OSB GROUP PLC

2022 Preliminary results presentation transcript

16 March 2023

Andy Golding, Group CEO
Thank you. Good morning, everyone, and welcome to OSB Group's 2022 Preliminary Results, and thank for joining the call today. We had originally intended to hold a good old-fashioned in-person meeting, but the train strike situation meant the take-up was minimal. Anyway, hopefully you'll find our results, as usual, as somewhat more reliable than public transport.

I'm going to start by covering the key highlights in terms of the performance for the year and an overview of the Group. April will then take you through some more detail in terms of the numbers, and you'll then hear a little more from me on how our lending and savings franchises have performed followed by the outlook before we open up to Q&A.

I'm delighted that we have had a record year for profit before tax, up 13%, whilst retaining our class-leading 24% return on equity. This performance was supported by an improved net interest margin, strong loan book growth and good customer outcomes. All of this demonstrating the strength of our strategy and business model.

Our lending franchise continues to perform strongly with originations accelerating, particularly during the second half, to deliver 12% growth in our loan book for the year.

We continued our relaunch of products during 2022, progressively expanding our criteria towards pre-pandemic levels, including reintroduction of broader LTVs and an increasing number of mortgage products on the shelf. All of this is underpinned by our underwriting expertise and strong risk management capability.

Credit performance remains consistently strong with three-months arrears stable compared to last year. However, a deteriorating macroeconomic outlook, together with a post-model adjustment for the growing cost of living and borrowing cost concerns, led to an increase in our impairment provision.

Capital remained strong, and April will cover more around our capital management framework later in the presentation. Although I will add that we remain well-positioned for strong capital generation and are committed to returning excess capital to shareholders, and I'm, therefore, delighted that we have announced a new upsized £150m share buyback programme as well as a special dividend.

As we announced at the Half Year, the Group intends to target a CET1 ratio of 14% once the capital stake has been fully optimised through Tier 2 and MREL issuance, and April will talk more about this later.

Looking ahead, we have a somewhat more sanguine outlook for 2023 than we did a few months ago, and we're still excited by the opportunities in our core markets. I'll cover more on the outlook towards the end of the presentation.

The following two slides contain both our statutory and our underlying financial performance. However, I'm going to hand over to April to talk you through the numbers in a little more depth.

April Talintyre, Group CFO
Thank you, Andy, and good morning, everyone. I'm delighted we maintained the exceptionally strong underlying return on equity of 24% in 2022. Our profitability strengthened significantly with underlying profit before tax increasing by 13% versus the prior year to a record £591m.

We grew underlying net interest income by 18% due primarily to growth in the net loan book and a strengthened net interest margin, which was up 21bps to 303bps on an underlying basis, primarily due to the beneficial impact of rising base rates. More on that later.

We have continued to maintain our strong focus on cost discipline and efficiency. As previously guided, our underlying cost-to-income ratio increased marginally by 1% to 25%, reflecting the anticipated return to a more normalised level of spend post pandemic, inflationary headwinds and planned investment in the business, and that included refreshing and upgrading our technology infrastructure post integration. This was moderated by strong income generation in the year, including a sizeable net fair value gain on hedging activities, which I'll come to a little bit later.

The underlying management expense ratio of 80bps was 10bps higher than in the prior period, reflecting that higher level of spend.

Looking ahead, we expect our underlying cost-to-income ratio to increase to around 29% in 2023 due to those significant fair value gains from hedging activities in 2022, as well as continuing inflationary headwinds and the full year impact of hiring we did last year, as well as some further planned investment in the business to deliver further efficiencies and also meet the evolving needs of our customers.

We recognised an underlying loan loss equivalent to a ratio of 14bps in 2022 as the economic outlook worsened, and I'll provide more detail on the key drivers a little bit later.

Turning to the income statement, you'll see that we recognised net underlying fair value gains on financial instruments of £48.5m, more than double the prior period. These are non-cash gains which amortise back to profit and loss over the life of the hedges, with the largest driver being gains on unmatched mortgage pipeline swaps due to the step up in swap pricing following the September mini budget.

Also on this slide you can see underlying earnings per share on 99.6 pence increased by 15%, which is commensurate with the increase in profit after tax.

Turning to the balance sheet, this summarises our strong, secure balance sheet. We delivered £5.8bn of gross new lending in 2022, which is up 29% on the prior year as we returned, as Andy mentioned, to pre-pandemic criteria in our core Buy-to-Let and Residential sub-segments, and also, cautiously, we relaunched additional Commercial and Bridging products. This, together with our continued focus on retention, drove a 12% increase in the net loan book to £23.6m.

Retail deposits grew by 13% to £19.8bn at the end of the year as the Group continued to attract new savers.

We remained predominately Retail-funded, but we do have diversification provided by Bank of England funding schemes as well as securitisations.

We drew down around £300m under the Index Long-term Repo scheme during the year, and our drawings under the TFSME scheme remains unchanged at £4.2bn.

The credit quality of our loan book remained very strong with three-month-plus arrears stable for the Group at 1.1%, and at the segment level, that included OSB at 1.2% and CCFS at 0.9%.

Our loan book remains secured at very sensible loan-to-value. The weighted average book loan-to-value for the Group fell to 60% from 62% in the prior year, supported by house price appreciation. And the new lending loan-to-value increased slightly to 71% from 69% in 2021, reflecting that return to pre-pandemic lending criteria.

