



# MIDLANDS

MIDLANDS INCOME WHOLESALE FUND

## STATEMENT OF INVESTMENT POLICY AND OBJECTIVES (SIPO)

Dated: 21 July 2021

# MIDLANDS FUNDS MANAGEMENT LIMITED

## Statement of Investment Policy and Objectives (“SIPO”) for the Midlands Income Wholesale Fund (the “Fund”)

**EFFECTIVE DATE:** 21 July 2021

The most current version of the SIPO is available from Midlands Funds Management Limited (“Manager”).

### **DESCRIPTION OF THE FUND**

The Fund is a wholesale managed investment scheme. The Fund is not registered under the Financial Markets Conduct Act 2013.

The Fund was established on 21 July 2021, pursuant to a trust deed between Trustees Executors Limited (“Trustee”) and the Manager dated 21 July 2021 (“Trust Deed”).

### **Roles and Responsibilities**

The Manager is, among other things, responsible for managing the Fund’s property and investments and under the Trust Deed must ensure that the Fund has a statement of investment policy and objectives. The purpose of the statement of investment policy and objectives is to provide details of:

- the nature or type of investments that may be made, and any limits on those; and
- any limits on the proportion of each type of asset invested in; and
- the methodology used for developing and amending the investment strategy and for measuring performance against the investment objectives of the Fund.

The Trustee is, among other things, responsible for holding the Fund’s assets and for supervising the performance by the Manager of its functions and obligations.

The Fund invests solely in units in a group investment fund called the Midlands Income Fund (“MIF”) (with the exception of a small amount of cash held by the Fund for transactional purposes). The Manager is also the manager of the MIF. The MIF invests in loans secured by first mortgages of land and buildings in New Zealand, within defined lending ratios. The MIF also invests in deposits with registered banks. The Manager generally has the discretion as to which authorised investments are acquired, held or disposed of in and for the MIF.

### **INVESTMENT OBJECTIVES**

#### **Investment objective**

The investment objective of the Fund is to provide investors with an income return at a level which is better than New Zealand registered commercial banks’ 1 year term deposit rates.

While not a formal investment objective, the Manager, as manager of the MIF, typically targets (but does not assure) a return of 2.5% to 3% above New Zealand registered commercial banks’ 1 year term deposit rates, while also seeking to maintain the credit quality of loans in the MIF loan portfolio, and subject to market conditions.

#### **Investment policy**

The Manager invests the Fund's assets solely in the MIF (with the exception of a small amount of cash held by the Fund for transactional purposes). The policy of the Manager, as manager of the MIF, in relation to the mortgage lending is to establish and maintain a broad range of mortgage investments with a mix of mortgage types, interest rates, maturity dates and physical locations of the mortgaged properties.

The policy of the Manager, as manager of the MIF, in relation to investing in deposits with registered banks is to have a mixture of on-call deposits and term deposits (with maturities of up to 6 months).

### **INVESTMENT PHILOSOPHY**

The Manager selects the loans that it invests into, and its investment style should be regarded as active.

### **INVESTMENT STRATEGY**

#### **Permitted investments**

There are restrictions on the types of investments the Fund can make, as set out in its Trust Deed.

Under the Trust Deed, the Fund must always be invested in “authorised investments”, which are defined as follows, and to the extent permitted under section HM 11 of the Income Tax Act 2007 if in the future the Fund is a PIE:

- Loans made upon the security of any mortgages or mortgage backed securities;
- Cash, deposits with, loans to, or other debt securities of any registered bank under the Reserve Bank of New Zealand Act 1989 or a bank authorised to carry on general banking business in New Zealand (“bank”) whether secured or unsecured;

- The acquisition of any mortgages or mortgage backed securities by way of transfer or assignment of the mortgagee or chargeholder's interest in the mortgage or security;
- Property which comes into the possession, ownership or control of the Trustee by virtue of the exercise of the powers, authorities and discretions vested in the Trustee by any mortgage or mortgage backed security held by the Trustee;
- Public sector securities; and
- Any managed investment scheme or other trust or scheme which invests primarily or wholly in one or more of the investments referred to in the preceding bullet points.

