



GROUP INVESTMENT FUND

Annual Report 2011



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Business Directory

Nature of Business	NZ Mortgage Income Trust (P.I.E. Fund) is a Group Investment Fund tailored to meet investment needs.	Trustee	Trustees Executors Limited Level 5 10 Customhouse Quay WELLINGTON
Business Address	Fund Managers Otago Limited Level 5 165 Stuart Street DUNEDIN	Bankers	The National Bank of New Zealand Ltd ASB Bank Ltd ANZ Banking Group New Zealand Ltd
Contact Details	Fund Managers Otago Limited PO Box 5741 DUNEDIN 9058 Phone: 03 471 6500	Solicitors to the Manager	Anderson Lloyd Lawyers Level 9, Otago House 481 Moray Place DUNEDIN
Address for Service	Fund Managers Otago Limited PO Box 5741 DUNEDIN 9058	Webb Farry	79 Lower Stuart Street DUNEDIN
Directors of the Manager	John Edward Farry David Joseph Ehlers Bruce Desmond Smaill John Francis Gallaher	Business Adviser	Deloitte Level 13, Otago House 481 Moray Place DUNEDIN 9016
Auditor	Polson Higgs PO Box 5346 DUNEDIN 9058		



Dear Investor

The directors of Fund Managers Otago Ltd are pleased to present the Annual Report of the NZ Mortgage Income Trust Portfolio Investment Entity (P.I.E.) Fund for the year ending 31 March 2011.

At balance date and on the advice of the auditors the allowance for impairment of investments was increased. In addition actual losses incurred on realisation of some of the impaired assets were also recognised. As a result of these actions the result for the year is disappointing and the losses incurred have reduced the unit value to less than one dollar. However the Fund continued to deliver stable returns and it is the directors opinion that the unit price can, and will, be restored to full value as we move forward. Regular returns to investors will also be maintained.

The year ahead is likely to be difficult but it is pleasing to report that significant progress has been made in dealing with the last of the impaired assets. Further bad debt recoveries have been achieved since balance date and the board remains optimistic that further recoveries can be achieved.

The directors wish to thank all investors for their continued patience and support as the company works its way through difficult economic conditions.

For and on behalf of the board of:
FUND MANAGERS OTAGO LTD



JOHN FARRY
Chairman



	Notes	March 2011 \$	March 2010 \$
Revenue			
Interest – mortgages		4,932,853	5,430,683
Interest – term deposits		85,108	271,948
Interest – other		9	245
Sundry income		3,011	1,583
Total Revenue		5,020,981	5,704,459
Less Expenses			
Accounting fees		46,318	37,086
Audit fees	9	62,727	51,439
Bank charges		1,563	1,731
Collection fees		42,287	–
Computer service charge		12,500	9,375
General expenses		282	250
Interest – Inland Revenue Department		126	–
Legal expenses deductible		22,148	31,618
Allowance for impairment of investments	15 (l)	2,027,185	587,397
Net loss on realisation of investments	15 (l)	1,337,649	673,120
Management fees	13	972,413	560,102
Postage		6,807	10,551
Printing & stationery		13,466	18,303
Telephone & tolls		409	1,173
Trustee fees	13	73,718	88,928
Total Expenses		4,619,598	2,071,073
Net Surplus Before Other Comprehensive Income		401,383	3,633,386
Other comprehensive income		–	–
Net Surplus		\$ 401,383	\$ 3,633,386

Statement of Changes in Equity

For the Year ended 31 March, 2011

	March 2011 \$	March 2010 \$
Equity at the Beginning of the Year	75,621,648	98,386,635
Surplus & Revaluations		
Total comprehensive income	401,383	3,633,386
Transactions with Unitholders		
Contributions from / (to) unitholders	(10,153,362)	(23,079,482)
Deferred tax asset	–	379,430
PIE tax refund receivable	157,099	–
Less distributions to unitholders	3,149,705	3,698,321
Equity at the End of the Year	\$ 62,877,063	\$ 75,621,648

