



Traditional values in a changing world

Report & Accounts

31 December 2010



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Chairman's Statement

The UK economy emerged from recession at the beginning of 2010, after six consecutive quarters of "negative growth" - the longest period since quarterly figures were first recorded in 1955. But its recovery has been faltering; initial figures from the Office for National Statistics indicate that output for the last quarter of 2010 decreased by 0.5%, and with the increase in VAT from the beginning of 2011 concerns remain that the UK might slip back into recession. The very low interest rate set and maintained by the Bank of England is seen by many commentators therefore as essential in order to preserve and foster the fragile recovery achieved thus far. However, it does little to combat inflation, which, largely due to increases in global oil and commodity prices, has risen steadily during 2010, and which the Governor of the Bank of England recently suggested may rise even further to somewhere between four per cent and five per cent in the first half of 2011.

House prices, after recovering slightly in 2009, remained flat for most of the year, although there were significant regional variations. Nationally, there was a slight reduction in the number of mortgages falling into arrears, and the number of properties being repossessed by lenders. The low interest rate environment has no doubt helped to maintain the affordability of loan repayments for many borrowers, but some remain vulnerable in the event of future rate increases. Happily, your Society's levels of mortgage arrears remain significantly lower than the industry average, and are enviable even within the mutual sector. This is a direct result of the prudent lending policy that we have pursued for a number of years. However, in recognition of the uncertain outlook for the economy and the impact that this could have on our borrowers' ability to pay their mortgages, we have decided to modestly increase the general mortgage provision.

The economic environment posed problems for lenders of all descriptions. Fears of a fresh round of house price falls and / or increased unemployment have led to fierce competition for "quality" loans - i.e. those where the loan to value ratio is relatively low, and the monthly repayment is comfortably affordable to the borrower. This is precisely the sort of business that your Society has sought for many years, and which has led to its success in weathering the economic storms of the last three years. Despite the additional competition in this market sector your Society was still able to achieve real growth in a year when some lenders have seen commercial assets fall.

In the interest rate environment that we have recently been experiencing savers have naturally been seeking products that offer some chance of a real return after inflation. In the interest of our members, your Society tried hard to maintain savings interest rates at reasonable levels, and indeed was successful in achieving significant inflows of retail funds for the year.

Overall your Society's results for 2010 are extremely sound, providing a very satisfactory level of profit which will further add to the Society's reserves. Set against the prevailing economic background, this is a good result.

It has been my privilege to serve as a director of your Society for more than thirteen years, and since 2002 I have held the position of Chairman. At the Annual General Meeting this April I shall not be seeking re-election, and I should therefore like to extend



“Overall your Society’s results for 2010 are extremely sound, providing a very satisfactory level of profit which will further add to the Society’s reserves. Set against the prevailing economic background, this is a good result”

particularly heartfelt thanks this year to all those who have supported me as Chairman for the last nine years, and contributed to the Society’s success. My thanks go to my fellow directors, the Executive team and management of the Society, the staff, agents, and other business and professional partners, and above all to the members of the Society. Many of our members have, I know, demonstrated their support over many years, and will, I hope, continue to do so. Plans to ensure a smooth succession to the Chairmanship are well advanced, and I feel confident that I am leaving the Society in good hands; I look forward to watching it go from strength to strength in the years to come.

David Baker

Chairman

24 February 2011



Chief Executive's Review

2010 was a year of solid progress as the Society was able to build on its sturdy foundations to deliver growth in both savings and mortgages balances in a very sluggish market. That this was achieved whilst delivering satisfactory profits was a reflection of continued support by our members of our mutual values.

As a result we maintained strong Gross and Free Capital ratios which now stand at 6.79% and 6.45% respectively (2009: 6.93% and 6.58%). Costs were actively managed whilst making appropriate investment in the business. At the same time the legacy of lending decisions made over many years is that we have seen no significant deterioration in the performance of our loan book and still have not made a single repossession since 2006.

SAVINGS

The record breaking low Bank of England Base Rate (in terms of value and duration) was a feature for the whole year and continues to present frustrations for savers in the face of price inflation for many of the goods in our shopping baskets and at the petrol pumps. Nevertheless, the Society's retail savings balances grew by £20.7m in 2010 as we held to our principles of not offering excessive "bonuses" designed to attract investors by briefly inflating headline rates. Instead, long term and dependable pricing found favour with our savers.

A number of account types underpinned this "inflow"; notably our affinity accounts (supporting LOROS and Cransley Hospice), Sixty60 for older savers and our internet Onthedot accounts.

In the year we saw and acted upon an opportunity to offer local businesses and charities fuss-free retail savings accounts with a rates considerably better than those typically on offer from High Street banks. As a result we were able to attract £6.5m of new money without expensive advertising and create a "word of mouth" success.

Our success in attracting retail savings meant we reduced our use of the wholesale funding market. As at 31 December this source represented 13.17% (2009:15.19%) of funding.

MORTGAGES

The Society's lending continues to focus on the prime residential market. Despite lower market activity and intensified competition for business our gross lending rose to £69.5m (2009:£61.2m). This, combined with our effective and customer friendly borrower retention, meant that mortgage assets grew in the year by 2.80%. Such growth represents a significant winning of market share from competitors. In doing this we are wholly committed to supporting only good lending propositions, including selectively assisting many first time buyers.

Our success in mortgages is based on our personal service and being very responsive to market opportunities. In this we always aim to combine professionalism with personality.

Although, of course, we have seen some borrowers who have found their circumstances worsened in 2010 we have only four loans which are 12 months or more in arrears at



"2010 was a year of solid progress as the Society was able to build on its sturdy foundations to deliver growth in both savings and mortgages balances..."

31 December 2010 (2009 : none). The capital balances on these accounts amounted to £154k and the aggregate arrears were £13k. As mentioned above we have repossessed no homes for over 4 years.

We still see no problems in the loan book which warrant a specific provision. However, the outlook for the economy remains muted and therefore we have again modestly added to our general mortgage provision.

OTHER PRODUCTS

Our core savings and mortgage offers are complemented by insurance, investment and equity release products from our like-minded business partners.

In 2010 we overhauled our insurance offer – deliberately seeking out more keenly priced household cover for all our customers (not just mortgage holders). First4Cover, our new provider, also gives more choice and, as a result, we have seen a significant improvement in take up in the second half of the year.

Our local seminars from our specialist partners again proved that well-targeted and relevant information remains of value to MHBS members.

IN OUR COMMUNITIES

I have mentioned our affinity accounts which generate a donation from the Society equal to 1% of their balances to local hospices. In addition, our Charitable Foundation made awards to several local good causes including Rainbows Children's Hospice, Kettering Citizen's Advice Bureau and Shelter. In total the Society made charitable donations in the year of £16k (2009: £18k).

In Kibworth our branch was improved and this has been well received by both new and regular customers there.

We offer all staff a paid day off in which to support local good causes. In the autumn the Society's executives donned their gardening gloves to help the Harborough Improvement Team.

Once again we supported the excellent Pride in Harborough awards hosted by the Harborough Mail and more recently the Christmas tree in the Square outside our Head Office.



Chief Executive's Review (continued)

AWARD WINNERS

Your Society attracted two national awards in 2010:

- Best Lender Discount Products (Moneywise)
- Best New Panel Lender (Mortgage Force)

This recognition illustrates the ability of a regional Society like Market Harborough to take on the big organisations in the financial services marketplace.

OTHER DEVELOPMENTS

The updating of our logo announced at last year's Annual General Meeting was cost effectively carried through to all our branches and agency. In addition, our website was developed further making it easier to use and offering more information.

In February our team was strengthened when we were joined by Louise Bunce to head up our Channel and Marketing areas. This development is important in helping your Society remain relevant in changing times whilst holding to its "Traditional Values".

As noted in the Directors' Report which follows, David Baker has told us that he will be retiring from his post as Chairman of the Society at the conclusion of our Annual General Meeting in April. Mr Baker has served as a director of the Society since 1997, and as its Chairman for the last nine years. The knowledge and experience that he brought to the Society has been invaluable, and in recent years he has played a pivotal role in steering the Society through very difficult economic times. I should like to place on record the Board's appreciation for the significant contribution that he has made to the success of the Society.

OUTLOOK

The impact of rising inflation and the effects of the Comprehensive Spending Review are starting to make themselves felt and 2011 is unlikely to see a significant improvement in our core markets. Dynamic competition for savings balances can be anticipated as banks rebuild their balance sheets.

The introduction of further "post crunch" regulation is certain and we expect some impacts from the Mortgage Market Review and the commencement of the transition of the Financial Services Authority itself into a new regulatory structure.

In facing these issues the Society is guided by our members and the lessons of its 141 year history. We will continue to focus on members' needs, seeking fresh opportunities whilst avoiding value-destroying markets. We are clear that the essence of providing fair, relevant products delivered with approachable professionalism should remain our "stock in trade".

As a result we look forward to a successful 2011.

Mark Robinson

Chief Executive
24 February 2011



Directors' Report

Your directors have pleasure in presenting their annual report for the year ended 31 December 2010.

BUSINESS OBJECTIVES

Your Society's principal business objectives are the provision of secured lending on residential property, savings products for private individuals, and related insurance and other financial services. Our products are promoted nationally via the internet and by post, and in Leicestershire and Northamptonshire via our branches and agency. We seek to develop by offering the combined advantages of value-for-money and innovation in our products and by delivering a distinctive service to members.

