BALMAIN INVESTMENT MANAGEMENT

The investment case for a Granular Portfolio of Australian Mid-Sized Secured Commercial Real Estate Loans

MAY 2012

BROOKVINE
A Brookvine Boutique Partnership

balmain
investment management

DISCLAIMER

This document has been prepared by Balmain Investment Management Pty Limited ABN 20 153 577 934 ("BIML"), for consideration by the Recipient ("Recipient") for its exclusive use, on the express understanding that the contents will be regarded and treated as strictly confidential. This document may not be reproduced or used in whole, or in part, for any purpose other than that approved in writing by BIML. BIML acts as an Authorised Representative of Balmain Fund Administration Limited ("BFAL") under BFAL's Australian Financial Services Licence, number 333213 (Authorised Representative No. 419018).

The contents of this document and all information relating to the Secured Private Debt Fund or a related SMA ("Fund") is confidential and must not be disclosed by the Recipient of the information to any person except on a need to know basis to its employees, its consultants and persons who have or may have an immediate association with the Recipient in relation to the Fund.

The Recipient must ensure that the persons referred to above are aware of and comply with these confidentiality requirements. If requested by BIML the Recipient must return all information in the possession of the Recipient and the persons referred to above. The Recipient may be required to sign a non-disclosure agreement.

BIML has prepared this document with reasonable care but does not represent or warrant that the information in this document is correct or complete. Neither BIML, nor any member of the Balmain Group (Balmain NB Corporation Ltd ABN 86 107 505 760 or any of its subsidiary companies), nor any associate of the Balmain Group, is liable (whether at law, in equity, under statute or otherwise) for any statement made or anything contained in or arising out of the information contained within this document, including without limitation, any errors, misrepresentations or omissions.

No person has been authorised to give any information (other than as contained in this document), or make any representation, or warranty in connection with the proposed arrangements on behalf of BIML, or any Balmain Group subsidiary or associate and any such information, representation or warranty should not be relied on as having been authorised by BIML or any Balmain Group subsidiary or associate.

The Recipient should take its own legal and other advice regarding its obligations under this disclaimer. Should the Recipient decide against participating in the proposed arrangement, the Recipient is required to return this document to Balmain immediately and to destroy all material prepared from and/or containing any information from this document.

No party assumes any responsibility to update this document in any respect. All amounts referred to in this document are in Australian dollars unless otherwise stated.

This presentation is being made only to 'wholesale clients' and must not be distributed to or relied upon by any other person.

CONTENTS

- Features of a Granular Portfolio of Australian Mid-Sized Secured Commercial Real Estate Loans
- Comparison of Current Market Yields
- Current Market Opportunity
- Why the Investment Opportunity is Enduring
- Advantages of a Mid-Sized Loan Program versus a Large Loan Program
- Avoiding the Pitfalls of a Mid-Sized Loan Program
- Structures and Arrangements Required to be Successful