The next slide is NIM, it shows our NIM waterfall where you can see the high-level drivers behind that strengthened NIM. So, as I mentioned earlier, NIM increased to 303bps from 282bps in the prior year, again, primarily due to the benefit of base rate rises. But if I go through the chart, the Retail funding spread benefited from delays in the market passing base rate rises onto savers in full, especially in the first half of the year, and that includes the back book of our easy access savings.

The cost of new Retail funds also benefited from widening swap spreads and the fact that all of those rises had not been passed on.

On the other hand, there were also delays in mortgage pricing reflecting the rate rises and the widening swap spreads in full. This was partially mitigated by an expectation of higher reversionary income following the end of the fixed period due to the higher base rate index, partially offset by an expectation that customers would spend less time on this higher rate before refinancing.

And the other primarily relates to the benefit of increased average funding from Bank of England and also from our own equity as well as favourable swap margins calls which increased liquidity.

The underlying NIM for 2023 is expected to be broadly flat to 2022 after the expected impact of planned Tier 2 and MREL qualifying debt issuance, albeit the exact quantum of the debt issuance drag will, of course, be subject to market conditions.

Turning to the next slide on impairments, this provides our usual waterfall explaining the movement in the statutory impairment provision during the year, and I'll talk you through this. And if we move from left to right, house price appreciation over the course of the year outperformed our model assumptions with led to a release of around £10m.

Modelling and staging enhancements reduced by around £8m, and that largely reflects the decrease in pandemic-related risks.

These movements were offset by an £11.6m increase to reflect the adoption of those more severe forward-looking macroeconomic scenarios, and you can find those at the very end of the presentation materials.

A £13.3m increase for post-model adjustments, and that's primarily to account for rising cost of living and borrowing concerns. The significant increase in the size of our loan book this year, together with profile changes, led to a further increase in the provision of around £15m.

And, finally, the other bar includes items such as changes to individually-assessed provisions.

Looking at our coverage ratio, you can see that the total coverage ratio increased by 7bps in the year, and remains more than twice the level it was pre-pandemic at the end of 2019 as geopolitical inflationary and cost of living concerns have replaced pandemic-related concerns.

Looking in a little bit more detail, you can see the increase in stage 2 balances. This is primarily due to accounts which are not in arrears but which we have assessed was being more likely to be impacted by the worsening economic outlook, including the rising cost of living and borrowing.

We will continue to proactively review our forward-looking economic scenarios and the coverage ratios as the outlook evolves.

Our next slide is capital. So, looking at our capital position, you can see that the Group's CET1 and total capital ratios remain strong at 18.3% and 19.7% respectively at the end of the year.

Again, going from left to right in the waterfall, which explains the movement in the CET1 ratio, you can see our very strong capital generation from profitability of 4.8%. We utilised 2.8% to support the significant 12% growth in the loan book during the year. Total ordinary dividends reduced it by 1.5% which reflects a 30% pay-out ratio in line with the prior year and consistent with our stated desire to lever a progressive dividend per share.

You can also see the diluted impact as we continue to amortise the fair value uplift on CCCFS and their assets at combination as well as the IRFS 9 capital addbacks. This takes the CET1 ratio to 20% before the distribution of additional capital.

£100m share repurchase programme was completed in November, and you can see also the effect of the £50m special dividend we announced today.

Looking ahead to 2023, we've also announced a further £150m share repurchase programme which will commence tomorrow subject to market conditions, which is equivalent to approximately 1.4% of CET1.

The Board remains committed to returning excess capital to shareholders, and the £150m share repurchase, combined with the 2022 ordinary and special dividends, represents a total cash return to shareholders of £332m and demonstrates our commitment to return excess capital to shareholders in an efficient way.

As we discussed at the Half Year, the Group intends to target a CET1 ration of 14% once the capital stake has been fully optimised through Tier 2 and MREL eligible debt issuance over the next two years.

We know the PRA has recently published a consultation paper on the implementation of Basel 3.1. We will be responding to that paper by the end of the month and await confirmation of the final rules which we expect to be available by the end of this year.

We've estimated the impact on our 31st December 2022 CET1 to be a reduction of up to 2% should the proposed rules be implemented as drafted in the consultation paper and prior to us receiving IRB accreditation. As previously guided, we have sufficient capital to support the temporary increase should this occur.

The Group continues to advance towards IRB accreditation with progress made throughout the year. We've completed a comprehensive self-assessment exercise to validate our level of compliance. Pre-application discussions have been held with the PRA and we are now actively engaging with them regarding a Module 1 submission date.

I'll now pass back to Andy who will give an update on our lending and funding franchises.

Andy Golding, Group CEO
Thank you, April. Our lending franchises are a story of doing the right thing for our customers, driving retention and delivering growth whilst maintaining our position at the forefront of the market.

Originations in our core sub-segments, Buy-to-Let and Residential, have been encouraging, both in terms of the significant volume increase and also the quality of those applications.

Commercial has performed particularly well too, reporting a near tripling of originations following our renewed focus in that sub-segment. The Group has delivered this improvement despite the strong prior year comparison which, as you know, was boosted by the stamp duty holiday.

Average interest coverage ratios for new originations were 207% and 191% for OSB and CCFS respectively, and our LTVs remain sensible in all segments.

Professionalisation of the Buy-to-Let market continued with 86% of OSB buy-to-let completions by professional landlords in the period. The transition continues to play to our strengths.

I'm proud that we supported our customers and broking partners by honouring both the offered and the pre-offered pipeline in the wake of the September mini budget. This provided stability during an uncertain time and underlined our long-term commitment to the market. Actions such as these enhance our reputation for service which continues to be recognised in industry awards.

