

**NORTHERN ROCK PLC**  
**HALF YEAR RESULTS**  
**6 MONTHS ENDED 30 JUNE 2008**

# **NORTHERN ROCK GROUP HALF YEAR RESULTS**

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# NORTHERN ROCK GROUP HALF YEAR RESULTS

## HIGHLIGHTS

### **Bank of England Loan**

- Net borrowings provided by the Bank of England have reduced by £9.4 billion to £17.5 billion, compared with £26.9 billion at the end of December 2007 and are ahead of the business plan
- The balance of £17.5 billion represents amounts outstanding to the Bank of England of £21.0 billion, less balances held for liquidity purposes at the Bank of England of £3.5 billion
- Bank of England loan to be novated to HM Treasury during the second half of 2008

### **Retail funding**

- Net inflow of £3.7 billion in the first half of 2008
- Retail balances of £14.2 billion at 30 June 2008, compared with £10.5 billion at 31 December 2007 and £24.4 billion at 30 June 2007

### **Redemptions**

- Cash inflows from redemptions of loans are ahead of Northern Rock's business plan
- Total redemptions of £16.2 billion in the first six months of 2008 (including £2.2 billion asset disposal)

### **Balance sheet reduction**

- Total assets reduced to £99.0 billion at 30 June 2008, compared with £109.3 billion at 31 December 2007
- Loans and advances to customers reduced by £14.5 billion in the first half of the year to £84.4 billion

### **Earnings**

- Under the business plan the Group is expected to be significantly loss making in 2008
- Loss before tax for six months to 30 June 2008 of £585.4 million – including various exceptional charges
- Underlying loss before tax of £176.3 million reflecting loan loss provisions, lower interest margins and reduced volume of new business

### **Capital**

- Significant strengthening of the Company's capital base through conversion into Ordinary shares of HM Treasury holding of £400 million of Preference shares as well as up to £3 billion of outstanding debt following novation of Bank of England loan to HM Treasury
- This capital restructuring will not involve any cash transfer and will be finalised subject to State aid approval

### **Organisation**

- Key appointments made to leadership team
- Risk and control environment strengthened and debt management capabilities upgraded

### **Northern Rock Foundation**

- Donation to The Northern Rock Foundation of £7.5 million in the first half of 2008, taking the total donated since 1997 to almost £200 million

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## CHAIRMAN'S STATEMENT

Northern Rock was taken into temporary public ownership on 22 February 2008. In the following weeks, a business plan (the "Plan") was developed that was approved by HM Treasury on 31 March 2008. This Plan was designed to deliver the Government's stated objectives of protecting UK taxpayers, maintaining financial stability and protecting consumers. It envisaged that Northern Rock, although significantly loss-making in 2008, would return to break-even in 2011 followed by progressive profit improvement thereafter. The Plan contained a number of key targets, including repayment of the Bank of England loan by the end of 2010, release of the Government guarantee arrangements (subject to FSA requirements) during 2011, and the creation of a smaller, profitable bank capable of returning to private ownership in due course.

To achieve the Government's stated objectives, Northern Rock set out four strategic priorities in its Plan:

- Repay the facilities provided by the Bank of England;
- Build a stand-alone funding and capital position;
- Align the organisation and operations of Northern Rock to reflect the new commercial strategy; and
- Strengthen the risk and control environment.

The period since 22 February has been one of intense activity at Northern Rock, and I am pleased to report that good progress has been made on all of these key priorities. Net of liquidity deposits held at the Bank of England of £3.5 billion, amounts outstanding to the Government have been reduced by £9.4 billion since the start of the year, which is considerably ahead of Plan; the retail deposit base has grown and the Company has successfully re-entered the wholesale markets; operational restructuring is well advanced; both the management team and the Board have been bolstered by key new appointments; and the risk procedures in the Company have been substantially overhauled.

However, the external environment has deteriorated and the consequences of this for Northern Rock are increased credit losses. Following a review in July of the Company's ongoing regulatory capital requirements, HM Treasury has committed to a significant strengthening of the Company's capital base. This will not involve any cash transfer to Northern Rock and will be provided by HM Treasury through conversion into Ordinary shares of both its holding of £400 million of Preference shares as well as up to £3 billion of outstanding debt, following transfer of the Bank of England loan to HM Treasury. This capital restructuring will be finalised, following a further review of the Plan and subject to approval by the European Commission of the application for State aid.

With this balance sheet strengthening, Northern Rock is well placed to press ahead with delivery of the Plan. While the losses reported today are likely to continue as the restructuring proceeds and as the credit environment remains difficult, I am confident that the foundations have been well laid for recovery and return in due course to private ownership.

### **Progress against Plan**

#### **Bank of England Facilities**

The Company is currently well ahead of its loan repayment target having, on a net basis, reduced the amount outstanding to the Bank of England by £9.4 billion to £17.5 billion at 30 June 2008 (from £26.9 billion at 31 December 2007). This represents a 35% reduction in the debt facilities (net of liquidity deposits held at the Bank of England) in the first six months of 2008 and is already approaching £3 billion ahead of the 25% repayment target originally set for the whole of the year. This strong performance reflects the Company's success in redeeming loans in the first half of the year.

The Plan is not without challenges, not least in relation to the Company's ongoing ability to redeem loans at the required pace given external market factors, but the experience so far is encouraging. The agreement reached with Lloyds TSB in June to offer its mortgage products to selected maturing borrowers should assist Northern Rock to continue to meet its maturity redemption target of 60% in the second half of the year. As

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anticipated in the Plan, it is the higher quality end of the loan book that is most easily able to re-mortgage with other lenders; this is contributing to the deterioration in the average quality of the Company's credit portfolio, although this still remains within planned parameters.

### **Funding and new lending**

Retail deposits have grown by £3.7 billion over the last six months, from £10.5 billion to £14.2 billion, although this is still substantially below the level at the same time last year. The majority of the growth in retail deposits in the first half of 2008 was achieved at the start of the period, and net inflows have slowed notably following the introduction in March of the Company's Competitive Framework, designed to minimise competitive distortions arising from the Government guarantees. Northern Rock is determined not to take unfair advantage of its Government support and has maintained a rigorous adherence to the Framework, which imposes considerable constraints on how the Company competes. The Board remains satisfied that an appropriate balance continues to be struck between the desire to minimise competitive distortions, and the need to create a sound, sustainable retail funding profile.

In July, the Company successfully re-entered the wholesale funding markets, albeit in modest amounts. This represents a further important step in rebuilding Northern Rock's funding franchise.

New lending in the first half of the year was below the levels anticipated in the Plan, reflecting the slowdown in the housing market and a cautious approach to the quality of lending that Northern Rock is pursuing. The level of new lending is expected to increase modestly in the second half of the year, while remaining significantly below the Company's historic levels.

### **Organisation**

A central element of the Plan is the restructuring of the Company leading to a reduction in staff numbers of approximately 2,000 over the next three years. The statutory 90 day collective consultation period with our staff concluded at the end of July and individual discussions are underway with all affected employees. This has been a challenging process, and inevitably one which is highly unsettling for the organisation. Nevertheless, the Company remains on track to conclude this process and achieve the necessary reductions in line with the Plan.

The engagement with Unite and other employee representatives has been constructive throughout and it is looking increasingly likely that the downsizing will be achieved with around 800 compulsory redundancies. The final figure will be subject to a number of existing members of staff, who are currently in jobs that will no longer exist, agreeing to stay on in new roles created within the restructured Company. It is pleasing to note that during this challenging period, the Company has continued to operate normally and high standards of customer service have been maintained throughout.

A determination to support all affected staff as fully as possible has been at the core of this process and appropriate outplacement services have been put in place for those who will be leaving the Company. The assistance of One NorthEast and other members of the Northern Rock Response Group has been invaluable, and the Company is indebted to these organisations for all of their efforts.

Strengthening the leadership team has been another key objective and in this regard, I am delighted with the appointment of Gary Hoffman who will take over as Chief Executive from 1 October. Gary's capabilities, experience and personal qualities will be invaluable in the years ahead. His appointment is complemented by additional outstanding new recruits into key executive positions in the Company: Rick Hunkin as Chief Risk Officer, Richard Smelt as HR Director and Andy Tate as Director of Debt Management. These appointments serve to strengthen considerably the senior leadership team of Northern Rock.

When the appointment of Gary Hoffman as Chief Executive takes effect in October, I shall relinquish my executive role and revert as planned to being a Non-Executive Chairman.

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### **Risk and control environment**

Alongside the recruiting activities, wide-ranging changes have been made to the management structure and processes within the Company, with a particular focus on improving decision-making effectiveness and strengthening the risk and control environment in the business. The Company has also embarked on a programme to upgrade its debt management capabilities, with significant investments in both people and technology. Staff numbers in debt management are planned to increase from 185 to around 500 over the course of the year and, as the housing market continues to be challenging, this will assist Northern Rock in dealing with its customers effectively and fairly during this difficult period.

Steps have also been taken to strengthen the Board, with the appointments of Kent Atkinson and Richard Coates as non-executive Directors. Both bring considerable experience in banking finance, and the management and control of risk.

### **Financial performance and capital position**

While the Company's performance against its strategic priorities is encouraging, there remain a number of areas of concern. Most significantly, the deterioration in the housing market and the broader economic environment, coupled with the evident stresses on household budgets as a result of rising food and fuel prices, have put pressure on the Company's loan books. Residential arrears over 3 months have more than doubled since the start of the year to 1.18% at the end of June, and the higher LTV end of the book is particularly exposed to housing market deterioration. Whilst this increase is partly attributable to the Company tightening the application of its arrears capitalisation policy and the shrinking of the mortgage book, the underlying trend is all too evident. The impact is also being felt on possessions. The number of properties in possession grew from 2,215 at the start of the year to 3,710 by the end of June.

As indicated in the Plan, the Company was expected to make a substantial loss in 2008. Actual performance in the first six months of 2008 shows a statutory loss before tax of £585.4 million. On an underlying basis, excluding various exceptional costs (including restructure costs, provisions against treasury assets, the volatility associated with changes in fair values and hedge ineffectiveness and recognition of the rebate on interest and fees which is subject to State aid approval), the loss before tax reduces to £176.3 million. The primary reasons for this underlying loss were lower net interest income reflecting the Company's current funding mix, higher loan loss impairment provisions and lower non-interest income reflecting much lower levels of new business.

The deterioration in market conditions, particularly the downturn in the housing market, and the need to ensure an adequate regulatory capital position throughout the period of State aid and temporary public ownership, have led to the need to strengthen the capital position of the Company.

HM Treasury has committed to reinforce the Company's capital base through conversion into Ordinary shares of its holding of £400 million of Preference shares and swapping up to £3 billion of the outstanding debt into equity (following the planned transfer of the Bank of England loan to HM Treasury). These measures will not involve any cash transfer to Northern Rock. This restructuring will be finalised following a further review of the Plan and will be implemented subsequent to State aid approval.

These actions to be taken to improve the regulatory capital position of the Company will not change the Government's net cash exposure to Northern Rock. We continue to envisage that the Government loan facilities will be repaid before the end of 2010, in line with the Plan. This is after the deduction of any amount converted under the debt for equity swap.

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### **Employees**

In what has undoubtedly been a most difficult time for Northern Rock's employees, I wish to thank all members of staff and applaud their maintenance of the highest levels of customer service and professionalism. Their drive to succeed and standards of performance have been exemplary throughout.

I wish to pay particular tribute to Andy Kuipers, who will be stepping down from his position as Chief Executive at the end of August. Andy took on the role in the most challenging of circumstances and his performance has been admirable. On behalf of his Board colleagues, I would like to thank him for all he has contributed to Northern Rock over the past twenty years.

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## OPERATIONAL PERFORMANCE

### Introduction / Description of Business

Northern Rock's core business is secured residential lending, which comprises over 90% by value of loans to customers. The balance of loans to customers includes a portfolio of personal unsecured loans and a small portfolio of secured commercial loans.

