MANCHESTER BUILDING SOCIETY GROUP

CONDENSED CONSOLIDATED HALF YEARLY FINANCIAL INFORMATION

30 JUNE 2013

Business Review

The Group reported a profitable start to 2013, with pre-tax profits of £1,623k for the 6 months ended 30 June 2013.

Retail savings: Retail balances at the end of June 2013 were in line with forecasts; at £591m they were broadly unaltered from the position reported at the end of December 2012.

Liquid funds: Robust levels of liquidity have been maintained throughout the period. The Society continues to take a cautious approach to the investment of its liquid funds, having significant balances deposited with the Bank of England and other smaller sums within instantly accessible accounts with a number of UK High Street banks.

Mortgage lending and arrears: New mortgage lending during the first half of the year has been subdued, but in line with the Board's forecasts. A cautious approach has continued to be taken to the underwriting of new applications, with interest rates offered reflecting the Society's caution. The Society saw its mortgage arrears decrease by £169k during the first half of 2013.

Capital: During April 2013, the Society issued £18m of subscribed capital in the form of Profit Participating Deferred Shares ("PPDS"). These instruments, which were issued and subscribed at par, are classified as equity within the financial statements and included as Core Equity Tier 1 capital for regulatory purposes (note 3).

Derivatives (interest rate swaps): In June 2013, the Society exited from its portfolio of interest rate swaps. As that point in time, the fair value of these derivatives was favourable when compared with the position recorded at 31 December 2012 and as a result, the Society crystallised a gain of £2.2m; this contributed favourably to the pre-tax half year position.

Exceptional items: During the period, the Society incurred one-off costs totalling £1.1 million. These costs have included various legal and professional fees and redundancy and other exit costs arising from an organisational re-structure undertaken during June 2013. As a result of the latter, the level of underlying management expenses has reduced notably.

Profit before tax: The Group has reported a profit before tax for the six months ended 30 June 2013 of £1,623k (2012: £825k loss). Included within this position are both the favourable out-turn arising from exiting from the interest rate swap portfolio and the recognition of exceptional costs. Accordingly, the Board is pleased to report a profit to the members for this period and it is expected that the results for the second half of 2013 will show a consistent and favourable level of business-as-usual profitability.

Board and staff changes

Since publishing the 2012 Annual Report and Accounts, there have been the following Board changes:

- Mrs Susan Molloy, non-executive director, resigned from the Board following a period of ill health.
- Mr David Cowie, Chief Executive, retired.
- Mr Ian Richardson, Director and Secretary, did not seek re-appointment at the Society's AGM and left at that time.

The Society has undertaken an internal restructuring of its support teams in order to streamline its operations. The Board considers that the current staffing compliment will support existing business levels.

Risks and uncertainties

Every business faces risks as part of its day-to-day operation. The Board seeks to minimise the risks that the Society faces, by articulating that it has a low appetite for risk and by deploying a range of risk management procedures within an appropriate control environment which mitigate the Society's exposure to risk. It is the Board's view that the risks and uncertainties that the Society faces have not changed by any great extent since the publication of the 2012 Annual Report and Accounts and accordingly, this latter financial information should be read in conjunction with the Half Year Financial Information.

Summarised below are a number of key risks and uncertainties:

- ***Credit risk:*** As a mortgage lender, the Society faces the risk that borrowers may not be able to repay sums owed as they fall due. The value of property that is mortgaged to the Society is monitored on a regular basis in order to assess the potential for loss. There is continued uncertainty regarding the health and resilience of the UK housing market, with various commentators expressing conflicting opinions: some forecasting material short term uplift in house prices, whilst others are more pessimistic. The Society seeks to mitigate its exposure to credit risk by applying cautious underwriting criteria to new mortgage lending and to identify appropriate levels of loss provision on a timely basis when it becomes evident that the Society is likely to incur a loss.

