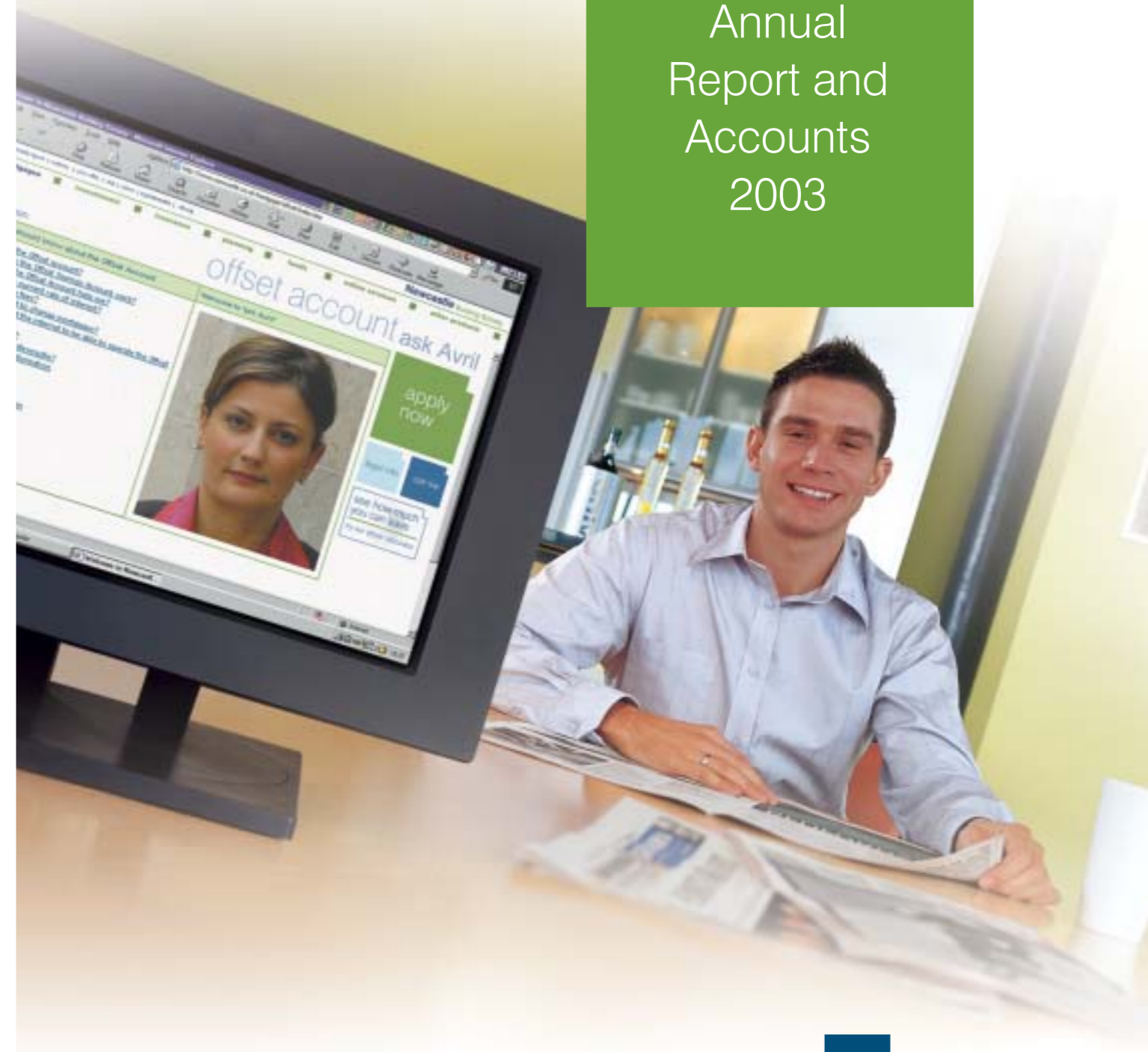


Annual Report and Accounts 2003



- mortgages
- investments
- savings
- insurance
- loans
- pensions
- financial planning



www.newcastle.co.uk

Principal Office: Portland House, New Bridge Street, Newcastle upon Tyne NE1 8AL. Tel: 0191 244 2000



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 well-being of the community. We recognise that our 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 range of innovative and competitively priced mortgage, savings and insurance products;
- To provide a secure home for savings;
- To provide effective customer service in a prompt, courteous and efficient manner and
- To treat members and customers fairly and in a way that is consistent with mutuality.

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 and
- To provide better than average remuneration packages in return for better than average contribution.

OUR COMMUNITIES

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

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CHAIRMAN'S STATEMENT

2003 has been a very demanding, but ultimately very successful year for the Society. I am delighted to report record levels of growth, record profits, reduced management expense ratios, our lowest level of arrears for many years and continued recognition of our reputation as an innovative and forward thinking building society. I would refer you to the Chief Executive's Overview for details of our financial performance.

A key part of our future strategy is to leverage our skills to generate income which enables us to underpin our core business. At the end of 2002 we formed a new company, Newcastle Strategic Solutions Limited (NSSL), with the specific objective of selling products and services to other organisations. The first year of operation has seen a number of successes including the provision of mortgage broking services, the manufacture of retail savings products and the processing of mortgages on behalf of other financial institutions. The year culminated in November when we were declared Mortgage Finance Gazette 'Innovator of the Year' for the third year running, for our work with NSSL.

We have also been innovative in product design to help counteract the problems that savers face with low rates of interest and new borrowers face in buying their first home at a time of sharply increasing property prices. We continue to offer savings accounts where the interest payable is linked to the performance of a number of different indices, providing the prospect of potentially greater returns but at the same time providing guaranteed capital protection. We have also developed a number of mortgage products that enable parents to use the equity in their own home, for example to help children buy their homes.

Our culture of innovation is strong and is something we are proud of but the Board is conscious that none of this would be possible without strong and efficient performance on the part of those involved in the day to day delivery of customer service. In recognition of this, Janet Towers was appointed as an executive director of the Society in May 2003 in charge of Operations and Human Resources. She has specific responsibility for the efficient and effective processing of all customer correspondence and has been instrumental in our virtualisation project, which has seen work transferred from our head office in Newcastle to branches and home workers. I am delighted that the cost of processing has thus been reduced and, at the same time, the level of service to our customers has increased.

We continue to pursue a multi-channel distribution strategy and branches remain very important to our future. It is therefore pleasing to report that we acquired a new branch in Alnwick, relocated our Ashington branch and upgraded 20 other branches during the course of 2003. The remaining branches will be completed during 2004. In addition to our investment in our branches, we are developing other distribution channels and in January 2004 we added online share dealing to our award-winning Internet site.

There has been much talk in the press about potential problems arising from high levels of personal debt and the risk of a serious setback to the housing market. Many of us remember the problems of the early 1990's and it does appear that some of the difficult lessons from those times have been forgotten. We have continued to take a very prudent approach to new mortgage lending and have deliberately avoided products such as 'buy-to-let' and self-certified mortgages. At December 2003, just 6% of our residential mortgage portfolio had a loan to value in excess of 80% and we had only 5 properties in possession at the year end. If there were to be a downturn in the economy, we are well placed to meet the challenges.

At the end of this year's Annual General Meeting we will be saying goodbye to two of our non executive directors, Sandy Hunter and Dick Johnson, who have both reached the Society's retirement age. I would like to place on record my thanks to them both. They have been great servants of the Society, and we will be sorry to see them go. Their contributions have been immense.

It seems inevitable that the Society will continue to face fierce competition, a demanding regulatory environment and potentially difficult economic conditions in 2004. I am confident, however, that we have the quality of staff and the robust, established strategies that will enable us to embrace change and continue to prosper.

**CHRIS HILTON,
CHAIRMAN**

CHIEF EXECUTIVE'S OVERVIEW

In the Chairman's statement on page 3, Chris Hilton outlines a successful year for the Society. There are a number of factors which have contributed to this success which are highlighted in this Overview.

HIGHLIGHTS OF THE YEAR

- 2003 was a year of outstanding financial achievement in which we were able to report both record growth and record profits.
- Over recent years we have made a significant investment in the infrastructure of our business and this continued in 2003 with the installation of a new communications network and the start of our branch refurbishment programme.
- We have a well-established strategy of diversifying around our core skills and we are encouraged by the progress made by Newcastle Strategic Solutions Limited in its first year of operations.
- 80 new jobs were created in 2003.

GROWTH IN ASSETS

In what continues to be a challenging and highly competitive market, I am pleased to announce that the Society's assets under management grew by an all time record of £492 million to £3.303 billion, an increase of 17.5% in the year. This was made possible by record gross lending for the year of £626 million and by the acquisition of the mortgage assets and deposit liabilities of the UK banking subsidiary of AMP Bank Limited.

A major contributor to new lending in 2003 was our offset mortgage. This product provides borrowers with a great deal of flexibility in managing their affairs and a highly tax efficient way of using their savings. The rapid rise in house prices has been good for existing borrowers but has made life very difficult for new borrowers. In order to help first time buyers, we have adapted our offset mortgage to incorporate 'family' and 'guarantor' features. These products enable parents to help children buy their first homes, whilst still retaining control of their own finances.

In June we completed the acquisition of the mortgage assets and deposit liabilities of AMP Banking UK, the UK banking subsidiary of AMP Bank Limited. As a result of this transaction, the Society acquired £350 million of high-quality mortgage balances, £13 million of endowment loans and £50 million of deposit accounts.

Whilst we have acquired mortgage portfolios in the past, this was by far the largest transaction of its type the Society has ever completed. Competition for the portfolio was intense, and critical to our success

was our technology capability which meant that the acquisition was completed in a little over 8 weeks.

PROFITABILITY

The Group's post tax profit increased by 4.6%, to £13.7 million which was a record but in line with our stated aim of achieving 'profit sufficiency'. Our interest rate margin, which is the difference between the rate we charge our borrowers and the rate we pay to savers, fell from 1.34% to 1.26%. We can therefore demonstrate that we have given more value back to our members than ever before. We have been able to reduce our margin but still increase profit because of improved efficiency, an increase in other income and because of a very low level of bad debts.

EFFICIENCY

The Society's management expenses grew by just 3% compared to the growth in assets under management of 17.5%. This has meant that the ratio of management expenses to mean assets under management has fallen from 0.93% to 0.86%. The key driver to this improved efficiency has been our virtualisation strategy which enables 'electronic paper' and telephone calls to be distributed around our organisation. This means that, not only can we utilise spare capacity, but it has also resulted in improved levels of customer service. The volume of work processed in 2003 was some 50% higher than in 2002, but the service levels achieved were significantly improved.

The Group's management expenses grew by 7%, resulting in a group management expense ratio (for assets under management) of 0.90% compared to 0.94% in the previous year. Group management expenses have grown by more than the Society management expenses because of the establishment of Newcastle Financial Services Limited (NFSL) but this increase in costs has been more than compensated for by increased levels of other income.

