Adjustment for Group transactions £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
Administrative 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	**13.4**	**2.5**	**7.3**	**-**	**23.2**
Other gains	-	-	-	-	-
Profit before taxation	13.4	2.5	7.3	-	23.2
Tax					(5.0)
Profit for the period from discontinued operations					-
Profit after tax and discontinued operations					18.2

Notes to the accounts
for the period ended 30 June 2015

2. Business segments (continued)

	6 months to 30.06.14 (Unaudited) - continuing activities				
	Retail financial services £m	Commercial lending £m	Secured personal lending £m	Adjustment for Group transactions * £m	Total £m
Net interest income	43.3	6.3	16.7	-	66.3
Other income and charges	3.8	0.9	-	(0.1)	4.6
Net operating income	47.1	7.2	16.7	(0.1)	70.9
Administrative expenses	(28.3)	(2.0)	(5.6)	10.9	(25.0)
Impairment provision for losses on loans and advances	(1.9)	(4.5)	(2.2)	-	(8.6)
Provision for other liabilities and charges	(4.3)	(0.6)	(1.8)	-	(6.7)
Operating profit	**12.6**	**0.1**	**7.1**	**10.8**	**30.6**
Other gains	-	-	-	-	-
Profit before taxation	12.6	0.1	7.1	10.8	30.6
Tax					(5.2)
Profit for the period from discontinued operations					0.1
Profit after tax and discontinued operations					25.5

	Year ended 31.12.14 (Audited) - continuing activities				
	Retail financial services £m	Commercial lending £m	Secured personal lending £m	Adjustment for Group transactions * £m	Total £m
Net interest income	88.7	13.1	32.0	-	133.8
Other income and charges	4.4	1.9	0.3	-	6.6
Net operating income	93.1	15.0	32.3	-	140.4
Administrative expenses	(60.3)	(4.0)	(11.9)	11.5	(64.7)
Impairment provision for losses on loans and advances	(2.1)	(9.2)	(2.2)	-	(13.5)
Provision for other liabilities and charges	(3.8)	(0.6)	(4.3)	-	(8.7)
Operating profit	**26.9**	**1.2**	**13.9**	**11.5**	**53.5**
Other gains	-	-	-	-	-
Profit before taxation	26.9	1.2	13.9	11.5	53.5
Tax					(11.7)
Profit for the period from discontinued operations					10.5
Profit after tax and discontinued operations					52.3

*In 2014 administrative expenses includes the pension past service credit of £10.1m. Further details can be found in the 2014 Annual Report and Accounts.

	6 months to 30.06.15 £m (Unaudited)	6 months to 30.06.14 £m (Unaudited)	Year ended 31.12.14 £m (Audited)
Total assets by business segments			
Retail financial services	6,036.5	5,986.1	5,921.6
Secured personal lending	528.0	561.6	530.9
Commercial lending	777.0	812.1	812.5
Assets classified as held for sale	-	11.6	-
Total assets	7,341.5	7,371.4	7,265.0

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

Notes to the accounts
for the period ended 30 June 2015

3. Interest receivable and similar income

	Group		
	6 months to 30.06.15 £m (Unaudited)	6 months to 30.06.14 £m (Unaudited)	Year ended 31.12.14 £m (Audited)
On loans fully secured on residential property	119.2	124.5	248.8
On other loans fully secured on land	7.9	9.1	17.6
On debt securities	2.3	3.1	5.6
Profit on realisation of investments	-	0.2	0.2
On other liquid assets	1.0	0.9	2.4
On derivative financial instruments	(9.3)	(7.6)	(16.6)
	121.1	130.2	258.0

4. Interest payable and similar charges

	Group		
	6 months to 30.06.15 £m (Unaudited)	6 months to 30.06.14 £m (Unaudited)	Year ended 31.12.14 £m (Audited)
On shares held by individuals	49.8	59.0	113.9
On deposits and debt securities	7.2	7.3	15.6
On subscribed capital	2.2	2.1	4.2
On subordinated liabilities	0.7	0.7	1.4
On derivative financial instruments	(5.6)	(5.2)	(10.9)
	54.3	63.9	124.2

5. Fees and commission receivable

	Group		
	6 months to 30.06.15 £m (Unaudited)	6 months to 30.06.14 £m (Unaudited)	Year ended 31.12.14 £m (Audited)
Insurance and related financial service products	1.0	1.3	2.5
Mortgage related fees	1.7	2.2	4.3
Other fees and commission	0.3	0.4	0.8
	3.0	3.9	7.6

6. Fees and commission payable

	Group		
	6 months to 30.06.15 £m (Unaudited)	6 months to 30.06.14 £m (Unaudited)	Year ended 31.12.14 £m (Audited)
Mortgage related fees	0.3	0.3	0.6
Bank charges	0.2	0.3	0.4
	0.5	0.6	1.0

7. Other fair value gains and losses

	Group		
	6 months to 30.06.15 £m (Unaudited)	6 months to 30.06.14 £m (Unaudited)	Year ended 31.12.14 £m (Audited)
Gains/(losses) on derivatives	1.6	0.4	(23.3)
(Losses)/gains on hedged items attributable to the hedged risk	(1.3)	0.4	21.8
	0.3	0.8	(1.5)

8. Administrative expenses

	Group		
	6 months to 30.06.15 £m (Unaudited)	6 months to 30.06.14 £m (Unaudited)	Year ended 31.12.14 £m (Audited)
Wages and salaries	17.8	16.9	33.7
Social security costs	1.9	1.7	3.4
Other pension costs	0.9	(9.1)	(8.2)
	20.6	9.5	28.9
Other administrative expenses	16.6	12.3	26.7
	37.2	21.8	55.6

In the 2014 comparatives, Other pension costs includes a pension past service credit of £10.1m. Further details can be found in the 2014 Annual Report and Accounts.