- ***Interest rate risk:*** The Society offers fixed rate mortgages to its members. Changes in market rates (Bank of England Base Rate, LIBOR and/or EURIBOR), are not passed on to these mortgage holders and consequently, there is a risk that the Society's interest rate margin could be reduced in the future. At previous reporting periods, the Society had held a range of interest rate swaps. However these were not deemed effective for hedge accounting purposes as the terms of the swaps did not match sufficiently well with the terms of the mortgages. As part of its interest rate risk mitigation strategy, the Board exited from all of its interest rate swaps during June 2013 and recorded a pre-tax gain of £2.2m in so doing. During Q3 2013, the Board intends to take a range of derivative products that will seek to reduce its exposure to interest rate risk over the short to medium term. The Board notes that with a number of its mortgage assets having a long (15 year plus) expected maturity profile, its intention is to deploy an interest rate risk management approach that will manage this risk on a continuing and rolling basis.

  One effect of The Bank of England's Funding for Lending scheme has been to reduce the rates that financial institutions offer to retail savers in general. As a result of this, the Society's interest margin has seen some recovery during H1 2013 and this improvement in margin is expected to continue for the remainder of 2013.

Improving margins allow the Society to increase its levels of capital and such capital acts as a mitigant for future changes in interest margin that could present themselves when market interest rates change in the future.

The Board is satisfied that its financial projections show a suitable level of profitability over the medium term that will allow it to accommodate volatility in its interest margin arising from changes in market rates.

The management of interest margin and mitigation of interest rate risk continue as areas of Board focus.

- ***Capital:*** The Board's focus is on the strengthening of both its level of total capital and its regulatory capital ratios. The primary means though which capital improvement may be achieved is through increases in reserves by way of the retention of post-tax profits. Accordingly, as the forecasting of post-tax profitability has some subjectivity associated with it, so too does the Board's projections for capital improvement over the medium term.

Forward-looking statements

Within the half yearly information we make comments about anticipated future events, which we believe to be reasonable. As these statements are based on the Group's current view of the UK economy and banking market, we can give no assurances that the markets will develop in the way that we document and actual outcomes may differ to those that we anticipate.

The Group does not undertake to update any of the statements that it has made about future events prior to reporting of the full year results.

Responsibility statement of the directors in respect of the condensed consolidated half yearly financial information

The directors confirm that, to the best of their knowledge:

- The condensed set of consolidated accounts has been prepared in accordance with IAS 34 *Interim Financial Reporting*, as adopted by the European Union.
- The half yearly accounts include the information required by the Financial Conduct Authority Disclosure and Transparency Rules (DTR 4.2.7 and DTR 4.2.8)

The results for the half year ended 30 June 2013 and those comparable figures for the half year ended 30 June 2012 are unaudited. The figures for the year ended 2012 are extracted from the 2012 Annual Report and Accounts, prepared in accordance with IFRS as adopted in the EU, on which the Independent Auditors gave an unqualified opinion.

The Board of Directors responsible for the half yearly accounts are listed below:

J. Allen ACIB Dip FS	Non-executive director
R.W. Dyson FRICS	Non-executive director
A. Finch FCII	Non-executive director
C.W. Gee FCA	Finance Director
D.A. Harding JP FCMA	Chairman
P.A. Lynch	Operations Director
J. Smith FCCA	Vice Chairman

Signed on behalf of the Board of Directors

D.A. Harding
Chairman
8 August 2013

CONDENSED CONSOLIDATED HALF YEARLY FINANCIAL INFORMATION

30 JUNE 2013

Basis of preparation

The half yearly financial information for the 6 months ended 30 June 2013 has been prepared in accordance with both the Financial Conduct Authority's Disclosure and Transparency Rules and IAS 34 *Interim Financial Reporting*, as adopted by the European Union.

The half yearly financial information set out above does not constitute Accounts within the meaning of the Building Societies Act 1986.

The financial information for the 12 months to 31 December 2012 has been extracted from the 2012 Annual Report and Accounts, prepared in accordance with IFRS as adopted in the EU. In relation to these accounts, the opinion of the external auditors was unqualified and it did not include a reference to any matters to which the auditors sought to draw attention by way of emphasis without qualifying their report.

The half-yearly financial information for the 6 months ended 30 June 2013 and the 6 months ended 30 June 2012 is unaudited.

This financial information should be read in conjunction with the 2012 Annual Report and Accounts.

The Half Yearly Financial Information for the six months ended 30 June 2012 contains two sets of restatement adjustments: one relating to the re-assessment of previous years' accounting policy and the other concerning the presentation and disclosure of the Society's Permanent Interest Bearing Shares ("PIBS"). The former had a material impact on the results for the six months ended 30 June 2012 and previous years, whilst the latter did not. Further detail may be found within note 1.

