

**STOCK EXCHANGE ANNOUNCEMENT  
NORTHERN ROCK PLC : TRADING STATEMENT  
9 MONTHS TO 30 SEPTEMBER 2005**

**INTRODUCTION**

Northern Rock plc informs the market of its continued strong trading performance – in line with its strategic intention of achieving annual growth in assets of 20% ( $\pm 5\%$ ) and profit growth of 15% ( $\pm 5\%$ ).

**STRATEGY**

Northern Rock's strategy remains unchanged. It is based on sector leading, low cost operations, transparency and customer driven distribution to produce attractive products at competitive prices. This generates strong growth in high quality assets to provide low risk, attractive returns to shareholders. Our strategic target is to maintain Return on Equity in the 19-22% range.

**ECONOMIC BACKGROUND AND MARKET OUTLOOK**

UK economic growth is expected to remain robust in 2005 at around 2% and is expected to be at similar levels in 2006. The general level of stability in the economy means that inflation should remain well controlled, albeit there may be some temporary impact as higher oil and energy prices feed through into the wider economy. Unemployment is slightly higher than six months ago but remains at historically low levels. With unemployment being the key driver of home loan defaults, this should mean continued strong credit performance for traditional and lifestyle mortgages.

The Bank of England Base Rate was reduced from 4.75% to 4.5% in August having peaked not only at historically very low levels, but also below the level predicted at the start of 2005. Indications for the remainder of 2005 and into early 2006 are that interest rates are likely to stay at or close to these levels. This continues to offer a good degree of certainty to both prospective and current homeowners.

The home moving market will continue to be underpinned by relatively low debt servicing costs, limited alternative forms of tenure and a shortage of additions to housing stock. We continue to expect the number of home moving transactions to be towards the lower end of the historical trend for the whole year, with similar volumes expected next year. There are some early signs, however, of First Time Buyers starting to return to the market, which may put upward pressure on this view.

Wider household indebtedness and the clear financial incentive for individuals to refinance will ensure a strong remortgage market continues - remortgaging has accounted for around 45% of all gross lending so far in 2005 and we expect this to continue.

The strength of the remortgage market, when added to the home moving market, means that our gross residential lending market forecast for 2005 has risen to around £270 billion. For 2006, we expect a similarly sized gross loan market, ensured by strong levels of remortgage activity.

## **LENDING**

Northern Rock's strong lending performance in the first half of the year has continued in the third quarter, with all three lending arms (secured residential, secured commercial and personal unsecured) performing in line with expectations. Total net lending for the first nine months of the year is 17% higher than the same period in 2004 and Northern Rock starts the fourth quarter with a total pipeline of agreed business of £6.3 billion – an increase of 11% above the same time last year, and 23% higher than the start of 2005.

Northern Rock's lending continues to be dominated by loans secured on residential property, which represent 90% of total lending. The strong gross lending market share seen in the first half of the year has continued in the second half. Northern Rock's successful retention policy of encouraging existing mortgage customers to transfer to any product available to new customers has ensured that the level of redemptions remains a step below our natural share.

This combination of strong origination and proactive retention has led to net residential lending in the first nine months of the year being 23% higher than in 2004 and maintaining net lending market share at the high levels seen in the first half of 2005. A residential pipeline of £5.6 billion is carried into October, 10% higher than last year. The risk profile of lending remains excellent, reflecting robust underwriting criteria, a high proportion of borrowers with a proven payment record and an avoidance of the higher risk areas of lending. Our lifestyle products, which comprise Together, Lifetime and Buy to Let, remain an important element of lending, and continue to represent around 30% of new business.

Whilst volumes of unsecured personal lending have increased in the second half, the aggregate remains substantially below 2004 and this portfolio continues to account for a small proportion of our total lending. Lending within our commercial portfolio, which is all secured on property, remains subdued as we maintain our emphasis on quality rather than volume.

These levels of lending are consistent with Northern Rock expecting to finish 2005 with asset growth towards the top of the strategic range of 20% ± 5%.

## **CREDIT QUALITY**

The credit quality of our lending continues to be tightly monitored and controlled. Against the market background of slightly weaker asset quality seen in some areas of consumer lending, it is particularly encouraging that the level of arrears on all our portfolios remains low.

Residential arrears of three months and above remain below half the industry average, and have shown no significant movement since those reported at the Interim Results. Our forward looking behavioural scoring systems continue to predict that this sustained good arrears performance will continue. Arrears within both the unsecured and commercial books remain low at levels, similar to the end of the first half.

## **FUNDING**

Funding volumes have been strong in the first nine months of the year, as we continue to maintain a balanced funding platform comprising retail, non-retail, securitisation and Covered Bonds.

