



Independent Research

October 2006

## Compass Secured Bonds

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## Research – Secured Bonds

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# Compass Secured Bonds

## Summary

### Offer Overview

Compass Capital Ltd (Compass Capital) seeks to raise up to \$100m by way of senior first ranking secured bonds (the Compass bonds), paying up to 8.5% p.a. quarterly, to fund the acquisition of a portfolio of authorised investments comprising primarily loans secured by either a first or second mortgage over freehold or leasehold real estate in New Zealand.

### Features of the Issue

In addition to the issue of \$100m of secured bonds, Compass Capital has issued subordinated second ranking secured bonds to Bridgecorp Limited (Bridgecorp), which will be the greater of \$2m or 5% of total tangible assets of Compass Capital measured at the end of each month. The Compass bonds are secured by a first ranking security interest in favour of the Trustee over the assets and undertakings of Compass Capital, which are primarily either first or second mortgage loans made or acquired by Compass Capital and will feature other security measures including loan insurance and interest over provisions (forward interest) by Compass Capital. Interest is payable quarterly in arrears. Investors have the option of compounding their interest and receiving principal and interest on maturity.

### Management

Compass Capital was incorporated on 10 May 2006 as a “special purpose” investment vehicle promoted by Bridgecorp, but 100% owned by The New Zealand Guardian Trust Company (NZGT), as trustee of the Compass Capital Trust (CCT), for the purpose of acquiring authorised investments pursuant to its trust deed. CCT is a discretionary trust, the beneficiary of which is Bridgecorp. The trustee of CCT is NZGT, which also acts as the trustee for the Compass bond holders. CCT’s Discretionary Trust Deed specifically provides that when NZGT exercises its trustee powers and duties it is subordinated to the exercise of its powers and duties under the Compass Bond Holders’ Trust Deed. The Fund is being managed by Compass Management Ltd (Compass Management) under a Management Agreement between it, Compass Capital and NZGT. In turn, Bridgecorp is contracted to provide loan administration services.

## Major Considerations

- ▲ Mortgage investments of Compass Capital are limited to \$3.5m and a maximum LVR of 66.67% and the conditions required by the Lending Policy imply that they comply with the Lloyds Underwriting Policy.
- ▲ Compass Capital maintains a dedicated bank account holding sufficient funds to be capable of meeting interest commitments 6 months forward (interest cover account).
- ◀ Debt-related investment products rely heavily on the capacity of Management, thus any changes to Management can have a substantial (positive or negative) impact on investment performance.
- ◀ Bridgecorp is both the promoter of Compass Capital and the appointed loan administrator.
- ▼ Despite other Authorised Investments being listed, initial investments are currently limited to a pool of loans provided by Bridgecorp.
- ▼ Loan concentration risk is currently limited to four loans and loan book diversification will require further capital inflows to achieve reasonable diversification levels.

<sup>1</sup> This report, dated 31 October 2006, expires when the initial offer closes or after 6 months or if there are any material changes in relation to the information contained in this report or any disclosure or offer document issued in relation to this offer. This report was not prepared for inclusion in any offer document and investors must only rely on information contained in the offer document and other associated information. PIR reserves the right to change its opinion, ratings and/or withdraw the report at any time on reasonable grounds.

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Overall Security  
Rating



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Latest report expiry: 30 April 2007 <sup>1</sup>

### Scheme Details

Compass Secured Bonds	
Prospectus dated	19 May 2006
Investment Type	First Ranking Debentures marketed as Secured Bonds
Duration of investment	12 months to 3 years
Minimum Initial Investment	\$1,000
Distribution frequency	Quarterly
Liquidity	Nil
Adviser Commissions	1%

### Issuer

Compass Capital Ltd

### Trustee:

The New Zealand Guardian Trust Company Ltd

### Financial Profile as at 31 August 2006 (Audited)

Cash	\$990,481
Mortgages	\$12,455,000
Other Assets	\$485,708
Total FUM	\$13,931,189

### Rate card as at 1 September 2006

Term	6mths	12mths	2 years
Interest Rate	n/a	8.00%	8.50%

## Conclusion

Qualitative Criteria		Star Ratings Assessment (0 – 5)				
Projected rate of return relative to duration and risk		★	★	★	★	
Day-to -day investment management	Default management	★	★	★	★	
	Arrears management	★	★	★	★	
Risk mitigation strategies	Geographic diversification	★	★	★		
	Sector diversification	★	★	★		
	LVR%	★	★	★	★	★
	Insurance	★	★	★	★	★
Assessment of loan	Borrower	★	★	★	★	
	Security valuation	★	★	★	★	
Quality of disclosure		★	★	★	★	
Experience / qualifications of Product Issuer		★	★	★	★	
Historical performance		N/A				
Market research		★	★	★	★	
Adherence to stated lending criteria		★	★	★	★	
Entity gearing		N/A				
Capital asset backing (does not require parent support)		★	★	★	★	
Matching assets and liabilities		★	★	★	★	
Market exposure risk		★	★	★		

Table i

PIR's overall star rating assessment is derived from a weighted calculation of key performance criteria set out in Table i. Performance in each criterion is scored out of a possible ten points for its contribution to the likely performance of the offer and then converted to a star rating with a maximum of five stars. The ratings range from zero stars (inferior performance and poor quality) to five-star (superior performance and high quality).