### Market Conditions

The UK residential mortgage market slowed in the first half of 2008, with gross residential lending of £149 billion, compared with £178 billion in the equivalent period in 2007. Net residential lending also slowed to £30 billion in the first six months of the year compared with £54 billion in the equivalent period in 2007. Mortgage market conditions reflect the reduced appetite of UK lenders for providing new mortgage lending due to the significant disruption and uncertainty in the funding markets. Housing transactions have also slowed noticeably over the last 12 months, and house prices have shown annualised falls in value of 5%-6% to the end of June 2008.

### Loans to Northern Rock Customers

An analysis of changes to each loan portfolio is set out in the following table:

	<b>Residential £m</b>	<b>Commercial £m</b>	<b>Unsecured £m</b>	<b>Total £m</b>
<b>2008 1st Half</b>				
Gross lending	1,882	2	69	1,953
Net lending	(13,309)	(17)	(966)	(14,292)
Closing balances	77,362	299	6,330	83,991
<b>2007 Full Year</b>				
Gross lending	29,494	245	2,512	32,251
Net lending	13,306	(1,270)	175	12,211
Closing balances	90,778	316	7,351	98,445
<b>2007 2nd Half</b>				
Gross lending	12,060	57	808	12,925
Net lending	3,237	(522)	(379)	2,336
Closing balances	90,778	316	7,351	98,445
<b>2007 1st Half</b>				
Gross lending	17,434	188	1,704	19,326
Net lending	10,069	(748)	554	9,875
Closing balances	87,495	818	7,829	96,142

Note: Gross and net lending represent net cashflows excluding fair value adjustments. Closing balances are stated including fair value adjustments. Net movements include asset disposals where appropriate.

At 30 June 2008, 92.1% by value of loans to customers (excluding unsecured investment loans) were residential secured loans (31 December 2007 - 92.2%), 0.4% commercial secured loans (31 December 2007 - 0.3%) and 7.5% within personal unsecured portfolios (31 December 2007 - 7.5%). Lending volumes in the first half of 2008 reflect the Company's Plan which is to reduce the size of the balance sheet in order to repay the loan from the Bank of England.

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### Residential Lending

In the first six months of 2008 gross residential lending was £1,882 million (2007 first half - £17,434 million), reflecting the Company's diminished appetite for new mortgages as it focuses on reducing the size of the balance sheet, whilst maintaining a presence in the mortgage market. As mortgage redemptions have increased in order to repay the loan from the Bank of England, this has led to a reduction in the size of the residential mortgage book from £90.8 billion at the end of 2007 to £77.4 billion at the end of June 2008.

Residential redemptions in the first six months of the year were £15.2 billion (including asset disposals), compared with £7.4 billion in the first half of 2007. Residential redemptions fall into two distinct categories: redemptions which occur following the end of a product incentive period (maturity redemptions), and redemptions which are separate from the product cycle (non-maturity redemptions). Since the implementation of the Plan, maturity redemptions have been running at levels higher than anticipated as customers who have come to the end of their product period have remortgaged to other lenders. Non-maturity redemptions have been running at lower levels than anticipated primarily as a result of the slowdown in the housing market reducing the number of home-mover redemptions.

In order to assist Northern Rock customers who reach the end of their current mortgage product move to a new mortgage lender, the Company entered into a three year agreement with Lloyds TSB in June 2008, under which Northern Rock will write to maturing customers who qualify, providing them with the opportunity to apply for a Lloyds TSB mortgage product as one of their options.

The following is an analysis of the secured residential mortgage book at the relevant date:

	<b>30 June 2008</b>	<b>31 December 2007</b>	<b>30 June 2007</b>
<b>Number of accounts (000s)</b>	662	777	782
<b>Product type (%)</b>			
Standard	67	67	67
Together	26	24	24
Lifetime	-	3	3
Buy to Let	7	6	6
<b>Geographic spread (%)</b>			
North	16	15	16
Scotland / Northern Ireland	10	10	10
Midlands	26	25	25
South	48	50	49
<b>Indexed loan to value (%)</b>	62	60	59

The Lifetime mortgage portfolio (comprising products aimed at homeowners aged 60 and over who wished to utilise equity in their homes to enhance their lifestyle) was sold to JP Morgan in January 2008 at a premium of 2.25% to the balance sheet value. The proceeds of this sale of approximately £2.3 billion were used to reduce the level of the loan with the Bank of England.

In February 2008, the Together products (which combined a secured loan and an unsecured loan at one interest rate) were withdrawn from Northern Rock's new loan product range in line with other mortgage lenders withdrawing equivalent products.

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### Unsecured Lending

Northern Rock's personal unsecured credit portfolios comprise the unsecured element of Together lending and standalone unsecured loans not linked to a residential mortgage. An analysis of movements on the separate elements of the unsecured portfolios is shown in the following table:

	Standalone Unsecured £m	Together Unsecured £m	Total £m
<b>2008 1st Half</b>			
Gross	28	41	69
Net	(726)	(240)	(966)
Closing Balances	3,237	3,093	6,330
<b>2007 Full Year</b>			
Gross	1,492	1,020	2,512
Net	(241)	416	175
Closing Balances	3,980	3,371	7,351
<b>2007 2nd Half</b>			
Gross	391	417	808
Net	(473)	94	(379)
Closing Balances	3,980	3,371	7,351
<b>2007 1st Half</b>			
Gross	1,101	603	1,704
Net	232	322	554
Closing Balances	4,497	3,332	7,829

Both the standalone and Together unsecured loan portfolios have reduced in size in the first half of the year following the withdrawal of these products in the first quarter of 2008. These portfolios will continue to run-off over time.

### Commercial Lending

Following the sale of the majority of the commercial loan portfolio to Lehman Commercial Mortgage Conduit Limited between June and October 2007, Northern Rock's commercial loan portfolio totalled £0.3 billion at 30 June 2008 (31 December 2007 - £0.3 billion). The Company has ceased offering new commercial loans and the book will run-off over time.

### Credit Quality and Loan Loss Impairment

#### Arrears

The arrears position of each of the Company's main personal loan portfolios based upon the number of accounts over three months in arrears is set out in the table below:

	CML residential average	Northern Rock residential	Non- Together residential	Together secured residential	Together unsecured	Standalone unsecured
<b>30 June 2008</b>	1.21%	1.18%	0.80%	2.14%	2.06%	2.00%
<b>31 December 2007</b>	1.10%	0.45%	0.28%	0.95%	1.12%	1.45%
<b>30 June 2007</b>	1.05%	0.38%	0.26%	0.73%	0.89%	1.04%

Source: Northern Rock and Council of Mortgage Lenders (CML)

Note: CML figure for 2008 is as at 31 March 2008, being the latest available data

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The 2007 arrears numbers have been restated to reflect the CML basis of arrears reporting, which is for loans greater than three months in arrears, whereas previously Northern Rock has reported loans equal to and greater than three months in arrears.

The percentage residential arrears expressed as a percentage of the total number of residential mortgage customer accounts are as follows:

	30 June 2008		30 June 2007		31 December 2007	
	Cases	%	Cases	%	Cases	%
Over 3 - 6 months	5,605	0.85	1,593	0.20	1,910	0.25
Over 6 - 12 months	1,966	0.30	1,317	0.17	1,439	0.18
Over 12 months	225	0.03	46	0.01	144	0.02
<b>Total</b>	<b>7,796</b>	<b>1.18</b>	<b>2,956</b>	<b>0.38</b>	<b>3,493</b>	<b>0.45</b>

Total residential accounts (including both Together and non-Together loans) over three months in arrears at 1.18% were significantly higher than the equivalent figure of 0.45% at the end of 2007. This increase has been due to a number of factors. The more difficult economic and market conditions have led to an increase in defaults which, in Northern Rock's case, has been exaggerated by the 15% reduction in the size of the Company's mortgage book and the sale of the Company's Lifetime portfolio which had nil arrears. In addition, as announced in the trading statement in May 2008, Northern Rock has strengthened its procedures regarding mortgage arrears capitalisation. The Company's general policy to capitalise any outstanding amounts in arrears following receipt of three consecutive full monthly payments remains unchanged. However, the Company no longer applies any discretion to capitalise amounts in arrears when the borrower has made less than three monthly payments. These revised procedures have contributed to the increase in arrears reported in the first six months of the year.

At 30 June 2008, properties in possession totalled 3,710, representing 0.56% of accounts, compared with 2,215 (0.29%) at the end of 2007. This increase is in line with the Company's policy of rapid movement towards recovery where it is clear the borrower will not maintain payments.

Arrears over three months within the unsecured portfolios also increased due to the background economic environment and the contraction in the size of the books. Together unsecured arrears increased to 2.06% (31 December 2007 - 1.12%) and standalone unsecured arrears increased to 2.00% (31 December 2007 - 1.45%).

Over the next few years as the size of the balance sheet reduces, the Company must actively manage the credit quality of the loan books, especially given the difficult mortgage market conditions and the associated challenges for some borrowers (for example those with higher loan to values) of moving to a new lender.

### **Loan Loss Impairment**

The charge for customer loan loss impairment in the first half of 2008 amounted to £191.6 million, compared with £56.8 million in the first half of 2007 and £182.9 million in the second half of 2007.

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Loan loss impairment provisions and coverage are set out in the following table:

	Residential	Commercial	Unsecured	Total
<b>30 June 2008</b>				
Impairment provisions, £m	124.0	1.5	226.3	351.8
% of closing balances	0.16%	0.50%	3.45%	0.42%
<b>31 December 2007</b>				
Impairment provisions, £m	63.7	0.7	178.6	243.0
% of closing balances	0.07%	0.22%	2.37%	0.25%

The increases in impairment charge and impairment provisions reflect both the increases in default rates and the deterioration in anticipated recoveries due to reductions in house prices.

### Treasury Investments

Treasury investments, which comprise cash and balances with central banks, loans and advances to banks, investment securities and unsecured investment loans, represented 11.4% of Northern Rock's balance sheet at the end of June 2008, compared with 7.3% at the end of December 2007. Investment securities comprise available for sale securities and assets held at fair value through the income statement. The credit ratings of treasury investments were as follows:

Credit Rating	30 June 2008 %	30 June 2007 %	31 December 2007 %
Central Banks	31.6	4.7	2.4
AAA	26.6	30.3	44.1
AA	20.0	30.7	22.3
A	14.1	28.0	21.5
BBB	5.8	5.2	7.4
Other	1.9	1.1	2.3
Total	100.0	100.0	100.0

Holdings of capital notes (before impairments) in Structured Investment Vehicles (SIVs) totalled £327 million at the end of June 2008 (31 December 2007 - £327 million). These SIV investments are classified as loans and receivables and are carried at cost but are subject to a test for impairment on a case by case basis, including whether committed funding is in place and taking into account the net asset value (NAV) of each SIV. In addition to the impairment charge of £232.2 million that was made in 2007, a further impairment charge of £46.6 million has been made in relation to this investment portfolio, which is reflected in the half year financial statements.

AFS assets are valued using quoted market prices wherever these are available. For assets where such prices are not available (e.g. for many asset backed securities) market prices are obtained from leading investment banks.

The Company's portfolio of US\$ collateralised debt obligations (CDOs), before impairments and converted to sterling, amounted to £196.0 million at the end of June 2008 (31 December 2007 - £195.5 million). An impairment provision of £23.8 million has been made against this portfolio in the first half of the year (£178.3 million in 12 months to December 2007). In addition, a mark to market reduction in the value of this portfolio of £4.3 million has been recorded within the available for sale (AFS) reserve (31 December 2007 - £11.2 million).

