

Annual Report
and Accounts **2007**



Firm Foundations

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Our vision

We aim to be a friendly, caring organisation that values customer loyalty, gives value for money and contributes to the current and future wellbeing of the community. We recognise that our members and customers, employees and the communities we serve all have a part to play in the future of the Society. We believe we can best serve the interests of all three by remaining a strong, dynamic and independent mutual building society.

Our objectives for each are:

OUR MEMBERS AND CUSTOMERS

- To provide a secure home for savings;
- To provide a range of innovative and competitively priced mortgage, savings, investment and insurance products;
- To be a customer focused organisation which understands its customers and listens to what they say;
- To offer expert and trusted advice on good value products across a range of services;
- To provide effective customer service in a prompt, courteous and efficient manner;
- To treat customers fairly and in a way that is consistent with mutuality;
- To provide effective solutions by sharing our technology and innovation with our business partners;
- To treat our business partner customers with the same integrity and professionalism with which we treat our members.

OUR EMPLOYEES

- To provide secure and rewarding long term employment;
- To respect our employees and endeavour to produce an environment of mutual trust and understanding;
- To provide better than average remuneration packages in return for better than average contributions.

OUR COMMUNITIES

- To be seen to be a major contributor to the economic wellbeing of the areas in which we operate;
- To support the communities in which we operate, by way of both personal and financial involvement.

CHAIRMAN'S STATEMENT

2007 has been a year of great success for Newcastle Building Society. In the face of turbulence in the money markets, it has also been a challenging year for the financial services industry as a whole. This has perhaps been felt more poignantly in the North East as the future of its largest financial institution, the Northern Rock bank, lay uncertain.

I am pleased to say that, as a mutual society, we have remained largely unaffected by the 'credit crunch'. I would like to offer my reassurance that, by remaining true to the principles of mutuality, we will continue to offer our members the security and stability that comes from shared ownership. Colin explains this in further detail in his Chief Executive's Review.

Before I focus on the year's highlights, there are a number of changes to our Board. First, two of our longest serving directors will retire following the 2008 AGM. Olivia Grant, Vice-Chairman, who has served as a director since 1995 and Tony Glenton, who has served for 20 years and chaired the Board for six years, both retire. Our sincerest thanks are due to Olivia and Tony for their unyielding contribution and commitment to the Society's success.

I would like to extend a warm welcome to Jonathan Westhoff who joined the Newcastle Board in September as Finance Director. Jonathan was previously Group Finance Director with Portman Building Society and I am confident that he will rise to the challenge of the role, which involves responsibility for all finance, treasury and risk operations.

We also welcome Ron McCormick, who was appointed to the Board in August. Ron has a wealth of experience, including serving as a director with Skipton Building Society from 1993 to 2005 and we are already benefiting from this in many ways.

Lucy Armstrong also joined the Board in February 2008. Lucy heads a business growth acceleration company and is a Governor of Northumbria University. I wish each of them every success in their roles.

Last year I formally reported the appointment of Colin Secombe as Chief Executive whose first task in the role was to oversee the merger with Universal Building Society at the end of 2006. The merger has reinforced our position as the largest building society in the North East, and the twelfth largest in the UK. The enlarged Society has been strengthened by the conjoined skills and cultures of the two societies, which means we now offer an improved range of products and services to our members, and even better opportunities for our staff. We did not make any redundancies as a result of the merger, and in fact have recruited consistently in 2007.

Recruitment will also feature strongly in 2008. It is my pleasure to report that the Society has acquired the lease of a new office at Cobalt Business Park, North Tyneside, where we plan significant business development. This demonstrates our commitment to the North East by creating employment opportunities and investing in the development of the region, which further emphasises the Society's strong mutual values.

The Cobalt office will provide facilities to enable us to offer improved service to our third party clients, which include Landsbanki Icesave, Bradford & Bingley and a newly established partnership with National Bank of Dubai. We are also in discussions with further parties, which we hope to conclude in 2008.

Most importantly, we are here to serve the interests of our members and as such we are committed to seeking feedback about how we can improve the service and products we offer, and then acting on it. This is central to our strategy.

I also mentioned last year our commitment to Treating Customers Fairly (TCF), a cornerstone principle of the FSA that a firm 'must pay due regard to the interests of its customers and treat them fairly'. As the Society is owned by its members, we will continue to place TCF as a primary objective, and our customer led strategy will help to ensure we do this.

I take this opportunity to congratulate the Executive for leading the business through an exceptionally successful year against unprecedented conditions in the second half, together with the efforts of our staff who have demonstrated their dedication, enthusiasm and skill in exceeding targets. I would like to thank everyone for their contribution.

2007 highlighted the unpredictability of the financial services industry and, while we can not say for certain what will happen in years to come, I am confident that we have the skills and dedication from our staff necessary to rise to any challenges that we may face.

In today's increasingly competitive economy, I believe we have demonstrated this year that, by concentrating on our core business, whilst also diversifying through innovative business solutions, we will face the future with firm foundations.

CHRIS HILTON
CHAIRMAN

CHIEF EXECUTIVE'S REVIEW

In what has been an eventful year for the financial services industry, it is my great pleasure to share some of Newcastle Building Society's highlights of 2007, my first full year as Chief Executive. I would also like to offer my views for the year ahead and reveal some of the Society's plans.

Growth

The Society has had a tremendously successful year. We now employ some 1,200 staff and I am delighted to report that our assets have increased from £4.42bn to £4.82bn. Our profit has risen 52% compared to 2006, from £11.6m to £17.6m. This is a direct result of growth across all areas of the Society as we expand and diversify in the face of challenging and toughening competition, and increasingly stringent regulation.

We ended 2007 in a very strong financial position, exceeding our retail funding targets through offering attractive savings products. I am also pleased to report that, as consumer confidence was shaken by the events with Northern Rock, existing savers remained justifiably confident in the security of their investments with the Newcastle.

The Society's performance and risk management is covered in greater detail in the Finance Director's Report.

Stronger together

2007 has seen the Society go from strength to strength. We began the year with the merger with Universal Building Society, which went very smoothly following overwhelming support from Universal members. We opened for 'business as usual', with merged systems fully tested and staff fully integrated, on 2 January after a seamless transition to the enlarged Society.

Members of Universal Building Society are now able to benefit from a greater portfolio of products and services, including guaranteed index-linked bonds and access to qualified consultants through our subsidiary company, Newcastle Financial Services Limited. The addition of four new branches following the merger offers improved access for all our members.

As a larger organisation, we are able to offer greater economies of scale and enhanced income generation. However this has not been at the expense of jobs; there have been no redundancies as a result of the merger and Universal employees now have improved career opportunities with the Newcastle.

I would like to thank all staff for their tremendous effort this year in working together to marry the culture and skills of both organisations for the benefit of our members.

Our core business

It has always been our core aim as a building society to provide a safe and rewarding home for our members' money, whilst supplying loans at attractive rates; this is even more important in light of current market conditions. Our savings and mortgage products, for example, featured regularly in the 'best buy' tables throughout 2007. In particular, many customers enjoyed up to a 70% return over five years when their Guaranteed Property Bond held with us matured. We were also highly commended for our fixed rate mortgages at the Moneyfacts Awards 2007.

We pride ourselves on getting to know our members and making available a portfolio of financial solutions that suit their individual needs. That is why we continue to offer professional financial guidance face to face in our branches to help steer our members on the best financial path for them. One of the ways we sought to inform and advise our members in 2007 was by holding a series of financial planning seminars covering a range of solutions from investment to inheritance tax, retirement planning and equity release.

We also, for the first time in 2007, produced a new style customer magazine called MoneySense, offering financial guidance, news and in-depth articles to our members. We received a great deal of positive feedback for the magazine and intend to continue this in 2008.

We always encourage feedback from our members and appreciate that there are times when it may not always be as good as we would hope. In 2007 we responded to comments about our customer service when some of our members experienced difficulty speaking to a telephone customer adviser. As a result we have introduced more advisers, new processes, improved telephony systems and increased staff training, which has reduced customer waiting times and improved standards of service.

In October we relaunched our Lifetime Mortgage proposition as Newcastle Building Society Equity Release Service, offering advice on the full range of regulated home reversion and equity release schemes. This was supported by a successful TV advertising campaign. TV advertising was also used to promote an ISA account and a Fifty Plus investment product, both of which proved extremely popular.

In 2007 we appointed Legal & General as our insurance provider. This partnership has enabled us to offer members a portfolio of home, mortgage payment protection and travel insurance, with a faster application process through Legal & General's online facility. The travel insurance is particularly suited to the over 50s, with an upper age limit of 79. We will also be adding motor insurance to our portfolio in the early part of 2008.

We focussed heavily this year on developing our products for the intermediary market and have attracted experienced individuals to head up our intermediary savings and intermediary lending departments. We are also working on improved IT infrastructure to enable us to offer a comprehensive service to IFAs, ultimately making our products available to a wider consumer and professional market, which will be a key feature for us in 2008.

Indeed, IT is one of our core strengths, leading us to be recognised at the FST Awards 2007 as 'IT Team of the Year', and shortlisted in three categories for the 2008 awards, announced in March.

CHIEF EXECUTIVE'S REVIEW *Continued*

The refurbishment of our Ponteland and Darlington branches in 2007 marked the completion of improvements made to all of our 35 UK branches. We now offer better facilities, providing an altogether better customer experience in our branches than we ever have. We have also now committed to new branch premises in Gibraltar, combining two small existing outlets into an improved single location.

Business Solutions

This year we celebrated the tenth anniversary of our Strategic Solutions business, which provides technology, processing capability and administrative support services to other businesses, such as banks and building societies. We have a number of major financial sector businesses as clients, such as Bradford & Bingley, Bank of Ireland and Landsbanki Icesave. This year we have experienced rapid growth in the size and scope of our contracts, for example launching a market leading ISA in association with BMW Financial Services, and announcing a new agreement in October with National Bank of Dubai to administer mortgages to UK citizens acquiring property in Dubai.

I am very gratified to report that our Card Solutions department, established in 2005 to produce prepaid cards, is recognised as the premier issuer of MasterCard prepaid cards in the UK. Schemes launched in 2007 include Think Banking, MasterCard® PayPass™ and The Sun. With over 50 schemes now live, 2007 saw us reach the milestone of issuing over 1.5m cards. We also acquired a SEPA licence authorising the Society to issue cards throughout Europe, which enhances our prepaid offering.

Our achievements were recognised at the first ever MasterCard Europe Prepaid Conference in 2007 where we received an award for best 'Multi-Channel Marketing Program', and at The Card Awards 2008 for 'Best Prepaid Card Marketing Campaign'.

Strength in numbers

As mentioned in the Chairman's Statement, one of the most significant and exciting events of the year took place in September when we announced the acquisition of the lease of a new office site at Cobalt Business Park, North Tyneside. We anticipate creating 500 additional jobs at this new site over the next five years, which will predominantly support the continued growth of our Strategic Solutions business. I am delighted and grateful that the regional development agency One NorthEast has granted us significant funding for the project, subject to the creation of these jobs at Cobalt.

In November, the Minister for the North East, the Right Honourable Nick Brown MP, pledged his support at the topping out ceremony for the new office, and publicly commended our commitment to job creation in the region. By 2012 we anticipate we will employ at least 1,700 people, reinforcing our position as one of the largest private sector employers in the North East.

Our new office will provide state of the art facilities to enable us to offer our third party customers an even greater level of service. The building will house improved IT equipment and a completely

new training suite where we can enhance our in-house training capabilities, as well as improved catering and recreation facilities for all our staff. The space is also designed to maximise energy efficiency and has complied with stringent energy regulations. The office was fully completed on schedule at the end of 2007.

Our Principal Office will remain in central Newcastle and our new site will provide a business continuity base for us to ensure we can continue to provide high quality and seamless customer service in the event of any unforeseen disruption.

While we look forward to creating jobs in 2008, I am also delighted to report the significant number of jobs we have created in 2007. Following the merger, which increased our staff from 865 to almost 1,000, we added a further 200 positions in 2007 in a range of roles including mortgage and customer advisers, telesales and to develop our IT, prepaid cards and training operations. As a holder of Investor in People status since 1999, we continue to invest heavily in staff training and development.

Social responsibility

In 2007 we gave even more emphasis to our corporate social responsibility (CSR) campaign. A group of staff volunteers now steer many of our CSR initiatives, such as a new recycling scheme with support from the Energy Savings Trust and ways we can reduce our carbon footprint and offset energy we use. Taking advice from CarbonNeutral Newcastle, in 2007 we became the largest business in the North East to pledge towards a carbon neutral future.

Indeed, for our 2007 AGM we introduced online voting, receiving nearly 3,000 votes via the website (around 10% of the total votes received). We also offered all our members the opportunity to receive information about future AGMs via email instead of post, which was the preferred option for 2,567 members. For every customer that signs up for this we donate 10p to charity.

During the year we have continued our commitment to the Community Foundation serving Tyne & Wear and Northumberland, and to date have given over £600,000 to more than 600 causes. To mention only a few, this year we have helped disabled children experience horse riding, supported IT education programmes and an anti-bullying campaign for schoolchildren, funded sports equipment for local teams, kitted out a local bowling association and a social group for the over 60s.

Other charitable support in 2007 went to Tyne & Wear Museums, the Princes Trust and Arts & Business. This year we also concluded a three year project with Seven Stories, the Centre for Children's Books, which aims to bring the joy of story telling to children.

I would also like to mention the charitable commitment from our staff, which has been substantial, raising money for national charities such as Red Nose Day, Children in Need, Jeans for Genes and Macmillan.

CHIEF EXECUTIVE'S REVIEW *Continued***Members matter**

As we have done in previous years, in 2007 we held a series of 'Meet the Chief Executive Roadshows'. These popular events provide our members with the opportunity to meet me and other senior representatives of the Society for discussion and debate, and to address any queries they may have. We have also now recruited over 1,700 members to our online customer panel, where we test ideas, concepts and invite feedback on our products, events and marketing. We also invited members of the panel to contribute their opinions via discussion groups.

Looking forward

I cannot speak of 2007 without acknowledging the widely reported 'credit crunch'. Deteriorating economic conditions in the United States had a global effect on the markets, affecting financial institutions that relied heavily on the wholesale markets for funding. I would like to take this opportunity once again to reassure our members that savings they hold with Newcastle Building Society are completely safe. As a mutual society, the majority of our funding comes from our members and we do not use wholesale markets to the extent of banks. Our customers should feel largely unaffected by the market turbulence.

2007 has proved that one cannot say for certain what will happen in the markets over the course of a year. In my view it is likely that interest rates will fall further and house price movements level off. This will be a welcome change for first time buyers who have found it increasingly difficult to purchase their first home. We will continue in 2008 to lend prudently and responsibly to the first time buyer market. We always aim to put our members first and promise that any of our borrower members who may be experiencing financial difficulty will always be treated sympathetically.

Looking back to a year when data security was in the spotlight, the Society regards the privacy and security of customer information of paramount importance. As such we have maintained the ISO 27001 accreditation, an International Standard regarding code of practice for Information Security Management. It shows the Society's high level of compliance with all relevant laws and that risks, such as software piracy, have been minimised. In addition it confirms that the Society's IT asset management is as cost effective as possible.

I believe that stability, security and trust of financial institutions will remain a key concern for consumers. Newcastle Building Society has nearly 150 years' experience in protecting the best interests of our members and we firmly intend to remain mutual. We have solid plans to maintain growth through offering competitive products, which we can afford to do because we are answerable to members and not to shareholders. We will also continue to develop relationships with third party businesses and expand our Strategic Solutions business.

We have set ourselves even tougher targets for 2008 and I am confident they can be achieved if we remain true to our mutual ethos. Thank you for your support in 2007.



COLIN SECCOMBE
CHIEF EXECUTIVE

FINANCE DIRECTOR'S REPORT

Business review

The Group has delivered a strong performance in 2007, in all areas of its operations, with:

- Retail share balances growing by **9%**.
- Gross lending **exceeding £1bn** for the first time.
- Net interest income up by **35%**, to **£43.7m**.
- Other income up **48%**, to **£18.5m**.
- A fall in the cost income ratio, from **74%** to **69%**.
- Profit, as a percentage of mean assets, improving from 0.20%, to **0.26%**.

