COVENTRY Building Society

2017 Year End Results Investor Presentation

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COVENTRY Building Society

1. Overview
2. Financial Performance
3. Asset Quality
4. Capital
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Overview

Overview

Simple business model

- Providing simple, transparent retail savings products which offer long term value.
- Helping customers buy residential properties through low risk mortgage lending primarily through intermediaries.
- Delivering sustainable growth without taking on higher levels of risk to protect existing members during periods of economic stress, and to safeguard the Society's future.
- Ensuring operations are cost efficient, allowing the society to pay above market interest rates to savers, whilst investing in the future and maintaining capital strength.
- Underpinned by our CARES values which shapes decision making and focuses on putting members first.

Financial Strength

Strong CET1 ratio highest reported by any top 20 lender.[1]	**34.9%**
Management expense ratio lowest reported by any top 10 UK building society.	**0.42%**
Leverage ratio exceeds regulatory requirements.[3]	**4.6%**

	Long term	Short term	Last credit opinion
Moody's	**A2**	**P-1**	August 2017
Fitch[2]	**A**	**F1**	May 2017

Member Focus

- Mortgage and savings rates remain competitive with pricing supported by low levels of operating costs, impairments and conduct provisions.
- The Society paid an average 1.49% interest on savings in 2017, compared to the market average 0.63%.[4]
- Awarded Fairer Finance Clear and Simple Mark for our General Terms for savers.

Low Risk

- Low LTV lending and third party distribution provides resilience to the business model if the market deteriorates.
- Strong margin management capability, with the capacity to increase margin if needed.
- 38% of mortgages and 66% of savings on administered rates at 31 December 2017.

- 1. Source: CML Top 20 mortgage lenders (as published August 2016) - latest published CET 1 data As at 23/02/2018 2.Fitch rating unchanged for 20 years 3.Under the BoE modified calculation excluding Central bank exposure less than 3 months 4. The Society's average month end savings rate (society mix of products) compared to BoE WA rate for household interest bearing deposit (market mix of products)

Financial Performance

Highlights from 2017

Financial performance

COVENTRY Building Society

Growth	**Mortgage assets and Savings balances both increased by £3bn. Mortgage balance growth 9.3%, Savings growth of 10.6% both significantly above market growth.**
Cost	**Continued focus on cost control with the costs to mean assets ratio at 0.42%, the lowest reported by any UK building society. [1]**
Impairments	**Minimal impairment charge of £0.2m, strong asset performance continues.**
Capital	**Financially safe and strong institution with a CET1 ratio, the highest reported by top 20 lender[1] at 34.9% and a leverage ratio of 4.6%[2] , reflecting the low credit risk business model.**
NIM	**Net interest margin at 102bps, in line with expectations, as the Society continues to reward members with competitive products.**
Profit	**Profit before tax of £242.7m - 2% increase on 2016.**

1. Source: CML Top 20 mortgage lenders (as published August 2016) - latest published CET 1 data As at 23/02/2018 2.Under the BoE modified calculation excluding Central bank exposure less than 3 months

Financial performance

COVENTRY Building Society

Income statement

£m	2017	2016
Interest receivable and similar income	**895.1**	**907.3**
Interest payable and similar charges	**(484.1)**	**(522.3)**
Net interest income	**411.0**	**385.0**
Other income	**5.1**	**10.5**
Net gains/losses from derivatives	**(0.3)**	**(1.0)**
Total income	**415.8**	**394.5**
Management expenses	**(167.9)**	**(149.5)**
Impairment charges/credit	**(0.2)**	**1.5**
Financial Services Compensation Scheme	**(2.5)**	**(4.3)**
Provisions for liabilities and charges	**(1.0)**	**(1.8)**
Charitable donation (Poppy Appeal)	**(1.5)**	**(1.3)**
Profit before tax	**242.7**	**239.1**
Taxation	**(57.9)**	**(56.7)**
Profit for the period	**184.8**	**182.4**

Net interest income rose 7%
Profit before tax increased 2%

Balance sheet

£bn	2017	2016
Liquidity	**6.2**	**4.8**
Loans and advances to customers	**35.9**	**32.9**
Derivative financial instruments	**0.3**	**0.4**
Intangible and tangible assets	**0.1**	**0.1**
Other assets	**0.1**	**0.1**
Total assets	**42.6**	**38.3**
Shares	**31.0**	**28.1**
Wholesale	**9.1**	**7.7**
Derivative financial instruments	**0.2**	**0.4**
Other liabilities	**0.3**	**0.3**
Subordinated liabilities	**0.0**	**0.0**
PIBS	**0.0**	**0.0**
Members' interests and equity	**2.0**	**1.8**
Total liabilities & equity	**42.6**	**38.3**

Balance sheet growth of 11%

Financial performance

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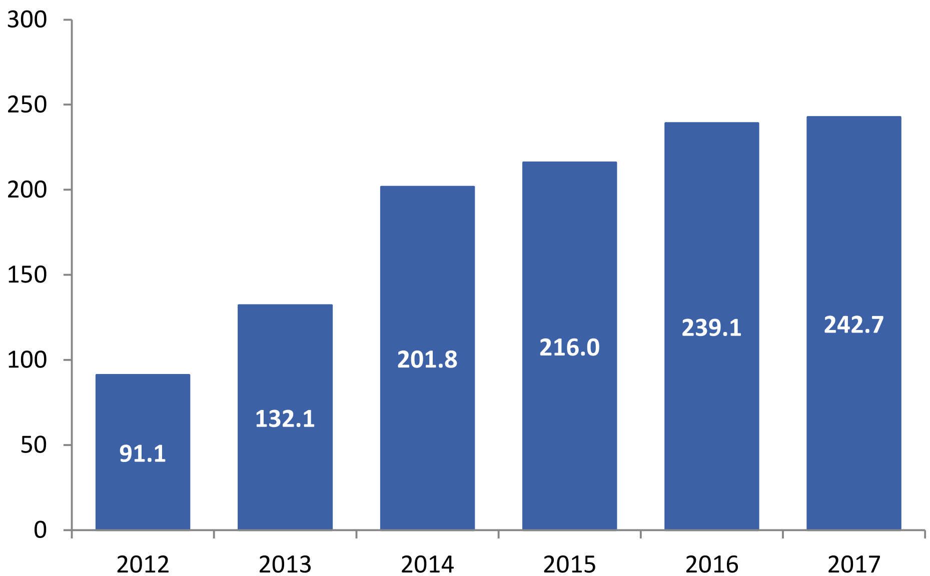
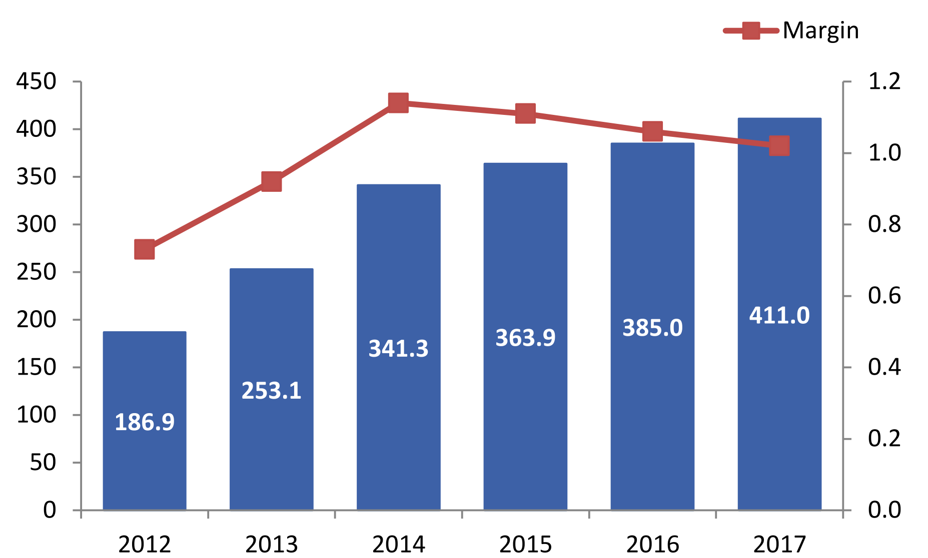
Net Interest Income 2017: £411m (£385m 2016)

