Preliminary Results

Year ended 31 March 2017

the West Brom

Forward Looking Statements

Statements in this document are forward looking with respect to plans, goals and expectations relating to the future financial position, business performance and results of the West Brom. Although the West Brom believes that the expectations reflected in these forward looking statements are reasonable, we can give no assurance that these expectations will prove to be an accurate reflection of actual results. By their nature, all forward looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of the West Brom including, amongst other things, UK domestic and global economic business conditions, market related risks such as fluctuation in interest rates and exchange rates, inflation/deflation, the impact of competition, changes in customer preferences, risks concerning borrower credit quality, delays in implementing proposals, the timing, impact and other uncertainties of future acquisitions or other combinations within relevant industries, the policies and actions of regulatory authorities, the impact of tax or other legislation and other regulations in the jurisdictions in which the West Brom operates. As a result, the West Brom's actual future financial condition, business performance and results may differ materially from the plans, goals and expectations expressed or implied in these forward looking statements. Due to such risks and uncertainties the West Brom cautions readers not to place undue reliance on such forward looking statements. We undertake no obligation to update any forward looking statements whether as a result of new information, future events or otherwise.

Chief Executive's Review

Performance

I am proud to report a year of strong underlying performance and unwavering focus on our simple mutual philosophy – to provide members with a secure home for, and a good return on, their savings and the ability to realise their home ownership ambitions.

New prime residential mortgage lending totalled £712m (2015/16: £673m) and, overall, prime owner occupied loans grew by a further 15%, as new and existing customers were supported throughout the year with a competitive mortgage offering. Whilst our focus has been on growing the prime residential book, alongside this we have continued to reduce our exposure to commercial lending.

After adjustment for the one-off items explained below, underlying profitability improved markedly, up 60% from £4.8m to £7.7m.

The statutory loss before tax of £19.8m (2015/16: profit of £13.5m) included the one-off costs of refunding additional interest charged since December 2013 on certain loans to landlord investors with multi-property portfolios. This followed the well-publicised overturning in June 2016, by the Court of Appeal, of an earlier decision of the High Court in respect of the Group's ability to vary the interest rate applicable to these loans. It is regrettable that our attempts to introduce fairness, for the benefit of our membership as a whole, were ultimately blocked. We have, nonetheless, duly met our obligations to cease charging the additional interest and to reimburse affected borrowers for what had previously been levied. The underlying profitability of £7.7m, referred to above, excludes the one-off costs of £27.5m. Of this amount, £8.7m related to additional interest charged on the affected loans during 2015/16 and has been adjusted for in the comparative figure.

The retail franchise remained strong, with retail deposits of £4.4bn (2015/16: £4.4bn) providing a healthy 104% (2015/16: 106%) cover for residential mortgage balances.

As capital is pivotal to the protection of members' interests it is pleasing that, despite reporting a loss and making significant investment in future growth, the Group's Common Equity Tier 1 (CET1) capital ratio remained robust at 13.8% (2015/16: 14.6%). At 6.8% (2015/16: 7.6%), our leverage ratio was one of the best in the bank and building society sector. In January 2017, a third party alleged that the profit participating deferred shares (PPDS) of the Society do not comply with one aspect of the Capital Requirements Regulation criteria for eligibility as CET1. The Society's Board believes that the PPDS are eligible as CET1 and that the PPDS meet the CET1 criteria in all respects. The Board has sought external legal advice on this matter which has confirmed the Board's position. We have also sought clarification on the matter from the European Banking Authority (EBA) and now await a response. Should the EBA not agree our position, it is possible that we would have to reduce the degree to which the PPDS would count towards our CET1 by 50% today and thereafter by 10% per annum on each 1 January. Under this scenario, the immediate impact on our CET1 ratio would be a reduction from 13.8% at 31 March 2017 to 10.6%. The PPDS not included as CET1 would instead be included as Tier 2 capital so there would be no change to the total capital, or solvency, ratio of 16.0% as at that date and there would be no breach of any regulatory capital requirements.

Asset quality

Residential mortgage arrears have fallen for the fourth consecutive year, evidencing the high credit quality of both new lending and the now well-seasoned back book. Since the Society's re-entry into the prime residential market, only one new customer has moved into a serious arrears position. At the year end, none remained in serious arrears.

The de-risking of the balance sheet has continued with a 14% decrease in our exposure to non-core commercial balances from £680m in 2015/16 to £588m. Some £73m of this exposure is in securitisation vehicles which have the effect of transferring the risk of loss out of the Society. Of the remaining £515m of exposure, £302m are non-performing loans being managed for recovery and £38m (7%) has been set aside as provisions in respect of these non-securitised commercial loans.

