METRO BANK PLC

Interim Report

Six months ended 30 June 2019

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COMPANY INFORMATION

Board of Directors

Chairman

Vernon W. Hill II

Non-Executive Directors

Stuart Bernau
Catherine Brown
Roger Farah
Alastair (Ben) Gunn
Gene Lockhart
Monique Melis
Sir Michael Snyder
Paul Thandi (Appointed 1 January 2019)
Keith Carby (Retired 30 April 2019)
Lord Howard Flight (Retired 1 April 2019)

Executive Directors

Craig Donaldson – Chief Executive Officer
David Arden – Chief Financial Officer

Company Secretary

David Arden

Registered Office

One Southampton Row
London
WC1B 5HA

Independent Auditors

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
7 More London Riverside
London
SE1 2RT

Registered Number

6419578

www.metrobankonline.co.uk

About Metro Bank

Metro Bank is the revolution in British banking. It is celebrated for its exceptional customer experience and achieved the top spot in the Competition and Market Authority's Service Quality Survey among personal current account holders for its overall service and came second among business current account holders in February 2019. It was also awarded 'Best All Round Personal Finance Provider' at the Moneynet Personal Finance Awards 2019 and it is recognised by Glassdoor in its 'Best Place to Work UK 2019' top 50 list.

Offering retail, business, commercial and private banking services, it prides itself on using technology to give customers the choice to bank however, whenever and wherever they choose. Whether that's through its growing network of stores open seven days a week, from early in the morning to late at night, 362 days a year; on the phone through its UK-based 24/7 contact centres manned by people not machines; or online through its internet banking or award-winning mobile app: the bank offers customers real choice.

The bank employs over 3,900 colleagues and is headquartered in Holborn, London.

KEY HIGHLIGHTS

The following metrics represent the core key performance indicators for the bank:

	Half year to 30 June 2019	Half year to 30 June 2018	Change	Half year to 31 December 2018	Change
Profit and loss (6 months)					
Underlying profit before tax[1]	**£13.6m**	£24.1m	(44%)	£26.4m	(48%)
Statutory profit before tax	**£3.4m**	£20.8m	(84%)	£19.8m	(83%)
Total income	**£220.5m**	£189.8m	16%	£214.3m	3%
Total operating expenses	**£212.7m**	£164.8m	29%	£190.7m	12%
Net interest margin	**1.62%**	1.85%		1.77%	
Net interest margin + fees	**2.07%**	2.19%		2.12%	
Average cost of deposits	**0.70%**	0.57%	13bps	0.64%	6bps
	30 June 2019	**30 June 2018**	**Change**	**31 December 2018**	**Change**
Customer data					
Customer deposits	**£13,703m**	£13,736m	0%	£15,661m	(13%)
Retail:commercial	**55%:45%**	46%:54%		47%:53%	
Customer loans	**£14,989m**	£12,013m	25%	£14,235m	5%
Retail:commercial	**71%:29%**	68%:32%		69%:31%	
Loan to deposit ratio	**109%**	87%	22pp	91%	18pp
Asset quality					
Non-performing loans to period-end loans	**0.17%**	0.17%	0bps	0.15%	2bps
Loan loss reserve to non-performing loans	**115%**	199%		162%	
Loan loss reserve to total loans	**0.20%**	0.33%	(13bps)	0.24%	(2bps)
Cost of risk	**0.06%**	0.08%	(2bps)	0.06%	0bps
Capital ratios					
Common Equity Tier 1 ("CET1") ratio	**15.8%**	12.7%		13.1%	
Regulatory leverage ratio	**7.0%**	4.6%		5.4%	
Capital as percentage of deposits	**13%**	8%		9%	
Capital as percentage of total assets	**8%**	6%		6%	
Total assets	**£21,357m**	£19,135m	12%	£21,647m	(1%)

Customer accounts have increased from 1,620,000 on 31 December 2018 to 1,810,000 at 30 June 2019

Customer loans:	Customer deposits:	Number of stores:
£15.0bn	**£13.7bn**	**67**

1. Underlying profit before tax excludes Listing Share Awards, the FSCS levy (included when reporting on a full year basis), impairment and write offs of property, plant & equipment ("PPE") and intangible assets, costs relating to the RBS alternative remedies package, Capability & Innovation fund income and expenditure and transformation and remediation costs. A reconciliation between our statutory and underlying results can be found on page 40.

BUSINESS AND FINANCIAL REVIEW

The first half of 2019 has been a challenging six months for us with headwinds in the external operating environment combined with company specific factors that have impacted our financial position and performance.

Total deposits at £13.7 billion are flat year-on-year following net outflows during the first half of 2019. Our deposit performance was impacted by intense speculation at the time of the capital raise in May, primarily driven by a limited number of commercial customers withdrawing deposits. However, we are pleased that retail deposits have continued to grow during the period, with stability across the SME deposit base. This was supported by continued customer account growth of 190,000 during the first six months of 2019 to 1.8 million, with sustained year-on-year growth in personal current accounts at 23%, and growth in business current accounts at 19%. Growth in customer accounts is underpinned by our focus on providing superior customer service, acknowledged by our 1st and 2nd place in the latest CMA survey results for overall customer service quality for personal and business customers respectively. Following completion of the £375 million capital raise, which was upsized from an initial target of £350 million due to investor demand, customer deposits have returned to business as usual growth during June, with continued positive momentum month-to-date in July.

We have taken action during the first six months of 2019 to maintain a strong and resilient balance sheet. Completion of the £375 million equity raise means our CET1 ratio increased to 15.8% from 13.1% at 31 December 2018, and is materially above our target of c.12.0% and regulatory tier 1 minimum requirement of 10.6% to support our growth plans. Our liquidity coverage ratio ("LCR") is 163%, up from 139% at year-end 2018 following the equity raise and sale of non-LCR eligible investment securities, remaining comfortably above our regulatory minimum of 100% throughout the period. We also continue to gradually manage down our loan to deposit ratio towards our medium-term guidance of 85%-90% and expect it to be c.100% by the end of the 2019. The loan to deposit ratio was 109% at 30 June 2019, incorporating the impact of executing the sale of a previously acquired loan portfolio. The portfolio has been sold to an affiliate purchaser of Cerberus Capital Management. It was not considered a strategic portfolio, with its sale having no impact on our customer franchise given it has continually been serviced by an external provider. The pro-forma CET1 ratio following the loan portfolio sale is 16.1%.

Net loan growth was up 25% to £15.0 billion (including the impact from the loan portfolio disposal), reflecting the strong lending pipeline at the end of 2018. In line with our strategy to rebalance our lending mix to optimise capital efficiency, lending to more capital intensive commercial customers reduced to 29% of total lending as of 30 June 2019 from 31% at 31 December 2018. Going forward we expect to continue rebalancing our lending mix while maintaining our low risk approach to lending. This is reflected in our low cost of risk at 6bps in the six months to 30 June 2019, down from 8bps a year earlier, with non-performing loans making up just 0.17% of the total loan portfolio. Looking forward, we expect to continue managing lending volumes in line with a gradual reduction in the loan to deposit ratio.

Mortgage yields have stabilised during the first half of 2019 but competition remains elevated. This, coupled with the adoption of IFRS 16 and interest expense on our Tier 2 debt, has meant our net interest margin has reduced to 1.62% from 1.85% a year earlier. Combined with continued growth in regulation, people, and technology costs, our underlying profit before tax for the six month for 30 June 2019 has reduced to £13.6 million from £24.1 million a year earlier. Statutory profit before tax of £3.4 million captures an increase in transformation and remediation costs as we implement our cost transformation programme and remediation work (six months to 30 June 2018: £20.8 million).

While profitability is down during the first six months of the year, we have made good progress with our cost transformation programme, with the plan tracking ahead of schedule and exit run-rate cost savings in 2019 expected to be at the top-end of the previously announced £15 million to £19 million range. We also continue to grow our fee income, supported by growth in customer accounts and the roll-out of new value-added services for customers. Receiving the £120 million Capability & Innovation funding in April has allowed for the planned expansion of further products and services we can offer to SME customers in the UK, and we continue to invest in bringing competition to this underserved and historically underinvested community in the UK.

Finally, following the risk-weighted asset ("RWA") adjustment announced on 23 January 2019, we continue to make progress implementing a remediation of internal systems, process and controls as well as recruiting additional expertise. A "big four" accounting firm is supporting our programme of remediation, expected to be completed in 2020. Among other actions internally, we have appointed a Director of Financial Transformation to coordinate our response and doubled the number of colleagues in our regulatory reporting team. We also intend to engage another accounting firm to undertake an external assurance review of our RWA calculations on a yearly basis, beginning with our full year 2019 results.

Income statement review

Summary income statement	Half year to 30 June 2019 £'million	Half year to 30 June 2018 £'million	Growth
Net interest income	**166.2**	156.3	6%
Fee, commission and other income	**50.2**	28.9	74%
Net gains on sale of assets	**4.1**	4.6	
Total income	**220.5**	189.8	16%
General operating expenses	**(174.7)**	(143.8)	21%
Depreciation and amortisation	**(37.0)**	(20.5)	
Impairment and write-off of property, plant & equipment and intangible assets	**(1.0)**	(0.6)	
Expected credit loss expense	**(4.4)**	(4.1)	
Profit before tax	**3.4**	20.8	(84%)
Taxation	**(2.1)**	(5.6)	
Profit after tax	**1.3**	15.2	(91%)

Net interest income

Net interest income was up 6% year-on-year to £166.2 million (six months to 30 June 2018 £156.3 million) driven by net lending growth of 25%. Although mortgage asset yields have stabilised during the first half of 2019, competition remains elevated and has impacted interest income. Interest expense also increased due to higher cost of deposits (up to 0.70% in the period from 0.57% in the same period last year) through a combination of both a base rate rise in August 2018 and the subsequent repricing of deposits, alongside further pricing actions in Q2 to support deposit flows. Following these pricing actions, we expect cost of deposits to be closer to base rate for the full year 2019. Interest expense also increased following the adoption of IFRS 16, the new leasing standard, on 1 January 2019, as well as interest expense on the Tier 2 debt instrument issued in June 2018.

Fee, commission and other income

The last quarter of 2018 saw the implementation of a number of initiatives such as dynamic foreign currency conversion, adjustments in pricing of safe deposit boxes and optimised transactions fees from Business debit cards. These initiatives, alongside a growing customer base, contributed to a year-on-year increase in fees and commission income.

