Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Andrew Triggs from JPMorgan.

Andrew Triggs
JP Morgan Chase & Co, Research Division

Just a couple of questions, please. I was hoping you could provide a little more commentary on some of the margin drivers heading into the second half given, obviously, a big increase in the front book/back book repricing headwind and a number of the other drivers which are pretty fluid in the market. And also just a second question around costs. For a small number of additional one-off costs taken below the line with respect to the Royal Commission and customer refunds, and we saw similar in the previous half, just given the industry has moved much more to a cleaner version of cash earnings, just the thoughts on why these are taken below the line. And also, would this be the treatment going forward for customer refunds?

Travis Crouch
Chief Financial Officer

Thanks, Andrew. Thanks for the questions. So maybe if I'll start with your NIM question first, and I'll just talk to Slide 18 with the table there around the drivers for the half. So as I called out, as I mentioned on the call, that front book/back book impact did increase. And as I've said, it was a combination of competition and that mix of our new business. If I think of that, and I've -- I mentioned it even on the slide there, I think that type of impact will continue as competition stays at the level and the mix of flows continues. When I look at some of the other drivers for our performance for the half, within January, we've actually been able to do some repricing or adjustments to our -- some of our accrual rates. So we're already starting to work through some of that opportunity around the funding cost side. The impact on retail TD rates was something that we saw come through right at the start of the half. We haven't seen that since, though. I'm actually more positive on that outlook for the retail side of the margin performance. And look, I think the hard one is obviously around the wholesale funding rates, where those sit. Obviously given the view of the cash rate, probably the next change is now more likely to be down. If those BBSW rates continue to settle a bit, then we wouldn't expect to see that same sort of impact. But I mean, that one's a hard one to pick, and I think we'll all watch that one on the way through. The funding mix side, I think we'll continue to get some benefit from that, the growth in our retail accruals, so I would have thought that type of mix will continue. But I think the big one is obviously around the wholesale funding impact, depending on what the wholesale rates do. And as far as your question around costs and the treatment of that, so the costs we did put below the line around the Royal Commission costs were purely external legals. And then that -- the remediation was to do with an acquisition from a number of years ago and the costs associated with that. So that was consistent with last half, and we've treated them that way again. But I think you'll appreciate the result's pretty clean as far as any other sorts of adjustments. If I think of more broader remediation expenses as we worked through those, it's my expectation that they'll be treated just as part of our ongoing expense line. We wouldn't -- it's not -- unless it was related to a previous acquisition, we wouldn't look to put them below the line, as you said, as is the practice across the industry.

Operator

Your next question comes from the line of Anthony Hoo from Deutsche Bank.

Anthony Hoo
Deutsche Bank AG, Research Division

Just a couple of questions. Firstly, in relation to Homesafe on Slide 16, am I reading correctly that the $16.4 million -- negative $16.4 million revaluation is a net number reflecting your property revaluations and then also the change in the valuation methodology? If that's the case, are you able to give us a breakdown of the 2 impacts from that?

Travis Crouch
Chief Financial Officer

Yes, that's -- so thanks, Anthony. Yes, you're right. So Page 16 has that split there. The movement for the half of that $16.4 million includes the property revaluations during the half following the indices for Melbourne and Sydney. As I've called out there on that slide, there was a net reduction of $2 million associated with the change in the growth outlook and the discount rates and removing the overlay. So the $1.9 million loss is included in that $16.4 million.

Anthony Hoo
Deutsche Bank AG, Research Division

And your sort of overlay was $30-odd million, I think from memory, is that correct?

Travis Crouch
Chief Financial Officer

Yes, that's correct, Anthony.

Anthony Hoo
Deutsche Bank AG, Research Division

Okay, so the sort of $30 million -- sort of $30-odd million is -- so we can refund this $30-odd million was the impact from your change in valuation methodology?

Travis Crouch
Chief Financial Officer

We were already reflecting that lower valuation. So the net effect of removing the overlay is that additional $2 million. And as I said, it just -- it reflects the carrying value now more appropriately, based on those, the new growth outlook. So that's -- the $2 million really was that net impact of moving to those new valuation assumptions.

Anthony Hoo
Deutsche Bank AG, Research Division

Okay. And then a second question, if I could. Did I hear earlier, Travis, that you said on your bad and doubtful debt on Slide 18 that you said your -- through the cycle, your bad debt charge is 11 basis points. Is that correct?

