Directors' report
Chairman and Chief Executive's introduction

Rod Kent
Chairman

Steven Crawshaw
Group Chief Executive

Introduction
2007 proved to be an eventful and difficult year for the banking sector.

Despite the turmoil in the financial markets in the second half of the year, Bradford & Bingley's underlying business progressed satisfactorily with underlying profit before tax of £351.6m, gaining by some 5%.

The disappointment of the year has been the write-downs and impairments, caused by the manifesting of the liquidity crunch, that have been made against a very small proportion of our Treasury assets. Largely because of this, our statutory profit before tax was reduced to £126.0m.

The Group's conservatism and diversity of funding, combined with our policy to prefund our new business pipeline and our decision to dispose of non-core mortgage portfolios, meant that we weathered the much publicised liquidity problems in the financial markets well.

Underlying trading
Despite the diversion caused by market events, and as a direct result of the fortitude of our colleagues throughout the Group, we achieved a great amount during the year. We grew underlying profit before tax by 5% to £351.6m (2006: £335.9m) and underlying earnings per share increased by 6% to 40.2 pence (2006: 38.1 pence). Statutory profit before tax was £126.0m (2006: £246.7m) and earnings per share 14.9 pence (2006: 28.2 pence). The difference between underlying and statutory profits arises due to the exclusion of certain strategic, external and fair value items from underlying profits. These are set out in the Income Statement table.

For more information on financial performance see pages → 12-15

We made good progress against our objective of growing residential lending, adding a record £8.3bn to our balances, an increase of 27%, to take our total residential balances at the year end to £39.4bn.

The savings business made an excellent contribution during the year, with an additional £1.6bn being raised through our traditional branch network. Retail Savings are a very valuable part of the business, attracting new customers to the Group and providing a stable source of funding. Total retail savings deposits were £21.0bn (2006: £19.7bn) and at the end of the year, total customer deposits of £24.2bn funded 60% of customer loans (2006: 61%).

The condition of our lending book is very important to us and we continue to have great belief in the quality and prospects for buy-to-let lending. Tenant demand remains very strong and is driven by robust fundamentals. We took the decision early in 2007 to reduce our appetite for self-cert lending to preserve business quality. We have not relaxed our credit criteria across any of our products and have focused on higher quality loans, using risk-based pricing to ensure we cover any incremental risk with a higher price. The credit performance of all our portfolios has been in line with expectations. Arrears levels have increased during the year, reflecting rising interest rates in the UK.

Liquidity and funding
We have been pleased with the way we dealt with the extreme liquidity problems which emerged in the wholesale markets in the second half of 2007.

In general terms, we were well placed for such difficulties. We had been careful to retain our conservative approach to our funding and, in particular, had continued to invest in our branch network and build up the amount of our retail deposits. We had also pursued the policy of prefunding our net new lending and of holding sufficient liquidity for at least four months without recourse to wholesale money markets.

In response to the unfolding liquidity crunch, we took a number of steps to reduce our funding needs. We increased our mortgage pricing to contain volumes and protect margins; raised our savings pricing to attract additional customer deposits; reduced the level of mortgage portfolio acquisitions; and increased our focus on lower risk lending. For many years we have worked hard at diversifying our funding base and building strong relationships. This proved very beneficial when we raised £2.5bn in private funding transactions in September and October when the public wholesale markets were effectively closed.

Year at a glance

February

Announced 2006 results with underlying profit before tax up 8% to £335.9m, with record gross and net lending and record pipeline of new mortgage applications

May

Completed a securitisation of £2.5bn equivalent in Euros, Sterling and US Dollars from the Aire Valley Mastertrust

Achieved £20bn of buy-to-let lending balances

Issued covered bond of £1.7bn equivalent in Euros and Swiss Francs

June

Relaunched our full status residential lending proposition through mortgage intermediaries, targeting niche segments of the market to achieve higher margins

We made good progress against our objective of growing residential lending, adding a record £8.3bn to our balances, an increase of 27%

At the time of these results, we had made good progress towards agreeing a range of secured standby facilities with our key relationship banks, at sensible margins, to take advantage of any particularly attractive growth opportunities.

In April 2007, the Board took the strategic decision to sell some commercial lending and housing association mortgage assets in order to focus on the higher-margin, high growth, specialist mortgage market. Market events protracted the sales process but we were pleased to complete the disposal in November 2007 of £4.0bn of loans for a net consideration £44.7m below book value. In addition, £13.3m of transaction and restructuring costs were incurred.

