ANNUAL FINANCIAL REPORT

COVENTRY BUILDING SOCIETY

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Coventry Building Society reports a strong performance

Commenting on these results, Steve Hughes, Chief Executive Coventry Building Society, said:

"This was a really strong performance in unprecedented economic conditions. We have balanced the needs of savers and borrowers whilst ensuring the Society remained safe and secure. We protected all members by lending responsibly and managing growth carefully in volatile markets. Our financial performance enabled us to increase capital to support future investment, resilience and growth. We made great progress with our technology transformation, also completing our branch redesign programme. It was a strong and balanced performance in the interests of members and the long-term resilience and relevance of the Society."

Growing mortgages and savings

- **Mortgage balances grew by £1.4bn (3%) to £48.0bn.** We managed growth in a disciplined way during the year in a period which has seen significant market volatility.
- **Savings balances grew by £2.4bn (6%) to £42.3bn**. The Society delivered a very strong savings performance and once again paid higher savings rates than the market average, increasing this differential in 2022 to 0.62%, equivalent to an additional £230m in interest for our savers (2021: £201m).

Strong financial performance whilst investing in the future

- **Profit before tax of £371m** (2021: £233m). The rising interest rate environment supported an improved income performance with a net interest margin of 1.16% (2021: 0.90%) even after offering better rates to savers and protecting variable rate mortgage customers from the full increase in the Bank of England Rate.
- **The Society's Leverage Ratio increased to 5.2%** (2021: 4.8%). Stronger profitability has materially strengthened our capital position and resilience as we face into a weaker economic outlook. Although the Common Equity Tier 1 (CET 1) ratio remains well above statutory requirements at 27.4% there has been a reduction from 2021 (36.2%) due to changes in industry-wide regulation.
- **Very low and stable arrears balances of 0.17% of mortgages more than three months in arrears (2021: 0.17%).** The credit quality of our mortgage book remains very strong although we are mindful of the potential impact on unemployment and house prices from a weaker economy and are monitoring and supporting mortgage customers who may experience payment difficulties.
- **Our cost ratios remain strong and we are making significant investment in our future.** We made good progress upgrading core infrastructure and investing in digital services, telephony and branches, providing increased choice and services for members, customers, employees and intermediary partners.

Market leading service and making a difference to the lives of members, colleagues, and communities

- **Excellent customer service** with Experience Net Promoter Score of +75 during a period of exceptional demand from customers and brokers. The Society also continues to report one of the lowest complaint overturn rates by the Financial Ombudsman Service at 3%.
- **Increased community investment of £3.2m** helping to tackle cost of living issues whilst maintaining focus on three priorities of homelessness, financial education/ employability and reducing loneliness.

- **Recognised as a Great Place to Work.** Improved position in Great Place to Work survey as Colleague Trust Index increased to +77 from +73.

Unprecedented economic conditions

The events of 2022 have been well documented and were remarkable in the range and severity of their impact. A UK economy that had little time to recover from the challenges of the Covid-19 pandemic, was hit by supply issues affecting fuel, energy and food, as the consequences of the heartbreaking conflict in Ukraine spread across Europe and the world.

These events were amplified by political instability at home and unprecedented volatility in the financial markets which contributed to significant swings in the costs of borrowing.

The overall economic story was one of rising prices. The UK inflation rate hit its highest level for over 40 years with the Bank of England increasing the base rate eight times during the year, from a position of 0.25% on 1 January to 3.50% on 31 December, in response. The impact on people's day-to-day lives, has left many struggling to cope with the rapidly increasing prices of gas, electricity, fuel and food. The UK economy continues to face economic headwinds with the Bank of England and other commentators forecasting a long period of lower growth.

We've seen that the housing market is not immune to these challenges. Following a period of high demand that began in 2021 and was sustained by supportive government policies, ultra-low interest rates and changes in attitudes to home ownership, this year's economic and political instability, combined with the steep rise in borrowing costs, changed people's behaviours. There was a movement towards re-mortgaging rather than new purchases, and redemptions were higher than usual as many borrowers chose to exit their existing mortgages early and lock into longer-term fixed rates. From late summer, we saw the expected drop in house price inflation and activity levels as confidence fell amongst potential house buyers and sellers alike.

Whilst a rising interest rate environment is generally good news for savers, the cost of living crisis has made the need for value even more important. This has led to a significantly more active savings market as consumers become more alert to the rates on offer and this has benefitted the Society due to the consistent value we offer.

