

Report & Accounts

31st December 2009



 **Market**
Harborough
BUILDING SOCIETY

Traditional values in a changing world

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Chairman's Statement

"In 2008 the global economy entered the most severe and synchronised recession since the Great Depression". Not my words, but those of the Chancellor of the Exchequer, Alistair Darling, as he presented his pre-budget report to Parliament in December 2009. And that recession has continued, lasting longer, in fact, in the UK than amongst most other European countries, despite cuts in Bank of England Base Rate to 0.50% in the first three months of the year and the policy of "quantitative easing" to inject additional cash into the economy. Unemployment reached its highest level since 1995¹, whilst the Retail Prices Index was negative for most of the year.

Surprisingly, share prices did not reflect the difficult state of the economy, and more significantly for your Society, the housing market did not collapse to quite the extent that might have been envisaged. In fact, at the end of 2009, house prices had risen by 5.9% year on year², following the major decline in 2008. The news on mortgage arrears and repossessions was also better than expected, with the Council of Mortgage Lenders revising downwards its forecast of the number of properties that would be taken into possession; nonetheless, arrears nationally rose significantly.

Although the chief casualties in the financial services sector have been the banks, the collapse of the Dunfermline Building Society, alongside a number of other Society mergers, reminded all of us that even a mutual Society is not immune from economic forces, where diversification into activities remote from traditional skills can create significant risk to capital.

In these circumstances I am delighted to be in a position to report that your Society remains in sound financial health mainly resulting from a consistently prudent lending approach. I touched last year on the key factors which have prevented a dilution of capital

- No lending in sub-prime markets
- No lending without validating the customer's ability to repay
- No lending in areas in which we have no expertise.

However, following the interest rate reductions in early 2008, we faced the real challenge of balancing the interests of our savers and borrowers. We determined that it would not be equitable to match every movement in Bank of England Base Rate, since this would have penalised our savings members too heavily. It was also important that we continued to raise stable funding from the retail market to enable us to continue to lend.

The levies charged by the Financial Services Compensation Scheme on your Society to reimburse savers with failed banks – particularly Bradford and Bingley and the Icelandic banks – significantly affected our profitability in 2008. Despite the requirement for ongoing contributions to the scheme, our profits in 2009 have been very satisfactory, further strengthening our capital position. I am particularly pleased that we were able to achieve these results without cutting savings interest rates to unacceptable levels.

¹ Office for National Statistics

² Nationwide Building Society

**'...your Society
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Whilst we had every reason to believe that the lending policies we had adopted over recent years would stand us in good stead in an economic downturn, we are pleased to report that at the end of 2009 mortgage arrears continue to be at very low levels. Furthermore, no mortgaged properties have been taken into possession – indeed, it is almost four years since we had to take such tough action. Nonetheless, given that the economic outlook remains uncertain, we have increased our provision against the possibility of mortgage losses.

The year has seen the implementation of further regulation for the financial services industry, and we know that there is more to follow as the tripartite authorities seek to prevent the reoccurrence of the disastrous events of the last two years. These restrictions are inevitable, and they will add to the challenges already posed by the difficult economic conditions. However, I have no doubt that your Society will be able to continue to compete successfully in the financial services arena. That it will be able to is down to the effort of many people - the Executive team, the management and staff of the Society, my fellow directors and our business and professional partners. My thanks go to all of these people for their contribution to our success, and, of course, to our members for their business and continued confidence in Market Harborough Building Society.

David Baker

Chairman

18 February 2010

Chief Executive's Review

Looking back over 2009 reminds all of us of how troubled the economy was around 12 months ago. Your Society began 2009 somewhat cautious about how the turmoil in the financial sector would develop. As the year unfolded it became clear that a low interest rate environment was a long term prospect and that some stability would return. Nevertheless the economy remained frail for the whole of 2009 and the building society sector (and with it your Society) was dealt many new regulatory "cards" over the year. New standards for liquidity, a proposal for a comprehensive framework for societies and a more prescriptive "rule book" on lending were just a few of the developments.

It is a testament to my predecessors over the last 140 years that Market Harborough Building Society can take on such regulatory and economic challenges without having to make fundamental change to our business. Your Society's strong governance and prudent strategy means that the impact of such challenges has been less severe than on some other firms.

In 2009 we continued to win business through personal service and attractively priced products which made several appearances as national "best buys". Overall we had another successful year of progress with a post-tax profit of just over £1m.

SAVINGS

The historically low level of Bank of England Base Rate (0.5% since March 5th 2009) has created a focus on savers' rates. We are very conscious of the importance of savings for our customers and as a result acted to protect savings rates for loyal members. This route was taken rather than operating a "two tier" model like some competitors under which unsustainably high rates on new products are run alongside very low rates for other accounts. As a result, we have seen a net inflow into a number of well established account types including instant access, our LOROS and Cransley Hospice affinity accounts as well as our online accounts.

Retail savers account for 85% of your Society's funding and we are committed to serving both the local and selected national markets.

MORTGAGES

The subdued housing market has meant net lending for the sector overall has been negative. Although at the time of writing final market data is not yet available, your Society's market share has held up well. Our approach has allowed us to bring attractive products quickly to the market. Without compromising quality we met strong demand early in 2009 for fixed rates and, in the final quarter, for discount mortgages. In the year new gross lending was £61.2m resulting in a modest reduction in mortgage assets of £6.4m – roughly equivalent to an average of one typical new mortgage a week. Our offset products were increasingly utilised by customers as a means of making their savings work harder for them.

