

**HALF-YEARLY
REPORT**
for the period ended
31 December 2008

Half-yearly report to members

On behalf of Heritage Building Society Limited we are proud to announce the results for the six months ended 31 December 2008. The results are unaudited. They are sound results given the prevailing economic conditions. In summary the profit before tax for the six months to 31 December 2008 was \$15.20 million compared with \$13.07 million for the six months ended 31 December 2007. This was a 16.3% increase over the prior period. Total consolidated assets grew from \$6.92 billion at 30 June 2008 to \$7.07 billion at 31 December 2008.

The impact of the global financial crisis continues to affect all markets including banking and financial services in Australia. The Society first responded to what was then referred to as the credit crunch or liquidity crunch early in the second half of calendar 2007. The Society has continued to respond to the external market factors including the significant decreases in interest rates which have flowed on from the changes in the Reserve Bank's cash rate. The major impact on the Society is that it has restricted its lending volumes due to the increased cost of wholesale funding. Loan approvals for the period 1 July to 31 December 2008 were \$497 million.

Unfortunately there is no indication that in the short term, wholesale funding costs will return to the levels experienced before the global financial crisis. Notwithstanding the difficult credit conditions the Society has put in place additional securitisation warehouse arrangements to provide the capacity if it is required. Again these facilities come at a greater cost than was the case prior to the global financial crisis commencing some 18 months ago.

GOVERNMENT RESPONSE

The Australian Government's response to the impact on the Australian financial services sector from the global financial crisis was to announce a Government guarantee for Authorised Deposit-taking Institutions (banks, building societies and credit unions). The Government is to be applauded for taking this action given some of the uncertainties within the market at the time. The Government guarantee was further refined in respect of retail deposits for amounts in excess of \$1 million whereby a fee is payable to the Government if any amounts are to be covered by the guarantee. This fee structure also applies for guaranteed wholesale deposits. The Society sees no rationale for the discriminatory fee structure where the fee paid for guaranteed Heritage

deposits is 1.5% and the fees paid for guaranteed deposits with the major banks is only 0.7%. This scale of fee differential adversely affects members of mutuals, adds to the confusion in the banking industry at a time where confidence has already been eroded and is not a reasonable cost for the risk that is being borne by the Government. The major banks may wish to perpetuate this anti-competitive fee structure but Heritage believes that Government should address this inequity.

Against this background the Society has been successful in increasing deposits from members. Retail deposit balances grew by \$348 million (approximately 13%) from 1 July to 31 December 2008. This comes on top of an increase of a similar magnitude for the year ended 30 June 2008. We believe this is a reflection of our members' view of the prudent business model that has been the foundation of the Society's continuing success.

A TIME OF CONSOLIDATION

The Society's strategic plan had identified this period as one of consolidation following three years of significant expansion in its branch network and significant growth levels. No significant increase in the branch network had been planned and an easing in growth in assets was planned along with a diversification of funding sources. The Society will continue to pursue having a more diverse funding base but the success of this will be dictated largely by the appetite of the market. As mentioned earlier the current cost of wholesale funding is less than attractive.

CREDIT QUALITY

One of the Society's strong points is the quality of its loan book. Notwithstanding the economic conditions and the higher interest rates that prevailed for most of 2008 the mortgage arrears greater than 30 days represented only 0.35% of the total portfolio balance at 31 December 2008. As at 31 October 2008, the SPIN results which are Standard & Poor's index of industry arrears show 30 days arrears at 1.27%. Our arrears results continue to be significantly below industry benchmarks and are reflective of the prudent long-term approach to risk management and the continuing focus on maintaining credit quality.

The excellent arrears results flowed through to our personal loan and credit card portfolios.

REGULATORY MEASURES

The Australian Prudential Regulation Authority is the regulatory body that supervises Authorised Deposit-taking Institutions. In this role it sets various prudential standards and guidelines. The Society has continued to manage its business to ensure that the ratios were above regulatory requirements. At 31 December 2008 the capital adequacy ratio was 11.94% compared with 12.31% at 30 June 2008. The liquidity ratio was 19.27% compared with 15.42% at 30 June 2008.

INVESTING IN THE FUTURE

The Society has adjusted its business plans based on market conditions. Even though times are uncertain significant resources need to be devoted to ensuring that the tools and systems available to all our staff are appropriate to meet the needs of our members. Accordingly there is ongoing investment in the various Society systems and processes to meet members' needs and also to satisfy regulatory requirements. During the last six months, this investment in systems has included Anti-Money Laundering compliance systems, an enhanced Customer Relationship Management System and continuing investment in training and development products and systems.

COMMUNITY

The Society has continued its commitment to the communities in which it operates. The Society continues to invest in and support a number of activities throughout south-east Queensland in many ways including the unique community branch model which currently delivers benefits to eight different communities.

During the last six months, the Society launched a new *communitys@ver* account which is expected to grow membership and dovetail with our significant commitment to building communities.

Our staff are also encouraged to participate in community and fund raising events and are supported by Heritage in doing so.

MUTUALITY

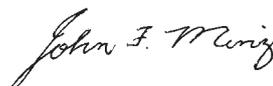
The Board and management strongly believe that notwithstanding some of the impacts both locally and globally of the global financial crisis that mutual financial organisations, such as Heritage, will continue to play an important role in the Australian financial system. Heritage retains its commitment to have a strong, robust organisation committed to the mutual philosophy and reinvesting the profits generated for the ongoing benefit of its members. Sadly, some regulators do not appear to understand the concept of mutuality.

Our staff have been instrumental in continuing to deliver on this philosophy even when there have been significant changes to our business as has been the case over the last eighteen months.

The Society intends to continue to provide its members with access to a range of services to be a competitive provider of financial products for the benefit of all its members.



BRIAN R. CARTER
CHAIRMAN



JOHN F. MINZ
CHIEF EXECUTIVE OFFICER



CONSOLIDATED INCOME STATEMENT SUMMARY

FOR THE HALF-YEAR ENDED 31 DECEMBER 2008

	DEC 2008 \$'000	DEC 2007 \$'000
Total Income	64,866	61,193
Total Expenses	49,122	47,394
Impairment Losses on Loans and Receivables	542	727
Profit Before Tax	15,202	13,072
Income Tax Expense	4,597	3,965
Profit After Tax	10,605	9,107

CONSOLIDATED BALANCE SHEET

AS AT 31 DECEMBER 2008

	DEC 2008 \$'000	JUN 2008 \$'000
Assets		
Cash and Cash Equivalents	55,477	43,739
Investment Securities	824,819	588,893
Loans and Receivables	5,963,049	6,145,237
Property, Plant and Equipment	23,901	25,153
Other Assets	207,308	114,236
Total Assets	7,074,554	6,917,258
Liabilities		
Deposits and Borrowings	6,719,984	6,605,443
Accounts Payable and Other Liabilities	75,754	47,131
Provisions	7,363	6,859
Subordinated Debt	50,000	57,000
Total Liabilities	6,853,101	6,716,433
Net Assets	221,453	200,825
Members' Funds		
Retained Profits	185,862	177,625
Reserves	35,591	23,200
Total Members' Funds	221,453	200,825

The Consolidated Income Statement and Consolidated Balance Sheet are unaudited and presented in an abridged format.

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