Notwithstanding the range of authorised investments described above, the Manager shall only invest the Fund's property in units in the MIF which it will manage pursuant to guidelines described further below. The Manager will also maintain what it considers to be a prudent amount of cash in an on-call bank account with a registered bank for the Fund's transactional purposes.

#### Specific policy guidelines

The specific investment policy guidelines determined by the Manager, as manager of the MIF, in relation to the MIF are as follows:

- **Interest rates and payment** - most investments by the MIF will be in mortgages with mostly floating interest rates but the Manager may maintain some fixed rate mortgages. Most borrowers from the MIF pay interest on the first of each month. It is not the Manager's general practice in respect of the MIF to permit borrowers to capitalise the interest for the term of the loan, however, for certain projects and subject to specific lending criteria it may be allowed from time-to-time.
- **Lending Limits** - as set out below.
- **Cash** - The MIF also holds cash. The Manager, as manager of the MIF, shall maintain at least 5% of the MIF value in cash to meet redemption requests and for the payment of the MIF's running expenses. Greater amounts of cash may be held in times when the Manager, as manager of the MIF, determines that the MIF requires greater liquidity. The MIF's cash holdings may only be invested in on-call or term deposits (with maturities of up to 12 months) with registered banks.
- **Participating loans** - The Manager, as manager of the MIF, may invite third parties to participate in lending opportunities identified by the Manager, on terms agreed with the Trustee, as supervisor of the MIF. All such loans must fall within the guidelines set out above, except that the maximum exposure limits will be assessed by reference to the MIF's portion of the loan, not the full loan value.

#### Limitation on borrowings

The Fund may borrow, if the Manager in good faith determines that borrowing is necessary or desirable for certain stated purposes set out in the Trust Deed. The aggregate of the principal moneys borrowed and outstanding in respect of the Fund or secured against the investments of the Fund may not exceed 25% of the Fund's fund value.

The MIF may borrow, if the Manager, as manager of the MIF (with the permission of the Trustee, as supervisor of the MIF) believes it is appropriate. The aggregate of the principal moneys borrowed and outstanding in respect of the MIF or secured against the investments of the MIF may not exceed 25% of the MIF's fund value.

#### Benchmark Asset Allocation Ranges for the MIF – Mortgage Types and Cash

The MIF will be spread between mortgages against residential, commercial and rural properties, and cash, within the following proportions (as to value) of the MIF's fund value

	RESIDENTIAL	COMMERCIAL	RURAL	CASH
Limits of the MIF value	10% - 75%	15% - 75%	0% - 50%	5% - 25%

#### Cash Limit for the Fund

The Manager shall maintain what it considers to be a prudent amount of cash in an on-call bank account with a registered bank for the Fund's transactional purposes (such as facilitating investments and withdrawals, and for the payment of tax). There is no specific minimum or maximum amount, but the amount of cash held for this purpose is typically expected to be relatively small.

#### Lending Limits (Valuation) for the MIF

The MIF has lending limits, based on the amount of the loan when compared with the value of the mortgage security property ("LVR") at the time of loan approval, as follows:

RESIDENTIAL MORTGAGES	COMMERCIAL MORTGAGES	RURAL MORTGAGES
Fee simple and cross lease land and buildings: up to 75% LVR	Fee simple and cross lease land and buildings: up to 66.7% LVR	Fee simple and cross lease: up to 60% LVR
		Property used for dairy farming (fee simple and cross lease): up to 66.67% LVR provided collateral

		security is obtained over co-operative shares
Leasehold: up to 50% LVR	Leasehold: up to 50% LVR	Leasehold: up to 50% LVR
Vacant land: up to 50% LVR	Vacant land: up to 50% LVR	Vacant land: up to 50% LVR

In addition, at the time of lending the following maximum exposure limits must be met:

- ▷ No more than 5% of the MIF fund value will be invested in any one mortgage or advanced to any one borrower or related group of borrowers.
- ▷ The total of the six largest exposures (including loans to a related group of borrowers) will not exceed 20% of the MIF fund value.