It may be worth stating again that your Society has no exposure to self certified or sub prime mortgages. All loans are underwritten by experienced professionals drawing on extensive experience and supported by technology.

'we continued to win business through personal service and attractively priced products'



We see no particular problems with the loans in our mortgage book and so continue to have no specific provision for bad debts. At the end of 2009 there were no mortgages 12 months or more in arrears. I am delighted to report that our lending decisions have meant we have not repossessed a single home since 2006. However, as you might expect, we are prudently increasing our general provision to reflect the continuing economic uncertainty which affects all those who operate in our market.

OTHER FINANCIAL NEEDS

We complement our savings and mortgage ranges by working with carefully selected partners who can provide relevant and good quality products. In 2009 a record number of customers chose bonds offering longer term investment. In addition, we hosted several well attended seminars on the topic of making the most of your savings.

FINANCIAL SERVICES COMPENSATION SCHEME LEVY

We highlighted the impact of this levy last year when we made a provision of £365,000 representing the Society's share of the cost of bailing out the collapsed banks. For 2009, because of the way the levies are accounted for, the charge is much less (£70,000). However, this cost has not gone away and it will continue to weigh very heavily on all building societies, probably for many years to come. This unwelcome cost is explained in more detail in note 21 of the full Report and Accounts.

CAPITAL

The Society has always taken a prudent view on capital and carries out stress tests to ensure we steer a course that maintains a solid capital base. Our approach this year has been to further strengthen capital through building reserves. As a result our capital has grown by £0.60m and our Gross Capital Ratio has improved to 6.93% (2008: 6.61%).

Chief Executive's Review (continued)

ON THE HIGH STREET

Following the refurbishment of our Kettering office we redesigned our Market Harborough branch in 2009. Our building in Market Harborough is one of the most prominent in the town and we have, whilst keeping its character, upgraded the interior to create a more welcoming branch with comfortable private meeting rooms in which to speak with customers. The result is a brighter and friendlier place to do business. We were also able to create an "Art Wall" which features frequently changing exhibitions from local artists.

IN THE COMMUNITY

We support staff who want to help local good causes by offering time off. In 2009 our people worked with many charities giving their time and helping fund raise throughout our operating area. Your Society also supported awards for both local sporting and unsung heroes. Pride of place in our Market Harborough branch has gone to a collage of our Head Office building created by artists from the local Roman Way Day Centre.

Your Society also made a contribution of £12,000 to its associated Charitable Foundation, and gave £4,000 and £1,500 respectively to its hospice affinity partners, LOROS and Cransley.

OUTLOOK

The economic outlook is for a continuation of the subdued prospects for employment and housing market volumes. Nonetheless the Society sees opportunities to achieve success through its focus on friendly, professional service combined with attractive products. In 2010 we will update our brand whilst respecting our roots.

Constraints on funding are likely to emerge in 2010 as the industry's biggest challenge and our strategy will be to maintain our approach of offering good long term value to our savers. However, intense competition for mortgage business will continue to be a feature of the industry despite the reduction in both the number of lenders and the range of product choice. Our healthy position on asset quality gives your Society strength to compete in both the mortgage and savings markets. We will therefore remain true to doing what we best understand whilst updating and innovating to reflect and anticipate customer needs. We are not a bank and so, in contrast, work only for our members – in doing so we will unapologetically hold to our traditional values.

Mark Robinson

Chief Executive

18 February 2010

Directors' Report

Your directors have pleasure in presenting their annual report for the year ended 31 December 2009.

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 first-class service to members.

REVIEW OF THE YEAR

A review of the Society's business performance during 2009 is included in the Chairman's Statement on pages 1 and 2 and the Chief Executive's Review on pages 3 to 5.

Key Performance Indicators

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

	2009 ¹	2008 ²	2007
Total assets	£417.33m	£426.08m	£418.89m
(Reduction)/growth in mortgage assets	(1.94%)	(1.12%)	6.57%
Net (decrease)/increase in retail share balances	(£6.12m)	£9.53m	£7.49m
Management expenses as a percentage of mean total assets	1.04%	0.99%	0.98%
Post-tax profit	£1.01m	£0.50m	£1.12m
Profit as a percentage of mean total assets	0.24%	0.12%	0.27%
Net interest receivable as a percentage of mean total assets	1.31%	1.13%	1.25%
Gross capital as a percentage of shares and borrowings	6.93%	6.61%	6.71%
Free capital as a percentage of shares and borrowings	6.58%	6.23%	6.30%

For a definition of terms see Annual Business Statement on page 38.

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.

² The post-tax profit for 2008 is after a charge of £0.36m in respect of the Society's liability to the Financial Services Compensation Scheme. If this is excluded the post-tax profit would have been £0.76m. The corresponding charge for 2009 is £0.07m. If this is excluded the post-tax profit for 2009 would have been £1.06m.

Directors' Report (continued)

DIRECTORS

Board Composition

As at 31 December 2009 the Board comprised six 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

Charles R Heaton (until 23 April 2009)

Nicholas J Johnston (from 1 August 2009)

Kenneth S Piggott

Kerry M Spooner

David P Woodward

On 1 January 2010 the Board appointed Melanie K Duke as an additional non-executive director.

Executive Directors

Mark T Robinson - Chief Executive

Michael W Parrott - Deputy Chief Executive and Finance Director

Paul E Beardsmore - General Manager (Compliance) and Secretary (until 28 February 2009)

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 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 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, with effect from 1 January 2008, has required 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 1 at 31 December 2009 (31 December 2008 : 8).