Income from safe deposit boxes continued to increase during the period, up 21% to £6.4 million compared to the first six months of 2018 and continues to make a vital contribution to helping cover the costs of operating our store network.

We remain focused on further developing our customer proposition, which in turn will continue to augment fee income growth. The second half of 2019 will see us further evaluate fee opportunities across existing products, make trade finance and foreign currency enhancements, and develop a mobile cash collection and drop-off service, with further products and services from 2020 and beyond. Receiving the £120 million Capability & Innovation funding has allowed for the planned expansion of products and services we can offer to SME customers in the UK, and we continue to focus and invest in bringing competition to this underserved and historically underinvested community in the UK.

Operating expenses

Operating costs during the first six months of the year rose 21% to £174.7 million up from £143.8 million in the same period in 2018. The increase reflects continued growth in regulation, people and technology costs to support the long-term growth of the bank, as well as further expansion of our physical and digital footprints.

Improving cost efficiency is a key part of the evolved strategy that we announced in line with our year-end 2018 results. The first half of 2019 saw the start of the cost transformation programme, and we are making good progress. 2019 exit run-rate cost savings are expected to be at the top end of the previously announced £15 million to £19 million range, with upgrades to savings targets in the outer years of the programme with a reduced cost to achieve relative to our initial guidance. We expect cost growth to moderate with low single digit growth in the second half 2019 compared to the first six months of 2019.

Transformation and remediation costs include costs associated with delivery of cost programme and remediation programme relating to our RWA adjustment.

Balance sheet review

Summary balance sheet	30 June 2019 £'million	31 December 2018 £'million	Growth
Assets			
Cash and balances with the Bank of England	**2,146**	2,286	
Loans and advances to banks	**152**	186	
Loans and advances to customers	**14,989**	14,235	5%
Investment securities	**2,370**	4,132	
Property, plant and equipment	**798**	454	
Intangible assets	**217**	197	
Assets classified as held for sale	**521**	-	
Other assets	**164**	157	
Total assets	**21,357**	21,647	(1%)
Liabilities			
Deposits from customers	**13,703**	15,661	(13%)
Deposits from banks	**3,801**	3,801	
Debt securities	**249**	249	
Repurchase agreements	**1,176**	344	
Lease liabilities	**342**	n/a	
Deferred government grant	**115**	-	
Other liabilities	**204**	189	
Total liabilities	**19,590**	20,244	
Total equity	**1,767**	1,403	

Deposits

The first half of 2019 has been a challenging period for deposit growth following intense speculation at the time of the capital raise in May. Total deposits at £13.7 billion were flat year-on-year, with a 13% reduction from 31 December 2018. Net deposit outflows of £2.0 billion in the first six months were primarily driven by a limited number of commercial customers with deposits from retail customers now representing 55% of total deposits (31 December 2018: 47%). Retail deposits have continued to grow in the period, with stability across the SME deposit base. Following the completion of the £375 million capital raise customer deposits have returned to business as usual growth during June, with continued momentum month-to-date in July.

Current accounts grew by 2% during Q2 2019 and make up 31% of total customer deposits as at 30 June 2019 (31 March 2019: 30%). The high proportion of current accounts supports the bank's low cost of deposits.

We continue to focus on attracting diversified low cost deposits, supported by continued strong growth in personal and business current accounts. Growth in customer accounts is underpinned by our focus on providing superior customer service, acknowledged by our 1st and 2nd place in the latest CMA survey results for overall customer service quality for personal and business customers respectively.

Lending

Lending continued to grow during the period as the strong pipeline as at year-end 2018 continued to flow through during the first few months of the year. Our loan to deposit ratio increased to 109% at the 30 June 2019, after incorporating the impact of executing the sale of a previously acquired loan portfolio, up from 91% at 31 December 2018. We expect to gradually reduce the loan to deposit ratio over time returning it to the guided range of 85%-90% and expect it to be c.100% by the end of the 2019. This will be achieved by managing our lending pipeline whilst growing customer deposits. Management of our loan growth also reflects the rebalancing of the lending mix away from more capital intensive commercial lending segments, with a focus on cost efficient residential mortgages. Commercial lending as a percentage of total lending reduced to 29% from 31% as at year-end 2018.

Asset quality remains strong due to a continued focus on low risk lending. Cost of risk remained flat during the first six months at 0.06% compared to 0.06% for the last six months of 2018 and improved from 0.08% for the same period last year. The bank's non-performing loan ratio was 0.17%, compared to 0.15% at 31 December 2018.

Property, plant & equipment and intangibles
Following the adoption of IFRS 16, the new leasing standard, on 1 January 2019, we added a £313 million right of use asset to our balance sheet in respect of right of use assets relating to our leases. Further increases in our property plant and equipment were driven by the expansion of our store network and IT infrastructure.

During the period we opened stores in Moorgate and Enfield. We have also continued to build our store pipeline and in the second half of the year we will expand into the Midlands as well as Northern England in Manchester and Liverpool.

We also continued to invest in our digital offering. Alongside this we also completed a major upgrade to our core banking platform which was implemented successfully at the start of July.

Capital structure
Following the completion of the £375 million equity capital raise our CET1 ratio is 15.8%, providing material headroom above our target of c.12%, supporting our future growth.

On a pro-forma basis following the loan portfolio sale of £521 million announced today our CET1 ratio at 30 June 2019 would be 16.1%, exceeding our Tier 1 regulatory minimum of 10.6%[1]. Our pro-forma total capital ratio at the same date was 18.8%, in excess of our current regulatory minimum of 13.0%[1]. Our Regulatory Leverage ratio was 7.2%.

We will issue MREL eligible debt during the second half of 2019 to satisfy our interim MREL requirement by 1 January 2020.

Capability & Innovation funding
On 22 February 2019 we were awarded £120 million from the RBS alternative remedies package Capability & Innovation fund, the largest award available. Investment through the Capability & Innovation Fund in new capabilities will enable us to compete against the 'big 4' in the SME market. For example, in 2019 we will introduce trade finance and FX services and additional support for customers in managing their bookkeeping and tax compliance needs.

We received the money in April 2019 and have made good progress in the period including investing in 'Business Insights' our app-based Artificial Intelligence powered money management tool for business customers, and a mobile cash collection and drop-off service for SMEs, as well as signing a lease for a store in Manchester and acquiring sites in Liverpool and Sheffield.

Going concern
These condensed consolidated interim financial statements are prepared on a going concern basis, as the Directors are satisfied that the both the Group and parent company have the resources to continue in business for the foreseeable future. In making this assessment, the Directors considered a wide range of information relating to present and future conditions, including future projections of profitability, cash flows and capital resources.

Governance
Governance is at the top of the Board's agenda. The Board has announced that it will commence the process of recruiting an independent, Non-Executive Chairman. The Chairman, Mr Hill, believes that the Bank has now reached a size and scale where it is appropriate to appoint an independent Chairman. This transition will also ensure that the Board continues to evolve in-line with best practice corporate governance guide lines. Mr Hill will continue as Chairman until a successor is appointed, after which he will remain as a Non-Executive Director, Founder and President.

In line with Board succession planning outlined in the 2018 Annual Report and Accounts, we have announced the appointment of Michael Torpey as a new Independent Non-Executive Director (subject to regulatory approval). Michael has extensive experience in senior roles across financial services and brings deep banking expertise. Michael will join the Board with effect from 1 September 2019. His appointment brings the number of directors on the Board to 12, including six independent directors.

The Board continues its proactive search for additional independent NED candidates and we expect to make further appointments this year.

[1] Regulatory minimums of 10.6% and 13.0% are based on current capital requirements excluding any confidential PRA buffer, if applicable.

Since 2010, InterArch has provided architectural, design and creative services, creating the iconic Metro Bank brand and stores. We are running a process to identify an additional alternative supplier of architecture services and intend to transition both architectural design as well as creative and branding services to alternative suppliers. InterArch will work with us to ensure a smooth operational transition by the end of 2020.

Looking ahead

Despite the challenges in the first half of 2019 we enter the second half of the year in a position of balance sheet strength with a robust capital and liquidity position. We are focused on continuing the momentum we have generated in customer account growth, capital-light fee income generation, the rebalancing of our lending mix, and delivery of our cost efficiency programme.

The appointments of Cheryl Newton as CIO and Daniel Frumkin at CTO will strengthen the executive team and bring specialist expertise and experience. Cheryl is a technology specialist and has held global managing director and IT Board level positions implementing IT solutions for financial companies worldwide. She will be responsible for developing our technology agenda to further enhance the service we provide to customers across all channels. Daniel Frumkin joins with a wealth of operational and risk experience in global executive roles in banks worldwide. He will take the lead in delivering the bank-wide efficiency programme to further enhance our already superior customer experience.

Both these appointments are a significant step forward in our year of transition and will help the bank to deliver on its strategic initiatives.

2019 remains a year of transition for us as we build on the strengths of our model, become more capital efficient, and implement initiatives to deliver our medium-term guidance.

Craig Donaldson
Chief Executive Officer
24 July 2019

PRINCIPAL RISKS AND UNCERTAINTIES

There has been no significant change to our business model, risk management framework or risk appetite during the six month period ended 30 June 2019.

A detailed description of the principal risks and uncertainties to which the Group is exposed, along with the Group's approach to mitigating these risk, is set out in the risk report on pages 23 to 43 of the 2018 Annual Report and Accounts. These risks include:

- **credit risk** - the risk of financial loss due to a borrower's failure to meet the terms of any contract or otherwise fail to perform as agreed.
- **market risk** - the risk that earnings or the economic value of equity will underperform due to changes in interest rates, foreign exchange rates, or other financial market asset prices. Our ability to manage market risks contributes to our overall capital management.
- **liquidity and funding risk** - the risk that future financial obligations are not met or future asset growth cannot occur because of an inability to obtain funds at a reasonable price within a reasonable time.
- **conduct risk** - the risk of treating customers unfairly, and delivering inappropriate outcomes that lead to customer detriment.
- **regulatory risk** - the risk of financial loss or reputational damage due to regulatory fines or penalties, restriction or suspension of business, or cost of mandatory corrective action as a result of failing to adhere to applicable laws, regulations and supervisory guidance.
- **operational risk -** the risk of direct or indirect loss from failed or inadequate processes, people or systems, or exposure to external events.
- **financial crime** - the risk of financial loss or reputational damage due to regulatory fines or penalties, restriction or suspension of business, or cost of mandatory corrective action as a result of failing to comply with prevailing legal and regulatory requirements relating to financial crime (which we define to include internal or external fraud, anti-money laundering/counter terrorist financing, bribery and corruption and sanctions compliance).
- **model risk** – the potential for negative outcomes from random or systematic errors in model development, input, calculation or use of outputs. Models are always approximations and never perfect and there are therefore risks associated with using them. These risks range from their theoretical basis, the data and methods used in their construction, the economic conditions under which they are developed, and their use.