Accordingly, the financial values for the 6 month period ending 30 June 2012 are annotated as being "restated", as they show a position that is different to that reported in the Half Yearly Financial Information 2012, issued in August 2012.

Other information

The Directors are responsible for the maintenance and integrity of information on the Society's website. Copies of the 2012 Annual Report & Accounts and this Half Yearly Financial information may be found at: www.themanchester.co.uk/Main/FinancialInformation

Accounting policies

The half yearly financial information has been prepared consistently with the accounting policies described on pages 19 to 22 of the 2012 Annual Report and Accounts. The Group expects that these accounting policies will be applied at the time of compiling the 2013 Annual Report and Accounts.

One new accounting policy was adopted during the period in relation to exceptional items and it is intended that the policy will be reflected in the 2013 Annual Report and Accounts.

- **Exceptional items**. Exceptional items are non-recurring material items which are outside the normal scope of the Group's ordinary activities such as the cost arising from the material restructuring of the Group's operations. Such items are disclosed separately within the financial statements.

One existing accounting policy was amended during the period to accommodate the issuance of PPDS. The previous accounting policy covered the accounting treatment of PIBS alone, whilst the revised policy below covers both the PIBS and the PPDS:

- **Subscribed capital**. The Society's subscribed capital consists of two tranches of PIBS and one tranche of PPDS; all were issued and subscribed at par and were recognised both initially and currently at par less directly attributable transaction costs net of tax, as relevant. The PIBS and PPDS were issued with the intention of enhancing the Society's regulatory capital position. In accordance with IAS 32 – *Financial Instruments: Presentation*, the instruments have been classified as equity, as the Board has some discretion to cancel the PIBS coupon under certain circumstances and to determine the extent of any dividend payable on the PPDS at is sole discretion (subject to a maximum level). PIBS interest and PPDS dividends are recognised through the Statement of Changes in Equity, net of tax, as relevant.

There were no new reporting standards that affected the results reported for the half year ended 30 June 2013.

Taxation

Corporation tax has been charged at the rate of 23.25% (H1 2012: 24.5%). The tax charge has been calculated as far as possible to approximate to the expected full year tax rate.

Related Party Transactions

The Group had no material or unusual related party transactions during the 6 months ended 30 June 2013.

Segmental information

The Group's results are predominantly derived from the Society's principal operations. The Group's other income streams are not sufficiently material to require segmental reporting.

Financial commitments and contingencies

There is no material change to Group's financial commitments or its contingent liabilities from the position reported in the 2012 Annual Report and Accounts

Events after the end of the reporting period

There have been no events occurring after the end of the reporting period that would have impacted upon the results reported.

Approval of interim financial statements

The condensed consolidated half yearly financial information was approved by the Board of directors on 8 August 2013.

MANCHESTER BUILDING SOCIETY GROUP
CONDENSED CONSOLIDATED HALF YEARLY FINANCIAL INFORMATION

Condensed Consolidated Statements of Comprehensive Income

	note		Unaudited 6 months to 30 Jun 13 £000		*Unaudited 6 months to 30 Jun 12 £000		Audited 12 months to 31 Dec 12 £000
Interest and similar income			13,114		14,938		28,775
Interest expense and similar charges			(6,955)		(8,776)		(17,021)
Net interest income			6,159		6,162		11,754
Other operating income			209		416		364
Interest rate swaps: receipts		2,874		1,079		3,422	
Interest rate swaps: payments		(5,392)		(3,075)		(7,926)	
Fair value movements on derivatives	*2*	2,279		(2,032)		(3,774)	
Loss from derivatives			(239)		(4,028)		(8,278)
Total net income			6,129		2,550		3,840
Administrative expenses and depreciation			(3,815)		(2,721)		(4,862)
of which: classified as exceptional	*2*	*(1,121)*					
Other operating charges			(48)		(53)		(805)
Impairment losses			(643)		(601)		(503)
Profit/(loss) for the period before taxation			1,623		(825)		(2,330)
Income taxation (expense)/credit			(378)		201		(393)
Profit/(loss) for the period			1,245		(624)		(2,723)