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

18 February 2010

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 Combined Code on Corporate Governance, in so far as this code applies to a mutual organisation, save that it has not appointed a Senior Independent Director, as provided for by the Code, since it believes that there are already sufficient channels through which members can contact the Society and resolve problems.

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 Combined Code on Corporate Governance.

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 does not have other business commitments which might prevent 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.

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, both statutory and voluntary.

The Assets & Liabilities Committee meets monthly, under the Chairmanship of John Hatcher. Its other members are David Baker, Kenneth Piggott, Nicholas Johnston, Mark Robinson and Michael Parrott. Melanie Duke joined this Committee in January 2010. 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)	-	13 (14)	-	3 (3)
John Hatcher	9 (9)	6 (6)	14 (14)	-	3 (3)
Charles Heaton	3 (3)	2 (2)	-	1 (1)	-
Nicholas Johnston	4 (4)	-	3 (3)	-	-
Kenneth Piggott	9 (9)	-	12 (14)	1 (1)	-
Kerry Spooner	9 (9)	5 (6)	-	2 (2)	3 (3)
David Woodward	8 (9)	4 (4)	11 (11)	2 (2)	-
Mark Robinson	9 (9)	-	14 (14)	-	-
Michael Parrott	9 (9)	-	14 (14)	-	-
Paul Beardsmore	2 (2)	-	-	-	-

() = number of meetings eligible to attend.

Corporate Governance Report (continued)

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

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

18 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 contractual benefits of the executive directors, and makes recommendations to the Board concerning the remuneration of non-executive directors. In making these decisions the Committee reviews comparative benefit packages from similar financial organisations and takes into account the need to recruit, retain and motivate directors with appropriate skills and experience to make an effective contribution to the Society's strategy and operations. The provisions of the Combined Code on Corporate Governance are, in so far as they relate to building societies, taken into account when reviewing and determining directors' remuneration.

EXECUTIVE DIRECTORS

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. These targets are determined annually by the Remuneration Committee at the beginning of the financial year. The rewards for 2009 were based on achievement against benchmarks for growth, control of costs and income generation.

Medium Term Performance Bonus

Medium term bonuses are payable annually with effect from 2009, based on performance over the previous three-year period. Targets for each new three-year scheme are determined by the Remuneration Committee at the commencement of the period to which the scheme relates. They include 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 medium term schemes the Remuneration Committee will have regard to the goals set by the Board in the Society's Corporate Plan.

Directors' Remuneration Report (continued)

EXECUTIVE DIRECTORS (CONTINUED)

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.

NON-EXECUTIVE DIRECTORS

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 2009 are given in note 6 to the accounts.

On behalf of the Board of Directors:

K M Spooner

Chairman of Remuneration Committee

18 February 2010

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 15, 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

18 February 2010

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 2009 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. These annual accounts have been prepared under the accounting policies set out on pages 20 and 21.

We have examined the annual business statement on pages 38 to 40 (other than the details of directors and officers upon which we are not required to report) and the directors' report on pages 6 to 8.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The directors' responsibilities for the preparation of the annual report, including the annual accounts, the corporate governance report, the directors' remuneration report, the annual business statement and the directors' report in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the statement of directors' responsibilities.

Our responsibility is to audit the annual accounts in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). 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.

We report to you our opinion as to whether the annual accounts give a true and fair view and whether the annual accounts have been properly prepared in accordance with the Building Societies Act 1986 and regulations made under it. We also report to you our opinion as to whether certain information included within the annual business statement gives a true representation of the matters in respect of which it is given, whether the information in the directors' report is consistent with the accounting records and the annual accounts, and whether the annual business statement and the directors' report have been prepared in accordance with the applicable requirements of the Building Societies Act 1986 and regulations made under it. We also report to you if, in our opinion, the annual accounts are not in agreement with the accounting records, or if we have not received all the information and explanations we require for our audit.

We read the other information contained in the annual report and consider whether it is consistent with the audited annual accounts. The other information comprises the annual business statement, the directors' report, the corporate governance report, the directors' remuneration report and all of the other information listed on the contents page. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the annual accounts, the annual business statement, the chairman's statement, the chief executive's review or the directors' report. Our responsibilities do not extend to any other information.

BASIS OF AUDIT OPINION

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the annual accounts and the annual business statement. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the annual accounts, and of whether the accounting policies are appropriate to the Group's and Society's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the annual accounts are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the annual accounts.

OPINION

In our opinion:

- a) 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 2009 and of the Group's and the Society's income and expenditure and the Group's cash flows for the year then ended;
- b) 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;
- c) the information given in the directors' report is consistent with the accounting records and the annual accounts; and
- d) the annual accounts, the annual business statement and the directors' report have each been prepared in accordance with the applicable requirements of the Building Societies Act 1986 and regulations made under it.