The Overall Security Rating on the front page is determined from a calculation of scores based on the number of stars weighted by the assumed importance of each criterion. See back page for more detailed explanation.

Investments for Compass Capital are intended to be primarily secured first or second mortgages initially sourced from Bridgecorp. However, the Trust Deed permits Compass Capital to originate mortgages in its own right and/or acquire mortgages from other mortgage originators, subject to compliance with Compass Capital's stringent authorised investments criteria.

Key elements of the security being provided to investors are:

- Bonds are secured under a Trust Deed, which only permits authorised investments which incorporate a conservative eligibility criteria;
- Mortgages acquired as part of the authorised investments must be on real property in New Zealand, cannot exceed a 66.67% loan to valuation ratio and the valuation cannot be more than 4 months old at the time the mortgage is acquired;
- There is a Lloyds insurance facility in place, which provides protection under certain limitations in the event of mortgage default;
- Compass Capital is required to maintain a secured dedicated bank account, which must hold an amount of money equivalent to six months interest payable on the total face value of the bonds outstanding.

While the Compass Capital loan book is currently only holding four loans, and as such scores relatively poorly in regards to diversification and its exposure to market risk, the level of insurance coverage currently held by Compass Capital largely mitigates these factors. This has caused a

positive influence on the Fund's rating, which might have otherwise been impacted by its relative small size at this point. Its relatively short track record as a fund is also mitigated by having systems, personnel and processes related directly to Bridgecorp.

## Key Assessment Issues

### Loan Profile as at 21 August 2006

Number of loans	4
Average size of loan	\$2,875,000
Average remaining loan term	2.9 months
Exposure to largest loan	\$3,500,000
Total number of loan defaults	0
Debentures on issue	\$10,974,343 (first ranking) + \$2,000,000 (second ranking)

Table ii

Investments for Compass Capital are primarily secured first or second mortgages sourced from Bridgecorp. However, the Trust Deed permits Compass Capital to originate mortgages in its own right and/or acquire mortgages from other mortgage originators, subject to compliance with Compass Capital's authorised investment criteria as permitted under the Trust Deed.

Authorised investments comprise:

- Registered First or Second Mortgages (or interests in mortgages) on freehold, or leasehold land located in New Zealand;
- Debt securities issued by a bank registered in New Zealand;
- Corporate debt issued by companies listed on the New Zealand Stock Exchange rated by Standard and Poors BBB- or higher (subject to a maximum of 5% of Compass Capital's total tangible assets);
- Government guaranteed or government issued securities in New Zealand.

PIR notes, however, that there has been no public disclosure by Compass Capital in relation to any limitations on allocations between first and second mortgages, or in relation to property sectors to which loans may be advanced. Currently, approximately 60% of the loan book is involved in residential loans. While this is undoubtedly affected by the small number of loans (4), further clarification should be made by Compass Capital regarding portfolio allocation on a longer term basis.

Compass Capital has indicated to PIR that there is a policy of preferring first security mortgages over

second mortgages, however this is not assured. To be an Authorised Investment, it must be 100% insured for any principal loss by Lloyd's, regardless of its security ranking.

There are a number of additional features which have been incorporated to further enhance the underlying quality of the investments comprising the assets securing the bonds. These are:

- The Lending Policy guidelines which provide a maximum loan size of \$3.5m to any one borrower and its related entities;
- A loan to valuation ratio (LVR) of not more than 66.67% at the date a mortgage loan is first drawn or acquired;
- All mortgage loans are covered by the Lloyds Mortgage Indemnity Insurance;
- Senior liabilities of Compass Capital (i.e. the secured bond holders) will not exceed 95% of Compass Capital's total tangible assets, and total liabilities cannot exceed total tangible assets.

Compass bonds are secured by a first ranking charge over all the present and future assets of Compass Capital in favour of the Trustee for the benefit of the bond holders (as well as Bridgecorp and other beneficiaries), however the bond holders rank in priority. The nature of the assets and the enhancement features inherent in the security underlying the bonds (issued mortgages to a maximum LVR of 66.67%) are reflected in the lower interest rate being offered to investors, which in turn reflects the lower risk profile associated with the underlying assets being provided as security, together with the addition of the Lloyds insurance policy as an overarching feature.

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Compass Capital has in place a Lloyds insurance policy, which provides protection up to \$3.5 million for any one claim, subject to a maximum pay out of \$20 million in any one year. This policy provides three types of cover on all mortgages held by Compass Capital, providing the mortgage term does not exceed two years from the date the mortgage was acquired or commenced and subject to being compliant with Compass Capital's own authorised investment criteria.

- Mortgage indemnity insurance, which covers up to 100% of the Principal Amount to a maximum of \$3.5 million for any one mortgage in the event of borrower default or the property becoming the subject of a compulsory acquisition notice by a government or territorial authority. (The \$3.5 million limit is also reflected in the maximum mortgage loan permitted under Compass Capital's authorised investment criteria.)

The amount of any claim settlement is limited to the amount of any deficit between the sale price achieved or the compensation received and the amount of debt outstanding on the mortgage.

- Mortgage impairment insurance, which covers up to \$5 million in the event of any direct physical loss or damage caused to the mortgaged property, and which would normally be recouped under normal insurance, save for error or accidental omission in processing procedures on the part of Compass Capital in ensuring that valid insurance is in force on the mortgaged property.