In addition to the review of the Company's US\$ CDOs, a review of all other AFS assets has been undertaken and, while these have seen market price falls, these falls are considered to be due to wider credit spreads and

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liquidity shortages rather than the performance of the underlying assets. Consequently, no provision for impairment is considered necessary against these assets. The fair value of AFS assets in total are recorded on the balance sheet at £5.1 billion (31 December 2007 - £6.0 billion).

The current holding value as a % of book value of the Company's AFS securities is as follows:

Price Range	30 June 2008 %	30 June 2007 %	31 December 2007 %
100+	3.7	39.8	20.9
80 – 100	89.0	60.2	78.0
60 – 80	7.1	0.0	0.7
< 60	0.2	0.0	0.4
Total	100.0	100.0	100.0

Included within AFS assets are £59 million nominal value of residential mortgage backed securities with exposures to US sub-prime and Alt-A loans, with a carrying value of £54 million. These securities are all rated AAA, and have no underlying exposures originated later than 2005. The Company also has exposure to commercial mortgage backed securities with a nominal value of £418 million and a carrying value of £380 million. Of these, only £18.5 million is rated below A. The exposures are highly seasoned and include no US transactions. Northern Rock does not have any direct exposure to the leveraged finance market but does have some indirect exposure through the Collateralised Loan Obligation (CLO) market. At 30 June 2008, the exposure was to a nominal value of £514 million with a carrying value of £436 million. Of the nominal exposure only £7.2 million is rated below A.

### Funding

Northern Rock traditionally had four funding arms comprising wholesale funding, securitisation, covered bonds and retail deposits. In addition to these sources of funding, in September 2007 the Company arranged a loan facility with the Bank of England.

Flows of each funding channel and closing balances are shown in the following table:

	Retail £m	Wholesale £m	Securitisation £m	Covered Bonds £m	Bank of England £m
<b>2008 1st Half</b>					
Net flow	3,680	(2,112)	(6,501)	-	(5,967)
Closing balances	14,197	10,775	37,657	9,403	20,963
<b>2007 Full Year</b>					
Net flow	(12,168)	(11,695)	1,744	2,194	26,930
Closing balances	10,469	11,472	43,070	8,938	26,930
<b>2007 2nd Half</b>					
Net flow	(13,902)	(14,204)	(4,104)	-	26,930
Closing balances	10,469	11,472	43,070	8,938	26,930
<b>2007 1st Half</b>					
Net flow	1,734	2,509	5,848	2,194	-
Closing balances	24,350	26,710	45,698	8,105	-

Note: Net flows represent net cashflows excluding fair value adjustments. Closing balances are stated including fair value adjustments. Bank of England funding excludes open market repo funding.

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### Retail

Retail funding in the first six months of the year comprised a net inflow of £3.7 billion, compared with a net outflow of £13.9 billion in the second half of 2007.

Closing retail balances comprised:

	30 June 2008 £m	30 June 2007 £m	31 December 2007 £m
Branch accounts	3,045	5,597	3,035
Postal accounts	5,995	9,943	4,351
Internet accounts	3,560	4,130	1,531
Offshore accounts	1,199	3,775	1,088
Telephone accounts	152	441	181
Legal & General branded accounts	246	464	283
Total retail balances	14,197	24,350	10,469

In March 2008, the Company announced its intention to close the retail funding operation in Denmark, which has been completed during the first half of the year and is reflected in the movements within offshore accounts balances. The offshore retail funding operations in Ireland and Guernsey remain in place.

Northern Rock has complied at all times with the commitments set out in its Competitive Framework, subsequent to its publication in March 2008. This Framework commits Northern Rock to:

- Not promote the Government guarantees
- Not sustain a prolonged presence as market leader
- Maintain market shares well below historic levels
- Achieve competitive differentiation through service and innovation
- Treat customers fairly and regularly monitor and review adherence to the Framework

At 30 June 2008, retail funding represented 15.3% of funding balances (31 December 2007 - 10.4%). In the medium term the Company plans to achieve a funding mix with retail representing approximately 50% of funding balances.

### Wholesale

Wholesale funding balances continued to reduce during the first half of 2008 in line with contractual maturities, following the significant reduction in balances during the second half of 2007. Northern Rock will seek to raise limited amounts of new funding through this channel in the second half of the year, with the intention of gradually increasing wholesale funding balances.

### Securitisation

Securitisation is the process whereby Northern Rock, through the Granite programme, has raised wholesale funding secured on a segregated pool of mortgage assets. These assets are held in special purpose entities (SPEs) set up for this purpose, which are fully consolidated in Northern Rock's financial statements. Northern Rock retains an economic interest in the SPEs through a combination of subordinated loans and profit retained in the SPEs. Borrowings secured on this pool of mortgages may not be repaid from any source other than the proceeds of those mortgages within the pool. In order to maintain this funding structure, Northern Rock periodically sells further mortgages to the SPEs when necessary.

Securitisation balances outstanding reduced to £37.7 billion at 30 June 2008 (31 December 2007 - £43.1 billion) as a result of note repayments made during the period. No new Granite notes were issued in the first half of 2008.

## NORTHERN ROCK GROUP HALF YEAR RESULTS

The notes of Granite issue 07-3, which were issued in the second half of 2007 to be used as collateral for loans from the Bank of England, were redeemed during the first half of 2008.

At 30 June 2008, securitised notes represented 40.5% of funding balances (31 December 2007 - 42.7%).

### Covered Bonds

Covered bonds are secured by a pool of ring-fenced residential mortgages. In the first half of 2008 no additional funds were raised through this programme, and no capital repayments fell due. Changes in the reported value of outstanding covered bonds reflect exchange rate movements in the first half of 2008.

At 30 June 2008, covered bonds represented 10.1% of funding balances (31 December 2007 - 8.9%).

### Bank of England Facilities

As of 30 April 2008, the structure of the Bank of England facilities was amended. The amendments included making a committed reserve facility available to Northern Rock, and also resulted in a number of deposit accounts being established for Northern Rock to lodge funds with the Bank of England for day-to-day liquidity purposes, rather than providing the Company with a revolving loan facility as was assumed in the original Plan. To ensure consistency in its external reporting of progress on repayment of the loan following these amendments, the Company will report on a net basis i.e. gross loan outstanding less liquidity deposits held with the Bank of England. On this basis the net loan amount has reduced by £9.4 billion in the first half of the year.

	<b>30 June 2008</b>	<b>31 December 2007</b>
	<b>£bn</b>	<b>£bn</b>
Amount due to Bank of England	21.0	26.9
Liquidity deposit accounts with Bank of England	(3.5)	-
	<hr/>	<hr/>
	17.5	26.9

The cost of the Bank of England net funding and HM Treasury guarantees will be revised once approval for State aid is granted by the European Commission. This revision will be back-dated to 1 April 2008 with a retrospective adjustment made when State aid is approved. If the post State aid approval basis of charging had been applied in the first half of 2008 the reported loss before tax would have been reduced by £64.0 million.

It is anticipated that the Bank of England loan facilities will be novated to HM Treasury during the second half of 2008.

## NORTHERN ROCK GROUP HALF YEAR RESULTS

### FINANCIAL PERFORMANCE

The summary income statement for the six months to 30 June 2008 and 2007 and the 12 months to 31 December 2007 is as follows:

	Six months to 30 June		Full Year
	2008	2007	2007
	£m	£m	£m
Net interest income	(51.9)	392.6	761.4
Other income	12.6	127.5	(39.0)
<b>Total income</b>	<b>(39.3)</b>	<b>520.1</b>	<b>722.4</b>
Administrative expenses	(134.8)	(152.4)	(276.1)
Exceptional expenses	(165.6)	-	(127.2)
Donation to the Northern Rock Foundation	(7.5)	(14.8)	(14.8)
Total expenses	(307.9)	(167.2)	(418.1)
Impairment charges on loans and advances	(191.6)	(56.8)	(239.7)
Impairment charges on unsecured investment loans	(46.6)	-	(232.2)
<b>(Loss) / profit before taxation</b>	<b>(585.4)</b>	<b>296.1</b>	<b>(167.6)</b>
Taxation	19.9	(88.0)	(31.4)
<b>(Loss) / profit for the year</b>	<b>(565.5)</b>	<b>208.1</b>	<b>(199.0)</b>
Attributable to:			
Appropriations	26.7	19.9	44.5
(Loss) / profit attributable to equity shareholders	(592.2)	188.2	(243.5)
<b>Total</b>	<b>(565.5)</b>	<b>208.1</b>	<b>(199.0)</b>

### Total Income and Interest Margin and Spread

The following table shows net interest income, total income and interest ratios for 2008 and 2007:

	Six months to 30 June		Full Year
	2008	2007	2007
	£m	£m	£m
Net interest income	(51.9)	392.6	761.4
Other income	12.6	127.5	(39.0)
<b>Total income</b>	<b>(39.3)</b>	<b>520.1</b>	<b>722.4</b>
Interest margin (as reported)	(0.13)%	0.70%	0.70%
Interest spread (as reported)	(0.33)%	0.53%	0.52%
Interest margin (underlying)	0.19%	0.86%	0.73%
Interest spread (underlying)	0.00%	0.68%	0.55%

Note: Interest margin has been calculated by reference to average interest earning assets excluding fair value adjustments. Average balances have been calculated on a monthly basis. Interest spread represents the difference between interest receivable as a % of average interest earning assets, excluding fair value adjustments, and interest payable as a % of average interest bearing liabilities, excluding fair value adjustments. For the purpose of calculating interest margin and spread, average balances for assets and liabilities denominated in foreign currencies, where these have been economically hedged, are based on the contract rate implicit in the associated hedging instrument.

Underlying interest margin (which primarily excludes hedge accounting ineffectiveness and reflects the potential impact of State aid approval) at 0.19% and underlying interest spread at 0.00% for the six months to 30 June 2008 compare with 0.73% and 0.55% respectively for the 12 months to 31 December 2007. The reductions primarily reflect higher funding costs due to the Bank of England funding being charged at a premium rate higher than the average cost of other funding.

## NORTHERN ROCK GROUP HALF YEAR RESULTS

The table below shows an analysis of other income:

	Six months to 30 June		Full Year
	2008	2007	2007
	£m	£m	£m
Net fee and commission income	13.4	80.5	137.4
Other operating income	0.4	0.8	1.3
(Losses) / gains on available for sale securities	(17.8)	37.9	(136.6)
Gains on disposal of loan books	39.3	17.8	23.8
Net trading expense	(22.7)	(9.5)	(64.9)
<b>Total other income</b>	12.6	127.5	(39.0)

Net fee and commission income, which mainly comprises valuation commission, commission income generated on sales of third party products such as building and contents and payment protection insurance less third party administration fees not included within net interest income, has reduced in line with significantly lower levels of new business.

(Losses) / gains on available for sale securities in the first half of 2008 comprised a charge of £23.8 million in relation to impairments on US\$ CDOs, compared with a charge of £178.3 million for the full year 2007 (2007 first half charge - nil). This charge was partially offset by realised gains on AFS securities sold in the first half of the year of £6.0 million (2007 first half - £37.9 million, 2007 full year - £41.7 million).

The gains on the disposal of loan books in the first half of 2008 represented the profit realised on the sale of the Lifetime mortgage portfolio to JP Morgan. The gains on disposal of loan books in 2007 represented the profit realised on the sale of the secured commercial loan portfolio to Lehman Commercial Mortgage Conduit Limited.

Net trading expense includes gains on fair value movements on derivatives not in designated hedge accounting relationships of £1,226.0 million (2007 first half - loss of £536.3 million, 2007 full year - gain of £998.4 million), offset by cross-currency exchange rate losses of £1,219.7 million (2007 first half - gain of £526.1 million, 2007 full year - loss of £1,045.2 million). These are covered in more detail below within the narrative on hedge ineffectiveness. In addition, within net trading expense is a negative movement in the fair value of treasury investment securities designated as "held at fair value through the income statement" amounting to £29.0 million net of income received on these instruments (2007 first half - gain of £0.7 million, 2007 full year - loss of £18.1 million).

