Paragon Banking Group PLC

Preliminary announcement

For the year ended 30 September 2024

RNS Announcement
Paragon Banking Group PLC
3 December 2024

Another year of strong operational and financial performance

Paragon Banking Group PLC ('Paragon' or 'the Group'), the specialist lender and banking group, today announces its full year results for the year ended 30 September 2024

Nigel Terrington, Chief Executive of Paragon said:

"It has been another year of strong financial and operational performance, building on our consistent track record over the past decade, underpinned by the strength of our business model and long-term strategy.

We have seen accelerating momentum throughout the year, with new lending levels reaching the upper range of our expectations and strong customer retention. Improving customer sentiment, robust year-end pipelines, and our strategic focus on specialist markets, gives us confidence as we enter the new financial year.

Our savings franchise also continues to grow at pace, with retail deposits up almost 23%, outperforming the market, supporting our growth ambitions and providing strong liquidity.

Paragon's consistent focus on sustainable growth, enabled by an increasingly diversified and digitalised operating model, together with strong internal capital generation, puts us in a strong position to continue delivering superior returns to our shareholders whilst continually supporting our customers' ambitions."

Financial highlights

- Operating profit before fair value items increased by 5.4% to £292.7 million (2023: £277.6 million)
- Statutory profit before tax increased by 27.0% to £253.8 million (2023: £199.9 million)
- Net interest margin widened by 7 basis points year-on-year to 316 basis points
- Cost efficiency remains strong, cost-to-income ratio 36.1% (2022: 36.6%)
- Cost-of-risk rose slightly, to 16 basis points from 12 basis points in 2023, reflecting the higher interest rate environment
- Underlying basic EPS increased 7.3% to 101.1p (2023: 94.2p) and statutory basic EPS increased 28.8% to 88.5p (2023: 68.7p)
- Capital ratios remain strong: CET1 ratio 14.2% (2023: 15.5%), reflecting strong growth and significant capital returns
- Underlying Return on Tangible Equity at top of target range 20.3% (2023: 20.2%)
- 30 September 2024 Tangible Net Asset Value per share £6.11 (2023: £5.79)
- Total dividend rose 8.0% to 40.4p (2023: 37.4p)

- £92.5 million of the £100.0 million FY24 share buy-back completed. Balance of £7.5 million together with a further £50.0 million announced for FY25

Operational highlights

- Total new lending of £2.73 billion (2023: £3.01 billion) delivered in line with guidance:
    - Mortgage Lending advances totalled £1.49 billion (2023: £1.88 billion)
    - Commercial Lending advances totalled £1.24 billion (2023: £1.13 billion)
- Year-end pipelines strong, driving volumes for FY25
    - Buy-to-let pipeline up 48.2% year-on-year to £0.88 billion (2023: £0.59 billion)
    - Development finance pipeline up 31.0% year-on-year to £0.20 billion (2023: £0.15 billion)
- Net loan book grew by 5.6% to £15.7 billion (2023: £14.9 billion)
- Buy-to-let 3-month plus arrears 0.38% (2023: 0.34%)
- Buy-to-let portfolio loan-to-value ratio at 62.8% (2023: 62.8%)
- Strong liquidity. Retail deposits up 22.9% to £16.3 billion (2023: £13.3 billion)
- £2.0 billion of TFSME repaid in the year, with £0.75 billion outstanding
- Digitalisation process continues apace, with new buy-to-let broker portal roll-out continuing during final quarter of 2024
- Continued engagement with PRA on modelling requirements for IRB. Near-final rules for Basel 3.1 reduce potential exposure to 104 basis points like-for-like with original consultation paper, where estimated impact was 210 basis points

For further information, please contact:

Paragon Banking Group PLC
Nigel Terrington, Chief Executive
Richard Woodman, Chief Financial Officer

0121 712 2505

Headland Consultancy
paragon@headlandconsultancy.com
Lucy Legh / Charlie Twigg

020 3805 4822

The Group will be holding a call for sell-side analysts on Tuesday 3 December 2024 at 9:30am at UBS, 5 Broadgate, London EC2M 2QS.

This will be webcast live at: https://secure.emincote.com/client/paragon/full-year-results-2024

A recording of the presentation will be available on our corporate website www.paragonbankinggroup.co.uk/investors from 2:30pm that day. The presentation material will be available on the website at 7:00am on the same day.

Cautionary statement

Your attention is drawn to the cautionary statement set out at the end of this announcement.

MANAGEMENT OVERVIEW

Introduction

The period ended 30 September 2024 has been another year of strong financial and operational performance, building on our consistent track record over the past decade, underpinned by the strength of our business model and long-term strategy.

A combination of new lending towards the top end of expectations and the strong retention of customers reaching product maturity saw our total loan portfolio grow to £15.7 billion at 30 September 2024, up 5.6% in the year and in line with our 10-year loan book CAGR of 5.4%. In addition to loan book growth, our savings franchise has also continued to develop, with balances up over 23% in the year, supporting a strong liquidity position and the accelerated repayment of the majority of our TFSME drawings.

Net loan growth totalled 4.0% in Mortgage Lending and 16.1% in our Commercial Lending division, underlining the ongoing delivery of our diversification strategy. Commercial Lending now comprises 14.6% of the net balance sheet loans but generates 27% of our total income. With Commercial Lending generating a stronger margin than Mortgages this mix effect has been an important factor in our continued strong NIM performance for the year.

Our digitalisation programme reached one of its most significant milestones to date, with our new buy-to-let origination platform being rolled out internally and to a first wave of brokers during the final quarter. This more digitalised, AI-enabled operating model will further expand our already extensive data, support improved efficiency and enhance customer interactions, whilst not diluting the specialist nature of our lending or our vital broker and customer relationships.

Financial performance

A combination of stronger margins and higher loan volumes resulted in net interest income rising by 7.6% from its 2023 level to £483.2 million. Within this, our net interest margin rose to 316 basis points (2023: 309 basis points), where the effects of the net free reserve hedge created during the year, and asset-side margin strength, have served to more than offset the effects of lower spreads between deposit rates and SONIA.

Operating costs, which now include the new PRA levy, came in around expectations at £179.2 million (2023: £170.4 million). With income rising faster than expenditure the cost-to-income ratio improved further in the year, to 36.1% (2023: 36.6%). We continue to expense the bulk of our digitalisation investment spend, with only £4.5 million being capitalised to software intangibles in the year, taking the year-end balance to £8.0 million (2023: £4.4 million). Our investment in digitalisation continues to support improved operational efficiency, which remains an important area of focus. At 1,411, our year end headcount was 7.3% lower than its September 2023 level.

The higher interest rate environment saw some greater pressure on customers with variable rate loans in our buy-to-let and development finance books. Overall impairments rose to £24.5 million from £18.0 million in 2023, reflecting a cost of risk of 16 basis points (2023: 12 basis points). The arrears performance in the buy-to-let book has improved in the second half of the year, with 30 September three-month plus arrears standing at 38 basis points compared to 34 basis points at September 2023 and 68 basis points at March 2024, while buy-to-let security levels remain robust, with a loan-to-value ratio of 62.8% (2023: 62.8%).

MANAGEMENT OVERVIEW

Underlying operating profit, before fair value items, rose 5.4% from its 2023 level to £292.7 million (2023: £277.6 million). When applied to the lower share count arising from the share buy-back programme, underlying basic earnings per share rose 7.3% to 101.1 pence per share.

Our dividend is based on underlying earnings per share and increased by 8.0% year-on-year to 40.4 pence per share (2023: 37.4 pence), in line with policy.

Fair value balances continued to unwind during the year, but at a slower rate than in 2023 at £38.9 million (2023: £77.7 million). Consequently, statutory pre-tax profits rose 27.0% from their 2023 level to £253.8 million (2023: 199.9 million).

Tax, at 26.7%, took statutory post-tax profit to £186.0 million (2023: £153.9 million), and basic earnings per share to 88.5 pence (2023: 68.7 pence), an increase of 28.8%.

Trading performance

New lending levels have been strong in each of our divisions, with a notable uptick in the second half of the year reflecting strengthening confidence amongst our customers as interest rates started to reduce, inflation fell and the outlook for property prices improved.

For the full year, total new lending of £2.73 billion was delivered, in line with market guidance (2023: £3.01 billion), with £1.49 billion of new buy-to-let mortgage business (2023: £1.88 billion) and £1.24 billion of advances in our Commercial Lending division (2023: £1.13 billion).

Total new advances in the second half of the year were 20.3% higher than in the first six months, and the year-end pipelines in both buy-to-let and development finance, at £0.88 billion and £0.20 billion respectively, were 47.7% and 31.0% higher than their positions at September 2023, which will drive volumes in the new financial year.

Customer retention remains strong, with aggregate buy-to-let redemptions of £0.86 billion compared to £1.11 billion in 2023, representing a redemption rate of 6.7% compared to 9.0% a year before. Together these factors drive the continuing growth of our loan book, which increased 5.6% in the year, reaching £15.7 billion, its highest ever level.

The motor finance industry has seen regulatory and legal intervention during 2024, initially with the FCA review of discretionary commission arrangements, and more recently on commission disclosures more generally, following a Court of Appeal ruling after the year end. Motor finance is a very small part of our business, but with so much uncertainty around how the regulators and courts will finally conclude on the various issues, the different customer journeys and fact patterns for our business when compared to the Court of Appeal cases and the potential implication for us, we have made no provision for potential redress or other costs, given our limited exposure to cases similar to those before the Court.

MANAGEMENT OVERVIEW

Sustainability

At 53.3%, over half of our new buy-to-let lending in the year was on more energy-efficient properties, those with EPC ratings of C or above, compared to 49.9% in 2023 and 45.1% in 2022. We also extended our Green Homes Initiative for property developers and increased our lending on electric vehicles. At the same time we continue to make strong progress on our own operational emission reductions, with 2024's levels representing a 48% reduction against our 2019 baseline. Further enhancements are planned over the coming years, particularly in respect of our head office building.

Capital and funding

Deposit generation has been very strong in the year, with growth from both direct business and our presence on third party platforms. Total balances ended the year at £16.3 billion (2023: £13.3 billion), with 23% having been accessed via platforms (2023: 22%). This range of alternative routes to market optimises our access to liquidity and is an important aspect of our diversified funding mix. Across all our funding sources, we continue to operate in both the fixed and variable rate markets, the latter having underpinned the majority of the growth seen in 2024. At the end of the period the fixed-to-variable split was 50.7% : 49.3% (2023: 65.5% : 34.5%).

The strong deposit flows resulted in an average LCR of 211.5% for the year (2023: 193.7%) which has facilitated the refinancing of £2.0 billion of our TFSME drawings together with our last outstanding public securitisation and our final retail bond.

Our capital ratios are prepared using the standardised approach, which results in a CET1 of 14.2% and a total capital ratio of 16.0% (2023: 15.5% and 17.5% respectively), which remain comfortably above the regulatory requirements.

We have now seen the PRA near-final proposals in respect of capital under Basel 3.1. For a buy-to-let dominated balance sheet the proposals increase capital requirements, albeit materially less so than the first consultation paper suggested. We estimate that the proposals would reduce our CET1 ratio by around 104 basis points, compared with the around 210 basis points effect of the earlier draft.

However, our objective remains to obtain an IRB accreditation, initially for our buy-to-let business, and 2024 has seen a far greater level of engagement with the PRA's specialist teams than had been the case in the recent past. With currently authorised IRB banks making more progress with their new hybrid models, we now have a clearer understanding of the regulator's expectations for our book in the context of this new approach. However, it should be noted that our specialist buy-to-let portfolio is, by definition, more complex than the more commoditised mortgage portfolios the regulator tends to see in the wider banking sector.

The planned share buy-back for 2024 was still in progress at the year end, with £76.2 million invested from the £100.0 million programme. An irrevocable instruction was put in place in September 2024 to continue the buy-back into October, when a further £16.3 million was utilised. This left £7.5 million of the original £100.0 million outstanding, which will be completed in the 2025 financial year alongside a newly announced programme of up to £50.0 million for that year.

MANAGEMENT OVERVIEW

Strategic outlook

We continue to build on our strong lending and savings franchises, providing attractive products to our customers. Over the coming years, our customers will be served in an increasingly efficient and effective manner as we deliver our digitalisation plans.

Strong positions in our chosen markets, together with diversification on both sides of our balance sheet, combine to deliver robust earnings from our operating model and we intend to maintain this approach into the future.

Capital management and prudential discipline remain key areas of focus, ensuring sufficient funds to grow in a prudentially strong manner, whilst at the same time distributing any excess through dividends and buy-backs. Our distribution policy for the forthcoming financial year remains unchanged, with a central assumption of distributing around 40% of underlying basic earnings per share, augmented by our share buy-back programmes.

Conclusion

Our 2024 results demonstrate the strength of our franchise and operating model and are especially pleasing after the challenging opening to the year, impacted by subdued demand in our key sectors during 2023.

We have seen accelerating momentum throughout the year, with new lending levels reaching the upper range of our expectations and strong customer retention. Improving customer sentiment, robust year-end pipelines, and our strategic focus on specialist markets, gives us confidence as we enter the new financial year. Our savings franchise also continues to grow at pace, with retail deposits up almost 23%, supporting our growth ambitions and providing strong liquidity.

Paragon's consistent focus on sustainable growth, enabled by an increasingly diversified and digitalised operating model, and supported by strong internal capital generation, puts us in a strong position to continue delivering superior returns to shareholders whilst continually supporting our customers' ambitions.

MANAGEMENT REPORT

This section describes our activities in the year under these headings:

Business review	Funding review	Capital and liquidity review	Financial results	Operational review
Lending and the performance of each of our business lines	*Deposit-taking and the other sources of funding used*	*Our regulatory capital, liquidity and distributions*	*Our results for the financial year*	*Systems, people, sustainability and risk highlights for the period*
Section 1	Section 2	Section 3	Section 4	Section 5

1 BUSINESS REVIEW

We report results analysed between two principal segments, Mortgage Lending and Commercial Lending, based on types of customers, products and the internal management structure. New business advances in the year and year-end loan balances for these segments are summarised below:

	Advances in the year		Net loan balances at the year end	
	2024 £m	2023 £m	2024 £m	2023 £m
Mortgage Lending	1,493.2	1,879.9	13,415.7	12,902.3
Commercial Lending	1,236.8	1,128.7	2,289.8	1,972.0
	2,730.0	3,008.6	15,705.5	14,874.3

Total loan balances increased by 5.6% in the year, as we pursued our strategic objective of managed, targeted growth. Total advances decreased 9.3% year-on-year, although the pattern of movements was not consistent between our specialist markets, with Mortgage Lending, in particular, reflecting a weak opening pipeline following the rapid escalation of base rates seen during the summer of 2023.

MANAGEMENT REPORT

1 BUSINESS REVIEW

1.1 MORTGAGE LENDING

Our Mortgage Lending division principally provides buy-to-let mortgages secured on UK residential property to specialist landlords. We have been active as a specialist in this market for almost thirty years, which gives us deep data on the market through various economic cycles. We have also developed strong relationships with business providers, landlords and trade bodies. These provide an unparalleled understanding of both the buy-to-let market and the specialist landlord customer base we target.

During the year we also offered a limited volume of loans to non-specialist landlords, although this activity is non-core and has diminished over recent periods. The segment also includes legacy assets from discontinued product lines, principally residential first and second charge mortgages, although these form a small fraction of the portfolio and are running off over time.

Our focus on the specialist buy-to-let market facilitates detailed, case-by-case underwriting, where our unique approach to managing property risk and building customer relationships differentiate us from both mass market and other specialist lenders.

Housing and mortgage market

The level of economic uncertainty in the UK over the year, coupled with the impact of higher interest rates and cost-of-living issues on mortgage affordability has significantly impacted the housing market. Activity remained subdued, with transactions for the year ended September 2024 reported by HMRC, at 1,048,000, 3.5% lower than the 1,086,000 in the previous year.

However, signs were more positive towards the year end, with the RICS September 2024 Residential Market Survey reporting stronger demand in the last months of the financial year, and RICS members being generally more optimistic on both demand and prices than in some time.

These factors led to a broadly stable performance by UK house prices in the period, with the Nationwide House Price Index recording a year-on-year increase of 3.2% to September 2024 (2023: decrease of 5.3%), although prices still remain around 2% below their August 2022 peak. This was a more resilient performance than some had predicted, however, the impact of inflation over the period means that prices fell in real terms, potentially benefitting affordability going forward.

In response to the level of activity in the housing market, new mortgage lending remained historically weak in the year, albeit with some recovery from the extreme low point of 2023. However, values remain below both 2022 and longer-term averages. The Bank of England reported new approvals of £242.4 billion for the year ended 30 September 2024, an increase of 14.2% on the £212.2 billion reported for the previous financial year. The increase was driven by mortgages for new purchases where the value of transactions increased by 28.7%. Remortgage activity, in contrast, fell by 8%, potentially as a result of the level of availability of attractive market rates, with the value of mortgages refinanced with their existing lender also falling, by 5.7%.

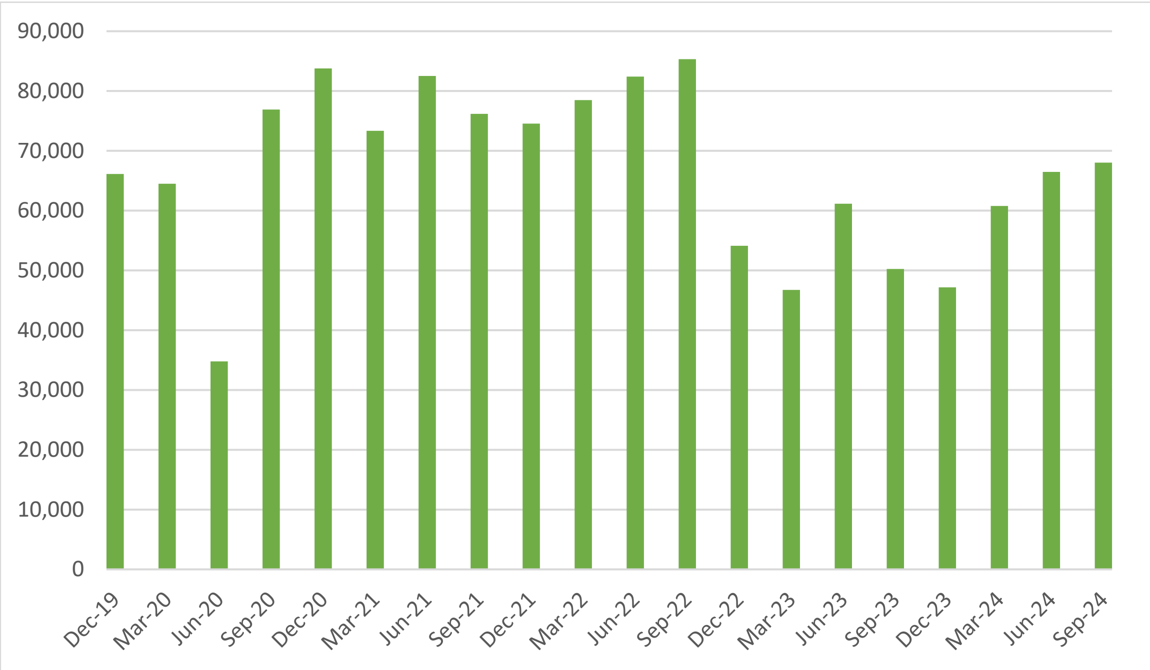
MANAGEMENT REPORT

1 BUSINESS REVIEW

Quarterly Bank of England UK mortgage approval data for the last five financial years is set out below.

UK mortgage approvals (£m)

Five years ended 30 September 2024



At 30 September 2024 the UK Finance ('UKF') survey of mortgage market arrears and possessions reported arrears levels easing in the last quarter of the financial year after building for most of the period. Possession numbers remained largely stable through the year, but at a level higher than seen for some years.

Private Rented Sector ('PRS') and buy-to-let mortgage market

Our target customers in the buy-to-let sector are specialist landlords active in the PRS. Such landlords will typically let four or more properties, or operate with more complex properties. They will generally run their portfolio as a business, and have both a strong understanding of their local lettings market and a high level of personal day-to-day involvement. We are amongst a group of mostly small, specialist lenders addressing this sector, which is underserved by many of the larger banks.

While it is clear that the changing economic environment and regulatory landscape has caused some landlords to step away from the PRS, our experience is that this reaction is concentrated amongst some smaller non-specialist amateur landlords, while our specialist customers remain committed to the sector.

The experience of these professional landlords, their level of involvement with their lettings business and the diversification of their income streams across properties make them less vulnerable to cash flow shocks in the event of a downturn and better able to cope when faced with an adverse economic situation impacting them or their tenants.

MANAGEMENT REPORT

1 BUSINESS REVIEW

The development of the regulatory landscape for the PRS has been dominated for some time by the Renters (Reform) Bill proposed by the last UK Government, which failed to become law before the dissolution of Parliament in May 2024, and its successor Renters' Rights Bill introduced by the new administration.

The new bill is largely based on the original proposals, on which a significant amount of work has already been done by organisations representing lenders, tenants and landlords since the publication of the original White Paper in 2022. As the Bill passes through the UK Parliament, we hope that care will be taken to ensure the measures in the final Act are practical and fully resourced, and that they balance the needs of both tenants and landlords, recognising the important role which responsible landlords play in satisfying the UK's housing needs, and in the economy more generally.

The importance of the PRS to the UK economy was demonstrated by research into the sector carried out for the Group and the National Residential Landlords Association ('NRLA') by the professional services firm PwC. This concluded that the PRS directly or indirectly supports 390,000 jobs in the UK and contributes £45 billion per year to the country's economy. The full report is available on our corporate website at www.paragonbankinggroup.co.uk, in the 'Insights' section of our 'News' pages.

The 2023-2024 English Housing Survey, published by the Ministry of Housing, Communities and Local Government in November 2024, shows that the PRS continues to represent around 19% of English households, as it has consistently done for some time. With research published in May 2024 by the Nationwide Building Society, indicating households deferring their first house purchase due to economic pressures, this makes the role of the rented sector particularly important at present.

The impact on this demand for rental property can be seen in the lettings market data published in the RICS September 2024 UK Residential Market Survey. This reported continuing strong tenant demand coupled with a shortage of new instructions from landlords, which was pushing rents upwards, with RICS members expecting further rent rises in the short term.

Research published by Zoopla suggested that, on average, rents for new tenancies across the UK had increased by 5.4% in the year to July 2024 (the most recent published figure), after three years of growth at even higher levels, driven by demand outpacing the supply of new properties to rent. Zoopla predicts rents to continue increasing in the short term, but at a slower rate.

Around two thirds of properties in the PRS in England are funded through buy-to-let mortgages (based on UK Government data), although buy-to-let mortgage activity in the year showed less evidence of improvement than the general market. New advances reported by UKF were £31.2 billion for the year ended 30 September 2024, 17.2% lower than for the previous year (2023: £37.7 billion), with the value of both house purchase and remortgage cases falling by similar proportions.

The propensity of borrowers to transfer to new products offered by their existing lender has also been affected. While such cases are not included in data for new mortgages, information published by UKF showed that around two thirds of landlords refinancing their mortgage in the year ended 30 September 2024 switched to a new product with the same lender, rather than remortgaging with a new provider. This represented a similar proportion to the previous year, but the value of these cases was reduced, with a significant number of landlords clearly deferring any refinancing of their property, either as a result of affordability issues, or in anticipation of more competitive rates becoming available in the short term.

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This mixed outlook for the sector was borne out by our own independently commissioned research amongst landlords and mortgage intermediaries.

In the Group's quarterly survey of buy-to-let landlords for the quarter ended 30 September 2024, 79% of landlords reported they were experiencing strong tenant demand, including 40% who reported very strong demand. Rental yields continued to move upwards, with 74% of respondents having made rent increases over the year, and landlords reported that rental arrears had plateaued at a low level.

However, expectations for future rental yields had fallen year-on-year and the proportion of landlords who are optimistic about their business prospects was only 33%, with the number of landlords looking to expand their portfolios at an historically low level. Only a very small number of landlords were positive about the UK economy, with a large proportion of respondents nervous that the incoming government's policies might affect their business negatively.

Amongst specialist mortgage intermediaries, our half-yearly insight survey, published in July 2024, showed the vast majority of intermediaries were confident or very confident about the prospects for their firms, the intermediary sector and the mortgage industry. The number who were confident about their buy-to-let business was lower, at 65%, but this was substantially more positive than the 56% reported a year earlier. The principal issues concerning the respondents were the impact of the change in UK government and the level of interest rates, even after those rates had stabilised.

The UKF analysis of arrears and possessions also provided analysis of buy-to-let cases, showing a similar position to the wider mortgage market, with arrears easing in the last months of the period after moving upwards through most of the year to that point.

Overall, this data indicates that the buy-to-let mortgage market remains fundamentally robust, even in the face of economic pressures, albeit with a degree of caution on its future prospects, both on an economic and a regulatory basis. It therefore underpins the strength of our proposition, particularly given our focus on specialist landlords, who may be best placed to deal with these headwinds.

Mortgage Lending activity

New mortgage lending activity during the year is set out below. Almost all the division's lending in the period was to its target specialist landlord customers.

	2024 £m	2023 £m
Originated assets		
Specialist buy-to-let	1,477.9	1,857.6
Non-specialist buy-to-let	15.3	22.3
Total buy-to-let	1,493.2	1,879.9

MANAGEMENT REPORT

1 BUSINESS REVIEW

Total mortgage originations decreased by 20.6%, broadly in line with the reductions in business volumes seen across the buy-to-let market. This was impacted by the low pipeline, the loans passing through the underwriting process, coming into the year, which led to low volumes in the early months of the period. However, demand built during the year with business levels strengthening quarter by quarter, finishing the year positively.

This resulted in a new business pipeline of £881.4 million at the year-end, 48.2% higher than the previous year end reflecting increased market activity as the economic outlook became more stable (2023: £594.6 million).

Our focus within the mortgage sector remained tightly on the specialist buy-to-let product, lending to larger landlords, those operating through corporate structures and those with complex properties, with other products ancillary to this activity.

The majority of our mortgage lending products offer fixed rates for an initial period, with many customers choosing a new product at the end of this fixed period. Since 2017 five-year fixes have been the dominant product, which means those customers whose loans are now reaching the end of the five-year period, are having to refix their mortgage rates at a higher level.

We have well-established, digitally-enabled retention procedures in place to support customers as their fixed rates expire. We offer track-to-fixed products as an alternative to fixed-rate loans, allowing customers to delay fixing their interest rates; this flexibility has helped to support retentions in the period, as well as providing an attractive option for new customers. Over 85% of the specialist landlord customers whose products matured in the past year remained with us at the period end.

Specialist intermediaries are the principal source of our buy-to-let applications, and we continue to strategically focus on ensuring that the service they receive is excellent. Our regular intermediary insight surveys in the year showed 95% were satisfied with the ease of obtaining a response from our team (2023: 95%), delivering a Net Promoter Score ('NPS') at offer stage of +55 (2023: +60).

78% of intermediaries dealing with us rated our service as good or better than that provided by other lenders (2023: 75%). Paragon Mortgages was also named 'Best Buy-to-Let Lender' at the 2024 Mortgage Strategy Awards and 'Specialist Lender of the Year' at the Mortgage Awards 2024.

Our long-term programme of re-engineering our mortgage business continued through the year. All systems and operational processes have been thoroughly reviewed and are being refined and upgraded to align them with our strategy for the division and the overarching plan of digitalising the business.

A major system upgrade, covering the process from application to offer, was launched to our people and began to be rolled out to the broker community during the period. As well as being easier to navigate and more intuitive for users, it now offers enhanced functionality to introducers. The new platform uses API technology to enable brokers to have real-time access to data related to an application, both from the Group and third parties, including credit bureaux and Companies House, enabling significantly more efficient application processing. This will also support more effective assessment processes, delivering more capacity to our buy-to-let new lending function.

1 BUSINESS REVIEW

The new platform has been well received so far, both externally and internally, and the wider rollout of the new functionality across our full broker network has continued into the new financial year. We also expect that the new system will enable us to expand our broker relationships, giving access to more opportunities in the future.

Enhancements already delivered under the mortgage digitalisation programme continue to demonstrate their value to our business. The redemption and retention process which went live in 2022 continues to underpin the division's success in this area, while the landlord self-service portal introduced in 2023 is now used by 25% of the operation's customers and was used to initiate around half of all product renewals in the period. This gives us confidence in the benefits that our new system and subsequent stages of this project will bring to the business and its customers as they are rolled out.

Environmental impacts

We understand the potential for climate change to affect our mortgage business and seek to mitigate this risk, both through the application of scenario analysis to the development of our underwriting procedures, and through careful consideration of the specific risks relating to properties on which we will lend. We also continue to develop systems and refine data to allow our overall exposure to be measured and the behaviour of the security portfolio under climate-related stresses to be better understood.

As part of our response to combatting climate change, a range of green buy-to-let mortgages is offered on all types of property within our lending criteria. These products offer lower interest rates for energy-efficient properties with EPC ratings of C or higher, the currently accepted benchmark for energy-efficient properties, which the UK Government proposes to make a requirement for buy-to-let properties by 2030.

Together with other UK banking entities, we have been working with the UK Government to develop a more consistent approach to the definition of green activities in the housing market and housing finance sectors. It is unlikely that significant progress can be made in greening the UK housing stock until all market participants have a shared concept of what that should mean in detail.

1 BUSINESS REVIEW

Our new buy-to-let lending volumes on energy-efficient properties, which have decreased by 15.1% in the year, less than the reduction in total mortgage lending, are set out below.

	2024	2023
	£m	£m
EPC rated A or B	189.1	187.6
EPC rated C	606.2	749.1
Total rated A to C	795.3	936.7
Percentage with available data (UK)	*99.8%*	*99.9%*

Our latest analysis identified EPC grades for 95.4% by value of the mortgage book at 30 September 2024 (2023: 94.2%). Of these properties, 99.4% were graded E or higher (2023: 99.2%) with 45.4% rated A, B or C (2023: 41.8%). The year-on-year movements are principally a result of the balance of new business, with over half of the advances in the current year, 53.3% (2023: 49.9%) having one of the top three grades.

While we monitor EPC ratings, we are also conscious of the need to avoid unintended consequences by focussing lending on this. Although upgrading existing properties is beneficial to overall emissions, the demolition and replacement of properties may be less so.

Potential physical risks to security values arising from climate change are also monitored. This includes assessing a property's flood risk as part of the underwriting process. In addition, the exposure relating to the current mortgage book is monitored using specialist bureau data. This addresses the risk of flooding from rivers, seas or surface water. The latest data, at 30 September 2024, showed that approximately 3.1% of properties securing buy-to-let mortgages, where data was available, were at 'higher' risk (2023: 3.0%).

According to our quarterly landlord survey, 67% of landlords understand the proposals for new EPC C requirements trailed by the UK Government, with 92% having at least some awareness. Around two thirds of landlords have at least one property with an EPC grade of D or lower, with at least 42% planning to carry out some form of remediation.

We are currently working to develop more products to support existing landlord customers in making their properties more energy efficient. Given that the majority of properties in the PRS require some form of upgrade to meet the Government targets, this kind of support will be vital to achieving net zero target.

MANAGEMENT REPORT

1 BUSINESS REVIEW

Performance

The outstanding first and second charge mortgage balances in the segment are set out below, analysed by business line.

	2024 £m	2023 £m
Post-2010 assets		
First charge buy-to-let	10,620.9	9,679.5
First charge owner-occupied	16.2	22.5
Second charge	56.7	75.8
	10,693.8	9,777.8
Legacy and acquired assets		
First charge buy-to-let	2,658.4	3,040.6
First charge owner-occupied	4.1	5.2
Second charge	59.4	78.7
	13,415.7	12,902.3

Balances within the mortgage portfolio have continued to increase steadily, reflecting, in particular, the success of the business in retaining existing customers. At 30 September 2024, the total net mortgage portfolio was 4.0% higher than at the start of the financial year, reflecting strong lending and retention performance. The balance of post-2010 buy-to-let lending grew by 9.7% and now represents 79.2% of the division's total loan assets (2023: 75.8%).

The annualised redemption rate on buy-to-let mortgage assets, at 6.7% (2023: 9.0%), has continued at a relatively low level. This is despite the potential impact of higher rates on customers whose interest charges are linked to reference rates, and the increasing numbers of five-year products now reaching the end of their fixed rate periods. The redemption rate during the year resulted partly from market pressures which depressed new lending, and partly from the willingness of customers to remain on reversionary interest rates for longer, in anticipation of fixed interest rates being offered in the market becoming more attractive in future. However, this also reflects the business's strategic priority of managing customer behaviour at the end of fixed-rate periods, with significant operational, product and systems focus placed on customer retention.

Arrears on the buy-to-let book increased marginally in the year to 0.38% (2023: 0.34%), with the payment performance of our customers remaining strong, despite the economic pressures in the UK. Arrears on post-2010 lending were even lower, at 0.11% (2023: 0.06%). Our arrears remain very low compared to the national buy-to-let market, as they have always been historically, highlighting the strength of our credit standards and account management processes. UKF reported arrears of 0.86% across the buy-to-let sector at 30 September 2024, sharply increased year-on-year (2023: 0.64%), though still less than the arrears seen in the wider mortgage market.

MANAGEMENT REPORT

1 BUSINESS REVIEW

Our buy-to-let underwriting is focussed on a potential customer's credit quality and financial capability, underpinned by a robust assessment of the security offered. Relying on a detailed and thorough assessment of the value and suitability of the property as security, this approach to valuation, including the use of a specialist in-house valuation team, provides significant security in times of economic stress.

The loan-to-value coverage in our buy-to-let loan book, at 62.8% (2023: 62.8%), represents significant security, supported by the strength of UK house prices over the year. Levels of interest cover and affordability in the portfolio remain substantial, even on a stressed basis, leaving customers well placed to develop their businesses going forward; indeed, on a simple weighted average basis, our landlord customers now have around £9.3 billion of equity in their mortgaged properties.

Arrears on the closed second charge mortgage lending portfolios increased to 24.63% (2023: 23.48%) as the books continue to run off, with the total balance on such loans reducing by 24.9% in the year. These levels of arrears remain higher than the average for the sector, reflecting the history and seasoning of the balances, with the continuing upward trend reflecting the redemption of performing accounts. This book contains a significant number of accounts which are currently making full monthly payments, but which had missed payments at some point in the past, inflating the arrears rate. Credit performance is in line with expectations and we benefit from substantial security on these assets, with an average loan-to-value ratio of 50.3% (2023: 52.3%) providing a significant mitigant to credit risk.

For accounting purposes, 5.8% of the segment's gross balances were considered as having a significant increase in credit risk ('SICR') at the year end (2023: 6.5%), including 1.4% which were credit impaired (2023: 1.2%). This resulted principally from a reduction in arrears cases, offset by an increase in the number of accounts where the property was being sold. However, the level of security on the particular cases involved meant that provision coverage was reduced in the year to 26 basis points (2023: 33 basis points). Coverage on fully performing accounts, however, remained at a broadly similar level to the previous year at 3 basis points (2023: 4 basis points).

Our receiver of rent process for buy-to-let assets helps to reduce the level of losses by giving us direct access to rental flows from the underlying properties, while allowing tenants to stay in their homes. At the year end, 643 properties were managed by a receiver on the customer's behalf, an increase of 14.0% over the year (2023: 564 properties). This increase was driven by the appointment of receivers on a number of legacy portfolios, with the resolution of long-standing cases continuing.

Almost all current receiver of rent arrangements relate to pre-2010 lending, with cases being resolved on a long-term basis to ensure the best outcome for the business, our landlord customers and their tenants. As part of the receivership process, an up-to-date valuation of the property is obtained, therefore provision on these cases is based on up-to-date security values.

1 BUSINESS REVIEW

1.2 COMMERCIAL LENDING

The Commercial Lending division includes four key specialist business streams lending to, or through, commercial organisations, mostly on a secured basis. This division provides a major source of both growth and diversification in our lending operations, two of our major strategic priorities.

The four business lines address:

- Development finance, funding property development projects, mostly houses and flats
- SME lending, providing leasing for business assets and unsecured cash flow lending for professional services firms, amongst other products
- Structured lending, providing finance for niche non-bank lenders
- Motor finance, focussed on specialist parts of the sector

Each of these businesses is led by a specialist management team with a strong understanding of their market. The principal competitors for each are small banks and non-bank lenders. We operate principally in markets where the largest lenders have little presence, creating both a credit availability issue for customers and significant opportunities for our businesses.

Our strategy in Commercial Lending is to target niches (either product types or customer groups) where our skill sets and customer service culture can be best applied, and capital effectively deployed to optimise the relationship between growth, risk and return.

1 BUSINESS REVIEW

Commercial Lending activity

New lending in the Commercial Lending segment increased by 9.6% in the year against an economic background which generally depressed customer demand and completion levels. However, the extent and impact on the division's four principal business lines varied. Performance in both the SME lending and structured finance businesses was stronger than in 2023. However, advances in development finance and motor finance fell, with the development finance reduction due, in large part, to the lower levels of pipeline business brought forward at the beginning of the year.

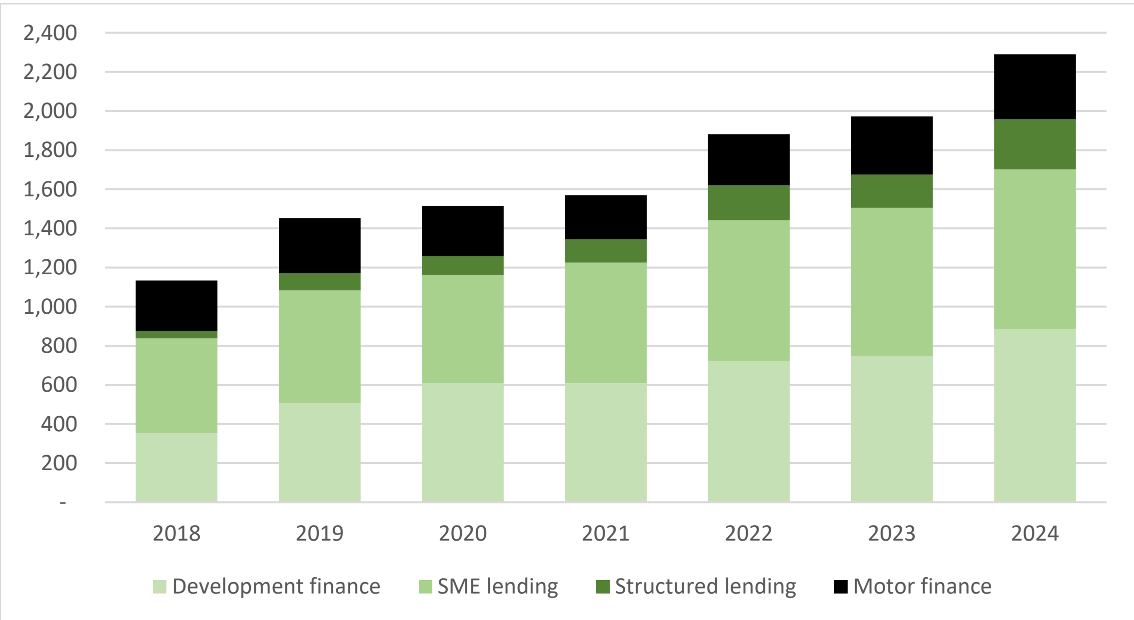
The new lending activity in the segment during the year is set out below, analysed by principal business line. As the structured lending business comprises revolving credit facilities, the net movement in the period is shown (which can be negative).

	2024 £m	2023 £m
Development finance	511.9	528.1
SME lending	480.7	447.9
Structured lending	87.8	(9.5)
Motor finance	156.4	162.2
	1,236.8	1,128.7

These advances continued the growth of the overall Commercial Lending portfolio, with the total loan book increasing by 16.1% in the year to £2,289.8 million (2023: £1,972.0 million), its highest level to date. The increase in the portfolio over the last seven years, and its impact on our diversification strategy is illustrated by the chart below.

Commercial Lending balance outstanding (£m)

30 September 2018-2024



MANAGEMENT REPORT

1 BUSINESS REVIEW

Development finance

The level of new advances in our development finance business was affected by economic and political uncertainty in the UK, particularly around the start of the year, which resulted in developers taking a more cautious approach to the timing of phased drawings on existing facilities, and led to a lower new business pipeline entering the period. However, advances for the year as a whole only declined by 3.1%, despite the weak start to the period, and the year saw the operation's total lending to date reach £3 billion since 2018, supporting the development of around 13,000 new homes.

The financial year began with both undrawn balances on agreed facilities, and cases in the process of underwriting, at an historically low level. Unsurprisingly, this led to a reduced level of lending in the early months of the year, with advances for the first six months of the period, at 243.8 million, 10.7% lower than those seen in the first six months of the 2023 financial year. However, as the year progressed increased levels of proposals were received, with these proposals generally of higher average quality, leading to a rising conversion rate in the period. Completions in the second half increased by 10.0% to £268.1 million, 5.1% higher than in the comparable period in 2023.

Our customer base comprises primarily smaller scale property developers, whose business model relies on a continuing flow of new projects, and during the year we have seen a flow of proposals that are economically feasible in spite of the prevailing conditions of higher costs and interest rates than seen in recent years. Concern over the availability of labour and supplies has reduced, which has helped boost confidence in the sector, as have positive statements on house building and planning from the incoming UK Government.

This resulted in a level of enquiries in the period which was 31.1% higher than that seen in the previous year, and the commitment value of new facilities which made their first drawing in the period reaching £558.2 million (2023: £365.0 million).

Undrawn balances on projects in progress increased by 23.1% year-on-year, to £497.7 million (2023: £404.1 million), while the new business credit approved pipeline recovered to £202.1 million, 31.0% higher than its September 2023 low point (2023: £154.3 million). These projects will provide advances into the new financial year, laying the foundations for a strong performance in 2025.

Our product range was expanded during the year to include projects under the Build-to-Rent ('BTR') initiative. This proposition supports the full lifecycle of BTR schemes in established residential locations in cities and large towns across the UK, including site acquisition, development, the letting of a completed scheme and a short-term stabilisation facility, before the property can be refinanced or sold as a buy-to-let investment.

We extended our Green Homes Initiative Fund by a further £100.0 million during the year, to £300.0 million. This scheme provides beneficial terms for projects which focus on the development of energy-efficient properties with an EPC A grade, and by 30 September 2024, £220.7 million of new lending facilities had been agreed under this initiative (2023: £175.2 million), with drawings in the year of £66.8 million (2023: £43.7 million) and several major projects completed. This initiative rewards energy-efficiency, improving the environment and reducing fuel bills for the ultimate residents, while providing financial benefits to customers.

1 BUSINESS REVIEW

The regional spread of development finance lending has continued to broaden gradually. While the proportion of the portfolio located in London and the South-East of England decreased only marginally, to 45.1% from the 45.8% recorded at 30 September 2023, it was still significantly less than the 53.7% recorded in September 2022. During the period the business also appointed a new relationship director for Yorkshire and the North East of England, to increase its presence in this under-represented area.

The underprovision of new homes in the UK, based on long standing requirements set out in government forecasts, has been stated as a priority issue by the incoming UK Government. Meeting this demand could, subject to the effect of any policy interventions, offer significant expansion opportunities for smaller developers and for our development finance business to support them. We also have a strong presence in the purpose-built student accommodation market, where evidence suggests there is a significant shortfall in high quality provision.