Travis Crouch
Chief Financial Officer

Yes, that's right, Anthony. That's how we think of that long-term average, 11 basis points.

Anthony Hoo
Deutsche Bank AG, Research Division

So that's sort of like a 10-year average or so rather than a through-the-cycle view. Is that right?

Travis Crouch
Chief Financial Officer

It's probably both, Anthony.

Anthony Hoo
Deutsche Bank AG, Research Division

Probably both? But then, I mean, we haven't really seen a cycle over the past 10 years. So if you talk -- if you think about through the cycle, would you still think 11 basis points is the right level?

Travis Crouch
Chief Financial Officer

Okay, that's pretty hard to call out at the moment, Anthony, but I think with the history and with our stress testing and what we look at, 11 points is how we think about it.

Operator

[Operator Instructions] Your next question comes from Victor German from Macquarie Bank.

Victor German
Macquarie Research

Hoping to ask maybe 2 questions. The first one is on your volume growth trends, and I was interested to hear that your new number of customers has increased quite dramatically in January. I'd just be interested in your observation as to what you think that's going to lead from a growth perspective given that we haven't really seen much balance sheet growth. I mean, are you expecting over the course of next 6 months for these new customers to actually generate more volume growth and for you to get back to and perhaps go -- slightly grow ahead of system?

Marnie A. Baker
MD & Director

Victor, I'll speak to that one. Yes, well, look, we've been really pleased with what we've seen around new customer growth, but not only new customer growth but net customer growth, too, so the loyalty from our existing customers as well. I think it's important to note that, as I said earlier, that in January especially, there's been a larger proportion of the net new customers coming from the digital banks, so from Up. The focus of Up is really focusing in on the younger demographic. We've been leveraging our relationships and partnerships that we have with universities and, in the first sense, with Deakin, and looking at the next generation of customers coming through. So the numbers are extremely pleasing. But it is worth putting in context that they are younger in a demographic sense to our existing customers and, as such, just starting on their journey to amass their financial wealth and to look at -- taking out products like credit products. So it is a longer-term strategy for us, setting us up for the longer term, so I would just caution of assuming that, that growth -- that immediate growth in customer numbers is going to have an immediate impact in the short term.

Victor German
Macquarie Research

That makes a lot of sense. And maybe just to follow up also on margin trends, and I think Travis sort of made a comment around deposit performance. In the past, we've seen you do very well in terms of managing your margins from a deposit perspective. This half, it's been a little bit of a drag. I'm mindful of the fact that you're growing your deposits, yet your balance sheet trends are fairly subdued. Can you maybe just give us sort of a trade-up between sort of managing margins and deposit side? And I mean, what position would you be comfortable with from a deposit perspective to actually see some of those more expensive deposits then impacting your margins, perhaps go and see a bit of a benefit from deposits performance in the next half or 2?

Travis Crouch
Chief Financial Officer

Thanks, Victor. Look, I think that the outcome from last half really reflected the industry, with those higher wholesale funding costs it did impact what competitors were offering for our -- for retail rates. And look, even some of our retail base rates through our financial markets and wealth areas do reference BBSW rates, so some of those rates were impacted because of higher BBSW rates, too. But also from a competition point of view, for us to be in the market there, we did have to increase those rates, as we said right back at the start. To your first part of your question though, look, I think we're always very comfortable. If it's purely a rate play, we will look to manage that as best we can. So if we were to lose some deposits that were with us purely for rate, then we would obviously get a benefit from margin. But that wouldn't be an issue in the way we manage the deposit base there.

Operator

Your next question comes from the line of Ed Henning from CLSA.

Edmund Anthony Biddulph Henning
CLSA Limited, Research Division

A couple of questions from me. Firstly, on the business lending side, you've talked about the rebalancing of the commercial property book. Has that now finalized or is there still some headwinds to go on that one?

Travis Crouch
Chief Financial Officer

Ed, thank you for the question. Look, we believe it's pretty well finalized. We are at the position we need to be. I think the outcome of that business lending growth also reflects probably that focus on the structure change and the work we've put into that. But if I think about that commercial real estate exposure, we're pretty comfortable we're there.