Board role

The Board is responsible for setting strategy, corporate objectives and risk appetite. The strategy and risk appetite considers the interests of our customers, shareholders and other stakeholders. On the advice of the Risk Oversight Committee ("ROC"), the Board approves the level of risk acceptable under each principal risk category, whilst providing oversight to ensure there is an adequate framework in place for reporting and managing those risks. The Board has delegated responsibility for reviewing the effectiveness of this framework to the ROC.

It is also responsible for maintaining an appropriate control environment to manage risk effectively, and for ensuring that the capital, liquidity, and other resources are adequate to achieve our objectives within our risk appetite.

The Board has delegated responsibility for reviewing the effectiveness of internal controls to the Audit Committee. This committee monitors and considers the internal control environment, internal and external audits and risk assurance, and is assisted in its oversight role by our Internal Audit function. Internal Audit carries out both regular and ad-hoc reviews of risk management controls and procedures and reports the results to the Audit Committee. Internal Audit and the Audit Committee will review the commercial RWA controls enhancement programme in 2019. The Director of Internal Audit's reporting line is to the Chairman of the Audit Committee, with a dotted line to the CEO, which underpins the function's independence.

Chief Risk Officer and the Risk function

Our Chief Risk Officer ("CRO") leads the Risk function, which is independent from operational and commercial functions. She is responsible for ensuring that appropriate risk management processes, policies and controls are in place, that they are sufficiently robust, that key risks are identified, assessed, monitored and mitigated, and that we are operating within our risk appetite.

The Risk team provides specialist knowledge and support to colleagues, acting as a reference point for advisory queries, whilst also overseeing colleagues and the risk management and controls in place. It operates themed, targeted and ad-hoc reviews to provide assurance to the leadership team, and ultimately to the Board, that risks are properly managed, controls are effective, and that we are not exceeding our risk appetite.

Risk management policies

We've established our risk management policies to identify and analyse the risks we face, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. The Risk team regularly reviews these policies and controls to verify compliance and to reflect changes in market conditions and our activities. We use training and management standards and procedures to develop a robust and effective control environment – one where all colleagues understand their roles and obligations.

Risk appetite

Our approach to risk appetite is to set relevant quantitative and qualitative measures against which risk management performance can be reviewed for each of our principal risks. Risk appetite is set by the Board, based on the recommendation of the ROC, and implemented by the Executive Risk Committee. Our risk appetite has been developed in line with our business plan, strategy and vision, and is underpinned by a culture in which all colleagues embed risk considerations in decision-making and are rewarded accordingly.

Risk Oversight Committee

The ROC assists the Board in providing leadership, direction and oversight with regard to risk governance and management, and also assists the Board in fostering a culture that emphasises and demonstrates the benefits of a risk-based approach to risk management and internal controls when creating FANS. It works closely with the Audit Committee. It is chaired by a Non-Executive Director and meets at least quarterly. Its responsibilities include:

- recommending to the Board our risk appetite;
- regularly reviewing risk exposures in relation to the risk appetite;
- reviewing risk policies, and approving or recommending to the Board for approval; and
- monitoring the effectiveness of risk management processes and procedures put in place by management.

DIRECTORS' RESPONSIBILITY STATEMENT

The Directors are responsible for preparing the interim financial report in accordance with applicable law and regulations.

We confirm that to the best of our knowledge:

(a) the condensed consolidated interim financial statements have been prepared in accordance with IAS 34 'Interim Financial Reporting';
(b) the interim management report includes a fair review of the information required by DTR 4.2.7R (indication of important events and their impact during the first six months and description of principal risks and uncertainties for the remaining six months of the year); and
(c) the interim management report includes a fair review of the information required by DTR 4.2.8R (disclosure of related parties' transactions and changes therein).

On behalf of the Board

Craig Donaldson

Chief Executive Officer

24 July 2019

David Arden

Chief Financial Officer

24 July 2019

INDEPENDENT REVIEW REPORT TO METRO BANK PLC

Report on the condensed consolidated interim financial statements

Our conclusion

We have reviewed Metro Bank PLC's condensed consolidated interim financial statements (the "interim financial statements") in the interim report of Metro Bank PLC for the 6 month period ended 30 June 2019. Based on our review, nothing has come to our attention that causes us to believe that the interim financial statements are not prepared, in all material respects, in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

What we have reviewed

The interim financial statements comprise:

- The consolidated Balance Sheet as at 30 June 2019;
- The consolidated statement of comprehensive income for the period then ended;
- The consolidated cash flow statement for the period then ended;
- The consolidated statement of changes in equity for the period then ended;
- The notes to the interim financial statements.

The interim financial statements included in the interim report have been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

As disclosed in note 1 to the interim financial statements, the financial reporting framework that has been applied in the preparation of the full annual financial statements of the Group is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Responsibilities for the interim financial statements and the review

Our responsibilities and those of the directors

The interim report, including the interim financial statements, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the interim report in accordance with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

Our responsibility is to express a conclusion on the interim financial statements in the interim report based on our review. This report, including the conclusion, has been prepared for and only for the company for the purpose of complying with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority and for no other purpose. We do not, in giving this conclusion, 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.

What a review of interim financial statements involves

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, 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.

We have read the other information contained in the interim report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the interim financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants
London
24 July 2019

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(UNAUDITED)

For the half year to 30 June 2019[1]

	Note	Half year to 30 June 2019 £'million	Half year to 30 June 2018 £'million
Interest income	2	**252.0**	202.2
Interest expense	2	**(85.8)**	(45.9)
Net interest income		**166.2**	156.3
Fee and commission income		**32.5**	17.4
Net gains on sale of assets		**4.1**	4.6
Other income		**17.7**	11.5
Total income		**220.5**	189.8
General operating expenses	3	**(174.7)**	(143.8)
Depreciation and amortisation	7,8	**(37.0)**	(20.5)
Impairment and write offs of property, plant & equipment and intangible assets	7,8	**(1.0)**	(0.6)
Total operating expenses		**(212.7)**	(164.8)
Expected credit loss expense		**(4.4)**	(4.1)
Profit before tax		**3.4**	20.8
Taxation	5	**(2.1)**	(5.6)
Profit for the period		**1.3**	15.2
Other comprehensive income for the period			
Items which will be reclassified subsequently to profit or loss where specific conditions are met:			
Movements in respect of investment securities held at fair value through other comprehensive income (net of tax):			
- changes in fair value		**0.7**	3.1
- changes in fair value transferred to the income statement on disposal		**0.4**	(4.6)
Total other comprehensive income/(expense)		**1.1**	(1.5)
Total comprehensive income for the period		**2.4**	13.7
Earnings per share			
Basic earnings per share	14	**1.0 pence**	17.1 pence
Diluted earnings per share	14	**1.0 pence**	16.7 pence

1. A reconciliation between our statutory and underlying results can be found on page 40.

CONSOLIDATED BALANCE SHEET (UNAUDITED)

As at 30 June 2019

	Note	30 June 2019 £'million	31 December 2018 £'million
Assets			
Cash and balances with the Bank of England		**2,146**	2,286
Loans and advances to banks		**152**	186
Loans and advances to customers	6	**14,989**	14,235
Investment securities held at fair value through other comprehensive income		**419**	674
Investment securities held at amortised cost		**1,951**	3,458
Property, plant and equipment	7	**798**	454
Intangible assets	8	**217**	197
Prepayments and accrued income		**65**	66
Deferred tax asset	5	**39**	41
Assets classified as held for sale	9	**521**	-
Other assets		**60**	50
Total assets		**21,357**	21,647
Liabilities			
Deposits from customers		**13,703**	15,661
Deposits from central banks[1]		**3,801**	3,801
Debt securities		**249**	249
Repurchase agreements		**1,176**	344
Derivative financial liabilities	10	**9**	1
Lease liabilities	11	**342**	n/a
Deferred government grants	12	**115**	-
Other liabilities		**195**	188
Total liabilities		**19,590**	20,244
Equity			
Called up share capital	13	**-**	-
Share premium account	13	**1,964**	1,605
Retained earnings		**(208)**	(209)
Other reserves		**11**	7
Total equity		**1,767**	1,403
Total equity and liabilities		**21,357**	21,647

1. Deposits from central banks comprises solely of amounts drawn down under the Bank of England's Term Funding Scheme ("TFS").

The notes on pages 20 to 39 form part of the condensed consolidated interim financial statements.

These condensed consolidated interim financial statements were approved and authorised for issue by the Board of Directors on 24 July 2019 and were signed on its behalf by:

Vernon W. Hill II	Craig Donaldson	David Arden
Chairman	**Chief Executive Officer**	**Chief Financial Officer**

CONSOLIDATED CASH FLOW STATEMENT (UNAUDITED)

For the half year to 30 June 2019

	Note	Half year to 30 June 2019 £'million	Half year to 30 June 2018 £'million
Reconciliation of profit before tax to net cash flows from operating activities:			
Profit before tax		**3**	21
Adjustments for:			
Impairment and write offs of property, plant & equipment and intangible assets	7,8	**1**	1
Depreciation and amortisation	7,8	**37**	21
Share option award charges		**2**	2
Gain on sale of assets		**(4)**	(5)
Accrued interest on and amortisation of investment securities		**3**	(6)
Government grant income recognised	12	**(5)**	-
Changes in operating assets		**(1,604)**	(2,399)
Changes in operating liabilities		**(779)**	2,526
Net cash (outflows)/inflows from operating activities		**(2,346)**	161
Cash flows from investing activities			
Net sale/(purchase) of investment securities		**1,765**	(464)
Receipt of government grant	12	**120**	-
Purchase of property, plant and equipment		**(33)**	(38)
Purchase and development of intangible assets	8	**(39)**	(38)
Net cash inflows/(outflows) from investing activities		**1,813**	(540)
Cash flows from financing activities			
Debt securities issued (net of costs)		**-**	249
Shares issued (net of costs)	13	**359**	1
Net cash inflows from financing activities		**359**	250
Net decrease in cash and cash equivalents		**(174)**	(129)
Cash and cash equivalents at start of period		**2,472**	2,212
Cash and cash equivalents at end of period		**2,298**	2,083
Profit before tax includes:			
Interest received		**253**	202
Interest paid		**(79)**	(45)
Cash and cash equivalent comprise of:			
Cash and balances with the Bank of England		**2,146**	1,994
Loans and advances to banks		**152**	89
Cash and cash equivalents at end of period		**2,298**	2,083