The amount of any claim settlement will be the lesser of:

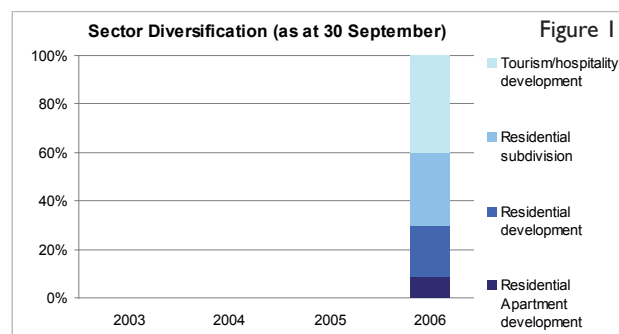
- the amount that would have been payable under the insurance policies that would have responded to the direct physical loss or damage had the error or accidental omission not occurred; or
- the outstanding principal amount of the mortgage; or
- the actual market value of that part of the mortgaged property that suffers direct physical loss.

Given that under the Trust Deed Compass Capital is limited to a maximum loan of \$3.5 million, and the Lloyd's insurance permits claims up to this amount, some security on individual loans is implied. The maximum pay out is limited to \$20m in any one year.

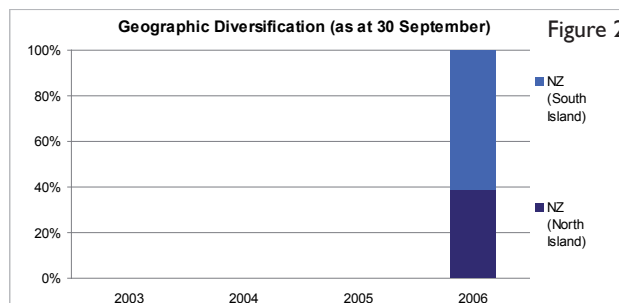
There is, however, some variation between the policy wording and the Compass Capital Lending Policy in respect to the permissible lending term allowed.

The Trust Deed allows loans of up to three years, whereas the Insurance Policy stipulates a maximum term of two years. This was questioned and management produced evidence that the insurers will extend on a case by case application. Nevertheless, it was considered to be anomalous and management agreed to pursue this prima facie discrepancy with a view to resolution.

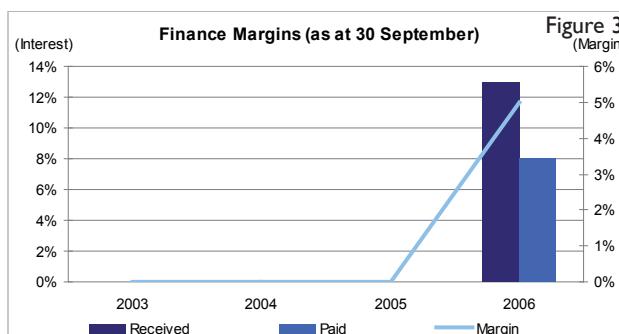
Compass Capital has stringent eligibility criteria in respect to authorised investments, and Bridgecorp in its capacity as the administrator, has good mortgage management systems and procedures and an experienced management team. All loans acquired by Compass Capital are subject to a rigorous selection criteria enshrined in the Lending Policy.



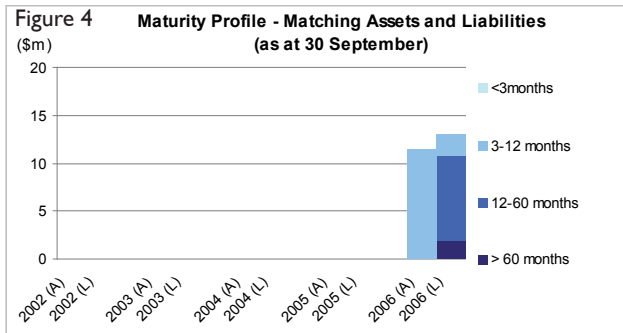
The initial spread of property sectors in the Compass Capital loan book is heavily weighted to the residential sector, particularly with a view to development projects as well as land subdivision.



The current geographic spread of loans in the portfolio is quite widespread given the low initial number. The four loans are each in geographically separate areas of New Zealand although are not in major metropolitan areas.



Current finance margins for Compass Capital show a reasonable margin of profitability between borrowers rates and lenders rates.



The current loan profile in comparison to the maturity profile of investor bonds indicates that the matching of assets to liabilities is currently in a strong position. This, however, is based on the existing four loans and future position of asset matching will depend on the terms of future lending and fund inflows.

