News release

COVENTRY Building Society

23 February 2018

COVENTRY BUILDING SOCIETY REPORTS STRONG RESULTS

Coventry Building Society has today announced its results for the year ended 31 December 2017. Highlights include:

- **Strong growth in mortgages:** Mortgage assets increased by £3.0 billion to £35.9 billion, representing growth of 9%, nearly three times faster than the market[1].
- **Record savings balances:** Savings deposit balances grew by £3.0 billion to £31.0 billion, representing growth of 11%, almost four times the rate of the market[1].
- **Strong capital:** Profit before tax increased by 2% to £243 million, increasing the Common Equity Tier 1 (CET 1) ratio to 35%, the highest reported by any top 20 lender[2] and a leverage ratio of over 4%.
- **Low costs:** The Society's cost to mean asset ratio[3] was 0.42%, the lowest reported by any building society[4] and a key advantage which allows us to give long term value to savings and mortgage members.
- **Low risk:** The Society is a low risk lender, which protects individual borrowers and the Society alike. During the year, mortgage arrears fell and were only a sixth of the industry average[5].
- **Competitive savings rates:** Our average savings rate in 2017 was 1.49% compared with a market average of 0.63%[6].
- **Exceptional customer service:** The Society works hard to sustain and improve the service it provides to members. It measures this using the common metric of Net Promoter Score® and in 2017 achieved a very high and increased score of +73, representing a strong endorsement from our members[7].
- **Highly engaged employees:** Excellent service is delivered by our people, who are proud to Put Members First. In 2017, the Society was rated one of the 100 Best Companies to Work For in the UK.
- **Supporting local communities:** In 2017, 79% of employees were actively involved in volunteering, fundraising or raising awareness for local charities and community groups.

Commenting, Mark Parsons, Coventry Building Society Chief Executive said:

Coventry Building Society delivered a strong and balanced performance in 2017, maintaining our record of savings and mortgage growth, excellent member service and a robust financial position. This was driven by our clear and consistent focus on Putting Members First.

We have grown our membership, attracted record savings deposits and increased mortgage balances nearly three times faster than the market[1], sustaining our position as a top 10 UK mortgage and savings provider[8]. We are well capitalised and efficient, retaining enough profit to support our capital strength, and we are using our financial strength to invest in meeting the expectations of current and future members.

Critically our performance has members at its heart. To be successful we must provide clear benefits to our members, not only in terms of the long-term value of savings and mortgages, but also in the quality of service and support we provide.

Central to our performance is our commitment to savers. Despite the UK's 10 year record of low savings rates we firmly believe in the importance of cash savings to individual savers and the wider UK economy. We are proud of our track record of paying significantly higher than average savings rates and in 2017 have maintained this record. The average rate of interest we paid on savings in 2017 was 1.49% which was 0.86% higher than the market average[6].

Our simple and open approach to savings is becoming an increasing point of differentiation for the Society. We were the first UK savings provider to enable individuals to compare our own savings products with those of competitors through our website. We think this transparency is how savings should be and that it reflects confidence in our strong rates.

This unique approach has been endorsed by Fairer Finance, which placed us first in its rankings of savings providers for the third year running, as well as presenting us with its Clear & Simple Mark for our savings terms and conditions – the first UK savings provider to receive this accolade. We have also become one of only four UK savings providers to become a Which? Recommended Provider for Savings accounts[9].

This approach to savings means we have attracted more savers and more deposits in 2017, with balances growing by 11%, almost four times faster than the market as a whole[1]. These deposits supported our mortgage performance in 2017, with mortgage balances growing by 9%.

This was a strong performance in an environment that has shown some softening of house purchase demand and strengthening of mortgage rate competition. Our performance was underpinned by well-priced products in the lower loan to value and remortgage segments of the market. Just as importantly it reflects the service we provide to our borrowers and mortgage intermediary partners; we were pleased to be awarded the highest accolade for mortgage servicing, the Financial Adviser Five Stars award, for the second year running.

Our focus on lower loan to value lending is reflected in an average loan to value of our mortgage book of 47%. Together with the low interest rate environment this has resulted in continued very low loan impairments.