Our funding platform continues also to serve us well. Our Retail savings strategy of attract, retain and satisfy saw over 190,000 new savings accounts opened across our brands, which is more the twice the number opened in the prior year.

We also retained 94% and 88% of maturing deposits with OSB and CCFS respectively.

Net promoter scores remained high at over +60 in each brand, although they were somewhat impacted by the exceptional volume of new account openings and the out of season ISA season that materialised once rate rises increased the attractiveness of these products again. However, I'm pleased the process improvements we quickly implemented are now showing a return to the exceptionally high 2021 levels.

We continue to enjoy Bank of England funding through TFSME and the Indexed Long-Term Repo scheme. The Group's collateral position continues to improve as well. In the summer, we completed a £1.3bn fully retained securitisation of buy-to-let mortgages, predominately for use as collateral with the Bank.

Before concluding, I want to take a moment to reflect on the progress we've made during the year in delivering for our customers and our vision to maintain our leadership position in the specialist lending market over the next decade.

As you can see on the left-hand side, we've taken a series of actions this year that demonstrate that we are continuing to place the customer at the heart of what we do.

I mentioned earlier how we supported customers through the period of uncertainty following the mini budget. We also published our Landlord Leaders research to understand our customers, their aspirations and their approach to sustainability. This has led to the formation of a community forum, the launch of a £50m property improvement fund and practical help for customers who are yet to incorporate.

We've also continued to launch new products, including those that help landlords meet further EPC requirements. And all of this continues to help to consolidate our position as the customers' lender of choice and the leader in our chosen markets.

However, we're not content to stand still. Looking to the right, you can see an overview of the actions we will be taking to keep the Bank future ready. We will use the time when the market does not provide double-digit growth opportunities to enhance our capabilities. These enhancements will range from leveraging digital solutions to support our deep underwriting expertise to improving the experience of both brokers and customers through the creation of new customer journeys. And these are medium-term objectives to ensure that OSB retains its leadership position in the market and we'll, of course, keep you updated as we progress.

So, in summary, a strong performance across all key metrics in the year. Our high-quality secured lending book continues to perform well with arrears flat to last year, high interest coverage ratios maintained, and a reduction in the LTV on our back book.

Looking ahead, the UK mortgage market as a whole is forecast to be subdued in 2023, with a particular reduction in expected purchase activity.

The Buy-to-Let segment is also predicted to see a reduction in lending following a strong 2022. However, whilst part-time landlords may be more sellers than buyers in the year ahead, professional landlords who comprise the majority of the Group's lending, remain active buyers and are looking favourably at opportunities supported by continued strong tenant demand and rental growth.

We remain, of course, cognisant of the uncertain macroeconomic outlook and the potential impact of the higher cost of living and borrowing on the mortgage market and its affordability. However, we are building a healthy pipeline of new business and have a proven track record of retaining customers, attracting new ones and working with high-quality borrowers. Based on current application volumes, we are targeting underlying net loan book growth of circa 5% for 2023.

And as we look at current pricing and funding costs, we're expecting the net interest margin to be broadly flat year on year, even after the impact of the anticipated debt issuance, and we expect the cost-to-income ratio to rise to circa 29% this year.

The Group has a proven track record of delivering strong results with a clear strategy and a robust risk-management framework. We have consistently demonstrated our resilience, which allows us to look to the future with optimism. Our latest set of results underline the quality of our business model and the strength of the OSB Group's balance sheet. Thank you for listening, and the operator will now open up to Q&A.

Q&A

Benjamin Toms, RBC
Good morning and thank you for taking my questions. The first one on guidance, please. If I stack up your various bits of guidance, it sounds like there are some tailwinds and some headwinds to ROE in 2023. In terms of the tailwinds, flat NIM and some loan growth should mean a better NII, and I guess the nature of the IFRS 9, and the sizeable management overlay should mean that cost of risk is lower this year, and the large buyback should bring down the E in the ROE. And in terms of headwinds, you're unlikely to get a repeat, I guess, of the fair value gains and cost growth will probably be higher I expect than NII. My guess is, if you stack all this together, do you get to a position where ROE is probably slightly down year over year but still meaningly above the 20% mark?

And then, secondly, on capital, you've guided that your expected impact from Basel 3.1, is up to 2% of capital. I accept that there may or may not be a timing difference between the implementation of Basel 3.1 and the bank receiving IRB approval, but do you expect that the benefit from the latter should largely neutralise the headwinds from the former?

And, as you go back to the regulator and respond to the rules laid out in the consultation, what areas are you most hopeful may, eventually, get repealed or watered down? And do you think the events over the last week in the US could impact the willingness of the regulator to roll back and implement softer regulation than initially laid on UK banks? Thank you.

Andy Golding, Group CEO
Thanks, Ben. April, I think they're probably mostly ones that you would want. I'm happy to talk about the consultation if you want, but I think guidance on cover and IRB and 3.1 versus IRB…

April Talintyre, Group CFO
No, I happy to take these. If I start with ROE, I think that was a very good summary, Ben, actually, and, you know, sort of, included in our cost guidance is the sort of, full year impact of the people we hired last year, it was a big hiring year for us, and, clearly, wage inflation and other inflation will continue. Clearly, inflation is expected to moderate but not go backwards.