## Investment Structure

### Fund Strategy

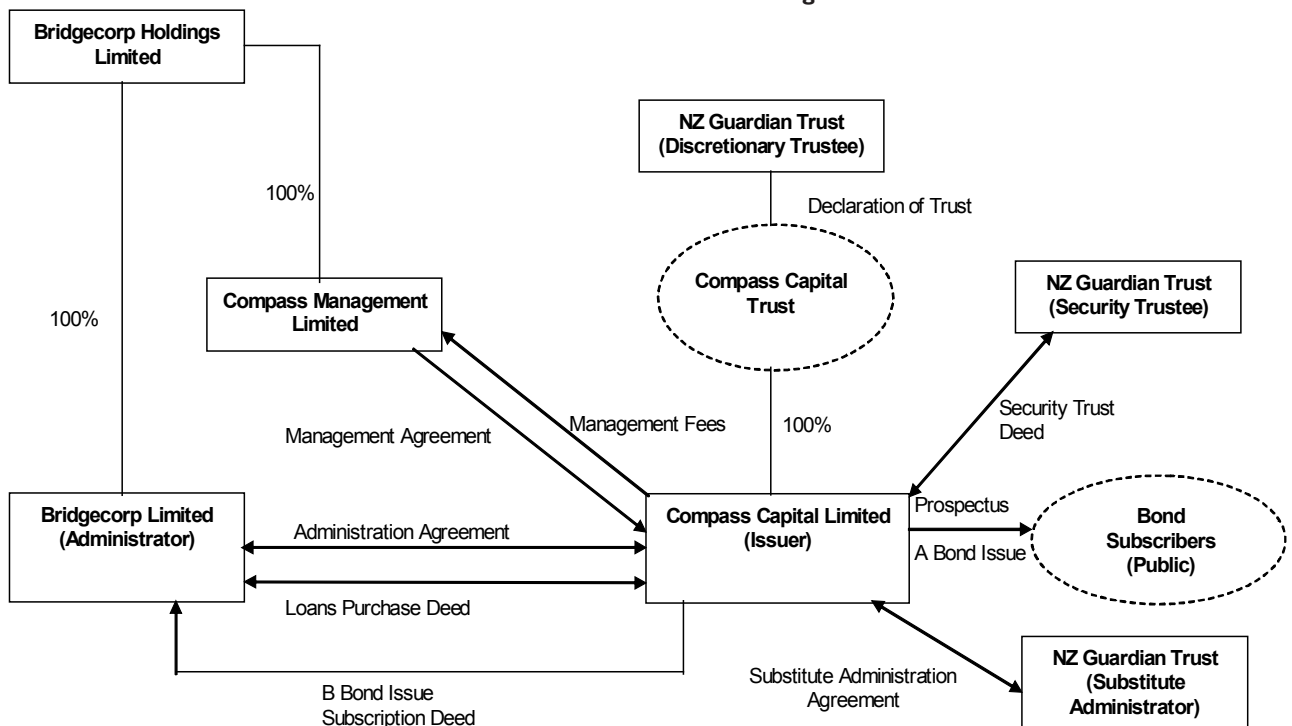
The investment strategy for this Fund is wealth preservation and income regularisation rather than wealth creation (capital growth). Specifically the Fund's objective is to provide investors with a capital stable investment and quarterly income through exposure only to authorised investments, which will be primarily registered mortgages, either first or second charge, secured by New Zealand real property with a maximum LVR of 66.67% in total, and with a term not exceeding two years. Additionally, all mortgages must be insured through the Lloyds mortgage underwriting facility. The Trust Deed specifies other eligible authorised investments, such as bank issued securities and cash; however these avenues are more in the nature of overall liquidity management mechanisms and are secondary to the mortgage investment activity which will comprise the major portfolio asset.

Although sponsored by Bridgecorp, Compass Capital is structured as a "stand alone" operation and can acquire mortgages from any originator – not just Bridgecorp – providing the mortgage meets the authorised investment criteria. Additionally, Compass Capital can originate mortgages in its own right.

- Figure 5 shows the underlying structural arrangement between Compass Capital and its sponsor, Bridgecorp. Compass Capital is not a finance company issuing securities in the traditional sense, rather, its nature is more closely aligned to that of a securitisation vehicle, which acquires existing mortgage loans which meet the investment or lending criteria.

Figure 5

### Structural and Contractual Arrangements



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Compass Capital does not have a formal Compliance Committee; although the board of directors meets regularly and is required to approve authorised investments. In addition, Compass Management undertakes the day to day compliance function. The independent review of compliance is undertaken by NZGT as trustee, who receives the following regular reports from Compass Management:

- Monthly management accounts;
- A Management Report on the balance of the Interest Cover Account, the amount of first ranking secured bonds and second ranking secured bonds and the balance standing to the credit of the Issuer Operating Account;
- A Mortgage Insurance Report listing each mortgage loan covered by insurance;

- A maturity analysis of the total assets and liabilities of Compass Capital;
- A quarterly Compliance Certificate signed by two or more directors attesting to the Compass Capital Fund being compliant in accordance with the Fourth Schedule of the Trust Deed;
- Half yearly, within 3 months of the end of each financial half year, an unaudited balance sheet and a statement of financial performance;
- Annually, within 4 months of the end of the financial year, the audited financial accounts.

Bridgecorp is the Administrator of the loans made or acquired by Compass Capital and the processes and procedures are well documented.

## Security

As Compass Capital was incorporated on 10 May 2006 there is no historical data of substance. Reliance, therefore, at this juncture, must be on Compass Capital's lending policy and the administrative capability of Bridgecorp and the "standby" substitute administrator - NZGT, in conjunction with the stringent eligibility criteria attaching to authorised investments, to assess the underlying strength of the Compass Secured Bonds.