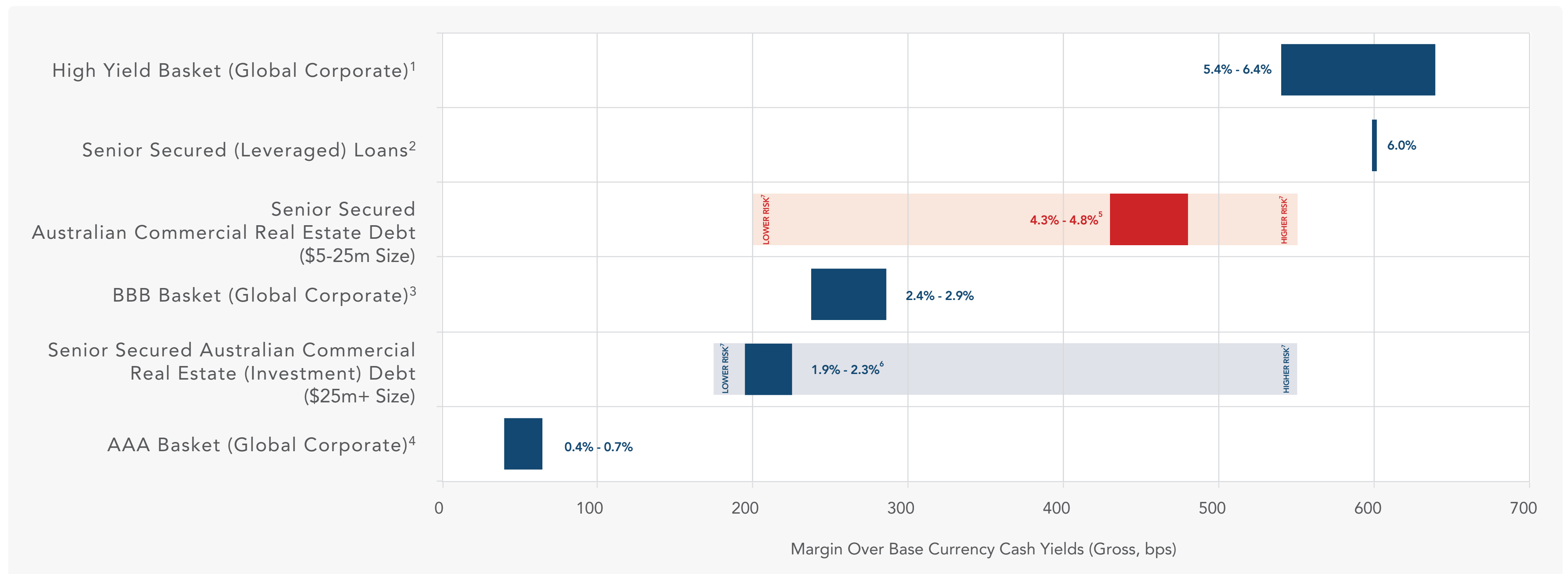
FEATURES OF A 'GRANULAR' REAL ESTATE LOAN PORTFOLIO

Favourable Risk-Reward Outcome and a Strong Complement to Larger Loan Programs

- Australian mid-sized first mortgage secured commercial real estate loans
- Average loan size of $5-$10m enhances portfolio diversification by geography, security type, borrower, loan type and industry sector
- Floating interest rate with current gross returns to investors of 4.3% – 4.8% p.a. over 90-day bills
- Quality borrowers that generally provide corporate and/or personal guarantees
- Securities are less complex, require less capital and are easier to manage on default
- Lower portfolio loss in the event of a single loan default with outstanding balances easier to recover
- Less competition as access to these assets requires significant distribution capacity
- Greater resilience to margin pressure given limited competition
- Closely mimics the diversity of commercial real estate lending by the Major Banks

