# Preliminary Results

Year ended 31 March 2018

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

**The Society has again performed well against its mutual purpose. At £837m residential lending was 18% higher than in the previous period, with lending to first time buyers the highest in the Society's history. For savers we were able to reverse the long term decline in interest rates by passing on benefits from the first increase in Bank Rate for over 10 years. Although we took the opportunity to raise some long term funding from institutional investors, which did result in overall retail balances reducing, our lending remains predominantly funded by retail savers. This mutual model of using members' deposits to promote residential lending to those who wish to own their own home has stood the test of time, nearly 170 years in fact for the West Brom and its generations of members.**

## Performance against our mutual purpose

Although the return to a statutory profit of £8.8m (2016/17: statutory loss of £19.8m) shows a dramatic swing in profitability, this is of course a distorted view given the one-off adjustment required in 2016/17. The prior year results included £27.5m of one-off costs related to reimbursing the interest charged on certain buy to let mortgages. It is therefore more appropriate to measure our progress in terms of the underlying position, whereby profits improved by 14% to £8.8m.

However, what truly reflects the success of the Society's strategy over the last decade has been returning its activities to those that best reflect our purpose. At 31 March 2008, the mortgage portfolio comprised only 36% lending for the purpose of home ownership, with the remainder being made up of 41% buy to let and 23% commercial loans. Moving forward 10 years, the Board's focus on the back to basics principles of the traditional building society model has fundamentally changed the composition of the loan book, which is now over 56% for home ownership, 34% buy to let and just 10% commercial lending. New residential lending for prime owner occupation has increased for the fifth consecutive year, by 18% to £837m (2016/17: £712m), with balances net of redemptions increasing to £2.7bn (2016/17: £2.3bn). These increased volumes have been achieved despite a fiercely competitive marketplace with historically low mortgage pricing being driven by the very low costs of funding provided under the Term Funding Scheme.

Clearly our support for home ownership also means we need to ensure we are able to help those wishing to buy their first house. It is pleasing to see that the Society has again supported an increasing number of first time buyers (nearly 2,000) through a range of products designed to keep initial setup costs to a minimum by offering up to 95% loan to value products with both free valuations and cashback options.

A number of demographic factors have continued to contribute to a decline in mortgage backed home ownership which has been particularly stark amongst younger generations. The Society recognises the importance of the role of the UK's housing market in supporting broader economic prosperity and in turn our own members' financial wellbeing. As a building society operating within the mutual sector our role is to ensure the availability of mortgage finance not only to first time buyers, but also those looking to build their own home and those looking to secure affordable borrowing options in retirement. Therefore, over the next year, we plan to expand our product offering to accommodate the changing needs of our borrowers.

The trust shown by our loyal saving members to hold their funds in safe and secure accounts in exchange for a good return underpins the success of our sustainable mutual model. Retail deposits of £4.1bn (2016/17: £4.4bn) represent a healthy 93% (2016/17: 104%) of residential mortgage balances. For savers, the long awaited decision of the Monetary Policy Committee to increase Bank Rate to 0.5% will have provided some good news for those reliant on interest receipts to support living costs or those who wish to grow their capital for a planned purpose or a rainy day. The weighted average savings rate paid by the Society across retail deposits continues to remain above the rate paid across the cash savings market as a whole with a number of competitively priced fixed and variable products launched through online, direct and branch channels. Last year in particular the launch of the Society's competitively priced Help to Buy ISA specifically through our branches illustrates our continued support for those looking to save for their first home in our heartland.

## A modernised capital base

In January last year the Society received a challenge from a new minority shareholder of the Society's issued capital as to the eligibility of the Profit Participating Deferred Shares (PPDS) as Common Equity Tier 1 (CET 1) capital. While the Board remained of the unequivocal view that the PPDS met CET 1 requirements in all respects confirmation of this position was sought from the European Banking Authority (EBA). In the meantime the Board continued to act in the interests of members and pursued opportunities to assure the Society's regulatory capital position irrespective of any response from the EBA. To this end constructive engagement was held with a different group of holders, representing a majority of the PPDS and nearly half of the Permanent Interest Bearing Shares (PIBS). Following these discussions, it became clear that a modernisation of the Society's capital base would be appropriate regardless of any EBA decision.