The financial markets in 2007

As has already been highlighted in the Chief Executive's Review, the background to the delivery of such a strong performance was one of significant market disruption in the second half of the year, as the financial services sector operated under the shadow of the sub-prime lending fallout from the USA. This resulted in a 'credit crunch' in the UK as major banks and other investors, active in providing funding to a wide variety of financial services groups either directly or indirectly (through securitisation or similar vehicles), found it necessary to restrict the amount they lent, until such time as their own exposures became clear. This meant that those lenders that were heavily reliant on funding their customer loans by borrowing in these markets suddenly found their funding sources reduced. In addition, funding that was available became expensive as inter-bank lending rates, Libor, increased dramatically.

For the Newcastle, the impact was not so dramatic. The vast majority of the Society's funding comes from its savers who, as is demonstrated below, increased significantly their deposits with us. Further, the nature of the Society's balance sheet meant that the rise in inter-bank rates was actually beneficial overall, as we receive more Libor linked income than we incur Libor linked expenses.

Growth

Over the year, total assets increased by 9%, to £4.8bn. Lending balances grew to £3.8bn, as new lending activity moved through the £1bn mark for the first time. Within this, both residential and commercial lending performed well, with the latter being to some extent constrained by the Board's desire to maintain exposure to a modest proportion of overall lending.

The increase in lending was funded by the growth in retail share balances, with the absolute level of non-share funding and deposits from banks remaining broadly unchanged over the year. This was attributable to a series of successful product launches, including products specifically aimed at those aged 50 or over and a range of guaranteed capital protection bonds (with the returns linked to growth in specified asset values, such as equities or house prices). Whilst it is difficult to be precise, it is clear that our retail inflows were impacted by the events at the Northern Rock as savers sought to move their money to the traditional safety of a building society.

Income

Net interest income benefited from both the increase in lending balances (including the first full year of the lending taken on from the Universal) and improved margins. The net interest margin of 0.89% compares with 0.80% in 2006, although the latter is distorted by the inclusion of the assets of the Universal on the last day of the year only (the interest income for these assets is not included). Adjusted for this, the underlying margin for 2006 was circa 0.86%, which still reveals a notable improvement. This has primarily been driven by the margins achieved on commercial and residential niche lending (residential investment property lending and bridging finance). Whilst these areas only represent a modest proportion of total lending, they do command a margin above that which can be obtained for core residential mortgages.

The net interest margin was also affected by the market disruption in the second half of the year, discussed earlier, as the nature of the balance sheet structure meant that market conditions marginally favoured the Group.

Other income, net of related charges, also grew strongly, up from £12.5m to £18.5m. This is particularly encouraging as the Society seeks to reduce its reliance on net interest income and increase non-member income streams that can improve its ability to continue to deliver competitive products to members. A key driver of this growth in Other income has been the expansion of the Strategic Solutions business. In addition, income from Newcastle Financial Services, the Group's subsidiary that delivers investment advice, increased by 82% over 2006, as many more members enjoyed the service offered, and the move to Legal & General for general insurance delivered a significant improvement.

Administrative expenses

Expenses of £41.2m represented an increase of £7.7m, which is mainly the result of job numbers increasing by around 20% to 1,200. However, this is after absorbing the cost base of the Universal (£7.1m in 2006) and investing in the expansion of the Strategic Solutions and Financial Services businesses.

Despite this increase, the cost:income ratio improved to 69%, from 74%, reflecting the efficiencies delivered from the merger and the improving scale of the Strategic Solutions business. The Society is already committed to expansion plans for this part of the business in 2008, with the additional premises at Cobalt planned to come on stream early in the year to provide the platform for an anticipated increase in headcount of circa 500 over the next few years. Whilst this will clearly result in a further increase in expenses, it is important that the level of investment in an area of strong growth is maintained. The Board has set challenging targets for the return on this investment.

FINANCE DIRECTOR'S REPORT Continued

Profit and capital

The improvements in net interest margin and other income, combined with improved cost efficiency and the first year of contribution from the former Universal Building Society, resulted in a rise in profit before tax of 52%, to £17.6m. After tax, the Group delivered a return on average assets of 0.26%, a marked improvement over 2006. Once other movements are taken into account, most notably the reduction in the deficit in respect of the Group's pension commitments, reserves increased by 8.0% to £210.7m.

From 1 January 2008, the Group will adopt the Capital Requirements Directive (Basel II) under the Standardised approach. The Board completed its Internal Capital Adequacy Assessment and will submit this to the FSA and await the outcome of the Supervisory Review and Evaluation Process. This will result in an agreed minimum level of capital to be held to reflect the risks inherent in the business, especially under stressed conditions (for example should a sharp downturn in the housing market occur). Until this review process is complete, the Newcastle is required to adopt a capital minimum in line with the FSA's Interim Capital Guidance (ICG). At the end of the year, the capital of the Group comfortably exceeded that required.

This meant that the Society did not need to acquire capital to support the growth and expansion detailed earlier in this report, although this will always be kept under review to make certain that the Newcastle remains strongly capitalised to the ultimate benefit of its members.

Risk management

The performance delivered in 2007 has not been at the expense of any change to the Society's attitude to risk. The Risk Management Report on pages 18 and 19 details the Board's approach to risk and the controls in place to manage exposure.

In terms of credit risk, the Newcastle has been very careful with moves into areas not considered as traditional core residential lending. No sub-prime or self-certification lending has been undertaken. Exposure to buy-to-let and residential investment activity is controlled by strict exposure limits. At the year end, exposure to these areas was just 5% of total residential lending. Commercial lending is predominantly to borrowers with considerable experience of commercial property transactions and to propositions with high quality tenants. Exposure to this segment is less than 10% of the Group's lending.

As a result, the risk profile of lending remains low, there having been no notable deterioration in arrears either since 2006 or in the second half of 2007, with just 0.43% of balances having arrears greater than 2.5% of the outstanding balance (2006: 0.32%). Moreover the average loan to value (a prime risk determinant) for the residential portfolio is just 44%, with only 3% exceeding 90%.

The expansion of operations over recent years has required the Society to embed a culture of risk awareness, supported by strong control functions. This has meant that actual losses incurred remained at extremely low levels in 2007. Despite this, the intensity of control and the profile of operational risk management increased still further during the year, with additional detection systems being developed. This investment will continue in 2008.

Liquidity and funding

The increase in lending achieved in 2007 was entirely funded by the increase in savings balances from our members and customers. As a result, the growth in assets did not require any additional access to the wholesale funding markets and the liquidity ratio (the proportion of all deposits held as cash and assets readily convertible into cash) improved to 21%. The Society's portfolio of liquid assets consists of highly rated, low risk instruments and does not include any holdings of sub-prime mortgage backed securities, collateralised debt obligations (CDOs) or any other such exposures.

The Society does not have any reliance on securitisation vehicles. The one securitisation undertaken by the Society was for a pool of commercial lending assets in 2002. The balance outstanding in this vehicle is just £122m and the Society has no further obligation in respect of funding, but does have the option to repurchase the outstanding notes once the balance outstanding falls below £21m or 1 February 2011 if earlier.

Summary

In performance terms, the Newcastle has had a very successful 2007. Against a backdrop of significant market turbulence in the second half of 2007, the Group has shown real progress in extending the sources of income to support the delivery of competitive products to its members and has both increased capital and further strengthened its funding structure. The economy may now be likely to go through a period of uncertainty, particularly in the housing market, but the Newcastle remains well positioned to deal with this and continue to deliver solid financial results.

JONATHAN WESTHOFF
FINANCE DIRECTOR

Our Directors



Chris Hilton, Chairman

Chris is in his seventh year as Chairman of Newcastle Building Society. He is a commercial lawyer and senior partner at Eversheds in Newcastle, with specific expertise in international trade. He advises the boards of a number of companies in the UK and abroad. As well as being a solicitor, Chris is a notary public, an arbitrator and a mediator. He was born in Newcastle, where he has spent much of his working life.



Colin Seccombe, Chief Executive

Colin joined Newcastle Building Society in 1997 as Finance Director and became Chief Executive in July 2006. Colin has also been a senior audit partner with accountants KPMG. One of his first roles as Chief Executive was to oversee the successful merger with Universal Building Society. Colin has a wide knowledge of finance, and of working with other building societies and high profile organisations within the wider financial services sector.



Olivia Grant, Vice-Chairman

Olivia has been Vice-Chairman since 2006 and brings with her a wide knowledge of the business community in the North East, and of the personnel, training and skills issues facing the Society today. She also chairs the Pension Committee. Olivia has numerous business and other interests, including Chairman of the Council of the University of Newcastle upon Tyne, and is Chair of Culture North East Limited. Olivia is also Managing Director of HBI, which is an innovative new company in the field of Bioscience.



Jonathan Westhoff, Finance Director

Jonathan joined Newcastle Building Society in September 2007 from the Portman Building Society where he spent seven years heading up finance, risk and strategy before becoming Group Finance Director. Jonathan has 25 years of financial services experience, including head of financial planning for Retail Financial Services which, at the time, was the largest business unit of the Barclays Group. Jonathan is responsible for the Society's finance, treasury and risk operations.



Colin Greaves, Operations Director

Colin joined Newcastle Building Society in 1990 and was appointed to the Board in 2006 as Operations Director. Colin's responsibilities cover Information Technology, Customer Service Operations and the development of the Strategic Solutions business.



Richard Mayland

Richard began a career in accountancy in 1974 and was a partner with PricewaterhouseCoopers for 17 years before retiring in 2003. He is currently Chief Executive of NorPrime Limited and is a Trustee of the Childrens' Heart Unit Fund.



Nigel Westwood

Nigel was appointed to the Universal Building Society Board in 2000 and joined the Newcastle Board following the merger in December 2006. He is a director of a regional chartered surveyors' practice based in Newcastle. Nigel performs the duties of the Consul for Norway and is High Sheriff of Tyne and Wear 2007/8.



David Holborn

David is former director for Lloyds TSB Northern region. He is a Fellow of the Chartered Institute of Financial Services and a past president of both the Bournemouth and Newcastle upon Tyne centres. He is also a Trustee of Rothley Trust. David chairs the Financial Risk Committee and the Remuneration Committee.



Maxine Pott

Maxine was appointed to the Universal Building Society Board in 2000 and joined the Newcastle Board following the merger in December 2006. Maxine is a chartered accountant and Partner in a regional business advisory group, RMT, where she advises a number of businesses in the UK and abroad. She is also Treasurer of the North East and Cumbria German-British Chamber of Commerce.



Tony Glenton

Tony is the Senior Partner in Chartered Accountants, Ryecroft Glenton. During his service with Newcastle Building Society he was Chairman for six years. He chairs the Society's Audit Committee and is a Trustee of the Newcastle Building Society Pension and Assurance Scheme.



Wendy Lee, Commercial Director

Wendy was appointed to the Board in July 2004 as Commercial Director. Wendy was formerly with Legal & General where she was Sales Development Director, managing part of their independent financial adviser business. Prior to this she was with Norwich Union for 15 years.



Ron McCormick

Ron was appointed in August 2007. He held the positions of both Group Finance Director then Group Commercial Director at Skipton Building Society until December 2005. He is a senior adviser to a range of businesses and has previous experience in a major insurance company and KPMG. He is a Chartered Accountant and a Fellow and Member of the Institute of Internal Auditors. He is a Partner in Mascot Financial Services Consultants.



Lucy Armstrong

Lucy is Chief Executive of The Alchemists, which matches up experienced and successful entrepreneurs with high growth businesses to accelerate their growth. Lucy is a former chairman of a trans-Atlantic think tank and national tutor for prison Independent Monitoring Boards. She is a Governor of Northumbria University.

DIRECTORS' REPORT

The Directors have pleasure in presenting their Annual Report, together with the audited Annual Accounts and Annual Business Statement of the Newcastle Building Society Group for the year ended 31 December 2007.

OBJECTIVES AND ACTIVITIES

The principal objective of Newcastle Building Society is to attract funds, through a competitive range of personal savings and investment products, in order to make available advances secured on land and property, primarily for use of our members.

This core activity is supported by offering a range of related financial products and services which are provided by the Society and its subsidiary companies. The principal subsidiary companies which affect the net profits and net assets of the Group are listed in Note 13 to the Accounts.

It is the intention of the directors that Newcastle Building Society will continue to remain an independent and mutual building society. We believe this status enables us to deliver consistent and fair value and to provide enhanced benefits to all our members and customers through our attractive, innovative products and our increasing network of business partnerships.

BUSINESS REVIEW

The Chief Executive's Review and Finance Director's Report on pages 5 to 9 report on the business activities and business performance for the year, likely future developments and post balance sheet events.

PRINCIPAL RISKS AND UNCERTAINTIES

The principal risks and uncertainties faced by the Group are included in the Finance Director's Report on pages 8 and 9, within the Risk Management Report on pages 18 and 19 and in Note 11 to the Accounts.

GROUP RESULTS FOR THE YEAR

The Finance Director's Report on pages 8 and 9 provides a detailed overview of the Group's results and performance during the year and should be read in conjunction with the following summary, which the Directors consider to be the key performance indicators used to manage the business:

- Group profit after tax amounted to **£12.1m**, an increase of **49%** when compared with the previous year which, as a percentage of mean total assets, was **0.26%** (2006: 0.20%).

- Assets now stand at **£4.82bn** (2006: £4.42bn).
- The cost income ratio in 2007 was **69%**, down from 74% in 2006.
- The credit quality of our lending book remains excellent with only **9** (2006: 6) properties in possession at the end of the year and only **0.43%** (2006: 0.34%) of our portfolio with arrears of more than 2.5% of the balance. At 31 December 2007, **26** (2006: 48) mortgage accounts were 12 or more months in arrears. The balances on these accounts amounted to **£1.1m** (2006: £1.4m) and the total amount of arrears in these cases was **£0.1m** (2006: £0.2m).
- At the year end, gross capital amounted to **£291.4m** (2006: £275.9m) which equates to a gross capital ratio of **6.72%** (2006: 7.01%). Free capital was **£252.6m** (2006: £246.3m) being **5.83%** (2006: 6.26%) of total shares and borrowings.
- Liquid assets, being cash and authorised securities but excluding liquidity balances held by special purpose securitisation vehicles, were **£911.8m** representing **21.05%** of shares and borrowings (compared to £764.3m, 19.41% of shares and borrowings in 2006).

STAFF

Newcastle Building Society operates an Equal Opportunities Policy. It is the intention of the Society that no applicant or employee receives less favourable treatment on the grounds of disability, sex, transgender status, sexual orientation, marital status, civil partnership status, race, ethnic origin, colour, age, nationality, national origins, political beliefs or trade union membership, or is disadvantaged by conditions or requirements that cannot be shown to be justifiable.

Staff remuneration reviews are carried out on an annual basis and a variety of performance related bonus schemes are in operation which enable individual and branch team efforts to be recognised and rewarded.

We are committed to effective communication at all levels and take steps to ensure that employee consultation is adequate and ongoing. Unite has negotiating rights on behalf of all staff up to and including senior management level.

RISK MANAGEMENT OBJECTIVES AND POLICIES

The Board seeks to manage the key risks faced by the Group in order to minimise any potential adverse impact on performance.

The key financial risks faced by the Group include market risk, credit risk and operational risk which are managed through the Group's documented risk management framework. Further details can be found in the Risk Management Report on pages 18 and 19.

CORPORATE SOCIAL COMMITMENT

In September, the Society gave a commitment to CarbonNeutral Newcastle, to work towards achieving carbon neutrality. This organisation has designed a two year work programme for us, which will generally involve saving energy, reducing emissions and, ultimately, offsetting that which cannot be reduced or eliminated.

The initial stages of the programme, which is currently underway, involves CarbonNeutral Newcastle assessing our carbon footprint. A scoping survey of energy and waste is also being carried out by Midas, who identify quick win cost savings and best practice.

The carbon reduction and saving plans will begin to take effect in 2008. The offsetting programme appeals to us as a mutual building society simply because any financial donation we make will be spent on regional community projects. Currently, the Society contribution would be spent on any one of the following three projects:

- Newcastle Warm Zone, insulating homes to alleviate fuel poverty and reduce emissions.
- Clean energy at Newbiggin Hall, a local social housing refurbishment, to supply renewable energy resources.
- Tree planting in three local forests.

Over the course of 2008 we expect to expand the work undertaken to pursue such initiatives as encouraging greater use of public transport, reviewing the possibility of introducing green energy suppliers and rolling out recycling programmes.

There is now a team of volunteers in the Society who support the operation of the programme and act as advocates for the various initiatives that are operating.