A GRANULAR PORTFOLIO HAS FAVOURABLE $A YIELDS

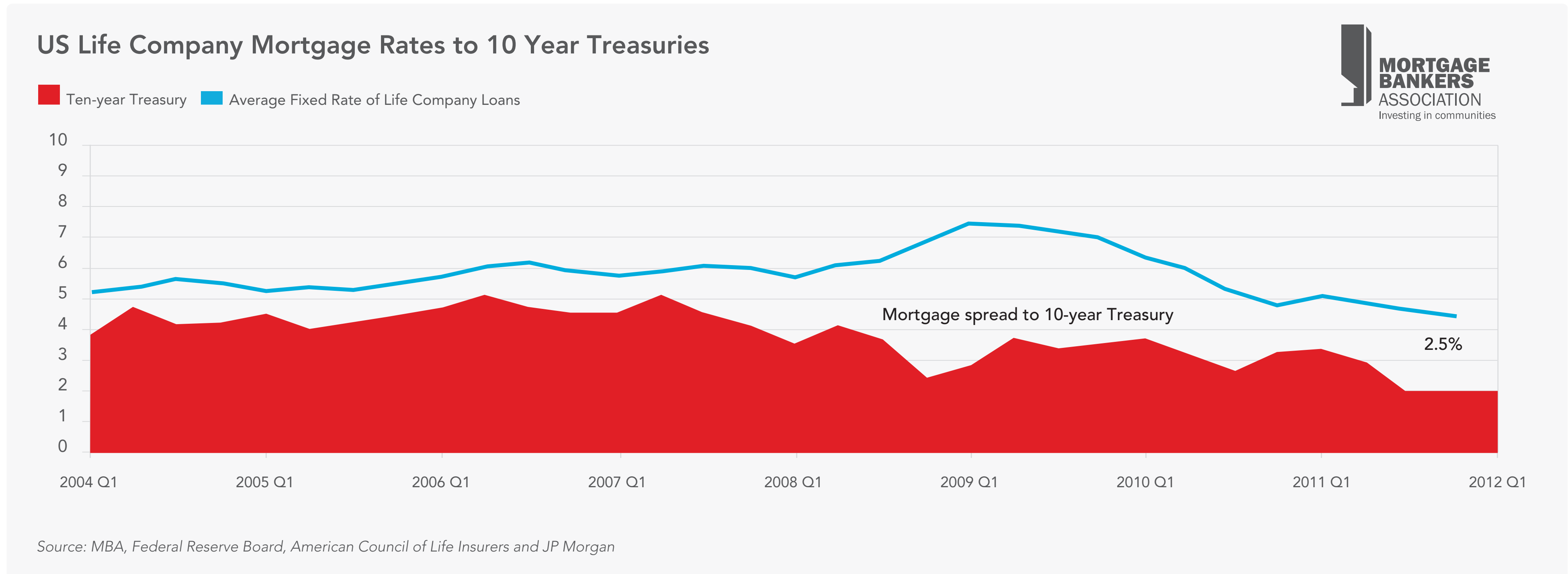
Current Margins over Cash Yields as at February 2012



1 Range of Merrill Lynch High Yield Indices spread over swap rate for the US High Yield Master II Index , Euro High Yield Index and Global High Yield Index
2 Credit Suisse Leveraged Loan Index, Weighted Spread to Maturity (including amortisation of discount), 31 March 2012
3 Range of Merrill Lynch High Yield Indices spread over swap rate for the US Corporates BBB 3-5 years, EMU Corporate Large Cap BBB 3-5 Years and Global Large Cap Corporate BBB
4 Range of first mortgage Prime (A-grade) commercial property debt in Australia. Sourced from Balmain database.
5 Target margin of the Balmain Secured Private Debt Fund, 4.3% - 4.8% (gross).
6 Target margin of "trophy debt", keenly sought by and preferred by Major Banks.
7 Realistic range of individual loan margins from low to high risk, dependent on leverage, size of loan, sponsor/counter party, environmental factors, location, quality of underlying assets, tenancy etc.

A COMPARISON WITH THE US MORTGAGE MARKET

US Life Company Mortgage Rates



* Note: US Life Company loans are typically 1st mortgage secured over income producing commercial property, average LTV 65% and average DSCR > 1.25:1.

A COMPARISON WITH SENIOR SECURED (LEVERAGED) LOANS[1]

Complementary Asset, with Many Fundamentally Different Portfolio and Risk Characteristics

