OSB GROUP PLC

2024 Interim results presentation transcript

(amended in places to improve accuracy and readability)

15 August 2024

Andy Golding, Group CEO
Good morning everybody and thank you for joining OSB Group's 2024 interim results presentation.

This morning we'll take you through the key highlights for the first half of the year, and update on our lending and savings franchises, then I'll hand over to Victoria for the financials in detail and return for some progress updates and take you through the outlook and add some additional colour.

This slide highlights three key themes that help summarise our strategy and results in the first half.

Firstly, we've been very disciplined in our approach to new lending. We've been focused on maintaining return on equity on new business during a period of high competition against a backdrop of a subdued market in volume terms.

During Q2, some lenders have elected to drop pricing to a level below those that deliver our target returns and as a result our net loan book growth is now slightly lower than we'd originally guided. This is reflective of our pricing discipline.

Our net interest margin reflects the impact felt across the market of lower prevailing spreads on mortgages as products written in prior years reach maturity and fixed term savings recycled onto higher rates in the first half, although that has now stabilised.

Our high-quality underwriting and deep credit expertise have contained growth in arrears and contributed to an impairment release in the first half, further demonstrating that our risk adjusted returns are appropriate.

Secondly, we've maintained cost discipline and efficiency. Our cost to income ratio is broadly in line with our expectations of 34% whilst the manex remains low at 83 basis points, supported by our continued focus on cost and the benefit of our wholly owned subsidiary OSB India.

Finally delivering ROE and returning capital to shareholders continues to be our primary objective. The 18% ROE which together with strong CET1 ratio underpins our ability to return capital to shareholders through a strong interim dividend and I'm delighted to announce a further share buyback of £50m.

This next slide summarises our financial highlights for the first half and whilst I'm pleased to see improvements compared to the prior year, I recognise that the non-recurrence of the adverse EIR adjustment reported in H123 has a significant impact which can overshadow other movements. Victoria will explain each of these for you in more detail and the moving parts that contribute towards them.

Next, I'll turn to the recent dynamics we've seen in the buy-to-let market and a reminder of the attractive fundamental drivers of the professional buy-to-let market. As you can see from the chart on the top left the volume of lending across the market in the first half remains subdued reflecting affordability pressures following steep rise in mortgage rates from the end of 2022. Monthly volumes are around half of their peak throughout 2023 and only in recent months have they began to show a modest recovery.

The next chart illustrates the competitive dynamics we've seen in the first half. Each of the grey lines representing the implied spread to SONIA of the prices charged by specialist lenders including fees for a typical five-year buy-to-let limited company mortgage. Our three main propositions are highlighted in colour.

As you can see a number of lenders have been seeking to take market share as they entered the second quarter and began accepting margins below 2%. In contrast we've exercised strong discipline in our pricing during the period which has seen us choose not to write some new business and not to retain some business in the more competitive areas. And while our Kent Reliance brand which handles more complex buy-to-let cases has largely maintained its volume our - less complex offering through Precise has been more impacted.

However over time whilst Precise will remain a specialist in smaller portfolio buy-to-let we will also inflect Precise further into the specialist residential market in which it has deep expertise as well as growing the volumes through its award-winning bridging franchise.

The structural drivers for professional multi-property buy-to-let remain strong and give me confidence that volumes will continue to recover, and pricing will stabilise particularly as Bank of England base rate reductions materialise.

The lower half of the slide summarises why this segment continues to be attractive. Fundamental drivers of demand for the private rented accommodation remain strong. For many years insufficient new homes have been built in the UK to meet demand and while we welcome the new Government's commitment to improving this imbalance it will take many years to recover from the shortfall in building compared to increasing demand over the last 20 years or more.

Buyer affordability remains challenging for first-time buyers who are renting for longer and now well into their 30s before buying their first property.

These drivers have translated into strong rental values with rental price inflation most recently at 8.6% in May. The Group is positioned to serve the professional landlords who are best placed to meet this demand.

And our research demonstrates that tenants have a better experience from professional landlords who have the scope and experience to be more customer focused. Larger portfolios give landlords the scale and resilience to manage the impact of unexpected events such as changes in their borrowing cost and void periods at the end of tenancies while also planning more strategically for the challenges and opportunities such as meeting potential higher energy efficiency standards and improving properties to improve yield.