SME lending

Our SME lending business has a focus toward construction equipment and similar wheeled plant, and therefore is exposed to UK sentiment around capital investment. The political uncertainties of the period in the UK and the impact of relatively high interest rates serve to increase levels of caution around committing to major capital projects, so the business has been faced with a testing operating environment for most of the year. Despite this, total volumes increased by 7.3% year-on-year, with much of the increase focussed on longer-term products.

Following the major update to its front-end IT systems two years ago, the business has continued to roll out incremental system changes, delivering operational efficiencies and an enhanced experience to its business partners, which have led to growth in application flows. Auto-decisioning systems, which use machine-learning AI to support our specialist underwriters, helping to give a quick response to proposals, have been extended and refined in the period. The enhanced underwriting system now handles 69% of the division’s cases and its increased level of automation has also facilitated the efficient processing of the increased number of applications for smaller value arrangements dealt with in the period. This enables us to decrease average exposures and reduce risk in the business at the same time as delivering growth.

Asset leasing volumes increased by 15.4% year-on-year to £330.7 million excluding government-backed balances (2023: £286.4 million), considerably exceeding the 1.1% increase in new leasing business, excluding cars and high value items, in the year to 30 September 2024 reported by the Finance and Leasing Association (‘FLA’), and the 0.6% increase in lending to SMEs reported in the same data. Investment in operating leases has also continued with £13.1 million of assets acquired in the period (2023: £15.3 million). New business applications were strong throughout the year, providing positive indications for new business going forward.

1 BUSINESS REVIEW

Short-term lending to professional services firms outside government-supported schemes reduced by 1.8% to £135.2 million (2023: £137.7million). These loans are often used to spread the impact of tax and other significant liabilities, and the level of take-up will be influenced by both the confidence and the profitability levels of the underlying customer base, both of which are likely to have been adversely affected by the economic climate. However, the underlying requirement for this form of finance remains for the longer-term.

We monitor the potential impact on climate change of the industries we do business with, and support UK SMEs with green propositions, initially with funding for alternative fuelled assets in the transport, manufacturing and construction sectors, as they transition their businesses towards net zero. These types of initiatives are expected to increase going forward as such considerations are prioritised by customers.

Overall sentiment in the SME market remains mixed, with a majority of SMEs becoming more confident, especially for the longer term, whilst others still have a more negative outlook. There are also marked differences between SMEs in different industries. This is confirmed by published SME surveys, which show SMEs' confidence in their business prospects and willingness to invest becoming much more positive in the third calendar quarter of 2024, although concerns over inflation remain.

While potential challenges remain in the operating environment, and the future impact of the new UK Government's policies on economic prospects for SMEs business and the general appetite for capital investment is not yet clear, our customer base continues to respond robustly. The outlook for SMEs in the UK, while more stable than twelve months ago, still presents significant potential threats. However, the decision announced in the 2024 budget, and endorsed by the incoming administration, to extend full expensing for tax purposes to leased assets, is a welcome initiative and may encourage some growth in new business.

Ultimately, the level of customer understanding in our SME lending business, supported by its ongoing programme of systems and process enhancements, positions it well to deal with customer requirements going forward, building on a positive reputation in the marketplace.

Structured lending

Despite the challenging economic conditions, activity levels in our structured lending business were much higher than in the previous year. Drawn balances increased by 52.0% from £169.0 million at 30 September 2023 to £256.9 million at the end of September 2024, with the total amount of the outstanding facilities increased by 40.0% to £330.0 million (2023: £235.7 million). This resulted from three new facilities totalling £55.0 million which made their first drawings in the period, and a positive retention performance on maturing facilities. All facilities continued to be managed in line with their agreements.

1 BUSINESS REVIEW

These facilities generally fund non-bank lenders of various kinds, provide us with increased product diversification and are constructed to provide a credit buffer in the event of default in the ultimate customer population. The business has an experienced team of account managers who receive regular reporting on the performance of the security assets, and maintain a high level of contact with clients to safeguard its position. To date we have not recorded any losses on structured lending facilities.

We continue to assess additional opportunities which would broaden the range of products and industries supported, diluting the concentration risk inherent in this form of lending. In the current economic climate these evaluations have a significant focus on the viability of the underlying customer activity.

Motor finance

Our motor finance business is a focussed operation targeting propositions not addressed by mass-market lenders, including specialist makes and vehicle types, such as light commercial vehicles ('LCVs'), motorhomes and leisure vehicles including caravans, static caravans and campervans. New business is largely sourced through specialist brokers, however there is a small flow generated through motor dealerships.

During the early part of the year new business volumes were constrained by market conditions, which continued to be affected by the elevated interest rate environment, resulting in new lending falling by 3.6% to £156.4 million (2023: £162.2 million). However, volumes recovered somewhat in the second half of the year as rate expectations moderated, with the new business at £84.8 million, 18.4% higher than the level for the first half and 11.6% higher than the comparable period in 2023. This result exceeded expectations, as the business was focussed on managing its margins, despite some aggressive pricing in the market, which also impacted short-term volumes.

Car finance volumes reported by the FLA fluctuated significantly in the period, with used cars particularly affected. The FLA's data showed new consumer car lending down by 0.6% overall for the year ended 30 September 2024, although the amount of used car business, which represents a significant part of our portfolio, fell by 4.1%.

Our lending to finance battery-powered electric vehicles ('BEVs'), including LCVs, continued to expand in the year. These vehicles increasingly contribute towards greenhouse gas ('GHG') reduction, with the data from the Society of Motor Manufacturers and Traders ('SMMT') suggesting that by the year end BEVs formed 21% of all new UK car registrations and 6.2% of those for new LCVs. We advanced £9.1 million of new loans on BEVs in the year, an increase of 16.7% (2023: £7.8 million), reflecting our continuing growth in this part of the motor finance market.

With the business focusing on used vehicles, the proportion of BEV lending will lag the growth in new registrations, however progress continues to be made, with almost 6% of new lending relating to such vehicles. This initiative will support the green aspirations of our customers, as electric vehicles become a more widely viable and popular option and increasing numbers enter the used car market.

Our motor finance business remains a stable, specialist franchise, which is well placed to continue to develop into the future.

MANAGEMENT REPORT

1 BUSINESS REVIEW

Performance

The size of our Commercial Lending book increased by 16.1% in the year, driven by our strategic focus on diversifying into this asset class over recent years. The loan balances in the Commercial Lending segment, analysed by product type, are set out below.

	2024 £m	2023 £m
Asset leasing	664.4	586.0
Professions finance	53.0	52.2
CBILS, BBLS and RLS	41.5	67.2
Invoice finance	32.7	31.7
Unsecured business lending	25.9	20.4
Total SME lending	817.5	757.5
Development finance	884.0	747.8
Structured lending	256.9	169.0
Motor finance	331.4	297.7
	2,289.8	1,972.0

The economic pressures in the UK generated an increased number of issues on development finance projects during the year, mostly relating to increased build costs or delays. This type of issue is typical of the development finance product in a stressed environment, and our experience is not dissimilar to that of other lenders in the field.

Development finance exposures are regularly monitored internally and graded on a case-by-case basis and by 30 September 2024 there were 19 accounts identified as being at risk and therefore attributed to IFRS 9 Stage 3 for impairment purposes (2023: 12), with one additional long-standing legacy case (2023: one).

These accounts have been carefully examined and projections stressed for the purposes of our IFRS 9 provisioning, generating an additional impairment charge. The majority of issues relate to projects which were evaluated by both us and the customer before late 2022, prior to the sharp rise in input costs and interest rates seen since then, which has led to a significant reduction in headroom. Additional provision has been made to allow for any further such cases, but security across the portfolio more generally remains strong. The average loan to gross development value for the portfolio at the year end was 63.0% (2023: 63.1%), which provides a substantial buffer if projects encounter problems.

In the SME lending and motor finance businesses, credit performance on our finance leasing portfolios has been generally strong, despite the adverse headwinds in the UK economy. Arrears in assets leasing, at 0.14%, remained very low (2023: 0.23%) and motor finance arrears improved slightly to 1.06% (2023: 1.08%). Despite these positive trends, we continue to monitor performance carefully and have processes in place to ensure any customers encountering problems achieve good outcomes.

MANAGEMENT REPORT

1 BUSINESS REVIEW

In January 2024 the FCA announced a review of discretionary commission arrangements across the motor finance industry. While we offered products which might fall within the scope of the review, our expectations of exposure remain low at this stage. The FCA was unable to complete its work in accordance with its originally anticipated timescales and now does not expect to report its conclusions before May 2025. There are also legal issues in progress on an industry-wide basis on related matters, particularly the recent Court of Appeal ruling in the cases of Johnson, Wrench and Hopcraft, which may result in additional exposure.

Where possible we have evaluated this potential probable exposure and determined that no material provision is required. However, it is not possible to quantify the potential impact of any of these matters on our historical motor finance commissions more broadly at this stage, due to the many factors involved and the case specific nature of the information which is available. We will report on any impacts when it is practicable to do so. Further information on these matters is given in note 28 to the accounts.

We continue to closely monitor the government-guaranteed portfolio for any adverse indications. Some lenders have reported significant performance issues with their CBILS, RLS and particularly BBLS lending related to either credit quality or fraud, with over 20% of loans under these schemes resulting in default. However, we have not yet seen any serious impacts of this type, possibly due to our primary focus on lending to existing customers, whose credit history was already well known to us, and to our limited exposure to the BBLS product.

These portfolios contained only £1.3 million of Stage 2 accounts at gross carrying value at 30 September 2024, and only £1.1 million of credit impaired cases. Our total claims made up to 30 September 2024 under the government guarantee were £4.4 million, only 3.4% of the £130.9 million advanced since the schemes began, with £4.1 million of this balance already recovered at the year end.

In the structured lending business, we carefully monitor the performance of the underlying asset pool on a monthly basis, to ensure the value of security remains adequate. We rely on our data monitoring and verification processes to ensure these reviews are able to detect any credit issues. Performance in the year has been broadly in line with expectations, with generally stable metrics across the book and all but one account classified in IFRS 9 Stage 1 at the year end. The one Stage 2 case is being carefully managed, with no losses expected.

For IFRS 9 impairments purposes, 12.7% of gross balances for the Commercial Lending segment as a whole were considered as having an SICR (2023: 9.5%) including 5.1% which were credit impaired (2023: 3.3%). The increase in credit impaired cases related mostly to the development finance projects noted above.

Provision coverage in the division increased to 177 basis points (2023: 156 basis points), principally as a result of the greater number of credit impaired cases. Coverage on fully performing accounts reduced from 82 basis points at 30 September 2023 to 62 basis points at the year end as some of the potential issues identified at the beginning of the year were clarified in the period, or the relevant accounts moved to Stage 2.

MANAGEMENT REPORT

2 FUNDING REVIEW

Paragon Bank's retail banking operation is central to our funding strategy. This is supplemented with central bank and wholesale funding and other liquidity sources to create an adaptable and sustainable funding model, including contingent funding options, which can respond to developments in our business, its operating environment and the external economic and regulatory landscape.

Our parent company debt has an investment grade credit rating, confirmed by Fitch in February 2024, which supports its status as a debt issuer. Following the year end this was supplemented when Moody's began coverage, with an initial rating of Baa3 for the Group. These ratings enable us to access cost-effective funding, as well as enhancing options for raising finance for strategic initiatives on a timely basis.

The retail deposit portfolio expanded in the year, both to support new lending and to enable early repayment of central bank borrowings and wholesale debt, reducing funding costs. This was achieved despite continuing cost-of-living pressures on savers, although there was some evidence of increased demand for fixed rate term deposits particularly in the first half as the upward trend in rates began to reverse. This growth in fixed term deposits has generated a flow of funds from clearing banks to smaller deposit takers, whose market focus has historically been on this type of product. We also continued to strengthen our position in the cash ISA market.

At the same time we have continued to pay down wholesale and central bank debt, with substantial early repayments made on Bank of England facilities.

Our funding at 30 September 2024 is summarised as follows:

	2024 £m	2023 £m	2022 £m
Retail deposit balances	16,298.0	13,265.3	10,669.2
Securitised and warehouse funding	-	28.0	995.3
Central bank facilities	755.0	2,750.0	2,750.0
Tier-2 and retail bonds	149.9	258.2	261.5
Sale and repurchase agreements	100.0	50.0	-
Total on balance sheet funding	17,302.9	16,351.5	14,676.0
Off balance sheet liquidity facilities	150.0	150.0	150.0
	17,452.9	16,501.5	14,826.0

The rising interest rate environment in the second half of 2022 and through most of 2023 saw a material switch in savers' preferences towards fixed rate deposits. This slowed, and then reversed, our long-term strategy of increasing the proportion of easy access products, which are repayable on demand, in our funding mix, more in line with normal industry practice. With a growing customer perception that market rates had peaked during 2024, demand for easy access products has strengthened, and we have been able to resume progress towards a higher easy access funding level. At 30 September 2024 the proportion of easy access deposits had risen to 44.6% of total on-balance sheet funding (2023: 25.7%).

MANAGEMENT REPORT

2 FUNDING REVIEW

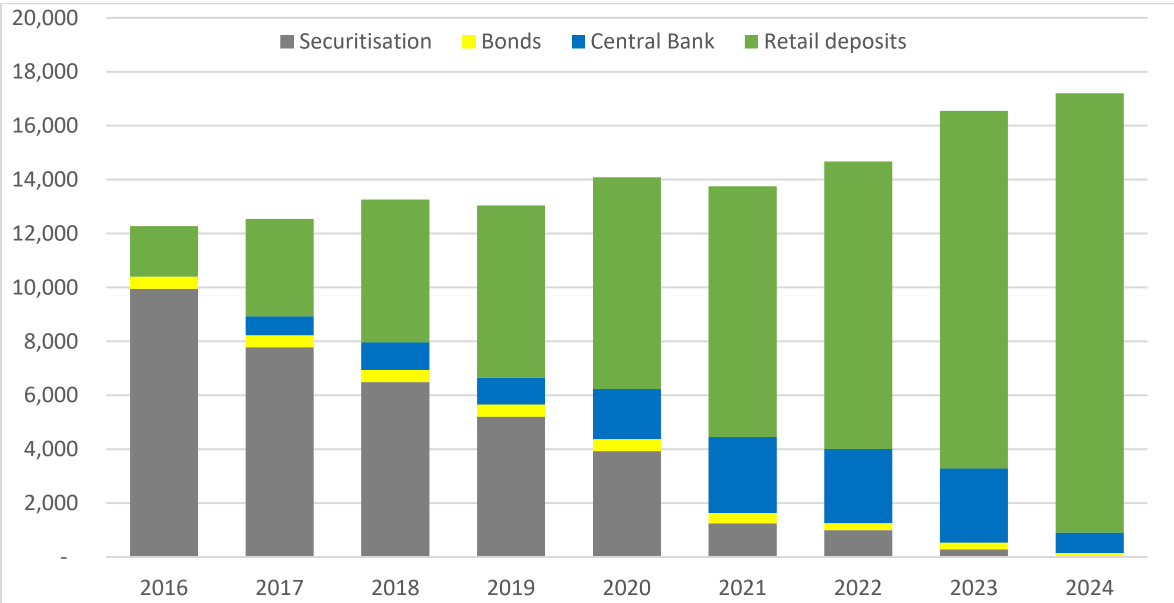
At the end of the year £2,844.8 million of cash and investments were available for liquidity and other purposes (2023: £2,907.7 million), with the liquidity portfolio diversifying to include UK government securities and covered bonds issued by UK financial institutions in the year. The overall level of liquid resources remains broadly similar to that twelve months earlier.

These resources provide sufficient operational liquidity and cash to make further TFSME repayments. The appropriate level of cash reserves is monitored on an ongoing basis as part of our capital and liquidity strategy, which continues to be based on a conservative view of the economic outlook, while allowing for the developing needs of the business.

Our long-term funding strategy, following the granting of our banking licence in 2014, has been to move to using retail deposits as our primary funding source, accessing the debt markets on an opportunistic basis for additional funding requirements. Progress towards this goal is illustrated by the chart below which shows, at each of the financial year ends since 2016, the outstanding funding balance by type.

Funding by type (£m)

30 September 2016 –2024



While the position at 30 September 2024, at 94.2%, represents the maximum proportion of our funding represented by retail balances historically (2023: 81.1%), we continue to evaluate the cost-effectiveness of new wholesale debt and it is likely that this funding source will be accessed again in the future.

We have also focussed on developing contingent funding sources as part of our overall strategy. Holdings of our own securities, investment securities issued by others and assets pre-positioned with the Bank of England provide ready access to additional funding, if required, without incurring the carry cost of additional borrowings.

2 FUNDING REVIEW

Hedging strategies continue to form an important part of our balance sheet risk management. This includes the use of derivative financial instruments, such as interest rate swaps, to protect our income and operating model from adverse fluctuation in market interest rates. This was particularly important during the year, with large fluctuations in market expectations for interest rates, and we extended our balance sheet reserves hedging, providing protection to returns in a falling base rate scenario.

2.1 RETAIL FUNDING

The UK savings market is a reliable, scalable and cost-effective source of funding, with our strategy centred on offering sterling deposit products to UK households through a streamlined online presence. Our in-house offering, supported by an outsourced administration function, is supplemented by additional routes to market provided by a presence on third party platforms. Development of this strategy is focussed on the management of the Bank's digital footprint, supported by investment in our people, systems and relationships.

Our proposition is based on generating and retaining customer accounts by providing competitive interest rates, attractive and innovative products and high-quality customer service. Products currently offered include cash ISAs, term and notice deposits, and easy access accounts, with the substantial majority of balances insured by the Financial Services Compensation Scheme ('FSCS'). We enjoy a significant market position in the cash ISA market, developed over eight years, which has benefitted margins as interest rates have increased in recent periods.

The protection provided to depositors by the FSCS both incentivises larger savers to divide their deposits between several institutions and reduces the risk perceived by customers in using institutions other than major banks and building societies, supporting our proposition. At 30 September 2024, this FSCS protection covered around 95% of our deposit balances.

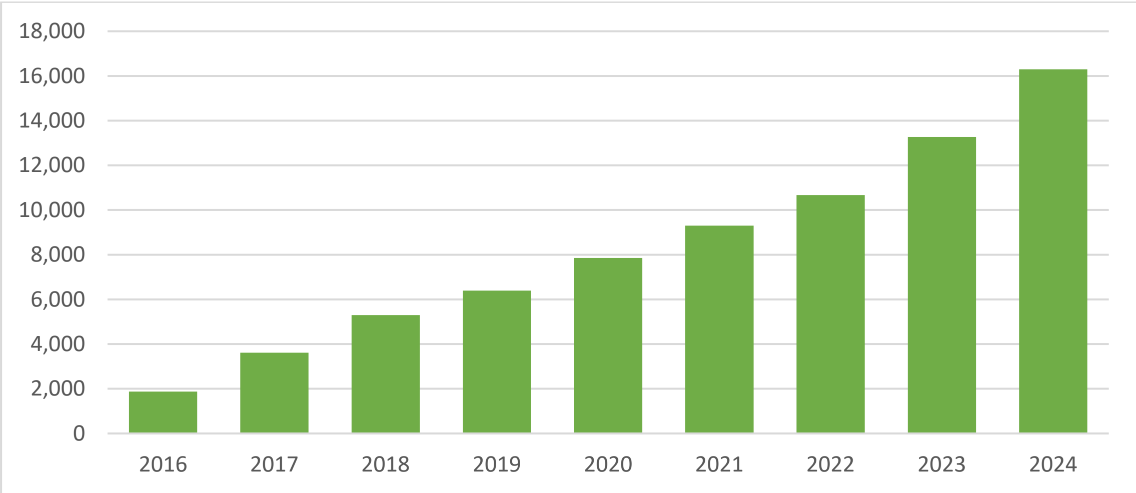
The retail deposit franchise continued to perform strongly over the year, with balances increasing by 22.9% in the period, meeting our funding needs at an attractive cost, compared to other alternatives. A strong performance in the cash ISA market, which is concentrated in the second half of the year helped drive this performance, with the value of new ISA accounts opened increasing by 36% year-on-year. Market pricing remained volatile with different deposit takers responding to changes in interest rate expectations in different ways and over differing time frames.

2 FUNDING REVIEW

The growth of the retail funding balance over recent years is set out below.

Retail deposits (£m)

At 30 September 2016 – 2024



During the year, UK deposit balances from individuals reported by the Bank of England remained relatively stable, despite increasing pressures on living costs. Balances at 30 September 2024 reached £1.75 trillion (2023: £1.67 trillion), a year-on-year increase of 4.9%. While, given the rate of inflation in the period, this represents only a small real-terms increase in total savings, it is not so marked as might have been expected from the pressure on household incomes.

Against this relatively static background, the 22.9% increase in our deposit balance has considerably outpaced the overall market, reflecting both the attractiveness of our proposition and our ongoing programme of business and systems development, which continued in the year.

Within the savings market there was also a move towards fixed-term and notice deposits, with the Bank of England reporting a 5.9% (£13.8 billion) increase in such deposits from individuals during the year, greater than the growth in the overall savings base. National Savings ('NS&I') deposits by individuals, which fulfil a similar function for consumers, also increased in the period but at a slower rate. Volumes of cash ISAs, a product where we have had a consistently strong presence, increased by 16.6% volumes, year-on-year, representing a £379.2 billion market, with our growth significantly outpacing the market.

Despite the broader market trend, we have also seen strong growth in variable interest rate products over the year, as new fixed rates on offer began to anticipate future falls in base rates, and as we maintained our strategic target to increase easy access balances as a proportion of the portfolio.

Customer retention, increasing diversification and the FSCS guarantee are likely to reduce the potential for liquidity impacts and the profiling of our target customers suggests they may be more resilient than average in the event of future economic stresses.

2 FUNDING REVIEW

Savings accounts at the financial year end are analysed below.

	Average interest rate		Proportion of deposits	
	2024 %	2023 %	2024 %	2023 %
Fixed rate deposits	4.77%	4.07%	50.7%	65.5%
Variable rate deposits	4.19%	3.74%	49.3%	34.5%
All balances	4.49%	3.95%	100.0%	100.0%

Average interest rates paid to our savers continued to move up during the year as base rate rises during 2023 continued to work their way through market pricing, with the rate cuts towards the end of the current year, which began to be reflected in our pricing for new accounts as the period closed, having little impact on average fixed rates as yet. The Bank of England has reported average interest rates at 30 September 2024 for new 2-year fixed rate deposits at 4.00% (2023: 5.50%), and at 2.60% for instant access balances (2023: 2.68%), with similar falls across other product types. These year-end averages for new business will reflect the impact of the most recent base rate cut.

Market savings rates remain at below SONIA levels, with the overnight benchmark decreasing 23 basis points from 5.18% at 30 September 2023 to 4.95% at 30 September 2024. The change in the mix of our accounts, however, means that the average variable rate we were paying at the year end represented a 76 basis point discount to SONIA (2023: 144 basis points) reversing the widening trend seen in the previous financial year. This was an expected effect of the more stable interest rate environment nationally and a similar narrowing of the gap between average deposit and lending rates can be seen across the banking industry.

The average initial term of fixed rate deposits was 20 months (2023: 22 months), with such products still representing over half the deposit book, despite the increase in variable deposits in the period. The proportion of the deposit portfolio represented by these products reduced in the year, with an increase in variable rate balances being strategically targeted.

Significant optionality is provided by our presence on third party investment platforms and digital banks' savings marketplaces, which accounts for almost a quarter of the savings book. These channels provide access to customer demographics which differ from the customers of our in-house offering and between the various platforms, with the more diversified sourcing offering enhanced opportunities to manage inflows and costs.

The difference in profile of the platform customers is highlighted by their average account balances, which can be far lower than that seen on direct business. We have nine such relationships, all of which were in place throughout the year. These channels represent around 23% of the total deposit base (2023: 22%) and we have the systems and control framework in place to further increase our reach through these channels, if appropriate and cost-effective.

2 FUNDING REVIEW

Our strategy in the savings market relies on providing a high-quality customer offering and we conduct insight surveys throughout the customer journey. Results in the year are summarised below:

Survey timing		2024	2023
At account opening	Would 'probably' or 'definitely' take a second product	89%	88%
	NPS	+66	+62
At maturity	Would 'probably' or 'definitely' take a second product	89%	88%
	NPS	+63	+59

These results maintain our strongly positive position, despite the downward trend of interest rates towards the end of the period, demonstrating that our customer-facing infrastructure serves us well in retaining and developing customers in this active and competitive market.

This is further borne out by our customer retention levels. Despite the short-term nature of the product and the ease with which deposits can be moved between institutions, 42.4% of our deposit balances at 30 September 2024 relate to customers who have been with us for five years or more.

Our service standards were also recognised when Paragon Bank won the 2024 Award for Customer Service at the Savings Champion Awards. Other recognition came in the 2024 MoneyComms Top Performers list, where it was recognised as both 'Best Easy Access Savings Provider' and 'cash ISA provider of the Year'.

Retail deposits continue to provide a stable foundation for our funding strategy, allowing volumes and rates to be effectively and flexibly managed. It is a key strategic objective to develop this business further, broadening the product range and employing increased digitalisation to enhance the service proposition and address wider demographics. At the same time we will continue to develop our systems and processes to ensure we are able to address the increasingly sophisticated needs of savers, while expanding our presence on third party platforms.

2.2 CENTRAL BANK FACILITIES

Wholesale funding comprises principally the Bank of England Term Funding scheme for SMEs ('TFSME'), introduced to support SME lending during the Covid pandemic. We also have access to other, shorter-term, facilities offered by the Bank, which are utilised from time-to-time as part of our overall funding strategy.

TFSME is the main wholesale funding source, with borrowings under this scheme at 30 September 2024 of £750.0 million (2023: £2,750.0 million). Interest is payable on these drawings at the Bank of England base rate, which is currently less attractive than rates available on retail deposits and during the year the outstanding balance has been strategically reduced by £2,000.0 million, providing cost benefits and mitigating the liquidity risk of any payment shock when the majority of the balance reaches its October 2025 maturity date.

2 FUNDING REVIEW

We also have access to other Bank of England funding channels, including the Indexed Long-Term Repo ('ILTR') and Short-Term Repo ('STR') schemes, providing shorter term funding for liquidity purposes, with outstanding ILTR drawings at the year end of £5.0 million (2023: £nil).

Central bank facilities will continue to be utilised going forward, in accordance with the objectives of the schemes, where their use is appropriate and cost-effective, or to test operational access.

To provide contingent funding, if and when required, mortgage loans have been pre-positioned with the Bank of England to act as collateral for any future drawings. This provides access to potential liquidity at 30 September 2024 of up to £4,445.9 million (2023: £1,715.4 million). Additionally, our retained AAA-rated asset backed notes and investment securities can also be used to access Bank of England funding arrangements.

2.3 WHOLESALE FUNDING

Our wholesale funding options include securitisation funding, warehouse bank debt and bond issuance, including senior and subordinated corporate bonds, each of which can be accessed from time to time as appropriate.

The Company's Long-Term Issuer Default Rating was confirmed at BBB+ by Fitch in February 2024 with a stable outlook, with Paragon Bank PLC, its principal operating subsidiary, also given a BBB+ rating for the first time as part of this rating exercise. In November 2024, following the year end, Moody's published its first ratings on our business, with the Company assigned a Long-Term Issuer rating of Baa3 and the Bank rated Baa2. These additional ratings will allow more flexibility in funding options in future, while potentially helping to manage funding costs.

During the year the Paragon Mortgages (No. 29) PLC securitisation was issued. This transaction is secured on buy-to-let mortgages and comprises £855.0 million of rated notes, denominated in sterling and bearing interest at a SONIA-linked floating rate. All these notes were retained, and the AAA-rated notes can be used to access contingent funding, through use as security against borrowing and liquidity transactions.

While historically we have been one of the principal issuers of UK residential mortgage-backed securities ('RMBS'), our reliance on this funding source has been significantly reduced over recent periods, with Paragon Mortgages (No. 26) PLC being repaid in the year. This leaves no external securitisation indebtedness, with all outstanding issuances held internally as contingent funding, rather than placed in the market.

The final outstanding retail bond issuance under our Euro Medium-Term Note programme was also paid down in the year, having reached its term. Our only remaining bond debt is the 2021 Tier-2 Bond.

We access the short-term repo market from time-to-time with £100.0 million of sale and repurchase transactions with financial institutions outstanding at the year end (2023: £50.0 million). During the period we broadened the range of counterparties used for such transactions, increasing our liquidity and contingent funding options.

2 FUNDING REVIEW

The wholesale funding position currently satisfies only a small part of our overall funding requirements, with the proportion supplied by wholesale debt the lowest since we received our banking licence in 2014. This will reduce further as prepayments of TFSME funding continue to be made. However, wholesale funding capacity remains available for use on a tactical basis, when interest rates and conditions are attractive, and to provide contingent funding and support liquidity.

During the year we have worked to develop increased optionality around our wholesale funding position, obtaining our Moody's ratings, but also investigating the possibilities of joining the thirteen UK banks and building societies authorised as covered bond issuers by the FCA. Our work on structuring has been completed, and a formal application for authorisation submitted to the FCA, with the process expected to be completed in the coming financial year. This will provide a flexible funding route for use in future periods, as required.

While capital markets in the UK remained volatile in the period, influenced by speculation over the likely direction of interest rates, the outlook towards the year end was more positive than for some time, with demand for credit risk solid across most classes of debt, and margins tightening. Coupled with movements in retail deposit rates, this has served to make wholesale funding relatively more attractive than it has been for some time, and our strategy is to maintain as wide a range of funding and contingent funding options as possible.

2.4 DERIVATIVES AND HEDGING

Derivative assets and liabilities continue to be used to hedge interest rate risk arising from fixed rate loans and deposits. We pre-hedge a proportion of our lending pipeline, which can result in derivative positions being established before loans are completed.

While this strategy has not materially changed in the period, the movements in interest rate expectations over the most recent financial periods have resulted in large derivative asset balances being carried on the balance sheet at fair value, although the 30 September 2024 position was reduced from the previous financial year end as the position unwound, and as swap rates trended lower overall during the year.

The size of these balances and the volatility in rates has also led to significant profit and loss account impacts. However, any such gains or losses, which tend to zero over time, are ancillary to our lending and deposit-taking activities and we undertake no trading in derivatives.

We also hedge our tier-2 fixed interest rate borrowings, and have hedged the interest rate risk on the investments in gilts acquired as part of the liquidity buffer in the year.

During the year we have continued to develop our balance sheet hedging strategy. This is intended to protect net interest margins from the impact of future falls in interest rates on equity, which otherwise would cause a fixed / floating mismatch between the asset and liability sides of the balance sheet.

2 FUNDING REVIEW

In order to mitigate this risk, an amount of fixed rate mortgage lending has been attributed to provide natural equity hedging, forming a net free reserve hedge. At 30 September 2024, £1,200.0 million had been attributed in this way (2023: £313.0 million). The year end hedge represents our current target hedging level, covering the majority of the equity balance. However, this form of hedging has no direct accounting impact.

3 CAPITAL AND LIQUIDITY REVIEW

Strong financial foundations form one of the three pillars of our strategy, with building and maintaining strong levels of core capital through the economic cycle a key strategic priority. We manage our balance sheet to maintain capital strength, ensuring that our regulatory capital and liquidity positions are sufficient to safeguard depositors and provide capacity to meet our strategic objectives and other opportunities going forward.

The year has seen continuing developments in the UK's economic environment, with the majority of metrics stabilising and sentiment becoming more cautiously optimistic towards the end of the year. However the July UK General Election has brought changes in political priorities for the country, the impact of which is not yet clear, while the Basel 3.1 process to reform the regulatory capital regime has continued to progress and while there was a delay due to the election, near-final proposals were published on 12 September 2024.

In the face of the potential uncertainties inherent in this environment we have remained focussed on ensuring that our capital strength remains sufficient to withstand the potential pressures and address future changes in requirements. At the same time we have been able to continue our stated distribution policy, approving buy-backs of up to £100.0 million in the period and announcing dividends for the period in line with policy.

For regulatory purposes our capital comprises shareholders' equity and a Tier-2 bond. We have no outstanding Additional Tier 1 ('AT1') issuance, but have the capacity to issue such securities, if considered appropriate, under an authority granted by shareholders at the 2024 Annual General Meeting ('AGM'), which will be proposed for renewal at the 2025 meeting.

3.1 REGULATORY CAPITAL

During the year we have maintained strong regulatory capital ratios, with capital balances being carefully managed. Our business is subject to supervision by the Prudential Regulation Authority ('PRA') and, as part of this supervision, the regulator sets a Total Capital Requirement ('TCR'), the minimum amount of regulatory capital which we must hold. This is defined under the international Basel 3 rules, implemented through the PRA Rulebook.

The TCR is held in order to safeguard depositors in the event of the business incurring severe losses and includes elements determined based on our Total Risk Exposure ('TRE') measure, together with fixed elements. The TCR is specific to our business and is set on the basis of periodic supervisory reviews carried out by the regulator, with the most recent results received in 2021.

Our TCR at 30 September 2024 represents 8.7% of TRE, similar to a year earlier (2023: 8.8%), compared to the minimum TCR allowed under the Basel 3 framework of 8.0%. This low TCR level gives us advantages in capital management and reflects the regulator's assessment of our risk strategy and their view of the appropriateness of our systems for the management of capital and risk.

3 CAPITAL AND LIQUIDITY REVIEW

We were granted transitional relief for the capital impacts of the adoption of the IFRS 9 impairment regime, along with most other UK banks. Additional relief was granted in 2020 for the impact on capital of provisions created in response to the Covid pandemic. This relief is being phased out, year-by-year, while any reversal of Covid-related provisions will generate a corresponding reduction in relief. The reliefs have a minimal impact on the capital position at 30 September 2024, and were phased out entirely from 1 October 2024.

The PRA requires firms to disclose capital measures both on the regulatory basis and as if these reliefs had not been given, referred to as the 'fully loaded' basis. The value of the reliefs tapers over time, and the difference between measures on the regulatory and fully loaded bases will converge for the financial year ending 30 September 2025. Our principal capital measures, CET1 and Total Regulatory Capital ('TRC') are set out below on both bases.

	Regulatory basis		Fully loaded basis	
	2024	2023	2024	2023
	£m	£m	£m	£m
Capital				
CET1 capital	1,177.9	1,188.9	1,175.2	1,175.4
Total Regulatory Capital ('TRC')	1,327.9	1,338.9	1,325.2	1,325.4
Exposure				
TRE	8,278.7	7,668.7	8,276.0	7,655.3
Requirements				
TCR	724.1	673.4	723.8	672.2
Capital buffers	372.5	345.1	372.4	344.5

Our CET1 capital comprises equity shareholders' funds, adjusted as required by Regulatory Capital Rules of the PRA and can be used for all capital purposes. TRC, in addition, includes tier-2 capital in the form of our Tier-2 Bond. This tier-2 capital can be used to meet up to 25% of the TCR. Capital levels on both measures in the year have remained broadly stable, with positive operational performance continuing to support the capital position, even after allowing for paid and proposed distributions.

The year-on-year increase in TCR requirements shown above relates principally to the growth in the asset base over the period, mitigated by a reduction in derivative exposures.

CET1 capital must also cover the buffers required by the 'Capital Buffers' part of the PRA Rulebook, the Counter-Cyclical ('CCyB') and Capital Conservation ('CCoB') buffers. These apply to all firms and are based on a percentage of their TRE. The CCoB remained at 2.5%, its long-term rate, throughout the year (2023: 2.5%), while the UK CCyB remained at 2.0% (2023: 2.0%), which the Financial Policy Committee ('FPC') of the Bank of England has stated that it expects to be its long-term standard level. Further buffers may be set by the PRA on a firm-by-firm basis but cannot be disclosed.

3 CAPITAL AND LIQUIDITY REVIEW

Our capital ratios, after allowing for the proposed dividend for the year, but excluding the effect of future share buy-backs, are set out below.

	Basic		Fully loaded	
	2024	2023	2024	2023
CET1 ratio	14.2%	15.5%	14.2%	15.4%
Total capital ratio	16.0%	17.5%	16.0%	17.3%
UK leverage ratio	7.0%	7.6%	7.0%	7.6%

Our capital ratios show a continued reversion to more normal levels over the year. This reflects the inclusion in trading profits of the unwind of fair value gains on hedge accounting recognised in the year ended 30 September 2022, which temporarily inflated capital at previous year ends. As the IFRS 9 reliefs are phased out the fully loaded and regulatory bases are automatically converging.

The PRA has published near-final proposals for changes to its Rulebook to reflect the impact of the revisions to the Basel 3 framework made by the Basel Committee on Banking Supervision ('BCBS'), referred to as Basel 3.1. These changes would affect both firms applying Internal Ratings Based ('IRB') approaches to capital and those using the Standardised Approach. The new requirements are to be phased in over a five-year period, currently expected to commence from 1 January 2026.

The PRA proposals, which principally impact on buy-to-let lending and lending to small businesses, have been evaluated as part of our capital planning. We estimate that the changes would reduce the CET1 ratio by 104 basis points, based on the 30 September 2024 position. However, our forecasts indicate that sufficient capital is being held to meet the proposed scenario.

We continue to refine our IRB submission with close engagement with the PRA. In addition to the submission for the buy-to-let approach, which is currently being processed, we have also prepared much of the documentation to support an IRB approach for development finance, which represents the next stage of our IRB roadmap.

The PRA has also set out its future approach to the supervision of smaller UK institutions, following the country's exit from the EU. The regulator has defined a category of 'Small Domestic Deposit Taker' ('SDDT') which will be subject to a lighter regulatory touch in some areas. To apply for designation as an SDDT an institution must operate only in the UK, have limited trading activities and less than £20.0 billion of assets, and must not operate an IRB approach to credit risk. The introduction of the SDDT regime is planned for January 2027.

To reduce disruption over the period when both the SDDT and Basel 3.1 are being introduced, the PRA has also introduced an Interim Capital Regime ('ICR') which firms can join subject to meeting the SDDT eligibility criteria, and then transition to either the SDDT or full Basel 3.1 capital basis on the implementation of SDDT. The ICR will allow qualifying firms to continue managing capital on a basis equivalent to the current regime until the SDDT capital regime is implemented, rather than transitioning to the Basel 3.1 rules from 1 January 2026.

We believe that we would meet the criteria to qualify as an SDDT as at 30 September 2024, and we expect to apply for ICR approval in the short term. Longer-term, our goal is to move to a Basel 3.1 IRB basis for capital, but this will be subject to the regulator endorsing our methodology.

3 CAPITAL AND LIQUIDITY REVIEW

3.2 LIQUIDITY

We hold liquid assets to meet cash requirements in the short and long term, as well as to provide a buffer under stress. There is also a regulatory requirement to hold liquidity in Paragon Bank. Our policy is to maintain strong levels of liquidity cover, and this policy impacts operational capital and funding requirements.

Our liquidity is principally held in the form of deposits at the Bank of England, although during the year the position was diversified with the purchase of highly rated gilts and UK covered bonds.

The Board regularly reviews liquidity risk appetite and closely monitors a number of key internal and external measures. The most significant of these, which are calculated for Paragon Bank's regulatory group on a basis which is standardised across the banking industry, are the Liquidity Coverage Ratio ('LCR') and Net Stable Funding Ratio ('NSFR').

The LCR measures short-term resilience and compares available highly liquid assets to forecast short-term outflows, calculated according to a prescribed formula, with a 30-day horizon. The monthly average of the Bank's LCR for the period was 211.5% compared to 193.7% during the 2023 financial year. This increase reflects higher levels of liquidity built up during the year to facilitate debt repayments, in particular those on our TFSME borrowings. Following the completion of these payments in the year, the coverage value was moving downwards by year end. The LCR in the year also includes the impact of £103.6 million of swap collateral held in cash (2023: £383.4 million), which also reduced through the year.

The NSFR is a longer-term measure of liquidity with a one-year horizon, supporting the management of balance sheet maturities. At 30 September 2024 the Bank's NSFR stood at 139.5% (30 September 2023: 123.4%), higher than its position twelve months earlier, reflecting a marginal strengthening of the position in the year.

3.3 DIVIDENDS AND DISTRIBUTION POLICY

The sustainable enhancement of shareholder returns is fundamental to our capital strategy, while protecting the capital base. The continuing positive results and our capital outlook support the ongoing return of capital to investors, both as dividends and through our share buy-back programme.

Our long-standing dividend policy is to distribute 40% of consolidated underlying earnings to shareholders in ordinary circumstances, achieving a dividend cover ratio of approximately 2.5 times. We use market buy-backs of shares to manage overall capital levels, where these enhance shareholder value and excess capital is available, addressing the expectations and requirements of different types of investor.

MANAGEMENT REPORT

3 CAPITAL AND LIQUIDITY REVIEW

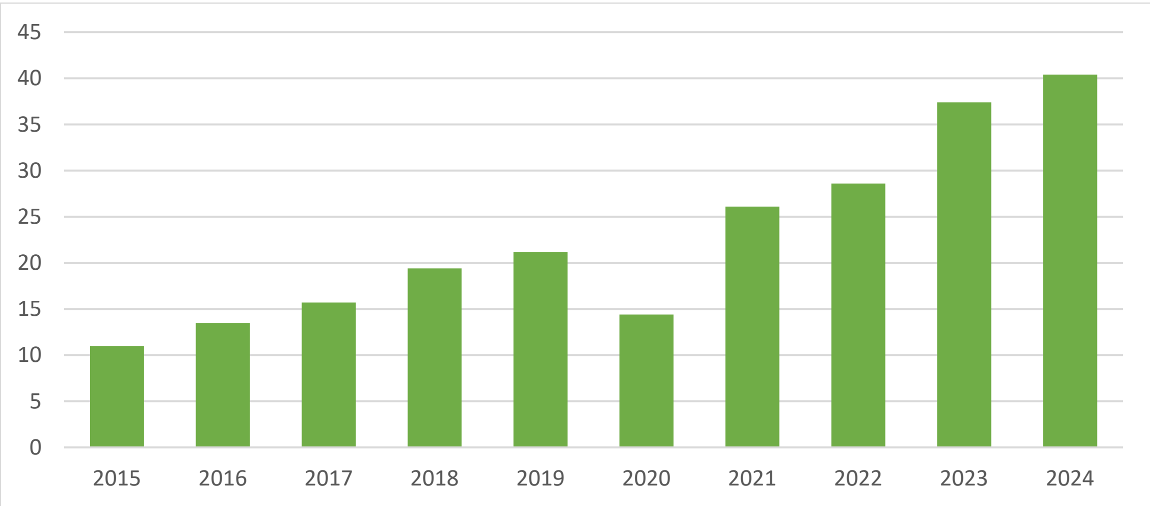
An interim dividend for the year of 13.2p pence per share (2023: 11.0 pence per share) was paid in July 2024, in line with our policy of paying an interim dividend equal to half the previous year's final dividend. For our final dividend the Board is proposing, subject to approval at the AGM on 5 March 2025, a final dividend for the year of 27.2 pence per share (2023: 26.4 pence per share). This would give a total dividend of 40.4 pence per share (2023: 37.4 pence per share). We have disregarded fair value losses in this calculation, in the same way as we have disregarded similar gains in earlier periods.

The dividend proposed therefore represents approximately 40% of the profit before fair value losses, giving a dividend cover on the adjusted basis of 2.50 times (2023: 2.52 times), in line with policy (Appendix D).

The progress of the dividend for the year is shown in the chart below.

Dividend for the year (pence)

In respect of the years 2015 –2024



The directors have considered the distributable reserves and available cash and other resources of the Company and concluded that the proposed dividend is appropriate.

In December 2023 the Board authorised a buy-back programme for the year of £50.0 million, which was extended to £100.0 million in June 2024. £76.6 million, including costs, was expended during the year (Note 31) (2023: £111.5 million). An irrevocable authority was given to our brokers at the year end to continue this programme, and by the time that regulatory authority for the programme had expired, £7.5 million of the programme remained outstanding.

