Paragon Banking Group PLC
(formerly The Paragon Group of Companies PLC)

Preliminary Financial Report

For the year ended 30 September 2017

Under stock exchange embargo until 7.00am Thursday 23 November 2017

TRANSITION TO BANKING GROUP

Paragon Banking Group PLC (‘Paragon’ or the ‘Group’) today announces its full year results for the year ended 30 September 2017.

Financial highlights

- Underlying profit rose by 1.0% to £145.2 million (2016: £143.8 million) having absorbed £10.9 million of Tier 2 Bond cost in the year
- Statutory profit before tax increased by 1.1% to £144.8 million (2016: £143.2 million)
- EPS up 6.4% to 43.1p (2015: 40.5p) and underlying RoTE improved to 13.4% (2016: 12.9%)
- Dividend cover ratio reduced from 3.00 to 2.75 for 2017, 2.50 expected in 2018
- Further £50.0 million share buy-back programme announced
- Strong capital and leverage ratios maintained

Strong lending growth across buy-to-let and newer product lines

- Total lending increased 28.8% to £1,853.4 million (2016: £1,439.1 million)
- Buy-to-let completions up 20.6% to £1,399.9 million (2016: £1,161.0 million)
- Commercial Lending increased 66.8% to £388.9 million (2016: £233.2 million)

Increasingly deep and efficient funding base

- Retail deposits nearly doubled over the year to £3.6 billion (30 September 2016: £1.9 billion)
- Term Funding Scheme (‘TFS’) drawings totalled £0.7 billion, with over £0.9 billion expected to be drawn in total
- In addition to funding new advances, the Group has generated efficiencies through refinancing several previously securitised or warehoused portfolios

Commenting on the results, Nigel Terrington, Chief Executive of Paragon, said:

“We have made outstanding progress across all business lines with lending growth exceeding 29% and deposit funding nearly doubling to £3.6 billion over the year. The improving strength and depth of the Group’s franchises reflects the growing importance of specialist lending in the UK retail banking market as it undergoes much needed structural change.

Paragon has undergone an extraordinary transformation in recent years with the diversification strategy delivering six new lending product lines and a growing deposit taking capability. The organisational restructure completed recently has enhanced this transformation, creating a new operating model which has immediate organisational benefits and will deliver improving funding efficiencies and capital mobility in the future. Significant progress has been made in our strategic development and we have put in place the foundations to support the growing demands and expectations of our customers and intermediaries and the increasing range of opportunities in specialist lending markets.

With a strong capital base and exemplary asset quality, increasingly diversified funding, and a broadening product range supported by a more financially efficient operating model, we are well positioned to exploit the opportunities and manage the challenges ahead.”

FINANCIAL HIGHLIGHTS

KEY PERFORMANCE INDICATORS

	2017	2016	Change	% change
Profit before tax	**£144.8m**	£143.2m	**£1.6m**	**1.1%**
Underlying profit	**£145.2m**	£143.8m	**£1.4m**	**1.0%**
Basic EPS	**43.1p**	40.5p	**2.6p**	**6.4%**
Dividend per share	**15.7p**	13.5p	**2.2p**	**16.3%**
Return on tangible equity	**13.4%**	12.9%		
Cost:income ratio	**40.5%**	37.9%		
Core Tier 1 ratio	**15.9%**	15.9%		
Total capital ratio	**18.7%**	19.0%		

New Business	Originations and investments		Pipeline	
	2017	2016	2017	2016
Mortgages	**£1,464.5m**	£1,205.9m	**£604.2m**	£321.1m
Commercial Lending	**£388.9m**	£233.2m		
Total loans	**£1,853.4m**	£1,439.1m		
Portfolio acquisitions	**£98.0m**	£208.8m		
Total new business	**£1,951.4m**	£1,647.9m		
Retail deposits	**£3,615.4m**	£1,873.9m		

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Paragon will be holding a results presentation for analysts on 23 November 2017 at 9:30am at UBS, 5 Broadgate, London, EC2M 2QS. The presentation material will be available on Paragon Banking Group's website at https://www.paragonbankinggroup.co.uk/investor/reports-results-presentations from 11am.

MANAGEMENT REPORT

STRATEGY REVIEW

The last few years have been a period of transition for the Group from a monoline centralised lender to an increasingly diversified banking group. Over the last twelve months, a significant component of this transition was completed with the reorganisation of the Group's operating structure, resulting in the bulk of its activities moving under its banking subsidiary, Paragon Bank, following authorisation from the Prudential Regulation Authority ('PRA') and Financial Conduct Authority ('FCA').

Recognising the focus on a retail deposit led banking strategy, the Group changed its name to Paragon Banking Group in September 2017 and has subsequently re-branded its operating units.

The reorganisation has created a simplified operating model, enhanced governance processes with a streamlined and unified board and management structure, and greater transparency. This has been reflected in the way the Group now reports its results, as three operating units – Mortgages, Commercial Lending and Idem Capital, as well as its centralised operations.

The restructure will deliver significant liquidity benefits, together with a notable reduction in the need for the Company to issue debt over the medium term, thereby reducing the Group's funding costs over time and, in turn, giving the Group far greater access to the retail deposit market to support its lending activities.

Notwithstanding the above, the overall Group's core strategy remains unchanged. The Group is a leading UK specialist lender, supporting the needs of consumers and SMEs. It is seeking to develop its presence further in these broad markets by increasing product diversification whilst utilising its highly efficient centralised operating platform and excellent technology. Organic growth has been strong and this is expected to continue into the future and will be supplemented by M&A activity where appropriate. The Group has an outstanding through-the-cycle track record in challenging markets with excellent risk metrics, reflective of the cautious and prudent approach it takes to its risk appetite alongside the highly efficient operating model.

Alongside its transition to a banking model, the Group has made good progress in delivering improved profits and strong organic new business generation. Underlying profits rose by 1.0% to £145.2 million during the year (2016: £143.8 million) having absorbed the costs of the Group's £150.0 million Tier 2 Bond, the start-up costs of new lending lines, incurred as part of the diversification strategy and the impact of the restructuring. Profits on the statutory basis increased by 1.1% to £144.8 million (2016: £143.2 million). Basic earnings per share ('EPS') increased by 6.4% to 43.1 pence (2016: 40.5 pence) and return on tangible equity ('RoTE') improved to 13.4% (2016: 12.9%).

Lending

The year has seen continued strong growth levels in organic business generation and further debt purchase activity, albeit the level of portfolio acquisitions, at £98.0 million, was at a lower level than the £208.8 million achieved in 2016. Group-wide organic originations rose 28.8% to £1,853.4 million compared to £1,439.1 million last year. The combination of portfolio purchases and organic growth contributed to net loan growth of 3.6% to £11,124.1 million over the last twelve months (2016: £10,737.5 million).

MANAGEMENT REPORT

STRATEGY REVIEW (Continued)

The Group's core business remains its buy-to-let franchise. The UK private rented sector continues to see strong levels of demand from tenants which is expected to continue for the foreseeable future. The buy-to-let market has experienced a period of disruption following a series of fiscal and regulatory changes aimed at both landlords and lenders. These changes disrupted the level of market activity during the year, dampening demand in the sector at an aggregate level. Against this backdrop the Group's performance has been strong, with its twenty-year experience of servicing the complex needs of professional landlords differentiating it from other lenders and allowing the business to make market share gains during the year. New buy-to-let origination levels increased by 20.6% from the previous year's level to £1,399.9 million in the year to September 2017 (2016: £1,161.0 million), with the Group's market share, as measured by the figures reported by UK Finance, increasing from 2.74% to 3.93%.

The most recent regulatory changes in the buy-to-let market require lenders to collect and analyse more information about the landlord's property portfolio and wider business than has previously been common in the market. The Group considers that this will lead to further disruption with some lenders restricting their buy-to-let activity as a result of the increased demands of a complex underwriting process. The Group's expertise in this particular market segment positions the business well to benefit from these changes and further increase its market share.

The Group's other mortgage businesses comprise its second mortgage activities, where new origination levels rose 35.2% to £60.7 million during the year (2016: £44.9 million) and a specialist residential lending operation, which remains in its pilot phase with distribution limited to a small fraction of the Group's broker panel pending final systems and process enhancements. New specialist residential volumes totalled £3.9 million during the year (2016: £nil).

Further asset and income diversification is generated by the Group's Commercial Lending division. The principal activity of the division is asset finance, where strong progress has been made following the acquisitions made in the previous year. The Group's asset finance activities are transforming to service a broader mid-market range of SME customers, as opposed to the more limited niches originally serviced. This strategy has resulted in higher new business volumes (up 52.5% on the eleven month performance in 2016 to £220.0 million in 2017). Customer credit profiles are generally stronger in this larger sector, with yields commensurately lower. The Group's motor finance business also saw strong growth in 2017. Operating in the hire and lease purchase segments of the market (with no exposure to personal contract purchase products), new business origination grew by 50.4% to £120.0 million during the year (2016: £79.8 million). The final established sector is the division's development finance operation, providing funding to smaller property developers, where new drawings totalled £48.9 million in the first full operating year of the business (2016: £9.1 million).

The Group has also established a team to provide structured lending solutions to non-bank financial institutions, with the first lending scheduled for the second quarter of the Group's 2018 financial year.

The Group's portfolio purchase business, Idem Capital, is an established purchaser of secured and unsecured portfolios. Gross purchases in 2017 were £98.0 million (2016: £208.8 million). The sector has proved increasingly popular for both specialist purchasers and credit funds in recent years, with yields reducing as a consequence. Idem Capital has retained its credit and pricing discipline across the past year, but as a consequence investment levels have reduced year-on-year.

STRATEGY REVIEW (Continued)

Funding

The increased banking focus of the Group is evidenced by the pace of development of its retail deposit funding base, together with Paragon Bank's increased access to Bank of England facilities. At 30 September 2017, retail savings balances were £3.6 billion and Term Funding Scheme ('TFS') drawings totalled £0.7 billion, compared with savings deposits of £1.9 billion and £nil TFS drawings a year earlier. In addition to funding new advances, the Group has also refinanced a number of previously securitised or warehoused portfolios using retail deposit funding during the year, with similar refinancing activity expected over the coming years.

Retail deposits represent the Group's primary source of funding for new lending, with its historical securitisation approach taking a more tactical role as and when conditions in that market are attractive, maintaining a diversified approach to the Group's funding.

Capital

The Group's core equity tier 1 ratio ('CET1') remained unchanged in 2017 at 15.9% (2016: 15.9%), despite balance sheet growth and higher distributions to shareholders through buy-backs and enhanced dividend levels. The Group's total capital ratio was 18.7% at September 2017 (2016: 19.0%). Free cash resources totalled £305.5 million at the end of the period (2016: £383.1 million). During the year, the Group repaid its £110.0 million subordinated bond which matured in April 2017.

Enhancing shareholder returns on a sustainable basis is a key objective for the Group and during the year basic EPS increased by 6.4%. The reorganisation of the Group in 2017 confers a number of benefits but the impact on Group-level liquidity requirements is particularly pronounced. Most notably, the Company no longer needs to inject capital into Paragon Bank at the start of each year and the requirement to fund the credit enhancement needs of the former warehouse to securitisation financing model has been removed. Given the increased efficiency of the new financing model, the Board has reviewed the Group's earnings retention requirements and concluded that it would be appropriate to reduce its dividend cover ratio from the current 3.00 times on a stepped basis. The cover ratio for 2017 will therefore be 2.75 times, and this is expected to fall to 2.50 times for the 2018 financial year, subject to the requirements of the business.

The increase in the Group's EPS and annual dividend rate over the past five years, together with their compound annual growth rates ('CAGR') is set out below.

	2017 **p**	**2012** **p**	**Increase** **p**	**CAGR** **%**
EPS	43.10	24.20	18.9	12.3
Dividend	15.70	6.00	9.7	21.2
Dividend cover (times)	2.75	4.03		

The Group will also adopt a formulaic approach to its interim dividend levels going forward, with the interim dividend per share for any given year being one half of the final dividend declared in the preceding period in normal circumstances.

The Group's share buy-back programme has progressed well, with £165.0 million having been invested to date. The £150.0 million cumulative target announced with the 2016 preliminary results was extended to £165.0 million during 2017 given the strong cash flow. The programme will be extended by an additional £50.0 million in the current financial year, further enhancing shareholder returns.

MANAGEMENT REPORT

STRATEGY REVIEW (Continued)

The business remains well funded, strongly capitalised and effectively placed to continue to deliver long term, sustainable returns through its robust operating model. The Group is positioned to respond quickly to the challenges and to take advantage of the opportunities that will arise given changes in the broader operating environment.

A more detailed discussion of the Group's performance is given below covering:

Business review	Funding review	Financial review	Operational review
Lending, performance and markets	Retail deposits, wholesale funding and capital management	Results for the year	People, risk and regulation

MANAGEMENT REPORT

LENDING REVIEW

Following the Group's reorganisation in September, its operations are organised into three divisions, based on product types and origination and servicing capabilities.

This review is based on the new organisational structure, and amounts from previous periods have been reanalysed on the basis of the new segments.

The Group's investments in loans and the amounts invested in the year for each of its divisions are summarised below:

	Advances and investments in the year		Investments in loans at the year end	
	2017	2016	2017	2016
	£m	£m	£m	£m
Mortgages	1,464.5	1,205.9	9,953.9	9,694.7
Commercial Lending	388.9	233.2	558.8	375.0
Idem Capital	98.0	208.8	611.4	667.8
	1,951.4	1,647.9	11,124.1	10,737.5

The Group's loan investments increased by 3.6% in the year, with new advances and investments 18.4% higher than in the previous financial year.

A3.2.1 Mortgages

The Group's Mortgages division offers buy-to-let first charge and owner-occupied first and second charge mortgages on residential property in the UK. In all its offerings, it targets niche markets where its focus on detailed case-by-case underwriting and its robust and informed approach to property risk differentiate it from mass market lenders.

As part of the Group reorganisation all lending on residential property was brought into this division, creating efficiencies and enhancing the service delivered to our customers and intermediaries.

Housing and mortgage market

The UK mortgage market is currently finely balanced and there is the potential for considerable volatility. However, the data would indicate that the market has been more robust than some media reports would suggest. Housing transactions, the key measure of market activity, have been improving through the year and monthly house purchase numbers are running at post-crisis highs. Mortgage transactions have also been on the increase, with advances increasing at a sharper rate than housing transactions.

The strength of the first-time buyer segment, supported by the Government's Help-to-Buy scheme, is clearly bolstering housing transactions in general and new build activity in particular. Gross mortgage lending, however, is also benefitting from growth in remortgaging activity which is being driven by increased levels of maturing products in extant mortgage portfolios as well as increased consumer sensitivity to potentially higher interest rates.

As a result of these activity levels, despite some ongoing weakness in London and the South, particularly for higher value properties, house prices across the country have seen modest increases in the period and the market remains stable.

LENDING REVIEW (Continued)

Across the whole of the mortgage industry, the low interest rate environment has led to benign conditions, with low arrears and a negligible level of forced sales. Overall the economic environment for the mortgage market currently appears both positive and sustainable.

The downside risks centre on the impact of any potential economic downturn, whether as a result of the Brexit process or otherwise. The Group seeks to mitigate its exposure to such conditions through a robust approach to property valuation across all its brands, employing an experienced in-house property team who undertake around two thirds of valuations and conduct validation work on 100% of valuations by third party surveyors. The internally conducted surveys are subject to regular monitoring and the Risk and Compliance function includes qualified property risk resource.

Buy-to-let

The buy-to-let market in particular has been disrupted through a series of government and regulatory interventions, which are in the process of reshaping the sector. Significant changes have been seen to date, and the effects are yet to work themselves out fully. The principal changes have been:

- the introduction of a stamp duty surcharge on buy-to-let properties
- the restriction of tax relief on finance costs for buy-to-let landlords
- regulatory changes affecting buy-to-let lending

The stamp duty changes appear to have had the least effect, with landlords considering their investment in the long term, mitigating the impact.

Tax relief changes have had a marked effect on customer behaviour, with amateur landlords (those with fewer than four properties) moving away from the market, leading to a fall in the volume of buy-to-let transactions which seems to be establishing a new ‘normal’ level. The reaction of the more professional landlords, who constitute the Group’s main target customer base, has been different. Their focus has generally been to adopt defensive measures, including putting properties into corporate structures and focussing on high yielding properties such as homes in multiple occupation (‘HMOs’). This has led to a sharper distinction between professional landlord investors and other buy-to-let borrowers, which the Group regards as a positive development and one beneficial to its business model.