Consequently, the Society announced a Liability Management Exercise (LME), which introduced two new capital instruments, Core Capital Deferred Shares (CCDS) and Subordinated Tier 2 Notes. This restructuring was completed in April, just after the financial year end, and resulted in an increase in member reserves of circa £50m. There was no material change in the Society's Common Equity Tier 1 or total capital ratios.

Our Common Equity Tier 1 ratio ended the year at 14.8% (2016/17: 13.8%) and our total capital ratio at 16.7% (2016/17: 16.0%). This is a strong position, enabling the Society to continue the success of recent years.

## Responsible lending, responsible funding

With significant growth in residential lending it is also pleasing to report that residential mortgage arrears have fallen for the fifth consecutive year. This performance is testament to the Society's capability to assess borrowers' creditworthiness supported by robust affordability models, scorecard processes and individual underwriting methods. Furthermore, the more seasoned residential loans that remain from the period leading up to the financial crisis are now performing well following a period of careful management. Core residential arrears ended the year at 0.38% (2016/17: 0.63%), below the UK Finance average of 0.81%.

I have already referred to the benefit of the Bank Rate increase for the Society's saving members although, of course, a number of borrowers will have seen an increase in their mortgage interest payments. However, with the vast majority, some 87%, of new lending on a fixed rate very few new borrowers are exposed to any immediate impact of Bank Rate increases. When ultimately borrowers do face the potential of paying a higher rate at the end of their initial fixed rate deal, we ensure that at the point of agreeing the loan that the mortgage is still affordable should there be a need to pay a considerably higher interest rate – currently more than three times the level of interest initially being paid.

As a mutual, the Society remains committed to funding the majority of new residential lending growth with members' retail deposits; however the quality of the lending portfolio also provides opportunities to source long term wholesale funding through the issuance of Residential Mortgage Backed Securities (RMBS) where it is economically sensible to do so. To this end I am pleased to report that in January the Society successfully raised £350m of low cost securitisation funding - the first time the Society has transacted in the market in five years, illustrating the confidence external investors have in the Society's ability to originate mortgage lending responsibly from good quality borrowers.

## Non-core progress

Our determination to offer high quality products and services tailored to the needs of members has underpinned the commitment we made in 2009 to exit those areas that did not fit with this fundamental principle. Coming into the financial crisis of 2008/9 the Society's exposure to the commercial real estate sector stood in the region of £1.7bn. We have been conducting a carefully managed exit from this high risk exposure such that at the year end this exposure had reduced to £488m, 17% lower than the previous year and over 70% lower than the peak position. Furthermore, of the outstanding exposure some £53m is held in securitisation vehicles which, in effect, transfers the risk out of the Society. Of the remaining balance sheet exposure £254m is being managed by a Law of Property Act Receiver or Administrator, in order to achieve the best possible outcome, with £34m set aside by way of provision.

## Our members' financial wellbeing

The Society strives to offer high quality products, in a responsible way, to support the financial wellbeing of our circa 434,000 members. The product range offered by the Society allows members to build financial resilience by maintaining a personal savings buffer against unexpected events and/or by continuing to build equity in their home funded through a mortgage. In addition to these core offerings the Society continues to offer a wide selection of auxiliary products from Household Insurance helping customers protect their homes to later life planning and the financial advice offering supported by our partners Wren Sterling.

## Our communities

We take our role as a regional building society seriously and continue to make a conscious effort to assist local communities, especially in our heartland area where our branches operate. This year the Society has partnered with The Kaleidoscope Plus Group who work tirelessly throughout the region to help people achieve better mental and emotional health. Through numerous fundraising events, the Society raised an impressive £30,000 for Kaleidoscope Plus. I would like to take this opportunity to thank Kaleidoscope Plus as our charity of the year for 2017/18 with funds raised by the Society going towards the charity's Safe Spaces initiative, which supports people affected by suicide. As part of our year-long partnership, Kaleidoscope Plus also worked with a number of our people on mental health awareness training.