COMMUNITY

Charitable donations and political contributions

In addition to providing considerable 'in kind' support, the Society made financial donations to charities and grass roots community activities amounting to **£72,500** (2006: £85,000). There were no political contributions during the year.

Registered Social Housing

The society continues to be a major lender in the Social Housing sector which, in turn, helps those who cannot afford their own home.

Taxes

During the year, we paid taxes in excess of **£31.2m**. (2006: £18.8m) on behalf of the Newcastle Group companies, employees and members.

DIRECTORS

As at 31 December 2007, the members of the Board were:

AAE Glenton, MO Grant, C Greaves*, CJ Hilton, FD Holborn, W Lee*, RD Mayland, RJ McCormick, JM Pott, CJ Seccombe*, J Westhoff*, NA Westwood.

All the above directors served throughout the year, except for JM Pott and NA Westwood, who were both appointed on 3 January 2007, RJ McCormick (appointed 16 August 2007) and J Westhoff (appointed 1 September 2007).

In addition, LWW Armstrong was appointed on the 25 February 2008 and, along with RJ McCormick and J Westhoff, retires under Rule 25(4). Under Rule 26 (1) CJ Hilton and W Lee retire at the Annual General Meeting. All are eligible and willing to serve on the Board for a further three years.

AAE Glenton and MO Grant retire at the Annual General Meeting and will not be seeking re-election.

*Executive directors

INDEPENDENT AUDITORS

A resolution to re-appoint PricewaterhouseCoopers LLP will be proposed at the Annual General Meeting.

ON BEHALF OF THE BOARD
CJ HILTON
25 FEBRUARY 2008

REPORT OF THE DIRECTORS ON CORPORATE GOVERNANCE

In discharging its responsibilities to be accountable to the Society's members for the operation of the Society, the Board regards good corporate governance as extremely important. In consequence, the Society complies with the Code of Governance (the Code) originally contained in the Interim Prudential Sourcebook issued by the Financial Services Authority (FSA).

Moreover, the Board acknowledges that it should seek wherever possible to comply with the updated Combined Code published in 2006. This is now effective for publicly quoted companies, but while it does not apply to building societies the Board looks to adopt those principles that are relevant to it. The Board believes it complies with all such provisions, except where noted below.

THE BOARD

The Board meets 11 times during the year and, in addition, a further meeting is devoted specifically to a review of the Society's strategy. The Board has responsibility for monitoring operational and financial performance in pursuit of this strategy. It also approves annual budgets, financial policy, risk management strategy and major capital expenditure, as well as the issue of annual and interim accounts.

At the year end, the Board consisted of eight non-executive and four executive directors. Each receives information and key performance indicators to ensure that the Board functions effectively. The Chairman ensures that the adequacy and relevance of this information is periodically reviewed.

The composition and attendance record of the Board for 2007 was:

	MEETINGS ATTENDED	ELIGIBLE TO ATTEND
Chris Hilton (Chairman)	11	11
Olivia Grant (Vice-Chairman)	9	11
Tony Glenton	11	11
David Holborn	9	11
Wendy Lee	11	11
Richard Mayland	10	11
Colin Seccombe	11	11
Colin Greaves	11	11
Maxine Pott	10	11
Nigel Westwood	11	11
Ron McCormick	5	5
Jonathan Westhoff	4	4

There are five main Committees of the Board, as detailed below:

1. AUDIT COMMITTEE

This Committee considers all audit matters relating to the Group, the system of internal control, financial reporting and the evaluation of operational risk. It receives reports from the Internal Audit function and external auditors, and considers all prudential requirements.

The composition and attendance record of this Committee for 2007 was:

	MEETINGS ATTENDED	ELIGIBLE TO ATTEND
Tony Glenton (Chairman)	5	5
Chris Hilton	5	5
Richard Mayland	5	5
Maxine Pott	1	1

All the Committee members are non-executive directors.

2. FINANCIAL RISK COMMITTEE

This Committee meets to consider and make recommendations to the Board on the level of credit, market and liquidity risk to which the Society seeks to be exposed by virtue of its treasury and lending activities. It also assesses the Society's insurance arrangements. All lending and treasury policies are set by this Committee.

The composition and attendance record of this Committee for 2007 was:

	MEETINGS ATTENDED	ELIGIBLE TO ATTEND
David Holborn (Chairman)	4	4
Chris Hilton	4	4
Colin Seccombe	4	4
Olivia Grant	3	4
Ron McCormick	1	1
Nigel Westwood	1	1
Jonathan Westhoff	2	2

The Committee comprises five non-executive directors and two executive directors.

3. PENSION COMMITTEE

This Committee typically meets prior to the meeting of the Pension Trustees to consider and make recommendations on any issues relating to the Society's pension schemes.

The composition and attendance record of this Committee for 2007 was:

	MEETINGS ATTENDED	ELIGIBLE TO ATTEND
Olivia Grant (Chairman)	2	2
Tony Glenton	2	2
Colin Seccombe	2	2

The Committee comprises two non-executive directors and one executive director.

4. REMUNERATION COMMITTEE

This Committee considers and makes recommendations on executive emoluments and contracts of employment as well as on the level of non-executive fees and pension arrangements. Its report is included on page 16 and 17.

The composition and attendance record of this Committee for 2007 was:

	MEETINGS ATTENDED	ELIGIBLE TO ATTEND
David Holborn (Chairman)	4	4
Tony Glenton	4	4
Richard Mayland	4	4

All the Committee members are non-executive directors.

5. NOMINATIONS COMMITTEE

This Committee advises on the structure of the Board, on nominations to it and the re-election of Board members retiring by rotation. The Committee consists of the entire Board.

Non-executive directors

In the opinion of the Board, each of its non-executive directors is independent and free of any relationships or circumstances which materially influence the exercise of their judgement. Under the terms of the Code, one of the factors to be taken into account when assessing independence is length of service, particularly when this is in excess of nine years. Consequently, the independence of two of the non-executive directors of the Society requires consideration.

Based upon the individual performance of each of these, and taking into account the results of the annual appraisal system, the Board has concluded that in terms of independence of character, of judgement and, most important of all, of robustness of challenge to the Executive of the Society, each of the directors affected may, unequivocally, be considered 'independent'.

The directors are:

Tony Glenton, who has served as a director for 20 years and was Chairman for six years between 1993 and 1998. He is a member of the Society's pension scheme.

Olivia Grant, who has served as a director for 12 years, and is a member of the Society's pension scheme.

Both of these directors are retiring at the 2008 AGM. The Board is also in the process of implementing a succession plan; progressively and without risking its effectiveness.

The Board believes that a senior independent director, who is available to shareholders, is unnecessary for an organisation which does not have external shareholders. Members of the Society have the opportunity to express their opinions to the Board at customer roadshows, through a member panel and feedback forum on our internet site.

Appointments to the Board

The appointment of new directors is considered by the Nominations Committee (see above) which makes its recommendations to the Board.

All directors are subject to election by members at the AGM following their appointment. This will be the case for Ron McCormick, Jonathan Westhoff and Lucy Armstrong at the forthcoming AGM. In addition, all directors must receive approval from the FSA as an 'Approved Person' in order to fulfil their controlled function as a director. Under the Society's rules, directors have to submit themselves for re-election at least once every three years. New non-executive directors are usually expected to serve two full three year terms following their election and, subject to their age and performance evaluation, may be proposed for a further term. Only in exceptional circumstances will non-executive directors be able to seek re-election when they have served for more than nine years.

Auditors

The Society has established a policy on the use of the external auditors for non-audit work which is considered and approved annually by the Audit Committee. The principal purpose of this policy is to ensure the continued independence and objectivity of the external auditors.

REMUNERATION COMMITTEE REPORT

Having regard to the Combined Code on Corporate Governance, the Remuneration Committee consists solely of non-executive directors, currently FD Holborn (Chairman), AAE Glenton and RD Mayland and meets at least twice a year to consider and make recommendations on the level of remuneration for executive and non-executive members of the Board as well as the contractual arrangements for the executive directors. In its consideration of remuneration levels and employment terms, the committee takes into account the following factors:

- Remuneration packages are set at a level to attract, motivate and retain executive directors of the calibre necessary to oversee the operations of the Society. Basic salaries for executive directors are set by taking into account salary levels within similar sized financial services organisations and the market as a whole, so as to attract and retain the skills levels that are appropriate to operate an organisation as complex as the Society. Basic salary levels also reflect the individual performance of each executive director.
- The executive directors are appraised annually by the Chief Executive; and in turn, he is appraised by the Chairman.
- An annual performance-related bonus scheme has been established for executive directors and senior executives. In any one year a bonus is primarily determined based on the achievement of specific objectives that have been set in the Society's corporate plan. The maximum bonus is 25% of basic salary and is non-pensionable. In recognition of outstanding performance in 2007, the Committee has agreed an additional, non-pensionable, bonus payment for the executive directors, equivalent to 21% of basic salary. These amounts are shown in the remuneration table that follows. From 2008, a medium term incentive plan will be introduced, based upon delivery of the Society's key performance indicators and a comparison to the performance of peer group societies.

- Three executive directors and three non-executive directors are members of the Newcastle Building Society Pension and Assurance Scheme, details of which are set out in Note 30 to the Society's Annual Accounts.
- Executive directors receive a range of taxable benefits which includes a motor vehicle or cash equivalent, private health care and concessionary mortgage arrangements. Life cover for a lump sum of four times basic salary on death in service and dependant's pensions are also provided.
- The executive directors have service contracts which are terminable at any time by the Society on one year's notice. There are no contracts for non-executive directors and no compensatory terms for loss of office.
- Non-executive directors' fees are set at a level appropriate to reflect the skills and time required to direct the Society's operations and progress. Fees are reviewed annually in light of those paid to directors of other financial services organisations and reflect individual involvement in board committees and subsidiaries. Non-executive directors do not participate in any bonus scheme. The performance of non-executive directors is reviewed by the Chairman annually and the performance of the Chairman is reviewed by the non-executive directors, led by the Vice-Chairman.

DIRECTORS' EMOLUMENTS (Audited)

Emoluments of the Society's directors from the Society and its subsidiary undertakings are detailed below:

	Salary or fees	Annual bonus	Benefits	Increase in accrued pension benefits earned in year (excl. inflation)	2007 Total	2006 Total
	£000	£000	£000	£000	£000	£000
Executive directors						
C Greaves (appointed 26 May 2006)	123	52	9	5	189	92
RJ Hollinshead (resigned 30 June 2006)	-	-	-	-	-	301
W Lee	132	57	74	2	265	267
CJ Seccombe	239	105	13	10	367	246
JV Towers (resigned 31 July 2006)	-	-	-	-	-	76
J Westhoff (appointed 1 September 2007)	50	21	68	-	139	-
	544	235	164	17	960	982
Non-executive directors						
CJ Hilton	60	-	-	1	61	58
RB Allan (retired 20 April 2006)	-	-	-	-	-	12
AAE Glenton	37	-	-	1	38	35
MO Grant	42	-	-	1	43	39
JW Heppell (retired 20 April 2006)	-	-	-	-	-	15
FD Holborn	37	-	-	-	37	35
RD Mayland	31	-	-	-	31	30
RJ McCormick (appointed 16 August 2007)	11	-	-	-	11	-
JM Pott (appointed 3 January 2007)	26	-	12	-	38	-
NA Westwood (appointed 3 January 2007)	26	-	12	-	38	-
	814	235	188	20	1,257	1,206

The benefits of Ms W Lee include a payment made in respect of her accepting the office of director and foregoing payments due from a former employer which would have become payable in 2007. These amounted to £61,016 and were subject to deduction of tax and national insurance.

The benefits of Mr J Westhoff include relocation expenses amounting to £57,904, which were subject to deduction of tax and national insurance, together with a contribution to personal pension arrangements of £10,000.

The benefits of Ms JM Pott and Mr NA Westwood each include an amount of £11,665 in respect of tax and national insurance on director's liability insurance paid during the year on behalf of the former Universal Building Society.

Set out below are details of the pension benefits, including unfunded arrangements, payable on retirement, to which each of the directors is entitled at 31 December 2007. The accrued benefits include any benefits earned as an employee prior to becoming a director, as well as those earned for qualifying services after becoming a director.

	Total accrued benefits at 31-Dec-07	Transfer value of accrued benefits at 31-Dec-07	Transfer value of accrued benefits at 31-Dec-06	Director's contributions during year	Increase in transfer value, less director's contribution
	£000	£000	£000	£000	£000
Executive directors					
C Greaves (appointed 26 May 2006)	40	607	556	11	40
RJ Hollinshead (resigned 30 June 2006)	-	-	1,474	-	-
W Lee	8	76	53	12	11
CJ Seccombe	43	700	544	22	134
JV Towers (resigned 31 July 2006)	-	-	279	-	-
Non-executive directors					
CJ Hilton	30	435	423	-	12
AAE Glenton	12	219	211	-	8
MO Grant	9	141	124	4	13
JW Heppell	-	-	246	-	-

The accrued pension benefit shown is the amount that would be paid each year to the director in the form of a pension if he or she left at the end of the year. This pension is calculated based on the total period of service with the Society, both before and after becoming a director. The transfer value has been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11.

No directors other than those detailed above are members of the Group's defined benefit scheme.

RISK MANAGEMENT REPORT

OVERVIEW

The provision of financial and administration services to customers exposes the Group to a number of risks. It is the aim of the Board to manage the Society in a prudent manner so that the risks undertaken by the business are well controlled and commensurate with the return achieved. In absolute terms the Board would not wish the Society to run risks within the business that could expose the Group to a material loss in any one financial year.

RISK DEFINITIONS

The risks applicable to the Group are broadly defined into three categories; market risk, credit risk and operational risk.

MARKET RISK

The net interest income and economic value of the Group are exposed to movements in interest rates and other market conditions. The most significant risks are interest rate risk and liquidity risk. The Group has no exposure to foreign currency and only a very moderate direct exposure to equity through small shareholding in Standard Life arising from the demutualisation of the insurance company in 2006. The Group does, however, have an exposure to the performance of equities through its defined benefit pension schemes.

Interest rate risk

Interest rate risk is the risk of loss caused by a change in interest rates. This may arise due to a difference in re-pricing timing between assets and liabilities. There is also a risk of loss caused by the effect of interest rate changes on assets and liabilities with different characteristics. For example, the Group is funded predominantly by retail savings accounts linked to base rate or an administered rate and invested in Libor linked (money-market) assets.

Liquidity risk

Liquidity risk is the risk of loss caused by the Group being unable to meet its liabilities or commitments as they fall due. The nature of the business of a building society is to agree to lend long term (typically 25 years) and fund with short term savings accounts. This leads to a maturity mismatch between assets and liabilities.

CREDIT RISK

Credit risk is the risk that counterparties will not be able to meet their obligations as they fall due.

OPERATIONAL RISK

Operational risk is the risk of loss, resulting from inadequate or failed internal processes, people and systems, or from external events. For the Group this definition includes legal risk, strategic risk and reputation risk.

RISK MANAGEMENT

The Group seeks to manage appropriately all the risks arising from its activities. The Board has responsibility for control and review of the effectiveness of risk management although detailed oversight is cascaded down to the various sub-committees including the Financial Risk Committee, Audit Committee, Pension Committee and Credit Committee.

The Group has a well developed risk and compliance structure with each risk area supported by separate compliance, business assurance and financial crime units. The Group has extensive policies and procedures covering financial risk, credit risk and operational risk that are approved by the Financial Risk Committee or Audit Committee as appropriate.

The Group has been recording risk events and operational losses for a number of years and has a good understanding of the risks within the business and the impact when the risk actually occurs. This is further supported by an open and honest culture where employees are encouraged to report mistakes, with the focus on the action plan to prevent the risk recurring, rather than the risk event itself.

MARKET RISK MANAGEMENT

By their nature, the Group's activities involve the use of financial instruments including derivatives. The Group accepts deposits from customers at both fixed and floating rates for various periods, and seeks to earn a positive margin by investing these funds in high quality assets. This is achieved by consolidating short term funds and lending for longer periods, at higher rates, whilst maintaining sufficient liquidity to meet all claims that might fall due.

This exposure is managed on a continuous basis, within limits set by the Board, using a combination of on and off balance sheet derivatives.

