

STOCK EXCHANGE ANNOUNCEMENT
NORTHERN ROCK PLC
PRE CLOSE PERIOD STATEMENT AND BASLE II STRATEGIC UPDATE
27 JUNE 2007

INTRODUCTION

In anticipation of receiving our IRB waiver under Basle II, Northern Rock takes the opportunity to update the market on the resulting evolution of strategy, on current trading performance and the outlook for profits given the current interest rate environment.

STRATEGY

The IRB waiver under Basle II changes the relative capital efficiency of owning various assets. Northern Rock will therefore seek to reduce the proportion of less capital efficient assets held on its balance sheet.

Northern Rock will continue its core strategy of strong growth in high quality residential mortgage assets which will be retained on the balance sheet.

We will maintain all of our current distribution and manufacturing capability. However, we will pass through some higher risk weighted loans directly to third parties – as has recently started via the Lehman Brothers arrangement for lower credit quality residential mortgages. Other higher risk weighted loans (for example commercial secured and personal unsecured) will continue to be distributed, manufactured and then warehoused and sold-on in smaller packets. Where desired, Northern Rock will service loans which have been sold, as is already the case for securitised assets.

Reflecting its strategy going forward, Northern Rock will generate sustainable distribution and manufacturing profits as well as servicing income in addition to the on-going interest, fee and commission income arising from the growing residential book.

The lasting capital benefits from the introduction of Basle II will see an increase in the dividend payout ratio and the release of capital from loan book sales will be repatriated through a share buy-back programme. Details on both of these will be given at the time of the Interim Results statement on 25 July 2007.

On 22 June 2007, Northern Rock completed the sale of approximately £838m of its Commercial Secured Loans to Lehman Commercial Mortgage Conduit Limited (a wholly owned subsidiary of Lehman Brothers), and conditionally agreed to sell up to a further £732m of such loans, to be completed in H2 2007. In conjunction with the transaction, we are proposing to negotiate an agreement for future secured Northern Rock originated commercial mortgage loans to be sold-on to Lehman Commercial Mortgage Conduit Limited.

MARKET OUTLOOK

The UK mortgage market has continued to be robust in 2007 with gross lending to the end of May running approximately 13% ahead of the equivalent period in 2006. Higher interest rates tend to mean slowing volumes of house moving transactions but provide a greater incentive to remortgaging activity.

Combining all the components of the UK mortgage market, our expectation is for the gross mortgage market in 2007 to be over £370bn and for house prices to be rising in line with wage inflation by the end of the year. Northern Rock remains confident of its ability to achieve its lending targets within this context.

LENDING

Residential lending dominates Northern Rock's business. We continue to compete well in the gross mortgage market, supported by our recently introduced home mover retention initiative. In the first five months of 2007 our gross market share is running above the level seen in 2006, at around 10%. Net market share of residential mortgage lending during the same period was around 19%.

Credit quality continues to be robust across all loan categories. Arrears levels are slightly higher than at the 2006 year end reflecting rising interest rates, but the loan impairment charge is anticipated to be in line with market expectations.

COSTS

Cost efficiency remains key to Northern Rock's strategy and we continue to target unit cost efficiencies to maintain our sector leading advantage. During 2007 we expect cost growth at the lower end of our target of between $\frac{1}{2}$ and $\frac{2}{3}$ asset growth, before disposals.

With cost growth also less than income growth, we expect to see both cost:income and cost:asset ratios improve further in 2007.

INCOME & PROFITS

Expectations for higher interest rates in the UK have risen further than anticipated at the time of Northern Rock's Q1 Trading Statement on 2 April 2007. Given Northern Rock's Libor-dominated funding platform, we have a structural mismatch between Libor and Bank Base Rates and because of changes in the forward interest rate curve. As forward interest rates have moved higher, it takes time for new retail fixed rate mortgage prices to adjust upwards. These loans, however, will be repriced when they are retained with a product switch at the end of their product term. In times of rising rates this dampens revenue growth with the opposite occurring as rates fall.

In 2007, the combined effect on net interest income of increases in Libor, swap rates, delays in retail repricing and the loss of interest from asset disposals is anticipated to be around £180m-£200m gross, equivalent to 18-20bps of gross spread erosion.

Offsetting these negative effects in 2007 will be net realised swap gains amounting to an anticipated £40m-£50m. These arise on the sale of swaps, where the fixed rate loans have redeemed and the swaps cannot, because of a timing mismatch, be used efficiently to hedge new loans. Such gains after redemption occur in a rising rate environment and can be considered as a partial natural hedge against the structural Libor mismatch.

Included in underlying interest income will be AFS gains anticipated to be around £35m, in line with 2006 underlying gains of £30m.

The commencement of the programme of sale of some of the less capital efficient assets as part of the evolving strategy of distribution, manufacturing and sale is anticipated to realise net gains of around £50m - £60m in 2007. These gains will not be included in net interest income but will be separately disclosed in the Income Statement.

Other Income is anticipated to grow strongly, reflecting higher residential lending volumes.

The current consensus from 19 analysts for 2007 is for underlying attributable profits, before the preference share dividend, of £403m - £457m, with a mid-point of £430m, an increase of 17%. Northern Rock expects its underlying attributable profits to increase by around 15% when compared to 2006.

Comment

Adam J Applegarth, Chief Executive, commented:

“The UK mortgage market remains robust and we are continuing to trade strongly, despite an adverse interest rate environment.

Receipt of our IRB waiver under Basle II will mean that the next stage of our strategic development can start.

We will continue to concentrate on adding high volumes of prime quality residential mortgages to our balance sheet. In addition, looking forward we will add revenue from the growing programme of manufacture, distribution and disposal of assets that we do not want to hold on the balance sheet in the long term.

This will help us to continue to drive up the Company's earnings while managing our capital more efficiently. Lasting Basle II benefits will be seen in higher dividend payments and asset disposals will lead to capital being repatriated through share buy-backs."

Conference Call Details

A conference call for analysts and investors will take place at 9.30 a.m. today (27 June). To access the call, please call 0845 245 5000 (International +44 1452 562 716) and ask for the Northern Rock Pre-Close conference call, ID 4487562. The call will also be broadcast via www.northernrock.co.uk.

A replay of the conference call will be available on the website, or by calling 0845 245 5205 (International +44 1452 550 000) and keying in the pass number 4487562#.

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Important Notice

This announcement should be read in conjunction with our announcement and the Annual Report and Accounts for the full year ended December 2006, 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

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 risk and uncertainty because they relate to events and depend on circumstances that will 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, unexpected difficulties with computer systems, unexpected changes to regulation, changes in customer preferences, competition and other factors.