The next slide summarises the strengths of our lending franchise and the opportunities that lie ahead. Buy-to-let is the largest component of our £26bn loan book and we target those professional multi-property landlords. We are a significant player in the buy-to-let segment of the market at fourth in overall share, but in terms of specialist lenders, OSB is the clear leader.

In May OSB represented nine percent of overall new mortgage flow and we were able to operate across the spectrum, from supporting the relatively simple requirements of a landlord with a small number of properties through to the more complex needs of a professional landlord.

Supported by improvements in the macroeconomic outlook the Group is now undertaking a cautious re-entry into the more cyclical higher margin sub-segments such as asset finance and development finance and building out our commercial and bridge lending offerings. We have long established capability, customer relationships and experienced teams in these lending segments that we're able to dial up as the outlook improves.

As you can see the market recognises our success in this area winning awards this year so far for both our bridging and our commercial propositions. And whilst it takes time to impact the overall net interest margin this approach will provide a positive contribution to returns in the medium term.

Our funding platform continues to deliver to our saving strategy of attract, retain and satisfy. We grew retail deposits by 10% in the first half and opened more than 130,000 new savings accounts growing our customer base.

We successfully retained maturing fixed rate savings customers at a rate of 90% and 86% in OSB and CCFS respectively. Net promoter scores also remained high at plus 66 in Charter Savings Bank and plus 73 in Kent Reliance.

We complement retail savings with our expertise in wholesale markets. The Group successfully completed two securitisations in the first half £509m of buy to let mortgages in February as we led the way in re-establishing this market and £330m of owner-occupied mortgages in May. Both saw strong demand from our growing investor base which allowed us to achieve attractive pricing.

Securitisations together with deposits have allowed us to continue the pay down of our TFSME borrowings with the Bank of England.

I'll now hand over to Victoria to walk you through the financials in more detail.

Victoria Hyde, Group CFO
Thank you, Andy and good morning everyone. I'm pleased to present my first results this morning following my appointment as CFO in May. It's certainly been an interesting and busy first few months. I've had the opportunity to meet some of you and I look forward to meeting more of you and building further relationships over time.

So on to the H1 results. I'll start with slide 7 that summarises the key dynamics all presented on an underlying basis that underpin the ROE of 18%.

The Group delivered an underlying pre-tax profit of £250m for the first six months of 2024 compared with £117m in the prior period. The predominant driver of the increase was the non-recurrence of the adverse EIR adjustment recognised in the first half of 2023 partially offset by lower prevailing spreads from mortgages and deposits.

The other positive drivers of pre-tax profit increase were net loan book growth as well as an impairment credit compared to a charge in the prior period.

Underlying net interest income grew by 29% to £362m again due primarily to the non-recurrence of the adverse EIR adjustment and net loan book growth particularly in the second half of 2023 leading to underlying net interest margin of 243 basis points up 40 basis points from the prior period. I will cover more on that later.

We maintained our strong focus on cost discipline and efficiency and the admin expenses of £126m on an underlying basis came broadly in line with our expectations. The 15% increase from the prior period largely reflected the investment in people and operations including planned spend on the digitalisation programme to enhance our customer solutions and the new Bank of England levy.

The underlying management expense ratio of 83 basis points for the first half was five basis points higher than the prior period but one point lower than in the second half of 2023 even after taking into account the new Bank of England levy.

The underlying cost income ratio improved to 34% in the first half primarily due to the higher income and excluding the levy the underlying cost to income would have been 33% for the first half.

The underlying loan loss ratio improved significantly the first half equivalent to a credit of four basis points on an annualised basis as we released impairment provisions due to updated more favourable forward-looking macroeconomic scenarios. I will provide more detail on the key drivers of the impairment credit a bit later.

Turning to the income statement there's a couple of points to highlight here. You'll see that we recognised a net underlying fair value gain on financial instruments of £5m compared to a £12.1m loss in the prior period. The key driver behind this change were fair value gains on our pipeline mortgage swaps due to movements in the SONIA forward curve which will reverse over the life of the swaps.

Underlying earnings per share of 46 pence in the first half increased commensurate with the increase in profit.