Registered valuations are required for all loans in excess of 50% of the rating valuation of a property. The rating valuation is only relied on when the property is inspected by the Manager (or their nominee). Where a registered valuation is required, it must be no older than 12 months prior to the date of loan approval.

As referred to above, all lending limits for the MIF are determined and are solely applicable as at the initial loan approval date and at the date of any renewal of a loan. The value of any individual loan or the proportionate value of a loan in relation to the MIF fund value may change subsequent to initial approval or renewal and, as a result, the above limits may sometimes be exceeded after those dates. This will not constitute a breach of this SIPO.

## INVESTMENT POLICIES

### Rebalancing policy

The assets of the MIF, being the underlying assets of the Fund, should be invested in line with its benchmark asset allocation. New lending determinations take these allocations into account. However, the allocation to each asset class will vary, due primarily to market movements, within the ranges set.

Given the relatively illiquid nature of mortgage loans, cash flow (either to or from the MIF) is the primary mechanism for ensuring that the asset allocation is maintained broadly in line with the benchmark asset allocation weightings for each asset class.

The exposure to the various asset classes is monitored monthly by the loans committee of the Manager. If, at the end of a month, the allocation to a particular class has moved outside the ranges set out for that class, steps will be taken to bring back the asset allocation within the permitted ranges. This will typically occur through new lending in other asset classes, meaning there can be some lag in completing the rebalancing. A practical approach is taken to any rebalancing, with one of the objectives being to minimise transaction costs.

### Hedging policy

There is no specific hedging policy for the MIF, other than maintaining what in the Manager's opinion is a prudent mix of types of mortgage investments and cash as described previously in this document.

### Conflict of interest policy

The Manager will only enter into transactions with related parties with the consent of the Trustee and if the Manager certifies that any such transaction is on arm's length terms.

### Liquidity and cash flow management policy

The Manager relies upon the liquidity of the MIF in order to maintain sufficient liquidity in the Fund. The Manager, as manager of the MIF, will maintain at least 5% of the MIF value in cash deposits and other liquid assets to meet redemption requests and for the payment of the MIF's running expenses.

Notwithstanding the minimum liquidity requirement, the Manager, as manager of the MIF, has targeted a minimum liquidity of 7.5% of the MIF value.

## METHODOLOGY FOR MONITORING, AMENDING AND DEVELOPING INVESTMENT STRATEGY

### Investment Policies

As referred to above, the Fund's investments are in units in the MIF (and cash for transactional purposes). The MIF invests in loans secured by first mortgages of land and buildings and deposits with registered banks.

Cash within the MIF may be held with any registered bank (as defined under the Reserve Bank of New Zealand Act) and the Manager's policy is to have a variety of deposit terms to provide a balance between greater liquidity and higher interest returns.

### Monitoring of underlying securities

The Manager, as manager of the MIF, closely reviews the loans once they are made to ensure that borrowers pay interest and principal as scheduled. Credit control and recovery functions are undertaken if payments are not made.

The Manager of the MIF makes appropriate general and specific provisions for loss on the mortgage portfolio and these provisions are discussed with and reviewed annually by the auditor of the MIF.

**Investment performance monitoring**

The Manager monitors the Fund and the MIF's investment performance as a continuous process and at least monthly.

The Manager gives monthly reports and quarterly reports to the Trustee. Amongst other things, these include confirmations relating to investments.

The Manager compares the Fund's and the MIF's quarterly returns with information it sources from information published by the Reserve Bank of New Zealand.

**Investment strategy review and amendment**

This SIPO is formally reviewed by the directors of the Manager annually and may also be reviewed at any other time if the Manager considers that a review is required as a result of the prevailing market conditions or for any other reason.

In the course of the review the Manager's executive team will consider whether the MIF's benchmark asset allocations remain appropriate given the prevailing market conditions. Consideration will also be given as to whether the MIF's liquidity policy remains appropriate once again given prevailing market and economic conditions. The Manager's executive team will make recommendations to the Manager's directors, who will then consider such recommendations and implement as necessary.

In accordance with the Trust Deed, the Manager may amend or replace this SIPO with the consent of the Trustee.



# MIDLANDS



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