Caledonian Trust PLC

Directors’ report and financial statements
for the year ended 30 June 2009

Company Number 1040126

Caledonian Trust PLC

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Company information

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Caledonian Trust PLC

CHAIRMAN’S STATEMENT

YEAR ENDED 30 JUNE 2009

Introduction

The Group made a pre-tax profit £1,346,000 in the year to 30 June 2009 compared with a loss of £7,875,000 last year. Excluding investment property revaluations the Group made a trading loss of £71,000 compared with £714,000 last year. The profit per share was 11.33p and the NAV per share was 167.8p compared with 156.6p last year.

Income from rent, service charges and dilapidations was £731,000 compared with £842,000 last year. Rental income fell £143,000 due to the sale of investment property and the determination of leases in Young Street and 57 North Castle. Gains from the sales of properties were £560,000 compared with £105,000 last year. Other operating income was £254,000 after including the final settlement of £222,000 at St Magnus Aberdeen compared with £61,000 last year.

Net interest payable was £457,000, £177,000 less than last year due to lower borrowings and lower interest rates. The weighted average base rate for the year was 2.49% compared with 5.45 %.

Review of Activities

The Group's property activities have continued to be concentrated on enhancing the value of our development properties principally by working towards or gaining more valuable planning consents.

The Group's Edinburgh New Town investment portfolio has changed further this year. In 17 Young Street, adjacent to Charlotte Square, the tenants exercised their option to determine the lease in August 2008. We agreed a dilapidation payment and after marketing the property for office or residential use it was sold in July 2009 for £407,500, above the then valuation. We obtained planning and listed building consent to return the vacant Georgian ground and first floors of 61 North Castle Street to residential use and to incorporate the Edwardian extension to the rear of 61 North Castle Street into the existing office space in Hill Street. The Georgian property was sold in May 2009 for £475,000 and the balance of the property was valued at £625,000 in June 2009 giving a total value of £1.1m compared with £975,000 at June 2008.

57 North Castle Street, the adjacent building, was vacated by the City of Edinburgh Council in March 2008 and was subject to a dilapidations claim which was eventually settled by an Expert determination with costs against the tenants. Subsequently planning and listed building consent was granted to divide the property into two residential units, a ground and first floor townhouse and a basement flat. The town house was sold in September 2009 for £540,000 which, together with the current basement valuation of £275,000, is considerably above the June 2008 valuation of £675,000. Work has started on the reconversion of the basement into a two bedroom flat for sale in the Spring.

The Group's other New Town property, 9 South Charlotte Street, between Charlotte Square and Princes Street, is let to La Tasca for a further 17 years. In the improving investment market the lease length and the quality of the covenant make this an attractive investment. Early in 2009 we sold our last investment property in Aberdeen, a warehouse/office unit at Wellheads Road, Dyce, adjacent to the BP HQ, to the tenants for £50,000 over the recent revaluation.

St Margaret's House, London Road, is our largest property in Edinburgh, where we are pursuing different short and long-term objectives. The building is wholly let on peppercorn short-term lets to charitable causes. In April we let almost all the car parking spaces to our neighbours, the Registrars of Scotland, on a short-term lease. We have made considerable progress towards our long-term objective for a large-scale redevelopment. In June 2007 our Architects produced an "Urban Analysis Report" and in July 2007 Draft Development Proposals from which the City of Edinburgh Council suggested that a Development Brief be prepared covering St Margaret's, the adjacent 125,000ft^2 Meadowbank House, owned and occupied by the Registrars of Scotland, and all the smaller varied properties lying between the A1 and "Smokey Brae". The preparation of this "Brief" involved considerable time and preparation including six community consultations over three months! The Development Brief was adopted by the City of Edinburgh Council in August 2009, so providing a "Master Plan" for the whole area. In July 2009 we lodged an application for outline consent for a 225,000ft^2 mixed use development of residential and/or student accommodation, an hotel and commercial space. This proposal is now the subject of detailed discussion between the Council and our Architects, and should be finalised next year.

Considerable progress has been made in our large development sites at Waterloo, London SE1. Last year we attempted to negotiate with Lambeth Council to purchase the contiguous garage site owned by them or to enter into an agreement with them to our mutual benefit by realising the considerable marriage value. Agreement has not been reached but the opportunity remains. We are promoting smaller schemes within our own site. One scheme provides 140 rooms for student accommodation together with 1,152ft^2 retail accommodation in the ground floor on our site only, but is capable of extension into the garage site. There are 250,000 full time students in London where student rents increased by 10% in 2008/09 and numbers and rents are expected to continue to rise.

In Glasgow, on the south side of the Clyde opposite the Broomielaw, now connected by an attractive modern pedestrian bridge, we own 100 West Street, Tradeston, currently a bespoke car showroom let to the Eastern Western Group. The May 2006 review was settled this year at £213,000, an uplift of 21.8%. Tradeston and the surrounding district is benefiting from an extensive improvement programme, including the demolition or conversion of several Victorian industrial warehouses and the development of the pedestrian bridge and its landscaped boulevard. As well as amenity improvements, vehicular access will be greatly improved when the extension of the M74 through Tradeston to meet the existing nearby M8 at the Kingston Bridge is completed in 2011, the date of the next review. That review is subject to a minimum uplift of 16% without any consideration for the prospective improvement in the location. The current valuation is based on the passing rent and the high investment yields extant in June and places no value on our existing consent for a development of 191 flats, predominantly two and three bedrooms, together with dedicated parking and 10,000ft^2 of commercial space.

In Tradeston we also own a small secondary shopping parade at 1-7 Scotland Street purchased in January 2005 in the expectation that the area would improve as the changes outlined in Tradeston above were realised. Once the M74 is completed, the disruption ended and access is improved the area will become "less secondary" and the rents reversionary.

We have three development sites in or near Edinburgh on which we decided in 2007 to delay development because of the worsening economic conditions. In Belford Road, Edinburgh, a quiet cul-de-sac, less than 500m from Charlotte Square and the West End of Princes Street we have a long-standing office consent for 22,500ft^2 and 14 cars which has been technically "commenced". We also have a separate residential consent for 20,000ft^2 and 20 cars. Even in the present depressed residential market a residential development is more valuable than an office development, as prices of £350 to £450/ft^2 were achieved in the area during the particularly depressed first half of 2009. We will seek to improve the existing residential consent and to redesign the structure to simplify construction and to increase the space. In August 2006, five years after the original application, consent was granted for eight detached houses at Wallyford which borders Musselburgh and is within 400 yards of the East Coast mainline station near the A1/A720 City Bypass junction, contiguous to a development of 250 houses by two national house builders which is over 90% complete. In Wallyford we consider that the market for smaller houses has improved relative to larger houses and we have lodged an application to replace the two largest detached houses with a terrace of four, providing ten houses altogether with a larger saleable area. In East Edinburgh at Brunstane Farm, adjacent to Brunstane rail station, we hold a consent to reconstruct an existing cottage attached to the farm steading and to convert the steading into nine houses of various sizes totalling 14,000ft^2 altogether. Beyond this steading lies another detached stone building on which consent was granted in May 2009 for conversion to a detached house extending to 3,500ft^2 on open ground with views to the Forth estuary. We expect to install French windows in the existing five two-storey stone farm cottages to improve their southern aspect.

Brunstane is in the Green Belt from which we made three separate unsuccessful applications for abstraction. However, once the redevelopment is complete and a large area to the South recently abstracted from the Green Belt is developed, a reassessment of the existing Green Belt boundaries, including two-and-a-half acres of scrubland which we own contiguous with Brunstane steading, is possible. Any abstraction from the Green Belt would be very valuable.

The Company owns 15 separate rural development opportunities, 9 in Perthshire, 3 in Fife, 2 in Argyll & Bute and 1 in East Dunbartonshire, almost all in accessible locations set in areas of high amenity. Unsurprisingly, proposals for any change there meet local opposition, usually vocal and often well co-ordinated. The new requirement to be outside the 1 in 200 year flood plan (i.e. 0.05% chance of flooding) can eliminate sites that pass all other tests. Small sites are by definition less financially rewarding to local authorities and less important in achieving their housing targets and support and priority in treatment from planning authorities is often "patchy". The elected members of the planning committees now gain their seats on the council by proportional representation and are much more influenced by individual constituents' concerns than previously. Thus the process of gaining planning consent for small well-located developments has become much more tortuous and in some cases the scale of development had been restricted beyond what in many cases originally seemed appropriate and reasonable. Paradoxically, the more tortuous the process becomes, the more restricted the permissions are, the more the overall supply is restricted, and the more valuable the reduced consents become.

In spite of all these difficulties I am pleased to report that considerable success has now been achieved in our planning applications. At Ardonachie Farm steading, near Perth, after extensive and detailed discussion with the planning authority, we submitted a planning application for sixteen houses over 20,000ft^2. However, due to policy changes, we resubmitted an application for ten houses over 16,429ft^2, including a new "farmhouse", in June 2008 which was approved in February 2009. At Tomperran, a smallholding set in Comrie, where we submitted an application for twelve houses over 19,047ft^2 in November 2007, we were required to change the proposed layout again, having previously adjusted it to accommodate a cycle path requested by the Council, which was approved in July 2009. The smallholding includes two acres zoned for industrial use and about 34 acres adjacent to the settlement, a proportion of which will be promoted for a housing allocation in the now long-overdue Strathearn Local Plan. At Chance Inn, where we had previously applied for seventeen houses plus four affordable houses, in April 2009 we applied for a revised scheme containing ten private houses over 21,836ft^2 which was approved in September 2009. At Balnaguard, where originally we applied for nine houses over 15,719ft^2, we reapplied for a different configuration of 16,254ft^2 which was approved in July 2009. At Myreside Farm, in the Carse of Gowrie between Perth and Dundee, we await the decision on the application lodged in September 2007 for eight houses totalling 12,410ft^2 on the steading adjacent to the attractive listed farmhouse. Planning permission is being sought at two other sites in Perthshire. At Strathtay we have submitted alternative proposals for four and three large detached houses within the village envelope and both proposals are presently at appeal. At Carnbo we have submitted a proposal for four houses, revised from the original six houses, in the large garden of the former farmhouse.

Planning considerations will also be pivotal in the development of our two properties at Gartshore near Kirkintilloch and at Ardpatrick on West Loch Tarbert, Argyll. Gartshore, derived from Old Scots "garden" and (loch) shore forms the heart of a large estate, formerly owned by the Baird family, the then largest Coal and Iron Masters in Scotland, before passing to the Whitelaw family, now extends to about 200 acres (77ha) of which about 80 acres comprises policies, designed landscape and gardens including a magnificent Georgian stone pigeonnier and a huge walled garden. The main remaining building is a 15,000ft^2 Victorian stable block, the large mansion house built in 1885 having been demolished in 1950s. Gartshore is only seven miles from central Glasgow, two miles from the M73/M80 junction and three miles from two Glasgow/Edinburgh mainline stations (Croy and Lenzie) and Cumbernauld commuter station. In our publication "A Secret to Share" we are promoting Gartshore, a site in the very centre of Scotland with excellent communications, as having enclosed landscaped sites within a designed landscape with mature trees suitable for high-quality offices together with a destination leisure centre, created from the restoration of the paths, avenues, walled gardens, and built landscape features. As this specification is unique in East Dunbartonshire we hope to promote Gartshore in conjunction with the Local Authority. Gartshore offers an immediately available site in a mature setting requiring no remediation and not suffering any of the sometimes difficult and long-delayed procedures associated with brownfield sites. The restoration of the designed landscape could include a scattering of "executive" detached housing to offer a unique "Garden Park".

At Ardpatrick, West Loch Tarbert, Argyll consents have been granted to divide the house in four, to build one new house, to convert the stone garden shed to a house, to make the existing coach house and flat into two dwellings and to undertake certain residential extensions. These are conditional on certain upgrading works to the UC33 Ardpatrick Ferry Road.

The main development opportunity at Ardpatrick lies in the development of "new" houses in areas designated as "Rural Development Opportunities" in the Local Plan. The Reporter at the Local Plan Inquiry recommended that the areas designated as "Rural Development Opportunities" should be reviewed by suitably-qualified landscape architects, especially those in areas of greatest landscape sensitivity. The result of the survey at South Knapdale which includes Ardpatrick is expected to be published shortly. Although much of the Ardpatrick landscape is of exceptional quality most of our proposals relate to areas where intrusion is minimal and we expect to be able to undertake appropriate developments in such areas.

We continue the long process of enhancing the values of our properties at Ardpatrick damaged by years of neglect, which has resulted in buildings becoming ruinous, houses falling into disrepair, ditches and drains becoming blocked, roadways becoming impassable and walls, gates and fences becoming broken or unserviceable, all impairing amenity and restricting residential and agricultural use. Much of the Estate's residential property has now been restored, including two houses within the house curtilage. Three outlying cottages were repaired and sold in 2007 and a fourth, the Old Post Office, at the northern extreme of the Estate was extensively restored and sold earlier this year for £162,000. In the autumn of 2008 these outlying buildings whose structural integrity had been compromised were secured and currently two large detached houses, Honey House and Stables House are undergoing building work to safeguard them prior to major repairs. At Ardpatrick House the rainwater goods have been extensively overhauled and repaired, essential repairs have been done on the roof and extensive structural repairs have been completed. In the drier summer months good progress was made repairing walls, ditches, roads and fences and controlling weeds, all of which enhances the agricultural and amenity value of the Estate. The foundations of the Estate's restoration have been laid and the effect of future work will be much more apparent.

Last year we judged that the agricultural arable land values had risen to levels higher than the prospective returns for agriculture justified and we decided to sell the lands at Larennie in Fife and at Chance Inn, near Kinross, while retaining the residential buildings, steadings and appropriate inbye or prospective development land. This land was under offer last year and subsequently sold at very attractive prices. As the land at Ardpatrick is not arable and has a high marriage value with the Estate, it is being retained and improved.