The next slide summarises our strong secured balance sheet. The underlying net loan book increased by 1.5% in the first half to £26.1bn supported by £1.9bn of originations which decreased by 18% from the prior period reflecting our disciplined approach to new lending.

Retail deposits grew by 10% to over £24bn as at the 30th of June as the Group continued to attract new savers. This in turn allowed us to progress with the repayment of our drawings under the Bank of England's TFSME scheme. We have been pleased that the market has so far absorbed the repayment of TFSME without widening spreads as had been previously feared.

You can see that MREL debt increased by circa £400m due to the issuance of senior notes in January and I am pleased that we have met our interim MREL requirement of 22.5% of risk-weighted assets plus regulatory buffers ahead of the deadline.

Finally, debt securities increased reflecting two securitisations we completed in the period as Andy mentioned earlier.

The credit quality of our loan book remained strong even though we saw a small increase in three months plus arrears in the first half to 1.6%. That included OSB at 1.9% and CCFS at 1.3%. The increase in arrears was inside our modelled expectations and continued to reflect the impact of higher cost of borrowing on a small group of borrowers.

Interest coverage ratios for buy-to-let originations strengthened in the period reflecting that mortgage pricing appears to have passed its peak.

Our loan book is secured at sensible loan-to-values. The weighted average book LTV for the group increased marginally to 66% in the first half from 64% at 2023 year end reflecting a reduction in house prices in the period.

The new lending LTV remained at 68% demonstrating the strength of our underwriting and quality of our security.

This slide presents the NIM waterfall and dynamics from the December exit rate of 273 basis points where we left you at the preliminary results. Moving from left to right, our fixed rate deposit book continued recycling onto higher prevailing rates in the period which is expected to be largely complete by the end of 2024.

The lending margins in the period were a headwind to NIM as maturing fixed term mortgages continued redeeming or switching onto lower prevailing spreads. As Andy explained earlier in the second quarter, we stayed disciplined in our pricing and saw increased competitive pressures leading to higher and earlier redemptions in our Precise book and lower income than forecasted on these historically higher margin loans.

New issuance of MREL qualifying debt diluted NIM by 8 basis points. We are now carrying a total of £950m of MREL debt on the balance sheet and the drag on NIM from this issued balance will progressively flatten off as it annualises.

Finally, the other funding bar relates primarily to the cost of our securitisation programme that has contributed to the repayment of Bank of England TFSME funding.

Coming back to EIR, there have been no changes to borrowers' behavioural assumptions in the first half and therefore the EIR reset charge was minimal. However, as you would expect, we will continue to monitor behaviour and will be prepared to make an adjustment if needed in the second half.

We will maintain our pricing discipline. This may lead to a continued trend of higher and earlier redemptions, particularly in our Precise book and we have therefore set net interest margin guidance for 2024 as a range between 230 and 240 basis points.

The next slide provides a waterfall at the movement in the statutory impairment provision in the first half. As you can see from the chart and moving from left to right, in the first half in line with policy we updated our IFRS 9 modelling with the latest more favourable forward looking macroeconomic scenarios. These scenarios showed an improvement from those used at year end, particularly in respect of house prices and unemployment. This led to a £24.7m provision release.

The release was partially offset by a charge of £1.6m for model enhancements and post model adjustments, a £7.5m charge related to an increase in provision for accounts with arrears of 3 months or more and a charge of £3.5m related to changes in the credit profile of borrowers as they transitioned through modelled IFRS 9 impairment stages. Stage 1 provisions in respect of loan book growth totalled £1.3m and finally the individually assessed provision increases and other balance sheet items amounted to a charge of £3.4m.

You can see that our total coverage ratio has decreased by 3 basis points in the first six months but remains more than twice the level it was pre-pandemic at the end of 2019. We will continue to proactively review our forward-looking macroeconomic scenarios and coverage ratios as the outlook evolves.

Turning to the capital position you can see that Group CET1 ratio remained strong at 16.2% at the end of June.

Moving from left to right in the waterfall the first block shows our strong capital generation from profitability of 1.5%. We utilised 0.3% in the period to support the 1.4% growth in the statutory net loan book.

The impact of the declared ordinary dividend - interim ordinary dividend was 0.5% and other non-cash items were 0.2%. Before the effect of the £50m share repurchase programme announced in March the CET1 would have been 16.6% and the buyback had a 0.4% impact on the ratio.