Our simple, focused business model means we have a low cost base. Notwithstanding a continued investment in technology and people, our management expense ratio[3] was broadly maintained at 0.42% (2016: 0.41%). This is significantly lower than that of our building society competitors[4], an advantage which allows us to provide long- term value to our savers and borrowers by operating at a relatively low net interest margin of 1.02%[10] as we return value to our members through favourable interest rates.

Looking forward, we expect price competition in the mortgage market to remain and margins to tighten further. However, our low cost operating model means that we will be able to continue to offer attractive long-term value to savings and mortgage members.

The combination of growth, low risks and low costs is the foundation of our financial strength and in 2017 we continued to deliver sufficient profits to support our capital position. As a mutual organisation dedicated to Putting Members First, we do not aim to maximise profits. Instead we aim to balance the long-term value we provide through consistently competitive pricing with being a secure and trusted home for our members' savings. In 2017 profit before tax was £243 million and our risk based capital measure[11] increased to 34.9%, the highest reported by any top 20 lender[2], demonstrating that we are strong and secure.

The service we provide to our members is an important part of our balanced performance and in 2017 our members continue to rate our core services highly, with more than 8 out of 10 members happy to recommend us to others[7]. Of the few complaints referred to the Financial Ombudsman Service only 4% were upheld, the lowest reported rate of all UK banks and building societies[12].

Despite a strong service record we are not complacent and understand that in a changing technological age our members will continue to expect more of us. To address this, we are investing to deliver further improved service functionality and customer experience, for example the new customer website that showcases our simplicity and transparency. Behind the scenes we are also investing to enhance our core technology systems and infrastructure to improve business resilience and service flexibility. This commitment to investing for the future will increase further in 2018, and includes investment in making our branches even more welcoming within their communities.

Above all we continue to invest in our people, who make the Society what it is. Our growth is a positive factor in this regard, providing opportunities for internal career progression as well as giving us greater relevance in the external job market. In 2017 the Society was rated one of the 100 Best Companies to Work For in the UK, an accolade which reflects our ambition in supporting and engaging our people. The Society was also named one of the Best Employers for Race[13], recognising our commitment to encouraging diversity. I know that our very high level of employee engagement has its foundation in the Society's commitment to do the right things for members.

Alongside Putting Members First, we also seek to do the right thing for the communities we serve. In 2017, over three quarters of our employees were actively engaged in a wide variety of fundraising and community volunteering activities. This year we celebrate the 10 year anniversary of our partnership with The Royal British Legion during which time we have become its largest corporate partner, donating over £15 million since October 2008. This work is mirrored by the contribution of our employees at a local level, supporting over 250 charities and schools. We are delighted that the city of Coventry has won the bid to become the 2021 UK City of Culture. We supported the bid and have committed to support this transformational opportunity for Coventry.

At its heart, Coventry Building Society is a people business, with a set of values that guide all of its decision making. Whilst our 2017 performance is notable for our continued growth and financial strength, it also demonstrates the strength of a business model built on doing the right things for our members.

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1. Source: Bank of England.
2. Source: CML Economics, 2016 top mortgage lenders (balance outstanding) latest published CET 1 data as at 22 February 2018.
3. Administrative expenses, depreciation and amortisation/Average total assets.
4. As at 22 February 2018.
5. Mortgage arrears greater than 2.5% of the outstanding balance. Source: Prudential Regulation Authority latest available information as at 30 September 2017.
6. The Society's weighted average month end savings rate (Society mix of products) compared to Bank of England weighted average rate for household interest-bearing deposits (market mix of products).
7. Source: Average from 6 surveys in 2017: 12,065 branch visitors scoring 9 or 10/10; 13,642 savings contact centre callers scoring 4 or 5/5; 3,761 online services users scoring 9 or 10/10; 1,749 brokers scoring 9 or 10/10; 1,943 mortgage contact centre callers scoring 9 or 10/10; 1,913 customers who have opened an account scoring 9 or 10/10.
8. Source: eBenchmarkers Spring 2017 (savings), CML Economics, 2016 top mortgage lenders (balance outstanding) latest published data as at 22 February 2018 (mortgages).
9. As at August 2017.
10. Net interest income as a percentage of average total assets.
11. Common Equity Tier 1 ratio.
12. Source: Financial Ombudsman Service – latest published information: 1 January 2017 to 30 June 2017.
13. Source: Business in the Community Best Employers for Race list 2017.