REVIEW OF THE YEAR

A review of the Society's business performance during 2010 is included in the Chairman's statement on pages 4 and 5 and the Chief Executive's Review on pages 6 to 8.

Key Performance Indicators

The following "key performance indicators" provide an overview in tabular form of the Group's progress.

	2010	2009 ¹	2008
Total assets	£432.67m	£417.33m	£426.08m
Growth/(reduction) in mortgage assets	2.80%	(1.94%)	(1.12%)
Net increase/(decrease) in retail share balances	£16.40m	(£6.12m)	£9.53m
Management expenses as a percentage of mean total assets	1.01%	1.04%	0.99%
Post-tax profit	£0.75m	£1.01m	£0.50m
Profit as a percentage of mean total assets	0.18%	0.24%	0.12%
Net interest receivable as a percentage of mean total assets	1.21%	1.31%	1.13%
Gross capital as a percentage of shares and borrowings	6.79%	6.93%	6.61%
Free capital as a percentage of shares and borrowings	6.45%	6.58%	6.23%

For a definition of terms see the Annual Business Statement on page 42.

Post-tax profit is after a charge in respect of the Society's liability to the Financial Services Compensation Scheme. If this is excluded the post-tax profit in 2010 would have been £0.83m. The post-tax profits in 2008 and 2009 would have been £0.76m and £1.06m respectively.

¹ The figures in 2009 for management expenses and post-tax profits were affected by a one-off "past service cost" adjustment of £0.20m in respect of the defined benefit pension scheme. Excluding this adjustment the management expenses ratio would have been 0.99% and post-tax profits would have been £1.15m.



Directors' Report (continued)

DIRECTORS

Board Composition

As at 31 December 2010 the Board comprised seven non-executive directors and two executive directors. It meets at least bi-monthly, additional meetings being held as required. A one day strategy conference is also held each year.

The directors holding office during the year were:

Non-Executive Directors

David W Baker - Chairman

John G Hatcher - Vice-Chairman

Melanie K Duke

Nicholas J Johnston

Kenneth S Piggott

Kerry M Spooner

David P Woodward

In January 2011 David Baker signalled his intention not to stand for re-election at this year's Annual General Meeting.

Executive Directors

Mark T Robinson - Chief Executive

Michael W Parrott - Deputy Chief Executive and Finance Director

The Society maintains liability cover for the directors as permitted by the Building Societies Act 1986.

CORPORATE SOCIAL RESPONSIBILITY

Your Society seeks to act responsibly in all its activities and has considered its operational impact on the economic, social and physical environment.

PRINCIPAL RISKS

The Board reviews, on a regular basis, the key risks and uncertainties that may affect the Society's business. Currently it does not believe that there are any exceptional matters that it needs to address, but it has identified the following as the principal risks to which it is exposed:

- **Credit Risk in the Society's mortgage book or in its treasury portfolio** – the risk that mortgage customers or treasury counterparties might be unable to make payments as they fall due.
- **Liquidity Risk** – the risk that outflows of funds might leave the Society with insufficient liquidity to meet its immediate financial obligations.

- **Interest Rate Risk** – including risks arising from inappropriate product pricing or balance sheet composition, and interest rate basis mismatches.
- **Operational Risk** – the risk that the Society might sustain a major loss from inadequate or failed internal processes, people and systems, or from external events.

The Board actively monitors the Society's exposure to these risks and has adopted robust strategies to mitigate both their likelihood and potential impact. Further information concerning financial risk management is provided at Note 24 to the Accounts.

FINANCIAL INSTRUMENTS RISK POLICY

The Society's policy on financial instruments is set out at note 24 to the Accounts.

CAPITAL ADEQUACY

The Board complies with the Basel II Capital Requirements Directive (CRD) which requires the Society to assess the adequacy of its capital through an Internal Capital Adequacy Assessment Process (ICAAP). Through the application of the ICAAP the Board is satisfied that the Society holds a level of capital more than sufficient to satisfy both the CRD's Pillar 1 minimum capital requirements and to cover those risks that the Board has identified under Pillar 2. The Pillar 3 disclosures required under the CRD are available from the Society's Secretary, or on our website www.mhbs.co.uk

SUPPLIER PAYMENT POLICY

It is the Society's policy to agree the terms of payment with suppliers in advance and to make payment within the agreed terms of credit once the supplier has performed in accordance with the terms of the contract. The number of creditor days was nil at 31 December 2010 (31 December 2009: 1).

AUDITORS

The Society's auditors, PricewaterhouseCoopers LLP, have expressed their willingness to continue in office and a resolution for their re-appointment will be proposed at the Annual General Meeting.

On behalf of the Board of Directors:

D W Baker

Chairman

24 February 2011



Corporate Governance Report

COMPLIANCE WITH CODES OF PRACTICE

Your Board assumes full responsibility for the overall stewardship of the Society and recognises the importance of effective and responsible management, both in complying with statutory and prudential requirements and in protecting the interests of members and staff. The Board is responsible for the Society's strategy and direction, and for monitoring the performance of the Executive management team to ensure that the Society develops in accordance with its stated business objectives.

Your Board has agreed to abide by the UK Corporate Governance Code 2010, which takes effect from 1 January 2011, in so far as this code applies to a mutual organisation, save that it has not appointed a Senior Independent Director. This is because it believes that there are already sufficient channels through which members can contact the Society and resolve problems. Throughout 2010 the Board followed the previous version of this Code, the Combined Code on Corporate Governance 2008, with the same single exception.

The Board considers that all the non-executive directors are independent in both character and opinion and collectively bring to the Society a wide range of valuable expertise. However, as John Hatcher has served in excess of nine years on the Board he stands for re-election on an annual basis in accordance with both the Society's policy and the UK Corporate Governance Code.

The individual performance of non-executive directors is appraised by the Chairman, and that of the Chairman by the Vice-Chairman following consultation with the other Board members. The Board is satisfied that the Chairman has not had other business commitments which might have prevented him from giving full attention to the Society's interests.

The Board is responsible for determining strategies for risk management and internal control. Senior management are responsible for designing, operating and monitoring risk management and internal control processes. The Audit & Compliance Committee (on behalf of the Board) is responsible for reviewing the adequacy of these processes. The Society's risk profile is compiled by Senior Management, reviewed in detail by the Audit & Compliance Committee and approved by the Board.

The Internal Audit function is outsourced to Mutual One Ltd under specific terms of reference and provides independent and objective assurance that these processes are adequate and applied effectively.

The Board meets at least bi-monthly.

BOARD COMMITTEES

There are four Board Committees, covering the areas of Audit & Compliance, Assets & Liabilities, Nominations and Remuneration.

The Audit & Compliance Committee is chaired by David Woodward, its other members being John Hatcher and Kerry Spooner. It meets regularly during the year and deals with matters relating to internal and external audit, accounting policies and procedures, and

compliance with regulatory requirements.

The Assets & Liabilities Committee meets monthly, under the Chairmanship of John Hatcher. Its other members are David Baker, Melanie Duke, Kenneth Piggott, Nicholas Johnston, Mark Robinson and Michael Parrott. Its primary responsibilities are to monitor performance in key financial areas, and to recommend or approve as appropriate changes to financial policies.

The Nominations Committee is chaired by David Baker, its other members being John Hatcher and Kerry Spooner. It meets whenever a director vacancy is expected, to make recommendations for appointments to the Board. In sourcing suitable candidates for consideration, the Committee will use one or more of the following methods:

- Open advertising
- The services of a search and selection agency
- Advertising within the Society's membership

The Remuneration Committee meets at least twice each year and is responsible for determining the remuneration of the Chairman, executive directors and other senior managers, and for making recommendations to the Board on remuneration for non-executive directors and staff. It consists of three non-executive directors: Kerry Spooner (Chair), Kenneth Piggott and David Woodward.

Attendance at Board and Committee meetings during the year was as follows:

	Board	Audit & Compliance	Assets & Liabilities	Remuneration	Nominations
David Baker	9 (9)	-	12 (12)	-	3 (3)
John Hatcher	8 (9)	6 (6)	11 (12)	-	2 (3)
Melanie Duke	9 (9)	-	12 (12)	-	-
Nicholas Johnston	9 (9)	-	12 (12)	-	-
Kenneth Piggott	9 (9)	-	12 (12)	5 (5)	-
Kerry Spooner	8 (9)	5 (6)	-	4 (5)	2 (3)
David Woodward	9 (9)	6 (6)	-	5 (5)	-
Mark Robinson	9 (9)	-	12 (12)	-	-
Michael Parrott	9 (9)	-	12 (12)	-	-

() = number of meetings eligible to attend.

Self-evaluation exercises were carried out during the year by the Audit & Compliance Committee the Assets & Liabilities Committee and the Remuneration Committee, and their findings were reviewed by the full Board. The Board also carried out its own self-evaluation, and reviewed the performance of the Nominations Committee.

SUBSIDIARY COMPANY

The Society has one subsidiary company, Market Harborough Mortgages Ltd, which is managed by a separate Board of Directors comprising David Baker (Chairman), John Hatcher, Mark Robinson and Michael Parrott. Meetings are held as necessary.