Use of derivatives

The principal derivatives used in market risk management are interest rate swaps that are used to hedge balance sheet exposures. Group balance sheet exposures arise from mismatches between fixed interest mortgages, savings products and treasury funding and investment activities. On a regular basis, management assesses mortgage pipeline exposures and hedges are taken out to cover exposures and to reduce interest rate risk.

The table below describes the activities undertaken by the Group and the derivatives used to manage the associated risks.

ACTIVITY	RISK	TYPE OF HEDGE
Fixed rate savings products and funding instruments	Sensitivity to fall in interest rates	Fair value interest rate swap
Fixed rate mortgage products and funding investment instruments	Sensitivity to rise in interest rates	Fair value interest rate swap
Index-linked savings products	Sensitivity to changes in underlying indices	Fair value hedges with index-linked swaps

Derivatives are only used by the Group in accordance with the Building Societies Act 1986. These instruments are not used for trading or speculative purposes and their sole purpose is to mitigate risks arising from movement in interest rates or indices.

The table in Note 11 gives details of the derivative financial instruments held at 31 December 2007.

RISK MANAGEMENT REPORT Continued

LIQUIDITY RISK MANAGEMENT

The Group's liquidity policy is to maintain sufficient liquid resources to cover cash flow imbalances and fluctuations in funding and enable the Group to meet its financial obligations as and when they fall due. This is achieved by maintaining a prudent level of liquid assets, committed wholesale funding facilities and managed growth of the business.

CREDIT RISK MANAGEMENT

The Financial Risk Committee is responsible for monitoring and, through the application of the Group's lending and financial risk policies, approving the Group's credit exposure. These policies not only address the individual exposures but place limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Credit risk is monitored on a revolving basis and the limits are subject to an annual or more frequent review.

OPERATIONAL RISK MANAGEMENT

The provisions for operational risk management are contained in the Operational Risk Policy. A key feature of the Group's operational risk framework is that key risks and controls are identified for all areas of the business ranging from the high level risks, discussed at Board level, down to the risks within individual departments.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

DIRECTORS' RESPONSIBILITIES FOR PREPARING ANNUAL ACCOUNTS

The following statement, which should be read in conjunction with the statement of auditors' responsibilities on page 20, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Report and Accounts, Annual Business Statement and Directors' Report.

The Building Societies Act 1986 ('the Act') requires the directors to prepare Annual Accounts for each financial year which give a true and fair view of:

- the Group's and Society's income and expenditure and cash flows for the year; and
- the state of affairs of the Group and Society at the end of the financial year.

In preparing the Accounts, the Directors are required to:

- Select proper, appropriate accounting policies and apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- State whether applicable accounting standards have been followed; and
- Prepare the Annual Accounts on the going concern basis.

In addition to the Accounts, the Act requires the directors to prepare, for each financial year, an Annual Business Statement and a Directors' Report, each containing prescribed information relating to the business of the Society and its subsidiary undertakings. The Directors are also responsible for the Remuneration Committee and Risk Management Reports.

All risks are scored in terms of the impact and probability of the risk arising and are scored before and after considering the impact of controls. The operational risk system is also fully utilised by business assurance with the internal audit inspection plan based on high scoring risk areas or where there is significant reliance on key controls to mitigate the impact of catastrophic and major risks.

CAPITAL MANAGEMENT

Capital adequacy is monitored on an ongoing basis by the FSA and the Board of Directors is responsible for ensuring that the Group has the requisite amount of capital at all times.

Basel

The Group has adopted the standardised approach to credit risk under Basel II and has applied the detailed requirements of BIPRU chapter 3 in calculating Pillar I capital requirements. The Group has adopted the standardised approach to operational risk under Pillar I. BIPRU 6.4.15 has been applied to calculate the base Operational Risk Capital Requirement. A Basel Committee has been formed to bring together, consider and assess the material risks and capital requirements across all areas of the Society and Group business. The Group is currently discussing with the FSA the capital requirements under Pillar 2.

DIRECTORS' RESPONSIBILITIES IN RESPECT OF ACCOUNTING RECORDS AND INTERNAL CONTROLS

The Directors are responsible for ensuring that the Society and its subsidiary undertakings:

- Keep proper accounting records in accordance with the Building Societies Act 1986; and
- Take reasonable care to establish, maintain, document and review such systems and controls as are appropriate to these businesses in accordance with the rules made by the Financial Services Authority under the Financial Services and Markets Act 2000.

The effectiveness of these controls is closely monitored by senior management and reported to the Board, via the Audit Committee, on a regular basis.

STATEMENT OF DISCLOSURE TO AUDITORS

So far as each director is aware, there is no relevant audit information of which the Society's auditors are unaware.

Each director has taken all steps that he or she ought to have taken as a director in order to make him / herself aware of any relevant information and to establish that the Society's auditors are aware of that information.

ON BEHALF OF THE BOARD
CJ HILTON
25 FEBRUARY 2008

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF NEWCASTLE BUILDING SOCIETY

We have audited the Group and Society Annual Accounts of Newcastle Building Society for the year ended 31 December 2007 which comprise the Group and Society Income Statements, the Group and Society Statements of Recognised Income and Expense, the Group and Society Balance Sheets, the Group and Society Cash Flow Statements and the related notes. These Annual Accounts have been prepared under the accounting policies set out therein. We have also audited the information in the Remuneration Committee Report that is described as having been audited, and the information contained in the Risk Management Report.

We have examined the Annual Business Statement (other than the details of Directors and Officers upon which we are not required to report) and the Directors' Report.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Directors' responsibilities for the preparation of the Annual Report, including the Annual Accounts, the Remuneration Committee Report, the Annual Business Statement and the Directors' Report in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the Annual Accounts, including the Risk Management Report and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for, and only for, the Society's Members as a body in accordance with Section 78 of the Building Societies Act 1986 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the Annual Accounts, including the Risk Management Report give a true and fair view and whether the Annual Accounts and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Building Societies Act 1986, regulations made under it and Article 4 of the IAS Regulation. We also report to you our opinion as to whether certain information included within the Annual Business Statement gives a true representation of the matters in respect of which it is given, whether the information given in the Directors' Report is consistent with the accounting records and the Annual Accounts, and whether the Annual Business Statement and the Directors' Report have been prepared in accordance with the applicable requirements of the Building Societies Act 1986 and regulations made under it.

We also report to you if, in our opinion, the Annual Accounts are not in agreement with the accounting records, or if we have not received all the information and explanations we require for our audit.

We read other information contained in the Annual Report and consider whether it is consistent with the audited Annual Accounts.

We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Annual Accounts, the Annual Business Statement or the Directors' Report. Our responsibilities do not extend to any other information.

BASIS OF AUDIT OPINION

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Annual Accounts, including the Risk Management Report, the Annual Business Statement and the part of the Remuneration Committee Report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Annual Accounts, and of whether the accounting policies are appropriate to the Group's and Society's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Annual Accounts, including the Risk Management Report and the part of the Remuneration Committee Report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Annual Accounts and the part of the Remuneration Committee Report to be audited.

OPINION

In our opinion:

- the Annual Accounts give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's and the Society's affairs at 31 December 2007 and of the Group's and the Society's income and expenditure and cash flows for the year then ended;
- the information given in the Annual Business Statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given;
- the information given in the Directors' Report is consistent with the accounting records and the Annual Accounts; and
- the Annual Accounts, including the Risk Management Report, the part of the Remuneration Committee Report to be audited, the Annual Business Statement and the Directors' Report have each been prepared in accordance with the applicable requirements of the Building Societies Act 1986 and regulations made under it and, as regards the Annual Accounts, including the Risk Management Report, Article 4 of the IAS Regulation.

PRICEWATERHOUSECOOPERS LLP
CHARTERED ACCOUNTANTS
AND REGISTERED AUDITORS
NEWCASTLE UPON TYNE
25 FEBRUARY 2008

INCOME STATEMENTS for the year ended 31 December 2007

Note	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
2	264.8	193.5	257.0	185.5
3	(221.1)	(161.2)	(213.5)	(153.7)
Net interest income	43.7	32.3	43.5	31.8
Other income	21.0	14.2	16.9	11.7
Other charges	(2.5)	(1.7)	(3.1)	(2.0)
Gains less losses from financial instruments	(2.9)	0.6	(2.9)	0.6
Dividend income	-	-	6.4	-
Total operating income	59.3	45.4	60.8	42.1
Administrative expenses	(41.2)	(33.5)	(38.8)	(31.0)
Impairment losses	(0.5)	(0.3)	(0.5)	(0.3)
Profit before taxation	17.6	11.6	21.5	10.8
Taxation expense	(5.5)	(3.5)	(4.8)	(3.2)
Profit for the financial year	12.1	8.1	16.7	7.6

STATEMENTS OF RECOGNISED INCOME AND EXPENSE for the year ended 31 December 2007

Note	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
30	4.8	0.4	4.8	0.4
	-	(8.3)	-	(8.3)
16	(1.5)	2.3	(1.5)	2.3
Net income / (expense) recognised directly in reserves	3.3	(5.6)	3.3	(5.6)
27	12.1	8.1	16.7	7.6
Total recognised income and expense since last annual accounts	15.4	2.5	20.0	2.0

The notes on pages 25 to 52 form part of these Accounts.

BALANCE SHEETS at 31 December 2007

	Note	GROUP		SOCIETY	
		2007 £m	2006 £m	2007 £m	2006 £m
ASSETS					
Cash and balances with the Bank of England		5.8	4.6	5.8	4.6
Loans and advances to banks	9	228.0	229.0	216.2	219.4
Other financial instruments at fair value through profit or loss	10	689.0	539.7	689.0	539.7
Derivative financial instruments	11	14.5	28.4	14.1	27.5
Fair value adjustments for hedged risk		34.1	12.4	33.5	11.9
Loans and advances to customers	12	3,772.5	3,542.2	3,643.4	3,415.6
Investment in subsidiaries	13	-	-	39.2	16.8
Investment securities		-	0.1	-	0.1
Property, plant and equipment	14	30.0	27.0	20.2	16.9
Investment property	15	8.9	2.1	-	-
Current tax assets		1.2	2.5	2.3	2.8
Deferred tax assets	16	2.4	7.0	2.4	6.9
Other assets	17	28.9	26.0	32.3	34.2
Non-current assets held for sale	18	0.4	0.5	0.4	0.5
TOTAL ASSETS		4,815.7	4,421.5	4,698.8	4,296.9

The notes on pages 25 to 52 form part of these Accounts.

BALANCE SHEETS at 31 December 2007

	Note	GROUP		SOCIETY	
		2007 £m	2006 £m	2007 £m	2006 £m
LIABILITIES					
Due to customers - shares	19	2,921.7	2,671.5	2,921.7	2,671.5
Due to other customers	20	774.4	631.6	778.0	640.1
Deposits from banks	21	96.2	140.5	96.2	140.5
Debt securities in issue	22	655.3	619.7	540.1	494.1
Derivative financial instruments	11	37.3	14.6	35.7	13.9
Fair value adjustments for hedged risk		3.0	12.4	2.6	11.5
Other liabilities	23	29.7	43.0	27.8	43.3
Provisions	24	0.5	0.8	0.5	0.8
Retirement benefit obligations	30	3.4	8.8	3.4	8.8
Deferred tax liabilities	16	2.8	2.7	2.0	1.7
Subordinated liabilities	25	60.8	60.7	60.8	60.7
Subscribed capital	26	19.9	19.9	19.9	19.9
General reserve	27	210.7	195.3	210.1	190.1
TOTAL LIABILITIES		4,815.7	4,421.5	4,698.8	4,296.9

These Accounts were approved by the Board of Directors on 25 February 2008 and signed on its behalf by:

CJ HILTON, CHAIRMAN
MO GRANT, VICE-CHAIRMAN
CJ SECCOMBE, CHIEF EXECUTIVE

The notes on pages 25 to 52 form part of these Accounts.

CASH FLOW STATEMENTS for the year ended 31 December 2007

	Note	GROUP		SOCIETY	
		2007 £m	2006 £m	2007 £m	2006 £m
Cash flows from operating activities	28	188.6	96.3	195.2	98.5
Taxation paid		(0.9)	(1.1)	(0.9)	(0.3)
Payment into defined benefit pension scheme		(0.4)	(9.0)	(0.4)	(9.0)
Dividend received		-	-	6.4	-
Payments made to qualifying members and borrowers in respect of merger		(14.5)	-	(14.5)	-
Cash flows from investing activities					
Purchase of property, plant and equipment		(5.7)	(3.6)	(5.6)	(1.5)
Purchase of investment property		(6.8)	-	-	-
Sale of property, plant and equipment		1.0	2.5	1.0	2.5
Additional investments in subsidiary undertakings		-	-	(22.4)	-
Purchase of investment securities		(1,353.7)	(1,096.0)	(1,353.7)	(1,096.0)
Sale and maturity of investment securities		1,209.2	1,009.5	1,209.2	1,009.5
Net cash flows from investing activities		(156.0)	(87.6)	(171.5)	(85.5)
Cash flows from financing activities					
Interest paid on subordinated liabilities		(4.9)	(3.1)	(4.5)	(3.1)
Interest paid on subscribed capital		(2.3)	(2.3)	(2.3)	(2.3)
Repayments under finance lease agreements		(0.3)	(0.4)	(0.3)	(0.4)
Net cash flows from financing activities		(7.5)	(5.8)	(7.1)	(5.8)
Net increase / (decrease) in cash		9.3	(7.2)	7.2	(2.1)
Cash and cash equivalents at start of year		221.0	228.2	211.4	213.5
Cash and cash equivalents at end of year	28	230.3	221.0	218.6	211.4

The notes on pages 25 to 52 form part of these Accounts.

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**1 SIGNIFICANT ACCOUNTING POLICIES****Basis of preparation**

The Accounts have been prepared in accordance with International Financial Reporting Standards ('IFRSs') as adopted for use in the EU; interpretations issued by the International Financial Reporting Interpretations Committee; and with those parts of the Building Societies (Accounts and Related Provisions) 1998 applicable to building societies reporting under IFRSs. The Accounts have been prepared under the historical cost convention except for those financial assets and hedging instruments which are required by IAS 39 to be carried at fair value. A summary of the Group's principal accounting policies is set out below:

Basis of consolidation

The Group Accounts include the results of the Society and its subsidiary undertakings, all of which have accounting periods ending 31 December.

Securitisation transactions

In accordance with IAS 39, where the Society has entered into securitisation transactions in which mortgages are transferred to special purpose vehicles (SPVs), the Group continues to recognise securitised assets as loans and advances to customers. The Group does not own the equity of the SPVs created for these securitisations. However, to comply with the Building Societies Act 1986 (International Accounting Standards and Other Amendments) Order 2004 and Standing Interpretations Committee 12 (SIC 12), the SPVs are included as subsidiaries in the Group Accounts.

Financial assets

The Group classifies its financial assets into the following categories:

Loans and receivables

The Group's mortgage assets and similar loans are classified as loans and receivables and measured at amortised cost using the effective interest method (EIR). In accordance with EIR methodology, incremental up-front costs and fees receivable which are directly related to the loans (including administration and completion fees, arrangement fees, early redemption charges, procurator fees and commissions paid to agents) are deferred and released to income over the effective life of the mortgage assets.

Financial assets at fair value through profit or loss

Classified as such when designated by management on initial recognition and permitted by IAS 39, these assets are recognised both initially and subsequently at fair value with changes recognised in the Income Statements.

Available for sale

These assets are non-derivative financial instruments where the intention is to hold them for an indefinite period of time. They are initially measured at fair value with subsequent movements recognised directly in equity, until the asset is derecognised or impaired, at which point the cumulative gain or loss previously recognised in equity should be recognised in the Income Statements. Interest received on the asset is recognised immediately in the Income Statements.

Cash and cash equivalents

For the purpose of the Cash Flow Statements, 'Cash and cash equivalents' comprises cash in hand and loans and advances to credit institutions available on demand or with original maturities of three months or less i.e. highly liquid assets readily convertible into cash with a low risk of material changes in value.

Impairment of financial assets

Individual assessments are made against all those known loans and advances in arrears, in possession, where an event or default has occurred, or where fraud has been identified. Based on these assessments, which consider such data as current valuation, time expected to sell the property and the amount ultimately expected to be recoverable, the value of those loans and advances that are considered to be impaired is reduced on an individual basis. Collective impairment allowances are also made to reduce the value of those loans and advances where there has been some event such as a death or divorce which will give rise to an impairment but of which we are not yet aware at the Balance Sheet date, with the result that the amount advanced may not be recovered in full. For the purposes of the collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics. Any impairment loss or allowance is recognised in the Income Statements.