The benefits of mutuality have never been clearer. One of the strengths of our simple and straightforward business model is its resilience to external stresses, and this enables us to take a long-term view even when there are significant short-term challenges. The clarity of direction that comes from mutual ownership, without the need to satisfy shareholder demands, means we make decisions based on what is best for members. This includes ensuring our capital strength and investing for the future, as well as managing our day-to-day products and services.

But it is the day to day that matters most to our members. It is not for them to make the connection between mutual ownership and long-term stability and security. They tell us very clearly what they want - and that is great value, great service, and the support we can give them, their families and their communities through good times and bad. In such a volatile year, our ability to keep delivering these things is how we judge success.

Delivering value to members

We are a simple business, focused purely on savings and mortgages. Doing the right thing for members means balancing the needs of savers and borrowers who are affected by a rising interest rate environment in very different ways. Our aim to offer competitive products over the long term means that members trust us to get this balance right.

We maintained our track record of increasing our savings rates above the market, which meant we paid an additional £230 million of interest to our members than if we'd simply matched the average rates paid in the market (2021: £201 million).[1] This shows very clearly the difference in the way we approached the rising interest rate environment compared with many of our competitors.

The strength of this approach was seen throughout the year, combining leading offers in both ISA and non-ISA markets with consistent and quickly communicated movements as the base rate changed. We developed our loyalty proposition with a range of bonds, and this has proved extremely popular with eligible members, another reminder of the benefits that mutuality can provide and nearly 80,000 members benefited from this. It is not surprising that our product offering has been independently recognised, with Moneynet awarding us 'Best Building Society Saving Provider', Savings Champion naming us Best Building Society and Fairer Finance awarding us its Gold Ribbon for savings for the eighth year in a row.

Our strong response to the rising interest rate environment has driven an increase in savings balances of 6.0% or £2.4 billion (31 December 2021: £1.7 billion), with overall balances exceeding £40 billion for the first time. Our ability to compete, attract and retain savings balances remains a hugely important part of our business model but also our purpose in making people better off through life. This was very clear in the second half of the year when we experienced a significant increase in savings activity. The continued rise in interest rates and broader economic uncertainty meant that, when members needed to talk to us, these conversations were significantly longer and more complex than previously. It put our services under real challenge, and I'm very proud of the way colleagues responded and provided great outcomes even when it took us longer to answer the phone.

Our purpose drives our mortgage lending too. Ensuring the right outcomes for members, whether in terms of individual affordability or protecting people from the possibility of negative equity, are as important as ensuring competitive pricing. We also have a responsibility to ensure our mortgage lending is profitable and supports the Society's future stability and growth. This meant that we took a deliberately cautious approach to lending in the first half of the year. As the market position changed, and despite the incredible volatility following the mini-budget, we kept our pledge to intermediary partners and stayed open for business. We saw record activity levels in the second half of the year as a result, and I want to thank colleagues who put in fantastic efforts to make sure our borrowers were able to change mortgages and move house when they wanted to. I know their efforts were much appreciated by mortgage brokers and their clients, and they continue to deserve the independent recognition they receive from Which? and Fairer Finance and Your Mortgage which awarded us 'Best Building Society'.

Our pricing remained competitive, and we took purposeful decisions not to increase all variable mortgage rates as the Bank of England Base Rate moved. We also extended our participation in the mortgage market and, following a very successful pilot, now includes a new-build proposition in our range. This fits well with our broader sustainability ambitions, being supportive of the first-time buyer market and, through the improved energy efficiency of new builds, our Climate Action Plan as well. It is possible that the immediate cost of living crisis and general economic uncertainty have affected people's desire to invest in enhancing the energy efficiency of existing homes, and the performance of our Green Together Reward, which offers incentives to do so, seems to bear this out. Whilst I believe large-scale changes to people's behaviour requires greater leadership and education from Government as well as business, we will continue to explore ways of encouraging action in this area. We also recognise that our level of lending to first time buyers has fallen in 2022. This is partly driven by fewer first time buyers entering the market and we retain our long term commitment to supporting first time buyers.

Our mortgage growth of 3.0% or £1.4 billion (31 December 2021: 7.2%, £3.1 billion) compares with the overall UK market growth of 4.1%[2]. At just 0.17%[3] (2021: 0.17%) we continue to record very low levels of arrears, but do expect more borrowers will require our support in 2023.

Delivering on our service promise

I said earlier that our members expect a good service, and this is a consistently strong part of who we are and what we do. In many ways, we maintained this through 2022, but it was noticeable as the interest rate environment changed, and under pressure of the cost of living crisis, our members contacted us in greater numbers than ever before and needed more time to deal with the complexity of decisions they were facing.