### **Hedge Ineffectiveness**

Volatility in reported results arises from hedge ineffectiveness on derivative instruments that hedge risk exposure on an economic basis. Such accounting volatility, which will offset over time, arises due to accounting ineffectiveness on designated hedges or because hedge accounting has not been adopted or is not achievable on certain transactions. The Company manages its risk exposures on an economic basis and does not include accounting hedge ineffectiveness in the assessment of its operating performance or in assessing the effectiveness of its derivative positions in any one financial period.

## NORTHERN ROCK GROUP HALF YEAR RESULTS

An analysis of hedge ineffectiveness and other fair value gains and losses is set out below:

	Six months to 30 June 2008	2007	Full Year 2007
	£m	£m	£m
Fair value hedge ineffectiveness	(84.6)	(22.8)	6.7
Cashflow hedge ineffectiveness	0.2	(3.9)	(7.5)
Hedge ineffectiveness included within interest margin	(84.4)	(26.7)	(0.8)
Fair value movements on hedging derivatives	1,226.0	(536.3)	998.4
Cross-currency movements	(1,219.7)	526.1	(1,045.2)
	6.3	(10.2)	(46.8)
Total hedge ineffectiveness and other fair value gains and losses	(78.1)	(36.9)	(47.6)
Interest implicit in forward foreign exchange contracts	-	22.9	49.6
	(78.1)	(14.0)	2.0

Northern Rock enters into derivative financial instruments for economic hedging purposes. Some of these are designated and accounted for as IAS 39 compliant fair value or cash flow hedge relationships. Where effective fair value hedge relationships can be established, the movement in the fair value of the derivative instrument is offset in full or in part by opposite movements in the fair value of the instrument being hedged. Any ineffectiveness arising from different movements in fair value will offset over time. Ineffectiveness is included within interest income or expense, as appropriate.

Where derivatives are economically effective for hedging purposes but cannot be included within effective IAS 39 compliant accounting hedge relationships, the movement in their fair value is recorded within net trading expense. These are also excluded from management's view of operational performance as these fair value adjustments are not realised in the current accounting period. The same treatment applies to the revaluation at each balance sheet date of economically hedged foreign currency assets and liabilities.

Hedge ineffectiveness has increased in the first half of 2008 partly as a result of a dislocation in LIBOR rates in the one to three month period, where three month rates have been significantly higher than one month rates. This has led to significant volatility in the valuation of derivative instruments which in turn has led to greater hedge ineffectiveness than previously experienced.

In the first half of 2008, Northern Rock ceased using forward foreign exchange contracts to hedge retail and wholesale currency exposures, and therefore the interest implicit in such contracts within underlying interest margin was negligible. Due to the reduction in balances of non-sterling retail and wholesale funding, these exposures can be matched with assets held in the same currency so they are naturally hedged.

### **Administrative Expenses**

Total administrative expenses in the first half of 2008, excluding non-recurring expenses and the donation to The Northern Rock Foundation amounted to £134.8 million, compared with £152.4 million in the first half of 2007. This reduction reflects the significantly reduced levels of new business activity and reduced staffing levels. The depreciation charge was lower in the first half of 2008 compared with the first half of 2007 as a result of software write-offs in the first half of 2008.

## NORTHERN ROCK GROUP HALF YEAR RESULTS

### Exceptional Expenses

Exceptional expenses of £165.6 million were incurred in the first half of 2008, compared with £127.2 million in the second half of 2007. These expenses represented professional fees and costs incurred as a result of the strategic review process implemented in the second half of 2007 and the development of the Company's business plan following the transfer to temporary public ownership in February 2008. These are analysed as follows:

	<b>6 months to 30 June 2008 £m</b>	<b>Full Year 2007 £m</b>
Provision for redundancy and associated costs	37.0	-
Professional fees incurred by the Company	21.6	21.2
Professional fees recharged by the Tripartite Authorities	10.8	12.5
Corporate advisory fees	4.2	2.5
Reimbursement of third party expenses relating to strategic review	8.7	5.1
Cost of staff withdrawals from Save As You Earn schemes	-	4.5
Accelerated charge on cancellation of share schemes	39.6	-
Other non-recurring administrative expenses	8.1	5.2
Non-recurring administrative expenses	130.0	51.0
Impairment charges on tangible and intangible fixed assets	35.6	76.2
Total exceptional expenses	165.6	127.2

In line with previous guidance provided in relation to the restructuring programme set out in the Plan, Northern Rock started the formal 90 day consultation period with Unite and other employee representatives in May 2008. Subject to the outcomes of this consultation, staff numbers are likely to reduce by around 2,000 compared with 2007, with the majority of the reduction occurring in 2008.

The accelerated charge on cancellation of share schemes represents the charge to the income statement of all previously unexpensed costs required by IFRS 2 – Share-Based Payment on Cancellation of Staff Share Schemes, after the transfer of all shares in the Company to HM Treasury on 22 February 2008.

### **Social Responsibility - The Northern Rock Foundation**

Since demutualisation in 1997, Northern Rock has donated 5% of pre tax profit to The Northern Rock Foundation. Such donations are used to support community and charitable causes mainly, but not exclusively, in the North East of England and Cumbria.

Following Northern Rock entering temporary public ownership, a commitment was made that the Foundation would receive at least £15 million per year in 2008, 2009 and 2010. In the first half of 2008 the amount donated was £7.5 million (2007 first half - £14.8 million). This results in almost £200 million having been donated since the Foundation's inception in 1997.

Further information on The Northern Rock Foundation is available on the Company's website.

## NORTHERN ROCK GROUP HALF YEAR RESULTS

### Taxation

Based on a loss before tax of £585.4 million, the effective tax rate in the first half of 2008 was 3.40% of pre tax losses (30 June 2007 – effective rate of 29.71%). This credit is unusually low and is primarily due to not recognising a deferred income tax asset on current year tax losses. Even though the deferred tax asset has not been recognised for accounting purposes it will be available to reduce future taxable profits. As at 30 June 2008, the Company had £192 million of unrecognised deferred income tax assets to carry forward against future taxable profits.

	Six months to 30 June		Full Year
	2008	2007	2007
	%	%	%
Expected effective tax rate	(28.49)	30.00	(30.00)
Deferred income tax asset not recognised	24.32	-	33.23
Exceptional, non-tax deductible costs	2.58	-	22.26
Current year recurring non-tax deductible costs / non-taxable income	0.31	0.17	(0.24)
Utilisation of previously unrecognised tax losses	-	(0.39)	(2.00)
Restatement of the group deferred tax liability from 30%	-	0.61	0.36
Net prior year adjustments	(2.12)	(0.69)	(4.87)
Effective tax rate	(3.40)	29.70	18.74

### Reconciliation of Statutory and Underlying (Loss) / Profit Before Tax

As described above, management do not consider the volatility in reported income arising from hedge ineffectiveness in their assessment of operating performance of the Group in any one financial period and have historically reported underlying results together with statutory results. In addition, exceptional expenses, impairments on treasury assets and the estimated impact of State aid approval on the cost of Bank of England funding and HM Treasury guarantees are excluded from management's assessment of underlying results as set out in the following table:

	Six months to 30 June		Full Year
	2008	2007	2007
	£m	£m	£m
Statutory (loss) / profit before tax	(585.4)	296.1	(167.6)
Adjustments:			
Hedge ineffectiveness	78.1	14.0	(2.0)
Impairments on treasury assets	70.4	-	410.5
Exceptional expenses	165.6	-	127.2
Realised gain on swaps	-	39.0	39.0
Net losses on changes in fair value of assets held at fair value	31.0	0.7	21.1
Impact of State aid approval on the cost of Bank of England funding and HM Treasury guarantees	64.0	-	-
Notional impact on covenant to The Northern Rock Foundation	-	(2.5)	(6.3)
Underlying (loss) / profit before tax	(176.3)	347.3	421.9

## **NORTHERN ROCK GROUP HALF YEAR RESULTS**

### **Capital**

Capital resources have been negatively impacted by the reported loss in the first half of the year with regulatory core Tier 1 capital falling to £767.8 million at 30 June 2008 and total Tier 1 after deductions to £1,355.1 million.

The reduction in the level of total Tier 1 resources also has an impact on the level of allowable Tier 2 and innovative Tier 1 capital that can be included in capital resources. The combined effect of this is to exclude £477.5 million from total allowable capital resources.

As a result of these factors the Tier 1 ratio at 30 June 2008 was 5.1% (31 December 2007: 7.7%) and the total capital ratio 10.2% (31 December 2007: 14.4%).

The deterioration in market conditions will result in increased levels of credit losses, which will impact negatively on capital resources. In addition, although as the balance sheet reduces capital requirements should fall, this will in the short to medium term be offset by risk weighted assets increasing as a proportion of exposures as credit quality deteriorates.

These factors have led to the requirement to strengthen the capital resources of the Company. This is to be achieved by the conversion to Ordinary shares of the existing £400 million of Preference shares and up to £3 billion of the Bank of England loan following its planned novation to HM Treasury. Such conversion will be finalised subject to State aid approval, and will significantly strengthen the Company's capital position.

At the Company's request, the FSA has agreed to waive the limits on use by the Company of Tier 2 capital. This will mean that all available Tier 2 capital will be included within capital resources without restriction for the purposes of meeting the Company's minimum regulatory capital requirements on a temporary basis until the recapitalisation of the Company following the obtainment of State aid approval or 31 December 2008 whichever is earlier.

### **Outlook**

The outlook for the UK mortgage industry remains uncertain, despite the various actions from central banks to improve the functioning of the financial markets during the first half of 2008. Combined with testing conditions in the wider global economy, this environment presents Northern Rock with challenges, particularly in relation to the Company's targeted mortgage redemptions level and in managing the quality of its shrinking loan portfolios. However, against this backdrop Northern Rock's progress against its Plan is encouraging. The rate of balance sheet contraction and the repayment of the Bank of England loan facilities are currently ahead of Plan.

Northern Rock anticipates that State aid approval will be obtained in the second half of the year which will enable the recapitalisation of the Company to be completed. The restructuring and realignment of the Company is progressing satisfactorily and will result in an organisation better equipped to meet the demands of the future.

# NORTHERN ROCK GROUP HALF YEAR RESULTS

## FINANCIAL INFORMATION

### CONSOLIDATED INCOME STATEMENT

	<u>Note</u>	<b>Six months to 30 June</b>		<b>Full year</b>
		<b><u>2008</u></b>	<b><u>2007</u></b>	<b><u>2007</u></b>
		<b><u>(Unaudited)</u></b>	<b><u>(Unaudited)</u></b>	<b><u>(Audited)</u></b>
		<b><u>£m</u></b>	<b><u>£m</u></b>	<b><u>£m</u></b>
<b>Interest and similar income</b>		2,967.0	3,190.5	6,907.5
<b>Interest expense and similar charges</b>		(3,018.9)	(2,797.9)	(6,146.1)
<b>Net interest income</b>	2	(51.9)	392.6	761.4
Fee and commission income		35.7	103.7	185.1
Fee and commission expense		(22.3)	(23.2)	(47.7)
Other operating income		0.4	0.8	1.3
(Losses)/gains on available for sale securities	3	(17.8)	37.9	(136.6)
Gains on disposal of loan books	4	39.3	17.8	23.8
Net trading expense	5	(22.7)	(9.5)	(64.9)
		12.6	127.5	(39.0)
<b>Total income</b>		(39.3)	520.1	722.4
Exceptional administrative expenses		(130.0)	-	(51.0)
Exceptional impairment charges on property, plant and equipment		(6.8)	-	(56.3)
Provisions for onerous contracts		(1.7)	-	(12.9)
Exceptional impairment charges on intangible assets		(27.1)	-	(7.0)
	6	(165.6)	-	(127.2)
Administrative expenses	6	(124.8)	(138.4)	(247.2)
Depreciation and amortisation	6	(10.0)	(14.0)	(28.9)
Covenant to The Northern Rock Foundation		(7.5)	(14.8)	(14.8)
Operating expenses		(307.9)	(167.2)	(418.1)
Impairment charges on loans and advances	7	(191.6)	(56.8)	(239.7)
Impairment charges on unsecured investment loans	7	(46.6)	-	(232.2)
<b>(Loss)/profit before taxation</b>		(585.4)	296.1	(167.6)
Income tax credit/(expense)		19.9	(88.0)	(31.4)
<b>(Loss)/profit for the period</b>		(565.5)	208.1	(199.0)
Attributable to:				
Appropriations	8	26.7	19.9	44.5
(Loss)/profit attributable to equity shareholders		(592.2)	188.2	(243.5)
<b>Total</b>		(565.5)	208.1	(199.0)

Details of dividends are set out in note 9.