And we continue to invest in the business, and I think we've always invested in the business within the, sort of, economies of scale that our double-digit growth has generated, but I think, as Andy outlined, we're totally committed and in a very strong position to continue to spend that and invest for the future, even in a year, where perhaps we're guiding single-digit growth. But, yeah, I think you've picked up the, sort of, positives and drags very effectively there in your summary.

Turning to Basel 3.1, I mean, the reason we, sort of, guided up to 2% is that some of the complexity and the rules that they've published, we actually, in common with every bank, have some data gaps. Just to explain that, and we have assumed, obviously, that where we have data gaps, we can't take advantage of favourable treatments.

But there were quite a few surprises in the consultation paper. I think I'd previously talked about a kind of, worse and a mid-case theoretically with you guys and I think we've probably ended up closer to the worse case than our mid-case.

And I think the areas we'll be particularly focused on is, you know, asking for a transition period for standardised banks who are too big to take advantage of the strong and simple regime, just in the way that, you know, IRB banks have been given a five-year transition. So, that will be an area that we will be, maybe idiosyncratically, including in our response. I think that's very reasonable because, as a large to buy-to-let lender, clearly, the significant increase in risk weights is largely coming from Buy-to-Let for us.

We have a nice offset from our Resi book, very low LTV Resi book, that's giving us a nice offset, and the loss of indexing, which is available if you're IRB but not, apparently, if you're standardised, is another area of lobbying, perhaps Commercial where, you know, it's underpinned at 100%, sort of, floored at 100% risk weight for mortgages, but 75% if you're lending unsecured to the same business. So, there are a few areas there on the risk weight.

I think, obviously, the whole industry through UK finance is making clear if you don't announce the final rules until the end of the year you can't possibly expect everyone to make the necessary system changes by 1st January '25. I'm hearing that they're trying to align to Europe and the US, and if Europe and the US take longer to implement, they will too, and I don't think the US has got a consultation paper out yet, just to put that into perspective. So, that's, kind of, the, sort of, key areas of perhaps interest.

I mean, what they did is platinum plate, you know, the actual CRR. Are the events of the last few days going to change that? I'm not sure. I mean, this is the PRA, not the Bank of England Resolution Authority. I think we'll have to see how this all plays out and whether or not there's a positive or negative, sort of, connotation.

I think, you know, what happened with Silicon Valley Bank is, sort of, very different regulatory regimes to what we already have in the UK. If anyone has any questions, of course, happy to answer those later. But it's hard to see a parallel situation for ourselves. Does that, sort of, answer all your various strands?

Benjamin Toms, RBC
Very good. Thank you.

April Talintyre, Group CFO
Thanks, Ben.

Grace Dargan, Barclays
Morning. Thank you for taking my questions. A couple from me, if I can. So, firstly, around landlord affordability. Obviously, you've had quite a stable ICR, but what are you seeing year to date? Has that stayed stable at the start of the year?

And I guess noting the rental increases that you think landlords have been able to pass on, maybe could you give us a sense of, kind of, the average net rental yields the landlords are seeing on the properties?

And then maybe, just finally, comments around the professional landlord demand are really helpful. Do you think there is a widening gap of affordability between professional and amateur landlords? It would be interesting to get your take on that. Thank you.

Andy Golding, Group CEO
Thanks, Grace. I'll tackle those two. I mean, landlord affordability, I think, you know, in the, sort of, aftermath of the mini budget when swap rates, sort of, skyrocketed, you know, we were looking where the whole mortgage market was looking, where you might price fixed rates, not just for Residential but for Buy to Let and thinking, cor, blimey, rents are going to have to go up a fair bit before, you know, those loans create the kind of yield that either meets your interest coverage ratio hurdle, which is, you know, typically a minimum of 125 for a limited company structure, and 140, 145 for a sole name.

However, obviously, as we know, swap rates have come off and, while there is, for borrowers, a maturing from five-year fixed rates that they took out five years ago, today, there is an affordability shock, of course. They've had several years now of quite strong rental increases, you know, and across the UK, rents have gone up, you know, anything from, sort of, 10% to 20% in some areas where property is in demand.

And landlords, at the moment, are facing a situation where they don't have to take offers on their properties because there's so much tenant demand, particularly in decent quality stock, but actually, they're able to hold out for those higher rents and get the tenancies filled very, very quickly.

So, you know, with what we now think as the direction of travel in terms of Bank of England base rate, what we think the impact of that is on swap rates, we think affordability is still there. It will preclude some from, sort of, new deals who want to really highly gear those new deals, and, for a while, will have a bit of a dampening effect on the purchase market, as we touched on earlier, but, you know, the prognosis for affordability looks good. Obviously, you'd expect us to splice and dice our book and make sure as deals mature, people could afford the next yield of loan.

Leaders also do things with product construct, so, you know, you're put on a larger arrangement fee onto a loan, which is capitalised over the term of the loan, to keep the pay rate, you know, within tolerances and more manageable, and, of course, we will all have products that offer borrowers that sort of facility if they want to do it.

The affordability piece between professional an amateur, I mean, there's a bit of an affordability dynamic between residential and rent, you know, the gap is closing back down again. You know, for a while, it was cheaper to buy than it was to rent, and that gap has really closed, you know. Cost of mortgages for first-time buyers is pretty strong, pretty high, and, of course, they've got to come up with a sizable deposit because there aren't really any high LTV well-priced first-time buyer products on the market and, therefore, rental is enjoying a very, very strong demand as a function of that.