As part of the review of capital management described above, the Board decided that it was appropriate to complete the remaining balance of the 2024 programme and to authorise a further share buy-back programme of up to £50.0 million for the 2025 financial year. These purchases will commence shortly after the announcement of the 2024 year-end results.

3 CAPITAL AND LIQUIDITY REVIEW

The Group has the general authority to make such purchases, granted at the AGM on 6 March 2024. Any purchases made under these programmes will be announced through the Regulatory News Service ('RNS') of the London Stock Exchange and the shares will initially be held in treasury.

During November 2024, the Board affirmed the existing dividend policy going forward, subject to an assessment of prevailing conditions at the time, including future operational and regulatory capital requirements, business strategy and external economic risks.

4 FINANCIAL RESULTS

Our results for the financial year ended 30 September 2024 continued the positive performance of recent periods, with underlying profits at a record level and margins remaining strong. We continued to deliver on our strategic targets despite the ongoing impacts of higher interest rates and prices on our customers and their clients, which should leave us well placed facing a seemingly more stable economic situation.

Underlying profit (Appendix A), which excludes fair value gains, increased by 5.4% in the year, reaching £292.7 million (2023: £277.6 million). This, together with the impact of share buy-backs in the period, generated growth in underlying earnings per share, which broke the £1 per share level for the first time, reaching 101.1 pence per share, 7.3% greater than in the previous year (2023: 94.2 pence per share).

The statutory results for the year continue to be affected by the accounting treatment required for pipeline hedging. We have historically hedged a substantial part of our fixed rate lending pipeline with interest rate derivatives, and these can lead to substantial fair value gains being recorded in a rapidly changing interest rate environment, such as those that we recorded in the 2022 financial year.

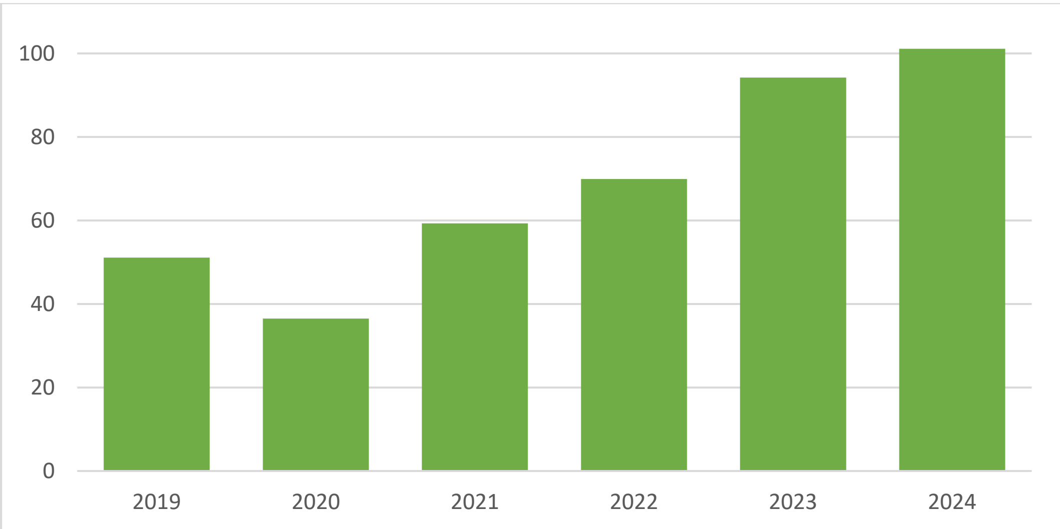
The actual cash flows from hedging will impact on net margin through the subsequent life of the loan and the fair value gains will unwind. The current year has seen the unwinding process continue, and this together with changes in expectations for future interest rates has resulted in fair value losses being recorded. These unwinding losses reduced profit before tax on the statutory basis to £253.8 million (2023: £199.9 million), with earnings per share at 88.5 pence per share (2023: 68.7 pence per share).

These fair value items have consistently been excluded from our underlying results as the timing of their recognition does not reflect that of their economic impact on our business.

The progression of our underlying earnings per share over the last six years is shown below.

Underlying earnings per share (pence)

Year ended 30 September 2019 –2024



4 FINANCIAL RESULTS

4.1 CONSOLIDATED RESULTS

CONSOLIDATED RESULTS
For the year ended 30 September 2024

	2024 £m	2023 £m
Interest receivable	1,314.7	1,010.6
Interest payable and similar charges	(831.5)	(561.7)
Net interest income	**483.2**	**448.9**
Net leasing income	6.2	5.6
Other income	7.0	11.5
Total operating income	**496.4**	**466.0**
Operating expenses	(179.2)	(170.4)
Provisions for losses	(24.5)	(18.0)
Underlying profit	292.7	277.6
Fair value net (losses)	(38.9)	(77.7)
Operating profit being profit on ordinary activities before taxation	**253.8**	**199.9**
Tax charge on profit on ordinary activities	(67.8)	(46.0)
Profit on ordinary activities after taxation	**186.0**	**153.9**

	2024	2023
Dividend – rate per share for the year	40.4p	37.4p
Basic earnings per share	88.5p	68.7p
Diluted earnings per share	85.2p	66.3p

Income

Total operating income increased by 6.5% in the year, reaching £496.4 million, compared to the £466.0 million recorded in the previous year. Net interest on our loan books continues to be the principal element of our income. This increased by 7.6% in the year, from £448.9 million in 2023 to £483.2 million in 2024. This growth was primarily driven by net loan book growth, with average outstanding balances increasing by 5.1% to £15,289.9 million (2023: £14,542.3 million) (Appendix B).

4 FINANCIAL RESULTS

Net interest margin ('NIM') increased overall by 7 basis points, a slower rate of improvement than in recent years, as a more stable interest rate environment impacted on funding costs in the retail deposit market. Given our approach to funding allocation, this led to slightly reduced NIM in both our divisions, with Commercial Lending particularly impacted, but correspondingly greater unallocated income being reported, as earnings on excess liquidity are not typically allocated to operating segments.

The progression of the Group's NIM over the past five years is set out below.

	Total basis points
Year ended 30 September	
2024	**316**
2023	309
2022	269
2021	239
2020	224

The long-term improvement in NIM is a result of the careful management of yields in the business, a prudent hedging strategy and improvements in our cost of funds as the distribution of our funding sources has developed over time. This is supported by the careful strategic allocation of our capital and management of our lending risk appetites to optimise overall returns.

Interest income from our loan assets is accounted for using the effective interest rate method set out in IFRS 9. This spreads the impact of initial and terminal fees received from the customer or paid to third parties through the life of the account and, where an account has different interest charging bases during its life, such as the majority of our buy-to-let mortgage accounts which have a fixed initial rate, attempts to spread this effect. The pattern of income recognition is therefore based on estimates of customer settlement behaviour and future charging rates, and where the economic environment is likely to cause these to vary, as in the current year, the rates at which income is included in profit are adjusted.

Other operating income which represents a combination of operating lease income and other sundry fees reduced to £13.2 million (2023: £17.1 million). This movement was principally a result of reduced third party servicing fees as contracts reached their end dates.

Costs

Our operating costs increased by 5.2% in the year to £179.2 million (2023: £170.4 million). The largest item within costs continues to be employment costs, which at £111.1 million form 65.2% of the total (2023: £108.3 million), a similar level to the previous year. The 2.6% increase in employment costs arose from market-based pay increases granted to almost all employees at the beginning of the period, and £1.5 million of additional costs for National Insurance on share-based awards, driven by the rising share price in the period. These were offset by the impact of a reduction in staff numbers with the average headcount falling by 5.4% to 1,444 (2023: 1,527).

4 FINANCIAL RESULTS

From 1 March 2024 the PRA introduced a funding levy to replace the cash ratio deposit ('CRD') scheme. This levy forms part of the Group's costs, unlike the CRD, resulting in a £2.1 million increase in costs for the year.

Costs not related to employment, excluding the levy, at £66.0 million, were 14.8% higher than those recorded in the 2023 financial year, when one-off costs in that period are excluded (2023: £57.5 million, excluding one-off items).

Part of this increase represents the impact of inflation in the UK, which has been particularly severe for professional services, but also it is affected by increased outsourced administration costs on our savings operations, which increase in line with the size of our savings balance.

Spend on our digitalisation programme remained a significant part of the cost base, with non-employment related IT costs of £12.6 million incurred (2023: £13.0 million). The digitalisation programme continues to deliver new systems and enhancements across our businesses, and significant milestones were achieved in the year.

The progress of our cost: income ratio over the last five years is set out below.

	Underlying %	Statutory %
Year ended 30 September		
2024	***36.1***	***36.1***
2023	36.6	36.6
2022	39.4	38.9
2021	41.7	41.7
2020	43.0	43.0

Our cost:income ratio continued its improvement over the year, despite the level of expenditure incurred to develop the business. This was partly a result of margins widening, but also as a result of cost control actions which we took last year.

Cost control is a strategic priority, but we recognise that our cost base must also adapt to deliver our strategic priorities and to meet regulatory expectations. A sustainably lower cost:income ratio is therefore a long-term aspiration, rather than a short-term priority, particularly in the face of competitive markets for the kinds of specialist people and services that we need to operate.

Impairment provisions

The impairment charge recognised in our accounts for the year ended 30 September 2024 was £24.5 million, an increase of 36.1% (2023: £18.0 million). This increase is largely a result of a higher incidence of problem cases in our development finance operation, together with an increased number of receiver of rent appointments on legacy buy-to-let mortgage cases.

4 FINANCIAL RESULTS

Apart from these cases, performance of our loan books has remained strong, with arrears marginally increased, but, in common with other lenders, not to the extent some commentators had predicted for the market. The current economic outlook also benefits our impairment position, with inflation at a lower level than seen recently and interest rates predicted as more likely to fall than rise, meaning future affordability concerns are allayed to some extent.

However, it is not clear to what extent the rises in consumer and business costs over recent years have fully impacted on credit quality, and with new administrations in place or incoming in the UK and USA, amongst other countries, the present, generally positive, economic outlook may be subject to new pressures.

Our recognition of credit losses is governed by the accounting standard IFRS 9, which requires the directors to take a view on the future performance of our loan assets and to base provisioning on expected credit losses ('ECL'). Where the economic outlook is complex, or where there is little relevant historical data to base loss predictions upon, this can be a challenging exercise.

The progress of the impairment charge and cost of risk in the five years is set out below.

	Charge / (release) £m	Cost of risk %
Year ended 30 September		
2024	***24.5***	***0.16***
2023	18.0	0.12
2022	14.0	0.10
2021	(4.7)	(0.04)
2020	48.3	0.39

The fluctuations shown above demonstrate the impact of various sources of economic and political uncertainty on our credit profile as they arise and then resolve over time. The high charge in 2020 represented the initial onset of the Covid pandemic, whilst in 2021 the position appeared to have become a little more stable. However, September 2022 saw the beginning of a period of much higher interest rates and significant inflation, leading to significantly increased economic headwinds, the impacts of which continue to be felt.

Multiple economic scenarios and impacts

Statistical models are used to support management's estimation of ECLs, where possible. These are kept under review and regularly updated. The models project losses for our largest books based on customer performance to the reporting date and anticipated future economic conditions. The use of these models therefore requires the use of a range of forward-looking economic scenarios which are each evaluated and then weighted to form an overall projection.

4 FINANCIAL RESULTS

For portfolios where detailed models cannot be used, generally because the number of accounts is small and historic data insufficient for statistical forecasting methodologies to be validly applied, we also consider the potential impact of these economic scenarios, if this is likely to be significant. In the current period this applied particularly to the development finance portfolio where the potential impacts of higher build costs, falling development values and longer project timescales were considered in our assessment of exposures.

At 30 September 2024, there was generally more consensus on the UK's economic outlook than at the previous year end. However, the majority of these forecasts remain cautious, with a significant potential for interest rates to remain high for some time, inflation to decline from current levels only slowly, house prices to remain subdued and growth to remain minimal. This, however, is an unfamiliar position for the UK economy, and the consequences for longer-term prospects remain an area of significant disagreement amongst experts.

These longer-term uncertainties include the potential for wider geopolitical events, including the conflicts in Eastern Europe and the Middle East, and the results of elections in the USA and other democracies during the year, to impact further on the UK economy. Closer to home, the detailed economic policies to be adopted by the new UK Government, and their potential effects, are not yet entirely clear. These factors may cause outturns to be significantly divergent from consensus economic forecasts.

To reflect the possible range of economic outcomes, four scenarios have been constructed for provisioning purposes, based on a number of forecasts from public and private bodies, synthesised to produce internally coherent sets of data. The general trend of the central forecast follows that published by the Bank of England in August 2024. This reflects the recent easing of monetary policy and recovering growth. Unemployment remains low, but trends upwards through the forecast period, inflation is generally stable and bank rates continue to fall. House prices, which have been more resilient than many had forecast, continue to increase modestly. This is rather more optimistic than the central forecast used in September 2023.

The upside and downside scenarios are derived from the central forecast, as they have been in previous periods. The shape of the curves representing all three scenarios are similar across the forecast period, but the upside scenario assumes inflation falling more rapidly, driving faster growth and enabling the Bank of England to cut the base rate further and faster than in the base case, while house prices recover more strongly. Conversely, the downside case represents increased pressure on CPI, leading to current levels of base rates persisting for longer, with reduced economic confidence impacting on both house price growth and unemployment levels.

The severe scenario has been derived from the most recent Annual Cyclical Scenario ('ACS') published by the Bank of England, as in recent periods. The supply shock scenario included in the ACS published in July 2024 forms the basis for this scenario and includes persistently high interest rates, causing a pronounced recession impacting on growth and employment levels, with a significant fall in house prices.

4 FINANCIAL RESULTS

The weightings applied to each scenario have been reviewed and revised. The consensus view for the UK economic outlook is both more settled and more benign than it was at 30 September 2023, however, the potential for significant downside impacts remains, to the extent of producing substantially different outcomes. On balance this represents an appropriate point to begin to move back towards a more normal set of economic weightings, and the impact of the severe scenario has been reduced. The forecast economic assumptions within each scenario, and the weightings applied, are set out in more detail in note 18.

To illustrate the impact of these scenarios on the IFRS 9 modelling, the impairment provisions before judgemental adjustments are set out below on the weighted average basis, and also shown on a single scenario basis, weighting each of the central and severe scenarios at 100%.

	2024		2023	
	Unadjusted provision £m	**Cover ratio**	**Unadjusted provision £m**	**Cover ratio**
Weighted average	70.0	0.45%	67.1	0.44%
Central scenario	64.8	0.41%	60.9	0.41%
Severe scenario	93.9	0.59%	89.3	0.60%

Despite the economic pressures on customers during the year, coverage levels remain similar to those seen at 30 September 2023. This will partly be a result of the stable or positively trending scenarios which reduce predicted default rates.

There is little recent historical evidence of the impact of a sustained period of high interest rates and inflation on customer credit, and both products and regulatory expectations have evolved significantly since interest rates last reached current levels. Our models have therefore been derived from datasets which include very few observations representative of the current type of economic environment and little evidence on which to base conclusions on how rapidly or severely customer behaviour might respond to the types of economic changes we are currently seeing.

The distribution of gross balances by IFRS 9 stage (defined in note 17) produced by our impairment methodology at the two most recent year ends is set out below.

	2024	**2023**
Stage 1	93.2%	93.5%
Stage 2	4.9%	5.0%
Stage 3	1.8%	1.3%
POCI	0.1%	0.2%
Total	**100.0%**	**100.0%**

4 FINANCIAL RESULTS

While Stage 2 cases have remained stable as a proportion of the book, the increased proportion of Stage 3 cases shows a higher incidence of customers impacted by the economic pressures seen over the last two years. However, these impacts remain modest overall.

The stability of Stage 2 is a function of the assumption of future stable or slowly declining interest rates and inflation, and the current relatively low level of arrears. This reduces the calculated provision and management must assess whether the result is appropriate, given the economic outlook, or whether adjustments over and above our normal provisioning approach are required.

Judgemental adjustments

Where key economic measures are at materially different levels to those which existed when the impairment models were created, management may add judgemental overlays to calculated impairment levels. These are required where it is considered, taking account of all available evidence, that current or anticipated levels of delinquency and / or loss in the modelled portfolios could exceed those implied by the model outputs, or where the normal methodology for provisioning on non-modelled books does not cover all identified risks.

Examples of such circumstances include the period of the Covid pandemic and its aftermath, and the recent period of rapid growth in interest rates and inflation. Whilst the current economic outlook at 30 September 2024 appears more stable than was seen in those periods, the cumulative effect of a longer period of elevated interest rates is also potentially challenging for the effectiveness of the provisioning models, and we have seen particular challenges in the cohort of development finance lending approved just before inflation and interest rates started to rise.

Having reviewed these potential additional impacts we have:

- Maintained the adjustment in our buy-to-let mortgage book at £3.0 million, to allow for the type of idiosyncratic impacts affecting legacy portfolios which we saw in the year and which might not be handled well by the approach in the model (2023: £3.0 million)
- Maintained the £1.0 million adjustment in our motor finance book while the ability of our new motor finance model, which was introduced towards the end of the year, to respond well to the current economic situation is assessed (2023: £1.0 million)
- Reduced the adjustment to the modelled SME lending outputs to £1.0 million, as a result of the stable performance in the year and satisfactory performance of the new model introduced in 2023 (2023: £2.5 million)
- Applied a temporary uplift to provision floors in the non-modelled development finance book, to allow for increased incidence of distress in projects planned and underwritten before the impact of rapidly increasing construction costs and interest rates in the period beginning in late 2022. This increased the impairment provision by £1.5 million (2023: £nil)

4 FINANCIAL RESULTS

The judgemental adjustments generated by this process, analysed by division are summarised below.

	2024 £m	2023 £m
Mortgage Lending	3.0	3.0
Commercial Lending	3.5	3.5
	6.5	6.5

We continue to monitor the appropriateness and scale of each of these overlays and consider the extent to which any of the elements giving rise to them can or should be incorporated into models and standard processes.

Ratios and trends

The results of the ECL modelling and other provisioning, including the impact of the economic scenarios described above, together with the adjustments adopted to address uncertainties over the future performance of accounts, has resulted in the overall provision amounts and coverage ratios set out below.

	2024 £m	2023 £m	2022 £m
Calculated provision	70.0	67.1	48.5
Judgemental adjustments	6.5	6.5	15.0
Total	76.5	73.6	63.5
Cover ratio			
Mortgage Lending	0.26%	0.33%	0.31%
Commercial Lending	1.77%	1.56%	1.34%
Total	**0.48%**	**0.49%**	**0.44%**

Following the judgemental adjustments, these ratios remain broadly in line with those seen in recent periods, although within the numbers the provision on most performing portfolios has reduced slightly, with more of the provision attributable to the increased value of credit impaired cases.

These coverage levels remain higher than the 0.34% coverage ratio observed in September 2019, before the outbreak of the pandemic, in what was a lower interest rate environment. Further, this level was recorded when there was less security cover in the buy-to-let loan book, with the average loan-to-value ratio of 67.4% at that time being higher than the 30 September 2024 value of 62.8% (2023: 62.8%).

Future levels of coverage will be dependent on the performance of the UK economy and its impact on our business, our customers and their markets.

4 FINANCIAL RESULTS

Fair value movements

The fair value line in our profit and loss account primarily reports fair value movements arising from interest rate hedging arrangements. These are put in place to protect margins when fixed interest rate products are offered in either our savings or lending markets, enabling us to continue to honour offers to customers in the event of significant interest rate movements. We also hedge certain fixed rate investments and liabilities.

We have a cautious approach to interest rate risk and consider our exposures to be appropriately economically hedged. No speculative derivative trading is undertaken, and all fair value movements relate to banking book exposures.

The accounting entries included in this balance are primarily non-cash items, which reverse over the life of the hedging arrangement and such movements are essentially considered to represent the anticipation of gains belonging economically to later accounting periods and their subsequent unwinding. They are therefore excluded from underlying results.

During the 2022 financial year, particularly during the second half, there was a significant level of volatility in UK benchmark interest rate expectations, resulting in a fair value gain of £191.9 million being recorded in the year. This impact was amplified by the approach adopted to pipeline hedging at that time and the retention strategy applied to five-year fixed loans maturing in that period, which meant that the pipeline was larger and of longer duration (and hence more exposed to movements in rates) than at most other times.

In the year ended 30 September 2024 the unwinding of this large gain, which had begun in 2023, continued to impact the fair value line. Coupled with the accounting hedge ineffectiveness in the period and the effect of new pipeline hedges, this resulted in a loss on fair value items of £38.9 million being reported (2023: £77.7 million).

We have £126.6 million (at net notional value) of derivative contracts at 30 September 2024 which are unmatched for hedge accounting, although form part of the economic hedging position (2023: £14.6 million). These derivatives must be carried at a fair value based on expected cash flows over their contractual lives. As a substantial proportion of this balance has a lifetime of two to five years, volatility in the interest rate markets can generate substantial month-to-month fluctuations in this valuation which have to be included in profit.

Tax

We operate only in the UK and materially all profit falls within the scope of UK taxation. The standard rate of corporation tax applicable to the business in the year was 25.0% (2023: 22.0%), with the surcharge applicable to the profits of Paragon Bank at 3.0% (2023: 5.5%). The effective tax rate applied to our profits has increased from 23.0% in 2023 to 26.7% during 2024, with the increase principally relating to changes in UK tax rates (note 9).

4 FINANCIAL RESULTS

As the bulk of the fair value loss arose in Paragon Bank, the banking surcharge means it is subject to a higher rate of tax than the overall effective rate for the Group. This meant the effective tax rate on underlying profit was 27.4% (2023: 23.9%), with the change mostly driven by the increased UK corporation tax rate (Appendix A).

Results

Profit before tax for the year on the statutory basis was £253.8 million (2023: £199.9 million), with the £15.1 million growth in profit at the underlying level enhanced by a £38.8 million reduction in the loss on fair value items. Profit after tax was increased by 20.9% at £186.0 million (2023: £153.9 million). In addition, other comprehensive income of £5.4 million was recorded, relating to valuation gains on the defined benefit pension scheme (the 'Plan').

Consolidated accounting equity at the year end, after dividends and share buy-backs was £1,419.5 million (2023: £1,410.6 million), and consolidated tangible equity was £1,248.0 million (2023: £1,242.4 million), representing a tangible net asset value of £6.11 per share (2023: £5.79 per share) and a net asset value on the statutory basis of £6.95 per share (2023: £6.57 per share) (Appendix E).

4.2 ASSETS AND LIABILITIES

The main driver of movements in our balance sheet is the size and composition of the loan book. This, together with policies on capital and liquidity, determines our funding requirements and hence the level of our liabilities.

The loan portfolio grew by 5.6% year-on-year during 2024, with growth in both Mortgage Lending and Commercial Lending. More detail on these movements is given in the business review in Section 1.

4 FINANCIAL RESULTS

Our assets and liabilities at the end of the financial year are summarised below.

SUMMARY BALANCE SHEET
30 September 2024

	2024 £m	2023 £m	2022 £m
Investment in customer loans			
Mortgage Lending	13,415.7	12,902.3	12,328.7
Commercial Lending	2,289.8	1,972.0	1,881.6
	15,705.5	14,874.3	14,210.3
Hedging adjustments	(75.2)	(379.3)	(559.9)
Derivative financial assets	391.8	615.4	779.0
Cash and investments	2,952.8	2,994.3	1,930.9
Pension surplus	22.2	12.7	7.1
Intangible assets	171.5	168.2	170.2
Other assets	101.4	134.6	116.0
Total assets	19,270.0	18,420.2	16,653.6
Equity	1,419.5	1,410.6	1,417.3
Retail deposits	16,298.0	13,265.3	10,669.2
Hedging adjustments	16.7	(30.9)	(99.7)
Other borrowings	1,005.3	3,086.4	4,007.2
Derivative financial liabilities	99.7	39.9	102.1
Other liabilities	430.8	648.9	557.5
Total equity and liabilities	19,270.0	18,420.2	16,653.6

Funding structure and cash resources

Our retail and wholesale funding balance increased by 5.8% during the year, a similar increase to the growth in the loan book. The year end liquidity buffer had been diversified to include investment securities for the first time. At 30 September 2024, £427.4 million of government and commercial bonds were held (2023: £nil). Overall, the total amount of cash and investment securities held remained broadly similar across the period, reducing by only 1.4%.

The proportion represented by retail deposits increased to 94.2% in accordance with our long-term funding strategy (2023: 81.1%), with wholesale borrowings paid down, including substantial early repayments of Bank of England TFSME funding. Movements in funding balances are discussed in more detail in Section 2.

4 FINANCIAL RESULTS

Derivatives and hedging

The derivative assets and liabilities shown in the table above relate almost entirely to arrangements for hedging interest rate risk on fixed rate mortgage and savings products. These assets and liabilities are held at fair value, with the valuation based on future expectations of interest rates. The size of the balances is driven by the difference between current expectations for variable rates and the fixed rates applicable to the hedged items, set at the point of origination, meaning that where market rates have moved sharply, large balances will be carried.

During the year, expectations of future interest rate increases moderated, and to some extent reversed, resulting in a reduction in the derivative valuations in the balance sheet, with swap assets falling by 36.3% in the year to £391.8 million (2023: £615.4 million) and swap liabilities increasing by 149.9% to £99.7 million (2023: £39.9 million). While these movements do contribute to the fair value differences in the profit and loss account described above, they are mainly offset by fair value accounting adjustments to loan assets and deposit liabilities, with the adjustment in assets reducing by £304.1 million in the year and that in liabilities by £47.6 million.

Pension obligations

The IAS 19 valuation surplus on our defined benefit pension scheme increased from £12.7 million at the start of the year to £22.2 million at the year end. The assumptions for this valuation are based on market-derived interest and bond rates and can be subject to fluctuation where market rates do not move in parallel.

The changes in inputs between the valuations at the beginning and end of the year are smaller than those seen in some recent periods, with the principal differences being the decrease in the discount rate used in evaluating scheme liabilities, based on long-term corporate bond yields, decreasing from 5.55% to 5.10%, and the assumed rate of RPI inflation, based on gilt yields decreasing by a lower amount, from 3.25% to 3.05%. These movements led to a pre-tax valuation gain of £7.2 million being booked in other comprehensive income (2023: £2.4 million).

Other assets and liabilities

Other assets decreased from £134.6 million to £101.4 million in the year, largely a result of the replacement of the CRD scheme, which required regulated banks to place a designated non-interest bearing deposit with the Bank of England, the income from which would fund the central bank's activities. This was replaced during the period with the Bank of England Levy, as noted above. A CRD asset of £38.0 million had been held at 30 September 2023 with none held at the 2024 year end. This reduction in sundry assets was partly offset by a higher level of accrued interest income, which increased by £6.5 million as a result of higher interest rates.

4 FINANCIAL RESULTS

Other liabilities reduced from £648.9 million to £430.8 million at 30 September 2024. This was principally the reduced value of collateral deposits received against swap assets, which fell by £279.8 million, reflecting the reduced amount outstanding. This was offset by an increase of £38.5 million in accrued interest, as funding balances and rates continued to rise.

4.3 SEGMENTAL RESULTS

The underlying operating profits of the two segments described in the Lending Review in Section 1 are detailed fully in note 2 and are summarised below.

	2024 £m	2023 £m
Segmental profit		
Mortgage Lending	257.7	246.6
Commercial Lending	88.3	113.2
	346.0	359.8
Unallocated central costs and income	(53.3)	(82.2)
	292.7	277.6

Central administration and funding costs, principally the costs of service areas, establishment costs and bond interest have not been allocated, nor has interest income from surplus liquidity. The increase in unallocated interest in the year, a result of higher interest rates, year-on-year, is the main cause of the change in unallocated balances.

Mortgage Lending

The Mortgage Lending division continues to perform well and grow its NIM, with margin on fixed rate accounts protected by hedging arrangements. Net interest grew by 1.7% in the year to £282.3 million (2023: £277.6 million) with the average net loan balance growing by 4.3% to £13,159.0 million (2023: £12,615.5 million). NIM decreased to 215 basis points (2023: 220 basis points), as a result of the tightening in retail funding costs in the period.

Overall credit performance of the book has worsened slightly in the period, with an increase in properties placed under the control of a receiver of rent, although observable adverse credit impacts have been minimal to date. Only 1.4% of the gross loan book by value at the year end was considered to be credit impaired (2023: 1.2%), including an increase in IFRS 9 Stage 3 cases from £142.2 million to £171.1 million, with increases concentrated amongst realisation cases.

4 FINANCIAL RESULTS

The charge for impairment decreased to £5.6 million in the year (2023: £10.4 million) with the cost of risk for the year at 4 basis points (Appendix B). The low cost of risk reflects the high levels of security cover in the division's portfolios.

Overall contribution from the division for the year increased by 4.5% to £257.7 million (2023: £246.6 million).

Commercial Lending

Average balances in the Commercial Lending division grew by 10.6% to £2,130.9 million (2023: £1,926.8 million), which, together with a decrease in NIM from 704 basis points to 586 basis points, generated a decrease of 8.0% in net interest to £124.8 million (2023: £135.7 million). This reflected changes in the proportion of segmental income generated in each of the division's operations, coupled with the increase in average funding costs, seen across the business.

Impairment charges for the period, at £18.9 million, had increased significantly from the 2023 financial year (2023: £7.6 million), with this increase concentrated in the development finance operation. Credit performance in the year remained largely stable in the motor finance and SME lending elements of the portfolio, with low arrears and relatively few defaulted cases, although we maintain a cautious attitude towards credit prospects for the sector.

5.1% by gross value of cases in the segment's portfolio were considered to be credit impaired at the year end compared to 3.5% at the previous year end. However, a substantial amount of this balance relates to development finance projects, where security cover is generally high. In development finance an increasing number of watchlist cases have been recorded, with a limited number encountering significant distress, contributing £47.3 million of the £48.7 million increase in IFRS 9 Stage 3 balances in the year. Losses in this business are highly cyclical and generally linked to idiosyncratic factors or economic shocks and these losses follow several years where loss levels were minimal.

These factors led to a reduction in segmental profit of 22.1% to £88.3 million (2023: £113.3 million).

5 OPERATIONS REVIEW

Our strategy relies on sector knowledge, specialist systems and the careful management of risk across all our operations to meet our goals. Our strategic pillars include maintaining a customer-focussed culture and a dedicated team, highlighting the importance of our experienced, skilled and engaged workforce facilitated by effective systems and detailed analytics in delivering our purpose.

This year has seen continued progress in our long-term programme to enhance processes and technology, with significant elements either completed in the period or nearing completion including major infrastructure upgrades and the roll-out of the new mortgage origination platform. The enhancements completed address both internal systems and those facing customers and business partners, and enhance our risk management framework and support our digitalised vision for our future operating model. At the same time we continue investing in our people and processes to ensure the effectiveness of our operations going forward.

This continuing prioritisation ensures we maintain a firm foundation for building the business and delivering our strategy into the future.

5.1 OPERATIONS

Our workforce is just over 1,400 people, most of whom work on a hybrid basis, dividing their time between home-based working and one of our office locations. The delivery of our strategy requires that we optimise our IT systems and physical infrastructure to provide the best level of service to customers, and a rewarding working experience for employees.

Over recent years we have been undertaking a major programme of systems re-engineering covering our IT infrastructure and our loan origination and administration systems, to support our digitally enabled strategic vision.

This year we continued to make progress with this programme, with several major milestones being achieved. In December our IT mainframe systems were migrated to a cloud-based solution, meaning that over 90% of our major IT applications are now cloud-based. Our largest business area, mortgage lending, saw a major upgrade to its operational platform in the second half of the year. The new mortgage system offers more functionality and better service to our mortgage brokers and a better user experience for our people, as well as increasing process efficiency. While the main system has now been launched, the rollout to the full broker population continued into the new financial year, and work to deliver further enhancements continues.

The launch of the new origination platform for mortgages means that new cloud-based, digitally-advanced application and underwriting platforms have been rolled out for three of our principal lending areas: buy-to-let mortgages, SME lending and development finance. Each represents a major step in our digitalisation journey, and with related staff training and process enhancements, a substantial investment in the future of our businesses.

5 OPERATIONS REVIEW

Customer take-up of the buy-to-let self-service portal, introduced in 2023, has increased in the period. This enables customers to generate customised statements and update their personal details, amongst other tasks, and has resulted in a reduction of approximately 25% in calls to the operation's contact centre.

Further enhancements were also rolled out to the new SME lending system, enabling a more seamless application process and swifter decisions, while further improvements to telephony, financial crime risk management, payments and customer self-service applications were also put in place, enhancing efficiency and the experience for internal and external users.

As progress is made on the digitalisation roadmap, work continues to deliver further enhancements for loan and savings customers, business partners and employees, which will come online in the coming periods.

We have made no significant changes in our approach to working, with our hybrid working model remaining in place and office occupancy remaining at similar levels to previous periods, with most people spending just over two days a week in an office location. This has continued to evolve in the year, with learnings being used to refine the approach. As a specialised business we believe that a 'one-size-fits-all' approach to working is unlikely to deliver the best results across our different operations, and business areas continue to adopt working methods which suit the needs of their people, processes and customers, investing in appropriate system enhancements as required.

Our office and other sites are valuable hubs where collaboration, communication, development and the growth of our culture and identity can be fostered, but we recognise that they must adapt as the business evolves. During the period we continued to review our physical footprint to ensure best use is being made of the estate. As a result, we were able to consolidate our Solihull-based staff in one location, while approving a long-term plan to improve the functionality, working environment and environmental impact of our Solihull headquarters.

As well as providing an enhanced working environment for our people, these developments should provide both financial and sustainability benefits and, alongside our relatively modern London and Southampton sites, deliver facilities well-suited to our hybrid working approach.

The operational resilience of the business remains an important area of focus for us and our regulators. During the year the second formal self-assessment required by regulators was successfully completed, providing an opportunity to evaluate developments in this area since the exercise was first completed.

We maintained our focus on high-quality customer service throughout the period. Regular surveys are conducted with customers and business introducers to monitor satisfaction, which have remained positive (as set out in section 1). To ensure this continues, we reviewed the structure of our main operational functions, reorganising reporting lines to create synergies and share specialist expertise. Together with enhancements to telephony and related systems, this delivers a function well able to support our future customer service aspirations.

5 OPERATIONS REVIEW

The Financial Conduct Authority ('FCA') Consumer Duty expanded to cover those of our legacy products which are within the scope of the Duty from July 2024. Building on the successful first phase introduction during 2023, which involved significant work to embed the Duty's requirements into our systems and processes, the further work carried out in the year meant that we were able to comply with the wider scope requirements by the FCA deadline. This was confirmed by our first formal Consumer Duty Annual Report, which was presented to, and approved by, the Board in the year.

We continue to monitor progress on the FCA Review of Motor Finance Commissions, which was launched in the year, together with associated legal cases, including the current judicial review relating to determinations made by the FOS and the Court of Appeal decision in the cases of Johnson, Wrench and Hopcraft. While we were not involved in the review directly, the cases currently in progress have a potentially significant impact across the industry as a whole. While we have received an increased level of contact from customers as a result of the publicity surrounding this issue, this has remained within manageable limits. However, we do have contingency plans in place to ensure that if volumes do grow, all customers can be appropriately dealt with.

5.2 GOVERNANCE

We believe that high standards of corporate governance are fundamental to the effective execution of our strategy. The Group is subject to the 2018 UK Corporate Governance Code (the 'Code'), and we have continued to comply with the Code's principles and provisions throughout the period.

A new edition of the Code, most of which will apply to us from our year ending 30 September 2026 (with provisions relating to financial control applicable from the 2027 financial year) was published in January 2024. We note the revisions made by the FRC to its original proposals, and work to respond to these changes is already in progress.

Our annual general meeting ('AGM') was held on 6 March 2024. All resolutions were carried comfortably with at least 95% of votes in favour, and the Board extends its thanks to those shareholders who participated. Detailed results can be found on our corporate website.

During the year, the Audit Committee conducted a tender process in respect of the appointment of external auditors with effect from the financial year ending 30 September 2026. All of the six major audit firms were considered in the process with opinions being canvassed from shareholders and their representatives during our normal investor relations meetings.

Following detailed consideration of the various firms' proposals the Committee recommended the appointment of Deloitte LLP in place of KPMG LLP, the current external auditor, once they have completed their tenth year in office, following the signing of the 30 September 2025 accounts. The Board accepted this recommendation, subject to shareholder approval, which will be sought at the 2026 AGM.

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Board of directors and senior management

As previously announced, Tanvi Davda, an independent non-executive director, succeeded Hugo Tudor as Chair of the Remuneration Committee on 7 December 2023. Hugo remains on the Board of Directors and has been considered a non-independent director with effect from the conclusion of the AGM on 6 March 2024. Hugo resigned from the Audit, Remuneration, Nomination and Risk and Compliance Committees on this date. The Board currently comprises two executive directors, six independent non-executive directors, one non-independent non-executive director and the Chair, who was considered independent on appointment.

Following the year end, on 1 November 2024, Tanvi also joined the Audit Committee, following consideration by the Nomination Committee of the appropriate level of resource required to fulfil its duties, and the most appropriate way to deliver this.

At 30 September 2024, our Board included four female directors, comprising 40% of its membership, with one of the senior roles designated by the FCA held by a woman, Alison Morris, the Senior Independent Director. Half of the Board's principal committees are also chaired by female directors.

On 13 August 2024 Louisa Sedgwick was promoted to the role of Managing Director – Mortgages. Louisa is a well-known and highly respected figure in the mortgage industry, with more than 30 years' experience in leading institutions. She was most recently Paragon's Commercial Director of Mortgages and has overseen the restructuring of the sales function and product offering in the division. She replaces Richard Rowntree, who has accepted an appointment elsewhere in the financial services sector.

During April 2024 Derek Sprawling, the Group's Savings Director, was appointed as Managing Director – Savings. Derek has been part of the development of our savings proposition from its early days, since joining the business in 2014. Michael Helsby, who had been both Managing Director – Savings and Strategic Development Director, retains his strategy role.

Both Louisa and Derek joined the Executive Performance Committee and Executive Risk Committee. This increases the membership of both committees to twelve at the year end, with 25% of members female.

In a reorganisation after the year end, Sarah Mayne, the Chief Internal Auditor, joined the committees as a member, having previously attended their meetings as an observer. Sarah's appointment brings the number of members to thirteen, and the percentage of female members to 30.8%.

Remuneration policy

The last triennial review of our director's remuneration policy was approved by the 2023 AGM, and a further approval at the 2026 AGM will be required. We will therefore be seeking input from shareholders and other interested parties over the course of the forthcoming financial year as our Remuneration Committee develop a revised policy to be presented with the 2025 Annual Report and Accounts. We would urge stakeholders to participate in this process, if invited, and representations can be made to the Remuneration Committee Chair through the office of the Company Secretary.

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5.3 MANAGEMENT AND PEOPLE

Over 1,400 people work in our business across the UK, with the majority based at our Head Office in Solihull, but with hybrid working arrangements. People are our most important asset, and we are proud to be accredited as a platinum employer under the Investors in People programme. We focus on providing people with opportunities for varied and rewarding careers, offering extensive training and coaching opportunities to enable them to meet their own ambitions, whilst delivering on our strategic objectives.

Conditions and culture

We continue to refine our operating model, streamlining and simplifying our organisational structure, ensuring that our businesses are best positioned to continue to focus on providing good outcomes for customers, while protecting and developing specialist skills. We focus on ensuring the resourcing requirements of potential future challenges and opportunities are met, while ensuring that we can operate in the most cost-efficient way possible.

Whilst we seek to avoid redundancies wherever possible, consultation exercises with a small number of employees in different business areas were entered into during the year. Some affected employees were redeployed to alternative roles, whilst a number left the business on a voluntary basis, minimising compulsory redundancies.

During the period, working practices continued to be enhanced to embed the Consumer Duty, contributing to driving good customer outcomes. This was supported by changes in our individual performance management approach, where formal performance ratings have been removed and the focus of performance conversations is based on five priority areas: customer, risk, commercial, people, and sustainability.

We continually strive to build an engaged workforce and encourage a culture where employees are comfortable providing feedback. Since April 2024, surveys have been used to gather feedback on the experiences of new hires and leavers as part of a larger project to understand particular elements of the employee lifecycle. Whilst still in their early days, these surveys have produced a strong set of positive indicators, with 96% of all new employees stating they are proud to work for the Group. The survey asks for employees' feedback on topics such as inclusion, management and leadership, access to development opportunities, and views of our commitment to delivering good customer outcomes. It was particularly pleasing that 100% of new employees agreed that we are committed to delivering a good outcome to customers. Both leavers and joiners described the business as being a welcoming, supportive, inclusive and professional employer.

With an employee attrition rate, excluding redundancies, of 10.8% (2023: 11.4%), our retention levels continue to be better than the national average. These high levels are further bolstered by 58.9% of employees achieving over 5 years' service, 12.5% achieving over 20 years with the Group and 3.7% achieving over 30 years' service.

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Our employees continued to show flexibility during the year with many undertaking secondments and transfers to different areas of the business to ensure that the needs of the customers continued to be appropriately met.

We retain our accreditation from the UK Living Wage Foundation and minimum pay exceeds the levels set by the Foundation. The minimum wage paid to our employees increased to £12.69 per hour from 1 October 2024, with a higher level for London-based employees.

The profit related pay scheme continues to provide employees with a benefit linked to our financial performance. In the current year, as a result of the 2023 profit, an additional £2,400 was paid to all full-time employees below senior management level. Employees also benefitted in the year from our maturing 2021 three-year Sharesave scheme, being able to buy shares with a market value in the region of £7.00 each for an option price of £4.24.

Equality and diversity

Continued progress has been made on our equality, diversity and inclusion ('EDI') agenda during the year, and in September 2024, we launched an updated equality, diversity, and inclusion strategy to employees, with three main focus areas: gender, ethnicity, and socio-economic background ('SEB'). The EDI Network continues to inform our plans in this area, and is sponsored at executive level by Ben Whibley, the Chief Risk Officer, who succeeded Richard Rowntree in this role in the year.

The drive to capture diversity data for as many employees as possible continues, with fresh initiatives in the year, and by September 2024, 80.9% (2023: 76.8%) of employees had completed a diversity profile on the HR management system. The collation of this data from employees provides us with an enhanced ability to monitor and improve the diversity of the workforce going forward.

We remain committed to improving workforce diversity and ensuring that talented people from all backgrounds can reach their full potential by breaking down barriers to progression.

Progress towards our Women in Finance target of 40.0% female representation in Senior Management roles by December 2025 continues, with female representation at 30 September 2024 at 37.9% (2023: 38.8%). Louisa Sedgwick's appointment to the Executive Committee in August 2024, as Managing Director of our Mortgage Lending business was also notable, with Louisa being the first female to hold executive committee level responsibility for an income-generating business area. This internal appointment also demonstrates the effectiveness of our succession planning strategy.

In line with the expectations of the Parker Review, we have committed to achieve 5% ethnic minority representation in Senior Management roles by December 2027. Ethnic minority representation in senior leadership roles currently stands at 1.7%, so developing the strength of our talent pipeline to provide candidates for these roles in future, and critically reviewing external recruitment procedures, will be central to achieving this stretching target.

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To support its efforts to improve socio-economic equality we have partnered with Progress Together to participate in the Accelerated Progress Programme, a cross-company scheme. This programme is uniquely designed to develop, empower and unlock the potential of high-performing middle managers from a low SEB.

