

**14 OCTOBER 2008**

**NORTHERN ROCK  
QUARTER 3 TRADING STATEMENT**

**“NORTHERN ROCK REPORTS ENCOURAGING PROGRESS AGAINST PLAN”**

“I am pleased with the progress Northern Rock is making. We have continued to repay the Government loan well ahead of plan, our deposit base is growing, our restructuring programme has been completed successfully, and a new and stronger management team is now in place. These are encouraging developments. However, dislocated financial markets and falling house prices mean that the pace of progress achieved to date will be significantly more challenging to maintain going forward.”

**Ron Sandler, Chairman**

**Progress against Business Plan**

Northern Rock (the “Company”) continues to make good progress towards achieving the objectives set out in its Business Plan (the “Plan”) approved in March 2008.

*Repayment of Government Loan*

The initial priority of the Plan is repayment of the Government loan and Northern Rock is repaying the loan well ahead of target. At 30 September 2008, the net balance outstanding on the loan stood at £11.5 billion (31 December 2007: £26.9 billion; 30 June 2008: £17.5 billion), a reduction of £15.4 billion since the start of the year. The net loan amount is stated after the deduction of Northern Rock’s liquidity deposits held with the Bank of England of £7.1 billion at 30 September 2008 (30 June 2008: £3.5 billion).

The Company’s success in repaying the Government loan has been achieved primarily through its mortgage redemption programme, providing assistance to customers to access new products with alternative lenders. This programme will continue, although the Company anticipates that it will be more challenging in the future to maintain the 2008 redemption levels, given the significant slowdown in the housing market and reduced availability of alternative mortgage financing.

As the Company announced in its Half Year Results for 2008, the Bank of England loan facilities were novated to HM Treasury during August.

### *Funding*

Northern Rock has continued to attract new retail deposits in the third quarter, with total retail funding balances rising to £17.2 billion at the end of September 2008, an increase of £3.0 billion since the end of June. UK retail deposits represent £15.5 billion of this total.

The Company has committed that it will not take unfair advantage of Government support while in receipt of State aid and remains within its self-imposed Competitive Framework (the “Framework”). This includes undertakings to avoid market-leading products and to limit Northern Rock’s share of UK retail deposit balances to 1.5%.

As a consequence of the turmoil in financial markets, the rate of retail deposit inflows to Northern Rock increased markedly during September. In response, the Company has taken a number of actions in recent weeks to uphold its competitive commitments. These include withdrawing a number of key products, lowering savings rates and introducing caps on the size of new deposits. The Company will continue to monitor the situation and will take action as necessary to ensure that it remains compliant with the Framework. No breach of the Framework has occurred since its introduction at the end of March.

Non-retail funding balances continue to reduce as the balance sheet contracts as planned. In July 2008, Northern Rock resumed new wholesale funding albeit on a modest scale, reflecting market conditions and the Company’s intention to achieve a more balanced mix of retail and non-retail funding. Since the resumption, £927 million of new wholesale funds have been raised.

### *Lending*

New mortgage lending volumes remain low in comparison to previous years, in line with the Company’s intention to reduce the size of its balance sheet whilst maintaining a presence in the residential mortgage lending market. Gross residential mortgage lending for the nine months to 30 September 2008 was £2.4 billion (six months to 30 June 2008 - £1.9 billion). The quality of the new lending has been high, with an average LTV of 60% in the third quarter.

### *Credit Quality*

The deterioration in economic and market conditions has resulted in mortgage arrears increasing for Northern Rock, and the sector as a whole. In addition, the reduction in the size of Northern Rock's total mortgage book has contributed to an increase in the proportion of the book in arrears. At the end of September 2008, residential arrears over three months were 1.87%, compared with 1.18% at the end of June 2008. The arrears figure on Together loans, which is included in the above, has continued to increase at a faster rate than non-Together loans. Together loans also accounted for the majority of the property possessions during the third quarter. The Company's possessions stock increased to 4,201 at the end of September (end-June 2008: 3,710).

Northern Rock is continuing to strengthen its debt management capabilities, including recruitment of new management and staff, redesign of core strategies and investment in new systems. Notwithstanding these actions, the trends outlined above are anticipated to continue, resulting in further expected increases in the Company's loan loss provisions going forward.

### *Organisation*

At the end of August, Northern Rock completed its formal redundancy consultation process and now employs around 4,500 staff, a reduction of approximately 1,500 from the start of the process. This reduction was achieved with no operational disruption or erosion of customer service. The Company worked hard to minimise the number of compulsory redundancies as part of this process and managed to redeploy over 600 staff into new roles within the business. It continues to work closely with the Regional Development Agency, One NorthEast, to offer comprehensive outplacement support services to help those made redundant find alternative employment.

As part of the restructuring, Northern Rock has reorganised its business operations to support the delivery of its key objectives, including a significant enhancement of its risk and control environment.

Northern Rock has completed the introduction of its company-wide incentive scheme as set out in the Plan. This scheme was designed alongside the Plan in March, although its introduction was deferred until the restructuring programme had been completed. It applies to all staff at Northern Rock, subject to certain qualification criteria, and delivers rewards based upon the Company achieving its core Plan objectives.

The Company has also taken a number of steps to strengthen significantly the management team. Gary Hoffman joined the Company as Chief Executive on 1 October 2008. He leads a substantially reconstituted Executive team with some key new external appointments, including Chief Risk Officer, HR Director and Director of Debt Management.