News release

COVENTRY Building Society

Financial Review

Overall performance

During 2017, the Society continued to grow both mortgage and savings balances and delivered a low management expense ratio and impairment charge, strengthening the Society's reserves and capital base.

Income Statement

Overview

Statutory profit before tax has increased by 2% to £242.7 million (2016: £239.1 million). Underlying profit[1] was £240.5 million (2016: £239.5 million) as set out in the summarised Income Statement below.

The 2017 profit performance primarily reflects an increase in net interest income offset by an increase in management expenses. This profit performance was achieved during a year when the interest paid by the Society's above market savings rates represented a return of value to members of over £210 million[2] compared with the market.

Year to 31 December 2017	Statutory profit £m	Gain on sale of VocaLink £m	Financial Services Compensation Scheme levy £m	Losses on derivatives and hedge accounting £m	Underlying profit £m
Net interest income	411.0	–	–	–	411.0
Other income	5.1	(5.0)	–	–	0.1
Losses on derivatives and hedge accounting	(0.3)	–	–	0.3	–
Total income	415.8	(5.0)	–	0.3	411.1
Management expenses	(167.9)	–	–	–	(167.9)
Impairment charge	(0.2)	–	–	–	(0.2)
Provisions	(3.5)	–	2.5	–	(1.0)
Charitable donation to Poppy Appeal	(1.5)	–	–	–	(1.5)
Profit before tax	242.7	(5.0)	2.5	0.3	240.5

Year to 31 December 2016	Statutory profit £m	Gain on sale of Visa Europe Limited £m	Financial Services Compensation Scheme levy £m	Losses on derivatives and hedge accounting £m	Underlying profit £m
Net interest income	385.0	–	–	–	385.0
Other income	10.5	(4.9)	–	–	5.6
Losses on derivatives and hedge accounting	(1.0)	–	–	1.0	–
Total income	394.5	(4.9)	–	1.0	390.6
Management expenses	(149.5)	–	–	–	(149.5)
Impairment credit	1.5	–	–	–	1.5
Provisions	(6.1)	–	4.3	–	(1.8)
Charitable donation to Poppy Appeal	(1.3)	–	–	–	(1.3)
Profit before tax	239.1	(4.9)	4.3	1.0	239.5

Net interest income

Net interest income in 2017 was £411.0 million, £26.0 million higher than in 2016 as a result of growth in mortgage assets offset by a modest decrease in the net interest margin.

Net interest income in 2017 includes a £12.6 million release of fair value adjustments which arose on the merger with the Stroud & Swindon Building Society. Credit performance of the book since the merger indicates that the adjustments were in excess of requirements.

The Society's net interest margin has decreased by 4 basis points to 1.02% in the year to 31 December 2017 as it continues to pay above market rates to savers despite market pressures on mortgage pricing. This margin has been sufficient to fund the Society's expenditure and support capital.

	Year to 2017 £m	Year to 2016 £m
Net interest income	411.0	385.0
Average total assets	40,434	36,205
	%	%
Net interest margin	1.02	1.06

The Board believes it is likely that that there will be a further modest decrease in the net interest margin in 2018 as a consequence of continuing pricing pressure in the mortgage market and its commitment to protect savings rates as far as possible.

Other income

Other income was £5.1 million, £5.4 million lower than in 2016 primarily as a result of lower general insurance fee income. Insurance fee income is not a strategic priority for the Society.

Other income includes a £5.0 million gain on sale of the Society's equity investment in VocaLink Holdings Limited to MasterCard. Other income in 2016 included a £4.9 million gain on sale of Visa Europe Limited to Visa Inc.

Derivatives and hedge accounting

The Society uses derivative financial instruments solely for risk management.

Income statement volatility arises as a result of the hedge accounting rules. This volatility is largely timing and the Society considers that it does not reflect the economic reality.

Management expenses

Management expenses increased in 2017 to £167.9 million (2016: £149.5 million) reflecting substantial investment in operational resilience together with increased costs to support growth.