OTHER INCOME

Other income for the Group increased by 36% from £8.3 million in 2002 to £11.3 million in 2003. A key feature of our future strategy is to 'leverage our core skills' into other areas of business and this is proving to be successful. I comment more about these activities later in my report, under Newcastle Strategic Solutions Limited.

There can be little doubt that the range and complexity of financial issues facing our members has never been greater. Whether it be pensions, inheritance tax, long-term care or the investment of surplus funds, we believe that our members need the best possible advice. Consequently, NFSL was launched in March 2003, to offer financial planning services for our customers.

This is a major new venture for the Society and, importantly, it means that the consultants providing financial advice are employees of the Newcastle Building Society Group, trained to our exacting standards. Having our own financial advisors available in our branch network and head office is an exciting development for the Society.

In the first nine months of its operation, the number of staff employed by the company has grown to 38 and this is expected to increase to 50 during 2004.

BAD DEBTS

Our lending policy is very conservative and we have avoided impaired credit mortgages, self-certified mortgages and 'buy-to-let' mortgages. These types of mortgages do offer a higher rate of return but clearly carry additional risk and we are not convinced that the additional return justifies the greater risk.

Our arrears, which were already at very low levels, fell by 60% in the year and at the end of the year we had just 5 properties in possession. All of this has enabled us to record a credit rather than a charge for bad debts of £37,000.

INVESTMENT IN OUR BUSINESS IDENTITY

In 2002 we announced a logo change and a major branch modernisation programme. The logo change has been completed and by the end of 2003, 20 branches had been upgraded and now carry the new corporate identity. The remaining branches will be completed by the end of 2004 and the total cost of the works is expected to be £4 million.

We feel the new image reflects our position as a forward-thinking and modern building society, which is prepared to embrace change to offer the best possible service and products for our members. It has been extremely well received by customers and staff alike.

BRANCHES

Branches are a fundamental part of our distribution strategy and this is why we are investing so much in a major upgrade programme. Our commitment was further demonstrated in December when we were delighted to have the opportunity to acquire a new branch in Alnwick, Northumberland and to relocate our branch in Ashington to a better location. We hope that our new branches will enhance the quality of service to those members who live there.

TECHNOLOGY AND THE INTERNET

Newcastle Building Society is one of the very few building societies to write the majority of its own software. We believe this gives us a competitive advantage as it does mean we are masters of our own destiny and are able to react flexibly and responsively to opportunities, as we identify them. During 2003 we made a number of significant investments in our infrastructure.

We have installed a new Wide Area Network. This is a powerful communications system that allows us to route contact centre calls and 'electronic paper' from head office to the branch network. Having this infrastructure means that we are becoming 'location independent'. We are able to direct work around our organisation to be serviced by the person best able and qualified to deal with it.

We have continued to invest in our Internet capability and it was pleasing that in a recent survey our site was ranked third out of 100 financial institutions. The other organisations ranked in the top 5 were significantly larger than us.

We are continuing to develop a customer portal which will enable customers to see all of their financial relationships with the Newcastle on a single page. We can already display savings accounts, mortgages and unit trusts bought through NewcastleNet Funds. In January 2004 we launched an online share dealing service which is not only very competitively priced but is fully integrated into our customer portal.

CHIEF EXECUTIVE'S OVERVIEW Continued

NEWCASTLE STRATEGIC SOLUTIONS LIMITED (NSSL)

NSSL was launched at the end of 2002 to sell our expertise in computer systems, mortgage processing, call centre operations, product development and commercial lending to other financial institutions.

I am pleased to report that this strategy continues to go from strength to strength. In 2003 NSSL facilitated a number of solutions including: a 'white labelled' savings product for the Mirror Group Newspapers, treasury expertise allowing Manchester Building Society to offer a Guaranteed Equity Bond, a mortgage broking service for the Hinckley and Rugby Building Society, and a mortgage packaging service for the Prudential Mortgage Club.

In December NSSL syndicated a multi-million pound commercial loan for the Cumberland and Newbury Building Societies. The total loan of £13.5 million was sourced by our commercial lending department and then shared between Newcastle, Cumberland and Newbury.

STAFF

One measure of success and vibrancy of an organisation is the increase in number of staff employed. During the course of 2003 we have employed an additional 80 staff which represents an increase of almost 12.5%. We do not employ staff for the sake of it but because we need them to help us grow and expand our business.

The need to offer our staff the right skills training and to support and nurture their talents is something we never lose sight of, and as a leading Investor in People we are continually creating new opportunities. Our investment in technology, for example, is allowing an increasing number of skilled staff based in the branches and even at home to perform vital customer service roles that previously would only have been possible in head office.

Utilising branch and home-based staff makes obvious sense for the Society as it ensures we maintain the highest levels of customer service at all times. Just as importantly, it offers far greater career opportunities and work flexibility to the staff.

LOOKING FORWARD

Last year was characterised by unrelenting competition and an increasing amount of regulation. Despite these challenges, we have produced a set of highly satisfactory results.

We are not so naive as to think that these pressures will go away in 2004, but by continuing to diversify around our core skills and by adopting a forward-thinking approach we are confident that we will continue to prosper.

We will continue to put our members first by providing the very best service that we possibly can offer. We will continue to develop new products and services and our commitment to a multi-distribution strategy means that both branches and investment in technology will be equally important to our future.

In short, everything we do will be underpinned by our traditional values as a mutual and caring society but we will continue to support and strengthen these values, by innovation and by harnessing the best available technologies.

OUR DIRECTORS



(1) CHRIS HILTON, CHAIRMAN (54) is a senior partner at Eversheds in Newcastle, with specific expertise in international shipping and international trade. He is also a member of the Council of the University of Newcastle upon Tyne.

(2) JAMES HEPELL, VICE CHAIRMAN (56) has served as a Director since 1980. Chief Executive of St Cuthbert Newcastle Estates Limited, he has day-to-day involvement in the property sector.

(3) ROBERT HOLLINSHEAD (48) joined Newcastle Building Society in September 1992. Originally appointed Finance Director, he progressed to Operations Director in early 1997 and became Chief Executive in March 1998. After qualifying from Bristol University with an honours degree in economics, Robert's career included four years with a firm of chartered accountants before joining the financial services industry.

(4) RICHARD ALLAN (63) retired as a partner in KPMG's London office in 1996. He has extensive experience working within the financial sector and is also a Director of Newcastle-based retailer, T&G Allan Limited.

(5) TONY GLENTON (60) is the Senior Partner in Chartered Accountants, Rycroft Glenton. He has been a Director for 17 years, six of which as Chairman. He chairs the Society's Financial Risk Committee and is Chairman of the Port of Tyne Authority.

(6) OLIVIA GRANT (57) 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. Olivia has numerous business and other interests, including Chairman of the Council of the University of Newcastle upon Tyne, and of the Regional Cultural Consortium, Culture North East.

(7) DAVID HOLBORN (56) is Area Director for Lloyds TSB in the North. 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 also has considerable commercial lending experience, and is a council member of the Chamber of Commerce for Tyneside, Wearside and Teesside.

(8) SANDY HUNTER (64), a retired Senior RAF Officer, recently stood down after a long period as Chairman of Home Group Limited, one of the UK's largest registered social landlords. He remains Deputy Chairman of Annington Holdings plc, and currently chairs the Society's Audit Committee. He is also Chairman of the North of England Reserve Forces and Cadets Association.

(9) DICK JOHNSON (64) retired as Director of Corporate Affairs at Procter & Gamble in 1997. His marketing expertise and general business skills have proved invaluable to the board since his appointment in 1998. He chairs the Society's Pension Committee and the Pension Trustees Committee.

(10) COLIN SECCOMBE (51) has been Finance Director since 1997. Prior to that he was a senior audit partner with KPMG. He has a wide knowledge of finance, and of working with other building societies and high profile organisations within the wider financial services sector.

(11) JANET TOWERS (42) was appointed to the Board in May 2003 as Operations Director. A qualified chartered accountant she joined the Newcastle in 1994 and has worked in finance, customer services and human resources. Janet has also worked with accountants Ernst & Young in Newcastle.

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 2003.

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, for the use of our members. These mainstream activities are supported by a range of related financial products through the Society and its subsidiary companies, as authorised by the Building Societies Acts of 1986 and 1997. It is the Board's intention that Newcastle Building Society will continue to remain an independent and mutual building society.

REVIEW OF THE YEAR

- Group profit after tax for the year was **£13.7 million**, an increase of **4.6%** when compared to 2002.
- The Group's total assets under management at 31 December 2003 were **£3.3 billion** (31 December 2002: £2.8 billion), an increase of **17.6%**.
- At the year end, gross capital amounted to **£242 million** (2002: £203 million) which equates to a gross capital ratio of **8.59%** (2002: 8.63%). Free capital was **£217 million** (2002: £182 million) being **7.71%** (2002: 7.72%) of total shares and borrowings.
- The management expenses ratio in respect of total assets under management fell to **90p** per £100 of assets (2002: 94p per £100).
- Liquid assets, being cash and authorised securities, were **£518 million** representing **18.39%** of shares and borrowings (compared to £531 million, 22.56% of shares and borrowings in 2002).
- Gross mortgage advances made during the year amounted to **£626 million**, **36%** higher than in 2002.
- The mortgage portfolio at 31 December 2003 included **77** (2002: 159) mortgage accounts twelve or more months in arrears. The balances on these accounts amounted to **£2.1 million** (2002: £5.6 million) and the total amount of arrears in these cases was **£0.5 million** (2002: £1.7 million). In addition, there was a credit for bad debts to the Income and Expenditure Account of **£37,000** compared to a charge in 2002 of £0.2 million.
- **£363 million** of mortgage assets and **£50 million** of deposit balances were acquired from AMP Banking UK, the UK banking subsidiary of AMP Bank Limited.

- One new branch was acquired during the year.
- **20** of the Society's branches were upgraded to reflect the new corporate identity and another was relocated to a better location.
- The Society was awarded 'Innovator of the Year' for the third year in succession.

CHARITABLE DONATIONS AND POLITICAL CONTRIBUTIONS

As well as providing considerable 'in-kind' support, the Society made financial donations to charities and grass roots community activities amounting to **£98,625** (2002: £86,500). There were no political contributions during the year.

SUPPLIER PAYMENT POLICY

The Society's policy regarding the payment of suppliers for the forthcoming year is to discharge supplier invoices within the agreed payment terms when they fully conform with the terms and conditions of the purchase.

The Society will agree terms of payment with suppliers at the start of trading and will pay in accordance with the contractual and other legal obligations. The creditor days were **34** days (2002: 33 days).

STAFF

Newcastle Building Society is committed to equal opportunities for everyone regardless of their race, creed, gender, sexual orientation, marital status, age, physical or mental disability. Appropriate training is given to disabled employees - including those who have become disabled during their employment - to ensure they have the same career development opportunities as able-bodied staff. 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. UNIFI has negotiating rights on behalf of all staff up to and including senior management level.