Offering great products was also a factor in the number of calls being taken, but the result was that our service came under pressure, with some of our members having to wait longer than usual to speak to us. What didn't change was the brilliant support they received from our branch and contact centre teams when they did talk to us and our Net Promoter Score[4] (NPS) - the primary way we judge overall satisfaction with our service - remained outstanding at +75 (2021: +76) for the Society as a whole.

We set a very high bar when it comes to customer service, and I want to thank our members for their patience as well as my colleagues for their fantastic efforts during these tough times. I also want to reassure members and colleagues alike that we are recruiting and training new colleagues and will provide the resources needed to deliver the brilliant service they expect.

One thing that will help with this is the ongoing digitisation of our mortgage and savings services, and we continue to make good progress with this work. We rolled out digital product switching capability across our intermediary network, with more than 80,000 switches undertaken by the end of the year. We launched SMS authentication and are in the final stages of developing our mobile savings app. With self-service options also enhancing our savings maturity process, we are beginning to see the benefits of this investment in terms of the efficiency and scalability which are fundamental to our future growth plans.

Making progress on our digital plans is hugely important to us and to our members. But so is the human touch, and in 2022 we completed the multi-million pound transformation of our branch network by opening our flagship branch in the heart of Coventry city centre. All our branches have now been transformed into warm and welcoming hubs at the heart of their local communities, and we have received great feedback from the members who use them as well as the colleagues who work in them. It underlines our commitment to the high street for many years to come. What people might not see is the integration of our customer-facing channels by which colleagues in the branch network are increasingly able to provide telephony and digital support - a flexible and joined-up approach to providing the best possible service to members however they contact us.

The investment we're making in frontline services is matched, and at times enabled, by the technology transformation that is happening behind the scenes, and here too we are making great progress. These programmes are focused on improving the Society's operational resilience, information security and the transformation of our financial planning, controls and reporting as well as providing the building blocks of new services. During the year, we achieved significant milestones in moving core applications and systems into new more secure data centres, as well as building the underlying components of new digital services. The transformation to new technologies is ongoing and on track, and I expect the benefits to be even more obvious during 2023.

We are making significant investments in our future. Our capital and revenue investment expenditure of £94 million in technology and change programmes shows the importance we attach to this work. Our cost to income ratio has improved to 43% as a result of our strong income performance. However, our cost to mean asset ratio and total management expenses increased to 0.52%[5] (2021: 0.50%) and £295 million (2021: £264 million) respectively.

Investing in our services is hugely important to us. The impending Consumer Duty regulations also lay out the expectations on us to deliver the right customer outcomes. Our purpose and culture are aligned to meet this expectation as we have shown this year, whether by making our branches more accessible, supporting vulnerable customers, delivering value to savers, or proactively contacting borrowers who may be struggling in a rising interest rate environment. Enabling the convenience, accessibility and ease of our digital services will go hand in hand with the warmth of our human touch.

Supporting our communities

I said earlier that members are clear about what they want from us, and I have talked about what we delivered in terms of value and service during 2022. They also want us to support the communities they live in and conduct our business in a way that contributes positively to some of the larger issues facing society, such as financial education, food poverty, climate change and equal opportunities.

Despite the external challenges, I remain absolutely committed to the Society's sustainability agenda, and recommend taking the time to read our annual Sustainability Report which provides more detail on our Environmental, Social and Governance progress and plans.

We have worked hard over the last two years to embed a new community strategy that focuses on issues affecting people in Coventry, the surrounding area and the communities our branches serve. During this time, we have built brilliant partnerships in the public, private and third sectors to deliver against three objectives where we believe we can add resources, knowledge and opportunities: Better Foundations, which targets housing issues; Better Futures, which deals with aspiration, employability and career development; and Better Connections, which supports the isolated and vulnerable members of our community.

I am very proud that, as the cost of living crisis hit harder in the latter half of the year, we were able to use these partnerships to donate £1 million, in addition to our normal support, directly to Coventry schools and local charities helping those most at risk, as well as a contribution to every one of our branches across the UK to support food banks in their communities.

2022 also brought to an end our long-standing and very successful partnership with The Royal British Legion. We have worked together for nearly 15 years, and during that time, the Society has donated over £20 million to fund the Legion's work. The new community strategy is the reason for the change. We'll announce our new corporate partner very soon and are very excited about the opportunities this partnership will bring in tackling one of our priority issues, nationally and at a local level.