Financial liabilities

Financial liabilities are carried at amortised cost, using the EIR method.

Investment properties

Investment properties are stated at their fair value at the Balance Sheet date. Movements on revaluation are charged directly to the Income Statements.

Property, plant, equipment and depreciation

On transition to IFRS, the Group elected to adopt the exemption in IFRS 1 which permits an entity to use, on transition to IFRS, a value, which is not depreciated cost, as the 'deemed cost' of the asset.

Property, plant and equipment are stated at cost (or 'deemed cost') less accumulated depreciation and any provisions for impairment.

Depreciation on assets commences when they are ready for their intended use and is provided at rates calculated to write down the assets to their estimated residual values over the course of their anticipated useful lives, on the following bases:

Freehold buildings and leasehold buildings with a residual lease term of greater than fifty years	- 2% per annum, straight line
Other leasehold buildings	- over the term of the lease
Refurbishment expenditure	- 10% per annum, straight line
Equipment, fixtures and fittings	- 10% per annum, straight line with effect from 1 January 2005
Computer equipment	- 20% per annum, straight line
Motor vehicles	- over the term of the lease, or if purchased, at 25% per annum, reducing balance.

Land is not depreciated

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**SIGNIFICANT ACCOUNTING POLICIES** Continued**Non-current assets held for sale**

Non-current assets classified as held for sale are measured at the lower of carrying value and fair value less costs to sell. Non-current assets are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use and where the sale is expected to complete within one year of the classification.

Lease purchase and leasing

The Group enters into lease purchase contracts and finance and operating leases. Assets held under lease purchase contracts and finance leases are capitalised in Property, plant and equipment at the fair value of the asset at the inception of the lease, with an equivalent liability categorised under other liabilities. Assets are depreciated in accordance with the relevant Group policy. Finance charges are allocated to accounting periods over the life of each lease on a straight line basis or using the sum of digits method, depending on the cash flows attaching to the agreement. Rentals under operating leases are charged on a straight line basis over the lease term. Both finance charges and rentals are recognised in administrative expenses in the Income Statement.

Taxation

Corporation tax is charged on profits adjusted for tax purposes. Deferred tax is provided for, at expected rates, on all temporary differences between the carrying amounts of assets and liabilities and their tax bases.

Hedging instruments

The criteria required for an instrument to be classified as a hedge are that the transaction must be reasonably expected to match or eliminate a significant proportion of the risk inherent in the assets, liabilities, other positions or cash flows being hedged and which results from potential movements in interest rates, equities or house price indices. At the outset of the transaction, the Group documents the relationship between the hedging instrument and the hedged item or transaction, the risk management objective and strategy for undertaking the hedge, together with the nature of the risk being hedged. It also documents how the hedging instrument's effectiveness in offsetting the exposures to changes in the hedged item's fair value flows, attributable to the hedged risk, will be assessed both at the inception of the hedge and on an ongoing basis. In accordance with IAS 39, all derivatives are measured at fair value. When a derivative qualifies for hedge accounting i.e. there is an effective hedge in place, the value of the hedged item is largely offset by changes in the value of the underlying assets and liabilities. Changes in fair value are recognised in the Income Statements.

Pension scheme costs

The Society operates both defined benefit and defined contribution schemes on behalf of directors and staff. The defined benefit schemes are funded by contributions partly from the employees and partly from the Society at rates determined by independent actuaries. These contributions are invested separately from the Group's assets. Under IAS 19, the Scheme assets are measured at bid value at each Balance Sheet date and the obligations are measured by independent actuaries using the projected unit valuation method, discounted using a high quality corporate bond rate. The resulting pension scheme surplus or deficit is recognised immediately on the Balance Sheet and any resulting actuarial gains and losses are recognised immediately in the Statement of Recognised Income and Expense. For the defined contribution schemes, contributions are charged to the Income Statement, as they become payable, in accordance with the rules of the Scheme.

Provisions

A provision is recognised when there is a present obligation as a result of a past event, it is probable that the obligation will be settled and it can be reliably estimated.

Accounting Estimates and Judgements in applying Accounting Policies

The Group has to make judgements in applying its accounting policies which affect the amounts recognised in the Accounts. In addition, estimates and assumptions are made that could affect the reported amounts of assets and liabilities within the following year. The most significant areas where judgements and assumptions are made are as follows:

Pensions

The Group operates two defined benefit pension schemes. Significant judgements (on issues such as discount, interest and mortality rates, inflation and future salary increases) have to be exercised in estimating the assets and liabilities of the scheme. These judgements, which are based upon the Board receiving independent external advice from the scheme actuaries, are outlined in Note 30 to the Accounts.

Effective interest rate (EIR)

To calculate the appropriate EIR, certain assumptions are made in respect of the expected lives of specific asset portfolios which take into account such factors as the terms of the particular product, historic repayment data and prevailing economic conditions. These estimates are reviewed on a regular basis to ensure they reflect the portfolio's actual performance.

Impairment of financial assets

Key assumptions, resulting in predictions of the value of underlying assets held as security for loans advanced, based on historic data and prudent expectations around future conditions, are used to determine the level of impairment required in respect of financial assets.

Taxation

The Group is subject to tax in three jurisdictions and, consequently, estimates are required in determining the provision for corporation tax.

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**2 INTEREST RECEIVABLE AND SIMILAR INCOME**

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
On loans and advances to customers	209.7	163.6	201.8	154.8
On debt securities				
- interest and other income	34.6	23.7	34.6	23.7
- profits net of losses on realisation	1.9	1.4	1.9	1.4
On other liquid assets				
- interest and other income	8.4	7.0	9.0	7.2
Net income / (expense) on derivative hedging assets	10.2	(2.2)	9.7	(1.6)
	264.8	193.5	257.0	185.5

3 INTEREST EXPENSE AND SIMILAR CHARGES

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
On shares held by individuals	135.6	95.2	135.6	95.2
On subscribed capital	2.3	2.3	2.3	2.3
On deposits and other borrowings				
- subordinated liabilities	4.9	3.2	4.5	3.1
- to subsidiary companies	-	-	0.2	0.1
- to other depositors and borrowers	80.9	60.4	73.5	52.9
Net (expense) / income on derivative hedging liabilities	(2.6)	0.1	(2.6)	0.1
	221.1	161.2	213.5	153.7

4 OTHER INCOME AND CHARGES

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
Other income				
Fee and commission income	10.0	7.5	6.2	5.2
Other operating income	11.0	6.7	10.7	6.5
	21.0	14.2	16.9	11.7

Other charges

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
Fee and commission expense	2.5	1.8	3.1	2.1
Other operating expense	-	(0.1)	-	(0.1)
	2.5	1.7	3.1	2.0

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**5 DIVIDEND INCOME**

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
Received from subsidiary undertaking	-	-	6.4	-

6 ADMINISTRATIVE EXPENSES

	Note	GROUP		SOCIETY	
		2007 £m	2006 £m	2007 £m	2006 £m
Staff costs	7	25.9	19.3	24.1	17.9
Depreciation of property, plant and equipment	14	2.7	2.3	2.3	1.8
Rentals under operating leases for land and buildings					
- payable to third parties		1.0	1.1	1.0	1.1
- payable to subsidiary undertaking		-	-	0.1	0.1
Other administrative expenses		11.6	10.8	11.3	10.1
		41.2	33.5	38.8	31.0

During the year the Group obtained the following services from the Group's auditors and these are included in other administrative expenses.

Fees payable for statutory audit	0.1	0.2	0.1	0.2
Fees payable for non audit services	0.1	-	0.1	-
	0.2	0.2	0.2	0.2

7 STAFF COSTS

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
Wages and salaries	22.5	16.7	20.9	15.5
Social security costs	2.1	1.5	1.9	1.3
Pension costs				
- defined benefit plans	0.9	0.8	0.9	0.8
- defined contribution plans	0.4	0.3	0.4	0.3
	25.9	19.3	24.1	17.9

The monthly average number of persons employed, including executive directors, during the year was:

	GROUP		SOCIETY	
	2007	2006	2007	2006
Full time	766	595	732	578
Part time	286	233	283	232
	1,052	828	1,015	810

By activity:

Principal Office	828	634	813	631
Branches	224	194	202	179
	1,052	828	1,015	810

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**8 TAXATION EXPENSE**

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
Current tax				
UK corporation tax on profits for the year	4.7	0.3	3.8	0.2
Group relief for the year	-	-	0.1	(0.2)
Overprovision in respect of previous years	(2.4)	(0.4)	(2.4)	(0.4)
Total current tax	2.3	(0.1)	1.5	(0.4)
Deferred tax				
Current year	0.8	3.2	0.9	3.2
Overprovision in respect of previous years	2.4	0.4	2.4	0.4
Total deferred tax	3.2	3.6	3.3	3.6
Total taxation expense in the Income Statement	5.5	3.5	4.8	3.2

Analysis of tax charge for the year

Profit before taxation	17.6	11.6	21.5	10.8
Profit before taxation at the standard rate of corporation tax in the UK of 30% (2006: 30%)	5.3	3.5	6.5	3.2
Non-taxable income	(0.1)	(0.3)	(2.0)	(0.3)
Expenses not deductible for tax purposes	0.3	0.3	0.3	0.3
Total tax charge	5.5	3.5	4.8	3.2

Factors affecting future tax charges

During the year, as a result of the change in UK Corporation Tax rates which will be effective from 1 April 2008, deferred tax balances have been remeasured. Deferred tax relating to temporary differences which are expected to reverse prior to 1 April 2008 is measured at 30% and deferred tax relating to temporary differences expected to reverse after 1 April 2008 is measured at the tax rate of 28% as these are the tax rates that will be applied on the reversal.

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**9 LOANS AND ADVANCES TO BANKS**

Repayable from the date of the Balance Sheet in the ordinary course of business as follows:

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
Accrued interest	1.0	1.1	1.0	1.1
On demand	18.7	12.2	6.9	2.6
In not more than three months	205.8	204.2	205.8	204.2
In more than three months but not more than one year	-	9.0	-	9.0
In more than one year but not more than five years	2.5	2.5	2.5	2.5
	228.0	229.0	216.2	219.4

10 OTHER FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
Transferable debt securities				
Issued by public bodies - listed	10.7	18.0	10.7	18.0
Issued by other borrowers - unlisted	678.3	521.7	678.3	521.7
	689.0	539.7	689.0	539.7

These have remaining maturities as follows:

Accrued interest	11.1	5.8	11.1	5.8
In not more than one year	481.6	353.0	481.6	353.0
In more than one year	196.3	180.9	196.3	180.9
	689.0	539.7	689.0	539.7

The Directors consider that the primary purpose of holding securities is to comply with prudential requirements. All transferable debt securities are held with the intention of use on a continuing basis in the Group's activities. They are designated by management on initial recognition as being at fair value through profit or loss and are recognised, both initially and subsequently, at fair value with changes recognised in the Income Statements.

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**11 FINANCIAL INSTRUMENTS****Fair values of financial assets and liabilities**

The following table summarises the carrying amounts and fair values of those financial assets and liabilities not presented on the Group's or Society's balance sheet at their fair value.

GROUP**At 31 December 2007**

Note	Carrying value		Fair value	
	2007 £m	2006 £m	2007 £m	2006 £m
	5.8	4.6	5.8	4.6
9	228.0	229.0	228.1	229.3
12	3,772.5	3,542.2	3,833.2	3,570.5
	2,921.7	2,671.5	2,922.5	2,669.7
20	774.4	631.6	774.4	631.7
21	96.2	140.5	92.3	140.2
22	655.3	619.7	656.3	621.2
25	60.8	60.7	65.2	60.7
26	19.9	19.9	32.9	39.5

Financial assets

Cash and balances with the Bank of England

Loans and advances to banks

Loans and advances to customers

Financial liabilities

Due to customers - shares

Due to other customers

Deposits from banks

Debt securities in issue

Subordinated liabilities

Subscribed capital

SOCIETY**At 31 December 2007**

Note	Carrying value		Fair value	
	2007 £m	2006 £m	2007 £m	2006 £m
	5.8	4.6	5.8	4.6
9	216.2	219.4	216.2	219.6
12	3,643.4	3,415.6	3,703.8	3,444.3
19	2,921.7	2,671.5	2,922.5	2,669.7
20	778.0	640.1	774.4	639.3
21	96.2	140.5	96.1	140.2
22	540.1	494.1	541.0	495.4
25	60.8	60.7	65.2	60.7
26	19.9	19.9	32.9	39.5

Financial assets

Cash and balances with the Bank of England

Loans and advances to banks

Loans and advances to customers

Financial liabilities

Due to customers - shares

Due to other customers

Deposits from banks

Debt securities in issue

Subordinated liabilities

Subscribed capital

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**11 FINANCIAL INSTRUMENTS** Continued**Loans and advances to banks**

Loans and advances to banks includes inter-bank placements and items in the course of collection.

The fair value of floating rate and overnight deposits is their carrying amount. The fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and remaining maturity.

Loans and advances to customers

Loans and advances to customers are net of provisions for impairment. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates to determine fair value.

Due to customers

The fair value of shares is assumed to approximate to the amount payable at the balance sheet date.

Deposits from banks

The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest-bearing deposits and other borrowings without market price is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

Debt securities in issue

The aggregate fair values are calculated based on quoted market prices. For those notes where quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity.

Derivatives held for hedging

Derivative financial instruments used by the Group have been described previously in the Risk Management Report. The fair values of the derivative instruments held are set out below:

GROUP	2007 Notional Amount £m	2007 Assets £m	2007 Liabilities £m	2006 Notional Amount £m	2006 Assets £m	2006 Liabilities £m
Fair value at 31 December						
Derivatives designed as fair value hedges						
Interest rate swaps	1,834.0	11.8	(33.8)	1,594.3	25.7	(12.1)
Other derivatives						
Interest rate options	190.0	0.1	-	40.0	0.1	-
Interest rate swaps	410.6	2.6	(3.0)	469.2	2.6	(2.5)
Basis risk derivatives	200.0	-	(0.5)	-	-	-
		<u>14.5</u>	<u>(37.3)</u>		<u>28.4</u>	<u>(14.6)</u>
SOCIETY						
	2007 Notional Amount £m	2007 Assets £m	2007 Liabilities £m	2006 Notional Amount £m	2006 Assets £m	2006 Liabilities £m
Fair value at 31 December						
Derivatives designed as fair value hedges						
Interest rate swaps	1,834.0	11.8	(33.8)	1,594.3	25.7	(12.1)
Other derivatives						
Interest rate options	190.0	0.1	-	40.0	0.1	-
Interest rate swaps	288.6	2.2	(1.4)	336.9	1.7	(1.8)
Basis risk derivatives	200.0	-	(0.5)	-	-	-
		<u>14.1</u>	<u>(35.7)</u>		<u>27.5</u>	<u>(13.9)</u>

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**11 FINANCIAL INSTRUMENTS** Continued**Liquidity risk**

For each material category of financial liability a maturity analysis is provided in notes 19 to 22, which represents the contractual maturities.

The table below analyses the Group's financial liabilities, which will be settled on a net basis, into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows. Balances due within 12 months equal their carrying balances as the impact of discounting is not significant.

At 31 December 2007	Repayable on demand	Up to 3 months	Between 3 and 12 months	Between 1 and 5 years	Over 5 years	Total
Due to customers - shares	2,519.9	155.2	76.8	162.4	7.4	2,921.7
Due to other customers	28.3	437.6	281.5	26.8	0.1	774.3
Deposits from banks	0.7	75.5	15.0	1.2	-	92.4
Debit securities in issue	5.4	-	335.0	199.8	115.2	655.4
Derivative financial instruments	-	-	0.8	16.2	20.3	37.3
Fair value adjustments for hedged risk	-	-	0.4	0.7	1.9	3.0
At 31 December 2006	Repayable on demand	Up to 3 months	Between 3 and 12 months	Between 1 and 5 years	Over 5 years	Total
Due to customers - shares	2,343.3	78.4	95.5	145.2	9.1	2,671.5
Due to other customers	34.4	381.8	170.8	44.4	0.2	631.6
Deposits from banks	1.4	110.2	27.8	1.1	-	140.5
Debit securities in issue	4.0	-	65.5	424.6	125.6	619.7
Derivative financial instruments	-	-	0.6	5.8	8.2	14.6
Fair value adjustments for hedged risk	-	-	0.5	6.6	5.3	12.4

Equity risk

The Group has no material direct exposure to equity risk. The Group has a number of structured products which have an embedded derivative attached to them i.e. the return payable is derived from the performance of an underlying index / unit trust price / company share price. Under IAS 39 both the underlying product and the derivative are fair value accounted through the Income Statements. The fair value amounts are approximately equal and offsetting so there is no material charge or credit in the accounts.