The regulatory changes in the year were implemented in two phases:

- From 1 January 2017 the PRA imposed common standards for affordability testing in the buy-to-let sector, similar, in principle, to the approach adopted by the FCA for owner occupied cases. Most lenders, including the Group, were able to adopt these changes without serious disruption
- From 1 October 2017, lenders were required to underwrite buy-to-let cases on a much more specialised basis, differentiating between professional and amateur landlords, based on the number of properties owned with buy-to-let finance. This caused little disruption to the Group’s business model as the PRA approach was in line with that already adopted and the required specific changes were put in place in July 2017. The market in general was slow to reflect these changes in published criteria, leading to some disruption around the implementation date, due to lack of clarity on lenders’ requirements. At present some of this disruption continues

Overall the Group sees these changes as positive, with a more sharply focussed class of buy-to-let landlords emerging. These should be motivated to provide a better service to tenants and their funding requirements are a good match for the service offered by the Group, providing an opportunity for the Group to grow its market share, albeit in a potentially smaller market.

LENDING REVIEW (Continued)

Lending activity

The new lending activity in the segment during the year is set out below.

	2017 £m	2016 £m
First charge buy-to-let	1,399.9	1,161.0
First charge owner-occupied	3.9	-
Second charge	60.7	44.9
	1,464.5	1,205.9

The Group's buy-to-let lending increased by 20.6% year on year, despite the disruption in the market described above and the consequent pressure on volumes. The pipeline of buy-to-let loans in process at the year end was £604.2 million, an increase of 88.2% on the position a year earlier (2016: £321.1 million). It had reduced, however, from the level at the half year as a result of the market disruption caused by the implementation of the second phase of PRA reforms.

The Group launched its pilot offering in the specialist sector of the owner-occupied mortgage market during the year. This is intended to address customers who are poorly served by mainstream lenders and who might benefit from a more bespoke approach to underwriting, including customers with irregular incomes or more complex properties or those who might wish to borrow into retirement, but not sub-prime cases.

The Group's approach to these cases involves a much more holistic assessment of the proposition, speaking directly to customers and their financial advisers to understand the case in the round. The Group initially worked with three intermediaries to prove the proposition, systems and processes were viable. The results so far are pleasing and the offering is now being expanded to a wider network of selected specialist intermediaries. Further increases in capacity will be phased in over the coming financial year, with the business not expected to reach its full capability until after the end of the 2018 financial year.

The Group's second charge mortgage lending has increased 35.2% during the year, but that is largely as a result of starting from a low base. The second charge market is currently not large, with total lending of £979 million in the financial year reported by the Finance and Leasing Association ('FLA'), and a significant part of this total does not fall within the Group's risk appetite. For its new lending, the Group seeks to target the population of customers seeking to access equity in their property while protecting an existing beneficial first mortgage rate, rather than those seeking to refinance consumer debt and adopts a cautious approach to credit quality in this area.

LENDING REVIEW (Continued)

Performance

The outstanding loan balances in the segment are set out below, analysed by business line.

	30 September 2017 £m	30 September 2016 £m
Post 2010 assets		
First charge buy-to-let	3,661.1	3,017.2
First charge owner-occupied	3.9	-
Second charge	98.4	54.1
	3,763.4	3,071.3
Legacy assets		
First charge buy-to-let	6,175.4	6,604.0
First charge owner-occupied	15.1	19.4
	9,953.9	9,694.7

At 30 September 2017 the balance on the Group's mortgage portfolio was 2.7% higher than a year earlier. The annualised redemption rate on post 2010 buy-to-let mortgage assets at 22.7% (2016: 16.2%), has reached the levels seen before the credit crisis as the book matures. Redemption activity has been particularly high over the summer months, influenced by very attractive refinancing options on offer, as lenders have utilised the TFS to subsidise product pricing. The annualised redemption rate on pre-crisis lending, at 6.0%, has marginally reduced from the 6.2% seen in the year ended 30 September 2016.

Average yields on the major product lines are set out below.

	Average Yield		Average Balance	
	2017	2016	2017 £m	2016 £m
Post 2010 buy-to-let	4.48%	4.71%	3,326.8	2,786.0
Second charge	4.65%	4.87%	76.7	36.1
Legacy	2.02%	2.24%	6,386.3	6,831.2

Yields in the segment have tightened somewhat in the year as a result of competitive pressures and market interest rate movements, but remain broadly in line with expectations and at sustainable levels.

Arrears on the buy-to-let book as a whole have reduced in the year to 0.08% (2016: 0.11%), with arrears on post-2010 lending standing at 0.02% (2016: 0.01%). These arrears remain very low compared to market performance, with UK Finance reporting arrears of 0.45% across the buy-to-let sector at 30 September 2017 (2016: 0.52%). This exemplary performance reflects the Group's focus in underwriting on the credit quality and financial capability of its customers, underpinned by a detailed and thorough assessment of the value and suitability of the property as security.

Second charge arrears increased to 0.06% from zero in the year, as the book began to season, but remain negligible compared to market levels.

The Group's receiver of rent process for buy-to-let assets helps to reduce the level of bad debt. At the year end 821 properties were managed by a receiver on the customer's behalf, a reduction of 13.2% since 2016 (2016: 946 properties) as cases on the old book resolve and post 2010 cases perform well.

LENDING REVIEW (Continued)

Outlook

The Group believes it is well placed to face the challenges of the mortgage market going forward. Aside from an economic downturn, the biggest risk to the business model is from further interventions in the buy-to-let sector. Exposure on owner-occupied lending is low, and the risk position on second charge lending has been carefully maintained.

While arrears performance at the moment is exceptional, in the event of an economic downturn the Group believes its strong credit standards and robust assessment of security condition and value will afford it a high degree of protection. Average loan-to-value ratios on new buy-to-let lending remain at around 70% with stressed affordability levels in line with or above the PRA requirements. Continued strong rental demand and good affordability suggests the Group's customers will be resilient in the face of anticipated rate rises.

The Group believes that the current trends in the buy-to-let market are likely to continue with the split between professional and amateur landlords becoming more marked and professional landlords increasingly dominant in the sector. This provides a good match for the Group's offerings and 71.2% of applications at 30 September 2017 were from landlords the Group classes as professional (2016: 67.2%).

This trend can be seen in the analysis of the Group's buy-to-let pipeline application numbers over the last three years.

The Group believes the division is well placed to deploy its core skills of bespoke assessment of credit risk, good customer service, expert understanding of property valuation and modern systems and processes, across a variety of niche markets in the residential mortgage field, as well as in its existing core buy-to-let specialism. These would be significant large, underserved, markets where detailed underwriting and the careful management of credit and property risk can produce a resilient and sustainable lending business with total lending in excess of £1.6 billion anticipated for 2018.

A3.2.2 Commercial Lending

Building on the asset finance operation acquired in 2015, the Group's Commercial Lending division brings together a number of streams of mostly asset backed lending to, or through, commercial organisations. The principal customer focus of the division is on lending to SME and mid-sized corporate customers, which is an important differentiator from the rest of the Group's business.

While asset and motor finance form the largest parts of the division's operations and finance leasing is its principal product, offerings are tailored to respond to specific needs identified in the marketplace.

The Group recognises that whilst the asset finance market is wide and deep, covering some £75.1 billion of outstanding balances at 30 September 2017 (2016: £70.7 billion) and £31.6 billion of advances in the year then ended, most of this funding is provided by commodity lenders. The Group targets niches within this market where its particular skill sets can be best applied.

Examples of such niches are the financing of waste collection vehicles for local authorities, construction equipment and complex veterinary equipment. Outside the leasing market the division also has niche offerings including invoice factoring, development finance and specialist lending.

Access to customers is generally though specialist brokers, including the Group's in-house brokerage, Premier Asset Finance ('Premier'), or equipment suppliers and the markets in which the division operates tend to be fragmentary, with different brokers focussed on different asset types.

LENDING REVIEW (Continued)

The common themes of these diverse business lines are a reliance on understanding and engaging with the customer and the valuation of any security, together with expertise in collections and security realisation. In common with the rest of the Group, the division's focus is on the maintenance of strong credit standards and it does not pursue business volumes at the expense of margins. The division relies heavily on specialist teams to address the separate business lines, either sourced externally or internally developed.

Lending activity

The new lending activity in the segment during the year is set out below.

	2017	**2016**
	£m	**£m**
Asset finance	220.0	144.3*
Motor finance	120.0	79.8
Development finance	48.9	9.1
	388.9	233.2

* 2016 activity for 11 months since acquisition

The asset finance business has seen a 39.8% annualised growth in new advances in the first full year of the Group's ownership, as changes made following the acquisition came into effect. Premier, acquired in 30 September 2016, has proved valuable as a source of new business, particularly in the business finance area. This has taken place against a backdrop of aggressive competition in the market and general economic nervousness in UK industry, leading to some reluctance by SMEs to take on new finance commitments.

The asset finance business also made a significant investment in assets for hire under operating leases, both term and spot, acquiring £12.9 million of assets to generate future income (2016: £8.7 million).

The motor finance business continues its development phase with a 50.4% increase in new lending as its distribution network expands. This rate of growth is expected to moderate as the business becomes more mature.

The development finance business, which provides funding for small scale property developments, was launched at the end of the previous year. It has seen significant growth as it moves from its pilot phase to a wider scale launch, expanding from its initial focus on London and the South East.

LENDING REVIEW (Continued)

Performance

The outstanding loan balances in the segment are set out below, analysed by business line.

	30 September 2017 £m	30 September 2016 £m
Asset finance	325.0	250.4
Motor finance	163.0	95.3
Development finance	42.3	9.1
Invoice factoring	14.8	12.1
Unsecured business lending	9.0	4.8
Other loans	4.7	3.3
	558.8	375.0

The motor finance and development finance businesses continued to mature in the year, with their distribution networks expanding and internal systems developments supporting their growth. The development finance business saw its first projects successfully completed and paid down in the year and has seen significant investment in systems and specialist personnel. Across all business lines growth has been carefully controlled with credit quality and margins prioritised over expansion.

Average yields on the major product lines are set out below.

	Average Yield		Average Balance	
	2017	2016	2017 £m	2016 £m
Asset finance	9.35%	11.78%	311.1	247.6
Motor finance	5.13%	4.85%	125.7	71.9
Development finance	9.63%	9.34%	29.2	3.2

Yields in the segment have remained strong. While the figures for motor and development finance are affected by their growth trajectories, the decline in the yield in asset finance reflects its strategic repositioning under the Group's ownership, to address the larger, higher quality but lower yielding mid-range segment of the market.

Arrears on the segment's business remain low with arrears in the asset finance business at 0.97% and motor finance at 0.56% (2016: 0.82% and 0.09% respectively), comparable to those in the wider sector, with the FLA reporting average arrears for asset finance at 0.60% and car finance at 1.70% at 30 September 2017 (2016: 0.60% and 1.50%).

Development finance accounts are monitored on a case-by-case basis by the Credit Risk function. At 30 September 2017, no accounts were in default and no defaults had been suffered in the year. The average loan to gross development value for the portfolio at the year end, a measure of security cover, was 60.6%.

Overall the charge for impairment in the segment was £0.1 million (2016: £0.8 million), representing both the quality of the lending and the Group's success in realising security on defaulted cases.

LENDING REVIEW (Continued)

Outlook

The division seeks to develop its businesses, both increasing the reach of its existing offerings and adding further lines or specialisms either organically or through M&A activity. It seeks to be responsive and flexible in addressing the market, but its UK focus means that it is exposed to a downturn in investment amongst UK business as a whole, particularly one affecting its core construction and broadcast sectors.

The coming year will see development of new product lines, including two already launched, aviation finance and structured lending.

The structured lending team was established to provide senior debt to the UK non-bank lending market. The business will deploy loans of up to £25.0 million to help support 'best-in-class' businesses working across consumer and commercial lending. The Group will work alongside clients to help fund their growth. Each transaction will be secured on underlying assets and structured using established robust methodologies. It is anticipated that each facility will generate attractive returns for shareholders and present a low risk way of accessing familiar and new markets. Structured lending is a means of addressing certain segments where the Group may be underweight or has no exposure at all and where working with a recognised industry expert would be preferable to setting up a business.

Aviation finance builds on the division's existing asset finance lending expertise, supplemented with product-specific teams joining the business from outside. The first advance in this business was made in the first weeks of the new financial year.

Further potential niche markets have been identified which might be addressed through organic development using existing business processes, creation of a new separate business line, or acquisition in the field.

Overall the division has a good platform on which to build and increasing scale will enable a better return to be generated from its resources, control framework and investments in systems and aggregate new advances of over £0.5 billion expected in 2018.

A3.2.3 Idem Capital

The Group's Idem Capital division includes its acquired consumer finance portfolios, together with legacy consumer portfolios originated before the credit crisis.

The division's focus is on acquiring portfolios where it can enhance value through its collections process and access to funding, using its analytical skills base, which it sees as a core differentiator, to identify and evaluate portfolios brought to market. Its principal area of focus over recent years has been on portfolios of UK paying secured and unsecured consumer finance balances.

Idem Capital has a strong capability in loan administration and an ability to self-develop systems, allowing it to respond to regulatory developments and more specialised portfolio requirements. Unlike many market participants, Idem Capital is able to deploy retail funding and securitisation funding to support its investment.

In the market the division's strategy has been to seek better returns, with a greater interest in transactions with a bespoke aspect. It is also willing to consider transactions, deal by deal, on a partnership basis, having acted as a co-investor, servicer or both in various deals in the past.

Overall Idem Capital's success rests on understanding assets, strong analytics, advanced servicing capabilities and the efficient use of funding.

LENDING REVIEW (Continued)

Lending activity

The portfolio purchase market has been busy in the year, with over 40 transactions in various asset classes coming to market. In transactions where it was successful, Idem Capital invested £98.0 million in loan portfolios (2016: £208.8 million). These portfolios comprised unsecured consumer finance balances. Activity in the asset sales market tends to be ‘lumpy’ and the level of investment will reflect the number, type and quality of portfolios offered, together with the levels of return other market participants are willing to accept.

The Group believes that its ability to accurately evaluate a potential acquisition is a core strength and it is not willing to compromise on credit quality or target return levels in pursuit of volumes. Idem Capital has participated in all the significant sales processes in the year in its target markets and remains on the panels of all the principal UK vendors.

The Group had also disposed of assets with a carrying value of £18.5 million during the year. These were assets where the Group had exhausted its collection procedures and therefore chose to dispose of the assets to other institutions whose systems are better set up to serve these customers and address such balances.

Performance

The value of the loan balances in the segment are set out below, analysed by business line.

	30 September 2017 £m	30 September 2016 £m
Second charge mortgage loans	392.3	472.7
Unsecured consumer loans	219.1	195.1
	611.4	667.8

The reduction in balances is a result of the scale of realisations from the brought forward portfolio outstripping the pace of acquisitions in the year. 120 month Estimated Remaining Collections on acquired assets reduced from £740.7 million at 30 September 2016 to £688.8 million at the year end.

Average yields on the major product lines are set out below.

	Average Yield		Average Balance	
	2017	2016	2017 £m	2016 £m
Second charge	13.13%	13.83%	432.6	435.9
Unsecured	17.73%	19.32%	237.7	210.2

Yields in the segment have remained stable. The reductions in the year can be attributed principally to mix variances as higher yielding seasoned portfolios amortise and new investments are made at yields below historic levels.

LENDING REVIEW (Continued)

None of the division’s portfolios at the year end were regarded as materially underperforming, with strong overall cash generation. Operational improvements have been made in systems, including the launch of a new customer facing website designed to further enhance customer service by increasing contact, information levels and payment options. This development is also expected to generate operational efficiencies in future periods.

Arrears on the segment’s secured lending business remain in line with recent performance at 17.5% (2016: 17.8%), which while higher than the average for the sector reflect the seasoning of the balances, which are mostly more than ten years old. Average arrears for secured lending of 10.7% at 30 September 2017 were reported by the FLA (2016: 12.4%).

The Group monitors actual cash receipts from acquired portfolios against those forecast in the evaluation which informed the purchase price. Up to 30 September 2017 such collections were 109.3% of those forecast to that point (2016: 109.0%)

Overall the charge for impairment in the segment reduced to £1.5 million (2016: £2.1 million), representing the stable arrears position and the impact of improving house prices on secured provisioning.

Outlook

The Group expects the flow of sale transactions to continue into the new financial year. Its strategic focus in this market will be on transactions which are more idiosyncratic in nature and therefore make best use of its core skills in pricing, data, operations and account management in generating value.