** Restated (see note 1)*

MANCHESTER BUILDING SOCIETY GROUP
CONDENSED CONSOLIDATED HALF YEARLY FINANCIAL INFORMATION

Condensed Consolidated Statement of Changes in Equity

Unaudited 6 months to 30 June 2013

	Subscribed capital £000	Reserves £000	Total £000
Balance at 1 January 2013	14,788	6,171	20,959
Profit for the period	-	1,245	1,245
Total transactions with equity holders - interest payable to holders of PIBS	-	(537)	(537)
Tax credit re: interest paid to PIBS holders	-	126	126
Issue of new subscribed capital – net receipt (note 3)	17,567	-	17,567
Change in equity	17,567	834	18,401
Balance at 30 June 2013	32,355	7,005	39,360

Unaudited 6 months to 30 June 2012

	*Subscribed capital £000	*Reserves £000	*Total £000
Balance at 1 January 2012	14,788	9,706	24,494
Loss for the period	-	(624)	(624)
Total transactions with equity holders - interest payable to holders of PIBS	-	(537)	(537)
Tax credit re: interest paid to PIBS holders	-	132	132
Change in equity	0	(1,029)	(1,029)
Balance at 30 June 2012	14,788	8,677	23,465

Audited 12 months to 31 December 2012

	Subscribed capital £000	Reserves £000	Total £000
Balance at 1 January 2012	14,788	9,706	24,494
Loss for the period	-	(2,723)	(2,723)
Total transactions with equity holders - interest payable to holders of PIBS	-	(1,075)	(1,075)
Tax credit re: interest paid to PIBS holders	-	263	263
Change in equity	0	(3,535)	(3,535)
Balance at 30 December 2012	14,788	6,171	20,959

** Restated (see note 1)*

MANCHESTER BUILDING SOCIETY GROUP
CONDENSED CONSOLIDATED HALF YEARLY FINANCIAL INFORMATION

Condensed Consolidated Statements of Financial Position

	note	Unaudited 30 Jun 13 £000	*Unaudited 30 Jun 12 £000	Audited 31 Dec 12 £000
Assets				
Liquid assets		186,976	138,329	142,930
Derivative financial instruments		0	399	1,097
Loans and advances to customers		557,553	600,027	574,383
Investments		250	250	250
Property, plant and equipment		8,527	8,570	8,477
Deferred income tax assets		9,419	9,079	9,419
Other assets		1,572	44,302	43,522
Total assets		764,297	800,956	780,078

	note	Unaudited 30 Jun 13 £000	*Unaudited 30 Jun 12 £000	Audited 31 Dec 12 £000
Liabilities				
Deposits from banks and others		114,152	71,876	81,577
Derivative financial instruments		1,244	39,673	42,101
Due to customers		590,882	648,158	617,009
Other borrowed funds		15,700	15,700	15,700
Other liabilities and charges, including current income tax liabilities		2,959	2,084	2,732
Total liabilities		724,937	777,491	759,119
Equity				
Retained earnings		7,005	8,677	6,171
Subscribed capital	3	32,355	14,788	14,788
Total equity		39,360	23,465	20,959
Total equity and liabilities		764,297	800,956	780,078

** Restated (see note 1)*

MANCHESTER BUILDING SOCIETY GROUP
CONDENSED CONSOLIDATED HALF YEARLY FINANCIAL INFORMATION

Condensed Consolidated Statements of Cash Flows

	Unaudited 6 months to 30 Jun 13 £000	*Unaudited 6 months to 30 Jun 12 £000	Audited 12 months to 31 Dec 12 £000
Net cash flows from operating activities	28,364	(58,960)	(41,908)
Taxation paid	0	0	(406)
Net cash flows from investing activities	39,879	32,651	17,916
Net cash flows from financing activities	17,029	(538)	(1,075)
Net decrease in cash and cash equivalents	85,272	(26,847)	(25,473)
Net (decrease)/increase in cash and cash equivalents	85,272	(26,847)	(25,473)
Cash and cash equivalents at the start of the period	75,229	100,702	100,702
Cash and cash equivalents at the end of the period	160,501	73,855	75,229