- As a mutual, we seek to optimise profits rather than maximise them, retaining only what we need to meet capital and regulatory requirements and invest in the future in order to grow the business.
- In recent years net interest margin has benefited from the positive influence of government funding schemes for retail and wholesale funding pricing. It remains elevated from the low 70bps area seen in the early post crisis years due to retail savings rates continuing to fall. Mortgage margins have tightened, but spreads remain attractive and even if margins reduce modestly, growth means the Society still benefits from economies of scale.
- Term Funding Scheme (TFS) introduction has continued to support this trend.
- PBT has risen in 2017 to £242.7m (£239.1m 2016) an increase of 2% to maintain our leverage ratio.

Profit before tax



Net interest income (£m) / Margin %



Financial performance

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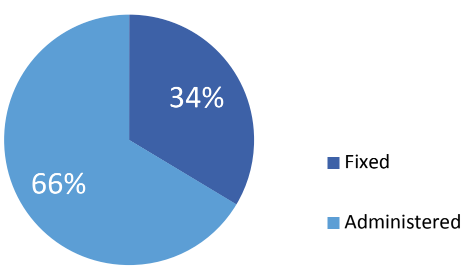
Large Proportion of Administered Rates

- Whilst margins have benefitted from the effects of government funding on retail pricing, the proportion of administered products allows commercial scope to manage margin if required.
- The Society paid an average 1.49% interest on savings in 2017, compared to the market average 0.63%.[1]
- Coventry's Flexx for Term mortgage offering, attracts borrowers to administered rate products.
- The Society passed on 25bps on to variable savings and administered mortgages after the November 2017 Base Rate rise.

Retail Funding led Lending Strategy

- Consistent growth in mortgage balances growing by over 9% in 2017.
- Mortgage assets continue to be of very high quality with the balance weighted average indexed LTV of the mortgage book at just 53.9% as at 31 December 2017.
- Competition continues to return to the mortgage market and we have seen a focus from other lenders on higher LTV lending and first time buyers. However our resilient business model, focused on low risk, low LTV lending, has remained.
- Retail savings growth of 10.6% versus market growth of 2.7%.[2]
- Over 91% of mortgages are funded by retail savings or capital.

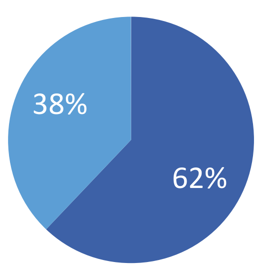
Savings

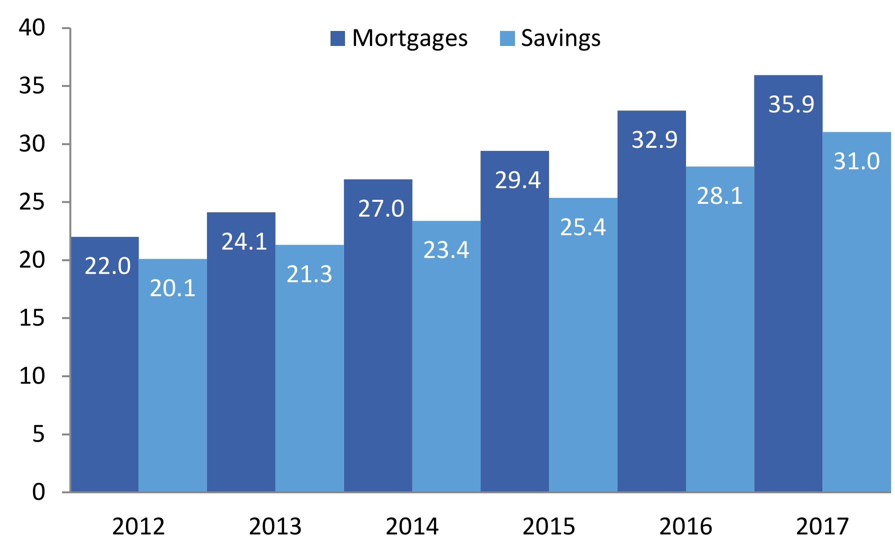


9.3%
Mortgage balance growth
11.8% (2016)

10.6%
Savings balance growth
10.6% (2016)

Mortgages





1. The Society's average month end savings rate (society mix of products) compared to BoE WA rate for household interest bearing deposit (market mix of products) 2.Source: Bank of England

Financial performance

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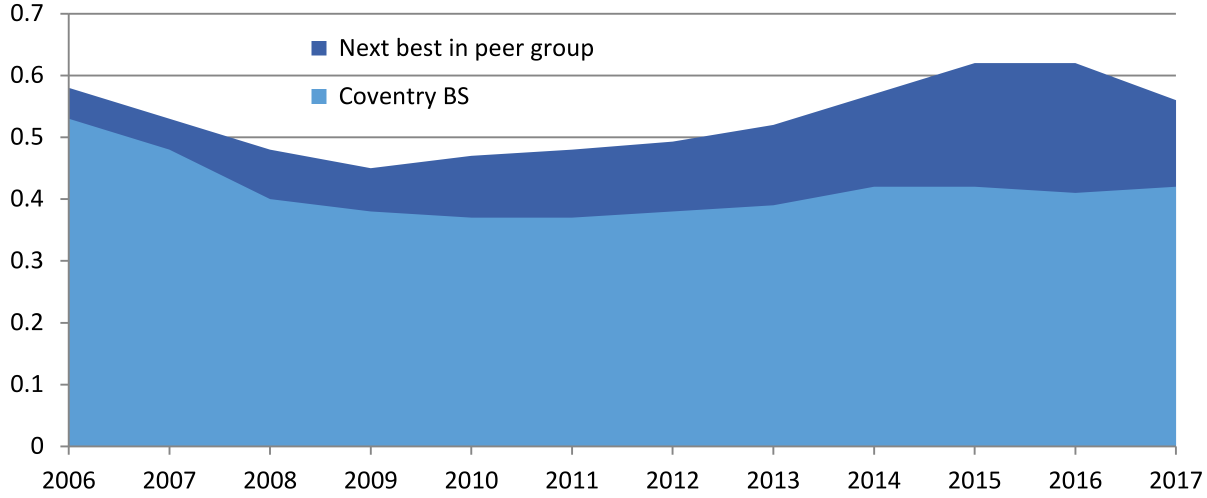
Management expenses (%)



0.42%

Cost to mean assets ratio

0.41% (2016)

Low Cost Base

- Low cost base gives a competitive advantage.
- Cost efficiency is enabled by a simple business model, efficient distribution channel and high average account balances with growth driving economies of scale.
- The costs to mean assets ratio remains the lowest of the top ten UK building societies.[1]
- The difference to the next best in the peer group is 14bps.[1]
- Exceptional investment initiated to increase capabilities in IT core infrastructure, to meet the changing expectations of members and regulators. This will lead to a rise in the management expense ratio in the short term.