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (UNAUDITED)

For the half year to 30 June 2019

	Called-up Share capital £'million	Share premium £'million	Retained earnings £'million	FVOCI reserve £'million	Share option reserve £'million	Total equity £'million
Balance at 1 January 2019	-	1,605	(209)	(3)	10	1,403
Net profit for the period	-	-	1	-	-	1
Other comprehensive income (net of tax) relating to investment securities designated at FVOCI	-	-	-	1	-	1
Total comprehensive income	-	-	1	1	-	2
Shares issued	-	375	-	-	-	375
Cost of shares issued		(16)				(16)
Net share option movements	-	-	-	-	3	3
Balance at 30 June 2019	-	1,964	(208)	(2)	13	1,767
Balance at 1 January 2018	-	1,304	(237)	1	16	1,084
Net profit for the period	-	-	15	-	-	15
Other comprehensive income (net of tax) relating to investment securities designated at FVOCI	-	-	-	(1)	-	(1)
Total comprehensive income	-	-	15	(1)	-	14
Net share option movements	-	-	-	-	(1)	(1)
Balance at 30 June 2018	-	1,304	(222)	-	15	1,097
Balance at 31 December 2018	-	1,605	(209)	(3)	10	1,403
Note	13	13				

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

1. Basis of preparation and accounting policies

1.1 General information

Metro Bank PLC ("our" or "we") provides retail and commercial banking services in the UK, is a public limited liability company incorporated and domiciled in England and Wales and is listed on the London Stock Exchange (LON:MTRO). The address of its registered office is: One Southampton Row London WC1B 5HA.

1.2 Basis of preparation

The condensed consolidated interim financial statements of Metro Bank and its subsidiaries ("the Group") for the six months ended 30 June 2019 were authorised for issue in accordance with a resolution of the Directors on 24 July 2019.

These condensed consolidated interim financial statements for the six months ended 30 June 2019 have been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority ("FCA") and IAS 34 Interim Financial Reporting as adopted by the European Union ("EU"). They do not include all the information required by International Financial Reporting Standards ("IFRS") in full annual financial statements and should be read in conjunction with our Annual Report and Accounts for the year ended 31 December 2018 which are available on our website.

The comparative financial information for the year ended 31 December 2018 does not constitute statutory accounts as defined in section 434 of the Companies Act 2006. A copy of the statutory accounts for that year has been delivered to the Registrar of Companies. The auditor's report on those accounts was not qualified, did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying the report and did not contain statements under section 498(2) or (3) of the Companies Act 2006.

The Directors consider that it is appropriate to continue to adopt the going concern basis of accounting in preparing the condensed consolidated interim financial statements. In reaching this assessment, the Directors have considered projections for our capital and funding position and have had regard to the principal risks and uncertainties of the liquidity and capital requirements of the business for the foreseeable future.

1.3 Accounting policies

The accounting policies and methods of computation are consistent with those applied in our 2018 Annual Report and Accounts, other than the following.

Leases

On 1 January 2019 we adopted IFRS 16 ("Leases"). IFRS 16 provides guidance on the classification, recognition and measurement of leases to help provide useful information to the users of financial statements and replaces IAS 17 ("Leases"). IFRS 16 provides a single lessee accounting model, requiring lessees to recognise right of use ("RoU") assets and lease liabilities for all applicable leases, with operating leases being brought onto the face of the balance sheet.

We adopted IFRS 16 using the modified retrospective approach. Under this approach the opening lease liability was measured as the present value of the remaining lease payments. We also elected to set the RoU asset equal to the related lease liability at the point of transition (prior to adjustments for previous amounts accrued in respect of rent free periods) for all leases and therefore there is no opening adjustment to retained earnings. As at the 1 January 2019 the lease liabilities and RoU assets recognised on the balance sheet were £328 million and £313 million respectively.

Under the modified retrospective approach comparative figures are not restated and as such these continue to be measured and presented under IAS 17.

Changes to our accounting policies as a result of the adoption of IFRS 16 can be found in notes 7 and 11.

1. Basis of preparation and accounting policies (continued)

Government Grants

On 22 February 2019 we were awarded £120 million from the Capability & Innovation fund part of the RBS alternative remedies package, the largest award available.

The contract was signed and the money received in April 2019. Our accounting policy for government grants can be found within note 12.

Derivatives

During 2019 we implemented a macro hedging programme as part of which we increased our use of interest rate swaps to manage our interest rate risk. Prior to this our use of interest rate swaps to hedge our exposure was immaterial. Our accounting policy for derivatives can be found within note 10.

1.4 Future accounting developments

There are no known future accounting developments that are likely to have a material impact on the Group.

1.5 Critical accounting judgements and estimates

There have been no significant changes in the basis upon which critical estimates and judgements have been determined, compared to those applied at 31 December 2018.

1.6 Operating segments

We provide retail and commercial banking services. The Board considers the results of the Group as a whole when assessing the performance of the business and allocating resources. Accordingly we have only a single operating segment.

We operate solely in the UK and as such no geographical analysis is required

2. Net interest income

Interest income

	Half year to 30 June 2019 £'million	Half year to 30 June 2018 £'million
Cash and balances held with the Bank of England	**7.6**	4.2
Loans and advances to customers	**218.8**	164.8
Investment securities held at amortised cost	**23.3**	27.7
Investment securities held at FVOCI	**2.3**	5.4
Total interest income	**252.0**	202.2

Interest expense

	Half year to 30 June 2019 £'million	Half year to 30 June 2018 £'million
Deposits from customers	**46.0**	31.8
Deposits from central banks	**14.1**	9.2
Repurchase agreements	**4.7**	0.3
Debt securities	**7.0**	0.2
Lease liabilities	**8.8**	n/a
Other	**5.2**	4.4
Total interest expense	**85.8**	45.9

3. General operating expenses

	Half year to 30 June 2019 £'million	Half year to 30 June 2018 £'million
People costs	**86.3**	73.2
Occupancy expenses	**7.7**	18.1
Information technology costs	**16.7**	13.5
Marketing costs	**1.7**	2.6
Legal, regulatory and professional fees	**6.9**	5.0
Money transmission and other banking related costs	**16.1**	9.3
Costs relating to preparing for the RBS alternative remedies package	**1.2**	1.3
Transformation and remediation costs	**7.0**	-
Capability & Innovation fund costs[1]	**3.8**	-
Other	**27.3**	20.8
Total general operating expenses	**174.7**	143.8

1. These costs consist of amounts spent in delivering the commitments we agreed to as part of our successful bid to the Capability & Innovation fund. Part of these costs are paid for by the £120 million grant we received, with offsetting income included within 'other income'. Further details can be found within note 12.

4. People costs

	Half year to 30 June 2019 £'million	Half year to 30 June 2018 £'million
Wages and salaries	**71.8**	60.0
Social security costs	**7.3**	6.7
Pension costs	**4.9**	4.0
Equity-settled share based payments	**2.3**	2.5
Total people costs	**86.3**	73.2

5. Taxation

Tax charge for the period

The components of tax expense for the six months ended 30 June 2019 and 2018 are:

	Half year to 30 June 2019 £'million	Half year to 30 June 2018 £'million
Current tax:		
Current tax	**0.1**	1.7
Adjustment in respect of prior years	**0.1**	-
Total current tax charge	**0.2**	1.7
Deferred tax:		
Origination and reversal of temporary differences	**1.3**	3.8
Effect of changes in tax rates	**0.9**	0.1
Adjustment in respect of prior periods	**(0.3)**	-
Total deferred tax charge	**1.9**	3.9
Total tax charge	**2.1**	5.6

5. Taxation (continued)

Reconciliation of the total tax expense

The tax expense shown in the income statement differs from the tax expense that would apply if all accounting profits had been taxed at the UK corporation tax rate.

A reconciliation between the tax expense and the accounting profit multiplied by the UK corporation tax rate for the six months ended 30 June 2019 and 2018 is as follows:

	30 June 2019 £'million	Effective tax rate %	30 June 2018 £'million	Effective tax rate %
Profit before tax	**3.4**		20.8	
Tax expense at statutory income tax rate of 19% (2018: 19%)	**0.6**	**19%**	4.0	19%
Tax effects of:				
Banking Surcharge	**-**	**-**	0.2	1%
Non-deductible expenses - depreciation on non-qualifying fixed assets	**0.3**	**9%**	1.2	6%
Non-deductible expenses - other	**0.1**	**1%**	0.3	2%
Share based payments	**0.4**	**11%**	(0.4)	(2%)
Taxable gains on financial instruments	**-**	**-**	0.2	1%
Adjustment in respect of prior years	**(0.2)**	**(6%)**	-	-
Effect of changes in tax rates	**0.9**	**28%**	0.1	-
Total tax charge	**2.1**	**62%**	5.6	27%

Share based payments

During the period our share price fell from £16.94 to £5.22. This had the impact of reducing the deferred tax asset held for share options and in turn resulted in an associated deferred tax charge of £0.4 million. This charge contributes 11% of the 62% effective tax rate.

Effective tax rate

The effective tax rate for the period is 62% (Six months to 30 June 2018: 27%).

The effective tax rate for the period excluding the effect of changes in tax rates, adjustments in respect of prior years and share based payments is 29% (Six months to 30 June 2018: 29%).

The main driver for the higher effective tax rate for the first six months of 2019 is the lower accounting profit before tax and the non-deductible expenses in the form of non-qualifying depreciation and the shared based payment charge.

5. Taxation (continued)

Deferred tax

A deferred tax asset must be regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not there will be suitable tax profits from which the future of the underlying timing differences can be deducted.