While Idem Capital has the most significant experience in secured and unsecured consumer loan transactions, it has access to specialists in other asset classes across the Group, enabling it to bid on a wider range of asset classes. It will also look for opportunities to deploy retail and corporate funding, with access to these funding sources giving it a potential competitive advantage.

FUNDING REVIEW

The Group's reorganisation in the period represents a major stage in its transition from an entirely wholesale funded lender, with equity representing a high proportion of working capital, reflecting more closely a typical funding structure with retail deposits at its core.

The structural changes have enhanced access to deposit funding and facilitated a review of the Group's equity and dividend strategy.

A3.3.1 Debt funding

During the year, the Group continued to pursue its strategy of making increased use of its retail savings capability.

The availability of central bank funding at attractive rates to support lending in the year impacted on the Group's use of other wholesale funding, with no securitisation transactions taking place. The amount of warehouse facilities available for new lending was also reduced to take account of the increased availability of retail funding.

The Group's funding at 30 September 2017 is summarised as follows:

	2017 £m	2016 £m	2015 £m
Retail deposit balances	3,615.4	1,873.9	708.7
Securitised and warehouse funding	7,781.8	9,947.1	9,700.0
Central bank facilities	700.0	-	-
Tier 2 and retail bonds	444.8	554.3	404.9
Total on balance sheet funding	12,542.0	12,375.3	10,813.6
Off balance sheet central bank facilities	109.0	108.8	-
	12,651.0	12,484.1	10,813.6

The Group's present medium term strategic funding objective is principally focussed on retail deposits, while optimising the use of central bank facilities. Securitisation will be used tactically if market conditions are favourable, or where it is appropriate for particular transactions.

Retail funding

Retail deposits represent a reliable, cost-effective and scalable source of finance. As a consequence of the Group adopting its funding strategy, the volume of retail deposits has grown significantly during the year, with balances at 30 September 2017 reaching £3,615.4 million, an increase of 92.9% over the period (30 September 2016: £1,873.9 million).

FUNDING REVIEW (Continued)

However, this represents only a small proportion of the UK savings market, with household savings balances reported by the Bank of England increasing by 1.3% in the year to 30 September 2017 to £1,120.8 billion (30 September 2016: £1,105.9 billion). This strong supply has helped to maintain the recent trend for low savings rates with the average annual interest on two year fixed interest bonds, reported by the Bank of England, having increased only from 1.00% in September 2016 to 1.26% in September 2017, in expectation of the autumn increase in bank base rates.

Paragon's savings model provides customers with a range of deposit options, offering value for money and competitive rates, combined with the protection provided by the Financial Services Compensation Scheme ('FSCS'). It provides the Group with a stable funding platform, with a focus on term funding to manage interest rate risk and the ability to limit product availability to short periods of time.

The Group's straightforward approach and consistently competitive products have been recognised in the industry and by customers and Paragon was commended in the Best Online Savings Provider category at the 2017 Moneyfacts Consumer awards, the third consecutive year it has received this accolade.

In customer feedback 87% of those opening a savings account with Paragon in the year, who provided data, stated that they would 'probably' or 'definitely' take a second product with Paragon. (2016: 87%). The net promoter score in the same survey was +59, up from +51 in 2016.

Savings balances at the year end are analysed below.

	Average interest rate		Average initial balance		Proportion of deposits	
	2017	2016	2017	2016	2017	2016
	%	%	£000	£000	%	%
Fixed rate deposits	1.89%	2.11%	24	28	74.0%	71.1%
Variable rate deposits	1.21%	1.65%	19	15	26.0%	28.9%
All balances	1.71%	1.98%	23	25	100.0%	100.0%

The average initial term of fixed rate deposits was 28 months (2016: 26 months).

Following the restructuring in the year, the scale of deposit-taking activity is expected to expand materially over the next few years.

Wholesale funding

The year has seen a scaling back of the Group's wholesale funding. The Group's strategic objective of creating a better balanced funding base, coupled with the availability of attractively priced funding from the Bank of England has meant that the Group has not accessed the public securitisation market since November 2015.

At the same time, the quality of the Group's loan assets has enabled three mortgage securitisations to be paid down, including one pre-credit crisis transaction, together with one of the Group's pre 2007 consumer finance transactions. All were refinanced with retail deposits, releasing significant cash balances for use elsewhere in the Group. Further such refinancing transactions should be expected over the coming years.

FUNDING REVIEW (Continued)

As a consequence of the increased focus on retail deposit funding, the Group's warehouse capacity, which had been used to fund buy-to-let mortgage originations, was rationalised, reducing from £850.0 million at 30 September 2016 to £550.0 million at the year end, and further, to £350.0 million shortly thereafter. The remaining warehouse provides a standby capability and an alternative to retail deposit funding.

The reduction in the use of securitisation and warehouse facilities reduces the Group's requirement to provide credit enhancement in these structures and releases working capital funds to the Group, where it can be used more effectively.

While the Group has not issued new securitisation debt in the year, it expects to do so in future, on an strategic basis when market conditions are favourable.

Central bank facilities

In the previous year the Group first accessed the borrowing facilities offered by the Bank of England, which provide flexible, low-cost collateralised funding designed to reinforce the transition of low base rates to households and businesses. The Group drew down £108.8 million under the Funding for Lending Scheme ('FLS') to support lending to SMEs, which increased to £109.0 million at 30 September 2017. The terms of this facility are such that neither the drawing or the liquidity provided appear on the Group's balance sheet.

During the year the Group has made further use of Bank of England facilities, most significantly through drawings on the Term Funding Scheme ('TFS'), with mortgage loans offered as security. The interest cost of TFS is very attractive compared with either retail deposits or securitisation and repayment is due four years after the drawing, in 2021. The Group uses the TFS to support new lending, rather than for the repayment of other facilities and total drawings are subject to a regulatory limit.

In common with many UK institutions, the Group has made extensive use of this facility and drawings have increased to £700.0 million at the end of the period (2016: £nil). Assets already pre-positioned with the Bank of England potentially give access to a further £114.3 million and the Group intends to optimise its use of this facility until the end of the drawdown window in February 2018.

Funding for Idem Capital assets

Idem Capital has continued its funding strategy of financing smaller scale acquisitions from the Group's equity while keeping under review the opportunities to access retail funding for assets of appropriate quality and to introduce external funding when asset volumes and types make that economically appropriate.

Since 2015, Idem Capital has had a non-recourse funding facility with Citibank, which it uses to fund assets from time to time, releasing Group working capital. During the year drawings of £69.8 million were made on this facility.

Certain legacy assets, principally second charge mortgage balances are also funded through pre-credit crisis securitisation structures.

FUNDING REVIEW (Continued)

At 30 September 2017 the funding of the assets in the Idem Capital segment was distributed as shown below.

	2017 £m	2016 £m	2015 £m
Purchased assets by funding source			
External non-recourse funding	270.8	414.5	449.2
Retail deposit funding	247.0	250.6	-
Funded through Group resources	93.6	2.7	144.2
	611.4	667.8	593.4

This demonstrates the flexibility in the Group's funding for its debt purchase activities, and its ability to access third party and retail funding for appropriate transactions. This is particularly useful when bidding for performing portfolios, which the operation has targeted.

The assets funded through the Group also provide an opportunity to raise further liquidity, should it be needed.

Corporate funding

While the Group's working capital has primarily been provided by equity since 2008, in recent years it has strategically expanded its use of corporate debt funding, allowing it to diversify its funding base and extend the tenor of its borrowings.

During the year, the Group paid down the £110.0 million Corporate Bond which matured in April 2017. This means that all the Group's working capital debt funding has now been raised since the credit crisis.

The Group is rated by Fitch Ratings, and maintains its BBB- senior debt rating, with Fitch confirming this rating with a stable outlook on 13 April 2017. On 25 September 2017, Fitch stated that the Group's reorganisation has no immediate rating implications. The Group's £1.0 billion Euro Medium Term Note Programme announced in January 2013 remains in place and continues to form part of the Group's long-term funding strategy, although no issuance was made in the period.

FUNDING REVIEW (Continued)

A3.3.2 Capital management

The Group has reviewed its capital management and maintenance policies following its reorganisation. The primary reliance on retail deposit funding in the new model fundamentally changes the working capital cycle of the Group, reducing the variability in working capital demand and hence enabling a reduction in working capital levels relative to the size of the balance sheet.

The Group has continued to enjoy strong cash generation during the year. Available cash balances were £305.5 million at the year-end (30 September 2016: £383.1 million) (note 14) after investments in loan assets, share buy-backs and the repayment of the £110.0 million Corporate Bond. The Company sees opportunities to deploy capital to support organic growth and invest in portfolio purchases and potentially in further M&A opportunities, but recognises also the opportunity to return more of this cash to its shareholders.

Dividend and dividend policy

Following its review of capital, the Company has determined that it is appropriate to increase its normal level of dividends and will move from the previously announced policy of targeting a dividend cover ratio of 3.00 times, to 2.75 times in 2017 and then to 2.50 times in 2018, subject to the requirements of the business and the availability of cash resources.

To provide greater transparency, the Company has also indicated that in future its interim dividend per share will normally be 50% of the previous final dividend, in the absence of any indicators which might make such a level of payment inappropriate.

In determining the level of dividend for the year, the Board has considered the dividend policy, but has also taken into account the Group's strategy, capital requirements, principal risks the level of available retained earnings in the Company, its cash resources and the objective of enhancing shareholder value.

On this basis, the Board is proposing, subject to approval at the Annual General Meeting on 15 February 2018, a final dividend of 11.0 pence per share which, when added to the interim dividend of 4.7 pence, gives a total dividend of 15.7 pence per share for the year. This represents an increase of 16.3% from 2016, bringing the dividend cover to 2.75 times (2016: 3.0 times).

Regulatory capital

The Group is subject to supervision by the PRA on a consolidated basis, as a group containing an authorised bank. As part of this supervision, the regulator will issue individual capital guidance setting an amount of regulatory capital, defined under the international Basel III rules, implemented through the Capital Requirements Regulation and Directive ('CRD IV'), which the Group is required to hold relative to its risk weighted assets in order to safeguard depositors in the event of severe losses being incurred by the Group.

The Group maintains extremely strong capital and leverage ratios, with a capital ratio of 18.7% at 30 September 2017 (2016: 19.0%) and a UK leverage ratio at 6.6% (2016: 6.3%) (note 5) leaving the Group's capital at 30 September 2017 comfortably in excess of the regulatory requirement. The CET1 ratio, 15.9% at 30 September 2017, remained stable in the period, (2016: 15.9%), despite the effect of share buy-backs and dividends, as a result of the Group's profit in the period and the actuarial gain on the defined benefit pension plan. The Group's medium term CET1 target is 13.0%.

FUNDING REVIEW (Continued)

The Group notes the consultation paper issued by the Basel Committee on Banking Supervision ('BCBS') on 15 December 2015 regarding the proposed amendments to the Standardised Approach ('SA') for assessing the capital adequacy of institutions. The most material proposal for the Group relates to a potential increase in the risk weightings applicable to buy-to-let lending assets. The Group considers that the proposed risk weightings do not properly reflect the strong credit performance of the asset class in the UK and has engaged with both the PRA and the BCBS as part of the consultation process. The BCBS has also issued a consultation paper in March 2016, proposing revisions to the Internal Ratings Basis ('IRB') for assessing capital, which is based on firms' own internal calculations and subject to supervisory approval. The proposals may serve to limit the comparative advantage available to IRB users over SA users through the use of floors. Final announcements on the results of these consultations are still expected and the Group will be closely monitoring developments as they progress.

The Group also notes the steps taken by the PRA towards using its assessment of Pillar 2 capital to ameliorate the perceived capital advantage of IRB banks over those using the SA, which they regard as distortive to the market. The regulator published its final policy statement on this in October 2017, and the Group is considering its potential impact.

Notwithstanding the outcome of these consultations, the Group has substantial performance data and excellent credit metrics to support the adoption of an IRB approach for determining appropriate risk weightings for its buy-to-let mortgage assets. Other UK institutions currently using an IRB approach for their buy-to-let portfolios achieve materially lower risk weightings than the 35% required by the present SA, with PRA benchmark figures, most recently updated in October 2017, being typically in the low to mid-teen percentages.

In addition to the potential capital advantages from adopting the IRB approach, the Group sees broader business benefits from adopting the disciplines required by IRB as a core part of its risk management structure and it has continued to progress a project to prepare an application to the PRA to adopt an IRB in future. This will build on the Group's existing core competencies in credit risk and data handling and should lead to further enhancements in the internal risk governance framework.

The Group expects to be in a position to apply formally for IRB authorisation for its buy-to-let portfolio in early 2019. This will be the first portfolio for which authorisation is sought, with further asset classes being added on a phased basis to achieve the coverage required by the IRB rules.

Gearing and share buy-backs

The Group's reorganisation during the year, coupled with the strong capital base and low leverage in the Company's balance sheet, provide the opportunity for the business to reduce its over-reliance on equity capital, improving returns for shareholders. The future requirement to raise debt for liquidity purposes has been reduced by its access to retail deposit funding and the Group is able to take a long-term view of opportunities available to it in the corporate debt markets to optimise its funding, working capital and regulatory capital position over time.

At the same time the Company will carefully monitor any excess equity position and consider whether any adjustment is required, either through further changes in the dividend policy or through share buy-backs.

The reversal of the trend above from equity toward debt is a result of the raising of the 2016 Tier 2 Bond ahead of the repayment of the £110.0 million Corporate Bond, leading to an element of double funding across the previous year end.

In November 2014 the Group announced a share buy-back programme, which had been extended to £150.0 million by November 2016, and was subsequently extended to £165.0 million in July 2017.

FUNDING REVIEW (Continued)

The size of the programme is reviewed periodically to take account of anticipated investment opportunities and the balance of the Group's debt and equity capital resources. During the year the Group bought back 15.3 million of its ordinary shares at a cost of £65.5 million, (note 25), these shares being held in treasury. The Board intends to extend the programme by up to £50.0 million in the financial year ending 30 September 2018. These shares will also be initially held in treasury but may be cancelled subsequently.

The Company currently has the necessary shareholder approval to undertake such share buy-backs and will propose the appropriate renewal of the relevant authority at its 2018 Annual General Meeting, when a special resolution seeking authority for the Company to purchase up to 26.5 million of its own shares (10% of the issued share capital excluding treasury shares) will be put to shareholders.

Capital Outlook

The Board keeps under review the appropriate level of capital for the business to meet its operational requirements and strategic development objectives. The strength of its business lines, the diversification which has been achieved in the funding base in recent years and the further opportunities for growth and sustainability opened up by the group reorganisation, have now created the foundations upon which to develop the Group's next phase of growth.

MANAGEMENT REPORT

FINANCIAL REVIEW

The financial year ended 30 September 2017 saw the Group's underlying profit increase by 1.0% to £145.2 million (30 September 2016: £143.8 million) while on the statutory basis profit before tax increased by 1.1% to £144.8 million (30 September 2016: £143.2 million). Earnings per share increased by 6.4% to 43.1p (30 September 2016: 40.5p).

A3.4.1 Results for the year

CONSOLIDATED RESULTS
For the year ended 30 September 2017

	2017 £m	2016 £m
Interest receivable	409.2	411.4
Interest payable and similar charges	(176.6)	(188.2)
Net interest income	232.6	223.2
Net leasing income	3.0	3.0
Other income	17.2	17.8
Total operating income	252.8	244.0
Operating expenses	(102.3)	(92.5)
Provisions for losses	(5.3)	(7.7)
	145.2	143.8
Fair value net (losses)	(0.4)	(0.6)
Operating profit being profit on ordinary activities before taxation	144.8	143.2
Tax charge on profit on ordinary activities	(27.6)	(27.2)
Profit on ordinary activities after taxation	117.2	116.0

	2017	2016
Dividend – rate per share for the year	15.7p	13.5p
Basic earnings per share	43.1p	40.5p
Diluted earnings per share	41.9p	39.7p

Total operating income increased by 3.6% to £252.8 million (2016: £244.0 million). Within this, net interest income increased by 4.2% to £232.6 million from the £223.2 million recorded in the year ended 30 September 2016. The increase reflects growth in the size of the average loan book, which rose by 5.1% to £10,930.8 million (2016: £10,400.0 million).

Net interest margins ('NIM') in the year ended 30 September 2017 reduced marginally to 2.13% compared to the 2.15% in the previous year, driven by increased funding costs from the £150.0 million corporate bond issued in 2016, which attracted interest of £10.9 million in the year, reducing NIM by 0.10%. The Group expects NIM to expand by between 0.05% and 0.10% in 2018.