DIRECTORS

As at 31 December 2003, the members of the Board were:

RB Allan	AAE Glenton	MO Grant	JW Heppell
FD Holborn	CJ Hilton	RJ Hollinshead	AFC Hunter
RW Johnson	CJ Seccombe*	JV Towers*	

All the above directors served throughout the year, with the exception of JV Towers who was appointed on 23 May 2003 and retires under Rule 25 (4).

Under Rule 26 (1) MO Grant, CJ Hilton and CJ Seccombe retire at the Annual General Meeting. They are eligible and willing to serve on the Board for a further three years.

AFC Hunter and RW Johnson retire at the Annual General Meeting.

* Executive directors

CORPORATE GOVERNANCE

In addition to monthly board meetings, the following sub-committees of the Board meet at regular intervals:

AUDIT COMMITTEE

AFC Hunter - chairman	CJ Hilton	RB Allan
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This committee considers all audit matters applying to the Group, in particular compliance matters under the Building Societies Acts of 1986 and 1997 and the Financial Services and Markets Act 2000. Internal controls, the scope and findings of the work of internal and external auditors, financial reporting and other relevant prudential requirements are also considered.

REMUNERATION COMMITTEE

CJ Hilton - chairman	JW Heppell	RW Johnson
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This committee sets the terms of employment and remuneration of directors and senior management of the Society.

NOMINATION COMMITTEE

CJ Hilton	JW Heppell	RJ Hollinshead
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This committee advises on the structure of the Board, on nominations to the Board and the re-election of board members retiring by rotation.

FINANCIAL RISK COMMITTEE

AAE Glenton - chairman	CJ Hilton	JW Heppell
FD Holborn	RJ Hollinshead	CJ Seccombe

This committee is responsible for setting lending and treasury policies and monitoring the risks associated with lending and treasury operations.

PENSION COMMITTEE

RW Johnson - chairman	AAE Glenton
MO Grant	RJ Hollinshead

This committee reviews all pension related issues.

AUDITORS

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

ON BEHALF OF THE BOARD
CJ HILTON
23 FEBRUARY 2004

REMUNERATION COMMITTEE REPORT

The Society complies with the sample Code of Governance on Boards and Management recommended by the Financial Services Authority, with the exception that the notice period in the service contract of the Chief Executive, entered into prior to the Code being issued, is two years as opposed to the now recommended period of one year. The Remuneration Committee, consisting solely of non-executive directors, considers and sets the level of remuneration for executive and non-executive members of the Board and in its consideration of remuneration levels and employment terms 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 organisations and also the level of salaries within 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.
- An annual performance-related bonus scheme has been established for executive directors and senior executives. In any one year a bonus is determined based on the achievement of specific objectives that have been set in the Society's corporate plan.
- Executive directors and non-executive directors, with the exception of three of the latter, are members of the Newcastle Building Society Pension Fund, details of which are set out in Note 32 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.
- The Chief Executive has a service contract which is terminable at any time by the Society on two years' notice or by himself on 12 months' notice. The other executive directors have service contracts which are terminable at any time by the Society on one year's notice or by themselves either on three or six months' notice, depending on the director. 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 in light of those paid to directors of other financial services organisations and reflect individual involvement in board committees and subsidiaries.
- Full details of individual directors' remuneration are contained in Note 7 to the Society's Annual Accounts.

DIRECTORS' RESPONSIBILITIES

The following statement, which should be read in conjunction with the statement of the respective responsibilities of Directors and Auditors on page 12, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Accounts, Annual Business Statement and Directors' Report.

The directors are required by the Building Societies Act 1986 ('the Act') to prepare, for each financial year, Annual Accounts which give a true and fair view of the state of the affairs of the Society and the Group as at the end of the financial year and of the Income and Expenditure of the Society and the Income and Expenditure and Cash Flows of the Group for the financial year. In preparing those Accounts, the directors are required to:

- Select appropriate accounting policies and apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- State whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the Accounts and
- Prepare the Accounts on the going concern basis, unless it is inappropriate to presume that the Group will continue in business.

The directors are satisfied that the Group has adequate resources to continue in business for the foreseeable future. For this reason the Accounts continue to be prepared on the going concern basis. In addition to the Annual 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 connected undertakings.

The directors are responsible for ensuring that the Society and its connected undertakings

- Keep 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.

**ON BEHALF OF THE BOARD
CJ HILTON
23 FEBRUARY 2004**

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF NEWCASTLE BUILDING SOCIETY

We have audited the Annual Accounts which comprise the Income and Expenditure Accounts, the Statement of Total Recognised Gains and Losses, the Balance Sheets, the Cash Flow Statement and the related Notes, which have been prepared under the historical cost convention as modified by the revaluation of certain investment properties, and the accounting policies set out in the statement of accounting policies.

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 include responsibility for the Annual Accounts, the Annual Business Statement and the Directors' Report. Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This opinion has been prepared for and only for the Society's members 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 in to 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 give a true and fair view and are properly prepared in accordance with the Building Societies Act 1986, on certain information included within the Annual Business Statement and on whether, in our opinion, the Directors' Report is consistent with the accounting records and the Annual Accounts. We also report to you if, in our opinion, we have not received all the information and explanations which we require for our audit, or if the Annual Accounts are not in agreement with the accounting records.

We read the other information contained in the Annual Report and consider the implications for our annual report if we become aware of any apparent misstatements or material inconsistencies with the Annual Accounts, the Annual Business Statement or the Directors' Report. The other information comprises only the Chairman's Statement, the Chief Executive's Overview and the Remuneration Committee Report.

BASIS OF AUDIT OPINION

We conducted our audit in accordance with Auditing Standards 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 and the Annual Business Statement.

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 Society's and Group'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 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.

OPINION

In our opinion:

- the Annual Accounts give a true and fair view of the state of affairs of the Society and of the Group as at 31 December 2003 and of the Income and Expenditure of the Society and the Income and Expenditure and Cash Flows of the Group 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, the Annual Business Statement and the Directors' Report have each been prepared in accordance with the applicable requirements of Part VIII of the Building Societies Act 1986 and regulations made under it.

PRICEWATERHOUSECOOPERS LLP
CHARTERED ACCOUNTANTS
AND REGISTERED AUDITORS
NEWCASTLE UPON TYNE
24 FEBRUARY 2004

INCOME AND EXPENDITURE ACCOUNTS for the year ended 31 December 2003

Note	All continuing operations			
	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
	130.1	128.1	130.0	128.0
2				
	(94.5)	(92.5)	(94.5)	(92.7)
3				
	35.6	35.6	35.5	35.3
	12.3	8.5	7.9	8.5
	(2.2)	(1.6)	(2.2)	(1.6)
	1.2	1.4	0.9	1.6
	46.9	43.9	42.1	43.8
	(25.5)	(23.6)	(25.2)	(24.1)
4				
	(2.0)	(2.1)	(1.0)	(1.2)
5				
	-	(0.2)	-	(0.2)
12				
	19.4	18.0	15.9	18.3
	(5.7)	(4.9)	(4.7)	(4.6)
8				
	13.7	13.1	11.2	13.7
28				

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES for the year ended 31 December 2003

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
	Profit for the financial year	13.7	13.1	11.2
Total gains and losses recognised for the year	13.7	13.1	11.2	13.7

There is no material difference between the profit on ordinary activities before tax and the profit for the financial year as stated above and their historical cost equivalents.

The notes on pages 17 to 47 form part of these Accounts.

BALANCE SHEETS at 31 December 2003

	Note	GROUP		SOCIETY	
		2003 £m	2002 £m	2003 £m	2002 £m
ASSETS					
Liquid Assets					
Cash in hand and balances with the Bank of England		5.0	4.0	5.0	4.0
Loans and advances to credit institutions	9	170.8	191.9	170.5	191.6
Debt securities	10	342.1	335.6	342.1	335.6
Loans and advances to customers					
Loans fully secured on residential property		2,220.1	1,743.3	2,218.3	1,741.0
Loans fully secured on land		156.1	146.8	156.0	146.8
Other loans		81.0	75.3	81.0	75.3
Loans fully secured on land subject to non-recourse finance		222.5	221.6	222.5	221.6
Non-recourse finance		(202.7)	(201.5)	(202.7)	(201.5)
		19.8	20.1	19.8	20.1
Other loans subject to non-recourse finance		46.7	39.7	46.7	39.7
Non-recourse finance		(23.1)	(21.6)	(23.1)	(21.6)
		23.6	18.1	23.6	18.1
Total loans and advances to customers	11	2,500.6	2,003.6	2,498.7	2,001.3
Investments					
Investments in subsidiary undertakings	13	-	-	6.7	7.7
Intangible fixed assets					
Negative goodwill	14	(0.7)	(1.4)	(0.7)	(1.4)
Tangible fixed assets					
	15	27.3	24.9	15.4	12.5
Other assets					
	16	19.5	9.4	16.6	9.1
Prepayments and accrued income					
	17	14.8	18.7	22.5	26.8
TOTAL ASSETS		3,079.4	2,586.7	3,076.8	2,587.2

The notes on pages 17 to 47 form part of these Accounts.

BALANCE SHEETS at 31 December 2003

	Note	GROUP		SOCIETY	
		2003 £m	2002 £m	2003 £m	2002 £m
LIABILITIES					
Shares					
	18	1,932.8	2,047.8	1,932.8	2,047.8
Amounts owed to credit institutions					
	19	295.5	52.8	295.5	52.8
Amounts owed to other customers					
	20	490.2	249.9	493.4	252.9
Debt securities in issue					
	21	97.5	5.0	97.5	5.0
Other liabilities					
	22	8.9	18.5	7.6	18.3
Accruals and deferred income					
	23	12.3	8.4	11.9	7.6
Provisions for liabilities and charges					
	24	0.2	0.9	-	0.8
Subordinated liabilities					
	25	49.7	24.8	49.7	24.8
		2,887.1	2,408.1	2,888.4	2,410.0
Subscribed capital					
	26	19.9	19.9	19.9	19.9
Investment property revaluation reserve					
	27	0.3	0.3	0.3	0.3
General reserve					
	28	172.1	158.4	168.2	157.0
TOTAL LIABILITIES		3,079.4	2,586.7	3,076.8	2,587.2
Memorandum Items					
Commitments					
	30	289.1	194.3	289.1	194.3

These Accounts were approved by the Board of Directors on 23 February 2004 and signed on its behalf by:

CJ HILTON, CHAIRMAN
JW HEPPELL, VICE CHAIRMAN
RJ HOLLINSHEAD, CHIEF EXECUTIVE

The notes on pages 17 to 47 form part of these Accounts.