Credit risk

The average loan to value (LTV) ratio of the Group's loans and advances to customers is estimated to be **43.5%** (2006: 42.0%). Further LTV information is shown below:

Total residential mortgage book

Loan to value analysis (indexed)	2007 £m	2007 %	2006 £m	2006 %
<70%	1,991.5	87.2	2,111.2	91.3
70% - <80%	114.8	5.0	110.4	4.8
80% - <90%	104.0	4.6	69.3	3.0
>90%	73.3	3.2	21.1	0.9

The table below provides further information by payment due status:

	2007 £m	2007 %	2006 £m	2006 %
Neither past due nor impaired	2,010.3	88.0	2,134.4	92.3
Past due but not impaired	191.0	8.4	133.8	5.7
Impaired:				
Past due up to 3 months	64.2	2.8	32.8	1.4
Past due 3 to 6 months	11.6	0.5	6.3	0.3
Past due over 6 months	5.6	0.2	3.9	0.2
In possession	0.9	0.1	0.8	0.1

Against past due and possession cases, **£679.1m** (2006: £508.2m) of collateral is held. No loans that would be past due or impaired have had their terms renegotiated.

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**11 FINANCIAL INSTRUMENTS** Continued**Commercial lending book**

The commercial lending book comprises:

GROUP	2007	2007	2006	2006
	£m	%	£m	%
Loans secured on commercial property	470.8	33.5	313.2	27.6
Loans secured on other residential property	116.3	8.3	58.1	5.1
Loans to Registered Social Landlords	819.6	58.2	764.7	67.3
	1,406.7	100.0	1,136.0	100.0

Loans to Registered Social Landlords are secured on residential property.

Loans secured on commercial property are diversified by industry type and an analysis is shown below:

	2007	2007	2006	2006
	£m	%	£m	%
Retail	201.0	42.7	148.6	47.5
Office	69.2	14.7	41.0	13.1
Industrial	155.8	33.1	79.5	25.4
Hotel / Leisure	44.5	9.4	37.7	12.0
Other	0.3	0.1	6.4	2.0
	470.8	100.0	313.2	100.0

The commercial lending book for the Group includes **£121.3m** of balances (£133.6m: 2006) held by the securitisation vehicle, Bamburgh Finance No. 1 PLC.

SOCIETY	2007	2007	2006	2006
	£m	%	£m	%
Loans secured on commercial property	349.5	27.2	179.6	17.9
Loans secured on other residential property	116.2	9.0	58.1	5.8
Loans to Registered Social Landlords	819.6	63.8	764.7	76.3
	1,285.3	100.0	1,002.4	100.0

	2007	2007	2006	2006
	£m	%	£m	%
Retail	157.0	44.9	97.7	54.4
Office	44.2	12.7	14.7	8.2
Industrial	122.0	34.9	45.5	25.3
Hotel / Leisure	26.0	7.4	15.3	8.5
Other	0.3	0.1	6.4	3.6
	349.5	100.0	179.6	100.0

Interest rate risk

Interest rate risk is the exposure of the Group's net interest income to movement in interest rates. This is managed using a combination of limits set by the Board and by use of derivative instruments. The sensitivity to interest rate movements is measured using dynamic stress tests for a series of parallel rate shifts over various time periods.

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**11 FINANCIAL INSTRUMENTS** Continued

The table below shows the impact of various interest rate scenarios on Group profit before tax:

	+1%	+2%	-1%	-2%
	£m	£m	£m	£m
At 31 December 2007				
Next 12 months	0.1	0.3	(0.1)	(0.5)
Next 2 years	(0.6)	(0.7)	0.6	0.4
Next 3 years	(0.1)	0.5	0.1	(0.9)
At 31 December 2006				
Next 12 months	(1.2)	(2.3)	1.2	1.8
Next 2 years	(1.9)	(3.6)	1.8	2.6
Next 3 years	(2.2)	(4.1)	2.1	2.9

The main risk measure used by the Asset and Liabilities Committee is an immediate 200 basis points parallel shift in interest rates.

The derivative gains less losses for the year in respect of fair value hedges comprise losses on derivatives of **£36.7m** (2006: £18m gain) and associated gains on hedged items of **£35.4m** (2006: £16.9m loss).

Interest rate risk in the pension schemes

A reduction of 0.1% in the discount rate would increase the pension deficit by approximately £1.5m.

Currency risk

The Group has no exposure to currency risk.

12. LOANS AND ADVANCES TO CUSTOMERS

	GROUP		SOCIETY	
	2007	2006	2007	2006
	£m	£m	£m	£m
Loans fully secured on residential property	3,188.8	3,113.6	3,166.0	3,105.4
Loans fully secured on land	439.9	310.8	333.6	192.4
Other loans	147.9	121.6	147.9	121.6
	3,776.6	3,546.0	3,647.5	3,419.4
Gross loans and advances				
Less: allowance for losses on loans and advances	(4.1)	(3.8)	(4.1)	(3.8)
	3,772.5	3,542.2	3,643.4	3,415.6

Loans and advances to customers have remaining maturities as follows:

	GROUP		SOCIETY	
	2007	2006	2007	2006
	£m	£m	£m	£m
On demand	10.5	5.5	10.5	5.5
In not more than three months	29.1	19.5	27.5	18.4
In more than three months but not more than one year	108.3	107.9	103.6	104.4
In more than one year but not more than five years	479.2	365.3	463.8	355.8
In more than five years	3,149.5	3,047.8	3,042.1	2,935.3
	3,776.6	3,546.0	3,647.5	3,419.4
Less: allowance for losses on loans and advances	(4.1)	(3.8)	(4.1)	(3.8)
	3,772.5	3,542.2	3,643.4	3,415.6

Where a loan is repayable by instalment, each such instalment has been treated as a separate repayment in the maturity analysis set out above. The Group's experience is that in many cases mortgages are redeemed before their scheduled maturity date. As a consequence, the maturity analysis illustrated above may not reflect actual experience.

Allowance for losses on loans and advances

	GROUP		SOCIETY	
	2007	2006	2007	2006
	£m	£m	£m	£m
Balance at 1 January	3.8	3.1	3.8	3.1
Taken on on transfer of engagements	-	0.4	-	0.4
Transferred to provisions during the year	(0.2)	-	(0.2)	-
Impairment losses on loans and advances	0.5	0.3	0.5	0.3
At 31 December	4.1	3.8	4.1	3.8

Of the above allowances, **£1.5m** (2006: £1.6m) is regarded as being 'collective provisioning' under FSA regulations.

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**13 INVESTMENTS IN SUBSIDIARY UNDERTAKINGS****SOCIETY**

	Shares £m	Loans £m	Total £m
Investments in subsidiary undertakings			
Cost			
At 1 January 2007	7.8	12.6	20.4
Additions	-	22.4	22.4
At 31 December 2007	7.8	35.0	42.8
Provisions			
At 1 January and 31 December 2007	1.8	1.8	3.6
Net book amount at 31 December 2007	6.0	33.2	39.2
Net book amount at 31 December 2006	6.0	10.8	16.8

The Society directly holds 100% of the issued ordinary share capital of all its subsidiary undertakings.

Name of principal undertakings	Principal activity
Kings Manor Properties Limited	Residential property rental
NBS Mortgage Advisor Limited	Provision of mortgage broking services
Newcastle Commercial Lending Limited	Commercial lending
Newcastle Financial Services Limited	Provision of financial services
Newcastle Mortgage Loans (Jersey) Limited	Mortgage lending
Newcastle Mortgage Services Limited	Provision of mortgage processing services
Newcastle Portland House Limited	Commercial property rental
Newcastle Strategic Solutions Limited	Provision of specialised products and services
Newton Facilities Management Limited	Provision of managed IT services
Newton Facilities Computer Purchasing Limited	Purchase, sale and leasing of IT equipment
Newton Facilities Computer Leasing Limited	Leasing of IT equipment

All the above subsidiary undertakings, except for Newcastle Mortgage Loans (Jersey) Limited, which is incorporated and operates in Jersey, are incorporated in England and Wales and operate in the United Kingdom. A Group segmental analysis is not provided since, in the opinion of the directors, the Group's activities are predominantly UK based and within one business sector.

The results of the following securitisation vehicles are consolidated into the Group under International Accounting Standard 27: 'Consolidated and separate Financial Statements'.

Name	Principal activity
Bamburgh Finance No. 1 PLC	Securitisation vehicle
Bamburgh Holdings Limited	Holding company
Bamburgh Mortgages Trustee Limited	Securitisation vehicle

The Society has no shareholdings in any of the companies listed above. Bamburgh Finance No. 1 PLC is incorporated in England and Wales and operates in the United Kingdom. The other companies are incorporated in Jersey.

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**14 PROPERTY, PLANT AND EQUIPMENT****GROUP**

	Freehold buildings £m	Leasehold land and buildings £m	Property in the course of construction £m	Equipment, fixtures, fittings and motor vehicles £m	Total £m
Cost					
At 1 January 2007	7.3	13.8	-	14.0	35.1
Additions	-	-	2.4	3.5	5.9
Disposals	(0.3)	-	-	(0.4)	(0.7)
At 31 December 2007	7.0	13.8	2.4	17.1	40.3
Depreciation					
At 1 January 2007	0.4	1.6	-	6.1	8.1
Charge for the year	0.1	0.3	-	2.3	2.7
Disposals	(0.2)	-	-	(0.3)	(0.5)
At 31 December 2007	0.3	1.9	-	8.1	10.3
Net book amount at 31 December 2007	6.7	11.9	2.4	9.0	30.0

GROUP

	Freehold buildings £m	Leasehold land and buildings £m	Equipment, fixtures, fittings and motor vehicles £m	Total £m	
Cost					
At 1 January 2006		6.2	11.4	12.0	29.6
Taken on on transfer of engagements		1.1	1.5	0.3	2.9
Additions		-	-	2.1	2.1
Disposals		-	-	(0.4)	(0.4)
Transferred from assets held for sale		-	0.9	-	0.9
At 31 December 2006	7.3	13.8	14.0	35.1	
Depreciation					
At 1 January 2006		0.3	1.0	4.6	5.9
Charge for the year		0.1	0.2	2.0	2.3
Disposals		-	-	(0.2)	(0.2)
Transferred from assets held for sale		-	0.1	-	0.1
Reclassifications		-	0.3	(0.3)	-
At 31 December 2006	0.4	1.6	6.1	8.1	
Net book amount at 31 December 2006	6.9	12.2	7.9	27.0	

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**14 PROPERTY, PLANT AND EQUIPMENT** Continued

SOCIETY	Freehold buildings £m	Leasehold land and buildings £m	Property in the course of construction £m	Equipment, fixtures, fittings and motor vehicles £m	Total £m
Cost					
At 1 January 2007	7.3	2.5	-	11.9	21.7
Additions	-	-	2.4	3.4	5.8
Disposals	(0.3)	-	-	(0.4)	(0.7)
At 31 December 2007	7.0	2.5	2.4	14.9	26.8

Depreciation

At 1 January 2007	0.4	0.1	-	4.3	4.8
Charge for the year	0.1	-	-	2.2	2.3
Disposals	(0.2)	-	-	(0.3)	(0.5)
At 31 December 2007	0.3	0.1	-	6.2	6.6
Net book amount at 31 December 2007	6.7	2.4	2.4	8.7	20.2

SOCIETY

	Freehold buildings £m	Leasehold land and buildings £m	Equipment, fixtures, fittings and motor vehicles £m	Total £m
Cost				
At 1 January 2006	6.2	0.1	10.0	16.3
Taken on on transfer of engagements	1.1	1.5	0.3	2.9
Additions	-	-	2.0	2.0
Disposals	-	-	(0.4)	(0.4)
Transferred from assets held for sale	-	0.9	-	0.9
At 31 December 2006	7.3	2.5	11.9	21.7

Depreciation

At 1 January 2006	0.3	-	2.8	3.1
Charge for the year	0.1	-	1.7	1.8
Disposals	-	-	(0.2)	(0.2)
Transferred from assets held for sale	-	0.1	-	0.1
At 31 December 2006	0.4	0.1	4.3	4.8
Net book amount at 31 December 2006	6.9	2.4	7.6	16.9

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**14 PROPERTY, PLANT AND EQUIPMENT** Continued

Assets under finance leases, which comprise motor vehicles and a long leasehold property, have the following net book amounts.

	GROUP and SOCIETY	
	2007 £m	2006 £m
Cost		
At 1 January	1.5	1.7
Accumulated depreciation	(0.2)	(0.2)
Net book amount at 31 December	1.3	1.5

15 INVESTMENT PROPERTY

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
Fair value				
At 1 January	2.1	0.1	-	0.1
Taken on on transfer of engagements	-	2.1	-	-
Additions	6.8	-	-	-
Disposals	-	(0.1)	-	(0.1)
At 31 December	8.9	2.1	-	-

Investment properties are carried at fair value. The fair value at 31 December 2007 was arrived at by reference to market prices for similar properties, as estimated by a qualified staff valuer. Investment properties are subject to an annual impairment test.

Investment property rental income and direct operating expenses for the Group are as shown below:

	GROUP	
	2007 £m	2006 £m
Income from rental properties which are all leased under operating leases	0.2	-
Operating expenses relating to rental properties	(0.1)	-
Net rental income from rented properties	0.1	-
Operating expenses above include unlet property expenses of:	-	-

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**16 DEFERRED TAX**

Deferred tax is calculated on all temporary differences under the liability method using a tax rate of **28%** (2006: 30%). The movement on the deferred tax account is shown below.

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
At 1 January	4.3	4.6	5.2	5.5
Income Statement charge	(0.8)	(3.2)	(0.9)	(3.2)
Taken on on transfer of engagements	-	1.0	-	1.0
Overprovision in respect of prior years	(2.4)	(0.4)	(2.4)	(0.4)
(Charge) / credit on items taken directly through reserves	(1.5)	2.3	(1.5)	2.3
At 31 December	(0.4)	4.3	0.4	5.2

Deferred tax assets and liabilities are attributable to the following items.

Deferred tax assets

Short term timing differences	0.5	2.9	0.5	2.9
Retirement benefit obligations	0.9	2.6	0.9	2.6
Fair value adjustments on adoption of IAS 32 and IAS 39	1.0	1.3	1.0	1.3
Other assets	-	0.2	-	0.1
	2.4	7.0	2.4	6.9

Deferred tax liabilities

Accelerated capital allowances	(1.3)	(1.4)	(0.5)	(0.4)
Pensions and other post retirement benefits	(1.5)	(1.3)	(1.5)	(1.3)
	(2.8)	(2.7)	(2.0)	(1.7)

The deferred tax charge in the Income Statement comprises the following temporary differences:

Accelerated capital allowances	-	(0.1)	(0.1)	(0.1)
Short term timing differences	(0.3)	(0.1)	(0.3)	(0.1)
Pensions and other post retirement benefits	(0.4)	(3.0)	(0.4)	(3.0)
Change in UK corporation tax rate	(0.1)	-	(0.1)	-
	(0.8)	(3.2)	(0.9)	(3.2)

17 OTHER ASSETS

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
Group relief receivable from subsidiary undertakings	-	-	0.2	0.4
Other assets	8.1	7.2	4.1	7.9
Interest receivable on financial instruments	14.3	5.9	14.3	5.9
Prepayments and accrued income	6.5	12.9	13.7	20.0
	28.9	26.0	32.3	34.2

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**18 NON-CURRENT ASSETS HELD FOR SALE****Cost**

	GROUP and SOCIETY	
	2007 £m	2006 £m
At 1 January	0.5	2.2
Taken on on transfer of engagements	-	0.2
Disposals	(0.1)	(1.1)
Transferred to Property, plant and equipment	-	(0.8)
At 31 December	0.4	0.5

These assets are primarily freehold premises vacant as a result of branch closures and expected premises moves.