Balance Sheet

As at 31 March, 2011

Group
Investment
Fund

**NZ MORTGAGE
INCOME TRUST**

P.I.E
Registered

	Notes	March 2011 \$	March 2010 \$
Assets			
National Bank cheque account		4,964	4,952
Bank deposits on call		1,845,546	3,128,439
Deferred taxation	10	-	379,430
Accounts receivable		1,425,394	68,512
GST receivable		745	(15,698)
Mortgage interest due	8	465,743	829,133
Term deposit interest due		-	31,103
Tax refund due	10	-	2,345
Current portion of mortgage receivables	11	53,019,729	56,759,962
Mortgage receivables	11	6,812,735	15,616,224
Total Assets		63,574,856	76,804,402
Liabilities			
Accounts payable	12	697,793	1,182,754
Total Liabilities		697,793	1,182,754
Unitholders' Funds			
Unitholders' funds	3	67,133,728	77,129,991
NZ Mortgage Income Trust capital reserve	6	-	257,050
Accumulated income / (losses)	7	(4,256,665)	(1,765,393)
Total Equity		\$ 62,877,063	\$ 75,621,648
Total Equity & Liabilities		\$ 63,574,856	\$ 76,804,402

Signed for and on behalf of the Manager,
Fund Managers Otago Limited



Director, Fund Managers Otago Limited

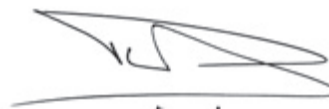


Director, Fund Managers Otago Limited

Signed for and on behalf of the Trustee,
Trustees Executors Limited



Director, Trustees Executors Limited



Director, Trustees Executors Limited

Date: 26 August 2011

	March 2011 \$	March 2010 \$
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash was provided from:		
Interest received	5,412,463	6,189,842
Sundry receipts / (payments)	21,467	(13,036)
Tax refund received	2,345	–
	<u>5,436,275</u>	<u>6,176,806</u>
Cash was applied to:		
Tax paid	–	2,345
Payments to suppliers	1,794,283	643,998
Interest paid	126	–
	<u>1,794,409</u>	<u>646,343</u>
NET CASH INFLOW FROM OPERATING ACTIVITIES	<u><u>3,641,866</u></u>	<u><u>5,530,463</u></u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash was applied to:		
Net (purchase) / sale of investments	7,943,567	18,687,780
	<u>7,943,567</u>	<u>18,687,780</u>
NET CASH INFLOW / (OUTFLOW) FROM INVESTING ACTIVITIES	<u><u>7,943,567</u></u>	<u><u>18,687,780</u></u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Cash was provided from:		
Unitholders funds	2,253,167	801,243
	<u>2,253,167</u>	<u>801,243</u>
Cash was applied to:		
Distributions to unitholders	3,094,382	5,949,354
Repayment of unitholders funds	12,027,099	23,880,725
	<u>15,121,481</u>	<u>29,830,079</u>
NET CASH INFLOW / (OUTFLOW) FROM FINANCING ACTIVITIES	<u><u>(12,868,314)</u></u>	<u><u>(29,028,836)</u></u>
NET CASH INFLOW / (OUTFLOW)	<u><u>(1,282,881)</u></u>	<u><u>(4,810,593)</u></u>
Plus opening cash carried forward	3,133,391	7,943,984
Ending cash carried forward	<u>1,850,510</u>	<u>3,133,391</u>
Cash consists of:		
National Bank cheque account	4,964	4,952
Bank deposits on call	1,845,546	3,128,439
	<u>1,850,510</u>	<u>3,133,391</u>
RECONCILIATION OF NET SURPLUS AFTER TAXATION WITH NET CASH FLOW FROM OPERATING ACTIVITIES		
Net surplus after taxation	401,383	3,633,386
Plus / (less) items not involving cash flows		
Allowance for impairment of investments	2,027,185	587,397
Loss on realisation of investments	1,337,649	673,120
	<u>3,766,217</u>	<u>4,893,903</u>
Movements in working capital		
(Increase) / decrease in accounts receivable	(1,373,325)	(14,619)
Accounts receivable cash flow relating to non-operating activities	1,392,420	–
Increase / (decrease) in taxation	2,345	(2,345)
Increase / (decrease) in accounts payable	(540,284)	166,558
(Increase) / decrease in term deposit interest due	31,103	21,456
(Increase) / decrease in mortgage interest due	363,390	465,510
	<u>(124,351)</u>	<u>636,560</u>
Net cash inflow from operating activities	<u><u>3,641,866</u></u>	<u><u>5,530,463</u></u>

1. Statement of Accounting Policies

Reporting Entity

NZ Mortgage Income Trust Group Investment Fund ("the Fund") is a Group Investment Fund. The Fund is a profit-orientated entity, which was formed on 30 July, 2001 and commenced operation on 1 October, 2001. It is registered under the Trustee Companies Act 1967. NZ Mortgage Income Trust Group Investment Fund is an issuer for the purposes of the Financial Reporting Act 1993. The Fund has elected to be a Portfolio Investment Entity for taxation purposes (refer to note 21 for details).