Edmund Anthony Biddulph Henning
CLSA Limited, Research Division

Okay. So there are no more headwinds other than the agri stuff that comes on and off and which is a bit more seasonal in your business lending book?

Travis Crouch
Chief Financial Officer

Yes, not that are planned, Ed.

Edmund Anthony Biddulph Henning
CLSA Limited, Research Division

Okay, great. Next one, agriculture. Maybe, Marnie, can you touch on the proposed changes from the Royal Commission around the distressed agricultural loans and the potential impact in your book and how you guys -- if something does go into trouble, how it's going to impact you going forward?

Marnie A. Baker
MD & Director

Yes, sure, Ed. There was a number of recommendations that came out from the Royal Commission in relation to agri and the agricultural businesses. The first one I'll probably touch on, Ed, was in relation to the Farm Debt Mediation scheme, something that we've been an advocate for, for some time, so we're really pleased to see that sort of come to fruition. In relation to the -- respect in relation to the drought support programs, we've rolled out a drought support program. We've -- and just in these more recent times, you've seen that in action in relation to how we're contacting our customers and working with our customers through that period of time to ensure that they are not even more adversely impacted by the conditions that they found themselves in. So I think in summary, we're very pleased I think with the recommendations to come out of the Royal Commission in relation to farming, and I think they'll put a solid base to ensure that through all economic conditions that our farming communities support it.

Edmund Anthony Biddulph Henning
CLSA Limited, Research Division

Okay. So from the changes, you obviously have pushed for a number of them, but you don't see it as a hindrance to your businesses, and the cost going up of trying to push if something does go awry, for some of these farmers, it doesn't become a more of a hindrance for you?

Marnie A. Baker
MD & Director

No, no, absolutely not because these are -- we have made changes over a number of years now, and so these are things that they're talking about in the Royal Commission the things that we already have in place.

Edmund Anthony Biddulph Henning
CLSA Limited, Research Division

Okay, great. And the second one, do you have any overlays in agriculture at the moment, as in a collective provision? I know you ran down some of your provisions in agriculture during the period.

Travis Crouch
Chief Financial Officer

Ed, there -- I don't have the details at hand, but there are definitely in the collective provision modeling, the way we do it, there are some overlays around ag as there are for a number of industries. I don't have the details, but yes, there are.

Operator

Your next question comes from the line of Andrei Stadnik from Morgan Stanley.

Andrei Stadnik
Morgan Stanley, Research Division

Can I ask my first question just around costs? So you've emphasized the uneven playing field versus the majors, but isn't the real issue that your cost-to-income ratio, at 57%, 58%, is a real impediment to compete with the majors properly on price and service? So to kind of address this, are you now targeting a lower absolute level of costs? And do you think that's achievable?

Travis Crouch
Chief Financial Officer

Andrei, thanks for the question. Look, I think we've had a long-term target for our cost-to-income ratio of that 56%, 55%. We are still working towards that. We are still maintaining that is where we need to get to. As I spoke about before, the outcome was just as much around the softer revenue as it was at costs. And look, that's why I think both Marnie and I have spoken about, we're continuing to look at ways that we -- our business processes and systems, our brands and how the business operates because we need -- we continue -- we need to do more with the costs. And we will continue to look at each of those processes and business models to make sure we can actually -- that we can compete. But it is something we've -- there's a lot of attention on.

Marnie A. Baker
MD & Director

Yes, and I'll just add to that, too, Andrei, in relation to -- we are absolutely and do need to focus on our costs and getting those to an appropriate level that we believe is appropriate for our business. But some of these things around the uneven playing field actually do go directly to costs. And funding costs is a really good example of that in a too big to fail and the 3 notch up with credit ratings that majors have to those that are to nonmajors. So that has a direct impact on the cost of our funding. So there is some direct costs there from the uneven playing field as well.

Andrei Stadnik
Morgan Stanley, Research Division

And my second question, I just wanted to ask around what kind of housing price declines from here would actually see Homesafe being a revenue bottom line at risk? And particularly, you mentioned that the recent contract sales are completing 7% over carrying value. So does this mean that if house prices fall another 7% from December levels, that contracts will be completing below carrying value?