1. Source: CML Top 20 mortgage lenders (as published August 2016) - latest published CET 1 data As at 23/02/2018 2. Next best in peer group HY2017 release used   Source: Annual report & accounts

Financial performance

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Investment for the Future

- Level of IT and technology change is rising as a result of:
  - Rising customer expectations for service delivery and enhanced functionality;
  - Higher levels of cyber threat;
  - Increased expectations from regulators.
- Our capital strength, low cost base and long term view enable us to invest despite a competitive market.

IT System and Operational resilience

- To enhance operational resilience we are progressing a move to a co-located / cloud hybrid datacentre environment.
- Will provide dedicated and resilient point to point connectivity.
- Cloud technology adopted subject to rigorous risk assessment.
- Planning the upgrade of our core banking platform to provide greater flexibility in responding to changing customer needs and regulatory requirements, more quickly and cheaply.
- Enhancements will create future competitive advantage.

Branch network re-design

- Important face of the Society with the membership which builds trust and engages the community.
- Branches account for over 30% of retail savings acquisition each year and manage around £10.5bn of the total retail book.
- Distributing mortgages through intermediaries and telephone contact centre means we have nationwide reach but only 70 branches concentrated in our heartland.
- The re-design of the branch network will meet evolving needs of members and better reflect the future of branch engagement and be rolled out from 2018.
- Flexible design principles will future proof our branches.

Financial performance

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%	2012	2013	2014	2015	2016	2017
Net interest margin / mean assets	0.73	0.92	1.15	1.11	1.06	**1.02**
Cost/ mean total assets	0.38	0.39	0.42	0.42	0.41	**0.42**
Cost / income ratio	49.4	41.1	35.7	37.2	37.9	**40.4**
Retained profit / mean assets	0.27	0.37	0.53	0.52	0.50	**0.46**
Liquidity (as percentage of SDL)	17.8	14.5	13.6	13.8	13.5	**15.5**
Wholesale funding	20.1	20.4	19.4	20.0	21.6	**22.7**
Mortgage assets growth	14.4	9.5	11.8	9.1	11.8	**9.3**
Common Equity Tier 1 ratio	23.6	24.3	25.4	29.4	32.2	**34.9**
Leverage Ratio[2]	-	-	4.2	4.4	4.4	**4.6**
Liquidity Coverage Ratio (LCR)			>100	141	151	**208**

Financial Strength

- Net interest margin reflects strong member pricing, whilst being sufficient to support growth and maintain capital ratios.
- Cost control is a key advantage in an increasingly competitive mortgage market.
- Wholesale funding higher due to £3bn of TFS drawing.
- CET1 ratio highest reported by any top 20 lender.[1]
- Liquidity Ratios increased due to TFS drawing.

1. Source: CML Top 20 mortgage lenders (as published August 2016) - latest published CET 1 data As at 23/02/2018 2.Under the BoE modified calculation excluding Central bank exposure less than 3 months

Asset Quality

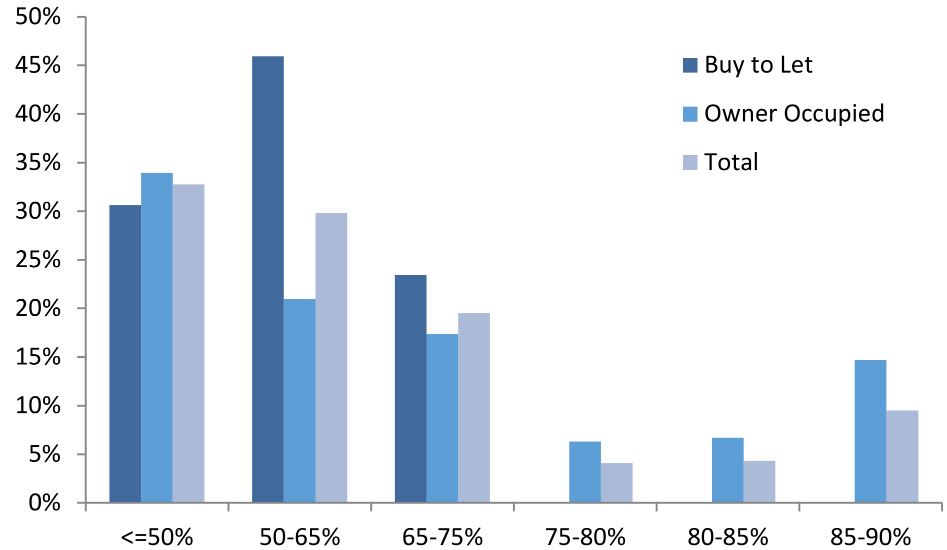
Asset quality

COVENTRY Building Society

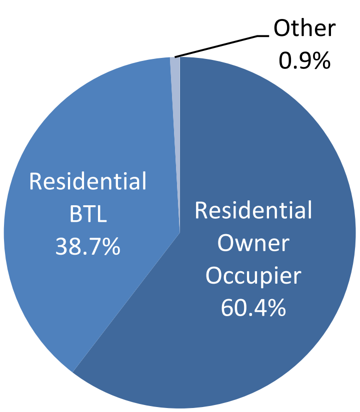
Low Risk Loan-to-Value (LTV)

- 82% of lending in 2017 has been at LTVs of 75% or below, in comparison to the market average of 65% (to end of Q3 2017).
- Market lending above 90% in the first 3 quarters of 2017 was 4%; Coventry lending above this LTV was nil.
- No sub-prime, commercial or second charge lending (legacy inherited commercial book currently £2.8m in run off).
- Negligible levels of legacy unsecured lending (c. £321m).
- The balance weighted average indexed LTV of the entire mortgage book is 53.9%.
- 97% of the overall book has an indexed LTV of 85% or less.
- Circa 70% of all buy-to-let lending was originated at 65% LTV or less.

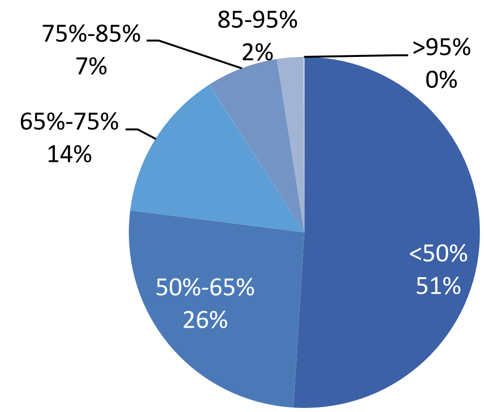
2017 New lending



Total book split by product



Total book split by LTV



Asset quality

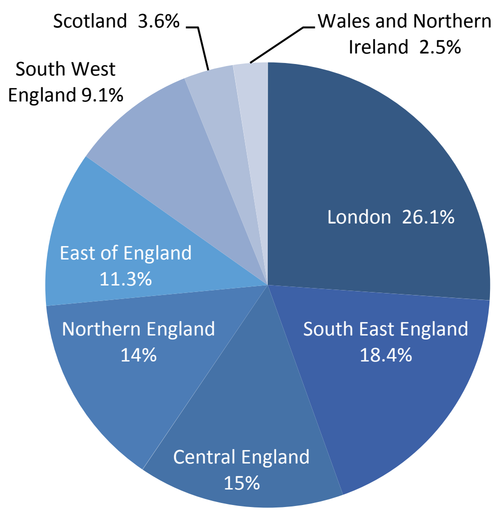
Geographic Split

- The majority of the UK mortgage market is introduced via intermediaries (e.g. independent financial advisors, mortgage brokers, estate agents).
- Intermediaries give national coverage and support the geographic diversification of the mortgage book.
- Crucially, all underwriting and servicing is performed by Coventry. There is no ‘packaging’; the intermediary acts solely as an introducer.