19 DUE TO CUSTOMERS - SHARES

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
Held by individuals	2,920.8	2,670.7	2,920.8	2,670.7
Other shares	0.9	0.8	0.9	0.8
	2,921.7	2,671.5	2,921.7	2,671.5

Repayable from the date of the Balance Sheet in the ordinary course of business as follows:

Accrued interest	90.2	107.0	90.2	107.0
On demand	2,429.7	2,236.3	2,429.7	2,236.3
In not more than three months	155.2	78.4	155.2	78.4
In more than three months but not more than one year	76.8	95.5	76.8	95.5
In more than one year but not more than five years	162.4	145.2	162.4	145.2
In more than five years	7.4	9.1	7.4	9.1
	2,921.7	2,671.5	2,921.7	2,671.5

Included in the shares balance is the contractual balance of **£252.4m** (2006: £286.3m) of Capital Protection Bonds with fair values at 31 December 2006 of **£261.4m** (2006: £299.6m). The fair value adjustments of **£9.0m** (2006: £13.3m) to the carrying value of the bonds is included in the figures above. All the changes in fair value are attributable to changes in benchmark equity and interest rates. The Society is contractually required to pay only the par value of the shares on maturity.

20 DUE TO OTHER CUSTOMERS

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
Amounts owed to subsidiary undertakings	-	-	3.6	8.5
Other	774.4	631.6	774.4	631.6
	774.4	631.6	778.0	640.1

Repayable from the date of the Balance Sheet in the ordinary course of business as follows:

Accrued interest	9.8	8.5	9.8	8.5
On demand	18.5	25.9	18.5	25.9
In not more than three months	437.7	381.8	441.3	390.3
In more than three months but not more than one year	281.5	170.8	281.5	170.8
In more than one year but not more than five years	26.8	44.4	26.8	44.4
In more than five years	0.1	0.2	0.1	0.2
	774.4	631.6	778.0	640.1

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**21 DEPOSITS FROM BANKS**

Repayable from the date of the Balance Sheet in the ordinary course of business as follows:

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
Accrued interest	0.7	1.4	0.7	1.4
In not more than three months	79.3	110.2	79.3	110.2
In more than three months but not more than one year	15.0	27.8	15.0	27.8
In more than one year but not more than five years	1.2	1.1	1.2	1.1
	96.2	140.5	96.2	140.5

22 DEBT SECURITIES IN ISSUE

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
Accrued interest	5.3	4.0	5.3	4.0
Certificates of deposit and Medium Term Notes repayable in not more than one year	335.0	65.5	335.0	65.5
Medium Term Notes repayable in more than one year but not more than five years	199.8	424.6	199.8	424.6
Non recourse finance on securitised advances repayable after five years	115.2	125.6	-	-
	655.3	619.7	540.1	494.1

The Medium Term Notes are repayable on 29 July 2008 (£225m) and 16 November 2009 (£199.8m).

Non recourse finance repayable after five years comprises:

	GROUP and SOCIETY	
	2007 £m	2006 £m
Class A Mortgage backed floating rate notes due 2038	77.9	88.3
Class B Mortgage backed floating rate notes due 2038	13.6	13.6
Class C Mortgage backed floating rate notes due 2038	14.2	14.2
Class D Mortgage backed floating rate notes due 2038	9.5	9.5
	115.2	125.6

The mortgage backed floating rate notes due 2038 (the 'Notes') are secured over a portfolio of mortgage loans secured by first charges over commercial properties in the United Kingdom. Prior to redemption of the Notes on the final interest payment date falling in May 2038, the Notes will be subject to mandatory and/or optional redemption in certain circumstances, on each interest payment date.

There are four classes of Notes. All classes are subject to interest based on the prevailing three month Libor plus an additional margin. The three month Libor is revised quarterly and the following margins, subject to revision, apply to the classes of notes as follows:

	Until 22 Feb 2011	23 Feb 2011 until Dec 2038
Class A	0.45%	0.90%
Class B	0.60%	1.20%
Class C	0.85%	1.70%
Class D	1.85%	2.85%

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**23 OTHER LIABILITIES**

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
Amounts payable to subsidiary undertakings	-	-	1.2	1.9
Third party income tax withheld	4.1	7.7	4.1	7.7
Amounts payable to qualifying shareholding members and borrowers	0.3	14.8	0.3	14.8
Obligations under finance leases	1.3	1.5	1.3	1.5
Other creditors	10.6	2.3	8.0	7.9
Accruals and deferred income	13.4	16.7	12.9	9.5
	29.7	43.0	27.8	43.3

Obligations under finance leases fall due as follows:

	2007 £m	2006 £m	2007 £m	2006 £m
Within one year	0.2	0.2	0.2	0.2
In one to two years	0.2	0.2	0.2	0.2
In two to five years	0.1	0.3	0.1	0.3
In more than five years	0.8	0.8	0.8	0.8
	1.3	1.5	1.3	1.5

These liabilities are secured by charges over the assets to which they relate.

24 PROVISIONS

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
Provision for liabilities and commitments	0.3	0.4	0.3	0.4
Provision for discontinued operations	0.2	0.4	0.2	0.4
	0.5	0.8	0.5	0.8

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
Balance at 1 January	0.8	2.5	0.8	2.5
New provisions during the year	0.4	0.4	0.4	0.4
Amounts utilised during the year	(0.7)	(2.1)	(0.7)	(2.1)
At 31 December	0.5	0.8	0.5	0.8

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**25 SUBORDINATED LIABILITIES**

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
6.380% fixed rate subordinated notes 2015	11.0	10.9	11.0	10.9
6.190% fixed rate subordinated notes 2017	25.0	25.0	25.0	25.0
6.625% fixed rate subordinated notes 2019	25.0	25.0	25.0	25.0
Less: unamortised issue costs	(0.2)	(0.2)	(0.2)	(0.2)
	60.8	60.7	60.8	60.7

On a winding up, the subordinated notes rank behind the claims against the Society of all depositors, creditors and investing members (other than holders of deferred shares i.e. permanent interest bearing shares) of the Society. The notes are repayable at the Society's option and with the prior consent of the Financial Services Authority, on any interest date within five years of the maturity date.

26 SUBSCRIBED CAPITAL

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
12.625% permanent interest bearing shares	10.0	10.0	10.0	10.0
10.750% permanent interest bearing shares	10.0	10.0	10.0	10.0
	20.0	20.0	20.0	20.0
Less: unamortised issue costs	(0.1)	(0.1)	(0.1)	(0.1)
	19.9	19.9	19.9	19.9

The subscribed capital was issued for an indeterminate period and is only repayable in the event of the winding up of the Society.

27 GENERAL RESERVE

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
At 1 January	195.3	168.8	190.1	164.1
Taken on on transfer of engagements	-	24.0	-	24.0
Actuarial gain on retirement benefit obligations	4.8	0.4	4.8	0.4
Payments made to qualifying members and borrowers in respect of merger	-	(8.3)	-	(8.3)
Movement on deferred tax in respect of these items	(1.5)	2.3	(1.5)	2.3
Profit for the financial year	12.1	8.1	16.7	7.6
At 31 December	210.7	195.3	210.1	190.1

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**28 NOTES TO THE CASH FLOW STATEMENTS**

	GROUP		SOCIETY	
	2007 £m	2006 £m	2007 £m	2006 £m
Reconciliation of profit before tax to net cash inflow from operating activities				
Profit before taxation and dividends	17.6	11.6	15.1	10.8
Depreciation and amortisation	2.7	2.3	2.3	1.8
Interest on subordinated liabilities	4.9	3.1	4.5	3.1
Interest on subscribed capital	2.3	2.3	2.3	2.3
Increase / (decrease) in derivative financial instruments	36.6	(2.0)	35.2	1.5
(Decrease) / increase in other financial liabilities at fair value through profit or loss	(31.1)	9.9	(30.5)	6.4
Decrease in retirement benefit obligations	(4.8)	(0.5)	(4.8)	(0.5)
Other non-cash movements	4.5	(0.3)	4.5	(0.3)
Amounts taken on on transfer of engagements	-	(15.7)	-	(15.7)
Deferred tax on these movements	1.5	(2.3)	1.5	(2.3)
Net cash inflow before changes in operating assets and liabilities	34.2	8.4	30.1	7.1
Increase in loans and advances to customers	(230.5)	(465.9)	(227.9)	(497.1)
Increase in shares	250.2	611.2	250.2	611.2
Decrease in loans and advances to banks	9.0	0.5	9.0	0.5
Increase / (decrease) in amounts due to other customers and deposits from banks	98.5	(171.6)	93.6	(131.9)
Increase in debt securities in issue	35.6	74.5	46.0	74.5
Decrease in investment securities	0.1	10.2	0.1	10.2
(Increase) / decrease in other assets, prepayments and accrued income	(9.6)	3.0	(4.9)	(4.1)
Increase / (decrease) in other liabilities	1.1	15.1	(1.0)	17.2
Subordinated liabilities taken on on transfer of engagements	-	10.9	-	10.9
Net cash inflow from operating activities	188.6	96.3	195.2	98.5
Cash and cash equivalents				
Cash and cash balances with the Bank of England	5.8	4.6	5.8	4.6
Loans and advances to banks repayable on demand	18.7	11.6	7.0	2.0
Investment securities	205.8	128.7	205.8	128.7
Taken on on transfer of engagements	-	76.1	-	76.1
At 31 December	230.3	221.0	218.6	211.4

Cash and cash equivalents comprise cash in hand and loans and advances to banks available on demand or with original maturities of three months or less i.e. highly liquid assets readily convertible into cash with an insignificant risk of changes in value.

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**29 GUARANTEES, CONTINGENT LIABILITIES AND COMMITMENTS****(i) Guarantees**

Until 11 June 1996, under Section 22 of the Building Societies Act 1986, the Society had an obligation to discharge the liabilities of its subsidiary undertakings insofar as they were unable to discharge the liabilities out of their own assets. Subsequently, the Society has voluntarily agreed to provide continued support to all of its subsidiary undertakings, insofar as any liabilities are not covered by legislation.

(ii) Contingent Liabilities

In common with other financial institutions, the Society has a contingent liability in respect of contributions to the Financial Services Compensation Scheme established under the Financial Services and Markets Act 2000. The Society has not been notified of any claims against the scheme.

(iii) Commitments

	GROUP and SOCIETY	
	2007 £m	2006 £m
Capital commitments at 31 December for which no provision has been made in the Accounts	0.6	-
Irrevocable undrawn committed loan facilities	<u>352.6</u>	<u>257.5</u>
Payments under operating lease agreements in respect of land and buildings		
Commitments which expire:		
Within one year	-	-
In one to five years	0.8	0.8
Over five years	6.3	6.5
	<u>7.1</u>	<u>7.3</u>

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**30 RETIREMENT BENEFIT OBLIGATIONS****Pension schemes**

The Group operates two defined benefit pension schemes, the Newcastle Building Society Pension and Assurance Scheme ("NBS Scheme") and the Universal Building Society Pension and Assurance Scheme ("UBS Scheme"), in addition to its defined contribution schemes. The principal funds are in the defined benefit schemes which pay out pensions at retirement based on service and final pay.

The Group has applied IAS 19 (Revised 2004) to this scheme and the following disclosures relate to this Standard. Any accumulated gains and losses in each period are recognised in the Statement of Recognised Income and Expense.

Neither of the pension scheme assets include assets from Newcastle Building Society's own financial instruments or property occupied by Newcastle Building Society, or other assets used by Newcastle Building Society.

The Society expects to contribute to the defined benefit pension scheme in the next financial year regular monthly contributions (inclusive of expenses and life assurance premiums) of 14.7% of pensionable earnings for 60ths members and 13.5% of pensionable earnings for 80ths members for the NBS Scheme and 24% for the UBS Scheme.

Where investments are held in bonds and cash, the expected long term rate of return is taken to be the yields generally prevailing on such assets at the Balance Sheet date. A higher rate of return is expected on equity investments, which is based more on realistic future expectations than on the returns that have been available historically. The overall expected long term rate of return on assets is then the average of these rates, taking into account the underlying asset portfolio of the pension plan.

NBS Scheme

	Year ended 31-Dec-07 £m	Year ended 31-Dec-06 £m	Year ended 31-Dec-05 £m
The amounts recognised in the Balance Sheet are as follows:			
Present value of pension obligation	55.6	57.3	54.4
Fair value of scheme assets	<u>(54.0)</u>	<u>(51.1)</u>	<u>(38.8)</u>
Net pension liability	<u>1.6</u>	<u>6.2</u>	<u>15.6</u>

The amounts recognised in the Income Statement are as follows:

Current service cost	0.9	0.9
Interest on obligation	3.0	2.7
Expected return on scheme assets	<u>(3.5)</u>	<u>(2.8)</u>
Total included in 'employee benefits expense'	<u>0.4</u>	<u>0.8</u>
Actual return on scheme assets	<u>3.5</u>	<u>3.1</u>

Changes in the present value of the defined benefit obligation are as follows:

Opening defined benefit obligation	57.3	54.4
Current service cost	0.9	0.9
Interest cost	3.0	2.7
Actuarial gains	<u>(4.3)</u>	<u>(0.2)</u>
Contributions by employees	0.3	0.4
Benefits paid	<u>(1.6)</u>	<u>(0.9)</u>
Closing defined benefit obligation	<u>55.6</u>	<u>57.3</u>

Changes in the fair value of scheme assets are as follows:

Opening fair value of scheme assets	51.1	38.8
Expected return	3.5	2.8
Actuarial gains	-	0.3
Contributions by employer	0.7	9.7
Contributions by employees	0.3	0.4
Benefits paid	<u>(1.6)</u>	<u>(0.9)</u>
Closing fair value of scheme assets	<u>54.0</u>	<u>51.1</u>

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**30 RETIREMENT BENEFIT OBLIGATIONS** Continued

The major categories of Scheme assets as a percentage of total Scheme assets are as follows:

	Year ended 31-Dec-07	Year ended 31-Dec-06
Equities	62.7%	64.4%
Corporate Bonds	14.8%	-
Fixed Interest Bonds	-	28.4%
Government Bonds	22.4%	-
Index Linked Bonds	-	7.1%
Cash	0.1%	-

Principal actuarial assumptions at the Balance Sheet date (expressed as weighted averages)

Discount rate	5.8%	5.2%
Future salary increases	4.9%	4.4%
Future pension increases - pre 1 July 2000*	5.0%	5.0%
- post 30 June 2000	3.4%	2.9%
Inflation assumptions	3.5%	3.0%

* On the excess over Guaranteed Minimum Pension

Mortality - current pensioners

Life expectancy at age 65		
Males	21.1 years	21.1 years
Females	24.0 years	24.0 years

Mortality - future pensioners

Life expectancy at age 65 (age 40 now)		
Males	22.5 years	22.5 years
Females	25.3 years	25.3 years

No allowance has been made for commutation of pension for cash by members on retirement.