On behalf of the Board of Directors:

D W Baker

Chairman

24 February 2010



Directors' Remuneration Report

This report sets out the Board's policy on the remuneration of directors. An advisory resolution on the policy will be put to the Annual General Meeting.

REMUNERATION COMMITTEE

The Remuneration Committee consists of three non-executive directors. It determines the remuneration of the Chairman and the salary and other benefits of the executive directors, and makes recommendations to the Board concerning the remuneration of non-executive directors.

In making its decisions and recommendations the Committee reviews comparative benefit packages from similar financial organisations. It is authorised by the Board to take any relevant legal or professional external advice. Such advice was sought in 2010, when an independent firm with considerable experience in this area was commissioned to carry out a benchmarking exercise on the remuneration of the executive directors and the fee levels of the non-executive directors, relative to appropriate market data. Their report analysed market practice at comparably sized building societies and in the wider market place, and has been taken into account in setting remuneration levels effective from January 2011 for both executive and non-executive directors.

POLICY AIMS AND OBJECTIVES

The Committee's decision-making processes take into account:

1. The need to recruit, retain and motivate staff with appropriate skills and experience to make an effective contribution to the Society's strategy and operations, and thus to act in the long-term interests of the Society's members.
2. The provisions of the FSA's Remuneration Code (with effect from 1 January 2011).
3. The provisions of the UK Corporate Governance Code in so far as they relate to building societies.

The Society seeks to ensure that its remuneration decisions are in line with its business strategy and long term objectives, and consistent with the Society's current financial condition and future prospects. Incentive schemes will take into account the need to retain a strong balance sheet, and variable remuneration amounts will not be paid unless they are sustainable within the Society's situation as a whole. Guaranteed incentive payments will not form part of the remuneration package.

CONFLICTS OF INTEREST

The Society seeks to ensure that its remuneration decisions avoid conflicts of interest. The Remuneration Committee is aware of the potential for such conflicts when considering remuneration for directors, and seeks external professional advice where appropriate.

CONTRACT TERMINATION

The Society will not enter into an employment contract which would compensate any individual for failing to perform his duties satisfactorily. Contractual notice periods will not exceed one year, and any contractual entitlement to a termination payment will not exceed twelve months' salary and benefits.

STATUTORY CONSIDERATIONS

The Society will ensure that its remuneration decisions are in line with statutory requirements in relation to equal pay and non-discrimination.

EXECUTIVE DIRECTORS

For executive directors the Society seeks to establish an appropriate balance between the fixed and variable elements of remuneration. The Committee has been mandated by the Board to ensure that salaries are in line with the median amount paid to executive directors in similar positions at comparable firms. Exceptional performance is rewarded through incentive schemes which provide the potential for overall reward to be within the upper quartile of remuneration for comparable post-holders. The main components of the executive directors' remuneration are:

Basic Salary

Basic salaries take into account the content and responsibilities of the job, salary levels in comparable organisations and individual performance in the role. The Chief Executive is appraised annually by the Chairman, and carries out a performance assessment of the Deputy Chief Executive & Finance Director.

Annual Performance Bonus

Annual bonuses are non-pensionable cash payments paid on achievement of key targets which will be of benefit to the Society and its members, and which take into account individual performance. The structure of the scheme is reviewed by the Remuneration Committee at the beginning of each financial year. The rewards for 2010 were based on achievement against benchmarks for growth, control of costs and income generation.

Long Term Performance Bonus

Long term bonuses are payable annually, based on performance over the previous three-year period as measured against business objectives. The structure of each new three-year scheme is determined by the Remuneration Committee at the commencement of the period to which it relates. Currently the schemes include targets for growth in loans and advances to customers, control of the management expenses ratio, income generation, profitability, customer service and compliance with regulatory requirements.

In considering the targets for both the annual and the long term schemes the Remuneration Committee will have regard to the goals set by the Board in the Society's Corporate Plan. All bonus schemes are non-contractual.

Pension Benefits

The Society contributes to a defined contribution scheme for eligible staff, including executive directors.

Other Benefits

The Society provides other taxable benefits to executive directors, namely the provision of a company car or an equivalent allowance, private medical insurance and a concessionary mortgage rate.

Neither of the executive directors has a contractual notice period which exceeds one year, or a contractual entitlement to a termination payment which would exceed twelve months' salary and benefits.



Directors' Remuneration Report (continued)

NON-EXECUTIVE DIRECTORS

The Board aims to ensure that salaries are in line with the median amount paid to non-executive directors in similar positions at comparable firms. The remuneration of non-executive directors does not include any bonus payments, pension or other benefits. Non-executive directors do not have service contracts providing for notice periods which exceed three months; neither do they have any contractual entitlement to termination payments. Their effectiveness is appraised annually by the Chairman, and the Board as a whole, under the leadership of the Vice-Chairman, assesses the Chairman's performance.

Full details of directors' remuneration for the year ended 31 December 2010 are given in note 6 to the accounts.

On behalf of the Board of Directors:

K M Spooner

Chairman of Remuneration Committee

24 February 2011



Responsibilities of the Directors

DIRECTORS' RESPONSIBILITIES FOR PREPARING THE ANNUAL ACCOUNTS

The following statement, which should be read in conjunction with the statement of the respective responsibilities of directors and auditors on page 18, is made by the directors to explain their responsibilities in relation to the preparation of the annual accounts, annual business statement and directors' report.

The Building Societies Act 1986 ('the Act') requires the directors to prepare, for each financial year, annual accounts which give a true and fair view of the state of affairs of the Society and the Group as at the balance sheet date and of the income and expenditure of the Society and the income and expenditure and cash flows of the Group for the year. In preparing those accounts, the directors are required to:

- a) select suitable accounting policies and then apply them consistently;
- b) make judgements and estimates that are reasonable and prudent;
- c) state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the annual accounts; and
- d) prepare the accounts on the going concern basis, unless it is inappropriate to presume that the Society and the Group will continue in business.

In addition to the accounts, the Act requires the directors to prepare, for each financial year, an annual business statement and a directors' report, each containing prescribed information relating to the business of the Society and its connected undertakings.

DIRECTORS' RESPONSIBILITIES FOR ACCOUNTING RECORDS AND INTERNAL CONTROL

The directors are responsible for ensuring that the Society and its connected undertakings:

- a) keep accounting records in accordance with the Building Societies Act 1986; and
- b) take reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business in accordance with the rules made by the Financial Services Authority under the Financial Services and Markets Act 2000.

The directors have general responsibility for safeguarding the assets of the Society and the Group and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

GOING CONCERN

The directors are satisfied that the Society and the Group have adequate resources to continue in business for the foreseeable future. For this reason, the accounts continue to be prepared on a going concern basis.

On behalf of the Board of Directors:

D W Baker

Chairman

24 February 2011



Independent auditors' report to the members of Market Harborough Building Society

We have audited the Group and Society annual accounts of Market Harborough Building Society for the year ended 31 December 2010 which comprise the Group and Society income and expenditure accounts, the Group and Society statements of total recognised gains and losses, the Group and Society balance sheets, the consolidated cash flow statement, and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

As explained more fully in the directors' responsibilities statement set out on page 17, the directors are responsible for the preparation of annual accounts which give a true and fair view. Our responsibility is to audit and express an opinion on the annual accounts in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Audit Practices Board's Ethical Standards for Auditors.

This report, including the opinion, has been prepared for, and only for, the Society's Members as a body in accordance with Section 78 of the Building Societies Act 1986 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

SCOPE OF THE AUDIT OF THE ANNUAL ACCOUNTS

An audit involves obtaining evidence about the amounts and disclosures in the annual accounts sufficient to give reasonable assurance that the annual accounts are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and Society's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the annual accounts.

OPINION ON THE ANNUAL ACCOUNTS

In our opinion the annual accounts:

- give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Group's and the Society's affairs at 31 December 2010 and of the Group's and the Society's income and expenditure and the Group's cash flows for the year then ended; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986.

OPINION ON OTHER MATTERS PRESCRIBED BY THE BUILDING SOCIETIES ACT 1986

In our opinion:

- the annual business statement and the directors' report have been prepared in

- accordance with the requirements of the Building Societies Act 1986;
- the information given in the directors' report for the financial year for which the accounts are prepared is consistent with the accounting records and the annual accounts; and
 - the information given in the annual business statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given.

MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

We have nothing to report in respect of the following matters where the Building Societies Act 1986 requires us to report to you if, in our opinion:

- proper accounting records have not been kept by the Group and Society; or
- the annual accounts are not in agreement with the accounting records; or
- we have not received all the information and explanations and access to documents we require for our audit.