Following the strong retail deposit flows seen in the first half of the year, the strength and diversity of the retail franchise has continued to be reflected in the third quarter, with the Silver Savings account and Irish deposit accounts performing particularly well.

We have recently completed a further securitisation issue from our residential programme (Granite 05-4), a £3.75 billion deal with pricing even tighter than the previous deals completed this year, making it our cheapest public issue ever and significantly below the cost of older deals being replaced. We have also made our first issue – of \$1 billion - under the de-linked structure during the quarter (Granite 05-3), demonstrating the substantial flexibility this innovation offers.

We continue to diversify within our non-retail programme both by geography and investor, maintaining an appropriate mix of both short and medium term funding. Following the second issue from our Covered Bond programme in the first half of the year, we anticipate making a further issuance later this year.

## **INCOME**

Driven by our strategy, we expect Total Income Margin to assets to ease slightly, offset by cost efficiency improvements, leading to relatively stable return on risk weighted assets

The gap between Libor and Bank Base Rate has narrowed to around 10 basis points negative after a protracted period of substantial negative gap - this should be favourable for liability spreads going forward. On the asset side, as the repricing of Northern Rock's mortgage back-book is largely complete, we would expect the pace of spread erosion to continue to slow. In relation to liquidity management, Northern Rock's policy is to maintain a consistent and sustainable return on liquid funds through a combination of interest margin and capital gains/losses, with the mix dictated by the underlying interest rate environment.

Northern Rock continues to offer a range of insurance products to both its residential and unsecured customers on which it earns commission income. Due to the high quality profile of our customer base, payment protection insurance (PPI) penetration rates on our unsecured lending portfolio are relatively low. We ensure through our regulated sales process that customers understand whether the product is appropriate to their needs. Additionally, as we announced at our Interim Results, we have already moved to a better value, more flexible and customer needs driven range of PPI products.

## **CAPITAL**

Active capital management remains a key part of Northern Rock's business strategy. Once Basel II is implemented we expect to be a major beneficiary as a result of our high quality, low risk asset base, and we continue to prepare in Q4 2005 for application to the FSA for IRB approval.

As announced at our Interim Results we intend, subject to market conditions, to sell, on a non-recourse and ongoing basis, the majority of the first loss position we hold in securitisation issues later this year and further details will be available following the transaction.

## **COSTS**

Cost control remains a key pillar of Northern Rock's strategy, allowing profitable growth of the business and the manufacture of competitive products for our customers. Costs continue to be tightly managed to ensure Northern Rock's cost efficiency advantage is maintained.

Following the incremental costs of regulation seen in the first half of the year, we expect the cost to income gap to narrow in the second half and cost growth to slow to around the mid-point of our strategic target of between  $\frac{1}{2}$  and  $\frac{2}{3}$  of asset growth for the full year. In 2006, the usual strategic cost metrics (cost growth less than income growth, and cost growth between  $\frac{1}{2}$  and  $\frac{2}{3}$  of asset growth) will apply.

## **PROFITS**

Northern Rock's strategic target is to grow profits (on a comparable basis) by  $15\% \pm 5\%$  each year. The range of pre-tax profit expectations for 2005 (excluding fair value adjustments) as provided by 20 of the major bank research analysts is £468 million to £509 million, with a mean of £494 million, growth of 12% on 2004's pro forma results, 13.5% growth versus 2004 statutory results. The range of post-tax attributable profit expectations for 2005 (also excluding fair value adjustments) is £280 million to £306 million, with a mean of £299 million and underlying growth of 10%. At this stage, Northern Rock remains comfortable with these consensus averages.

Growth in EPS and DPS will continue to be consistent with growth in post-tax profits.

## **COMMENT**

Adam J Applegarth, Chief Executive, commented:

“Northern Rock's strategy of high growth through attracting high quality assets remains in place. It is pleasing to note that the credit quality of our books remains significantly better than industry average.”

“The robustness of our business model means we are again set to deliver on all our strategic targets in 2005 and we remain confident on the prospects for 2006.”

Further, more detailed, information on Northern Rock's 2005 trading performance will be produced at the Preliminary Results announcement on Wednesday, 25 January 2006.

**City Contacts**

Bob Bennett  
Group Finance Director  
0191 279 4346

Richard Moorin  
Investor Relations  
0191 279 4093

Simon Hall  
Investor Relations  
0191 279 6090

**Press Contacts**

Brian Giles  
Communications Director  
0191 279 4676

Jaqualyn Purcell  
PR Manager  
0191 279 4676

James Murgatroyd  
Finsbury Limited  
0207 251 3801

**Important Notice**

This announcement should be read in conjunction with our announcement for the half year ended June 2005, 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 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.