CONSOLIDATED CASH FLOW STATEMENT for the year ended 31 December 2003

	Note	2003 £m	2002 £m
Net cash (outflow) / inflow from operating activities	29	(7.7)	45.7
Returns on investments and servicing of finance			
Interest paid on subordinated liabilities		(1.5)	(0.3)
Issue costs of subordinated liabilities		(0.1)	(0.2)
Interest paid on subscribed capital		(2.3)	(2.3)
Interest paid on lease purchase contracts		(0.1)	(0.1)
		(4.0)	(2.9)
Tax paid		(4.8)	(6.2)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(4.9)	(1.5)
Sale of tangible fixed assets		0.3	-
Purchase of financial fixed assets		(1,342.7)	(930.7)
Sale and maturity of financial fixed assets		1,336.1	871.5
		(11.2)	(60.7)
Net cash outflow before financing		(27.7)	(24.1)
Financing			
Issue of subordinated liabilities		25.0	25.0
Principal repayments under lease purchase contracts		(0.5)	(0.4)
		24.5	24.6
(Decrease) / increase in cash		(3.2)	0.5

The notes on pages 17 to 47 form part of these Accounts.

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

1 ACCOUNTING POLICIES

Accounting convention

The Accounts have been prepared under the historical cost convention, as modified by the revaluation of investment properties.

Basis of preparation

The Accounts have been prepared in accordance with the Building Societies (Accounts and Related Provisions) Regulations 1998 ('the Regulations') and with applicable Accounting Standards in the United Kingdom.

Basis of consolidation

The Group Accounts consolidate the accounts of the Society, its subsidiary undertakings and other companies which are considered by the directors to be quasi-subsidiaries as defined in Financial Reporting Standard No.5 'Reporting the Substance of Transactions', all of which have accounting periods ended 31 December.

Liquid assets

Debt securities intended for use on a continuing basis in the Group's activities are classified as financial fixed assets. They are shown at maturity value plus any premium and less any discount not yet amortised. The premium or discount, representing the difference between the purchase price and the par value of financial fixed assets, is amortised on a straight line basis to the maturity date of the security. Any amounts so amortised are charged or credited to the Income and Expenditure Account for the relevant year. Where there is a permanent diminution in value of a financial fixed asset, a provision is made so as to write down the cost of the security to its recoverable amount.

Acquisition of mortgage portfolios

Premiums arising on the acquisition of mortgage portfolios are capitalised in other assets and amortised over the effective life of the mortgages.

Loans subject to non-recourse finance

Loans fully secured on land and other loans subject to non-recourse finance meeting with the conditions specified in Financial Reporting Standard No. 5 are included in the Balance Sheet using the linked presentation method. All loan balances which are subject to non-recourse finance are stated at book value less provisions for impairment.

Provisions for losses on loans and advances to customers

Provisions are made to reduce the value of loans and advances to customers to the amount which the directors consider is likely to be ultimately recoverable. Individual assessments are made against all loans and advances where the arrears are 2.5% or more of the capital balance or where fraud has been identified. Specific provisions are made against those loans and advances which are considered to be impaired. A general provision is made against those loans and advances which have not been specifically identified as impaired to reflect the probability that other loans and advances may already have become impaired at the Balance Sheet date, with the result that the amount advanced may not be recovered in full.

Interest in respect of all loans is credited to the Income and Expenditure Account as it becomes receivable, except in respect of advances where the property has been taken into possession and where the collectability of the interest is subject to significant doubt. Such interest is credited to an interest suspense account, the balance on which is deducted from the appropriate assets in the Balance Sheet.

Loans in the Balance Sheet are shown net of specific and general provisions. The charge or credit to the Income and Expenditure Account comprises the increase in the provisions less adjustments to provisions resulting from recoveries, together with losses written off in the year.

Negative goodwill

Negative goodwill arising on the acquisition of Nottingham Imperial Building Society in 2000 is being amortised over the period during which the directors expect to benefit from the fixed assets and mortgages acquired and is based on an estimate of their remaining useful lives. The income released during the year is included in depreciation and amortisation. During the year, the directors re-assessed the remaining useful lives of the assets acquired from seven years to five years and the effect of this revision is to increase the amortisation release for the year by £0.35 million.

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

Tangible fixed assets and depreciation

Fixed assets, other than investment properties, are stated at cost less accumulated depreciation. Depreciation is provided at rates calculated to write down the assets to their estimated residual values over the course of their anticipated useful lives.

The rates and bases of depreciation used are as follows:

Freehold buildings and leasehold buildings with a residual lease term of greater than fifty years	- 2% per annum, straight line
Other leasehold land and buildings	- over the term of the lease
Refurbishment expenditure	- 10% per annum, straight line
Equipment, fixtures and fittings	- 15% per annum, reducing balance
Computer equipment	- 20% per annum, straight line
Motor vehicles	- over the term of the lease, or if purchased, at 25% per annum, reducing balance

Investment properties

In accordance with Statement of Standard Accounting Practice No.19 (SSAP 19), investment properties are revalued annually on an open market, existing use basis subject to existing tenancies. Movements on revaluation, other than permanent diminutions which are charged directly to the Income and Expenditure Account, are applied to an investment property revaluation reserve.

No depreciation has been provided in respect of investment properties. Compliance with SSAP 19 'Accounting for Investment Properties' requires a departure from the requirements of the Regulations relating to depreciation: namely to depreciate all properties, but that requirement conflicts with the generally accepted accounting principle set out in SSAP 19. The directors consider that, since these properties are held for investment purposes, then to depreciate them would result in the Group's Accounts not giving a true and fair view. The accounting policy adopted is therefore necessary for the Accounts to give a true and fair view. Investment properties are included in Note 15 to the Accounts, tangible fixed assets.

Lease purchase and leasing

The Group enters into lease purchase contracts and operating leases. Assets held under lease purchase contracts are capitalised 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 depreciation 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.

Taxation

Deferred tax is provided at current rates on all timing differences between the recognition of gains and losses in the accounts and their recognition in the tax computations and is measured on a discounted basis to reflect the time value of money over the period between the Balance Sheet date and the dates on which it is estimated that the underlying timing differences will reverse. The discount rates used reflect the post-tax yields to maturity that can be obtained on government bonds with similar maturity dates to those of the deferred tax assets or liabilities.

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

Retained mortgage risk charges

The Society charges certain borrowers a premium for its exposure to uninsured mortgage losses. This income is deferred and released to the Income and Expenditure Account on a level yield basis over the expected life of the mortgages.

Subordinated liabilities issue costs

Costs associated with the issues of subordinated liabilities are accounted for as a deduction from the amount of the liability and are being amortised over the life of the related debt.

Subscribed capital issue costs

Costs associated with the first issue of permanent interest bearing shares have been treated as a financing cost of the Society's Principal Office and capitalised in the Accounts of the subsidiary undertaking which owns it. Costs associated with the second issue of permanent interest bearing shares are accounted for as a deduction from the amount of the liability and are being amortised over twenty five years.

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. The intention to hedge and the relationship with the underlying risk inherent in the positions being hedged must also be established at the outset of the transaction.

Interest rate, equity or house price related contracts are classified at the Balance Sheet date as hedging contracts. Cash flows arising in relation to such instruments are accounted for on an accruals basis. If a hedge is terminated early, the realised gain or loss is amortised over the residual life of the underlying instrument. If the underlying instrument is redeemed, the remaining unamortised amount is recognised in the Income and Expenditure Account immediately in net interest receivable. Amounts accrued on hedging instruments are included in prepayments and accrued income or accruals and deferred income.

Pension scheme costs

The Society operates an externally managed pension scheme on behalf of directors and staff. The scheme is 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. Pension costs have been calculated in accordance with Statement of Standard Accounting Practice No. 24 and the transitional disclosure requirements of Financial Reporting Standard No.17 'Retirement Benefits' have been fully adopted in these Accounts (see Note 32).

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

2 INTEREST RECEIVABLE AND SIMILAR INCOME

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
On loans fully secured on residential property	100.4	93.7	100.3	93.6
On other loans				
- to connected undertakings	-	-	-	0.1
- on other loans	16.0	25.7	16.0	25.6
On debt securities				
- interest and other income	13.8	11.0	13.8	11.0
- profits net of losses on realisation	1.4	0.8	1.4	0.8
On other liquid assets				
- interest and other income	7.0	7.2	7.0	7.2
Net expense on financial instruments	(8.5)	(10.3)	(8.5)	(10.3)
	130.1	128.1	130.0	128.0
Income derived from fixed income securities included above:	13.8	11.0	13.8	11.0
Interest on loans fully secured on residential property has been reduced by:				
Incentives provided to customers	0.1	3.6	0.1	3.6
Interest suspended / written back on non-performing loans	(0.1)	0.1	(0.1)	0.1
	-	3.7	-	3.7
Movements in the suspended interest account are as follows:				
At 1 January 2003	0.4	0.3	0.4	0.3
Interest written off during the year	(0.1)	-	(0.1)	-
Interest suspended in the year	(0.1)	0.1	(0.1)	0.1
At 31 December 2003	0.2	0.4	0.2	0.4

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

3 INTEREST PAYABLE AND SIMILAR CHARGES

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
On shares held by individuals	69.6	72.5	69.6	72.5
On subscribed capital	2.3	2.3	2.3	2.3
On deposits and other borrowings				
- subordinated liabilities	1.5	0.3	1.5	0.3
- to connected undertakings	-	-	-	0.2
- to other depositors and borrowers	26.8	16.6	26.8	16.6
Net (income) / expense on financial instruments	(5.7)	0.8	(5.7)	0.8
	94.5	92.5	94.5	92.7

4 ADMINISTRATIVE EXPENSES

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
Staff costs				
- wages and salaries	13.0	10.6	11.8	10.6
- social security costs	0.9	0.8	0.9	0.8
- other pension costs	1.5	1.8	1.5	1.8
	15.4	13.2	14.2	13.2
Remuneration and expenses of auditors				
- audit services	0.1	0.1	0.1	0.1
- non audit services	-	-	-	-
Rentals under operating leases for land and buildings				
- payable to third parties	1.4	1.4	1.4	1.4
- payable to connected undertaking	-	-	0.1	0.1
Other administrative expenses	8.6	8.9	9.4	9.3
	25.5	23.6	25.2	24.1

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

5 DEPRECIATION AND AMORTISATION

	Note	GROUP		SOCIETY	
		2003 £m	2002 £m	2003 £m	2002 £m
Depreciation of tangible fixed assets	15	2.7	2.4	1.7	1.5
Amortisation of negative goodwill	14	(0.7)	(0.3)	(0.7)	(0.3)
		2.0	2.1	1.0	1.2

6 STAFF NUMBERS

	2003	GROUP		SOCIETY	
		2003	2002	2003	2002
The average number of persons employed during the year was:					
Full time	548	473	517	473	
Part time	240	241	239	241	
	788	714	756	714	
Principal Office	458	406	453	406	
Branches	330	308	303	308	
	788	714	756	714	

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

7 DIRECTORS' EMOLUMENTS

A report to members by the Remuneration Committee outlining the remuneration policy for directors is set out on page 10 of the Annual Report and Accounts.

