FSC Guidance Note No. 6.00

Mortgage Trusts – Disclosure Guidelines

March 2007

Main features of this Guidance Note are:

- **To establish minimum disclosure requirements relating to Scheme's who invest in Mortgage Investments;**
- **To standardise the framework by which certain information is considered by Scheme Managers as it relates to Mortgage Trusts; and**
- **To specify minimum disclosures in Product Disclosure Statements (PDS), financial statements and marketing collateral.**

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1 Title

1.1 This Guidance Note may be cited as FSC Guidance Note No.6.00 "Mortgage Trusts – Disclosure Guidelines".

2 Guidance Note and Commentary

2.1 The guidelines set out in this Guidance Note are shown in bold print; commentary is shown in normal print immediately after a guideline, as an aid to the interpretation of the guideline.

3 Date of Issue

3.1 1 March 2007

4 Effective Date

4.1 This Guidance Note should be applied in relation to the Scheme Offering Documents and financial statements on or after 1 July 2007.

5 Application

5.1 This Guidance Note should be applied by the Operator of a Scheme (whether offered for public subscription or otherwise) in relation to that Scheme.

5.2 Where there is a conflict between the requirements of this Guidance Note, applicable legislation, and the Constitution document, the requirements of this Guidance Note should, having regard to the purpose of the Guidance Note, be modified appropriately

so that, as far as practicable, the Operator complies with the requirement of this Guidance Note.

6 Statement of Purpose

6.1 To establish minimum disclosure requirements relating to Scheme's which invest predominantly in Mortgage Investments;

6.2 This Guidance Note seeks to standardise the framework by which certain information is considered by Scheme Managers as it related to Mortgage Trusts; and

6.3 To specify minimum disclosures in PDS, financial statements and marketing collateral

7 Application of Materiality

7.1 The contents of PDS for mortgage trusts are prescribed, in part, by provisions in the Corporations Law and the Regulations to the Corporations Law. PDS must contain additional information which is known by the directors, promoters and others who authorise or cause the PDS to be issued and which is material to the Scheme members decision to invest.

7.2 In all cases it is necessary to determine whether any particular information is material. If particular information is material, it should be disclosed; if it is not material, it need not be disclosed. If information is highly material, it should be given prominence. It may well be that for some entities additional information, not referred to in these guidelines, is also material and accordingly must be disclosed.

8 Definitions

8.1 **In this Guidance Note:**

- **'Associate'** has the same meaning as in FSC Guidance Note No. 5.00 'Industry Terms and Definitions';
- **'Commercial properties'** is a generic term and includes offices, retail shops, factories and warehouses.
- **'Completion value or estimate of end value lending'** means that the estimated profit margin is taken into account in establishing financial exposure limits, this may mean a higher exposure to the underlying loan asset and a commensurate reduction in the requirement for borrower equity.
- **'Construction & development properties'** are properties on which buildings are being built. The full value of the property is only realisable upon successful completion of the project and will depend on the project being completed within budget and on time.

- **'Cost to complete'** means**,** that the Manager only lends money against the actual construction costs and retains sufficient funds such that it is able to complete the project.
- **'Fixed interest securities'** are investments that give the holder the right to a fixed money income or contractually determined variable money income.
- **'Full Doc'** is where the Lender requires a borrower to provide full financial documentation (i.e. balance sheet and profit and loss statements for the past two financial years, asset and liability statements for any individuals associated with a loan together with any other details deemed necessary by the Lender) so as to demonstrate a clear capacity to pay interest on a loan as and when it falls due.
- **'Investors'** has the same meaning as in FSC Guidance Note No. 5.00 'Industry Terms and Definitions';
- **'Loan to Value Ratio (LVR)'** is one of the factors lenders consider before they approve a mortgage. This is the loan amount expressed as a percent of either the purchase price or the appraised value of the property.
- **'Low Doc'** is where the Lender requires a borrower to provide limited financial documentation (i.e. Balance sheet and profit and loss statement for one year only and /or cash flow projections and /or loan statement from outgoing mortgagee(s)/retention of interest for the loan term, so as to demonstrate an acceptable capacity to pay interest on a loan as and when it falls due;
- **'Manager'** has the same meaning as in FSC Guidance Note No. 5.00 'Industry Terms and Definitions';
- **'Material'** has the same meaning as in FSC Guidance Note No. 5.00 'Industry Terms and Definitions';
- **'Mezzanine debt'** is where funds are borrowed on a second or subsequent mortgage basis. Mezzanine debt attracts a higher interest rate due to higher risks and in the event of default, will rank behind prior mortgages;
- **'Mortgage Trust'** means a Scheme that invests in loan receivables and secured by a registered mortgage against real property;
- **'No Doc'** is where the Lender provides a loan on the strength of the proposed security only and does not require a borrower to provide any financial statements or accounts to demonstrate a capacity to pay interest on a loan as and when it falls due.
- **'Operator',** in relation to a Scheme has the same meaning as in FSC Guidance Note No. 5.00 'Industry Terms and Definitions';
- **'PDS'**, in relation to a Scheme has the same meaning as in FSC Guidance Note No. 5.00 'Industry Terms and Definitions';
- **'Registered first mortgage'** is the charge over the property securing the payment of the loan. A registered first mortgage is the first charge over the property and must be repaid before any subsequent charge (e.g. a second registered mortgage);
- **'Related Party'** has the same meaning as in FSC Guidance Note No. 5.00 'Industry Terms and Definitions';
- **'Related Party Transaction'** has the same meaning as in FSC Guidance Note No. 5.00 'Industry Terms and Definitions';