	BALMAIN SECURED PRIVATE DEBT TRUST	SENIOR SECURED (LEVERAGED) LOANS[1]
OVERVIEW OF UNDERLYING SECURITY	First mortgage over Australasian real estate.	Generally first charge/lien over corporate operating entities and collateral securities.
PORTFOLIO CHARACTERISTICS:		
Senior	Yes	Yes
Diversification	Granular	Granular
Leverage	Moderate (to security value)	Moderate (to business earnings)
Grade of Debt	Sub-Investment Grade	Sub-Investment Grade
Security Access	Property accessed by efficient statutory enforcement procedures	Operating businesses accessed by insolvency appointments
Enforceability	Control of security readily available with no requirement for managing operating businesses	Control of security may require management of operating business
Geographic Markets	Australia	US, Europe
Risk of Spread Dilution/ Product Structure	Nil/ Closed End	High/ Typically Open Ended
TRANSACTIONAL STRUCTURE		
Origination	Mostly Proprietary	Varies; Commonly 3rd Party Bank
Syndicated &/ or Club Deals	No	Usually
Lead Role in Transaction Structure	Always	Not Common
Primary, Secondary	Always Fresh Loans (Primary)	Primary and Secondary
Transaction Complexity	Low	High
Covenants, Protections	Yes	Yes

A COMPARISON WITH SENIOR SECURED (LEVERAGED) LOANS[1]

Complementary Asset, with Many Fundamentally Different Portfolio and Risk Characteristics

	BALMAIN SECURED PRIVATE DEBT TRUST	SENIOR SECURED (LEVERAGED) LOANS[1]
Transparency of All Fees to End Investor[2]	Full & Complete	None
Alignment of Origination Economics[3]	Yes	No
ASSET MANAGEMENT AND RECOVERY		
Secondary Market	No	Yes
Monitoring Complexity	Low, security revaluations occur annually	High, relies on analysis of trading performance
Ease of Recovery	Easier	Harder
FINANCIAL CHARACTERISTICS		
Mark–to–Market Volatility	None	Moderate; 9% per annum (ave. of last 3 Years)
Drawdowns	None	Moderate; 30%+ (Jun-07; 30 months Recovery)
Spread	Moderate	Higher
Spread Volatility	Low/Stable	Moderate
Default Rate (Thru Cycle)	<5%	<5%
Default Rate (Peak)	>5%	>10%
Loss Given Default Rate	<1%	20% – 30% (Last 10 years)
Correlation to Equity Markets	Low; Negligible	Moderate; 0.4 to 0.6

Favourable Sub-Optimal

1 Also commonly referred to as leveraged loans, bank loans, term loans and syndicated loans. Data based on Credit Suisse Leveragd Loan Index.
2 Includes all origination and on-going monitoring and administration fees
3 Extent to which fees earned by origination are able to be offset against capital losses or clawed back in default

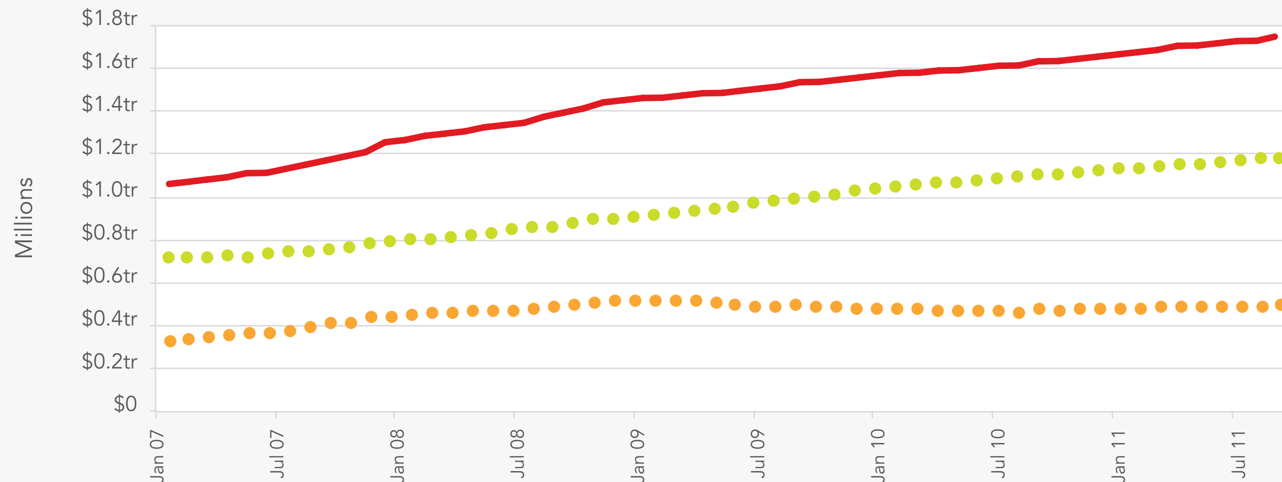
DISLOCATION OF LENDING MARKETS AND REDUCED COMPETITION

