



Heritage

Building Society

People first.

Half-Yearly Report
for the period ended 31 December 2009

Heritage



Half-yearly report to members

FINANCIAL PERFORMANCE

We are proud to announce the results of Heritage Building Society Limited for the six months ended 31 December 2009. These results have been the subject of an audit review.

Profit before tax for the six months to 31 December 2009 was \$22.89 million compared with \$15.20 million for the six months ended 31 December 2008 which represents a 50.6% increase over the prior period. Total consolidated assets grew by 5.0% from \$7.11 billion at 30 June 2009 to \$7.47 billion at 31 December 2009. In light of the prevailing market conditions we believe it is a solid result for the Society.

The ongoing impact of the global financial crisis continues to make conditions very challenging. However the Society has managed the effects of market changes whilst providing its members with attractively priced products and services. At the same time the Society is striving to ensure that the business remains profitable to fund ongoing operations and growth.

FUNDING THE BUSINESS

The intense competition for retail deposits has significantly increased our funding costs. This was a material factor in loan pricing tactics during the period. Despite this, the Society continues to offer very competitive loan pricing.

Two of the major impacts of the global financial crisis are the competition for funding and the effective cost of funding. Given the higher effective funding costs, the Society has had to carefully manage lending volumes. Loan approvals for the period 1 July 2009 to 31 December 2009 were \$830.74 million compared with \$497.48 million for the six months ended 31 December 2008. This represents a 67.0% increase over the previous period.

For some time now, the Society has been diversifying its funding bases and reducing its reliance on securitisation. During the six month period ended 31 December 2009, the Society completed a successful \$400 million Government Guaranteed wholesale debt issue. In October 2009, the Society achieved another first for a mutual building society with the very successful \$50 million raising of retail-based subordinated debt via Heritage Notes. Heritage Notes are listed on the Australian Stock Exchange providing a market for investors to manage their note-holdings. For regulatory purposes Heritage Notes are treated as prudential capital which, combined with retained profits, provides depositor protection and a framework for organisational growth. The Society continues to be innovative in achieving a diversified set of funding sources.

The litigation commenced by Société Générale Australia Branch (SG) in 2008, in connection with the funding of a securitisation entity, was settled in November 2009. As a result of the settlement, both SG and the Society have obtained long-term clarity in this funding relationship. The terms of the settlement are confidential but we are able to say that, in our opinion, as far as the Society is concerned, the outcome was favourable and more than justified the approach that we adopted throughout to SG's claim.

There has also been a range of changes to various structured funding facilities during the course of the last two years adding to the cost of funding.

The Society has also been successful in increasing the level of retail funding by \$111.5 million during the last six months which is less than the levels of growth in funding in the previous period. However, the previous period result was boosted by the Government's stimulus package. The growth in funding has been achieved during a period of intense competition for transaction and savings accounts and particularly term deposits. The interest rates for term deposits during the period have been relatively high compared with

other periods. From the viewpoint of our members investing in term deposits, the higher yields are extremely attractive.

There is no strong indication that market conditions are going to change in the near future so they will continue to be a challenge in managing the various aspects of the business and at the same time providing products and services to our members, a challenge that the Society has successfully taken up in recent times.

GOVERNMENT REGULATION

The current Government Guarantee scheme on retail deposits is due to end in October 2011. There is currently a discussion paper on a Financial Claims Scheme which is likely to apply from that time, however at this stage there will be a significant amount of consultation before the details of the Scheme and how it affects the Society, will be clear.

The Australian Prudential Regulation Authority (APRA) has announced further changes to the regulations which govern the Society's business as an Authorised Deposit-taking Institution (ADI). It is not in anyone's interest for a regulator to simply use an opportunity to impose additional regulatory hurdles without a commensurate benefit to the public at large and/or ADIs. Any such benefit is not immediately apparent to us in relation to a number of recent consultation issues. We urge APRA to reconsider the more punitive suggested changes to its prudential framework given the health of the Australian banking system relative to other adverse banking sector performances across the globe.

The Society has been working hard preparing for the introduction of the National Consumer Credit Protection and unfair contract terms legislation. Again there will be significant imposts on businesses like the Society in the form of implementation costs and ongoing compliance costs though we challenge if the incremental benefits outweigh these costs. The Society will continue to do the right thing by our members.

CREDIT QUALITY

For some time now, the quality of the Society's loan book has been outstanding. This is a reflection of the Society's prudent approach to risk management and lending policies and the ongoing management of the loan book. Against the background of the global financial crisis and predictions of worsening economic conditions, loans arrears greater than 30 days represented only 0.21% of the total mortgage portfolio balance as at 31 December 2009. These results are substantially below industry benchmarks and similarly good results were achieved in the personal loan and credit card and business loan portfolios. This is compared against 0.30% as at 30 June 2009.

REGULATORY RATIOS

APRA sets various prudential standards and guidelines to protect depositors and allow performance comparisons within the industry. The Society has continued to manage its business to ensure that the ratios remain above regulatory requirements. At 31 December 2009, the Capital Adequacy ratio was 13.95%, compared with 12.46% at 30 June 2009 and the Liquidity ratio was 17.69%, compared with 17.31% at 30 June 2009.

BUILDING FOR THE FUTURE

The Society has reviewed its strategies and business plans to take account of the existing market conditions. There are a number of strategies in place to ensure

that the business continues to grow and also positions the Society to respond to changes in the regulatory and market environment.

There will be continued investment in the Society's people, infrastructure and processes to ensure that the business continues to be well managed into the future while also able to respond to and take advantage of any potential opportunities which might present.

The Society launched its financial planning business on 1 July 2009. This is a joint venture between the Society and MAP Funds Management Limited. The financial planning business originated since 1 July has significantly exceeded expectations.

LIVING THE HERITAGE VALUES

The Society has a number of core values, including Integrity, Excellence and Community. The continuing success of the business is based on living these values in everything that we do.

The commitment of the Society to its members, staff and the communities in which it operates continues and is reflected in a number of ways, including the Society's unique community branch model.

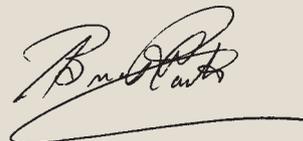
MEMBER BASED ORGANISATIONS

The Society is proudly a member-based or mutual company. The owners of the Society are the people who do

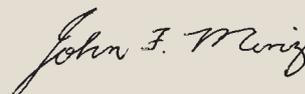
business with it and its sole reason for existence is to provide products and services to its members on the best terms possible. The business is not run like shareholder-based organisations where the shareholders are the beneficiaries of the business operations. The needs of members are considered in all decisions balanced against the need to provide sufficient levels of profit to invest in the future and provide for ongoing services to our members. We continue to operate in a *People first* way.

Our employees are committed to servicing our members to the highest possible level and the collective efforts of all staff, have been exceptional.

The Society's Board, Management and staff continue to live the Society's values and provide the levels of service expected by our members. The Society will continue to provide our members with access to a range of services and to be a competitive provider of a range of financial products and services for the benefit of our members.



Brian R Carter
Chairman



John F Minz
Chief Executive Officer

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