We just think professional landlords with multiple properties have a spread of risk. You know, it's interesting, Ben asked the question about the consultation, I mean, one of the points I will continue to make to the regulator is I do not understand why they think there's a higher risk weight requirement for a multi-property landlord versus a single property landlord because, actually, having a spread of risk, i.e. not all your eggs in one basket, means that you can have tenants changing at different times across the portfolio. You can have maintenance requirements on some properties at different times in the portfolio. It's not like all the bills come at once on a single debt, where, if you haven't got a tenant paying, you've got a problem because you've still got to pay the mortgage.

So, we just think the market will continue to professionalise. We think that's the way to go. I think that's a better outcome for tenants as well because, you know, professional landlords will know what they're doing, they understand upcoming legislation, they're already making moves to drive the energy efficiency of their properties upward because they know it's potentially likely they'll have to have higher EPC ratings, and that's why we continue to back that population. So, we think the affordability dynamic looks okay. Does that answer your question, Grace?

Grace Dargan, Barclays
It does. Maybe I would just press you if you do have any comment around the net rental yields, you're seeing at the moment?

Andy Golding, Group CEO
It's massively different according to geography. I mean, you know, anything from 4% to – I mean, on HMOs, you know, and student let accommodation, you can see yields of, sort of, 9%. And, of course, remember that professional landlords aren't only in it for a quick income buck, they're also in it for the longer-term capital appreciation, so they're factoring longer-term capital appreciation into their yield calculation. But, you know, rental yields have been growing over the last few years, and, as I say, it's wildly dependant on geography and supply and demand.

Grace Dargan, Barclays
Okay, perfect. Thank you very much.

Andy Golding, Group CEO
Thanks, Grace.

Edward Firth, KBW
Good morning. Thanks very much. Can I just bring you back to the whole capital and MREL thing because it seems that we've got quite a lot of moving parts over the next 12, 18 months? So, just in terms of, firstly, the Basel 3.1, the up to -2%, is that the total impact you expect from the total implementation of Basel 3.1 or is that just the initial impact and then there will be a later one, because, as I understand it, the rollout has the credit coming in later. So, that's my first question. Shall I give you all the questions, or do you want to knock them off one at a time?

April Talintyre, Group CFO
Well, let me take that one very quickly if that's okay.

Edward Firth, KBW
Yeah, of course.

April Talintyre, Group CFO
That's the thing here, there's no transitional arrangement if you're a standardised bank, so one day it's one figure and then the next day it's 2% off the CET1 ratio, but only if it's implemented as written in the consultation paper and prior to us obtaining IRB accreditation. And as I mentioned in my prepared remarks, we've got the capital set aside in case that happens, and so, it's a temporary thing only. But, yeah, that's how it works.

Edward Firth, KBW
Perfect. And, for the IRB, could you just update us on where we are with that? And have you given any, sort of, guidance or any help you can give us in terms of is it equal and opposite, is it more, is it less, because it's going for quite a while now, and I would imagine you're beginning to get some clarity?

April Talintyre, Group CFO
Well, I mean, I'm not going to tell you what's in our models.

Edward Firth, KBW
No, sure.

April Talintyre, Group CFO
But, to some extent, we can model it out as we go through the process of the accreditation, you know, whether the regulator agrees with all of our models, of course, or whether they want to put some initial output floors on it. So, I think it certainly mitigates all of the impact of Basel 3.1, you know, whether we get more benefit beyond then, of course, is a question for where the consultation lands and, therefore, where the IRB underpins land.

Edward Firth, KBW
Sure.

April Talintyre, Group CFO
But, yeah, it will mitigate it, yeah.

Edward Firth, KBW
Great. And then the other question was about, sort of, MREL and funding. I mean, I guess it's a particular focus at the moment given what's going on in the market. Is it possible to give us some idea, and I guess I could go through every single instrument, and work it all out, but I'm sure you have it in your head, as we look over the next 12 months, how much MREL do you have to issue, and how much do you want to issue, I guess?

So, in terms of your planning, you've obviously got a plan in there in terms of the £150m buyback, do you have to issue a certain amount of MREL in order to deliver that, and how much do you have to deliver to refinance an existing MREL instrument? So, some sort of idea of what the, sort of, dynamics are around that would be helpful.

And then the second question is, I guess, we're still quite a way away, but you've got quite a lot of TFSME, I think, in your balance sheet. As we roll up towards that, could you replace all that with retail funding if you chose? I mean, how should we expect the balance sheet to move? At the moment, you're slightly long asset loans to deposits, do you think you could feasibly bring your retail deposits up to match your loans if you needed to rather than having to rely on the wholesale market? Thanks very much.

April Talintyre, Group CFO
Right, some very good questions there, Ed. I'm afraid, I'm not really going to answer your first question. I think you understand that, in the markets, to try and give an expectation of quantum timing and even cost is probably something that would be, you know, inappropriate for me to speculate on.

Edward Firth, KBW
Could you highlight what's running off though?

April Talintyre, Group CFO
Nothing.

Edward Firth, KBW
Okay, right.

April Talintyre, Group CFO
We don't have anything, yeah. But as soon as we, sort of, see an opportunity in the market and we start to issue, of course, we'll give an update. I mean, perhaps all I could guide you towards is we have, somewhere in the Appendices, given our capital requirement and our current capital resources chart for a kind of, fully optimised balance sheet, and our interim MREL requirement from July '24 is 18% of risk-weighted assets.

