

**STOCK EXCHANGE ANNOUNCEMENT  
NORTHERN ROCK PLC : TRADING STATEMENT  
FOR THE 3 MONTHS TO 31 MARCH 2006**

**INTRODUCTION**

Northern Rock informs the market of its continued strong trading performance – in line with guidance given at the time of the 2005 Preliminary Results and its strategic intention of achieving annual growth in assets of 20% ( $\pm 5\%$ ) and growth in profit attributable to shareholders 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. Backed up by strong retention, 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 fundamentals are sound despite a slowdown in GDP growth. Whilst unemployment is increasing, it remains at historic low levels, and inflation is under control. We expect these trends to continue and therefore that interest rates and debt servicing costs will be relatively low.

This backdrop will continue to provide support for the UK housing market, especially when combined with the long-standing preference for home ownership in a market where housing demand outstrips supply. The latter stages of 2005 and the start of 2006 have seen a small but encouraging increase in the number of First Time Buyers returning to the housing market. We expect this gentle trend to continue, providing increased support to the home moving market, which is expected to see a slight increase in the number of housing transactions compared to 2005.

As households continue to reorganise their finances, demand for remortgage products will remain high, supporting gross loan volumes in 2006. Remortgaging is expected to represent around 45% of gross lending in 2006.

Combining our outlook for the UK housing and mortgage markets, our expectation is for a gross mortgage market in 2006 of around £300 billion, compared with £288 billion in 2005. Northern Rock remains confident of its ability to achieve its lending targets within this context.

**LENDING**

Our strong lending performance continued in the first quarter of 2006. During the first three months of 2006, total net lending was 26% higher than the same period last year, due to a

combination of a good gross mortgage market share, enhanced by customer retention. In Q1 2006, gross and net lending market shares have been in line with those for 2005 as a whole.

Going into the second quarter, Northern Rock's total lending pipeline stood at £5.7 billion; an increase of 15% over the same time last year and 8% higher than at the start of 2006.

Net residential lending during the first three months of the year was 14% higher than at the same point in 2005. This is encouraging, as the first quarter of 2005 saw strong lending following the introduction of mortgage regulation. Northern Rock's policy of offering existing mortgage customers the same products available to new customers, combined with active promotion and dedicated retention resources, has led to a continued good retention performance. At 31 March 2006, Northern Rock's residential lending pipeline was £5.1 billion, 14% higher than the same time last year.

The risk profile of residential lending during the first quarter was consistent with that seen in 2005. The proportion of Together, Buy-to-Let and HERM products are at similar levels to H2 2005. Higher Together sales reflect the drift back into the housing market of First Time Buyers.

Total unsecured lending represents a small but consistent proportion of Northern Rock's overall loan book, at around 8% of commercial assets. Total unsecured lending so far this year – both in net lending and share of pipeline – maintains this lending mix. The proportion of new unsecured lending which is mortgage-linked has increased, in line with Together sales in the first three months of the year. Unsecured loans linked to a mortgage demonstrate a similar performance profile to the secured element of the loan. We target quality rather than volume in both our personal unsecured and commercial secured lending. The growth in our commercial secured book remains quieter, as seen in H2 2005.

At this early stage, Northern Rock's lending performance during the first quarter of 2006 is consistent with the company achieving asset growth in the top half of the strategic range.

## **CREDIT QUALITY**

Credit quality at Northern Rock remains tightly monitored and controlled. Our strong underwriting criteria, the high proportion of borrowers with a proven payment track record and the targeting of low risk sectors ensure credit quality remains robust. Despite the backdrop of modestly increasing arrears in the mortgage industry and within some areas of consumer lending, Northern Rock's arrears profile remains low.

All of our loan books have shown little movement in their arrears profile since the end of 2005. Our residential arrears (3 months plus) remain below half the industry average, which at December 2005 was 0.92%, according to CML data.

Reflecting our view of the economy and our expectation for broadly flat house prices, we will continue the policy of 2005 in seeking quicker crystallisation on defaulting loans – secured and unsecured – where they are higher risk loans. Combined with the introduction of Basle

II-style impairment models, this will mean a shift in the relationship between provisions and write-offs, a trend already evidenced in 2005's figure.