Far Fewer Lenders and a Focus on Household Lending

Numbers of Active Lenders	1st Tier Bank	2nd Tier Bank	Commercial Securitised	1st Tier Mortgage Fund	2nd Tier Mortgage Fund	Total
2008	4	14	2	8	22	**50**
2012	4	6	0	1	4	**15**

Source: Balmain NB Corporation Limited

Commercial & Household Assets



Bank Lending: November 2008 to December 2011:

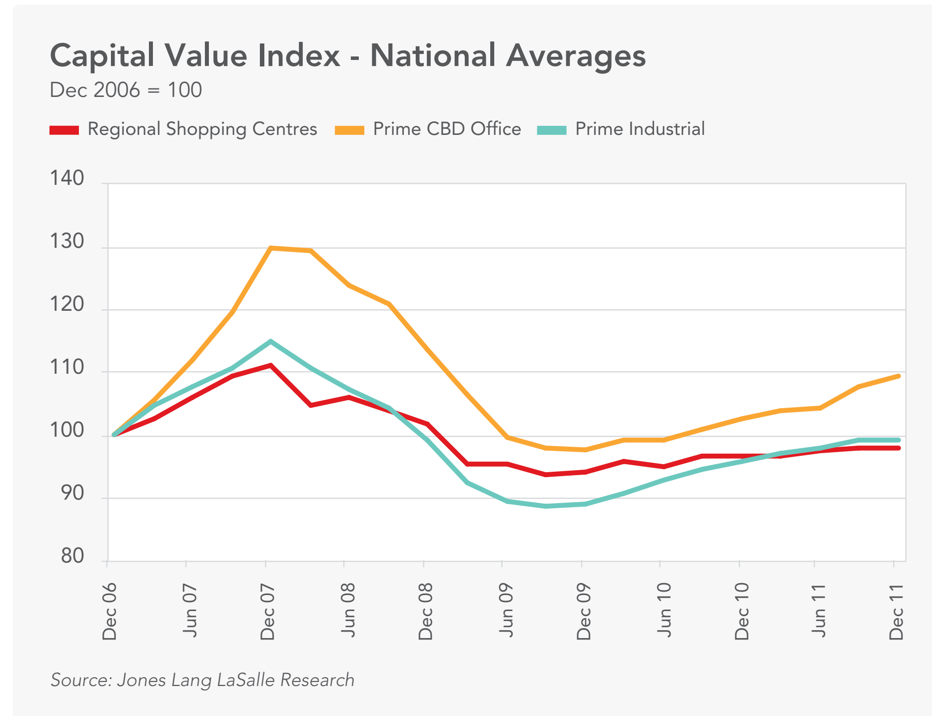
Total:	**21.44%** ▲
Household:	**36.25%** ▲
Commercial:	**2.25%** ▼

In percentage terms commercial lending has dropped from 38.2% to 30.75% of total lending over this period.