We have the regulatory buffers, the countercyclical and on the conservation buffer on top of that, so you are kind of looking at 22.5%, and I think you would expect us to have a bit of a Board buffer on top of that. And we've given you our capital resources, total capital resources at the moment. You can take off the share repurchase. And if you think about growth in your model, you should be able to, kind of, get there, but what I don't want to do, particularly as an issuer, is give out to the market exactly what we want to issue when if that makes sense.

Edward Firth, KBW
Well, certainly not at the moment!

April Talintyre, Group CFO
So, I'm sort of dodging the question a little bit, but, hopefully, sort of, this allows you to get you get a feel ...

Edward Firth, KBW
No, that's very helpful, super helpful.

April Talintyre, Group CFO
And if you have any questions, obviously, reach out to the IR Team as well if you want to socialise it with them.

On TFSME, you know, I think the whole industry has a bit of a cliff event, don't they, in October '25, and we are planning to start repaying early. So, probably from next year, we'll start to look for opportunities to repay. And right now, the cost of retail funds is super favourable, well, perhaps before the swap spreads came in, we were able to raise a mix of retail funds that may be SONIA -30, -40. So, it makes sense to actually, then, repay Bank of England funding at SONIA, you know, at base rate. So, we might do a little bit of that opportunistically, which is fairly neutral, I think, to NIM and, clearly, beneficial to the bottom line.

Our primary intention is to use wholesale markets, but we want to stage out our repayments, but if, at the point in time that we're planning to repay the wholesale market pricing doesn't look compelling, then we'll use retail funds. So, I guess you might see us using a combination. If wholesale markets return to nice liquidity, we would plan to use mostly securitisation.

I think, if there was a real dislocation in the wholesale markets, we would expect the Bank of England to extend the deadline, to be frank, and I think, you know, was is it one of you asked me earlier about whether I felt that what happened over the last few days might impact how the regulator here thinks about resolvability. And I think, watching very carefully a cliff event for the whole industry and, you know, in those circumstances, wanting to take out positive action earlier, maybe that might be a benefit coming out from, you know, the learnings of the last few days.

Edward Firth, KBW
Sure.

April Talintyre, Group CFO
But hopefully that's a fairly fulsome answer.

Edward Firth, KBW
No, that's super helpful, very helpful. Thanks very much indeed.

Andy Golding, Group CEO
Thanks, Ed.

James Invine, Societe Generale
Hi. Good morning to both of you. I've got a couple, please. The first is a follow-up to Grace's question about ICRs, you know, I hear what you say about the fact that anybody refinancing in 2022 has enjoyed 5-years' worth of rental growth and so on, but I guess the same will also have applied to anybody refinancing in 2021 as well. So, I can't quite square the circle how, in '22 versus '21, your new business LTV has stayed basically the same, but your interest coverage ratios have gone up despite the fact that, obviously, we've had higher rates during 2022. So, I was wondering if you could just help us work that one out, please?

And then the second question is on your origination, the Buy to Let at £3.8bn. I was just wondering if you'd be willing to split that, please, into origination from new to Group customers and how much of it came from deepening penetration of existing customers, just, kind of, when we're thinking about how those might evolve in '23 and beyond?

Andy Golding, Group CEO
Yeah, okay. Thanks, James. They're both good questions. I mean, look, we continue to enjoy high ICRs. We, typically, always have done. You know, because we're in that professional market where you've got borrowers that have got, you know, a blend within their portfolio, so they might have some multi-occupancy properties, they might have a bit of student, they might have, you know, a bit of semi-commercial, so a couple of flats above the corner shop-type territory.

Because of, you know, professional landlords being a bit more savvy about looking for the yield, and also having equity across a portfolio that means that can tinker with their LTVs accordingly, you know, we are not seeing, I mean, you do see the odd loan that is, kind of, coming through and it's only just scrapping your minimum requirement for ICR, but, you know, we continue to see a good, strong portfolio of interest coverage ratio across the piece. And, you know, a deal that's refinancing today that was written five years ago, you know, there has been quite a chunk of rental increase during that period of time which, sort of, moves the ICR forward, you know, depending on how much equity they're removing, etc.

The new to Group or existing, I mean, clearly, we quote our retention numbers, we work very hard at not throwing business off the back of the truck. The majority of our originations are not necessarily new customers to Group but new loans. So some of it is existing customers refinancing in from other providers and their deals come to maturity, some of it is existing customers expanding their portfolio, but a good lump is also customers newly coming to Group who haven't had exposure with us before, but, you know, as their, sort of, portfolio grows or their deals come to maturity with lenders they've used in the past, their brokers are saying this lender will, you know, do you a service that is appropriate for what you're looking for. I don't think we publish a number exactly on existing customers bringing new deals to us.

April Talintyre, Group CFO
No, we don't.

Andy Golding, Group CEO
But we work hard on both sides of the equation, so we do do a good chunk of business with existing borrowers. And, actually, I said this before at our Senior Credit Committee where we look at all of our larger exposures to sanction those, if we have a borrower that's an existing borrower and we like them and they've got a good track record and the evidence suggests they, you know, got good stock and they know what they're doing. We don't do committed facilities, but we do give a 'we're minded to do more' indication and what that does is it means, for both the broker and the borrower, that they know, as that individual expands the portfolio, they've got a lender that's very happy to listen to the next part of their business expansion plan, and that, again, you know, definitely yields for us. We've always done that, and I think its wholly appropriate that we continue it.

James Invine, Societe Generale
That's lovely. Thank you very much. Can I just ask a follow-up to the first one? What proportion of your new business is HMO and, you know, what was it last year, please?