Today the Board has announced a new £50m share buyback to commence on the 6th of September as we continue to return capital to shareholders.

Looking forwards we continue to target a CET1 ratio of 14% but expect to operate above this target as we wait for clarity on the final Basel 3.1 rules which have recently been delayed.

I will now pass back to Andy.

Andy Golding, Group CEO
Thank you, Victoria. As Victoria already mentioned we're investing in our tech stack modernising the business to build on our already high levels of efficiency and customer service and I wanted to provide a couple of examples to help bring this to life.

In H1 with the launch of a dedicated mobile app for intermediaries under the Precise brand this is a unique offering from a specialist lender and enables brokers to work with us and get updates from us at their convenience. This helps cement our relationship with these important stakeholders making it easier to do business with us and it complements our dedicated BDM network.

We trialled the app with several trusted partners prior to the full launch and the feedback has been overwhelmingly positive, not just about the smoothness of the app itself but also the game-changing nature of being able to track and manage cases on the go without needing to log into a traditional lender system.

Looking ahead to the second half we will launch a new savings platform that will take our engagement with customers to the next level, with integrated chat and telephony facilities whilst also enabling customers to complete key account management actions on a self-service basis.

These are just two components of our digitalisation programme and we're continuing our development of our services to enable us to meet the future needs of our customers, brokers and the wider stakeholders while delivering further operational efficiencies.

So in summary a strong operational performance in the first half and our results were resilient despite the subdued mortgage market.

And to summarise our guidance for the year based on current market activity and our disciplined approach to lending and retention the Group now expects to deliver underlying net loan book growth of circa 3% for 2024.

Underlying net interest margin is expected to be in the range between 230 and 240 basis points and the underlying cost to income ratio is expected to be circa 36% commensurate with that NIM guidance.

The Group is well capitalised, highly liquid and well positioned to successfully leverage our unique multi-brand structure and benefit from the opportunities as they arise.

I remain confident in the outlook for the Group and our ability to deliver long-term sustainable and attractive returns for our shareholders.

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Questions and Answers

Grace Dargan, Barclays
Morning, thank you both for taking my questions. So firstly on the NIM, could we just understand a little bit more about the EIR assumptions or what you're assuming within that range of guidance and are you including any kind of specific EIR adjustments in the lower end? Kind of what's the difference between the lower and upper end? That would be helpful.

And then secondly what would prevent NIM expansion from H2 going into 2025? Thank you very much.

Andy Golding, Group CEO
Thanks Grace. Victoria do you want to take the first one and I'll talk about the second one?

Victoria Hyde, Group CFO
Yes, I guess on the EIR impacts as we'd said in Q2 we did see some early signs of behaviour but definitely too early to make a judgment on a trend. What we are saying is if we do see a persistent reduction in the time borrowers are spending on reversion that would cause us to change our EIR judgment to some extent, this would take us to the lower end of the range.

I can't comment on sort of what weighted average life we are seeing. As we published previously, we were on a five-month weighted average life and we do publish the sensitivity to a three-month movement in that and we're not seeing anything in that range of guidance or that range of movement currently.

Towards the higher end of the guidance, that would be if we saw some tempering of the recent observations back towards the norms we saw in late ‘23 and in Q1 ‘24 but with no specific trend emerging.

It is very much a changing dynamic and therefore it is something we will continue to monitor in H2 and hence why we felt the range of guidance was the best option for 2024.

Andy Golding, Group CEO
Okay thanks, Victoria. I mean NIM on that - Grace on the NIM point around what prevent NIM expansion I guess we've got a pretty balanced view of things here. We know that currently there's some competitive pressure and there's a bit of a lack of volume in the market, but we think as base rate starts to call off a little that recovery that we perhaps started to already see in volume terms will continue so that's beneficial in terms of the competitive dynamic.