9. Retirement benefit obligations

	Group		
	6 months to 30.06.15 £m (Unaudited)	6 months to 30.06.14 £m (Unaudited)	Year ended 31.12.14 £m (Audited)
Fair value of plan assets	55.8	51.2	54.6
Present value of funded and unfunded obligations	(61.7)	(59.8)	(61.5)
Pension scheme deficit	(5.9)	(8.6)	(6.9)

10. Taxation

Estimated tax for the Group for 2015 is charged at 20.8% (30 June 2014: 22.1%), representing the best estimate of the annual effective tax rate expected for the full year, applied to the forecast pre-tax income for the year and pro-rated for the six month period. The reduction in rate is largely driven by the reduction in the UK Corporation tax rate from 21.0% to 20.0% from 1 April 2015.

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) will be introduced from 1 January 2016. These changes were not substantively enacted by 30 June 2015 and have therefore not been reflected in these interim accounts. The impact of these changes on deferred tax will be taken in to account in the Annual Report and Accounts for the year ended 31 December 2015, but is not anticipated to be material.

Notes to the accounts
for the period ended 30 June 2015

11. Assets measured at fair value

As at 30.06.15 (Unaudited)	Group		
		Level 1	Level 2
	£m	£m	£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 30.06.14 (Unaudited)	Group		
		Level 1	Level 2
	£m	£m	£m
Financial assets at fair value through profit or loss:			
Derivative financial instruments	36.7	-	36.7
Available-for-sale financial assets:			
Debt securities	549.2	549.2	-
Total	**585.9**	**549.2**	**36.7**

As at 31.12.14 (Audited)	Group		
		Level 1	Level 2
	£m	£m	£m
Financial assets at fair value through profit or loss:			
Derivative financial instruments	30.9	-	30.9
Available-for-sale financial assets:			
Debt securities	454.1	454.1	-
Total	**485.0**	**454.1**	**30.9**

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 2015 (2014: none).

12. Loans and advances to customers

	Group		
	As at 30.06.15 £m (Unaudited)	As at 30.06.14 £m (Unaudited)	As at 31.12.14 £m (Audited)
Maturity analysis of loans and advances to customers from the date of the statement of financial position:			
Less than three months	151.6	149.0	179.0
Between three months and one year	227.0	232.0	214.5
Between one year and five years	1,110.9	1,078.6	1,088.5
More than five years	4,849.0	4,619.2	4,668.4
	6,338.5	6,078.8	6,150.4
Provision for impairment losses	(53.2)	(61.7)	(62.7)
Unamortised loan origination fees	13.7	16.4	15.2
Fair value adjustment for hedged risk	26.6	5.4	37.0
	6,325.6	6,038.9	6,139.9

13. Provision for liabilities and charges

	Group		
	As at 30.06.15 £m (Unaudited)	As at 30.06.14 £m (Unaudited)	As at 31.12.14 £m (Audited)
At beginning of the period/year	3.9	12.7	12.7
Charge for the period/year	4.1	6.7	8.7
Utilisation	(0.4)	(4.3)	(17.5)
At end of the period/year	7.6	15.1	3.9

The provisions balance includes £6.1m for the FSCS levy. This balance includes the expected interest charges for scheme years April 2014 to March 2015 and April 2015 to March 2016 and the expected capital charge for 2015-16.

Further details of the provisions held and expected timing of payments are set out in note 15 of these Interim Financial Statements and in note 38 to the 2014 Annual Report and Accounts.

14. Analysis of general reserve

	Group		
	As at 30.06.15 £m (Unaudited)	As at 30.06.14 £m (Unaudited)	As at 31.12.14 £m (Audited)
Balance at beginning of the period/year	408.7	357.7	357.7
Profit for the financial period/year	18.2	25.5	52.3
Actuarial gain/(loss) on retirement benefit obligations	0.3	(2.1)	(1.6)
Movement in deferred tax relating to retirement benefit obligations	-	0.2	0.4
Total recognised income for the period/year	18.5	23.6	51.0
Balance at end of period/year	427.2	381.3	408.7
Reserves excluding pension liability	433.1	389.9	415.6
Pension liability	(5.9)	(8.6)	(6.9)
	427.2	381.3	408.7

15. Financial commitments and contingent liabilities

Financial Services Compensation Scheme levy

As described in note 38 to the 2014 Annual Report and Accounts, the Society is required to make payments to the FSCS in relation to the restructuring of a number of failed financial institutions.