Nearly half of this increase relates to the Society's continued investment in core IT infrastructure and change programmes which have increased IT and project costs by £5.1 million year on year and depreciation and amortisation by a further £4.0 million. The Society expects cost growth to continue during 2018 as its change programmes progress.

The remaining £9.3 million of additional cost largely related to employee wage inflation and a 5% increase in head count to support business growth and continuing regulatory change.

Despite the investments made during 2017, the Society's ratio of costs to mean total assets has been broadly maintained at 0.42% (2016: 0.41%). For over 10 years the Society has achieved the lowest reported cost to mean asset ratio in the UK building society sector, reflecting a consistent focus on spending members' money wisely. The Society's ability to grow whilst retaining control of costs continues to represent a significant competitive advantage.

Arrears and Impairment charge

The Society has a strong record of low impairments, reflecting its low risk and prudent lending strategy. The Society has never undertaken commercial lending or second charge lending[3], and its exposure to unsecured lending is negligible.

There was an impairment charge of £0.2 million in 2017 (2016: £1.5 million credit). This low impairment charge reflects a consistently prudent lending strategy together with continuing benign economic conditions including moderate house price growth, falling unemployment and prolonged low interest rates, notwithstanding the small increase in the Bank of England Base Rate late in the year.

From 1 January 2018, the introduction of IFRS 9 will mean that the Society calculates impairment provision on an expected credit loss basis, rather than on an incurred loss basis as is the case at 31 December 2017. The impact of this is not expected to be significant for the Society, as a result of the Society's high credit quality, low risk mortgage lending. The IFRS 9 impairment provision on loans and advances to customers at 31 December 2017 is £0.1 million less than the existing IAS 39 impairment provision. In addition, the impact of IFRS 9 transition on regulatory capital is negligible.

Provisions

Provisions for liabilities and charges have reduced to £3.5 million (2016: £6.1 million) as a result of lower Financial Services Compensation Scheme (FSCS) fees and customer redress provisions including Financial Conduct Authority (FCA) guidance on the calculation of monthly payments for customers in arrears.

FSCS fees reduced from £4.3 million in 2016 to £2.5 million reflecting the substantial repayment of the loan from HM Treasury to the FSCS during the year.

The charge for Payment Protection Insurance (PPI) was £1.0 million compared with £1.2 million in 2016. The Society's provisions for PPI claims continue to be materially lower than for many other organisations, reflecting the design of the PPI product previously offered by the Society.

Charitable donation to the Poppy Appeal

The Society donated £1.5 million to The Royal British Legion's Poppy Appeal during the year (2016: £1.3 million) bringing the total donated over the Society's nine year relationship with the Legion to £15.4 million.

Taxation

In 2017 the corporation tax charge was £57.9 million (2016: £56.7 million). This represents an effective tax rate of 23.9% (2016: 23.7%) which is significantly above the statutory corporation tax rate of 19.25% (2016: 20.0%). This is mainly due to a charge of £11.1 million (2016: £9.4 million) in respect of the 8% surcharge on the profits of banking companies. The Society's subsidiaries are outside the scope of the surcharge. The Society expects that its future effective tax rate will continue to exceed the standard rate due to the surcharge.

Balance sheet

Overview

Mortgage balances and on-balance sheet liquidity have grown during the year by £3.0 billion and £1.4 billion respectively. This was funded by increases in retail funding of £3.0 billion and wholesale funding of £1.4 billion, mainly as off-balance sheet Funding for Lending Scheme (FLS) drawings were replaced by on-balance sheet Term Funding Scheme (TFS) funding.

	2017 £m	2016 £m
Assets		
Loans and advances to customers	35,930.9	32,881.6
Liquidity	6,209.5	4,827.8
Other	432.1	586.5
Total assets	42,572.5	38,295.9
Liabilities		
Retail funding	31,035.7	28,054.3
Wholesale funding	9,127.3	7,742.0
Subordinated liabilities and subscribed capital	67.1	67.1
Other	366.4	611.2
Total liabilities	40,596.5	36,474.6
Equity		
General reserve	1,553.1	1,376.1
Other equity instruments	396.9	396.9
Other	26.0	48.3
Total equity	1,976.0	1,821.3
Total liabilities and equity	42,572.5	38,295.9
Unencumbered FLS Treasury bills (off-balance sheet liquidity)*	–	1,142.8

* Treasury bills (obtained under the FLS quoted at market value above) provide very high quality liquidity but, in accordance with accounting standards, are not recognised on the balance sheet, as the Society does not retain the risks and rewards in relation to these assets.