The principal activity of the Fund is to provide investment in a diversified portfolio of nationwide first registered mortgages, to provide regular income to unitholders.

These financial statements have been prepared for NZ Mortgage Income Trust Group Investment Fund by Fund Managers Otago Limited (the "Manager"), on behalf of Trustees Executors Limited (the "Trustee"), in accordance with the Trustee Companies Act 1967, the Financial Reporting Act 1993 and the provisions of the Trust Deed.

The financial statements were authorised for issue by the Directors on 26 August, 2011.

Statement of Compliance

These financial statements comply with International Financial Reporting Standards ("IFRS"). The financial statements have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand ("NZ GAAP"). They comply with New Zealand Equivalents to International Financial Reporting Standards ("NZ IFRS") and other applicable financial reporting standards as appropriate for profit-oriented entities. Compliance with NZ IFRS ensures that the financial statements comply with IFRS.

Basis of Preparation

The financial statements have been prepared on a historical cost basis except for the revaluation of certain items for which accounting policies are stated below.

Cost is based on the fair value of the consideration given in exchange for assets.

The financial statements are presented in New Zealand dollars, rounded to the nearest one dollar.

The accounting policies set out below have been applied in preparing the financial statements for the year ended 31 March, 2011 and the comparative information presented in these financial statements for the year ended 31 March, 2010.

The financial statements have been prepared on the going concern assumption. The basis for this assumption is detailed in note 24.

Critical Judgements in Applying Accounting Policies

In the application of NZ IFRS management is required to make judgements, estimates and assumptions about carrying values of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstance, the results of which form the basis of making the judgements. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of NZ IFRS that have significant effects on the financial statements and estimates with a significant risk of material adjustments in the next year are disclosed, where applicable, in the relevant notes to the financial statements.

2. Summary of Specific Accounting Policies

The principal accounting policies applied in the preparation of the financial report are set out below. These policies have been consistently applied unless otherwise stated.

a) Goods & Services Tax

The Fund is GST registered for the purposes of returning GST on rental income received on repossessed properties, being rental income received between repossession and sale by the Fund, and

the sale of any repossessed properties when GST is payable. The Fund has also elected to treat the supply of qualifying financial services as zero rated for GST purposes allowing the Fund to obtain a refund for some of its expenditure in relation to those services. All other items in the financial statements have been shown inclusive of GST.

b) Taxation

Current Tax

The reporting entity is a Group Investment Fund for the purposes of the Income Tax Act 2007. Following the Fund's election to become a Portfolio Investment Entity (as detailed in note 21) distributions from 1 October, 2007 are subject to the PIE regime where income is allocated to investors. The Fund deducts tax at the prescribed investor's tax rate. The tax deducted is a debt due to the Crown and is paid directly to Inland Revenue on the investors' behalf.

Deferred Tax

Deferred tax is accounted for using the comprehensive balance sheet liability method in respect of temporary differences arising from differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax base of those items.

In principle, deferred tax liabilities are recognised for all taxable temporary differences. Deferred tax assets are recognised to the extent that it is probable that sufficient taxable amounts will be available against which deductible temporary differences or unused tax losses and tax offsets can be utilised. However, deferred tax assets and liabilities are not recognised if the temporary differences giving rise to them arise from the initial recognition of assets and liabilities (other than as a result of a business combination) which affects neither taxable income nor accounting profit.

Current & Deferred Tax for the Period

Current and deferred tax is recognised as an expense or income in the Statement of Comprehensive Income, except when it relates to items credited or debited directly to equity, in which case the deferred tax is also recognised directly in equity, or where it arises from the initial accounting for a business combination, in which case it is taken into account in the determination of goodwill or excess.

c) Mortgage Receivables

The mortgage portfolio is initially recognised at fair value and subsequently measured at amortised cost using the effective interest method less any losses due to impairment. The recovery of mortgage receivables is reviewed on an ongoing basis and debts which are determined to be unrecoverable are written off. A provision for impairment is recorded where there is information available to the Fund that recovery of all amounts as specified under the original terms of the mortgage agreement is not likely. Any difference between the asset's carrying amount and the present value of discounted cashflows at the effective interest rate, represents the provision for impairment. The amount of this provision is recognised in the Statement of Comprehensive Income.

d) Financial Assets

Financial assets may be classified into the following specified categories: Financial assets 'at fair value through profit or loss' (FVTPL), 'held-to-maturity' (HTM), 'available-for-sale' (AFS) financial assets and 'loans and receivables'. The classification depends on the nature and purpose of the financial asset and is determined at the time of initial recognition.