The Group's liquidity portfolio is efficiently managed and, at 31 March 2016 and 2017, all investment securities were rated single A or above or held with a Global Systemically Important Counterparty. The Society's Liquidity Coverage Ratio - a measure of whether there are sufficient high quality liquid assets to cover expected cash outflows under a 30-day liquidity stress scenario - was 127% (2015/16: 111%), comfortably in excess of the regulatory minimum.

Our members' needs

As a traditional, regional building society we remain committed to the principles of mutuality and all our decision-making is centred around the delivery of long-term value to our circa 446,000 members.

The West Brom looks after the interests of its members by offering prime residential mortgages for homeowners, competitive retail savings and a range of ancillary products and services designed to meet individual financial needs. During the last financial year, we invested substantially in our mortgage application and customer management systems to make it easier for our members to do business with us and to provide operational efficiencies.

Throughout 2016/17 we offered borrowers a competitive range of fixed and discounted variable mortgages, including features such as fees assisted legal services, free valuations and cashbacks. These incentives were well received, in particular, by those borrowers looking to own their first home, with 23% of new mortgages advanced in the year attributable to first time buyers (2015/16: 21%).

Savers faced further downward pressure on returns following the Monetary Policy Committee's decision to lower Bank Rate to 0.25% in August 2016 and of course the impact of the decision of the Court of Appeal I referred to earlier. Savings rates were also adversely impacted by the Bank of England's Term Funding Scheme, introduced to stimulate the mortgage markets by providing banks and building societies with low cost funding, which had the impact of lowering rates across the market. Despite this, the average interest margin paid to savers continues to remain above the average paid across the entire cash savings market.

Against this backdrop, the Society's net interest margin, which is broadly the difference between what is charged on mortgage lending and what is paid to savers, is not maximised but managed at a level which balances the current needs of savers and borrowers with the requirement to deliver business growth and member value over a longer horizon. Throughout the year, we maintained a consistent presence in the Best Buy tables, offering flexibility and choice through a range of savings products available via branch, post and online channels.

Our members' views

As a building society the West Brom operates first and foremost in the interests of its members.

Our expanding Customer Panel enables members to ultimately shape the way we do things. It provides a platform for us to engage with members and hear their views. During the year, we sought and responded to the Panel's feedback on topics such as our latest savings application form, communication preferences and what constitutes a great branch experience.

Members' ViewPoint events, hosted in the Head Office and in locations across the branch network, offer an opportunity for customers to make suggestions and convey their opinions about the Society to the Chief Executive and senior managers in a relaxed setting. This year, we discussed the future for interest rates, rewarding loyalty, mortgage fees and housing market growth with members who attended.

Real-time surveys within our Customer Services, Direct Mortgage and branch teams invite members to give immediate feedback on our service, an important tool for monitoring performance against members' expectations. During 2016/17, we were delighted to win 'Improvement Strategy of the Year' in the Midlands and Yorkshire Contact Centre Awards for improvements to our Customer Services department.

Outlook

Interest rates are predicted to remain low for the coming year, maybe longer. Together with the availability of low cost funding through the Bank of England's Term Funding Scheme, this will stimulate lending but may also serve to intensify competition in the mortgage markets.

The Government's recent housing white paper, 'Fixing our Broken Housing Market', states an intention to increase the supply of new housing stock and provide affordable options for people wishing to buy or rent their own homes. We will keep abreast of these developments and consider any opportunities and concerns they present for home finance providers.

We will continue to invest in systems to improve the customer experience, as well as moving forwards with the Internal Ratings Based (IRB) approach to credit risk capital requirements - a regulatory project which we expect, due to the low risk nature of our core mortgage books, will ultimately improve our already robust capital position.

As the UK negotiates its departure from the EU, there is considerable uncertainty over its future relationships within and beyond Europe. Against this backdrop, we are starting to see a slowdown in house price inflation and real household income growth. While our prime residential mortgages are of a high credit quality and able to withstand a deterioration in market conditions, the commercial loan book is much more sensitive to adverse movements and further loss provisions may be necessary.

Despite the uncertainty that may result from the events of 2016, the Society has achieved lending growth and maintained a solid capital base. Furthermore, the upward trend in underlying profitability is testimony to the strength of the Society's business model. We are therefore well equipped to face the challenges which may lie ahead and remain confident in our ability to continue doing what we do best - fulfilling the needs of our membership.