Mortgage Book Performance

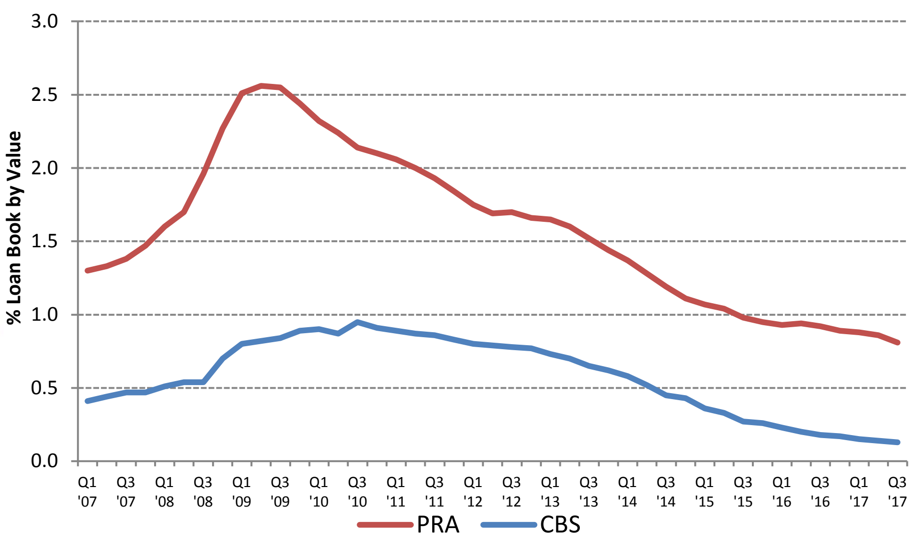
- The Society’s arrears performance continues to improve and to be significantly better than the industry as a whole.[1]
- The value of loans in arrears by ≥ 2.5% of the mortgage balance at 31 December 2017, as a proportion of the total book, has fallen to 0.13%.
- Unlike some lenders, arrears are very rarely capitalised. There were only 2 cases in 2017 for Coventry versus 7,900 for the industry as a whole up to Q3.
- IFRS 9 will be introduced in 2018, with a small decrease of impairment for consumer loans and a negligible impact on regulatory capital.

Geographic distribution by value



2017 **0.13%**
Mortgage balances were 2.5% or more in arrears
0.17% (2016)

Arrears ≥ 2.5% of mortgage balance (including possessions)



Asset quality

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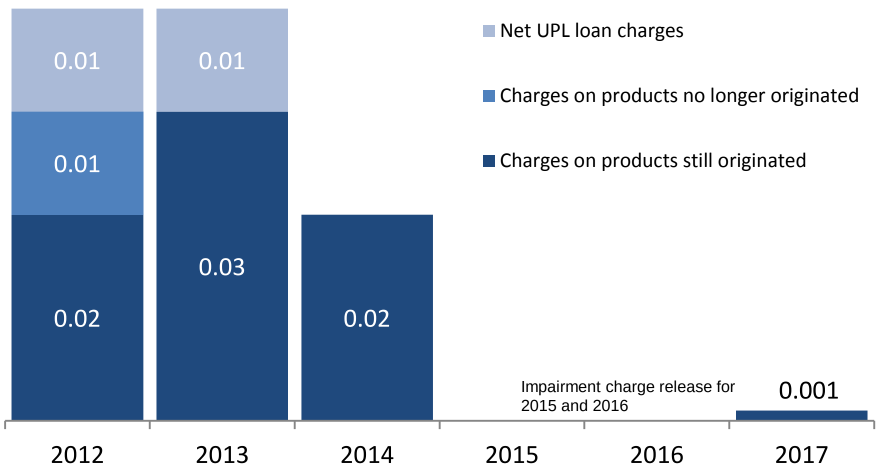
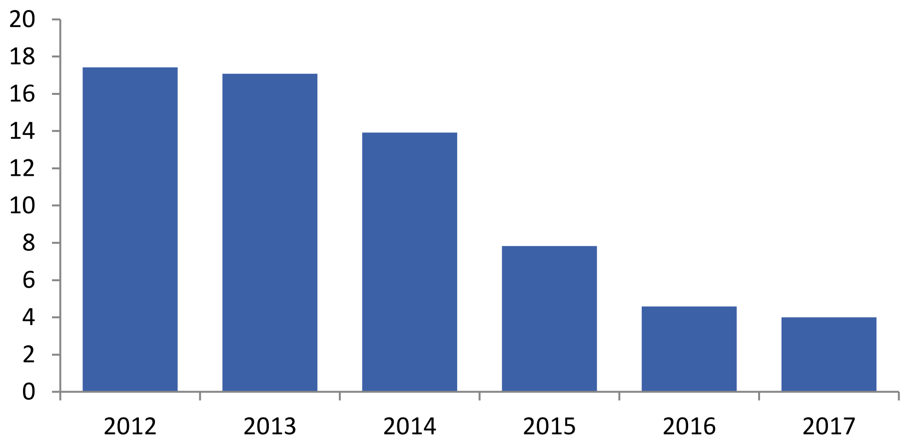
Robust Origination and Monitoring

- Coventry has strong and experienced central underwriting and collections teams, with no outsourcing.
- The Credit Risk department analyses the performance of the mortgage book and conducts quality assurance assessments.
- We consistently target low risk areas of the mortgage market, primarily low LTV owner occupier and buy-to-let.
- No lending has been advanced at more than 90% LTV since 2009.
- Arrears levels are consistently below industry averages at just 0.23% of accounts being more than three months in arrears (Industry average 0.82%).[1]
- At 31 December 2017, only 29 properties were in possession.

Impairment charges as % of loans



Average Society Possessions per month



Very Low Impairments

- Impairments are very low on a mortgage book of £35.9bn.
- Impairment charges have fallen over the recent past with releases reported in 2015 and 2016.
- Impairment charges in the last recession between 2008 and 2012 averaged c. 8 bps per year. A significant proportion (55%) of the impairment charges seen in that period were on loan products that are no longer offered e.g. unsecured personal loans. Impairments have been consistently falling since exiting such markets, with the continued focus being on high quality lending.

1. Source UK Finance

Asset quality – Buy-to-let

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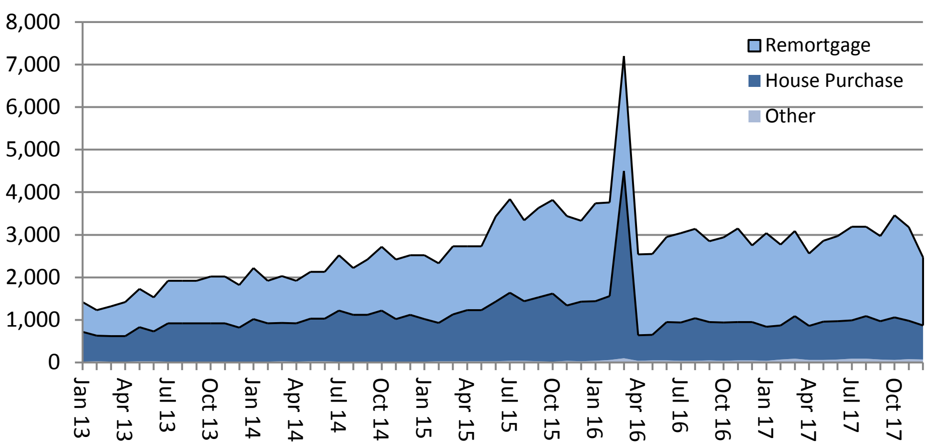
Coventry BTL Experience

- Approximately 2/3 of Coventry's buy-to-let lending is on houses, with one third on flats.
- Buy-to-let demographic is older than typical owner occupied demographic.
- Arrears and impairment levels have been very low. On over £23.7bn of lending since entering the market in 2002, we have incurred total losses of £8.9m.
- The balance weighted average LTV of the buy-to-let book is only 54.1% as at 31 December 2017.
- There have been only 4 losses on all buy-to-let lending originated in 2010 or later (total losses £49k) and only 16 buy-to-let properties in possession from a book of c. 101,000 properties.

