Final Results

COVENTRY BUILDING SOCIETY

Released 07:00:07 25 February 2022

RNS Number : 7847C
Coventry Building Society
25 February 2022

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Coventry Building Society delivers a strong performance, growing its mortgage market share, whilst maintaining excellent service to customers and investing for the future.

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

We delivered a strong financial performance and made good progress against our strategic goals. This performance reflects an exceptional commitment to members and customers by my colleagues across the Society and I am so proud of what they have delivered. We continue to focus on running the Society in the long-term interest of our members and ensuring that we are set up for long-term success.

Strong growth in savings and mortgages

- **Mortgage balances grew by £3.1bn (7.2%) to £46.6bn**, significantly above the level of market growth[1] and doubling the number of first time buyers to 7,100.
- **Savings balances grew by £1.7bn (4.6%) to £39.9bn** with the average savings rate of 0.83%, 0.56% higher than the market average[2], and the equivalent of an additional £201m interest for savers.

Sustainable profitability and resilient capital and liquidity position

- **Profit before tax of £233m** (2020: £124m). Profitability recovered from 2020 levels driven by balance sheet growth, improved margin and supported by the release of £29m of pandemic related provisions held to cover potential future credit losses.
- **Net Interest Margin of 0.90%** (2020: 0.81%). 1.03% excluding an adjustment of £69m relating to updated assumptions for future SVR income.
- **Common Equity Tier 1 (CET 1) ratio remains well above statutory requirements at 36.2%** whilst the Society's Leverage Ratio on a UK modified basis increased to 4.8%. The Liquidity Coverage Ratio of 187% is also considerably above the regulatory minimum requirement.

Excellent service while investing to meet the changing needs of members and stakeholders

- **Excellent customer service** with Experience Net Promoter Score[3] of +76 and average call waiting times of 49 seconds during a period of exceptional demand. The Society continues to report one of the lowest complaint overturn rates by the Financial Ombudsman Service at below 5%.
- **Leading cost efficiency with a cost to mean asset ratio of 0.50%[4]** amongst the lowest of any UK building society and a cost to income ratio of 56%[5], whilst investing £96 million in 2021 in technology infrastructure, digital services and transforming our branch network.
- **Strong community investment of £1.6m[6]** tackling three priority issues around homelessness, helping young people acquire the financial skills and knowledge on which to base good careers, and social isolation.
- **Responding to climate change.** The Society signed up to the UN Global Compact, transitioned to 100% renewable sources of energy, and achieved net zero for its Scope 2 emissions and carbon neutrality for Scope 1.

Chief Executive's review

Adapting to change

2021 has again been a year of significant change and continued uncertainty. The early predictions that suggested a global pandemic may take some years to work through look increasingly accurate, and we have continued to adjust to new ways of working. It has been a catalyst for change in many ways as people have altered their aspirations and expectations for the way they want to live and work.

Change brings challenge and opportunity, of course. The first six months of 2021 saw a buoyant mortgage market as the impact of the stamp duty holiday aligned with people's desire for homes with more indoor and outdoor space, which didn't need to be close to work. I am very proud of the way my colleagues, the majority working remotely, stepped up and delivered fantastic service to brokers and members during these months. Together we delivered record volumes of mortgage applications and completions.

We also felt the challenge of the low interest rate environment. With more uncertainty and fewer opportunities to spend on entertainment and socialising, many households accumulated higher savings in non-interest earning current accounts. This excess funding, concentrated in the high street banks, resulted in significant competitive pressure in the mortgage market in the latter half of the year and I expect this to continue into 2022. It is clearly a tough time for savers and we continue to pay the best rates we can whilst maintaining the Society's financial resilience and balancing the long-term needs of all our members.

The change caused by the pandemic extends to our own ways of working. Our priority has been people's safety and wellbeing, and I would like to thank everyone - colleagues and members alike - who helped keep each other safe with no interruption to our excellent service throughout this year.

We have adapted to 'hybrid working', learning how to balance the benefits of increased working from home with those of working collaboratively in the office. This will continue to evolve as the pandemic declines. However, I believe that the progress we're making on our digital journey, the developments to our brand, our accreditation as a 'Great Place to Work' and the stride forward on our Environment, Social and Governance (ESG) strategy all point to a business that is adapting successfully to new ways of working and the changing demands of consumers and society as a whole.