Clearly, we've got you know customer behaviour on the back but particularly around Precise that Victoria's just talked about. And then you know on the upside you know we do think the macro is now supportive of re-entering into some of those more sort of cyclical markets and we will do that we'll do it cautiously and you know it is accretive to NIM, but as I said in the presentation on a balance sheet of our size that takes time to have a kind of overarching impact,

And I guess the other one which we don't always have – or we don't have full control over is the funding cost dynamic but at the end of the day funding cost is inside what our expectations are at the moment. TFSME seems to be getting repaid by the market pretty well and pretty substantially without over-impacting prices. But we've seen before the likes of NS&I coming into the market and kind of influencing for short periods of time pricing upwards, so we always keep a strong eye for that and endeavour not to be needing to overfund at the points when you know companies like NS&I are out there in the market looking for the dollops of cash.

So I think it's a pretty balanced picture in terms of looking forward on the NIM line.

Grace Dargan, Barclays
Understood thank you very much for your help.

Andy Golding, Group CEO
Thanks, Grace.

Benjamin Toms, RBC
Morning both thank you for taking my questions. The first is really a follow-up just on the EIR behaviour assumption of five months on the Precise book. I know you provided a sensitivity for that which is at £66m I think if the numbers move from five months to two months. But I'm just trying to get a sense from you or an indication of how likely you think it is that sensitivity will materialise in full i.e. move from five months to two months and over what time frame could we see that change?

Secondly, you've updated your cost income ratio for the year to 36%. I just wanted to get some feeling of how confident you are that this cost income ratio is sustainable as we go into 2025 as that ratio has been creeping up over time?

And then lastly on your structural hedge which you've implemented in half one a £1bn notional 50% of equity. The purpose of the hedge presumably to reduce your interest rate sensitivity could you provide some colour on how your interest rate sensitivity has changed versus year-end 2023 perhaps expressed as an NII sensitivity to 100 base points downwards parallel shift in the curve? Thank you.

Andy Golding, Group CEO
Thanks, Victoria that sounds like three for you there.

Victoria Hyde, Group CFO
Yeah, so you'll note the sensitivity to the EIR behaviour has reduced since year-end. I guess one area on that is we do expect that to continue to reduce as the book seasons.

As I said before you know we aren't seeing that movement from five to two months, you know the early signs we do look at a longer period when we evaluate behaviour, it is something that moves over time. So I would say I don't see any immediate move from five to two months and it very much depends on the external environment, it is a judgment.

We may see that stabilise in H2 we may see it continue over the next couple of years as areas like Choices get established. So at present it is very much a customer - customer behaviour driver with some small acceleration and perhaps over time we may expect that to slowly creep down to two months, but that would be probably over a multi-year period.

So that was the first question. On the cost income ratio, 36% is driven by - really the income dynamics. I would say I'm pleased with where the costs have landed in in H1, we are pretty flat to last year as guided excluding the levy. I mean I do expect a slight increase in spend and we are - in H2 we are continuing to invest which I think is an imperative to make sure that we are offering the better – the best propositions to our customers and we can scale.

What I would say about cost income ratio, it's in you know the mid-30s but even with the investment we are a very efficient bank operating with one of the lowest manex and cost income ratios in the market. So I think our levels, if they stay around where they are long term, are still a pretty strong result.

Then your third - I guess what I would say on the structural hedge. I think the key point on this is you know it is 50% of equity we don't hold much interest rate exposure on our equity. It's not the same as the large banks that have the big current account franchises and sort of have that stream to manage. So for us we don't see it as a big impact on NIM probably going forwards in the future, it just protects us from the volatility.

So I haven't got the exposure to the 100 basis points, but I would just say it is a relatively small component of our NIM and it probably will continue to do in the future and just gives us that protection from the volatility.

Benjamin Toms, RBC
Thank you very much.

Victoria Hyde, Group CFO
Did that answer? Thanks Ben.

Harry Bartlett, Redburn Atlantic
Hi both. Thanks for taking my questions. First one's just on margins in Precise. I guess what do you think the kind of niche is for this brand now that that will allow you to kind of maintain an element of pricing power. I guess if we look at some of the larger lenders that you're competing with they have obviously a funding cost and a capital advantage. So what do you think stops this being a race to the bottom as has been the case with the residential market?

And then previously you mentioned you price it to achieve a minimum level of return. I just wonder what your thoughts are on this. Does this still apply? Is there a need to refresh this to maybe a sort of lower level of return given the increased competition in the market? Thank you.

