OnePath Mortgages and Income Plus funds – Additional information

25 FEBRUARY 2011

In this document, the terms 'we' and 'our' refer to OnePath Funds Management Limited (OnePath Funds Management).

This document contains important information for investors in OnePath's Mortgage and Income Plus funds. This document sets out additional information that may assist you to better understand your investment in the relevant fund. This information will be updated quarterly and will be posted in the 'Product updates' section of the ANZ website.

OnePath Mortgage and Income Plus funds

The OnePath Mortgage and Income Plus funds invest in OnePath's Mortgage Pool ARSN 089 455 425 (Fund). Withdrawals from, and applications to, the Fund have been suspended (please see below).

The investment funds listed below have at least 50% exposure to the Fund:

Investment fund	Constitutional name	Benchmark allocation to Mortgage Pool
OnePath Mortgages	ANZ OA OnePath Mortgage Trust	100%
ANZ Mortgage Fund (Series 1 and 2)	ANZ Mortgage Fund	100%
OnePath Income Plus	ANZ OA OnePath Income Plus Trust	50%
OnePath Original Income Plus	ANZ OA OnePath Income Plus Trust	50%

The above funds are collectively referred to in this document as "**Mortgage and Income Plus funds**". The Mortgage and Income Plus Funds gain exposure to mortgages by investing in the Fund. Given the high level of exposure to the Fund, withdrawals (including switch requests) from and applications to the Mortgage and Income Plus Funds have also been suspended.

Unless stated otherwise, the information in this document relates to the "**Fund**".

Investors in OnePath Income Plus and OnePath Original Income Plus should note that the information provided in this document relates only to the mortgages component of their investment and not the Australian shares and property securities assets.

Suspension of the Fund

In late 2008, and during the global financial crisis (**GFC**), the Fund experienced a greater volume of redemption requests and the assets could not be easily and quickly sold. A decision was made to suspend the Fund to ensure that the assets in the Fund could be managed and continue over time to produce a return to investors through the orderly realisation of assets rather than 'fire sales'. This was the preferred option rather than simply writing down these assets and realising losses in the Fund, which would not have been in the investors' best interests. This action was taken to protect investors' and is not a reflection of the strength or quality of the Fund. As a result, withdrawals (including switch requests) from the Mortgage and Income Plus Funds can only be made through a withdrawal offer.

We have since made a number of withdrawal offers. Details of withdrawal offers are posted in the Product Updates section of the ANZ website. The amount available for withdrawals depends on the available liquidity in the Mortgage and Income Plus Funds and market conditions that prevail at that time.

We will action withdrawal requests in accordance with the withdrawal offer and the Corporations Act 2001 such that if withdrawal requests submitted exceed the amount available for a particular offer, then requests will be satisfied proportionally as follows:

$$\text{Amount of money available} \times \frac{\text{Amount requested by unitholder}}{\text{Total of all amounts unitholders request to withdraw}}$$

That is, the actual withdrawal amount paid to each investor will depend on the value of all withdrawal requests received during the withdrawal offer period and the level of cash available within the relevant fund to meet the requests at that time. All withdrawal requests will receive the same proportion of their request, irrespective of when the request is received.

Please be advised that we are in the process of considering a new approach to the way we distribute liquidity to investors. The change will not affect the amount of funds available to be distributed to investors or the quarterly cycle, rather it would change the way funds are distributed. We intend to communicate the outcome to investors as soon as it is known. Updates can be accessed via the website www.anz.com

Liquidity

Liquidity refers to the proportion of cash or cash equivalents within the Fund. Typically these cash assets are used to meet the Fund's short-term commitments. There are numerous factors that impact on the liquidity of the Fund, including the value of:

- investments into the Fund
- monthly interest payments by borrowers
- loans repaid by borrowers
- redemptions from the Fund
- new loans
- any undrawn loans
- market conditions.

We maintain and update cash flow estimates for the Fund on a regular basis by taking into account all of the above factors. These estimates are used to ensure the Fund has enough liquid assets to meet its projected cash needs for at least the next three months.

We have currently suspended withdrawals from (and applications into) all Mortgage and Income Plus Funds until further notice. This action has been taken to protect the best interests of all investors in the Fund

Borrowing

The Fund does not borrow funds or use credit facilities for any purpose.

Portfolio diversification

The Fund's portfolio of loans is well diversified across geographic region, property type, loan type and borrowers. The policies governing the lending of the Fund's assets specify limits for each of these elements, ensuring a conservative approach to lending.

The Fund has entered into a number of interest rate swaps to swap fixed rate loans to variable rate loans

This section provides information on the portfolio's diversification using data as at 21 February 2011 (unless otherwise specified).

