Financial Data & Credit Ratings

About Newcastle Building Society

Newcastle Building Society is a top ten UK building society with assets of £4.5 billion. It is the largest mutual society to be based in the North East and has more branches in the region than any other building society.

Newcastle Intermediary Services was developed in 2008 to specifically provide a range of deposit products to the intermediary market. Since launch over 3,000 individual advisers from around 20 Networks or distributors have registered to use our services. In addition we have provided deposit account solutions to around half of all UK registered SIPP administrators.

Financial Strength

Newcastle Building Society is trading profitably and maintains a healthy capital position. Retail savings amount to 91% of its total mortgage balances, highlighting its relatively low exposure to the wholesale money markets. Newcastle has no exposure to the sub-prime and self-cert sectors, very low exposure to buy to let, and no longer undertakes new commercial lending. It operates with high levels of retail funding and benefits from a diversified income base, including through its Strategic Solutions division.

The Newcastle is committed to remaining an independent mutual building society, with no plans to merge.

Financial Overview at Half Year 2009

Highlights

- Profit of £0.7m before taxation
- Solvency ratio improved from 11.9% to 12.8% due to reduction in risk weighted assets.
- Tier one capital improved from 9.2% to 9.8%.
- Wholesale funding ratio has fallen from 27.9% to 17.4% reflecting reducing reliance on treasury markets.
- Retail funding of mortgage balances has improved from 86% to 91%.
- Residential lending portfolio continues to perform well with arrears at less than 1% which is below CML averages and a reduction for the last two consecutive months in May and June.

Despite the difficult market conditions which existed throughout the period, the Society has returned to profitability. Lending activity has been subdued in line with the objective that all new lending is funded by retail deposits; moreover by 30 June, 91% of all lending was funded in this way compared to 86% at the end of 2008.

Competition for savings has been intense resulting in pressure on the net interest margin. However, recent inflows have been particularly strong, especially through a market leading Five Year Fixed Rate ISA. Overall, the Society attracted nearly 20,000 new customers over the first six months of 2009 with the strong performance continuing into July.

As a result, the Society's use of wholesale funding has reduced from 27.9% at the end of 2008 to 17.4%.

The Society's capital ratios have also improved. Overall capital has risen to 12.8% from 11.9% and Tier 1 has increased to 9.8% from 9.2%. The liquidity ratio was 22.2% at the end of June, subsequently rising through the retail deposits mentioned earlier.

The Society's lending portfolio remains of high quality and is performing well. The last two months have also seen an improvement in residential arrears. At 30 June, less than 1% of residential owner occupied borrowers were in arrears of greater than three months, compared with the industry average of 2.39%. Only five owner occupied repossessions were instigated by the Society and there was a 7.5% decrease in the total number of properties in possession in the first half. Despite property price falls, the average loan to value across the Society's residential mortgage portfolio was just 53.6%.

The Society has no sub-prime or self-certification exposures and relatively low buy-to-let exposure. The vast majority of its lending is instead to traditional low risk residential borrowers and to housing associations, where there is a low risk of default compared to other types of lending. The commercial book performed well with no new problem cases emerging in the half year.

In its 2008 results the Society made prudent provisions against its exposure to the Icelandic banks. With the benefit of recent information, especially from the administrators of the UK subsidiaries, those provisions have been reassessed leading to a write back of £2.7m. The net impairment loss of £0.2m includes this write back offset by a prudent supplement to existing provisions to reflect losses which may have been incurred but have not yet emerged.

The Society's Strategic Solutions division, which provides financial outsourcing services based on its core competencies, is recovering well following a reduction in income due to the loss of a major contract. Three new contracts are expected to go live by the end of 2009. This follows the success of the online banking and telephone administration facilities for Icesave customers provided by the Society as part of the Financial Services Compensation Scheme (FSCS) automated payment process which came to an end in January 2009. The importance and value of the Society's role in providing this service was publicly acknowledged by the FSCS.

The Card Solutions offering from the Strategic Solutions division continues to perform well, with over 150 live schemes, in excess of 500,000 cards in circulation and 1 million transactions each month. The Society is the number one provider of MasterCard® prepaid cards in Europe.

Current Credit Ratings

Moody's – Latest Action 15 April 2009

Baa2 / P-2
Long term / Short term

The Society was downgraded in this action along with a number of other banks and building societies as part of a sector wide review by Moody's.

The Moody's analysis is based on very pessimistic house price scenarios. Its base case scenario is of a 40% reduction in house prices peak to trough and it appears to be stress testing a 60% reduction. According to Nationwide Building Society, peak to trough decline for house prices to the date of this action (from October 2007 to end of March 2009) was 18.9% and the rate of decline is falling. Moody's appears to think that house prices continue to have a long way to fall – an outlook with which many other commentators disagree.

Even with Moody's' very pessimistic house price scenarios, all rated building societies remain of investment grade [around a dozen are rated].

Fitch – Latest Action 24 June 2009

BBB- / F3
Long term / Short term

As part of its report on 24 June 2009 Fitch said:

"The agency acknowledges that ***the majority of commercial mortgages extended by NBS are to low risk housing associations.*** *Despite the current good performance of the society's other commercial investment mortgages which benefit from mainly good quality tenants, Fitch believes that the concentration in this book might amplify and accelerate any deterioration in asset quality. The society's ratings also take into account its* ***sound liquidity and funding position and diversified revenue sources.****" [emphasis added]*

Fitch's main concern with the Newcastle, and the reason for the last downgrading, centres around the Society's commercial loan book. Although Fitch confirms this book continues to perform well, it believes that a further significant fall in commercial property values could have a detrimental effect on the Society's profits.

Summary of ratings actions

These ratings are intended for use by wholesale investors, to which the Society has greatly reduced its reliance, and are what they think might happen in the future under a set of extreme circumstances. In any case the Society continues to be rated as investment grade. Retail investors should not be worried; no customer has lost a penny held with a building society since records began and deposits with the Society are as secure now as they have ever been. The FSA recently commented (in its Financial Risk Outlook) that building societies had been less weakened than large banks because they were less exposed to wholesale funding and other complex financial instruments.

Contacts

For further trading updates, latest financial results, press releases and products please visit our websites:

www.newcastle.co.uk
www.newcastleis.co.uk

If you have any queries on anything contained within this document please call your BDM.
If you do not know who your BDM is please call our Intermediary helpline on 0845 603 9299.
Lines open 9am – 5pm, Monday – Friday.