Jonathan Westhoff
Chief Executive
30 May 2017

Income Statement

for the year ended 31 March 2017

	Group 2017 £m	Group 2016 £m
Interest receivable and similar income	**108.9**	126.7
Interest expense and similar charges	**(53.6)**	(66.7)
Net interest receivable	**55.3**	60.0
Fees and commissions receivable	**2.7**	3.7
Other operating income	**4.1**	3.9
Total operating income	**62.1**	67.6
Fair value losses on financial instruments	**(0.2)**	(1.0)
Net realised profits	**0.5**	0.6
Total income	**62.4**	67.2
Administrative expenses	**(44.4)**	(42.0)
Depreciation and amortisation	**(5.7)**	(5.1)
Operating profit before revaluation gains, impairment and provisions	**12.3**	20.1
Gains on investment properties	**5.4**	5.5
Impairment on loans and advances	**(7.6)**	(8.1)
Provisions for liabilities	**(29.9)**	(4.0)
(Loss)/Profit before tax	**(19.8)**	13.5
Taxation	**(6.0)**	(4.1)
(Loss)/Profit for the financial year	**(25.8)**	9.4

Statement of Comprehensive Income

for the year ended 31 March 2017

	Group 2017 £m	Group 2016 £m
(Loss)/Profit for the financial year	**(25.8)**	9.4
Other comprehensive income		
Items that may subsequently be reclassified to profit or loss		
Available for sale investments		
Valuation gains/(losses) taken to equity	**0.5**	(2.2)
Amounts transferred to Income Statement	**(0.5)**	(0.6)
Cash flow hedge losses taken to equity	**(0.5)**	(0.2)
Taxation	**0.1**	0.2
Items that will not subsequently be reclassified to profit or loss		
Gains on revaluation of land and buildings	**0.6**	-
Actuarial losses on defined benefit obligations	**(10.4)**	(0.9)
Amortisation of original discount on subscribed capital	**0.1**	-
Taxation	**1.7**	0.1
Other comprehensive income for the financial year, net of tax	**(8.4)**	(3.6)
Total comprehensive income for the financial year	**(34.2)**	5.8

Statement of Financial Position

at 31 March 2017

	Group 2017 £m	Group 2016 £m
Assets		
Cash and balances with the Bank of England	**294.8**	215.4
Loans and advances to credit institutions	**174.0**	204.0
Investment securities	**385.0**	410.1
Derivative financial instruments	**6.3**	8.9
Loans and advances to customers	**4,776.5**	4,739.0
Deferred tax assets	**16.4**	20.4
Trade and other receivables	**3.5**	2.7
Intangible assets	**13.3**	8.2
Investment properties	**128.9**	123.7
Property, plant and equipment	**32.1**	33.9
Retirement benefit assets	**-**	0.8
Total assets	**5,830.8**	5,767.1
Liabilities		
Shares	**4,427.3**	4,385.1
Amounts due to credit institutions	**450.3**	259.0
Amounts due to other customers	**132.7**	157.0
Derivative financial instruments	**69.0**	77.1
Debt securities in issue	**263.2**	368.6
Deferred tax liabilities	**5.0**	4.7
Trade and other payables	**10.2**	15.2
Provisions for liabilities	**3.1**	2.7
Retirement benefit obligations	**6.5**	-
Total liabilities	**5,367.3**	5,269.4
Equity		
Profit participating deferred shares	**173.0**	179.5
Subscribed capital	**75.0**	74.9
General reserves	**211.0**	239.3
Revaluation reserve	**3.5**	3.4
Available for sale reserve	**1.7**	0.9
Cash flow hedging reserve	**(0.7)**	(0.3)
Total equity attributable to members	**463.5**	497.7
Total liabilities and equity	**5,830.8**	5,767.1

Statement of Changes in Members' Interest

for the year ended 31 March 2017

Group	Profit participating deferred shares £m	Subscribed capital £m	General reserves £m	Revaluation reserve £m	Available for sale reserve £m	Cash flow hedging reserve £m	Total £m
At 1 April 2016	**179.5**	**74.9**	**239.3**	**3.4**	**0.9**	**(0.3)**	**497.7**
Loss for the financial year	(6.5)	-	(19.3)	-	-	-	**(25.8)**
Other comprehensive income for the period							
Amortisation of original discount on subscribed capital	-	0.1	-	-	-	-	**0.1**
Available for sale investments: reallocation of tax*	-	-	(0.8)	-	0.8	-	**-**
Actuarial losses on defined benefit obligations	-	-	(8.5)	-	-	-	**(8.5)**
Gains on revaluation of land and buildings	-	-	-	0.4	-	-	**0.4**
Realisation of previous revaluation gains	-	-	0.3	(0.3)	-	-	**-**
Cash flow hedge losses	-	-	-	-	-	(0.4)	**(0.4)**
Total other comprehensive income	**-**	**0.1**	**(9.0)**	**0.1**	**0.8**	**(0.4)**	**(8.4)**
Total comprehensive income for the year	**(6.5)**	**0.1**	**(28.3)**	**0.1**	**0.8**	**(0.4)**	**(34.2)**
At 31 March 2017	**173.0**	**75.0**	**211.0**	**3.5**	**1.7**	**(0.7)**	**463.5**