Andrew Mair (Senior Statutory Auditor)

For and on behalf of PricewaterhouseCoopers LLP

Chartered Accountants and Statutory Auditors

Birmingham

18 February 2010

Income and Expenditure Account for the year ended 31 December 2009

	Notes	Group 2009 £000	Group 2008 £000	Society 2009 £000	Society 2008 £000
Interest receivable and similar income	2	12,967	23,126	12,863	23,021
Interest payable and similar charges	3	(7,445)	(18,331)	(7,445)	(18,331)
Net interest receivable		5,522	4,795	5,418	4,690
Fees and commissions receivable		929	718	924	714
Fees and commissions payable		(247)	(179)	(247)	(179)
Other operating income		57	56	57	56
Total income		6,261	5,390	6,152	5,281
Administrative expenses:					
Excluding past service costs in respect of the pension scheme		(3,888)	(3,769)	(3,851)	(3,732)
Pension scheme past service cost adjustment		(200)	-	(200)	-
	4	(4,088)	(3,769)	(4,051)	(3,732)
Depreciation and amortisation	14	(292)	(403)	(292)	(403)
Other operating charges	7	(170)	(164)	(170)	(164)
Financial Services Compensation Scheme Levy	21	(70)	(365)	(70)	(365)
Operating profit		1,641	689	1,569	617
Provisions for bad and doubtful debts	8	(238)	(45)	(238)	(45)
Other finance (cost) / income	25	(13)	52	(13)	52
Profit on ordinary activities before tax		1,390	696	1,318	624
Tax on profit on ordinary activities	9	(384)	(195)	(369)	(180)
Profit for the financial year	20	1,006	501	949	444

The notes on pages 20 to 37 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 2009

	Notes	Group 2009 £000	Group 2008 £000	Society 2009 £000	Society 2008 £000
Profit for the financial year		1,006	501	949	444
Actuarial loss recognised in the pension scheme	25	(561)	(612)	(561)	(612)
Movement in deferred tax relating to the pension scheme		157	171	157	171
Total recognised gains in the year	20	602	60	545	3

Balance Sheet

as at 31 December 2009

ASSETS	Notes	Group 2009 £000	Group 2008 £000	Society 2009 £000	Society 2008 £000
Liquid assets:					
Cash in hand		352	319	352	319
Loans and advances to credit institutions	10	48,331	52,484	48,249	52,416
Debt securities	11	44,550	42,950	44,550	42,950
		<u>93,233</u>	<u>95,753</u>	<u>93,151</u>	<u>95,685</u>
Loans and advances to customers:					
	12				
Loans fully secured on residential property		320,315	326,536	317,744	323,088
Other loans fully secured on land		1,214	1,362	1,214	1,362
Other loans		-	-	1,557	2,480
		<u>321,529</u>	<u>327,898</u>	<u>320,515</u>	<u>326,930</u>
Tangible fixed assets	14	1,844	1,748	1,844	1,748
Other assets	15	388	362	381	355
Prepayments and accrued income		334	323	334	323
TOTAL ASSETS		<u>417,328</u>	<u>426,084</u>	<u>416,225</u>	<u>425,041</u>
LIABILITIES					
Shares	16	328,448	334,564	328,448	334,564
Amounts owed to credit institutions	17	50,661	43,114	50,661	43,114
Amounts owed to other customers	18	9,169	20,159	9,169	20,159
Other liabilities	19	556	838	540	824
Accruals		630	346	629	346
Net pension liability	25	661	394	661	394
Provisions for liabilities and charges	21	297	365	297	365
		<u>390,422</u>	<u>399,780</u>	<u>390,405</u>	<u>399,766</u>
General reserve	20	26,906	26,304	25,820	25,275
TOTAL LIABILITIES		<u>417,328</u>	<u>426,084</u>	<u>416,225</u>	<u>425,041</u>

The notes on pages 20 to 37 form part of these accounts.

Approved by the Board of Directors on 18 February 2010, 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 2009

	2009 £000	2008 £000
Net cash inflow from operating activities	721	19,055
Taxation	(372)	(316)
Capital Expenditure:		
Purchase of tangible fixed assets	(389)	(417)
Disposal of tangible fixed assets	2	22
Financial Investment:		
Increase in investment in debt securities (note 11)	(1,877)	(11,944)
(Decrease)/increase in cash	<u>(1,915)</u>	<u>6,400</u>
Reconciliation of operating profit before tax to net cash inflow from operating activities		
Profit on ordinary activities before tax	1,390	696
(Increase) / decrease in prepayments and accrued income	(11)	8
Decrease in accruals	(3,089)	(99)
Depreciation and amortisation	292	403
Profit on sale of fixed assets	(1)	(21)
Net cash (outflow) / inflow from operating activities	<u>(1,419)</u>	<u>987</u>
Decrease in loans and advances to customers	6,124	3,623
(Decrease) / increase in shares	(3,077)	9,629
Decrease in deposits and other borrowings	(3,109)	(3,029)
Decrease in loans and advances to credit institutions	2,000	7,500
Decrease in other assets	522	73
Decrease in other liabilities	(307)	(121)
(Decrease) / increase in provisions for liabilities and charges	(68)	365
Increase in provisions for bad and doubtful debts	245	80
Contributions to final salary pension scheme	(438)	(32)
Charge / (credit) in respect of final salary pension scheme	248	(20)
Net cash inflow from operating activities	<u>721</u>	<u>19,055</u>

	1 Jan 2009 £000	Net decrease £000	31 Dec 2009 £000
Analysis of (decrease) / increase in cash			
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>
	1 Jan 2008 £000	Net increase £000	31 Dec 2008 £000
Cash in hand	296	23	319
Loans and advances to credit institutions repayable on demand	9,337	6,377	15,714
	<u>9,633</u>	<u>6,400</u>	<u>16,033</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 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.

Notes to the Accounts (continued)

1. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

Provisions for bad and doubtful debts (continued)

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 2009 £000	Group 2008 £000	Society 2009 £000	Society 2008 £000
On loans fully secured on residential property	13,337	18,178	13,192	17,938
On other loans:				
To connected undertakings	-	-	41	135
To others	70	91	70	91
On debt securities	547	2,115	547	2,115
On other liquid assets	682	2,530	682	2,530
Net (expense) / income on derivative instruments	(1,669)	212	(1,669)	212
	12,967	23,126	12,863	23,021

No interest was suspended in 2009 in respect of properties in possession (2008: £nil).