The fund does not hold any financial assets classified as FVTPL, HTM or AFS.

Loans & Receivables

Accounts receivable and mortgage receivables that have fixed or determinable payments and that are not quoted in an active market are classified as loans and receivables. Loans and receivables are initially recognised at fair value plus transaction costs and subsequently measured at amortised cost using the effective interest method, less any impairment. Interest income is applied using the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

Effective interest method

The effective interest method is a method of calculating the amortised cost of a financial asset, and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including any fees, discounts or premiums) through the expected life of the financial assets, or where appropriate, a shorter period.

Risk

The Fund's activity exposes it to a variety of financial risks such as market risk (including interest rate risk), credit risk and liquidity risk. The Fund's management of these risks is discussed in note 15..

e) Revenue Recognition

Interest income comprises the fair value for the lending monies and is recognised on a time-proportional basis using the effective interest method.

f) Revenue Recognition of Impaired Assets

When a mortgage receivable is impaired, the Fund reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at original effective interest rate of the instrument, and continues unwinding the discount as interest income. Interest income on impaired loans is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

g) Impaired Assets, Past Due Assets & Restructured Assets

"Impaired assets" are any assets where the Manager considers that there is a measurable decrease in the estimated future cash flows from the asset. Details of impaired assets are included in note 15 (l).

At each reporting date, the Manager reviews the carrying amounts of mortgage receivables on an asset by asset basis to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). A specific provision for impairments is created when recovery of principal and/or interest is not considered fully collectable in accordance with the terms of the loan contract. A collective impairment is determined by the Manager after assessing the remaining mortgage receivables according to their credit risk characteristics and considering objective evidence of impairment events.

If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment provision reduces the carrying amount of the mortgage receivable, and the amount of the estimated loss is recognised in the Statement of Comprehensive Income as an expense immediately. When a mortgage security is realised the actual realisation is first recorded against the provision with any difference being recorded in the Statement of Comprehensive Income.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. Any reversal of an impairment loss is recognised as income immediately unless the asset is carried at fair value, in which case the reversal of the impairment loss is treated as a revaluation increase.

"Past due assets" are any assets which have not been operated by the counterparties within their key terms and which are not considered impaired assets. Details of past due assets are included in note 15 (m).

"Restructured assets" are assets which, were it not for the Fund agreeing to vary the original terms of the asset, would have been considered either past due or impaired. These varied terms are not generally comparable with those offered to new borrowings with comparable risk. No assets would ever be restructured on terms which might potentially result in increased risk for the Fund. Details of restructured assets are included in note 15 (n).

If a restructured asset subsequently becomes past due or impaired it is classified accordingly and is no longer regarded as a restructured asset.

h) Accounts Payable

Accounts payable represents liabilities for goods and services provided to the Fund and that remain unpaid at the end of the period. They are initially measured at fair value plus transaction costs and subsequently measured at amortised cost using the effective interest rate method.

i) Statement of Cash Flows

The Statement of Cash Flows has been prepared using the direct method and is inclusive of GST, which is consistent with the method used in the Statement of Comprehensive Income. The Statement of Cash Flows represents gross amounts of cash flows except where otherwise described. NZ IAS 7 allows cash flows to be presented on a net basis where the cash flows represent the purchase and sale of investments. The purchase and sale of investments is presented in the Statement of Cash Flows on a net basis, as the gross amounts would not provide useful information for financial statement purposes.

Definition of terms used in the Statement of Cash Flows:

"Cash" includes cash on hand, demand deposits, and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of change in value.

"Operating activities" include all transactions and other events that are not investing or financing activities.

"Investing activities" are those activities relating to the acquisition and disposal of current and non-current investments and any other non-current assets.

"Financing activities" are those activities relating to changes in the equity and debt capital structure of the Fund and those activities relating to the cost of servicing the Fund's unitholder investments.

j) Distributions

In accordance with the Trust Deed, distributable income is distributed to unitholders by way of cash or re-investment into the Fund. A small percentage of income may be retained to help meet losses on individual loans and is recorded in the NZ Mortgage Income Trust Capital Reserve (refer Note 6).

Distributions to unitholders comprise the income of the Fund to which unitholders are presently entitled.