- **'Residential properties'** are houses and apartment blocks; individual units/apartments.
- **'Scheme'** has the same meaning as in FSC Guidance Note No. 5.00 'Industry Terms and Definitions'; and
- **'Self declaration'** is where the Lender only requires a borrower to provide a 'self declaration' form certifying that the borrower believes he/she/ has the capacity to pay interest on a loan as and when it falls due;
- **'Specialised properties'** are properties built for a specific and specialised purpose such as child care, aged care, hospitals, service stations, hotels, motels and conference centres. These properties generally require specialist management to run, have configurations which tend to make them unsuitable for alternative use (in their present state) and, if offered for sale or lease may have a restricted market.

9 General Principles and Disclosure Requirements

9.1 Why are Specific Disclosures Needed?

Significant scope exists to disclose different information in PDS, financial statements and marketing collateral as they relate to Schemes. In particular, the unique nature of the risks involved in Mortgage Trusts results in a need to ensure minimum disclosures are maintained. The disclosure of minimum information ensures Investors are able to compare different Schemes in a transparent manner.

9.2 Related Party Disclosures

9.2.1 The PDS and financial statements should contain a statement which provides details of the fees, benefits and advantages derived by the Manager and its Associates in connection with managing the Scheme and the sale or purchase of mortgage loans to or from the Scheme during the previous year. The statement should describe each type of service provided, eg. The procuration of mortgage loans, and the disclosure of the name of the entity providing the services.

9.2.2 Where Mortgage Trusts involve Related Party Transactions, adequate disclosure of the nature of such transactions is important.

9.3 Specific Disclosures:

9.3.1 Composition of Mortgage Investments

The PDS and the financial statements provided to Scheme members should disclose in an appropriate manner, preferably in a table, graph and/or chart, prepared as at a date

no later than the last financial quarter preceding the PDS or balance date, (where relevant):

- **in relation to mortgage loans that are drawn down in more than one tranche, the value of these mortgage loans and un-drawn loan commitments. The Manager must be able to demonstrate that, at the time of making the loan, they are covered by funds in situ or a standby facility from a recognised financial institution;**
- **the total number and value of mortgage loans and total number of mortgagors (where mortgagors are related companies, they should be treated as one mortgagor). In any case where more than 5% of the entity's funds have been lent to one mortgagor, the percentage of the fund so lent should be disclosed;**
- **if loans are secured by second or subsequent mortgages or if loans are assigned, in part, on terms which effectively subordinate the rights of the entities to the rights of the assignee. The distribution of the mortgage portfolio between first mortgages and other mortgages should be broken down in 5% increments e.g. 60-65%, 65-70%, 70-75%;**
- **the distribution of the mortgage portfolio according to the type of property securing the mortgage loans (vacant land, improved residential, improved commercial, improved industrial, improved retail, specialised properties {such as hotels, motels, clubs, bowling alleys, squash courts, nursing homes, hospitals and the like}, predevelopment land, and construction projects);**
- **in relation to the distribution of the mortgage portfolio (above) the manager is to specify the maximum percentages for the following categories: specialised properties, vacant land, development land and construction projects;**
- **the distribution of the mortgage portfolio in different states. The manager should indicate the criteria used to define which states and territories the manager may provide mortgage loans. Moreover within each state and territory the manager should list the types of geographic locations e.g. capital cities, major regional centres and remote locations;**
- **the interest rates payable on the mortgage loans in the portfolio in groups of not less than 0.5%;**
- **the dates, at no later than yearly intervals, at which mortgage loans included in the portfolio, reach maturity. The manager should specify number and value of mortgage loans in each interval;**
- **the number and status of mortgage loans for which principal and/or unpaid interest are 90 days or more in arrears or principal and/or unpaid interest are 60 days or more in arrears in groupings of 30 days e.g. how many loans are in arrears 90 days or more, 60 days or more.**