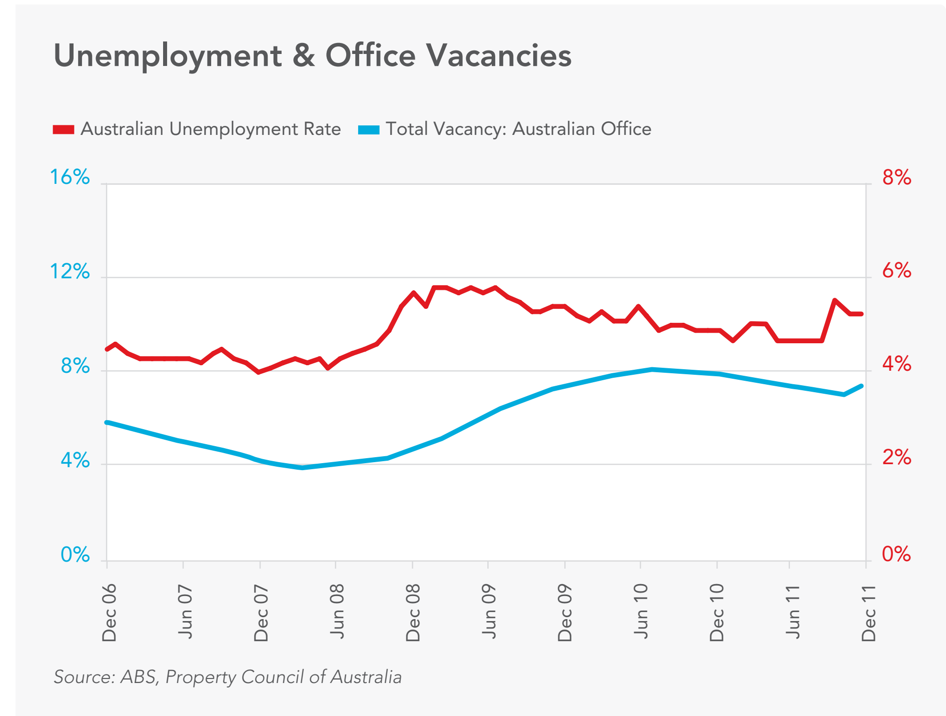
Source: APRA Monthly Banking Statistics

COMMERCIAL PROPERTY VALUES RE-RATED AND STABILISED

Leading Indicators Favourable



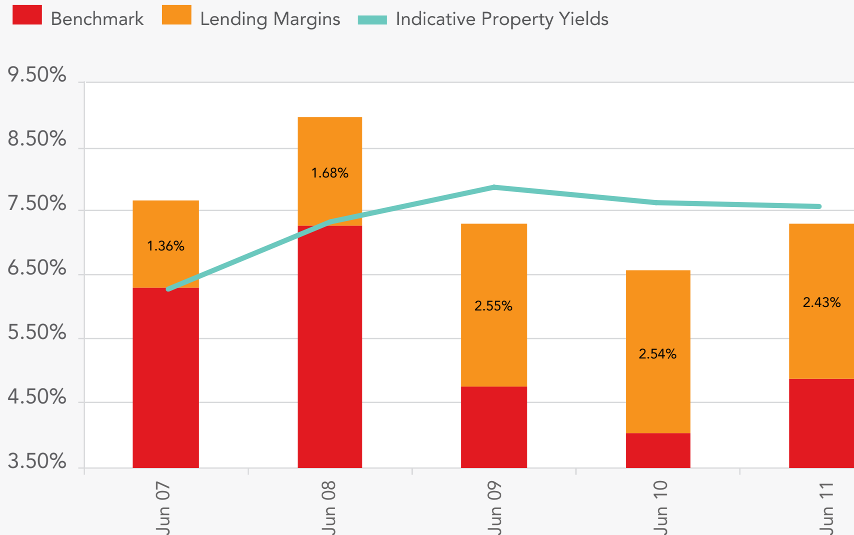
Source: Jones Lang LaSalle Research



Source: ABS, Property Council of Australia

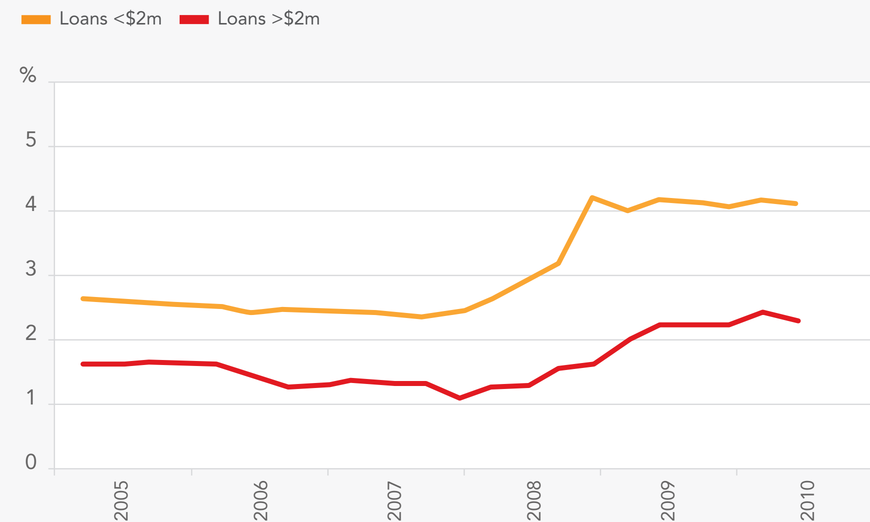
MARGINS HIGHER BUT NEW BORROWER ECONOMICS HEALTHY

Cost of Debt Lower & Yields Higher



Source: Balmain NB Corporation Limited, Average margin on Secured Private Debt loans 2007-2011
La Salle Investment Management

Spreads on Outstanding Business Loans



Source: APRA; RBA

INVESTORS BENEFIT FROM HIGHER MARGINS AND REDUCED RISK

- Market dislocation has given the Major Banks market dominance[8]
- Removal of many market participants (foreign banks, 2nd tier banks and mortgage trusts) has created opportunity for new investors
- Re-rating of commercial property values has reduced capital risk and improved debt servicing capacity on new loans
- Property fundamentals remain sound with no systemic overdevelopment and stable vacancy rates
- Resulting market conditions have enabled remaining lenders to improve risk-reward by:
    - Lowering LVRs and increasing debt service requirements
    - Achieving more advantageous loan covenants
    - Obtaining margins 2-3 times higher than pre-GFC

But:

- Notwithstanding margin increases, the fall in benchmark rates and improved property yields have improved the economics for property borrowers post-GFC

8 Balmain estimates that due to the withdrawal of foreign banks, the acquisition of 2nd tier banks and removal of the mortgage trust sector, the Major Banks currently advance over 95% of all secured private debt loans.