We also continue to make good progress in pursuit of our climate change objectives. We received overwhelming support at our 2022 Annual General Meeting for our Climate Action Plan and have backed that up with a transformation plan to achieve our Net Zero ambition by 2040. This forms part of The Climate Pledge, which we signed early in 2022 and which commits us to report our progress accurately and transparently. I believe our actions in joining the Science-Based Targets initiative shows that we are serious about our climate change ambitions.

Engaging colleagues

The role played by my colleagues across the Society cannot be overstated. In a very challenging year, they continued to do everything possible to meet member expectations and deliver a great service. In turn, we have worked hard to recognise and reward their contribution and give them the support they and their families need.

At a time of great change and uncertainty, when the headlines have been full of discord and instability, it would have been understandable for engagement and motivation to falter. Instead, our second year participating in the Great Place to Work survey showed an increase in overall engagement and a rise in 72 of the 78 measures the survey covered. I am very proud of this result which positions the Society as one of the best organisations of its size and shows the commitment we make on an organisational and individual level to do the right things for our people.

A key aim is to recruit and develop talent that shares our values, and I am really encouraged by the personal and career development we're achieving at the Society. In 2022, over 45% of vacancies were filled by internal candidates, something that I believe is motivational for the individual but also great for the Society's culture and future success.

As part of this, we want to build a colleague base that reflects the diversity of our city and the communities we serve. We have been recognised by Great Place to Work as being one of the best places to work for women, ranking 14th amongst the top 39 super large companies in this regard. Our aim is 50:50 representation on our Board and 40% female representation in our management roles by 2025. We had more women than men on our management development programmes this year and as well as on our apprentice and graduate cohorts too. We continue to develop our working environment to provide whatever support is needed.

We have a similar ambition for 25% of our manager roles to be held by colleagues with an ethnic minority background by 2025. Progress on this is slower than I would wish despite a lot of initiatives and a lot of support across the business. As I have said before, we will make a difference and I am hopeful that initiatives that include a tailored talent programme, mentoring and reverse mentoring and diversity and inclusion programmes for recruiting managers will start to deliver real change.

Colleague wellbeing is something we are passionate about. We measure it every quarter and have been able to track the impact of the cost of living crisis on colleagues' mental and financial wellbeing. We anticipated some of the impact in our 2022 pay award but took the additional step of a £1,000 cost of living allowance for all colleague's that were basic rate taxpayers. This payment was made in a series of instalments from September 2022 through to February 2023 and was massively appreciated. But whether it is being proactive in the face of clear evidence of need or anticipating and surprising colleagues with our range of wellbeing initiatives, the result is clear in the brilliant engagement we have. I have said before that our people are our greatest asset and we will continue to recognise and appreciate them for all that they do.

A strong and balanced performance

I wrote this thinking about what matters most to our members. They expect great value and service, and they expect us to do the right things for the wider community we serve. In times of uncertainty and volatility, they also expect us to keep their money safe and secure, and ensure the Society's financial strength and stability.

In 2022, we delivered a strong and balanced performance across all these objectives. Our profit before tax of £371 million was higher than in 2021 (£233 million). This has been supported by the increases in the Bank of England Base Rate which has improved our margin and income performance notwithstanding the strong value provided to members. More importantly, we took prudent decisions to deliver the capital strength that will be needed to support future growth and investment, particularly in view of a less certain economic outlook.

It is a very positive thing for the Society and its members that we continue to maintain a strong capital position. Our leverage ratio increased to 5.2% (2021: 4.8%) and our Liquidity Coverage Ratio was 195% (2021: 187%). Our Common Equity Tier 1 ratio at 27.4% (2021: 36.2%), is well above regulatory requirements and the 2022 reduction reflects a change in industry wide regulation. This clearly demonstrates our financial strength and shows that we provide a safe home for savers and borrowers alike.

Looking to the future with confidence

There seems little doubt that 2023 will see further economic challenges. We can hope that inflation has peaked and we see greater market stability, but the impact on our members and colleagues of a 'new normal' in the cost of living will continue with rising mortgage rates for existing members and mortgage demand likely to remain subdued.

Having said that, the Society is well positioned. In 2022, we took prompt decisions to communicate and reassure our savers and continued to pay the best rates we could afford. We protected borrowers from the extremes of the rising interest rate environment, supported them through the flexibility of our product design and kept the confidence of mortgage intermediaries by maintaining our commitments to them despite the fast-moving market. We grew, but grew appropriately, with the right focus on margin, capital strength and economic outlook that balanced the needs of all our stakeholders.