April Talintyre, Group CFO
We don't disclose that one, I'm afraid, James.

James Invine, Societe Generale
Okay, all right. Thanks anyway.

John Cronin, Goodbody
Morning, Andy. Morning, April.

Andy Golding, Group CEO
Morning.

John Cronin, Goodbody
Thank you for the update and the for the reassuring guidance for '23, on margins particularly for me, but just a couple of questions on capital. So, look, the first one is, and this has been asked before, I appreciate, but why aren't you returning more capital? I guess, and in an interrelated way, can you just remind us again why you're targeting 14% CET1? Like, I look at Barclays, a global systemically important institution, they're targeting 13% to 14%, so what is it that you're not calling out here? Is there something the Board is afraid of in terms of capital return?

My second question is on IRB and probably a bit more strategic. I guess, first of all, look, we've been talking about it for a the best part of five years, you still haven't submitted the Module 1 application, your competitors are, arguably, getting closer. I mean, from a competitive position, you could be in a very difficult situation in the relative near term if another bank, one of your key peers, does attain IRB accreditation and is then conferred with the ability to under-price relative to where you sit, for the same return. Just wondering how worried are you about it and would you push back against me if I was to say that the reality is you're years away from it yourselves?

And then, thirdly, look, a very micro point and nothing that's presenting me with any concern, but in the past Charter Court did, I think it's the end of 2017, disclosed that their insured deposits were 97% of deposit balances. Just in terms of housekeeping, can you give us an updated number, give us a broad sense of the proportion of insured versus uninsured? Thanks.

April Talintyre, Group CFO
Oh, that's a long list. Andy, are they all for me?

Andy Golding, Group CEO
Yes, I think so.

April Talintyre, Group CFO
Okay. So, let's take the capital, there's nothing that we haven't publicly said about capital. I think it's looking for the most efficient way to return capital as we go through the journey of optimising the stack.

There were lots of factors as to how the Board decided on 14%, it felt appropriate given the uncertainties and the outlook that we've already discussed at some length today, and we still feel that's appropriate and that's the right level to get to when we have a fully optimised capital stake. And, you know, I think we've disclosed and we've discussed every aspect of positive and negative potential on our CET1 ratio, so there's no concern that I'm not sharing with you. You know me, I'm always a plain speaker.

And, you know, we decided to do a special because we were constrained on how much share repurchase we could announce because £150m was the maximum amount any of the investment banks would do for us given the liquidity in our shares, and we thought we wanted to return a bit more and, therefore, we put the special on as well. And I think it demonstrates that we're willing to use all tools available to us, but I think, by far, the most efficient way of returning excess capital is share repurchase, and if we do that over, you know, a couple of years as we optimise the capital stack, I think that's probably the right thing for us to do for our shareholders, to be frank.

And, of course, we need regulatory approval for some of these actions and, you know, it has to be done over the same time as you're issuing Tier 2 and you're issuing MREL. So, there's really nothing else hidden there, John. And, at the moment, the Board feels very comfortable with 14% being the right target given the economic outlook and given these, you know, uncertainties that, unfortunately, still prevail from a timing perspective between Basel and IRB.

You know, IRB, look, you know, we're waiting for our date. There are limited resources at the regulator. They focus on the new models for the existing IRB. There are some of our competitors, who perhaps started the journey slightly earlier than us, but because we're submitting a bit later, we're in the position that we are, you know, materially compliant and we've also had the advantage of hearing, not directly but through the advisors, the kind of challenges that the regulator has made on, sort of, the big bank and the current application people on the models, you know, things like cyclicality, use of bureau data, and we're able to, you know, work on that alongside those people.

So, you know, resources to one side, I would expect a faster run through the application process as a result of being in a much stronger position when this Module 1 goes in. I appreciate that's probably what I told you at the interim, but we really are, you know, at the point where we're discussing dates and hopeful that the regulator will find the resources for us.

I think you also asked about insured deposits, didn't you? You know, it's broadly in a similar place, I mean, maybe a percentage or so plus or minus. The vast majority of our deposits are insured and, you know, the vast majority of what we do is retail. We've got some very small corporate-style deposits. We don't actually disclose that number, but, you know, it's not materially out of sync.

John Cronin, Goodbody
That's very helpful. Thank you.

Andy Golding, Group CEO
John, I mean, I would just add on, you specifically asked the question about competitive disadvantage and are we, you know, sweating that.

April Talintyre, Group CFO
Oh yes, sorry. Yeah, go for it, Andy.

Andy Golding, Group CEO
Look, we're already at a competitive disadvantage. There's tons of IRB banks and tons of banks that have got significantly cheaper funding than us. But, you know, in the marketplace in which we operate, you need to have a really detailed understanding of the market, you need to understand how to price for risk, you need to have balance sheet scale, you know, in order to have consistency of offering, and you need to have the operational capacity to deliver a service proposition that means that borrowers and brokers want to use you.

We have never, I mean, I think I could probably say Kent Reliance has always been, as one of our big But-to-Let brands, probably the most expensive buy-to-let lender in the market, but we've never struggled to grow it. So I'm not particularly concerned that, if we have a short overlap period, we're going to find an inability to write business, but, you know, if the overlap period materialises, so be it, but we'll find a way to pick through it.