Travis Crouch
Chief Financial Officer

Andrei, I think that, yes, so you're right, 7% was the -- for the last half, the value that the sales exceeded the carrying value. I think that the heartbeat around that situation is, well, there's obviously a range of contracts that could complete, and there's obviously different ages with those ones. The work -- the modeling that we've done, if I think about the cash earnings contribution, we would need to see property prices fall by more than 30% for that, I think, $7 million cash earnings contribution to actually come back to 0, so in the order of 30% to actually remove that cash earnings gain -- net gain that we're actually showing at the moment. So I think that probably provides some context. And if I think about the unrealized gains that we're holding there, they're not part of our retained earnings for capital purposes, so we're actually not getting a benefit there, for property prices would have to fall by nearly 50% to actually see that unrealized gain come back and start to impact capital. So I think that probably shows the significance of the position that we're in there, either 30% from that cash earnings or over 50% for those unrealized gains.

Operator

Your next question comes from the line of Jon Mott from UBS.

Jonathan Mott
UBS Investment Bank, Research Division

Just had a follow-up question. Just looking at the business bank and the restructuring, you did mention the reduced size of the commercial real estate. But it's quite a material runoff. If you're looking at the lending book, construction down 18% and the real estate services down 11% just over the last 12 months, and these are the biggest portfolios that you've got outside residential mortgages and agri. So what are you seeing, firstly, that made you change your strategy? Have you got any residual concerns there? And secondly, how have you done it? Have you actually gone to customers and said it's probably wise that you move elsewhere, or you're actually waiting for these positions to mature and just not renewing them?

Travis Crouch
Chief Financial Officer

Yes. So Jon, it is a material decrease in our portfolios, and we've -- that's how we've actually been -- we have been actively managing it. I think over history, we've built up a strong portfolio there, but we were overweight. So we've actually probably done a combination of either waiting for when those facilities are up for renewal but also actively talking to our customers ahead of time to explain where we need to -- what will happen upon repricing. So I think we've actually managed that as best we can over that time. To the question before, I think we are at that level where we're comfortable with the exposure -- with the level of exposure, but it has been a piece of work over the last 12 to 18 months.

Jonathan Mott
UBS Investment Bank, Research Division

And what average size is the size of this exposure, is there an awful lot of small $1 million, $2 million developments? Or is there a handful of large exposures you're exiting?

Travis Crouch
Chief Financial Officer

Look, Jon, I think from memory, it's probably more the $2 million to $3 million-type facilities amount.

Jonathan Mott
UBS Investment Bank, Research Division

Okay. And so why stop now? Is it the high-risk exposures? How did you decide that?

Travis Crouch
Chief Financial Officer

No, we -- well, I think we felt we're overweight with where we were. We're very comfortable with where we are now at the level we're at.

Operator

Your next question comes from the line of Brendan Sproules from Citi.

Brendan Sproules
Citigroup Inc, Research Division

Just sort of following on from Jon's question around the business lending growth, can you give us an indication on the impact that the loss of these facilities will have on the net interest margin over -- for the group over the next 12 months? And also, within this division, obviously, it's quite a shrinkage of the amount of loans outstanding. Is there going to be some action around the growth in the operating expenses to -- given that this division will be a lot smaller going forward?

Travis Crouch
Chief Financial Officer

Yes, thanks, Brendan. Around the impact on margin, I think we're probably already all starting to see that come through. I haven't got the details on the outlook of what that might do. But the other balance with the commercial portfolio was, obviously, that is priced off the BBSW rate, so that's obviously -- has increased over the last 6 to 8 months. But I think a lot of that impact on margin we're already seeing in the half there. And sorry, I've forgotten your second question.

Brendan Sproules
Citigroup Inc, Research Division

The second question just relates to the size of the operating expenses in that division given that division's obviously a lot smaller now going forward.

Travis Crouch
Chief Financial Officer

Yes, look, the asset portfolio is smaller. I think the work that Bruce and the team are doing is around rightsizing and getting the right business banking staff there to actually service those target markets that we're looking for. So that underlying cost base, yes, will continue to be a focus. But I think it's actually been more around getting the business bankers in place and that structure behind around the back-office risk and operational processes to make sure they're well supported. But that cost base, like for all the divisions, will be something that we'll look at -- continue to look at.

Operator

Your next question comes from the line of Ashley Dalziell from Goldman Sachs.