3. INTEREST PAYABLE AND SIMILAR CHARGES

	Group & Society	
	2009 £000	2008 £000
On shares held by individuals	6,978	14,053
On deposits and other borrowings	1,133	4,161
Net (income)/expense on derivative instruments	(666)	117
	7,445	18,331

4. ADMINISTRATIVE EXPENSES

	Group 2009 £000	Group 2008 £000	Society 2009 £000	Society 2008 £000
Staff costs (note 5)	2,397	2,179	2,397	2,179
Remuneration of external auditors:				
for audit work	39	39	38	38
for non-audit work	-	-	-	-
Operating lease charges - land and buildings	110	112	110	112
Other administrative expenses	1,542	1,439	1,506	1,403
	4,088	3,769	4,051	3,732

5. STAFF NUMBERS AND COSTS

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

	2009 Full Time	2009 Part Time	2009 Total	2008 Full Time	2008 Part Time	2008 Total
Head office	39	21	60	49	15	64
Branch offices	5	22	27	6	20	26
	44	43	87	55	35	90

The aggregate costs of these persons were as follows:

	Group & Society	
	2009 £000	2008 £000
Wages and salaries	1,881	1,856
Social security costs	197	190
Pension costs:		
Contributions to defined contribution arrangements	84	101
Other pension costs relating to defined benefit scheme (note 25):		
Current service cost	35	32
Past service cost	200	-
	2,397	2,179

Staff costs in 2008 include £124,230 in respect of restructuring.

Notes to the Accounts (continued)

6. DIRECTORS' EMOLUMENTS AND TRANSACTIONS

2009	Salary/ Fees £	Benefits £	Performance Pay Annual Incentive Scheme £	Performance Pay Medium 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 - appointed 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>

2008	Salary/ Fees £	Benefits £	Performance Pay Annual Incentive Scheme £	Performance Pay Medium Term Incentive Scheme £	Total £	Pension Contributions £
David W Baker - as Chairman	27,933	-	-	-	27,933	-
John G Hatcher - as Vice-Chairman	20,912	-	-	-	20,912	-
Paul E Beardsmore	65,530	6,292	5,189	-	77,011	6,389
Charles R Heaton	17,250	-	-	-	17,250	-
Michael W Parrott	82,450	7,970	6,528	-	96,948	8,039
Kenneth S Piggott - appointed 1 March	13,958	-	-	-	13,958	-
Mark T Robinson	122,000	11,372	9,660	-	143,032	7,930
Michael J Smith - until 29 February	2,792	-	-	-	2,792	-
Kerry M Spooner	16,750	-	-	-	16,750	-
David P Woodward	16,750	-	-	-	16,750	-
Pension to former director	1,948	-	-	-	1,948	-
	<u>388,273</u>	<u>25,634</u>	<u>21,377</u>	<u>-</u>	<u>435,284</u>	<u>22,358</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 medium term scheme introduced in 2007, 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. The maximum bonus payable per annum under the medium term scheme is 20% of basic pay.

Directors' loans and transactions

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

A total of £272,550 (2008: £297,742) was outstanding at the year end on mortgage loans granted in the ordinary course of business to 4 (2008: 4) 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 29 April 2010.

7. OTHER OPERATING CHARGES

	Group & Society	
	2009 £000	2008 £000
Incentives to borrowers	158	152
Other	12	12
	<u>170</u>	<u>164</u>

8. PROVISIONS FOR BAD AND DOUBTFUL DEBTS

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

	Loans secured on residential property		
	General £000	Specific £000	Total £000
Group			
At 1 January 2009	240	-	240
Income and expenditure account	245	(7)	238
Amounts written off during year	-	(5)	(5)
Adjustments resulting from recoveries	-	12	12
At 31 December 2009	<u>485</u>	<u>-</u>	<u>485</u>
Society			
At 1 January 2009	205	-	205
Income and expenditure account	245	(7)	238
Amounts written off during year	-	(5)	(5)
Adjustments resulting from recoveries	-	12	12
At 31 December 2009	<u>450</u>	<u>-</u>	<u>450</u>

Notes to the Accounts (continued)

9. TAX ON PROFIT ON ORDINARY ACTIVITIES

	Group 2009 £000	Group 2008 £000	Society 2009 £000	Society 2008 £000
The taxation charge for the year comprises:				
United Kingdom corporation tax:				
Current year	397	306	382	291
Deferred tax:				
Origination and reversal of timing differences (note 15)	(66)	(126)	(66)	(126)
Other timing differences relating to pension scheme	53	15	53	15
	<u>384</u>	<u>195</u>	<u>369</u>	<u>180</u>
Factors affecting the tax charge for the year:				
Profit on ordinary activities before tax	1,390	696	1,318	624
Current tax at 28% (2008: 30% to 31 March and 28% from 1 April)	389	199	369	178
Effects of:				
Depreciation in excess of capital allowances	(17)	-	(17)	-
Capital allowances in excess of depreciation	-	5	-	5
Other timing differences	30	108	30	108
Marginal relief	(5)	(6)	-	-
Current tax charge for the year	<u>397</u>	<u>306</u>	<u>382</u>	<u>291</u>

Based on current capital investment plans there are no significant factors that will affect the tax charge in future years.