The following table shows deferred tax recorded in the statement of financial position and changes recorded in the tax expense:

	Unused tax losses £'million	Investment securities & impairments £'million	Share based payments £'million	Property, plant & equipment £'million	Intangible assets £'million	Total £'million
2019						
Deferred tax assets	**53**	**7**	**-**	**-**	**-**	**60**
Deferred tax liabilities	**-**	**(2)**	**-**	**(12)**	**(7)**	**(21)**
Deferred tax assets (net)	**53**	**5**	**-**	**(12)**	**(7)**	**39**
At 1 January 2019	**53**	**5**	**1**	**(11)**	**(7)**	**41**
Income statement	**-**	**-**	**(1)**	**(1)**	**-**	**(2)**
Other comprehensive income	**-**	**-**	**-**	**-**	**-**	**-**
Equity	**-**	**-**	**-**	**-**	**-**	**-**
At 30 June 2019	**53**	**5**	**-**	**(12)**	**(7)**	**39**
2018						
Deferred tax assets	55	7	9	-	-	71
Deferred tax liabilities	-	(3)	-	(9)	(7)	(19)
Deferred tax assets (net)	55	4	9	(9)	(7)	52
At 1 January 2018	57	4	11	(8)	(6)	58
Income statement	(2)	(1)	1	(1)	(1)	(4)
Other comprehensive income	-	1	-	-	-	1
Equity	-	-	(3)	-	-	(3)
At 30 June 2018	55	4	9	(9)	(7)	52
At 31 December 2018	53	5	1	(11)	(7)	41

6. Loans and advances to customers

Accounting policy

Updates to our accounting policy

The period-end assumptions used for the ECL estimate as at 30 June 2019 are as follows:

Macroeconomic variable	Scenario	2019	2020	2021	2022	2023
Interest rates (%)	Baseline	1.38%	1.88%	2.12%	2.39%	2.64%
	Upside	1.54%	2.06%	2.61%	3.08%	3.26%
	Downside	0.70%	0.83%	1.06%	1.21%	1.28%
Unemployment (%)	Baseline	4.05%	4.38%	4.66%	4.84%	4.94%
	Upside	3.64%	3.08%	3.24%	3.60%	3.91%
	Downside	4.63%	6.43%	7.15%	7.13%	6.79%
House price index (YoY%)	Baseline	1.36%	0.56%	1.22%	1.67%	2.21%
	Upside	3.13%	6.35%	3.72%	1.86%	0.98%
	Downside	(0.21%)	(8.12%)	(4.98%)	1.85%	4.21%
UK GDP (YoY%)	Baseline	1.26%	1.63%	1.64%	1.66%	1.65%
	Upside	2.18%	3.57%	2.17%	1.58%	1.37%
	Downside	(0.31%)	(1.14%)	1.30%	2.42%	1.83%

	30 June 2019		
	Gross carrying amount £'million	ECL allowance £'million	Net carrying amount £'million
Retail mortgages	**10,412**	**(7)**	10,405
Consumer lending	**265**	**(11)**	254
Commercial lending	**4,343**	**(13)**	4,330
Total loans and advances to customers	**15,020**	**(31)**	14,989

	31 December 2018		
	Gross carrying amount £'million	ECL allowance £'million	Net carrying amount £'million
Retail mortgages	9,625	(11)	9,614
Consumer lending	288	(9)	279
Commercial lending	4,356	(14)	4,342
Total loans and advances to customers	14,269	(34)	14,235

6. Loans and advances to customers (continued)

Loans and advances to customers by category

	30 June 2019 £'million	31 December 2018 £'million
Retail owner occupied	**8,447**	7,351
Retail buy-to-let	**1,965**	2,274
Total retail mortgages	**10,412**	9,625
Overdraft	**73**	70
Credit cards	**11**	11
Term loans	**181**	207
Total consumer and other	**265**	288
Total retail lending	**10,677**	9,913
Overdraft	**225**	226
Credit cards	**3**	3
Term loans	**3,811**	3,828
Asset and invoice finance	**304**	299
Total commercial lending	**4,343**	4,356
Total loans to customers	**15,020**	14,269

Residential mortgage lending

The average debt to value ("DTV") of our residential mortgage book is 61% (31 December 2018: 61%).

An analysis of our retail mortgages by DTV is set out below:

	30 June 2019			31 December 2018		
	Retail owner occupied £'million	Retail buy-to-let £'million	Total retail mortgages £'million	Retail owner occupied £'million	Retail buy-to-let £'million	Total retail mortgages £'million
Less than 50%	**2,392**	**381**	**2,773**	2,124	,458	2,582
51-60%	**1,267**	**406**	**1,673**	1,195	493	1,688
61-70%	**1,415**	**517**	**1,932**	1,374	553	1,927
71-80%	**1,676**	**584**	**2,260**	1,362	596	1,958
81-90%	**1,511**	**66**	**1,577**	1,205	129	1,334
91-100%	**175**	**5**	**180**	80	33	113
More than 100%	**11**	**6**	**17**	11	12	23
Total retail mortgage lending	**8,447**	**1,965**	**10,412**	7,351	2,274	9,625

An analysis of our retail mortgages by repayment type is set out below:

	30 June 2019			31 December 2018		
	Retail owner occupied £'million	Retail buy-to-let £'million	Total retail mortgages £'million	Retail owner occupied £'million	Retail buy-to-let £'million	Total retail mortgages £'million
Interest only	**2,502**	**1,857**	**4,359**	2,242	2,166	4,408
Capital and interest	**5,945**	**108**	**6,053**	5,109	108	5,217
Total retail mortgage lending	**8,447**	**1,965**	**10,412**	7,351	2,274	9,625

6. Loans and advances to customers (continued)

A geographical analysis of the location of retail mortgage collateral is set out below:

	30 June 2019			31 December 2018		
	Retail owner occupied £'million	Retail buy-to-let £'million	Total retail mortgages £'million	Retail owner occupied £'million	Retail buy-to-let £'million	Total retail mortgages £'million
Greater London	**3,419**	**1,215**	**4,634**	3,034	1,231	4,265
South east	**2,074**	**341**	**2,415**	1,797	383	2,180
South west	**720**	**98**	**818**	616	122	738
East of England	**575**	**78**	**653**	492	91	583
North west	**483**	**67**	**550**	405	138	543
West Midlands	**336**	**61**	**397**	293	81	374
Yorkshire and the Humber	**242**	**28**	**270**	207	73	280
East Midlands	**279**	**38**	**317**	241	57	298
Wales	**164**	**22**	**186**	141	36	177
North east	**93**	**11**	**104**	83	31	114
Northern Ireland	**-**	**-**	**-**	4	27	31
Scotland	**62**	**6**	**68**	38	4	42
Total retail mortgage lending	**8,447**	**1,965**	**10,412**	7,351	2,274	9,625

Commercial term lending

The average debt to value ("DTV") of our commercial term loan book is 60% (31 December 2018: 59%).

An analysis of our commercial term loan book by DTV is set out below:

	30 June 2019 £'million	31 December 2018 £'million
Less than 50%	**1,279**	1,277
51-60%	**893**	936
61-70%	**797**	791
71-80%	**300**	249
81-90%	**75**	100
91-100%	**35**	51
More than 100%	**432**	424
Total commercial term lending	**3,811**	3,828

An analysis of our commercial term loan book by repayment type is set out below:

	30 June 2019 £'million	31 December 2018 £'million
Interest only	**1,554**	1,592
Capital and interest	**2,257**	2,236
Total commercial term lending	**3,811**	3,828

6. Loans and advances to customers (continued)

A geographical analysis of our commercial term loan book is set out below:

	30 June 2019 £'million	31 December 2018 £'million
Greater London	**2,441**	2,465
South east	**690**	677
South west	**221**	229
East of England	**145**	151
North west	**156**	145
West Midlands	**52**	50
Yorkshire and the Humber	**21**	26
East Midlands	**37**	33
Wales	**26**	29
North east	**16**	16
Northern Ireland	**2**	3
Scotland	**4**	4
Total commercial term lending	**3,811**	3,828

A sector analysis of our commercial term loan book is set out below:

	30 June 2019 £'million	31 December 2018 £'million
Real estate (rent, buy and sell)	**2,354**	2,547
Legal, Accountancy & Consultancy	**408**	384
Health & Social Work	**274**	217
Hospitality	**265**	235
Retail	**93**	72
Real estate (management of)	**123**	99
Construction	**75**	60
Recreation, cultural and sport	**45**	19
Investment and unit trusts	**3**	1
Education	**22**	15
Real estate (development)	**53**	52
Other	**96**	127
Total commercial term loans	**3,811**	3,828

Credit risk exposures

Retail mortgages

	30 June 2019			
	Stage 1 12 month ECL £'million	Stage 2 Lifetime ECL £'million	Stage 3 Lifetime ECL £'million	POCI Lifetime ECL £'million
Up to date	**10,154**	**163**	**16**	**1**
1 to 29 days past due	**6**	**8**	**5**	**-**
30 to 89 days past due	**-**	**40**	**9**	**-**
90+ days past due	**-**	**-**	**10**	**-**
Gross carrying amount	**10,160**	**211**	**40**	**1**

6. Loans and advances to customers (continued)

	31 December 2018			
	Stage 1 12 month ECL £'million	Stage 2 Lifetime ECL £'million	Stage 3 Lifetime ECL £'million	POCI Lifetime ECL £'million
Up to date	9,242	275	19	2
1 to 29 days past due	3	14	4	1
30 to 89 days past due	-	47	7	1
90+ days past due	-	-	9	1
Gross carrying amount	9,245	336	39	5

Consumer lending

	30 June 2019			
	Stage 1 12 month ECL £'million	**Stage 2 Lifetime ECL £'million**	**Stage 3 Lifetime ECL £'million**	**POCI Lifetime ECL £'million**
Up to date	**243**	**-**	**-**	**-**
1 to 29 days past due	**11**	**-**	**-**	**-**
30 to 89 days past due	**-**	**2**	**-**	**-**
90+ days past due	**-**	**-**	**9**	**-**
Gross carrying amount	**254**	**2**	**9**	**-**

	31 December 2018			
	Stage 1 12 month ECL £'million	Stage 2 Lifetime ECL £'million	Stage 3 Lifetime ECL £'million	POCI Lifetime ECL £'million
Up to date	272	-	-	-
1 to 29 days past due	3	3	-	-
30 to 89 days past due	-	5	-	-
90+ days past due	-	-	5	-
Gross carrying amount	275	8	5	-

Commercial lending

	30 June 2019			
	Stage 1 12 month ECL £'million	**Stage 2 Lifetime ECL £'million**	**Stage 3 Lifetime ECL £'million**	**POCI Lifetime ECL £'million**
Up to date	**4,293**	**-**	**-**	**-**
1 to 29 days past due	**7**	**8**	**-**	**-**
30 to 89 days past due	**-**	**26**	**-**	**-**
90+ days past due	**-**	**-**	**9**	**-**
Gross carrying amount	**4,300**	**34**	**9**	**-**

	31 December 2018			
	Stage 1 12 month ECL £'million	Stage 2 Lifetime ECL £'million	Stage 3 Lifetime ECL £'million	POCI Lifetime ECL £'million
Up to date	4,213	6	2	-
1 to 29 days past due	52	44	-	-
30 to 89 days past due	-	27	5	-
90+ days past due	-	-	7	-
Gross carrying amount	4,265	77	14	-

6. Loans and advances to customers (continued)

Loss allowance

The following tables explain the changes in both the gross carrying amount and loss allowances of our loans and advances during the period.