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

	Salary or Fees £000	Annual Bonus £000	Benefits £000	Increase in accrued pension £000	2003 Total £000	2002 Total £000
Executive directors						
RJ Hollinshead	194	29	21	17	261	224
CJ Seccombe	116	18	13	3	150	142
JV Towers (appointed 23 May 2003)	50	7	6	3	66	-
	360	54	40	23	477	366
Non-executive directors						
CJ Hilton	50	-	-	1	51	42
JW Heppell	32	-	-	2	34	29
RB Allan	28	-	-	-	28	28
AAE Glenton	32	-	-	1	33	32
MO Grant	24	-	-	1	25	24
FD Holborn (appointed 1 January 2003)	27	-	-	-	27	-
AFC Hunter	28	-	-	1	29	28
RW Johnson	32	-	-	-	32	32
	613	54	40	29	736	581

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

7 DIRECTORS' EMOLUMENTS *Continued*

Pensions disclosure

The following table shows the value of directors' pension benefits including those which are unfunded.

	Accrued pension at 31-Dec-03 £000	Transfer value of accrued pension at 31-Dec-03 £000	Transfer value of accrued pension at 31-Dec-02 £000	Director's contributions during year £000	Increase in transfer value over year net of contributions £000
Executive directors					
RJ Hollinshead	65	746	401	9	336
CJ Seccombe	12	151	85	6	60
JV Towers (appointed 23 May 2003)	14	112	65	3	44
Non-executive directors					
CJ Hilton	19	195	129	2	64
JW Heppell	13	149	87	1	61
RB Allan	-	-	-	-	-
AAE Glenton	9	133	101	2	30
MO Grant	3	41	26	2	13
FD Holborn (appointed 1 January 2003)	-	-	-	-	-
AFC Hunter	5	99	71	3	25
RW Johnson	-	-	-	-	-

The accrued pension at 31 December 2003 is the pension which the director would have been entitled to receive, based on all their pensionable service, had he or she left on 31 December 2003. The increase in accrued pension represents the change in the annual pension to which each director is entitled as a result of changes in pensionable earnings and increases in pensionable service during their period of office.

Directors' Pensions

Two of the executive directors are entitled to receive pension benefits which are unfunded. Based on actuarial advice, provision for these contracted but unfunded benefits has been made in the Accounts. The cumulative provision at 31 December 2003 was **£540,000** (2002: £327,000).

Directors' Loans and Transactions

The aggregate amount of loans outstanding to directors and connected persons at 31 December 2003 was **£745,726** (2002: £996,985) in respect of **6** (2002: 6) directors. These loans were made on normal commercial terms. A register of these loans is available for inspection at the Principal Office for a period of 15 days up to and including the Annual General Meeting.

Related Party Transactions

Mr CJ Hilton is a partner in Eversheds, a firm which supplied professional services amounting to **£58,025** (2002: £6,726) to the Society during the year.

Throughout the year ended 31 December 2003 (and the previous year), the Society maintained a loan on commercial terms with The MEA Trust, an organisation of which Mr RJ Hollinshead is a director.

Throughout the year ended 31 December 2003 (and the previous year), the Society rented premises to and was a principal member of Newcastle Gateshead Initiative, a charity of which Mr RJ Hollinshead is a director.

The Society is party to an agreement for branded savings products with the charity Shelter. Mr RB Allan is a member of this organisation's audit and finance committees. During 2003, the Society paid Shelter **£807** (2002: £nil).

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

8 TAX ON PROFIT ON ORDINARY ACTIVITIES

	Note	GROUP		SOCIETY	
		2003 £m	2002 £m	2003 £m	2002 £m
Current tax					
UK corporation tax at 30% (2002: 30%) on profits for the year		5.6	5.0	4.6	5.0
Overprovision in respect of previous years					
- Corporation tax		-	-	-	(0.1)
- Group relief		-	-	-	(0.3)
Total current tax		5.6	5.0	4.6	4.6
Deferred tax					
Origination and reversal of timing differences	24	0.1	(0.1)	0.1	-
Total deferred tax		0.1	(0.1)	0.1	-
Total tax on profit on ordinary activities		5.7	4.9	4.7	4.6

Analysis of tax charge for the year

Profit on ordinary activities before tax	19.4	18.0	15.9	18.3
Profit on ordinary activities before tax at the standard rate of corporation tax in the UK of 30% (2002: 30%)	5.8	5.4	4.8	5.5
Group relief	-	-	-	(0.3)
Non-taxable income	(0.2)	(0.5)	(0.2)	(0.9)
Expenses not deductible for tax purposes	0.1	-	0.1	0.3
Capital allowances for year in excess of depreciation	(0.1)	0.1	(0.1)	0.1
Overprovision in respect of previous years	-	-	-	(0.1)
Current tax charge for year	5.6	5.0	4.6	4.6

Factors affecting future tax changes

There are no known factors which are expected to materially affect future tax charges.

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

9 LOANS AND ADVANCES TO CREDIT INSTITUTIONS

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

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
Accrued interest	1.0	0.6	1.0	0.6
On demand	0.3	4.5	-	4.2
In not more than three months	153.0	175.3	153.0	175.3
In more than three months but not more than one year	14.0	2.0	14.0	2.0
In more than one year but not more than five years	2.5	9.5	2.5	9.5
	170.8	191.9	170.5	191.6

10 DEBT SECURITIES

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
Transferable debt securities				
Issued by public bodies - listed	14.0	6.3	14.0	6.3
Issued by other borrowers - unlisted	328.1	329.3	328.1	329.3
	342.1	335.6	342.1	335.6
Debt securities have remaining maturities as follows:				
Accrued interest	2.6	2.7	2.6	2.7
In not more than one year	259.0	269.5	259.0	269.5
In more than one year	80.5	63.4	80.5	63.4
	342.1	335.6	342.1	335.6
Market value of listed transferable debt securities	13.8	6.4	13.8	6.4
Included in debt securities are:				
Unamortised premiums / (discounts)	(1.4)	0.3	(1.4)	0.3

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 and are therefore classified as financial fixed assets.

Movements in financial fixed assets (excluding accrued interest) during the year were as follows:

GROUP and SOCIETY	£m
Adjusted cost and net book value	
At 1 January 2003	332.9
Additions	1,342.7
Disposals / maturities	(1,336.1)
At 31 December 2003	339.5

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

11 LOANS AND ADVANCES TO CUSTOMERS

Loans and advances to customers have remaining maturities as follows:

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
On demand	20.0	15.4	20.0	15.4
In not more than three months	40.3	6.8	40.3	6.8
In more than three months but not more than one year	35.0	25.2	34.9	25.2
In more than one year but not more than five years	231.9	148.4	231.6	148.1
In more than five years	2,403.5	2,035.2	2,402.0	2,033.2
	2,730.7	2,231.0	2,728.8	2,228.7
Less: Provisions for bad and doubtful debts	(4.3)	(4.3)	(4.3)	(4.3)
Less: Non-recourse finance	(225.8)	(223.1)	(225.8)	(223.1)
	2,500.6	2,003.6	2,498.7	2,001.3

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.

Loans and advances to customers subject to non-recourse finance

Loans fully secured on land

A quasi-subsiary of the Society, Bamburgh Finance No.1 plc has loans secured on land subject to non-recourse finance. As clearly stated in agreements with the providers of the funding, the Society is not obliged to support any losses in respect of these loans other than to the extent of its subordinated funding, nor does it intend to do so. Repayment of the non-recourse funding facilities and the deferred consideration will be made solely from the cash flows generated by the underlying mortgages.

The Society has rights to the residual income from mortgages amounting to £193.2 million in Bamburgh Finance No.1 plc and its rights are subordinated to all other creditors of the company. Non-Group providers of finance have no recourse other than to the assets of Bamburgh Finance No.1 plc.

Bamburgh Finance No.1 plc has total funding of £224.2 million, £10.5 million of which has been funded by the Society.

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

11 LOANS AND ADVANCES TO CUSTOMERS Continued

The results of Bamburgh Finance No.1 plc and Bamburgh Mortgage Trustees Limited have been incorporated using the linked presentation method as quasi-subsidiaries. The summarised financial statements at 31 December 2003 are as follows:

	2003 £m	2002 £m
Income and Expenditure Account		
Interest receivable and similar income	10.8	-
Interest payable and similar charges	(10.6)	-
Net interest receivable	0.2	-
Administrative expenses	(0.7)	-
Loss on ordinary activities before tax	(0.5)	-
Tax on loss on ordinary activities	-	-
Loss for the financial period	(0.5)	-
Balance Sheet		
Assets		
Loans fully secured on land subject to non-recourse finance	193.2	202.7
Cash at bank	29.0	18.1
Other assets	0.2	-
Unamortised issue costs	1.8	-
	224.2	220.8
Capital and liabilities		
Notes in issue	210.0	210.0
Subordinated funding from Newcastle Building Society	10.5	10.6
Other liabilities	4.2	0.2
Capital and reserves	(0.5)	-
	224.2	220.8

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

11 LOANS AND ADVANCES TO CUSTOMERS Continued

	2003 £m	2002 £m
Cash Flow Statement		
Net cash inflow from operating activities	1.5	0.2
Net decrease / (increase) in loan balances	9.5	(202.7)
Net (decrease) / increase in subordinated funding	(0.1)	10.6
Issue of notes	-	210.0
Increase in cash	10.9	18.1
Reconciliation of operating loss to net cash inflow from operating activities		
Operating loss	(0.5)	-
Increase in other assets	(0.2)	-
Increase in other liabilities	4.0	0.2
Increase in unamortised issue costs	(1.8)	-
Net cash inflow from operating activities	1.5	0.2
Other loans subject to non-recourse finance		

The Society has entered into sub-participation agreements with other lenders in respect of certain other loans amounting to **£46.7 million** (2002: £39.7 million). The sub-participants to the agreements have no rights of recourse to the Society.

12 PROVISIONS FOR BAD AND DOUBTFUL DEBTS

GROUP and SOCIETY	Note	Total £m	Loans fully secured on residential property		Loans fully secured on land		Other loans	
			Specific £m	General £m	Specific £m	General £m	Specific £m	General £m
At 1 January 2003		4.3	2.1	1.3	0.3	0.5	-	0.1
Charge for the year		-	(0.1)	-	-	-	0.1	-
At 31 December 2003	11	4.3	2.0	1.3	0.3	0.5	0.1	0.1

During the year, both Group and Society recovered **£0.1 million** (2002: £0.2 million) against amounts previously written off.