Distributions are normally included in the accounts on a quarterly basis at the end of June, September, December and March.

k) Cash & Cash Equivalents

Cash and cash equivalents comprise cash on hand, demand deposits, and other short-term highly liquid investments with average maturities of six months or less, that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

l) Accounts Receivable

Accounts receivable are measured on initial recognition at fair value plus transaction costs and are subsequently measured at amortised cost using the effective interest rate method. Appropriate allowances for estimated irrecoverable amounts are recognised in the Statement of Comprehensive Income when there is objective evidence that the asset is impaired. The allowance recognised is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the effective interest rate computed at initial recognition.

The carrying amount of the asset is reduced by the allowance account, and the amount of the loss is recognised in the Statement of Comprehensive Income within expenses. When an accounts receivable is uncollectible it is written off against the allowance account.

m) Standards and Interpretation Not Yet Effective

There are no standards and interpretations, applying to the Fund, that have been issued or amended and are not yet effective, with the exception of NZ IFRS 9: Financial Instruments. This standard becomes applicable for periods beginning on or after 1 January 2013. It will have an impact on classification of financial instruments.

n) Changes in Accounting Policies

There have been no changes in the accounting policies applied during the period.

3. Unitholders' Funds

	31 March 2011	March 2010
	\$	\$
Balance at the Beginning of the Period	77,129,991	99,830,043
Plus:		
Investor funds – full \$1 units purchased	1,175,361	360,784
Investor funds – distributions reinvested	1,077,806	439,760
Investor funds – full \$1 units unissued	–	699
	2,253,167	801,243
Less:		
Investor funds – full \$1 units withdrawn	12,027,099	23,880,725
Net contributions / (withdrawals)	(9,773,932)	(23,079,482)
Add:		
PIE tax refund receivable	157,099	–
Less:		
Deferred tax asset utilised / (recognised)	379,430	(379,430)
Balance at the End of the Period	67,133,728	77,129,991

Unitholders' funds included a \$379,430 deferred tax asset at 31 March, 2010 which arose due to allowance for impairment of investments being expensed in the financial statements but which had not been deducted for tax purposes. The deduction, for tax purposes, occurred in the period to 30 September, 2010 resulting in the deferred tax asset being received in the current period and has been applied against tax payable for the Fund.

Unitholders' Funds by Region	31 March 2011		March 2010	
	\$	%	\$	%
Otago / Southland	54,504,877	81.4	62,531,129	81.5
Other – South Island	7,950,342	11.9	8,337,517	10.9
Auckland	1,518,613	2.3	1,910,291	2.5
Wellington	1,940,407	2.9	2,604,245	3.4
Other – North Island	795,660	1.2	1,068,052	1.3
New Zealand resident total	66,709,899	99.6	76,451,234	99.6
Overseas residents	266,730	0.4	299,327	0.4
Investor funds total	66,976,629	100%	76,750,561	100%
PIE tax adjustments	157,099		379,430	
	67,133,728		77,129,991	

The Manager on behalf of the Trustee shall calculate the Fund value and unit value as at each valuation day. A valuation day, being a day specified by the Trustee as a day on which the market value of the investments in the Fund is determined, occurs at least once a week. Whenever a determination of the Fund value is required, such value shall be the value calculated as at the valuation day. If the Trustee has cause to believe at any time that on the relevant valuation day there may be a material discrepancy or potential error in the calculation of the Fund value or unit value the Trustee shall calculate the Fund value or unit value as the case may be and that calculation shall be conclusive or binding upon all unitholders and former unitholders.

Each unit issued represents a right to an individual share in the Fund per the Trust Deed. There are no separate classes of units; all units have the same rights. Funds are from Individuals, Trusts, Companies and Estates.

Requests for units to be withdrawn that have been received but have not been paid by the Fund at 31 March, 2011 were \$3,376,847 (March, 2010 \$3,078,042).

4. Manager's and Trustee's Fees

The Manager is entitled to be paid an annual fee as may be agreed between the Manager and the Trustee. The annual fee for the Manager is 1.5 % per annum of the gross value of the Fund plus GST (if any) calculated daily and paid quarterly in arrears from the distributable income. The Manager forgave some of its fee equal to 0.15% of the gross value of the Fund (resulting in a fee of 1.35% per annum of the gross value of the Fund) for the period from 1 April, 2010 to 31 March, 2011. In the comparative period, the Manager forgave its entire fee in the six month period to 30 September, 2009 and forgave some of its fee equal to 0.15% of the gross value of the Fund (resulting in a fee of 1.35% per annum of the gross value of the Fund) for the period from 1 October, 2009 to 31 March, 2010. The Manager may pay commissions to law firms or other investment advisers for investment applications lodged through them, but any commissions are paid out of the Manager's own funds. Some of these payments are made to related parties of the Fund. Details are disclosed in the financial report of the Manager.