A provision of £6.1m (31 December 2014: £2.2m) is held in respect of these levies and represents the Society's best estimate of total levies payable in July 2015 and 2016. The FSCS levy provision has been calculated with the most up-to-date information with regards to the scheme 2014/2015 and 2015/16 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 future levies resulting from the failure of Dunfermline Building Society along with potential 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.

16. Related party transactions

The Group had no related party transactions outside the normal course of the business during the half-year to 30 June 2015. Transactions for this period are similar to those for the year to 31 December 2014, details of which can be found in the 2014 Annual Report and Accounts.

17. Financial instruments

a) Carrying values and fair values

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

	6 months to 30.06.15		Year ended 31.12.14	
	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	362.5	362.5	432.6	432.6
Loans and advances to credit institutions	159.0	159.0	150.7	150.7
Debt securities	413.0	413.0	454.1	454.1
Derivative financial instruments	22.7	22.7	30.9	30.9
Loans and advances to customers	6,325.6	6,417.7	6,139.9	6,174.7
	7,282.8	7,374.9	7,208.2	7,243.0
Group liabilities				
Shares	5,530.7	5,516.2	5,613.0	5,613.9
Amounts owed to credit institutions	399.9	399.9	227.5	227.5
Amounts owed to other customers	242.0	242.0	173.9	173.9
Debt securities in issue	510.8	512.0	600.3	602.0
Derivative financial instruments	31.7	31.7	42.8	42.8
Subordinated liabilities	92.3	89.1	92.3	87.9
Subscribed capital	70.3	61.7	71.9	60.0
	6,877.7	6,852.6	6,821.7	6,808.0

Further details on the methods and assumptions which have been applied in determining fair value are set out in note 39 of the 2014 Annual Report and Accounts.

As at 30 June 2015, the gross amount of foreign currency swaps held was nil (30 June 2014: 20.0m Euro).

Notes to the accounts
for the period ended 30 June 2015

17. Financial instruments (continued)

b) Credit Risk

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

i) Loans and advances to customers

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

	Group		
	6 months to 30.06.15 £m (Unaudited)	6 months to 30.06.14 £m (Unaudited)	Year ended 31.12.14 £m (Audited)
In respect of loans and advances to customers:			
Fully secured by a first charge on residential property	5,456.5	5,090.7	5,213.7
Fully secured by a first charge on land	348.1	421.1	393.4
Secured by a second charge on residential property	533.9	567.0	543.3
	6,338.5	6,078.8	6,150.4
Provisions for impairment losses	(53.2)	(61.7)	(62.7)
Unamortised loan origination fees	13.7	16.4	15.2
Fair value adjustments	26.6	5.4	37.0
	6,325.6	6,038.9	6,139.9

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 30.06.15 £m (Unaudited)	6 months to 30.06.14 £m (Unaudited)	Year ended 31.12.14 £m (Audited)
Retail financial services	5,017.3	4,667.1	4,783.9
Commercial lending	759.1	812.1	790.6
Secured personal lending	522.6	554.3	528.4
Fair value adjustments	26.6	5.4	37.0
	6,325.6	6,038.9	6,139.9

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 2015, approximately 30.2% (31 December 2014: 30.7%) of first and second charge retail loans by account and 27.7% (31 December 2014: 28.5%) by value were concentrated in Wales.

The average index-linked loan to value (LTV) in respect of the Group's loans secured by first and second charge on residential property is 59.9% (31 December 2014: 59.4%).

The percentage of retail lending cases fully secured by a first charge currently with arrears greater than 2.5% of the total outstanding balance is 0.53% (31 December 2014: 0.74%) which compares favourably with the industry average of 1.03% (CML arrears and possession data as at March 2015).

Residential lending fully secured by a first charge which were 6 months or more in arrears had arrears balances of £0.6m (31 December 2014: £0.7m) with 139 (31 December 2014: 155) cases.

17. Financial instruments (continued)

b) Credit Risk (continued)

The percentage of secured personal loans currently in arrears by number is 7.25% (31 December 2014: 8.44%), which by value is 8.13% (31 December 2014: 10.14%).

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

ii) Commercial

Loans secured on commercial property are diversified by industry type with the largest exposure to one counterparty amounting to £30.0m (31 December 2014: £30.0m) or 3.8% (31 December 2014: 3.6%) of gross balances.

Asset quality remains strong with impaired balances of £56.8m (31 December 2014: £78.9m), or 7.2% of gross balances (31 December 2014: 9.6%). Specific provisions of £14.1m (31 December 2014: £19.5m) 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 Society's key counterparties regarding the potential levels of direct or indirect exposure to distressed Eurozone economies. This assessment concludes that no impairment provisions are required.

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

4 August 2015

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 2015 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 17. 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 2015 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
4 August 2015

Other information

The information for the period ended 30 June 2015 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 2014 has been extracted from the Annual Report and Accounts for that year. The annual accounts for the year ended 31 December 2014 have been filed with the Financial Conduct Authority (formerly the Financial Services Authority).

The auditor's report on the 2014 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.