Retail mortgages

	Gross carrying amount					Loss allowance					Net carrying amount				
£'million	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**
Balance at 1 January 2019	**9,245**	**336**	**39**	**5**	**9,625**	**-**	**(5)**	**(4)**	**(2)**	**(11)**	**9,245**	**331**	**35**	**3**	**9,614**
Transfers to/from stage 1[1]	**131**	**(127)**	**(4)**	**-**	**-**	**(1)**	**1**	**-**	**-**	**-**	**130**	**(126)**	**(4)**	**-**	**-**
Transfers to/from stage 2[1]	**(100)**	**100**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(100)**	**100**	**-**	**-**	**-**
Transfers to/from stage 3[1]	**-**	**(9)**	**9**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(9)**	**9**	**-**	**-**
Net remeasurement due to transfers[2]	**-**	**-**	**-**	**-**	**-**	**1**	**(1)**	**(1)**	**-**	**(1)**	**1**	**(1)**	**(1)**	**-**	**(1)**
New lending[3]	**1,620**	**2**	**-**	**-**	**1,622**	**-**	**-**	**-**	**-**	**-**	**1,620**	**2**	**-**	**-**	**1,622**
Repayments, additional drawdowns and interest accrued	**(128)**	**(2)**	**(1)**	**-**	**(131)**	**-**	**-**	**-**	**-**	**-**	**(128)**	**(2)**	**(1)**	**-**	**(131)**
Derecognitions[4]	**(247)**	**(9)**	**-**	**(4)**	**(260)**	**-**	**-**	**-**	**2**	**2**	**(247)**	**(9)**	**-**	**(2)**	**(258)**
Transfer to disposal group classified as held for sale[5]	**(361)**	**(80)**	**(3)**	**-**	**(444)**	**-**	**3**	**1**	**-**	**4**	**(361)**	**(77)**	**(2)**	**(1)**	**(440)**
Changes to model assumptions[6]	**-**	**-**	**-**	**-**	**-**	**-**	**(1)**	**-**	**-**	**(1)**	**-**	**(1)**	**-**	**-**	**(1)**
Balance at 30 June 2019	**10,160**	**211**	**40**	**1**	**10,412**	**-**	**(3)**	**(4)**	**-**	**(7)**	**10,160**	**208**	**36**	**1**	**10,405**

1. Represents the stage transfers prior to any ECL remeasurement
2. Represents the remeasurement between the twelve month and lifetime ECL due to stage transfer, including any changes to the model assumptions and forward looking information
3. Represents the increase in balances resulting from loans and advances that have been newly originated, purchased or renewed
4. Represents the decrease in balances resulting from loans and advances that have been fully repaid, disposed of or written off
5. Represents the decrease in balances resulting from the reclassification of loans and advances that as at the reporting date are treated as held for sale
6. Represents the change in loss allowances resulting from changes to the model assumptions, forward looking information and changes in the customers risk profile

	Gross carrying amount					Loss allowance					Net carrying amount				
£'million	Stage 1	Stage 2	Stage 3	POCI	Total	Stage 1	Stage 2	Stage 3	POCI	Total	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at 1 January 2018	6,065	129	33	4	6,231	(1)	(3)	(5)	(1)	(10)	6,064	126	28	3	6,221
Transfers to/from stage 1	60	(52)	(8)	-	-	(1)	1	-	-	-	59	(51)	(8)	-	-
Transfers to/from stage 2	(222)	223	(1)	-	-	1	(1)	-	-	-	(221)	222	(1)	-	-
Transfers to/from stage 3	(16)	(7)	23	-	-	-	1	(1)	-	-	(16)	(6)	22	-	-
Net remeasurement due to transfers	-	-	-	-	-	1	(2)	(1)	-	(2)	1	(2)	(1)	-	(2)
New lending	3,933	76	3	2	4,014	(1)	(1)	-	-	(2)	3,932	75	3	2	4.012
Repayments, additional drawdowns and interest accrued	(151)	(7)	(1)	(1)	(160)	-	-	-	-	-	(151)	(7)	(1)	(1)	(160)
Derecognitions	(424)	(26)	(10)	-	(460)	1	-	1	-	2	(423)	(26)	(9)	-	(458)
Changes to model assumptions	-	-	-	-	-	-	-	2	(1)	1	-	-	2	(1)	1
Balance at 31 December 2018	9,245	336	39	5	9,625	-	(5)	(4)	(2)	(11)	9,245	331	35	3	9,614

Consumer lending

	Gross carrying amount					Loss allowance					Net carrying amount				
£'million	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**
Balance at 1 January 2019	**275**	**8**	**5**	**-**	**288**	**(3)**	**(3)**	**(3)**	**-**	**(9)**	**272**	**5**	**2**	**-**	**279**
Transfers to/from stage 1	**5**	**(5)**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**5**	**(5)**	**-**	**-**	**-**
Transfers to/from stage 2	**(2)**	**2**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(2)**	**2**	**-**	**-**	**-**
Transfers to/from stage 3	**(2)**	**(2)**	**4**	**-**	**-**	**-**	**2**	**(2)**	**-**	**-**	**(2)**	**-**	**2**	**-**	**-**
Net remeasurement due to transfers	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(2)**	**-**	**(2)**	**-**	**-**	**(2)**	**-**	**(2)**
New lending	**27**	**-**	**-**	**-**	**27**	**-**	**-**	**-**	**-**	**-**	**27**	**-**	**-**	**-**	**27**
Repayments, additional drawdowns and interest accrued	**(21)**	**-**	**-**	**-**	**(21)**	**-**	**-**	**-**	**-**	**-**	**(21)**	**-**	**-**	**-**	**(21)**
Derecognitions	**(28)**	**(1)**	**-**	**-**	**(29)**	**-**	**-**	**-**	**-**	**-**	**(28)**	**(1)**	**-**	**-**	**(29)**
Changes to model assumptions	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Balance at 30 June 2019	**254**	**2**	**9**	**-**	**265**	**(3)**	**(1)**	**(7)**	**-**	**(11)**	**251**	**1**	**2**	**-**	**254**

6. Loans and advances to customers (continued)

£'million	Gross carrying amount					Loss allowance					Net carrying amount				
	Stage 1	Stage 2	Stage 3	POCI	Total	Stage 1	Stage 2	Stage 3	POCI	Total	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at 1 January 2018	191	20	6	-	217	(1)	(11)	(5)	-	(17)	190	9	1	-	200
Transfers to/from stage 1	2	(2)	-	-	-	-	-	-	-	-	2	(2)	-	-	-
Transfers to/from stage 2	(3)	3	-	-	-	-	-	-	-	-	(3)	3	-	-	-
Transfers to/from stage 3	(1)	(1)	2	-	-	-	-	-	-	-	(1)	(1)	2	-	-
Net remeasurement due to transfers	-	-	-	-	-	-	(1)	(1)	-	(2)	-	(1)	(1)	-	(2)
New lending	160	2	1	-	163	(2)	(1)	-	-	(3)	158	1	1	-	160
Repayments, additional drawdowns and interest accrued	(27)	(1)	-	-	(28)	-	-	-	-	-	(27)	(1)	-	-	(28)
Derecognitions	(47)	(13)	(4)	-	(64)	-	10	3	-	13	(47)	(3)	(1)	-	(51)
Changes to model assumptions	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Balance at 31 December 2018	275	8	5	-	288	(3)	(3)	(3)	-	(9)	272	5	2	-	279

Commercial lending

£'million	**Gross carrying amount**					**Loss allowance**					**Net carrying amount**				
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**
Balance at 1 January 2019	**4,265**	**77**	**14**	**-**	**4,356**	**(6)**	**(3)**	**(5)**	**-**	**(14)**	**4,259**	**74**	**9**	**-**	**4,342**
Transfers to/from stage 1	**55**	**(55)**	**-**	**-**	**-**	**(2)**	**2**	**-**	**-**	**-**	**53**	**(53)**	**-**	**-**	**-**
Transfers to/from stage 2	**(21)**	**21**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(21)**	**21**	**-**	**-**	**-**
Transfers to/from stage 3	**(4)**	**(2)**	**6**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(4)**	**(2)**	**6**	**-**	**-**
Net remeasurement due to transfers	**-**	**-**	**-**	**-**	**-**	**2**	**-**	**(1)**	**-**	**1**	**2**	**-**	**(1)**	**-**	**1**
New lending	**388**	**1**	**-**	**-**	**389**	**(1)**	**-**	**-**	**-**	**(1)**	**387**	**1**	**-**	**-**	**388**
Repayments, additional drawdowns and interest accrued	**(105)**	**-**	**(5)**	**-**	**(110)**	**-**	**-**	**-**	**-**	**-**	**(105)**	**-**	**(5)**	**-**	**(110)**
Derecognitions	**(201)**	**(6)**	**(4)**	**-**	**(211)**	**-**	**-**	**-**	**-**	**-**	**(201)**	**(6)**	**(4)**	**-**	**(211)**
Transfer to disposal group classified as held for sale	**(77)**	**(2)**	**(2)**	**-**	**(81)**	**-**	**-**	**-**	**-**	**-**	**(77)**	**(2)**	**(2)**	**-**	**(81)**
Changes to model assumptions	**-**	**-**	**-**	**-**	**-**	**-**	**1**	**-**	**-**	**1**	**-**	**1**	**-**	**-**	**1**
Balance at 30 June 2019	**4,300**	**34**	**9**	**-**	**4,343**	**(7)**	**-**	**(6)**	**-**	**(13)**	**4,293**	**34**	**3**	**-**	**4,330**