Compass Capital and Bridgecorp have covenanted in favour of the Trustee (as Trustee for the senior bond holders) that Bridgecorp subscribes a minimum of \$2 million or 5% of total tangible assets, whichever is the greater, as measured at the end of each month; by way of subordinated second ranking secured bonds of Compass Capital. These are additional to the first ranking secured bonds being offered under the Prospectus by Compass.

These "buffer bonds" are issued under a Subscription Deed, which is separate to the Trust Deed securing the first ranking Compass secured bonds. The buffer bonds are subordinated as to repayment and any other claims due to the public bond holders. Although these second ranking secured bonds issued to Bridgecorp are entitled to 10% p.a. interest, they are subordinate to the entitlements of Compass first ranking bond holders in all respects; including the payment of interest. The 'buffer bonds' also cannot be redeemed or repurchased while there are Compass bonds outstanding. They are, in effect, the equivalent of shareholders' "equity" being contributed by Bridgecorp and rank behind all other claims on Compass Capital in the manner of shareholders' equity. The requirement under the Trust Deed covenants allows Compass Capital to have a 20:1 gearing potential on the basis of these subordinate second ranking secured bonds issued to Bridgecorp.

Property Type	Exposure	Proportion	LVR	Maximum LVR
Residential apartment development	\$1,000,000	8.70%	59.93%	66.67%
Residential Development	\$3,500,000	30.43%	22.19%	66.67%
Residential Subdivision	\$3,500,000	20.68%	51.03%	66.67%
Tourism & Hospitality Development	\$3,500,000	40.19%	63.96%	66.67%
	Weighted average LVR		46.52%	

Table iii

Geographic Diversity	Exposure	Proportion
North Island – Tauranga	\$3,500,000	30.43%
North Island – Napier	\$1,000,000	8.71%
South Island – Hammer Springs	\$3,500,000	30.43%
South Island – Queenstown	\$3,500,000	30.43%

Table iv

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As can be seen from Tables iii and iv, the existing mortgages are predominantly residential development with some geographic diversification in the New Zealand market. These mortgages are essentially short duration.

Arrears and default management are handled by Bridgecorp as the loan administrator and are dealt with according to Bridgecorp's standard practice utilising an "off the shelf" software management system which has been further modified by Bridgecorp in house. This system grades all loans and applies a credit risk classification where some irregularity has occurred.

- Category A (Technical Default) - automatically identifies loans in arrears (payment overdue or loans matured but not yet paid);
- Category B (Watch) – loans more than 30 days in arrears;
- Category C (Past Due) – loans more than 90 days in arrears;

- Category D (Non-accrual) – loans which have already been classified as Category C where it is considered a shortfall is likely;
- Category E (Write Off) – loans being written off.

Assets are regarded as impaired once they reach Past Due (Category C) and Non Accrued (Category D) and are reported in the statutory accounts and internally on a quarterly basis. Management advises that there have been no loan defaults in the limited history to date. As such, PIR can form no opinion as to Compass Capital's abilities in defaults and bad debt management.

PIR notes that one of the existing loans (30.4% of portfolio) was due for settlement in August 2006. Compass Capital has indicated that the loan has been extended until 1 February 2007.

## Income Returns

Compass Capital earns interest on its mortgages and other investments and pays a distribution to investors quarterly at the carded coupon rate.

The minimum investment is \$1000. Ranking is subject to preferential claims given priority under legislation and the trust deed relating to Compass Secured Bonds.

### Rate card as at 31 August 2006

	12mths	18mths	2 years	3 years
Interest Rate (% p.a.)	8.0	8.25	8.50	8.50

Table v

## Lending Policy

In order for Compass Capital to comply with the Lending Policy, it must adhere to the Trust Deed and the Loan Purchase Deed between Compass Capital and Bridgecorp. Where Compass Capital undertakes a loan which has been originated by Bridgecorp, it relies on the documented lending policies of Bridgecorp for the approval of mortgage originations and the ongoing administrative management thereafter. There are, in effect, two screening processes in place before Compass Capital is able to acquire a mortgage.

At the mortgage origination stage, Bridgecorp requires independent valuations, credit checks for all loan applications, external preparation and review of all mortgage documentation, and has a clear remedial action process in the event of repayment default. Borrowers are required to demonstrate the capacity to service all commitments, including other loans. Unconditional and irrevocable guarantees are obtained where additional

security is required. Typical mortgage securities will include commercial, industrial and residential real estate secured by registered first mortgage or second mortgage.

Mortgages offered to Compass Capital are subject to a separate screening process managed by Compass Capital, which, in order to qualify for acquisition by Compass Capital, must meet the security conditions contained in the Lending Policy. The key lending policy criteria are:

- each loan acquired or made must be secured by a first or second ranking mortgage over real property situated in New Zealand;
- the principal amount cannot exceed \$3,500,000 (including any participatory interest);
- the total amount which can be made to any one person does not in the aggregate exceed \$3,500,000, including loans made to a related party;

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- the maturity date of each loan cannot exceed two years unless it is specifically covered by mortgage insurance;
- the LVR does not exceed 66.67% of the valuation;
- the valuation cannot be more than four months old at the time the loan is approved;
- all mortgages acquired are registered in the name of Compass Capital and all collateral security relating to the mortgage is assigned to Compass Capital;
- All mortgages must comply with Compass Capital's Lending Policy with respect to the minimum interest rate payable by borrowers. This currently is not less than 12% p.a. although loans are being acquired at 13% p.a.