Our purpose and strategy

Our purpose and strategy underpin this progress. The pandemic may be a catalyst for change but a broader transformation is happening as businesses, governments and the public recognise the need for sustainable solutions to the big issues - whether climate change, equality of opportunity, the housing market or how we support savers.

We are a simple business, with an absolute focus on savings and mortgages. It is a business model that has stood the test of time with an emphasis on resilience and stability that is as relevant today as it has ever been. Sustainability is part of our DNA, and at the heart of our long-term approach to delivering value to members.

But I believe we can do more, and 18 months into this fantastic role I can see how our ambition is starting to transform what we do.

We describe our purpose as 'Giving people the power to be better off through life'. This is represented externally by our brand promise to be 'All together, better'. These statements reflect both our commitment to mutuality and the importance of all our stakeholders in delivering a sustainable and successful future.

A strong performance

In 2021, we grew our mortgage and savings balances, took the opportunities presented by a growing market to improve our profitability to a more sustainable level, invested in our brand, channels and technology and maintained a strong focus on costs, whilst delivering excellent service and continued value to our members.

Profit before tax of £233 million was significantly higher than in 2020 (£124 million) reflecting the strong demand for mortgages, improved margins and lower credit losses throughout the year. To some extent, this was a game of two halves and we took decisions to slow growth in the latter months in the face of an increasingly competitive market and the sharp contraction of margins - a clear example of both our long-term perspective and member-focused purpose. Our aim is always to optimise profitability rather than maximise it, to underpin our long-term financial resilience, fund investment in future services and keep members' money and data safe and secure.

During the year we also updated our accounting estimate for future Standard Variable Rate (SVR) mortgage income, reflecting our view that customers will switch products at the end of their fixed rate periods more quickly in future based on planned improvements to our mortgage systems and market trends. This adjustment reduced our profits by £69 million in the year and as a result has importantly reduced the risk of volatility in our profit in future periods as consumers interact with their mortgage providers in a more automated, digital way.

Our mortgage growth of 7.2% (2020: 3.0%) was not only higher than the previous year but higher than the market overall[1]. The end of the temporary reduction in Stamp duty led to record purchase and redemption activity, followed by rise in remortgage and product transfer transactions towards the end of the year as interest rate expectations increased. Equally important was the strength of the labour market as the furlough scheme ended, which helped support both demand for new mortgages and the continued repayment of our existing loans. At just 0.10%[7] (2020: 0.09%) we continue to record very low levels of arrears and have released £29 million of provisions that were set aside for potential credit losses in 2021 that may have resulted from the economic impact of the pandemic. Although uncertainty remains, these more worrying economic outcomes for our customers did not emerge.

We extended our participation in the first time buyer sector, helping more people move into their first home, as well as launching an incentive for existing or new borrowers to increase the energy efficiency of their property. By designing the Green Together Reward as an addition to any new mortgage or change to existing borrowing, our aim was to encourage the take-up of this environmental incentive. The modest demand to date, however, shows that industry, government and homeowners collectively have more to do to address the energy inefficiencies of UK housing stock. We see our support for this in the coming years as an intrinsic part of our purpose and strategy.

It's not just the design of our mortgages that makes a difference but the exceptional service we provide too. I want to thank colleagues who supported our mortgage delivery and maintained an exemplary level of service throughout the year despite the increased volume of transactions. I know that their efforts were hugely appreciated by our broker partners and customers aiming to complete moves before stamp duty deadlines, and they thoroughly deserve the independent accolades they have received from Which? and Fairer Finance.

Our savings balances increased by 4.6% (2020: 5.3%) during a year in which we had to balance the returns we offer savings members with our long-term sustainability. However, we continued to pay above market pricing with our average savings rate of 0.83% comparing favourably with a UK average savings rate of 0.27%[2]. This meant we paid additional interest of £201 million to our savings members[2] in 2021 (2020: £196 million) when compared with the market average, and this long-term value is something we are very proud of.

We also launched purposeful savings propositions, which encourage the savings habit and strengthen the relationship between members and the Society. Our First Home Saver is a clear example of this, incentivising and supporting people aiming to take their first step on the housing ladder, and our Regular Saver was singled out as the best in the market. We also ran a successful pilot looking at member loyalty as a means of demonstrating the benefits of mutuality and will do more on this in the future. Our commitment to savings was recognised by Savings Champion, which awarded us 'Best Building Society for Savings'.