Economic Prospects

The UK has completed its sixth quarter of economic contraction, falling a revised 0.3% in the three months to September 2009, resulting in a total contraction of 6.1% points including a swingeing fall of 2.4% in Q1 2009. This is proving the UK's longest and deepest post-war recession, surpassing the 4.7% contraction of the early 1980s recession. The economic contraction may even exceed that of the 1930s where, on different basis, a 5.4% fall was recorded.

The 1930s recession was marked by very high unemployment, 3.4m or 16.5% of the workforce at its peak, but in the 1980s, although unemployment was almost as high at 3.3m, it represented 11.9% of the workforce, a much lower incidence. Currently "only" 2.47m are unemployed, or 7.9% of the workforce, a much lower percentage, but the recession is not yet over and unemployment is usually a lagging indicator. The UK's deepening recession contrasts with the re-expansion of all other major economies.

The UK recession, although it arrived unexpectedly and abruptly, was adumbrated by the vivid image of depositors queuing round the block at Northern Rock in late 2007, the first run on any UK bank since the Bank of Glasgow collapsed in 1878. When Northern Rock collapsed the Governor wrote an incisive essay on the evils of moral hazard before fortunately, but after much valuable time had been lost, the MPC loosened monetary policy. Growth continued in the first quarter of 2008 at a high annualised rate of 3.2% and the consensus forecast then was for continuing growth, but falling to 2% in 2009. As late as August 2008 the Bank identified escalating inflation as the key risk and economic output was then projected to be "flat", but in that quarter, when interest rates were still 5%, the UK entered recession with an economic contraction of 0.7% following one of 0.1%. By November 2008 the Bank's greater concern was deflation and it then forecast a peak-to-trough decline in GDP of about 1.9% with the recession lasting into late 2009. The Governor reversed his previously stated opposition to a fiscal stimulus, saying the "transmission mechanism" of monetary policy had become impaired through the banking crisis. In accordance with this change the Bank cut interest rates to 3% in November 2008, and stressed that fiscal policy was likely to be relaxed and that the MPC would be able to take further action to lower interest rates in the months to come, a commitment delivered by the cut to 2% in December, equal to the lowest level since 1694. By way of some reassurance the Governor said that the expected recession would not be like Japan's "lost decade", of 1996 to 2005, but milder like Sweden's in the early 1990s: a recession that lasted from 1990 to 1993 with a contraction of almost 5%. At least he did not compare it to the great US depression. Cuts of 0.50% point in the repo rate followed in the next three months coinciding with the 2.4% contraction in activity in the first quarter of 2009. The UK was not alone in this sudden adjustment as the whole world fell into a deep recession. Annualised moving average world industrial output fell an estimated 25% and world trade even more.

Recessions are a recurring feature of market economies. In the UK they have occurred in every decade since WWI and in the US 15 times since 1926. There is no common cause for these recessions but recurring themes have been wars, external shocks, particularly oil prices and defaults, inflation, and asset booms in finance and property. The current recession is clearly not as a result of the aftermath of conflict nor of an external shock or inflation: the underlying cause is the collapse of an asset boom, or bubble.

Two categories of asset bubble can be differentiated, called for convenience "pure irrational exuberance bubble" and "credit boom bubble". The bursting of both types of bubbles can cause recessions but the "irrational" bubble is benign compared to the malign "credit" bubble. Benign bubbles do not involve credit, or the "cycle of leveraging against higher asset values", as Professor Frederic Mishkin, a former governor of the Fed describes. The "irrational" bubble in the high tech stocks which burst dramatically in the late 1990s did not cause much collateral damage and was not accompanied by a marked deterioration in bank balance sheets. Similarly the stock market bubble in the late 1980s was not primarily sustained by credit and so, when it burst in 1987, did not put the financial system under great stress, so allowing the economy to recover quickly.

Unfortunately, malign or credit bubbles are much more dangerous. The Great US Depression that lasted almost four years from 1929 in which employment fell 30% was preceded by a bubble in stock market prices fuelled by a credit boom, represented by margin purchases of stocks and a boom in the relatively new instalment credit, and a fall in savings. The similarities of the present credit based consumption bubble burst are very high. The evolution of such an economic cycle was described by Hyman P Minsky in 1992 as a Financial Instability Hypothesis. Minsky portrayed three types of borrower: a hedge borrower repaying interest and principal; a speculative borrower repaying interest; and a ponzi borrower repaying out of capital appreciation, a series of overlapping but progressive stages which characterised the credit and housing bubbles up to August 2007.

The instability described in the "Minsky" cycle results primarily from the asset based inflation and the ponzi lending based on such inflation being mutually reinforcing which he describes: "capitalist economies exhibit inflations and debt deflations which seem to have the potential to spin out of control ….. the economic system's reaction to a movement of the economy amplify the movement - inflation fuels an inflation and debt deflation fuels a debt deflation". In investment terms such speculation might be described as momentum rather than value investing, a strategy that expands the apex and nadir of cycles. The "ponzi" lending contributing to this Minsky cycle was facilitated by the emergence of purchasers for the securitised assets, SIVS, conduits, CDOs etc of financial engineering, a product of financial deregulation, which in turn was dependent on the new lending opportunity afforded by sub-prime borrowers. Securitisation, broadly deployed into consumer markets where it extended beyond housing to credit cards and auto credit was a major financial innovation and may have been the catalyst allowing all the other ingredients determining this particular Minsky cycle to coalesce. Certainly many other cases have followed a financial innovation such as securitisation or a technical innovation, a process described in "Manias, Panics, and Crashes" by Kindleberger as "displacements" of normal investors' expectations: the concept of a joint stock company was followed by the South Sea Bubble and the Mississippi Bubble of 1720; the development of new electrical and transport technologies in the 1920s, resulting in then hi-tech stocks like RCA rising 1000% to a PE of 73 stimulating "ponzi" speculation, often on a margin, preceded the 1929 crash and the Great Depression; the internet technologies developing in the 1990s produced the "irrational exuberance" that preceded the dot.com crash in 2001.

Minsky cycles, such as we have just experienced, are predominantly associated with developing countries, but now one has occurred in the very heart of the world economy, in countries accounting for about half the world economy with the USA and the UK particularly affected. Paul Volcker put it: "Simply stated, the bright new financial system - for all its talented participants, for all its rich rewards - failed the test of the market place". The economic crisis resulting form this Minsky cycle is the worst since the 1930s. The overriding threat to the economy was of systemic risk i.e. the collapse of the banking system and in its wake the whole financial system and, indeed, the present structure of society. The risk was recognised as immediate and the costs calamitous and all affected administrations set aside all moral, political, administrative and ideological considerations in the rescue.

Fortunately the rescue has worked, or, as the Economist put it "deft policy saw off calamity". How very near that calamity was has only recently been revealed - now too late to spook anyone, one imagines - by the Bank of England which reported that at the height of the emerging crisis last year it extended £61.6bn to HBOS and RBS as they were within minutes of closing cash points and normal business operations. In a now rare example of English classic understatement Paul Tucker, deputy governor, told the Treasury select committee "If we hadn't done it, the economic cycle would have been a lot worse". The rescue has been extremely expensive as evidenced by three separate criteria. The IMF estimates that the total writedowns in different economies on bank holdings at October 2009 were US $1,025bn; UK $604bn, and Eurozone $813bn:- the UK's writedowns being proportionally much higher than any other economy. The "costs" of Government actions, including guarantees, and Central Bank supports were: UK $1,710bn, 74% of GNP; US $10,480bn, 73% of GNP; and Eurozone $1.29bn, 18% of GNP. The third criterion, widely publicised by Martin Wolf, Chief Economics Commentator for the FT, measures the change between the deficit and the surplus in the private sector before the crisis and at the latest estimated position. The change is most easily illustrated by contrasting the German economy before the crisis with the UK and the US and comparing the German economy in 2009 after the crisis with the UK. The German economy has a prodigious surplus external current account balance, approximately 8% of GNP resulting from a surplus of private savings over private investment equal to the sum of a small deficit of Government savings over investment plus a large capital outflow. In contrast the UK and the USA, like most high income countries, had deficits of private savings over private investment and a deficit of higher Government consumption over savings equal to inflows of capital representing about 3% of GNP in the UK and 6% in the US. After the crisis the German position has changed only in degree. However, in stark reversal, the UK and the US (and most high income European countries) have private sector surpluses, just like Germany before

CHAIRMAN'S STATEMENT (continued)

and after the crisis, to which are added net capital inflows, as before and the sum of these two variables is matched by huge negative Government balances equivalent to over 10% of GNP. The huge increase in the Government balance is due to a vast increase in private savings, a private sector surplus of saving over investment. The credit crunch has unsurprisingly resulted in a huge adjustment in the private sector.

The UK entered the recession with a deficit of 2.5% of GDP, significantly above the OECD average of about 0.5%. The recessionary effect of reduced taxes together with the fiscal stimulus used to replace the contraction of the private sector has caused the Government deficit to rise sharply. Both the IMF and the EIU report this at 5% in 2008 but rising to between 12% and 14% in 2009 and 13% to 16% in 2010. All developed economies exhibit a similar trend, but, with the exception of Ireland, Spain and the US, to a much lesser extent.

These Government deficits will cause a substantial increase in the UK Government Debt as a percentage of GDP from 40% (the Sustainable Investment Rule!) in 2007 to an estimated 60% in 2009, 78% in 2010 and 95% in 2014. All other major developed economies have similar projected trends but the rate of deterioration in the UK is considerably greater than in any other economy.

The leaders of the G - 20 meeting in Pittsburgh in September 2009 said "it worked" reinforcing the unprecedented monetary and fiscal stimulus. Certainly the IMF revised its 2009 world growth estimate from -1.4 to "only" -1.1% and its 2010 forecast from 2.5% to 3.1%, comprising 1.7% from the high income economies and 7.5% for Asia, including 9.2% for China. A return to growth in the developing economies represents a dramatic change from the recent contraction, but at 1.7% it is well below the underlying historic natural growth rate. Unfortunately even so muted a recovery is dependent on the surge in Government spending to counter, as the IMF says, "the main risk is that private demand in advanced economies remains very weak". Thus, at least in the short term, withdrawal of the current stimuli is undesirable.

In contrast the long-term effects of continuing the stimuli are also undesirable. At present there is a desirable reduction in "yesterday's" private debt but an increasingly undesirable increase in "today's" public debt which could in turn lead to "tomorrow's" financing and currency crises. The rise of 0.33% points recently in the 10yr Gilt yield provides a "to-day" warning of such a "tomorrow" potential crisis as each percentage point change alters the Government's borrowing costs by about £15bn. For the UK to regain stability the economy has to operate without these current fiscal and monetary stimuli and this requires a recovery in either private or foreign demand. The private sector's financial balance swung from a negative position in 2006 to a surplus of about 10% of GNP in 2009 as shown by a reduction in bank financing and the record reduction of £10bn unsecured debt in the last three months. The current high level of savings in the UK militates against such a private sector recovery and the high savings of the surplus countries' economies, the largest being China, moderate against growth in foreign demand. The IMF includes China within emerging developing economies and shows savings rates rising faster than domestic investment, the difference described as "net lending". As recently as the late 1990s this was negative (ie net borrowing) but has since risen to 5.2% of their GDP. 5.2% of GDP may appear "small" compared, say, with the projected UK fiscal deficit of 13.2% in 2010, but these emerging countries account for 45% of world GDP equal to more than $30,000bn per annum.

The conventional economic policy response to a high savings rate is a reduction in interest rates, making saving less attractive and investment returns higher. Unfortunately, however, as interest rates are already nearly zero in many economies, and sometimes negative in real terms, this policy is no longer practicable.

In order to supplement the already fully utilised low interest rate policy, central banks, including the Bank of England, are creating additional money - the delightfully termed "quantitative easing". The success of this policy is a matter for conjecture and Samuel Brittan, writing in the FT included the sceptical view: "unfortunately instead of being dropped by helicopter, the cash is being injected into the banks that have a thousand and one excuses for not passing it on in loans".

CHAIRMAN'S STATEMENT (continued)

Notwithstanding the difficulties of increasing demand in the world economy, the UK could benefit from gaining a greater share of the existing world demand via higher exports and/or lower imports. Over the last two years there has been about a 20% fall in Sterling trade weighted index which, after an appropriate lag, should be beneficial. Unfortunately so far the response has been disappointing, but interpretation is difficult as there is no control, and world economic conditions are very unusual. The present low levels of Sterling were last reached about thirty years ago. However, the probability of an export led recovery is not high.

The private sector's contribution to a recovery is tightly circumscribed. Borrowing is exceptionally high and deleveraging has barely begun. In 2008 the savings rate was just 1.8% but rose to 3.9% and 5.6% in the first and second quarters of this year, levels still well below the long-term average of 8%. Demand for investment is likely to be poor as considerable excess capacity exists in the economy and many investment opportunities are not realisable because of the cost of credit or of its rationing. The IMF summarises the position "the main risk is that private demand in advanced economies remains very weak". Recovery in the economy is thus dependant on the continuing huge stimulus provided by the authorities. The Economist phrased it "if you take me off life support, I'll kill you".

This patient may soon be in remission from his systematic debt disease but will be discharged into an environment where re-infection is likely. His underlying disease has a symbiotic relationship with an intermediate host, the financial system, which multiplies, intermediates and transmits the disease so facilitating re-infection. The origin of the disease is remote from the patient, its route to the patient convoluted, and the means of its control uncharted.

The UK economy had expanded since it emerged from the recession of the early 1990s for 64 consecutive quarters until Q2 2008, the largest unbroken expansion period on record. Labour policies, benefiting from the reforms of the previous administration, and from granting operational independence to the Bank of England had in Gordon Brown's now notorious boast "Abolished Boom and Bust". Or so it seemed. The main focus in the "care of public health" of the economy was on inflation control but the risk was elsewhere, as the "credit crunch" so aptly termed, illustrates. Indeed, the Bank was so closely focused on inflation that when the Northern Rock collapsed interest rates were 5.75% and did not drop below 5.00% until October 2008. I wrote in 2007: "The MPC is constrained by its remit to target inflation at a low level on a specific narrow definition. Wider, broader objectives favoured by some commentators and considered more likely by them to provide enhanced economic stability and growth are normally excluded from consideration. CPI inflation, like all "single" targets, money supply, the gold standard, the balance of payments, the £/$ rate and the shadowing of the D-Mark is proving necessary but not sufficient. Perhaps the Bank will surprise us all with a "Nelsonian" turn: "You know Foley, I have only one eye - and I have a right to be blind sometimes ……….. I really do not see the signal".