Class of activity – (property type)

Property Type		
Type	**Number**	**$'000**
Commercial office	55	321,589
Residential	19	98,232
Retail	36	129,017
Industrial	66	190,241
Vacant land	20	146,946
Other	6	65,903
Total	**202**	**951,928**

A full review of mortgage portfolio Key Risk Indicators (KRIs) is undertaken annually in May and current exposures within each of the above property types are within approved KRI Geographic region

Geographic region

Geographic region		
Location	**Number**	**$'000**
NSW	85	319,665
VIC	79	418,660
QLD	35	175,452
WA	2	25,123
ACT/NT/TAS/SA	1	13,028
Total	**202**	**951,928**

A full review of mortgage portfolio Key Risk Indicators (KRIs) is undertaken annually in May and current exposures within each of the above property types are within approved KRI.

Defaults

Borrowers* that are in material Default/Impairment		
	Number	**$'000**
Default/Impaired Borrowers	18	159,729
Total	**18**	**159,729**

*A borrower may have one or more loans but has no more than 3 loans

Under the Problem Loan Guidelines an Impaired Loan is defined as either a:

- loan where payment arrears is over 30 days
- loan where review has uncovered covenant breaches of a material nature
- loan where a review has uncovered an unacceptable deterioration in the security position
- loan which is in material default

An Impaired Loans report is provided to Senior Management for each loan that is determined to be Impaired detailing:

- why the loan has become a problem loan,
- full review of the security position including the existence of guarantees and a fixed & floating charge (if applicable),

- An assessment as to whether the fund is likely to suffer a loss or not. The loss assessment process involves calculating the difference between the loan amount and the updated valuation amount. The need for a specific provision forms part of this process.
- A Corrective Action Plan is developed and will focus on one or more of the different loan recovery options. These options include but are not limited to seeking loan refinance, borrower's voluntarily sale of the security property or other assets, or mortgagee sale of the security property via the formal appointment of a Receiver under the mortgage.

Where the Impaired Loans report reveals a strong likelihood of loss of loan principal (based on comparison of loan balance to an up to date valuation report by a panel valuer or sale of property at an amount insufficient to repay loan), the need to raise a Specific Provision for Loss is assessed.

Accounting Standard AASB 139 requires the Responsible Entity (RE) to conduct impairment tests if there is any indication that an asset may be impaired. The standard defines an impairment loss as "the amount by which the carrying amount of an asset exceeds its recoverable amount". The fair value of recoverable amount is calculated using the net present value method.

The Responsible Entity is required to consider indicators of impairment using external and internal sources of information. For the Fund, management, on behalf of the RE, has determined that the indicators of impairment may include, but not limited to, the following:

- Significant decline in market value of the asset, and or
- Significant changes in market conditions

Under the impairment testing, if the recoverable amount is less than the carrying value of an asset, the carrying value of the asset must be reduced to its recoverable amount. This impairment amount is recognised immediately in the profit and loss for the mortgage pool by reducing the monthly distribution by the amount of the estimated impairment/loss.

Security type

All loans are secured by a Registered First Mortgage over investment and owner occupied industrial, retail, commercial office, vacant land and residential property.

Joint and several guarantees are generally required from all shareholders/ directors of the borrowing entity and any corporate shareholders of the borrowing entity. Guarantees may be required from other corporate entities controlled by the borrower or any guarantor, if the income from those entities is to be relied upon for loan servicing

Borrower concentration – Largest borrower and largest group exposure as a percentage of mortgages under management

Borrower concentration	%
Largest borrower	10.17
Ten largest borrowers	47.35
Largest group exposure	10.17

Undrawn loan commitments – the amount that can be drawn down under approved limits

Undrawn loan commitments	Number	$'000
Approved limits	5	32,870
Undrawn portion of approved limits		**6,895**

Maturity profile

Maturity profile		
Maturity in months	**Number**	**$'000**
Matured	34	176,017
0 – 3 months	21	83,555
3 – 6 months	36	150,920
6 – 12 months	19	178,277
1 – 2 years	48	249,091
2 – 3 years	33	79,077
3 – 4 years	10	32,886
4 – 5 years	1	2,105
Total	**202**	**951,928**

Loan to security valuation ratios

Loan valuation ratios		
Loan to value ratio	**Number**	**$'000**
0.00% – 50.00%	58	159,858
50.01% – 60.00%	35	206,426
60.01% – 66.00%	36	272,615
66.01 – 70.00%	42	121,350
70.01% – 75.00%	6	39,509
75.01% +	25	152,170
Total	**202**	**951,928**