It is great to receive external recognition for the fantastic service we provide as well as the quality of our products. Overall, the service my colleagues delivered in 2021, as measured by Net Promoter Score[3] (NPS), improved from +73 in 2020 to +76 in 2021 - an incredible achievement given the volume of activity we experienced at times though the year and the challenges of the pandemic.

Our aim is to support the investment we're making in our future whilst maintaining a cost advantage to compete in today's market. Our continued growth in 2021 helped ensure that our cost to mean asset ratio remained broadly stable at 0.50%[4] (2020: 0.49%), despite total management expenses increasing to £264 million (2020: £246 million). Our investment of £96 million in technology and change programmes shows the importance we attach to enhancing our digital infrastructure and the Society's IT resilience as well as developing new services. Cost, however, remains a key focus for the Society, which benefits from the simplicity of our business model and focused strategy.

Our profit in the year enabled us to maintain our strong capital ratios. Our Common Equity Tier 1 ratio was 36.2% (2020: 33.0%), well above the regulatory minimum requirements. Our Leverage Ratio was 4.8% (2020: 4.6%) and our Liquidity Coverage Ratio was 187% (2020: 179%).

Known for a better service today and investing for tomorrow

Financial services are changing fast, and at times it feels as if you have to run to stand still. However, in 2021 we took significant strides in delivering our change agenda, and can now demonstrate a track record of progress which is essential to our future success.

Central to this is building the strong technology infrastructure and operational resilience that underpin the services we provide today and the services we'll introduce over the coming months and years. We completed the Infrastructure Transformation Programme so that our new data centres are up and running, and upgraded our databases and testing capability to enable future changes to be introduced more quickly and efficiently.

We made big progress on our digital journey. Our multi-year programme to make our mortgage offer more tailored to individuals, as well as easier and quicker service for borrowers and brokers alike, is delivering tangible results. Borrowers can now complete product transfers online using a new self-service capability that extends to owner-occupier and buy to let products. It is a better service for borrowers, adds scale to our business, reduces risk and is more operationally efficient. Brokers love the new webchat support we launched this year, which complements the intermediary support teams in delivering our leading service. We redesigned our website and upgraded our online services, making them simpler and more accessible and incorporating many changes that members have asked for. The progress can be clearly seen in our online service users NPS[3] which rose from +20% to +46% during the year. This underpins our ability to grow the Society in future years and meet the changing expectations of our members.

We aim to provide a brilliant integrated experience whatever channel our members choose to use and have made great progress with our branch investment too. We have now redesigned and refurbished 50 branches to fantastic feedback from members and colleagues, including relocating a number to better locations and opening our first new branch for many years. The programme is on schedule to complete the refurbishment of all remaining branches during 2022.

We are matching our investment in services with an increased focus on brand. We launched a new 'look and feel' that helps us stand out in the crowded financial marketplace. And in May we announced our naming rights sponsorship of the Coventry Building Society Arena, in partnership with Wasps Rugby. The Arena is a sporting hub, hosting elite rugby, netball and football as well as being part of the Commonwealth Games and Rugby League World Cup. It is also a unique entertainment, business conference and exhibition centre that makes it a nationally important venue. We want to be locally loved and nationally famous and with over 1.6 million visitors every year, and in a prime location in the heart of the country, the sponsorship will ensure that more people know about the Society as well as enable many purposeful opportunities to support our ambition, our community partners and other stakeholders.

Making a difference

I mention purpose deliberately. As I said earlier, a transformation is starting to take place in people's attitudes and behaviours which is also reflected in government policy and regulations. Collectively the Environment, Social and Governance (ESG) agenda is challenging businesses to deliver financial and operational success in new and sustainable ways.

Our environmental commitments are set out in our Climate Action Plan which sets out tangible measures covering our use of resources and performance on emissions, as we investigate the wider impact of our lending. In addition to the Green Together proposition I mentioned earlier, we have transitioned to 100% renewable sources of energy, including the installation of solar panels at our head office site. We have achieved net zero merits for our Scope 2 emissions and carbon neutrality for Scope 1. Collectively, these actions show that this is not something we are talking about but doing.