Andy Golding, Group CEO
Thanks Harry. Look you know what's the USP of Precise. I mean Precise is still a very good lender in that you know portfolio - smaller portfolio landlord by select market. And I do think that pricing pressure in that market that we've seen in recent months will dissipate, particularly as we perhaps get another one or two reductions in base rate as we go through 2025.

But equally I also said in the presentation I mean Precise is a very good specialist residential lender and ironically the ROEs on its residential lending particularly under Basel 3.1 if it comes in as per the consultation are significantly better than more mainstream buy to let.

So we will continue to look for opportunity to inflect Precise further into the residential market. That includes that specialist slightly off high street near prime residential segment that Precise has deep underwriting expertise in.

But also in bridging Precise is becoming a world recognised bridge lender these days. We've been quite tight on risk appetite in that particular segment, but we are starting now to see demand for that kind of product coming back as people want to get markets moving again. And the margins are very strong in it, and we will, where we think the risk price returns are appropriate, do more in that space and it has already won an award this year for the offering that we're putting out under bridging.

Which is why when you're looking at some of the more simplistic cases actually having an app out to brokers for them to track, you know update work out what documentation we need particularly when it's something like a bridge where you need to get it done quickly. That is a real game changer in terms of helping us do that.

So subject to macroeconomic environment we'll continue to push that proposition and continue to inflect it further into that specialist residential market. But equally you know it will maintain its presence as a buy to let lender for the slightly less complex portfolio landlord that it historically has dealt with. And I think returns on those will come back as the market dynamic shifts.

You also touched on you know on the price to a hurdle. We do we have a pricing model at the front end for every price that every product that we put on the shelf. We are looking for an ROE return on that and sometimes that's a higher NIM and sometimes it's a lower NIM because it depends on the capital structure of the product, etc. But we think return on equity you know is king more so than the net interest margin. But you know for us that is a discipline that we try and maintain.

And we don't want to be writing single digit ROE business. We don't take that business on board if that's what a particular segment presents as a market dynamic. We know what our hurdles are, and we price to, and we don't publish the hurdle clearly. But I think ROE will continue to be a key facet in what we do and how we put our product on the shelf.

Harry Bartlett, Redburn Atlantic
That's great thank you.

Andy Golding, Group CEO
Thanks Harry.

Gary Greenwood, Shore Capital
Oh hi thanks for taking my questions. I've got a couple on NIM and then one on capital if I can. So first of all just coming back to the EIR. I mean the thing that sort of drove down the assumptions last year was a sharp rise in interest rates. Obviously, we are into an environment now where rates are coming down. So I'm just trying to understand why the assumptions would start to reduce again as I thought if anything the risk would have been the other way. So is that really just down to the competitive pressures that you're seeing at the moment? That's the first question.

Then second question was just on front book back book spread, if you could just give us some indication of the differential there given that that seems to be part of what is causing the margin squeeze?

And then last question on capital, I think sort of helpfully in the past you've given an indication of a potential impact of Basel 3.1. I'm just wondering if there's any update there and also on your IRB application? Thank you.

Victoria Hyde, Group CFO
Okay so your first question around why assumptions would reduce again. Customers on average have stayed that weighted average life of five months. I mean through second half of last year into Q1 that sort of remained.

It is quite hard to determine what factors are that make people change that and in Q2 there was political and macroeconomic uncertainty. But you know we speculate that potentially the calling of a general election created some more decisions.

So I wasn't particularly expecting behaviour to extend. And I think then with increased competitive dynamics and prices coming down people perhaps accepted that oh look that's an acceptable level right now. I'll jump onto it rather than thinking look rates are going to come down in a few months. I'll hold and stand reversion a bit longer before I move.

So it isn't a massive step down and I guess we see everyone moving off sooner first than we do to wait and see sort of what stays in the longer tail. But definitely as I said earlier you do expect that this would probably come down over time. But it does very much - it will vary and hence why we have to make a judgment in H2 on that.

Sorry your second question on the front book back book spread.

Gary Greenwood, Shore Capital
So yeah, front book back book spread.

Victoria Hyde, Group CFO
Yeah, I mean you know as Andy said we're very much focused on getting - making sure the front book you know returns - the NIM we're writing is at a good level that's accretive to the long term. I mean the back book, in 2019 and 2020 there were some really high historic margins that will continue to roll down. You know we did have that small period where we honoured our pipeline and a few lower margins in ‘22- ‘23.