The emphasis on inflation control in economic management is consistent with acceptance of the macro economic theory termed Real Business Cycle which postulates that economic cycles have four primary fluctuations: random, seasonal, secular (or trend) and business cycle, the fluctuation that inflation targeting is designed to control. Under this theory recessions arise as an efficient response to exogenous changes in the real economic environment and do not represent a failure of the markets to clear or to operate effectively. In effect markets represent the most efficient regulation of the economy and Government policy should concentrate on long-run structural policy changes without undue interventions. The theory that markets are self-regulating and produce optimal results is a theory that chimes with the deregulation of the financial markets which originated in the suspension of the WWII Bretton Woods system of fixed exchange rates and the dollar/gold convertibility in 1971, expanded with the liberalisation of the City, as exemplified by "Big Bang" in 1986, and culminated in the abolition in 1995 of the Glass Steagall Act, which had required the separation of merchant/investment banking and commercial banking. UK economic policy is strongly fashioned by such a detached/arms' length approach to the extent of almost using inflation targeting as a panacea: a golfer with a "one club" approach: "a putter". Apologists could argue that at the end of the long hole, in this recession a threatened violent deflation, a putter is what is needed, but, before being on the green a variety of clubs is greatly advantageous.

The focus of policy when the storm was gathering was still on inflation and the medicines available were designed for its treatment. The risk from another threat to the health of the economy was almost entirely ignored and no medicines were deployed to attenuate it. The major public health risk was credit, whose potency was formally recognised over 300 years ago: "Credit is a present remedy against poverty &, like the best medicines in Physick works strongly & has a poisonous quality": Sir Isaac Newton, then Master of the Royal Mint. The poisonous potential of credit was reinforced by its addictive nature and by the huge profits to its purveyors who become increasingly less licensed. Sir Isaac's views have a very recent endorsement by Professor Rogoff of Harvard who writes in "This Time is Different": "if there is one common theme to the vast range of crises we consider in this book, it is that excessive debt accumulation, whether by government, banks, corporations or consumers poses greater systemic risks than it seems during a boom". The author has studied the data on 66 countries for over 800 years and the main conclusion is that "This Time is NOT Different". Indeed, "cycles of confidence and panic are inevitable in a world of debt……… credit is extended freely and then withdrawn brutally". Interestingly, more recently since 1945, of the 66 countries studied, only four, Austria, Belgium, Portugal and the Netherlands, have escaped a banking crisis.

Credit is addictive as rising asset prices attract further investment reinforcing the rise and asset prices usually show positive serial correlation in the short term, this for "bubbles", being the length of the growth of the bubble. Such increases reward ponzi-type borrowers expecting the continuing rise of the asset class, a speculation usually built on a sound rationalisation of the investment decision at the time, later denounced almost invariably by wise after the event commentators, as a "bubble". Unfortunately the existence of bubbles is not always self evident as intrinsic value itself is not. Sir Isaac, Master of the Royal Mint, understood "Tis mere opinion that sets a value upon coined precious metals money…."

Bubbles can be traced back to the 17th Century tulip mania. Notable early successors were the South Sea Bubble, the Victoria US railway stocks, and the 1929 Wall Street Stocks. Recently bubbles have appeared more frequently - gold in 1980, Mexican stocks in 1982 and 1994, Japanese stocks in 1990, Asian economies in 1997 and the dotcom bubble in 2000 culminating in the current bubbles in house prices, initially the US sub prime, and in mortgage backed securities. Behaviourists argue that the evolution and collapse of bubbles has a large psychological component and are linked to the human emotional phases of euphoria and panic: Keynes' "animal spirits". The significant point is that, whereas it is almost inconceivable that the human nature, "animal spirits", have changed over the years, the frequency and type of bubbles appears to have done so.

A hypothesis has been advanced which explains the increased frequency of bubbles, especially those of a financial nature. In 1998 Long-Term Capital Management failed but the Federal Reserve engineered a rescue, a rescue repeated following the Internet bubble and these rescues either altered the downside risk of failure i.e. because rescue was likely or reminded certain participants of the special position they enjoyed in the financial system of being "too big to fail". Their risks were judged to be asymmetric. The weighted probability of the fruits of the upside - profits, expansion and bonuses became less than offset by a much lower weighted downside which excluded failure, collapse, bankruptcy and unemployment - a financier's one-way bet.

This asymmetry becomes more significant as the financial sector expands and becomes more highly geared. Fifty years ago the assets of the UK banks represented half that of GDP, 15 years ago they represented twice that of GDP and now represent five times that of GDP. In the US the debt of the financial sector rose from 60% of GDP ten years ago to 120% recently, while the UK financial sector reached 250%: a potential bomb getting bigger. There were two further ingredients in this time bomb: the rise of the market economy and light touch regulation which in the UK had been split into three separate components none of which has an overall responsibility. This took place at a time of the significant development of financial innovation and engineering, new techniques that "appeared" to diversify and spread risk often into asset classes believed to have low positive correlations but as it transpired the risks were actually still concentrated and most or all the asset classes became subject to the same adverse factors, all of which required at the very least stronger not lesser control.

Given the extent of the inflation of the bubble, or interconnected bubbles, the scale of resources committed to the assets subject to the bubble, asymmetric analysis of the risk attached to investment made, the inadequate supervision, and the interconnected ties of the so called separate asset classes it is not surprising that we are passing through the worst economic and financial crisis since the Great Depression. The patient, the economy, is being discharged into an environment when the major cause of the disease continues to be harboured by the basically unreformed financial system. Nouriel Roubini comments that "as markets begin to mend and financial institutions return to profitability the drive to reform the regulation of the system is losing political momentum. There is now a serious danger that risky practices and leverage could return. If another systematic crisis were to occur, the backlash against global finance and the free market would be even more severe".

Critics are unanimous on the need for reform, but this is modulated by the need to get credit flowing as quickly as possible to restore economic health. Most critics agree on the need for extensive reform - and as Martin Wolf comments acidly, "Doing what banks want is potentially poisonous - fundamental change is essential" - and on the many subjects of reform, including revised regulation, recapitalisation, lower lending ratios, lower leverage higher capital requirements, especially for "too big to fail" institutions, higher sanctions for losses so reducing moral hazard, and important technical and financial procedure on exchanges to facilitate transparency and objectivity and to provide a rapid resolution regime to assist in minimising the effects on the system of an individual failure. These reassurances are designed to make both the individual "modes" and the "network" safer.

Some proposals for reform are much more radical. These include making the financial sector permanently a heavily regulated ward of the state. John Kay, colourfully describes the banks as being a utility, basic banking including deposit taking and lending to the non-financial economy, attached to a casino whose losses threaten the whole. In such a system the deposits of the retail bank, effectively underwritten by the taxpayer, are used for collateral for the highly-leveraged trading activities of the bank. The takeover of the Bank of Scotland by the Halifax is an unusual exemplification of such an amalgamation - the Halifax was able to gear up its very considerable deposits via the Bank of Scotland's trading activities. John Kay calls for a separation of these two functions to avoid the use of deposit insurance. Further, he adds that the business styles for two such different functions are so different that any organisation combining both becomes unmanageable and, effectively, unmanaged. A conclusion many of us would draw from the current unravelling of the Scottish Banks.

Unfortunately stereotypical narrow banks, the Post Office Savings Bank and the Trustee Savings Bank did not previously compete successfully with commercial banks and would not do so without special protection. In any future crisis deposits would return to the narrow banking sector exacerbating the developing crisis. Narrow banking, being essentially "safe" would restrict the flow of credit to the economy without which it malfunctions just as we currently experience. Thus narrow banking would restrict economic growth unless it was sufficiently "wide" to be commercial.

In the US the Glass Steagall Act enacted in 1933, was designed to restore confidence in the banking system. Amongst its many provisions it curtailed the range of activities in which banks could participate, notably investment business. A broadly similar differentiation existed in the UK until the "big bang" in 1986. Undoubtedly difficulties exist in supervision and definition but it operated, whatever the difficulties, for over 30 years and its repeal in 1999 was, according to President Obama, "more about facilitating mergers than creating an efficient regulatory framework". It seems likely that new regulation will at least place new restrictions on the type and extent of banks' investment and dealing activities, echoing the more rigorous regime existing before "Big Bang".

Reform of the financial system, while eminently desirable, does not of itself cure the malady from which the patient, the economy, is currently suffering, although it does raise its immunity and perhaps reduce the virulence of any subsequent infection. The disease, global imbalances has many foci but, as so often, the principal ones are the East and the Middle East where emerging and developing countries have, in aggregate, became large net capital exporters due to their huge surplus of savings over investment. In some instances these surpluses, linked to undervalued exchange rates, result in reduced domestic living standards, a position only maintainable under certain political regimes. The accumulation of foreign assets by a creditor country certainly reduces its financial risk but beyond a certain level destabilises the debtor nation.

Importantly for the creditor nation the vast holdings of US debt potentially represent more than a financial claim, as they might represent a possible political resource, perhaps of limited value now, but one which in very different circumstances and a very long time hence could be very powerful. When Mao Tse Tung was asked what he thought were the effects of the French Revolution, he replied "It's too early to tell". Shortly after the French Revolution China's share of world GDP was 33% and the US 2%, by 1950 China's share had dropped to 5% and the US' had grown to 27% and by 2014 China's share is forecast to rise to 12% and the US' 23%. Perhaps it really is too early to tell.

To contain the effects of the worst of economic financial crises since the Great Depression required immediate action rather than a more considered approach to its financial causes, the transmission methods and to the presenting symptoms. Fortunately such dramatic and immediate action was undertaken by all fiscal and monetary authorities in the developed economies, including unprecedented qualitative and quantitative measures in the UK, measures which were summarised by Martin Wolf, writing in the FT as "the risks of doing too little are far greater than those of doing too much: sometimes boldness is caution". Fortunately the authorities were "cautious" and the global recovery has now commenced. The EIU forecast that growth in the second half of 2009 will limit overall contraction in 2009 to 1.4% and that by 2011 real growth will have risen to 3.3%, about 1percentage point below the previous five year average. In the third quarter of 2009 most of the world's big economies moved officially out of recession, the UK being a notable exception.

The IMF expects growth to return to levels expected before the crisis, 2% to 2½% for the "rich country" economies, but later falling to around 1¾% for demographic reasons. However the level from which that growth takes place is the lower level to which the economy fell during the crisis. The IMF found that in 88 banking crises between 1970 and 2002 economies do not claw back all the lost ground once the recession ended. On average, seven years after the crisis, output achieved was 10% less than that predicted by the pre-crisis rate.

Milton Friedman has argued that, as a recession impinges primarily on demand rather than supply, then following a recession the expansion is more forceful because resources, which had been lying idle, are brought back so allowing a period of faster growth. However, in recessions organisations shed labour and mothball or close or scrap equipment and premises. Idle labour and equipment atrophy and become less productive, and, because of the cost or availability of finance, capital equipment is not renewed. This causes the 10% drop in output normally persisting seven years after the crisis. An even worse possibility is that the growth rate is permanently damaged, an outcome more likely with financial crises which erode wealth, a loss at the trough estimated by Goldman Sachs to be almost equivalent to 75% of world GDP. As a financial crisis develops assets are wiped out leaving the debt secured on them extant. This contrasts with the more typical "inflation led" recession where the flow of spending puts a strain on productive resources forcing prices up which is relatively easily curtailed by raising interest so reducing demand. This process can be reversed and little damage occurs to the capital and labour stock. In a financial crisis the cause is not too much demand but too little, as holders of debt uncovered by assets seek to increase savings to repay the debt. Japan suffered such an asset led or balance sheet recession in the 1990s when a spectacular bubble in both stocks and property burst after which the economy never recovered the growth rate of the 1980s.

Fortunately there are significant differences between these two balance sheet recessions. In the US both the bubble and the burst are much smaller relative to the size of the economy. In both the US and the UK (and elsewhere) the Banks have already been very extensively recapitalised whereas in Japan the major recapitalisation was delayed for seven years until 1999 with a further recapitalisation in 2002, ten years after the crisis broke. The US and the UK recapitalisation may also be insufficient but the restoration of the inter-bank lending rates (Libor in the UK) to "normal" levels in the autumn this year indicated, as Alan Greenspan, a former chairman of the Federal Reserve, said, "things are getting back to normal". In both the US and the UK the authorities have already required the banks to identify and isolate a large proportion of the problematic or "toxic" loans, a model previously used successfully in Sweden's banking recession of the 1990s. This isolation contributed to the regaining of confidence reflected in the "normal" inter-bank rates. Japan delayed such extensive identification of "toxic" assets for ten years until 2002.

Warren Buffett said "There's never just one cockroach in the kitchen" and I suspect that we have not yet seen the whole family. In particular in the US, where the residential market is so very much worse than in the UK, whole mortgages, never diced, spliced and bundled, mostly still lie with the banks where, as the Economist says, "They will bleed slowly". Time may staunch the flow. Asset values seem likely to recover, as already is evident in the UK, rather than deteriorate further and so the wound will heal. Western banks have been much more profitable than Japanese banks and, relieved of the current asset write-downs and benefiting from the current unusually high margins, they should revert to high profitability, so rebuilding their capital bases. Thus as time passes, asset price rises and/or banks' own accumulated profits may assist them in containing any further damage. The Economist compared such a process to a child rolling a hoop - if you keep it turning it won't fall over - and the Western banks can roll it much faster than the Japanese. The structure of the debtors also assists the western banks. In Japan the banks' main loans were to "zombie companies" who could not repay them, but in the US, and to a lesser extent the UK, banks have large holdings of loans to "zombie households". Both types of zombies save remorselessly, draining the economy of demand, but the companies do more lasting damage. Companies use the investors' money to invest in fruitful activities that expand the economy, but households provide that money that companies invest. Thus household saving does not inhibit the growth of productive capacity to the extent that the Japanese company saving did. The West, particularly the US, is not like Japan. The US will not fall into a Japanese-style long-term deflation and by the same token the world economy will not relive the 1930s in spite of such a serious drop in output.