We have transformed our Social agenda helping young people acquire the skills and knowledge on which to base good careers, tackling isolation and homelessness amongst the more vulnerable members of society.

These are tough problems, made worse by the pandemic, and we have had to adapt and change the way we help. For example, we moved all our work with schools online, including a curriculum-based numeracy package called Coventry Counts, developed in conjunction with local educationalists, which was taken up by 50 schools in its first week of operation. We also extended our online employability support to include webinars for all sixth form students in Coventry.

The key is forming long-term partnerships with charities that share our goals, and concentrating our resources on issues and in places where we can make most difference. We now work with six charities across Coventry and in 2021 began to use dormant account funding to support the long-term delivery of programmes across the city. We've also been proud to support Coventry's UK City of Culture year which brought together our commitment to the city and our community goals.

One of our successes over many years has been using the strength of our savings brand to generate funding for charities through affinity products. In particular we have enjoyed a tremendous relationship with The Royal British Legion, which has resulted in donating £19.4 million since 2008, including £0.6 million in 2021, its centenary year. Over the same period, we have also donated over £1 million through affinity accounts to smaller, local charities, primarily in the South-West region. As we look forward, we plan to align our financial and organisational strengths more closely to our new community strategy.

Flexible and engaged colleagues

None of this would have been possible without the hard work and dedication of my colleagues. I strongly believe that our people are our greatest asset and, in what continues to be a very challenging time for them personally and their families, I have been hugely impressed by the way they have stepped up and delivered for our members.

Although 2021 ended in similar fashion to 2020, with concerns about tighter restrictions and an uncertain start to the year ahead, it felt very different overall. Whilst our priority remains the safety of colleagues and members, we are also seeing how working from home for an extended period of time is leading to a fundamental shift in the way many people view their relationship with work.

We have adapted accordingly and moved towards a 'hybrid' way of working that blends home working and time in the office for nearly 2,000 colleagues. This is not 'one size fits all' but varies according to the type of work undertaken and the individuals themselves. In many ways, it meets our ambition to empower colleagues and to offer careers at the Society that challenge and develop our people.

I am proud of the fact that around 200 colleagues per year move into a new role at the Society, meaning 40% of our vacancies are filled through internal moves. We are committed to at least 40% of our senior management roles and above being held by women compared to 37% at the end of 2021. We have also set a target of 25% of all management roles to be held by people from ethnically diverse backgrounds compared to 12% now. Our commitment to making progress is demonstrated by signing the Race at Work Charter, our sponsorship of the MOBO awards and the creation of inclusion and diversity groups. I believe passionately in inclusion, not just as 'the right thing to do' but something with enormous value to us as a firm and to wider society.

Our approach to inclusion and diversity, the support we give colleagues to develop and progress, the flexibility we show in our ways of working, our commitment to a rewarding career and the help that's there when colleagues experience tough times were all tested against the benchmark of the Great Place to Work survey. I was delighted that the Society was accredited as a Great Place to Work at our first go, a benchmark that I am committed to building on in coming years.

There is no doubt that expectations of work are changing fast, and to succeed we must embrace the opportunities that this presents. We will continue to attach great importance to listening to our colleagues, whether virtually, or through My Society, our colleague forum attended by Jo Kenrick, our Deputy Chair. It is a strength of the Society and hugely helpful in informing our decision making.

Looking forward

I started by saying that the pandemic is proving a catalyst for change.

I have no doubt that future success will depend on taking a long-term view. This is a strength of the mutual business model. We will continue to run the Society prudently and in the interests of our members by providing excellent service and propositions that offer great value. We are investing to deliver this integrated service across our branches, contact centres and digital channels, and developing new propositions to help people save and buy their own homes.

At the same time these will be increasingly aligned to our sustainability agenda, and highlight the positive impact we can have on wider society and the environment. We can be 'All together, better' through taking account of our responsibilities to all our stakeholders.

I am confident about the year ahead. We have shown, despite the challenges of the pandemic, that we can meet the needs of today's members whilst laying the foundations for the future. We will continue to change and adapt to new ways of working, and enhance our resilience in the face of any future economic and competitive headwinds. I would like to thank our members, colleagues, customers and partners for their support and loyalty. The pandemic has challenged all of us over the last two years, and I hope that 2022 will see us emerge from the uncertainties and worries it has presented. I look forward to working with colleagues to deliver our exciting and ambitious plans on behalf of our members.