Interest rates

Interest rates		
Interest rate mix	**Number**	**$'000**
0.00% – 5.99%	2	19,000
6.00% – 6.49%	33	217,521
6.50% – 6.99%	45	101,648
7.00% – 7.49%	16	148,296
7.50% – 7.99%	32	96,745
8.00% – 8.49%	21	108,866

Interest rates		
8.50% – 8.99%	15	38,377
9.00% – 9.49%	4	22,347
9.50% +	34	199,128
Total	**202**	**951,928**

Interest capitalisation loans – Loans where interest is capitalised within the approved limits

Capitalisation		
Loans capitalised	**Number**	**$'000**
Approved limits	0	0
Undrawn portion of approved limits	0	0

Related party transactions

The Fund does not lend any assets to related parties.

A portion of the Fund's non-loan assets are invested with the Australia and New Zealand Banking Group Limited (ANZ). These investments are made on commercial terms into ANZ's banking products.

Valuations

Valuations on properties (excluding development properties) are based on their current state ('as is'). For development properties, valuations are based on 'as is' and 'on completion' basis.

Valuations are obtained prior to loan approval and properties are re-valued after three years if applicable. Valuations may be no more than 90 days old on the date of settlement.

Valuations for the Fund are conducted by valuers selected from a panel of registered valuers, and must comply with industry standards and codes. One valuer cannot conduct more than 1/3 of valuations for the Fund by dollar value.

OnePath maintains a panel of external valuers (formally reviewed by OnePath every six months) that are used to value security properties. The panel comprises mainly large independent firms with a national presence, as well as more specialist valuers selected on their known level of experience in the type of property being valued. All valuations must be conducted pursuant to OnePath's Valuation Policy, under OnePath's instructions and must be counter-signed by a director if the valuer is not a director. Valuations may be no more than 90 days old on the date of loan settlement. There can be no more than two consecutive valuations that may be conducted by the same valuation firm or the individual valuer on the same security property. Vacant possession value is adopted where security property is substantially owner occupied. For loan rollovers, valuation may be waived in some circumstances provided an up to date rental income schedule is provided and verified by OnePath and security property is re-inspected by an OnePath Mortgage Investment team member or a panel valuer

Lending principles – loan-to-valuation ratios

A loan-to-valuation ratio (LVR) is determined by dividing the loan amount by the property's value. The higher the LVR, the greater the risk that the Fund will not be able to fully recover the loan amount if property prices reduce. The maximum LVR at approval on the Fund's loans is 75%, with the standard LVR being 70%.

For construction loans (where the property is being developed for future use or sale) the maximum LVR is limited to the lesser of 80% of total development costs or 70% of the 'as if complete' or net realisable value.

The initial advance should not exceed 65% of the site value, including reasonable value attributed to the development application or permit by the OnePath Australia Panel Valuer. This is provided that pre-sales/pre-lease requirements are satisfied at the time of the initial advance otherwise the maximum initial advance is limited to 60%.

These loans stipulate that monies are only released on a cost to complete basis as certified by OnePath Australia's appointed Panel Quantity Surveyor

Distributions

Monthly distributions from the Fund are provided to investors based solely on the level of income earned in the month. This income is derived from the monthly interest paid on the Fund's loans, as well as interest and movements in capital value of the Fund's cash and fixed interest assets.

Distributions from the investment funds that invest in the Fund are made from income they receive from the Fund. For OnePath Income Plus and OnePath Original Income Plus, monthly distributions also take into account an estimate of income earned by share and property assets, as well as any capital gains within the funds.

Withdrawals

The constitution sets out your ability and OnePath Funds Management's obligations in relation to withdrawing from the Mortgage and Income Plus Funds. When the Mortgage and Income Plus Funds are liquid, OnePath Funds Management is required to pay a withdrawal request within the time prescribed by the constitution. That time period is different for each fund and OnePath Funds Management may have the power, in certain circumstances, to extend that timeframe to a further period as authorised by the relevant constitution

Investment fund	Constitutional name	When the fund is liquid, period when a redemption request must be paid
OnePath Mortgages	ANZ OA OnePath Mortgage Trust	Within 30 days.
ANZ Mortgage Fund (Series 1 and 2)	ANZ Mortgage Fund	Within 90 days.
OnePath Income Plus	ANZ OA OnePath Income Plus Trust	Within 30 days. We have the power to extend that time by an additional 28 days under certain circumstances.
OnePath Original Income Plus	ANZ OA OnePath Income Plus Trust	Within 30 days. We have the power to extend that time by an additional 28 days under certain circumstances.