The West Brom's support does not end with financial donations. This year, some 115 of the Society's people actively engaged in our popular volunteering programme where various teams from the Society supported a variety of local community projects. Our financial awareness programme 'The Money-Go-Round' continues to go from strength to strength, promoting the importance of financial awareness for the next generation. I am proud to report that these awareness sessions have now been delivered to 20 schools all within the Midlands Region.

Along that same theme, earlier this year the Society announced plans to bring our regional heritage to life through a unique partnership with the Black Country Living Museum. This new project, due for completion in 2022, will see construction of a replica West Brom 1940s branch as part of a new museum development. This educational facility will enable visitors to gain a contextual understanding of how the principles of mutuality supported the home ownership aspirations of local communities – the same premise from which the Society functions today.

## Promoting engagement

Over recent years I have frequently talked about the importance of maximising the feedback we get in order to ensure we understand what will best support our members, and we are clear on what best enables my colleagues to deliver the best service we can. We have decided to make a further significant step and move beyond the initiatives we have launched in recent years by introducing two new important groups: a Member Council and an Employee Council. Both of these will be asked to consider issues that directly affect the Society, its members and how we deliver our products, services and community responsibilities, to contribute thoughts and provide perspectives that will be taken into account by the Executive and the Board when making key decisions. Recruitment for these two important groups is expected to be before the end of 2018. Continuing the theme of ensuring we, as a modern mutual, retain the vital participation of members in decision making, we are the first building society to move to a binding vote on the Directors' Remuneration Policy; this vote will take place at the forthcoming Annual General Meeting.

## A vibrant future based on a traditional approach

Over what is now nearly 170 years the Society has existed through times of immense upheaval and changing thoughts on how core financial products and services can be delivered. Thriving through these times means that the Society has remained constantly modern and relevant. Perhaps we are now facing as much change and uncertainty as has existed for many periods throughout our history, not just in relation to the economy and how we come through Brexit, but also technology and the drive to digitalisation. These are all challenges we are set to take on and ensure we remain relevant for our members, present and future.

This will involve considerable change, principally in our core technologies, but we have started on this journey. We have ensured we have the capital strength, have reshaped the Society's business mix to be very clear as to who we are here to serve and have resourced ourselves to progress the next phase of technology change.

**Jonathan Westhoff**
Chief Executive
30 May 2018

## Income Statement

### for the year ended 31 March 2018

| | Group 2018 £m | Group 2017 £m |
|---|---|---|
| Interest receivable and similar income | **97.3** | 108.9 |
| Interest expense and similar charges | **(41.8)** | (53.6) |
| **Net interest receivable** | **55.5** | 55.3 |
| Fees and commissions receivable | **2.7** | 2.7 |
| Other operating income | **3.8** | 4.1 |
| Fair value gains/(losses) on financial instruments | **2.5** | (0.2) |
| Net realised profits | **-** | 0.5 |
| **Total income** | **64.5** | 62.4 |
| Administrative expenses | **(43.5)** | (44.4) |
| Depreciation and amortisation | **(7.2)** | (5.7) |
| **Operating profit before revaluation gains, impairment and provisions** | **13.8** | 12.3 |
| Gains on investment properties | **3.8** | 5.4 |
| Impairment on loans and advances | **(7.9)** | (7.6) |
| Provisions for liabilities | **(0.9)** | (29.9) |
| **Profit/(Loss) before tax** | **8.8** | (19.8) |
| Taxation | **(0.9)** | (6.0) |
| **Profit/(Loss) for the financial year** | **7.9** | (25.8) |