1. Source: Bank of England.
2. Based on the Society's average month end savings rate compared to the CACI market average rate for savings accounts, excluding current accounts and offset savings, for the first 11 months of the year. This measure and comparative have been updated in the year to use CACI source data for the market rate; previous source Bank of England.
3. 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.
4. Administrative expenses, depreciation and amortisation/Average total assets.
5. Administrative expenses, depreciation and amortisation/Total income.
6. Total community investment made by the Society including donations from the Society and fundraising activities.
7. Percentage of mortgages where arrears are more than 2.5% of the balance.

Chief Financial Officer's review

Income Statement

Overview

In 2021, the Society improved its financial performance after the challenges in 2020 as a result of the Covid-19 pandemic. The following significant factors impacted the 2021 financial results:

- Net interest income increased by £67 million, supported by improved mortgage margins in the first half of 2021, lower funding costs and after a £69 million reduction to our expectations for future Standard Variable Rate (SVR) income. The increase in the Bank of England Bank Rate in December 2021 did not have a material impact on our result for the year.
- Expected credit losses (ECLs) did not emerge at the level assessed at the end of 2020 with those mortgage customers who took payment holidays having returned to making full mortgage payments in the vast majority of cases and house price growth remaining strong. As a result £29 million of ECL provisions were released during the year, compared to a charge of £36 million in 2020.

As a result, profit before tax increased to £233 million (2020: £124 million) which is a more normal level of profit relative to our size and high level of growth in the period.

	2021 £m	2020 £m
Interest receivable	**833.9**	859.9
Interest payable	**(357.7)**	(451.4)
Net interest income	**476.2**	408.5
Other income	**(1.4)**	(0.1)
Losses on derivatives and hedge accounting	**(6.6)**	(0.7)
Total income	**468.2**	407.7
Management expenses	**(263.5)**	(245.6)
Impairment release/(charge)	**28.7**	(36.4)
Provisions	**-**	(0.5)
Charitable donation to Poppy Appeal	**(0.6)**	(0.8)
Profit before tax	**232.8**	124.4
Tax	**(42.0)**	(23.0)
Profit after tax	**190.8**	101.4

Net interest income

Net interest income increased to £476 million (2020: £409 million).

Before the adjustment to future SVR income, interest receivable on mortgages increased by £33 million as a result of the growth in balances, although the average interest rate paid by our mortgage customers fell slightly in the year. The remaining £10 million increase related to interest receivable on treasury assets.

Interest payable on retail savings reduced by £86 million as savings rates continued to fall across the market. The Society continued to pay favourable savings rates, returning £201 million (2020: £196 million) in member value compared to market average rates[8], whilst continuing to invest in the Society and maintain its long-term resilience.

The remaining £7 million movement related to lower interest payable on other borrowings and hedging instruments.

The Bank of England Bank Rate remained at 0.10% for most of 2021, and the increase to 0.25% in December 2021 had no material impact on 2021 results.

The increase in net interest income was partly offset by an accounting adjustment of £69 million as a result of an update to the Society's estimate of future SVR income on mortgages.

This estimate was revised lower in 2021 as a result of the change in future assumptions relating to mortgage redemptions with expectations that customers will spend less time paying SVR at the end of their fixed rate period. This flows from our investment in digital mortgage switching being implemented from 2021 to 2023, and similar investment by other firms, making more cautious income recognition assumptions appropriate.

This adjustment has removed the majority of our 'Effective Interest Rate' asset for future SVR income which is now £17.3 million (2020: £71.1 million), reducing the risk of future income volatility.

Net interest margin

At 0.90%, our net interest margin improved significantly from the 0.81% reported in 2020 as a result of the movements in net interest income outlined above relative to our average total assets. Excluding the impact of the accounting adjustment for SVR the net interest margin for the year would have been 1.03%.

As a result of a more competitive market, new mortgage margins fell in the second half of 2021. This is expected to reduce net interest margin beyond 2022.