The recovery will not be prolonged, and the previous growth rate will probably be regained but the gap in the output trend will not be regained. As with Billy Bunter, "a meal missed is a meal lost". The permanent gap in the output trends is estimated by the Treasury at 5% and represents lost factors of production, including particularly, laid-off workers not returning to work, a loss that becomes greater the longer demand remains below potential. The only encouraging aspect of the current recession in the UK is the relatively low increase in unemployment compared with previous recessions and when compared with other western economies that have endured the collapse of the housing bubble in addition to the banking crisis and the ensuing global recession, such as the US, Spain and Ireland. US and Spanish unemployment has more than doubled to 10.2% and 19.0% respectively and Ireland has trebled to 13.0% but in the UK it has risen by less than half to 9.7%. Eurozone job losses have been lower and unemployment has only risen a third, due to the absence there of the property crash and to the existence of Government "Top-Up" schemes for short-term working. In the UK Government schemes with a £5bn budget are reported "to be having an effect". More important has been flexibility within the labour market - pay freezes and short working. Past recessions have not been noted for similar flexibility, probably because the downturn was largely outside the service sector, unlike the present position. The service sector differs from other sectors as the labour cost is a much higher percentage of total costs and service businesses do not have the same economies of scale or operational complexity. Put simply, partners or staff hours in an estate agency can be reduced removing the major costs but a complex manufacturing operation, if only for technical reasons, cannot easily be scaled down and, if it is, continues to have heavy overheads. Moreover such a manufacturing operation is likely to be part of an inter-dependent production chain where any closure has significant collateral effects. In short, a service economy is more flexible, a conclusion supported by the small rise of 30,000 unemployed only in the third quarter as opposed to 200,000 previously and the current rate being only 8% compared to peaks of 12% and 10.5% in the 1980s and 1990s recessions.

The relatively moderate fall in employment will assist the UK's economy to return to growth in 2010, variously forecast as 1.3% Economist Poll of Forecasters, 0.6% EIU, 1% Deloitte and 1% to 1.5% Bank of England and PBR. Forecasts for 2011 vary more greatly from 1.0% EIU or 1.5% Deloitte to the much higher 3.5% to 4.0% of the Bank of England and the PBR, forecasts that seem politically very convenient. Unfortunately, as John Kay points out, the accuracy of Treasury forecasts is not high with each recent five year forecast having been progressively downgraded each following year and the outcome worse than any forecast. He adds that the large structural deficit with which the UK entered the recession is the direct result of the persistently unrealistic projections made since the turn of the century. High growth rates in 2011 are unrealistic.

The Continental European economies of the 1980s are the most likely model for the UK's 2010s with large deficits, heavy public debts and stubborn unemployment: the fear and panic of the last two years will yield to a dull mediocrity. Alfred Marshall the eminent Cambridge economist observed: "The commercial storm leaves its path strewn with ruin; when it is over there is calm, but a dull heavy calm".

Property Prospects

In the previous property investment cycle the CBRE All Property Yield Index peaked at 7.4% in November 2001 and fell steadily to a trough of 4.8% in May 2007 before rising in this cycle to a peak of 7.8% in February 2009, a yield surpassed only twice since 1970. A higher yield occurred over six quarters in 1974/75, the time of the secondary banking crisis, but when "Bank Rate" averaged about 11% and again in one quarter in 1991, just before Sterling left the ERM in 1992 when "Bank Rate" was again over 10%. In contrast in February 2009 Base Rate was 1.0%. This time last year in one quarter, November 2008 to February 2009, the yield rose from 6.5% to 7.4%, a rapid rise equalled only once before in 1974. In the current cycle the fall in value indicated by the yield change is 38.5%. Mercifully since the peak of 7.8% the All Property Yield has fallen in each of the subsequent quarters to 7.5% in August. Figures published by Jones Lang LaSalle show that in the subsequent four months further falls occurred and prime yields surveyed by them fell from 7.02% to 6.2%, a sudden improvement in the market.

The 7.8% peak yield in February 2009 was 4.6 percentage points higher than the 10 year Gilt Yield, the highest "yield gap" since records began in 1972, and 1.4 percentage points higher than the previous record in February 1999. From the 1970s until the late 1990s except for one year, the 1993/94 downturn, the position was reversed the "reverse yield gap" and the Gilt yield exceeded the property yield. The "Yield Gap" was re-established in 1997 and has persisted since then until very briefly, only at the recent 2007 property peak.

The All Property Rent Index which, apart from a brief fall in 2003, had risen consistently since 1994, fell 0.1% in the Quarter to August 2008 and then fell substantially in each of the following four quarters giving an annual rental loss of 12.2%. The Office sector fell furthest by 19.6% and the Industrial least by 3.5%. Unsurprisingly the largest falls have occurred in the London Office Markets where rents are up to 34% less than one year earlier, followed by Shops outside the South East of England where rents are 15% to 21% less and the 16% fall in Bulky Goods retail parks rentals. Offices outside London are amongst the least affected. Office rents started to fall earlier than 2008 and, since the 2007 peak, All Office rents have fallen 23% and London offices up to 37%. In the last property crash, 1990 to 1992, the Offices sector also suffered the greatest falls, the rental index declined 44% with most of the London office sectors falling by over 50%. Fortunately the fall in rents has already greatly moderated and most forecasts show that after continuing but much smaller falls in rentals, growth will return in 2012.

Unsurprisingly returns to property investment have been truly awful, just as they were last year. In the year to 30 September 2008 the IPD All Property Index returned -18.1% and the returns continued to decline culminating in a total monthly return in December 2008 of -5.3%. In August 2009 capital values rose for the first time since mid 2007 and have continued to rise subsequently. The 12 months return to 31 October 2009 improved to -14.0% as October witnessed a record, a plus 2.5% capital return. Relative to the other asset classes, equities and bonds, which returned 23.5% and 12.2% to 31 August 2009 respectively, property's minus 14.0% return was even more dire.

Property's recent performance indicates a welcome reversal in trend. In support of such a trend Cushman and Wakefield report that in November 2009 in the properties sampled by them yields fell another 38 basis points, or 121 basis points since the market low in February 2009, and that prime yields are now 6.2% so reversing 40% of the yield loss since the market peak in mid 2007. Colliers CRE report a "mini" gold rush for property" ….. "resulting in a sharp contraction in initial yields" and suggest London City offices are trading at sub 6% and West End Offices at sub 5%, almost 1% point below earlier levels. The Sunday Times reported "a white hot rally for prime buildings" The FT corroborates these reports suggesting that prime yields have dropped from 6.8% to 5.5%, or over 1 percentage point.

The sudden rise in values is based on investment demand from many separate sources. For overseas investors the current low Sterling exchange provided an additional possible attraction. DTZ report that 81% of the £4.3bn invested in central London in the nine months to September 2009 came from overseas and for the UK as a whole, overseas investors accounted for 45%. These investors include German property funds, US private equity and property companies and a range of sovereign wealth funds, including South Korea's National Pension Service that purchased HSBC's flagship London tower. Property funds are attracting fresh investment as Standard Life for example cite near record inflows of £500m per month. New investment has allowed Aviva to lift its existing redemption restrictions and caused Threadneedle and Hermes to stagger the rate of acceptance of new funds to fit investment opportunities. Last month Legal and General Property, one of the largest fund managers, announced £110m acquisitions, part of a £600m investment programme. Colliers report that some of these funds have 20-25% of their assets as cash and are at risk of becoming "forced buyers". UK Investment companies, REITS and Prop Cos have also returned to the market. Colliers consider that the increased number of willing buyers accounts for the high number of bids and this competition has caused most of the price rises. Investment purchases are being increasingly supported by bank lending. Savills report that compared with six months ago twice as many banks offer significant loans and that other institutions, but excluding US investment banks, are also now willing to lend. Traditionally prime London property is, as now, the first property sector to recover, but funds are reported as already offering in regional centres. For example two large investments in Glasgow have just been marketed and attracted widespread bids above the asking price and are under offer at less than 6%, one of them Kentigern House for over £70m to Canada Life. The improved investment market is also spreading to "secondary" investments. In November Colliers CRE report that since June 2009, probably the trough in the market, prime yields had dropped by 0.80% but secondary yields had dropped by 1.80% thus reducing the gap between prime and secondary property. Due to the shortage of prime investments, 38% of these surveyed were now considering investments with shorter leases and/or poorer covenant strength. Allsop report that secondary property has sold well at auction. In an October sale realising £83m, yields averaged 6.7%, below the current IPD All Property average of 7.72%, and representing a reduction of the yield gap of about 0.6% points between prime and secondary investments.

The recent transformation of the investment market has significantly altered forecasts for future returns. In November 2008 the projections for future returns measured by the IPF Index for 2009 and 2010 were -5.3% and 6.2% but by June 2009 this had fallen to -15.1% and 3.4% with the 2009-13 average at 4.5%. Since the market turned in the summer the November 2009 estimates are for -2.6%, 10.0% and 9.4% in 2009 and subsequent years and for an average of 7.4% in 2009-13. The key to the recovery in the November 2009 survey is capital growth due to lower yields as rental values are estimated to continue to contract by 6.1% until stabilising during 2011 and then increasing 7.6% over the next two years.

The change in the investment market is even more starkly seen in the "derivatives" or "swaps" market derived from the IPD All Property Index. The low point for the property derivatives occurred in February 2009 when, after the IPD Index had already returned -23.2% in the year to 31 January 2009, say, net of minus 30% capital and plus 6.8% income, the bid pricing for December 2009 and December 2010 implied returns of minus 22.5% in 2009 and about minus 20.0% in 2010, implying an overall capital fall of about 60%. Unsurprisingly those placing any appreciable degree of reliability on such a market, notably advisors and professionals, were severely spooked - a fear that touched us all.

Fortunately that frisson passed as doom was replaced by gloom which may now shade into glee. Six months later in August 2009 the December 2010 contract implied "only" a compound return of minus

3% and the 2009 contract a return of only minus 10%. Since then the substantial rally in the investment market will have been responsible for the very considerable further recent improvement in the derivatives pricing. In early December the 2009 contract - just about to expire - turned positive, a huge change from -22.5%, - and the December 2010 contract implied a compound positive return of 5.25% pa.

In February 2009 there was a major disjuncture between the returns implied by the derivative pricing and the IPF forecasts, the IPF figures proving less unreliable, at least for 2009. At present the prediction derived from the derivative market, and from the IPF survey, together with those of certain surveyors is remarkably similar. All predict positive returns in 2010 of between 6% and 10% followed by slightly lower returns in 2011.

"Is this the end of the house price boom?" - so John Kay wrote in the FT as long ago as 12 October 2004. His conclusions were: that housing is a good long-term investment, that the current boom will be followed by a sharp slump (as now!) and that those who make "confident" predictions about the future of house prices are mistaken! "Is this the beginning, the middle or the end of a house price recovery?" one might ask today. Last year market conditions and market projections made then were very different from now. Last year I reported that since November 2007 both the Halifax and the Nationwide had reported price falls of nearly 15% and the Halifax an 18% fall from the August 2007 peak. Year-on-year falls of 10.1% had been reported by the Land Registry, 8.2% by FT HPI, and 6.3% by Rightmove, all lower than the two mortgage lenders probably due to delays in reporting and differing mixes of properties. Some new builds were allegedly available at over 20% off "new" prices and bulk new builds were reportedly available at up to 40% off, while repossessions were generally selling for at least 10-30% below already discounted prices. Forecasts made towards the end of last year of the peak to trough fall were very pessimistic. The Treasury and the two main mortgage providers, Halifax and Nationwide predicted a 25% fall, Jones Lang LaSalle 29% and Roger Bootle of Capital Economics 35%. In December 2008 price falls implied by derivatives based on the Halifax Property Index (HPI) were even greater. In November 2008 the HPI had already fallen 18% from its August 2007 peak and the price derived from that Index was equivalent to a further drop of 21% in 2009 followed by another and final drop of 15%. The peak-to-trough drop indicated was an astonishing 45%. Fortunately, as John Kay said, those who make "confident" predictions about the future of house prices have indeed been mistaken.

Acadametrics compile an index of house prices based on complete actual house price data for England and Wales adjusted for season and "mix" of property types. Their figures show that the market peak, £230,000 ± ½%, occurred between August 2007 and April 2008 inclusive. Peak monthly falls of over 1.5% occurred in October, November and December 2008 leading to a market trough of £200,021 in April 2009 representing a 13.04% fall from the peak. The Market has risen every month since May 2009 and in November 2009 significantly was £212,018, 1.4% above November 2008 and only 7.8% down from the 2007/08 peak although this varies considerably amongst regions. Clearly at the present time the market is much better than all the predictions cited.

The least accurate prediction was based on the HPI derivatives. In mitigation the market makers did comment that "Instinct suggests that these prices are too low …. liquidity is an issue in this market due to lack of buyers with prices potentially being pushed to artificially low levels …. these longer date contracts appear to offer an excellent opportunity and a large discount" . The FT commented that house price derivatives markets are not the perfect guide to the real thing as they are often illiquid and dominated by mortgage banks seeking to hedge their mortgage exposure. The present derivatives index shows prices broadly unchanged in both 2010 and 2011 but increasing at around 2.5% thereafter, effectively no real change. The Halifax say "overall our view is that house prices will be flat during 2010".