£'million	Gross carrying amount					Loss allowance					Net carrying amount				
	Stage 1	Stage 2	Stage 3	POCI	Total	Stage 1	Stage 2	Stage 3	POCI	Total	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at 1 January 2018	3,074	95	16	1	3,186	(5)	(1)	(3)	-	(9)	3,069	94	13	1	3,177
Transfers to/from stage 1	50	(50)	-	-	-	-	-	-	-	-	50	(50)	-	-	-
Transfers to/from stage 2	(53)	53	-	-	-	-	-	-	-	-	(53)	53	-	-	-
Transfers to/from stage 3	(6)	(4)	10	-	-	-	-	-	-	-	(6)	(4)	10	-	-
Net remeasurement due to transfers	-	-	-	-	-	-	(2)	(2)	-	(4)	-	(2)	(2)	-	(4)
New lending	1,654	10	1	-	1,665	(3)	-	-	-	(3)	1,651	10	1	-	1,662
Repayments, additional drawdowns and interest accrued	(120)	(7)	(4)	-	(131)	-	-	-	-	-	(120)	(7)	(4)	-	(131)
Derecognitions	(334)	(20)	(9)	(1)	(364)	-	-	1	-	1	(334)	(20)	(8)	(1)	(363)
Changes to model assumptions	-	-	-	-	-	2	-	(1)	-	1	2	-	(1)	-	1
Balance at 31 December 2018	4,265	77	14	-	4,356	(6)	(3)	(5)	-	(14)	4,259	74	9	-	4,342

Non-performing loans

	30 June 2019		31 December 2018	
	NPLs £'million	**NPL ratio**	NPLs £'million	NPL ratio
Retail mortgages	**10**	**0.10%**	9	0.09%
Consumer lending	**9**	**3.40%**	5	1.74%
Commercial lending	**9**	**0.21%**	7	0.16%
Total	**28**	**0.17%**	21	0.15%

7. Property, plant and equipment

Accounting policy

Policy applicable from 1 January 2019
(Policy is in addition to that disclosed in the 2018 annual report and account)

Upon the recognition of a lease liability (see note 11 for further details) a corresponding Right-of-use ("RoU") asset is recognised. This is adjusted for any initial direct costs incurred, lease incentives paid or received and any restoration costs at the end of the lease (where applicable).

The RoU asset is depreciated on a straight line basis over the life of the lease.

All of the RoU assets are reviewed annually for impairment.

	Investment property £'million	Leasehold improvements £'million	Freehold land & buildings £'million	Fixtures fittings & equipment £'million	IT hardware £'million	Right of use assets £'million	Total £'million
Cost or valuation							
31 December 2018	**10**	**275**	**199**	**33**	**39**	n/a	**556**
IFRS 16 transition adjustment	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**313**	**313**
1 January 2019	**10**	**275**	**199**	**33**	**39**	**313**	**869**
Additions	**-**	**23**	**7**	**2**	**1**	**17**	**50**
30 June 2019	**10**	**298**	**206**	**35**	**40**	**330**	**919**
Accumulated depreciation							
1 January 2019	**3**	**39**	**9**	**18**	**33**	**-**	**102**
Charge for the period	**-**	**5**	**2**	**2**	**2**	**8**	**19**
30 June 2019	**3**	**44**	**11**	**20**	**35**	**8**	**121**
Net book value at 30 June 2019	**7**	**254**	**195**	**15**	**5**	**322**	**798**
Cost or valuation							
1 January 2018	11	198	136	26	35	n/a	406
Additions	-	26	7	4	1	n/a	38
Transfers	-	(5)	5	-	-	n/a	-
30 June 2018	11	219	148	30	36	n/a	444
Accumulated depreciation							
1 January 2018	-	29	6	14	29	n/a	78
Charge for the period	-	5	1	2	2	n/a	10
Transfers	-	(1)	1	-	-	n/a	-
Impairments	-	1	-	-	-	n/a	1
30 June 2018	-	34	8	16	31	n/a	88
Net book value at 30 June 2018	11	185	140	14	5	n/a	356
Net book value at 31 December 2018	7	236	190	15	6	n/a	454

8. Intangible assets

	Goodwill £'million	Customer contracts £'million	Software £'million	Total £'million
Cost or valuation				
1 January 2019	**4**	**1**	**249**	**254**
Additions	**-**	**-**	**39**	**39**
Government grant			**(1)**	**(1)**
Write offs	**-**	**-**	**(1)**	**(1)**
30 June 2019	**4**	**1**	**286**	**291**
Accumulated amortisation				
1 January 2019	**-**	**1**	**56**	**57**
Charge for the period	**-**	**-**	**17**	**17**
30 June 2019	**-**	**1**	**73**	**74**
Net book value at 30 June 2019	**4**	**-**	**213**	**217**
Cost or valuation				
1 January 2018	4	1	174	179
Additions	-	-	38	38
30 June 2018	4	1	212	217
Accumulated amortisation				
1 January 2018	-	1	30	31
Charge for the period	-	-	11	11
30 June 2018	-	1	41	42
Net book value at 30 June 2018	4	-	171	175
Net book value at 31 December 2018	**4**	**-**	193	197

9. Assets classified as held for sale

Accounting policy	Non-current assets (including disposal groups) are classified as assets held for sale when their carrying amount is to be recovered principally through a sale transaction and a sale is considered highly probable. They are stated at the lower of their carrying amount and fair value less costs to sell, unless they are exempt from the measurement criteria.

During the period a portfolio of mortgages we previously acquired in 2017 was deemed to constitute a disposal group and classified as held for sale. This followed the agreement of terms with an affiliate purchaser of Cerberus Capital Management (the purchaser) and the Board providing outline approval to sell.

Further detail of allowances for credit losses on the held for sale loans is provided in note 6. The sale of these loans was accounted for on 24 July 2019 on signature of the sale contracts; further detail is provided in note 18.

10. Derivatives

Accounting policy

In accordance with our risk management strategy, to the extent not naturally hedged, we use interest rate swaps to manage our exposure to the interest rate risk. On adoption of IFRS 9 we chose to continue applying the hedge accounting rules set out in IAS 39 as adopted by the EU (EU-IFRS) as we employ dynamic portfolio hedge accounting of interest rate risk across fixed rate financial assets and fixed rate financial liabilities. Relevant differences between IFRS as issued by the IASB and EU-IFRS specifically relate to our dynamic hedges of non-interest bearing liabilities and fixed rate mortgages.

Where we are using interest rate swaps to hedge the changes in fair value attributable to the interest rate risk of a recognised asset or liability that could affect profit or loss, we apply fair value hedge accounting. If there is an effective hedge relationship, the hedged item (such as fixed rate mortgages or non-interest bearing customer deposits) is adjusted for fair value changes in respect of the hedged risk. These fair value changes are recognised in the income statement together with the fair value movements on the hedging instrument (the interest rate swaps).

Where we are using interest rate swaps to hedge the exposure to variability in cash flows attributable to interest rate risk on a recognised asset or liability or a highly probable forecast transaction that could affect profit or loss, we apply cash flow hedge accounting. If there is an effective hedge relationship, the effective portion of the movement in fair value of the hedging instrument (the interest rate swaps) is recognised in other comprehensive income ("OCI") and taken to the cash flow hedge reserve. The financial hedged item (such as floating rate loans and advances to customers) are accounted for as normal in line with IFRS 9 accounting requirements.

Hedge accounting is discontinued when a hedge ceases to be highly effective, a derivative expires or is sold, the underlying hedged item matures or is repaid or periodically if a new underlying hedged item or hedging instrument is added to the hedge relationship. Where a fair value hedge is de-designated (either due to becoming ineffective or as part of our dynamic approach to hedge accounting) any hedge adjustments accrued to that point are amortised over the remaining life of the hedged item. When a cash flow hedge is de-designated any accumulated amounts in the cash flow hedge reserve are recycled to profit or loss as and when the hedged forecast cash flows impact the income statement.

At the inception of every hedge, we produce hedge documentation which identifies the hedged risk, hedged item and hedging instrument. This documentation sets out the methodology used for testing hedge effectiveness.

We use derivatives as part of our approach to hedging interest rate exposure. As at the 30 June 2019 all of our derivatives are fair value hedges achieved via the use of interest rate swaps.

Our derivative financial instruments are analysed below. The notional contract amount is the amount from which the cash flows are derived and therefore does not represent the principal amounts at risk relating to these contracts.

	30 June 2019			31 December 2018		
	Notional contract amount £'million	**Fair value of assets £'million**	**Fair value of liabilities £'million**	Notional contract amount £'million	Fair value of assets £'million	Fair value of liabilities £'million
Interest rate swaps	**1,362**	**-**	**9**	**372**	**-**	**1**
Total	**1,362**	**-**	**9**	**372**	**-**	**1**

11. Lease liabilities

Accounting policy

Policy applicable from 1 January 2019

At the inception of a contract we assess whether the contract contains a lease.

At the commencement of a lease we recognise a lease liability and right-of-use asset (see note 7 for further details). The lease liability is initially measured as the present value for the future lease payments discounted at the rate implicit in the lease (where available) or our incremental cost of borrowing. Generally we use our deemed incremental cost of borrowing as the discount rate. Following initial recognition the lease liability is measured using the effective interest method.

Where we are certain to exercise a break in the lease, only the lease payments up until the date of the break are included.

We subsequently re-measure the lease liability when there is a change to an index or rate used or when there is a change in expectation that we will exercise a purchase option or break clause or if we extend the lease. When such an adjustment is made to the lease liability a corresponding adjustment is made to the right-of-use asset.

Irrecoverable VAT on lease payments is excluded from the lease liability and is taken to the income statement over the period which is due. This is included within note 3 ('Operating expenses') under 'occupancy expense'

We have elected not to recognise a lease liability and right-of use assets for any leases that have a term of less than 12 months or are for an asset which is deemed to be of low value (item is worth less than £5,000). For these leases the lease payments are recognised as an expense in the income statement on a straight-line basis over the life of the lease.

Due to us adopting IFRS 16 on 1 January 2019 under the modified retrospective approach no comparatives are shown for the tables below, as all of the leases we have are operating leases and were held off-balance sheet under IAS 17.