	2021	2020
	£m	£m
Net interest income	**476**	409
Average total assets	**53,014**	50,515
	%	%
Net interest margin	**0.90**	0.81

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 throughout the period. The overall impact in the Income Statement is significantly reduced compared with the underlying movements in swap valuations seen in the market. The loss of £7 million for the year represents hedge ineffectiveness and fair value movements on derivatives where hedge accounting has not been obtained (2020: £1 million).

Management expenses

Overall management expenses increased by £18 million or 7%. The majority of the increase was due to the impact of higher variable pay in recognition of the strong performance against our targets, salary and cost inflation, continued investment to improve the resilience of services to members, enhancements to online services and investment in our new mortgage platform. We also continued our refurbishment of branches.

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 0.50%[9] (2020: 0.49%) is expected to remain among the lowest in the UK building society sector. The cost to income ratio improved to 56%[10] (2020: 60%). Excluding the impact of the accounting adjustment for SVR income, the ratio for the year would have been 49%.

Expected credit losses

The performance of our mortgage book improved compared with our expectations following the emergence of the Covid-19 pandemic. In 2020, the Society granted 40,000 mortgage Covid-19 payment holidays, none of which were active at 31 December 2021. The vast majority of customers returned to making full mortgage payments and only 0.10% of all of our mortgage customers were in arrears of greater than 2.5% of the balance at the year end (2020: 0.09%).

Despite a continued cautious approach to estimating expected credit losses (ECLs), our improving credit performance together with an improved economic outlook resulted in a reduction to our provision for ECLs and a release of £29 million (2020: charge of £36 million) has been recognised in the accounts.

Notwithstanding this improved performance, uncertainty remains and judgement has been required in order to calculate the provision required at 31 December 2021. We have continued to consider a range of potential scenarios including a severe downside where house prices fall by around a third and unemployment more than doubles.

At the year end, total provisions were £19 million, of which £9 million related to post model adjustments (PMAs) where the risks were not assessed as adequately captured in the Society's modelling. This has reduced from 2020 where a total provision of £48 million was recognised, of which £38 million was PMAs.

The adjustments cover the following risk areas:

- The potential for losses as a result of cladding remediation on flats where fire safety standards have not been met.
- Risks relating to Covid-19 payment holidays for accounts with extended payment holidays or additional risk flags.
- 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.

In 2020 there were adjustments which covered risks relating to all Covid-19 mortgage payment holiday accounts and for the potential of a house price index (HPI) fall once support measures such as the stamp duty holiday and furlough were removed.

Following the continued good performance of the mortgage book and sustained house price performance, these adjustments are no longer required.

The remaining £9.6 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.

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 2021 stage 2 accounts reduced to 6.9% (2020: 8.2%). 92.7% of the book remains in stage 1 (2020: 91.3%).

As a result of these changes the ECL provision now equates to 0.04% of the overall mortgage book (2020: 0.11%).

Charitable donation to the Poppy Appeal

The Society continued to support The Royal British Legion's Poppy Appeal with £0.6 million donated during the year (2020: £0.8 million), bringing the total donated over the Society's relationship with the Legion to £19.4 million.

Taxation

In 2021, the corporation tax charge was £42 million (2020: £23 million), reflecting an effective tax rate of 18.0% (2020: 18.5%). In 2021 it was announced that from 2023 the Corporation Tax rate is set to increase to 25% and the banking surcharge is set to decrease to 3%. Due to the timing of the royal assents, the corporation tax increase is reflected in the deferred tax liability at the balance sheet date. However, the banking surcharge decrease had not been substantively enacted at the balance sheet date and therefore is not reflected in these financial statements. The changes in rates are not expected to have a significant impact on the effective tax rate in future.

Balance Sheet

Overview

Mortgage balances grew by £3.1 billion and liquidity increased by £0.3 billion. Retail savings balances grew by £1.7 billion and wholesale funding increased by £1.5 billion.

Mortgage growth was funded by a mix of growth in retail savings and wholesale funding.