5.4 SUSTAINABILITY

Sustainability, including resilience in the face of climate change risks, is core to our strategy: to focus on specialist customers, delivering long-term sustainable growth and returns through a low risk and robust business model. Sustainability influences every aspect of our business and means:

- Delivering sustainable lending through the design of products and the choices of sectors in which to operate
- Reducing the impact of our operations on the environment
- Ensuring we have a positive effect on our stakeholders and communities

Sustainability issues are coordinated on a group-wide basis by the Sustainability Committee, which reports directly to the Executive Performance Committee. The Sustainability Committee is responsible for driving the Group's initiatives on climate change and progressing other projects in the field of sustainability, ensuring that information on all such initiatives is shared across our businesses and facilitates the development of a coordinated and proactive approach.

During the year the Committee has overseen a sustainability materiality exercise, facilitated by third party experts. The exercise prioritised key sustainability areas ensuring our strategy and reporting remain current and up to date.

In December 2024 we will publish our fourth Responsible Business Report, our annual sustainability report. This provides more detailed information on sustainability initiatives and demonstrates how sustainability is embedded. It can be found, alongside other information and documentation relevant to ESG issues, on our corporate website at www.paragonbankinggroup.co.uk.

Climate change

We have made a commitment to achieve net zero in line with, and in support of, UK Government commitments. In doing so we recognise that net zero cannot be achieved by any entity in isolation and therefore our commitment is dependent on appropriate government and industry support and action. As members of Bankers for Net Zero ('B4NZ'), we are active in providing input into the wider efforts of the financial services industry to creating a clear pathway to support the decarbonisation of the UK economy.

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We have designated climate change as a principal risk within our Enterprise Risk Management Framework. This means that our response to climate change issues is considered within our overall strategy at board level. These risks fall into two main groups:

- Physical risks (which arise from the impact of more frequent or severe weather-related events on our business or our customers)
- Transitional risks (which come from the speed, nature and level of regulations designed to promote the adoption of a low-carbon economy)

Information and measures on climate-related risks and opportunities are considered at board level through the CEO's monthly reports. Developments in sustainable products and climate-related exposures are considered for each of our business lines as part of strategy deep dives which feed into the annual board strategy event and into our business planning process.

No new material risks related to climate change were identified during the annual risk reviews, carried out on each key business area supported by the ESG and Credit Risk teams. The findings have been used to inform this year's climate change scenario analysis exercise and to identify the key drivers of our climate change risk profile and opportunities. The exercise was conducted in line with the outputs of the Climate Financial Risk Forum ('CFRF') scenario analysis working group, which we are represented on, and incorporated within the broader 2024 ICAAP analysis.

As part of the ongoing development of our climate-related reporting, we have enhanced our analysis of financed emissions, and a more detailed emissions balance sheet is being presented in the 2024 Annual Report and Accounts.

Developments within business lines which contribute towards our climate risk strategy are set out in the relevant business reviews.

As a financial services provider the direct environmental impact of our operational footprint is considered low. However, we recognise the importance of reducing the impact our operations have on the environment. We have committed to reduce our operational footprint to net zero by 2030 and it is now reported on a quarterly basis to the Sustainability Committee, with a summary report escalated to the Board.

In support of this net zero target, certified carbon offsets equivalent to our operational footprint for the twelve months ended 30 September 2024 have been purchased, in the same way as for the two preceding financial years. We intend to repeat this for each future year, but accept that reducing impacts is preferable to offsetting, where possible.

Initiatives to reduce operational environmental impacts during the year include:

- Initialising a project on the refurbishment and decarbonisation of our Solihull head office building based on the decarbonisation assessment delivered during 2023.
- Centralising Solihull-based employees in the head office building, following changes to the working environment and building renovations. The relocation of staff has facilitated a reduction in operational emissions, while also delivering other benefits, such as enhanced opportunities for collaboration and for building our culture and communities.

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- Continuing to electrify our company car fleet and working to reduce unnecessary business travel. At 30 September 2024 95% of all company cars were either fully electric or hybrid (2023: 80%). We also offer an electric car scheme via salary sacrifice to all employees, providing those not entitled to a company vehicle with access to lower emissions travel. These initiatives are expected to reduce both direct and indirect travel emissions.
- Continuing to transition our electricity supplies to renewable or low carbon sources. During the year the proportion of our purchased electricity certified as renewable rose to 91% from 86% in the 2023 financial year.
- Enhancing ESG due diligence at the beginning of the relationship with new suppliers, considering climate related targets and greenhouse gas reporting.

Social engagement

During the year, the employee-led Paragon Charity Committee raised £49,000 for Molly Ollys, the charity chosen by employees. Molly Ollys supports children with life-threatening illnesses and their families and helps with their emotional wellbeing. For the financial year ending 30 September 2025, Guide Dogs has been selected as the beneficiary of the committee’s fundraising activities.

Our employee volunteering initiative also continued to make an impact in our communities during the year. Employees are entitled to an annual paid volunteering day, and opportunities offered during the year have focussed on supporting people who are experiencing poverty, providing educational opportunities for children and young people and improving the local environment. These have included initiatives building on long-standing relationships with charities and schools.

Engagement in the volunteering programme across all our locations has remained stable this year, with the number of volunteer days completed in the financial year totalling 460 (2023: 469).

Customer experience

We are committed to delivering good customer outcomes and continue to find ways to enhance the customer journey and experience in all our operations. During the year our comprehensive insight programme has supported the updating of communications materials, making sure they are as clear, accessible and understandable as possible for all customers, including those in vulnerable circumstances. The programme also facilitated updates of our customer websites and the simplification of product ranges offered, all aimed at improving the wider customer experience. Our internal Customer Vulnerability Awareness Group continues to raise awareness around vulnerabilities, making sure that impacted customers are considered throughout every stage of their financial journey.

The Customer and Conduct Committee monitors complaint volumes, identifies any trends and makes sure issues are addressed and lessons learnt, and throughout the year complaint metrics have remained positive, excluding the effect of motor finance related cases.

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5.5 RISK

The effective management of risk remains crucial to the achievement of our strategic objectives. Our risk governance framework is designed around a formal three lines of defence model (business areas, the risk and compliance function and internal audit), which is supervised at board level.

Risk environment

The risk landscape has shifted considerably since the end of 2023. Certain challenges which we face have remained constant, others have receded, whilst new threats have emerged which impact on our ongoing planning and approach to risk management.

The evolving nature of global, national and sectoral risks requires us to monitor the environment proactively to ensure we remain responsive in reacting to emerging threats and adjust our assessment and management of known risks as their impact changes. We continue to rely on our Enterprise Risk Management Framework ('ERMF') to ensure that new and developing risks are promptly identified, assessed and managed, with appropriate escalation and oversight provided. We are committed to ensuring that our business remains resilient in the face of such challenges and is able to respond in an agile manner.

The importance of the ERMF has been evident throughout the year as we have navigated the ongoing geopolitical and economic threats that have impacted the UK through the continuing cost-of-living challenges and high costs of doing business. Whilst inflationary pressures have eased somewhat, and interest rates have stabilised and are now on a downward trajectory, there is still considerable uncertainty as to what the longer-term path and timescale looks like. We remain cautiously optimistic, but continue to assess a full suite of potential scenarios as part of our ongoing financial and operational planning.

Whilst prospects of a prolonged recession seem now to have diminished, the new UK government has only been in office for a few months and its full agenda and detailed policies are yet to be clarified. Further detail was provided in October's budget, but it is already clear that despite the improving situation, the Chancellor considers her policy options to be constrained by legacy issues. The detailed longer-term impact of this is yet to be seen and we continue to monitor developing initiatives closely to assess any impacts on our activities.

Aside from economic policy, the UK Government has already stated that it intends to make reforms in the private rented sector through its 'Renters' Rights Bill', including ending 'no fault' Section 21 evictions and introducing a 'Decent Homes Standard' for rental homes. We continue to engage with the government, both directly and in conjunction with trade bodies, on how this can be practically implemented, building on work carried out on earlier proposals made by the outgoing UK Government. At the same time we maintain our focus on how these proposals may impact the risk profile of our buy-to-let portfolio.

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In addition to the domestic landscape, 2024 has seen significant global change of which the potential impacts are yet to be fully determined. The results of the US presidential election which took place in November 2024 will undoubtedly have far reaching economic impacts beyond the US borders and the year has also seen political change across a range of other democracies.

We continue to monitor the ongoing impacts of the armed conflicts in Ukraine and the Middle East, where the situation remains highly uncertain. Given the unfolding nature of these events, their full potential impacts on the UK economy remain unclear and may be wide-ranging and varied, depending on the extent of direct UK involvement. We are keeping a close watch on how these situations develop and continue to evaluate how they may impact our risk profile, either by influencing macro-economic behaviours or in areas such as global supply chain disruption, physical security and increased cyber threats.

Despite the significant challenges these geopolitical and economic threats bring to the overall operating environment, our businesses continue to perform positively. Whilst these issues continue to develop and demand ongoing vigilance, we are well-placed to manage these and other risks as we have shown through our approach to the significant and varied challenges of recent years:

- Interest rates are widely considered to have peaked and to have begun a slow downward trajectory. The prevailing view is that the outlook is more stable than at the start of the period. However, given the higher cost environment, we continue to closely monitor potential impacts on customers and employees
- We continue to focus on high-quality lending, applying prudent credit policies. Actual and projected arrears trends are assessed in setting lending criteria. However, the wider economic challenges of recent years have yet to translate into significant adverse performance across the lending portfolios
- Whilst the current risk profile of loans across our lending portfolios does not indicate any noticeable signs of significantly increased widespread financial stress, we continue to take a forward-looking, as well as current, view of affordability, and adjust credit policy to ensure loan repayments are sustainable for customers where necessary:
    - The credit performance of our buy-to-let lending book saw some movement as landlords adjusted to higher interest rates but default rates have remained broadly static. The sustained growth in property valuations seen in the period, coupled with very strong rental demand, provide a sound basis for buy-to-let lending. Together with the prospects of decreasing interest rates in the coming financial year, the risk outlook is generally positive
    - Arrears for SME lending have remained largely stable over the year, with consistent market demand for the types of asset we fund supporting both loan performance and asset values

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- The development finance market has generally adjusted to the higher costs and interest environment, with these factored into project planning, although we have seen a higher incidence of accounts experiencing credit issues.

  The availability of both labour and raw materials is also no longer providing the level of constraint to the sector seen in previous periods. However, the impacts of higher costs on older inceptions and planning delays both at the approval stage and at completion sign-off, which can lead to extended loan periods, can erode developer profitability. The strength of the underlying property values however remains firm and provides a ready exit for developers

- We take our responsibilities in respect of customers in vulnerable circumstances extremely seriously and continue to ensure that, where appropriate forbearance solutions are necessary, these are tailored to individual customer circumstances and aligned to regulatory guidance and expectations

Risk management

Our risk management framework remains core to the effective identification, assessment and mitigation of risks and level of maturity around risk understanding across our businesses continues to deepen and improve.

We have invested significantly in our risk management capability since the inception of the current ERMF in 2021, with focus on improved design and enhancements to the risk toolkit to ensure that the nature of risk is well-understood, accountabilities for risk management are embedded in day-to-day operations and material risk issues are promptly identified and escalated. By ensuring that risk management remains a core discipline across all business lines and support functions, we maintain the ability to manage all categories of risk and can respond to challenges in an agile and proportionate way. The well-understood ERMF enables us to manage all categories of risk and further mature our overall risk approach ensuring that risk considerations remain central to day-to-day and strategic decision making.

Whilst the ERMF has been successfully rolled out and embedded across our businesses, continuing development, ensuring it remains relevant and aligns to our strategic aspirations, are core to its ongoing effectiveness. During the year this has included the refreshment of the principal risk policies and associated appetites that provide the foundation and framework for managing the individual risk exposures. Significant work has also been undertaken in scoping the requirements for an improved risk and compliance IT system. This will better provide an automated solution to support the functioning of the ERMF, the user community and to further improve the analysis and reporting of risk-related data, giving better insight into the risk profile at all levels.

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We are committed to the further development of the ERMF, as necessary, to ensure it remains relevant and in line with regulatory expectations. Regular risk maturity and risk culture assessments provide an invaluable aid to identifying potential enhancements. The strategy of continuous improvement is underpinned by ongoing upskilling in the risk function, ensuring that appropriately skilled resource is available to provide oversight and assurance around the management of all categories of risk.

Experienced hires have been onboarded during the year into the function which bring the advantages of further benchmarking and wider perspectives on core risk processes such as internal control assessments and emerging risk identification as we look to refine these over the next twelve months.

The ERMF has performed a critical role in managing the wider geopolitical and economic challenges which have been prevalent during the year, and continues to do so. However, there are a number of ongoing risk management initiatives which remain key to the successful execution of our strategy. Good progress has been made on these and we remain focussed on delivering these commitments which include:

- **Consumer Duty** – Successfully delivering Consumer Duty rules and requirements, meeting the regulatory deadlines for all open and closed products and services in scope, ensuring that the Group's culture is driving good outcomes for its customers
- **Operational Resilience** – Continuous embedding of operational resilience capabilities including addressing actions and vulnerabilities identified in the regular self-assessment process. This includes ongoing refinement of critical business services and tolerances, ensuring these considerations are embedded as both part of day-to-day operations, and as a core principle within our digital strategy and technology roadmap which increasingly relies on third parties to deliver core services
- **Climate** – Addressing the impact of climate change on managing financial risks and considering this as part of the wider ESG agenda, with clear commitments made to drive net zero ambitions in line with wider governmental strategy
- **IRB** – Continuing to refine established IRB model methodologies for the buy-to-let and development finance portfolios, while refining the embedded overarching model risk framework to further enhance credit risk management and support the application process. Focus is on updating buy-to-let models, following recent PRA binding feedback as part of the ongoing close contact with the regulator
- **Stress testing** – Ongoing enhancement to stress testing procedures to ensure the robustness of capital and liquidity positions including further refinement of our IRB models for buy-to let and development finance

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- **Cyber-security** – Ensuring effective cyber-security controls and a robust data protection approach are in place, particularly with the evolving and increasingly sophisticated nature of cyber threats and in support of our commitment to further digitalisation. As the use of artificial intelligence ('AI') becomes more widely embedded, we have further formalised oversight and governance procedures in this area to ensure that cyber defences are not compromised whilst embracing the possibilities that AI offers
- **Third-party dependency** – Further strengthening the oversight frameworks around significant third-party relationships as reliance on such contractors continues to increase across the industry

We continue to monitor and focus on these initiatives to ensure the expectations of regulators and wider stakeholders are met whilst maintaining good outcomes for customers.

Significant and emerging risks

The principal significant and emerging risk areas expected to impact our businesses during the coming year ending 30 September 2025 and beyond include:

- **Interest rates** – Continuing uncertainty over the speed and timing of any potential future reductions in interest rates remains at the forefront of business planning. We continue to closely monitor UK and macro-economic trends and assess the impact on lending and savings to ensure we are well placed to manage the associated risks
- **Motor finance commissions** – We continue to monitor the FCA's work in relation to motor finance commissions, and other related developments in that area. Given the comparatively small size of the motor finance portfolio, our expectations of exposure remain low. However, the full impact cannot be accurately assessed in full until the FCA's proposed approach to such complaints is known and related legal cases resolved. We continue to manage all complaints in line with the regulator's requirements
- **Costs of living and doing business** – Management of risks associated with the wider economic landscape and the impacts this has already had, and will continue to have, on the finances of individuals and corporates in the UK. We remain committed to ensuring appropriate treatment of ongoing arrears and the position of affected customers. Key to this will be ensuring that treatment of customers is fair and conduct principles remain at the forefront of all interactions
- **Compliance expectations** – Addressing an increasing level of regulatory standards, where we are committed to ensuring all areas of our businesses remain compliant. Particular focus in the year has been on meeting extended regulatory requirements in respect of the FCA Consumer Duty for those remaining products in scope. Our priority is to continue to embed the Duty within all business lines, ensuring that good outcomes and a culture of continuous improvement remain at the forefront of all customer interactions

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- **Financial crime** – We continue to prioritise work in this area and have invested heavily in ensuring that regulatory expectations in respect of anti-money laundering and wider financial crime control frameworks are met. There is an ongoing programme of continuous improvement in our financial crime technology and resources, and this remains a key focus and consideration in our wider strategic change initiatives

- **Climate** – We continue to focus on increasing our understanding of the impact of the risks associated with climate change and related timescales. The new UK Government has confirmed its goal of net zero carbon by 2050, however significant uncertainty remains as to the detailed policies and regulations which might be implemented to achieve this. As global and domestic strategies are further refined, we seek to ensure that the impact of climate change is considered as a core driver for our operational footprint and our lending strategies, ensuring we are well placed to adapt and advance as the outlook becomes more certain

A5.6 REGULATION

Paragon Bank is authorised by the PRA and regulated by the PRA and the FCA. The Group is subject to consolidated supervision by the PRA and a number of subsidiary entities are authorised and regulated by the FCA. As a result, current and projected regulatory changes continue to pose a significant risk for our business. All potential regulatory changes impacting on our operations are closely monitored through the comprehensive governance and control structures we have in place.

During the year all relevant regulatory publications have been considered, their implications identified and required changes implemented within an appropriate timeframe. The volume of requests for information from the FCA has, as expected, remained high during the year with particular concentrations around data regarding levels of appropriate support provided to customers and information to support the FCA's ongoing investigations into the motor finance market and discretionary commission arrangements. We respond to all such requests in a timely fashion and maintain robust controls to support the delivery of good outcomes for customers.

The following regulatory developments currently in progress have the greatest potential impact on our businesses:

- **Consumer Duty** – The FCA Consumer Duty sets higher expectations for the standard of support provided to customers, and challenges firms to evidence the customer outcomes they are delivering. Dates for implementation of the rules have been staged across 2023 and 2024. This has been a priority area during the year with activity being championed by the Board, and a non-executive director assigned responsibility for oversight of the programme. All areas targeted for implementation were delivered as planned, with the focus now on continuing to embed the introduced enhancements. As the new rules have been updated into business-as-usual standards and processes, this also aligns with expectations within the FCA 2024/2025 business plan around vulnerability, cost-of-living pressures and financial inclusion

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- **Basel 3.1** – In December 2023, the PRA published Part 1 of its Basel 3.1 implementation standards. This covered a range of areas including counterparty credit risk ('CCR'), credit valuation adjustment ('CVA') and operational risk. The final part that focused on Pillar 1 credit risk capital requirements was published on 12 September 2024, with publication having been delayed by the UK election. The PRA has made a number of changes to the proposals set out in the original consultation reflecting the extensive industry feedback received. These changes which will have an impact on all firms, will take effect from January 2026, postponed from July 2025. Before implementation the PRA intends to rebase and adjust all firms' Pillar 2A requirements and PRA buffers

- **Small Domestic Deposit Taker regime ('SDDT')** – Alongside the publication of the Basel 3.1. package, the PRA also set out its approach to the capital requirements for firms qualifying for the SDDT regulation. This builds on the liquidity, reporting and remuneration rules for SDDTs published in 2023, and is expected to be introduced from 1 January 2027

  The capital rules include an initial Interim Capital Regime ('ICR') which firms can join subject to meeting the SDDT eligibility criteria. The ICR will allow firms to continue being subject to current requirements until January 2027, then transitioning to either the SDDT or full Basel 3.1 capital regime

  While we are currently eligible to apply for the ICR and SDDT regimes and expect to submit an application to join the ICR, once the application window opens, receiving IRB model approval would disqualify us from the point of approval and from that point we would adopt a full Basel 3.1 approach

- **Recovery Planning** – In May 2024 the PRA published a 'Dear CEO' letter on its review of non-systemic firms' recovery planning. Their review found that although many firms understand the basics of recovery planning, there are significant areas for improvement, most notably related to the development of recovery scenarios and the calculation of recovery capacity. We have reviewed the points covered in the letter and, where appropriate, updates have been made to the Recovery Plan

- **Solvent Exit planning** – In the early part of 2024, the PRA published a final policy on solvent exit plans for non-systemic banks and building societies (PS5/24), which includes the Group. It requires firms to undertake a Solvent Exit Analysis and, when the circumstances require it, develop a Solvent Exit Execution Plan. We are fully aware of the requirements, which will complement existing work undertaken on recovery planning, and will be compliant by the deadline of 1 October 2025

- **MREL** – Although we are not subject to MREL (Minimum Requirement for own funds and Eligible Liabilities) requirements currently, given our potential for growth, we may be required to issue MREL eligible instruments at some point in the future and therefore continue to closely monitor developments and potential impacts

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- **Enhancing the Special Resolution Regime** – The Bank Resolution (Recapitalisation) Bill is currently before the UK Parliament. This legislation would extend the powers of HM Treasury under the Special Resolution Regime (for example the use of partial sale, transfer, or bridge bank) to small firms. The proposals also include a greater role for the FSCS in the provision of funds to support recapitalisation. This legislation is, to some extent, a response to issues identified following the failure of Silicon Valley Bank in March 2023. We would expect to be covered by these new rules and will actively engage with the Bank of England consultation process once it commences

- **Borrowers in financial difficulties** – Following the findings from its 'Borrowers in Financial Difficulties' project, the FCA confirmed new measures to strengthen protection for consumer credit and mortgage borrowers in financial difficulties. We consider that we are well positioned to meet these requirements. Supporting customers in difficulty, including those with characteristics of vulnerability, is, and will remain a key area of focus within our business model

- **Operational Resilience** – We remain on track to meet all requirements of the final rules and guidance on 'building operational resilience in financial services' published in 2021 by the FCA, PRA and Bank of England. The 2024 iteration of our self-assessment was successfully completed in March 2024, enabling us to validate progress in addressing any gaps identified by the 2023 assessment. Activity is ongoing to complete the objectives identified as part of the self-assessment for further enhancement and refinement of the approach

  We are committed to a programme of continuous improvement in our resilience capability. Important business services are mapped and tested using severe but plausible scenarios to push the boundaries on the ability of the infrastructure, key dependencies and third parties to recover from disruption, using a scenario library which was enhanced for this year's testing programme. The groupwide disaster recovery testing plan also helps support the ongoing scenario testing programme, with clear focus on recovery of important business services. Identified actions to manage and close vulnerabilities identified through mapping, testing and other activities are tracked through to completion

  This approach should ensure our ability to meet the 2025 regulatory deadline, when we will need to be able to demonstrate our ability to stay consistently within impact tolerances

- **Climate change** – Work towards embedding our approach to managing climate-related financial risks continues. The Sustainability Committee, alongside the executive level risk committees, ensures comprehensive consideration of such risks across all aspects of the business, leaving us well-positioned to address emerging challenges

  Managing the impacts of climate change is seen as a key strategic priority, with board-agreed commitments and a detailed plan of work, which has been developed reflecting regulatory and wider requirements. This is reviewed on an ongoing basis to ensure it reflects new thinking and developing expectations as they emerge

5 OPERATIONS REVIEW

Certain regulations applying in the financial services sector only affect entities over a certain size, which the Group might meet within its current planning horizon. We consider whether and when these regulations might apply in light of the growth implicit in our business plans and put appropriate arrangements in place to ensure we would be able to comply at that point.

Our governance and risk management framework continues to be developed to ensure the impacts of all new regulatory requirements are clearly understood and mitigated as far as possible. Regular reports on key regulatory developments are received at both executive and board risk committees.

We are monitoring how the July 2024 change in UK government might impact wider national and regulatory priorities and continue to engage proactively with the new government to fully understand and assess the impact of proposed policy changes on our operations and those of our customers.

We also continue to review our exposure to emerging developments in the Brexit process as the UK's future relationship with the EU becomes more certain, and the process of embedding EU legislation into UK law and regulations continues, with the remaining parts of the EU capital regime due to be migrated to the PRA Rulebook. However, it is clear that this is an ongoing process, with impacts that will take time to manifest themselves fully. Further clarity is still required from the new government on this and other matters as it sets out its agenda.

Overall, we believe that we are well placed to address all the regulatory changes to which our businesses are presently exposed.

PRINCIPAL RISKS

We have identified a number of principal risks, arising from both the environment in which we operate and our business model, which could impact our ability to achieve our strategic priorities. We have an Enterprise Risk Management Framework ('ERMF') in place to ensure that these risks are monitored and managed in accordance with the Group's risk appetite.

Capital

Risk of insufficient capital to operate effectively and meet minimum requirements.

Liquidity and funding

Risk of insufficient financial resources to enable us to meet our obligations as they fall due.

Market

Risk of changes in the net value of, or net income arising from, our assets and liabilities from adverse movements in market prices.

Credit

Risk of financial loss arising from a borrower or counterparty failing to meet their financial obligations.

Model

Risk of making incorrect decisions based on the output of internal models.

Reputational

Risk of failing to meet the expectations and standards of our stakeholders.

Strategic

Risk that the corporate plan does not fully align to and support strategic priorities or is not executed effectively.

Climate change

Risk of financial risks arising through climate change impacting the Group and our strategy.

Conduct

Risk of poor behaviours or decision making leading to failure to achieve good outcomes for customers or to act with integrity.

Operational

Risk resulting from inadequate or failed internal procedures, people, systems or external events.

DIRECTORS' RESPONSIBILITIES

The following statement of directors' responsibilities in respect of financial statements is included in the Annual Report and Accounts of the Group for the year ended 30 September 2024.

The directors are responsible for preparing this Annual Report, including the consolidated and company financial statements in accordance with applicable law and regulations.

Company law, including the Companies Act 2006 (the 'Companies Act'), requires the directors to prepare consolidated financial statements for the Group and separate financial statements for the Company in respect of each financial year. In respect of the financial statements for the year ended 30 September 2024, that law requires the directors to prepare the consolidated financial statements in accordance with UK-adopted international accounting standards in conformity with the requirements of the Companies Act and they have also elected to prepare the separate financial statements of the Company on the same basis.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Company and the Group's profit or loss for the year. In preparing each of the consolidated and company financial statements the directors are also required to:

- select suitable accounting policies and apply them consistently
- make judgements and estimates that are reasonable, relevant and reliable
- state whether the consolidated and company financial statements have been prepared in accordance with UK-adopted international accounting standards
- assess the ability of the Group and the Company to continue as a going concern, disclosing, as applicable, matters related to going concern
- use the going concern basis of accounting unless they intend to liquidate the Company and / or the Group or to cease operation or they have no realistic alternative to doing so
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information
- provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance

The directors are responsible for keeping adequate accounting records for the Company that are sufficient to record and explain its transactions, disclose with reasonable accuracy at any time its financial position and enable them to ensure that its financial statements comply with the requirements of the Companies Act.

They are responsible for the implementation of such internal control processes as they deem necessary to enable the preparation of financial statements which are free from material misstatements, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

5 OPERATIONS REVIEW

Under applicable law and regulations, the directors are also responsible for the preparation of a strategic report, directors' report, directors' remuneration report and corporate governance statement, which comply with that law and those regulations.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website (www.paragonbankinggroup.co.uk). Legislation in the UK governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

In accordance with Disclosure Guidance and Transparency Rule ('DTR') 4.1.16R, the financial statements will form part of the annual financial report prepared in accordance with DTR 4.1.17R and 4.1.18R. The auditor's report on these financial statements provides no assurance over whether the annual financial report has been prepared in accordance with those requirements.

Confirmation by the Board of Directors

The Board of Directors currently comprises:

R D East (Chair of the Board)

N S Terrington (CEO)

R J Woodman (CFO)

H R Tudor (Non-executive director)

B A Ridpath (Non-executive director)

G H Yorston (Non-executive director)

A C M Morris (Senior Independent Director)

P A Hill (Non-executive director)

T P Davda (Non-executive director)

Z L Howorth (Non-executive director)

5 OPERATIONS REVIEW

Each of the directors named above confirms that, to the best of their knowledge:

- The financial statements, prepared in accordance with applicable accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and of the Group taken as a whole
- The Directors' Report, including those other sections of the Annual Report incorporated by reference, comprises a management report for the purposes of the DTR, and includes a fair review of the development and performance of the business and the consolidated position of the Group taken as a whole, together with a description of the principal risks and uncertainties that it faces
- The Annual Report (including the consolidated and company financial statements), taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position, performance, business model and strategy

Approved by the Board of Directors as the persons responsible within the Company.

Signed on behalf of the Board

CIARA MURPHY

Company Secretary

3 December 2024

CONSOLIDATED STATEMENT OF PROFIT OR LOSS
For the year ended 30 September 2024

		2024	2024	2023	2023
	Note	£m	£m	£m	£m
Interest receivable	3		1,314.7		1,010.6
Interest payable and similar charges	4		(831.5)		(561.7)
Net interest income			483.2		448.9
Other leasing income		30.4		27.4	
Related costs		(24.2)		(21.8)	
Net operating lease income		6.2		5.6	
Other income	5	7.0		11.5	
Other operating income			13.2		17.1
Total operating income			496.4		466.0
Operating expenses			(179.2)		(170.4)
Provisions for losses	7		(24.5)		(18.0)
Operating profit before fair value items			292.7		277.6
Fair value net (losses)	8		(38.9)		(77.7)
Operating profit being profit on ordinary activities before taxation			253.8		199.9
Tax charge on profit on ordinary activities	9		(67.8)		(46.0)
Profit on ordinary activities after taxation for the financial year			186.0		153.9

	Note	2024	2023
Earnings per share			
- basic	10	88.5p	68.7p
- diluted	10	85.2p	66.3p

The results for the current and preceding years relate entirely to continuing operations.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
For the year ended 30 September 2024

	Note	2024 £m	2024 £m	2023 £m	2023 £m
Profit for the year			186.0		153.9
Other comprehensive income					
Items that will not be reclassified subsequently to profit or loss					
Actuarial gain on pension scheme	22	7.2		2.4	
Tax thereon		(1.8)		(0.8)	
Other comprehensive income for the year net of tax			5.4		1.6
Total comprehensive income for the year			191.4		155.5

CONSOLIDATED BALANCE SHEET
30 September 2024

	Note	2024 £m	2023 £m	2022 £m
Assets				
Cash – central banks	11	2,315.5	2,783.3	1,612.5
Cash – retail banks	11	209.9	211.0	318.4
Investment securities	12	427.4	-	-
Loans to customers	13	15,630.3	14,495.0	13,650.4
Derivative financial assets	20	391.8	615.4	779.0
Sundry assets	21	20.7	51.0	39.2
Current tax assets		9.7	8.9	5.4
Retirement benefit obligations	22	22.2	12.7	7.1
Property, plant and equipment		71.0	74.7	71.4
Intangible assets	23	171.5	168.2	170.2
Total assets		19,270.0	18,420.2	16,653.6
Liabilities				
Short term bank borrowings		0.4	0.2	0.4
Retail deposits	24	16,314.7	13,234.4	10,569.5
Derivative financial liabilities	20	99.7	39.9	102.1
Asset backed loan notes	25	-	28.0	409.3
Secured bank borrowings	25	-	-	586.0
Retail bond issuance	25	-	112.4	112.3
Corporate bond issuance	25	149.9	145.8	149.2
Central bank facilities	25	755.0	2,750.0	2,750.0
Sale and repurchase agreements	25	100.0	50.0	-
Sundry liabilities	27	417.4	631.2	513.1
Deferred tax liabilities		13.4	17.7	44.4
Total liabilities		17,850.5	17,009.6	15,236.3
Called up share capital	29	210.6	228.7	241.4
Reserves	30	1,274.3	1,257.5	1,223.9
Own shares	31	(65.4)	(75.6)	(48.0)
Total equity		1,419.5	1,410.6	1,417.3
Total liabilities and equity		19,270.0	18,420.2	16,653.6

Approved by the Board of Directors on 3 December 2024.

Signed on behalf of the Board of Directors

N S Terrington	R J Woodman
Chief Executive	Chief Financial Officer

CONSOLIDATED CASHFLOW STATEMENT
For the year ended 30 September 2024

	Note	2024 £m	2023 £m
Net cash generated by operating activities	33	2,216.4	2,171.7
Net cash (utilised) by investing activities	34	(424.7)	(3.1)
Net cash (utilised) by financing activities	35	(2,260.8)	(1,105.0)
Net (decrease) / increase in cash and cash equivalents		(469.1)	1,063.6
Opening cash and cash equivalents		2,994.1	1,930.5
Closing cash and cash equivalents		2,525.0	2,994.1
Represented by balances within:			
Cash	11	2,525.4	2,994.3
Short term bank borrowings		(0.4)	(0.2)
		2,525.0	2,994.1

CONSOLIDATED STATEMENT OF MOVEMENTS IN EQUITY
For the year ended 30 September 2024

Year ended 30 September 2024	Share capital	Share premium	Capital redemption reserve	Merger reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m
Transactions arising from							
Profit for the year	-	-	-	-	186.0	-	186.0
Other comprehensive income	-	-	-	-	5.4	-	5.4
Total comprehensive income	-	-	-	-	191.4	-	191.4
Dividends paid (note 32)	-	-	-	-	(83.5)	-	(83.5)
Own shares purchased	-	-	-	-	-	(89.5)	(89.5)
Irrevocable instruction accrual	-	-	-	-	-	(23.8)	(23.8)
Exercise of share awards	-	-	-	-	(12.8)	13.5	0.7
Shares cancelled	(18.1)	-	18.1	-	(110.0)	110.0	-
Capital reorganisation	-	-	-	-	-	-	-
Charge for share based remuneration	-	-	-	-	9.2	-	9.2
Tax on share based remuneration	-	-	-	-	4.4	-	4.4
Net movement in equity in the year	(18.1)	-	18.1	-	(1.3)	10.2	8.9
Opening equity	228.7	71.4	12.9	(70.2)	1,243.4	(75.6)	1,410.6
Closing equity	210.6	71.4	31.0	(70.2)	1,242.1	(65.4)	1,419.5

Year ended 30 September 2023	Share capital	Share premium	Capital redemption reserve	Merger reserve	Profit and loss account	Own shares	Total equity
Transactions arising from							
Profit for the year	-	-	-	-	153.9	-	153.9
Other comprehensive income	-	-	-	-	1.6	-	1.6
Total comprehensive income	-	-	-	-	155.5	-	155.5
Transactions with owners							
Dividends paid (note 32)	-	-	-	-	(67.9)	-	(67.9)
Own shares purchased	-	-	-	-	-	(120.5)	(120.5)
Irrevocable instruction accrual	-	-	-	-	-	10.8	10.8
Exercise of share awards	0.2	0.3	-	-	(11.4)	14.8	3.9
Shares cancelled	(12.9)	-	12.9	-	(67.3)	67.3	-
Capital reorganisation	-	-	(71.8)	-	71.8	-	-
Charge for share based remuneration	-	-	-	-	9.6	-	9.6
Tax on share based remuneration	-	-	-	-	1.9	-	1.9
Net movement in equity in the year	(12.7)	0.3	(58.9)	-	92.2	(27.6)	(6.7)
Opening equity	241.4	71.1	71.8	(70.2)	1,151.2	(48.0)	1,417.3
Closing equity	228.7	71.4	12.9	(70.2)	1,243.4	(75.6)	1,410.6

NOTES TO THE FINANCIAL INFORMATION

For the year ended 30 September 2024

1. GENERAL INFORMATION

The financial information set out in the announcement does not constitute the Company's statutory accounts for the years ended 30 September 2022, 30 September 2023 or 30 September 2024, but is derived from those statutory accounts, which have been reported on by the Company's auditors. Statutory accounts for the years ended 30 September 2022 and 30 September 2023 have been delivered to the Registrar of Companies and those for the year ended 30 September 2024 will be delivered to the Registrar following the Company's 2025 Annual General Meeting. The reports of the auditors in each case were unqualified, did not draw attention to any matters by way of emphasis and did not contain an adverse statement under sections 498(2) or 498(3) of the Companies Act 2006.

Copies of the Annual Report and Accounts for the year ended 30 September 2024 will be distributed to shareholders in due course. Copies of this announcement can be obtained from the Company Secretary, Paragon Banking Group PLC at 51 Homer Road, Solihull, West Midlands, B91 3QJ and on the Group's website at www.paragonbankinggroup.co.uk.

These financial statements are presented in pounds sterling, which is the currency of the economic environment in which the Group operates.

The remaining notes to the accounts are organised into three sections:

- Analysis – providing further analysis and information on the amounts shown in the primary financial statements
- Capital and Financial Risk – providing information on the Group's management of operational and regulatory capital and its principal financial risks
- Basis of preparation – providing details of the Group's accounting policies and of how they have been applied in the preparation of the financial statements

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS

For the year ended 30 September 2024

The notes set out below give more detailed analysis of the balances shown in the primary financial statements and further information on how they relate to the operations, results and financial position of the Group.

2. SEGMENTAL INFORMATION

The Group analyses its operations, both for internal management reporting and external financial reporting, on the basis of the markets from which its assets are generated. The segments used at 30 September 2024 are described below:

- Mortgage Lending, including the Group's buy-to-let, and owner-occupied first and second charge lending and related activities
- Commercial Lending, including the Group's equipment leasing activities, development finance, structured lending and other offerings targeted towards SME customers, together with its motor finance business

These segments are the same as those used at 30 September 2023.

Dedicated financing and administration costs of each of these businesses, including the interest impacts of fair value hedging, are allocated to the segment. Shared central costs are not allocated between segments, nor is income from central cash balances or the carrying costs of unallocated savings balances.

Loans to customers and operating lease assets (other than those related to the internal green car scheme re allocated to segments as are dedicated securitisation funding arrangements and their related cash balances.

Retail deposits and their related costs are allocated to the segments based on the utilisation of those deposits. Retail deposits raised in advance of lending are not allocated.

Other assets and liabilities are not allocated between segments.

All the Group's operations are conducted in the UK, all revenues arise from external customers and there are no inter-segment revenues. No customer contributes more than 10% of the revenue of the Group.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS

For the year ended 30 September 2024

2. SEGMENTAL INFORMATION (CONTINUED)

Financial information about these business segments, prepared on the same basis as used in the consolidated accounts of the Group, is shown below.

Year ended 30 September 2024

	Mortgage Lending £m	Commercial Lending £m	Unallocated items £m	Total £m
Interest receivable	914.9	234.7	165.1	1,314.7
Interest payable	(632.6)	(109.9)	(89.0)	(831.5)
Net interest income	282.3	124.8	76.1	483.2
Other leasing income	-	30.1	0.3	30.4
Related costs	-	(24.0)	(0.2)	(24.2)
Net operating lease income	-	6.1	0.1	6.2
Other income	3.8	3.2	-	7.0
Other operating income	3.8	9.3	0.1	13.2
Total operating income	286.1	134.1	76.2	496.4
Operating expenses	(22.8)	(26.9)	(129.5)	(179.2)
Provisions for losses	(5.6)	(18.9)	-	(24.5)
Segment profit	257.7	88.3	(53.3)	292.7

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

2. SEGMENTAL INFORMATION (CONTINUED)

Year ended 30 September 2023

	Mortgage Lending £m	Commercial Lending £m	Unallocated items £m	Total £m
Interest receivable	713.6	207.4	89.6	1,010.6
Interest payable	(436.0)	(71.7)	(54.0)	(561.7)
Net interest income	277.6	135.7	35.6	448.9
Other leasing income	-	27.3	0.1	27.4
Related costs	-	(21.7)	(0.1)	(21.8)
Net operating lease income	-	5.6	-	5.6
Other income	5.6	5.9	-	11.5
Other operating income	5.6	11.5	-	17.1
Total operating income	283.2	147.2	35.6	466.0
Operating expenses	(26.2)	(26.4)	(117.8)	(170.4)
Provisions for losses	(10.4)	(7.6)	-	(18.0)
Segment profit	246.6	113.2	(82.2)	277.6

The segmental profits disclosed above reconcile to the Group results as shown below.

	2024 £m	2023 £m
Results shown above	292.7	277.6
Fair value items	(38.9)	(77.7)
Operating profit	253.8	199.9

The assets of the segments listed above are:

	2024 £m	2023 £m	2022 £m
Mortgage Lending	13,523.6	12,988.4	12,569.2
Commercial Lending	2,333.7	2,016.3	1,923.2
Total segment assets	15,857.3	15,004.7	14,492.4
Unallocated assets	3,412.7	3,415.5	2,161.2
Total assets	19,270.0	18,420.2	16,653.6

An analysis of the Group's loan assets by type and segment is shown in note 13.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

3. INTEREST RECEIVABLE

Interest receivable is analysed as follows.

	Note	2024 £m	2023 £m
Interest receivable in respect of			
Loans and receivables		819.8	642.9
Finance leases		73.4	59.6
Invoice finance income		5.8	4.3
Interest on loans to customers		899.0	706.8
Effect of fair value hedging of loan assets		245.8	210.0
Interest on loans to customers after hedging		1,144.8	916.8
Pension scheme surplus	22	0.8	0.4
Investment securities		8.0	-
Effect of fair value hedging of securities		2.4	-
Other interest receivable		158.7	93.4
Total interest on financial assets		1,314.7	1,010.6

The above amounts relate to:

	2024 £m	2023 £m
Financial assets held at amortised cost	992.3	740.6
Finance leases	73.4	59.6
Pension scheme surplus	0.8	0.4
Derivative financial instruments held at fair value	248.2	210.0
	1,314.7	1,010.6

Other interest receivable relates principally to cash deposits at central and retail banks.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

4. INTEREST PAYABLE AND SIMILAR CHARGES

	2024 £m	2023 £m
On financial liabilities		
Retail deposits	667.0	334.1
Effect of fair value hedging of deposits	33.6	54.4
Interest on retail deposits after hedging	700.6	388.5
Asset backed loan notes	2.6	10.9
Bank loans and overdrafts	14.1	34.8
Corporate bonds	6.6	6.6
Effect of fair value hedging of bonds	1.8	0.6
Retail bonds	5.7	6.5
Central bank facilities	95.2	111.9
Sale and repurchase agreements	4.0	0.7
Total interest on financial liabilities	830.6	560.5
Discounting on lease liabilities	0.3	0.3
Other finance costs	0.6	0.9
	831.5	561.7

The above amounts relate to:

	2024 £m	2023 £m
Financial liabilities held at amortised cost	795.2	505.5
Derivative financial instruments held at fair value	35.4	55.0
Other items	0.9	1.2
	831.5	561.7

Amounts payable in respect of bank loans and overdrafts include interest and fees payable in respect of collateral amounts received in respect of derivative financial instruments (note 27).

5. OTHER INCOME

	2024 £m	2023 £m
Loan account fee income	4.5	4.8
Broker commissions	1.6	2.1
Third party servicing	0.7	4.3
Other income	0.2	0.3
	7.0	11.5

All loan account fee income arises from financial assets held at amortised cost.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

6. TBMC CLOSURE

During the year ended 30 September 2023, after a review of strategic priorities, the Group announced the closure of its TBMC mortgage brokerage business, which it considered to be non-core. As a result of this decision the remaining goodwill balance of the TBMC CGU and the other intangible assets relating to the business were derecognised.

The total amount expense to the profit and loss account on the closure is set out below.

	Note	2023 £m
Goodwill derecognised		1.6
Intangible assets derecognised	23	0.2
Other closure costs		0.2
Total closure costs		2.0

The contribution to profit of the closed business in that year, which was included in the Mortgage Lending segment, was a loss of £0.5m excluding the costs shown above.

7. LOAN IMPAIRMENT PROVISIONS CHARGED TO INCOME

The amounts charged to the profit and loss account in the year are analysed as follows.