FINANCIAL REVIEW (Continued)

Other operating income was £20.2 million for the year, compared with £20.8 million in 2016. The reduction principally results from lower levels of third party servicing income, where previously serviced assets were acquired in the previous financial year, partly offset by broker income from the Premier business acquired on 30 September 2016.

Operating expenses increased by 10.6% to £102.3 million from £92.5 million reported in the previous year, partly reflecting the increase in the average number of employees to 1,317, a 5.4% rise (2016: 1,249) and the acquisition of Premier. The year has also seen significant investments in systems and personnel in order to support the launch of new projects and the expansion of existing business lines. This resulted in the overall cost:income ratio increasing to 40.5% from 37.9% for the corresponding period last year, although it remains significantly below the industry average.

The Board remains focused on controlling operating costs through the application of rigorous budgeting and monitoring procedures. Costs of between £105.0 million and £115.0 million are anticipated for the Group in 2018 and the Group expects the overall cost:income ratio to improve over time as acquired and start-up operations are integrated into the Group and it starts to see the benefits of income growth from its new and expanded operations.

The charge of £5.3 million for loan impairment has decreased from that for 2016 (2016: £7.7 million). As a percentage of average loans to customers the impairment charge remains broadly stable at 0.05% compared to 0.07% in 2016. The Group has seen favourable trends in arrears performance over the period, both in terms of new cases reducing and customers correcting past arrears, whilst increasing property values have served to reduce overall exposure to losses on enforcement of security. The loan books continue to be carefully managed and the credit performance of the buy-to-let book remains exemplary.

Yield curve movements during the period resulted in hedging instrument fair value net losses of £0.4 million (2016: £0.6 million net losses), which do not affect cash flow. The fair value movements of hedged assets or liabilities are expected to trend to zero over time, as such this item represents a timing difference. The Group remains economically and appropriately hedged.

Corporation tax has been charged at the rate of 19.1%, a broadly similar level compared with 19.0% for the previous year. For the next financial year, Paragon Bank is expected to reach the threshold for the Bank Tax Surcharge and will pay an additional 8% tax on the excess of its company profit over £25.0 million. This is expected to increase the Group’s overall tax charge.

Profits after taxation of £117.2 million (2016: £116.0 million) have been transferred to shareholders’ funds, which totalled £1,009.4 million at the year end (2016: £969.5 million), representing a tangible net asset value of £3.45 per share (2016: £3.12) and an unadjusted net asset value of £3.84 per share (2016: £3.50).

FINANCIAL REVIEW (Continued)

3.4.2 Segmental results

Following the group reorganisation in September 2017, the Group now analyses its results between three segments, which are the principal divisions for which performance is monitored:

- Mortgages, including the Group's buy-to-let, and owner-occupied first and second charge lending and related activities
- Commercial Lending, including the Group's motor finance and other equipment leasing activities, together with other offerings targeted towards SME customers
- Idem Capital, including loan assets acquired from third parties and legacy assets which share certain credit characteristics with them

The Group's central administration and funding costs, principally the costs of service areas, establishment costs, and bond interest have not been allocated.

Results for the year have been presented on the basis of the new segments and comparative amounts restated accordingly.

The underlying operating profits of these business segments are detailed fully in note 8 and are summarised below.

	2017 £m	2016 £m
Segmental profit		
Mortgages	143.3	133.2
Commercial Lending	14.1	9.0
Idem Capital	75.9	79.0
	233.3	221.2
Unallocated central costs	(88.1)	(77.4)
	145.2	143.8

Mortgages

Trading activity during the year in the Mortgages division was very strong, with the segmental profit at £143.3 million, up 7.6% from the previous year (2016: £133.2 million). This increase arose both from increases in the loan book and from improved funding costs as the business made more use of retail funding.

Commercial Lending

Segmental profit in Commercial Lending increased 56.7% in the year to £14.1 million (2016: £9.0 million) as the asset finance operation acquired in 2016 contributed a full year's activity to the results. The Premier brokerage business, acquired on 30 September 2016 also made its first contribution. Loan assets were substantially increased, especially in motor and asset finance, with the segment's loans to customers increasing 49.0% over the year.

FINANCIAL REVIEW (Continued)

Idem Capital

The Idem Capital division's portfolios continued to perform well in the year to 30 September 2017. However, the level of new investment was offset by the scale of reductions in the brought forward balance, reducing earnings marginally, which coupled with the reduction in third party servicing income noted above, reduced segment profit by 3.9% to £75.9 million (2016: £79.0 million).

A3.4.3 Assets and liabilities

SUMMARY BALANCE SHEET
30 September 2017

	2017 £m	2016 £m
Intangible assets	104.4	105.5
Investment in customer loans	11,124.1	10,737.5
Derivative financial assets	906.6	1,366.4
Free cash	305.5	383.1
Other cash	1,191.4	854.5
Other assets	50.2	71.4
Total assets	13,682.2	13,518.4
Equity	1,009.4	969.5
Retail deposits	3,615.4	1,873.9
Borrowings	8,927.2	10,502.6
Pension deficit	29.8	58.4
Other liabilities	100.4	114.0
Total equity and liabilities	13,682.2	13,518.4

The Group's loan assets include:

- Buy-to-let and owner-occupied first mortgage assets in the Mortgages segment
- Second charge mortgages, with new originations in Mortgages and purchased and similar legacy assets in Idem Capital
- Other unsecured consumer lending in Idem Capital
- Asset finance and motor finance loans in the Commercial Lending segment
- Development finance loans in the Commercial Lending segment

FINANCIAL REVIEW (Continued)

The allocation of these loan assets between segments is set out below:

	2017 £m	2016 £m
Mortgages	9,953.9	9,694.7
Commercial Lending	558.8	375.0
Idem Capital	611.4	667.8
	11,124.1	10,737.5

An analysis of the Group's financial assets by type is shown in note 16. Movements in the Group's loan asset balances are discussed in the lending review section.

Movements in derivative financial assets arise principally as a result of the effect of changes in exchange rates on instruments forming cash flow hedges for the Group's floating rate notes. These movements do not impact on the Group's results.

Cash flows from the Group's securitisation vehicle companies and the acquired portfolios remain strong. These, together with debt raisings, financed further investments in loan portfolios, the capital requirements of Paragon Bank and credit enhancement for mortgage originations. Cash was also utilised in the share buy-back programme, which commenced during December 2014 and where £166.2 million (including costs) had been deployed by 30 September 2017. Free cash balances were £305.5 million at 30 September 2017 (2016: £383.1 million) following the repayment of the Group's £110.0 million corporate bond in the year.

Movements in the Group's funding are discussed in the funding review section.

The accounting value of the deficit in the Group's defined benefit pension plan has reduced significantly over the year ended 30 September 2017. The triennial valuation of the Plan was completed in the period and the actual experience of the scheme membership over the three years ended 31 March 2016 was incorporated into the valuation under the International Accounting Standard ('IAS') 19. Gilt yields also increased over the year and together these resulted in the deficit under IAS 19 falling to £29.8 million (2016: £58.4 million). A corresponding actuarial gain of £29.0 million before tax was recognised in other comprehensive income (2016: loss of £37.2 million).

While the valuation under IAS 19 is that which is required to be disclosed in the accounts, pension trustees generally use the technical provisions basis as provided in the Pensions Act 2004 to measure scheme liabilities. On this basis, the valuation at the triennial valuation date was £18.0 million and this had reduced to £14.9 million at 30 September 2017, representing an 87.0% funding level.

OPERATIONAL REVIEW

A3.5.1 Management and people

The Group has always recognised that its people are its most important asset and are key to its future growth and development. The learning and development of its employees, together with a rigorous recruitment process are a key part of the Group's organic growth strategy and underpins the strong progress it has made. It retains its Gold Investor in People status, reflecting the quality of its internal processes, and during the year has continued to act, by invitation, as an Investor in People Champion, sharing its experience with other businesses. This places it in the top 1% of companies in the UK for people development.

The Group prides itself on the fact that its people remain with it for a long time. Its annual employee attrition rate of 13.2% is below the national average and 28.8% of its people have over ten years service, with 9.3% having achieved over 20 years with the Group. We believe this is due to providing quality development opportunities and creating a place where people want to work, which has meant that knowledge and experience have been retained in each of our specialist areas. We believe our people are well positioned to support the Group's future growth strategy.

The Group is proud to have signed the Women in Finance Charter, sponsored by HM Treasury, during the year. The Charter's objectives reflect the Group's own aspirations in the field of gender diversity and the Group published its targets under the Charter during the year.

The Group is making good progress and will issue its first report under the Charter in January 2018. The Group notes the publication of the Hampton-Alexander ('HA') review on gender diversity during the year. The Group believes that its Women in Finance objectives are consistent with the review's recommendation and notes that its proportion of female senior managers at the year end, as defined by HA, was 31.4% (2016: 29.2%).

The Group has calculated its gender pay gap at April 2017, as required by law. This calculation shows that median female pay in the Group was 30.4% less than the median male pay. This is broadly in line with the results reported by the few financial services companies to publish their results so far and narrower than the 33.7% gap for the sector reported by the Office of National Statistics in their Annual Survey of Hours and Earnings published in October 2017.

The Group will be analysing its gender pay gap data as part of its Women in Finance initiative to determine if there are areas where urgent action is required, but preliminary results suggest where groups of similar positions exist, there is no evidence of systematic gender bias on pay.

During the year, as part of the preparations for the Group reorganisation, the Board, initially through the Nomination Committee, gave in depth consideration to the appropriate Board and governance structure for the reorganised Group. It concluded that it was appropriate to invite two independent non-executive directors of the Bank, Patrick Newberry and Finlay Williamson, to join the Board and to appoint two additional non-executive directors, particularly looking to increase the Board's experience and skills in retail banking and risk, as well as improving the Board's diversity.

As a result, Barbara Ridpath and Graeme Yorston, together with the two Bank directors, joined the Board on 20 September 2017. The four newly appointed directors bring a wealth of experience to the Board, including retail banking experience.

Barbara brings listed PLC experience and a strong financial background as well as experience in operational risk and financial ethics, having worked for the Federal Reserve Bank of New York, Standard & Poor's and JP Morgan. She is currently a Director of St Paul's Institute which examines moral and ethical aspects of finance and economics, and a non-executive director of ORX, a trade association for operational risk professionals.

OPERATIONAL REVIEW (Continued)

Graeme is a former Chief Executive of the Principality Building Society, which operates in many of the same markets as the Group. He has over 43 years experience in the financial services industry and held a number of senior roles with Abbey National including leading IT, change management and call centre activities. His experience will enhance the Board's understanding of operational and customer issues in retail banking.

In appointing Patrick Newberry and Finlay Williamson to the Board, their experience of seeing the Bank through its early development, the launch of its various product lines and the establishment of its relationship with the regulator, is retained. This will be of great value to the Board in its strategic considerations for future developments. Patrick and Finlay also have a broad knowledge of the Group's operations which will enable them to contribute strongly to the Board immediately.

Before joining the Paragon Bank board, Patrick spent 25 years with PricewaterhouseCoopers as a consulting and regulatory partner, focusing on the financial services industry, adding to the Board's regulatory experience. Finlay is a former Finance Director of Virgin Money, having previously held a number of senior finance roles in The Royal Bank of Scotland Group. He brings significant experience of finance, management and accounting in the UK retail banking industry to the Group.

The Group's succession planning strategy has also been an important area of focus during the year, with all Board and executive management roles together with their direct reports identified from a leadership and specialist perspective. Immediate successors are in place for these roles for the short term to provide business continuity and longer term succession plans are being developed for those with career aspirations and strong potential. This area will remain a priority for the Board, with the assistance of the Nomination Committee, during the forthcoming year.

A3.5.2 Risk

The effective management of risk is crucial to the achievement of the Group's strategic objectives. It operates a risk governance framework, designed around a formal three lines of defence model (business areas, Risk and Compliance function and Internal Audit) supervised at Board level.

The Risk Management framework was reviewed in detail during the year as part of the preparations for the Group's internal reorganisation. In particular, the Board reviewed its procedure for setting and managing risk appetites, together with the risk appetites themselves.

The first line of defence has continued to exercise effective control of the risks arising from the Group's operational activities. Supported by the Risk and Compliance function, further progress has been made in the year by business areas in embedding the Group's risk management framework, including enhancements to risk event reporting, risk and control self-assessments and the development of key risk indicators.

The Group has continued to strengthen its second line risk management capabilities including in areas such as cyber security risk, credit risk modelling and data protection. The Risk and Compliance division now includes dedicated functions responsible for the oversight of Credit Risk, Property Risk, Compliance and Conduct Risk, Operational Risk, IT and Cyber Security, and Financial Crime. To progress its objective of obtaining regulatory approval for the implementation of an IRB approach to credit risk, the Risk and Compliance function also has a Director of IRB and supporting specialist resource.

As part of the Group's reorganisation, the former Group and Bank Risk and Compliance functions were integrated, helping to remove unnecessary duplication and thereby maximise the effectiveness of the second line of defence.

OPERATIONAL REVIEW (Continued)

The principal challenges in the risk environment faced by the Group during the year include:

- The potential impact of the proposals on capital regulation from the BCBS
- Execution and transitional risks arising from the recent major internal reorganisation
- The impact of continuing uncertainty as to the terms on which the UK will leave the EU in March 2019
- The impact of fiscal changes on the demand for buy-to-let mortgages in the UK
- Changes in the regulatory environment relating to the underwriting of buy-to-let mortgages
- Continuing transitional risks arising from the integration and expansion of the acquired Asset Finance business
- Heightened cyber-security risks as a result of the increasing sophistication and frequency of cyber-attacks affecting the financial services sector
- Major regulatory developments including the implementation of the fourth Money Laundering Directive and the impending implementation of the General Data Protection Regulation ('GDPR')

The Group continues to closely monitor its exposure to current and emerging risks as they develop and considers itself well placed to mitigate their impact.

A3.5.3 Regulation

The Bank is authorised by the PRA and regulated by the PRA and the FCA. The Group is subject to consolidated supervision by the PRA and a number of its subsidiaries are authorised and regulated by the FCA. As a result, current and projected regulatory changes, particularly revisions to the Basel supervisory regime, continue to pose a significant risk for the Group. The governance and risk management framework within the Group has therefore been developed to ensure that the impacts of all new regulatory requirements are clearly understood and mitigated as far as possible. Regular reports on key regulatory developments are received at both executive and board risk committees.

Whilst the Group is impacted by a broad range of prudential and conduct regulations, given the nature of its operation, the following are of particular note:

- The PRA completed the implementation of major policy changes to underwriting standards for buy-to-let mortgage contracts during 2017. These require firms to assess whether the rental income derived from the mortgaged property is sufficient to support the monthly interest cost of the loan payments using an interest coverage ratio ('ICR') test. In addition, supplementary underwriting requirements apply for "portfolio landlords" which the PRA has defined as borrowers with four or more distinct, mortgaged, buy-to-let properties. As a result of its extensive experience within the buy-to-let sector and its historically conservative approach to underwriting, the Group was able to begin operating in line with the new requirements well ahead of the regulatory deadline

OPERATIONAL REVIEW (Continued)

- In March 2017, the FCA issued a policy statement to complete the consultation process regarding Payment Protection Insurance ('PPI') that it began in 2015. This included setting a deadline of 29 August 2019 by which consumers will need to make PPI complaints and new rules and guidance on the handling of PPI complaints. The Group has assessed the operational and financial implications arising from the policy statement which it does not consider to be material
- The PRA has updated its supervisory statement setting out the approach to strengthening individual accountability in banking under the Senior Managers Regime ('SMR'). Whilst the Bank has fully implemented the regime, the Group is conscious of its extension to other Financial Services and Markets Acts firms with effect from 2018. It is therefore taking appropriate steps to ensure it is able to comply with the requirements
- In June 2017, the PRA published a policy statement on IRB residential mortgage risk weights. This has been incorporated into the Group's IRB project approach
- In July 2017, the PRA published the results of its review of consumer credit lending, expressing concern that firms' credit models might not always fully consider a borrower's total indebtedness nor how their ability to repay could be affected in the future. The Group has reviewed its approach in this area and is confident with the robustness of its assessment processes and controls
- The GDPR will come into force with effect from May 2018 and represents the most significant revision to data protection legislation for several decades. The Group is therefore taking appropriate steps to ensure it will be compliant with the new legislation by the required deadline

Whilst the Group along with the rest of the UK corporate sector does not have clear visibility on potential regulatory changes that may be introduced following the UK's decision to leave the EU, it does not have any EU passporting issues that need to be considered.