Most commentators predict a fall in prices in 2010 but a recovery thereafter. Deloitte forecasts falls of 10.0% moderating to 5% in 2011 whilst Savills and Jones Lang LaSalle forecast setbacks in 2010 of 7%. The Nationwide predict a "period of moderation" in the months ahead. I see no basis for choosing among the forecasts although the array of derivatives, historical patterns, trends, estimates, statistics and forecasts gives them the comfort of authority but patently undermined by John Kay's assessment of "confident" projections.

The ultimate determinant of prices is the supply of and demand for housing. The supply of houses is relatively inelastic and slow to respond to changes in demand. The supply is limited by the long cycle time of acquiring, planning and then building. The supply is further restrained by the planning process which determines how many houses shall be built in a given place in a given time but then, because of increasing complexities in the planning system, is frequently unable to deliver the programmed number of houses. Within established housing areas supply can be further curtailed by restrictions due to listing, conservation or by the requirements of flood protection. The long-term demand for houses, according to the currently used econometric models, is likely to continue to grow at a rate which is unlikely to be significantly altered, even by a recession as severe as is currently being experienced. Demand also grows with increasing affluence as time, convenience, amenity and quality of location all become of greater value. There is a fundamental imbalance between the supply and demand which will result in higher prices in the long term.

The short-term position is subject to other more immediate criteria affecting supply and demand. In the broadest terms there are two sources of short-term supply. Extra supply is provided by current building operations but the industry is operating at a fraction of its normal capacity and appears to have liquidated much of its stock. Thus the supply of new houses is well below average. Existing houses provide the major source of supply to the market in two streams, one elective, the other non-elective. Supply in the elective stream depends on households moving, almost certainly to another house - larger, upmarket, smaller, self-contained flat, retirement home or whatever - and this supply is effectively the same as the demand it creates: the supply is largely recycled. The non-elective supply has three main components: from estates, from household breakups and divorces; and from repossessions and then eviction. The volume of the first two should be relatively fixed, although the recession may have somewhat reduced "breakups", but the supply from evictions will vary considerably with interest rates and with economic activity. In the 1990s recession repossession peaked at 0.40% in 1991, relatively early in the recession, but the present rate is only 0.22%. Mortgage arrears as a percentage of outstanding mortgages are also less than half the 1990s figures. Thus the supply of houses from forced sales, while it may be significant, is likely to be lower than in the previous recession.

The low repossession rate has two reinforcing causes: low interest rates and relatively low unemployment. Since Repo rate fell rapidly in late 2008 and early 2009 quoted mortgage rates have fallen about 2 percentage points from previous rates reducing mortgage interest costs by about a third. However, an unusual feature of this recession is the very low increase in unemployment in spite of the depth and duration of the recession. In the last recession GDP decreased by about 2% but employment decreased by about 5.5 percentage points, but in this recession GDP has decreased by about 5.75% but employment has decreased by less than 2 percentage points. Accordingly it seems likely that in this recession the supply of houses due to repossession will be considerably lower than might otherwise be expected.

The key factors in determining short term demand are mortgage cost and mortgage availability, effectively a rationing of credit. Due to current interest rates mortgage costs, despite increased margins, are lower than normal, effectively reducing purchasers' costs. Recent mortgage approvals were 56% below the late 2006 peak but were 79% higher than in October 2008 and at their highest level since March 2008. The increase in funding seems likely to continue, especially as Libor rates have returned to levels available in August 2007 and wholesale funding should become more available. Recent measures by the authorities and by the banks have substantially re-established the banks' capital bases and their stability and this is being reflected in the increasing range of mortgage products and the more favourable terms. Even buy-to-let mortgages are increasingly available, a major sign of relaxation. The reduced rationing of finance will increase demand.

Demand is also influenced by sentiment - the housing market is not a "random walk" i.e. where prices are as likely to be down as up. The reverse is the case: if house prices rose last year, there is strong evidence that they will rise this year - prices display positive serial correlation in the short term: house prices have risen because they have risen. This is a strong reinforcing mechanism.

Many contend, presumably for behavioural reasons, that a small rise in prices will increase the supply of houses - effectively shifting the supply curve up so that at any given price a great many more houses are available. For any given demand such an increase in supply would result in lower prices, an outcome the commentators expect. However, the question is not what happens if the supply curve shifts up but why it should shift up! One possible reason for an upward shift in the supply curve could be "sheer fatigue" or "market acceptance", but such a change in attitude should be independent of price changes, and probably more related to the passage of time than to rising prices. Indeed the rational position would be for "fatigue" or "acceptance" to set in as prices fall or stay steady and for rising prices to reinforce the determination to sell at a higher price or at least not to sell at a lower price. In practical terms if you are prepared to sell at say £200,000, regardless of what you think it is "worth" and the price of comparable property is only £180,000 how much do you alter your behaviour when the comparable price is £190,000? Of course you might reduce your expectation from £200,000 to say £190,000 and sell, but such a price is still above £180,000 and the average of all such sale prices is still very near £190,000, much above £180,000. Only if as a result of the prices rising to £190,000 enough sales occur below the previous price of £180,000 do prices fall as a result of rising!! Thus it seems unlikely that rising prices produce the supply increase more than that required to clear the market at the higher price. Indeed, per contra, the supply might diminish as supply is withdrawn in the expectation of yet higher prices. The argument that increased prices result in reduced prices seems at best equivocal.

The key determinant of the housing market is rationing - demand rationing for the short-term housing market and supply rationing for the long-term housing market. The short-term market will be crucially influenced by interest rates, employment and credit mortgage availability. In my view these will be sufficiently favourable at least to sustain the housing market in 2010. The key determinant of the long-term housing market will continue to be the restrictions of supply by many overlapping and reinforcing controls and conventions producing significantly higher real prices.

Future Progress

We are not at present undertaking any development. During the year we succeeded in gaining planning permission for several of our sites which we have added to our existing portfolio of sites ready for development. However we will not commission development until market conditions improve further. We are undertaking minor refurbishments in the basement at 57 North Castle Street, at Carnbo Farmhouse and at Chance Inn Farmhouse. These houses will be marketed in the Spring.

Refurbishment and restoration will continue at Ardpatrick on West Loch Tarbert, Argyll. Previously we have sold six separate properties, including four refurbished cottages, and at least two more properties will be marketed in 2010. The greater overall development prospects await the outcome of a landscape review required by the Local Plan.

Planning work continues on many of our development sites. This comprises both submissions to the Local Authority for inclusion in future Local Plans and for developments under existing or evolving Local Plans. At Gartshore in East Dunbartonshire, but only seven miles from central Glasgow, discussions continue on the long-term prospects for the restoration of the estate coupled with a high quality "Green Park". At St Margaret's House, which now benefits from a Development Brief, we have submitted an outline proposal for a mixed redevelopment of 225,000ft^2. At Baylis Road, Waterloo, there have been a number of proposals, one of which we expect to finalise in 2010.

We have recently gained valuable consents on several of our fifteen rural development sites. Most of these sites were purchased unconditionally, i.e. without planning permission, for prices not far above their existing use value, and before the 2007 house price peak. The main component of the possible development value lies in the grant of planning permission and its extent and is relatively independent of even large changes in house values. For development or trading properties no change is made to the

Company's balance sheet even when improved development values have been obtained. Naturally, however, the balance sheet will reflect such enhanced value when the properties are developed or sold.

I have commented on the investment property market in these statements over the last few years. The broad conclusion was that over the cycle real returns were at best poor. Consequently we decided to withdraw from that market and reinvest in specialist development opportunities. In the years immediately before the 2007 crash I reported that investment yields were too low to be sustainable. Fortunately, during that period we declined several very highly-geared investment proposals. We retained investment properties where we expected them to provide value additional to investment value.

Our conservative view of the investment market had been reflected in a conservative financing policy and our long-term relationships with our bankers. Our main funding is a low LTV loan maturing in 2011 which, in spite of the significant falls in investment values, has always remained within covenant. Other facilities are with banks with whom we have had borrowings secured over the same properties since 1990 and 1994 respectively. I expect these relationships to continue.

The mid market share price on 22 December 2009 was 105p a discount of 37.4% to the NAV of 167.8p. The Board does not recommend a final dividend but will restore dividends when profitability and consideration for other opportunities and obligations permits.

Conclusion

Two years ago I concluded: "The UK economy is expected to experience a major deflationary shock resulting from an unprecedented contraction of credit" and last year I concluded: "Fortunately the recession will pass, but will not leave its passage unmarked". Both these conclusions appear to have been correct although, anomalously, each outcome is likely to be both worse and better than expected. The losses in the financial sector exceeded even the most pessimistic earlier assessments and still seem to be extending. However, proper, unprecedented and timely reactions by the authorities contained the damage: the Economist said "Deft policy saw off disaster". Indeed the recession has passed for almost all economies.

The effects of recession are proving less severe in the short term but will prove more severe in the long term. In spite of the severity of the recession, house prices have fallen far less and unemployment and repossessions have risen far less than expected. However, this present alleviation comes at a terrible and continuing long-term cost: huge debts; high servicing costs; lower output and, if remedial action is inappropriate, higher interest rates, and social and political instability.

History will endow this recession with meaning beyond that currently evident: a watershed in economic management, in political power and moral sway and in changing world order.

The Group's position has improved considerably since last year and is likely to continue to improve. Investment property prices will rise and residential property prices will at worst be stable. Development sites will increase in value due to planning gains and higher site values.

I D Lowe
Chairman 23 December 2009

Directors' report for the year ended 30 June 2009

The directors present their report and the group financial statements for the year ended 30 June 2009.

Activities

The principal activities of the group are the holding of property for both investment and development purposes.

Results and dividends

The group profit for the year after taxation amounted to £1,346,000 (*2008 loss of £7,159,000).* The directors do not propose a dividend in respect of the current financial year (*2008 Nil*).

Business review

A full review of the group's business results for the year and future prospects is included in the Chairman's Statement within the Review of Activities on pages 2 to 17 and Future Progress on page 18. In accordance with legislation the accounts have been prepared in accordance with IFRS as adopted by the EU ("adopted IFRS").

Key performance indicators

The key performance indicators for the group are property valuations, planning progress and the stability of house prices, all of which are discussed in the Chairman's Statement.

Principal risks and uncertainties

There are a number of potential risks and uncertainties, which have been identified within the business which could have a material impact on the group's long-term performance.

Planning and development

The increasing development profile of the group places increased emphasis on the planning stage of each project. The group seeks to minimise this risk with its firmly established risk control strategy, which includes detailed research and planning advice. On obtaining planning consent a decision will be taken on progressing the project on its own or with a joint development partner. At all stages the company seeks professional advice, conducts thorough diligence and continually monitors each development.

Property values

Conditions in the UK property market represent uncertainties in the operating environment rather than risks which can be managed. Nevertheless, many of the investment properties held by the group have development prospects or a development angle which will insulate them against the full effect of any general investment downgrade of commercial property.

Principal risks and uncertainties (continued)

Tenant relationships

All property companies have exposure to the covenant of their tenants as rentals drive capital values as well as providing the necessary cash flow to service debt. The group seeks to minimise exposure to any single sector or tenant across the portfolio and continually monitors payment performance.

Availability of funding

The group is dependent upon bank borrowings for current and future property transactions. Bank facilities are negotiated and tailored to each project in terms of quantum and timing. Any intended borrowings for future projects will be at conservative levels of gearing and therefore should be readily available.

Management of funding risk

The group seeks to ensure that adequate resources are available to meet the short and long term funding requirements of the group at all times and that any funding risks arising from group activities be effectively identified and managed.

Management of interest rate risks

Group borrowings are primarily in relation to and secured by properties, which are held as investments or are being developed. As and when future development projects are undertaken banking facilities will be negotiated and tailored to each project. Interest rate risk is constantly monitored and reviewed. This risk is managed by securing floating rate debt, which can be fixed from time to time by the group or by the use of interest rate swaps or other financial instruments.

Environmental policy

The group recognises the importance of its environmental responsibilities, monitors its impact on the environment and designs and implements policies to reduce any damage that might be caused by the group's activities.

Directors

The directors who held office at the year end and their interests in the company's share capital are set out below:

Beneficial interests - Ordinary shares of 20p each

	Percentage held	**30 June 2009 £**	30 June 2008 £
ID Lowe	78.5	9,324,582	9,324,582
MJ Baynham	6.1	729,236	729,236
RJ Pearson	-	-	-
AJ Hartley	-	-	-

Beneficial interests - Floating rate loan stock 2010

ID Lowe	100.0	1,700,000	1,350,000

No rights to subscribe for shares or debentures of group companies were granted to any of the directors or their immediate families or exercised by them during the financial year.

Suppliers

It is the company's policy to settle suppliers' invoices within sixty days of their receipt.

Donations

The group made charitable donations of £27,374 *(2008: £65,080)*

Disclosure of information to auditors

The directors who held office at the date of approval of the Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the company auditors are unaware; and each director has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the company auditors are aware of that information.

Auditors

In accordance with Section 489 of the Companies Act 2006, a resolution for the re-appointment of KPMG Audit Plc as auditors of the company is to be proposed at the forthcoming Annual General Meeting.

By Order of the Board

MJ Baynham
Secretary

23 December 2009

Caledonian Trust PLC

Statement of Directors’ responsibilities in respect of the directors’ report and financial statements

The directors are responsible for preparing the Directors' Report and the group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare group and parent company financial statements for each financial year. As required by the AIM Rules of the London Stock Exchange they are required to prepare the group financial statements in accordance with IFRSs as adopted by the EU and applicable law and have elected to prepare the parent company financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the group and parent company and of their profit or loss for that period. In preparing each of the group and parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- for the group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- for the parent company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and the parent company will continue in business

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

KPMG Audit Plc
Saltire Court
20 Castle Terrace
Edinburgh EH1 2EG
United Kingdom

Independent Auditors' report to the members of Caledonian Trust PLC

We have audited the financial statements of Caledonian Trust Plc for the year ended 30 June 2009 set out on pages 26 to 55.

The financial reporting framework that has been applied in the preparation of the group financial statements is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

This report is made solely to the company's members, as a body, in accordance with sections 495 and 496 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 24, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's web-site at www.frc.org.uk/apb/scope/UKNP.