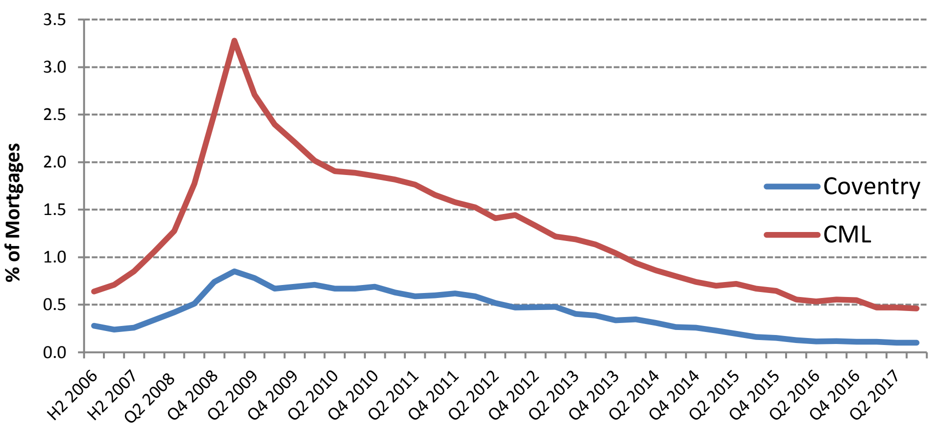
Coventry BTL Performance

- The focus on low LTV lending and on properties that are suitable for the owner occupier market has led to low levels of arrears, and as at 31 December 2017 the number of loans >3 months in arrears (including possessions) reduced to just 0.10%.
- Buy-to-let lending proved to be even more resilient than owner occupier lending during the crisis, with peak > 3 months arrears of 0.73% compared to 1.34% for the owner occupier book.
- 86% of our borrowers have only one property with the Society and c. 3% have more than two with the Society (maximum 3 properties).

New mortgages by purpose of loan, non-seasonally adjusted, UK (CML) (£m)



Coventry vs. CML >3mths buy-to-let arrears (incl. possessions)



Asset quality – Buy-to-let

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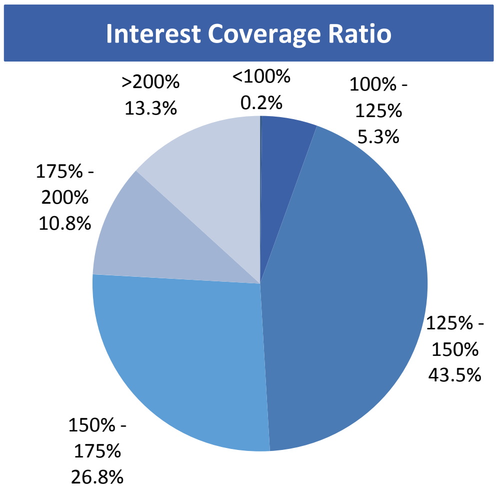


Lending Criteria

- 100% subject to physical valuations.
- Properties must be readily saleable into the owner occupier market.
- Maximum of 3 properties with the Coventry and an aggregate loan limit of £1,000,000.
- 50% maximum LTV on new build flats.
- Minimum rental coverage of 125% for basic tax payers and 140% for higher rate tax payers.
- The Society does not lend on Studio and High Rise Flats (above ten storeys)

London Market

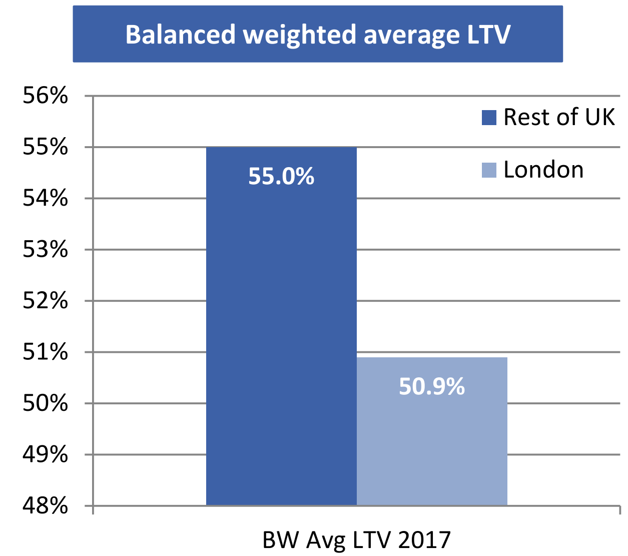
- 43% of all BTL Balances are in London compared to 26% of overall book
- Coventry lending policy ensures any loan greater than £500k to be less than 50% LTV, and above 80% LTV loan size is capped at £350k.
- Coventry does not lend on licensed HMO properties.
- Severe stress testing carried out on our London BTL book, showed strong resilience.
- Lower arrears than the rest of the country with 3bps >3 months in arrears (9bps national average).

Interest Coverage Ratio (ICR)

- For over 99% of accounts, rent provides over 100% coverage of the interest due on the loan.
- The pay rate in this calculation was floored at 5%. In actuality, the pay rate on many of these mortgages is significantly lower, and as such true interest cover is likely to be considerably higher.
- Coventry's actual indexed ICR for 31 December 2017 was 176.7%.

Portfolio Landlords

- Portfolio landlord regulation introduced in 2017.
- Buy-to-let criteria maintained and additional checks by dedicated portfolio underwriters only.
- Assessment of geographical concentration and whole portfolio.
- Portfolio maximum LTV of 65% across all properties within the portfolio.
- The whole portfolio minimum ICR of 125%.
- No individual property with ICR < 125%.



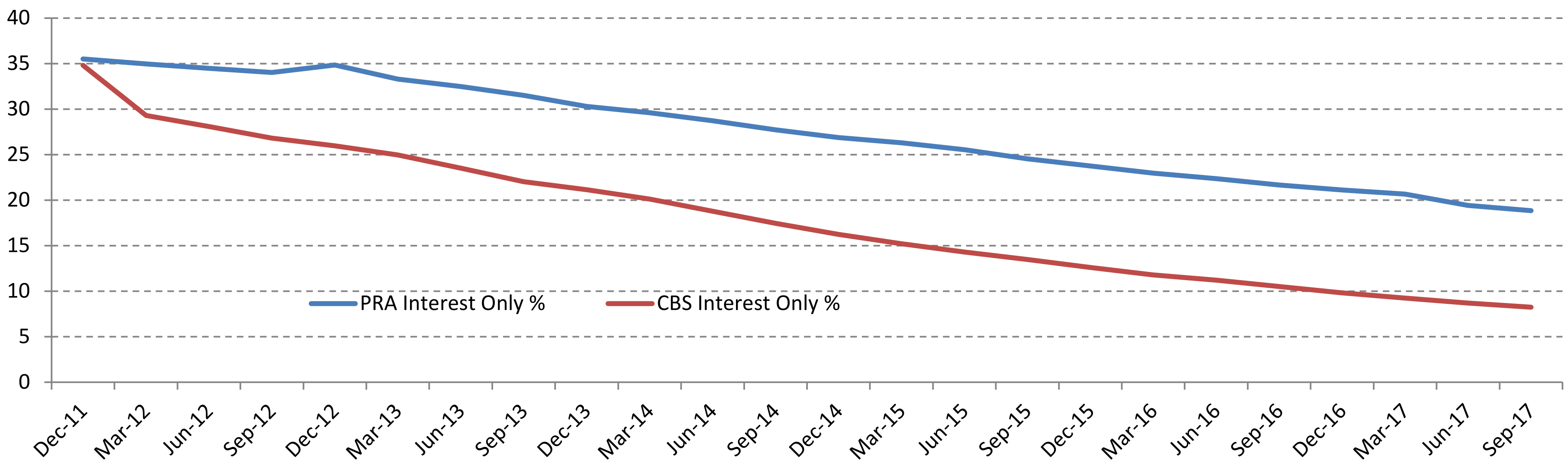
Based on original rental at 5% stress rate - All data as at 31 December 2017