	Mortgage Lending £m	Commercial Lending £m	Total £m
30 September 2024			
Provided in period (note 17)	6.0	20.4	26.4
Recovery of written off amounts	(0.4)	(1.5)	(1.9)
	5.6	18.9	24.5
Of which			
Loan accounts	5.6	17.9	23.5
Finance leases	-	1.0	1.0
	5.6	18.9	24.5
30 September 2023			
Provided in period (note 17)	10.8	8.3	19.1
Recovery of written off amounts	(0.4)	(0.7)	(1.1)
	10.4	7.6	18.0
Of which			
Loan accounts	10.4	10.5	20.9
Finance leases	-	(2.9)	(2.9)
	10.4	7.6	18.0

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

8. FAIR VALUE NET (LOSSES)

	2024 £m	2023 £m
Ineffectiveness of fair value hedges		
Portfolio hedges of interest rate risk		
Deposit hedge	7.3	7.8
Loan hedge	(3.1)	(23.7)
	4.2	(15.9)
Individual hedges of interest rate risk	-	-
	4.2	(15.9)
Other hedging movements	(26.2)	(53.5)
Net (losses) on other derivatives	(16.9)	(8.3)
Total net (loss)	(38.9)	(77.7)

The fair value net (loss) represents the accounting volatility on derivative instruments which are matching risk exposures on an economic basis, generated by the requirements of IAS 39. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting has not been adopted or is not achievable on certain items. The losses and gains are primarily due to timing differences in income recognition between the derivative instruments and the economically hedged assets and liabilities. Such differences will reverse over time and have no impact on the cash flows of the Group.

9. TAX CHARGE ON PROFIT ON ORDINARY ACTIVITIES

Income tax for the year ended 30 September 2024 is charged at an effective rate of 26.7% (2023: 23.0%).

The standard rate of corporation tax in the UK applicable to the Group in the year was 25.0% (2023: 22.0%), based on legislation enacted at the year end. During the year ended 30 September 2021, the UK Government enacted legislation increasing the standard rate of corporation tax in the UK from 19.0% to 25.0% from April 2023. The effect of these changes on deferred tax balances was accounted for in the year ended 30 September 2021.

The Bank Corporation Tax Surcharge subjects any taxable profits arising in the Group's banking subsidiary, Paragon Bank PLC (and no other Group entity), to an additional rate of tax to the extent these profits exceed a threshold. The effect of the surcharge shown in note (b) below.

In the financial year ended 30 September 2022 the UK Government enacted legislation reducing the rate of the Banking Surcharge from 8.0% to 3.0%, from April 2023, while increasing the profit threshold at which the surcharge applies to £100.0m from £25.0m. This has resulted in the surcharge applying to Paragon Bank in the current year reducing to 3.0% on earnings over £100.0m. The impact of this change on deferred tax balances was accounted for in the year ended 30 September 2022. The combination of the standard rate of tax and the surcharge results in taxable profits in excess of the annual threshold arising in Paragon Bank being taxed at 28.0% in the current year (2023: 27.5%).

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

10. EARNINGS PER SHARE

Earnings per ordinary share is calculated as follows:

		2024	2023
Profit for the year (£m)		186.0	153.9
Basic weighted average number of ordinary shares ranking for dividend during the year (m)		210.1	224.1
Dilutive effect of the weighted average number of share options and incentive plans in issue during the year (m)		8.3	8.0
Diluted weighted average number of ordinary shares ranking for dividend during the year (m)		218.4	232.1
Earnings per ordinary share	- basic	88.5p	68.7p
	- diluted	85.2p	66.3p

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11. CASH AND CASH EQUIVALENTS

'Cash and Cash Equivalents' includes current bank balances, money market placements and fixed rate sterling term deposits with London banks, and balances with the Bank of England. It is analysed as set out below.

	2024 £m	2023 £m	2022 £m
Deposits with the Bank of England	2,315.5	2,783.3	1,612.5
Balances with central banks	2,315.5	2,783.3	1,612.5
Deposits with other banks	209.9	211.0	318.4
Balances with other banks	209.9	211.0	318.4
Cash and cash equivalents	2,525.4	2,994.3	1,930.9

Not all of the Group's cash is immediately available for its general purposes, including liquidity management. Cash received in respect of loan assets funded through warehouse facilities and securitisations is not immediately available, due to the terms of those arrangements. This cash is shown as 'securitisation cash' below.

Cash held by the Trustee of the Group's employee share ownership plan ('ESOP') may only be used to invest in the shares of the Company, pursuant to the aims of that plan. This is shown as 'ESOP cash' below.

The total consolidated 'Cash and Cash Equivalents' balance may be analysed as shown below:

	2024 £m	2023 £m	2022 £m
Available cash	2,417.4	2,907.7	1,689.1
Securitisation cash	107.9	86.1	240.5
ESOP cash	0.1	0.5	1.3
	2,525.4	2,994.3	1,930.9

Cash and cash equivalents are classified as Stage 1 exposures (see note 16) for the purposes of impairment provisioning. The probabilities of default have been assessed to be so low as to require no significant impairment provision.

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For the year ended 30 September 2024

12. INVESTMENT SECURITIES

The Group's investment securities, which are held as part of Paragon Bank's liquidity buffer, are analysed as follows:

	Principal amount		Carrying value	
	2024	2023	2024	2023
	£m	£m	£m	£m
UK Government securities	400.0	-	404.4	-
Covered bonds	23.0	-	23.0	-
	423.0	-	427.4	-

All the investment securities bear credit risk and are classified as Stage 1 exposures (see note 16) for IFRS 9 impairment purposes. As the securities are UK sovereign exposures, or secured exposures to UK financial institutions, the probability of default has been assessed to be so low that no significant impairment provision is required.

13. LOANS TO CUSTOMERS

The Group's loans to customers at 30 September 2024, analysed between the segments described in note 2 are as follows:

	Note	2024	2023	2022
		£m	£m	£m
First mortgages		13,299.6	12,747.8	12,122.4
Second charge mortgages		116.1	154.5	206.3
Total Mortgage Lending		13,415.7	12,902.3	12,328.7
Finance lease receivables		995.6	907.3	825.2
Development finance		884.0	747.8	719.9
Other secured commercial lending		320.8	227.6	238.1
Other commercial loans		89.4	89.3	98.4
Total Commercial Lending		2,289.8	1,972.0	1,881.6
Loans to customers		15,705.5	14,874.3	14,210.3
Fair value adjustments from portfolio hedging	20	(75.2)	(379.3)	(559.9)
		15,630.3	14,495.0	13,650.4

Other secured commercial lending includes structured lending, aviation mortgages and invoice finance.

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For the year ended 30 September 2024

13. LOANS TO CUSTOMERS (CONTINUED)

Other commercial loans includes principally professions finance, discounted receivables, term loans issued under schemes sponsored by the British Business Bank ('BBB') and other short term commercial balances.

14. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS

The following notes set out information on the Group's impairment provisioning under IFRS 9 for the loans to customers balances set out in note 13, including both finance leases, accounted for under IFRS 16, and loans held at amortised cost, accounted for under IFRS 9, as both groups of assets are subject to the IFRS 9 impairment requirements.

The disclosures are set out within the following notes:

- 15 Loan impairments – Basis of provision
- 16 Loan impairments by stage and division
- 17 Loan impairments – Provision movements in the year
- 18 Loan impairments – Economic inputs to calculations
- 19 Loan impairments – Sensitivity analysis

The impact on the Group's profit and loss account for the year is set out in note 7.

15. LOAN IMPAIRMENT - BASIS OF PROVISION

IFRS 9 requires that impairment is evaluated on an expected credit loss ('ECL') basis. ECLs are based on an assessment of the probability of default ('PD') and loss given default ('LGD'), discounted to give a net present value. The estimation of ECL should be unbiased and probability weighted, considering all reasonable and supportable information, including forward-looking economic assumptions and a range of possible outcomes. The provision may be based on either twelve month or lifetime ECL, dependent on whether an account has experienced a significant increase in credit risk ('SICR').

The Group's process for determining its provisions for impairments is summarised below. This includes:

i. The methods used for the calculation of ECL
ii. How it defines SICR
iii. How it defines default
iv. How it identifies which loans are credit impaired, as defined by IFRS 9
v. How the ECL estimation process is monitored and controlled
vi. How the Group develops and enhances the models it uses in the ECL estimation process
vii. How the Group uses judgemental adjustments to ensure all elements of credit risk are fully addressed

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15. LOAN IMPAIRMENT – BASIS OF PROVISION (CONTINUED)

i) Calculation of expected credit loss ('ECL')

For the majority of the Group's loan assets, the ECL is generated using statistical models applied to account data to generate PD and LGD components. In determining for which portfolios a statistically modelled approach is appropriate, the Group considers the volume of available data and the level of similarity of the credit characteristics of the underlying accounts.

PD on both a twelve month and lifetime basis is estimated based on statistical models for the Group's most significant asset classes. The PD calculation is a function of current asset performance, customer information and future economic assumptions. The models were developed through the analysis of correlation in historic data, which identified which current and historical customer attributes and external economic variables were predictive of future loss. PD measures are calculated for the full contractual lives of loans with the models deriving probabilities that, at a given future date, a loan will be in default, performing or closed. The Group utilised all reasonably available information in its possession for this exercise.

LGD for each account is derived by calculating a value for exposure at the point of default (which will include consideration of future interest, account charges and receipts) and reducing this for security values, net of likely costs of recovery. These calculations allow for the Group's potential case management activities, including the use of receivers of rent in buy-to-let cases. This evaluation includes the potential impact of economic conditions at the time of any future default or enforcement. The derivation of the significant assumptions used in these calculations is discussed below.

In certain asset classes a fully modelled approach is not possible. This is generally where there are few assets in the class, where there is insufficient historical data on which to base an analysis or where certain measures, such as days past due are not useful (including cases where the loan agreement does not require regular payments of pre-determined amounts). In these cases, which represent a small proportion of the total portfolio, alternative approaches are adopted. These rely on internal cost monitoring practices and professional credit judgement. For each of these portfolios, minimum provision levels are set based on overall performance for the asset class and the risk appetites informing underwriting processes.

The largest portfolio where a fully modelled approach is not taken is the Group's development finance book, which has a relatively low number of cases (around 250) and a low incidence of historical losses on which to base a model. For this portfolio the impairment provision is based on the output of internal case-by-case monitoring, performed within the business and subject to a process of challenge by the finance and credit risk functions.

Notwithstanding the mechanical procedures discussed above, the Group will always consider whether the process generates sufficient provision for particular loans, especially large exposures, and will provide additional amounts as appropriate.

In extreme or unprecedented economic conditions, it is likely that mechanical models will be less predictive of outcomes as the historical data used for modelling will be insufficiently representative of conditions at the balance sheet date. This may be the case where economic indicators at the reporting date and future expectations for those indicators lie outside the range of the observations used to construct the models. In such circumstances, management carefully review all outputs to ensure provision is adequate.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

15. LOAN IMPAIRMENT – BASIS OF PROVISION (CONTINUED)

During the current financial year interest rates have maintained the highest levels seen in some time, having reached this point with unusual speed, putting financial pressure on businesses and households. Rates of inflation began the year at what were historically relatively high levels and declined only slowly. This type of economic environment is not significantly represented in the historic data sets used by the Group to construct its IFRS 9 impairment models. It was also noted that a rapidly developing economic situation is likely to lead to a lagging impact on the credit bureau data which forms an input to models of customer behaviour, which may delay the recognition of an account potentially at risk.

These factors led management to conclude that current and forecast economic conditions were not ones under which the Group's models would necessarily perform well, and that judgemental adjustments might be required to compensate for these weaknesses.

The methodologies used to derive the Group's ECL provisions at 30 September 2024 are analysed below.

	Gross £m	Impairment £m	Net £m
30 September 2024			
Modelled portfolios	14,418.7	(41.2)	14,377.5
Judgemental adjustments thereon	-	(5.0)	(5.0)
	14,418.7	(46.2)	14,372.5
Non-modelled portfolios	1,363.3	(30.3)	1,333.0
Total	15,782.0	(76.5)	15,705.5
30 September 2023			
Modelled impairments	13,825.4	(48.3)	13,777.1
Judgemental adjustments thereon	-	(6.5)	(6.5)
	13,825.4	(54.8)	13,770.6
Non-modelled	1,122.5	(18.8)	1,103.7
Total	14,947.9	(73.6)	14,874.3

In addition to the judgemental adjustments to model outputs shown above, management have applied a £1.5m uplift to provision floors in the development finance operation, reflecting specific economic risks to that business, meaning that total uplifts were £6.5m (2023: £6.5m). The derivation of these adjustments is discussed further below.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

15. LOAN IMPAIRMENT – BASIS OF PROVISION (CONTINUED)

ii) Significant Increase in Credit Risk ('SICR')

Under IFRS 9, SICR is not defined solely by account performance, but on the basis of the customer's overall credit position, and this evaluation should include consideration of external data. The Group's aim is to define SICR to correspond, as closely as possible, to that population of accounts which are subject to enhanced administrative and monitoring procedures operationally. The Group assesses SICR in its modelled portfolios primarily on the basis of the relative difference in an account's lifetime PD between origination and the reporting date. The levels of difference required to qualify as an SICR may differ between portfolios and will depend, to some extent, on the level of risk originally perceived and are monitored on an ongoing basis to ensure that this calibrates with actual experience.

It should be noted that the use of the current PD, which includes external factors such as credit bureau data, means that all relevant information in the Group's hands concerning the customers' present credit position is included in the evaluation, as well as the impact of future economic expectations.

For non-modelled portfolios, the SICR assessment is based on the credit monitoring position of the account in question and for all portfolios a number of qualitative indicators which provide evidence of SICR have been considered.

Loans will generally be considered to remain significantly increased credit risk for a period after the SICR trigger no longer remains.

As part of its determination of whether model outputs form a reliable basis for impairment provisioning, the Group considered whether it had any evidence of groups of accounts demonstrating factors indicating a higher level of credit risk than other accounts in the same portfolios, either from operational experience or its regular credit risk monitoring activities. No such evidence was noted at 30 September 2024 or 30 September 2023, and hence no additional accounts were identified as having an SICR.

iii) Definitions of default

As the IFRS 9 definition of ECL is based on PD, default must be defined for this purpose. The analysis of these default cases provides the foundation for the Group's PD modelling. IFRS 9 provides a rebuttable presumption that an account is in default when it is 90 days overdue and this was used as the basis of the Group's definition, combined with qualitative and quantitative factors specific to each portfolio.

The most influential quantitative factor in the majority of portfolios is the arrears level, while the principal qualitative factors relate to internal account management statuses. In particular the decision to commence a process of enforcement will be considered as a default in all portfolios. In the Group's buy-to-let mortgage portfolio the appointment of a receiver of rent to manage the property on the customer's behalf is considered a default, while for portfolios assessed on a case-by-case basis, such as the Group's development finance loans, the movement of an account to the highest risk category used for internal monitoring is considered as a default.

15. LOAN IMPAIRMENT – BASIS OF PROVISION (CONTINUED)

This ensures that Group's definitions of default for its various portfolios are materially aligned to the regulatory definitions of default used internally, and are broadly aligned to its internal operational procedures, allowing for the arbitrary nature of the 90-day cut-off, which is a regulatory rather than an operational requirement. In particular the Group's receiver of rent cases are defined as defaulted for modelling purposes as the behaviour of the case after that point is significantly influenced by internal management decisions.

iv) Credit Impaired loans

IFRS 9 defines a credit impaired account as one where an account has suffered one or more events which have had a detrimental effect on future cash flows. It is thus a backward-looking definition, rather than one based on future expectations.

Credit impaired assets are identified either through quantitative measures or by operational status. Designations of accounts for regulatory capital purposes are also taken into account. Assets may also be assigned to Stage 3 if they are identified as credit impaired as a result of management review processes.

All loans which are in the process of enforcement, from the point where this becomes the administration strategy, are classified as credit impaired.

Loans are retained in Stage 3 for three months after the point where they cease to exhibit the characteristics of default. After this point, they may move to Stage 2 or Stage 1 depending on whether an SICR trigger remains.

All default cases are considered to be credit impaired, including all receiver of rent cases and all cases with at least one payment more than 90 days overdue, even where such cases are being managed in the expectation of realising all of the carrying balance.

In order to provide better information for users, additional analysis of credit impaired accounts has been presented in note 16, distinguishing between probationary accounts, receiver of rent accounts, accounts subject to realisation / enforcement procedures and long term managed accounts, all of which are treated as credit impaired. While other indicators of default are in use, the categories shown account for the overwhelming majority of Stage 3 cases.

v) Monitoring of ECL estimation processes

The Group's ECL models are compiled on the basis of the analysis of relevant historical data. Before a model is adopted for use its operations and outputs are examined to ensure that it is expected to be appropriately predictive and, if it is an updated model, expected to be more predictive than any existing model. Before a new model is adopted the changes and impacts will be considered by the CFO, alongside any advice from the Group's independent model review functions. The performance of all models is reviewed on an ongoing basis, by senior finance and risk management, including the CFO. Monitoring packs comparing actual and predicted loss levels are produced at regular intervals, set on the basis of the materiality of each model. The continuing appropriateness of model assumptions is also reviewed as part of this process.

Models are revisited on a regular basis to ensure that they continue to reflect the most recent data as the available information increases over time.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS

For the year ended 30 September 2024

15. LOAN IMPAIRMENT – BASIS OF PROVISION (CONTINUED)

On a monthly basis all model outputs, model overlays and provisions calculated for non-modelled books are reviewed by senior finance management including the CFO in conjunction with the latest credit risk operational and economic metrics to ensure that the impairment provision by asset type remains appropriate. This exercise will be the subject of particular focus at the year end and the half year.

This information is summarised for the Audit Committee on a biannual basis, and they have regard to this data in forming their conclusions on the appropriateness of provisioning levels.

vi) Model development

The models used by the Group are updated from time to time to allow for changes in the business, developments in best practice and the availability of additional data with the passing of time. During the year ended 30 September 2024 a major update to the Motor Finance PD model took place, meaning that three of the Group's four principal PD models, covering over 99% of modelled balances, have been updated since IFRS9 was implemented.

The adoption of the new Motor Finance model has enabled the reporting process in the year to be more streamlined, and supported increased use of scenario analysis, and increased the ability of the model to respond to economic inputs and wider customer credit data. It is also based on a greater volume of current data, as the Group only re-entered this market in 2014, four years before the implementation date of the first generation PD model.

The impacts of the adoption of the new Motor Finance PD model in the year ended 30 September 2024 on a like-for-like basis were to increase provision by £0.8m and transfer £6.5m of gross balances from Stage 1 to Stage 2.

The Group's programme of model development continued during the year with a particular focus on analysing how default and loss data recorded over the period of the Covid pandemic should be reflected in the next generation of forward-looking models, given the unprecedented nature of the pandemic and the national and international response to it.

All revised models and model enhancements are carefully reviewed and tested before adoption, and are subject to a governance process for their approval.

vii) Judgemental Adjustments

To ensure that the Group's loan portfolios are properly provisioned, the Group considers factors might impact on customers, but which may either not be reflected by its provision processes, be only partially reflected or not be reflected sufficiently quickly. These may include consideration of the likely impact of the broad economic environment, customer and market sentiment and expert knowledge within the Group's businesses.

In the year ended 30 September 2024 the most significant factors in these considerations were the extent to which uncertainties in the UK economy arising from rapidly rising interest rates, and increases in the cost of living and doing business in the UK seen in recent periods, and the impacts of continuing world conflicts were reflected in current customer performance at the period end and were being fully addressed by the Group's provision modelling, particularly in view of the lack of recent observations relating to similar conditions. These impacts were felt particularly in the Group's development finance business where some projects priced before recent rises in costs and interest rates came under stress in the period.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS

For the year ended 30 September 2024

15. LOAN IMPAIRMENT – BASIS OF PROVISION (CONTINUED)

The divergence of the current economic environment from those experienced over much of recent history inevitably weakens the ability of any experience-based model to predict credit performance accurately, and means that management have to consider carefully the requirement for the mechanically generated provision to be adjusted.

Where management has identified a requirement to amend the calculated provision as a result of either model deficiencies or idiosyncratic behaviour in part of the portfolio, judgemental adjustments are applied to the modelled outputs so that the ECL recognised corresponds to expert judgement, taking into account the widest possible range of current information, which might not be factored into the modelling process. Similarly where non-modelled books come under stress, methodologies may be adjusted to ensure coverage is sufficient.

The Group's approach to impairment modelling is based on the analysis of historical credit data. In normal circumstances the Group's objective is to develop its modelling to the point where the level of judgemental adjustments required is minimal, but in economic conditions where previous relevant experience is limited or non-existent, some form of judgemental adjustment is always likely to be necessary. While high interest rate and sharp price rises have occurred in the UK in the past, market conditions, products and regulatory expectations have moved on considerably in the meantime, and most such observations would pre-date the existence of buy-to-let mortgages as a distinct asset class. This means that the value of past history as a guide to future credit performance is reduced.

Current model behaviours and the potential for unobserved credit issues have meant that the requirement for such adjustments over recent periods has been significant, even given the work done to replace and enhance the Group's first generation of IFRS 9 impairment models. Evidence considered by management in order to assess the size of the adjustments required included internal performance data, customer and broker feedback, insight surveys, industry intelligence, evidence on the wider economy and quantitative and qualitative data and statements from industry, government and regulatory bodies. These were combined with the expert knowledge within the business to form a broad estimate of the level of provision required across the Group.

A similar process was undertaken in respect of non-modelled books to ensure that specific issues and impacts were being identified, and the minimum provisions set for each portfolio remained sufficient.

As part of these exercises, the potential for climate related issues to impact on customer business models or security values over the timescales for ECL calculation required by IFRS 9 was considered. No specific requirement for additional impairment provisions over the amounts already determined was identified.

The requirement for judgemental adjustments is considered on a portfolio-by-portfolio basis, and the potential for the existence of significant groups of assets being particularly exposed to credit risk in the expected economic scenarios is also considered.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS

For the year ended 30 September 2024

15. LOAN IMPAIRMENT – BASIS OF PROVISION (CONTINUED)

The total amounts of judgemental adjustments provided across the Group are set out below by segment.

	2024 £m	2024 £m	2023 £m	2023 £m
Mortgage Lending – modelled		3.0		3.0
Commercial Lending -modelled	2.0		3.5	
Commercial Lending -non-modelled	1.5		-	
		3.5		3.5
		6.5		6.5

The position at 30 September 2024 is broadly similar to that at 30 September 2023, representing the extent to which the concerns over future customer performance and the potential for future economic headwinds which gave rise to the original adjustments remain in place. While some adverse trends in performance have been noted in the portfolios, these have been offset, to some extent, by the impact of forecast downward trends in future inflation and interest rates in the scenarios underlying the impairment models. Within the overall position, there has been some movement on individual books, with the solid performance of the SME asset finance book reducing the need for overlay, while the conditions faced by developers in the current economic situation generated a need for additional overlay.

The adjustment in the Mortgage Lending book at the previous year end had represented the level to which the credit metrics and other model inputs did not produce a result for the buy-to-let portfolio which accorded with the credit expectations of management, brokers and customers, particularly in respect of legacy assets. While there has been some upward movement in arrears metrics, both for the Group and the buy-to-let market more generally, and some long standing cases have been resolved, future expectations remain broadly in line with those twelve months earlier. In response to these factors, management decided that it was appropriate to maintain the level of overlay at 30 September 2024.

The Group's SME lending portfolio performed generally strongly in the period, with a consequent impact on the calculated provision. However, a level of caution remains as to the broader outlook for UK SMEs in the current economic climate, and there remain concerns as to the effectiveness of the Group's provisioning model in a high interest rate environment. On this basis the judgemental adjustment has been reduced to £1.0m for the current year (2023: £2.5m).

For the motor finance portfolio, the £1.0m overlay to the modelled provision, first included at 30 September 2023, has been maintained (2023: £1.0m). While early indications show the second generation model to be more effective at identifying credit risk cases, the data it is built on still includes little information corresponding to a period of falling inflation rapidly following a period of sharp price rises. Therefore the overlay has been retained to ensure provision in that book remains reasonable overall, considering other portfolio data.

The Group's analysis found no evidence of particular concentrations of credit risk below portfolio level. Given this, and the high level nature of the exercise undertaken, the judgemental adjustments on modelled balances have been apportioned across the Group's buy-to-let mortgage, SME lending and motor finance portfolios, as appropriate, to individual Stage 1 cases. As such they are included in the credit risk disclosures required by IFRS 7.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

15. LOAN IMPAIRMENT – BASIS OF PROVISION (CONTINUED)

Within the development finance book, performance deteriorated in the year, impacted by increased materials and labour costs and higher interest rates, particularly on projects approved and costed before these became likely. In response, as well as focussed reviews on individual cases, the Group determined that the minimum provision for all cases should be uplifted from normal levels, generating an additional provision of £1.5m, focussed on older cases (2023: £nil).

The Group will continue to monitor the requirement for all these adjustments as the economic situation develops and its impacts are more fully reflected in model outputs. It is anticipated that a more normal economic situation would require a lower value of adjustments, but the timescale in which such a scenario might be reached appears uncertain.

The Group has adopted the terminology for impairment adjustments proposed by the Taskforce on Disclosures about Expected Credit Loss ('DECL') which restricts the use of the term 'Post Model Adjustment' ('PMA') to those adjustments calculated on an account-by-account basis and therefore no longer uses that term for other judgemental adjustments.

16. LOAN IMPAIRMENTS BY STAGE AND DIVISION

IFRS 9 calculations and related disclosures require loan assets to be divided into three stages, with accounts which were credit impaired on initial recognition representing a fourth class.

The three classes comprise: those where there has been no SICR since advance or acquisition (Stage 1); those where there has been an SICR (Stage 2); and loans which are impaired (Stage 3).

- On initial recognition, and for assets where there has not been an SICR, provisions will be made in respect of losses resulting from the level of credit default events expected in the twelve months following the balance sheet date
- Where a loan has experienced an SICR, whether or not the loan is considered to be credit impaired, provisions will be made based on the ECLs over the full life of the loan
- For credit impaired assets, provisions will also be made on the basis of lifetime ECLs

For assets which were 'Purchased or Originated as Credit Impaired' ('POCI') accounts (those considered as credit impaired at the point of first recognition), such as certain of the Group's acquired assets in Mortgage Lending, the carrying valuation is based on expected cash flows discounted by the EIR determined at the point of acquisition.

The recommendations of the taskforce on Disclosures about Expected Credit Loss ('DECL') suggest standard categories for analysis of firm's loan books. In the context of the DECL categorisation the Group's Mortgage Lending balances are classified as 'UK retail mortgage' business while its Commercial Lending balances, being advanced primarily to SME entities correspond with the 'UK other retail' business classification.

The Group defines coverage as the value of the ECL provision divided by the gross carrying value of the related loans.

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For the year ended 30 September 2024

16. LOAN IMPAIRMENTS BY STAGE AND DIVISION (CONTINUED)

An analysis of the Group's loan portfolios between the stages defined above is set out below.

	Stage 1 £m	Stage 2 * £m	Stage 3 * £m	POCI £m	Total £m
30 September 2024					
Gross loan book					
Mortgage Lending	12,670.3	598.9	171.1	10.7	13,451.0
Commercial Lending	2,034.9	177.2	112.5	6.4	2,331.0
Total	14,705.2	776.1	283.6	17.1	15,782.0
Impairment provision					
Mortgage Lending	(3.4)	(2.2)	(29.7)	-	(35.3)
Commercial Lending	(12.6)	(5.0)	(21.1)	(2.5)	(41.2)
Total	(16.0)	(7.2)	(50.8)	(2.5)	(76.5)
Net loan book					
Mortgage Lending	12,666.9	596.7	141.4	10.7	13,415.7
Commercial Lending	2,022.3	172.2	91.4	3.9	2,289.8
Total	14,689.2	768.9	232.8	14.6	15,705.5
Coverage ratio					
Mortgage Lending	0.03%	0.37%	17.36%	-	0.26%
Commercial Lending	0.62%	2.82%	18.76%	39.06%	1.77%
Total	0.11%	0.93%	17.91%	14.62%	0.48%

* Stage 2 and 3 balances are analysed in more detail below.

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16. LOAN IMPAIRMENTS BY STAGE AND DIVISION (CONTINUED)

	Stage 1 £m	Stage 2 * £m	Stage 3 * £m	POCI £m	Total £m
30 September 2023					
Gross loan book					
Mortgage Lending	12,159.7	625.0	142.2	17.7	12,944.6
Commercial Lending	1,812.6	119.8	63.8	7.1	2,003.3
Total	13,972.3	744.8	206.0	24.8	14,947.9
Impairment provision					
Mortgage Lending	(4.8)	(6.1)	(31.4)	-	(42.3)
Commercial Lending	(14.8)	(3.3)	(8.4)	(4.8)	(31.3)
Total	(19.6)	(9.4)	(39.8)	(4.8)	(73.6)
Net loan book					
Mortgage Lending	12,154.9	618.9	110.8	17.7	12,902.3
Commercial Lending	1,797.8	116.5	55.4	2.3	1,972.0
Total	13,952.7	735.4	166.2	20.0	14,874.3
Coverage ratio					
Mortgage Lending	0.04%	0.98%	22.08%	-	0.33%
Commercial Lending	0.82%	2.75%	13.17%	67.61%	1.56%
Total	0.14%	1.26%	19.32%	19.35%	0.49%

* Stage 2 and 3 balances are analysed in more detail below.

In terms of the Group's credit management processes, Stage 1 cases will fall within the appropriate customer servicing functions and Stage 2 cases will be subject to account management arrangements. Stage 3 cases will include both those subject to recovery or similar processes and those which, though being managed on a long-term basis, are included with defaulted accounts for regulatory purposes. However, these broad categorisations may vary between different product types.

POCI balances included in the Commercial Lending segment arise principally from acquired businesses, where those assets were identified as credit impaired at the point of acquisition when the acquired portfolios as a whole were evaluated. Additional provision arising on these assets post-acquisition is shown as 'Impairment Provision' above.

The Group's acquired secured consumer loans are included in the Mortgage Lending segment, together with its closed second charge mortgage portfolios. Acquired loans which were performing on acquisition are included in the staging analysis above.

Acquired portfolios of second charge mortgage assets which were largely non-performing at acquisition, and which were purchased at a deep discount to face value, are shown as POCI assets above. Although no provision is shown above for such assets, the effect of the discount on purchase is included in the gross value ensuring that the carrying value is substantially less than the current balances due from customers and the level of cover is considerable. These balances continue to reduce as customers make payments.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

16. LOAN IMPAIRMENTS BY STAGE AND DIVISION (CONTINUED)

Analysis of Stage 2 loans

The table below analyses the accounts in Stage 2 between those not more than one month in arrears where an SICR has nonetheless been identified from other information and accounts more than one month in arrears.

Cases which have been greater than one month in arrears in the last three months, but which are not at the balance sheet date are shown as ‘recent arrears’ in the tables below.

In all cases accounts which are more than one month in arrears, where this is a meaningful measure, are considered to have an SICR. However, in certain loan portfolios, regular monthly payments of pre-set amounts are not required and hence this criterion cannot be used.

The Group uses arrears multiples as a proxy for days past due, as this measure is commonly used in its arrears reporting. A loan will generally be one month in arrears from the point at which a payment is one day past due until it is thirty days past due.

The value of Stage 2 loans in the mortgage segment has declined somewhat in the year as a result of more benign economic conditions. This has resulted in fewer cases of accounts between one and three months in arrears, with older Stage 2 cases either curing or passing to Stage 3 a lower incidence of new arrears in the year. The most significant part of the Stage 2 balance remains cases identified through their PD scores, although the size of this balance remained stable in the period.

Both provision coverage levels for Stage 2 Mortgage Lending cases, and the absolute level of provision have reduced in the period. This is partly a result of the reduction in current arrears cases, which tend to attract the highest provision relatively, but is also an effect of the slow, but continuing growth in house prices, and therefore security values, in the period. The coverage levels have also been reduced as a result of some long standing, high provision cases having moved though to Stage 3, and in some cases realisation, in the year.

For Commercial Lending cases values of Stage 2 accounts have increased significantly, with the most marked growth in the non-arrears cases. This includes the Stage 2 element of the development finance book, which accounted for almost all of the growth, reflecting the additional scrutiny applied in what has been a difficult period for the construction industry. The trend for Stage 2 arrears cases in the period was largely positive, reflecting the more stable economic environment.

Stage 2 coverage has increased slightly in the Commercial Lending segment. While the high theoretical levels of real estate security available in the development finance business tend to reduce potential impairment calculated, the uplift in minimum provision applied in response to the issues seen in the business in the year, described above, has enhanced coverage levels. This has caused an increased coverage on non-arrears accounts. Coverage on the relatively low number of Stage 2 arrears cases in the segment tends to be idiosyncratic, based on the nature of security available on each of the cases included.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

16. LOAN IMPAIRMENTS BY STAGE AND DIVISION (CONTINUED)

	< 1 month arrears £m	Recent arrears £m	> 1 <= 3 months arrears £m	Total £m
30 September 2024				
Gross loan book				
Mortgage Lending	521.8	13.5	63.6	598.9
Commercial Lending	171.9	2.7	2.6	177.2
Total	693.7	16.2	66.2	776.1
Impairment provision				
Mortgage Lending	(1.7)	-	(0.5)	(2.2)
Commercial Lending	(4.5)	(0.1)	(0.4)	(5.0)
Total	(6.2)	(0.1)	(0.9)	(7.2)
Net loan book				
Mortgage Lending	520.1	13.5	63.1	596.7
Commercial Lending	167.4	2.6	2.2	172.2
Total	687.5	16.1	65.3	768.9
Coverage ratio				
Mortgage Lending	0.33%	-	0.79%	0.37%
Commercial Lending	2.62%	3.70%	15.38%	2.82%
Total	0.89%	0.62%	1.36%	0.93%

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

16. LOAN IMPAIRMENTS BY STAGE AND DIVISION (CONTINUED)

	< 1 month arrears	Recent arrears	> 1 <= 3 months arrears	Total
	£m	£m	£m	£m
30 September 2023				
Gross loan book				
Mortgage Lending	518.1	15.8	91.1	625.0
Commercial Lending	116.3	0.4	3.1	119.8
Total	634.4	16.2	94.2	744.8
Impairment provision				
Mortgage Lending	(2.3)	(0.1)	(3.7)	(6.1)
Commercial Lending	(2.9)	-	(0.4)	(3.3)
Total	(5.2)	(0.1)	(4.1)	(9.4)
Net loan book				
Mortgage Lending	515.8	15.7	87.4	618.9
Commercial Lending	113.4	0.4	2.7	116.5
Total	629.2	16.1	90.1	735.4
Coverage ratio				
Mortgage Lending	0.44%	0.63%	4.06%	0.98%
Commercial Lending	2.49%	-	12.90%	2.75%
Total	0.82%	0.62%	4.35%	1.26%

Analysis of Stage 3 loans

The table below analyses the accounts in Stage 3 between those:

- In the process of sale or other enforcement procedures ('Realisations')
- Where a receiver of rent ('RoR') has been appointed by the Group to manage the property on the customers' behalf
- Which are being managed on a long-term basis and where full recovery is possible, but which are considered to meet regulatory default criteria at the balance sheet date ('>3 month arrears'). This category includes accounts identified as defaults using non-arrears based unlikeliness to pay ('UTP') indicators.
- Which no longer meet regulatory default criteria, but which are being retained in Stage 3 for a probationary period ('Probation')

Where an account meets two of the criteria, it will be assigned to the category shown first in the list above.

RoR accounts in Stage 3 may be fully up-to-date with full recovery possible. These accounts are included in Stage 3 as they are classified as defaulted for regulatory purposes.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS

For the year ended 30 September 2024

16. LOAN IMPAIRMENTS BY STAGE AND DIVISION (CONTINUED)

The value of Stage 3 cases has increased in the period, as cases impacted by the economic issues of recent years continue to make their way through the system. Increases have been registered across almost all categories, although the receiver of rent book in the Mortgage Lending segment continues to reduce as older cases are worked out.

While the incidence of new receivership arrangements in the year has increased, these have generally moved to sale more quickly, based on the positive property market in the year, accounting for the increased number shown in the realisations column. However, the Group continues to use the receivership process to ensure good outcomes for its landlord customers, their tenants and itself and, where appropriate, will manage these accounts on a longer term basis.

Stage 3 coverage levels in the Mortgage Lending segment are a little reduced, a result of increasing property values in the period providing enhanced security and also of the crystallisation of losses on some older, heavily provided, receivership cases.

The growth in Stage 3 cases in the Commercial Lending division is attributable largely to a number of cases in the development finance business impacted by issues in the UK building sector over recent periods. These appear in the '>3 months arrears column. While such cases enjoy security over the development funded, the Group has taken a careful approach to estimating recoverable values, especially where the security may comprise an unfinished structure. This has also driven a growth in provision coverage in the period for the segment.

	Probation	> 3 month arrears	RoR managed	Realisations	Total
	£m	£m	£m	£m	£m
30 September 2024					
Gross loan book					
Mortgage Lending	10.3	44.6	45.2	71.0	171.1
Commercial Lending	0.4	105.0	-	7.1	112.5
Total	10.7	149.6	45.2	78.1	283.6
Impairment provision					
Mortgage Lending	-	(0.7)	(11.2)	(17.8)	(29.7)
Commercial Lending	(0.1)	(17.7)	-	(3.3)	(21.1)
Total	(0.1)	(18.4)	(11.2)	(21.1)	(50.8)
Net loan book					
Mortgage Lending	10.3	43.9	34.0	53.2	141.4
Commercial Lending	0.3	87.3	-	3.8	91.4
Total	10.6	131.2	34.0	57.0	232.8
Coverage ratio					
Mortgage Lending	-	1.57%	24.78%	25.07%	17.36%
Commercial Lending	25.00%	16.86%	-	46.48%	18.76%
Total	0.93%	12.30%	24.78%	27.02%	17.91%

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

16. LOAN IMPAIRMENTS BY STAGE AND DIVISION (CONTINUED)

	Probation	> 3 month arrears	RoR managed	Realisations	Total
	£m	£m	£m	£m	£m
30 September 2023					
Gross loan book					
Mortgage Lending	8.8	40.4	50.3	42.7	142.2
Commercial Lending	1.1	57.8	-	4.9	63.8
Total	9.9	98.2	50.3	47.6	206.0
Impairment provision					
Mortgage Lending	-	(1.2)	(16.6)	(13.6)	(31.4)
Commercial Lending	(0.3)	(5.5)	-	(2.6)	(8.4)
Total	(0.3)	(6.7)	(16.6)	(16.2)	(39.8)
Net loan book					
Mortgage Lending	8.8	39.2	33.7	29.1	110.8
Commercial Lending	0.8	52.3	-	2.3	55.4
Total	9.6	91.5	33.7	31.4	166.2
Coverage ratio					
Mortgage Lending	-	2.97%	33.00%	31.85%	22.08%
Commercial Lending	27.27%	9.52%	-	53.06%	13.17%
Total	3.03%	6.82%	33.00%	34.03%	19.32%

The security values available to reduce exposure at default in the calculation shown above for Stage 3 accounts are set out below. The estimated value of the security represents, for each account, the lesser of the valuation estimate and the exposure at default in the central scenario. Security values are based on the most recent valuation of the relevant asset held by the Group, indexed or depreciated as appropriate.

	2024	2023
	£m	£m
First mortgages	119.1	89.5
Second mortgages	8.0	10.2
Asset finance	1.9	1.6
Motor finance	1.2	1.2
	130.2	102.5

16. LOAN IMPAIRMENTS BY STAGE AND DIVISION (CONTINUED)

The RoR managed accounts are being managed to ensure the optimal resolution for landlords, tenants and lenders and have largely reached a long-term, stable position, but the existence of the RoR arrangement causes the accounts to be treated as defaulted for regulatory purposes. The Group's RoR arrangements are described in more detail below.

Mortgage Lending balances with over three months arrears include second charge mortgage accounts originated over ten years ago which have been over three months in arrears for some time. These accounts are generally making regular payments and have significant levels of equity in the underlying property which reduces the required provision to the value shown above. It is expected that a high proportion of these accounts will eventually redeem naturally, either on the sale of the property or by the satisfaction of the amount due through instalment payments.

Buy-to-let receiver of rent cases (Stage 3)

Where a buy-to-let mortgage customer in England or Wales falls into arrears on their account the Group has the power to appoint a receiver of rent under the Law of Property Act. The receiver will then manage the property on behalf of the customer, collecting rents and remitting them to make payments on the account. While the receiver has the power to sell the property, in many cases they will operate it as a buy-to-let on at least a short to medium term basis, potentially longer, depending on the individual circumstances of the case. This causes less disruption to the tenants and may result in the mortgage account returning to performing status and the property being handed back to the customer.

While legacy cases continued to be resolved in the period, economic pressures have led to an increasing number of new receiver of rent appointments in the year, including some larger portfolio cases. These overwhelmingly relate to legacy cases advanced before 2009 and will therefore have a long rental history, with tenants in place in many cases.

The following table analyses the number and gross carrying value of RoR managed accounts shown above by the date of the receivers' appointment, illustrating this position.

	30 September 2024		30 September 2023	
	No.	£m	No.	£m
Managed accounts				
Appointment date				
2010 and earlier	94	14.6	135	20.1
2011 to 2015	16	2.2	31	4.5
2016 to 2020	6	0.8	15	2.0
2021 and later	167	27.6	154	23.7
Total managed accounts	283	45.2	335	50.3
Accounts in the process of realisation	356	57.6	225	41.0
	639	102.8	560	91.3

Receiver of rent accounts in the process of realisation at the period end are included under that heading in the Stage 3 tables above. In addition to the cases analysed above there were four other receiver of rent cases in acquired mortgage books classified as POCI (2023: four), meaning that the Group's total of receiver of rent cases at 30 September 2024 was 643 (2023: 564).

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For the year ended 30 September 2024

17. LOAN IMPAIRMENTS – PROVISION MOVEMENTS IN THE YEAR

The movements in the impairment provision calculated under IFRS 9, analysed by business segments, are set out below.

	Mortgage Lending £m	Commercial Lending £m	Total £m
At 30 September 2023	42.3	31.3	73.6
Provided in period (note 7)	6.0	20.4	26.4
Amounts written off	(13.0)	(10.5)	(23.5)
At 30 September 2024 (note 16)	35.3	41.2	76.5
At 30 September 2022	38.0	25.5	63.5
Provided in period (note 7)	10.8	8.3	19.1
Amounts written off	(6.5)	(2.5)	(9.0)
At 30 September 2023 (note 16)	42.3	31.3	73.6

Accounts are considered to be written off for accounting purposes if a balance remains once standard enforcement processes have been completed, subject to any amount retained in respect of expected salvage receipts. This has no effect on the net carrying value, only on the amounts reported as gross loan balances and accumulated impairment provisions.

At 30 September 2024, enforceable contractual balances of £15.3m (2023: £7.6m) were outstanding on non-POCI assets written off in the period. This excludes those accounts where a full and final settlement was agreed and those where the contractual terms do not permit any further action. Enforceable balances are kept under review for operational purposes, but no amounts are recognised in respect of such accounts unless further cash is received or there is a strong expectation that it will be.

A more detailed analysis of these movements by IFRS 9 stage on a consolidated basis for the years ended 30 September 2024 and 30 September 2023 is set out below.

These tables, and the matching tables analysing movements in gross balances, have been compiled by comparing opening and closing balances on each account and analysing the movements between them.

Changes due to credit risk includes all changes in model parameters whether related to account performance, external credit data or model assumptions, including economic scenarios and weightings.