## Statement of Comprehensive Income

### for the year ended 31 March 2018

| | Group 2018 £m | Group 2017 £m |
|---|---|---|
| **Profit/(Loss) for the financial year** | **7.9** | (25.8) |
| **Other comprehensive income** | | |
| **Items that may subsequently be reclassified to profit or loss** | | |
| Available for sale investments | | |
| Valuation (losses)/gains taken to equity | **(1.1)** | 0.5 |
| Amounts transferred to Income Statement | **-** | (0.5) |
| Cash flow hedge gains/(losses) taken to equity | **0.8** | (0.5) |
| Taxation | **0.1** | 0.1 |
| **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 | **(1.6)** | (10.4) |
| Amortisation of original discount on subscribed capital | **-** | 0.1 |
| Taxation | **0.4** | 1.7 |
| **Other comprehensive income for the financial year, net of tax** | **(1.4)** | (8.4) |
| **Total comprehensive income for the financial year** | **6.5** | (34.2) |

## Statement of Financial Position

### at 31 March 2018

| | Group 2018 £m | Group 2017 £m |
|---|---|---|
| **Assets** | | |
| Cash and balances with the Bank of England | **324.7** | 294.8 |
| Loans and advances to credit institutions | **120.6** | 174.0 |
| Investment securities | **311.9** | 385.0 |
| Derivative financial instruments | **19.5** | 6.3 |
| Loans and advances to customers | **4,805.4** | 4,776.5 |
| Deferred tax assets | **15.3** | 16.4 |
| Trade and other receivables | **6.4** | 3.5 |
| Intangible assets | **15.3** | 13.3 |
| Investment properties | **132.2** | 128.9 |
| Property, plant and equipment | **30.2** | 32.1 |
| **Total assets** | **5,781.5** | 5,830.8 |
| **Liabilities** | | |
| Shares | **4,051.4** | 4,427.3 |
| Amounts due to credit institutions | **571.3** | 450.3 |
| Amounts due to other customers | **133.1** | 132.7 |
| Derivative financial instruments | **38.7** | 69.0 |
| Debt securities in issue | **493.3** | 263.2 |
| Deferred tax liabilities | **4.5** | 5.0 |
| Trade and other payables | **12.0** | 10.2 |
| Provisions for liabilities | **2.1** | 3.1 |
| Retirement benefit obligations | **5.1** | 6.5 |
| **Total liabilities** | **5,311.5** | 5,367.3 |
| **Equity** | | |
| Profit participating deferred shares | **175.0** | 173.0 |
| Subscribed capital | **75.0** | 75.0 |
| General reserves | **215.8** | 211.0 |
| Revaluation reserve | **3.4** | 3.5 |
| Available for sale reserve | **0.8** | 1.7 |
| Cash flow hedging reserve | **-** | (0.7) |
| **Total equity attributable to members** | **470.0** | 463.5 |
| **Total liabilities and equity** | **5,781.5** | 5,830.8 |

## Statement of Changes in Members' Interest

### for the year ended 31 March 2018

| 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 2017** | 173.0 | 75.0 | 211.0 | 3.5 | 1.7 | (0.7) | **463.5** |
| Profit for the financial year | 2.0 | - | 5.9 | - | - | - | **7.9** |
| **Other comprehensive income for the period (net of tax)** | | | | | | | |
| Available for sale investments | - | - | - | - | (0.9) | - | **(0.9)** |
| Actuarial losses on defined benefit obligations | - | - | (1.2) | - | - | - | **(1.2)** |
| Realisation of previous revaluation gains | - | - | 0.1 | (0.1) | - | - | **-** |
| Cash flow hedge gains | - | - | - | - | - | 0.7 | **0.7** |
| **Total other comprehensive income** | **-** | **-** | **(1.1)** | **(0.1)** | **(0.9)** | **0.7** | **(1.4)** |
| **Total comprehensive income for the year** | **2.0** | **-** | **4.8** | **(0.1)** | **(0.9)** | **0.7** | **6.5** |
| **At 31 March 2018** | **175.0** | **75.0** | **215.8** | **3.4** | **0.8** | **-** | **470.0** |

### 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 (net of tax) | | | | | | | |
| 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 |