So those dynamics will continue to roll through the book and hence we will manage that through. But we're very much focused on making sure the front book gives us that long term accretion as well as the diversity. I think that's pretty in line – I think other banks have had similar back book roll off - higher margin back book rolling off and we're dealing with the same as that over the coming years.

And then on your question on Basel 3.1, we have been looking at that, I would say previously we've said that the impact is about 2%. I probably think it's going to come in a bit lower than that. But we are hoping that in September as has been messaged that we should get the final rules. I guess that will enable us to do our full review and refresh on that and come up with a longer-term capital plan with more certainty.

So I think the only update at the minute is probably slightly lower than that 2%, but hopefully we can work through the numbers within the next month or so.

Gary Greenwood, Shore Capital
And any updates on the IRB applications?

Victoria Hyde, Group CFO
Nothing really since the prelims. We continue the discussion with the regulators. We continue to use it internally. You know it's good to have those here but no nothing to update on that one.

Gary Greenwood, Shore Capital
Okay thanks for taking my questions.

Victoria Hyde, Group CFO
Thank you. Thanks Gary.

Edward Firth, KBW
Thanks so much. Good morning everybody. I just have two questions really.

The first one is I'm quite struck that this year we've seen quite a recovery in the vanilla mortgage market particularly in terms of application volumes and a lot of excited talk about the sort of second half pickup, which doesn't seem to be coming through in the buy to let market. And I guess my concern is that successive governments now for many years have been trying to make - to sort of weight them up if you like in favour of people buying houses rather than renting it whether that's stamp duty whether that's tax deductibility etc.

And I'm just wondering to what extent do you think that these sort of successive policy changes are perhaps now starting to really bite and that actually as we look forward from here you know the buy to let market may be you know somewhat more tempered sort of structurally more tempered for some years as you know buyers become sort of favourably disposed by the tax system and by policies, etc? So that was my first question.

Shall I go on with the other ones as well is that easier?

Andy Golding, Group CEO
Do you want me to do that one Ed and then we'll pick up the second one.

Edward Firth, KBW
Yeah, why don’t we do that.

Andy Golding, Group CEO
That one had a few facets to it so let me see if I can kind of cover them off. I mean the first thing is I'm not sure I necessarily agree that there is a lot of excitement around a big recovery in the vanilla mortgage market. I think estate agents are talking up the number of people coming in the shop and making inquiries, etc. But actually if you look at cold hard facts and transaction volumes the market hasn't really kind of got itself back into gear again.

And I think it will - I think it will take a while and I think the things that restore confidence to the market, so the fact we've had a recent 25 basis point reduction in base rate I think that's positive for the market, the buy to let market by the way as well as the residential market. And I think if we were to get another one in November or in the early part of next year that will do another job of helping to instil that confidence because people make bigger decisions when they think the market's going in their favour rather than when they think the market's been going against them. And I think for a while that has been the flavour.

Look on the buying becoming more straightforward. I mean I'm afraid post the kind of FCA’s MCOB requirements, global financial crisis, everything else mortgage regulation has really becoming a sort of first-time buyer more and more difficult in terms of the residential space.

I mean when I were a lad and that was a long time ago now where to be fair you could get 100% mortgage on an interest only basis and you know worry about getting a washing machine on tick from Rumbles or whoever. You just can't do that anymore. All the affordability hurdles are around a forward payment basis. It's got to be stress tested for rises in interest rates. And all of that regulatory hurdle has basically pushed out the age of the first-time buyer and that isn't changing. First time buyers aren't getting younger. If anything, they're continuing to rent for longer.

The buy to let market at least - look I think we've had an environment where interest rates have been really low for a really long time so what I would describe, and you've heard me describe before is the dinner party landlord brigade. If you've got spare cash putting that into a deposit account earning 75 basis points you know isn't worth a hill of beans, whereas buying another property and renting out your previous one or inheriting grandma's property and deciding you're going to put a mortgage on it and rent it and use the mortgage to get a deposit for a second one that looks like a very attractive option even if you are a higher rate taxpayer on a on an individual basis. I think that market, that dinner party market is challenged by the current interest rate dynamic, and we have seen some of that stock finding its way back into the market, etc.