CONCLUSION

In recent years Paragon's business model has undergone significant change as it transitioned from a non-bank monoline lender into a retail funded banking group. A diversification strategy has led to the development of six new lending product lines within three years and the formation of a bank to establish a deposit funding franchise, which in 2017 saw balances exceed £3.6 billion. The transition of the model developed further this year with the structural reorganisation, which effectively saw the Bank re-positioned at the top of the Group subsuming virtually all the business' assets and liabilities. This structure has provided numerous immediate benefits to the operating model and will improve funding efficiencies and capital mobility over time. The business is now better positioned to exploit the increasing opportunities in the UK retail banking market as it structurally shifts in favour of specialist lenders which can display a greater understanding of the markets, products and customers they serve.

In 2017 Paragon has, alongside this transition, witnessed strong growth across all products with total lending increasing by 29% to £1.9 billion. Buy-to-let lending benefitted from the increased professionalisation of the sector, a trend that is expected to continue following further regulatory change. Commercial Lending also experienced strong growth following investment in technology and distribution in the year. Notwithstanding this growth, and the benign credit environment, the Group is maintaining a firm discipline on risk and pricing, being cognizant of the potential for more uncertain times ahead.

With a strong capital base, exemplary asset quality, increasingly diversified funding, and a broadening product range supported by a more financially efficient operating model, the Group is well positioned to exploit the opportunities and manage the challenges ahead.

PRINCIPAL RISKS

There are a number of potential risks and uncertainties to which the Group is exposed and which could impact significantly on its ability to conduct its business successfully. In the opinion of the directors these have not changed materially from those described in section A2.2 of the last annual report and accounts of the Company for the year ended 30 September 2016. These are summarised below.

Category	Risk	Description
Business	Economic	The Group could be materially affected by a severe downturn in the UK economy given its income is wholly derived from activities within the UK. This is more difficult to forecast given current uncertainties on the terms on which the UK will leave the EU in March 2019. This could reduce demand for the Group's loan products, increase the number of customers that default on their loans and cause security asset values to fall.
	Concentration	The Group's business plans could be particularly affected by any downturn in the performance of the UK private rented sector and / or further regulatory intervention to control buy-to-let lending.
	Transition	Failure to manage major internal reorganisations or integrate acquired businesses safely and effectively could adversely affect the Group's business plans and damage its reputation.
Credit	Customer	Failure to target and underwrite credit decisions effectively could result in customers becoming less able to service debt, exposing the Group to unexpected material losses.
	Counterparty	Failure of an institution holding the Group's cash deposits or providing hedging facilities for risk mitigation could expose the Group to loss or liquidity issues.
Conduct	Fair outcomes	Failure to deliver fair outcomes for its customers could impact on the Group's reputation and its financial performance.
Operational	People	Failure to attract or retain appropriately skilled key employees at all levels could impact upon the Group's ability to deliver its business plans and strategic objectives.
	Systems	The inability of the Group's systems to support its business operations effectively and/or guard against cyber security risks could result in reputational damage and financial loss.
	Regulation	Given the highly regulated sectors in which the Group operates, compliance failures or failures to respond effectively to new and emerging regulatory and legal developments could result in reputational damage and financial loss.
Liquidity and Capital	Funding	If access to funding became restricted, either through market movements or regulatory intervention, this might result in the scaling back or cessation of some business lines.
	Capital	Proposals by the BCBS to change capital requirements for lending secured on residential property could have adverse financial implications for the Group.

PRINCIPAL RISKS (Continued)

Category	Risk	Description
Market	Interest rates	Reduction in margins between market lending and borrowing rates or mismatches in the Group balance sheet could impact profits.
Pension Obligation	Pensions	The obligation to support the Group's defined benefit pension plan might deplete resources.

The Group has considered and responded to all of these risks, mitigating the exposure as far as is practicable to ensure that its risk profile remains within the Board's stated risk appetite.

STATEMENT OF DIRECTORS' RESPONSIBILITES
in relation to financial statements

The responsibility statement below has been prepared in connection with the full annual accounts of the Company for the year ended 30 September 2017. Certain parts of these accounts are not presented within this announcement.

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations. The directors are required to prepare accounts for the Group in accordance with IFRS and have also elected to prepare company financial statements in accordance with IFRS. In respect of the financial statements for the year ended 30 September 2017, company law requires the directors to prepare such financial statements in accordance with IFRS, the Companies Act 2006 and Article 4 of the IAS Regulation.

International Accounting Standard 1 – 'Presentation of Financial Statements' requires that financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the Preparation and Presentation of Financial Statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRS. Directors are also required to:

- Properly select and apply accounting policies
- Make an assessment of the Group's and the Company's ability to continue as a going concern
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information
- Provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance

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

The directors are responsible for keeping adequate accounting records which disclose with reasonable accuracy at any time the financial position of the Company, for safeguarding the assets, for the Group's systems of internal control, as described in B3.1, and for taking reasonable steps for the prevention and detection of fraud and other irregularities. They are also responsible for the preparation of a strategic report, directors' report, directors' remuneration report and corporate governance statement which comply with the applicable requirements of the Companies Act 2006.

The directors are responsible for the maintenance and integrity of the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

STATEMENT OF DIRECTORS' RESPONSIBILITES
in relation to financial statements (Continued)

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

- The financial statements, prepared in accordance with IFRS as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and of the Group taken as a whole
- The Directors' Report, including those other sections of the Annual Report incorporated by reference, comprises a management report for the purposes of the Disclosure and Transparency Rules, which includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face
- The Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy

Approved by the Board of Directors and signed on behalf of the Board.

PANDORA SHARP

Company Secretary

23 November 2017

Board of Directors

R G Dench	A K Fletcher	P J Newberry
N S Terrington	P J N Hartill	B A Ridpath
R J Woodman	F J Clutterbuck	F F Williamson
J A Heron	H R Tudor	G H Yorston

CONSOLIDATED INCOME STATEMENT
For the year ended 30 September 2017

	Note	2017 £m	2017 £m	2016 £m	2016 £m
Interest receivable	9		409.2		411.4
Interest payable and similar charges	10		(176.6)		(188.2)
Net interest income			232.6		223.2
Other leasing income		14.4		13.0	
Related costs		(11.4)		(10.0)	
Net leasing income		3.0		3.0	
Other income	11	17.2		17.8	
Other operating income			20.2		20.8
Total operating income			252.8		244.0
Operating expenses			(102.3)		(92.5)
Provisions for losses	17		(5.3)		(7.7)
Operating profit before fair value items			145.2		143.8
Fair value net (losses)	12		(0.4)		(0.6)
Operating profit being profit on ordinary activities before taxation			144.8		143.2
Tax charge on profit on ordinary activities			(27.6)		(27.2)
Profit on ordinary activities after taxation for the financial year			117.2		116.0

	Note	2017	2016
Earnings per share			
- basic	13	43.1p	40.5p
- diluted	13	41.9p	39.7p

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
For the year ended 30 September 2017

	Note	2017 £m	2017 £m	2016 £m	2016 £m
Profit for the year			117.2		116.0
Other comprehensive income					
Items that will not be reclassified subsequently to profit or loss					
Actuarial gain / (loss) on pension scheme	22	29.0		(37.2)	
Tax thereon		(5.5)		6.8	
			23.5		(30.4)
Items that may be reclassified subsequently to profit or loss					
Cash flow hedge gains taken to equity		0.5		5.0	
Tax thereon		(0.1)		(1.0)	
			0.4		4.0
Other comprehensive income for the year net of tax			23.9		(26.4)
Total comprehensive income for the year			141.1		89.6

CONSOLIDATED BALANCE SHEET
30 September 2017

	Note	2017 £m	2016 £m	2015 £m
Assets				
Cash – central banks	14	615.0	315.0	286.0
Cash – retail banks	14	881.9	922.6	770.0
Short term investments	15	-	7.1	41.1
Loans to customers	16	11,115.4	10,750.0	10,067.6
Investments in structured entities		-	-	18.1
Derivative financial assets	18	906.6	1,366.4	660.1
Sundry assets		12.7	12.7	6.2
Property, plant and equipment		46.2	39.2	22.1
Intangible assets	19	104.4	105.4	7.7
Total assets		13,682.2	13,518.4	11,878.9
Liabilities				
Short term bank borrowings		0.6	1.2	0.7
Retail deposits	20	3,611.9	1,874.7	708.7
Derivative financial liabilities	18	7.1	15.8	6.7
Asset backed loan notes	21	6,475.8	8,374.1	8,274.6
Secured bank borrowings	21	1,306.0	1,573.0	1,425.4
Retail bond issuance		295.7	295.3	294.9
Corporate bond issuance		149.1	259.0	110.0
Central bank facilities	21	700.0	-	-
Sundry liabilities		74.6	78.7	43.1
Current tax liabilities		17.4	16.7	12.5
Deferred tax liabilities		4.8	2.0	11.3
Retirement benefit obligations	22	29.8	58.4	21.5
Total liabilities		12,672.8	12,548.9	10,909.4
Called up share capital	23	281.5	295.9	309.3
Reserves	24	811.0	736.1	760.2
Own shares	25	(83.1)	(62.5)	(100.0)
Total equity		1,009.4	969.5	969.5
Total liabilities and equity		13,682.2	13,518.4	11,878.9

Approved by the Board of Directors on 23 November 2017.

Signed on behalf of the Board of Directors

N S Terrington
Chief Executive

R J Woodman
Chief Financial Officer

CONSOLIDATED CASH FLOW STATEMENT
For the year ended 30 September 2017

	Note	2017 £m	2016 £m
Net cash generated by operating activities	27	1,474.7	865.2
Net cash generated / (utilised) by investing activities	28	3.2	(278.6)
Net cash (utilised) by financing activities	29	(1,218.0)	(405.5)
Net increase in cash and cash equivalents		259.9	181.1
Opening cash and cash equivalents		1,236.4	1,055.3
Closing cash and cash equivalents		1,496.3	1,236.4
Represented by balances within:			
Cash		1,496.9	1,237.6
Short term bank borrowings		(0.6)	(1.2)
		1,496.3	1,236.4

CONSOLIDATED STATEMENT OF MOVEMENT IN EQUITY
For the year ended 30 September 2017

Year ended 30 September 2017

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Cash flow hedging reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m
Transactions arising from								
Profit for the year	-	-	-	-	-	117.2	-	117.2
Other comprehensive income	-	-	-	-	0.4	23.5	-	23.9
Total comprehensive income	-	-	-	-	0.4	140.7	-	141.1
Transactions with owners								
Dividends paid (note 26)	-	-	-	-	-	(38.0)	-	(38.0)
Shares cancelled	(15.0)	-	15.0	-	-	(45.1)	45.1	-
Own shares purchased	-	-	-	-	-	-	(69.7)	(69.7)
Shares issued to ESOP	-	-	-	-	-	-	-	-
Exercise of share awards	0.6	0.9	-	-	-	(4.0)	4.0	1.5
Charge for share based remuneration	-	-	-	-	-	4.2	-	4.2
Tax on share based remuneration	-	-	-	-	-	0.8	-	0.8
Net movement in equity in the year	(14.4)	0.9	15.0	-	0.4	58.6	(20.6)	39.9
Opening equity	295.9	64.6	13.7	(70.2)	2.1	725.9	(62.5)	969.5
Closing Equity	281.5	65.5	28.7	(70.2)	2.5	784.5	(83.1)	1,009.4

CONSOLIDATED STATEMENT OF MOVEMENT IN EQUITY (Continued)
For the year ended 30 September 2017

Year ended 30 September 2016

	Share capital	Share premium	Capital redemption reserve	Merger reserve	Cash flow hedging reserve	Profit and loss account	Own shares	Total equity
	£m	£m	£m	£m	£m	£m	£m	£m
Transactions arising from								
Profit for the year	-	-	-	-	-	116.0	-	116.0
Other comprehensive income	-	-	-	-	4.0	(30.4)	-	(26.4)
Total comprehensive income	-	-	-	-	4.0	85.6	-	89.6
Transactions with owners								
Dividends paid (note 26)	-	-	-	-	-	(33.9)	-	(33.9)
Shares cancelled	(13.7)	-	13.7	-	-	(94.0)	94.0	-
Own shares purchased	-	-	-	-	-	-	(59.9)	(59.9)
Shares issued to ESOP	0.3	-	-	-	-	-	(0.3)	-
Exercise of share awards	-	-	-	-	-	(3.7)	3.7	-
Charge for share based remuneration	-	-	-	-	-	4.4	-	4.4
Tax on share based remuneration	-	-	-	-	-	(0.2)	-	(0.2)
Net movement in equity in the year	(13.4)	-	13.7	-	4.0	(41.8)	37.5	-
Opening equity	309.3	64.6	-	(70.2)	(1.9)	767.7	(100.0)	969.5
Closing Equity	295.9	64.6	13.7	(70.2)	2.1	725.9	(62.5)	969.5

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

1. GENERAL INFORMATION

The financial information set out in the announcement does not constitute the Company's statutory accounts for the years ended 30 September 2015, 30 September 2016 or 30 September 2017, but is derived from those statutory accounts, which have been reported on by the Company's auditors. Statutory accounts for the years ended 30 September 2015 and 30 September 2016 have been delivered to the Registrar of Companies and those for the year ended 30 September 2017 will be delivered to the Registrar following the Company's Annual General Meeting. The reports of the auditors in each case were unqualified, did not draw attention to any matters by way of emphasis and did not contain an adverse statement under sections 498(2) or 498(3) of the Companies Act 2006.

Sections of this preliminary announcement, including but not limited to the Management Report, may contain forward-looking statements with respect to certain of the plans and current goals and expectations relating to the future financial condition, business performance and results of the Group. These have been made by the directors in good faith using information available up to the date on which they approved this report. By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of the Group and depend upon circumstances that may or may not occur in the future. There are a number of factors that could cause actual future financial conditions, business performance, results or developments to differ materially from the plans, goals and expectations expressed or implied by these forward-looking statements and forecasts. Nothing in this document should be construed as a profit forecast.

Copies of the Annual Report and Accounts for the year ended 30 September 2017 will be distributed to shareholders in due course. Copies of this announcement can be obtained from the Company Secretary, Paragon Banking Group PLC at 51 Homer Road, Solihull, West Midlands, B91 3QJ and on the Group's website at www.paragonbankinggroup.co.uk.

2. CHANGE OF PRESENTATION

During September 2017, the Group underwent an internal reorganisation, as a result of which the majority of the Group's activity is now undertaken through its banking subsidiary, Paragon Bank PLC ('The Bank') and other entities falling within the scope of banking regulation. Following this reorganisation, the directors concluded that the financial statements of the Group should be presented in a way which enhances comparability with other banking entities.

The changes made affect presentation only and the Group's accounting policies and its reported assets, liabilities, equity, profits and cash flows in preceding years remain as previously disclosed.

The new Group structure also affects the segments reported by the Group under International Financial Reporting Standard 8 – 'Operating Segments' and in these financial statements new segments, reflecting the new organisational structure, have been adopted, as described in note 8. As required by IFRS 8, comparative disclosures on the basis of the new segments have been provided.

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

3. ACCOUNTING POLICIES

The annual financial statements of the Group for the year ended 30 September 2017 have been prepared in accordance with International Financial Reporting Standards ('IFRS') as adopted for use in the European Union. Accordingly, the preliminary financial information has been prepared in accordance with the recognition and measurement criteria of IFRS. Except as noted below, the particular accounting policies adopted are those described in the Annual Report and Accounts of the Group for the year ended 30 September 2016.

The critical accounting estimates and judgements affecting the condensed financial information are the same as those described in note 6 to the accounts of the Group for the year ended 30 September 2016.

New and revised reporting standards

No new or revised reporting standards significantly affecting the Group's accounting have been issued since the approval of the Group's financial statements for the year ended 30 September 2016.

The Group's IFRS 9 project, described in note 2 of those financial statements, continues to make progress towards the Group's implementation date for the standard of 1 October 2018. A more detailed report on progress will be given in the Annual Report and Accounts for the year ending 30 September 2017.

Going concern

The business activities of the Group, its current operations and those factors likely to affect its future results and development, together with a description of its financial position and funding position, are described in the Management Report. The principal risks and uncertainties affecting the Group are described on pages 36 and 37.