# NORTHERN ROCK GROUP HALF YEAR RESULTS

## CONSOLIDATED BALANCE SHEET

	<u>Note</u>	<b>30 June 2008 (Unaudited) £m</b>	<b>30 June 2007 (Unaudited) £m</b>	<b>31 December 2007 (Audited) £m</b>
<b>Assets</b>				
Cash and balances with central banks	10	3,559.4	767.7	190.2
Derivative financial instruments		3,923.5	1,432.9	2,241.0
Loans and advances to banks		2,217.4	6,812.3	1,292.5
Loans and advances to customers	11	84,355.2	96,760.8	98,834.6
Fair value adjustments of portfolio hedging		(561.6)	(835.5)	183.9
Investment securities	12	5,165.8	8,119.5	6,108.7
Intangible assets		68.9	100.8	95.8
Property, plant and equipment		193.7	215.9	184.0
Current tax asset		3.2	-	115.0
Deferred income tax asset		-	4.5	-
Retirement benefit asset		3.1	13.3	5.7
Other assets		30.4	33.7	27.1
Prepayments and accrued income		52.9	80.4	42.5
<b>Total assets</b>		<b>99,011.9</b>	<b>113,506.3</b>	<b>109,321.0</b>
<b>Liabilities</b>				
Loans from central bank	14	21,246.0	-	28,473.0
Deposits by banks		1,517.6	3,683.8	744.2
Customer accounts	15	14,565.4	30,122.8	11,562.8
Derivative financial instruments		1,251.0	2,872.8	1,743.4
Debt securities in issue				
Securitised notes	16	37,657.1	45,697.8	43,069.5
Covered bonds	13, 16	9,402.7	8,104.9	8,938.1
Other	16	8,889.8	17,253.1	9,633.7
Other liabilities		63.2	141.1	66.3
Current taxation liabilities		-	62.2	-
Accruals and deferred income		895.9	928.5	962.9
Provisions for liabilities and charges		56.0	-	58.4
Subordinated liabilities		1,249.8	1,069.7	1,161.8
Tier one notes		196.4	187.5	207.6
		<b>96,990.9</b>	<b>110,124.2</b>	<b>106,621.7</b>
<b>Equity</b>				
<b>Shareholders' funds</b>				
Called up share capital				
Ordinary		123.9	123.9	123.9
Preference		0.1	0.1	0.1
Share premium account				
Ordinary		6.8	6.8	6.8
Preference		396.4	396.4	396.4
Capital redemption reserve		7.3	7.3	7.3
Other reserves				
Revaluation reserve – available for sale investments	17	(312.6)	(49.7)	(93.7)
Hedging reserve – cash flow hedges		62.7	114.6	(29.2)
Retained earnings		700.6	1,746.9	1,251.9
<b>Total equity attributable to equity shareholders</b>		<b>985.2</b>	<b>2,346.3</b>	<b>1,663.5</b>
<b>Non shareholders' funds</b>				
Reserve capital instruments		299.3	299.3	299.3
Subordinated notes		736.5	736.5	736.5
<b>Total non shareholders' funds</b>		<b>1,035.8</b>	<b>1,035.8</b>	<b>1,035.8</b>
<b>Total equity</b>		<b>2,021.0</b>	<b>3,382.1</b>	<b>2,699.3</b>
<b>Total equity and liabilities</b>		<b>99,011.9</b>	<b>113,506.3</b>	<b>109,321.0</b>

# NORTHERN ROCK GROUP HALF YEAR RESULTS

## CONSOLIDATED CASH FLOW STATEMENT

	Six months to 30 June		Full year
	<u>2008</u>	<u>2007</u>	<u>2007</u>
	<u>(Unaudited)</u>	<u>(Unaudited)</u>	<u>(Audited)</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
<b>Net cash inflow/(outflow) from operating activities</b>			
(Loss)/profit before taxation	(585.4)	296.1	(167.6)
Adjusted for:			
Depreciation and amortisation	10.0	14.0	28.9
Impairment charges on property, plant and equipment	6.8	-	56.3
Impairment charges on intangible assets	27.1	-	7.0
Impairment charges on loans and advances	191.6	56.8	239.7
Impairment charges on unsecured investment loans	46.6	-	232.2
Income taxes refunded/(paid)	96.5	(69.1)	(69.3)
Fair value adjustments on financial instruments	485.0	194.6	(552.7)
Other non cash movements	280.4	30.1	(114.4)
Net cash inflow/(outflow) from operating (losses)/ profits before changes in operating assets and liabilities	<u>558.6</u>	<u>522.5</u>	<u>(339.9)</u>
Changes in operating assets and liabilities			
Net decrease/(increase) in deposits held for regulatory or monetary control purposes	38.2	(7.2)	11.4
Net decrease/(increase) in loans and advances	14,200.1	(10,890.8)	(12,044.3)
Net increase in derivative financial instruments receivable	(1,682.5)	(561.6)	(1,369.7)
Net (increase)/decrease in other assets	(13.7)	(2.2)	42.3
Net (decrease)/increase in debt securities in issue	(5,464.7)	7,063.1	(2,567.2)
Net (decrease)/increase in loans from central bank	(7,227.0)	-	28,473.0
Net increase/(decrease) in deposits from other banks	773.5	1,547.6	(1,392.1)
Net increase/(decrease) in amounts due to customers	3,010.3	3,271.1	(15,313.6)
Net (decrease)/increase in derivative financial instruments payable	(492.4)	480.3	(649.1)
Net (decrease)/increase in other liabilities	(3.1)	18.5	(56.3)
Net (decrease)/increase in accruals and deferred income	(67.0)	8.8	43.2
Net cash inflow/(outflow) from operating activities	<u>3,630.3</u>	<u>1,450.1</u>	<u>(5,162.3)</u>
<b>Net cash inflow/(outflow) from investing activities</b>			
Net investment in intangible assets	(12.2)	(17.3)	(32.7)
Net investment in property, plant and equipment	(14.5)	(25.9)	(51.8)
Purchase of securities	(24.7)	(3,020.2)	(3,550.8)
Proceeds from sale and redemption of securities	757.9	1,605.8	3,784.4
	<u>706.5</u>	<u>(1,457.6)</u>	<u>149.1</u>
<b>Net cash (outflow)/inflow from financing activities</b>			
Issue of subordinated liabilities	-	328.1	328.1
Ordinary dividend paid	-	(105.0)	(105.0)
Preference dividend paid	-	-	(27.8)
Appropriations (including tax of £1.3m, 30 June 2007 - £8.5m, 31 December 2007 - £19.4m)	(28.0)	(28.4)	(63.9)
	<u>(28.0)</u>	<u>194.7</u>	<u>131.4</u>
Net increase/(decrease) in cash and cash equivalents	<u>4,308.8</u>	<u>187.2</u>	<u>(4,881.8)</u>
Opening cash and cash equivalents	1,435.9	6,317.7	6,317.7
Closing cash and cash equivalents	<u>5,744.7</u>	<u>6,504.9</u>	<u>1,435.9</u>

## NORTHERN ROCK GROUP HALF YEAR RESULTS

### CONSOLIDATED STATEMENT OF RECOGNISED INCOME AND EXPENSE (Unaudited)

	Note	Called up share capital £m	Share premium account £m	Capital redemption reserve £m	Other reserves £m	Retained earnings £m	Total shareholders' funds £m	Non shareholders' funds £m	Total equity £m
<b>Six months ended 30 June 2008</b>									
Net movement in available for sale reserve		-	-	-	(240.5)	-	(240.5)	-	(240.5)
Net movement in cash flow hedge reserve		-	-	-	116.2	-	116.2	-	116.2
Actuarial gains and losses		-	-	-	-	(0.9)	(0.9)	-	(0.9)
Tax effects of the above		-	-	-	(2.7)	0.3	(2.4)	-	(2.4)
<b>Total of items recognised directly in equity</b>		-	-	-	<b>(127.0)</b>	<b>(0.6)</b>	<b>(127.6)</b>	-	<b>(127.6)</b>
Loss for the period		-	-	-	-	(592.2)	(592.2)	26.7	(565.5)
<b>Total recognised income and expense for the period</b>		-	-	-	<b>(127.0)</b>	<b>(592.8)</b>	<b>(719.8)</b>	<b>26.7</b>	<b>(693.1)</b>
<b>Note – reconciliation of movements in equity</b>									
<b>Total – as above</b>		-	-	-	<b>(127.0)</b>	<b>(592.8)</b>	<b>(719.8)</b>	<b>26.7</b>	<b>(693.1)</b>
Dividends	9	-	-	-	-	-	-	-	-
Appropriations		-	-	-	-	-	-	(26.7)	(26.7)
Movement in own shares	18	-	-	-	-	41.5	41.5	-	41.5
Balance at 31 December 2007		124.0	403.2	7.3	(122.9)	1,251.9	1,663.5	1,035.8	2,699.3
<b>Balance at 30 June 2008</b>		<b>124.0</b>	<b>403.2</b>	<b>7.3</b>	<b>(249.9)</b>	<b>700.6</b>	<b>985.2</b>	<b>1,035.8</b>	<b>2,021.0</b>

## NORTHERN ROCK GROUP HALF YEAR RESULTS

### CONSOLIDATED STATEMENT OF RECOGNISED INCOME AND EXPENSE (Unaudited)

	Note	Called up share capital £m	Share premium account £m	Capital redemption reserve £m	Other reserves £m	Retained earnings £m	Total shareholders' funds £m	Non shareholders' funds £m	Total equity £m
<b>Six months ended 30 June 2007</b>									
Net movement in available for sale reserve		-	-	-	(70.1)	-	(70.1)	-	(70.1)
Net movement in cash flow hedge reserve		-	-	-	158.5	-	158.5	-	158.5
Actuarial gains and losses		-	-	-	-	35.6	35.6	-	35.6
Tax effects of the above		-	-	-	(22.2)	(10.4)	(32.6)	-	(32.6)
<b>Total of items recognised directly in equity</b>		-	-	-	<b>66.2</b>	<b>25.2</b>	<b>91.4</b>	-	<b>91.4</b>
Profit for the period		-	-	-	-	188.2	188.2	19.9	208.1
<b>Total recognised income and expense for the period</b>		-	-	-	<b>66.2</b>	<b>213.4</b>	<b>279.6</b>	<b>19.9</b>	<b>299.5</b>
<b>Note – reconciliation of movements in equity</b>									
<b>Total – as above</b>		-	-	-	<b>66.2</b>	<b>213.4</b>	<b>279.6</b>	<b>19.9</b>	<b>299.5</b>
Dividends	9	-	-	-	-	(105.0)	(105.0)	-	(105.0)
Appropriations		-	-	-	-	-	-	(19.9)	(19.9)
Movement in own shares	18	-	-	-	-	(3.1)	(3.1)	-	(3.1)
Balance at 31 December 2006		124.0	403.2	7.3	(1.3)	1,641.6	2,174.8	1,035.8	3,210.6
<b>Balance at 30 June 2007</b>		<b>124.0</b>	<b>403.2</b>	<b>7.3</b>	<b>64.9</b>	<b>1,746.9</b>	<b>2,346.3</b>	<b>1,035.8</b>	<b>3,382.1</b>