The serviceability of the loan for the borrower must be established to Compass Capital's satisfaction. Credit checks are undertaken on all borrowers and guarantors. All hazard insurances, including fire, storm etc, must be in force for an amount of cover that represents at least the insurable value, as disclosed in the sworn valuation.

The Lending Committee comprises the Directors of Compass Management and all mortgage investments considered for purchase from mortgage originators must comply with Compass Capital's Trust Deed pertaining to authorised investments and the Lending Policy agreed between Compass Capital and an originator (only Bridgecorp at this juncture) pursuant to a Loan Purchase Deed. This Deed covers:

- Acquisition of loans by the Issuer from Bridgecorp Limited;
- The loan criteria (must comply with lending policy);
- Defines Bridgecorp's obligations to comply with the Lending Policy;
- Interest Cover Account must have required funds;
- Defines required documents in support – Loan agreement, mortgage, valuations etc; and
- Deals with Participatory Interests in mortgages.

Compass Capital is quite able to enter into other loan purchase deeds with other mortgage originators and acquire mortgage loans subject to complying with the lending policy and being an authorised investment.

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## Risks

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Investing in fixed interest securities carries risks relating to the issuer and management failing to anticipate market movements, manage investment risk, execute the Fund's investment strategy effectively, or otherwise comply with their duties. Some of the more relevant risks applicable to Compass Capital are:

**Investment risk:** An investment in debt fund securities includes a certain amount of risk and is therefore only suitable for investors who are capable of assessing risks of this nature and who fully understand all the implications in relation to their own financial position.

**Interest Rate Risk:** Occurs when market interest rates rise and the Fund is locked into a lower level of interest rates on the fixed rate portion of its loan portfolio. This is not considered to be a high risk given the short maturity duration of the assets compared to the liabilities.

**Capital Risk:** Occurs when the loan defaults and the realisation of the security property is insufficient to repay the debt. This may occur if the value of the property

has declined since the loan was granted due to an adverse change in the economy generally, or a specific adverse change affecting the property security such as a tenant vacating the property. Investments in the Fund are not capital guaranteed. This risk is managed by a credit assessment process documented in Compass's Lending Policy and Procedures and via proactive arrears management.

**Liquidity Risk:** Occurs when there is insufficient cash on hand to meet investors' redemption requests. Compass Management's monitoring of the maturity of loans and the likely redemption patterns of investors mitigates this risk. Liquidity is monitored on a daily basis. There are no external liquidity support facilities; however investors are required to invest for a minimum of one year with no automatic right of withdrawal during this year. Additionally Compass Capital maintains an interest cover account, which, under the terms of the Trust Deed, must at all times hold a sum amounting to the equivalent of 6 months interest on the first ranking bonds balance outstanding at month end.

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**Operational Risk:** Compass Capital outsources its business and loan origination. It is therefore dependent upon external parties. There is a risk of business failure as a result of people or systems, regulatory, geo-political, economic or systemic failures or changes with negative consequences. Compass Capital is reliant on the commercial judgement and investment experience of Compass Management Ltd and the lending experience of Bridgecorp to source and manage mortgage loans as well as the systems and processes employed by these entities. A termination of Bridgecorp's services should not, however, have an effect on Compass Capital's ability to raise funds and acquire suitable mortgage loans. Both Compass Capital and Compass Management have common directors and it is also unlikely that under normal circumstances the Administration Agreement with Bridgecorp would be terminated. In any event, NZGT is able to step in immediately, pursuant to the Substitute Administration Agreement, to manage the loan portfolio.

**Property Value Risk:** A decline in the value of properties over which the Fund holds mortgages. This risk implies that a fall in value will reduce or extinguish the margin between the loan and the value of the security. This would undermine the underlying security in the event of a forced sale under default conditions, which would not normally realise full market value in a willing buyer/seller scenario. Compass Capital minimises this risk by carrying out an assessment on both the borrower and the security offered. A fall in the value of the underlying asset would become a problem in the event of the borrower defaulting and Compass Capital needing to liquidate the asset to realise the security for the loan.

There is a risk that the valuation of assets over which Compass Capital takes security is inaccurate. This could mean that in the event of a default on a loan, enforcement and a forced sale, the amount realised is less than expected. Where an independent valuation is relied on, there is the risk that professional indemnity insurance of the valuer may prove to be unavailable or inadequate to cover an inaccurate valuation.

Compass Capital manages this risk by ensuring mortgage investments or interests in mortgage investments, together with the amount outstanding, which may be secured in favour of all other prior charge holders (as may exist), and the cost to complete of the relevant development, as certified by a registered quantity surveyor, do not exceed 66.67% at the date the mortgage loan was acquired.

**Capitalisation of Interest:** Most loans will provide for interest to be capitalised and payable by the borrower when

the loan is due to be repaid. This means that Compass Capital will not always receive income from mortgages within authorised investments in a regular manner. Also the Lloyds insurance policy only covers principal default – not amounts outstanding as a result of capitalisation of interest.

**Competition Risk:** The range and quality of mortgage loans has the potential to deteriorate as competition for mortgage lending increases. Compass Capital's stringent selection criteria may mean that there are insufficient mortgages of the requisite quality to utilise available funds.