Andrew Mair (Senior Statutory Auditor)

for and on behalf of
PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Birmingham
24 February 2011

Income and Expenditure Account for the year ended 31 December 2010

	Notes	Group 2010 £000	Group 2009 £000	Society 2010 £000	Society 2009 £000
Interest receivable and similar income	2	11,769	12,967	11,688	12,863
Interest payable and similar charges	3	(6,611)	(7,445)	(6,611)	(7,445)
Net interest receivable		5,158	5,522	5,077	5,418
Fees and commissions receivable		872	929	869	924
Fees and commissions payable		(275)	(247)	(275)	(247)
Other operating income		52	57	52	57
Total income		5,807	6,261	5,723	6,152
Administrative expenses					
Excluding past service costs in respect of the pension scheme		(3,995)	(3,888)	(3,958)	(3,851)
Pension scheme past service cost adjustment		-	(200)	-	(200)
	4	(3,995)	(4,088)	(3,958)	(4,051)
Depreciation and amortisation	14	(300)	(292)	(300)	(292)
Other operating charges	7	(189)	(170)	(189)	(170)
Financial Services Compensation Scheme Levy	21	(115)	(70)	(115)	(70)
Operating profit		1,208	1,641	1,161	1,569
Provisions for bad and doubtful debts	8	(141)	(238)	(141)	(238)
Other finance cost	25	(8)	(13)	(8)	(13)
Profit on ordinary activities before tax		1,059	1,390	1,012	1,318
Tax on profit on ordinary activities	9	(309)	(384)	(298)	(369)
Profit for the financial year	20	750	1,006	714	949

The notes on pages 23 to 41 form part of these accounts.

There is no difference between the profit on ordinary activities before tax and the profit for the financial year as stated above, and their respective historical cost equivalents.

All of the above arise from continuing operations.

Statement of Total Recognised Gains and Losses for the year ended 31 December 2010

	Notes	Group 2010 £000	Group 2009 £000	Society 2010 £000	Society 2009 £000
Profit for the financial year		750	1,006	714	949
Actuarial loss recognised in the pension scheme	25	(399)	(561)	(399)	(561)
Movement in deferred tax relating to the pension scheme		96	157	96	157
Total recognised gains in the year	20	447	602	411	545

Balance Sheet as at 31 December 2010

	Notes	Group 2010 £000	Group 2009 £000	Society 2010 £000	Society 2009 £000
ASSETS					
Liquid assets:					
Cash in Hand		337	352	337	352
Treasury Bills	11	22,471	-	22,471	-
Loans and advances to credit institutions	10	47,481	48,331	47,440	48,249
Debt securities	11	29,046	44,550	29,046	44,550
		<u>99,335</u>	<u>93,233</u>	<u>99,294</u>	<u>93,151</u>
Loans and advances to customers:					
Loans fully secured on residential property	12	329,436	320,315	327,637	317,744
Other Loans fully secured on land		1,110	1,214	1,110	1,214
Other Loans		-	-	713	1,557
		<u>330,546</u>	<u>321,529</u>	<u>329,460</u>	<u>320,515</u>
Tangible fixed assets	14	1,972	1,844	1,972	1,844
Other assets	15	434	388	427	381
Prepayments and accrued income		379	334	379	334
TOTAL ASSETS		<u>432,666</u>	<u>417,328</u>	<u>431,532</u>	<u>416,225</u>
LIABILITIES					
Shares	16	344,844	328,448	344,844	328,448
Amounts owed to credit institutions	17	32,299	50,661	32,299	50,661
Amounts owed to other customers	18	25,953	9,169	25,953	9,169
Other liabilities	19	520	556	509	540
Accruals		564	630	563	629
Net Pension liability	25	847	661	847	661
Provisions for liabilities and charges	21	286	297	286	297
		<u>405,313</u>	<u>390,422</u>	<u>405,301</u>	<u>390,405</u>
General reserve	20	27,353	26,906	26,231	25,820
TOTAL LIABILITIES		<u>432,666</u>	<u>417,328</u>	<u>431,532</u>	<u>416,225</u>

The notes on pages 23 to 41 form part of these accounts.

Approved by the Board of Directors on 24 February 2011, and signed on its behalf by:

D W Baker
Chairman

J G Hatcher
Vice - Chairman

M T Robinson
Chief Executive

Consolidated Cash Flow Statement for the year ended 31 December 2010

	2010	2009
	£000	£000
Net cash Inflow from operating activities	13,368	721
Taxation	(329)	(372)
Capital expenditure:		
Purchase of tangible fixed assets	(460)	(389)
Disposal of tangible fixed assets	28	2
Financial investment:		
Decrease / (increase) in investment in debt securities	15,503	(1,877)
Increase in investment in treasury bills	(22,448)	-
Increase / (decrease) in cash	<u>5,662</u>	<u>(1,915)</u>
Reconciliation of operating profit before tax to net cash inflow from operating activities		
Profit on ordinary activities before tax	1,059	1,390
Increase in prepayments and accrued income	(45)	(11)
Increase / (decrease) in accruals	136	(3,089)
Depreciation and amortisation	300	292
Loss / (profit) on sale of fixed assets	4	(1)
Net cash inflow / (outflow) from operating activities	<u>1,454</u>	<u>(1,419)</u>
(Increase) / decrease in loans and advances to customers	(9,167)	6,124
Increase / (decrease) in shares	16,232	(3,077)
Decrease in deposits and other borrowings	(1,616)	(3,109)
Decrease in loans and advances to credit institutions	6,500	2,000
(Increase) / decrease in other assets	(25)	522
Increase / (decrease) in other liabilities	13	(307)
Decrease in provisions for liabilities and charges	(11)	(68)
Increase in provisions for bad and doubtful debts	150	245
Contributions to final salary pension scheme	(212)	(438)
Charge in respect of final salary pension scheme	50	248
Net cash inflow from operating activities	<u>13,368</u>	<u>721</u>

	1 Jan	Net	31 Dec
	2010	increase	2010
	£000	£000	£000
Analysis of increase / (decrease) in cash			
Cash in hand	352	(15)	337
Loans and advances to credit institutions repayable on demand	13,766	5,677	19,443
	<u>14,118</u>	<u>5,662</u>	<u>19,780</u>
	1 Jan	Net	31 Dec
	2009	decrease	2009
	£000	£000	£000
Cash in hand	319	33	352
Loans and advances to credit institutions repayable on demand	15,714	(1,948)	13,766
	<u>16,033</u>	<u>(1,915)</u>	<u>14,118</u>



Notes to the Accounts

1. PRINCIPAL ACCOUNTING POLICIES

The accounts have been prepared on a going concern basis in accordance with UK Generally Accepted Accounting Principles (UK GAAP) and British Bankers' Association Statements of Recommended Practice. A summary of the accounting policies, which have been applied consistently, is set out below.

Basis of preparation

The accounts are prepared in accordance with the historical cost convention, and in accordance with the Building Societies (Accounts and Related Provisions) Regulations 1998. The group accounts consolidate the accounts of Market Harborough Building Society and its subsidiary Market Harborough Mortgages Limited, which are all made up to 31 December.

Taxation

In accordance with Financial Reporting Standard 19 "Deferred Tax", deferred taxation has been recognised as a liability or asset if transactions have occurred at the balance sheet date that give rise to an obligation to pay more taxation in the future, or a right to pay less taxation in the future. An asset is not recognised to the extent that the transfer of economic benefits is uncertain. Deferred tax assets and liabilities recognised have not been discounted.

Tangible fixed assets

The cost of fixed assets is their purchase cost, together with any incidental costs of acquisition. In the case of property, cost also includes the cost of improvements since acquisition. Freehold premises are continually maintained in a state of good repair and the directors consider that residual values, based on prices prevailing at the time of acquisition, are at least equal to or greater than carrying values such that depreciation is not significant; consequently these buildings are not depreciated, but are reviewed for impairment on an annual basis. Depreciation is provided by equal annual instalments over the anticipated useful life of other assets, of up to 5 years, with the exception of leasehold property which is amortised over the life of the lease.

Premiums paid on the acquisition of loans and advances to customers

Premiums paid on the acquisition of loans and advances to customers from third parties are included in 'loans and advances to customers - loans fully secured on residential property', and are written off against 'interest receivable on loans fully secured on residential property' on a straight line basis over the anticipated average life of the assets acquired.

Provisions for bad and doubtful debts

Specific provisions are made against mortgage loans on a case by case basis to cover anticipated losses in respect of all accounts that are in arrears by 2.5% or more of the balance outstanding, or are otherwise impaired, and where a probable loss has been identified. Anticipated losses on such accounts are calculated as the difference between the current achievable market value of the security, based on current valuations of the property performed by qualified local surveyors, and the outstanding loan balance, after making appropriate allowance for costs of repossession and sale. These forecast shortfalls



Notes to the Accounts (continued)

1. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

Provisions for bad and doubtful debts (continued)

are aggregated using actual data over the last 12 months to calculate the propensity for individual accounts to migrate through to possession based on conditions at the balance sheet date, including the extent of arrears and borrower circumstances where relevant.

In addition, general provisions are made on a portfolio basis to reflect the probability that other loans (including short-term arrears and negative equity cases) may also be impaired at the balance sheet date, with the result that the amount advanced may not be recovered in full. Such provisions are calculated by segmenting the total portfolio (excluding cases already specifically provided for) according to risk profiles reflecting product characteristics, borrower credit-worthiness and loan-to-value ratios, and applying estimated rates of loss based on historical experience and anticipated market conditions.

In calculating both general and specific provisions, an allowance is made for recoveries from external loss insurance cover where appropriate. No provision is made for future interest.

Where its collectability is subject to significant doubt, interest relating to repossessed properties is treated as being irrecoverable and is not recognised in the income and expenditure account. Such interest is credited to the suspended interest account.

Operating leases

Operating lease rentals for leasehold land and buildings are charged to administrative expenses on a straight line basis over the period of the lease.