## NORTHERN ROCK GROUP HALF YEAR RESULTS

### CONSOLIDATED STATEMENT OF RECOGNISED INCOME AND EXPENSE (Audited)

	Note	Called up share capital £m	Share premium account £m	Capital redemption reserve £m	Other reserves £m	Retained earnings £m	Total shareholders' funds £m	Non shareholders' funds £m	Total equity £m
<b>Year ended 31 December 2007</b>									
Net movement in available for sale reserve		-	-	-	(132.6)	-	(132.6)	-	(132.6)
Net movement in cash flow hedge reserve		-	-	-	(29.4)	-	(29.4)	-	(29.4)
Actuarial gains and losses		-	-	-	-	29.5	29.5	-	29.5
Tax effects of the above		-	-	-	40.4	(8.4)	32.0	-	32.0
<b>Total of items recognised directly in equity</b>		-	-	-	<b>(121.6)</b>	<b>21.1</b>	<b>(100.5)</b>	-	<b>(100.5)</b>
Loss for the year		-	-	-	-	(243.5)	(243.5)	44.5	(199.0)
<b>Total recognised income and expense for the year</b>		-	-	-	<b>(121.6)</b>	<b>(222.4)</b>	<b>(344.0)</b>	<b>44.5</b>	<b>(299.5)</b>
<b>Note – reconciliation of movements in equity</b>									
<b>Total – as above</b>		-	-	-	<b>(121.6)</b>	<b>(222.4)</b>	<b>(344.0)</b>	<b>44.5</b>	<b>(299.5)</b>
Dividends	9	-	-	-	-	(132.8)	(132.8)	-	(132.8)
Appropriations		-	-	-	-	-	-	(44.5)	(44.5)
Movement in own shares	18	-	-	-	-	(34.5)	(34.5)	-	(34.5)
Balance at 31 December 2006		124.0	403.2	7.3	(1.3)	1,641.6	2,174.8	1,035.8	3,210.6
<b>Balance at 31 December 2007</b>		<b>124.0</b>	<b>403.2</b>	<b>7.3</b>	<b>(122.9)</b>	<b>1,251.9</b>	<b>1,663.5</b>	<b>1,035.8</b>	<b>2,699.3</b>

# NORTHERN ROCK GROUP HALF YEAR RESULTS

## NOTES TO THE RESULTS

### **1. Basis of Preparation**

#### **Principles underlying going concern assumption**

As a result of disruption in the liquidity and wholesale funding markets in August and September 2007, Northern Rock approached the Bank of England for loan facilities in the event that it was unable to obtain adequate funds from other sources to meet its obligations.

Following significant withdrawals by retail customers, together with wholesale maturities, Northern Rock drew on the facilities during September 2007.

During the remaining period of 2007, the Chancellor of the Exchequer announced arrangements to guarantee, should it be necessary, all existing deposits in Northern Rock, including all unsecured retail products, all uncollateralised and unsubordinated wholesale deposits and wholesale borrowings, all payment obligations under any uncollateralised derivative transactions and all obligations of the Company to make payments on the repurchase of mortgages under the documentation for the Granite securitisation programme.

On 21 February 2008, the Banking (Special Provisions) Bill received Royal Assent. This enabled Northern Rock to be brought into temporary public ownership which was effected on 22 February 2008.

On 30 April 2008, the Bank of England amended and extended the loan agreement with the Company to provide additional loan facilities to enable the Company to pursue its restructuring plans. Details of these facilities are given in note 14 below.

All of the facilities referred to above are subject to appropriate clearance being obtained from the European Commission for State aid for the Company and any other constraints imposed by European legislation. Consent was obtained from the European Commission for the provision of support for the six months from 17 September 2007 under European State aid law. A further submission to the European Commission in relation to longer term restructuring proposals was made on 17 March 2008 and the existing arrangements are expected to be maintained while the submission is considered.

The financial statements have been prepared on a going concern basis. The validity of this assumption depends on the European Commission approving the financing facilities provided by the Bank of England and HM Treasury. If approval is not received it is likely the Company would then submit a solvent wind down plan for European Commission State aid approval. If this were not forthcoming the financing facilities may be withdrawn in which case the Company may not be able to meet its financial obligations as they fall due. The Company may then have to take appropriate insolvency proceedings and cease to trade as a going concern, and adjustments may have to be made to reduce the monetary value of assets to recoverable amounts, to provide for further liabilities that might arise and reclassify all assets and liabilities as current assets and liabilities.

The financial information contained in this half year report has been prepared in accordance with IAS 34 "Interim Financial Reporting" and the Disclosure and Transparency Rules of the Financial Services Authority as applicable to issuers of listed debt securities. The accounting policies and method used to prepare the 2008 half year results remain unchanged from those used in the preparation of the 2007 full year statutory accounts.

#### **New standards, amendments and interpretations**

The following new standards, amendments to standards or interpretations are mandatory for the first time for financial years beginning on 1 January 2008 and have been endorsed for adoption by the EU, but have no financial impact on the Group:

# NORTHERN ROCK GROUP HALF YEAR RESULTS

## NOTES TO THE RESULTS (CONTINUED)

### **1. Basis of Preparation (continued)**

IFRIC 11 – IFRS 2 – Group and treasury share transactions

The following new standards, amendments to standards or interpretations that are relevant to the Group have been issued and have been endorsed for adoption by the EU but are not effective for financial years beginning 1 January 2008 and have not been early adopted:

IFRS 8 – Operating segments, effective for financial years beginning on or after 1 January 2009. The Group believes the application of this standard will have no material impact on the financial statements in the period of initial application.

IFRIC 13 – Customer loyalty programmes, effective for financial years beginning on or after 1 July 2008. The Group believes the application of this interpretation will have no material impact on the financial statements in the period of initial application.

The following new standards, amendments to standards or interpretations are mandatory for the first time for financial years beginning on 1 January 2008 but have not yet been endorsed for adoption by the EU, but have no financial impact on the Group:

IFRIC 12 – Service concession arrangements

IFRIC 14 – IAS 19 – The limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction.

The following new standards, amendments to standards or interpretations that are relevant to the Group have been issued but have not yet been endorsed for adoption by the EU, are not effective for financial years beginning 1 January 2008 and have not been early adopted:

IAS 23 (amendment) – Borrowing costs, effective for financial years beginning on or after 1 January 2009. The Group believes the application of this amendment will have no material impact on the financial statements in the period of initial application.

IFRS 3 (revised) – Business combinations and consequential revisions to IAS 27 – Consolidated and separate financial statements, effective prospectively for business combinations with an effective date on or after 1 July 2009. Management is assessing the impacts of these amendments on acquisition accounting and Group consolidation.

IAS 1 (amendment) – Presentation of financial statements, effective for financial years beginning on or after 1 January 2009. Management is assessing the impact of this amendment on its financial statements, to ensure it meets the revised disclosure requirements introduced by this amendment.

IAS 32 (amendment) – Financial instruments: presentation, and consequential amendments to IAS 1 – Presentation of financial statements, effective for financial years beginning on or after 1 January 2009. The Group believes this amendment has no impact on its financial statements as it has no puttable instruments.

IFRIC 15 – Agreements for the construction of real estate

IFRIC 16 – Hedges of a net investment in a foreign operation

# NORTHERN ROCK GROUP HALF YEAR RESULTS

## NOTES TO THE RESULTS (CONTINUED)

### 2. Net Interest Income

Interest margin has been calculated by reference to average interest earning assets excluding fair value adjustments. Average balances have been calculated on a monthly basis. Interest spread represents the difference between interest receivable as a % of average interest earning assets, excluding fair value adjustments, and interest payable as a % of average interest bearing liabilities, excluding fair value adjustments.

For the purpose of calculating interest margin and spread, average balances for assets and liabilities denominated in foreign currencies, where these have been economically hedged, are based on the contract rate implicit in the associated hedging instrument.

	Six months to 30 June		Full year
	<u>2008</u>	<u>2007</u>	<u>2007</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
<b>Interest income</b>			
Secured advances	2,493.9	2,546.1	5,646.1
Other lending	243.8	254.3	533.1
Investment securities and deposits	229.3	390.1	728.3
Interest income	<u>2,967.0</u>	<u>3,190.5</u>	<u>6,907.5</u>
<b>Interest expense</b>			
Retail customer accounts	389.5	571.7	1,034.1
Other deposits and loans including loans from central bank	2,573.0	2,190.7	5,015.4
Subordinated liabilities	43.3	26.0	71.7
Other	5.1	2.2	9.5
Tier one notes	8.0	7.3	15.4
Interest expense	<u>3,018.9</u>	<u>2,797.9</u>	<u>6,146.1</u>
<b>Net interest income</b>	<u>(51.9)</u>	<u>392.6</u>	<u>761.4</u>
Average interest earning assets excluding fair value adjustments	99,837.2	106,050.5	108,054.1
Average interest bearing liabilities excluding fair value adjustments	96,657.2	102,734.0	104,710.8
Interest margin	(0.13%)	0.70%	0.70%
Interest spread	(0.33%)	0.53%	0.52%

Included within interest income is an adjustment of £1.7m (30 June 2007: £1.6m, 31 December 2007: £3.3m) with respect to the unwind of the discount included in the impairment allowance.

# NORTHERN ROCK GROUP HALF YEAR RESULTS

## NOTES TO THE RESULTS (CONTINUED)

### **3. (Losses)/Gains on Available For Sale Securities**

(Losses)/gains on available for sale securities are analysed as follows:

	<b>Six months to 30 June</b>		<b>Full year</b>
	<b><u>2008</u></b>	<b><u>2007</u></b>	<b><u>2007</u></b>
	<b><u>£m</u></b>	<b><u>£m</u></b>	<b><u>£m</u></b>
Gains on disposal of available for sale securities	6.0	37.9	41.7
Impairment of available for sale securities	(23.8)	-	(178.3)
	(17.8)	37.9	(136.6)

Gains of £6.0m (30 June 2007: £37.9m, 31 December 2007: £41.7m) previously recognised in reserves have been transferred to (losses)/gains on available for sale securities in the Group income statement on the disposal of available for sale securities.

Cash CDOs are classified as available for sale securities and have a carrying value of £619.1m (30 June 2007: £464.8m, 31 December 2007: £670.1m). Their fair value is based on quoted prices in an active market unless there is evidence that the investment is impaired in which case an impairment charge is calculated.

The impairment charge of £23.8m (30 June 2007: £nil, 31 December 2007: £178.3m) is attributable to cash CDOs and is based upon the Group's accounting policies and IAS 39 which requires such impairment to be determined by reference to their quoted market price.

### **4. Gains on Disposal of Loan Books**

During the first half of 2008, the Group sold £2,240.7m (net of provisions) of its residential equity release mortgage portfolio to JP Morgan Limited. Total proceeds (net of costs) amounted to £2,280.0m. The surplus on disposal amounted to £39.3m. Included in the reported results for the period ended 30 June 2008 is net interest income of £0.9m (30 June 2007: £14.9m, 31 December 2007: £23.6m) in relation to those assets to the date of disposal.

During 2007, the Group sold £1,437.8m (net of provisions and fair value adjustments) of its commercial loan portfolio to Lehman Commercial Mortgage Conduit Limited in three separate transactions. Total proceeds (net of costs) amounted to £1,461.6m (30 June 2007: £850.9m). The surplus on disposal amounted to £23.8m (30 June 2007: £17.8m). Included in the reported results for the year ended 31 December 2007 is net interest income of £7.6m (30 June 2007: £3.4m) in relation to those assets to the date of disposal.