### **Treasury Investments**

Holdings of capital notes in Structured Investment Vehicles (SIVs) totalled £358 million sterling equivalent at the end of September 2008 (30 June 2008 - £327 million), with the increase since the end of June reflecting exchange rate movements. An impairment charge of £28 million has been made against SIVs in the third quarter, bringing the total impairment balance to £334 million at 30 September 2008.

Northern Rock's portfolio of US\$ Collateralised Debt Obligations (CDOs), before impairments, amounted to £207 million in sterling equivalent at the end of September 2008 (30 June 2008 - £196 million), with the increase since June also reflecting exchange rate movements. No further impairments have been required against this portfolio in the third quarter of 2008, as the previous impairments taken have written the carrying value of these assets down to nil.

In addition, due to market conditions and events in the third quarter, impairments totalling £83 million have been made against other treasury assets.

### **Governance**

The Board has been further strengthened in recent weeks by the appointments of Kent Atkinson, Richard Coates and Bob Davies as Non-Executive Directors. These appointments bring valuable further experience to the Board and will provide considerable assistance to the Company as it proceeds towards delivery of the Plan.

On 7 September and 30 September 2008 respectively, Andy Kuipers and Stephen Hester resigned from the Board. Following Mr Hester's departure, John Devaney has been appointed Chair of the Company's Remuneration Committee. Simon Laffin has confirmed his intention to step down from the Board on 31 December 2008, at which time he will also cease to be Chair of the Audit Committee, and will be replaced in this role by Kent Atkinson with effect from 1 January 2009.

Following Gary Hoffman's appointment as Chief Executive, Ron Sandler became Non-Executive Chairman on 1 October 2008. Details of Ron Sandler's revised remuneration are included in the notes to editors below.

A review of the conduct of the previous Board in respect of funding and liquidity has been undertaken with the assistance of external advisors, Freshfields and KPMG Forensic. The Board has concluded that there are insufficient grounds to proceed with any legal action for negligence against the former Directors, and has no intention of bringing any such action. The Board has also completed a similar review in respect of the Company's auditors and has determined that no action is warranted.

## **Outlook**

As set out in the Company's Plan in March 2008 and reported for the first six months of the year, Northern Rock will be significantly loss-making in 2008, due to one-off restructuring costs, higher funding costs and the deteriorating credit environment. The extremely difficult housing and mortgage market conditions which have emerged in recent months will make the Company's achievement of its objectives more challenging going forward. Notwithstanding these conditions, however, the Company's progress to date is encouraging. The balance sheet continues to contract, retail savings balances continue to grow, the loan to the Government is being repaid rapidly, the restructuring of the organisation has been satisfactorily concluded, and a new, high quality management team has been recruited.

As announced in August, HM Treasury has committed to reinforce the Company's capital base through conversion into Ordinary shares of its holding of £400 million of Preference shares and swapping up to £3 billion of the outstanding debt into equity. These measures will not involve any cash transfer to Northern Rock. The Company is working with HM Treasury to finalise the package and obtain State aid approval.

Over time the emphasis of the Plan will shift from repaying the government loan towards restoring profitability to allow, in due course, the lifting of the Government's deposit guarantees and the return of the Company to private ownership.

## **Media Conference Call Details**

A media telephone conference call hosted by Ron Sandler (Chairman), Gary Hoffman (Chief Executive) and Ann Godbehere (Chief Financial Officer) will be held at 11.00am today. The access details for the call are as follows:

Telephone number: +44 (0) 1452 565 124

Conference Id: 68405769

## **Contacts**

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## **Notes to Editors**

Following the appointment of Gary Hoffman as Chief Executive, Ron Sandler became Non-Executive Chairman on 1 October 2008. Reflecting this change in role, and with regard to the ongoing responsibilities and requirements of the role, his fee has been set at £350,000 per annum. At the discretion of the Remuneration Committee, he will be eligible for a bonus when the Company is successfully returned to private ownership.

## **Important Notice**

This announcement should be read in conjunction with our announcement for the half year ended June 2008, the Summary of the Proposed Business Plan and the Shareholder Relationship Framework Document, copies of which are available from Northern Rock plc, Northern Rock House, Gosforth, Newcastle upon Tyne, NE3 4PL or on our website at [www.northernrock.co.uk](http://www.northernrock.co.uk)

This document contains certain forward-looking statements with respect to certain of the plans of Northern Rock, its current goals and expectations relating to its future financial condition and performance.

By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future. Northern Rock's actual future results may differ materially from the results expressed or implied in these forward-looking statements as a result of a variety of factors, including UK domestic and global economic and business conditions, market related risks such as interest rates and exchange rates, delays in implementing proposals, difficulties with computer systems, legislative, fiscal and regulatory developments and changes, changes in customer preferences, competition and other factors.

All forward-looking statements in this press release are based on information available to Northern Rock as of the date hereof. All written or oral forward-looking statements attributable to Northern Rock or any person acting on behalf of Northern Rock are expressly qualified in their entirety by the foregoing.

Other than in accordance with its legal or regulatory obligations, neither Northern Rock nor anyone acting on its behalf undertakes any obligation to update or revise any forward looking statement, whether as a result of new information, future events or otherwise.