Liquid assets

Liquid assets are stated at cost together with interest accrued to the balance sheet date.

Pension costs

The Society operates a defined benefit pension scheme that was closed for the accrual of future benefits on 6 April 2005. At each balance sheet date the assets are measured at market value and the liabilities are measured using the projected unit valuation method, discounted using a corporate bond rate. The resulting surplus or deficit is recognised on the balance sheet net of deferred taxation and any resulting actuarial gains or losses are recognised immediately in the statement of recognised gains and losses.

Since April 2005 the Society has contributed to the personal pension plans of those staff who have joined its defined contribution group personal pension scheme. These contributions are charged to the income and expenditure account in the year in which they are payable.

Incentives to borrowers

Amounts paid to borrowers in the form of mortgage incentives and other expenses related to new mortgage loans are charged to 'other operating charges' in the period in which the loan is completed (note 7).

Off balance sheet instruments

All interest rate contracts are classified at the balance sheet date as hedging contracts.

Income and expenditure is recognised on an equivalent basis to the assets and liabilities being hedged. Amounts accrued on such contracts are included within prepayments and accruals.

Income recognition

All of the Group's material sources of income are accounted for on an accruals basis. Fees receivable from existing savers and borrowers are included in fees and commissions receivable. Fees payable to third parties are included in fees and commissions payable. Valuation fees and other amounts receivable on origination of new mortgages are credited to fees and commissions receivable as received, unless a refund is anticipated when the mortgage advance is completed.

2. INTEREST RECEIVABLE AND SIMILAR INCOME

	Group 2010 £000	Group 2009 £000	Society 2010 £000	Society 2009 £000
On loans fully secured on residential property	12,020	13,337	11,919	13,192
On other loans:				
To connected undertakings	-	-	20	41
To others	61	70	61	70
On debt securities	242	547	242	547
On other liquid assets	345	682	345	682
Net expense on derivative instruments	(899)	(1,669)	(899)	(1,669)
	11,769	12,967	11,688	12,863

No interest was suspended in 2010 in respect of properties in possession (2009: £nil).

3. INTEREST PAYABLE AND SIMILAR CHARGES

	Group & Society	
	2010 £000	2009 £000
On shares held by individuals	5,845	6,978
On deposits and other borrowings	888	1,133
Net income on derivative instruments	(122)	(666)
	6,611	7,445

4. ADMINISTRATIVE EXPENSES

	Group 2010 £000	Group 2009 £000	Society 2010 £000	Society 2009 £000
Staff costs (note 5)	2,198	2,397	2,198	2,397
Remuneration of external auditors:				
for audit work	42	39	41	38
for non-audit work	-	-	-	-
Operating lease charges - land and buildings	110	110	110	110
Other administrative expenses	1,645	1,542	1,609	1,506
	3,995	4,088	3,958	4,051

Notes to the Accounts (continued)

5. STAFF NUMBERS AND COSTS

The average number of staff, including executive directors, employed during the year was:

	2010 Full Time	2010 Part Time	2010 Total	2009 Full Time	2009 Part Time	2009 Total
Head office	40	23	63	39	21	60
Branch offices	6	20	26	5	22	27
	<u>46</u>	<u>43</u>	<u>89</u>	<u>44</u>	<u>43</u>	<u>87</u>

The aggregate costs of these persons were as follows:

	Group & Society	
	2010 £000	2009 £000
Wages and salaries	1,876	1,881
Social security costs	192	197
Pension costs:		
Contributions to defined contribution arrangements	88	84
Other pension costs relating to defined benefit scheme (note 25):		
Current service cost	42	35
Past service cost	-	200
	<u>2,198</u>	<u>2,397</u>

6. DIRECTORS' EMOLUMENTS AND TRANSACTIONS

2010	Salary/ Fees	Benefits	Performance pay annual incentive scheme	Performance pay long-term incentive scheme	Total	Pension contributions
	£	£	£	£	£	£
David W Baker						
- as Chairman	28,832	-	-	-	28,832	-
John G Hatcher						
- as Vice-Chairman	21,570	-	-	-	21,570	-
Melanie K Duke						
- from 1 January	18,000	-	-	-	18,000	-
Nicholas J Johnston	18,000	-	-	-	18,000	-
Michael W Parrott	86,792	7,822	8,977	11,267	114,858	8,462
Kenneth S Piggott	18,000	-	-	-	18,000	-
Mark T Robinson	128,425	12,235	13,283	16,671	170,614	8,348
Kerry M Spooner	18,000	-	-	-	18,000	-
David P Woodward	18,500	-	-	-	18,500	-
	<u>356,119</u>	<u>20,057</u>	<u>22,260</u>	<u>27,938</u>	<u>426,374</u>	<u>16,810</u>

2009	Salary/ Fees	Benefits	Performance pay annual incentive scheme	Performance pay long-term incentive scheme	Total	Pension Contributions
	£	£	£	£	£	£
David W Baker						
- as Chairman	28,547	-	-	-	28,547	-
John G Hatcher						
- as Vice-Chairman	21,361	-	-	-	21,361	-
Paul E Beardsmore						
- until 28 February	11,162	1,059	-	-	12,221	1,088
Charles R Heaton						
- until 23 April	5,873	-	-	-	5,873	-
Nicholas J Johnston						
- from 1 August	7,133	-	-	-	7,133	-
Michael W Parrott	84,264	7,806	8,540	10,111	110,721	8,216
Kenneth S Piggott	17,118	-	-	-	17,118	-
Mark T Robinson	124,684	12,257	12,636	11,221	160,798	8,104
Kerry M Spooner	17,118	-	-	-	17,118	-
David P Woodward	17,452	-	-	-	17,452	-
	<u>334,712</u>	<u>21,122</u>	<u>21,176</u>	<u>21,332</u>	<u>398,342</u>	<u>17,408</u>

Benefits to executive directors include the provision of private health insurance, membership of the Society's car scheme and membership of the Society's concessionary mortgage scheme. Executive directors also participate in two executive bonus schemes. The first, an annual scheme, provides rewards based on achievement against benchmarks set at the beginning of the financial year for growth in loans and advances to customers, control of costs, and income generation. The second, a long term scheme, is based on performance against benchmarks set at the beginning of three year rolling periods for growth in loans and advances to customers, control of the management expenses ratio, income generation, profitability, customer service and compliance with regulatory requirements.

In recognition of the difficult economic climate the executive directors, Mark Robinson and Michael Parrott, irrevocably waived £8,417 and £5,688 respectively of their entitlements under the annual incentive scheme for 2010. Similarly they waived £16,071 and £10,861 respectively in 2009. The figures in the above tables are net of these amounts.

Directors' loans and transactions

There have been no significant contracts during the year in which any director had a material interest.

A total of £115,029 (2009: £249,943) was outstanding at the year end on mortgage loans granted in the ordinary course of business to 3 (2009: 3) directors of the Society at that time.

A register is maintained in accordance with the requirements of Section 68 of the Building Societies Act 1986, and the requisite particulars are available for inspection at the Society's head office during the period of 15 days expiring with the annual general meeting, and at the annual general meeting on 28 April 2011.

Notes to the Accounts (continued)

7. OTHER OPERATING CHARGES

	Group & Society	
	2010 £000	2009 £000
Incentives to borrowers	177	158
Other	12	12
	<u>189</u>	<u>170</u>

8. PROVISIONS FOR BAD AND DOUBTFUL DEBTS

Provision against loans and advances to customers has been made as follows:

	Loans fully secured on residential property		
	General £000	Specific £000	Total £000
Group			
At 1 January 2010	485	-	485
Income and expenditure account	150	(9)	141
Amounts written off during year	-	(1)	(1)
Adjustments resulting from recoveries	-	10	10
At 31 December 2010	<u>635</u>	<u>-</u>	<u>635</u>
Society			
At 1 January 2010	450	-	450
Income and expenditure account	150	(9)	141
Amounts written off during year	-	(1)	(1)
Adjustments resulting from recoveries	-	10	10
At 31 December 2010	<u>600</u>	<u>-</u>	<u>600</u>

9. TAX ON PROFIT ON ORDINARY ACTIVITIES

	Group 2010 £000	Group 2009 £000	Society 2010 £000	Society 2009 £000
The taxation charge for the year comprises:				
United Kingdom corporation tax:				
Current year	279	397	268	382
Deferred tax:				
Origination and reversal of timing differences (note 15)	(16)	(66)	(16)	(66)
Other timing differences relating to pension scheme	46	53	46	53
	<u>309</u>	<u>384</u>	<u>298</u>	<u>369</u>
Factors affecting the tax charge for the year:				
Profit on ordinary activities before tax	1,059	1,390	1,012	1,318
Current tax at 28% (2009: 28%)	297	389	283	369
Effects of:				
Capital allowances in excess of depreciation	(22)	(17)	(22)	(17)
Other timing differences	7	30	7	30
Marginal relief	(3)	(5)	-	-
Current tax charge for the year	<u>279</u>	<u>397</u>	<u>268</u>	<u>382</u>

During the year, as a result of the change in the UK main corporation tax rate from 28%

to 27% that was substantively enacted on 20 July 2010 and that will be effective from 1 April 2011, the relevant deferred tax balances have been re-measured. Further reductions to the UK corporation tax rate were announced in the June 2010 Budget. The changes, which are expected to be enacted separately each year, propose to reduce the rate by 1% per annum to 24% by 1 April 2014. The changes had not been substantively enacted at the balance sheet date and therefore are not recognised in these financial statements.