The changes in models introduced during the year did not create significant movements in balances.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

17. LOAN IMPAIRMENTS – PROVISION MOVEMENTS IN THE YEAR (CONTINUED)

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Loss allowance at 30 September 2023	19.6	9.4	39.8	4.8	73.6
New assets originated	6.5	-	-	-	6.5
Changes in loss allowance					
Transfer to Stage 1	2.0	(1.8)	(0.2)	-	-
Transfer to Stage 2	(2.2)	3.0	(0.8)	-	-
Transfer to Stage 3	(0.2)	(4.5)	4.7	-	-
Changes on stage transfer	(1.6)	2.4	26.4	-	27.2
Changes due to credit risk	(8.1)	(1.3)	4.4	(2.3)	(7.3)
Write offs	-	-	(23.5)	-	(23.5)
Loss allowance at 30 September 2024	16.0	7.2	50.8	2.5	76.5
Loss allowance at 30 September 2022	25.5	8.0	28.5	1.5	63.5
New assets originated	9.5	-	-	-	9.5
Changes in loss allowance					
Transfer to Stage 1	2.8	(2.7)	(0.1)	-	-
Transfer to Stage 2	(1.7)	2.0	(0.3)	-	-
Transfer to Stage 3	(0.2)	(1.9)	2.1	-	-
Changes on stage transfer	(2.5)	2.3	14.6	-	14.4
Changes due to credit risk	(13.8)	1.7	4.0	3.3	(4.8)
Write offs	-	-	(9.0)	-	(9.0)
Loss allowance at 30 September 2023	19.6	9.4	39.8	4.8	73.6

During the year ended 30 September 2024, provision levels remained broadly stable overall, although the generally more benign economic climate and increased confidence in the UK saw provision in Stages 1 and 2 falling, compensated by an increase in Stage 3 provision as problem cases moved through the credit cycle, but were not generally replaced by new arrears accounts at the same rate.

Provision levels on secured lending tended to decline, especially for loans secured on property, with prices in most areas growing in the year. However, a number of problem cases in development finance saw an increased level of provision being booked, as issues with project progress and financing emerged in the year, with these changes being recognised in the Stage 3 movements.

The level of write-offs in the year was higher than in the previous period as some long-term cases were finally resolved and the related provision applied.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS

For the year ended 30 September 2024

17. LOAN IMPAIRMENTS – PROVISION MOVEMENTS IN THE YEAR (CONTINUED)

During the year ended 30 September 2023 the impairment allowance increased, driven mostly by the increase in Stage 3 and POCI cases, a result of the level of actual defaults in the period, particularly in the development finance business, and by reduced levels of available security through declining house prices in the mortgage segment.

The net reduction in Stage 1 provisions in that year included the effect of changes in judgemental adjustments in the period, with items formerly addressed by these provisions beginning to move through Stage 2 and Stage 3. These movements were driven by both account performance, and by the impact of more severe actual and forecast economic conditions.

The movements in the Loans to Customers balances in respect of which these loss allowances have been made are set out below.

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
Balance at 30 September 2023	13,972.3	744.8	206.0	24.8	14,947.9
New assets originated	2,757.4	-	-	-	2,757.4
Changes in staging					
Transfer to Stage 1	329.3	(325.9)	(3.4)	-	-
Transfer to Stage 2	(566.5)	585.2	(18.7)	-	-
Transfer to Stage 3	(38.1)	(137.6)	175.7	-	-
Redemptions and repayments	(2,558.0)	(137.2)	(76.0)	(11.0)	(2,782.2)
Write offs	-	-	(23.5)	-	(23.5)
Other changes	808.8	46.8	23.5	3.3	882.4
Balance at 30 September 2024	14,705.2	776.1	283.6	17.1	15,782.0
Loss allowance	(16.0)	(7.2)	(50.8)	(2.5)	(76.5)
Carrying value	14,689.2	768.9	232.8	14.6	15,705.5
Balance at 30 September 2022	12,157.0	1,963.6	124.4	28.8	14,273.8
New assets originated	3,128.4	-	-	-	3,128.4
Changes in staging					
Transfer to Stage 1	1,258.9	(1,255.7)	(3.2)	-	-
Transfer to Stage 2	(365.6)	372.9	(7.3)	-	-
Transfer to Stage 3	(28.9)	(104.7)	133.6	-	-
Redemptions and repayments	(2,773.3)	(250.6)	(44.8)	(10.5)	(3,079.2)
Write offs	-	-	(9.0)	-	(9.0)
Other changes	595.8	19.3	12.3	6.5	633.9
Balance at 30 September 2023	13,972.3	744.8	206.0	24.8	14,947.9
Loss allowance	(19.6)	(9.4)	(39.8)	(4.8)	(73.6)
Carrying value	13,952.7	735.4	166.2	20.0	14,874.3

Other changes includes interest and similar charges.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS

For the year ended 30 September 2024

18. LOAN IMPAIRMENTS – ECONOMIC INPUTS TO CALCULATIONS

Impairment provision under IFRS 9 is calculated on a forward-looking ECL basis, based on expected economic conditions in multiple internally coherent scenarios. While the provision calculation is intended to address all possible future economic outcomes, the Group, in common with most other lenders, uses a small number of differing scenarios as representatives of this universe of potential outturns.

The Group uses four distinct economic scenarios chosen to represent the range of possible outcomes and allow for the impact of economic asymmetry in the calculations. Each scenario comprises a number of economic parameters and while models for different portfolios may not use all of the variables, the set, as a whole, is defined for the Group and must be internally consistent.

As the Group does not have an internal economics function, in developing its economic scenarios it considers analysis from reputable external sources to form a general market consensus which informs its central scenario. These sources include data and forecasts produced by the Office of Budget Responsibility (‘OBR’) and the PRA as well as private sector economic research bodies and industry sources. The Group also takes account of public statements from bodies such as the Bank of England and the UK Government to inform its final position.

The central scenario used for IFRS 9 impairment purposes is consistent with the scenario which forms the basis of the Group’s business planning and forecasting and will therefore generally carry the highest probability weighting. In its September 2024 forecasting cycle (the ‘October forecast’), the Group has adopted a central economic scenario derived using a broadly equivalent approach to that used in September 2023, with the starting point of the scenario updated to reflect the actual movements of economic variables in the year.

The general trend of the Group’s central forecast follows that published by the Bank of England in August 2024. This reflects the recent easing of monetary policy and recovering growth. Unemployment remains low, but trends upwards through the forecast period, inflation is generally stable and bank rates continue to fall. House prices, which have been more resilient than many had forecast, continue to increase modestly.

Compared with the central forecast adopted at 30 September 2023, this is rather more optimistic, with unemployment and interest rates at lower levels and a more positive outlook for house prices in the short term. However, GDP and inflation remain on a similar trajectory. The scenario also begins from the actual September 2024 position, so that variances against the 2023 scenarios in the year are reflected, with house prices at 30 September 2024, especially, starting the forecast period at a higher level than previously modelled.

The upside and downside scenarios are derived from the central forecast, as they have been in previous periods. The shape of the curves representing all three scenarios are similar across the forecast period, but the upside scenario assumes inflation falling more rapidly, driving faster growth and enabling the Bank of England to cut the base rate further and faster than in the base case, while house prices recover more strongly. Conversely, the downside case represents increased pressure on CPI, leading to current levels of base rates persisting for longer, with reduced economic confidence impacting on both house prices growth and unemployment levels.

The severe scenario has been derived from the most recent Annual Cyclical Scenario (‘ACS’) published by the Bank of England, as in recent periods. They supply shock scenario included in the ACS published in July 2024 forms the basis for the Group’s scenario and includes persistently high interest rates, causing a pronounced recession impacting on growth and employment levels, with a significant fall in house prices.

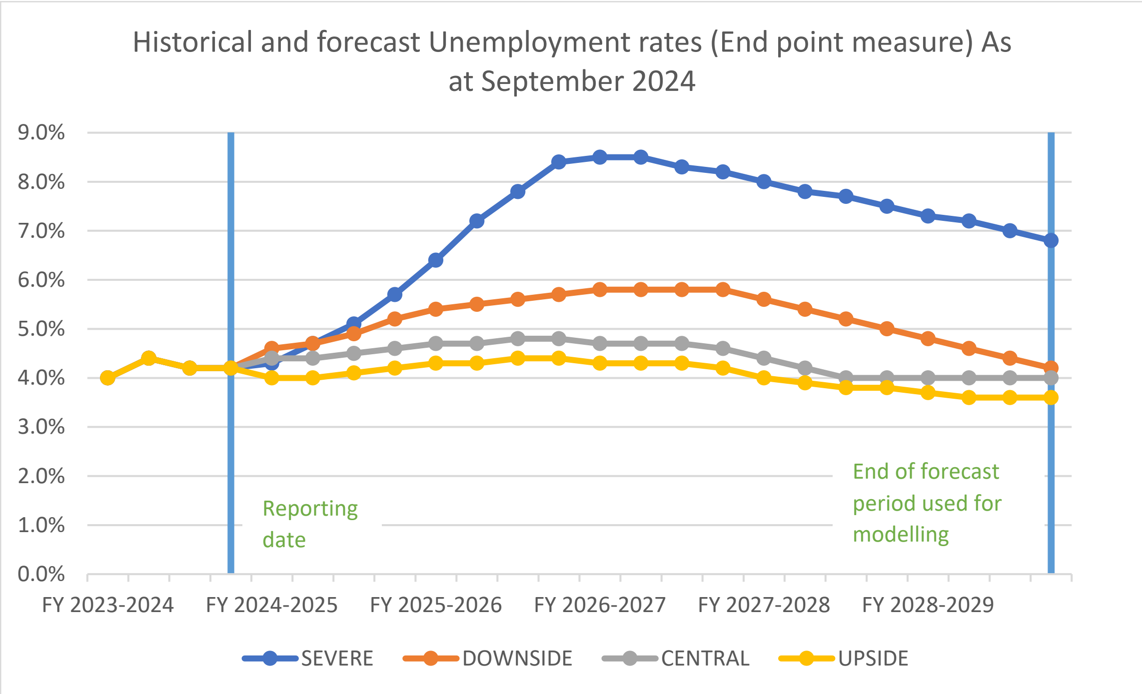
NOTES TO THE FINANCIAL INFORMATION - ANALYSIS

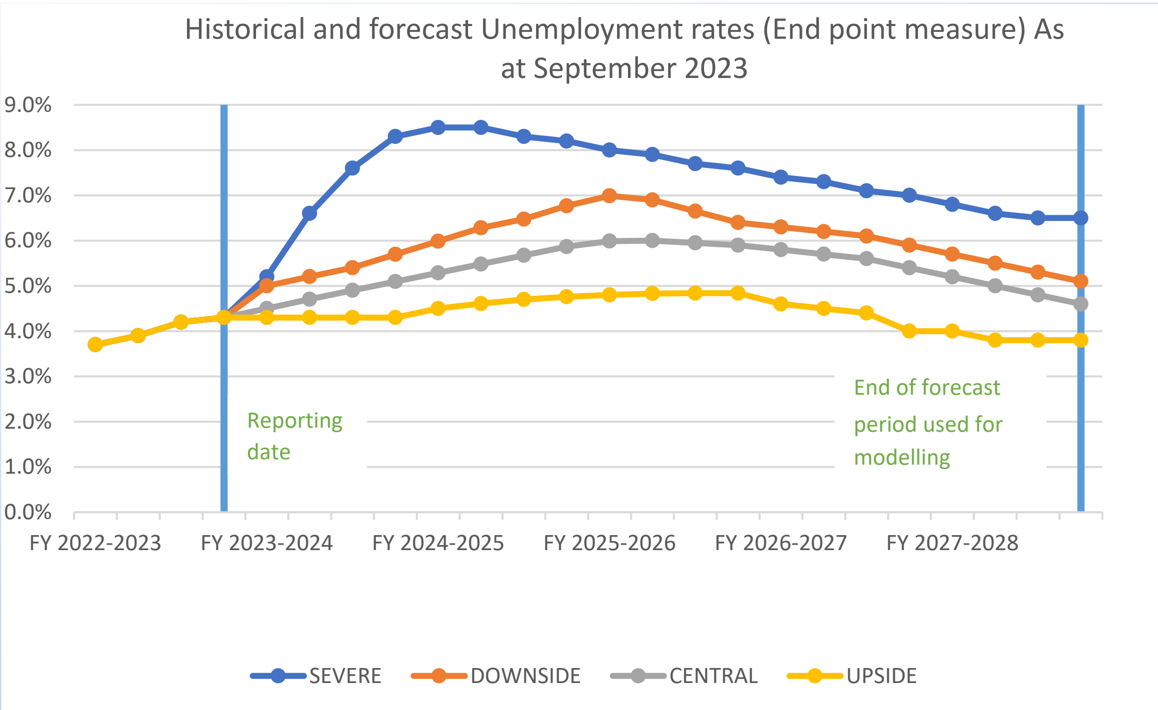
For the year ended 30 September 2024

18. LOAN IMPAIRMENTS – ECONOMIC INPUTS TO CALCULATIONS (CONTINUED)

The overall shape of the scenarios adopted, and the change in the forecasts year-on-year is illustrated by the forecasts of the UK's unemployment rate set out in the charts below. The unemployment rate has been presented as it is the principal indicator of general economic activity used in modelling losses in the Group's buy-to-let mortgage portfolio.

The forecast levels of house price inflation, the economic variable which has the most significant impact on the size of the Group's impairment provision, are also shown.





NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
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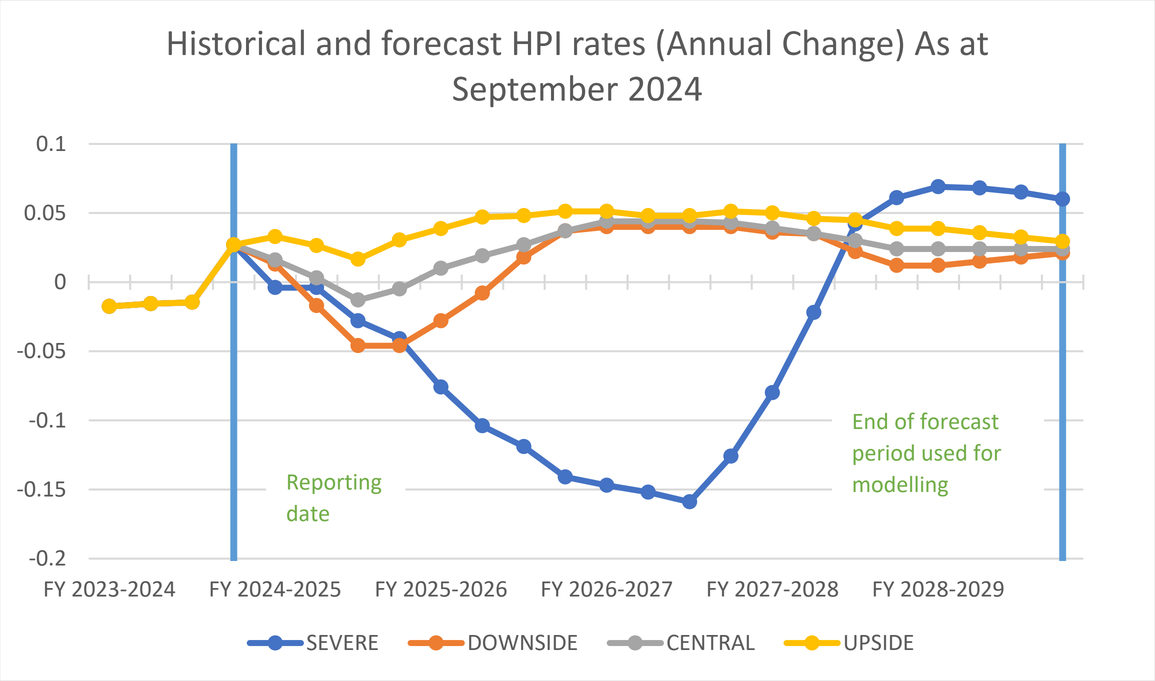
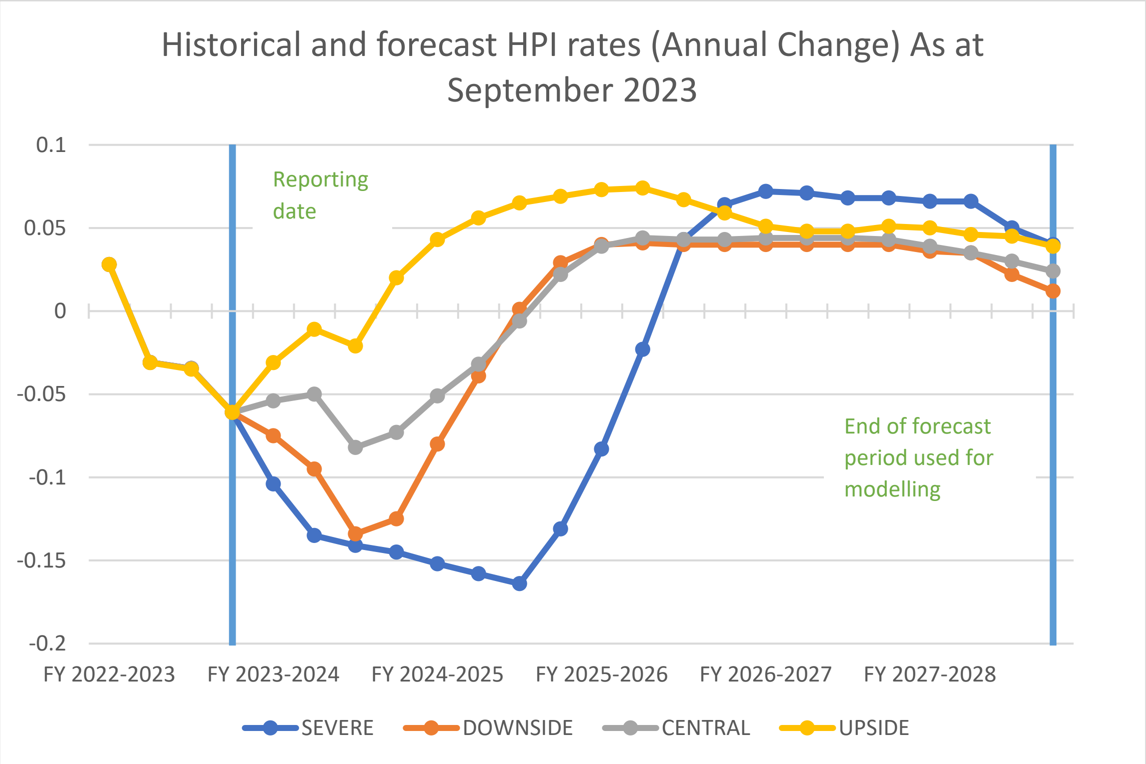
18. LOAN IMPAIRMENTS – ECONOMIC INPUTS TO CALCULATIONS (CONTINUED)





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18. LOAN IMPAIRMENTS – ECONOMIC INPUTS TO CALCULATIONS (CONTINUED)

Following a review of the weightings of the different scenarios, set against the overall potential for variability in the future economic outlook, the Group decided to adjust the scenario weightings used at 30 September 2024.

The consensus view for the UK economic outlook is both more settled and more benign than it was at 30 September 2023, however, the potential for significant downside impacts from geopolitical factors, including conflicts in Eastern Europe and the Middle East, remains. The emerging polices of the new UK Government and the outcome of November's US elections are both likely to impact economic sentiment, to the extent of producing substantially different outcomes.

Balancing these factors the Group determined that this was an appropriate point to begin to move back towards a more normal set of economic weightings, closer to those seen in the early years of IFRS 9, before the impacts of Brexit and Covid. As a first step the impact of the severe scenario has been reduced in the weightings set out below.

Sensitivities comparing the effect of these weightings with those adopted in the previous year and which might be seen in a more normal economic environment are set out in Note 19.

	2024	2023
Central scenario	45%	40%
Upside scenario	10%	10%
Downside scenario	30%	30%
Severe scenario	15%	20%
	100%	100%

The Group's economic scenarios comprise seven variables based on standard publicly available metrics for the UK. These variables are

- Year-on-year change in Gross Domestic Product ('GDP') as measured by the Office of National Statistics ('ONS')
- Year-on-year change in the House Price Index ('HPI') as measured by the Nationwide Building Society
- Bank Base Rate ('BBR'), as set by the Bank of England
- Consumer Price Inflation ('CPI') rate, as measured by the ONS
- Unemployment rate, as measured by the ONS
- Annual change in secured lending, as measured by the Bank of England 'mortgage advances' data series
- Annual change in consumer credit, as measured by the Bank of England 'unsecured advances' data series

The projected average annual values of each of these variables in each of the first five financial years of the forecast period are set out below.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

18. LOAN IMPAIRMENTS – ECONOMIC INPUTS TO CALCULATIONS (CONTINUED)

30 September 2024

GDP (year-on-year change)

	2025	2026	2027	2028	2029
Central scenario	1.4%	1.2%	1.6%	1.6%	1.6%
Upside scenario	2.9%	2.4%	2.3%	1.7%	1.6%
Downside scenario	0.5%	0.5%	1.3%	1.6%	1.6%
Severe scenario	(0.5)%	(3.1)%	(0.1)%	1.9%	1.8%

HPI (year-on-year change)

	2025	2026	2027	2028	2029
Central scenario	-	2.3%	4.4%	3.2%	2.4%
Upside scenario	2.7%	4.6%	5.0%	4.5%	3.4%
Downside scenario	(2.4)%	0.5%	4.0%	2.6%	1.7%
Severe scenario	(1.9)%	(11.0)%	(14.6)%	-	6.5%

BBR (rate)

	2025	2026	2027	2028	2029
Central scenario	4.3%	3.6%	3.4%	3.3%	3.3%
Upside scenario	4.1%	3.2%	3.0%	3.0%	3.0%
Downside scenario	5.0%	5.0%	4.6%	3.7%	3.5%
Severe scenario	7.1%	8.8%	6.3%	4.3%	3.5%

CPI (rate)

	2025	2026	2027	2028	2029
Central scenario	2.6%	1.9%	1.5%	1.7%	2.0%
Upside scenario	2.1%	1.9%	2.0%	2.0%	2.0%
Downside scenario	2.5%	2.5%	2.3%	1.9%	2.0%
Severe scenario	4.7%	11.9%	4.7%	2.1%	2.0%

Unemployment (rate)

	2025	2026	2027	2028	2029
Central scenario	4.5%	4.8%	4.7%	4.2%	4.0%
Upside scenario	4.1%	4.4%	4.3%	3.9%	3.6%
Downside scenario	4.9%	5.6%	5.8%	5.3%	4.5%
Severe scenario	5.0%	7.5%	8.4%	7.8%	7.1%

Secured lending (annual change)

	2025	2026	2027	2028	2029
Central scenario	0.3%	1.8%	3.0%	3.0%	3.0%
Upside scenario	1.3%	2.8%	3.3%	3.0%	3.0%
Downside scenario	(0.5)%	1.0%	2.8%	3.0%	3.0%
Severe scenario	(1.8)%	(0.3)%	2.5%	3.0%	3.0%

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

18. LOAN IMPAIRMENTS – ECONOMIC INPUTS TO CALCULATIONS (CONTINUED)

Consumer credit (annual change)

	2025	2026	2027	2028	2029
Central scenario	6.8%	5.1%	4.8%	5.0%	5.0%
Upside scenario	7.5%	5.9%	5.0%	5.0%	5.0%
Downside scenario	5.8%	4.1%	4.6%	5.0%	5.0%
Severe scenario	4.3%	2.6%	4.2%	5.0%	5.0%

30 September 2023

Gross Domestic Product ('GDP') (year-on-year change)

	2024	2025	2026	2027	2028
Central scenario	0.4%	0.9%	1.0%	1.2%	1.2%
Upside scenario	1.6%	1.4%	1.0%	1.2%	1.2%
Downside scenario	(0.4)%	0.7%	1.0%	1.2%	1.2%
Severe scenario	(3.6)%	(0.2)%	1.2%	1.2%	1.2%

House Price Index ('HPI') (year-on-year change)

	2024	2025	2026	2027	2028
Central scenario	(6.4)%	(1.7)%	4.7%	4.4%	3.2%
Upside scenario	(1.1)%	5.8%	6.8%	5.0%	4.5%
Downside scenario	(10.7)%	(2.2)%	4.0%	4.0%	2.6%
Severe scenario	(13.1)%	(15.1)%	-	7.0%	5.6%

Bank Base Rate ('BBR') (rate)

	2024	2025	2026	2027	2028
Central scenario	5.5%	5.4%	4.8%	4.4%	4.1%
Upside scenario	5.2%	4.4%	3.7%	3.5%	3.5%
Downside scenario	5.6%	3.8%	2.6%	2.0%	2.0%
Severe scenario	6.0%	5.8%	5.1%	4.3%	3.4%

Consumer Price Inflation ('CPI') (rate)

	2024	2025	2026	2027	2028
Central scenario	4.4%	2.6%	1.6%	1.8%	2.0%
Upside scenario	3.7%	2.1%	2.1%	2.0%	2.1%
Downside scenario	4.5%	1.0%	0.7%	1.8%	2.0%
Severe scenario	15.7%	12.8%	3.7%	2.4%	2.1%

Unemployment (rate)

	2024	2025	2026	2027	2028
Central scenario	4.8%	5.6%	6.0%	5.6%	4.9%
Upside scenario	4.3%	4.6%	4.8%	4.4%	3.9%
Downside scenario	5.3%	6.4%	6.7%	6.1%	5.4%
Severe scenario	6.9%	8.4%	7.8%	7.2%	6.6%

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS

For the year ended 30 September 2024

18. LOAN IMPAIRMENTS – ECONOMIC INPUTS TO CALCULATIONS (CONTINUED)

Secured lending (annual change)

	2024	2025	2026	2027	2028
Central scenario	0.8%	0.3%	1.8%	3.0%	3.0%
Upside scenario	1.5%	1.0%	2.5%	3.2%	3.0%
Downside scenario	-	(0.5)%	1.0%	2.8%	3.0%
Severe scenario	(1.3)%	(1.8)%	(0.3)%	2.5%	3.0%

Consumer credit (annual change)

	2024	2025	2026	2027	2028
Central scenario	3.5%	2.3%	3.9%	4.9%	5.0%
Upside scenario	4.3%	3.0%	4.7%	5.1%	5.0%
Downside scenario	2.8%	1.5%	3.2%	4.8%	5.0%
Severe scenario	1.5%	0.3%	1.9%	4.4%	5.0%

After the end of the initial five year period, the final rate or rate of change (as appropriate) is assumed to continue into the future in each scenario.

To illustrate the levels of non-linearity in the various scenarios, the maximum and minimum quarterly levels for each variable over the five year period commencing on the balance sheet date are set out below.

30 September 2024

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max %	Min %	Max %	Min %	Max %	Min %	Max %	Min %
Economic driver								
GDP	2.0	1.0	3.0	1.6	1.6	(0.3)	1.9	(3.7)
HPI	4.4	(1.3)	5.1	1.7	4.0	(4.6)	6.9	(15.9)
BBR	4.5	3.3	4.5	3.0	5.0	3.5	9.0	3.5
CPI	2.7	1.5	2.2	1.7	2.7	1.7	12.3	1.9
Unemployment	4.8	4.0	4.4	3.6	5.8	4.2	8.5	4.3
Secured lending	3.0	-	4.0	1.0	3.0	(0.8)	3.0	(2.0)
Consumer credit	7.0	4.5	7.8	4.8	6.0	3.5	5.0	2.0

30 September 2023

	Central scenario		Upside scenario		Downside scenario		Severe scenario	
	Max %	Min %	Max %	Min %	Max %	Min %	Max %	Min %
Economic driver								
GDP	1.2	0.3	2.3	0.9	1.2	(0.8)	1.2	(5.0)
HPI	4.4	(8.2)	7.4	(3.1)	4.1	(13.4)	7.2	(16.4)
BBR	5.5	4.0	5.3	3.5	5.8	2.0	6.0	3.3
CPI	5.0	1.5	4.3	1.8	6.0	0.4	17.0	2.0
Unemployment	6.0	4.5	4.8	3.8	7.0	5.0	8.5	5.2
Secured lending	3.0	-	3.8	0.8	3.0	(0.8)	3.0	(2.0)
Consumer credit	5.0	2.0	5.8	2.8	5.0	1.3	5.0	-

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS

For the year ended 30 September 2024

18. LOAN IMPAIRMENTS – ECONOMIC INPUTS TO CALCULATIONS (CONTINUED)

The asymmetry in the models is demonstrated by comparing the calculated impairment provision with that which would have been produced using the central scenario alone, 100% weighted.

	2024 £m	2023 £m
Provision using central scenario 100% weighted		
Mortgage Lending	31.6	38.4
Commercial Lending	39.7	29.0
	71.3	67.4
Calculated impairment provision	76.5	73.6
Effect of multiple economic scenarios	5.2	6.2

19. LOAN IMPAIRMENTS – SENSITIVITY ANALYSIS

The calculation of impairment provisions under IFRS 9 is subject to a variety of uncertainties arising from assumptions, forecasts and expectations about future events and conditions. To illustrate the impact of these uncertainties, sensitivity calculations have been performed for some of the most significant.

These sensitivities are intended as mathematical illustrations of the impacts of the various assumptions on the Group's modelling. They do not necessarily represent alternative potential impairment values as other factors might also need to be considered in arriving at a final provision figure if circumstances differed from those at the balance sheet date.

Economic conditions

To illustrate the potential impact of differing future economic scenarios on the total impairment, the provisions which would be calculated if each of the economic scenarios were 100% weighted are shown below:

	2024		2023	
Scenario	**Provision £m**	**Difference £m**	**Provision £m**	**Difference £m**
Central	71.3	(5.2)	67.4	(6.2)
Upside	68.0	(8.5)	59.0	(14.6)
Downside	76.8	0.3	73.4	(0.2)
Severe	100.4	23.9	95.7	22.1

The weighted average of these 100% weighted provisions need not equal the weighted average ECL due to the impact of the differing PDs on staging.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

19. LOAN IMPAIRMENTS – SENSITIVITY ANALYSIS (CONTINUED)

Scenario weightings

In order to illustrate the impact of scenario weightings on the outcomes, the impairment provision requirements were sensitised using alternative weightings. Sensitivity A is based on the weightings used at IFRS 9 transition on 1 October 2018. The use of the 2018 weighting is intended to represent a more settled outlook than has been evident at any of the most recent year ends. Sensitivity B is based on the weightings used at the previous year end, to demonstrate the impact of the adoption of the new weightings.

The weightings used, and the results of applying these sensitivities to the 30 September 2024 scenarios are set out below.

	Weighting				Impairment	Difference
	Central	Upside	Downside	Severe	£m	£m
As reported	45%	10%	30%	15%	76.5	-
Sensitivity A	40%	30%	25%	5%	72.9	(3.6)
Sensitivity B	40%	10%	30%	20%	77.8	1.3

Significant increase in credit risk

The most important driver of SICR is relative PD. If all PDs across the Group's principal buy-to-let mortgage book were increased by 10%, loans with a gross value of £44.4m would transfer from Stage 1 to Stage 2 (2023: £68.4m), and the total provision would increase by £0.3m from the combined effects of higher PDs on expected losses and the impact of providing for expected lifetime losses, rather than 12-month losses on the additional Stage 2 cases (2023: £0.8m).

Value of security

The principal assumptions impacting on LGD are the estimated security values. If the rate of growth in house prices assumed by the model after the forecast minimum were halved, ignoring any PD effects, then the provision for the Group's first and second mortgage assets under the central scenario would increase by £0.5m (2023: £0.7m).

Receiver of rent

The majority of receiver of rent cases, which are included in Stage 3, are managed long-term and therefore their assumed realisation date has an important impact on the provision calculation. If the assumed rate of realisations was increased by 20%, the impairment provision in the central scenario would increase by £0.4m (2023: £0.1m).

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

20. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

The Group's hedging arrangements can be analysed for accounting purposes between:

- Fair value hedges of portfolio interest rate risk, which are used to manage the interest rate risk inherent in fixed rate lending and deposit taking
- Fair value hedges of interest rate risk relating to individual financial assets or liabilities.

An economic hedge of the interest rate risk in fixed rate lending must also address pipeline exposures, where future lending at a given fixed rate is anticipated. However, such pre-hedging arrangements do not qualify as hedges for accounting purposes.

While the Group utilises economic hedging strategies to mitigate the impact of the changes in market interest rates on its capital base, these activities do not give rise to accounting entries.

A detailed description of the Group's use of derivatives and its accounting for derivatives and hedging is set out in note 26 to the 2023 Group Accounts.

The analysis below splits derivatives between those accounted for within portfolio fair value hedges and those which, despite representing an economic hedge, are not accounted for as hedges.

	2024 Assets £m	2024 Liabilities £m	2023 Assets £m	2023 Liabilities £m
Derivatives in hedge accounting relationships				
Fair value portfolio hedges				
Interest rate swaps				
Fixed to floating	216.3	(44.7)	519.0	(5.1)
Floating to fixed	123.8	(1.7)	76.2	(27.0)
Total derivatives in portfolio for value hedging relationship	340.1	(46.4)	595.2	(32.1)
Individual fair value hedges				
Fixed to floating	5.9	(8.4)	-	-
Floating to fixed	0.3	-	-	(3.7)
Total derivatives in hedge accounting relationships	346.3	(54.8)	595.2	(35.8)
Other derivatives				
Interest rate swaps	45.5	(44.9)	20.2	(4.1)
Currency futures	-	-	-	-
Total recognised derivative assets / (liabilities)	391.8	(99.7)	615.4	(39.9)

All hedging relationships and strategies at 30 September 2023 described in note 26 to the 2023 Group Accounts have continued in the period.

In addition, the fixed rate investment securities described in note 12 have been hedged using interest rate swaps. These hedging arrangements have been designated as fair value micro hedges for IAS 39 hedge accounting purposes.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS

For the year ended 30 September 2024

20. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING (CONTINUED)

The balances held on the Group's balance sheet relating to the hedging of interest rate risk on its fixed rate customer loan and deposit balances are summarised below.

	Note	2024 £m	2023 £m
Derivative financial instruments			
Assets		391.8	615.4
Liabilities		(99.7)	(39.9)
		292.1	575.5
Fair value hedging adjustments			
On loans to customers	13	(75.2)	(379.3)
On investment securities	12	7.7	-
On retail deposits	24	(16.7)	30.9
On borrowings		(0.3)	3.7
		(84.5)	(344.7)
Net balance sheet position		207.6	230.8
Collateral balances			
Posted (in sundry assets)	21	-	-
Received (in sundry liabilities)	27	(103.6)	(383.4)
		(103.6)	(383.4)

21. SUNDRY ASSETS

	Note	2024 £m	2023 £m	2022 £m
Receivable in less than one year				
Accrued interest income		11.1	4.6	1.0
CSA assets	21	-	-	-
CRDs		-	38.0	30.2
Other sundry assets		9.6	8.4	8.0
		20.7	51.0	39.2

Cash ratio deposits ('CRDs') were non-interest-bearing deposits lodged with the Bank of England, based on the value of the Bank's eligible liabilities. These deposits were required to comply with regulatory rules, but the scheme was terminated by the Bank of England during the year.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS

For the year ended 30 September 2024

22. RETIREMENT BENEFIT OBLIGATIONS

Since the last IAS 19 actuarial valuation at 30 September 2023 there have been movements in financial conditions, requiring an adjustment to the actuarial assumptions underlying the calculation of the defined benefit obligation at 30 September 2024. In particular, over the period since the 30 September 2023 actuarial valuation, the discount rate has reduced by 45 basis points per annum, whereas expectations of long-term inflation have decreased by only around 20 basis points. The performance of the Plan assets was also impacted by market movements.

The Group has recognised the surplus as an asset at the balance sheet date as it anticipates being able to access economic benefits at least as great as the carrying value. However such assets are eliminated from capital for regulatory purposes (note 37).

The movements in the deficit on the defined benefit plan during the year ended 30 September 2024 are summarised below.

	2024	**2023**
	£m	**£m**
Opening pension surplus	12.7	7.1
Employer contributions	2.8	3.9
Amounts posted to profit and loss		
Service cost	(0.4)	(0.5)
Past service cost	-	-
Net funding income (note 3)	0.8	0.4
Administrative expenses	(0.9)	(0.6)
Amounts posted to other comprehensive income		
Return on plan assets not included in interest	7.0	(7.8)
Experience gain / (loss) on liabilities	1.5	(1.8)
Actuarial (loss) / gain from changes in financial assumptions	(3.7)	11.1
Actuarial gain / (loss) from changes in demographic assumptions	2.4	0.9
Closing pension surplus	22.2	12.7

Pursuant to the recovery plan agreed with the Trustee of the pension plan, the Group has effectively granted a first charge over its freehold head office building as security for its agreed contributions. No account of this charge is taken in the calculation of the above deficit.

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For the year ended 30 September 2024

23. INTANGIBLE ASSETS

Intangible assets at net book value comprise:

	2024 £m	2023 £m	2022 £m
Goodwill	162.8	162.8	164.4
Computer software	8.0	4.4	3.9
Other intangibles	0.7	1.0	1.9
Total assets	171.5	168.2	170.2

The balance for goodwill at 30 September 2024 shown above includes £113.0m in respect of the SME lending Cash Generating Unit ('CGU') and £49.8m in respect of the Development Finance CGU.

(a) SME lending

The goodwill carried in the accounts relating to the SME lending CGU was recognised on acquisitions in the years ended 30 September 2016 and 30 September 2018.

An impairment review undertaken at 30 September 2024 indicated that no write down was required.

The recoverable amount of the SME lending CGU used in this impairment testing is determined on a value in use basis using pre-tax cash flow projections based on financial budgets approved by the Board in November 2024 covering a five-year period.

The key assumptions underlying the value in use calculation for the SME lending CGU are:

- Level of business activity, based on management expectations. The forecast assumes a compound annual growth rate ('CAGR') for new lending over the five-year period of 11.7%, compared with 14.1% used in the calculation at 30 September 2023. The new lending forecasts are the key driver for the profit and cashflow forecasts. Cash flows beyond the five-year budget are extrapolated using a constant growth rate of 1.2% (2023: 1.2%) which does not exceed the long term average growth rates for the markets in which the business is active

  Management have concluded that the levels of activity assumed for the purpose of this forecast are reasonable, based on past experience and the current economic environment
- Discount rate, which is based on third-party estimates of the implied industry cost of capital. The pre-tax discount rate applied to the cash flow projection is 16.5% (2023: 16.2%)

As an illustration of the sensitivity of this impairment test to movements in key assumptions, the Group has calculated that a 0.0% growth rate combined with a 19.8% reduction in profit levels would eliminate the projected headroom of £91.7m. While such movements are not expected by management, they are considered 'reasonably possible' for the purposes of IAS 36. A 0.0% growth rate combined with an 22.6% reduction in profit levels would generate a write down of £10.0m.

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For the year ended 30 September 2024

23. INTANGIBLE ASSETS (CONTINUED)

In the testing carried out at 30 September 2023, a 0.0% growth rate combined with an 11.5% reduction in profit levels, would have eliminated the projected headroom at that date of £59.1m. A 0.0% growth rate combined with an 14.4% reduction in profit levels would have generated a write down of £10.0m.

(b) Development finance

The goodwill carried in the accounts relating to the development finance CGU was first recognised on a business acquisition in the year ended 30 September 2018.

An impairment review undertaken at 30 September 2024 indicated that no write down was required.

The recoverable amount of the development finance CGU used in this impairment testing is determined on a value in use basis using pre-tax cash flow projections based on financial budgets approved by the Board in November 2024 covering a five-year period.

The key assumptions underlying the value in use calculation for the development finance CGU are:

- Level of business activity, based on management expectations. The forecast assumes a CAGR for drawdowns over the five-year period of 15.6%, compared with 11.1% used in the calculation at 30 September 2023. Cash flows beyond the five-year budget are extrapolated using a constant growth rate of 1.2% (2023: 1.2%) which does not exceed the long-term average growth rate for the UK economy

  Management have concluded that the levels of activity assumed for the purpose of this forecast are reasonable, based on past experience and the current economic environment

- Discount rate, which is based on third party estimates of the implied industry cost of capital. The pre-tax discount rate applied to the cash flow projection is 16.4% (2023: 15.9%)

As an illustration of the sensitivity of this impairment test to movements in key assumptions, the Group has calculated that a 0.0% growth rate combined with a 9.5% reduction in profit levels would eliminate the projected headroom of £53.2m. While such movements are not expected by management, they are considered 'reasonably possible' for the purposes of IAS 36. A 0.0% growth rate combined with a 12.1% reduction in profit levels would generate a write down of £10.0m.

In the testing carried out at 30 September 2023 a 1.1% growth rate combined with a 3.1% reduction in profit levels would have eliminated the projected headroom at that date of £13.9m. A 0.2% growth rate combined with a 2.9% reduction in profit would have generated a write down of £10.0m.

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For the year ended 30 September 2024

24. RETAIL DEPOSITS

The Group's retail deposits, held by Paragon Bank PLC, were received from customers in the UK and are denominated in sterling. The deposits comprise principally term deposits, and notice and easy access accounts. The method of interest calculation on these deposits is analysed as follows:

	2024 £m	2023 £m	2022 £m
Fixed rate	8,257.2	8,690.2	6,201.3
Variable rates	8,040.8	4,575.1	4,467.9
	16,298.0	13,265.3	10,669.2

The weighted average interest rate on retail deposits at 30 September 2024, analysed by charging method, was:

	2024 %	2023 %	2022 %
Fixed rate	4.77	4.07	1.74
Variable rates	4.19	3.74	1.55
All deposits	4.49	3.95	1.66

The contractual maturity of these deposits is analysed below.

	2024 £m	2023 £m	2022 £m
Amounts repayable			
In less than three months	1,621.4	1,589.4	929.0
In more than three months, but not more than one year	4,847.1	5,193.7	3,732.1
In more than one year, but not more than two years	1,502.6	1,643.0	1,627.3
In more than two years, but not more than five years	615.0	631.8	421.4
Total term deposits	8,586.1	9,057.9	6,709.8
Repayable on demand	7,711.9	4,207.4	3,959.4
	16,298.0	13,265.3	10,669.2
Fair value adjustments for portfolio hedging (note 20)	16.7	(30.9)	(99.7)
	16,314.7	13,234.4	10,569.5

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For the year ended 30 September 2024

25. BORROWINGS

On 15 February 2024, Fitch Ratings affirmed the Group's Long-Term Issuer Default Rating at BBB+, with a stable outlook. It also affirmed the senior unsecured debt rating at BBB and the rating of the Group's Tier-2 bond at BBB-, with this security therefore enjoying an investment-grade rating.

At the same time Fitch Ratings assigned a BBB+ Long-term Issuer Default Rating to Paragon Bank PLC, the Group's principal operating subsidiary, the first time a company-level rating has been issued for this entity.

All borrowings described in the Group Accounts for the year ended 30 September 2023 remained in place throughout the period, except that the Groups remaining retail bond was repaid in August 2024, at its due date, and the Paragon Mortgages (No. 26) PLC securitisation was also repaid in August 2024.

Substantial prepayments were also made on central bank borrowings.

On 1 November 2023, a group company, Paragon Mortgages (No. 29) PLC, issued £855.0m of sterling mortgage-backed floating rate notes analysed below, at par.

Class	Fitch rating	Moody's rating	Interest margin above compounded SONIA	Principal value £m
A	AAA	Aaa	1.20%	747.0
B	AA	Aa1	1.90%	33.7
C	A-	Aa2	2.75%	29.3
D	B+	A2	3.80%	45.0
				855.0

All the above notes were retained by the Group.

Repayments made in respect of the Group's borrowings are shown in note 35.

The Group continued to make short-term drawings on sale and repurchase arrangements with UK banks, and on the Bank of England ILTR scheme during the year.