Just as importantly our investment in technology and the transformation of our business is realising the benefits we aimed for. In 2023 we expect to complete further steps towards the digitisation of our savings and mortgage services, which will deliver operational efficiencies, greater capacity and improvements in the ease and convenience our members expect. We will continue to expand our participation in the mortgage market, and support more people in buying their homes. Saving members can expect a consistently great service, supported by new digital capabilities. And our resilience will continue to be strengthened by our ongoing investment in our technological foundations.

Our performance makes me confident that we can continue to protect our members and invest for the future despite the challenges of economic and competitive headwinds.

I will finish by thanking our members, customers and partners for their continued support and loyalty, and my colleagues across the Society for their passion, professionalism and commitment.

1. Based on the Society's average month end savings rate compared to the CACI Ltd's Current Account and Savings Database rest of market average rate for savings accounts, excluding current accounts and offset savings, for the 12 months of the year (2021: first 11 months of the year).
2. Source: Bank of England.
3. Percentage of mortgages with more than three months of arrears.
4. Net Promoter Score (NPS) is a measure of customer advocacy that ranges between -100 and +100, which represents how likely a customer is to recommend our products and services.
5. Administrative expenses, depreciation and amortisation/Average total assets.

Income Statement

Overview

In 2022, the Society improved its financial performance after the challenges in 2021 due to the Covid-19 pandemic and despite the market volatility observed in the year. The following factors impacted the 2022 financial results:

- Net interest income increased by £181 million, driven by the rising base rate environment with mortgage interest receivable rising more quickly than interest payable on retail deposits. The increase was also impacted by the £69 million charge recognised in the prior year due to changes made to the estimations within our Effective Interest Rate (EIR) calculation (2022: £17 million).
- Gains on derivatives and hedge accounting of £27 million (2021: £7 million loss) as a result of market volatility and changes in customer behaviour.
- We have increased our provisions for future expected credit losses (ECLs) in light of the continued uncertainty surrounding the economic outlook. As a result, £17 million of ECL provisions were charged during the year, compared to a release of £29 million in 2021.

As a result, profit before tax for the year increased to £371 million (2021: £233 million).

	2022	**2021**
	£m	**£m**
Interest receivable	**1,421.1**	833.9
Interest payable	**(763.8)**	(357.7)
Net interest income	**657.3**	476.2
Other income	**(1.6)**	(1.4)
Gain/ (loss) on derivative financial instruments	**26.8**	(6.6)
Total income	**682.5**	468.2
Management expenses	**(294.8)**	(263.5)
Impairment (charge)/release	**(16.6)**	28.7
Charitable donation to Poppy Appeal	**(0.6)**	(0.6)

Profit before tax	**370.5**	232.8
Tax	**(84.3)**	(42.0)
Profit after tax	**286.2**	190.8

Net interest income

Net interest income increased to £657 million (2021: £476 million).

The Bank of England Base Rate increased eight times during the year, increasing from 0.25% at 31 December 2021 to 3.50% at 31 December 2022.

Interest receivable on mortgages increased by £468 million, predominantly as a result of the impact of base rate increases on our mortgage book and growth in balances. The Society consciously improved the competitiveness of the standard variable rate (SVR) product to protect these customers from the impact of rising rates. In addition, we benefitted from a £119 million increase related to interest receivable on higher liquidity balances and rates.

Interest payable on retail savings increased by £286 million following the eight base rate increases during 2022. For each base rate change we have passed through on average 54% to our savings members. Throughout 2022, the Society continued to pay above average savings rates, returning £230 million (2021: £201 million) in member value compared to market average rates[1], whilst continuing to invest in the Society and maintain its long-term resilience.

The remaining £120 million movement related to higher interest payable on our wholesale funding.

Net interest income included a charge of £17m (2021: £69 million) relating to a change to the future assumptions on mortgage redemption behaviour as customers spend less time on SVR.

Net interest margin

At 1.16%, our net interest margin improved significantly from the 0.90% reported in 2021 (1.03% excluding the impact of the prior year EIR adjustment), as a result of the movements in net interest income outlined above relative to our average total assets.

	2022	2021
	£m	£m
Net interest income	**657**	476
Average total assets	**56,698**	53,014
	%	%
Net interest margin	**1.16**	0.90

Derivatives and hedge accounting

The Society uses derivative financial instruments (swaps) solely for risk management purposes to manage interest rate and currency risk arising from its fixed mortgage and savings activity and from non-sterling and fixed rate wholesale funding.