But our specialism is in that professional portfolio landlord segment. They're in it for yield and the yields are pretty good I have to say because they have been putting rents up significantly. They have absorbed the additional cost of borrowing that they've had to absorb and are still making a decent return.

I think professional landlords have made changes, they've made their portfolios different in some ways so a bit more student lets, a bit more HMOs, a bit more blended of commercial semi-commercial in with mainstream residential. But professional landlords will still when they see opportunities expand their portfolios and when borrowing cost comes off a bit and I predict that it may well do I think we'll see some of that expansion come back in. And Kent and InterBay particularly are well versed to do that and for those portfolio landlords with up to 10 properties and they are still professionals. Precise will be well placed to help look after them as well.

I just think there's been a risk and reward dynamic for that "I've got one or two property" market that's meant some of that has exited. But I think the" I've got 20, 100, 200 property" market, they're in it for long term capital appreciation and wealth creation and I think that market still works and landlords tell us it does.

So that would be my sense of it, so hopefully that that covers points in that one. What was the next one Ed?

Edward Firth, KBW
Yeah, that's helpful. Yeah, the next one was just a detail point and then a capital point. On the detail point, I think you said in the past that you saw your through the cycle margins at sort of 270 to 280 is that still a number that we should be thinking about or should we really you know consign that one to history? And that that would be the detail point.

And then the in terms of capital, I've got the 2% headwind from Basel 3. I just want to check is there any other things we should worry about in the capital sort of story? And if not, am I right in the assumption that broadly speaking lower volumes will mean bigger cash returns?

And I guess related to that it's a sort of £50m a half is that about the maximum buyback you could do sort of you know mechanically because there's just not enough shares available? And if so, do we - is a special dividend something you would never do or is that something we should think about? So how would you think about sort of cash return I guess in a lower growth environment? Thanks very much.

Andy Golding, Group CEO
Okay thanks I'll tackle the first part of that and then I'll ask Victoria to talk about the capital piece. What I actually said on through the cycle margins where if you look at our historic averages prior to the period of rapidly rising interest rates, we've traded at margins between 240 and 280. That I do think is a relatively normal stable market position for this organisation excepting that clearly you know we're now an MREL bank so there is a bit of drag from having to carry that MREL.

And I think you know in the medium term that's the kind of NIM delivery range that a fully secured lender with a low loan to value profile and you know not too much in the way of kind of credit loss baked into the balance sheet I think that's a very acceptable and tolerable net interest margin.

Victoria Hyde, Group CFO
So on the capital, no I don't see that there's - you know anything to worry about, we have got that uncertainty over Basel what we have put in you know per the current consultation paper and hopefully in the very near future we will get the clarity on that.

I think we have been well capitalised and we will always continue to evaluate growth opportunities versus return and the Board has made that commitment to return excess capital to shareholders.

For lower growth, that has facilitated and assisted with that buyback and we do very much just look at it, you know at the point in time to make that decision. On special dividends, we did do one last year, we would always contemplate it in the future. But I think we just need to get through, get Basel, get that clarity that we've been waiting for, for a few years now and then we will re-look at everything again, and get onto that strategic capital path. But we will always look to return excess and balance that against attractive growth.

Edward Firth, KBW
Perfect thanks so much indeed.

Andy Golding, Group CEO
Thanks Ed.

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Concluding remarks

Andy Golding, Group CEO
Thank you very much operator. I think in closing obviously I'd like to say thank you for joining and thank you for the questions.

I hope what you've heard in our presentation this morning is that we're endeavouring in some relatively complex market circumstances to do the right thing. We're exercising discipline, we're not gunning after growth for growth's sake. We are re-entering some of those higher margin segments because we think the macro is now supportive. We're chunking through the repayment of our TFSME by making use of a blend of retail and wholesale expertise.

I think, we’re demonstrably managing costs while still investing in the business for the future so that we can modernise the shop for the long-term benefit of what the shop delivers to its customer base and that's good for growth, operational efficiency and cost in the long run.

And we're planning conservatively and endeavouring to be transparent about trying to take you guys and our owners on the journey with us. So I hope that some of those key points have come across this morning and once again thank you very much for joining.

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