A summarised Balance Sheet is set out below:

	2021 £m	2020 £m
Assets		
Loans and advances to customers	**46,620.6**	43,482.8
Liquidity	**7,622.0**	7,314.5
Other	**287.1**	701.0
Total assets	**54,529.7**	51,498.3
Liabilities		
Retail savings	**39,890.2**	38,151.1
Wholesale funding	**11,907.3**	10,367.9
Subordinated liabilities and subscribed capital	**56.9**	67.2
Other	**215.7**	706.0
Total liabilities	**52,070.1**	49,292.2
Equity		
General reserve	**2,012.6**	1,835.1
Other equity instruments	**415.0**	415.0
Other	**32.0**	(44.0)
Total equity	**2,459.6**	2,206.1
Total liabilities and equity	**54,529.7**	51,498.3

Loans and advances to customers

Our lending strategy remains focused on high quality, low loan to value first charge 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 2021, we advanced a record £9.6 billion of mortgages (2020: £6.7 billion) and mortgage balances grew by £3.1 billion (2020: £1.2 billion). The year on year growth in mortgages of 7.2% was above mortgage market growth of 4.6%[11] resulting in our market share increasing to 3.0% (2020: 2.9%).

We also repurchased two buy to let loan portfolios totalling £0.5 billion. The loans were previously originated by the Society and have been recognised within loans and advances to customers from the point of repurchase.

The Society seeks to adjust growth in response to market pricing and funding conditions; as a result of this growth was moderated in the second half of the year with balance growth of £0.7 billion compared with £2.4 billion in the first six months of the year.

New lending on owner-occupier homes accounted for 65% of total new lending in 2021 (2020: 60%) at an average LTV of 65.7% (2020: 65.5%). During the year the Society introduced a range of 95% LTV loans to support first time buyers entering the market. The number of first time buyer loans advanced was 7,100, an increase from 3,200 in 2020.

Total mortgage assets at 31 December 2021 stood at £46.6 billion (2020: £43.4 billion) which comprised £27.4 billion of owner-occupier loans (2020: £25.7 billion) and £19.2 billion buy to let loans (2020: £17.7 billion). The balance weighted indexed LTV of the mortgage book at 31 December 2021 reduced to 50.9%[12] (2020: 52.8%).

Possessions and forbearance have remained low with 27 cases in possession at the year end (2020: 22), with forbearance levels having increased by 27.1% year on year in value terms and 13.9% in number of cases as the Society continues to support its customers following the Covid-19 pandemic. Despite these increases, the Society continues to have very low arrears with only 0.10% of mortgage balances where arrears are more than 2.5% of the balance (2020: 0.09%) at 31 December 2021 compared with the latest available industry average of 0.67%[13].

Liquidity

Liquidity assets increased to £7.6 billion (2020: £7.3 billion) as we maintained a prudent liquidity buffer, demonstrated by our Liquidity Coverage Ratio (LCR) remaining high at 187% (2020: 179%), significantly above the minimum regulatory requirement.

Liquid assets are principally held in deposits at the Bank of England and UK Government investment securities. This means that asset quality remains very high with 98% of the portfolio rated Aaa-Aa3 (2020: 93%). 99% of liquid assets are held in UK sovereign or UK financial institutions (2020: 98%).

Included in liquid assets are £0.7 billion of assets held at fair value through other comprehensive income (FVOCI). As at 31 December 2021, the balance on the FVOCI reserve was a £5 million gain, net of tax (2020: £2 million gain, net of tax).

Retail funding

Retail savings increased in the year by £1.7 billion to £39.9 billion (2020: £38.2 billion), representing growth of 4.6%, compared with market growth of 7.8%[11]. As a result, the Society's savings market share reduced slightly to 2.4%[11] (2020: 2.5%).

The Society continued to support the cash ISA market, increasing our market share to 6.5%[11] (2020: 6.3%).

Our lower growth relative to the household savings market followed a particularly strong savings performance at the end of 2020. Market growth was also strong in current accounts, products that are not offered by the Society.

Our mortgage book continues to be predominantly funded by retail savings with 86% of mortgage loans funded in this way (2020: 88%).

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 £1.5 billion in the year to £11.9 billion (2020: £10.4 billion) with further drawdowns from the Term Funding Scheme with additional incentives for Small and Medium Sized Enterprises (TFSME).

Wholesale issuances during the year included £0.3 billion from an inaugural issuance in senior non-preferred debt and £0.4 billion issued through the Economic Master Issuer Retail Mortgage Backed Securities (RMBS) programme which was recognised in the year with two industry awards. A further EURO

€0.8 billion covered bond was issued in July 2021. There was £5.25 billion of Central Bank Term Funding (TFSME) outstanding as at 31 December 2021 (2020: £4.55 billion).