WHY THE INVESTMENT OPPORTUNITY WILL ENDURE

Favourable Lending Environment Unlikely to Change in Medium Term

SUPPLY INADEQUATE

- Capital adequacy ratios required after Basel I & II do not favour bank commercial lending
- Funding concerns limit banks' desire to lend longer-term (i.e. 3+ years) in non-residential sectors
- Banks are focusing on business lending with shorter terms and higher margins
- Dislocation of the capital markets inhibits commercial securitised lending
- 2nd tier & foreign banks absorbed or departed and retail mortgage funds unable to re-establish
- Unlike in other developed markets large institutional funds are absent from this sector

DEMAND STRONG

- Property investment economics favourable
- Borrowers remain frustrated by lack of choice/competition
- Borrowers frustrated by lack of tenure
- Borrowers continue to require diversified funding sources
- Borrowers seek patient, long-term finance providers for core investment holdings

ADVANTAGES OF A GRANULAR PORTFOLIO OF MID-SIZED LOANS

$5m to $10m Mid-Sized Loan Program versus Large Loan Program

$5M TO $10M MID-SIZED LOAN PROGRAM

- Guarantees are usually provided
- Less competition for smaller loans – the demise of the 2nd tier banks, retail mortgage trusts and capital market participants has reduced competition in the mid-sized commercial loan space to levels not previously experienced
- Lower competition leads to higher margins
- Securities easier to manage on default
- Higher risk diversification able to be achieved
- Easier to shape portfolios in light of strategic changes to asset allocations