Other percentages

	Unaudited 6 months to 30 Jun 13 %	*Unaudited 6 months to 30 Jun 12 %	Audited 12 months to 31 Dec 12 %
Gross capital as a percentage of shares and borrowings	7.81	5.44	5.25
Liquid funds as a percentage of shares and borrowings	26.52	19.21	20.46
Wholesale deposits as a percentage of shares and borrowings	11.02	9.90	10.86
Profit after tax as a percentage of mean total assets (*expressed on an annualised basis)*	0.32	(0.15)	(0.33)
Group management expenses as a percentage of mean total assets (*expressed on an annualised basis)*	0.78	0.66	0.60

** Restated (see note 1)*

Notes to the Condensed Consolidated Financial Statements

1. Restatement

The financial information for the six months ended 30 June 2012 has been restated in two areas: one relating to the re-assessment of previous years' accounting policy and the other concerning the presentation and disclosure of the Society's Permanent Interest Bearing Shares ("PIBS"). Both of these restatements were reported in the Group's 2012 Annual Report and Accounts. They are repeated below, as within this Condensed Half Yearly Financial Statement, the comparative position shown for the period ended 30 June 2012 is different to that reported in last year's Half Yearly Financial Information.

- **Interest rate swaps.** The Society entered into interest rate swaps in order to reduce the interest rate risk associated with its fixed rate mortgage products. The purpose of taking swaps was to "lock in" a fixed and certain interest margin on the mortgage products concerned. Where the swaps and the mortgages meet a number of very specific IAS 39 criteria, a fair value of the mortgage assets may also be calculated and recognised, with the effect of offsetting the movement in the fair value of the swaps. Whilst this set of calculations has been undertaken since 2006, it was determined that the swaps arrangements that were in place did not meet the technical requirements for this IAS 39 accounting treatment. As a result, a restatement was undertaken so as to recognise the full fair value movements in the swaps but not to recognise any offsetting fair value in the hedged mortgages.

- **PIBS.** During 2012 a review was undertaken of the detailed terms of issue of the PIBS, comparing these to the requirements of IAS 32. As a result, a presentational amendment was made, disclosing the PIBS as Equity, rather than as a Liability. This restatement does not change the total assets or retained earnings positions.

The effect of the restatements on the Consolidated Statements of Comprehensive Income and the Consolidated Statement of Financial Position at 30 June 2012 was as follows:

	Original 6 months to 30 June 2012 £000	Reclassification and restatement £000	Restated 6 months to 30 June 2012 £000
Interest and similar income	12,853	2,085	14,938
Interest expense and similar charges	9,313	(537)	8,776
Net interest income	3,540	2,622	6,162
Other income and charges	363	-	363
Gain/(loss) from derivatives	281	(4,309)	(4,028)
Total operating income	4,184	(1,687)	2,497
Administrative expenses	2,721	-	2,721
Impairment losses	601	-	601
Profit/(loss) before taxation	862	(1,687)	(825)
Income tax (expense)/credit	(212)	413	201
Profit/(loss) for the period	650	(1,274)	(624)

	Original 6 months to 30 June 2012 £000	Movement relating to earlier periods £000	Movement relating to 6 months ended 30 June 2012 £000	Restated 6 months to 30 June 2012 £000
Assets				
Liquid assets	138,329	-	-	138,329
Derivative financial instruments	399	-	-	399
Loans and advances to customers	639,497	(37,592)	(1,878)	600,027
Property, plant and equipment	8,570	-	-	8,570
Investments	250	-	-	250
Deferred income tax assets	0	9,079		9,079
Other assets	44,302	-	-	44,302
Total assets	831,347	(28,513)	(1,878)	800,956
Liabilities				
Shares	648,158	-	-	648,158
Deposits	71,876	-	-	71,876
Derivative financial instruments	39,673	-	-	39,673
Other liabilities	2,084	199	(199)	2,084
Subordinated liabilities	15,700	-	-	15,700
Subscribed capital	14,788	(14,788)	-	0
Total liabilities	792,279	(14,589)	(199)	777,491
Equity				
Reserves	39,068	(28,712)	(1,679)	8,677
Subscribed capital	-	14,788	-	14,788
Total equity	39,068	(13,924)	(1,679)	23,465
Total equity and liabilities	831,347	(28,513)	(1,878)	800,956

2. Exceptional items

During June 2013, the Society undertook an organisational review, which resulted in a streamlining of its operational team structures; these costs have been classified as being exceptional, as they are considered to be one-off in nature and outside the ordinary course of the Society's day-to-day business.