Opinion on financial statements

In our opinion:
• the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 30 June 2009 and of the group's profit for the year then ended;
• the group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
• the parent company financial statements have been properly prepared in accordance with UK Generally Accepted Accounting Practice;
• the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Independent Auditors’ report to the members of Caledonian Trust PLC (continued)

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

H Harvie (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants

23 December 2009

Caledonian Trust PLC

Group income statement for the year ended 30 June 2009

	Note	**2009 £000**	2008 £000
Gross rental income		**650**	793
Service charge income		**24**	20
Dilapidation income		**57**	29
Property charges		**(265)**	(234)
Net rental and related income		**466**	608
Proceeds from sale of trading properties		**1,058**	175
Carrying value of trading properties sold		**(661)**	(70)
Profit from disposal of trading properties		**397**	105
Administrative expenses		**(880)**	(840)
Other income		**254**	61
Other expenses		**(14)**	(14)
Net other income		**240**	47
Net operating profit/(loss) before investment property disposals and valuation movements	5	**223**	(80)
Profit on disposal of investment properties		**163**	-
Valuation gains on investment properties		**1,932**	709
Valuation losses on investment properties		**(515)**	(7,870)
Net valuation gains/(losses) on investment properties		**1,417**	(7,161)
Operating profit/(loss)		**1,803**	(7,241)
Financial income	7	**7**	30
Financial expenses	7	**(464)**	(664)
Net financing costs		**(457)**	(634)
Profit/(loss) before taxation		**1,346**	(7,875)
Income tax credit	8	**-**	716
Profit/(loss) for the financial period attributable to equity holders of the company		**1,346**	(7,159)
Earnings/(loss) per share			
Basic earnings/(loss) per share (pence)	9	**11.33p**	(60.25p)
Diluted earnings/(loss) per share (pence)	9	**11.33p**	(60.25p)

The notes on pages 31-48 form part of these financial statements.

Caledonian Trust PLC

Consolidated statement of recognised income and expense for the year ended 30 June 2009

	2009 **£000**	2008 £000
Change in the fair value of equity securities available for sale	**(9)**	(30)
Net loss recognised directly in equity	**(9)**	(30)
Profit/(loss) for the period	**1,346**	(7,159)
Total recognised income and expense for the period attributable to equity holders of the parent company	**1,337**	(7,189)

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Consolidated balance sheet as at 30 June 2009

	Note	2009 £000	2008 £000
Non current assets			
Investment property	10	**17,045**	16,915
Property, plant and equipment	11	**25**	22
Investments	12	**2**	11
Total non-current assets		**17,072**	16,948
Current assets			
Trading properties	13	**11,032**	11,383
Trade and other receivables	14	**207**	434
Cash and cash equivalents	15	**906**	42
Total current assets		**12,145**	11,859
Total assets		**29,217**	28,807
Current liabilities			
Trade and other payables	16	**(612)**	(462)
Interest bearing loans and borrowings	17	**(1,985)**	(987)
		(2,597)	(1,449)
Non current liabilities			
Interest bearing loans and borrowings	17	**(6,675)**	(8,750)
		(6,675)	(8,750)
Total liabilities		**(9,272)**	(10,199)
Net assets		**19,945**	18,608
Equity			
Issued share capital	21	**2,377**	2,377
Capital redemption reserve	22	**175**	175
Share premium account	22	**2,745**	2,745
Retained earnings	22	**14,648**	13,311
Total equity attributable to equity holders of the parent company		**19,945**	18,608

The financial statements were approved by the board of directors on 23 December 2009 and signed on its behalf by:

ID Lowe
Director

Company registration number 1040126

The notes on pages 31-48 form part of these financial statements.

Caledonian Trust PLC

Consolidated cash flow statement for the year ended 30 June 2009

	2009 £000	2008 £000
Cash flows from operating activities		
Profit/(loss) for the period	**1,346**	(7,159)
Adjustments for :		
(Profit) on sale of investment property	**(163)**	-
(Gains)/losses on fair value adjustment of investment property	**(1,417)**	7,161
Depreciation	**10**	7
Net finance expense	**457**	642
Income tax credit	**-**	(716)
Operating cash flows before movements in working capital	**233**	(65)
Decrease/(Increase) in trading properties	**351**	(616)
Decrease in trade and other receivables	**252**	105
Increase/(decrease) in trade and other payables	**129**	(192)
Cash generated from operating activities	**965**	(768)
Interest paid	**(468)**	(665)
Interest received	**7**	22
Cash flows from operating activities	**504**	(1,411)
Investing activities		
Proceeds from sale of investment property	**1,450**	-
Acquisition of property, plant and equipment	**(13)**	(12)
Cash flows from investing activities	**1,437**	(12)
Financing activities		
(Proceeds from)/repayments of long term borrowings	**(1,077)**	641
Cash flows from financing activities	**(1,077)**	641
Net increase/(decrease) in cash and cash equivalents	**864**	(782)
Cash and cash equivalents at beginning of year	**42**	824
Cash and cash equivalents at end of year	**906**	42

1 Reporting entity

Caledonian Trust PLC is a company domiciled in the United Kingdom. The consolidated financial statements of the company for the year ended 30 June 2009 comprise the company and its subsidiaries as listed in note 5 in the parent company's financial statements (together referred to as "the Group"). The Group's principal activities are the holding of property for both investment and development purposes.

2 Statement of Compliance

The group financial statements have been prepared and approved by the directors in accordance with International Financial Reporting Standards as adopted by the EU ("Adopted IFRSs"). The Company has elected to prepare its parent company financial statements in accordance with UK GAAP; these are presented on pages 48 to 55.

3 Basis of preparation

The financial statements are prepared on the historical cost basis except for available for sale financial assets and investment properties which are measured at their fair value.

The preparation of the financial statements in conformity with Adopted IFRSs requires the directors to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

These financial statements have been presented in pounds sterling which is the company's functional currency. All financial information has been rounded to the nearest pounds thousand.

Going concern

The group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Chairman's Statement on pages 2 to 19.

Note 18 to the financial statements includes the group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk.

The Directors have prepared cash flow forecasts for the group and company for a period of 12 months from the date of authorisation of these financial statements. The group's forecasts and projections reflect the Directors' plans for the coming year and include rental income and expected income from the sales of properties and development land. These forecasts show that the group should be able to operate within the level of its current loan facilities. When performing sensitivity analysis on these projections the group has also considered the cash flow position assuming that sales of property are confined to those which are currently unconditional. In this scenario the group will require additional support from the major shareholder. This support has been confirmed in writing. As with any company placing reliance on a shareholder for financial support, the directors acknowledge that there can be no certainty that this support will continue although, at the date of approval of these financial statements, they have no reason to believe that it will not do so.

3 Basis of preparation (continued)

Certain of the group's loan facilities are demand facilities or are due for renewal within the next 12 months and the directors will enter into renewal negotiations with the banks in due course. The group is regularly in discussion about its future borrowing needs and no matters have been drawn to its attention to suggest that renewal may not be forthcoming on acceptable terms

The group's main banking facility is subject to financial covenants and other conditions which the group monitors regularly. These covenants and conditions are sensitive to changes in rental income, interest rates and the value of properties. Whilst the directors cannot envisage all possible circumstances, the directors believe that, taking account of reasonably foreseeable adverse movements in rental income, interest or property values, the group has sufficient resources available to it, including additional support from the major shareholder if necessary, to ensure continued compliance with these conditions.

In preparing their sensitivity analyses the directors have taken account of the circumstances prevailing in the property market at the current time and recognise that the current economic climate creates uncertainty over the timing and amount of ultimate realisation of these cashflows, in particular in respect of the sale of certain assets. However, after making enquiries, the Directors have a reasonable expectation that the company and the group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and financial statements

Areas of estimation uncertainty and critical judgements

Information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements is contained in the following notes:

- *Valuation of investment properties (note 10)*
  The valuation of properties is subjective and based on similar transactions in the market, rental yields and development potential. The company's directors are experienced in dealing with such properties. Valuations at the balance sheet date are based on independent external valuations.

- *Valuation of trading properties (note 13)*
  Trading properties are carried at lower of cost and net realisable value. The net realisable value of such properties is based on the amount the company is likely to achieve in a sale to a third party which is dependent on availability of planning consent and demand for sites which is influenced by the housing and property markets.

- *Taxation (note 8)*

As noted in note 8, the company have treated a dilapidations payment from a tenant as a capital receipt and accordingly no taxation has been provided in these financial statements. In the event that HMRC do not agree with this treatment the directors will vigorously challenge any such contrary view. The tax that would be payable if the receipt were to be treated as revenue is approximately £615,000.

4 Accounting policies

The accounting policies below have been applied consistently to all periods presented.

Basis of consolidation
The financial statements incorporate the financial statements of the company and all its subsidiaries. Subsidiaries are entities controlled by the group. Control exists when the group has the power to determine the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date it ceases.

Revenue
Rental income from properties leased out under operating leases is recognised in the income statement on a straight line basis over the term of the lease. Costs of obtaining a lease and lease incentives granted are recognised as an integral part of total rental income and spread over the period from commencement of the lease to the earliest termination date on a straight line basis.

Revenue from the sale of trading properties is recognised in the income statement on the date at which the significant risks and rewards of ownership are transferred to the buyer with proceeds and costs shown on a gross basis.

Other income
Other income comprises income from agricultural land and other miscellaneous income

Finance income and expenses
Finance income and expenses comprise interest payable on bank loans and other borrowings. All borrowing costs are recognised in the income statement using the effective interest rate method. Interest income represents income on bank deposits using the effective interest rate method.

Taxation
Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case the charge / credit is recognised in equity. Current tax is the expected tax payable on taxable income for the current year, using tax rates enacted or substantively enacted at the reporting date, adjusted for prior years under and over provisions.
Deferred tax is provided using the balance sheet liability method in respect of all temporary differences between the values at which assets and liabilities are recorded in the financial statements and their cost base for taxation purposes. (Deferred tax includes current tax losses which can be offset against future capital gains.) As the carrying value of the group's investment properties is expected to be recovered through eventual sale rather than rentals, the tax base is calculated as the cost of the asset plus indexation. Indexation is taken into account to reduce any liability but does not create a deferred tax asset. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

Investment properties
Investment properties are properties owned by the group which are held either for long term rental growth or for capital appreciation or both. Properties transferred from trading properties to investment properties are revalued to fair value at the date on which the properties are transferred. When the Group begins to redevelop an existing investment property for continued future use as investment property, the property remains an investment property, which is measured based on fair value model, and is not reclassified as property, plant and equipment during the redevelopment.

4 Accounting policies (continued)

Investment properties (continued)
The cost of investment property includes the initial purchase price plus associated professional fees. Borrowing costs directly attributable to the acquisition or construction of qualifying assets are capitalised during the period of construction. Subsequent expenditure on investment properties is only capitalised to the extent that future economic benefits will be realised.
Investment property is measured at fair value at each balance sheet date. External independent professional valuations are prepared at least once every three years. The fair values are based on market values, being the estimated amount for which a property could be exchanged on the date of valuation between a willing buyer and a willing seller in an arms length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

Any gain or loss arising from a change in fair value is recognised in the income statement.

Purchases and sales of investment properties
Purchases and sales of investment properties are recognised in the financial statements at completion which is the date at which the significant risks and rewards of ownership are transferred to the buyer.

Property, plant and equipment
Property, plant and equipment are stated at cost, less accumulated depreciation and any provision for impairment. Depreciation is provided on all property, plant and equipment at varying rates calculated to write off cost to the expected current residual value by equal annual instalments over their estimated useful economic lives. The principal rates employed are:

Office equipment	-	33.3 per cent
Plant and equipment	-	20.0 per cent
Fixtures and fittings	-	33.3 per cent
Motor vehicles	-	33.3 per cent

Trading properties
Trading properties held for short term sale or with a view to subsequent disposal in the near future are stated at the lower of cost or net realisable value. Cost is calculated by reference to invoice price plus directly attributable professional fees. Net realisable value is based on estimated selling price less estimated cost of disposal

Financial assets
Trade and other receivables
Trade and other receivables are initially recognised at fair value and then stated at amortised cost.

Financial instruments
Available for sale financial assets
The group’s investments in equity securities are classified as available for sale financial assets. They are initially recognised at fair value plus any directly attributable transaction costs. Subsequent to initial recognition they are measured at fair value and changes therein, other than impairment losses, are recognised directly in equity. The fair value of available for sale investments is their quoted bid price at the balance sheet date. When an investment is disposed of, the cumulative gain or loss in equity is recognised in profit or loss. Dividend income is recognised when the company has the right to receive dividends either when the share becomes ex dividend or the dividend has received shareholder approval.

4 Accounting policies (continued)

Cash and cash equivalents

Cash includes cash in hand, deposits held at call (or with a maturity of less than 3 months) with banks, and bank overdrafts. Bank overdrafts that are repayable on demand and which form an integral part of the Group's cash management are shown within current liabilities on the balance sheet and included with cash and cash equivalents for the purpose of the statement of cash flows.

Financial liabilities

Trade payables

Trade payables are non-interest-bearing and are initially measured at fair value and thereafter at amortised cost.

Interest bearing loans and borrowings

Interest-bearing loans and bank overdrafts are initially carried at fair value less allowable transactions costs and then at amortised cost.

Segmental analysis

The company's principal activity consists of holding property for investment and development. The directors believe that these activities comprise one business unit and consequently segmental analysis is not considered necessary.

IFRS not yet effective

The following IFRS have been adopted and so will require to be applied in future periods and are expected to affect the entity.

IFRS 8 operating segments

This is a disclosure standard which will have no impact on the financial position of the group.

Amendment to IAS 1 presentation of financial statements: A revised presentation. The standard will require the group to present a statement of comprehensive income and may require additional disclosures.

Amendment to IAS 23 borrowing cost. This standard requires borrowing costs related to qualifying fixed assets to be capitalised. This will only affect the entity if it incurs significant capital expenditure in the future.