### **5. Net Trading Expense**

Net trading expense comprises:

	<b>Six months to 30 June</b>		<b>Full year</b>
	<b><u>2008</u></b>	<b><u>2007</u></b>	<b><u>2007</u></b>
	<b><u>£m</u></b>	<b><u>£m</u></b>	<b><u>£m</u></b>
Net losses from changes in fair value from financial assets designated at fair value	(31.0)	(0.7)	(21.1)
Net income from financial assets designated at fair value	2.0	1.4	3.0
Fair value movements of future cash flows excluding accruals on derivatives not in hedge accounting relationships	1,226.0	(536.3)	998.4
Translation (losses)/gains on underlying instruments	(1,219.7)	526.1	(1,045.2)
	(22.7)	(9.5)	(64.9)

# NORTHERN ROCK GROUP HALF YEAR RESULTS

## NOTES TO THE RESULTS (CONTINUED)

### 6. Operating Expenses

Operating expenses, excluding the covenant to The Northern Rock Foundation, are as follows:

	Six months to 30 June		Full year
	<u>2008</u>	<u>2007</u>	<u>2007</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Staff costs	82.9	95.2	158.6
Other expenses	41.9	43.2	88.6
Depreciation and amortisation	10.0	14.0	28.9
Total operating expenses	<u>134.8</u>	<u>152.4</u>	<u>276.1</u>

Exceptional administrative expenses are the costs associated with the restructuring of the business and comprise:

	Six months to 30 June		Full year
	<u>2008</u>	<u>2007</u>	<u>2007</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Staff costs	37.0	-	-
Professional fees incurred by the Company	21.6	-	21.2
Professional fees recharged by the Tripartite Authorities	10.8	-	12.5
Corporate advisory fees	4.2	-	2.5
Reimbursement of third party expenses	8.7	-	5.1
Cost of staff withdrawals from Save As You Earn and other share schemes	-	-	4.5
Accelerated charge on cancellation of share schemes	39.6	-	-
Other exceptional administrative expenses	8.1	-	5.2
	<u>130.0</u>	<u>-</u>	<u>51.0</u>
Exceptional impairment charges on property, plant and equipment	6.8	-	56.3
Provision for onerous contracts	1.7	-	12.9
Exceptional impairment charges on intangible assets	27.1	-	7.0
	<u>165.6</u>	<u>-</u>	<u>127.2</u>

Exceptional staff costs of £37.0m (30 June 2007: £nil, 31 December 2007: £nil) mainly represent the costs of redundancy, payments in lieu of notice and outplacement services associated with the reduction in the workforce as part of the restructuring of the business.

The reimbursement of third party expenses represents costs incurred by third parties as part of the strategic review process.

The accelerated charge on cancellation of share schemes represents the charge to the income statement of all previously unexpensed costs required by IFRS 2 – Share-based Payment on cancellation of staff share schemes after the acquisition of all shares in the Company by HM Treasury on 22 February 2008.

The exceptional impairment charges on property, plant and equipment of £6.8m (30 June 2007: £nil, 31 December 2007: £56.3m) and the provisions for onerous contracts of £1.7m (30 June 2007: £nil, 31 December 2007: £12.9m) represent the costs associated with properties and computer hardware no longer required after the restructuring of the business.

The exceptional impairment charges on intangible assets of £27.1m (30 June 2007: £nil, 31 December 2007: £7.0m) represent the costs associated with the accelerated amortisation of software no longer required after the restructuring of the business.

# NORTHERN ROCK GROUP HALF YEAR RESULTS

## NOTES TO THE RESULTS (CONTINUED)

### 6. Operating Expenses (continued)

The average number of persons employed by the Group was as follows:

	Six months to 30 June		Full year
	<u>2008</u>	<u>2007</u>	<u>2007</u>
Full time	4,811	5,059	5,145
Part time	1,154	1,198	1,189

### 7. Impairment Charges on Loans and Advances

	Six months to 30 June		Full year
	<u>2008</u>	<u>2007</u>	<u>2007</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
<b>Impairment charge</b>			
Secured on residential property	55.5	4.3	53.2
Secured on residential buy to let property	18.9	(2.3)	0.5
Secured commercial	0.7	(1.1)	8.6
Unsecured	116.5	55.9	177.4
Total on retail loans and advances	<u>191.6</u>	<u>56.8</u>	<u>239.7</u>
Unsecured investment loans	46.6	-	232.2
<b>Total impairment charge</b>	<u>238.2</u>	<u>56.8</u>	<u>471.9</u>
% of mean advances to customers	0.42%	0.12%	0.26%

	30 June	30 June	31 December
	<u>2008</u>	<u>2007</u>	<u>2007</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
<b>Impairment allowance</b>			
Secured on residential property	100.5	17.0	58.4
Secured on residential buy to let property	23.5	2.5	5.3
Secured commercial	1.5	2.6	0.7
Unsecured	226.3	98.2	178.6
Total on retail loans and advances	<u>351.8</u>	<u>120.3</u>	<u>243.0</u>
Unsecured investment loans	278.5	-	232.2
<b>Total impairment allowance</b>	<u>630.3</u>	<u>120.3</u>	<u>475.2</u>
% of period end advances to customers	0.42%	0.13%	0.25%

Impairment ratios have been calculated excluding the effect of unsecured investment loans.

# NORTHERN ROCK GROUP HALF YEAR RESULTS

## NOTES TO THE RESULTS (CONTINUED)

### 8. Appropriations

	Six months to 30 June		Full year
	<u>2008</u>	<u>2007</u>	<u>2007</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Reserve capital instruments	-	-	25.2
Subordinated notes	28.0	28.5	38.7
Tax on appropriations	(1.3)	(8.6)	(19.4)
<b>Total</b>	<u>26.7</u>	<u>19.9</u>	<u>44.5</u>

### 9. Dividends

The following tables analyse dividends when paid and the period to which they relate:

	Six months to 30 June		Full year
	<u>2008</u>	<u>2007</u>	<u>2007</u>
	<u>pence per share</u>	<u>pence per share</u>	<u>pence per share</u>
Ordinary dividends	-	25.3	25.3
2006 final dividend	-	25.3	25.3

There was no interim or final dividend declared in respect of 2007 and no interim dividend is proposed in respect of 2008.

	Six months to 30 June		Full year
	<u>2008</u>	<u>2007</u>	<u>2007</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Ordinary dividends	-	105.0	105.0
2006 final dividend	-	105.0	105.0
Preference dividend	-	-	27.8
	<u>-</u>	<u>105.0</u>	<u>132.8</u>

### 10. Cash and Balances with Central Banks

	30 June	30 June	31 December
	<u>2008</u>	<u>2007</u>	<u>2007</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Cash in hand	10.4	9.3	19.7
Balances with Bank of England for liquidity purposes	3,466.5	-	-
Mandatory reserve deposits with central banks	30.1	86.9	68.3
Other balances with central banks	52.4	671.5	102.2
	<u>3,559.4</u>	<u>767.7</u>	<u>190.2</u>

Mandatory reserve deposits with central banks are not available for use in day-to-day operations.

# NORTHERN ROCK GROUP HALF YEAR RESULTS

## NOTES TO THE RESULTS (CONTINUED)

### 11. Loans and Advances to Customers

	<b>30 June 2008 £m</b>	<b>30 June 2007 £m</b>	<b>31 December 2007 £m</b>
Advances secured on residential property not subject to securitisation	31,351.3	31,550.9	34,951.8
Advances secured on residential property subject to securitisation	40,011.3	49,762.7	49,326.1
	<u>71,362.6</u>	<u>81,313.6</u>	<u>84,277.9</u>
Residential buy to let loans not subject to securitisation	5,999.6	6,071.5	6,499.8
Residential buy to let loans subject to securitisation	-	110.0	-
	<u>5,999.6</u>	<u>6,181.5</u>	<u>6,499.8</u>
Total advances secured on residential property	<u>77,362.2</u>	<u>87,495.1</u>	<u>90,777.7</u>
Commercial secured advances not subject to securitisation	298.6	341.9	315.9
Commercial secured advances subject to securitisation	-	475.8	-
Total commercial secured advances	<u>298.6</u>	<u>817.7</u>	<u>315.9</u>
Unsecured loans not subject to securitisation	6,329.6	7,828.9	7,350.6
Unsecured investment loans	364.8	619.1	390.4
	<u>84,355.2</u>	<u>96,760.8</u>	<u>98,834.6</u>

An amount of £102.1m at 30 June 2007, in respect of accrued income that forms part of the effective interest rate on loans and advances to customers, has been reclassified from prepayments and accrued income to advances secured on residential property not subject to securitisation. The corresponding amount for 30 June 2008 is £60.6m and for 31 December 2007 is £86.3m. The cash flow statements have been adjusted accordingly.

Fair value adjustments of portfolio hedging amounting to £(561.6)m (30 June 2007: £(835.5)m, 31 December 2007: £183.9m) relate to fair value adjustments of loans and advances to customers in relation to interest rate risk as a result of their inclusion in a fair value portfolio hedge relationship.

### 12. Investment Securities

	<b>30 June 2008 £m</b>	<b>30 June 2007 £m</b>	<b>31 December 2007 £m</b>
Available for sale securities	5,085.6	8,000.4	6,002.7
Assets held at fair value through the income statement	80.2	119.1	106.0
	<u>5,165.8</u>	<u>8,119.5</u>	<u>6,108.7</u>

### 13. Covered Bonds

Included within loans and advances to customers not subject to securitisation are £9,416.4m (30 June 2007: £10,292.7m, 31 December 2007: £10,389.6m) of mortgage advances assigned to a bankruptcy remote special purpose vehicle. These loans provide security to issues of covered bonds made by Northern Rock, which are included within debt securities in issue amounting to £9,402.7m (30 June 2007: £8,104.9m, 31 December 2007: £8,938.1m). Northern Rock retains substantially all the risks and rewards associated with these loans and therefore these transactions do not qualify for derecognition under IAS 39.

# NORTHERN ROCK GROUP HALF YEAR RESULTS

## NOTES TO THE RESULTS (CONTINUED)

### 14. Loans from Central Bank

	<b>30 June <u>2008</u> <u>£m</u></b>	<b>30 June <u>2007</u> <u>£m</u></b>	<b>31 December <u>2007</u> <u>£m</u></b>
Amounts due to Bank of England	20,963.0	-	26,930.0
Open market repo funding	283.0	-	1,543.0
	<u>21,246.0</u>	<u>-</u>	<u>28,473.0</u>

As at 30 June 2008, the amount due to the Bank of England was repayable on demand and is charged interest at a margin above the Official Bank Rate. During the period, it consisted of three facilities; a repo facility fully repaid by 30 June 2008 (30 June 2007: £nil, 31 December 2007: £3,590.0m) secured on investment securities, Facility A of £2,203.0m (30 June 2007: £nil, 31 December 2007: £6,910.0m) secured on residential mortgages, and Facility B, amounting to £18,760.0m (30 June 2007: £nil, 31 December 2007: £16,430.0m), which is secured by a fixed and floating charge over the assets and undertakings of the Group that were not already encumbered under prior arrangements such as securitisation vehicles and covered bonds. The value of the security supporting Facility A was £6,319.2m at 30 June 2008 (30 June 2007: £nil, 31 December 2007: £9,905.0m). The value of the security supporting the repo facility at 31 December 2007 was £5,221.5m. In addition to the interest payable on the amount due to the Bank of England, the Group pays a guarantee fee to HM Treasury in respect of the Group's obligations that are guaranteed by HM Treasury (see note 19).

The open market repo funding represents repos with the Bank of England as part of their open market operations and is secured against assets with a market value of £288.7m (31 December 2007: £1,647.6m).