## Statement of Cash Flows

### for the year ended 31 March 2018

| | Group 2018 £m | Group 2017 £m |
|---|---|---|
| **Net cash (outflow)/inflow from operating activities (below)** | **(323.4)** | 138.7 |
| **Cash flows from investing activities** | | |
| Purchase of investment securities | **(155.6)** | (230.4) |
| Proceeds from disposal of investment securities | **267.7** | 213.1 |
| Proceeds from disposal of investment properties | **0.5** | 0.2 |
| Purchase of property, plant and equipment and intangible assets | **(7.1)** | (9.6) |
| Proceeds from disposal of property, plant and equipment | **-** | 0.5 |
| **Net cash flows from investing activities** | **105.5** | (26.2) |
| **Cash flows from financing activities** | | |
| Issue of mortgage backed loan notes | **348.5** | - |
| Repayment of mortgage backed loan notes | **(113.4)** | (106.0) |
| **Net cash flows from financing activities** | **235.1** | (106.0) |
| Net increase in cash | **17.2** | 6.5 |
| Cash and cash equivalents at beginning of year | **475.3** | 468.8 |
| **Cash and cash equivalents at end of year** | **492.5** | 475.3 |

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 2018 £m | Group 2017 £m |
|---|---|---|
| Cash in hand (including Bank of England Reserve account) | **318.1** | 287.6 |
| Loans and advances to credit institutions | **120.6** | 174.0 |
| Investment securities | **53.8** | 13.7 |
| | **492.5** | 475.3 |

The Group is required to maintain certain mandatory balances with the Bank of England which, at 31 March 2018, amounted to £6.6m (2016/17: £7.2m). The movement in these balances is included within cash flows from operating activities.

| | Group 2018 £m | Group 2017 £m |
|---|---|---|
| **Cash flows from operating activities** | | |
| Profit/(Loss) on ordinary activities before tax from continuing activities | **8.8** | (19.8) |
| Movement in prepayments and accrued income | **(3.0)** | (0.8) |
| Movement in accruals and deferred income | **1.1** | (2.6) |
| Impairment on loans and advances | **7.9** | 7.6 |
| Depreciation and amortisation | **7.2** | 5.7 |
| Revaluations of investment properties | **(3.8)** | (5.4) |
| Movement in provisions for liabilities | **(1.0)** | 0.4 |
| Movement in derivative financial instruments | **(43.5)** | (5.5) |
| Movement in fair value adjustments | **24.1** | (0.7) |
| Movement in subscribed capital | **-** | 0.1 |
| Change in retirement benefit obligations | **(3.0)** | (3.1) |
| **Cash flows from operating activities before changes in operating assets and liabilities** | **(5.2)** | (24.1) |

## Statement of Cash Flows (continued)

### for the year ended 31 March 2018

| Cash flows from operating activities (continued) | Group 2018 £m | Group 2017 £m |
|---|---|---|
| **Cash flows from operating activities before changes in operating assets and liabilities** | **(5.2)** | (24.1) |
| Movement in loans and advances to customers | **(69.5)** | (47.7) |
| Movement in loans and advances to credit institutions | **0.6** | (0.5) |
| Movement in shares | **(373.2)** | 45.7 |
| Movement in deposits and other borrowings | **123.1** | 167.0 |
| Movement in trade and other receivables | **0.1** | - |
| Movement in trade and other payables | **0.6** | (1.7) |
| Tax received | **0.1** | - |
| **Net cash (outflow)/inflow from operating activities** | **(323.4)** | 138.7 |

## Ratios

### for the year ended 31 March 2018

| | Group 2018 % | Statutory limit % |
|---|---|---|
| Lending limit | **10.5** | 25.0 |
| Funding limit | **14.8** | 50.0 |

| | Group 2018 % | Group 2017 % |
|---|---|---|
| As a percentage of shares and borrowings: | | |
| Gross capital | **8.95** | 8.79 |
| Free capital | **5.88** | 5.90 |
| Liquid assets | **14.43** | 16.19 |
| As a percentage of mean total assets: | | |
| Profit/(Loss) for the financial year | **0.14** | (0.44) |
| Management expenses | **0.87** | 0.86 |

| | Group 2018 % | Group 2017 % |
|---|---|---|
| Common Equity Tier 1 capital ratio | **14.8** | 13.8 |

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