The Society applies hedge accounting where possible and its approach continued to be effective overall throughout the period. The gain of £27 million for the year represents hedge ineffectiveness and fair value movements on derivatives where hedge accounting was not obtained (2021: £7 million loss), and includes net gains from ineffectiveness arising from higher volumes of early redemptions following changes in customer behaviour on both mortgages and savings.

Management expenses

Overall management expenses increased by £31 million. The increase in costs was primarily driven by an increase of £10 million in spending related to the Society's strategic investment programme, salary and cost inflation across all of our operations, accelerated depreciation as we consolidate our head office footprint and the impact of higher variable pay in recognition of the strong performance against our targets. We also finalised the refurbishment of our branches and increased our contribution to community and charitable activities.

Ensuring that we spend our members' money wisely and maintain our cost efficiency advantage is a key part of the Society's strategy. The cost to mean total assets ratio of 0.52%[2] (2021: 0.50%) is expected to remain among the lowest in the UK building society sector. The cost to income ratio improved to 43%[3] (2021: 56%).

Expected credit losses

The performance of our mortgage book has remained strong following the overall economic outlook in the first half of 2022 being better than expected in certain key metrics with the growth in house prices and observed lower unemployment levels. However, in the second half of the year, the economic outlook worsened with the highest inflation levels in over 40 years and base rate now at the highest level in over a decade.

The Society has updated its economic scenarios to account for a period of heightened inflation and the subsequent impact to the economy, including HPI reductions and, in turn, Expected Credit Losses (ECLs).

In addition, we have introduced a new post model adjustment (PMA) to reflect the potential risk associated from the increase in the cost of living and higher mortgage payments for borrowers.

We have taken a deliberately cautious approach to estimating ECLs, given the structural challenges facing our members from the cost of living crisis, which has resulted in an increase to our provision for ECLs, and a charge of £17 million (2021: release of £29 million) being recognised.

At the year end, total provisions were £36 million (2021: £19 million), of which £19 million (2021: £9 million) related to PMAs, where the risks were not assessed as adequately captured in the Society's core modelling.

The post model adjustments cover the following risk areas:

- Risk relating to the impact of the cost of living on our members where we have identified behavioural characteristics which may lead to future difficulties (£14 million).
- The potential for losses as a result of cladding remediation on flats where fire safety standards have not been met.
- A more granular assessment of house price information which provides a more accurate view of indexed loan to values (LTVs) and risks associated with pockets of negative equity.
- Risks which cannot easily be modelled such as for fraud within the portfolio.
- We have taken the opportunity to remove the Covid-19 payment holiday adjustment following the end of the cure period for impacted customers.

The remaining £16 million (2021: £10 million) of ECL provision relates to the modelled losses, including the impact of alternative economic scenarios. The alternative scenarios reflect a range of possible outcomes as the economy recovers from the pandemic but moves into a further period of uncertainty related to the cost of living crisis and inflationary pressures.

IFRS 9 requires loans to be assessed as 'stage 2' where there has been a significant increase in credit risk. Loans are held in stage 2 until such a time when they are considered to have 'cured' by performing for a sustained period of time, typically 12 months from the stage 2 trigger event. In 2022, stage 2 accounts increased to 9% (2021: 7%) principally due to the cost of living PMA put in place. 90% of the book remains in stage 1 (2021: 93%).

As a result of these changes, the ECL provision now equates to 0.07% of the overall mortgage book (2021: 0.04%).

Charitable donation to the Poppy Appeal

The Society brought to an end its very successful long-standing support for the Royal British Legion's Poppy Appeal with £0.6 million donated during the year (2021: £0.6 million), bringing the total donated over the Society's relationship with the Legion to £20 million.

Taxation

In 2022, the corporation tax charge was £84 million (2021: £42 million), reflecting an effective tax rate of 22.8% (2021: 18.0%). In 2021, it was announced, that from 2023, the corporation tax rate is set to increase from 19% to 25% and the banking surcharge is set to decrease from 8% to 3%. Both rates were substantially enacted during 2022, and so are reflected in the deferred tax liabilities at the balance sheet date.

Balance Sheet

Overview

Mortgage balances grew by £1.4 billion and liquidity increased by £2.4 billion. Retail savings balances grew by £2.4 billion and wholesale funding increased by £1.3 billion.

Mortgage growth was funded by retail savings.