10. LOANS AND ADVANCES TO CREDIT INSTITUTIONS

	Group 2009 £000	Group 2008 £000	Society 2009 £000	Society 2008 £000
Loans and advances to credit institutions have remaining maturities as follows:				
Accrued interest	65	270	65	270
Repayable on demand	13,766	15,714	13,684	15,646
In not more than three months	33,500	36,500	33,500	36,500
In more than three months but not more than one year	1,000	-	1,000	-
	<u>48,331</u>	<u>52,484</u>	<u>48,249</u>	<u>52,416</u>

11. DEBT SECURITIES

	Group & Society	
	2009 £000	2008 £000
Debt securities, all of which are unlisted, have remaining maturities as follows:		
Accrued interest	29	306
In not more than one year	<u>44,521</u>	<u>42,644</u>
	<u>44,550</u>	<u>42,950</u>
Analysis of debt securities:		
Issued by borrowers other than public bodies	<u>44,550</u>	<u>42,950</u>

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

Movements during the year of debt securities held as financial fixed assets are as follows (excluding accrued interest):

	£000
At 1 January 2009	42,644
Additions	196,600
Disposals	<u>(194,723)</u>
At 31 December 2009	<u>44,521</u>

12. LOANS AND ADVANCES TO CUSTOMERS

	Group 2009 £000	Group 2008 £000	Society 2009 £000	Society 2008 £000
The remaining maturity of loans and advances to customers is as follows:				
Repayable on demand	1,318	1,071	1,151	1,021
In not more than three months	2,894	2,820	2,886	2,812
In more than three months but not more than one year	9,750	10,240	9,641	10,091
In more than one year but not more than five years	66,724	63,742	66,156	63,238
In more than five years	241,328	250,265	241,131	249,973
General and specific provisions for bad and doubtful debts (note 8)	<u>(485)</u>	<u>(240)</u>	<u>(450)</u>	<u>(205)</u>
	<u>321,529</u>	<u>327,898</u>	<u>320,515</u>	<u>326,930</u>

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

	Society	
	2009 £000	2008 £000
Included in loans and advances to customers are amounts due from Market Harborough Mortgages Limited of:	<u>1,557</u>	<u>2,480</u>

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 (2008: £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.

Notes to the Accounts (continued)

14. TANGIBLE FIXED ASSETS

	Freehold Property £000	Leasehold Property £000	Equipment Fixtures and Fittings £000	Motor Vehicles £000	Total £000
Cost					
At 1 January 2009	1,093	73	4,793	129	6,088
Additions	42	-	329	18	389
Disposals	-	-	(102)	(15)	(117)
At 31 December 2009	<u>1,135</u>	<u>73</u>	<u>5,020</u>	<u>132</u>	<u>6,360</u>
Depreciation					
At 1 January 2009	-	73	4,212	55	4,340
Charged in year	-	-	269	23	292
Disposals during year	-	-	(101)	(15)	(116)
At 31 December 2009	<u>-</u>	<u>73</u>	<u>4,380</u>	<u>63</u>	<u>4,516</u>
Net book value					
At 31 December 2009	<u>1,135</u>	<u>-</u>	<u>640</u>	<u>69</u>	<u>1,844</u>
At 31 December 2008	<u>1,093</u>	<u>-</u>	<u>581</u>	<u>74</u>	<u>1,748</u>

15. OTHER ASSETS

	Group 2009 £000	Group 2008 £000	Society 2009 £000	Society 2008 £000
Due within one year:				
Deferred tax	378	312	371	305
Other debtors	10	50	10	50
	<u>388</u>	<u>362</u>	<u>381</u>	<u>355</u>

The deferred tax asset recognised in the accounts is as follows:

	Group 2009 £000	Group 2008 £000	Society 2009 £000	Society 2008 £000
Tax effect of timing differences in relation to:				
Excess of depreciation over capital allowances	102	119	102	119
General provisions	133	64	126	57
Other	143	129	143	129
	<u>378</u>	<u>312</u>	<u>371</u>	<u>305</u>

16. SHARES

	Group & Society	
	2009 £000	2008 £000
Held by individuals	328,440	334,556
Other shares	8	8
	<u>328,448</u>	<u>334,564</u>
Repayable from the balance sheet date in the ordinary course of business as follows:		
Accrued interest	1,908	4,947
Repayable on demand	128,458	121,530
In not more than three months	167,701	166,147
In more than three months but not more than one year	23,910	40,508
In more than one year but not more than five years	6,471	1,432
	<u>328,448</u>	<u>334,564</u>

17. AMOUNTS OWED TO CREDIT INSTITUTIONS

	Group & Society	
	2009 £000	2008 £000
Repayable from the balance sheet date in the ordinary course of business as follows:		
Accrued interest	161	314
In not more than three months	38,000	28,550
In more than three months but not more than one year	12,500	12,500
In more than one year but not more than five years	-	1,750
	<u>50,661</u>	<u>43,114</u>

18. AMOUNTS OWED TO OTHER CUSTOMERS

	Group & Society	
	2009 £000	2008 £000
Repayable from the balance sheet date in the ordinary course of business as follows:		
Accrued interest	20	201
Repayable on demand	849	808
In not more than three months	8,300	12,650
In more than three months but not more than one year	-	5,500
In more than one year but not more than five years	-	1,000
	<u>9,169</u>	<u>20,159</u>

Notes to the Accounts (continued)

19. OTHER LIABILITIES

	Group 2009 £000	Group 2008 £000	Society 2009 £000	Society 2008 £000
Amounts falling due within one year:				
Income tax	210	523	210	523
Corporation tax	191	166	176	154
Other taxation and social security	91	71	91	71
Other creditors	64	78	63	76
	556	838	540	824

20. GENERAL RESERVE

	Group 2009 £000	Group 2008 £000	Society 2009 £000	Society 2008 £000
At 1 January	26,304	26,244	25,275	25,272
Net movement in actuarial loss recognised in pension scheme	(404)	(441)	(404)	(441)
Profit for the financial year	1,006	501	949	444
At 31 December	26,906	26,304	25,820	25,275

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 September 2008 a claim was triggered against the FSCS by the transfer of Bradford and Bingley plc's retail deposit business to Abbey National plc and in October 2008 claims were triggered 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 further claim was triggered in November 2008 by London Scottish Bank plc.