9.3.2 Policies of the Manager

The PDS and financial statements should disclose any restrictions contained in the Constitution document relating to mortgage loans, which may be entered into. In particular, PDS should disclose whether loans are to be secured by first or subsequent

mortgages; the upper limit of the LVR; whether loans may be made at fixed interest rates, variable rates or both; and any requirement for mortgage insurance. If mortgage insurance is required by the Constitution document, particulars of the type of mortgage insurance so required should be disclosed.

9.3.3 Investment Policies

To allow Investors the ability to understand the different approaches to the management of Mortgage Trusts, it is important the key approach the Manager will take is accurately disclosed.

The PDS should disclose investment policies of the Manager and a clear explanation of the attendant risk, including:

- **proposed distribution of the mortgage portfolio having regard to the matters referred to in paragraph 9.3 above;**
- **the method of determining borrowers' individual capacity to provide loan servicing. The manager should be specific and indicate if debt servicing is undertaken on a 'full doc' basis, 'lo doc' basis, 'no doc' basis or borrowers 'self declaration' basis or a combination of them. If the manager has a mix of policy governed by increasing loan amounts then this should be stated;**
- **whether or not security properties are required to be income producing, and whether or not loans are made on the security of development projects;**
- **proposed use of derivatives, how they are being used. Note, the Responsible Entity may use derivatives for the purposes of managing interest rate risk. Derivatives should not be used for speculative purposes;**
- **that all valuations will be prepared by independent licensed valuers and Scheme Operators should disclose in their PDS how the valuation of the mortgage trust was derived. Where loans are made for development projects, the manager should specify what basis the valuation has been undertaken i.e. on total development costs, hard costs, on completion or any other method;**
- **Where a scheme undertakes lending on a completion or end value basis or on a basis that a reasonable person would believe is similar to that, the manager should clearly outline the in risks inherent in such lending and indicate the actual LVR / potential LVR exposure of the fund as if the Loan was considered on a 'On Completion' basis; and**
- **The managers' policy on revaluing mortgaged property upon loan maturity prior to formally renewing and extending the facility.**

9.3.4 Buy-back and Borrowings

The PDS and annual report to members should disclose the arrangements made to meet the buy-back obligations (if any) of the Manager, including disclosures of the liquid assets of and any lines of credit available to the entity or the Manager. Liquid assets would be

those readily realisable within the entity's buy-back period but tradeable securities and cash should be shown separately from mortgage loans maturing within the buy-back period. For lines of credit, amounts available, conditions under which they may be drawn upon, and for the Manager details of other entities they may also support should also be disclosed together with current (no later than the last financial quarter preceding the PDS or balance date, where relevant) and proposed liquidity levels of the entities in percentage terms; and

9.3.5 Scheme Borrowing

The PDS and annual report should disclose any provisions in the Constitution document relating to borrowing by the entity, current borrowings by the Manager and the entity whether for lending, buy-back, redemption or other purposes and the policy of the Manager in relation to borrowings.

9.3.6 Borrowers represent a particular risk that is important for Investors to be informed about as they assess the merits of individual Schemes.

9.3.7 Loan origination fees

The PDS and financial statements should disclose where the Manager will pay a loan originator a % of the value of a loan for the life of that loan, the % range between X & Y%. Where this fee is negotiable it would be appropriate to detail that it is negotiable as opposed to a set % amount.

Where the Manager or a 3rd party that a reasonable person would believe is a related party to the Manager receives fees in relation to arranging or approving the loan the range of such fees expressed as a % of the loan amount, eg 'between 0.25 and 1% of the loan amount".