A summarised Balance Sheet is set out below:

	2022	2021
	£m	£m
Assets		
Loans and advances to customers	**48,014.3**	46,620.6
Liquidity	**10,009.8**	7,622.0
Other	**843.0**	287.1
Total assets	**58,867.1**	54,529.7

Liabilities		
Retail savings	**42,288.7**	39,890.2
Wholesale funding	**13,207.2**	11,907.3
Subordinated liabilities and subscribed capital	**57.0**	56.9
Other	**366.5**	215.7
Total liabilities	**55,919.4**	52,070.1

Equity		
General reserve	**2,250.7**	2,012.6
Other equity instruments	**415.0**	415.0
Other	**282.0**	32.0
Total equity	**2,947.7**	2,459.6
Total liabilities and equity	**58,867.1**	54,529.7

Loans and advances to customers

Our lending strategy remains focused on high quality, low loan to value mortgages within the prime residential market. These loans are primarily distributed through third-party intermediaries, giving the Society a regionally diverse mortgage portfolio in a cost-effective way.

In 2022, we advanced £8.7 billion of mortgages (2021: £9.6 billion) and mortgage balances grew by £1.4 billion (2021: £3.1 billion). The year on year growth in mortgages of 3.0% compares with the UK mortgage market growth of 4.1%[4] and our market share remained at 3% (2021: 3%).

The Society manages its growth according to economic conditions, market pricing and funding conditions. As a result, with mortgage margin pressure within the market in the first six months of the year, this led to the overall book remaining stable at 30 June 2022. With changing conditions in mortgage pricing following further base rate increases in the second half of the year, the Society has taken the opportunity to grow its book by 3.0% to over £48 billion at 31 December 2022.

This growth was offset by higher levels of redemptions as customers looked for rate certainty and continued to lock into longer-term fixed products in response to base rate rises.

New lending on owner-occupier homes accounted for 67% of total new lending in 2022 (2021: 65%) at an average LTV of 65.3% (2021: 65.7%). The Society continues to support first time buyers; however, with current market conditions impacting this segment of the market, the number of loans advanced in 2022 reduced to 5,400 (2021: 7,100).

Total mortgage assets at 31 December 2022 stood at £48.0 billion (2021: £46.6 billion) which comprised £28.5 billion of owner-occupier loans (2021: £27.4 billion) and £19.5 billion buy to let loans (2021: £19.2 billion). The balance weighted indexed LTV of the mortgage book at 31 December 2022 remained broadly stable at 51.0%[5] (2021: 50.9%) when compared to the prior year.

Possessions and forbearance remained low, with 27 cases in possession at the year end (2021: 27), with forbearance levels having decreased by 23.5% year on year in value terms and 12.9% in number of cases. With the impact of the cost of living crisis expected to materialise more fully in 2023, the Society continues to focus on supporting its members. Despite the current economic conditions, the Society continues to have very low arrears, with only 0.17% of mortgages more than three months in arrears (2021: 0.17%) at 31 December 2022 compared with the latest available industry average of 0.71%[6].

Liquidity

Liquid assets increased to £10.0 billion (2021: £7.6 billion) as we maintained a prudent liquidity buffer, demonstrated by our Liquidity Coverage Ratio (LCR) remaining strong at 195% (2021: 187%), significantly above the minimum regulatory requirement.

Liquid assets are principally held in deposits at the Bank of England and in UK Government investment securities. This means that asset quality remains very high, with 93% of the portfolio rated Aaa-Aa3 (2021: 98%). 98% of liquid assets are held in UK sovereign or UK financial institutions (2021: 99%).

Included in liquid assets are £1.6 billion of assets held at fair value through other comprehensive income (FVOCI). As at 31 December 2022, the balance on the FVOCI reserve was a £5 million gain, net of tax (2021: £5 million gain, net of tax).

Retail funding

Retail savings increased in the year by £2.4 billion to £42.3 billion (2021: £39.9 billion), representing growth of 6.0%, compared with market growth of 4.1%. The Society's overall savings market share is 2.4%4 (2021: 2.4%).

The Society continued to support the cash ISA market, increasing our market share to 6.7%4 (2021: 6.5%).

Our increase in market share reflects a more active savings market in 2022 and our competitive product offers, particularly towards the end of the year.

Our mortgage book continues to be predominantly funded by retail savings, with 88% of mortgage loans funded in this way (2021: 86%).

Wholesale funding

We use wholesale funding to diversify our sources of funding, enabling growth and lowering risk, which then benefits savings members through better savings rates and mortgage customers through enabling us to offer more competitive long-term rates.

Wholesale funding increased by £1.3 billion in the year to £13.2 billion (2021: £11.9 billion) driven by higher swap valuations and the associated change in collateral impacting our short term funding position.