**Property Development Risk:** Some loans that may be acquired by Compass Capital are for property development purposes. Property development by nature is high risk where a multitude of factors may impact on value and the ability of the borrower to repay. Factors such as project delays, construction cost increases, lower sale prices than expected, slower than anticipated sales, higher than anticipated marketing costs and cash flow problems are to name a few. If this occurs, the level of security may be in jeopardy, affecting Compass Capital's ability to recover amounts owing in the event of default by a borrower.

**Major Disaster Risk:** Compass Capital relies on the Bridgecorp disaster recovery plan. All IT systems are backed up daily and back up files are stored offsite. In addition, Compass Capital maintains its own data backup, which is done weekly. Compass Capital has contingency plans in place that will allow it to recover data and operate from a remote site if a disaster struck its main operations in Auckland.

Mortgages acquired are generally earning 13% and the cost of funds is around 9.62% (including commission payments on funds raised). The operational spread is therefore in excess of 3%.

Mortgages can have a maximum term of 24 months, however the current mortgage loan portfolio has a duration of less than one year. First ranking secured borrowings (Compass bonds) have a weighted average maturity of 20 months, thus the liability profile of Compass Capital is considerably longer than the underlying investments, reflecting a conservative approach to liability management.

<b>Matching Assets and Liabilities 31 August 2006</b>		<b>\$m</b>
Total loans approved		12,455
Total drawdown on Loans		12,455
Undrawn loans		0
Total Secured Bonds on Issue	\$11,764,164 (first ranking ) +\$2,000,000 (second ranking)	

Table vi

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## Fees

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Investors do not pay any fees other than a \$30 transfer fee, which may be applied if secured bond holders transfer their bonds to another party.

Compass Capital will pay fees to various parties in connection with the raising of funds and the management and administration of the authorised investments:

- Brokerage will be paid in respect of successful applications emanating from brokers. The standard rate is 1%, however Compass Capital reserves the right to pay brokerage at different rates;
- An administration Fee is payable quarterly to Bridgecorp, pursuant to the Administration Agreement between Compass Management and Bridgecorp;

- The Trustee, NZGT, receives a fee for undertaking the trustee responsibility on behalf of secured bond holders;
- A fee is payable quarterly in advance to Compass Management in respect to operating the business of Compass Capital;
- A fee is payable to NZGT, pursuant to the Substitute Administration Agreement between Compass Capital, Bridgecorp, and NZGT, by way of a facility payment in the event that NZGT is called upon to take over the administration of Compass Capital.

Compass Capital has made no disclosure on the level of fees payable to other parties, with the exception of adviser commissions. PIR sees this as an opportunity to improve its disclosure.

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## Balance sheet

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The financial position of Compass Capital is set out in Table vii in the form of a simplified balance sheet.

As the company was incorporated in May 2006 the first set of audited final accounts are for the period ended 31 August 2006.

<b>Compass Capital</b>	<b>31 August 2006 (\$'000)</b>
Total cash on deposit	990.48
Total mortgage loans	12,455.00
Other assets	485.71
<b>Total assets</b>	<b>13,931.19</b>
Accounts payable	19.17
Interest payable	142.50
First ranking secured bonds	2,000.00
Second ranking secured bonds	11,764.16
<b>Total liabilities</b>	<b>13,925.83</b>
<b>Net assets</b>	<b>5.36</b>

Table vii

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## Capacity of Manager

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Compass Capital does not have any staff or business systems. Day to day management is contracted out to an independent manager, Compass Management, which in turn has implemented an arms length contractual arrangement with Bridgecorp to administer loans acquired through Bridgecorp or other eligible mortgage originators under loan purchase agreements. To date there is only one executed loan purchase deed. The Loan Purchase Deed (or agreement) fully documents the terms and conditions by which Compass Capital can acquire mortgage loans originated by Bridgecorp.

Under the Constitution of Compass Capital there are a maximum of three Board Members, of which Bridgecorp can appoint one. The other two directors must be independent, and the New Zealand Guardian Trust

Company has the power of veto over the appointment of directors, acting in its trustee capacity under the bond investors' trust deed. Compass Capital and Compass Management have the same directors.

Compass Management retains the power pursuant to the Administration Deed to terminate Bridgecorp as the Administrator if events occur which Compass Capital / Compass Management view as materially prejudicial to the interests of Compass Capital or the bond holders. Under these circumstances, The New Zealand Guardian Trust Company Ltd. will take over as the administrator with immediate effect. Such a "back up" capability is provided pursuant to a Substitute Administration Agreement executed between Compass Capital and NZGT.

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As the sole shareholder of Compass Capital, NZGT, as trustee of CCT, has a restricted and limited role. It cannot sell or dispose of its shareholding in Compass Capital and must act first and foremost in the interest of the Compass bond holders. Similarly, in exercising fiduciary responsibility for both parties, the potential for a conflict of interest on the part of the Trustee is resolved in favour of the Compass bond holders.

To date Compass Capital has acquired four loans totalling \$12,455,000. There are no related party transactions, as these are not permitted under the Trust Deed.