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

13 INVESTMENTS

SOCIETY	Shares £m	Loans £m	Total £m
Investments in subsidiary undertakings			
Cost			
At 1 January 2003	7.8	3.3	11.1
Additions	-	1.0	1.0
Repayments received	-	(1.8)	(1.8)
At 31 December 2003	7.8	2.5	10.3
Provisions			
At 1 January 2003	1.5	1.9	3.4
Increase during the year	0.3	-	0.3
Decrease during the year	-	(0.1)	(0.1)
At 31 December 2003	1.8	1.8	3.6
Net book value at 31 December 2003	6.0	0.7	6.7
Net book value at 31 December 2002	6.3	1.4	7.7

The Society directly holds 100% of the issued ordinary share capital of all its subsidiary undertakings except for Newton Facilities Management Limited, where the Society's holding is 75%.

Name of principal undertakings	Principal activity
Newcastle Financial Services Limited	Provision of financial services
Newcastle Mortgage Corporation Limited	Mortgage financiers
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 are incorporated in England and Wales and operate principally in Great Britain. A Group segmental analysis is not provided as, in the opinion of the directors, the Group's activities are predominantly UK based and within one business sector.

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

13 INVESTMENTS Continued

Quasi-subidiaries

The companies considered by the Directors to be quasi-subidiaries as defined in Financial Reporting Standard No. 5 are set out below:

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

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 Great Britain. The other quasi-subidiaries are incorporated in Jersey.

14 INTANGIBLE FIXED ASSETS

Negative goodwill

GROUP and SOCIETY	£m
Cost	
At 1 January 2003 and 31 December 2003	2.4
Amortisation	
At 1 January 2003	1.0
Released during year	0.7
At 31 December 2003	1.7
Net book value at 31 December 2003	0.7
Net book value at 31 December 2002	1.4

The negative goodwill arose as a result of the acquisition of Nottingham Imperial Building Society which transferred its engagements to Newcastle Building Society with effect from 1 February 2000.

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

15 TANGIBLE FIXED ASSETS

GROUP	Freehold Land and Buildings £m	Leasehold Land and Buildings £m	Investment Properties £m	Equipment, Fixtures, Fittings and Motor Vehicles £m	Total £m
Cost or valuation					
At 1 January 2003	3.7	15.6	3.1	16.9	39.3
Additions	1.5	0.4	-	3.5	5.4
Disposals	-	-	(0.1)	(3.4)	(3.5)
At 31 December 2003	5.2	16.0	3.0	17.0	41.2
Depreciation					
At 1 January 2003	0.3	3.7	-	10.4	14.4
Charge for the year	0.1	0.4	-	2.2	2.7
Disposals	-	-	-	(3.2)	(3.2)
At 31 December 2003	0.4	4.1	-	9.4	13.9
Net Book Value at 31 December 2003	4.8	11.9	3.0	7.6	27.3
Net Book Value at 31 December 2002	3.4	11.9	3.1	6.5	24.9

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

15 TANGIBLE FIXED ASSETS Continued

SOCIETY	Freehold Land and Buildings £m	Leasehold Land and Buildings £m	Investment Properties £m	Equipment, Fixtures, Fittings and Motor Vehicles £m	Total £m
Cost or valuation					
At 1 January 2003	3.7	4.4	3.1	11.9	23.1
Additions	1.5	0.3	-	3.1	4.9
Disposals	-	-	(0.1)	(3.1)	(3.2)
At 31 December 2003	5.2	4.7	3.0	11.9	24.8
Depreciation					
At 1 January 2003	0.3	3.1	-	7.2	10.6
Charge for the year	0.1	0.2	-	1.4	1.7
Disposals	-	-	-	(2.9)	(2.9)
At 31 December 2003	0.4	3.3	-	5.7	9.4
Net Book Value at 31 December 2003	4.8	1.4	3.0	6.2	15.4
Net Book Value at 31 December 2002	3.4	1.3	3.1	4.7	12.5

Included in the total net book value of equipment, fixtures, fittings and motor vehicles for both Group and Society in both 2003 and 2002 is **£0.6 million** in respect of assets held under lease purchase contracts. Depreciation for the year in both 2003 and 2002 on these assets amounted to **£0.2 million**.

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
Included in leasehold land and buildings:				
Leaseholds with residual term of more than fifty years	10.7	10.8	0.2	0.2
Other leaseholds	1.2	1.1	1.2	1.1
	11.9	11.9	1.4	1.3
Land and buildings occupied by the Group for its own activities	13.6	11.5	4.2	3.4

Investment properties are included at directors' valuation.

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

16 OTHER ASSETS

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
Amounts receivable from subsidiary undertakings	-	-	0.6	0.3
Other	19.5	9.4	16.0	8.8
	19.5	9.4	16.6	9.1

17 PREPAYMENTS AND ACCRUED INCOME

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
Interest receivable on financial instruments	10.0	13.8	10.0	13.8
Other	4.8	4.9	12.5	13.0
	14.8	18.7	22.5	26.8

18 SHARES

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
Held by individuals	1,931.5	2,046.8	1,931.5	2,046.8
Other shares	1.3	1.0	1.3	1.0
	1,932.8	2,047.8	1,932.8	2,047.8

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

Accrued interest	66.7	57.0	66.7	57.0
On demand	1,502.6	1,612.8	1,502.6	1,612.8
In not more than three months	12.8	35.3	12.8	35.3
In more than three months but not more than one year	119.9	61.6	119.9	61.6
In more than one year but not more than five years	230.8	281.1	230.8	281.1
	1,932.8	2,047.8	1,932.8	2,047.8

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

19 AMOUNTS OWED TO CREDIT INSTITUTIONS

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

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
Accrued interest	1.4	0.3	1.4	0.3
On demand	-	20.5	-	20.5
In not more than three months	275.1	29.0	275.1	29.0
In more than three months but not more than one year	18.0	3.0	18.0	3.0
In more than one year but not more than five years	1.0	-	1.0	-
	295.5	52.8	295.5	52.8

20 AMOUNTS OWED TO OTHER CUSTOMERS

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
Amounts owed to subsidiary undertakings	-	-	3.2	3.0
Other	490.2	249.9	490.2	249.9
	490.2	249.9	493.4	252.9

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

Accrued interest	4.2	2.1	4.2	2.0
On demand	23.3	68.7	23.3	71.8
In not more than three months	321.8	126.3	325.0	126.3
In more than three months but not more than one year	130.9	42.8	130.9	42.8
In more than one year but not more than five years	10.0	10.0	10.0	10.0
	490.2	249.9	493.4	252.9

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

21 DEBT SECURITIES IN ISSUE

Being certificates of deposit repayable from the date of the Balance Sheet in the ordinary course of business as follows:

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
Accrued interest	0.5	-	0.5	-
In not more than one year	97.0	5.0	97.0	5.0
	97.5	5.0	97.5	5.0

22 OTHER LIABILITIES

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
Income tax	3.9	4.3	3.9	4.3
Corporation tax	4.2	3.4	2.6	2.9
Obligations under lease purchase contracts	0.6	0.6	0.6	0.6
Other creditors	0.2	10.2	0.5	10.5
	8.9	18.5	7.6	18.3

Obligations under lease purchase contracts fall due as follows:

	GROUP	SOCIETY
	2003 £m	2002 £m
Within one year	0.2	0.3
In one to two years	0.2	0.2
In two to five years	0.2	0.1
	0.6	0.6

The lease purchase contracts are secured by charges over the assets to which they relate.

23 ACCRUALS AND DEFERRED INCOME

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
Interest accrued on subordinated liabilities	0.4	0.4	0.4	0.4
Interest accrued on subscribed capital	0.4	0.4	0.4	0.4
Retained mortgage risk charge premiums	0.7	1.3	0.7	1.3
Other	10.8	6.3	10.4	5.5
	12.3	8.4	11.9	7.6

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

24 PROVISIONS FOR LIABILITIES AND CHARGES

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
Provision for deferred tax	0.2	0.1	-	-
Provision for pension costs in respect of part-time staff	-	0.7	-	0.7
Provision for claims	-	0.1	-	0.1
	0.2	0.9	-	0.8

Deferred tax

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
Accelerated capital allowances	1.6	1.6	0.5	0.5
Short term timing differences	(0.7)	(0.9)	(0.7)	(0.9)
Undiscounted provision for deferred tax	0.9	0.7	(0.2)	(0.4)
Discount	(0.7)	(0.6)	(0.2)	(0.1)
Discounted provision for deferred tax	0.2	0.1	(0.4)	(0.5)

Provision

	GROUP	SOCIETY
	2003 £m	2002 £m
At 1 January 2003	0.1	(0.5)
Income and Expenditure Account	0.1	0.1
At 31 December 2003	0.2	(0.4)

The Society's deferred tax asset is included in 'Other Assets'.

25 SUBORDINATED LIABILITIES

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
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	-
Less: Unamortised issue costs	(0.3)	(0.2)	(0.3)	(0.2)
	49.7	24.8	49.7	24.8

On 24 October 2003 the Society issued a further £25 million of fixed rate subordinated debt. 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.

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

26 SUBSCRIBED CAPITAL

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £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 INVESTMENT PROPERTY REVALUATION RESERVE

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
At 1 January 2003	0.3	(0.4)	0.3	(0.4)
Revaluation surplus for the year	-	0.7	-	0.7
At 31 December 2003	0.3	0.3	0.3	0.3

28 GENERAL RESERVE

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
At 1 January 2003	158.4	145.3	157.0	143.3
Profit for the financial year	13.7	13.1	11.2	13.7
At 31 December 2003	172.1	158.4	168.2	157.0

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

29 CONSOLIDATED CASH FLOW STATEMENT

	2003 £m	2002 £m	
Reconciliation of operating profit to net cash (outflow) / inflow from operating activities			
Operating profit	19.4	18.0	
Decrease / (increase) in prepayments and accrued income	3.6	(6.9)	
Increase in accruals and deferred income	3.8	-	
Provisions for bad and doubtful debts	-	0.2	
Net advances written off	-	(0.3)	
Depreciation and amortisation	2.0	2.1	
Interest on subordinated liabilities	1.5	0.3	
Interest on subscribed capital	2.3	2.3	
Interest on lease purchase contracts	0.1	0.1	
Other non-cash movements	1.4	0.1	
Net cash inflow from trading activities	34.1	15.9	
(Increase) / decrease in loans and advances to customers	(497.0)	106.7	
Decrease in loans and advances to credit institutions	17.2	37.0	
Increase / (decrease) in amounts owed to credit institutions	145.2	(67.8)	
Increase / (decrease) in amounts owed to customers	222.9	(11.8)	
Increase / (decrease) in debt securities in issue	92.5	(35.0)	
Decrease in other assets	(11.4)	(8.0)	
(Decrease) / increase in other liabilities	(11.2)	8.7	
Net cash (outflow) / inflow from operating activities	(7.7)	45.7	
Analysis of changes in cash during the year			
At 1 January	8.5	8.0	
Net cash (outflow) / inflow	(3.2)	0.5	
At 31 December	5.3	8.5	
Analysis of the balances of cash as shown in the Balance Sheet	2003 £m	Flows £m	2002 £m
Cash in hand and balances with Bank of England	5.0	1.0	4.0
Loans and advances to credit institutions repayable on demand	0.3	(4.2)	4.5
	5.3	(3.2)	8.5

The Group is required to maintain balances with the Bank of England which at 31 December 2003 amounted to **£2.5 million** (2002: £2.6 million).