for the year ended 31 March 2016

Group	Profit participating deferred shares £m	Subscribed capital £m	General reserves £m	Revaluation reserve £m	Available for sale reserve £m	Cash flow hedging reserve £m	Total £m
At 1 April 2015	177.1	74.9	233.1	3.4	3.5	(0.1)	491.9
Profit for the financial year	2.4	-	7.0	-	-	-	9.4
Other comprehensive income for the period							
Available for sale investments: current year movement net of tax	-	-	-	-	(2.6)	-	(2.6)
Actuarial losses on defined benefit obligations	-	-	(0.8)	-	-	-	(0.8)
Cash flow hedge losses	-	-	-	-	-	(0.2)	(0.2)
Total other comprehensive income	-	-	(0.8)	-	(2.6)	(0.2)	(3.6)
Total comprehensive income for the year	2.4	-	6.2	-	(2.6)	(0.2)	5.8
At 31 March 2016	179.5	74.9	239.3	3.4	0.9	(0.3)	497.7

* Tax in relation to available for sale investments has been reallocated to reflect the underlying transactions.

Statement of Cash Flows

for the year ended 31 March 2017

	Group 2017 £m	Group 2016 £m
Net cash inflow from operating activities (below)	**138.7**	220.3
Cash flows from investing activities		
Purchase of investment securities	**(230.4)**	(386.7)
Proceeds from disposal of investment securities	**213.1**	298.0
Proceeds from disposal of investment properties	**0.2**	0.4
Purchase of property, plant and equipment and intangible assets	**(9.6)**	(8.8)
Proceeds from disposal of property, plant and equipment	**0.5**	-
Net cash flows from investing activities	**(26.2)**	(97.1)
Cash flows from financing activities		
Repayment of mortgage backed loan notes	**(106.0)**	(98.5)
Net cash flows from financing activities	**(106.0)**	(98.5)
Net increase in cash	**6.5**	24.7
Cash and cash equivalents at beginning of year	**468.8**	444.1
Cash and cash equivalents at end of year	**475.3**	468.8

For the purposes of the statement of cash flows, cash and cash equivalents comprise the following balances with less than 90 days maturity:

Analysis of cash and cash equivalents	Group 2017 £m	Group 2016 £m
Cash in hand (including Bank of England Reserve account)	**287.6**	208.7
Loans and advances to credit institutions	**174.0**	204.0
Investment securities	**13.7**	56.1
	475.3	468.8

The Group is required to maintain certain mandatory balances with the Bank of England which, at 31 March 2017, amounted to £7.2m (2015/16: £6.7m). The movement in these balances is included within cash flows from operating activities.

	Group 2017 £m	Group 2016 £m
Cash flows from operating activities		
(Loss)/Profit on ordinary activities before tax from continuing activities	**(19.8)**	13.5
Movement in prepayments and accrued income	**(0.8)**	(0.2)
Movement in accruals and deferred income	**(2.6)**	(0.4)
Impairment on loans and advances	**7.6**	8.1
Depreciation and amortisation	**5.7**	5.1
Revaluations of investment properties	**(5.4)**	(5.5)
Movement in provisions for liabilities	**0.4**	0.5
Movement in derivative financial instruments	**(5.5)**	6.4
Movement in fair value adjustments	**(0.7)**	(2.3)
Movement in subscribed capital	**0.1**	-
Change in retirement benefit obligations	**(3.1)**	(9.2)
Cash flows from operating activities before changes in operating assets and liabilities	**(24.1)**	16.0

Statement of Cash Flows (continued)

for the year ended 31 March 2017

Cash flows from operating activities (continued)	Group 2017 £m	Group 2016 £m
Cash flows from operating activities before changes in operating assets and liabilities	**(24.1)**	16.0
Movement in loans and advances to customers	**(47.7)**	(72.4)
Movement in loans and advances to credit institutions	**(0.5)**	0.6
Movement in shares	**45.7**	407.1
Movement in deposits and other borrowings	**167.0**	(129.7)
Movement in trade and other receivables	**-**	2.4
Movement in trade and other payables	**(1.7)**	(3.7)
Net cash inflow from operating activities	**138.7**	220.3

Ratios

for the year ended 31 March 2017

	Group 2017 %	Statutory limit %
Lending limit	**11.5**	25.0
Funding limit	**11.7**	50.0

	Group 2017 %	Group 2016 %
As a percentage of shares and borrowings:		
Gross capital	**9.25**	10.37
Free capital	**6.21**	7.29
Liquid assets	**17.04**	17.28
As a percentage of mean total assets:		
(Loss)/Profit for the financial year	**(0.44)**	0.17
Management expenses	**0.86**	0.83

	Group 2017 %	Group 2016 %
Common Equity Tier 1 capital ratio	**13.8**	14.6

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the West Brom

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