The expected rates of return for each asset class, gross of Scheme expenses, were:

	Year ended 31-Dec-07	Year ended 31-Dec-06
Equities	7.80%	7.75%
Corporate Bonds	5.80%	-
Fixed Interest Bonds	-	5.36%
Government Bonds	4.55%	-
Index Linked Bonds	-	4.75%
Cash	5.25%	4.50%

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**30 RETIREMENT BENEFIT OBLIGATIONS** Continued

Amounts for the current and previous four periods are as follows:

	Year ended 31-Dec-07 £m	Year ended 31-Dec-06 £m	Year ended 31-Dec-05 £m	Year ended 31-Dec-04 £m	Year ended 31-Dec-03 £m
Defined benefit obligation	55.6	57.3	54.4	44.8	40.2
Scheme assets	(54.0)	(51.1)	(38.8)	(29.3)	(26.1)
Deficit	1.6	6.2	15.6	15.5	14.1
Experience adjustments on plan liabilities	-	-	-	2.8	(0.1)
Experience adjustments on plan assets	-	0.3	2.8	0.6	1.3

Analysis of amounts recognised in Statement of Recognised Income and Expense:

	Year ended 31-Dec-07 £m	Year ended 31-Dec-06 £m
Total amount of actuarial gains recognised in the Statement of Recognised Income and Expense for the year:	4.3	0.5
Cumulative amount of actuarial losses recognised in the Statement of Recognised Income and Expense at the year end:	(0.8)	(5.1)

UBS Scheme

	Year ended 31-Dec-07 £m	Year ended 31-Dec-06 £m	Year ended 31-Dec-05 £m
The amounts recognised in the Balance Sheet are as follows:			
Present value of pension obligation	10.9	11.4	10.7
Fair value of scheme assets	(9.1)	(8.8)	(8.0)
Net pension liability	1.8	2.6	2.7

The amounts recognised in the Income Statements are as follows:

Current service cost	0.2	0.4
Interest on obligation	0.6	0.5
Expected return on scheme assets	(0.5)	(0.5)
Total included in 'employee benefits expense'	0.3	0.4
Actual return on scheme assets	0.5	0.3

Changes in the present value of the defined benefit obligation are as follows:

Opening defined benefit obligation	11.4	10.7
Current service cost	0.2	0.3
Interest cost	0.6	0.5
Actuarial gains	(0.7)	-
Contributions by employees	0.1	0.1
Benefits paid	(0.7)	(0.2)
Closing defined benefit obligation	10.9	11.4

Changes in the fair value of scheme assets are as follows:

Opening fair value of scheme assets	8.8	7.9
Expected return	0.5	0.4
Actuarial (losses) / gains	(0.2)	0.3
Contributions by employer	0.6	0.3
Contributions by employees	0.1	0.1
Benefits paid	(0.7)	(0.2)
Closing fair value of scheme assets	9.1	8.8

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**30 RETIREMENT BENEFIT OBLIGATIONS** Continued

The major categories of Scheme assets as a percentage of total Scheme assets are as follows:

	Year ended 31-Dec-07	Year ended 31-Dec-06
Equities	54.0%	56.1%
Bonds	12.0%	41.5%
Gilts	33.0%	-
Other	1.0%	2.4%

Principal actuarial assumptions at the Balance Sheet date (expressed as weighted averages)

Discount rate	5.8%	5.4%
Future salary increases	4.9%	4.4%
Rate of increase in pensions in payment	3.0%	2.9%
Revaluation rate for deferred pensioners	3.5%	3.0%
Inflation assumptions	3.5%	3.0%

Mortality - current pensioners

Life expectancy at age 65		
Males	21.1 years	21.1 years
Females	24.0 years	24.0 years

Mortality - future pensioners

Life expectancy at age 65 (age 40 now)		
Males	22.5 years	22.5 years
Females	25.3 years	25.3 years

No allowance has been made for commutation of pension for cash by members on retirement.

The expected rates of return for each asset class, gross of Scheme expenses, were:

	Year ended 31-Dec-07	Year ended 31-Dec-06
Equities	7.80%	7.75%
Bonds	5.80%	4.90%
Gilts	4.55%	-
Other	3.50%	4.50%

Amounts for the current and previous four periods are as follows:

	Year ended 31-Dec-07 £m	Year ended 31-Dec-06 £m	Year ended 31-Dec-05 £m	Year ended 31-Dec-04 £m	Year ended 31-Dec-03 £m
Defined benefit obligation	10.9	11.4	10.7	8.8	7.2
Scheme assets	(9.1)	(8.8)	(8.0)	(6.2)	(5.1)
Deficit	1.8	2.6	2.7	2.6	2.1
Experience adjustments on plan liabilities	(0.3)	0.2	0.1	0.0	0.2
Experience adjustments on plan assets	(0.2)	0.3	0.8	0.2	0.5

Analysis of amounts recognised in the Statement of Recognised Income and Expense:

	Year ended 31-Dec-07 £m	Year ended 31-Dec-06 £m
Total amounts of actuarial gains recognised in the Statement of Recognised Income and Expense for the year:	0.5	0.3
Cumulative amount of actuarial losses recognised in the Statement of Recognised Income and Expense at the year end:	(1.5)	(2.0)

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**31 RELATED PARTIES**

The Group is controlled by Newcastle Building Society. Further details of subsidiary undertakings are disclosed in Note 13 to these Accounts. The Directors are considered to be the only key management personnel as defined by IAS 24.

Transactions with directors and their close family members

Directors and their close family members have entered into the following transactions with Newcastle Building Society in the normal course of business.

Loans outstanding to directors and their close family members

	2007 £000	2006 £000
At 31 December	1,405	1,631

These loans were made on normal commercial terms and a register of them is available for inspection at the Principal Office for a period of 15 days up to and including the Annual General Meeting.

Deposits and investments held by directors and their close family members

	2007 £000	2006 £000
At 31 December	787	250

Amounts deposited by directors and members of their close families earn interest on the same terms and conditions applicable to other customers.

Other transactions

CJ Hilton is a partner in Eversheds. Professional services amounting to **£118,570** (2006: £495,360) were supplied by Eversheds to the Group during the year.

AAE Glenton is senior partner in Ryecroft Glenton. Professional services amounting **£2,817** (2006: £2,685) were supplied by Ryecroft Glenton to the Trustees of the Universal Building Society Pension and Assurance Scheme during the year.

CJ Seccombe is treasurer of the MEA Trust which maintained a loan, on commercial terms, with the Society throughout this and the previous year.

JM Pott, who was appointed as a non-executive director in January 2007, is a partner in RMT Accountants. **£2,427** was received by RMT Accountants for a Nursery Voucher Scheme. **£927** was received by RMT Financial Management Limited for mortgages placed with Newcastle Building Society.

NOTES TO THE ACCOUNTS for the year ended 31 December 2007**31 RELATED PARTIES** Continued**Transactions with Group Companies**

The Society undertook the following transactions with Group companies during the year.

Year ended 31 December 2007

	Interest paid to Society £000	Interest received from Society £000	Rent received from Society £000	Other amounts paid to Society £000	Other amounts received from Society £000
Newcastle Financial Services Limited	-	65	-	-	-
Newcastle Mortgage Loans (Jersey) Limited	820	-	-	-	22,700
Newcastle Portland House Limited	-	152	66	-	-
Newcastle Strategic Solutions Limited	-	-	-	297	1,000
Newton Facilities Computer Leasing Limited	-	4	-	-	520
Newton Facilities Computer Purchasing Limited	25	-	-	-	-
Newton Facilities Management Limited	-	3	-	344	346

Year ended 31 December 2006

	Interest paid to Society £000	Interest received from Society £000	Rent received from Society £000	Other amounts paid to Society £000	Other amounts received from Society £000
Newcastle Financial Services Limited	-	16	-	-	-
Newcastle Mortgage Loans (Jersey) Limited	161	-	-	-	8,209
Newcastle Portland House Limited	-	123	66	-	-
Newcastle Strategic Solutions Limited	-	-	-	210	700
Newton Facilities Computer Leasing Limited	-	3	-	-	701
Newton Facilities Computer Purchasing Limited	26	-	-	-	-
Newton Facilities Management Limited	-	3	-	218	219

At the year end the following unsecured balances were outstanding.

	Amounts owed by Society 2007 £000	Amounts owed to Society 2007 £000	Amounts owed by Society 2006 £000	Amounts owed to Society 2006 £000
Adamscastle Limited	-	1,320	-	1,320
Adamson Newcastle Limited	36	-	36	-
Kings Manor Properties Limited	95	9,253	-	2,131
NBS Financial Services Limited	81	149	81	149
Newcastle Developments Limited	-	437	-	437
Newcastle Mortgage Corporation Limited	7	-	7	-
Newcastle Mortgage Loans (Jersey) Limited	-	23,520	-	8,370
Newcastle Mortgage Services Limited	5	-	5	-
Newcastle Portland House Limited	2,783	18	2,725	-
Newcastle Strategic Solutions Limited	1,205	202	1,610	-
Newcastle Financial Services Limited	1,870	31	233	-
Newton Facilities Management Limited	151	56	28	26
Newton Facilities Computer Leasing Limited	75	39	-	2
Newton Facilities Computer Purchasing Limited	70	524	-	301
Strachans (Newcastle) Limited	591	5	591	5
NBS Mortgage Advisor Limited	6	47	-	5

Transactions with securitisation vehicles

Newcastle Building Society undertook the following transactions with securitisation vehicles during the year.

	Interest paid to Society 2007 £000	Interest received from Society 2007 £000	Interest paid to Society 2006 £000	Interest received from Society 2006 £000
Bamburgh Finance No. 1 PLC	699	-	938	-

At the year end the following balances were outstanding with securitisation vehicles.

	Loans owed by Society 2007 £000	Loans owed to Society 2007 £000	Loans owed by Society 2006 £000	Loans owed to Society 2006 £000
Bamburgh Finance No. 1 PLC	-	10,548	-	10,548

ANNUAL BUSINESS STATEMENT for the year ended 31 December 2007**1 Statutory percentages**

	2007 %	Statutory %
Lending limit	13.91	25.00
Funding limit	32.56	50.00

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986 as amended by the Building Societies Act 1997.

The statutory limits are as laid down under the Building Societies Act 1986, as amended by the Building Societies Act 1997, and ensure that the principal purpose of a building society is that of making loans which are fully secured on residential property and are funded substantially by its members.

2 Other percentages

	2007 %	2006 %
As a percentage of shares and borrowings:		
Gross capital	6.72	7.01
Free capital	5.83	6.26
Liquid assets	21.05	19.41
Profit for the year as a percentage of mean total assets	0.26	0.20
Management expenses as a percentage of mean total assets	0.90	0.81

The above percentages have been prepared from the Group Accounts.

Gross capital represents the aggregate of the general reserve, subordinated liabilities and subscribed capital.

Free capital represents gross capital less Property, plant and equipment, investment property and non-current assets held for sale.

Liquid assets are as shown in the Group Balance Sheet but exclude liquidity balances held in special purpose securitisation vehicles.

Shares and borrowings represent the total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.

Management expenses represent the aggregate of administrative expenses and depreciation.

Mean total assets are the average of the 2007 and 2006 total assets.

ANNUAL BUSINESS STATEMENT for the year ended 31 December 2007**DIRECTORS**

To comply with the requirements of Section 63 of the Building Societies Act 1986, general notice is hereby given of Directors' interests in the following companies, firms and organisations:-

	Date of Birth	Date of Appointment	Occupation
LVW Armstrong BA (Hons) Oxon (With effect from 25.02.08)	13.07.69	25.02.08	Company Director
Other Directorships/Interests: The Alchemists (Chief Executive); The Derwent Initiative; Tyneside Cinema Trust; National Glass Centre. Member: Independent Monitoring Boards at HMP/YOI Castington. Governor: Northumbria University.			
AAE Glenton CBE TD FCA DL	21.03.43	20.11.87	Chartered Accountant
Other Directorships/Interests: Ryecroft Glenton (Senior Partner); Percy Special Ltd; Portland Financial Management Ltd; Ryecroft Glenton Services Ltd. Trustee: W.A. Handley Charitable Trust; Roy & Pixie Baker Charitable Trust; The Londonderry Trust; North of England Cadet Forces Trust; The Tomlinson Memorial Trust; Goodacre Benevolent Fund. Freeman of the City of London; Liveryman of the Worshipful Company of Chartered Accountants. Chairman: Northumberland Branch, The Soldiers, Sailors, Airmen and Families Association - Forces Help. President: Coquetdale Branch, The Royal British Legion.			
MO Grant BA (Hons) OBE FRSA Vice-Chairman	16.08.46	22.05.95	Company Managing Director
Other Directorships/Interests: Aroline Ltd; Dame Allan's School; Chair of Culture North East Ltd; HB Innovations Ltd. Trustee: J.T. Dove Pensions Trust Ltd; Chairman of Council: The University of Newcastle upon Tyne.			
C Greaves PG Dip, MSc Operations Director	21.08.55	26.05.06	Building Society Executive
Other Directorships/Interests: Newcastle Mortgage Services Ltd; Newcastle Savings Management Ltd; Newcastle Strategic Solutions Ltd; Newton Facilities Management Ltd.			
CJ Hilton MA (Cantab), FCI Arb, DL Chairman	19.01.50	01.01.78	Solicitor
Other Directorships/Interests: Council Member of the University of Newcastle upon Tyne; Eversheds LLP; Newcastle Strategic Solutions Ltd; NEPIA Trust Company Ltd; Joint Company Secretary of Graig Shipping plc.			
FD Holborn FCIB	26.05.47	01.01.03	Former Director
Other Directorships/Interests: Newcastle Commercial Lending Ltd; Newcastle Portland House Ltd. Trustee: Rothley Trust.			
W Lee MBA Commercial Director	05.06.63	12.07.04	Building Society Executive
Other Directorships/Interests: Newcastle Financial Services Ltd; Newcastle Mortgage Loans (Jersey) Ltd.			
RD Mayland FCA	22.05.53	27.06.05	Company Director
Other Directorships/Interests: NorPrime Ltd. Trustee: Age Concern North Tyneside; The Children's Heart Unit Foundation at the Freeman Hospital.			
RJ McCormick FCA, FIIA, MIA	09.05.49	16.08.07	Business Consultant
Other Directorships/Interests: Partner: Mascot Financial Services Consultants LLP			
JM Pott BA (Hons), FCA	19.04.58	03.01.07	Chartered Accountant
Other Directorships/Interests: Partner: RMT. Maxbox Developments Ltd. Member: Regional Council: CBI. Treasurer: German/British Chamber of Commerce.			
CJ Seccombe BSc (Hons) FCA Chief Executive	28.10.52	01.09.97	Building Society Executive
Other Directorships/Interests: Adamscastle Ltd; Adamson Newcastle Ltd; Bamburgh Finance No. 1 Plc; Bamburgh Options Ltd; Bank of Newcastle Ltd; Community Foundation Serving Tyne & Wear and Northumberland; Kings Manor Properties Ltd; Kings Manor Investments Ltd; Kings Manor Estate Agents Ltd; MEA Trust; NBS Financial Services Ltd; NBS Mortgage Advisor Ltd; Newcastle Bank Ltd; Newcastle Commercial Lending Ltd; Newcastle Developments Ltd; Newcastle Mortgage Corporation Ltd; Newcastle Mortgage Loans (Jersey) Ltd; Newcastle Mortgage Services Ltd; Newcastle Portland House Ltd; Newcastle Savings Management Ltd; Newcastle Strategic Solutions Ltd; Newton Facilities Computer Leasing Ltd; Newton Facilities Computer Purchasing Ltd; Newton Facilities Management Ltd; Strachans (Newcastle) Ltd; Universal Ltd; Universal Financial Services Ltd. Chairman: Sponsors Club for Arts & Business.			
J Westhoff BA (Hons) Fin Serv, ACIB Finance Director	11.07.64	01.09.07	Building Society Executive
Other Directorships/Interests: Kings Manor Properties Ltd; Newcastle Financial Services Ltd; Newcastle Savings Management Ltd; Newcastle Strategic Solutions Ltd.			
NA Westwood R'FO, FRICS	30.04.50	03.01.07	Chartered Surveyor
Other Directorships/Interests: Sanderson Weatherall Ltd; Sanderson Townsend & Gilbert Ltd; Consul for Norway.			

ANNUAL BUSINESS STATEMENT for the year ended 31 December 2007**OTHER OFFICERS**

	Occupation
PG Grand MCMi, DMS, MBA	Building Society Executive
Directorships/Other Interests: Director of Newcastle Savings Management Ltd.	
CW Jopling BA	Building Society Executive
IJ Kilmartin DPM, DMS, BA, MSc	Building Society Executive
Directorships/Other Interests: Director of Newcastle Mortgage Services Ltd. Director of Newcastle Savings Management Ltd; Director of Newcastle Strategic Solutions Ltd.	
S Marks ACIBS, DMS	Building Society Executive
Directorships/Other Interests: Director of NBS Mortgage Advisor Limited; Director of Newcastle Commercial Lending Ltd.	
RJ Mottershead	Building Society Executive
Directorships/Other Interests: Director of Newcastle Financial Services Ltd.	
AM Russell BA, FCA, CPA	Building Society Executive
Directorships/Other Interests: Director of St. Cuthberts Care Ltd.	
IW Stafford BSc Fifs	Building Society Executive
G Tiplady LLB	Building Society Executive
Directorships/Other Interests: Director of Kings Manor Properties Ltd; Group Secretary.	
SA Urwin BSc, DipM	Building Society Executive
Directorships/Other Interests: Director of Newcastle Mortgage Loans (Jersey) Ltd.	
S Watchman BSc	Building Society Executive

Documents marked 'private and confidential' may be served on the above named directors at the following address: Portland House, New Bridge Street, Newcastle Upon Tyne NE1 8AL. The executive directors have service contracts which are terminable at any time by the Society on one year's notice. There are no contracts for non-executive directors and no compensatory terms for loss of office.