Impairment of treasury assets

In common with other banks and institutions, we have invested a small proportion of our assets in slightly higher yielding and more complex instruments. At the time of our pre-close statement, the Group held £125m of investments in structured investment vehicles ('SIVs'), and a further £140m holding in collateralised debt obligations ('CDOs') which have an element of exposure to the US sub-prime market. Of this CDO holding, including synthetic CDOs, £72m is the specific exposure to the US sub-prime mortgage market. Until the last quarter of 2007, no payment problems and no credit concerns had been encountered by these assets.

In the light of the recent problems with such assets, we have undertaken a careful analysis in order to identify those whose value has been permanently impaired. To our disappointment, we have concluded that £64.2m of our SIVs and £30.2m of our CDOs are impaired, and have charged these amounts to our Income Statement.

Fair value accounting

Under International Financial Reporting Standards introduced in 2005, for certain assets which include a derivative as part of their structure, the fair value change of that derivative is required to be shown in the Income Statement. Such changes on our portfolio of synthetic CDOs amount to £49.7m. It is important to emphasise that all these assets continue to perform and this change in fair value may not be permanent.

In addition, the hedging of fixed rate mortgage and savings, using interest rate swaps to remove the economic risk, creates a small amount of fair value movement described as hedge ineffectiveness. This amounted to a charge of £23.5m in 2007 (2006: £0.3m income).

Capital and dividend

We initiated a share buy-back in July 2007 in a move to improve the structure of our capital by changing the proportions of equity and interest bearing tier 1 capital on our balance sheet. As market conditions deteriorated it made sense to suspend our buy-back programme until greater stability returns to the capital markets. We will continue to review the amount and structure of our capital in the context of our strategy to grow our lending and market conditions. Our tier 1 ratio is improved at 8.6% (2006: 7.6%).

The Board is pleased to propose a final dividend of 14.3 pence per share (2006: 13.4 pence) for payment on 2 May 2008 to shareholders on the register as at 25 March 2008. If approved, the full year dividend for 2007 will be 21.0 pence per share (2006: 20.0 pence), an increase of 5%, reflecting our underlying profit growth.

People

The Board has been extremely impressed with Bradford & Bingley's employees during 2007. Many areas of the Group experienced testing times during the year, particularly our branches and Savings' deposit operations where a very high level of transactions took place. Their commitment and enthusiasm was critical and much appreciated by the Board. We are very proud of our culture and values at Bradford & Bingley and it is this collective spirit and sense of belonging that has enabled our people to work together very effectively in 2007, in the face of extremely challenging market conditions. The Board would like to thank Sir George Cox who retired at the end of 2007, for his advice and service over the past seven years.

Outlook

It is widely anticipated that the economic conditions for the year ahead will be difficult and that the residential housing market will be adversely affected, despite the recent cuts in interest rates. In these circumstances we would expect arrears to eventually rise.

However, in our core buy-to-let lending, we see that rents are continuing to rise and that tenant demand remains very strong, with recent surveys of private property investors showing that they remain committed to maintaining or expanding their portfolios. Within our specialist markets, some competitive pressures have eased and we will seek the opportunity to rebuild our margins to offset the increased costs of funding whilst maintaining our overall credit quality.

The wholesale financial markets may be subject to further shocks and consequent turbulence and we will continue to exercise great caution in our approach to both funding and liquidity. The rate at which we can grow will depend on the rate at which we can fund the business both through our retail savings deposits and via the wholesale markets. Both of these have shown strong growth in the first few weeks of this year.

The Board believes Bradford & Bingley has the brand, the market positioning, the expertise and the policies in place to respond well to these conditions.

July

Announced half year results with underlying profit before tax up 11% to £181.5m and residential new net lending up 92% to 4.5bn with residential lending balances up 14% to 35.6bn

October

A total of £2.5bn raised from wholesale markets since liquidity crisis hit in August via privately placed securitisation, covered bonds and other structured transactions

November

Launched ASDA Internet Saver, an exciting venture with one of the UK's leading retailers

Completed the sale of our commercial lending and housing association mortgage portfolios for £4.0bn, following a review of the growth potential and capital utilisation of these assets