10. LOANS AND ADVANCES TO CREDIT INSTITUTIONS

	Group 2010 £000	Group 2009 £000	Society 2010 £000	Society 2009 £000
Loans and advances to credit institutions have remaining maturities as follows:				
Accrued interest	38	65	38	65
Repayable on demand	19,443	13,766	19,402	13,684
In not more than three months	28,000	33,500	28,000	33,500
In more than three months but not more than one year	-	1,000	-	1,000
	47,481	48,331	47,440	48,249

11. DEBT SECURITIES AND TREASURY BILLS

		Group & Society	
		2010 £000	2009 £000
Debt securities:			
Debt securities, all of which are unlisted, have remaining maturities as follows:			
Accrued interest		28	29
In not more than one year		29,018	44,521
		29,046	44,550
Analysis of debt securities:			
Issued by borrowers other than public bodies		29,046	44,550
Movements during the year of debt securities held as financial fixed assets are as follows (excluding accrued interest):			
	£000		
At 1 January 2010	44,521		
Additions	175,580		
Disposals	(191,083)		
At 31 December 2010	29,018		
Treasury Bills:			
Treasury Bills have remaining maturities as follows:			
Accrued interest		23	-
In not more than one year		22,448	-
		22,471	-
Movements during the year of treasury bills held as financial fixed assets are as follows (excluding accrued interest):			
	£000		
At 1 January 2010	-		
Additions	30,926		
Disposals	(8,478)		
At 31 December 2010	22,448		

The directors of the Society consider that the primary purpose of holding debt securities and treasury bills is prudential. They are held with the intention of use on a continuing basis in the Society's activities and are therefore classified as financial fixed assets.

Notes to the Accounts (continued)

12. LOANS AND ADVANCES TO CUSTOMERS

	Group 2010 £000	Group 2009 £000	Society 2010 £000	Society 2009 £000
Maturity analysis				
The remaining maturity of loans and advances to customers is as follows:				
Repayable on demand	897	1,318	766	1,151
In not more than three months	2,976	2,894	2,966	2,886
In more than three months but not more than one year	10,415	9,750	10,305	9,641
In more than one year but not more than five years	65,961	66,724	65,337	66,156
In more than five years	250,932	241,328	250,686	241,131
General and specific provisions for bad and doubtful debts (note 8)	(635)	(485)	(600)	(450)
	330,546	321,529	329,460	320,515

It should be noted that this may not reflect actual experience of repayments since many mortgage loans are repaid early.

	Society	
	2010 £000	2009 £000
Included in loans and advances to customers are amounts due from Market Harborough Mortgages Limited of:	713	1,557

13. INVESTMENTS

Investments in subsidiaries

The Society directly holds 100% of the issued ordinary share capital of Market Harborough Mortgages Limited. The principal activity of the company is mortgage related finance. Its share capital is £1 (2009: £1). Its principal place of business is Welland House, The Square, Market Harborough, Leicestershire, LE16 7PD. It is registered in England and Wales.

There have been no additions or disposals of investments during the year.

Other participating interests

The Society holds a 20p ordinary share in Mutual One Limited. The company is registered in England and Wales.

14. TANGIBLE FIXED ASSETS

Group and Society	Freehold Property	Leasehold Property	Equipment	Motor	Total
	£000	£000	Fixtures and Fittings £000	Vehicles £000	
Cost					
At 1 January 2010	1,135	73	5,020	132	6,360
Additions	19	-	381	60	460
Disposals	-	-	(4)	(68)	(72)
At 31 December 2010	1,154	73	5,397	124	6,748
Depreciation					
At 1 January 2010	-	73	4,380	63	4,516
Charged in year	-	-	278	22	300
Disposals during year	-	-	(4)	(36)	(40)
At 31 December 2010	-	73	4,654	49	4,776
Net book value					
At 31 December 2010	1,154	-	743	75	1,972
At 31 December 2009	1,135	-	640	69	1,844

15. OTHER ASSETS

	Group 2010 £000	Group 2009 £000	Society 2010 £000	Society 2009 £000
Due within one year:				
Deferred tax	394	378	387	371
Other debtors	40	10	40	10
	434	388	427	381
The deferred tax asset recognised in the accounts is as follows:				
Tax effect of timing differences in relation to:				
Excess of depreciation over capital allowances	78	102	78	102
General provisions	169	133	162	126
Other	147	143	147	143
	394	378	387	371

16. SHARES

	Group & Society	
	2010 £000	2009 £000
Held by individuals	344,836	328,440
Other shares	8	8
	344,844	328,448
Repayable from the balance sheet date in the ordinary course of business as follows:		
Accrued interest	2,072	1,908
Repayable on demand	141,117	128,458
In not more than three months	169,852	167,701
In more than three months but not more than one year	27,236	23,910
In more than one year but not more than five years	4,567	6,471
	344,844	328,448

Notes to the Accounts (continued)

17. AMOUNTS OWED TO CREDIT INSTITUTIONS

	Group & Society	
	2010	2009
	£000	£000
Repayable from the balance sheet date in the ordinary course of business as follows:		
Accrued interest	99	161
In not more than three months	16,500	38,000
In more than three months but not more than one year	12,700	12,500
In more than one year but not more than five years	3,000	-
	<u>32,299</u>	<u>50,661</u>

18. AMOUNTS OWED TO OTHER CUSTOMERS

	Group & Society	
	2010	2009
	£000	£000
Repayable from the balance sheet date in the ordinary course of business as follows:		
Accrued interest	120	20
Repayable on demand	449	849
In not more than three months	17,634	8,300
In more than three months but not more than one year	7,750	-
	<u>25,953</u>	<u>9,169</u>

19. OTHER LIABILITIES

	Group 2010 £000	Group 2009 £000	Society 2010 £000	Society 2009 £000
Amounts falling due within one year:				
Income tax	207	210	207	210
Corporation tax	142	191	132	176
Other taxation and social security	89	91	89	91
Other creditors	82	64	81	63
	<u>520</u>	<u>556</u>	<u>509</u>	<u>540</u>

20. GENERAL RESERVE

	Group 2010 £000	Group 2009 £000	Society 2010 £000	Society 2009 £000
At 1 January	26,906	26,304	25,820	25,275
Net movement in actuarial loss recognised in pension scheme	(303)	(404)	(303)	(404)
Profit for the financial year	750	1,006	714	949
At 31 December	<u>27,353</u>	<u>26,906</u>	<u>26,231</u>	<u>25,820</u>

21. GUARANTEES AND OTHER FINANCIAL COMMITMENTS

Financial Services Compensation Scheme

In common with all regulated deposit takers, the Society pays levies to the Financial Services Compensation Scheme (FSCS) based on its market share of Protected Deposits, to enable the FSCS to meet claims against it. These levies consist of two parts; a management expenses levy and a compensation levy. The management expenses levy covers the costs of running the scheme and the compensation levy covers the amount of compensation paid by the scheme, net of any amounts it recovers using the rights that have been assigned to it.

In 2008 claims were triggered against the FSCS by the transfer of Bradford and Bingley plc's retail deposit business to Abbey National plc and by the transfer of Kaupthing Singer and Friedlander's (KSF) internet deposit business ('Kaupthing Edge') and Heritable Bank's (a subsidiary of Landesbanki hf) deposit business to ING Direct. The FSCS is also liable to claims from depositors of KSF and Landesbanki hf whose balances have not been transferred to ING Direct, but are covered by the FSCS. A claim was also triggered in 2008 by London Scottish Bank plc. The first half of 2009 saw a further claim triggered by the transfer of core parts of the Dunfermline Building Society to the Nationwide Building Society.

It is understood that the FSCS has met, or will meet, the above claims by way of loans received from the Bank of England which will eventually be replaced by a loan from HM Treasury. The FSCS has, in turn, acquired rights to the realisation of the assets of those banks in respect of which claims have been triggered. The FSCS is liable to pay interest on the loans from the Bank of England. It may have a further liability if there are insufficient funds available from the realisation of the assets of the banks to fully repay the respective Bank of England loans. To the extent that the loans have not been repaid in full by 31 March 2012, the FSCS will agree a schedule of repayments with HM Treasury. The FSCS will then levy deposit takers (including Market Harborough Building Society) accordingly.

In its 2009 results the Society recognised provisions for levies totalling £297,000, using information provided in notifications from the Financial Services Authority (FSA). The FSCS has since notified deposit takers of the actual levy for 2009/10 and has revised its estimates for the management expenses levy for 2010/11. As a result there has been a reduction in the amount provided of £62,000.

Based on notifications that it has received from the FSA and the Society's market share of Protected Deposits as at 31 December 2010, it is estimated that the Society will be liable for levies totalling £177,000 in respect of the scheme year 2011/12 and this amount has been recognised in the 2010 results. Using the same data it is estimated that the Society will be liable for further levies totalling £203,000 in respect of the scheme year 2012/13, and this will be recognised in the 2011 results. At the date of signing of these accounts there is uncertainty over the amounts provided in respect of both the 2010/11 and 2011/12 scheme years as the years run to 31 March 2011 and 31 March 2012 respectively and additional levies may be raised up to those dates.