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

30 MEMORANDUM ITEMS

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
Commitments				
Irrevocable undrawn committed loan facilities	289.1	194.3	289.1	194.3

31 GUARANTEES AND FINANCIAL COMMITMENTS

- (i) 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) 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) Capital commitments at 31 December 2003 not provided for in these Accounts

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
Capital expenditure contracted but not provided for	-	0.5	-	0.5

(iv) Operating lease commitments

The Group and Society are committed in the year ahead to the following payments under operating lease agreements in respect of land and buildings.

	GROUP		SOCIETY	
	2003 £m	2002 £m	2003 £m	2002 £m
Commitments which expire:				
Within one year	0.1	0.1	0.1	0.1
In one to five years	0.2	0.2	0.2	0.2
Over five years	1.1	1.1	1.1	1.2
	1.4	1.4	1.4	1.5

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

32 RETIREMENT BENEFITS

Pension schemes

The Group operates both a defined benefit pension scheme and a defined contribution scheme. Costs are assessed by an independent qualified actuary on the basis of triennial valuations using the attained age method. The most recent Actuarial valuation of the Scheme was at 1 July 2001 and the market value of the scheme's assets at that date was £22 million which represented 77% of the value of the benefits that had accrued to members with a deficit of £6.5 million.

The SSAP 24 figures were calculated at 1 July 2001 based on the following assumptions:

Future price inflation		2.50%
Discount rate		6.00%
Increases in earnings		4.00%
Increases in pensions	Pre 1 July 2000	5.00%
	Post 30 June 2000	2.50%

The pension charge for the period was: Group and Society **£1.5 million** (2002: £1.8 million). The current contribution rates for the defined benefit scheme paid by the Society and by Scheme Members are 21% and 5% respectively.

The actuarial valuation used in assessing the FRS 17 disclosures was carried out as at 1 July 2001, and has been updated by Watson Wyatt LLP to take account of the requirements of FRS 17 and to assess the assets and liabilities of the Scheme at 31 December 2003. Scheme assets are stated at their market value on 31 December 2003.

The liabilities of the Scheme under FRS 17 were calculated using the projected unit method with the following assumptions:

	At 31-Dec-03	At 31-Dec-02	At 31-Dec-01
Future price inflation	2.80%	2.40%	2.50%
Discount rate	5.60%	5.80%	5.75%
Increases in earnings	4.30%	3.90%	4.00%
Increases in pensions	Pre 1 July 2000	5.00%	5.00%
	Post 30 June 2000	2.80%	2.40%
		2.50%	

The Scheme is closed to new entrants. Under the projected unit method, the current service cost will increase as members of the Scheme approach retirement.

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

32 RETIREMENT BENEFITS Continued

The assets of the Scheme and the expected rates of return were:

	Long term expected rate of return per annum at			Value at 31-Dec-03 £m	Value at 31-Dec-02 £m	Value at 31-Dec-01 £m
	31-Dec-03 % pa	31-Dec-02 % pa	31-Dec-01 % pa			
Equities	8.50	8.50	7.75	14.8	12.1	12.0
Fixed Interest Bonds	5.20	5.15	5.37	9.0	8.0	7.9
Index Linked Bonds	4.80	4.60	4.75	2.1	1.9	2.0
Cash	3.80	3.90	4.50	0.2	0.2	0.2
Total market value of assets at 31 December				26.1	22.2	22.1
Present value of liabilities of the Scheme				39.7	34.0	31.6
Deficit in the Scheme				(13.6)	(11.8)	(9.5)
Related deferred tax asset				4.1	3.5	2.9
Net pension liability				9.5	8.3	6.6

Movement in deficit during the year

	£m	£m
Deficit in the Scheme at the beginning of the year	11.8	9.5
Current service cost	1.0	1.0
Contributions	(1.2)	(3.1)
Past service cost	-	-
Other finance income	0.4	0.3
Actuarial loss	1.6	4.1
Deficit in the Scheme at the end of the year	13.6	11.8

If FRS 17 had been fully adopted in these Accounts, then the impact would have been as follows:

	Note	Group 2003 £m	Group 2002 £m
Other liabilities			
Other liabilities excluding pension liability	22	8.9	18.5
Pension liability		9.5	8.3
Total other liabilities		18.4	26.8
Reserves			
General reserve excluding pension liability	28	172.1	158.4
Pension liability		(9.5)	(8.3)
Investment property revaluation reserve	27	0.3	0.3
Total reserves		162.9	150.4

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

32 RETIREMENT BENEFITS Continued

	Group 2003 £m	Group 2002 £m
Analysis of the amount charged to operating profit		
Current service cost	1.0	1.0
Past service cost	-	-
Total operating charge	1.0	1.0
Analysis of the amount credited to other financing income		
Expected return on pension scheme assets	(1.6)	(1.5)
Interest on pension scheme liabilities	2.0	1.8
Net return	0.4	0.3

Analysis of the amounts recognised in the Statement of Recognised Gains and Losses

(Gain) / loss on pension scheme assets	(1.3)	4.0
Experience loss arising on the scheme liabilities	0.1	0.6
Loss / (gain) on changes in assumptions underlying the present value of the scheme liabilities	2.8	(0.5)
Actuarial loss recognised	1.6	4.1

The experience gains and losses for the year were as follows:

(Gain) / loss on scheme assets		
Amount	£(1.3) million	£4.0 million
Percentage of scheme assets	5%	18%
Experience loss on scheme liabilities		
Amount	£0.1 million	£0.6 million
Percentage of the present value of the scheme liabilities	0%	2%
Total amount recognised in the Statement of Recognised Gains and Losses		
Amount	£1.6 million	£4.1 million
Percentage of the present value of the scheme liabilities	4%	12%

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

33 FINANCIAL INSTRUMENTS

A financial instrument is a contract which gives rise to a financial asset of one entity and a financial liability of another entity. The Group is a retailer of financial instruments, mainly in the form of mortgages and savings products. It also uses wholesale financial instruments to invest liquid asset balances, raise wholesale funding and to manage the risks arising from its operations. Instruments used for risk management purposes include derivative financial instruments ('derivatives'), which are contracts or agreements whose value is derived from one or more underlying price, rate or index in the the contract or agreement, such as interest rates, equity indices or house price indices. The Group uses derivatives only in accordance with the Building Societies Act 1986 to limit the extent to which its activities may be affected by changes in interest rates or other factors specified in the legislation. Derivatives are not used in trading activity or for speculative purposes and all derivatives are therefore designated as hedging instruments.

Control of derivatives

The Board has authorised use of derivatives, retains overall responsibility for the Group's treasury activities and has appointed a Financial Risk Committee and Assets and Liabilities Committee to control and supervise these functions. The Group has a formal structure for managing risk which includes established risk limits, reporting lines, mandates and other control procedures. The structure is reviewed by the Financial Risk Committee and its minutes are presented to the Board on a regular basis.

Types of derivatives

The only derivatives used in balance sheet risk management are interest rate contracts which are used to hedge Group balance sheet exposures arising from fixed rate mortgage lending and savings products and from fixed rate funding and fixed rate investments. The risk associated with such activities is sensitivity to changes in interest rates. Such risk may alternatively be managed using on balance sheet instruments as part of the Group's integrated approach to risk management. Derivative products which are combinations of more than one basic derivative are used only in circumstances where the underlying position being hedged contains the same risk characteristics. For example, where guaranteed equity bonds are issued by the Group these would be hedged with a single contract incorporating both the interest rate and equity index risk features. In such cases, the derivatives used will be designed to match exactly the risks of the underlying asset or liability so that exposure to market risk on such contracts is fully hedged.

The following table analyses the derivatives by type of contract and maturity and shows the nominal principal amount, credit risk weighted amount and replacement cost of the contracts. Nominal principal amount indicates the volume of business outstanding at the Balance Sheet date and does not represent amounts at risk. The replacement cost represents the cost of replacing contracts with positive values, calculated at market rates current at the Balance Sheet date and reflects the Group's exposure, should the counterparties default. The credit risk weighted amount, which is calculated in accordance with the rules specified by the Financial Services Authority, is based on the replacement cost but also takes into account measures of the extent of potential future exposure and the nature of the counterparty.

GROUP and SOCIETY

	Nominal Principal Amount 2003 £m	Credit Risk Weighted Amount 2003 £m	Replacement Cost 2003 £m	Nominal Principal Amount 2002 £m	Credit Risk Weighted Amount 2002 £m	Replacement Cost 2002 £m
Interest rate contracts						
Interest rate swaps	1,432.7	15.2	63.4	1,290.6	15.0	63.0
Caps, collars and floors	242.0	0.2	0.6	253.5	0.3	1.0
	1,674.7	15.4	64.0	1,544.1	15.3	64.0
Under one year	412.3	7.8	39.1	296.4	2.3	11.6
Between one and five years	559.3	3.7	15.6	634.5	9.0	41.8
Over five years	703.1	3.9	9.3	613.2	4.0	10.6
	1,674.7	15.4	64.0	1,544.1	15.3	64.0

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

33 FINANCIAL INSTRUMENTS Continued

The financial risks faced by the Group include credit risk, liquidity risk and interest rate risk. The Group has no exposure to foreign currency rate risk.

Credit risk

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

Liquidity risk

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

Interest rate risk

The net interest income and economic value of the Group is exposed to movements in interest rates. This exposure is managed on a continuous basis, within limits set by the Board, using a combination of on and off balance sheet instruments. The tables below set out the interest rate sensitivity exposure after taking into account the various derivatives entered into by the Group. Items are allocated to time bands by reference to the earlier of the next repricing date and the maturity date.