LARGE LOAN PROGRAM

- Guarantees are generally unavailable in respect of large loans as borrowers are typically SPVs, Trusts or large Corporates unwilling to furnish guarantees
- Large loans are typically the domain of the Major Banks – levels of competition have not reduced as much as for mid-sized loans
- Higher competition leads to lower margins
- In the event of default it is usually more complex to manage a large property (e.g. a 25,000m2 shopping centre) to retain value
- More concentrated, less flexible

MID-SIZED LOANS ARE LOWER RISK

- A portfolio of mid-sized loans allows geographic risk to be de-concentrated – natural disasters such as the Brisbane floods could be devastating to a geographically concentrated large loan portfolio
- Mid-sized loans have less re-financing risk on loan expiry whilst the larger a loan the smaller the group of potential re-financiers
- Mid-sized loans have lower capital expenditure risk – large loans are generally secured by large buildings which can have significant capital expenditure requirements
- Properties securing mid-sized loans are generally more adaptable to renewal or changes of use
- Heavy reliance on a single counter-party (e.g. a tenant) can be highly detrimental with a large loan as the pool of potential replacement tenants is far smaller than for a smaller loan
- Large, high value properties demonstrate high beta risk – significant value swings can occur as buyers retreat in bad times and over-compete in good times
- A portfolio of mid-sized loans allows borrower risk to be spread over a multiplicity of entities securing multiple obligations
- A portfolio of mid-sized loans can be more readily spread across industrial, commercial, retail, etc. sectoral weakness can cause problems in concentrated large loan portfolios

AVOIDING THE PITFALLS OF MID-SIZED LOAN PROGRAMS

Importance of a Large Origination Network and In-House Expertise

- A portfolio of loans with an average size of $5m to $10m will take longer to build than an equivalently sized portfolio of large loans – a large loan origination network coupled with strong credit underwriting resources can minimise the lag
- Without a distribution partner, or significant investment in distribution infrastructure, new entrants can end up with marginal, less established borrowers
- A portfolio of small to medium loans requires a significantly larger pool of potential borrowers than would be required for a portfolio of large loans – this disadvantage is readily overcome by a large loan origination network
- A portfolio of small to medium loans requires a higher level of resources and systems for loan origination, credit underwriting, asset management and loan servicing

A FRESH AND TRANSPARENT APPROACH IS ESSENTIAL

Protections Investors Should Seek – for all Mid-Sized and Large Loan Programs

INVESTOR ISSUE	INVESTORS SHOULD SEEK...
Investor does not get fair share of lending fees	Arrangements that ensure investors are advised of all fees, backed-up with warranties and indemnities provided by all parties in the lending chain, and participate in an appropriate share of these fees
Investor does not get fair share of borrower economics	Dedicated investment manager concentrating on a single asset class with no retention of economics in other loan categories, transactions or deposits
Related party lending and "future value" lending	Complete embargo on both
Inability to access quality assets in sufficient quantity	Extensive distribution network, long-standing relationships with established borrowers and proven ability to generate quality assets in volume
Management not experienced in all facets of mortgage investment	Cycle-experienced investment team across the entire value chain
Poorly defined investment criteria	Clearly defined investment categories and embedded diversification requirements
Poor reporting and portfolio analysis	Proprietary look-through systems that provide complete access to borrower and portfolio information daily

WHY INVEST IN A GRANULAR LOAN PORTFOLIO?

- Higher risk diversification able to be achieved
- Easier to shape portfolios in light of strategic changes to asset allocations
- Lower capital risk due to borrower guarantees
- Higher loan margins = higher investor returns
- Reduced competition for loans
- Strong and largely unsatisfied borrower demand
- Investment case strengthened by a dedicated and specialised investment manager with appropriate structures and arrangements