Loans and advances to customers

The Society's lending strategy is focused on high quality, low loan to value loans within the prime residential market, through attractively priced mortgages. These loans are primarily distributed through third party intermediaries, giving the Society a regionally diverse mortgage portfolio in a cost-effective manner.

In 2017, the Society advanced £8.6 billion of mortgages, (2016: £9.0 billion). Mortgage balance growth was £3.0 billion (2016: £3.5 billion) increasing market share of stock to 2.6%[4] (2016: 2.5%). The year-on-year growth in mortgages of 9.3% was significantly above mortgage market growth of 3.4%[4]. As a result the Society expects to at least retain its end 2016 position as the eighth[5] largest UK mortgage lender by stock.

This is a strong performance in what has been an increasingly price competitive market and has been achieved whilst maintaining the low risk nature of the loan book. The overall indexed loan to value of the mortgage book at 31 December 2017 fell to 53.9% (balance weighted) (2016: 54.6%).

The Society's arrears performance continues to improve and to be significantly better than that of the industry as a whole. As at 31 December 2017, 0.13% of mortgage balances were 2.5% or more in arrears (2016: 0.17%) compared with the latest available industry average[6] of 0.81%.

Liquidity

On-balance sheet liquid assets have increased to £6.2 billion (2016: £4.8 billion). This growth is predominantly due to the replacement of off-balance sheet Funding for Lending Scheme (FLS) liquidity with on-balance sheet Term Funding Scheme (TFS) drawdowns.

Liquid assets are held primarily in deposits at the Bank of England and UK Government investment securities such that asset quality remains very high with 96% of the portfolio rated Aaa–Aa3 (2016: 96%) and 4% rated A1–A3 (2016: 4%). The Society has no direct exposure to the peripheral Eurozone countries and 99% of liquid assets are held in UK sovereign and financial institutions.

As at 31 December 2017, no liquidity investments were either past due or impaired and as such no impairment provision has been made.

Of the £6.2 billion liquid assets, £1.0 billion are held as Available-for-sale (AFS) assets and are marked to market with any changes in value recorded through other comprehensive income. As at 31 December 2017, the balance on the AFS reserve was a £5.7 million gain, net of tax (2016: £6.7 million gain, net of tax).

On-balance sheet liquid assets have previously been supplemented by unencumbered Treasury bills obtained under the FLS which were held off balance sheet in accordance with FLS scheme rules. At year end all FLS Treasury bills have been repaid (2016: £2.4 billion drawn with £1.1 billion unencumbered).

The Liquidity Coverage Ratio (LCR) at 31 December 2017 was 208% (2016: 151%), considerably above the minimum regulatory requirement. The LCR increase reflects amounts drawn down against the TFS ahead of its closure in February 2018.

Retail funding

Retail savings have increased in the year by £3.0 billion to £31.0 billion (2016: £28.1 billion), representing growth of 10.6%, in comparison with market growth of only 2.7%[4]. The Society's savings market share increased to 2.4%[4] (2016: 2.0%) with over 145,000 new savings accounts opened in 2017. The increase in savings balances allowed the Society to offer mortgages on 17,000 additional homes. In total over 91% of mortgage balances are funded by retail savings or capital.

The Society has continued to support the cash ISA market with competitive rates of interest, increasing its share of this market to 5.1%[4] (2016: 3.9%).

The growth in savings demonstrates the Society's commitment to providing its members with attractive rates of interest relative to the market despite the availability of cheaper wholesale funding. During the year the interest paid by the Society represented a return of value to savers of over £210 million relative to the average UK bank or building society[2].

Wholesale funding

The Society accesses the wholesale markets to provide funding diversity which reduces risk and also lowers the overall cost of funding.