Note 6 to the accounts for the year ended 30 September 2016 includes an analysis of the Group's working and regulatory capital position and policies, while note 7 includes a detailed description of its funding structures, its use of financial instruments, its financial risk management objectives and policies and its exposure to credit, interest rate and liquidity risk. Critical accounting estimates affecting the results and financial position disclosed in that annual report are discussed in note 5. The position and polices described in these notes remain materially unchanged to the date of this preliminary announcement.

The Group has a formalised process of budgeting, reporting and review. The Group's planning procedures forecast its profitability, capital position, funding requirement and cash flows. Detailed annual plans are produced for two year periods with longer term forecasts covering a five year period, which include detailed income forecasts. These plans provide information to the directors which is used to ensure the adequacy of resources available for the Group to meet its business objectives, both on a short term and strategic basis.

The Group's securitisation funding structures ensure that both a substantial proportion of its originated loan portfolio and a significant amount of its acquired Idem Capital assets are match-funded. Repayment of the securitisation borrowings is restricted to funds generated by the underlying assets and there is limited recourse to the Group's general funds. Recent and current loan originations utilising the Group's available warehouse facilities are refinanced through securitisation or retail deposits from time to time.

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

3. ACCOUNTING POLICIES (CONTINUED)

The Group's retail deposits of £3,615.4 million (note 20), accepted through Paragon Bank are repayable within five years, with 61.3% of this balance (£2,215.7 million) payable within twelve months of the balance sheet date. The liquidity exposure represented by these deposits is monitored; a process supervised by the Asset and Liability Committee. The Group is required to hold liquid assets in Paragon Bank to mitigate this liquidity risk. At 30 September 2017 Paragon Bank held £615.0 million of balance sheet assets for liquidity purposes, in the form of central bank deposits (note 21). A further £109.0 million of liquidity was provided by the Bank of England FLS, bringing the total to £724.0 million.

Paragon Bank manages its liquidity in line with the Board's risk appetite and the requirements of the PRA, which are formally documented in the Board's approved Individual Liquidity Adequacy Assessment Process ('ILAAP'). The Bank maintains a liquidity framework that includes a short to medium term cash flow requirement analysis, a longer term funding plan and access to the Bank of England's liquidity insurance facilities, where an additional £84.1 million has been pre-positioned.

The earliest maturity of any of the Group's working capital debt is in December 2020, when the oldest of the Group's retail bond issues matures.

The Group's cash analysis continues to show strong free cash balances, even after allowing for significant discretionary cash flows, and its securitisation investments produce significant cash flows.

The Group has demonstrated its ability to raise retail and corporate bond debt when required through its Euro Medium Term Note Programme and other programmes. The Group's access to debt is also enhanced by its corporate BBB- rating, reaffirmed by Fitch Ratings in the year, and its status as an issuer is evidenced by the BB+ rating of its £150.0m Tier-2 bond issue.

At 30 September 2017, the Group had free cash balances of £305.5 million immediately available for use (note 14).

In order to assess the appropriateness of the going concern basis the directors considered the Group's financial position, the cash flow requirements laid out in its forecasts, its access to funding, the assumptions underlying the forecasts and the potential risks affecting them.

After performing this assessment, the directors concluded that it was appropriate for them to continue to adopt the going concern basis in preparing the Annual Report and Accounts.

4. FAIR VALUES OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

IFRS 7 – 'Financial Instruments: Disclosures' requires that where assets are measured at fair value these measurements should be classified using a fair value hierarchy reflecting the inputs used, and defines three levels.

- Level 1 measurements are unadjusted market prices
- Level 2 measurements are derived from observable data, such as market prices or rates
- Level 3 measurements rely on significant inputs which are not derived from observable data

As quoted prices are not available for level 2 and 3 measurements, the valuation is derived from cash flow models based, where possible, on independently sourced parameters. The accuracy of the calculation would therefore be affected by unexpected market movements or other variances in the operation of the models or the assumptions used.

The Group had no financial assets or liabilities in the year ended 30 September 2017 or the year ended 30 September 2016 valued using level 3 measurements.

The Group has not reclassified any of its measurements during the year.

The methods by which fair value is established for each class of financial assets and liabilities is set out below.

a) Assets and liabilities carried at fair value

Derivative financial assets and liabilities

Derivative financial instruments are stated at their fair values in the accounts. The Group uses a number of techniques to determine the fair values of its derivative assets and liabilities, for which observable prices in active markets are not available. These are principally present value calculations based on estimated future cash flows arising from the instruments, discounted using a risk adjusted interest rate. The principal inputs to these valuation models are LIBOR benchmark interest rates for the currencies in which the instruments are denominated, sterling, euros and dollars. The cross currency basis swaps have a notional principal related to the outstanding currency borrowings and therefore the estimated rate of repayment of these notes also affects the valuation of the swaps. In order to determine the fair values the management applies valuation adjustments to observed data where that data would not fully reflect the attributes of the instrument being valued, such as particular contractual features or the identity of the counterparty. The management reviews the models used on an ongoing basis to ensure that the valuations produced are reasonable and reflect all relevant factors. These valuations are based on market information and they are therefore classified as level 2 measurements.

Short term investments

The short term investments described in note 15 are freely traded securities for which a market price quotation is available and are classified as level 1 measurements.

4. FAIR VALUES OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

b) Assets and liabilities carried at amortised cost

Cash, bank loans and securitisation borrowings

The fair values of cash and cash equivalents, bank loans and overdrafts and asset backed loan notes, which are carried at amortised cost are considered to be not materially different from their book values. In arriving at that conclusion market inputs have been considered but because all the assets mature within three months of the year end and the interest rates charged on financial liabilities reset to market rates on a quarterly basis, little difference arises. This also applies to the parent company's loans to its subsidiaries.

While the Group's asset backed loan notes are listed, the quoted prices for an individual note may not be indicative of the fair value of the issue as a whole, due to the specialised nature of the market in such instruments and the limited number of investors participating in it and an adjustment is required. As these valuation exercises are not wholly market based they are considered to be level 2 measurements.

Corporate debt

The Group's retail and corporate bonds are listed on the London Stock Exchange and there is presently a reasonably liquid market in the instruments. It is therefore appropriate to consider that the market price of these borrowings constitutes a fair value. As this valuation is based on a market price, it is considered to be a level 1 measurement.

Retail deposits

To assess the likely fair value of the Group's retail deposit liabilities, the directors have considered the estimated cash flows expected to arise based on a mixture of market based inputs, such as rates and pricing and non-market based inputs such as redemption rates. Given the mixture of observable and non-observable inputs, these are considered to be level 2 measurements.

Loan assets

To assess the likely fair value of the Group's loan assets in the absence of a liquid market, the directors have considered the estimated cash flows expected to arise from the Group's investments in its loans to customers based on a mixture of market based inputs, such as rates and pricing and non-market based inputs such as redemption rates. Given the mixture of observable and non-observable inputs these are considered to be level 2 measurements.

Sundry assets and liabilities

Fair values of financial assets and liabilities disclosed as sundry assets and sundry liabilities are not considered to be materially different to their carrying values.

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

4. FAIR VALUES OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES (CONTINUED)

The fair values for financial assets and liabilities held at amortised cost, other than those where carrying values are so low that any difference would be immaterial, determined in accordance with the methodologies set out above is summarised below.

	2017 Carrying amount £m	2017 Fair value £m	2016 Carrying amount £m	2016 Fair value £m
Financial assets				
Loans and receivables				
Loans to customers	11,124.1	11,191.9	10,737.5	10,754.4
Cash	1,496.9	1,496.9	1,237.6	1,237.6
	12,621.0	12,688.8	11,975.1	11,992.0
Financial liabilities				
Other liabilities				
Asset backed loan notes	6,475.8	6,475.8	8,374.1	8,374.1
Corporate and retail bonds	444.8	480.4	554.3	573.3
Retail deposits	3,615.4	3,615.1	1,873.9	1,887.2
Secured bank borrowings	1,306.0	1,306.0	1,573.0	1,573.0
	11,842.0	11,877.3	12,375.3	12,407.6

5. CAPITAL MANAGEMENT

(a) **Dividend cover**

The Board reviewed its dividend policy following the Group's reorganisation in September 2017, concluding that the changes made would make the Group's use of working capital more efficient and that there was, therefore, less need to retain earnings to support future growth. It therefore determined that the targeted dividend cover ratio (on the basis set out below) would be reduced from 3.00 times, initially to 2.75 times for the current year and then to 2.50 times. The Company considers it has access to sufficient cash resources to pay dividends at this level and that its distributable reserves are abundant for this purpose.

For the purposes of dividend policy, the Group defines dividend cover based on earnings and dividend per share. This is the most common measure used by financial analysts. The expected level of dividend cover in respect of the year, subject to the approval of the final dividend at the Annual General Meeting, is shown below.

	Note	2017	2016
Earnings per share (p)	13	43.1	40.5
Proposed dividend per share in respect of the year (p)	26	15.7	13.5
Dividend cover (times)		2.75	3.00

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

5. CAPITAL MANAGEMENT (CONTINUED)

(b) Return on tangible equity ('RoTE')

RoTE is a measure of an entity's profitability used by investors. RoTE is defined by the Group by comparing the profit after tax for the year, adjusted for amortisation charged on intangible assets, to the average of the opening and closing equity positions, excluding intangible assets and goodwill.

The Group's consolidated RoTE for the year ended 30 September 2017 is derived as follows:

	Note	2017 £m	2016 £m
Profit for the year		117.1	116.0
Amortisation of intangible assets		1.6	1.6
Adjusted profit		118.7	117.6
Divided by			
Opening equity		.969.5	969.5
Opening intangible assets	19	(105.4)	(7.7)
Opening tangible equity		864.1	961.8
Closing equity		1,009.4	969.5
Closing intangible assets	19	(104.4)	(105.4)
Closing tangible equity		905.0	864.1
Average tangible equity		884.5	913.0
Return on Tangible Equity		13.4%	12.9%

This table is not subject to audit

(c) Gearing

The Board of Directors regularly review the proportion of working capital represented by debt and equity. Net debt is calculated as total debt, other than securitised and warehouse debt, valued at principal value, less free cash up to a maximum of the total debt. Adjusted equity comprises all components of equity (share capital, share premium, capital redemption reserve, retained earnings, and revaluation surplus) other than amounts recognised in equity relating to cash flow hedges.

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

5. CAPITAL MANAGEMENT (CONTINUED)

The debt and equity amounts at 30 September 2017 and at 30 September 2016 were as follows:

	Note	2017 £m	2016 £m
Debt			
Corporate bonds		150.0	260.0
Retail bonds		297.5	297.5
Bank overdraft		0.6	1.2
Less: Applicable free cash	14	(305.5)	(383.1)
Net debt		142.6	175.6
Equity			
Total equity		1,009.4	969.5
Less: cash flow hedging reserve		(2.5)	(2.1)
Adjusted equity		1,006.9	967.4
Total working capital		1,149.5	1,143.0
Debt		12.4%	15.4%
Equity		87.6%	84.6%
Total working capital		100.0%	100.0%

The movements in the proportion of working capital represented by debt and equity during the year ended 30 September 2017, including the scheduled repayment of the £110.0m corporate bond in the year, resulted primarily from the operation of the policy described above.

Regulatory capital

The Group is subject to supervision by the PRA on a consolidated basis, as a group containing an authorised bank. As part of this supervision the regulator will issue individual capital guidance setting an amount of regulatory capital, defined under the international Basel III rules, implemented through the Capital Requirements Regulation and Directive (‘CRD IV’), which the Group is required to hold relative to its risk weighted assets in order to safeguard depositors against the risk of losses being incurred by the Group.

The Group’s regulatory capital is monitored by the Board of Directors, its Risk and Compliance Committee and the Asset and Liability Committee, who ensure that appropriate action is taken to ensure compliance with the regulator’s requirements. The future regulatory capital requirement is also considered as part of the Group’s forecasting and strategic planning process.

The tables below demonstrate that at 30 September 2017 the Group’s regulatory capital of £1,030.5m (2016: £1,005.6m) was comfortably in excess of that required by the regulator.

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

5. CAPITAL MANAGEMENT (CONTINUED)

The Group's regulatory capital differs from its equity as certain adjustments are required by the regulator. A reconciliation of the Group's equity to its regulatory capital determined in accordance with CRD IV at 30 September 2017 is set out below.

	Note	2017 £m	2016 £m
Total equity		1,009.4	969.5
Deductions			
Proposed final dividend	26	(28.9)	(25.5)
Intangible assets	19	(104.4)	(105.4)
Common Equity Tier 1 ('CET1') capital		876.1	838.6
Other tier 1 capital		-	-
Total Tier 1 capital		876.1	838.6
Corporate bond		150.0	260.0
Less: amortisation adjustment	†	-	(97.8)
		150.0	162.2
Collectively assessed credit impairment allowances		4.4	4.8
Total Tier 2 capital		154.4	167.0
Total regulatory capital		1,030.5	1,005.6

† When tier 2 capital instruments have less than five years to maturity the amount eligible as regulatory capital reduces by 20% per annum. As the Group's £110.0m Corporate Bond matured in 2017, this adjustment was required in respect of this instrument at 30 September 2016. No such adjustment is required in respect of the Corporate Bond issued in the year ended 30 September 2016, which matures in 2026.

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

5. CAPITAL MANAGEMENT (CONTINUED)

The total exposure amount calculated under the CRD IV framework against which this capital is held, and the proportion of these assets it represents, are calculated as shown below.

	2017 £m	2016 £m
Credit risk		
Balance sheet assets	4,907.7	4,728.4
Off balance sheet	68.3	51.5
Total credit risk	4,976.0	4,779.9
Operational risk	464.9	445.7
Market risk	-	-
Other	67.8	61.9
Total exposure amount	5,508.7	5,287.5
	%	%
Solvency ratios		
CET1	15.9	15.9
Total regulatory capital	18.7	19.0

This table is not subject to Audit

The table below shows the calculation of the UK leverage ratio, based on the consolidated balance sheet assets adjusted as shown. The PRA has set a minimum UK leverage ratio of 3.25% for UK firms.

	Note	2017 £m	2016 £m
Total balance sheet assets		13,682.2	13,518.4
Less: Derivative assets	18	(906.6)	(1,366.4)
Central bank deposits	14	(615.0)	(315.0)
CRD		(1.6)	(0.6)
On-balance sheet items		12,159.0	11,836.3
Less: Intangible assets	19	(104.4)	(105.4)
Total on balance sheet exposures		12,054.6	11,731.0
Derivative assets	18	906.6	1,366.4
Potential future exposure on derivatives		191.3	68.6
Total derivative exposures		1,097.9	1,435.0
Post offer pipeline at gross notional amount		417.9	273.8
Adjustment to convert to credit equivalent amounts		(208.9)	(136.9)
Off balance sheet items		209.0	136.9
Tier 1 capital		876.1	838.6
Total leverage exposure		13,361.5	13,302.9
UK leverage ratio		6.6%	6.3%

This table is not subject to audit

5. CAPITAL MANAGEMENT (CONTINUED)

This leverage ratio is prescribed by the PRA and differs from the Basel and the CRR ratio due to the exclusion of central bank deposits from exposures.

6. CREDIT RISK

The Group's business objectives rely on maintaining a high-quality customer base and place strong emphasis on good credit management, both at the time of acquiring or underwriting a new loan, where strict lending criteria are applied, and throughout the loan's life.

The Group's credit risk is primarily attributable to its loans to customers. There are no significant concentrations of credit risk to individual counterparties due to the large number of customers included in the portfolios.

The Group's loan assets at 30 September 2017 are analysed as follows:

	2017 £m	2017 %	2016 £m	2016 %
Buy-to-let mortgages	9,836.5	88.4%	9,621.2	89.6%
Owner occupied mortgages	19.0	0.2%	19.4	0.2%
Total first residential mortgages	9,855.5	88.6%	9,640.6	89.8%
Second charge mortgage loans	490.7	4.4%	526.8	4.9%
Loans secured on residential property	10,346.2	93.0%	10,167.4	94.7%
Development finance	42.3	0.4%	9.1	0.1%
Commercial mortgages	2.7	-	2.9	-
Loans secured on property	10,391.2	93.4%	10,179.4	94.8%
Motor finance loans	163.0	1.5%	95.3	0.9%
Other consumer loans	219.1	2.0%	195.1	1.8%
Asset finance loans	325.0	2.9%	250.4	2.3%
Factoring and discounting balances	23.8	0.2%	16.9	0.2%
Other loans	2.0	-	0.4	-
Total loans to customers	11,124.1	100.0%	10,737.5	100.0%

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

6. CREDIT RISK (CONTINUED)

An analysis of the indexed loan to value ratio ('LTV') for those loan accounts secured on property by value at 30 September 2017 is set out below. For acquired accounts the effect of any discount on purchase is allowed for.