At 31 December 2003

	Not more than three months £m	More than three months but not more than six months £m	More than six months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Non interest bearing £m	Total £m
Assets							
Liquid assets	421.6	27.5	44.7	13.2	-	10.9	517.9
Loans and advances to customers	1,698.6	74.6	46.9	377.0	303.5	-	2,500.6
Tangible and intangible fixed assets	-	-	-	-	-	26.6	26.6
Other assets	6.7	-	-	1.2	7.2	19.2	34.3
Total Assets	2,126.9	102.1	91.6	391.4	310.7	56.7	3,079.4
Liabilities							
Shares	1,352.9	79.4	126.6	263.1	110.8	-	1,932.8
Amounts owed to credit institutions, other customers and debt securities in issue	712.3	105.8	54.0	11.0	0.1	-	883.2
Other liabilities	-	-	-	-	-	21.4	21.4
Subordinated debt	-	-	-	-	-	49.7	49.7
Subscribed capital	-	-	-	-	-	19.9	19.9
Reserves	-	-	-	-	-	172.4	172.4
Total Liabilities	2,065.2	185.2	180.6	274.1	110.9	263.4	3,079.4
Off Balance Sheet items	165.5	29.4	72.2	(24.7)	(242.4)	-	-
Interest rate sensitivity gap	227.2	(53.7)	(16.8)	92.6	(42.6)	(206.7)	-
Cumulative gap	227.2	173.5	156.7	249.3	206.7	-	-

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

33 FINANCIAL INSTRUMENTS Continued

At 31 December 2002

	Not more than three months £m	More than three months but not more than six months £m	More than six months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Non interest bearing £m	Total £m
Assets							
Liquid assets	460.5	23.3	30.2	8.2	-	9.3	531.5
Loans and advances to customers	1,332.8	27.3	40.0	328.3	275.2	-	2,003.6
Tangible assets	-	-	-	-	-	23.5	23.5
Other assets	-	-	-	0.4	7.6	20.1	28.1
Total Assets	1,793.3	50.6	70.2	336.9	282.8	52.9	2,586.7
Liabilities							
Shares	1,506.0	29.8	38.6	382.2	91.2	-	2,047.8
Amounts owed to credit institutions, other customers and debt securities in issue	255.7	11.7	30.2	10.0	0.1	-	307.7
Other liabilities	-	-	-	-	-	27.8	27.8
Subordinated debt	-	-	-	-	-	24.8	24.8
Subscribed capital	-	-	-	-	-	19.9	19.9
Reserves	-	-	-	-	-	158.7	158.7
Total Liabilities	1,761.7	41.5	68.8	392.2	91.3	231.2	2,586.7
Off Balance Sheet items	221.4	(168.7)	14.5	159.8	(227.0)	-	-
Interest rate sensitivity gap	253.0	(159.6)	15.9	104.5	(35.5)	(178.3)	-
Cumulative gap	253.0	93.4	109.3	213.8	178.3	-	-

Liquid assets include cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities. Other assets include other assets, prepayments and accrued income. Other liabilities include other liabilities, accruals and deferred income, provisions for liabilities and charges.

NOTES TO THE ACCOUNTS for the year ended 31 December 2003

33 FINANCIAL INSTRUMENTS Continued

Fair values of financial instruments

The table below compares the book and fair values of some of the Group's financial instruments by category at 31 December 2003 and 31 December 2002.

	2003 Book Value £m	2003 Fair Value £m	2002 Book Value £m	2002 Fair Value £m
On Balance Sheet instruments				
Liquid assets	517.9	517.7	531.5	532.0
Amounts owed to credit institutions, other customers and debt securities in issue	883.2	883.2	307.7	307.7
Off Balance Sheet and similar instruments	-	32.6	-	17.9

The table excludes certain financial assets and liabilities which are not listed or publicly traded, or for which a liquid and active market does not exist. It excludes mortgages, retail savings and other Balance Sheet items whose book and fair values may differ. Liquid assets include cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities. Market values have been used to determine the fair value of all financial instruments. The fair values of all other items have been calculated by discounting expected future cash flows at prevailing interest rates.

Gains and losses on hedges

Hedges which comprise 'Off Balance Sheet and similar instruments' referred to above are used to reduce the risk of loss arising from changes in interest rates. Gains and losses on instruments used for hedging are generally not recognised until the exposure which is being hedged is itself recognised. Unrecognised gains and losses on these instruments, and the movements therein are as follows:

	Total gains £m	Total losses £m	Total net gains / (losses) £m
Unrecognised gains / (losses) on hedges at 1 January 2003	64.1	(46.2)	17.9
Gains arising in previous year that were recognised in year to 31 December 2003	(11.6)	-	(11.6)
Gains / (losses) arising before 1 January 2003 that were not recognised in year to 31 December 2003	52.5	(46.2)	6.3
Gains arising in year to 31 December 2003 that were not recognised in the same year	11.5	14.8	26.3
Unrecognised gains / (losses) on hedges at 31 December 2003	64.0	(31.4)	32.6
Of which:			
Gains / (losses) expected to be recognised in the year to 31 December 2004	39.1	(0.3)	38.8
Gains / (losses) expected to be recognised after 31 December 2004	24.9	(31.1)	(6.2)
	64.0	(31.4)	32.6

ANNUAL BUSINESS STATEMENT for the year ended 31 December 2003

1 STATUTORY PERCENTAGES

	2003 %	Statutory %
Lending limit	12.44	25.00
Funding limit	31.37	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.

The lending limit measures the proportion of business assets not in the form of loans fully secured on residential property and is calculated as $(X-Y)/X$ where:

X= business assets, being the total assets as shown in the Group Balance Sheet plus provisions for bad and doubtful debts, less tangible fixed assets, negative goodwill and liquid assets.

Y= the principal of, and interest accrued on, loans fully secured on residential property owed to the Group.

The funding limit measures the proportion of shares and borrowings not in the form of shares held by individuals and is calculated as $(X-Y)/X$ where:

X= shares and borrowings, being the aggregate of:

- (i) the principal value of, and interest accrued on, shares in the Society;
- (ii) the principal value of, and interest accrued on, sums deposited with the Society or any subsidiary undertaking of the Society and
- (iii) the principal value of, and interest accrued on, instruments or agreements creating or acknowledging indebtedness and accepted, issued or entered into by the Society or any subsidiary undertaking, less any amounts qualifying as own funds.

Y= the principal value of, and interest accrued on, shares held by individuals otherwise than as a bare or simple trustee for bodies corporate or for persons who include bodies corporate.

ANNUAL BUSINESS STATEMENT for the year ended 31 December 2003

2 OTHER PERCENTAGES

	2003 %	2002 %
As a percentage of shares and borrowings:		
Gross capital	8.59	8.63
Free capital	7.71	7.72
Liquid assets	18.39	22.56
Profit for the financial year as a percentage of mean total assets	0.48	0.50
Management expenses as a percentage of mean total assets	0.97	0.98
Management expenses as a percentage of mean total assets under management	0.90	0.94

The above percentages have been prepared from the Group Accounts.

Gross capital represents the general reserve together with the investment property revaluation reserve, subordinated liabilities, subscribed capital and minority interests.

Free capital represents the gross capital plus general provisions for bad and doubtful debts and negative goodwill less tangible fixed assets.

Liquid assets are as shown in the Group Balance Sheet.

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, depreciation and amortisation.

Mean total assets are the average of the 2003 and 2002 total assets.

Mean total assets under management include those assets, administered by the Society, which are subject to non-recourse finance.

ANNUAL BUSINESS STATEMENT for the year ended 31 December 2003

DIRECTORS

		Date of Birth	Date of Appointment	Occupation
CJ Hilton MA	Chairman	19.1.50	1.1.78	Solicitor
	Other Directorships: Council Member of the University of Newcastle upon Tyne; NEPIA Trust Company Limited.			
JW Hoppel	Vice Chairman	30.8.47	5.12.80	Company Director
	Other Directorships: Adamscastle Limited; Adamson Newcastle Limited; Bank of Newcastle Limited; Grainger Newcastle Properties Limited; NBS Financial Services Limited; Newcastle Bank Limited; Newcastle Developments Limited; Newcastle Financial Services Limited; Newcastle Mortgage Corporation Limited; Newcastle Portland House Limited; Newcastle Strategic Solutions Limited; Newton Facilities Computer Leasing Limited; Newton Facilities Computer Purchasing Limited; Northern Football Ground Limited; Paramount Homes Limited; St. Cuthbert Newcastle Estates Limited; Strachans (Newcastle) Limited.			
RJ Hollinshead BSc (Hons) ACA ATII	Chief Executive	20.5.55	8.9.92	Building Society Executive
	Other Directorships: Adamscastle Limited; Adamson Newcastle Limited; Bank of Newcastle Limited; Common Purpose; NBS Financial Services Limited; Newcastle Bank Limited; Newcastle Developments Limited; Newcastle Financial Services Limited; Newcastle Gateshead Initiative; Newcastle Mortgage Corporation Limited; Newcastle Portland House Limited; Newcastle Strategic Solutions Limited; Newton Facilities Computer Leasing Limited; Newton Facilities Computer Purchasing Limited; Newton Facilities Management Limited; Strachans (Newcastle) Limited; The MEA Trust; Tyne & Wear Play Association.			
RB Allan MA FCA	-	2.8.40	1.5.99	Chartered Accountant
	Other Directorships: Shelter Trading Limited; T & G Allan Limited.			
AAE Glenton CBE TD FCA DL	-	21.3.43	20.11.87	Chartered Accountant
	Other Directorships: Port of Tyne Authority; Portland Financial Management Limited; Ryecroft Glenton Services Limited.			
MO Grant BA (Hons) OBE FRSA	-	16.8.46	22.5.95	Company Director
	Other Directorships: Aroline Limited; Council Member of the University of Newcastle upon Tyne; Dame Allan's Schools; Port of Tyne Authority.			
FD Holborn	-	26.5.47	1.1.03	Area Director
	Other Directorships: Area Director North, Lloyds TSB			
AFC Hunter CBE AFC MA LLB DL	-	8.3.39	1.5.93	Company Director
	Other Directorships: Annington Holdings plc; Kenton Bar Bunker Company Limited.			
RW Johnson MA FCIM FMS	-	22.3.39	1.5.98	Company Director
	Other Directorships: Northumberland Golf Club Limited.			
CJ Seccombe BSc (Hons) FCA	Finance Director	28.10.52	1.9.97	Building Society Executive
	Other Directorships: Bamburgh Finance No. 1 plc; Bamburgh Options Limited; NBS Financial Services Limited; Newcastle Mortgage Corporation Limited; Newcastle Portland House Limited; Newton Facilities Computer Leasing Limited; Newton Facilities Computer Purchasing Limited; Strachans (Newcastle) Limited.			
JV Towers BA ACA	Operations Director	23.2.62	23.5.03	Building Society Executive
	Other Directorships: None			

OTHER OFFICERS

C Greaves	Building Society Executive, Director of Newcastle Strategic Solutions Limited; Newton Facilities Management Limited.
L Todd	Building Society Executive, Director of NBS Financial Services Limited; Newcastle Mortgage Corporation Limited; Newton Facilities Management Limited; Strachans (Newcastle) Limited.
S Marks	Building Society Executive, Director of Newcastle Financial Services Limited.
A Macnaughton	Building Society Executive, Director of Newcastle Strategic Solutions Limited.
M Lant	Building Society Executive
AM Russell	Building Society Executive
SA Urwin	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. Mr RJ Hollinshead has a service contract entered into on 1 March 1998 which is terminable at any time by the Society on two year's notice or by himself on one year's notice. Mr CJ Seccombe has a service contract entered into on 16 September 1997 which is terminable at any time by the Society on one year's notice or by himself on three month's notice. Mrs JV Towers has a service contract entered into on 22 March 1999 which is terminable at any time by the Society on one year's notice or by herself on six month's notice.