There was one wholesale issuance during the year, with a €0.5 billion covered bond which was issued in September 2022. There was £5.25 billion of Central Bank Term Funding (TFSME) outstanding as at 31 December 2022 (2021: £5.25 billion).

Equity

The Society's equity is predominantly made up of 138 years of retained profits in the general reserve and Additional Tier 1 (AT 1) capital. The Society made post-tax profits of £286 million in the year and total equity increased £0.5 billion to £2.9 billion, including a £29 million distribution to AT 1 capital holders and £250 million movement in the cash flow hedge reserve.

Pension fund

The pension scheme assets and liabilities are recorded in the Society's financial statements and the overall position was a surplus of £3 million at the end of 2022 (2021: £29 million). These assets and liabilities are impacted by market movements, and the decrease in the year was driven by the movement in the UK corporate bond market and the updated valuation of the pension scheme assets. The Society continues to monitor the pension scheme to ensure that there is no scheme deficit over the medium term.

Regulatory capital

We hold capital to protect members against unexpected future losses. As we grow our mortgage book, the amount of capital we need to hold to meet the UK Capital Requirements Directive (CRD) V increases.

The Society's CRD V capital position7 as at 31 December 2022 is summarised below. During the year, the capital resources increased to £2,584 million, primarily through the increase in Common Equity Tier 1 (CET 1) driven by profit after tax of £286 million.

We are not currently bound by regulatory leverage ratios, which measure Tier 1 capital against total exposures, including off-balance sheet items. The PRA confirmed in policy statement PS21/21 that the UK leverage ratio framework only applies to banks and building societies with either retail deposits of £50 billion or more, or non-UK assets equal to or greater than £10 billion; neither of these measures currently applies to the Society. The UK leverage ratio increased slightly to 5.2% (2021: 4.8%) driven by the increase in capital resources in the year. The Society expects leverage will be its binding constraint in the future.

The increase in risk weighted assets (RWAs) in 2022 was due to an update in the IRB modelling approach due to regulatory changes. This increase in RWAs was partially offset by increases in capital resources. The Society's CET 1 and Total Capital ratios consequently reduced to 27.4% (2021: 36.2%) and 32.7% (2021: 44.1%) respectively.

The Society continues to work towards meeting regulatory changes for IRB models that were brought in at the beginning of 2022 and is in the final stages of development work required to address the updated requirements.

Until the updated models are fully approved, and in common with many other IRB institutions, the Society has agreed to hold additional risk weighted assets (RWAs) that represent its best view of the change in capital requirements that will result from the new models once they are implemented. This has contributed to the increase in RWA and hence, the lower CET 1 ratio in 2022.

The final model output may vary from this initial assessment, which may further lower the CET 1 ratio, effectively bringing forward changes of increasing RWAs envisaged in Basel 3.1. The Society expects that from 2025, Basel 3.1 changes to capital requirements will be phased in and, as transition develops, this will reduce the Society's reported CET 1 ratio. Applying the Basel 3.1 RWA floors to the year end figures on a full transition basis would result in a CET 1 ratio of approximately 20%.

The Society's Total Capital Requirement (TCR) at December 2022 was £846 million, equating to 10.7% of RWAs (2021: £565 million; 10.7%). We exceed this requirement using CET 1 capital alone.

	End-point 31 Dec 2022 £m	End-point 31 Dec 2021 £m
Capital resources:		
Common Equity Tier 1 (CET 1) capital	**2,169.0**	1,921.8
Total Tier 1 capital	**2,584.0**	2,336.8
Total capital	**2,584.0**	2,336.8
Risk weighted assets	**7,911.7**	5,303.6
Capital and leverage ratios:	**%**	%
Common Equity Tier 1 (CET 1) ratio	**27.4**	36.2
Leverage ratio including central bank reserves and full AT1 capital amount	**4.5**	4.3
UK leverage ratio[7]	**5.2**	4.8

1. Based on the Society's average month end savings rate compared to the CACI Ltd's Current Account and Savings Database rest of market average rate for savings accounts, excluding current accounts and offset savings, for the 12 months of the year (2021: first 11 months of the year).
2. Administrative expenses, depreciation and amortisation/Average total assets.

3. Administrative expenses, depreciation, and amortisation/Total income.
4. Source: Bank of England.
5. LTV is calculated using the Nationwide Building Society quarterly regional house price index (HPI).
6. Source: UK Finance
7. The UK leverage ratio includes a restriction on the amount of Additional Tier 1 capital and excludes central bank reserves from the calculation of leverage exposures.

END

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