	2017 First Mortgages %	2017 Secured Loans %	2016 First Mortgages %	2016 Secured Loans %
Loan to value ratio				
Less than 70%	62.1	56.7	60.7	50.9
70% to 80%	25.0	17.5	23.4	17.8
80% to 90%	9.5	11.5	11.3	13.0
90% to 100%	1.3	7.1	2.2	8.9
Over 100%	2.1	7.2	2.4	9.4
	100.0	100.0	100.0	100.0
Average loan to value ratio	66.3	70.0	67.1	72.7
Of which:				
Buy-to-let	66.4		67.2	
Owner-occupied	30.9		27.5	

The regionally indexed LTVs shown above are affected by changes in house prices, with the Nationwide house price index, for the UK as a whole, registering an annual increase of 2.0% in the year ended 30 September 2017 (2016: 5.3%).

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

6. CREDIT RISK (CONTINUED)

The number of accounts in arrears by asset class, based on the most commonly quoted definition of arrears for the type of asset, at 30 September 2017 and 30 September 2016, compared to the industry averages at those dates published by UK Finance (formerly the CML) ('UKF') and the FLA, was:

	2017 %	2016 %
First mortgages		
Accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	0.08	0.11
Buy-to-let accounts excluding receiver of rent cases	0.02	0.02
Owner-occupied accounts	3.55	3.23
UKF data for mortgage accounts more than three months in arrears		
Buy-to-let accounts including receiver of rent cases	0.45	0.52
Buy-to-let accounts excluding receiver of rent cases	0.41	0.47
Owner-occupied accounts	0.95	1.03
All mortgages	0.86	0.94
Second charge mortgage loans		
Accounts more than 2 months in arrears		
All accounts	17.55	17.15
Post-2010 originations	0.06	0.00
Legacy cases	16.75	16.33
Purchased assets	19.69	17.86
FLA data for secured loans	10.70	12.40
Car loans		
Accounts more than 2 months in arrears	0.67	0.30
FLA data for point of sale hire purchase	1.70	1.50
Asset finance loans		
Accounts more than 2 months in arrears	0.97	0.82
FLA data for business lease / hire purchase loans	0.60	0.60
Other loans		
Accounts more than 2 months in arrears	96.03	96.35

No published industry data for asset classes comparable to the Group's other books has been identified. Where revised data at 30 September 2016 has been published by the FLA or UKF, the comparative industry figures above have been amended.

Arrears information is not given for development finance or factoring activities as the structure of the products means that such a measure is not relevant.

The Group calculates its headline arrears measure for buy-to-let mortgages, shown above, based on the numbers of accounts three months or more in arrears, including purchased Idem Capital assets, but excluding those cases in possession and receiver of rent cases designated for sale. This is consistent with the methodology used by the UKF in compiling its statistics for the buy-to-let mortgage market as a whole.

The number of accounts in arrears will be higher for legacy books than for comparable active ones, as performing accounts pay off their balances, leaving arrears accounts representing a greater proportion of the total.

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

6. CREDIT RISK (CONTINUED)

The figures shown above for secured loans and other loans include purchased portfolios which generally include a high proportion of cases in arrears at the time of purchase and where this level of performance is allowed for in the discount to current balance represented by the purchase price.

The payment status of the carrying balances of the Group's live loan assets, before provision for impairment, at 30 September 2017 and at 30 September 2016 split between those accounts considered as performing and those included in the population for impairment testing, is shown below. Balances for immaterial asset classes are not shown. Asset finance loans below includes other related loan balances. Fully provided non-live accounts are excluded from the tables below

Days past due is not a relevant measure for the development finance or invoice discounting businesses, due to their particular contractual arrangements.

First Mortgages

	2017 £m	**2016 £m**
Not past due	9,724.2	9,528.1
Arrears less than 3 months	112.6	82.1
Performing accounts	9,836.8	9,610.2
Arrears 3 to 6 months	1.1	2.4
Arrears 6 to 12 months	1.9	2.8
Arrears over 12 months	7.7	11.0
Possessions and similar cases	22.5	31.1
Impairment population	33.2	47.3
Total gross balances	9,870.0	9,657.5
Impairment provision on live cases	(12.7)	(16.4)
Timing adjustments	(1.8)	(0.5)
Carrying balance	9,855.5	9,640.6

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

6. CREDIT RISK (CONTINUED)

Consumer and Asset Finance

	Second charge mortgage loans £m	Car loans £m	Asset finance loans £m	Total £m
30 September 2017				
Not past due	400.8	158.0	315.3	874.1
Arrears less than 2 months	20.5	5.0	10.0	35.5
Performing accounts	421.3	163.0	325.3	909.6
Arrears 2 to 6 months	14.9	0.7	0.5	16.1
Arrears 6 to 9 months	7.1	0.2	0.7	8.0
Arrears 9 to 12 months	5.4	0.1	-	5.5
Arrears over 12 months	46.2	0.3	0.1	46.6
Specifically impaired asset finance cases	-	-	2.7	2.7
Impairment population	73.6	1.3	4.0	78.9
Total gross balances	494.9	164.3	329.3	988.5
Impairment provision on live cases	(2.1)	(1.2)	(3.1)	(6.4)
Timing adjustments	(2.1)	(0.1)	(1.2)	(3.4)
Carrying balance	490.7	163.0	325.0	978.7
30 September 2016				
Not past due	415.0	92.7	251.6	759.3
Arrears less than 2 months	33.3	3.0	1.5	37.8
Performing accounts	448.3	95.7	253.1	797.1
Arrears 2 to 6 months	20.3	0.2	1.0	21.5
Arrears 6 to 9 months	8.3	-	0.3	8.6
Arrears 9 to 12 months	7.4	-	-	7.4
Arrears over 12 months	51.0	0.2	0.4	51.6
Specifically impaired asset finance cases	-	-	3.3	3.3
Impairment population	87.0	0.4	5.0	92.4
Total gross balances	535.3	96.1	258.1	889.5
Impairment provision on live cases	(3.4)	(0.6)	(0.5)	(4.5)
Timing adjustments	(5.1)	(0.2)	(3.9)	(9.2)
Carrying balance	526.8	95.3	253.7	875.8

Arrears in the tables above are based on the contractual payment status of the customers concerned. Where assets have been purchased by the Idem Capital loan investment business, customers may already have been in arrears at the time of acquisition and an appropriate adjustment made to the consideration paid.

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

6. CREDIT RISK (CONTINUED)

In the debt purchase industry, ERC is commonly used as a measure of the value of a portfolio. This is defined as the sum of the undiscounted cash flows expected to be received over a specified future period. In the Group's view, this measure may be suitable for heavily discounted, unsecured, distressed portfolios, but is less applicable for the types of portfolio in which the Group has invested, where cash flows are higher on acquisition, loans may be secured on property and customers may not be in default. In such cases, the IAS 39 amortised cost balance, at which these assets are carried in the Group balance sheet, provides a better indication of value.

However, to aid comparability the 84 and 120 month ERC values for the Group's purchased assets, are set out below. These are derived using the same models and assumptions used in the EIR calculations, but the differing bases of calculation lead to different outcomes.

	2017 Carrying value £m	**2017 84 month ERC £m**	**2017 120 month ERC £m**	**2016 Carrying value £m**	**2016 84 month ERC £m**	**2016 120 month ERC £m**
Loans to customers	503.5	608.9	688.8	533.9	651.3	740.7

Amounts shown as loans to customers above include loans disclosed as first mortgages and other loans (note 16).

7. ACQUSITIONS

During the year ended 30 September 2016, the Group acquired two businesses, Paragon Asset Finance ('PAF') on 3 November 2015 and Premier Asset Finance ('Premier') on 30 September 2016.

No adjustments have been made in the year to the fair values at acquisition for PAF reported in the financial statements for the year ended 30 September 2016 and these values are now therefore final.

Following the agreement of the completion accounts for Premier during the year the cash consideration payable was reduced by £0.3m and the goodwill balance has been adjusted accordingly. No other fair value balances at acquisition have been revised.

8. SEGMENTAL INFORMATION

Following the reorganisation announced in the year, the Group now analyses its operations, both for internal management reporting and external financial reporting, on the basis of the markets from which its assets are generated. The segments used are described below:

- Mortgages, including the Group's buy-to-let, and owner-occupied first and second charge lending and related activities
- Commercial Lending, including the Group's motor finance and other equipment leasing activities, together with other offerings targeted towards SME customers
- Idem Capital, including loan assets acquired from third parties and legacy assets which share certain credit characteristics with them

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

8. SEGMENTAL INFORMATION (CONTINUED)

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

Loans to customers and operating lease assets are allocated to segments as are dedicated securitisation funding arrangements and their related cross currency basis swaps and cash balances.

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

Other assets and liabilities are not allocated between segments.

The costs arising in the year ended 30 September 2016 from the PAF and Premier acquisitions of £3.1m have not been allocated as they are not directly related to customer facing activity.

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

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

Year ended 30 September 2017

	Mortgages £m	Commercial Lending £m	Idem Capital £m	Total Segments £m
Interest receivable	274.7	33.8	98.9	407.4
Interest payable	(123.6)	(10.6)	(11.4)	(145.6)
Net interest income	151.1	23.2	87.5	261.8
Other operating income	9.6	9.9	0.7	20.2
Total operating income	160.7	33.1	88.2	282.0
Direct costs	(13.7)	(18.9)	(10.8)	(43.4)
Provisions for losses	(3.7)	(0.1)	(1.5)	(5.3)
	143.3	14.1	75.9	233.3

Year ended 30 September 2016

	Mortgages £m	Commercial Lending £m	Idem Capital £m	Total Segments £m
Interest receivable	282.2	25.9	101.0	409.1
Interest payable	(139.5)	(8.3)	(13.2)	(161.0)
Net interest income	142.7	17.6	87.8	248.1
Other operating income	7.7	8.4	4.7	20.8
Total operating income	150.4	26.0	92.5	268.9
Direct costs	(12.4)	(16.2)	(11.4)	(40.0)
Provisions for losses	(4.8)	(0.8)	(2.1)	(7.7)
	133.2	9.0	79.0	221.2

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

8. SEGMENTAL INFORMATION (CONTINUED)

The assets and liabilities attributable to each of the segments at 30 September 2017 and 30 September 2016 on the basis described above were:

	Mortgages £m	Commercial Lending £m	Idem Capital £m	Total Segments £m
30 September 2017				
Assets				
Loans to customers	9,953.9	558.8	611.4	11,124.1
Operating lease assets	-	23.4	-	23.4
Cross currency basis swaps	896.3	-	-	896.3
Securitisation Cash	543.0	-	31.0	574.0
	11,393.2	582.2	642.4	12,617.8
Segment liabilities				
Allocated deposits	3,401.2	686.9	249.8	4,337.9
Securitisation funding	7,597.1	-	184.7	7,781.8
	10,998.3	686.9	434.5	12,119.7

	Mortgages £m	Commercial Lending £m	Idem Capital £m	Total Segments £m
30 September 2016				
Assets				
Loans to customers	9,694.7	375.0	667.8	10,737.5
Operating lease assets	-	16.0	-	16.0
Cross currency basis swaps	1,364.8	-	-	1,364.8
Securitisation Cash	460.3	-	76.8	537.1
	11,519.8	391.0	744.6	12,655.4
Segment liabilities				
Allocated deposits	1,091.1	494.9	254.6	1,840.6
Securitisation funding	9,668.6	-	278.5	9,947.1
	10,759.7	494.9	533.1	11,787.7

An analysis of the Group's financial assets by type and segment is shown in note 16. All of the assets shown above were located in the UK.

The additions to non-current assets, excluding financial assets, in the year which are included in segmental assets above are investments of £12.9m (2016: £8.7m) in assets held for leasing under operating leases, included in the Commercial Lending segment. All other such additions were not allocated to segments.

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

8. SEGMENTAL INFORMATION (CONTINUED)

The segmental assets and liabilities may be reconciled to the consolidated balance sheet as shown below.

	2017 £m	2016 £m
Total segment assets	12,617.8	12,655.4
Unallocated assets		
Central cash and investments	922.9	707.6
Unallocated derivatives	10.3	1.6
Operational property, plant and equipment	22.8	23.2
Intangible assets	104.4	105.4
Other	4.0	25.2
Total assets	13,682.2	13,518.4

	2017 £m	2016 £m
Total segment liabilities	12,119.7	11,787.7
Unallocated liabilities		
Unallocated retail deposits	(722.5)	33.3
Derivative financial instruments	7.1	15.8
Central borrowings	1,145.4	555.5
Tax liabilities	22.3	18.7
Retirement benefit obligations	29.8	58.4
Other	71.1	79.5
Total liabilities	12,672.9	12,548.9

9. INTEREST RECEIVABLE

	2017 £m	2016 £m
Interest receivable in respect of		
Loans and receivables	375.1	377.8
Finance leases	28.8	22.6
Factoring income	2.2	3.0
Interest on loans to customers	406.1	403.4
Other interest receivable	3.1	5.6
Income from structured entities	-	2.4
Total interest on financial assets	409.2	411.4

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

10. INTEREST PAYABLE AND SIMILAR CHARGES

	Note	2017 £m	2016 £m
On retail deposits		47.9	29.5
On asset backed loan notes		70.2	103.4
On corporate bonds		13.1	4.8
On retail bonds		18.6	18.5
On central bank facilities		1.1	-
On bank loans and overdrafts		22.7	29.7
Total interest on financial liabilities		173.6	185.9
On pension scheme deficit	22	1.3	0.8
Discounting on contingent consideration		0.3	-
Other finance costs		1.4	1.5
		176.6	188.2

11. OTHER INCOME

	2017 £m	2016 £m
Loan account fee income	9.0	7.7
Broker commissions	3.6	1.3
Third party servicing	3.3	7.4
Other income	1.3	1.4
	17.2	17.8

12. FAIR VALUE NET (LOSSES)

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

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

13. EARNINGS PER SHARE

Earnings per ordinary share is calculated as follows:

		2017	2016
Profit for the year (£m)		117.2	116.0
Basic weighted average number of ordinary shares ranking for dividend during the year (million)		271.6	286.5
Dilutive effect of the weighted average number of share options and incentive plans in issue during the year (million)		8.0	5.5
Diluted weighted average number of ordinary shares ranking for dividend during the year (million)		279.6	292.0
Earnings per ordinary share	- basic	43.1p	40.5p
	- diluted	41.9p	39.7p

14. CASH AND CASH EQUIVALENTS

	2017 £m	2016 £m	2015 £m
Balances with central banks	615.0	315.0	286.0
Balances with other banks	881.9	922.6	770.0
	1,496.9	1,237.6	1,056.0

Only ‘Free Cash’ is unrestrictedly available for the Group’s general purposes. Cash received in respect of loan assets funded through warehouse facilities and securitisations is not immediately available, due to the terms of those arrangements.

Balances with central banks form part of the liquidity buffer of Paragon Bank PLC and are therefore not available for the Group’s general purposes.

Cash held by the Trustees of the Paragon Employee Share Ownership Plans may only be used to invest in the shares of the Company, pursuant to the aims of those plans.

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

	2017 £m	2016 £m	2015 £m
Free cash	305.5	383.1	237.2
Securitisation cash	574.0	537.1	530.9
Liquidity buffer	615.0	315.0	286.0
ESOP cash	2.4	2.4	1.9
	1,496.9	1,237.6	1,056.0

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

15. SHORT TERM INVESTMENTS

This amount represented fixed rate securities issued by the UK Government for which a liquid market exists and which were held as part of the liquidity requirement of Paragon Bank PLC. As such they were designated as 'Available for Sale', as defined by IAS 39 - 'Financial Instruments: Recognition and Measurement' and consequently shown at fair value which corresponded to their market value. The Bank's liquidity requirements are currently met through central bank deposits and liquidity facilities and therefore it is no longer necessary to hold treasury bills.

There were no securities held at 30 September 2017. The total nominal value of the securities at 30 September 2016 was £7.0m, the weighted average coupon was 1.75% and their carrying value was £7.1m.