Due to the uncertainty over whether a charge may become due, the above amounts do not take account of any compensation levies which may arise from claims on the FSCS following the realisation of the assets of the deposit takers in respect of which the above claims have been triggered. If such claims were to become payable it is estimated, based on notifications received from the FSA, that the amount of the Society's liability would be in the range £100,000 and £1,000,000.

Notes to the Accounts (continued)

21. GUARANTEES AND OTHER FINANCIAL COMMITMENTS (CONTINUED)

Financial Services Compensation Scheme levy

	£000
At 1 January 2010	297
Charge for the year	115
Paid in the year	(126)
At 31 December 2010	<u>286</u>

Contingent liabilities

The Society has given an undertaking to discharge the liabilities of Market Harborough Mortgages Limited in so far as the company is unable to discharge them out of its own assets.

Capital commitments

	Group & Society	
	2010	2009
	£000	£000
Capital expenditure that has been contracted for but has not been provided for in the accounts	-	<u>79</u>

Operating lease commitments

Payments committed at the end of the year in respect of the next financial year for

	Group & Society	
	2010	2009
	£000	£000
Land and buildings:		
leases expiring in less than five years	72	69
leases expiring after five years	42	41
	<u>114</u>	<u>110</u>

22. RELATED PARTY TRANSACTIONS

As the directors of the Society and its subsidiary owe a duty of confidentiality to their customers, they do not consider it appropriate to make disclosures relating to balances and transactions with related parties other than as required under Section 68 of the Building Societies Act 1986. All transactions and balances with related parties arise in the normal course of business and on terms equivalent to those available to all customers.

23. SEGMENTAL ANALYSIS

A Group segmental analysis is not disclosed as the Group's business is exclusively UK based and within one business sector.

24. FINANCIAL INSTRUMENTS

Risk Management

The Group is a retailer of financial instruments, mainly in the form of mortgages, savings and insurance products. Through its normal operations it is exposed to a number of risks, the most significant of which are liquidity, credit and interest rate risks (see below). The

Group has a formal structure for managing these, including established risk limits, reporting lines, mandates and other control procedures. This structure is reviewed regularly by the Assets & Liabilities Committee, which is charged by the Society's Board with the responsibility for managing and controlling the balance sheet exposures of the Group.

Instruments used for risk management purposes include derivative financial instruments (derivatives). Derivatives are financial contracts or agreements whose value is derived from one (or more) underlying price, rate or index inherent in the contract or agreement, such as the interest rate. The principal derivatives used by the Group in balance sheet risk management are interest rate swaps, caps and collars which are used to hedge Group balance sheet exposures arising from fixed and capped rate mortgage lending, and fixed rate savings products. Such derivatives are only used in accordance with Section 9A of the Building Societies Act 1986, to reduce the risk of loss arising from changes in interest rates or other factors specified in the legislation. They are not used in trading activity or for speculative purposes.

The table below shows the notional principal amount, credit risk weighted amount and replacement cost of derivatives. The notional principal amount indicates the value of unmatured balances hedged by derivative instruments at the balance sheet date and does not represent the amount of risk. The credit risk weighted amount, which is calculated according to rules specified by the Financial Services Authority, is based on replacement cost, but also takes into account a measure of the extent of potential future exposure and the nature of the counterparty. The replacement cost represents the cost of replacing contracts with a positive value, calculated at market rates current at the balance sheet date, reflecting the Group's maximum exposure should all counterparties default.

Unmatured financial instruments - interest rate contracts

	Group & Society	
	£000	£000
Notional principal amount	107,500	74,700
Credit risk weighted amount	15	10
Replacement cost	74	48

Liquidity risk

The Group's policy is to maintain sufficient liquid resources to cover cash flow imbalances and fluctuations in funding, to maintain public confidence in the solvency of the Group and to enable it to meet its financial obligations as they arise. This is achieved through maintaining a prudent level of liquid assets, through wholesale funding facilities, and through control of the growth of the business. A significant proportion of the Society's liquidity is held either at call or in the form of debt securities and treasury bills, which are capable of being sold at short notice to meet unexpected and severe adverse cash flows. Stress tests are undertaken to measure the Society's ability to meet such adverse flows, the results of which are reviewed monthly by the Assets & Liabilities Committee. The Society maintained its liquidity at normal levels throughout the "credit crunch" which has adversely affected some credit institutions since late 2007. The Board is confident that the Society will continue to be able to meet its future financial obligations as they arise.

Credit risk

All loan applications are assessed with reference to the Society's lending policy. Changes to the policy are approved by the Board and the approval of loan applications is mandated.

Notes to the Accounts (continued)

24. FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk (continued)

In assessing credit risk in respect of treasury counterparties the Board uses credit ratings provided by a recognised credit rating agency. The financial health of treasury counterparties is also monitored on an ongoing basis using "market intelligence" and where it is considered that the rating agency's credit ratings may not yet fully recognise the credit risk associated with a particular counterparty, this can result in the counterparty concerned being immediately removed from the Society's approved list. As a result of this approach the Society has not been affected by exposures to failed financial institutions. The approved list is reviewed every month by the Assets and Liabilities Committee.

Interest rate risk

The Group is exposed to movements in interest rates and manages this exposure on a continuous basis, within limits set by the Board, using a combination of on balance sheet instruments and off balance sheet derivative instruments.

After taking into account the various derivatives entered into by the Group, the interest rate sensitivity exposure of the Group at 31 December 2010 was:

	Not more than three months £000	More than three months but not more than six months £000	More than six months but not more than one year £000	More than one year but not more than five years £000	Non interest-bearing £000	Total £000
Assets						
Liquid assets	98,932	-	-	-	403	99,335
Loans and advances to customers	272,323	8,332	17,740	32,151	-	330,546
Tangible fixed assets	-	-	-	-	1,972	1,972
Other assets	-	-	-	-	813	813
Total assets	371,255	8,332	17,740	32,151	3,188	432,666
Liabilities						
Shares	311,668	9,543	16,726	4,835	2,072	344,844
Deposits and other borrowings	47,033	7,500	3,500	-	219	58,252
Other liabilities	-	-	-	-	2,217	2,217
Reserves	-	-	-	-	27,353	27,353
Total liabilities	358,701	17,043	20,226	4,835	31,861	432,666
Off balance sheet items	27,300	600	(2,650)	(25,250)	-	-
Interest rate sensitivity gap	39,854	(8,111)	(5,136)	2,066	(28,673)	-

Liquid assets include cash in hand, loans and advances to credit institutions, debt securities and treasury bills. Other assets include other loans, investments and prepayments and accrued income. Other liabilities include accruals, deferred income and provisions for liabilities and charges.

After taking into account the various derivatives entered into by the Group, the interest rate sensitivity exposure of the Group at 31 December 2009 was:

	Not more than three months £000	More than three months but not more than six months £000	More than six months but not more than one year £000	More than one year but not more than five years £000	Non interest-bearing £000	Total £000
Assets						
Liquid assets	91,787	-	1,000	-	446	93,233
Loans and advances to customers	272,534	2,631	4,874	41,490	-	321,529
Tangible fixed assets	-	-	-	-	1,844	1,844
Other assets	-	-	-	-	722	722
Total assets	364,321	2,631	5,874	41,490	3,012	417,328
Liabilities						
Shares	306,480	1,447	12,142	6,471	1,908	328,448
Deposits and other borrowings	53,149	6,500	-	-	181	59,830
Other liabilities	-	-	-	-	2,144	2,144
Reserves	-	-	-	-	26,906	26,906
Total liabilities	359,629	7,947	12,142	6,471	31,139	417,328
Off balance sheet items	30,300	(1,500)	6,600	(35,400)	-	-
Interest rate sensitivity gap	34,992	(6,816)	332	(381)	(28,127)	-

Liquid assets include cash in hand, loans and advances to credit institutions and debt securities. Other assets include other loans, investments and prepayments and accrued income. Other liabilities include accruals, deferred income and provisions for liabilities and charges.

Fair values of financial instruments

Set out below is a comparison of the book and fair values (including accrued interest) of some of the Society's financial instruments as at 31 December 2010. The table excludes certain financial assets and financial liabilities which are not listed or publicly traded, or for which a liquid and active market does not exist. It therefore excludes items such as mortgages, share accounts and deposits with credit institutions. Market values have been used to determine the fair value of interest rate swaps, debt securities and treasury bills held.

	Group & Society	
	Book value £000	Fair value £000
Financial assets and liabilities for which active markets exist:		
Debt securities	29,046	29,045
Treasury bills	22,471	22,466
Off balance sheet instruments	69	(518)



Notes to the Accounts (continued)

24. FINANCIAL INSTRUMENTS (CONTINUED)

Hedges

Unrecognised gains and losses on hedges at the balance sheet date were £74,000 (2009: £52,000) and £523,000 (2009: £898,000) respectively. These gains and losses represent the expected future benefit of interest rate hedges to the Group at 31 December 2010, given prevailing economic conditions. They do not represent absolute gains or losses expected by the Group as they would be substantially offset by corresponding losses or gains from on balance sheet items.