Lease liabilities

	£'million
31 December 2018	**n/a**
IFRS 16 opening adjustment	**328**
1 January 2019	**328**
Additions	**17**
Lease payments made	**(12)**
Interest on lease liability	**9**
30 June 2019	**342**
Current	**27**
Non-current	**315**

Maturity analysis (contractual undiscounted cash flows – excluding VAT)

	£'million
Less than one year	**28**
One to five years	**118**
More than five years	**428**
30 June 2019	**574**

12. Government grants

Accounting policy	Government grants are recognised where there is reasonable assurance that we will both receive the grant and will be able to comply with all the attached conditions. When the grant relates to an expense item, it is recognised as income on a systematic basis over the periods that the related costs, for which it is intended to compensate, are expensed. When the grant relates to an asset, it is recognised directly against the cost of the asset.

	Half year to 30 June 2019 £'million	Half year to 30 June 2018 £'million
At beginning of the period	**-**	-
Grants received	**120**	-
Released to the income statement	**(4)**	-
Offset against capital expenditure	**(1)**	-
At the end of the period	**115**	-

On 22 February 2019 we were awarded £120 million from the Capability & Innovation fund part of the RBS alternative remedies package, the largest award available. Under the terms of the grant we have committed to certain public obligations which we are required to deliver upon. In the event that we are unable to deliver these commitments Banking Competition Remedies Limited (the administering body) is allowed to request the repayments of these funds, either in part of whole, along with accumulated interest.

We anticipate delivering all the commitments we have agreed.

13. Called-up share capital

As at 30 June 2019 we had 172.4 million ordinary shares of 0.0001 pence (31 December 2018: 97.4 million) in issue.

During the six months to 30 June 2019 we issued 75 million shares for £375 million. Related transactions costs of £16 million have been deducted.

Called up ordinary share capital (issued and fully paid)

	Half year to 30 June 2019 £'million	Half year to 30 June 2018 £'million
At beginning of the period	**-**	-
Shares issued	**-**	-
At end of the period	**-**	-

Share premium

	Half year to 30 June 2019 £'million	Half year to 30 June 2018 £'million
At beginning of the period	**1,605**	1,303
Shares issued	**375**	1
Transaction costs	**(16)**	-
At end of the period	**1,964**	1,304

14. Earnings per share

Basic earnings per share is calculated by dividing the earnings attributable to ordinary equity holders by the weighted average number of ordinary shares in issue during the period.

	Half year to 30 June 2019	Half year to 30 June 2018
Earnings attributable to ordinary equity holders of Metro Bank PLC (£'million)	**1.3**	15.2
Weighted average number of ordinary shares in issue (thousands)	**122,420**	88,519
Basic earnings per share (pence)	**1.0**	17.1

Diluted earnings per share has been calculated based on the same profit attributable to ordinary equity holders and weighted average number of ordinary shares in issue after the effect of adjustment for potential dilutive ordinary shares, which comprise share options granted to colleagues. Potential ordinary shares should only be treated as dilutive when their conversion to ordinary shares results in a reduction in earnings per share. The number of share options excluded from the weighted average number of dilutive potential share for the six month period to 30 June 2019 is 4.9 million (30 June 2018: 1.0 million).

	Half year to 30 June 2019	Half year to 30 June 2018
Earnings attributable to ordinary equity holders of Metro Bank PLC (£'million)	**1.3**	15.2
Weighted average number of ordinary shares in issue (thousands)	**122,425**	90,590
Diluted earnings per share (pence)	**1.0**	16.7

15. Fair value of financial instruments

	Carrying value £'million	Quoted market price Level 1 £'million	Using observable inputs Level 2 £'million	With significant unobservable inputs Level 3 £'million	Total fair value £'million
30 June 2019					
Assets					
Loans and advances to banks	**152**	**-**	**-**	**152**	**152**
Loan and advances to customers	**14,987**	**-**	**-**	**14,920**	**14,920**
Investment securities	**2,370**	**833**	**1,532**	**-**	**2,365**
Liabilities					
Deposits from customers	**13,703**	**-**	**-**	**13,656**	**13,656**
Deposits from central banks	**3,801**	**-**	**-**	**3,801**	**3,801**
Debt securities	**249**	**210**	**-**	**-**	**210**
Repurchase agreements	**1,176**	**-**	**-**	**1,176**	**1,176**
31 December 2018					
Assets					
Loans and advances to banks	186	-	-	186	186
Loan and advances to customers	14,235	-	-	14,857	14,857
Investment securities	4,132	1,212	2,891	-	4,103
Liabilities					
Deposits from customers	15,661	-	-	15,605	15,605
Deposits from central banks	3,801	-	-	3,801	3,801
Debt securities	249	219	-	-	219
Repurchase agreements	344	-	-	344	344

For the cash and balances with the Bank of England the carrying value approximates to the fair value, and therefore no pricing level has been identified for them above.

Information on how fair values are calculated for the financial assets and liabilities noted above are explained below:

Loans and advances to banks
Fair value is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the balance sheet date. Fair values approximate carrying amounts as their balances are generally short dated.

Loans and advances to customers
Fair value is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the balance sheet date, adjusted for future credit losses and prepayments, if considered material.

Investment securities
The fair value of investment securities is based on either observed market prices for those securities that have an active trading market (fair value level 1 assets), or using observable inputs (in the case of fair value level 2 assets).

Deposits from customers
Fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities. The fair value of a deposit repayable on demand is approximated by its carrying value.

Debt securities
Fair values are determined using the quoted market price at the balance sheet date.

Deposits from central banks / repurchase agreements
Fair values are estimated using discounted cash flows, applying current rates. Fair values approximate carrying amounts as their balances are generally short dated.

16. Legal proceedings and regulatory matters

PRA and FCA investigations

On 26 February 2019 we received notification that the PRA and FCA intended to independently investigate the circumstances and events that led to the adjustment to our RWAs announced on 23 January 2019. These investigations are focusing on our regulatory reporting; the systems, controls and governance we have in place to ensure compliance with our reporting and disclosure obligations; and the timing and content of announcements related to the RWA matter. As at the date of this report these investigations remain ongoing.

Arkeyo

Arkeyo LLC, a software company based in the United States, filed a civil suit against us in June 2017 (which was subsequently amended and refiled in February 2019) in the United States District Court for the Eastern District of Pennsylvania, alleging, among other matters, that we misappropriated certain of Arkeyo's trade secret technology relating to money counting machines (i.e., our Magic Money Machines). Arkeyo has sought damages in respect of a number of claims. We have filed a Motion to Dismiss in respect of Arkeyo's claim.

Sanctions related matters

In November 2017, we gave notice (the "Notice") to the US Office of Foreign Assets Control ("OFAC") that a UK-based entity with which we held a banking relationship was subject to US sanctions relating to Cuba. We terminated our relationship with the relevant entity. In addition, in 2019, we discovered that a payment made into a customer account, processed via a UK-based financial institution, originated from a UK-based subsidiary of an Iranian entity. Following the identification of the payment, we updated the Notice. A review is ongoing.

Possible securities class actions

On 30 May 2019, a purported class action was filed against us in a US federal court in Los Angeles, California alleging material misrepresentations made about our capital resources. If it becomes necessary, we will defend ourselves vigorously in this matter.

Based on the facts currently known, it is not practical at the moment to predict the outcome of any of these matters, including any financial impact. We are not subject to any other regulatory investigations, reviews or any legal proceedings which could have a material impact on the business.

17. Related party transactions

Architecture, design and branding services are provided to us by InterArch, Inc., ("InterArch") a firm which is owned by Shirley Hill, the wife of Chairman Vernon W. Hill II. The cost of these services in the six months to 30 June 2019 was £3.6 million (six months to 30 June 2018: £2.8 million). The balance owed to InterArch at 30 June 2019 was £0.2 million (30 June 2018: £0.5 million).

In order to ensure that the terms of the InterArch arrangements are consistent with those that could be obtained from an independent third party, the contractual arrangements with InterArch are subject to an annual review by our Audit Committee using benchmarking reviews conducted by independent third parties.

In May 2019 we announced in our equity issuance prospectus that we intend to transition both architectural design as well as creative and branding services to alternative suppliers by the end of 2020. We have started this process in order to ensure a smooth transition.

18. Post balance sheet events

As detailed in note 9 during the period we agreed to sell a portfolio of loans to an affiliate purchaser of Cerberus Capital Management for consideration of £521 million. The sale was executed on 24 July 2019 following the signing of the sale contracts.

The sale will be accounted for on 24 July 2019 with an expected loss on sale of £1.8 million recognised on this date.

There have been no other material post balance sheet events.

RECONCILIATION OF STATUTORY TO UNDERLYING RESULTS

(UNAUDITED)

The underlying results referred to in these accounts reflect our results for the period prepared on an underlying basis. These exclude certain items that are considered to disport comparability between periods in order to provide users with a better and more relevant understanding of the underlying trends in the business. A reconciliation from our statutory to underlying results is set out below:

Half year to 30 June 2019	Statutory basis £'million	Listing Share Awards £'million	Impairment and write offs of property, plant & equipment and intangible assets £'million	Costs relating to the RBS alternative remedies package £'million	Capability & Innovation fund spending and income £'million	Transformation and remediation costs £'million	FSCS levy £'million	Underlying basis £'million
Interest income	**252.0**	-	-	-	-	-	-	**252.0**
Interest expense	**(85.8)**	-	-	-	-	-	-	**(85.8)**
Net interest income	**166.2**	-	-	-	-	-	-	**166.2**
Fee and commission income	**32.5**	-	-	-	-	-	-	**32.5**
Net gains on sale of assets	**4.1**	-	-	-	-	-	-	**4.1**
Other income	**17.7**	-	-	-	(3.8)	-	-	**13.9**
Total income	**220.5**	-	-	-	(3.8)	-	-	**216.7**
General operating expenses	**(174.7)**	0.3	-	1.2	3.8	7.0	0.7	**(161.7)**
Depreciation and amortisation	**(37.0)**	-	-	-	-	-	-	**(37.0)**
Impairment and write offs of property, plant & equipment and intangible assets	**(1.0)**	-	1.0	-	-	-	-	**-**
Total operating expenses	**(212.7)**	0.3	1.0	1.2	3.8	7.0	0.7	(198.7)
Expected credit loss expense	**(4.4)**	-	-	-	-	-	-	**(4.4)**
Profit before tax	**3.4**	0.3	1.0	1.2	-	7.0	0.7	13.6
Taxation	**(2.1)**	-	-	(0.2)	-	(1.3)	(0.1)	(3.7)
Profit for the period	**1.3**	0.3	1.0	1.0	-	5.7	0.6	9.9