Low Risk – Interest only

Owner Occupier IO Loans

- The UK market has long had a tradition of interest only mortgages. However, in recent years, there has been increased focus on how borrowers will repay their interest only loans after the typical 25 years contractual term.
- Coventry no longer offers new owner occupier interest only loans and has set up an interest only team to deal with customers reaching the end of their mortgage terms. As the Society grows, the overall stock will inevitably continue to reduce. As at 31 December 2017 the number of cases on an interest only basis represented 8.6% of the owner occupier book, compared to 34.8% at 31 December 2011.
- Only 15 interest only owner occupier mortgages with a LTV greater than 75% were more than 6 months beyond their scheduled term end date as at 31st December 2017.
- Buy-to-let mortgages, where the property is the repayment vehicle, continue to be predominantly interest only.

Interest only by value as proportion of book (owner occupier)

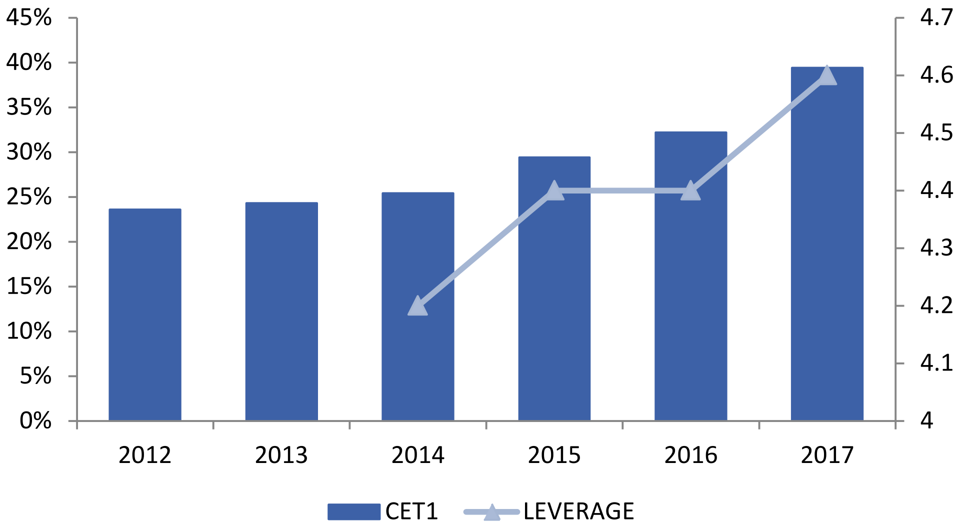


Capital

Capital

COVENTRY Building Society

CET1 and leverage ratios[1]



Leverage Ratio Framework

- A binding UK leverage ratio applies to firms with retail deposits of £50bn or more. All firms are expected to be in scope under the EU rules from 2019.
- The components of the UK leverage ratio framework are a minimum ratio of 3.25% (excluding Central Bank exposures below 3 months to maturity). The CCyB is set by the FPC and is currently 1% not enforced until November 2018. [2]
- The modified leverage ratio on a PRA basis at 31 December 2017 is 4.6% (4.1% when Bank of England reserve account is included), comfortably above the 3.25% minimum level (3.6% including the CCyB).

Capital and Reserves

- Following a Supervisory Review process in the first half of 2016 the Society has been issued with an ICG, currently 12.8% of RWAs. Retained earnings from strong profitability are Coventry's primary source of CET1 capital, currently c. £1.47bn.
- Capital levels were strengthened by the issuance of £400m of AT1 in 2014, a deal which attracted an order book in excess of £3bn.
- The whole loan sale of £310m non-member buy-to-let mortgages to a third party in 2015 provides a further capital management option.

34.9%

Capital strength

Common Equity Tier 1 ratio

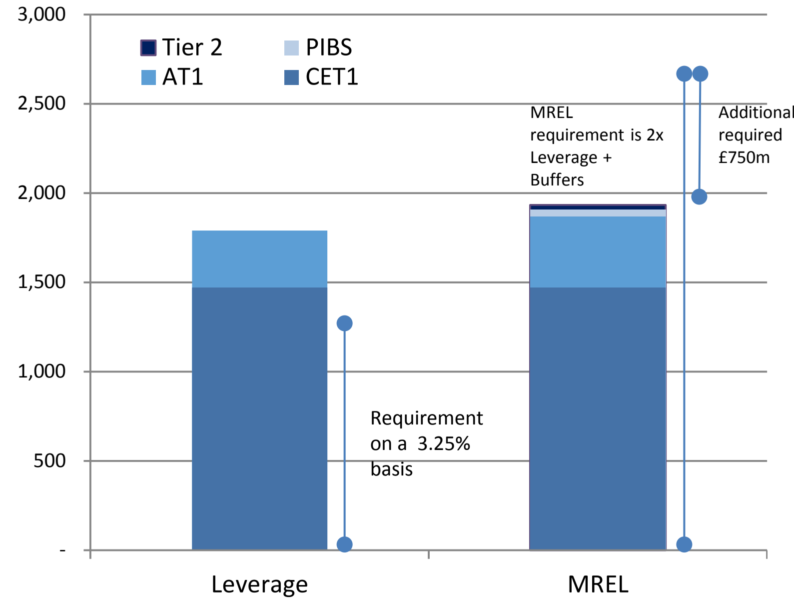
32.2% (2016)

1.The BoE modified calculation excluding Central bank exposure less than 3 months 2.For Leverage Counter cyclical leverage buffer (CCLB) is calculated as 35% of 1% CCyB

Capital and Accounting Future

MREL

- The MREL requirements , announced in 2016, are designed to make it easier to manage the failure of banks and building societies in an orderly way and to prevent future tax payer bail-outs in the UK. MREL capital requirements are based on a loss absorption amount to cover losses up to and in resolution, and a recapitalisation amount to enable continuation after resolution.
- Under the rules the Society is required to meet an interim MREL requirement of 18% of risk weighted assets by 1 January 2020. The indicative end-state MREL requirement for all firms will be twice the binding capital requirement, for the Society this is currently two times Pillar 1 and Pillar 2a or 25.6% of risk weighted assets. The Society currently exceeds this constraint. If leverage becomes the binding constraint for the Society, this will result in the need to raise MREL eligible debt.