During the period, the Society recorded a £2.2m pre-tax gain arising from exiting its portfolio of interest rate swaps. The Society uses interest rate derivative contracts to manage and mitigate its exposure to interest rate risk as part of is normal business operations. The gain arose in the current period as a result of the increase in fair value of the Society's interest rate swaps and from the Board's decision to exit from these at that time. It has not been classified as exceptional, as it arose from activities that were considered to be within the normal scope of the Society's business. The pre-tax gain is reported under the heading "Loss on derivatives".

3. Subscribed capital

	Unaudited 30 Jun 13 £000	Unaudited 30 Jun 12 £000	Audited 31 Dec 12 £000
8.00% Permanent Interest Bearing Shares	5,000	5,000	5,000
6.75% Permanent Interest Bearing Shares	9,788	9,788	9,788
Profit Participating Deferred Shares	17,567	-	-
Total subscribed capital	32,355	14,788	14,788

- **Permanent Interest Bearing Shares**

  The Society's two tranches of PIBS are unsecured and rank pari passu with each other. In priority terms, the PIBS holders rank behind the Society's depositing members, its wholesale counterparties and all subordinated note holders.

  Under the terms of offer, the Board may, subject to a resolution, cancel in whole or in part any scheduled interest payment due to holders of the PIBS. Whilst the Board does not intend to avail itself of this discretion, the facility to do so results in the assertion that the PIBS should be considered not to confer a contractual obligation on the Society to deliver cash in the form of interest payments. As such, the PIBS are now treated as forming a part of the Society's equity, rather than being classified within the Liabilities section of the Statement of Financial Position.

- **Profit Participating Deferred Shares**

  On 27 April 2013, the Society issued £18m of Profit Participating Deferred Shares ("PPDS"). The shares were issued and subscribed at par. At the time of reporting, in total, the known and estimated transaction costs, post-tax (as relevant), have been assessed as £433k. Accordingly the instruments are shown at a value of £17.6m.

  The shares are unsecured and rank pari passu with any other deferred shares comprising Core Equity Tier 1 Capital issued or to be issued by the Society and rank behind any other deferred shares of the Society in issue not comprising Core Equity Tier 1 Capital, including the Society's 1999 and 2005 PIBS.

  The PPDS holders rank behind the Society's depositing members, its wholesale counterparties and all subordinated note holders.

  The terms of the PPDS allow the Board, at its sole discretion, to declare a dividend of up to 30% of the Society's post tax profits. Dividends are non-cumulative.

4. Fair values of financial assets and liabilities

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties. The methods and assumptions that the Society uses in determining fair value may be found in note 1 (c) of the 2012 Annual Report and Accounts.

The following methods and assumptions have been applied in determining the fair value of the financial instruments in these reports:

(i) Trade investments are measured at cost (of £250k) as the fair value cannot be estimated reliably. The investments are treated as available-for-sale and are grouped into the fair value hierarchy under level 3.

(ii) The fair value of derivatives and investment securities are calculated by utilising internal valuation models. External market data is used within these internal valuation models. Derivatives are held for trading. Investment securities are designated at fair value through profit or loss. Movements in the valuations of derivatives and investment securities are treated as fair value through profit and loss and these financial assets and liabilities are grouped into the fair value hierarchy under level 2.

(iii) The fair value of loans and advances to customers at a variable rate of interest is assumed to approximate to their carrying amounts. The fair value of loans and advances at a fixed rate of interest is estimated by internal valuation models. External market data is used within these internal valuation models.

(iv) All other financial assets and liabilities are held at amortised cost.

The Group has disclosed within these financial statements all the assets and liabilities for which fair values are required. The Board does not believe it is necessary to place a fair value on the outstanding minimal amount of assets and liabilities on which a fair value has not been placed as these predominantly attract variable rates of interest and therefore their carrying value is deemed to reflect their fair value.

In relation to the position at 30 June 2013, the fair value of the Society's assets and liabilities are the same as the carrying values detailed within the Condensed Consolidated Statement of Financial position, save for the two items below, where the calculated fair value is in excess of the carrying value:

	Carrying value 30 Jun 13 £000	Fair value 30 Jun 13 £000
Loans and advances to customers	557,553	620,501
Due to customers	590,882	592,232