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 2008 results the Society recognised provisions for levies of £142,000 for the scheme year 2008/09 and £223,000 for the scheme year 2009/10 using information provided in notifications from the FSA. The FSA has now notified deposit takers that there is an additional levy in respect of the scheme year 2008/09 and has revised downwards its estimates for the management expenses levy for 2009/10. For Market Harborough Building Society this results in an increase in the amount provided for the 2008/09 levy of £8,000 and a reduction in the amount provided for the 2009/10 levy of £105,000.

Based on notifications that it has received from the FSA and the Society's market share of Protected Deposits as at 31 December 2009, it is estimated that the Society will be liable for levies totalling £167,000 in respect of the scheme year 2010/11 and this amount has been recognised in the 2009 results. Using the same data it is estimated that the Society will be liable for further levies totalling £221,000 in respect of the scheme year 2011/12, and this will be recognised in the 2010 results. At the date of signing of these accounts there is uncertainty over the amounts provided in respect of both the 2009/10 and 2010/11 scheme years as the years run to 31 March 2010 and 31 March 2011 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.

Financial Services Compensation Scheme levy

	£000
At 1 January 2009	365
Charge for the year	70
Paid in the year	(138)
At 31 December 2009	<u>297</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	
	2009 £000	2008 £000
Capital expenditure that has been contracted for but has not been provided for in the accounts	<u>79</u>	<u>63</u>

Notes to the Accounts (continued)

21. GUARANTEES AND OTHER FINANCIAL COMMITMENTS (CONTINUED)

Operating lease commitments

Payments committed at the end of the year in respect of the next financial year for operating leases were as follows:

	Group & Society	
	2009 £000	2008 £000
Land and buildings:		
leases expiring in less than five years	69	70
leases expiring after five years	41	41
	<u>110</u>	<u>111</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.

	Group & Society	
	2009 £000	2008 £000
Unmatured financial instruments - interest rate contracts		
Notional principal amount	74,700	99,100
Credit risk weighted amount	10	126
Replacement cost	48	630

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 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.

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 was not affected by exposures to failed financial institutions. The approved list is reviewed every month by the Assets & Liabilities Committee.

Notes to the Accounts (continued)

24. FINANCIAL INSTRUMENTS (CONTINUED)

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 2009 was:

	Not more than 3 months £000	More than 3 months but not more than 6 months £000	More than 6 months but not more than 1 year £000	More than 1 year but not more than 5 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.

After taking into account the various derivatives entered into by the Group, the interest rate sensitivity exposure of the Group at 31 December 2008 was:

	Not more than 3 months £000	More than 3 months but not more than 6 months £000	More than 6 months but not more than 1 year £000	More than 1 year but not more than 5 years £000	Non interest-bearing £000	Total £000
Assets						
Liquid assets	94,858	-	-	-	895	95,753
Loans and advances to customers	277,253	9,087	29,889	11,669	-	327,898
Tangible fixed assets	-	-	-	-	1,748	1,748
Other assets	-	-	-	-	685	685
Total assets	372,111	9,087	29,889	11,669	3,328	426,084
Liabilities						
Shares	293,547	13,254	21,384	1,432	4,947	334,564
Deposits and other borrowings	59,258	2,000	1,500	-	515	63,273
Other liabilities	-	-	-	-	1,943	1,943
Reserves	-	-	-	-	26,304	26,304
Total liabilities	352,805	15,254	22,884	1,432	33,709	426,084
Off balance sheet items	19,350	250	(7,600)	(12,000)	-	-
Interest rate sensitivity gap	38,656	(5,917)	(595)	(1,763)	(30,381)	-

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.

Notes to the Accounts (continued)

24. FINANCIAL INSTRUMENTS (CONTINUED)

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 2009. 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 and debt securities held.

	Group & Society	
	2009 Book value £000	2009 Fair value £000
Financial assets and liabilities for which active markets exist:		
Debt securities	44,550	44,544
Off balance sheet instruments	(120)	(726)

Hedges

Unrecognised gains and losses on hedges at the balance sheet date were £52,000 (2008: £647,000) and £898,000 (2008: £1,350,000) respectively. These gains and losses represent the expected future benefit of interest rate hedges to the Group at 31 December 2009, 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. A triennial actuarial valuation carried out as at 6 April 2006 was updated to provide the information required by FRS 17 as at 31 December 2007 and 31 December 2008. A triennial valuation carried out as at 6 April 2009 was used to provide the information required as at 31 December 2009. Details are given below.

The major assumptions used by the actuary for the purposes of FRS 17 were:	2009	2008	2007
	%	%	%
Rate of increases to pensions in payment	3.60	2.70	3.40
Pensionable salary growth	4.10	3.20	3.90
Discount rate	5.80	6.50	5.90
Rate of inflation	3.60	2.70	3.40

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 2007 and 2008 in determining mortality before retirement are in accordance with mortality table AM92 for males and AF92 for females. The assumptions used in 2009 are in accordance with mortality tables 55% of AM92 for males and 55% of AF92 for females.