April Talintyre, Group CFO
Apologies, I forgot that question, John. I would perhaps just add that, because we are a specialist lender, the difference between the IRB model than the current standardised are nothing like as broad as the original IRBs, you know, the big bank mainstream, low LTV prime borrower. There's a big difference between the IRB and the current 35% standardised. But when you start getting into the more specialist markets that we're in, that differential is much tighter and, therefore, I think it's that temporary step up, and we wouldn't change pricing for a temporary step up should Basel come in before IRB accreditation.

John Cronin, Goodbody
Yeah, that all makes sense. Thanks very much.

Andy Golding, Group CEO
Thanks, John.

April Talintyre, Group CFO
Yeah, good questions though, John. Thank you.

Aman Rakkar, Barclays
Good morning, Andy. Good morning, April. Just two quick questions, one is, if the Bank of England were to hike base rates from here, are you positively geared to rate hikes from here given your expectations around pass through and the way it impacts your NIM? Is that a potential source of upside that we should think about?

April Talintyre, Group CFO
To be honest, looking at the market expectation, there isn't really, today, an expectation of rate rises, so I definitely haven't baked in any future benefit from delays in passing that on into the guidance. So, if there were further rate rises and the market, you know, if we didn't pass that on in full to savers then, yes, there is potentially some upside, but, at the moment, there isn't the expectation of that. But, you know, if rates go up a lot higher, there might be a little bit more of the book where we think they might struggle to meet the ICR hurdles. But I think, even after, sort of, the mini budget, there was still big proportions of the book that could have afforded the financing shock.

But, I mean, I'm just drawing your attention back to the impairment provisions. I mean, I mentioned we had post-model adjustments of about £13m, and that was, clearly, deep dives into every part of our book to see who we thought was most likely to be impacted by cost of living or cost of borrowing concerns. And that's everything from, you know, obviously knowing your Residential borrowers, but if it's a Buy-to-Let landlord, using ONS data and the postcode of the property to work out the income decile of the people likely to rent it and what sort of affordability shock they are facing.

And looking at, you know, as Andy mentioned, maybe people in the past where we did lend at 125 ICR, you know, what rent increases have been seen in that area of the country, what do we think going forward when they come up to refinancing. So it's really deep, deep, deep dive and a huge piece of work to come up with that, sort of, £13m figure because what we did is we moved people into a lifetime loss stage 2 rather than a 12-month horizon in stage 1, all forward-looking, of course, but I hope that gives you a sense of scale as well.

Aman Rakkar, Barclays
That's really helpful. Thank so much. I guess the second question was, I think when we spoke post the Liz Truss affair, when, sort of, rates were blowing out and there was a real concern around the demand within your customer base and buy-to-let more broadly, and there was a suggestion, I think, that you'd be able to, kind of, potentially, repackage the manner in which you charge interest on your customers, so, kind of, amortising a chunk of the interest cost as an upfront fee and, you know, putting it into the life of a loan as a potential way of keeping the, kind of, monthly borrowing cost down for your customers. Are you having to do any of that?

Andy Golding, Group CEO
Well, I mean, especially with buy-to-let loans, always have a relatively chunky fee that ranges for anything between 1% to typically 2.5%. We do have a couple of products on the shelf where the fee is at 3% and it nudges the payrate down slightly. We have been asked occasionally, and I mean occasionally, like a handful of times, by a borrower to structure a deal in a particular way because they we've got plenty of LTV coverage they'd like to amortise maybe a 6% fee over the 5-year life of the loan and keep the pay rate lower because they're investing and doing works and, you know, making product improvement, etc.

But we haven't seen a wholesale need to really manufacture products with super high fees versus super low pay rates, but, you know, it is a structural place you can go to, and subject to the LTV on the portfolio or the particular loan being good enough, landlords will go for that if it means that their cash flow is maintained while they're still considering, sort of, future capex and then growing the rent on the property over the period of the loan. So, it happens from time to time.

Aman Rakkar, Barclays
Are you positively surprised by the resiliency of your customers then, the kind of demand that's coming through?

Andy Golding, Group CEO
No, I don't think I am. I think, because we're in the professional landlord market and because these guys are, you know, they're savvy operators, I mean, I know a number of the really big buy-to-let borrowers in the UK personally, and, you know, they have had so many, you know, kind of, problems to deal with and they found a way around it and they tweaked their business models.

And, you know, I've talked before about a borrower that owns big chunks of West London, you know, significant chunks of West London, and, over the years, you know, he's added and changed his business model to, you know, kind of, have a, sort of, food in the fridge model, if you like, where it's targeted at professionals, it's a lovely property, the broadband's fired up, the bills are all in, you know, the thing is absolutely stunning in terms of the way it's furnished. So, you literally rock up, hang your clothes in the wardrobe, stick a bottle of Sauvignon Blanc in the fridge and you're good to go, and he charges, you know, significantly more than an unfurnished, slightly grotty standard rent for that property and is finding a way to generate yield.

Landlords all have their pros, all have their idiosyncrasies about the way in which they leverage their particular skill portfolio and, sort of, geographic area to keep that going. So, we're not surprised about the resilience because, you know, we target high-quality borrowers and I have been working with them, you know, over the last decade or so.

Aman Rakkar, Barclays
That's great. Thank you so much, really appreciate it.

Andy Golding, Group CEO
Okay, if we don't have any further, it is 10.30am, I'd like to thank everybody for joining this morning and I hope you all have a good day, whether you've managed to get into London or not, get into London or whatever, and we look forward to speaking to you all again soon. Thank you very much everyone.

April Talintyre, Group CFO
Thanks, everyone.