Ashley Dalziell
Goldman Sachs Group Inc., Research Division

I just had a couple of questions on noninterest income. Just firstly, on trading income, in the past, you've suggested that you're positioned within that book to benefit from a downward revision in market estimates for the direction of the cash rate, which I suppose is sort of seen this calendar year. Should we still be expecting that you will benefit in that sort of environment? And then secondly, how should we be thinking about the launch of this new NDIS Bcause business? And is that likely to add any meaningful contribution to the noninterest income line on a 12-month outlook?

Travis Crouch
Chief Financial Officer

Thanks, Ashley. So firstly, on the trading book, look, I think the contribution we saw this half was -- that was $1.5 million. I think I spoke 6 months ago that I would expect somewhere around that $1.5 million to $2.5 million is that normal contribution in the environment we're in at the moment. So I don't see that outlook changing. I still see a contribution of that size being appropriate given the positioning and the view on rates. And then I think it's from the Bcause initiative, I don't expect any material impact in the next 12 months in the sense of other revenue. I think it is in that early pilot stages, and we'll -- happy to give some update in 6 months' time with what we're seeing there. But I'm not expecting any material change on other income because of Bcause for the next 6 or 12 months.

Ashley Dalziell
Goldman Sachs Group Inc., Research Division

Okay. Maybe just to round it out, I mean, on the discussion around the roll-off of the [CRA] balances, if you think that, that's mostly within the NIM in the half, to the same end have we seen the impact roll through the noninterest income line? Or is this a more, I suppose, headwind on that front into the second half?

Travis Crouch
Chief Financial Officer

I would've thought we've eventually seen most of that come through the non-GAAP or the fee income based on those facilities already. I think the big part around the non-GAAP or the fee income is competition, and that continues to be a space that's pretty heavily used as a customer acquisition tool, particularly to that commercial and business portfolio.

Operator

Your next question comes from the line of Brett Le Mesurier from Shaw and Partners.

Brett Le Mesurier
Shaw and Partners Limited, Research Division

You've commented that your front to back book margin compression is 6 basis points in the first half; likely to be that in the second half. You might have a few beneficial impacts from deposits. But from what you're saying, it's likely that the margin will be down. You've got hardly any loan growth. So it looks like your net interest income is going to be -- it's going to be difficult to have that increasing from the first half to the second half. Also, your noninterest income looks like it's struggling to grow as well, so doesn't that imply that you're going to be doing very well if you get any income growth from the first half to the second half?

Travis Crouch
Chief Financial Officer

Our nonincome lines, Brett, actually performed really strongly. I think that as I said, there was an underlying level of activity through our FX and commission income. That fee income held up okay. So obviously, subject to competition and what else happens there, I think that other income was actually a pretty good result. There were some seasonal factors in this half, but underlying activity was still strong. Your comments around NIM, I spoke about the drivers that we can control. We'll certainly be doing everything we can around managing our funding costs and continuing to manage that asset pricing and that mix there. But I guess that funding cost side is the big swing factor particularly around that wholesale. But as I said, we've already started to do some work on our retail funding. We're able to do some repricing in January. So we're certainly doing everything we can there. And then activity through lending, we have seen that pickup in -- as I said, through the -- our third-party channels. More customers are choosing to use that channel, and we're returning to the more natural level of flows that we should be at. And we're doing a lot of work around some of that retail lending experience, too. So we're doing everything we can there to improve that activity. And obviously, that takes time to come through, but we're certainly -- it's certainly a focus.

Brett Le Mesurier
Shaw and Partners Limited, Research Division

And your expense growth is running at the rate of 2% every half, so I gather you're a bit more upbeat on your income growth than I am. So are you suggesting that you will be able to get income growth as high as your expense growth in the second half?

Travis Crouch
Chief Financial Officer

No, I said that revenue growth is challenging, but the cost outlook is something we need to work through and keep managing. We did have that 2% growth for the half, and it's an absolute focus for our revenue growth is challenging. So as Marnie said as well, it's something we're working through pretty hard around that business processes and systems and making sure we're operating it as efficiently as we can be.

Operator

There are no further questions. I will now hand back to the speakers for any closing remarks.

Marnie A. Baker
MD & Director
So thank you, everyone, for joining us here today, and thank you again for your interest in our organization and ongoing support.