IFRS 9

- IFRS 9 replaces IAS 39 incurred loss approach to calculating impairment in 2018.
- IFRS 9 requires categorisation of assets into three Stages, based on a credit assessment.
  - Stage 1 requires recognition of expected loss in 12 months and performing
  - Stage 2 & 3 requires recognition of lifetime expected losses and reflects a significant increase in credit risk from inception (Stage 2) or in default (Stage 3)
- The assessment of what qualifies as a ‘significant increase in credit risk’ is key but is subjective and down to an individual firm’s judgement. The Society has employed qualitative, quantitative and backstop indicators to capture all areas where an increase in credit risk might be observed.
- The calculation of lifetime expected losses also requires significant management judgement, using economic scenarios with differing weightings to assess expected credit losses.
- The impairment charges are expected to be more volatile across the market under IFRS 9 compared with IAS 39.
- The IFRS 9 impact will decrease impairment provision for credit losses on consumer loans by £0.1m and reflects the Society’s low risk profile. The impact on capital is negligible.

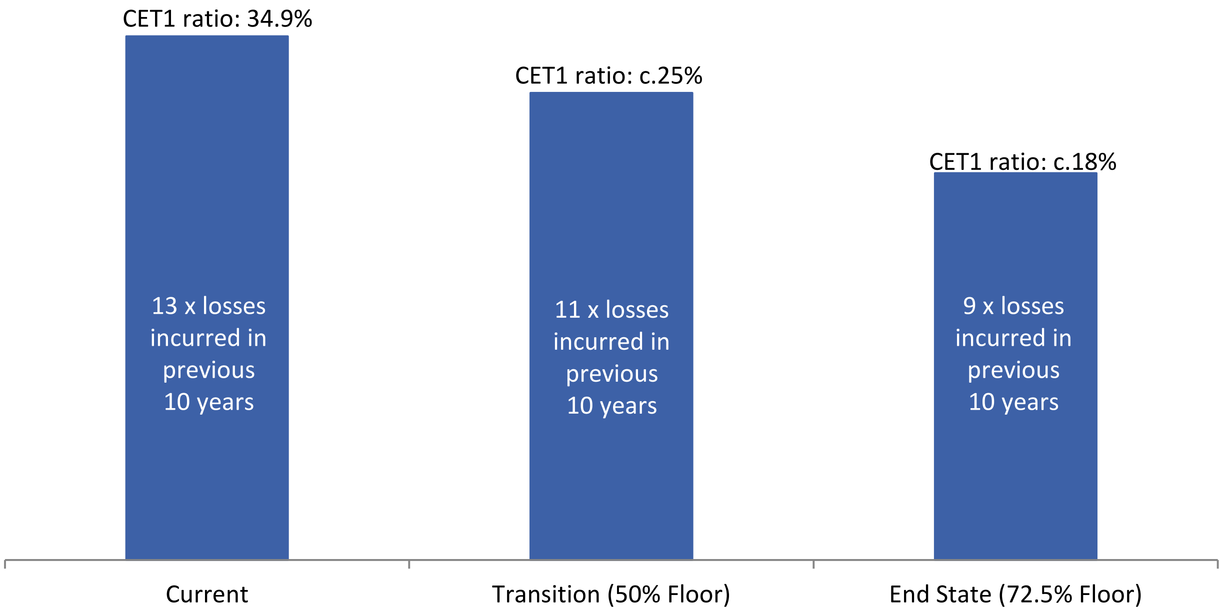
Basel IV Capital implications

COVENTRY Building Society

Basel IV

- BCBS Paper released in December 2017 outlining Standardised Risk Weights and output floors that seek to remove variability in internal models (IRB).
- Regulation and implications still need finalising and have national discretion (especially in the treatment of differing mortgage types).
- Output floor phased in from 50% in 2022 to 72.5% in 2027.
- Assuming the implementation of 50% output floor, the CET1 ratio reduces materially but remains above 22% reflecting the impacts of the flooring on a low risk business model.
- Surplus to regulatory minima remains considerable, equal to over 10 times the actual credit losses experienced in the last 10 years.

Surplus over Basel IV Requirement[1]



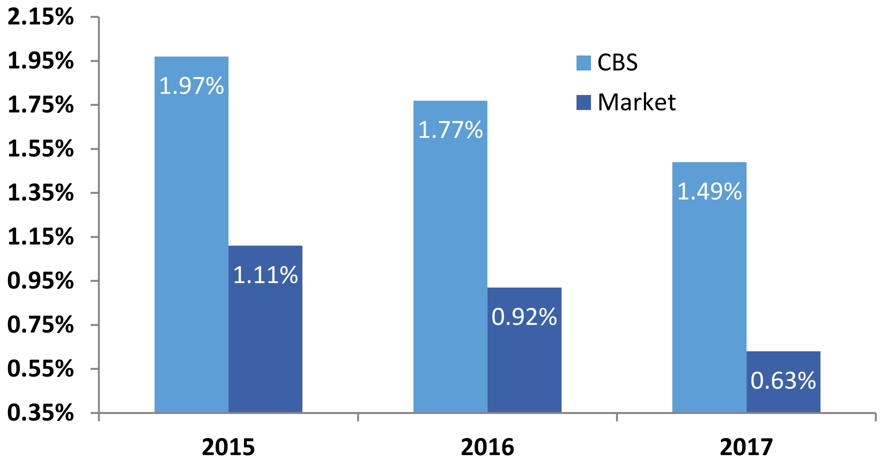
1. Based on Portfolio Landlords (landlords with 4 or more properties) risk weighted as real estate exposures with repayment materially dependant on cash flows generated by property

Funding and Liquidity

Retail funding

COVENTRY Building Society

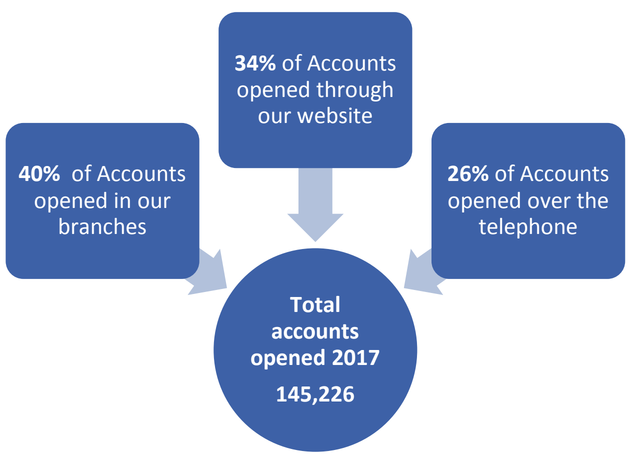
Retail Funding Prices vs. Market[1]



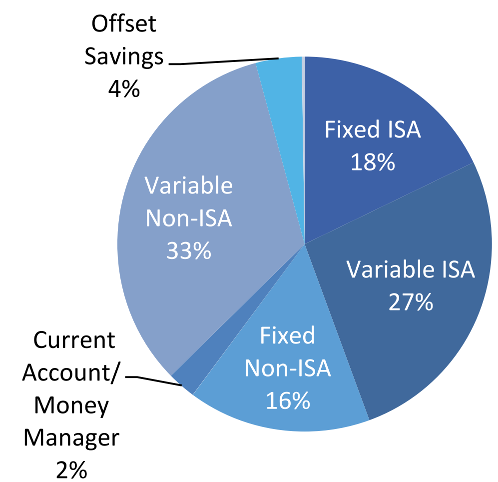
Retail Savings Focus

- Lending is primarily funded through retail deposits.
- Coventry has a proven track record in acquiring and retaining retail balances.
- Savings book growth 10.6% in comparison to market growth of 2.7%.
- Savings well diversified over distribution channels; Branch, Internet and Telephone.
- Coventry market share increased to 2.4%, with over 145,000 new accounts opened in 2017.
- Coventry passed on the full benefit of the 25bps Base Rate rise in November 2018 to variable rate savers.