16. LOANS TO CUSTOMERS

	Note	2017 £m	2016 £m	2015 £m
Loans and receivables		10,636.1	10,391.8	10,019.0
Finance lease receivables		488.0	345.7	43.4
Loans to customers		11,124.1	10,737.5	10,062.4
Fair value adjustments from portfolio hedging		(8.7)	12.5	5.2
		11,115.4	10,750.0	10,067.6

The Group's loan assets at 30 September 2017, analysed between the segments described in note 8 are as follows:

	Mortgages £m	Commercial Finance £m	Idem Capital £m	Total £m
At 30 September 2017				
First mortgages	9,855.5	-	-	9,855.5
Consumer loans	98.4	-	611.4	709.8
Motor finance	-	163.0	-	163.0
Asset finance	-	325.0	-	325.0
Development finance	-	42.3	-	42.3
Other loans	-	28.5	-	28.5
Loans to customers	9,953.9	558.8	611.4	11,124.1
At 30 September 2016				
First mortgages	9,640.6	-	-	9,640.6
Consumer loans	54.1	-	667.7	721.8
Motor finance		95.3	0.1	95.4
Asset finance	-	250.4	-	250.4
Development finance	-	9.1	-	9.1
Other loans	-	20.2	-	20.2
Loans to customers	9,694.7	375.0	667.8	10,737.5

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

17. IMPAIRMENT PROVISIONS ON LOANS TO CUSTOMERS

The following amounts in respect of impairment provisions, net of allowances for recoveries of written off assets, have been deducted from the appropriate assets in the balance sheet.

	First mortgages £m	Other loans and receivables £m	Finance leases £m	Total £m
At 1 October 2015	86.0	24.4	0.6	111.0
Amounts provided in the period	4.9	2.7	1.9	9.5
Amounts written off	(2.1)	(4.5)	(1.3)	(7.9)
At 30 September 2016	88.8	22.6	1.2	112.6
Amounts provided in the period	3.8	2.3	2.2	8.3
Amounts written off	(3.5)	(6.6)	(0.2)	(10.3)
At 30 September 2017	89.1	18.3	3.2	110.6

Of the above balances, the following provisions were held in respect of realised losses not charged off, which remain on the balance sheet and provided for in full.

	First mortgages £m	Other loans and receivables £m	Finance leases £m	Total £m
At 30 September 2017	76.4	0.3	0.3	77.0
At 30 September 2016	72.4	0.1	0.1	72.6

The amounts charged to the profit and loss account, net of recoveries of previously provided amounts are set out below.

	First mortgages £m	Other loans and receivables £m	Finance leases £m	Total £m
Year ended 30 September 2017				
Amounts provided in the year	3.8	2.3	2.2	8.3
Recovery of amounts previously provided	(0.1)	(0.7)	(2.2)	(3.0)
Net impairment for year	3.7	1.6	-	5.3
Year ended 30 September 2016				
Amounts provided in the year	4.9	2.7	1.9	9.5
Recovery of amounts previously provided	(0.1)	(0.1)	(1.6)	(1.8)
Net impairment for year	4.8	2.6	0.3	7.7

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

18. DERIVATIVE FINANCIAL ASSETS AND LIABILITIES

	Note	2017 £m	2016 £m	2015 £m
Derivative financial assets		906.6	1,366.4	660.1
Derivative financial liabilities		(7.1)	(15.8)	(6.7)
		899.5	1,350.6	653.4
Of which:				
Foreign exchange basis swaps		896.3	1,364.8	659.8
Other derivatives		3.2	(14.2)	(6.4)
		899.5	1,350.6	653.4

The Group's securitisation borrowings are denominated in sterling, euros and US dollars. All currency borrowings are swapped at inception so that they have the effect of sterling borrowings. These swaps provide an effective hedge against exchange rate movements, but the requirement to carry them at fair value leads, when exchange rates have moved significantly since the issue of the notes, to large balances for the swaps being carried in the balance sheet. This is currently the case with both euro and US dollar swaps, although the debit balance is compensated for by retranslating the borrowings at the current exchange rate.

19. INTANGIBLE ASSETS

	2017 £m	2016 £m	2015 £m
Goodwill	98.1	98.4	1.6
Computer software	2.0	2.1	1.6
Other intangible assets	4.3	4.9	4.5
	104.4	105.4	7.7

Other intangible assets comprise brands and the benefit of business networks recognised on the acquisition of subsidiary companies.

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

20. RETAIL DEPOSITS

The Group's retail deposits, held by Paragon Bank PLC, were received from customers in the UK and are denominated in sterling. The deposits comprise principally term deposits and 120 day notice accounts. The method of interest calculation on these deposits is analysed as follows:

	2017 £m	2016 £m	2015 £m
Fixed rate	2,675.9	1,332.5	508.3
Variable rates	939.5	541.4	200.4
	3,615.4	1,873.9	708.7

The weighted average interest rate on retail deposits at 30 September 2017, analysed by charging method, was:

	2017 %	2016 %	2015 %
Fixed rate	1.89	2.11	2.33
Variable rates	1.21	1.65	1.62

The contractual maturity of these deposits is analysed below.

	2017 £m	2016 £m	2015 £m
Amounts repayable			
In less than three months	211.4	55.7	9.1
In more than three months but not more than one year	1,399.6	690.3	242.6
In more than one year, but not more than two years	770.0	572.9	181.7
In more than two years, but not more than five years	629.7	283.9	188.1
Total term deposits	3,010.7	1,602.8	621.5
Repayable on demand	604.7	271.1	87.2
	3,615.4	1,873.9	708.7
Fair value adjustments for portfolio hedging	(3.5)	0.8	-
	3,611.9	1,874.7	708.7

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

21. BORROWINGS

All borrowings described in the Group Accounts for the year ended 30 September 2016 remained in place throughout the period, except as noted below.

During the period the Group accessed further facilities under the Bank of England's Sterling Monetary Framework.

Drawings under the Term Funding Scheme have a maturity of four years and bear interest at bank base rate. The average remaining maturity of the Group's drawings is 47 months and the drawings are secured against a designated pool of Paragon Bank mortgage assets. Drawings under the TFS as at 30 September 2017 were £700.0m (2016: £nil).

On 20 October 2015, a Group company, Idem Luxembourg (No. 8) entered into an agreement under which £117.3m of sterling floating rate notes have been issued to Citibank NA on a limited recourse basis. These notes bear interest at a rate of one month LIBOR plus 3.50% and are secured on financial assets. A further £69.8m of notes was issued under the facility after the end of the period. This issue was used to refinance existing Idem Capital unsecured loan assets.

Of the Group's borrowings at 30 September 2016, the mortgage backed floating rate notes issued by Paragon Mortgages (No. 18) PLC were repaid in December 2016, those issued by Paragon Mortgages (No. 19) PLC were repaid in May 2017 and those issued by Paragon Mortgages (No. 7) PLC were repaid in August 2017. The assets were refinanced through warehouse facilities and retail deposits. The asset backed loan notes issued by Paragon Personal and Auto Finance (No. 3) PLC were repaid in January 2017, following the purchase of its loan assets by other group companies, principally Paragon Bank.

During the period, the warehouse facility in Paragon Fourth Funding was not renewed. This has reduced the Group's available warehouse capacity by £300.0m.

The Group's £110.0m corporate bond was repaid, in accordance with its terms of issue, in April 2017.

22. RETIREMENT BENEFIT OBLIGATIONS

The defined benefit obligation takes into account the results of the statutory funding valuation as at 31 March 2016, which results in a reduction in the value of the defined benefit obligation at 30 September 2017. Since the last IAS 19 actuarial valuation at 30 September 2016 there have also been movements in financial conditions, requiring an adjustment to the actuarial assumptions underlying the calculation of the defined benefit obligation at 30 September 2017. In particular, over the period since the 30 September 2016 actuarial valuation, the discount rate has increased by 0.3% per annum, whereas expectations of long term inflation have increased by 0.1% per annum.

The net effect of these changes has resulted in a decrease in the value of the defined benefit obligation at 30 September 2017. The impact of allowing for the results of the 31 March 2016 statutory funding valuation and the change in actuarial assumptions has been recognised as an actuarial gain in other comprehensive income.

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

22. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

The movements in the deficit on the defined benefit plan during the year ended 30 September 2017 are summarised below.

	Year to 30 September 2017 £m	**Year to 30 September 2016 £m**
Opening pension deficit	58.4	21.5
Service cost	2.4	1.7
Net funding cost	1.3	0.8
Administrative expenses	0.4	0.4
Employer contributions	(3.7)	(3.2)
Amounts posted to other comprehensive income		
Return on plan assets not included in interest	(7.4)	(7.7)
Actuarial (gain) arising from demographic assumptions	(6.7)	-
Actuarial (gain) arising from experience adjustments	(4.2)	-
Actuarial (gain)/loss from changes in financial assumptions	(10.7)	44.9
Closing pension deficit	29.8	58.4

23. CALLED-UP SHARE CAPITAL

The share capital of the Company consists of a single class of £1 ordinary shares.

Movements in the issued share capital in the year were:

	2017 Number	**2016 Number**
Ordinary shares		
At 1 October 2016	295,852,094	309,349,316
Shares issued	637,607	218,872
Shares cancelled	(15,000,000)	(13,716,094)
At 30 September 2017	281,489,701	295,852,094

During the year, the Company issued 637,607 shares (2016: 55,827) to satisfy options granted under sharesave schemes for a consideration of £1,575,925 (2016: £68,070). In the year ended 30 September 2016, the Company had also issued 163,045 shares at par to the trustees of its Employee Share Ownership Plan ('ESOP') Trust in order that they could fulfil their obligations under the Group's share based award arrangements.

On 1 June 2017 15,000,000 shares held in treasury were cancelled by the Company. (2016: 13,716,094 shares).

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

24. RESERVES

	2017 £m	2016 £m	2015 £m
Share premium account	65.5	64.6	64.6
Capital redemption reserve	28.7	13.7	-
Merger reserve	(70.2)	(70.2)	(70.2)
Cash flow hedging reserve	2.5	2.1	(1.9)
Profit and loss account	784.5	725.9	767.7
	811.0	736.1	760.2

25. OWN SHARES

	2017 £m	2016 £m
Treasury shares		
At 1 October 2016	46.2	89.2
Shares purchased	65.5	51.0
Shares cancelled	(45.1)	(94.0)
At 30 September 2017	66.6	46.2
ESOP shares		
At 1 October 2016	16.3	10.8
Shares purchased	4.2	8.9
Shares subscribed for	-	0.3
Options exercised	(4.0)	(3.7)
At 30 September 2017	16.5	16.3
Balance at 30 September 2017	83.1	62.5
Balance at 1 October 2016	62.5	100.0

At 30 September 2017, the number of the Company's own shares held in treasury was 15,693,643 (2016: 15,348,714). These shares had a nominal value of £15,693,643 (2016: £15,348,714). These shares do not qualify for dividends.

The ESOP shares are held in trust for the benefit of employees exercising their options under the Company's share option schemes and awards under the Paragon Performance Share Plan, Matching Share Plan and Deferred Bonus Plan. The trustees' costs are included in the operating expenses of the Group.

At 30 September 2017, the trusts held 3,180,661 ordinary shares (2016: 3,594,175) with a nominal value of £3,180,661 (2016: £3,594,175) and a market value of £13,975,824 (2016: £11,267,738). Options, or other share-based awards, were outstanding against all of these shares at 30 September 2017 (2016: all). The dividends on all of these shares have been waived (2016: all).

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

26. EQUITY DIVIDEND

Amounts recognised as distributions to equity shareholders in the Group and the Company in the period:

	2017 Per share	2016 Per share	2017 £m	2016 £m
Equity dividends on ordinary shares				
Final dividend for the year ended 30 September 2016	9.2p	7.4p	25.5	21.7
Interim dividend for the year ended 30 September 2017	4.7p	4.3p	12.5	12.2
	13.9p	11.7p	38.0	33.9

Amounts paid and proposed in respect of the year:

	2017 Per share	2016 Per share	2017 £m	2016 £m
Interim dividend for the year ended 30 September 2017	4.7p	4.3p	12.5	12.2
Proposed final dividend for the year ended 30 September 2017	11.0p	9.2p	28.9	25.5
	15.7p	13.5p	41.4	37.7

The proposed final dividend for the year ended 30 September 2017 will be paid on 19 February 2018, subject to approval at the Annual General Meeting, with a record date of 5 January 2018. The dividend will be recognised in the accounts when it is paid.

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

27. NET CASH FLOW FROM OPERATING ACTIVITIES

	2017 £m	2016 £m
Profit before tax	144.8	143.2
Non-cash items included in profit and other adjustments:		
Depreciation of operating property, plant and equipment	1.9	1.9
Profit on disposal of operating property, plant and equipment	(0.1)	(0.1)
Amortisation of intangible assets	1.6	1.6
Foreign exchange movement on borrowings	(468.9)	699.9
Other non-cash movements on borrowings	6.4	14.3
Impairment losses on loans to customers	5.3	7.7
Charge for share based remuneration	4.2	4.4
Net (increase) / decrease in operating assets:		
Operating lease assets	(7.4)	(5.4)
Loans to customers	(391.9)	(443.0)
Derivative financial instruments	459.8	(706.3)
Fair value of portfolio hedges	21.2	(7.3)
Other receivables	-	(2.1)
Net decrease / (increase) in operating liabilities:		
Retail deposits	1,741.5	1,165.2
Derivative financial instruments	(8.7)	9.1
Fair value of portfolio hedges	(4.3)	0.8
Other liabilities	(1.8)	4.9
Cash generated by operations	1,503.6	888.8
Income taxes (paid)	(28.9)	(23.6)
	1,474.7	865.2

Cash flows relating to plant and equipment held for leasing under operating leases are classified as operating cash flows.

28. NET CASH FLOW FROM INVESTING ACTIVITIES

	2017 £m	2016 £m
Proceeds from sales of operating property, plant and equipment	0.3	0.4
Purchases of operating property, plant and equipment	(1.7)	(1.5)
Purchases of intangible assets	(0.9)	(1.4)
Decrease in short term investments	7.1	34.0
Acquisitions (Note 7)	(1.6)	(310.1)
Net cash generated / (utilised) by investing activities	3.2	(278.6)

NOTES TO THE FINANCIAL INFORMATION
For the year ended 30 September 2017

29. NET CASH FLOW FROM FINANCING ACTIVITIES

	2017 £m	2016 £m
Shares issued	1.5	-
Dividends paid (note 26)	(38.0)	(33.9)
Issue of asset backed floating rate notes	69.8	531.0
Repayment of asset backed floating rate notes	(1,503.0)	(1,137.2)
Issue of corporate bonds	-	149.0
Repayment of corporate bonds	(110.0)	-
Movement on central bank facilities	700.0	-
Movement on other bank facilities	(268.6)	145.5
Purchase of shares (note 25)	(69.7)	(59.9)
Net cash (utilised) by financing activities	(1,218.0)	(405.5)

30. RELATED PARTY TRANSACTIONS

In the year ended 30 September 2017, the Group has continued the related party relationships described in note 66 on page 291 of the Annual Report and Accounts of the Group for the financial year ended 30 September 2016. Related party transactions in the period comprise the compensation of the Group's key management personnel, transactions with the Group Pension Plan and fees paid to a non-executive director in respect of his appointment as a director of the Corporate Trustee of the Group Pension Plan. There have been no changes in these relationships which could have a material effect on the financial position or performance of the Group in the period.

Save for the transactions referred to above, there have been no related party transactions in the year end 30 September 2017.

ADDITIONAL FINANCIAL INFORMATION
For the year ended 30 September 2017

A. INCOME STATEMENT RATIOS

The average net interest margin is calculated as follows:

	Note	2017 £m	2016 £m
Opening loans to customers	16	10,737.5	10,062.4
Closing loans to customers	16	11,124.1	10,737.5
Average loans to customers		10,930.8	10,400.0
Net interest		232.6	223.2
Net interest margin		2.13%	2.15%
Impairment provision	17	5.3	7.7
Impairment as a percentage of average loan balance		0.05%	0.07%

B. COST:INCOME RATIO

Cost:income ratio is derived as follows:

	Note	2017 £m	2016 £m
Cost – operating expenses		102.3	92.5
Total operating income		252.8	244.0
Cost / Income		40.5%	37.9%

C. NET ASSET VALUE

	Note	2017	2016
Total equity (£m)		1,009.4	969.5
Outstanding issued shares (m)	23	281.5	295.8
Treasury shares (m)	25	(15.7)	(15.3)
Shares held by ESOP schemes (m)	25	(3.2)	(3.6)
		262.6	276.9
Net asset value per £1 ordinary share		£3.84	£3.50
Tangible equity (£m)	5	905.0	864.1
Tangible net asset value per £1 ordinary share		£3.45	£3.12