In 2017, on-balance sheet wholesale funding increased by £1.4 billion to £9.1 billion (2016: £7.7 billion). The increase primarily reflects wholesale issuances (medium-term notes and covered bonds – see below) net of maturities and TFS drawdowns. At the year end, the Society had drawn down £3.0 billion under the TFS (2016: £nil) but had returned all of the £2.4 million FLS Treasury bills held at the 2016 year end.

In January 2017, the Society issued a €500 million euro covered bond. The Society also issued a £350 million medium-term note in May 2017 and a further £450 million medium-term note in October 2017.

Equity

The Society's equity is predominantly made up of its general reserve and Additional Tier 1 capital; it also includes the Available-for-sale (AFS) reserve and cash flow hedge reserve. The Society's total equity increased by £0.2 billion to £2.0 billion, reflecting retained profits generated during the year.

Regulatory capital

Capital is held to protect members against future losses under the Capital Requirements Directive (CRD) IV.

The Society's CRD IV capital position (excluding any transitional provisions) as at 31 December 2017 is summarised below. During the year capital resources have increased primarily driven by profit after tax of £184.8 million.

At the same time, despite mortgage growth of 9.3%, risk-based capital requirements or risk weighted assets have only marginally increased as a result of house price inflation reducing effective risk weights and a continuing focus on low loan to value lending.

As a result, the Society's Common Equity Tier 1 (CET 1) ratio has increased from 32.2% to 34.9%.

The leverage ratio was stable at 4.1% as the increase in capital was matched by an 11% increase in non-risk based leverage ratio exposures driven primarily by mortgage growth and higher liquidity assets.

During 2016, the Prudential Regulatory Authority (PRA) announced that the leverage ratio used within the UK leverage framework would exclude central bank reserves and on this modified basis the Society's leverage ratio is 4.6% (2016: 4.4%).

	End-point 31 Dec 2017 £m	End-point 31 Dec 2016 £m
Capital resources:		
Common Equity Tier 1 (CET 1) capital	1,471.6	1,320.8
Total Tier 1 capital	1,868.5	1,717.7
Total capital	1,910.0	1,722.0
Risk weighted assets	4,213.1	4,099.3
Capital and leverage ratios:	%	%
Common Equity Tier 1 (CET 1) ratio	34.9	32.2
Leverage ratio[1]	4.1	4.1
Leverage ratio (modified)[2]	4.6	4.4

1. The leverage ratio is calculated in accordance with the definitions of CRD IV as amended by the European Commission delegated regulation. The calculation reflects constraints in the inclusion of Additional Tier 1 capital in accordance with the Financial Policy Committee's leverage ratio regime regulations.
2. Leverage ratio modified under the UK regulatory regime by excluding central bank reserves from the calculation of leverage exposures.

The Society is provided with Individual Capital Guidance (ICG) by the PRA. Following a Supervisory Review process in the first half of 2016, the Society was issued with an ICG, which is currently 12.8% of risk weighted assets, or £539 million. This sets the minimum capital which the Society must hold under Pillar 1 and Pillar 2A requirements and is driven by both Balance Sheet growth and risk factors determined by the PRA. The Society comfortably meets this requirement using CET 1 capital alone.

1. Underlying profit represents management's view of underlying performance and is presented to aid comparability across reporting periods.
2. Based on the Society's average month end savings rate compared with the Bank of England average rate for household interest-bearing deposits on the Society's mix of products.
3. Other than as a result of small books acquired as part of the merger with Stroud & Swindon Building Society in 2010.
4. Source: Bank of England, household sector.
5. Source: CML Economics – 2016 balance outstanding.
6. Source: Prudential Regulation Authority latest available information as at 30 September 2017.

Forward looking statements

Certain statements in this document are forward looking. The Society, defined in this document as Coventry Building Society and its subsidiary undertakings, believes that the expectations reflected in these forward looking statements are reasonable based on the information available at the time of the approval of this report. However, we can give no assurance that these expectations will prove to be an accurate reflection of actual results; because these statements involve risks and uncertainties, actual results may differ materially from those expressed or implied by these forward looking statements. We undertake no obligation to update any forward looking statements whether as a result of new information, future events or otherwise.

For more information or additional comment please contact: the press office on **0800 121 6868** or email **media@thecoventry.co.uk**

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