The assumptions used in 2007 and 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 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 expected at 31 December 2009		Long-term rate of return expected at 31 December 2008		Long-term rate of return expected at 31 December 2007	
	%	Value at 31 December 2009 £000	%	Value at 31 December 2008 £000	%	Value at 31 December 2007 £000
Equities	8.00	2,546	8.00	1,712	8.00	2,792
Bonds	5.50	2,130	5.50	1,982	5.50	1,890
Property	7.00	381	7.00	378	7.00	518
Cash	3.50	14	5.00	17	5.00	86
Total market value of assets		5,071		4,089		5,286
Present value of scheme liabilities		(5,989)		(4,636)		(5,273)
(Deficit) / surplus in the scheme		(918)		(547)		13
Related deferred tax asset / (liability)		257		153		(4)
Net pension (liability) / asset		(661)		(394)		9

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

	2009 £000	2008 £000
Reconciliation of present value of scheme liabilities		
1 January	4,636	5,273
Current service cost	35	32
Past service cost	200	-
Interest cost	296	310
Benefits paid	(340)	(189)
Actuarial loss / (gain)	1,162	(790)
31 December	5,989	4,636
Reconciliation of fair value of scheme assets		
1 January	4,089	5,286
Expected return on scheme assets	283	362
Actuarial gain / (loss)	601	(1,402)
Benefits paid	(340)	(189)
Contributions paid by employer	438	32
31 December	5,071	4,089

Notes to the Accounts (continued)

25. PENSIONS (CONTINUED)

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

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.

	2009 £000	2008 £000
Analysis of charge to operating profit		
Current service cost	(35)	(32)
Past service cost	(200)	-
Charge to operating profit	(235)	(32)

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.

	2009 £000	2008 £000
Analysis of other finance (cost) / income		
Expected return on pension scheme assets	283	362
Interest on pension scheme liabilities	(296)	(310)
Net other finance (cost) / income	(13)	52
Analysis of amount recognised in statement of recognised gains and losses		
Actual return less expected return on the pension scheme assets	601	(1,402)
Experience loss arising on the scheme liabilities	(41)	(13)
Change in assumptions underlying the present value of the scheme liabilities	(1,121)	803
Actuarial loss recognised in the statement of total recognised gains and losses	(561)	(612)

The annual actuarial report as at 6 April 2008 showed a deficit of £320,000. This was updated at the trustees' request to 24 October 2008, at which date, due to adverse market conditions, the deficit had increased to £951,000. It was agreed with the trustees that this deficit would be addressed by the Society making a single contribution of £250,000 in January 2009, followed by monthly contributions of £15,500 to eliminate the deficit over five years. The amount of the monthly contributions is to be re-visited in early 2010 using the results of the triennial valuation as at 6 April 2009.

Details of experience gains and losses for the year to 31 December	2009 £000	2008 £000	2007 £000	2006 £000	2005 £000
Experience gains and losses on scheme assets:					
Amount	601	(1,402)	(164)	36	338
Percentage of scheme assets	12%	-34%	-3%	1%	7%
Experience gains and losses arising on scheme liabilities:					
Amount	(41)	(13)	17	(11)	(50)
Percentage of scheme assets	1%	0%	0%	0%	-1%
Total amount recognised in statement of total recognised gains and losses:					
Amount	(561)	(612)	542	231	(138)
Percentage of the present value of scheme liabilities	-9%	-13%	10%	4%	-2%

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 2009

1. STATUTORY RATIOS AND PERCENTAGES

	Percentage as at 31 December 2009 %	Statutory Limit %
Lending limit Proportion of business assets other than in the form of loans fully secured on residential property	0.60	25
Funding limit Proportion of shares and borrowings other than in the form of shares held by individuals	15.41	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

	2009 %	2008 %
As a percentage of shares and borrowings:		
Gross capital	6.93	6.61
Free capital	6.58	6.23
Liquid assets	24.01	24.07
As a percentage of mean total assets:		
Profit after taxation	0.24	0.12
Management expenses	1.04	0.99

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 2009 and 2008 year end total assets.

Annual Business Statement for the year ended 31 December 2009 (continued)

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
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	Airlinks Airport Services Ltd Altram LRT Ltd Eurolines (UK) Ltd National Express Ltd National Express Operations (Stansted) Ltd National Express Operations Ltd National Express Rail Replacement Ltd Tayside Public Transport Co Ltd West Midlands Travel Ltd WM Property Holdings Ltd	18-Nov-62	01-Apr-07

The two executive directors are employed on contracts with a notice period of twelve months by the Society and six months by the executive director.

Documents may be served on any of the directors at the offices of PricewaterhouseCoopers LLP, Cornwall Court, 19 Cornwall Street, Birmingham, B3 2DT. Correspondence should be marked "Private and Confidential" and quote reference MHBS/AJM/SKJ.

4. OTHER SENIOR EXECUTIVES

Name	Occupation	Directorships
Paul E Beardsmore	Secretary	None
Elizabeth R Souter	Financial Controller	Mawsley Villagers Association
Paul Tilley	Head of Business Services and Compliance	None
Neil M Williams	Head of Information Technology	None
Nicholas J Williams	Head of Sales and Marketing	The Ellen MacArthur Trust

5. NEW ACTIVITIES

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

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Members of the Building Societies Association

Please note, calls may be recorded.

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Traditional values in a changing world