Funding Channels



Retail Product Breakdown



1. The Society's average month end savings rate (society mix of products) compared to BoE WA rate for household interest bearing deposit (market mix of products)

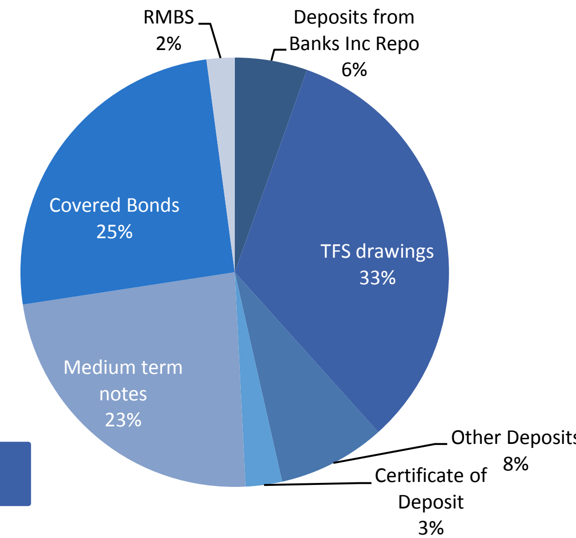
Wholesale

COVENTRY Building Society

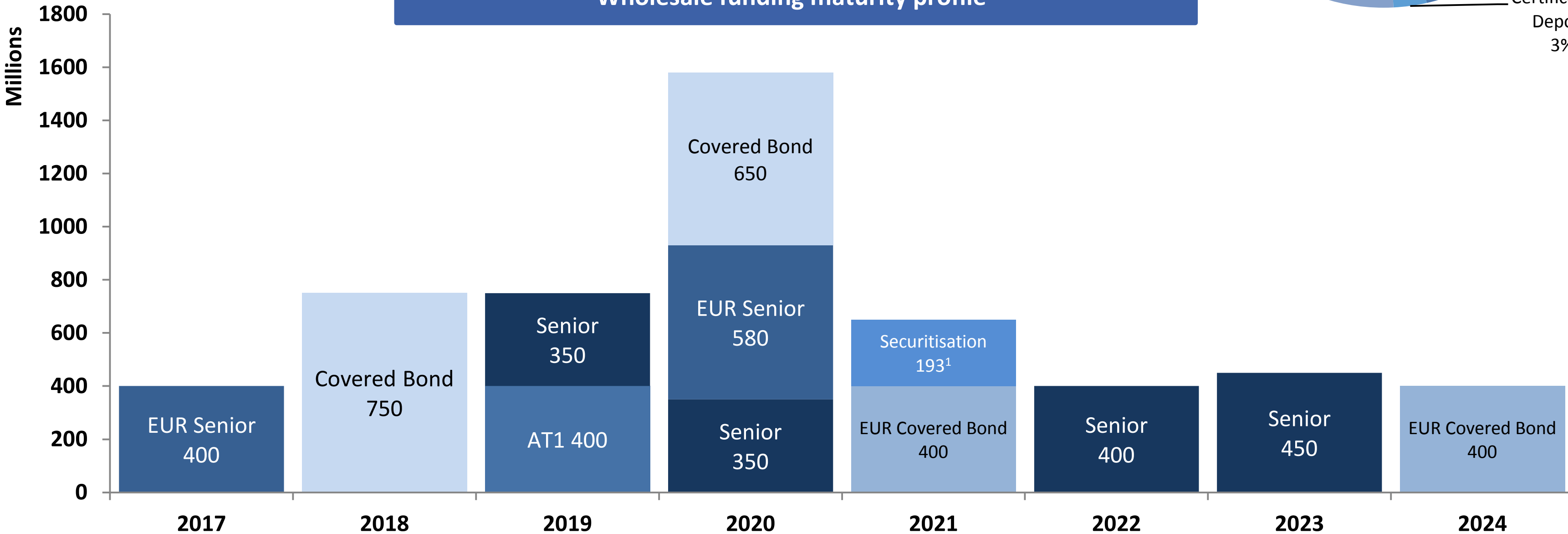
Funding Strategy

- Retail deposits are supplemented by a number of wholesale funding options.
- Wholesale market access provides competitive advantage and diversification of funding via:
  - MTNs.
  - Covered Bonds.
  - Securitisation.
- Continued move towards longer dated wholesale deals providing reliable long term funding.
- Wholesale funding ratio 22.7% as at 31 December 2017.
- TFS drawings of £3bn as at 31 December 2017 with FLS repaid during the year.

Wholesale Funding as at 31 December 2017



Wholesale funding maturity profile[2]



1. Current value after amortisation 2. In GBP, excluding TFS

Liquidity

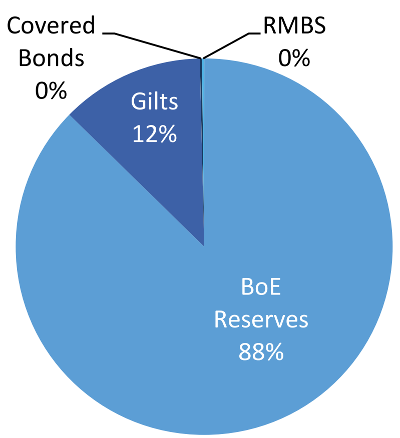
Liquidity

- Over 99% of core liquidity is eligible as High Quality Liquidity Assets Buffer and consists of UK Government or Bank of England assets.
- Core liquidity holdings are solely UK exposure, the Society has no direct exposure to peripheral Eurozone countries.
- The UK authorities have placed increased emphasis on contingent liquidity, from central bank facilities via the pre-positioning of loan books, retained bonds and other assets. The Society prepositioned an additional £5.1bn of mortgage assets in January 2018 as part of its on-going liquidity management strategy.

LCR

- The Liquidity Coverage Ratio (LCR) was implemented in 2015 measuring liquidity and outflows over a 30 day period as opposed to the previous 90 day PRA regime. However, in keeping with the Society's low risk appetite, we still conduct an internal three month stress test that is more severe than the previous regulatory measure.
- The Society maintains liquidity considerably above regulatory requirements with LCR 208% as at 31 December 2018, which reflects the cash injection from the TFS scheme.

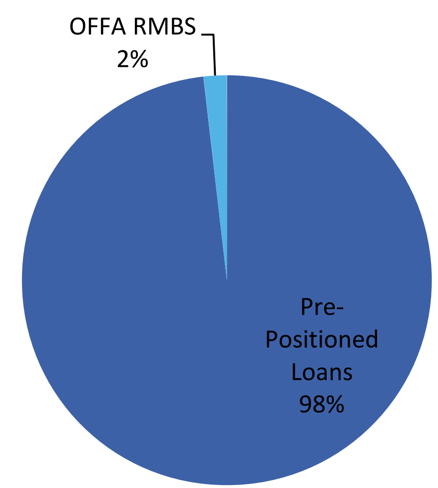
Core Liquidity[1]



£5.3bn Core Liquidity

£7.2bn Contingent Liquidity[2]

Contingent Liquidity[2]



1.Showing value of unencumbered assets as at 31 December 2017 – The Society held £300m Gilts in repurchase agreements as at 31st December 2017. 2. including £5.1bn preposition loans at the BoE in January 2018

Contacts

Contact details

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Useful links

- **Main website** http://www.coventrybuildingsociety.co.uk/
- **Financial results** http://www.coventrybuildingsociety.co.uk/consumer/our-performance/financial-results.html