### 15. Customer Accounts

	<b>30 June <u>2008</u> <u>£m</u></b>	<b>30 June <u>2007</u> <u>£m</u></b>	<b>31 December <u>2007</u> <u>£m</u></b>
Branch accounts	3,044.9	5,597.2	3,034.9
Postal accounts	5,995.4	9,943.2	4,350.9
Internet accounts	3,559.7	4,129.4	1,531.5
Offshore accounts	1,199.1	3,775.8	1,087.7
Telephone accounts	152.0	440.8	180.7
Legal & General branded accounts	246.4	463.8	283.1
Total retail balances	<u>14,197.5</u>	<u>24,350.2</u>	<u>10,468.8</u>
Non bank wholesale customer accounts	367.9	5,772.6	1,094.0
	<u>14,565.4</u>	<u>30,122.8</u>	<u>11,562.8</u>

# NORTHERN ROCK GROUP HALF YEAR RESULTS

## NOTES TO THE RESULTS (CONTINUED)

### 16. Debt Securities in Issue

	Securitised notes £m	Covered bonds £m	Other debt securities in issue £m
<b>Balance at 1 January 2008</b>	43,069.5	8,938.1	9,633.7
Repayments	(6,500.6)	-	(985.6)
Exchange rate movements and fair value adjustments	1,088.2	464.6	241.7
<b>Balance at 30 June 2008</b>	<u>37,657.1</u>	<u>9,402.7</u>	<u>8,889.8</u>

	Securitised notes £m	Covered bonds £m	Other debt securities in issue £m
<b>Balance at 1 January 2007</b>	40,225.7	6,201.8	17,866.8
Issuances	10,722.9	2,194.3	20,928.9
Repayments	(4,874.7)	-	(21,348.1)
Exchange rate movements and fair value adjustments	(376.1)	(291.2)	(194.5)
<b>Balance at 30 June 2007</b>	<u>45,697.8</u>	<u>8,104.9</u>	<u>17,253.1</u>

	Securitised notes £m	Covered bonds £m	Other debt securities in issue £m
<b>Balance at 1 January 2007</b>	40,225.7	6,201.8	17,866.8
Issuances	10,722.9	2,194.3	29,785.4
Repayments	(8,979.1)	-	(38,158.9)
Exchange rate movements and fair value adjustments	1,100.0	542.0	140.4
<b>Balance at 31 December 2007</b>	<u>43,069.5</u>	<u>8,938.1</u>	<u>9,633.7</u>

### 17. Revaluation Reserve – Available for Sale Investments

	Six months to 30 June		Full year
	<u>2008</u> £m	<u>2007</u> £m	<u>2007</u> £m
<b>Balance at 1 January</b>	<b>(93.7)</b>	<b>(1.3)</b>	<b>(1.3)</b>
Net losses from changes in fair value	(258.3)	(32.2)	(269.2)
Losses transferred to net income due to impairment	23.8	-	178.3
Net profits on disposal transferred to net income	(6.0)	(37.9)	(41.7)
Current income taxes	-	21.3	61.1
Deferred income taxes	22.0	(0.2)	(23.0)
Restatement of deferred tax liability from 30%	(0.4)	0.6	2.1
<b>Balance at 30 June / 31 December</b>	<u><b>(312.6)</b></u>	<u><b>(49.7)</b></u>	<u><b>(93.7)</b></u>

# NORTHERN ROCK GROUP HALF YEAR RESULTS

## NOTES TO THE RESULTS (CONTINUED)

### 18. Own Shares

The credit/(charge) to retained earnings in respect of movements on own shares for the period is as follows:

	Six months to 30 June		Full year
	<u>2008</u>	<u>2007</u>	<u>2007</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Employee share schemes - value of employee services	-	12.3	0.5
Accelerated charge on cancellation of share schemes (see note 6)	39.6	-	-
Cash received on exercise of employee options and for other employee share plans	-	1.6	1.7
Tax impact of share based payments	1.9	(0.6)	(5.1)
Purchase of shares	-	(16.4)	(31.6)
	<u>41.5</u>	<u>(3.1)</u>	<u>(34.5)</u>

As a result of The Northern Rock plc Transfer Order 2008, all shares were transferred to the Treasury Solicitor as nominee for the Treasury on 22 February 2008. Consequently, Northern Rock plc no longer owns any of its own shares. The consideration it will receive for these shares has not yet been determined and therefore no asset has been recognised for the proceeds in these accounts.

### 19. Related Party Transactions

On 22 February 2008, under the terms of The Northern Rock plc Transfer Order 2008, all shares in Northern Rock plc were transferred to the Treasury Solicitor as nominee of the Treasury, and the Foundation shares were converted to Ordinary shares. At this point, therefore, The Northern Rock Foundation ceased to be a related party. No transactions occurred between Northern Rock plc and The Northern Rock Foundation during the period 1 January 2008 to 22 February 2008. Total contributions paid under deed of covenant by Northern Rock plc to The Northern Rock Foundation were £14.8m at 30 June 2007 and 31 December 2007.

As a further consequence of the transfer of all shares in Northern Rock plc to the Treasury Solicitor on 22 February 2008, the Company regards HM Government as a related party from this date. Details of loan facilities with the Bank of England are set out in note 14 above. Interest and guarantee fees payable on the loan from 22 February 2008 to 30 June 2008 were £587.6m.

In addition to these loans and guarantees the Group has transactions with numerous Government bodies on an arm's length basis. Transactions with these entities are not disclosed owing to the volume of transactions conducted.

# NORTHERN ROCK GROUP HALF YEAR RESULTS

## NOTES TO THE RESULTS (CONTINUED)

### 20. Capital Structure

	<b>30 June <u>2008</u> £m</b>	<b>31 December <u>2007</u> £m</b>
<b>Core Tier 1</b>		
Ordinary share capital	123.9	123.9
Share premium on ordinary share capital	6.8	6.8
Capital redemption reserve	7.3	7.3
Retained earnings	638.1	1,187.8
Pension scheme	(8.3)	(9.4)
Total Core Tier 1 capital	767.8	1,316.4
<b>Perpetual Non-Cumulative Preference Shares</b>		
Preference share capital	0.1	0.1
Share premium on preference share capital	399.9	399.9
Tier one notes	196.5	207.7
Total Perpetual Non-Cumulative Preference Shares	596.5	607.7
<b>Innovative Tier 1</b>		
Reserve capital instruments	300.0	300.0
Total Innovative Tier 1 capital	300.0	300.0
<b>Regulatory deductions and restrictions</b>		
	(309.2)	(625.8)
Tier 1 capital after deductions	1,355.1	1,598.3
<b>Upper Tier 2</b>		
Perpetual subordinated debt	1,028.7	1,028.8
Reserve capital instruments	72.3	-
Collectively assessed impairment allowance	3.1	0.4
Total Upper Tier 2 capital	1,104.1	1,029.2
<b>Lower Tier 2</b>		
Term subordinated debt	899.5	811.9
Total Tier 2 capital	2,003.6	1,841.1
<b>Regulatory deductions and restrictions</b>		
	(648.5)	(445.8)
Tier 2 capital after deductions	1,355.1	1,395.3
<b>Deductions from totals of Tier 1 and Tier 2</b>		
Investments in subsidiary undertakings	(5.1)	(5.1)
<b>Tier 3</b>		
	8.1	-
Total capital resources	2,713.2	2,988.5
Risk weighted assets	26,726.1	20,768.0
Tier 1 ratio	5.1%	7.7%
Total capital	10.2%	14.4%

In the above table the impact of exposures to securitised assets are included within regulatory deductions at 31 December 2007 but within risk weighted assets at 30 June 2008. The impact at 30 June 2008 is to increase risk weighted assets by £7,241.1m. At 31 December 2007, deductions in respect of securitised assets amounted to £537.7m and were made equally against Tier 1 and Tier 2 capital resources.

# NORTHERN ROCK GROUP HALF YEAR RESULTS

## NOTES TO THE RESULTS (CONTINUED)

### **21. Other Information**

The information in this announcement is unaudited and does not constitute statutory accounts within the meaning of section 240 of the Companies Act 1985. The statutory accounts of Northern Rock plc for the year ended 31 December 2007 have been filed with the Registrar of Companies in England and Wales. The auditors' report on these accounts was unqualified and did not include a statement under section 237(2) or (3) of the Act, although the auditors' report contained an emphasis of matter in relation to the Company's ability to continue as a going concern, reflecting the need for continued support from the Bank of England and HM Treasury.

The report will be available on the Northern Rock website [www.northernrock.co.uk](http://www.northernrock.co.uk) from 8.30am on 5 August 2008.

# NORTHERN ROCK GROUP HALF YEAR RESULTS

## Statement of Directors' Responsibilities

The Directors confirm that the Group half year results have been prepared in accordance with IAS 34 as adopted by the European Union and that the management commentary and supporting notes to the half year results includes a fair review of the information required by DTR 4.2.7, namely, an indication of important events that have occurred in the first six months and their impact on the condensed set of financial statements and a description of the principle risks and uncertainties for the remaining six months of the financial year.

As set out in note 1 to the Group half year results, the Bank of England and HM Treasury have provided financing facilities to the Company. These facilities are subject to clearance being obtained from the European Commission. If such clearance is not obtained then the facilities may be withdrawn. Subject to this material uncertainty pertaining to the Company's funding requirements, the Directors are satisfied at the time of approval of the Group half year results that the Group has adequate resources to continue in business for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the half year results.

The Directors of Northern Rock plc at the date of this report are:

RA Sandler  
LP Adams  
JF Devaney  
AF Godbehere  
SAM Hester  
AM Kuipers  
ST Laffin  
PJ Remnant  
TW Scholar

By order of the Board

RA Sandler  
5 August 2008  
Executive Chairman

AM Kuipers  
5 August 2008  
Chief Executive Officer

AF Godbehere  
5 August 2008  
Chief Financial Officer

# NORTHERN ROCK GROUP HALF YEAR RESULTS

## Independent review report to Northern Rock plc

### Introduction

We been engaged by the Company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2008, which comprises the consolidated income statement, consolidated balance sheet, consolidated statements of recognised income and expense, consolidated cash flow statement and related notes. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

### Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the Directors. The Directors are responsible for preparing the half-yearly financial report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority, as applicable to the issuers of listed debt securities.

As disclosed in note 1, the annual financial statements of the Company are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with International Accounting Standard 34, "Interim Financial Reporting", as adopted by the European Union.

### Our responsibility

Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review. This report, including the conclusion, has been prepared for and only for the Company for the purpose of the Disclosure and Transparency Rules of the Financial Services Authority, as applicable to the issuers of listed debt securities, and for no other purpose. We do not, in producing this report, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

### Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

### Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2008 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority, as applicable to the issuers of listed debt securities.

# NORTHERN ROCK GROUP HALF YEAR RESULTS

## Independent review report to Northern Rock plc (continued)

### Emphasis of Matter - Going Concern

In forming our conclusion on the condensed financial statements, which is not qualified in this respect, we have considered the adequacy of the disclosure made in note 1 to the condensed financial statements concerning the Company's ability to continue as a going concern. The going concern assumption is dependent on the European Commission approving financing facilities provided by the Bank of England and HM Treasury. This outstanding approval indicates the existence of a material uncertainty which may cast significant doubt about the Company's ability to continue as a going concern. The condensed financial statements do not include the adjustments that would result if the Company was unable to continue as a going concern.

PricewaterhouseCoopers LLP  
Chartered Accountants  
89 Sandyford Road  
Newcastle upon Tyne  
5 August 2008

#### Notes:

- (a) The maintenance and integrity of the Northern Rock plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.
- (b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

## NORTHERN ROCK GROUP HALF YEAR RESULTS

### Contacts

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This document contains certain forward-looking statements with respect to certain of the plans of Northern Rock, its current goals and expectations relating to its future financial condition and performance. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. Northern Rock's actual future results may differ materially from the results expressed or implied in these forward-looking statements as a result of a variety of factors, including UK domestic and global economic and business conditions, market related risk such as interest rates and exchange rates, delays in implementing proposals, unexpected difficulties with computer systems, unexpected changes to regulation, changes in customer preferences, competition and other factors.