Equity

The Society's equity is predominantly made up of 137 years of retained profits in the general reserve and Additional Tier 1 (AT 1) capital. The Society made post-tax profits of £191 million in the year and total equity increased £0.3 billion to £2.5 billion, reflecting a £29 million distribution to AT 1 capital holders and movements in the cash flow hedge reserve.

Pension fund

The pension scheme assets and liabilities are recorded in the Society's accounts and the overall position was a surplus of £29 million at the end of 2021 (2020: £10 million). These assets and liabilities are impacted by market movements and the increase in the year was driven by the growth in UK corporate bond yields 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 future losses. As we grow our mortgage book the amount of capital we need to hold to meet the Capital Requirements Directive (CRD) IV increases.

The Society's CRD IV capital position[14] as at 31 December 2021 is summarised below. During the year, the capital resources increased to £2,337 million, primarily through the increase in Common Equity Tier 1 (CET 1) driven by profit after tax of £191 million.

The increase in capital, together with a 2% decrease in risk weighted assets (RWAs), has increased our CET 1 ratio to 36.2% (2020: 33.0%).

The Society submitted an updated Internal Ratings Based (IRB) model to the PRA to comply with required regulatory changes due in January 2022. The update addresses changes in the loss given default and the cyclicality of the probability of default model. Initial feedback has been received and further work is being undertaken prior to adopting the model updates in 2022.

Until the updated models are fully approved, the Society has agreed to hold additional risk weighted assets (RWAs) from 1 January 2022, if this was applied at 31 December 2021 it would lead to an increase in RWAs of 43% and a reduction in the CET 1 ratio for the Society to 26.4%. The final model output may vary from this initial assessment, which may further adjust the CET 1 ratio, effectively bringing forward changes of increasing RWAs envisaged in Basel IV. The Society expects that from 2024, Basel IV RWA floors will be phased in and as transition develops will reduce the Society's reported CET 1 ratio, as they will not reflect our low risk mortgage book and long run loss experience. Applying the Basel IV RWA floors to the year end figures on a full transition basis would result in a CET 1 ratio of approximately 18%. It is important to note that whilst we do not have a regulatory leverage requirement today (see below) we do expect leverage will be our binding capital constraint in the future.

The Society's Total Capital Requirement (TCR) at December 2021 was £565 million, equating to 10.7% of RWAs (2020: £574 million; 10.6%). We exceed this requirement using CET 1 capital alone. The setting of the Society's Pillar 2 requirements will be updated in 2022 as it changes from an absolute amount to a percentage of RWAs as set out in recent regulatory guidance.

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 has increased slightly to 4.8% (2020: 4.6%) driven by the increase in capital resources in the year.

	End-point 31 Dec 2021 £m	End-point 31 Dec 2020 £m
Capital resources:		
Common Equity Tier 1 (CET 1) capital	**1,921.8**	1,783.3
Total Tier 1 capital	**2,336.8**	2,198.3
Total capital	**2,336.8**	2,198.3
Risk weighted assets	**5,303.6**	5,410.6
Capital and leverage ratios:	**%**	%
Common Equity Tier 1 (CET 1) ratio	**36.2**	33.0
CRR leverage ratio[15]	**4.3**	4.3
UK leverage ratio[16]	**4.8**	4.6

8. Based on the Society's average month end savings rate compared to the CACI market average rate for savings accounts, excluding current accounts and offset savings, for the first 11 months of the year. This measure and comparative have been updated in the year to use CACI source data for the market rate; previous source Bank of England.

9. Administrative expenses, depreciation and amortisation/Average total assets.

10. Administrative expenses, depreciation and amortisation/Total income.

11. Source: Bank of England.

12. LTV is calculated using the Nationwide Building Society quarterly regional House Price Index (HPI).

13. Source: Prudential Regulation Authority - latest available information at 30 September 2021.

14. Excluding any IFRS 9 transitional provisions which were negligible.

15. The Capital Requirements Regulation (CRR) leverage ratio is calculated in accordance with the definitions of CRD IV as amended by the European Commission delegated regulation.

16. 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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