26. RETAIL BONDS

The Group's final outstanding issue of retail bonds, issued under its Euro Medium Term Note Programme, was repaid in the year, on 28 August 2024. These bonds were listed on the London Stock Exchange. The principal amount of notes in issue at 30 September 2023 was £112.5m and they bore interest at a fixed rate of 6.0% per annum.

The notes were unsubordinated unsecured liabilities of the Company and the amount included in the accounts of the Group and the Company in respect of these bonds at 30 September 2023 was £112.3m. No bonds remained outstanding at 30 September 2024.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

27. SUNDRY LIABILITIES

	Note	2024 £m	2023 £m	2022 £m
Amounts payable within one year				
Lease payables		2.9	2.6	2.2
Accrued interest		191.7	156.7	42.2
CSA liabilities	20	103.6	383.4	388.6
Purchase of own shares	31	23.8	-	10.8
Other sundry liabilities		50.1	47.2	46.2
		372.1	589.9	490.0
Amounts payable after more than one year				
Lease payables		5.0	6.3	6.8
Accrued interest		35.0	31.5	13.0
Other accruals		5.3	3.5	3.3
		45.3	41.3	23.1
Lease payables		7.9	8.9	9.0
Other sundry liabilities		409.5	622.3	504.1
Total sundry liabilities		417.4	631.2	513.1

28. CONDUCT

The Group, as a regulated participant in the financial services industry, is exposed to a high level of regulatory supervision, which could in the event of conduct failures expose it to additional liabilities. The objective of the Group's compliance and conduct framework, which is supervised by the second line compliance function, is to provide a strong mitigant to the risk, although it is impossible to eliminate it entirely.

As described below, there is significant uncertainty with regard to legal and regulatory interventions around commissions paid in the motor finance market. These processes are far from complete, and therefore the scope and extent of any exposure is unclear. It is also possible that the principles articulated in relation to the motor finance market may turn out to have a broader application.

The broader regulatory environment continues to develop, through regulatory policies, legislative rules and court rulings, and the Group's assessment of potential liabilities for issues relating to motor finance commission or other conduct issues, is based on our current interpretation of requirements and hence further liabilities may arise as these develop over time.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

28. CONDUCT (CONTINUED)

Motor finance commissions

During the year a number of issues were raised surrounding historical practices for the payment of commissions by lenders in the motor finance market. These claims have been pursued through various regulatory and legal routes. Paragon Bank, the Group's principal operating subsidiary was active in this market from 2014, the date of its authorisation, and had written approximately £1,270.0m of motor finance loans by 30 September 2024, and paid out £48.8m of commissions to support the origination of the loans. While the Group has not knowingly breached relevant regulations and does not believe that it has disadvantaged customers, the extent of any potential exposure will not become clear until the issues raised in these claims are clarified.

In January 2024 the FCA announced that it was conducting a review of the historical use of discretionary commission arrangements across the motor finance industry, following action taken in this field by the courts and the Financial Ombudsman Service ('FOS'). The FCA's original intention was to publish its policy on the treatment of such matters before 30 September 2024, but in July 2024 it announced that it required more time to address these issues and now expects to set out its next steps in May 2025. It also proposed to impose a pause on the handling of such complaints until December 2025, to allow for the development of any redress scheme that might be required.

On 25 October 2024, following the year end, the Court of Appeal handed down judgment in the cases of Hopcraft, Wrench and Johnson (the 'Hopcraft case'). This provided a ruling on claims involving 'secret' or 'half secret' commissions. In all of these cases the broker-dealers (who both sold the vehicle and arranged the finance) were deemed to owe a fiduciary duty to their customer. The disclosure of commission was either deemed insufficient or absent (and thus 'secret') or half-secret as the customer had not given informed consent. The lenders in question, First Rand and Close Brothers (the 'Lenders') were considered an accessory to such breach by the broker-dealer and thus held liable. The Lenders were ordered to pay the amount of commission plus interest from the day the loan was made. The Court of Appeal's common law principle goes over and above the current regulatory requirements and guidance concerning disclosure of commission (including the FCA's CONC rules). We are awaiting confirmation as to whether the Hopcraft case will be successfully appealed to the Supreme Court.

From 2014 to September 2024, the Group paid £9.0 million of commission to broker-dealers, comprising 18% of all motor commissions paid, with the balance being paid to brokers and a variety of other different forms of introducers, independent of the vehicle retailer, reflecting differing customer journeys.

The Group has reviewed its own lending practices for motor finance and has issued revised terms and conditions for both customers and intermediaries in late September 2024, addressing the points of law in Hopcraft.

The Group has considered its various exposures at 30 September 2024 and the differing customers journeys and fact patterns underlying them, together with both the potential costs of any remediation or settlement, any interest payable thereon and the legal and administrative costs which might be involved with the processing of any claims. For the broker-dealer cases noted above, where the broad fact patterns are similar to those in the Hopcraft case, and £9.0m of total commissions were originally paid, an estimate of the liability has been made, and no material provision was identified.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

28. CONDUCT (CONTINUED)

However, the case law in Hopcraft is specific to the fact patterns considered by the Court and therefore additional liabilities may exist in respect of other fact patterns, or from the results of the FCA review and other ongoing legal and regulatory processes which address different issues related to motor finance commissions. While these might impact on the Group's historical lending and result in additional cash outflows, any such amount is uncertain and therefore these are disclosed as contingent liabilities.

29. CALLED-UP SHARE CAPITAL

The share capital of the Company consists of a single class of £1 ordinary shares.

Movements in the issued share capital in the year were:

	2024 Number	2023 Number
Ordinary shares		
At 1 October 2023	228,700,413	241,409,624
Shares issued	-	160,833
Shares cancelled	(18,095,453)	(12,870,044)
At 30 September 2024	210,604,960	228,700,413

During the year ended 30 September 2023, the Company issued 160,833 shares to satisfy options granted under Sharesave schemes for a consideration of £543,954. No such issues were made in the year ended 30 September 2024.

On 1 June 2023, 12,870,044 of the shares held in treasury at that date were cancelled, with 12,095,453 further shares cancelled on 23 February 2024, and 6,000,000 cancelled on 30 August 2024 (note 31).

30. RESERVES

	2024 £m	2023 £m	2022 £m
Share premium account	71.4	71.4	71.1
Capital redemption reserve	31.0	12.9	71.8
Merger reserve	(70.2)	(70.2)	(70.2)
Profit and loss account	1,242.1	1,243.4	1,151.2
	1,274.3	1,257.5	1,223.9

The share premium account and capital redemption reserve are non-distributable reserves which are required by, and operate under the provisions of, UK company law.

The merger reserve arose, due to the provisions of UK company law at the time, on a group restructuring on 12 May 1989 when the Company became the parent entity of the Group.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS

For the year ended 30 September 2024

30. RESERVES (CONTINUED)

On 28 March 2023 the High Court confirmed the cancellation of the Company's capital redemption reserve, following shareholder approval at the AGM on 1 March 2023. This reserve had arisen on the cancellation of ordinary shares which had been purchased in the market and held in treasury. The balance outstanding on the capital redemption reserve at that time was transferred to the profit and loss account.

31. OWN SHARES

	2024 £m	2023 £m
Treasury shares		
Opening balance	54.0	18.2
Shares purchased	76.6	111.5
Options exercised	(4.3)	(8.4)
Shares cancelled	(110.0)	(67.3)
Closing balance	16.3	54.0
ESOP shares		
Opening balance	21.6	19.0
Shares purchased	12.9	9.0
Options exercised	(9.2)	(6.4)
Closing balance	25.3	21.6
Irrevocable authority to purchase		
Opening balance	-	10.8
Given in year	23.8	-
Expiring / utilised in year	-	(10.8)
Closing balance	23.8	-
Total closing balance	65.4	75.6
Total opening balance	75.6	48.0

At 30 September 2024 the number of the Company's own shares held in treasury was 2,124,162 (2023: 10,074,002). These shares had a nominal value of £2,124,162 (2023: £10,074,002). These shares do not qualify for dividends.

At 30 September 2024 an irrecoverable instruction for the purchase of shares with a market value of £23.8m to be held in treasury was in place. At 31 October 2024, when regulatory approval for the buy-back programme lapsed, £7.5m of this instruction remained outstanding.

The ESOP shares are held in trust for the benefit of employees exercising their options under the Company's share option schemes and awards under the Paragon PSP and Deferred Share Bonus Plan. The trustees' costs are included in the operating expenses of the Group.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

31. OWN SHARES (CONTINUED)

At 30 September 2024, the trust held 4,182,232 ordinary shares (2023: 4,009,490) with a nominal value of £4,182,232 (2023: £4,009,490) and a market value of £32,516,854 (2023: £19,727,084). Options, or other share-based awards, were outstanding against all of these shares at 30 September 2024 (2023: all). The dividends on all of these shares have been waived (2023: all).

32. EQUITY DIVIDEND

Amounts recognised as distributions to equity shareholders in the Group and the Company in the period:

	2024 Per share	2023 Per share	2024 £m	2023 £m
Equity dividends on ordinary shares				
Final dividend for the previous year	26.4p	19.2p	56.1	43.7
Interim dividend for the current year	13.2p	11.0p	27.4	24.2
	39.6p	30.2p	83.5	67.9

Amounts paid and proposed in respect of the year:

	2024 Per share	2023 Per share	2024 £m	2023 £m
Interim dividend for the current year	13.2p	11.0p	27.4	24.2
Proposed final dividend for the current year	27.2p	26.4p	55.6	56.7
	40.4p	37.4p	83.0	80.9

The proposed final dividend for the year ended 30 September 2024 will be paid on 7 March 2025, subject to approval at the AGM, with a record date of 6 February 2025. The dividend will be recognised in the accounts when it is paid.

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

33. NET CASH FLOW FROM OPERATING ACTIVITIES

	2024 £m	2023 £m
Profit before tax	253.8	199.9
Non-cash items included in profit and other adjustments:		
Depreciation of operating property, plant and equipment	5.4	4.0
(Profit) on disposal of operating property, plant and equipment	(0.1)	(0.1)
Amortisation and derecognition of intangible assets	1.2	3.6
Non-cash movements on investment securities	(7.8)	-
Non-cash movements on borrowings	4.5	(2.5)
Impairment losses on loans to customers	24.5	18.0
Charge for share based remuneration	9.2	9.6
Net (increase) / decrease in operating assets:		
Assets held for leasing	0.7	(2.7)
Loans to customers	(855.7)	(682.0)
Derivative financial instruments	223.6	163.6
Fair value of portfolio hedges	(304.1)	(180.6)
Other receivables	28.0	(15.0)
Net increase / (decrease) in operating liabilities:		
Retail deposits	3,032.7	2,596.1
Derivative financial instruments	59.8	(62.2)
Fair value of portfolio hedges	47.6	68.8
Other liabilities	(236.6)	128.3
Cash generated by operations	2,286.7	2,246.8
Income taxes (paid)	(70.3)	(75.1)
	2,216.4	2,171.7

Cash flows relating to plant and equipment held for leasing under operating leases are classified as operating cash flows.

34. NET CASH FLOW FROM INVESTING ACTIVITIES

	2024 £m	2023 £m
Investment in securities	(419.6)	-
Proceeds from sales of operating property, plant and equipment	0.3	0.1
Purchases of operating property, plant and equipment	(0.9)	(1.6)
Purchases of intangible assets	(4.5)	(1.6)
Net cash (utilised) by investing activities	(424.7)	(3.1)

NOTES TO THE FINANCIAL INFORMATION - ANALYSIS
For the year ended 30 September 2024

35. NET CASH FLOW FROM FINANCING ACTIVITIES

	2024 £m	2023 £m
Shares issued (note 29)	-	0.5
Dividends paid (note 32)	(83.5)	(67.9)
Repayment of asset backed floating rate notes	(28.3)	(382.1)
Repayment of retail bond	(112.5)	-
Repayment of long-term central bank facilities	(2,000.0)	-
Movement on short-term central bank facilities	5.0	-
Movement on other bank facilities	-	(586.0)
Movement on sale and repurchase agreements	50.0	50.0
Capital element of lease payments	(2.7)	(2.4)
Purchase of own shares (note 31)	(89.5)	(120.5)
Exercise of share awards	0.7	3.4
Net cash (utilised) by financing activities	(2,260.8)	(1,105.0)

36. RELATED PARTY TRANSACTIONS

During the year, certain directors of the Group were beneficially interested in savings deposits made with Paragon Bank, on the same terms as were available to members of the public. Deposits of £850,000 were outstanding at the year-end (2023: £720,000), and the maximum amounts outstanding during the year totalled £939,000 (2023: £771,000).

The Paragon Pension Plan (the 'Plan') is a related party of the Group. Transactions with the Plan are described in note 22.

The Group had no other transactions with related parties other than key management compensation.

NOTES TO THE FINANCIAL INFORMATION – CAPITAL AND FINANCIAL RISK
For the year ended 30 September 2024

The notes below describe the processes and measurements which the Group uses to manage their capital position and their exposure to financial risks including credit, liquidity and market risk. It should be noted that certain capital measures, which are presented to illustrate the Group's position, are not subject to audit. Where this is the case, the relevant disclosures are marked as such.

37. CAPITAL MANAGEMENT

The Group's objectives in managing capital are:

- To ensure that the Group has sufficient capital to meet its operational requirements and strategic objectives
- To safeguard the Group's ability to continue as a going concern, so that it can continue to provide returns to shareholders and benefits for other stakeholders
- To provide an adequate return to shareholders by pricing products and services commensurately with the level of risk
- To ensure that sufficient regulatory capital is available to meet any externally imposed requirements

The protection of the Group's capital base and its long-term viability are key strategic priorities.

The Group sets its target amount of capital in proportion to risk, availability and cost. The Group manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets, having particular regard to the relative costs and availability of debt and equity finance at any given time. In order to maintain or adjust the capital structure the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares, issue or redeem other capital instruments, such as retail or corporate bonds, or sell assets to reduce debt.

The Group is subject to regulatory capital rules imposed by the PRA on a consolidated basis as a group containing an authorised bank. This is discussed further below.

NOTES TO THE ACCOUNTS – CAPITAL AND CREDIT RISK

For the year ended 30 September 2024

37. CAPITAL MANAGEMENT (CONTINUED)

(a) Regulatory capital

The Group is subject to supervision by the PRA on a consolidated basis, as a group containing an authorised bank. For regulatory purposes the Company is designated as a CRR consolidation entity, as defined by the PRA rulebook. As part of this supervision the regulator will issue a Total Capital Requirement ('TCR') setting the amount of regulatory capital relative to its Total Risk Exposure ('TRE') which the Group is required to hold at all times, in order to safeguard depositors from loss through the business cycle. This requirement is set in accordance with the international Basel 3 rules, issued by the Basel Committee on Banking Supervision ('BCBS'), which are implemented through the PRA Rulebook.

The Group's regulatory capital is monitored by the Board, its Risk and Compliance Committee and by the Executive Risk Committee ('ERC') and the Asset and Liability Committee, which ensure that appropriate action is taken to ensure compliance with the regulator's requirements. The future regulatory capital requirement is also considered as part of the Group's forecasting and strategic planning process.

The Group has elected to take advantage of the IFRS 9 transitional arrangements set out in Article 473a of the CRR, which allow the capital impact of expected credit losses to be phased in over a five-year period. The phase-in factors applying to transition adjustments will allow for a 95% add back to CET1 capital and Risk Weighted Assets ('RWA') in the financial year ended 30 September 2019, reducing to 85%, 70%, 50% and 25% for the financial years ending in 2020 to 2023, with full recognition of the impact on CET1 capital in the current financial year.

As part of the regulatory response to Covid, Article 473a was revised to extend the transitional arrangements for Stage 1 and Stage 2 impairment provisions created in the financial year ended 30 September 2020 and the financial year ended 30 September 2021, while maintaining the transitional arrangements for impairment provisions created before those years. In order to increase institutions lending capacity in the short term, the EU determined that these additional provisions should be phased into capital over the financial years ending 30 September 2022 to 30 September 2024, rather than recognising the reduction in capital immediately.

Where these reliefs are taken, firms are also required to disclose their capital positions calculated as if the reliefs were not available (the 'fully loaded' basis). From 1 October 2024 the reliefs will be fully phased out and the fully loaded and regulatory bases for the Group will be equal.

The tables below demonstrate that at 30 September 2024 the Group's total regulatory capital of £1,327.9m (2023: £1,338.9m) exceeded the amounts required by the regulator, including £724.1m (2023: £673.4m) in respect of its TCR, which is comprised of fixed and variable elements (amounts not subject to audit).

The total regulatory capital at 30 September 2024 on the fully loaded basis of £1,325.2m (2023: £1,325.4m) was in excess of the TCR of £723.8m (2023: £672.2m) on the same basis (amounts not subject to audit).

At 30 September 2024, the Group's TCR represented 8.7% of TRE (2023: 8.8%).

The CRR also requires firms to hold additional capital buffers, including a Capital Conservation Buffer ('CCoB') of 2.5% of TRE (at 30 September 2024) (2023: 2.5%) and a Counter-cyclical Capital Buffer ('CCyB'), currently 2.0% of TRE (2023: 2.0%). This is expected to be the long-term rate of the CCyB in a standard risk environment. Firm specific buffers may also be required.

NOTES TO THE ACCOUNTS – CAPITAL AND CREDIT RISK
For the year ended 30 September 2024

37. CAPITAL MANAGEMENT (CONTINUED)

The Group's regulatory capital differs from its equity as certain adjustments are required by the PRA Rulebook. A reconciliation of the Group's equity to its regulatory capital determined which that capital accordance with the PRA Rulebook at 30 September 2024 is set out below.

	Note	Regulatory basis		Fully loaded basis	
		2024	2023	2024	2023
		£m	£m	£m	£m
Total equity		1,419.5	1,410.6	1,419.5	1,410.6
Deductions					
Proposed final dividend	32	(55.6)	(56.7)	(55.6)	(56.7)
IFRS 9 transitional relief	*	2.7	13.5	-	-
Intangible assets	23	(171.5)	(168.2)	(171.5)	(168.2)
Pension surplus net of deferred tax	22	(16.7)	(9.6)	(16.7)	(9.6)
Prudent valuation adjustments	§	(0.5)	(0.6)	(0.5)	(0.6)
Insufficient coverage	ψ	-	(0.1)	-	(0.1)
Common Equity Tier 1 ('CET1') capital		1,177.9	1,188.9	1,175.2	1,175.4
Other tier 1 capital		-	-	-	-
Total Tier 1 capital		1,177.9	1,188.9	1,175.2	1,175.4
Corporate bond		150.0	150.0	150.0	150.0
Eligibility cap	Φ	-	-	-	-
Total Tier 2 capital		150.0	150.0	150.0	150.0
Total regulatory capital ('TRC')		1,327.9	1,338.9	1,325.2	1,325.4

* Firms are permitted to phase in the impact of IFRS 9 transition as described above.

§ For capital purposes, assets and liabilities held at fair value, such as the Group's derivatives, are required to be valued on a more conservative basis than the market value basis set out in IFRS 13. This difference is represented by the prudent valuation adjustment above, calculated using the 'Simplified Approach' set out in the PRA Rulebook.

ψ Regulatory deduction where there is insufficient coverage for non-performing exposures required under AT1BCAGR 47(c) of the CRR. This remained in force in the UK, under the Brexit arrangements, but was removed by the PRA with effect from 14 November 2023.

Φ The PRA Rulebook restricts the amount of tier 2 capital which is eligible for regulatory purposes to 25% of TCR.

NOTES TO THE ACCOUNTS – CAPITAL AND CREDIT RISK

For the year ended 30 September 2024

37. CAPITAL MANAGEMENT (CONTINUED)

The TRE amount calculated under the PRA Rulebook framework against which this capital is held, which includes Risk Weighted Asset ('RWA') amounts for credit risk, and the proportion of the TRE which that capital represents, are calculated as shown below.

	Regulatory basis		Fully loaded basis	
	2024	2023	2024	2023
	£m	£m	£m	£m
Credit risk				
Balance sheet assets	7,303.0	6,784.2	7,303.0	6,784.3
Off balance sheet	95.8	87.2	95.8	87.2
IFRS 9 transitional relief	2.7	13.5	-	-
Total credit risk	7,401.5	6,884.9	7,398.8	6,871.5
Operational risk	848.0	740.2	848.0	740.2
Market risk	-	-	-	-
Other	29.2	43.6	29.2	43.6
Total risk exposure amount ('TRE')	8,278.7	7,668.7	8,276.0	7,655.3
Solvency ratios	%	%	%	%
CET1	14.2	15.5	14.2	15.4
TRC	16.0	17.5	16.0	17.3

This table is not subject to audit

The risk weightings for credit risk exposures are currently calculated using the Standardised Approach ('SA'). The Basic Indicator Approach is used for operational risk.

NOTES TO THE ACCOUNTS – CAPITAL AND CREDIT RISK

For the year ended 30 September 2024

37. CAPITAL MANAGEMENT (CONTINUED)

Leverage ratio

The table below shows the calculation of the Group's leverage ratio as defined in the PRA Rulebook. This rate is based on consolidated balance sheet assets adjusted as shown. The PRA has set a minimum UK leverage ratio of 3.25% for UK firms with retail deposits of over £50.0 billion, or with significant overseas assets. In addition, in October 2021 the PRA stated its expectation that all other UK firms, such as the Group, should manage their leverage risk so that this ratio does not ordinarily fall below 3.25%.

	Note	2024 £m	2023 £m
Total balance sheet assets		19,270.0	18,420.2
Add: Credit fair value adjustments on loans to customers	13	75.2	379.3
Debit fair value adjustments on retail deposits	24	-	30.9
Adjusted balance sheet assets		19,345.2	18,830.4
Less: Derivative assets	20	(391.8)	(615.4)
Central bank deposits	11	(2,315.5)	(2,783.3)
CRDs	21	-	(38.0)
Accrued interest on sovereign exposures		(3.8)	(4.2)
On-balance sheet items		16,634.1	15,389.5
Less: Intangible assets	23	(171.5)	(168.2)
Pension surplus	22	(22.2)	(12.7)
Total on balance sheet exposures		16,440.4	15,208.6
Regulatory exposure for derivatives		154.7	179.6
Total derivative exposures		154.7	179.9
Post offer pipeline at gross notional amount		1,210.2	993.3
Adjustment to convert to credit equivalent amounts		(1,000.1)	(815.7)
Off balance sheet items		210.1	177.6
Tier 1 capital		1,177.9	1,188.9
Total leverage exposure before IFRS 9 relief		16,805.2	15,565.8
IFRS 9 relief		2.7	13.5
Total leverage exposure		16,807.9	15,579.3
UK leverage ratio		7.0%	7.6%

This table is not subject to audit

NOTES TO THE ACCOUNTS – CAPITAL AND CREDIT RISK
For the year ended 30 September 2024

37. CAPITAL MANAGEMENT (CONTINUED)

The fully loaded leverage ratio is calculated as follows

	2024 £m	2023 £m
Fully loaded Tier 1 capital	1,175.2	1,175.4
Total leverage exposure before IFRS 9 relief	16,805.2	15,565.8
Fully loaded UK leverage exposure	7.0%	7.6%

This table is not subject to audit

The Group calculates regulatory exposure on derivatives using the Standardised Approach for Counterparty Credit Risk ('SA-CCR'), which includes elements based on the market value of derivative assets adjusted for collateral, amongst other things, and based on potential future exposure in respect of all derivatives held.

The UK leverage ratio is prescribed by the PRA and differs from the leverage ratio defined by Basel due to the exclusion of central bank balances from exposures.

Capital requirements in subsidiary entities

The regulatory capital disclosures in these financial statements relate only to the consolidated position for the Group. Individual entities within the Group are also subject to supervision on a standalone basis. All such entities complied with the requirements to which they were subject during the year.

NOTES TO THE ACCOUNTS – CAPITAL AND CREDIT RISK

For the year ended 30 September 2024

37. CAPITAL MANAGEMENT (CONTINUED)

(b) Return on tangible equity ('RoTE')

RoTE is a measure of an entity's profitability used by investors. RoTE is defined by the Group by comparing the profit after tax for the year, adjusted for amortisation charged on intangible assets, to the average of the opening and closing equity positions, excluding intangible assets and goodwill.

It effectively reflects a return on equity as if all intangible assets are eliminated immediately against reserves. As this is similar to the approach used for the capital of financial institutions it is widely used in the sector.

The Group's consolidated RoTE for the year ended 30 September 2024 is derived as follows:

	Note	2024 £m	2023 £m
Profit for the year after tax		186.0	153.9
Amortisation and derecognition of intangible assets		1.2	3.6
Adjusted profit		187.2	157.5
Divided by			
Opening equity		1,410.6	1,417.3
Opening intangible assets	23	(168.2)	(170.2)
Opening tangible equity		1,242.4	1,247.1
Closing equity		1,419.5	1,410.6
Closing intangible assets	23	(171.5)	(168.2)
Closing tangible equity		1,248.0	1,242.4
Average tangible equity		1,245.2	1,244.7
Return on Tangible Equity		15.0%	12.7%

This table is not subject to audit

(c) Dividend and distribution policy

The Company is committed to a long-term sustainable dividend policy. Ordinarily, dividends will increase in line with earnings, subject to the requirements of the business and the availability of cash resources. The Board reviews the policy at least twice a year in advance of announcing its results, taking into account the Group's strategy, capital requirements, principal risks and the objective of enhancing shareholder value.

In determining the level of dividend for any year, the Board expects to follow the dividend policy, but will also take into account the level of available retained earnings in the Company, its cash resources and the cash and capital requirements inherent in its business plans. In addition to the payment of dividends, the Board may also consider whether it is appropriate to apply excess capital in the market purchase of the Group's shares.

NOTES TO THE ACCOUNTS – CAPITAL AND CREDIT RISK
For the year ended 30 September 2024

37. CAPITAL MANAGEMENT (CONTINUED)

The distributable reserves of the Company comprise its profit and loss account balance (note 30) and, other than the regulatory requirement to retain an appropriate level of capital in Paragon Bank PLC, there are no restrictions preventing profits elsewhere in the Group from being distributed to the parent.

Since the year ended 30 September 2018, the Company has adopted a policy of paying out approximately 40% of its basic earnings per share as dividend (a dividend cover ratio of around 2.5 times), in the absence of any idiosyncratic factors which might make such a dividend inappropriate. This policy is reviewed by the Board at least annually. The Company considers it has access to sufficient cash resources to pay dividends at this level and that its distributable reserves are abundant for this purpose.

To provide greater transparency, the Board also adopted a policy of paying an interim dividend in each year equivalent to half of the preceding final dividend in the absence of any factors which might make such a distribution inappropriate. For the current year, based on its review of the Group's capital position and forecasts, the Board determined that an interim dividend in line with this policy was appropriate. It therefore declared an interim dividend for the year of 13.2p per share (2023: 11.0p per share). The Board also confirmed that the Group's normal approach of paying an interim dividend of 50% of the preceding year's final dividend would continue to apply in future years.

The appropriate level of final dividend for the current year was considered by the Board in light of economic and regulatory developments in the year, and the various potential paths for the UK economy. In particular the levels of provision in the Group's loan portfolios and the potential for further provision under stress in the event of a worsening UK economic position were considered by the Board. These were compared to the regulatory capital position at the year end along with the capital impacts of stress testing carried out as part of the ICAAP and forecasting processes, and the potential impacts of ongoing developments in the regulatory regime for capital including the introduction in the UK of Basel 3.1.

The Board particularly considered the appropriateness of including net losses relating to fair value adjustments from hedging in the calculation of any dividend or distribution, as these primarily result from the reversal of gains recorded in earlier years which were disregarded, at the time, for the purpose of determining dividends. Given the size of such adjustments in the period, the Board concluded that their inclusion was not consistent with its overarching aim of delivering a sustainable dividend which grows with the earnings of the business. This is in line with the approach adapted in previous years.

On the basis of this analysis the Board concluded that a total dividend of around 40% of earnings excluding fair value items could be paid.

The Board will therefore propose a final dividend for the year of 27.2p per share (2023: 26.4p per share) for approval at the 2025 AGM, making a total dividend for the year of 40.4p per share (2023: 37.4p per share).

A share buy-back programme for the current financial year, for up to £50.0m of ordinary shares was authorised at the time of the Group's 2023 results announcement. This was extended to £100.0m in June 2024. The amount expended in the year was £76.6m (note 31) and the share buy-back continued after the year end, until regulatory authority for the programme lapsed on 31 October 2024, under an irrecoverable purchase instruction given to the Group's brokers shortly before the end of the financial year.

NOTES TO THE ACCOUNTS – CAPITAL AND CREDIT RISK
For the year ended 30 September 2024

37. CAPITAL MANAGEMENT (CONTINUED)

As part of its consideration of capital described above the Board of Directors authorised the completion of the remaining £7.5m of the buy-back programme described above together with a new buy-back of up to £50.0m to commence shortly after the announcement of the 2024 results. All shares acquired in buy-back programmes are initially held in treasury.

The directors have considered the distributable resources of the Company and concluded that these distributions are appropriate.

The most recent policy review, in November 2024, also confirmed the existing dividend policy would continue to apply for future periods, subject to the impact of any future events, and the Board will consider the appropriateness and scale of any interim dividend in the context of the Group's results and the operating and economic environment at the time. Share buy-backs will be considered where excess capital has arisen, either operationally or as a result of changed regulatory requirements.

NOTES TO THE ACCOUNTS – CAPITAL AND CREDIT RISK
For the year ended 30 September 2024

38. CREDIT RISK

Loans to customers

The Group's credit risk is primarily attributable to its loans to customers and its business objectives rely on maintaining a high-quality customer base and place strong emphasis on prudent credit management, both at the time of acquiring or underwriting a new loan, where robust lending criteria are applied, and throughout the loan's life.

The Group's balance sheet loan assets at 30 September 2024 are analysed as follows:

	2024		2023	
	£m	%	£m	%
Buy-to-let mortgages	13,279.3	84.6%	12,720.1	85.6%
Owner-occupied mortgages	20.3	0.1%	27.7	0.1%
Total first charge residential mortgages	13,299.6	84.7%	12,747.8	85.7%
Second charge mortgage loans	116.1	0.7%	154.5	1.0%
Loans secured on residential property	13,415.7	85.4%	12,902.3	86.7%
Development finance	884.0	5.6%	747.8	5.0%
Loans secured on property	14,299.7	91.0%	13,650.1	91.7%
Asset finance loans	633.2	4.1%	559.1	3.8%
Motor finance loans	331.4	2.1%	297.7	2.0%
Aircraft mortgages	31.2	0.2%	26.9	0.2%
Secured BBB schemes	31.0	0.2%	50.5	0.4%
Structured lending	256.9	1.6%	169.0	1.1%
Invoice finance	32.7	0.2%	31.7	0.2%
Total secured loans	15,616.1	99.4%	14,785.0	99.4%
Professions finance	53.0	0.3%	52.2	0.4%
Unsecured BBB schemes	10.5	0.1%	16.7	0.1%
Other unsecured commercial loans	25.9	0.2%	20.4	0.1%
Total loans to customers	15,705.5	100.0%	14,874.3	100.0%

First and second charge mortgages are secured by charges over residential properties in England and Wales, or similar Scottish or Northern Irish securities.

Development finance loans are secured by a first charge (or similar Scottish security) over the development property and various charges over the build.

Asset finance loans and motor finance loans are effectively secured by the financed asset, while aircraft mortgages are secured by a charge on the aircraft funded.

Structured lending and invoice finance balances are effectively secured over the assets of the customer, with security enhanced by maintaining balances at a level less than the total amount of the security (the advance percentage).

Professions finance balances are generally short term unsecured loans made to firms of lawyers and accountants for working capital purposes.

Loans made under BBB supported schemes have the benefit of a guarantee underwritten by the UK Government.

NOTES TO THE ACCOUNTS – CAPITAL AND CREDIT RISK

For the year ended 30 September 2024

38. CREDIT RISK (CONTINUED)

There are no significant concentrations of credit risk to individual counterparties due to the large number of customers included in the portfolios. All lending is to customers within the UK. The total gross carrying value of the Group's loans to customers due from customers with total portfolio exposures over £10.0m is analysed below by product type.

	2024 £m	2023 £m
Buy-to-let mortgages	162.0	149.6
Development finance	497.9	390.6
Structured lending	239.3	160.3
Asset finance	11.5	24.6
	910.7	725.1

The threshold of £10.0m is used internally for monitoring large exposures.

NOTES TO THE ACCOUNTS – CAPITAL AND CREDIT RISK

For the year ended 30 September 2024

38. CREDIT RISK (CONTINUED)

Credit grading

An analysis of the Group's loans to customers by absolute level of credit risk at 30 September 2024 is set out below. The analysed amount represents gross carrying amount.

	Stage 1 £m	Stage 2 £m	Stage 3 £m	POCI £m	Total £m
30 September 2024					
Very low risk	12,028.0	75.6	1.1	3.3	12,108.0
Low risk	2,194.7	343.9	44.9	0.7	2,584.2
Moderate risk	182.1	199.5	16.4	1.4	399.4
High risk	127.6	78.1	12.4	3.0	221.1
Very high risk	37.0	76.3	205.2	8.2	326.7
Not graded	135.8	2.7	3.6	0.5	142.6
Total gross carrying amount	14,705.2	776.1	283.6	17.1	15,782.0
Impairment	(16.0)	(7.2)	(50.8)	(2.5)	(76.5)
Total loans to customers	14,689.2	768.9	232.8	14.6	15,705.5
30 September 2023					
Very low risk	11,393.7	23.0	1.9	6.6	11,425.2
Low risk	2,236.4	395.5	73.8	2.5	2,708.2
Moderate risk	157.1	147.3	9.7	1.8	315.9
High risk	34.0	113.3	13.6	3.2	164.1
Very high risk	37.7	63.3	104.1	9.3	214.4
Not graded	113.4	2.4	2.9	1.4	120.1
Total gross carrying amount	13,972.3	744.8	206.0	24.8	14,947.9
Impairment	(19.6)	(9.4)	(39.8)	(4.8)	(73.6)
Total loans to customers	13,952.7	735.4	166.2	20.0	14,874.3

Gradings above are based on credit scorecards or internally assigned risk ratings as appropriate for the individual asset class. These measures are calibrated across product types and used internally to monitor the Group's overall credit risk profile against its risk appetite.

These gradings represent current credit quality on an absolute basis and this may result in assets in higher IFRS 9 stages with low risk grades, especially where a case qualifies through breaching, for example, an arrears threshold but is making regular payments. This will apply especially to Stage 3 cases reported in note 16, other than those shown as 'realisations'.

Examples of lower risk cases in higher IFRS 9 stages include fully up-to-date receiver of rent cases; accounts where the customer is in arrears on their account with the Group but up to date on accounts with other lenders, creating an overall positive credit rating; and accounts where the default on the Group's loan has yet to impact on the external credit score.

NOTES TO THE ACCOUNTS – CAPITAL AND CREDIT RISK

For the year ended 30 September 2024

38. CREDIT RISK (CONTINUED)

A small proportion of the loan book (2024: 0.9%, 2023: 0.8%) is classed as 'not graded' above. This rating generally relates to loans that have been fully underwritten at origination but where the customer falls outside the automated assessment techniques used post-completion.

Credit characteristics by portfolio

Loans secured on residential property

First mortgage loans have a contractual term of up to thirty-five years and second charge mortgage loans up to twenty five years. In all cases the customer is entitled to settle the loan at any point and in most cases early settlement does take place. All customers on these accounts are required to make monthly payments.

An analysis of the indexed Loan-to-Value ('LTV') ratio for those loan accounts secured on residential property by value at 30 September 2024 is set out below. LTVs for second charge mortgages are calculated allowing for the interest of the first charge holder, based on the most recent first charge amount held by the Group, while for acquired accounts the effect of any discount on purchase is allowed for.

	First charge mortgages		**Second charge mortgages**	
	2024	**2023**	**2024**	**2023**
	%	**%**	**%**	**%**
Loan to value ratio				
Less than 70%	71.5	72.7	96.1	94.6
70% to 80%	25.9	23.8	2.3	3.2
80% to 90%	1.7	2.5	0.8	0.9
90% to 100%	0.2	0.2	0.2	0.3
Over 100%	0.7	0.8	0.6	1.0
	100.0	100.0	100.0	100.0
Average LTV ratio	62.8	62.7	50.3	52.3
Of which:				
Buy-to-let	62.8	62.8		
Owner-occupied	38.9	39.0		

The regionally indexed LTVs shown above are affected by changes in house prices, with the Nationwide house price index, for the UK as a whole, registering an annual increase of 3.2% in the year ended 30 September 2024 (2023: decrease of 5.3%).

NOTES TO THE ACCOUNTS – CAPITAL AND CREDIT RISK

For the year ended 30 September 2024

38. CREDIT RISK (CONTINUED)

The geographical distribution of the Group's residential mortgage assets by gross carrying value is set out below.

	First Charge		Second Charge	
	2024	2023	2024	2023
	%	%	%	%
East Anglia	3.3	3.3	3.3	3.4
East Midlands	6.0	5.9	6.3	6.2
Greater London	18.0	18.2	7.5	7.4
North	3.4	3.5	4.4	4.2
North West	10.1	10.3	7.4	7.5
South East	31.0	30.6	37.8	37.8
South West	9.1	9.0	8.0	8.4
West Midlands	6.3	6.2	7.2	7.3
Yorkshire and Humberside	7.1	7.4	6.0	6.2
Total England	94.3	94.4	87.9	88.4
Northern Ireland	-	-	2.5	2.3
Scotland	2.6	2.5	5.8	5.5
Wales	3.1	3.1	3.8	3.8
	100.0	100.0	100.0	100.0

Development finance

Development finance loans have an average term of 28 months (2023: 26 months). Settlement of principal and accrued interest takes place either on the sale of the development, or units within it, where appropriate, or on the refinancing of the property following its completion. The customer is not normally required to make payments during the term of the loan. The loans are secured by a legal charge over the site and/or property together with other charges and warranties related to the build.

As customers are not required to make payments during the life of the loan, arrears and past due measures cannot be used to monitor credit risk. Instead, cases are monitored on an individual basis against the costs and progress in the agreed development programme by management and Credit Risk. The average loan to gross development value ('LTGDV') ratio for the portfolio at year end, a measure of security cover, is analysed below.

	2024	2024	2023	2023
	By value	By number	By value	By number
LTGDV	%	%	%	%
50% or less	12.4	8.9	8.2	6.1
50% to 60%	13.4	20.1	17.3	21.7
60% to 65%	27.5	27.3	37.7	33.0
65% to 70%	24.1	30.1	25.5	27.4
70% to 75%	8.1	7.2	5.8	7.4
Over 75%	14.5	6.4	5.5	4.4
	100.0	100.0	100.0	100.0

NOTES TO THE ACCOUNTS – CAPITAL AND CREDIT RISK

For the year ended 30 September 2024

38. CREDIT RISK (CONTINUED)

The average LTGDV cover at the year end was 63.0% (2023: 63.1%).

LTGDV is calculated by comparing the current expected end of term exposure with the latest estimate of the value of the completed development based on surveyors' reports. The focus on residential property development within the portfolio means that asset values will generally move in line with the UK residential property market.

At 30 September 2024, the development finance portfolio comprised 251 accounts (2023: 230) with a total carrying value of £884.0m (2023: £747.8m). Of these accounts 17 were included in Stage 2 at 30 September 2024 (2023: 15), with 19 accounts classified as Stage 3 (2023: 12). In addition, one acquired account had been classified as POCI (2023: one). An allowance for this loss was made in the IFRS 3 fair value calculation.

The geographical distribution of the Group's development finance loans by gross carrying value is set out below.

	2024	2023
	%	%
East Anglia	4.6	4.4
East Midlands	11.2	11.8
Greater London	11.0	11.8
North	0.6	0.8
North West	0.7	0.4
South East	33.9	34.0
South West	19.7	21.3
West Midlands	7.9	6.2
Yorkshire and Humberside	6.1	6.6
Total England	95.7	97.3
Northern Ireland	-	-
Scotland	3.8	2.7
Wales	0.5	-
	100.0	100.0

NOTES TO THE ACCOUNTS – CAPITAL AND CREDIT RISK

For the year ended 30 September 2024

38. CREDIT RISK (CONTINUED)

Asset finance and motor finance

Asset and motor finance lending includes finance lease and hire purchase arrangements, which are accounted for as finance leases under IFRS 16. The average contractual life of the asset finance loans was 51 months (2023: 49 months) while that of the motor finance loans was 69 months (2023: 68 months), but historical behaviour suggests that a significant proportion of customers will choose to settle their obligations early.

Asset finance customers are generally small or medium sized businesses. The nature of the assets underlying the Group's asset finance lending, including loans financed through BBB sponsored schemes, by gross carrying value is set out below.

	2024 %	2023 %
Commercial vehicles	45.3	41.9
Construction plant	29.4	30.9
Manufacturing	5.3	6.3
Technology	4.2	4.8
Other vehicles	4.4	4.7
Refuse disposal vehicles	4.2	3.4
Agriculture	1.6	2.1
Print and paper	1.1	1.6
Other	4.5	4.3
	100.0	100.0

Motor finance loans are secured over cars, leisure vehicles (motorhomes, caravans and campervans) and light commercial vehicles and represent exposure to consumers and small businesses.

Structured lending

The Group's structured lending division provides revolving loan facilities to support non-bank lending businesses. Loans are made to a Special Purpose Vehicle ('SPV') company controlled by the customer and effectively secured on the loans made by the SPV. Exposure is limited to a percentage of the underlying assets, providing a buffer against credit loss.

Summary details of the structured lending portfolio are set out below.

	2024	2023
Number of active facilities	11	9
Total facilities (£m)	330.0	235.7
Carrying value (£m)	256.9	169.0

The maximum advance under these facilities was generally 80% of the underlying assets, except where loans secured by residential property form the security for the facility, where 90% is permissible.

NOTES TO THE ACCOUNTS – CAPITAL AND CREDIT RISK
For the year ended 30 September 2024

38. CREDIT RISK (CONTINUED)

Customers are charged interest on their drawn balance at a rate linked to SONIA, and a commitment fee on the undrawn amount of their facility. However, there is generally no requirement to make regular payments of specific amounts, with the facilities operating on a revolving basis, able to be paid down and redrawn over their term.

The performance of each loan is monitored monthly on a case by case basis by the Group's Credit Risk function, assessing compliance with covenants relating to both the customer and the performance and composition of the asset pool. These assessments, which are reported to Credit Committee, are used to inform the assessment of expected credit loss under IFRS 9.

At 30 September 2024 one of these facilities was identified as Stage 2 (2023: none) with the remainder in Stage 1.

BBB supported schemes

These schemes are managed by the British Business Bank ('BBB') and loans made them have the benefit of guarantees underwritten by the UK Government. They were originally launched as a response to the impact of Covid on UK SMEs, but remain in place.

The Coronavirus Business Interruption Loan Scheme ('CBILS') and the Bounce Back Loan Scheme ('BBLS') were launched in 2020 and remained open for new applications until March 2021. The Recovery Loan Scheme ('RLS') was launched in April 2021 as a successor scheme and has subsequently been extended twice. It was available for new lending until June 2024 at which point it was rebranded as the Growth Guarantee Scheme ('GGS'), on broadly similar terms.

The Group offered term loans and asset finance loans under the CBIL scheme. Interest and fees were paid by the UK Government for the first twelve months and the government guarantee covers up to 80% of the lender's principal loss after the application of any proceeds from the asset financed (if applicable).

Loans under the BBL scheme are six year term loans at a standard 2.5% per annum interest rate. The UK Government paid the interest on the loan for the first twelve months and provides lenders with a guarantee covering the whole outstanding balance.