## **FUNDING**

Funding volumes across our diversified funding platform remained strong in the first quarter of 2006.

We continue to develop our retail funding arm, building on last year's strong performance, and are attracting further strong net inflows of retail savings, which is expected to be the pattern for 2006 as a whole.

January saw the first of Northern Rock's residential mortgage-backed security (RMBS) issues for 2006. As with previous transactions, the issue was heavily oversubscribed leading to the issue being increased to £6 billion. This deal was achieved at an all-in cost of Libor +19bps, comparable with recent deals despite substantial upsizing, reflecting the strength and liquidity of this market and the appetite for Northern Rock's paper.

The first quarter of 2006 also saw the fourth issue from Northern Rock's €10 billion Covered Bond Programme as we further develop this funding stream. The €2 billion issue (at an all-in cost of Libor + 2bps) was also oversubscribed reflecting the significant appetite for this type of investment. We expect to raise further funds through the Covered Bond Programme in 2006.

We recently completed our first Australian dollar medium term note issue totalling A\$1.2 billion, further expanding our wholesale franchise and making us a genuinely global player in the wholesale funding markets.

## **COSTS**

Costs at Northern Rock continue to be tightly controlled. As we noted at the 2005 Preliminary Results, we expect cost growth to be at the bottom of our strategic range of  $\frac{1}{2}$  to  $\frac{2}{3}$  of asset growth in 2006, thus improving the cost:asset ratio. We expect to see the cost:income ratio improve in 2006, (reflecting positive "jaws") and so further improve our relative cost position as incremental regulatory cost growth moderates and further efficiency gains are realised.

## **CAPITAL**

We expect to be a major beneficiary of Basle II, given the low risk nature of our lending assets, and we will be well prepared for the introduction of Basle II from January 2007. We were one of the first banks to apply at the end of 2005 to the FSA for approval to adopt the Retail Internal Ratings Based approach under the new regulations and we intend to move from the Standardised Approach for Operational Risk to the Advanced Methodology as quickly as possible.

We continue to manage capital actively and, as part of our capital management plans, we intend to complete another Whinstone transaction in 2006, further transferring residual risk in securitisation issues. We believe this further strengthens our capital position, particularly ahead of Basle II, both with our regulator and the credit rating agencies.

## **INCOME & PROFITS**

As asset growth slows to the middle of our strategic target of 20% ( $\pm 5\%$ ) over the next 2-3 years, we expect to see attributable profit growth move towards and then above the mid-point of its target range of 15% ( $\pm 5\%$ ). This will, in part, reflect the gradual unwinding of the initial income deferral caused by IFRS. It also reflects the fact that we have repriced our retail backbooks and that our asset spreads largely reflect the general stability of front end lending margins. With Other Income expected to grow in line with the type of lending with which it is associated, all this should result in strong income growth in 2006.

This year will see further movements within the geography of the profit and loss account. Whinstone costs will be a deduction from income (in 2006 there will be a 12 month impact versus the 2 months in 2005) with the benefit primarily being lower growth in the appropriations line.

The range of post-tax attributable profit forecasts from 19 analysts for 2006 is £339 million to £361 million. At this early stage, Northern Rock remains comfortable with this consensus average of £352m, growth of 14%.

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

## **COMMENT**

Adam J Applegarth, Chief Executive, commented:

“We have started 2006 strongly, with lending performance and pipeline ahead of the good numbers of the comparable period last year, and entirely in keeping with our expectation of being in the top half of the asset growth target range.”

“Credit quality remains robust, with arrears well below industry averages, demonstrating the ongoing high quality of our lending.”

“Based on the enduring strengths of our business model, we are comfortable that we are again set to deliver against all our strategic targets in 2006.”

Further, more detailed, information on Northern Rock’s 2006 trading performance will be produced at the Interim Results announcement on Wednesday, 26 July 2006.

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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 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.