The Directors and key personnel of Compass Capital and Compass Management Ltd. are as follows:

**Anthony J McCullagh, BEcon, LLB, CA (Director):**

Mr McCullagh is the Managing Director of Horwarth Corporate (Auckland) Ltd. With qualifications in economics, law and accounting, Mr McCullagh has specialised as an insolvency advisor for over 15 years involving substantial receiverships, monitoring and work-out assignments on behalf of banks and other financial institutions as well as undertaking numerous liquidation assignments.

**Robert Roest, BCom, CA (Director):** Mr Roest is the Bridgecorp nominated Director and is the finance director of Bridgecorp Holdings Ltd. He has a commerce degree and is member of the Institute of Chartered Accountants in New Zealand. Mr Roest has more than 25 years of commercial experience gained in New Zealand, Australia and the South Pacific. For the past seven years Mr Roest has been within the finance industry.

**John Moody, LLB (Hons) (Director):** Mr Moody is a barrister in his own practice since 2002. Prior to that, Mr Moody was a commercial litigator. He has held, and continues to hold, a number of senior positions both in the legal sphere and the wider community and is significantly involved in community activities.

**Ian Gladwell, BCom, CA (Fund Manager):** Mr Gladwell is responsible for managing the Compass Capital Fund. Mr Gladwell has a commerce degree and is member of the Institute of Chartered Accountants in New Zealand. With over 23 years of financial and commercial experience he has been managing the Bridgecorp Mortgage Trust No 1 and Bridgecorp Mortgage Trust No. 2 funds for the past four years.

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## Due Diligence

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PIR was engaged by **Compass Capital Ltd** to undertake this investment evaluation for a fixed fee established prior to commencement of work on the investment evaluation. Property Investment Research Pty Ltd (PIR) advises that in the compilation of this report, a full due diligence on this offer has not been conducted. Investors would be well advised to consult the offer document, conduct their own inquiries, and receive professional advice. This report was not prepared to form any part of any offer document.

PIR has relied upon information contained in the Prospectus dated 19 May 2006. PIR has carried out its own independent inquiries by:

- having discussions with senior representatives of Compass Capital Ltd;
- reviewing the offer and related document dated 19 May 2006; and
- conducting a site visit.

PIR has received copies of the Prospectus, Constitution and Trust Deed and an accounting report. PIR has also received copies of the following documents:

- Management Team Biographies, organisational chart and corporate profile;

- The Administration Agreement between Compass Management Ltd and Bridgecorp;
- The Substitute Administration Agreement between Compass Management and The New Zealand Guardian Trust Company;
- The Constitution of Compass Capital;
- The Loan Purchase Deed between Compass Capital, Bridgecorp, Compass management and NZGT;
- Bridgecorp's Business Continuity Plan;
- Disaster Recovery Plan;
- The Investment Management Agreement between Compass Management and Compass Capital;
- The Administration deed between Compass Management and Bridgecorp;
- Liquidity Management Policies;
- Compass Capital Lending Policy;
- Bridgecorp's Policy and Procedures Manual;
- Arrears and Collections Management Manual;
- Insurance Certificate of Currency in respect to Director's and Officer Liability; and
- Compass Capital Ltd and Compass Management Ltd Board Minutes for June, July and August 2006.

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## Explanation of Investment Rating

### EXPLANATION OF SECURITY RATING

**Rate of return relative to duration and risk:** Required rates of return are higher for investments of longer duration. This criterion scores rate of return relative to benchmarks for the duration and associated risk.

**Default management:** The quality of management systems and procedures to deal with loans in default.

**Arrears management:** The quality of systems and procedures to accurately monitor loans in arrears.

**Geographic diversification:** This reduces exposure to any particular region.

**Sectoral diversification:** This reduces exposure to any particular sector.

**LVR % - loan to value ratio:** This is the loan amount expressed as a percentage of value of the property used for loan security. It is also a measure of risk especially at high LVRs.

**Insurance:** Building insurance over the value of the improvements and insurance for the loans themselves.

**Borrower assessment:** The thoroughness of the systems and procedures in assessing each applicant and their suitability for various types of mortgage finance. The loan portfolio should be consistent with information set out in the offer document and the constitution.

**Security valuation:** Process of appointing valuers with appropriate experience and adequate PI cover, checking the security valuations and board approval of loan.

**Quality of disclosure:** Disclosure should be full, frank and unambiguous

with risks addressed.

**Experience/qualifications of product issuer:** A Manager depends on the experience and services of its Directors and senior management (and to a lesser extent) other staff to direct and manage policies and business practices.

**Historical performance:** Whether the Manager has met distribution targets in the past (or reasons for failure) over various trading conditions and various circumstances.

**Market Research:** The subscription to independent and credible research services.

**Adherence to stated lending criteria:** Managers should not deviate from the stated lending criteria beyond the scope of any flexibility in the provisions of the Constitution which might allow them to do so.

**Entity gearing:** Their level of debt is a consideration in assessing the Manager's financial stability and capacity.

**Capital asset backing (parent support):** A parent company guarantee can provide additional support should the borrower's business falter or fail and augments capital adequacy required to maintain an acceptable level of operational capacity.

**Matching assets and liabilities:** Minimisation of 'lazy money'.

**Market exposure risk:** The overall exposure of the fund to non-diversifiable market risk.

Visit [www.pir.com.au](http://www.pir.com.au) to view and download a detailed explanation of the PIR Security Rating System.

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Richard Cruickshank, Managing Director.

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