Amendment to IAS 27 Consolidated and Separate financial statements and IFRS 3 (revised) Business combinations. These amendments require changes to the accounting for business combinations and will only affect the entity if it makes acquisitions in the future.

5 Operating profit/(loss)

	2009	2008
	£000	£000
The operating profit/(loss) is stated after charging/(crediting):		
Depreciation	**10**	7
Fees paid to auditors		
- audit of the financial statements	**13**	11
- audit of financial statements of subsidiaries pursuant to legislation	**14**	18
	======	======

6 Employees and employee benefits

	2009	2008
	£000	£000
Employee remuneration		
Wages and salaries	**349**	321
Social security costs	**39**	37
Other pension costs	**64**	52
	452	410

Other pension costs represent contributions to defined contribution plans

The average number of employees during the year was as follows:

	No.	No.
Management	**2**	2
Administration	**2**	2
Other	**3**	2
	7	6

The directors consider that key management personnel are the company's directors. Compensation is shown below:

	2009	2008
Remuneration of directors	**£000**	£000
Directors' emoluments	**251**	244
Company contributions to money purchase pension schemes	**59**	48

The aggregate of emoluments of the highest paid director was £123,000 *(2008 - £113,600)* and company pension contributions of £27,000 *(2008 - £27,500)* were made to a money purchase scheme on his behalf.

Retirement benefits are accruing to 2 *(2008 - 2)* directors under money purchase schemes.

7 Finance income and finance costs

	2009	2008
	£000	£000
Finance income		
Interest receivable:		
- on bank balances	**7**	30
Finance costs		
Interest payable:		
- Bank loans and overdrafts	**377**	577
- Loan stock repayable within five years	**87**	87
	464	664

8 Income tax

	2009	2008
	£000	£000
Recognised in the income statement		
UK corporation tax – current period	-	-
	-	-
Deferred tax – effect of change in rate	-	(52)
Deferred tax – current period	-	(664)
Total income tax credit in income statement	-	(716)

Reconciliation of effective tax rate

	2009		2008	
	%	**£000**	%	£000
Profit/(loss) before tax		**1,346**		(7,875)
Current tax	**28.0**	**377**	29.5	(2,323)
Effects of:				
Expenses not deductible for tax purposes		**18**		15
Movement in capital gains tax indexation (restricted)		**(345)**		816
Movement in deferred tax change in rate		-		52
Deferred tax asset not recognised		**(53)**		724
Other		**3**		-
Total tax credit		-		(716)

In the case of deferred tax in relation to investment property revaluation surpluses, the base cost used is historical book cost and includes allowances or deductions which may be available to reduce the actual tax liability which would crystallise in the event of a disposal of the asset.

8 Income tax (continued)

Factors affecting the future tax charge

The group received a dilapidations payment from the former tenants of an investment property amounting to £2,100,000 during the year ended 30 June 2005. The payment was made to fulfil the tenant's obligations under the repairing lease held by them. The directors are presently progressing a development brief for the island site of which the property forms part which once formally adopted by the Planning Authority will enhance the value. Accordingly the repair work to the property has not been carried out and it is unlikely that they will be undertaken. The receipt was treated as a capital receipt for taxation purposes on which basis no taxation was payable or has been provided. HMRC has queried the tax treatment of this receipt and there is an ongoing dialogue with HMRC local inspector on the matter. The directors continue to be of the opinion that the receipt is a capital receipt and accordingly no taxation has been provided in these financial statements. In the event that HMRC do not agree with this treatment the directors will vigorously challenge any such contrary view. The tax that would be payable if the receipt were to be treated as revenue is approximately £615,000.

9 Earnings/(loss) per share

Basic earnings/(loss) per share is calculated by dividing the earnings/(loss) attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period as follows:

	2009	2008
	£000	£000
Profit/(loss) for financial period	1,346	(7,159)
	========	======
	No.	No.
Weighted average no. of shares:		
For basic earnings per share and for diluted earnings per share	11,882,923	11,882,923
	========	========
Basic earnings/(loss) per share	11.33p	(60.25p)
Diluted earnings/(loss) per share	11.33p	(60.25p)

The diluted figure per share is the same as the basic figure per share as there are no dilutive shares.

10 Investment properties

	2009	2008
	£000	£000
Valuation		
At 30 June 2008	**16,915**	24,076
Revaluation in year	**1,417**	(7,161)
Sold in year	**(1,287)**	-
Valuation at 30 June 2009	**17,045**	16,915

The carrying amount of investment property is the fair value at the balance sheet date as determined by external independent valuations at open market value made by Montagu Evans, independent property consultants, at 30 June 2009. The properties have been valued individually in accordance with the definition of market value and good practice guidelines set out in the 6th Edition of the Royal Institution of Chartered Surveyors valuation and appraisal manual. In this regard, market value is defined as "the estimated amount for which a property should exchange between a willing buyer and willing seller in an arm's length transaction after proper marketing wherein the parties had acted knowledgeably, prudently and without compulsion". The valuers have taken into account rental values and development potential.

Fair values were calculated having regard to recent transactions for similar properties.

Investment properties comprise a number of commercial properties, some of which are leased to third parties with an initial rental period. Subsequent renewals are negotiated with the tenant.

The cumulative amount of interest capitalised in respect of the group's investment properties is £744,502 *(2008: £869,467)*.

Certain of the company's investment properties with a carrying value of £13,760,000 *(2008: £13,615,000)* are secured against bank borrowings and as such on disposal of investment properties a proportion of proceeds are remitted to reduce bank borrowings

11 Property, plant and equipment

	Motor Vehicles £000	Fixtures and fittings £000	Other equipment £000	Total £000
Cost				
At 30 June 2007	15	45	24	84
Additions in year	-	3	9	12
At 30 June 2008	**15**	**48**	**33**	**96**
Additions in year	3	-	10	13
At 30 June 2009	**18**	**48**	**43**	**109**
Depreciation				
At 30 June 2007	14	44	9	67
Charge for year	1	1	5	7
At 30 June 2008	**15**	**45**	**14**	**74**
Charge for year	**2**	**-**	**8**	**10**
At 30 June 2008	**17**	**45**	**22**	**84**
Net book value				
At 30 June 2008	-	-	22	22
At 30 June 2009	**1**	**3**	**21**	**25**

12 Investments

	2009 £000	2008 £000
Available for sale investments		
At the start of the year	**11**	41
Loss on available for sale investments recognised in equity	**(9)**	(30)
Available for sale financial assets	**2**	11
	======	======

13 Trading properties

	2009 £000	2008 £000
At start of year	**11,383**	10,767
Additions	**310**	686
Disposals	**(661)**	(70)
At end of year	**11,032**	11,383
	======	======

Trading properties with carrying value of £2,524,000 (2008: £2,474,000) are secured against the Group’s bank borrowings.

14 Trade and other receivables

	2009	2008
	£000	£000
Amounts falling due within one year		
Other debtors	**97**	282
Prepayments and accrued income	**110**	152
	207	434

The company's exposure to credit risks and impairment losses relating to trade receivables is given in note 18.

15 Cash and cash equivalents

	2009	2008
	£000	£000
Cash	**906**	42

Cash and cash equivalents comprise cash at bank and in hand. Cash deposits are held with UK banks. The carrying amount of cash equivalents approximates to their fair values. The company's exposure to credit risk on cash and cash equivalents is regularly monitored.

16 Trade and other payables

	2009	2008
	£000	£000
Accruals and other creditors	**612**	462

The Group's exposure to currency and liquidity risk relating to trade payables is disclosed in note 18.

17 Other interest bearing loans and borrowings

The Group's interest bearing loans and borrowings are measured at amortised costs. More information about the Group's exposure to interest rate risk and liquidity risk is given in note 18.

Current liabilities

	2009	2008
	£000	£000
Current portion of secured bank loans	**1,985**	987
	=======	=======

Non current liabilities

	2009	2008
Non-current portion of secured bank loans	**4,975**	7,400
Floating rate unsecured loan stock	**1,700**	1,350
	6,675	8,750
	=======	=======

Terms and debt repayment schedule

Terms and conditions of outstanding loans and loan stock were as follows:

			2009		2008	
	Currency	Nominal interest rate	**Fair value £000**	**Carrying amount £000**	Fair value £000	Carrying amount £000
Secured bank loans	GBP	LIBOR + 0.95 to 3.00% Base +1.5%	**6,960**	**6,960**	8,387	8,387
Floating rate unsecured loan stock	GBP	Base + 3%	**1,700**	**1,700**	1,350	1,350
			8,660	**8,660**	9,737	9,737

The bank loans are secured by standard securities and charges over the assets of certain subsidiaries and by an unlimited guarantee by Caledonian Trust PLC.

18 Financial instruments

Fair values

Fair values versus carrying amounts

The fair values of financial assets and liabilities, together with the carrying amounts shown in the balance sheet, are as follows:

	30 June 2009		30 June 2008	
	Fair value	**Carrying amount**	Fair value	Carrying amount
	£000	**£000**	£000	£000
Available for sale financial assets	**2**	**2**	11	11
Loans and receivables	**207**	**207**	346	346
Cash and cash equivalents	**906**	**906**	42	42
	1,115	**1,115**	399	399
Secured bank loans	**(6,843)**	**(6,960)**	(8,387)	(8,387)
Loan from related party	**(1,700)**	**(1,700)**	(1,350)	(1,350)
Trade and other payables	**(612)**	**(612)**	(462)	(462)
	(9,155)	**(9,272)**	(10,199)	(10,199)

Estimation of fair values

The following methods and assumptions were used to estimate the fair values shown above:

Available for sale financial assets – as such assets are listed, the fair value is determined at the market price.

Trade and other receivables/payables – the fair value of receivables and payables with a remaining life of less than one year is deemed to be the same as the book value.

Cash and cash equivalents – the fair value is deemed to be the same as the carrying amount due to the short maturity of these instruments.

Secured bank loans and other loans – the fair value is calculated by discounting the expected future cashflows at prevailing interest rates

Overview of risks from its use of financial instruments

The Group has exposure to the following risks from its use of financial instruments:

- credit risk
- liquidity risk
- market risk

The Board of Directors has overall responsibility for the establishment and oversight of the company's risk management framework and oversees compliance with the Group's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by the Group.

Notes to the consolidated financial statements (continued)

18 Financial instruments (continued)

The Board's policy is to maintain a strong capital base so as to cover all liabilities and to maintain the business and to sustain its development.

The Board of Directors also monitors the level of dividends to ordinary shareholders.

There were no changes in the Group's approach to capital management during the year.

Neither the company nor any of its subsidiaries are subject to externally imposed capital requirements.

The group's principal financial instruments comprise bank loans, cash and short term deposits. The main purpose of these financial instruments is to finance the group's operations.

As the group operates wholly within the United Kingdom, there is currently no exposure to currency risk.

The main risks arising from the group's financial instruments are interest rate risks and liquidity risks. The board reviews and agrees policies for managing each of these risks, which are summarised below

Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the Group's receivables from customers, cash held at banks and its available for sale financial assets.

Trade receivables

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each tenant. The majority of rental payments are received quarterly in advance which reduces the group's exposure to credit risk on trade receivables.

Other receivables

Other receivables consist of amounts due from a company in which the group holds a minority investment and an amount due from a previous tenant in respect of dilapidations.

The Group reviews the carrying value of trade and other receivables and will establish an impairment provision only if there are indications that the debt is not recoverable.

Available for sale financial assets

The Group does not actively trade in available for sale financial assets. The Group's investments had a fair value of £2,000 at 30 June 2009 *(2008: £11,420)* and so the Group does not have significant exposure to credit risk in relation to these assets.

Bank facilities

At the year end the company had loan facilities of £8.7 million *(2008: £8.4 million)* available.

Exposure to credit risk

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

18 Financial instruments (continued)

Credit risk (continued)

	Carrying value 2009 £000	2008 £000
Available for sale investments	**2**	11
Other receivables	**97**	282
Cash and cash equivalents	**906**	42
	1,005	335

A table showing the ageing of receivables at the balance sheet date is not disclosed as the company does not have trade receivables at the year end or previous year end. This position is representative of the position throughout the year.

The company does not have an allowance for impairment on trade receivables as, based on historical experience, management does not consider that such an impairment is required.

Credit risk for trade receivables at the reporting date was all in relation to property tenants in United Kingdom.

The company's exposure is spread across a number of customers.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due without incurring unacceptable losses or risking damage to the Company's reputation.

The group's main banking facility is subject to financial covenants and other conditions which the group monitors regularly. These covenants and conditions are sensitive to changes in rental income, interest rates and the value of properties. Whilst the directors cannot envisage all possible circumstances, the directors believe that, taking account of reasonably foreseeable adverse movements in rental income, interest or property values, the group has sufficient resources available to it, including additional support from the major shareholder if necessary, to ensure continued compliance with these conditions.

18 Financial instruments (continued)

Liquidity risk (continued)

The group's exposure to liquidity risk is given below

30 June 2009	Carrying amount	Contractual cash flows	6 months or less	6-12 months	1-2 years	2-5 years
Secured bank loans	6,960	7,155	2,059	53	5,043	-
Floating rate unsecured loan stock	1,700	1,760	30	30	1,700	-
Trade and other payables	612	612	612	-	-	-

30 June 2008	Carrying amount	Contractual cash flows	6 months or less	6-12 months	1-2 years	2-5 years
Secured bank loans	8,387	9,236	1,183	196	392	7,465
Floating rate unsecured loan stock	1,350	1,512	40	41	1,431	-
Trade and other payables	462	462	462	-	-	-

Market risk

Market risk is the risk that changes in market prices, such as interest rates, will affect the company's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

Interest rate risk

The Group borrowings are at floating rates of interest based on LIBOR or Base Rate.

The interest rate profile of the Group's borrowings as at the year end was as follows:

	2009 £000	2008 £000
Floating rate instruments – financial liabilities	**8,660**	9,737
	=======	=======

The weighted average interest rate of the floating rate borrowings was 2.61% *(2008: 7.20%)*.