The Group offers term loans and asset finance loans under the RLS. Interest and fees are payable by the customer from inception. The Government guarantee covers up to 80% of the lender's principal loss, after the application of any proceeds from the asset financed (if applicable), on applications received before 1 January 2022 and up to 70% for applications received thereafter under the RLS or under the successor GGS.

NOTES TO THE ACCOUNTS – CAPITAL AND CREDIT RISK

For the year ended 30 September 2024

38. CREDIT RISK (CONTINUED)

The Group's outstanding RLS / GGS, CBILS and BBLS loans at 30 September 2024 were:

	2024 £m	2023 £m
RLS / GGS		
Term loans	0.6	1.0
Asset finance	23.4	36.0
Total RLS	24.0	37.0
CBILS		
Term loans	7.7	12.6
Asset finance	7.6	14.5
Total CBILS	15.3	27.1
BBLS	2.2	3.1
	41.5	67.2
Total term loans	10.5	16.7
Total asset finance	31.0	50.5
	41.5	67.2

At 30 September 2024, £0.5m of this balance was considered to be non-performing (2023: £0.7m).

NOTES TO THE ACCOUNTS – CAPITAL AND CREDIT RISK
For the year ended 30 September 2024

38. CREDIT RISK (CONTINUED)

Arrears performance

The number of accounts in arrears by asset class, based on the most commonly quoted definition of arrears for the type of asset, at 30 September 2024 and 30 September 2023, compared to the industry averages at those dates published by UK Finance ('UKF') and the Finance and Leasing Association ('FLA'), was:

	2024	2023
	%	%
First mortgages		
Accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	0.38	0.34
Buy-to-let accounts excluding receiver of rent cases	0.19	0.15
Owner-occupied accounts	6.59	2.93
UKF data for mortgage accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	0.86	0.64
Buy-to-let accounts excluding receiver of rent cases	0.76	0.60
Owner-occupied accounts	0.97	0.87
All mortgages	0.93	0.82
Second charge mortgage loans		
Accounts more than 2 months in arrears		
All accounts	24.63	23.48
Post-2010 originations	2.92	2.42
Legacy cases (pre-2010 originations)	26.88	26.58
Purchased assets	31.47	30.10
FLA data for second mortgage loans	6.50	6.30
Motor finance loans		
Accounts more than 2 months in arrears		
All accounts	1.06	1.08
Originated cases	1.06	1.07
Purchased assets	1.13	1.32
FLA data for consumer point of sale hire purchase	4.10	3.60
Asset finance loans		
Accounts more than 2 months in arrears	0.14	0.23
FLA data for business lease / hire purchase loans	0.70	0.60

No published industry data for asset classes comparable to the Group's other books has been identified. Where revised data at 30 September 2023 has been published by the FLA or UKF, the comparative industry figures above have been amended.

Arrears information is not given for development finance, structured lending or invoice finance activities as the structure of the products means that such a measure is not appropriate.

NOTES TO THE ACCOUNTS – CAPITAL AND CREDIT RISK

For the year ended 30 September 2024

38. CREDIT RISK (CONTINUED)

The Group calculates its headline arrears measure for buy-to-let mortgages, shown above, based on the numbers of accounts three months or more in arrears, including purchased assets, but excluding those cases in possession and receiver of rent cases designated for sale. This is consistent with the methodology used by UKF in compiling its statistics for the buy-to-let mortgage market as a whole.

The number of accounts in arrears will naturally be higher for legacy books, such as the Group's legacy second charge mortgages and residential first mortgages than for comparable active ones, as performing accounts pay off their balances, leaving arrears accounts representing a greater proportion of the total.

The figures shown above for second charge mortgage loans incorporate purchased portfolios which generally include a high proportion of cases in arrears at the time of purchase and where this level of performance is allowed for in the discount to current balance represented by the purchase price. However, this will lead to higher than average reported arrears.

Acquired assets

A significant proportion of the Group' second charge mortgage balances were part of purchased debt portfolios, where the consideration paid was based on the credit quality and performance of the loans at the point of the transaction. No additional loans to customers treated as POCI were acquired in the year ended 30 September 2023 or the year ended 30 September 2024.

Collections on purchased accounts have been comfortably in excess of those implicit in the purchase prices.

In the debt purchase industry, Estimated Remaining Collections ('ERC') is commonly used as a measure of the value of a portfolio. This is defined as the sum of the undiscounted cash flows expected to be received over a specified future period. In the Group's view, this measure may be suitable for heavily discounted, unsecured, distressed portfolios (which will be treated as POCI under IFRS 9), but is less applicable for the types of portfolio in which the Group has invested, where cash flows are higher on acquisition, loans may be secured on property and customers may not be in default. In such cases, the IFRS 9 amortised cost balance, at which these assets are carried in the Group balance sheet, provides a better indication of value.

NOTES TO THE ACCOUNTS – CAPITAL AND CREDIT RISK

For the year ended 30 September 2024

38. CREDIT RISK (CONTINUED)

However, to aid comparability, the 84 and 120 month ERCs value for the Group's purchased consumer loan assets, are set out below. These are derived using the same models and assumptions used in the EIR calculations. ERCs are set out both for all purchased consumer portfolios and for those classified as POCI under IFRS 9.

	2024 £m	2023 £m	2022 £m
All purchased consumer assets			
Carrying value	41.1	58.6	75.3
84 month ERCs	48.6	68.9	88.6
120 month ERCs	52.9	73.4	94.2
POCI assets only			
Carrying value	10.6	17.7	21.4
84 month ERCs	15.6	24.5	29.9
120 month ERCs	18.7	27.8	33.0

Amounts shown above are disclosed as loans to customers (note 13). They include first mortgages and second charge mortgage loans.

NOTES TO THE FINANCIAL INFORMATION – BASIS OF PREPARATION

For the year ended 30 September 2024

The notes set out below describe the accounting basis on which the Group and the Company prepare their accounts, the particular accounting policies adopted by the Group and the principal judgements and estimates which were required in the preparation of the financial statements.

They also include other information describing how the accounts have been prepared required by legislation and accounting standards.

39. ACCOUNTING POLICIES

The preliminary financial information has been prepared on the basis of the accounting policies used in the production of the financial statements for the year.

The Group is required, by the Companies Act 2006 and the Listing Rules of the FCA, to prepare its financial statements for the year ending 30 September 2024 in accordance with UK-adopted international accounting standards. In the financial years reported on this also means, in the Group's circumstances, that the financial statements also accord with IFRS as approved by the International Accounting Standards Board.

The requirements of UK-adopted IFRS have not changed for the current year and therefore the accounting policies adopted in the current year are the same as those set out in the 2023 Annual Report and Accounts of the Group.

In addition, the investment securities described in note 11 are held as part of the Group's liquidity buffer. They are therefore classified as 'held to collect', following an example set out in IFRS 9. These securities are carried at amortised cost, with income recognised on an EIR basis.

The Group has historically chosen to present an additional comparative balance sheet.

IFRS 18

On 9 April 2024 the IASB issued IFRS 18 – 'Presentation and Disclosure in Financial Statements'. This is expected to impact the way in which information is disclosed in financial statements without impacting materially on the underlying accounting.

IFRS 18 is expected to apply to the Group with effect from its financial year ending 30 September 2028 if the standard is endorsed for use in the UK. A detailed exercise to determine the impact of the new Standard on the Group's annual and half-year reporting will be carried out before the implementation date.

New and revised reporting standards

In the preparation of these consolidated financial statements, no accounting standards are being applied for the first time.

Other than IFRS 18, described above, there are no new reporting standards and interpretations in issue but not effective which address matters relevant to the Group's accounting and reporting.

No new or revised reporting standards significantly affecting the Group's accounting have been issued since the approval of the Group's financial statements for the year ended 30 September 2023, other than IFRS 18.

D2.4 NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2024

39. ACCOUNTING POLICIES (CONTINUED)

Going concern basis

The going concern basis has been adopted in the preparation of this preliminary financial information. The reasons for the adoption of this basis are set out in note 39.

40. CRITICAL ACCOUNTING JUDGEMENTS

The most significant judgements which the directors have made in the application of the accounting policies relate to:

(a) Significant Increase in Credit Risk ('SICR')

Under IFRS 9, the directors are required to assess where a credit obligation has suffered a Significant Increase in Credit Risk ('SICR'). The directors' assessment is based primarily on changes in the calculated PD, but also includes consideration of other qualitative indicators and the adoption of the backstop assumption in the Standard that all cases which are more than 30 days overdue have an SICR, for account types where days overdue is an appropriate measure.

As part of its consideration of the adequacy of its impairment provisioning, management have considered whether there are any factors not reflected in its normal approach which indicate that a group, or groups of accounts should be considered as having an SICR. No such accounts were identified.

If additional accounts were determined to have an SICR, these balances would attract additional impairment provision, as such cases are provided on the basis of lifetime expected loss, rather the 12-month expected loss, and the overall provision charge would be higher. Conversely, if cases are incorrectly identified as SICR, impairment provisions will be overstated. Furthermore, adjustments to current PD estimates in the Group's models may also have the effect of identifying more or less accounts as having an SICR.

More information on the definition of SICR adopted is given in note 15.

(b) Definition of default

In applying the impairment provisions of IFRS 9, the directors have used models to derive the probabilities of default. In order to derive and apply such models, it is required to define 'default' for this purpose. The Group's definition of default is aligned to its internal operational procedures. IFRS 9 provides a rebuttable presumption of default when an account is 90 days overdue, and this was used as the starting point for this exercise. Other factors include account management activities such as appointment of a receiver, internal grading processes or enforcement procedures.

A combination of qualitative and quantitative measures was considered in developing the definition of default.

If a different definition of default had been adopted the expected loss amounts derived might differ from those shown in the accounts.

More information on the Group's definition of default adopted is given in note 15.

D2.4 NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

For the year ended 30 September 2024

40. CRITICAL ACCOUNTING JUDGEMENTS (CONTINUED)

(c) Classification of financial assets

The classification of financial assets under IFRS 9 is based on two factors:

- The company's 'business model' – how it intends to generate cash and profit from the assets
- The nature of the contractual cash flows inherent in the assets

Financial assets are classified as held at amortised cost, at fair value through OCI, or at fair value through profit and loss.

For an asset to be held at amortised cost, the cash flows received from it must comprise solely payments of principal and interest ('SPPI'). In effect, this restricts this classification to 'normal' lending activities, excluding arrangements where the lender may have a contingent return or profit share from the activities funded. The Group has considered its products and concluded that, as standard lending products, they fall within the SPPI criteria.

This is because all the Group's lending arrangements involve the advancing of amounts to customers, either as loans or finance lease products and the receipt of repayments of principal and charges, where those charges are calculated based on the amount loaned. There are no 'success fee' or other compensation arrangements not linked to the loan principal.

The use of amortised cost accounting is also restricted to assets which a company holds within a business model whose object is to collect cash flows arising from them, rather than seek to profit by disposing of them (a 'Held to Collect' model). The Group's strategy is to hold loan assets until they are repaid or written off. Loan disposals are rare, and the Group does not manage its assets in order to generate profits on sale. On this basis, it has categorised its business model as Held to Collect.

Therefore, the Group has classified its customer loan assets as carried at amortised cost. There were no significant changes in the nature of the Group's products, nor in the business models in which they are held, during the year.

41. CRITICAL ACCOUNTING ESTIMATES

Certain balances reported in the financial statements are based wholly or in part on estimates or assumptions made by the directors. There is, therefore, a potential risk that they may be subject to change in future periods. The most important of these, those which could, if revised significantly in the next financial year, have a material impact on the carrying amounts of assets or liabilities are:

(a) Impairment losses on loans to customers

Impairment losses for the majority of loans are calculated based on statistical models, applied to the present status, performance and management strategy for the loans concerned, which are used to determine each loan's PD and LGD.

Internal information used will include number of months arrears, qualitative information, such as possession by a first charge holder on a second charge mortgage or where a buy-to-let case is under the control of a receiver of rent, the receiver's present and likely future strategy for the property (which might include keeping current tenants in place, refurbish and relet, immediate sale etc).

D2.4 NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

For the year ended 30 September 2024

41. CRITICAL ACCOUNTING ESTIMATES (CONTINUED)

External information used includes customer specific data, such as credit bureau information as well as more general economic data.

Key internal assumptions in the models relate to estimates of future cash flows from customers' accounts, their timing and, for secured accounts, the expected proceeds from the realisation of the property or other charged assets. These cash flows will include payments received from the customer, and, for buy-to-let cases where a receiver of rent is appointed, rental receipts from tenants, after allowing for void periods and running costs. These key assumptions are based on observed data from historical patterns and are updated regularly based on new data as it becomes available.

In addition, the directors consider how appropriate past trends and patterns might be in the current economic situation and make any adjustments they believe are necessary to reflect current and expected conditions.

In evaluating the potential impact of the economic situation at 30 September 2024 there is little recent history against which to benchmark likely customer behaviour. Interest rates in the UK increased rapidly in the preceding year and have remained at elevated levels throughout the period. The UK base rate remained at 5.25% throughout most of the period, a level it had not touched since April 2008, since when significant regulatory intervention in the UK's lending markets has taken place. There have also been significant changes in product structures in that period, including the growth of longer term fixed-rate mortgage lending in recent years. All these factors make the historical record of behaviours in higher interest rate environments an uncertain guide to the likely impact of current rate levels.

There is also some disagreement among economic forecasters as to the future direction of the UK economy, exacerbated by uncertainties as to the impact of the policies of the new UK Government. At the same time, the level to which economic pressures on customers have yet to manifest themselves in credit metrics is still unclear, with credit performance across the markets in which the Group is active being better than some expected over the past two years. However, considerable uncertainty exists as to whether this represents a more benign outcome, or merely a delay in credit issues emerging beyond what was anticipated. Together, these factors make forecasting credit behaviour in current conditions challenging.

The accuracy of the impairment calculations would be affected by unexpected changes to the economic situation, variances between the models used and the actual results, or assumptions which differ from the actual outcomes. In particular, if the impact of economic factors such as employment levels on customers is worse than is implicit in the model then the number of accounts requiring provision might be greater than suggested by the model, while falls in house prices, over and above any assumed by the models might increase the provision required in respect of accounts currently provided. Similarly, if the account management approach assumed in the modelling cannot be adopted the provision required may be different.

In order to provide forward looking economic inputs to the modelling of the ECL, the Group must derive a set of scenarios which are internally coherent. The Group addresses these requirements using four distinct economic scenarios chosen to represent the range of possible outcomes. These scenarios at 30 September 2024 have been derived in light of the current economic situation modelling a variety of possible outcomes as described in note 18.

As noted above, there remains a significant range of different opinions amongst economists about the longer-term prospects for the UK, and although these have converged, to some extent, over recent months, the medium-term uncertainty over the direction and impact of UK economic policy under the new administration adds inherent complexity to any forecasting exercise.

D2.4 NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

For the year ended 30 September 2024

41. CRITICAL ACCOUNTING ESTIMATES (CONTINUED)

The variables are used for two purposes in the IFRS 9 calculations:

- They are applied as inputs in the models which generate PD values, where those found by statistical analysis to have the most predictive value are used
- They are used as part of the calculation where the variable has a direct impact on the expected loss calculation, such as the HPI

The economic variables will also inform assumptions about the Group's approach to account management given a particular scenario.

In addition to uncertainty represented by the economic scenarios, the Group recognises that economic situations can arise which lie outside the range of potential positions considered as a basis for its IFRS 9 approach to impairment when the current models were built. The current forecast scenarios, which include higher rates of interest and inflation than in the historically observed data, represent situations where these models may not be able to fully allow for potential economic impacts on the loan portfolios. The Group therefore assessed, for each class of asset, whether any adjustment to the normal approach was required to ensure sufficient provision was created by the models. It also reviewed other available data, both from account performance and customer feedback to form a view of the underlying reasons for observed customer behaviours and of their future intentions and prospects.

As a result of this exercise additional requirements for provision were identified, to compensate for potential model weakness and to allow for economic pressures in the wider economy which cannot be identified by a modelled approach. By their nature such adjustments are less systematic and therefore subject to a wider range of outturns. The nature and amounts of these judgemental adjustments are set out in note 15.

The position after considering all these matters is set out in notes 15 to 17, together with further information on the Group's approach. The economic scenarios described above and their impact on the overall provision are set out in note 18, while sensitivity analyses on impairment provisioning are set out in note 19.

(b) Effective interest rates

In order to determine the EIR applicable to loans and borrowings an estimate must be made of the expected life of each asset or liability and the cash flows relating thereto, including those relating to early redemption charges together with any initial fees receivable from the customer or procurement fees payable to a mortgage broker or other introducer.

Where an account may have differing interest charging arrangements in different phases of its contractual life, such as the Group's buy-to-let mortgage accounts which have a fixed interest rate for a set period and then revert to a variable rate set by the Group (the 'reversionary rate'), the behavioural life and the expected level of the reversionary rate will have a significant impact on the overall EIR. For each portfolio a model is in place to ensure that income is appropriately spread.

D2.4 NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

For the year ended 30 September 2024

41. CRITICAL ACCOUNTING ESTIMATES (CONTINUED)

For loan accounts such as those in the Group's mortgage portfolios where borrowers typically repay their balances before the contractual repayment date, the estimated life of the account will be dependent on customer behaviour. The customer may choose to sell their property and redeem the mortgage at any point, but may also choose to refinance their account, if a more attractive alternative is available, based on the interest rate they are being charged at that point in time, or expect to be charged in the future. The behavioural life of the loan may therefore by influenced by levels of activity in the residential property market, or by the nature and pricing of alternative funding sources, at each point in the loans life and these are likely to vary over time.

For loans which have a fixed-rate period, the length of that period will have a significant behavioural impact, with many customers choosing to consider their positions at the point at which the fixed rate expires, influenced by the market conditions then prevailing. The future forecast future choices of customers currently on fixed-rate products at this point therefore has a significant impact on the EIR modelling for these assets.

Where loans are more likely to run to contractual term, and interest rates are less likely to vary over that term, as is the case for the majority of the Group's motor finance and asset-backed SME lending, the determination of an EIR model is less judgemental, and reflects principally the spreading of known fees and commissions.

The Group models lives for each of its asset classes, based on its current expectation of future borrower behaviour, and uses these profiles, together with its expectations of future reversionary interest rates, to determine the correct EIR to be applied to each account. The underlying estimates are based on historical data, adjusted for expected for changes, and reviewed regularly. The accuracy of the EIR applied would therefore be compromised by any differences between actual repayment profiles and charging rates and those predicted, which in turn would depend directly on customer behaviour and market conditions.

The Group therefore keeps its models under review and refines its modelling in the light of any emerging deviations from expected behaviour. These are particularly likely where the current or expected economic environment differs from historic scenarios for which relevant data observations are available. This is currently the case, with market mortgage rates at far higher levels than have been seen in many years, but beginning to fall. In such cases management consider carefully the impacts which any new conditions may have on customer behaviour and reversionary rates and reflect them in the model as appropriate, revisiting these assumptions regularly as observable data becomes available, with a detailed exercise to analyse any emerging themes taking place every six months as part of the half-year and year-end results processes.

The application of these estimates results in an overall decrease in the carrying value of the Group's loans to customers, including POCI accounts, at 30 September 2024 of £4.4m (2023: increase of £20.5m).

D2.4 NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

For the year ended 30 September 2024

41. CRITICAL ACCOUNTING ESTIMATES (CONTINUED)

To illustrate the potential variability of the estimate, the amortised cost values were recalculated by changing one factor in the EIR calculation and keeping all others at their current levels.

- Currently the average behavioural life used in the buy-to-let modelling for non-legacy assets, which have an average fixed period of 48 months (2023: 49 months), was 80 months (2023: 83 months).

  A reduction of the assumed average lives of all loans secured on residential property by three months would reduce balance sheet assets by £9.3m (2023: £9.3m), while an increase of the assumed asset lives of such assets by three months would increase balance sheet assets by £9.1m (2023: £9.2m). £8.9m of the increase (2023: £8.8m) and £9.1m of the decrease (2023: £8.8m) related to non-legacy buy-to-let assets.

  A reduction of the assumed average lives of all loans secured on residential property by six months would reduce balance sheet assets by £18.5m (2023: £18.5m), while an increase of the assumed asset lives of such assets by six months would increase balance sheet assets by £17.5m (2023: £18.4m). £17.2m of the increase (2023: £17.5m) and £18.2m of the decrease (2023: £17.5m) related to non-legacy buy-to-let assets.

- The EIR calculation is based on management estimates of the reversionary rates which would be charged to customers after the end of their fixed rate periods.

  If it was assumed that the maximum reversionary rate which could be charged in future was 6.00%, then the value of the non-legacy buy-to-let loan book would be decreased by £12.3m (2023: decrease by £3.0m).

  If it was assumed that the maximum reversionary rate which could be charged in future was 8.00%, then the value of the non-legacy buy-to-let loan book would be increased by £29.3m (2023: increase by £3.9m).

- Where fixed rate buy-to-let assets redeem before the end of their fixed rate period, an early redemption charge is made, and an estimate for the impact of these charges must be included in the EIR calculation.

  An increase of 50% in the number of five year fixed rate buy-to-let loan assets assumed to redeem before the end of the fixed rate period would increase balance sheet assets by £9.9m (2023: £9.6m).

As any of these changes would, in reality, be accompanied by movements in other factors, actual outcomes may differ from these estimates.

D2.4 NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

For the year ended 30 September 2024

41. CRITICAL ACCOUNTING ESTIMATES (CONTINUED)

(c) Impairment of goodwill

The carrying value of goodwill recognised on acquisitions is verified by use of an impairment test based on the projected cash flows for the CGU, based on management forecasts and other assumptions described in note 23, including a discount factor.

The accuracy of this impairment calculation would therefore be compromised by any differences between these forecasts and the levels of business activity that the CGU is able to achieve in practice. As the Group forecasts are based on the Group's central economic scenario, any variance from this will potentially impact on the valuation. This test will also be affected by the accuracy of the discount factor used.

The sensitivity of the impairment test to reasonably possible movements in these assumptions is discussed in note 23.

42. GOING CONCERN

Accounting standards require the directors to assess the Group's ability to continue to adopt the going concern basis of accounting. In performing this assessment, the directors consider all available information about the future, the possible outcomes of events and changes in conditions and the realistically possible responses to such events and conditions that would be available to them, having regard to the 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' published by the Financial Reporting Council in September 2014.

Particular focus is given to the Group's financial forecasts to ensure the adequacy of resources, including liquidity and capital, available for the Group to meet its business objectives on both a short-term and strategic basis. The guidance requires that this assessment covers a period of at least twelve months from the date of approval of these financial statements.

Financial and capital forecasting

The Group has a formalised process of budgeting, reporting and review. The Group's planning procedures forecast its profitability, capital position, including its regulatory capital position, funding requirement and cash flows. Detailed plans are produced for two year periods with longer-term forecasts covering a five year period, including detailed income forecasts. These plans provide information to the directors which is used to ensure the adequacy of resources available for the Group to meet its business objectives, both on a short-term and strategic basis.

The forecast is updated every six months, and the directors have based their going concern assessment of the forecast for the period beginning on 1 October 2024.

The Group makes extensive use of stress testing in compiling and reviewing its forecasts. This stress testing approach was reviewed in detail during the year as part of the annual Internal Capital Adequacy Assessment Process ('ICAAP') cycle, where testing considered the impact of a number of severe but plausible scenarios. During the planning process, sensitivity analysis was carried out on a number of key assumptions that underpin the forecast to evaluate the impact of the Group's principal risks.

D2.4 NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

For the year ended 30 September 2024

42. GOING CONCERN (CONTINUED)

The key stresses modelled in detail to evaluate the forecast were:

- An increase in buy-to-let volumes. This examined the impact of higher volumes at a reduced yield on profitability and illustrated the extent to which capital resources and liquidity would be stretched due to the higher cash and capital requirements
- Higher funding costs. Higher cost on all new savings deposits, both front book and back book throughout the forecast horizon. This scenario illustrates the impact of a significant, prolonged margin squeeze on profitability, and whether this would cause significant impacts on any capital, liquidity or encumbrance ratios
- Higher buy-to-let redemption rates for buy-to-let mortgages reaching the end of their fixed rate period. This illustrates the potential risk inherent in the five-year fixed rate business
- Reduced development finance volumes and yield. This replicates a significant increase in competition within the sector, reducing yields and impacting market share, demonstrating how a lower mix of the Group's highest margin product impacts on contribution to costs and other profitability ratios.
- Increased economic stress on customers. As well as modelling the impact of each of the economic scenarios set out in note 18 across the forecast horizon, the severe economic scenario was also modelled over the five-year horizon. To ensure this represented a worst-case scenario all other assumptions were held steady, although in reality adjustments to new business appetite and other factors would be made
- Combined downside stress. The IFRS 9 downside economic scenario described in note 18 was modelled out for the plan horizon along with a plausible set of other adverse factors to the business model, creating a prolonged tail-risk

These stresses did not take account of management actions which might mitigate the impact of the adverse assumptions used. They were designed to demonstrate how such stresses would affect the Group's financing, capital and liquidity positions and highlight any areas which might impact the Group's going concern status. Under all these scenarios, the Group was able to meet its obligations over the forecast horizon and maintain a surplus over its regulatory requirements for both capital and liquidity through normal balance sheet management activities.

As part of the ICAAP process the Group also assessed the potential operational risks it could face. This was done through the analysis of the impact and cost of a series of severe but plausible scenarios. This analysis did not highlight any factors which cast doubt on the Group's ability to continue as a going concern.

The Group begins the forecast period with a strong capital and liquidity position, enabling the management of any significant outflows of deposits and / or reduced inflows from customer receipts. Overall the forecasts, even under reasonable further levels of stress show the Group retaining sufficient equity, capital, cash and liquidity throughout the forecast period to satisfy its regulatory and operational requirements.

D2.4 NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

For the year ended 30 September 2024

42. GOING CONCERN (CONTINUED)

Availability of funding and liquidity

The availability of funding and liquidity is a key consideration, including retail deposit, wholesale funding, central bank and other contingent liquidity options.

The Group's retail deposits of £16,298.0m (note 24), raised through Paragon Bank, are repayable within five years, with 87.0% of this balance (£14,180.4m) payable within twelve months of the balance sheet date. The liquidity exposure represented by these deposits is closely monitored; a process supervised by the ALCO. The Group is required to hold liquid assets in Paragon Bank to mitigate this liquidity risk. At 30 September 2024 Paragon Bank held £2,635.3m of balance sheet assets for liquidity purposes, in the form of central bank deposits and investment securities. A further £150.0m of liquidity was provided by an off balance sheet long / short transaction, bringing the total to £2,785.3m.

Paragon Bank manages its liquidity in line with the Board's risk appetite and the requirements of the PRA, which are formally documented in the Board's approved Individual Adequacy Assessment Process ('ILAAP'), updated annually. The Bank maintains a liquidity framework that includes a short to medium-term cash flow requirement analysis, a longer-term funding plan and access to the Bank of England's liquidity insurance facilities, where pre-positioned assets would support further drawings of £4,445.9m (2023: £1,715.4m). Holdings of the Group's own externally rated mortgage backed loan notes can also be used to access the Bank of England's liquidity facilities or other funding arrangements. At 30 September 2024 the Group had £1,797.2m (2023: £1,205.6m) of such notes available for use, of which £1,536.2m (2023: £986.9m) were rated AAA. The available AAA notes would give access to £751.9m (2023: £769.8m) if used to support drawings on Bank of England facilities.

The earliest maturity of any of the Group's wholesale debt is the central bank debt payable in 2025.

The Group's access to debt is enhanced by its corporate BBB+ rating, confirmed by Fitch Ratings in February 2024, and its status as an issuer is evidenced by the BBB- investment grade rating of its £150.0m Tier-2 bond.

Additionally, during the year Fitch Ratings assigned a BBB+ Long-term Issuer Default rating to Paragon Bank PLC, the Group's principal operating subsidiary, the first time a company-level rating has been issued for this entity. This provides additional flexibility to the Group's wholesale funding options.

The Group regularly accessed the capital markets for warehouse funding and corporate and retail bonds over recent years and continues to be able to access these markets. It also has access to the short-term repo market which it accesses from time to time for liquidity purposes.

The Group's cash analysis, which includes the impact of all scheduled debt and deposit repayments, continues to show a strong position, even after allowing scope for significant discretionary payments and capital distributions.

As described in note 37 the Group's capital base is subject to consolidated supervision by the PRA. Its capital at 30 September 2024 was in excess of regulatory requirements and its forecasts indicate this will continue to be the case, even allowing for currently proposed changes in the UK's capital requirements framework.

D2.4 NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

For the year ended 30 September 2024

42. GOING CONCERN (CONTINUED)

Going concern assessment

In order to assess the appropriateness of the going concern basis, the directors considered the Group's financial position, the cash flow requirements laid out in its forecasts, its access to funding, the assumptions underlying the forecasts and potential risks affecting them. As part of this exercise, the potential impacts on funding, capital and cash of the contingent liabilities described in note 28 were considered.

After performing this assessment, the directors concluded that there was no material uncertainty as to whether the Group would be able to maintain adequate capital and liquidity for at least twelve months following the date of approval of these financial statements and consequently that it was appropriate for them to continue to adopt the going concern basis in preparing the financial statements of the Group.

43. FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The Group's financial assets and financial liabilities are valued on one of two bases, defined by IFRS 9:

- Financial assets and liabilities carried at fair value through profit and loss ('FVTPL')
- Financial assets and liabilities carried at amortised cost

IFRS 7 – 'Financial Instruments: Disclosures' requires that where assets are measured at fair value these measurements should be classified using the fair value hierarchy set out in IFRS 13 – 'Fair Value Measurement'. This hierarchy reflects the inputs used and defines three levels:

- Level 1 measurements are unadjusted market prices
- Level 2 measurements are derived from directly or indirectly observable data, such as market prices or rates
- Level 3 measurements rely on significant inputs which are not derived from observable data

As quoted prices are not available for level 2 and 3 measurements, the valuation is derived from cash flow models based, where possible, on independently sourced parameters. The accuracy of the calculation would therefore be affected by unexpected market movements or other variances in the operation of the models, or the assumptions used.

The Group had no financial assets or liabilities at 30 September 2024 or 30 September 2023 carried at fair value and valued using level 3 measurements.

The Group has not reclassified any of its measurements during the year.

The methods by which fair value is established for each class of financial assets and liabilities are set out below.

D2.4 NOTES TO THE ACCOUNTS – BASIS OF PREPARATION
For the year ended 30 September 2024

43. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

(a) Assets and liabilities carried at fair value

The following table summarises the Group's financial assets and liabilities which are carried at fair value.

	Note	2024 £m	2023 £m
Financial assets			
Derivative financial assets	20	391.8	615.4
Financial liabilities			
Derivative financial liabilities	20	99.7	39.9

All of these financial assets and financial liabilities are required to be carried at fair value by IFRS 9.

Derivative financial assets and liabilities

Derivative financial instruments are stated at their fair values in the accounts. The Group uses a number of techniques to determine the fair values of its derivative assets and liabilities, for which observable prices in active markets are not available. These are principally present value calculations based on estimated future cash flows arising from the instruments, discounted using a market interest rate, adjusted for risk as appropriate. The principal inputs to these valuation models are SONIA sterling benchmark interest rates.

In order to determine the fair values, the management applies valuation adjustments to observed data where that data would not fully reflect the attributes of the instrument being valued, such as particular contractual features or the identity of the counterparty. The management reviews the models used on an ongoing basis to ensure that the valuations produced are reasonable and reflect all relevant factors. These valuations are based on market information, and they are therefore classified as level 2 measurements. Details of these assets are given in note 20.

D2.4 NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

For the year ended 30 September 2024

43. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

(b) Assets and liabilities carried at amortised cost

The fair values for financial assets and financial liabilities held at amortised cost, determined in accordance with the methodologies set out below are summarised below.

	Note	2024 Carrying amount £m	2024 Fair value £m	2023 Carrying amount £m	2023 Fair value £m
The Group					
Financial assets					
Cash	11	2,525.4	2,525.4	2,994.3	2,994.3
Investment securities	12	427.4	422.0	-	-
Loans to customers	13	15,705.5	15,772.5	14,874.3	14,524.0
Sundry financial assets	21	15.8	15.8	46.0	46.0
		18,674.1	18,735.7	17,914.6	17,564.3
Financial liabilities					
Short-term bank borrowings		0.4	0.4	0.2	0.2
Asset backed loan notes		-	-	28.0	28.0
Retail deposits	24	16,298.0	16,334.2	13,265.3	13,177.3
Corporate and retail bonds		149.9	145.5	258.2	234.8
Sale and repurchase agreements		100.0	100.0	50.0	50.0
Other financial liabilities	27	398.1	398.1	608.8	608.8
		16,946.4	16,978.2	14,210.5	14,099.1

The fair values of retail deposits and corporate and retail bonds shown above will include amounts for the related accrued interest.

Cash, sale and repurchase agreements, bank borrowings and securitisation borrowings

The fair values of cash and cash equivalents, sale and repurchase agreements, bank borrowings and asset-backed loan notes, which are carried at amortised cost are considered to be not materially different from their book values. In arriving at that conclusion market inputs have been considered but because all the assets and the sale and repurchase agreements mature within three months of the year end and the interest rates charged on financial liabilities reset to market rates on a quarterly basis, little difference arises.

While the Group's asset-backed loan notes are listed, the quoted prices for an individual note may not be indicative of the fair value of the issue as a whole, due to the specialised nature of the market in such instruments and the limited number of investors participating in it.

As these valuation exercises are not wholly market-based, they are considered to be level 2 measurements.

D2.4 NOTES TO THE ACCOUNTS – BASIS OF PREPARATION

For the year ended 30 September 2024

43. FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

Investment securities

The Group's investment securities are of types for which a liquid market exists, and for which quoted prices are available. It is therefore appropriate to consider that the market price of these assets constitutes a fair value. As this valuation is based on a market price it is considered to be a level 1 measurement.

Loans to customers

To assess the likely fair value of the Group's loan assets in the absence of a liquid market, the directors have considered the estimated cash flows expected to arise from the Group's investments in its loans to customers based on a mixture of market-based inputs, such as rates and pricing and non-market based inputs such as redemption rates. Given the mixture of observable and non-observable inputs these are considered to be level 3 measurements.

Corporate debt

The Group's retail and corporate bonds are listed on the London Stock Exchange and there is presently a reasonably liquid market in the instruments. It is therefore appropriate to consider that the market price of these borrowings constitutes a fair value. As this valuation is based on a market price, it is considered to be a level 1 measurement.

Retail deposits

To assess the likely fair value of the Group's retail deposit liabilities, the directors have considered the estimated cash flows expected to arise based on a mixture of market based inputs, such as rates and pricing and non-market based inputs such as withdrawal rates. Given the mixture of observable and non-observable inputs, these are considered to be level 3 measurements.

Sundry assets and liabilities

Fair values of financial assets and liabilities disclosed as sundry assets and sundry liabilities are not considered to be materially different to their carrying values.

These assets and liabilities are of relatively low value and may be settled at their carrying value at the balance sheet date or shortly thereafter.

Appendices to the Financial Information

APPENDICES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2024

A. UNDERLYING RESULTS

The Group reports underlying profit excluding fair value accounting adjustments arising from its hedging arrangements and certain one-off items of income and costs relating to asset sales and acquisitions.

The fair value adjustments arise principally as a result of market interest rate movements, outside the Group's control. They are profit neutral over time and are not included in operating profit for management reporting purposes. They are also disregarded by many external analysts.

The transactions relating to the asset disposals and acquisitions do not form part of the day-to-day activities of the Group and, therefore, their removal provides greater clarity on the Group's operational performance.

This definition of 'underlying' has been chosen following consideration of the needs of investors and analysts following the Group's shares, and because management feel it better represents the underlying economic performance of the Group's business. However, it should be noted that definitions used for these measures differ between firms, and caution should be exercised in making direct comparisons.

	Note	2024 £m	2023 £m
Profit on ordinary activities before tax		253.8	199.9
Add back: Fair value adjustments	8	38.9	77.7
Underlying profit		292.7	277.6

Underlying basic earnings per share, calculated on the basis of underlying profit adjusted for tax, is derived as follows.

	2024 £m	2023 £m
Underlying profit	292.7	277.6
Tax on underlying result	(80.3)	(66.4)
Underlying earnings	212.4	211.2
Basic weighted average number of shares (note 10)	210.1	224.1
Underlying earnings per share	101.1p	94.2p

Tax has been charged on the underlying profit at 27.4%, being the effective rate at which would result from the exclusion of the adjusting items from the corporation tax calculation (2023: 23.9%).

APPENDICES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2024

A. UNDERLYING RESULTS

Underlying return on tangible equity is derived using underlying earnings calculated on the same basis shown above. Tangible equity is adjusted to exclude the impacts of fair value hedging.

	Note	2024 £m	2023 £m
Underlying earnings		212.4	211.2
Amortisation and derecognition of intangible assets		1.2	3.6
Adjusted underlying earnings		213.6	214.8
Opening underlying tangible equity			
Equity		1,410.6	1,417.3
Intangible assets	23	(168.2)	(170.2)
Balance sheet impact of fair values	20	(230.8)	(216.7)
Deferred tax thereon		32.8	53.2
		1,044.4	1,083.6
Closing underlying tangible equity			
Equity		1,419.5	1,410.6
Intangible assets	23	(171.5)	(168.2)
Balance sheet impact of fair values	20	(207.6)	(230.8)
Deferred tax thereon		19.6	32.8
		1,060.0	1,044.4
Average underlying tangible equity		1,052.2	1,064.0
Underlying RoTE		20.3%	20.2%

The Group has noted that several comparable entities present underlying RoTE adjusting only the earnings figure, and this practice is more common than the approach taken by the Group. It has therefore decided to present an alternative underlying RoTE measure on this basis for the current year and to adopt this as its principal underlying RoTE measure in future periods. This measure is calculated as follows:

	Note	2024 £m	2023 £m
Adjusted underlying earnings		213.6	214.8
Average tangible equity	37	1,245.2	1,244.7
Alternative underlying RoTE		17.2%	17.3%

APPENDICES TO THE FINANCIAL INFORMATION

For the year ended 30 September 2024

B. INCOME STATEMENT RATIOS

NIM and cost of risk (impairment charge as a percentage of average loan balance) for the Group and its segments are calculated as shown below. Not all net interest is allocated to segments and therefore total segment net interest in these tables will not equal net interest for the Group (see note 2).

Year ended 30 September 2024

	Note	Mortgage Lending £m	Commercial Lending £m	Group Total £m
Opening loans to customers	13	12,902.3	1,972.0	14,874.3
Closing loans to customers	13	13,415.7	2,289.8	15,705.5
Average loans to customers		13,159.0	2,130.9	15,289.9
Net interest	2	282.3	124.8	483.2
NIM		2.15%	5.86%	3.16%
Impairment provision charge	7	5.6	18.9	24.5
Cost of risk		0.04%	0.89%	0.16%

Year ended 30 September 2023

	Note	Mortgage Lending £m	Commercial Lending £m	Group Total £m
Opening loans to customers	13	12,328.7	1,881.6	14,210.3
Closing loans to customers	13	12,902.3	1,972.0	14,874.3
Average loans to customers		12,615.5	1,926.8	14,542.3
Net interest	2	277.6	135.7	448.9
NIM		2.20%	7.04%	3.09%
Impairment provision (release) / charge	7	10.4	7.6	18.0
Cost of risk		0.08%	0.39%	0.12%

APPENDICES TO THE FINANCIAL INFORMATION

For the year ended 30 September 2024

C. COST:INCOME RATIO

Cost:income ratio is derived as follows:

	Note	2024 £m	2023 £m
Cost – operating expenses		179.2	170.4
Total operating income		496.4	466.0
Cost / Income		36.1%	36.6%

D. DIVIDEND COVER

For the purposes of dividend policy, the Group defines dividend cover based on basic earnings per share, adjusted where considered appropriate, and dividend per share. This is the most common measure used by financial analysts.

For the current and preceding years, the Board has determined that is appropriate to exclude the post-tax impact of fair value (losses) / gains from its calculation. The dividend cover for the year, subject to the approval of the 2024 final dividend at the AGM in March 2025 is therefore as set out below.

	Note	2024	2023
Earnings per share (p)	10	88.5	68.7
Attributable fair value gains (p)		18.5	34.7
Attributable tax thereon (p)		(5.9)	(9.2)
Adjusted earnings (p)		101.1	94.2
Proposed dividend per share in respect of the year (p)	32	40.4	37.4
Dividend cover (times)		2.50	2.52

APPENDICES TO THE FINANCIAL INFORMATION

For the year ended 30 September 2024

E. NET ASSET VALUE

	Note	2024	2023
Total equity (£m)		1,419.5	1,410.6
Outstanding issued shares (m)	29	210.6	228.7
Treasury shares (m)	31	(2.1)	(10.1)
Shares held by ESOP schemes (m)	31	(4.2)	(4.0)
		204.3	214.6
Net asset value per £1 ordinary share		£6.95	£6.57
Tangible equity (£m)	37	1,248.0	1,242.4
Tangible net asset value per £1 ordinary share		£6.11	£5.79

CAUTIONARY STATEMENT

Sections of this Preliminary Announcement, including but not limited to the Management Overview and the Management Report may contain forward-looking statements with respect to certain of the plans and current goals and expectations relating to the future financial condition, business performance and results of the Group. These statements can be identified by the fact that they do not relate strictly to historical or current facts. They use words such as 'anticipate', 'estimate', 'expect', 'intend', 'will', 'project', 'plan', 'believe', 'target' and other words and terms of similar meaning in connection with any discussion of future operating or financial performance but are not the exclusive means of identifying such statements. These have been made by the directors in good faith using information available up to the date on which they approved this report, and the Group undertakes no obligation to update or revise these forward-looking statements for any reason other than in accordance with its legal or regulatory obligations (including under the UK Market Abuse Regulation, UK Listing Rules and the Disclosure Guidance and Transparency Rules of the Financial Conduct Authority ('FCA')).

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 Group and depend upon circumstances that may or may not occur in the future that could cause actual results or events to differ materially from those expressed or implied by the forward-looking statements. There are also a number of factors that could cause actual future financial conditions, business performance, results or developments to differ materially from the plans, goals and expectations expressed or implied by these forward-looking statements and forecasts. As a result, you are cautioned not to place reliance on such forward-looking statements as a prediction of actual results or otherwise.

These factors include, but are not limited to: material impacts related to foreign exchange fluctuations; macro-economic activity; the impact of outbreaks, epidemics or pandemics, and the extent of their impact on overall demand for the Group's services and products; potential changes in dividend policy; changes in government policy and regulation (including the monetary, interest rate and other policies of central banks and other regulatory authorities in the principal markets in which the Group operates) and the consequences thereof; actions by the Group's competitors or counterparties; third party, fraud and reputational risks inherent in its operations; the UK's exit from the EU; unstable UK and global economic conditions and market volatility, including currency and interest rate fluctuations and inflation or deflation; the risk of a global economic downturn; social unrest; acts of terrorism and other acts of hostility or war and responses to, and consequences of those acts; technological changes and risks to the security of IT and operational infrastructure, systems, data and information resulting from increased threat of cyber and other attacks; general changes in government policy that may significantly influence investor decisions (including, without limitation, actions taken in support of managing and mitigating climate change and in supporting the global transition to net zero carbon emissions); societal shifts in customer financing and investment needs; and other risks inherent to the industries in which the Group operates.

Nothing in this Preliminary Announcement should be construed as a profit forecast.