25. PENSIONS

Defined benefit scheme

The Society operates a pension scheme providing benefits based on final pensionable pay that was closed for the accrual of future benefits on 6 April 2005 and replaced with a defined contribution group personal pension scheme. The assets of the former are held separately from those of the Society being invested with an insurance company in managed funds.

Financial Reporting Standard 17 (FRS 17) requires that the net assets or liabilities of defined benefit pension schemes are included on the balance sheet net of any deferred tax. The triennial valuation carried out as at 6 April 2006 was updated to provide the information required as at 31 December 2008. The triennial valuation carried out as at 6 April 2009 was used to provide the information required as at 31 December 2009 and was updated to provide the information required as at 31 December 2010. Details are given below.

The major assumptions used by the actuary for the purposes of FRS 17 were:

	2010 %	2009 %	2008 %
Rate of increases to pensions in payment	3.60	3.60	2.70
Pensionable salary growth	4.10	4.10	3.20
Discount rate	5.30	5.80	6.50
Rate of inflation	3.60	3.60	2.70

The rate of increase to pensions in payment for pensions accrued prior to 6 April 2004 is 3.00%.

The assumptions used by the actuary in 2008 in determining mortality before retirement are in accordance with mortality table AM92 for males and AF92 for females. The assumptions used in 2009 and 2010 are in accordance with mortality tables 55% of AM92 for males and 55% of AF92 for females.

The assumptions used in 2008 to determine mortality after retirement are in accordance with mortality tables PMA92 (C=2020) rated down 4 years for males and PFA92 (C=2020) rated down 4 years for females. The assumptions used in 2009 and 2010 are in accordance with mortality tables PCMA00 for males and PCFA00 for females with long cohort improvements, subject to minimum levels of future improvement of 1% per annum for males and 0.5% per annum for females.

The assets in the scheme and the expected rates of return were:

	Long-term rate of return		Long-term rate of return		Long-term rate of return	
	expected	Value	expected	Value	expected	Value
	at 31	at 31	at 31 Dec	at 31	31 Dec	at 31
	December	December	December	December	December	December
	2010	2010	2009	2009	2008	2008
	%	£000	%	£000	%	£000
Equities	8.00	1,784	8.00	2,546	8.00	1,712
Bonds	5.00	3,312	5.50	2,130	5.50	1,982
Property	7.00	422	7.00	381	7.00	378
Cash	3.50	23	3.50	14	5.00	17
Total market value of assets		5,541		5,071		4,089
Present value of scheme liabilities		(6,696)		(5,989)		(4,636)
Deficit in the scheme		(1,155)		(918)		(547)
Related deferred tax asset		308		257		153
Net pension liability		(847)		(661)		(394)

The scheme's assets are invested in unitised funds for which there is a single swinging price.

Acting on the Scheme Actuary's advice, and in accordance with the Board's appetite to control risk, the trustees took action in the year to realign the asset mix between equities and bonds with a view to achieving a closer match with the scheme's liabilities.

	2010	2009
	£000	£000
Reconciliation of present value of scheme liabilities		
1 January	5,989	4,636
Current service cost	42	35
Past service cost	-	200
Interest cost	346	296
Benefits paid	(222)	(340)
Actuarial loss	541	1,162
31 December	6,696	5,989
Reconciliation of fair value of scheme assets		
1 January	5,071	4,089
Expected return on scheme assets	338	283
Actuarial gain	142	601
Benefits paid	(222)	(340)
Contributions paid by employer	212	438
31 December	5,541	5,071

The scheme's assets do not include any investments in the Society, or in any property owned or occupied by the Society.

Notes to the Accounts (continued)

25. PENSIONS (CONTINUED)

Defined benefit scheme (continued)

The expected return on scheme assets is calculated taking into account market conditions and long term expected rates of return set at the start of the accounting period.

	2010	2009
	£000	£000
Analysis of charge to operating profit		
Current service cost	(42)	(35)
Past service cost	-	(200)
Charge to operating profit	<u>(42)</u>	<u>(235)</u>

Current service cost relates to the costs of administering the scheme and death in service premiums. The past service cost relates to a one-off adjustment to restore the final salary linkage to members of the scheme with deferred pensions who continued to be in the Society's employment after the scheme was closed to the accrual of future benefits on 6 April 2005.

	2010	2009
	£000	£000
Analysis of other finance cost		
Expected return on pension scheme assets	338	283
Interest on pension scheme liabilities	(346)	(296)
Net other finance cost	<u>(8)</u>	<u>(13)</u>
Analysis of amount recognised in statement of recognised gains and losses		
Actual return less expected return on the pension scheme assets	142	601
Experience gain / (loss) arising on the scheme liabilities	40	(41)
Change in assumptions underlying the present value of the scheme liabilities	(581)	(1,121)
Actuarial loss recognised in the statement of total recognised gains and losses	<u>(399)</u>	<u>(561)</u>

The triennial annual actuarial valuation as at 6 April 2009 showed a deficit of £972,000. This was updated at the trustees' request to 1 November 2009, at which date, due to an improvement in market conditions, the deficit had decreased to £724,000. It was agreed with the trustees that this deficit would be addressed by the Society making monthly contributions of £15,800 to eliminate the deficit over a period of five years ending November 2014.

Details of experience gains and losses for the year to 31 December	2010 £000	2009 £000	2008 £000	2007 £000	2006 £000
Experience gains and losses on scheme assets:					
Amount	142	601	(1,402)	(164)	36
Percentage of scheme assets	3%	12%	-34%	-3%	1%
Experience gains and losses arising on scheme liabilities:					
Amount	40	(41)	(13)	17	(11)
Percentage of scheme liabilities	-1%	1%	0%	0%	0%
Total amount recognised in statement of total recognised gains and losses:					
Amount	(399)	(561)	(612)	542	231
Percentage of the present value of scheme liabilities	-6%	-9%	-13%	10%	4%

Defined contribution scheme

Since April 2005 the Society has operated a defined contribution group personal pension scheme for eligible employees. Contributions are paid into personal pension plans held in the names of individual employees with a major UK insurance company.

Annual Business Statement for the year ended 31 December 2010

1. STATUTORY RATIOS AND PERCENTAGES

	Percentage as at 31 December 2010 %	Statutory Limit %
Lending limit		
Proportion of business assets other than in the form of loans fully secured on residential property	0.58	25
Funding limit		
Proportion of shares and borrowings other than in the form of shares held by individuals	14.45	50

The percentages are calculated in accordance with, and the statutory limits are those prescribed by, sections 6 and 7 of the Building Societies Act 1986 (as amended by the Building Societies Act 1997) and are based on the consolidated balance sheet.

Business assets are the total assets of the Group as shown in the consolidated balance sheet plus provisions for bad and doubtful debts, less tangible fixed assets and liquid assets.

Loans fully secured on residential property are the amount of principal owed by borrowers and interest accrued not yet payable. This is the amount shown in the consolidated balance sheet plus provisions for bad and doubtful debts and interest in suspense, less unamortised premiums on the acquisition of loans.

2. OTHER PERCENTAGES

	2010 %	2009 %
As a percentage of shares and borrowings:		
Gross capital	6.79	6.93
Free capital	6.45	6.58
Liquid assets	24.64	24.01
As a percentage of mean total assets:		
Profit after taxation	0.18	0.24
Management expenses	1.01	1.04

The above percentages have been calculated from the Group accounts.

Definitions

'Gross capital' represents the general reserve.

'Free Capital' represents the general reserve plus general provisions for bad and doubtful debts less tangible fixed assets.

'Mean total assets' is the average of the 2010 and 2009 year end total assets.

3. INFORMATION RELATING TO THE DIRECTORS

Name	Business Occupation	Other Directorships	Date of Birth	Date of Appointment as Director
David W Baker	Bank director (retired)	Market Harborough Mortgages Ltd	14-Sep-42	01-Aug-97
John G Hatcher	Chartered accountant	Market Harborough Mortgages Ltd S H & B Financial Services Ltd	17-Aug-50	01-Feb-96
Melanie K Duke	Corporate treasurer	None	22-Jul-64	01-Jan-10
Nicholas J Johnston	Chartered accountant	None	10-Jul-59	01-Aug-09
Michael W Parrott	Building society deputy chief executive and finance director	Market Harborough Mortgages Ltd	09-Dec-53	16-Apr-98
Kenneth S Piggott	Company director	Boots Charitable Trust Disabled Living Foundation Dyslexia Institute Ltd Simplyhealth (HSA) Group Ltd United Carpets Group Plc William Sinclair Holdings Plc	13-Oct-48	01-Mar-08
Mark T Robinson	Building society chief executive	Market Harborough Mortgages Ltd Market Harborough Building Society Charitable Foundation Mutual One Ltd	16-Mar-57	17-Sep-07
Kerry M Spooner	Solicitor	Market Harborough Building Society Charitable Foundation	31-Jan-61	16-Feb-06
David P Woodward	Chartered management accountant	None	18-Nov-62	01-Apr-07

4. OTHER SENIOR EXECUTIVES

Name	Occupation	Directorships
Paul E Beardsmore	Secretary	None
Elizabeth R Souter	Financial Controller	None
Paul Tilley	Head of Business Services and Compliance	None
Neil M Williams	Head of Information Technology	None
Louise J Bunce	Head of Sales and Marketing	None

5. NEW ACTIVITIES

No new powers were exercised for the first time during the year.

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Traditional values in a changing world