A 1% movement in interest rates would be expected to change the Group's annual net interest charge by £86,000 *(2008: £97,732)*.

19 Operating leases

Leases as lessors

The group leases out its investment properties under operating leases. The future minimum receipts under non cancellable operating leases are as follows:

	2008 £000	2008 £000
Less than one year	**524**	**625**
Between one and five years	**1,982**	**2,139**
Greater than five years	**5,022**	**5,246**
	7,528	**8,010**

The amounts recognised in income and costs for operating leases are shown on the face of the income statement.

20 Income tax and deferred tax

At 30 June 2009, the group has a potential deferred tax asset of £670,000 (2008: £723,000) of which £261,000 (2008: £265,000) relates to differences between the carrying value of investment properties and the tax base. In addition the group has tax losses which would result in a deferred tax asset of £409,000 (2008: £458,000). This has not been recognised due to the uncertainty over future taxable profits.

Movement in temporary differences in the year

	Balance 1 July 07 at 28% £000	Recognised in profit or loss 2008 £000	Balance 30 June 2008 at 28% £000	Recognised in profit or loss 2009 £000	**Balance 30 Jun 09 at 28%** £000
Investment properties	873	(873)	-	-	-
Tax losses	(157)	157	-	-	-
Total	716	(716)	-	-	-

Movement in unrecognised deferred tax asset

£'000	Balance 1 July 07 at 28% £000	Additions £000	Balance 30 June 08 at 28% £000	Additions/ (disposals) £000	**Balance 30 Jun 09 at 28% £000**
Investment properties	-	265	**265**	(4)	**261**
Tax losses	-	458	**458**	(49)	**409**
Total	-	723	**723**	(53)	**670**

21 Issued share capital

	30 June 2009 No	30 June 2009 £000	30 June 2008 No.	30 June 2008 £000
Authorised				
Ordinary shares of 20p each	**20,000,000**	**4,000**	20,000,000	4,000
	========	=======	========	=======
Issued and fully paid				
Ordinary shares of 20p each	**11,882,923**	**2,377**	11,882,923	2,377
	========	=======	========	=======

Holders of ordinary shares are entitled to dividends declared from time to time, to one vote per ordinary share and a share of any distribution of the company's assets.

22 Capital and reserves

	Share capital £000	Capital redemption reserve £000	Share premium account £000	Retained earnings £000	Total £000
At 1 July 2008	2,377	175	2,745	13,311	**18,608**
Total recognised income and expense	-	-	-	1,337	**1,337**
At 30 June 2009	2,377	175	2,745	14,648	**19,945**
	======	======	======	======	======

Capital redemption reserve arose in prior years on redemption of share capital. The reserve is not distributable.

The share premium account is used to record the issue of share capital above par value. This reserve is not distributable and can only be reduced with court approval.

The retained earnings reserve is distributable with the exception of amounts arising in relation to property revaluations of £1.2m (2008: £nil). Such reserve is only distributable when the revalued assets are sold outside the group.

23 Related parties

Transactions with key management personnel

Transactions with key management personnel consist of compensation for services provided to the company. Details of this are given in note 6.

Other related party transactions

The group and company has unsecured floating rate loan stock due to Leafrealm Limited, a company of which ID Lowe is the controlling shareholder. This is on normal commercial terms. Leafrealm received £87,000 *(2008: £88,000)* interest in respect of its holding of Floating Rate Unsecured Loan Stock. The balance due to this party at the year end was £1,700,000 (2008: £1,350,000).

Company balance sheet at 30 June 2009

Caledonian Trust PLC

	Note	£000	2009 £000	£000	2008 £000
Fixed assets					
Tangible assets					
Investment properties	3		**5,435**		5,690
Equipment and vehicles	4		**25**		22
			5,460		5,712
Investments	5		**11,159**		11,168
			16,619		16,880
Current assets					
Stock of development property	6	**3,270**		3,272	
Debtors	7	**16,702**		18,042	
Cash at bank and in hand		**638**		29	
		20,610		21,343	
Creditors					
Amounts falling due within one year	8	**(12,358)**		(11,907)	
Net current assets			**8,252**		9,436
Total assets less current liabilities			**24,871**		26,316
Creditors					
Amounts falling due after more than one year	8		**(6,675)**		(7,750)
Net assets			**18,196**		18,566
Capital and reserves					
Called up shares capital	9		**2,377**		2,377
Share premium account			**2,745**		2,745
Capital redemption reserve			**175**		175
Revaluation reserves:					
Property	10		**2,520**		2,266
Investments	10		**1,305**		1,305
Profit and loss account	10		**9,074**		9,698
Shareholders' funds			**18,196**		18,566

The financial statements were approved by the board of directors on 23 December 2009 and signed on its behalf by:

ID Lowe
Director

The notes on pages 50-56 form part of these financial statements.

1 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the financial statements.

Basis of preparation

The financial statements are prepared under the historical cost convention as modified by the revaluation of investment properties and investments and in accordance with applicable accounting standards. The company has not presented its own profit and loss account in accordance with section 408 of the Companies Act 2006.

The company has taken advantage of the exemption contained within FRS 8 and has not disclosed details of transactions or balances with companies the results of which are included within the consolidated accounts of Caledonian Trust PLC.

Properties

Properties held by the group are classified within fixed assets as investment properties, or current assets if held as trading stock.

Investment properties

In accordance with Statement of Standard Accounting Practice No 19, investment properties are revalued annually at open market value either by the directors or by independent professional advisers. Independent professional valuations are prepared at least once every three years. All surpluses and deficits on valuation are taken directly to revaluation reserve except that any permanent diminution in the value of the investment property is taken to the profit and loss account for the year. No depreciation or amortisation is provided in respect of freehold investment properties.

This treatment may be a departure from the Companies Act requirements concerning the depreciation of fixed assets. However, the properties are not held for consumption but for investment and the directors consider that systematic annual depreciation would be inappropriate. The accounting policy adopted is therefore necessary for the accounts to give a true and fair view. Depreciation or amortisation is only one of the many factors reflected in the annual valuation and the amount which might otherwise have been shown cannot be separately identified or quantified.

1 Accounting policies (continued)

Properties held as stock

Properties held as trading stock are stated at the lower of cost or net realisable value.

For properties previously held as investment properties which are now held for development and reclassified as current assets, cost is considered to be the latest valuation prior to their reclassification. This is not in accordance with the Companies Act 2006, which requires current assets to be included at the lower of cost and net realisable value, and which would therefore require such properties to be restated on the basis of historical cost when they are reclassified. The directors consider that compliance with this requirement would fail to give a true and fair view of the profit and loss to the company on disposal of such properties from current assets, since such profit or loss would be dependent on the classification of the asset immediately prior to sale. The effect of this departure is to increase both the value of properties held for resale and the balance on the revaluation reserve by £36,249 at 30 June 2009 *(2008 - £36,249).*

Investments

Investments in subsidiary undertakings are included in the balance sheet of the company at cost or historic valuation less any provisions for permanent impairment. Surpluses or deficits arising on revaluations are taken to the revaluation reserve except in the case of impairments which are taken to the profit and loss account. The revaluation reserve is not distributable.

Other investments are held at cost unless they are considered to have suffered a permanent impairment. Such impairments are taken to the profit and loss account.

Dividends on shares presented within shareholders' funds

Dividends unpaid at the balance sheet date are only recognised as a liability at that date to the extent that they are appropriately authorised and are no longer at the discretion of the company. Unpaid dividends that do not meet these criteria are disclosed in the notes to the financial statements.

Depreciation

Tangible fixed assets, other than investment properties, are depreciated by equal instalments over their estimated useful lives at the following rates:

Office equipment	-	33.3 per cent
Plant and equipment	-	20.0 per cent
Fixtures and fittings	-	33.3 per cent
Motor vehicles	-	33.3 per cent

1 Accounting policies (continued)

Taxation

The charge for taxation is based on the profit for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred tax is recognised, without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date, except as otherwise required by FRS 19.

Post retirement benefits

The group makes payments to defined contribution pension schemes on behalf of certain employees. The amount charged to the profit and loss account represents the contributions payable to the schemes in respect of the accounting period.

2 Profit of parent company

As permitted by Section 230 of the Companies Act 1985, the profit and loss account of the parent company is not presented as part of these financial statements. The parent company's loss for the financial period after taxation was £499,523

3 Investment properties

	£000
Valuation	
At 30 June 2008	5,690
Revaluation in year	132
Disposals in year	(387)
Valuation at 30 June 2009	5,435

The carrying amount of investment property is the fair value at the balance sheet date as determined by external independent valuations at open market value made by Montagu Evans, independent property consultants, at 30 June 2009.

Fair values were calculated having regard to recent transactions for similar properties.

Investment properties comprise a number of commercial properties, some of which are leased to third parties with an initial rental period. Subsequent renewals are negotiated with the tenant.

	2009	2008
	£000	£000
The historical cost of investment properties included at valuation is:	**2,915**	3,424

The cumulative amount of interest capitalised for the company is £218,000 *(2008 - £343,000).*

4 Tangible fixed assets

	Motor vehicles £000	Office equipment £000	Other equipment £000	Total £000
Cost				
At 30 June 2008	15	48	33	96
Additions in year	3	-	10	13
At 30 June 2009	**18**	**48**	**43**	**109**
Depreciation				
At 30 June 2008	14	46	-	74
Charged in year	2	-	8	10
At 30 June 2009	**16**	**46**	**8**	**84**
Net book value				
At 30 June 2009	**2**	**2**	**21**	**25**
At 30 June 2008	-	-	22	22

5 Investments

	Shares in subsidiary investments £000	Listed investments £000	Total £000
Cost			
At 30 June 2008	4,933	11	4,944
Impairment	-	(9)	(9)
At 30 June 2009	4,933	2	4,935
Revaluation surplus			
At 30 June 2009 and 2008	6,224	-	6,224
Net book value			
At 30 June 2009	**11,157**	**2**	**11,159**
At 30 June 2008	11,157	11	11,168

Subsidiary undertaking	% held	Activity
Caledonian Scottish Developments Ltd	100%	Property Development
South Castle Properties Ltd	100%	Property Investment
Caledonian Stoneywood Ltd	100%	Investment Holding Company
Caledonian City Developments Ltd	100%	Property Development
West Castle Properties Ltd	100%	Property Investment
Melville Management Ltd	100%	Property Investment

All the principal subsidiary undertakings are registered in Scotland except Caledonian City Developments Limited and Caledonian Stoneywood Ltd, which are registered in England and Wales. A list of the other subsidiary undertakings will be included in the company's next annual return.

The company holds an unlisted investment of 19.9% of the share capital of Bedrocks Limited, a leisure activity operator registered in Scotland.

The market value of the company's listed investments at 30 June 2009 was £2,000 (2008 £11,000)

6 Stock of development property

	2009 £000	2008 £000
Properties held for resale or development	**3,270**	3,272

7 Debtors

	2009 £000	2008 £000
Amounts falling due within one year		
Prepayments and accrued income	**71**	40
Group relief receivable	**225**	-
	296	40
Amounts falling due in more than one year		
Amounts owed by subsidiary undertakings	**16,406**	18,002
	16,702	18,042

8 Creditors

Amounts falling due within one year

	2009	2008
Bank loans	**287**	290
Amounts owed to subsidiary undertakings	**11,665**	11,294
Other creditors and accruals	**406**	323
	12,358	11,907

	2009	2008
Amounts falling due after more than one year		
Bank loans	**4,975**	6,400
Floating rate unsecured loan stock	**1,700**	1,350
	6,675	7,750

Analysis of debt

Debt can be analysed as falling due:	2009	2008
In one year or less, or on demand	**287**	**290**
Between one and two years	**1,700**	**-**
Between two and five years	**4,975**	**7,750**
	6,962	**8,040**

The company's bank loans are secured by standard securities and floating charges over the assets of the company and certain subsidiaries and by an unlimited guarantee from Caledonian Trust PLC. Interest charged on these loans is based on margins ranging from 0.95% over the prevailing London Interbank Offer Rate to 1.5% over the Bank of Scotland base rate.

The floating rate unsecured loan stock is repayable in July 2010. Interest is charged at a margin of 3% over the Bank of Scotland base rate.

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9 Share capital

	2009		2008	
	No.	**£000**	No.	£000
Authorised				
Ordinary shares of 20p each	**20,000,000**	**4,000**	20,000,000	4,000
	========	========	========	=======
Allotted, called up and fully paid				
Ordinary shares of 20p each	**11,882,923**	**2,377**	11,882,923	2,377
	========	========	========	=======

10 Reserves

	Revaluation reserves		Profit and
	Property	**Investments**	**loss account**
	£000	**£000**	**£000**
Balance at 30 June 2008	2,266	1,305	9,698
Property revaluation	132	-	-
Loss for the financial year	-	-	(502)
Transfer to profit and loss	122	-	(122)
Balance at 30 June 2009	**2,520**	**1,305**	**9,074**
	=======	=======	========

The movement in the valuation of investment properties has been reflected through the revaluation reserve as the directors are of the opinion that such movements are temporary.

11 Reconciliation of movements in shareholders' funds

	2009	2008
	£000	£000
Retained loss for the financial year	**(502)**	(6,835)
Revaluation surplus/(deficit)	**132**	(71)
Net decrease in shareholders' funds	**(370)**	(6,906)
Opening shareholders' funds	**18,566**	25,472
Closing shareholders' funds	**18,196**	18,566
	========	========

12 Related party transactions

The group and company have unsecured floating rate loan stock due to Leafrealm Limited, a company of which ID Lowe is the controlling shareholder. This is on normal commercial terms. Leafrealm received £87,000 *(2008: £88,000)* interest in respect of its holding of Floating Rate Unsecured Loan Stock. The balance due to this party at the year end was £,1700,000 (2008: £1,350,000). Transactions with subsidiary undertakings have not been disclosed as the company has taken advantage of the exemption contained within FRS 8.