The Trustee is entitled to be paid an annual fee as may be agreed between the Manager and the Trustee. Currently the Trustee receives an annual fee of up to 0.1% per annum of the gross value of the Fund plus GST (if any) up to the gross value of the Fund of \$50,000,000 at which time the annual fee is reduced to 0.08% plus GST (if any) for those funds over \$50,000,000. This is calculated daily and paid quarterly in arrears from the distributable income. There is a minimum fee of \$7,500 plus GST (if any) per annum payable. Refer to Note 13 for details of current period payments.

Both the Trustee and Manager are entitled to be reimbursed out of the Fund for all costs, expenses or liabilities incurred by either of them whilst acting for the Fund. Both the Trustee and the Manager are entitled to alter their fees by agreement between the Trustee and the Manager. The Manager's and Trustee's fees and expense reimbursements are payable out of the Fund and are not directly payable by investors. However, returns to investors are affected by these fees and expenses in that distributions to investors are made after the deduction of these fees and expenses from the Fund.

5. Contributions Received in Advance

Moneys received on 31 March, 2011 applying for units which had not been created by the Trustee at that date was \$270 (March, 2010 \$Nil; September 2009 \$Nil). The moneys received are included in accounts payable at the reporting date.

6. NZ Mortgage Income Trust Capital Reserve

	31 March 2011	March 2010
	\$	\$
Balance at the Beginning of the Period	257,050	257,050
Plus transfer to accumulated income	257,050	–
Balance at the End of the Period	–	257,050

The Trust Deed allows the Manager to establish a capital reserve to help meet losses on individual loans by setting aside a very small part of the Fund's income for that purpose. The amount set aside will be reviewed from time to time. At present all losses are dealt with directly through the Statement of Comprehensive Income as they occur along with specific provisions on loans known to be impaired. Until trading conditions return to normal no further contributions will be made to the capital reserve. Changes in accounting standards may mean in future that maintaining a tax paid capital reserve may no longer be the most effective means of managing losses on investments. In the current reporting period, the balance of the capital reserve was utilised by transferring the capital reserve to accumulated income in order to be paid to unitholders as part of the distributions to unitholders (refer note 7).

7. Undistributed Accumulated Income

	31 March 2011	March 2010
	\$	\$
Balance at the Beginning of the Period	(1,765,393)	(1,700,458)
Plus:		
Net surplus for the period	401,383	3,633,386
Transfer from reserve fund	257,050	–
	<u>658,433</u>	<u>3,633,386</u>
Less:		
Distributions to unitholders	3,149,705	3,698,321
Transfer to reserve fund	–	–
	<u>3,149,705</u>	<u>3,698,321</u>
Balance at the End of the Period	<u>(4,256,665)</u>	<u>(1,765,393)</u>

The over distributions of income for the Fund have occurred due to higher than anticipated specific allowances for impairment and losses on realisation of security assets, particularly in the year ending 31 March, 2009 and the current period, due to a continued deterioration of the property market. As from 1 October, 2009, the Fund operates a fluctuating unit value which means that any deficit will impact on the value of each unit. At 31 March, 2011 the unit value was \$0.94 (March 2010: \$0.98). The Manager has had debt recoveries negotiated which amount to \$235,310 as at balance date which due to timing issues are not reflected in the current unit price. They amount to 0.0035 cents per unit.

8. Mortgage Receivables Interest Due

	31 March 2011	March 2010
	\$	\$
Mortgage interest	465,743	829,133
Mortgage penalty interest	–	–
	<u>465,743</u>	<u>829,133</u>

All mortgage receivables interest relates to mortgage lending on non impaired assets.

9. Remuneration to Auditors

	31 March 2011	March 2010
	\$	\$
Auditing the financial statements	60,832	49,526
Auditing the prospectus	1,895	1,913
	<u>62,727</u>	<u>51,439</u>

10. Taxation

	31 March 2011	March 2010
	\$	\$
Tax payable (Refund due)		
Balance at the Beginning of the Period	(2,345)	–
Plus:		
Taxation on surplus for the period	–	–
Tax refunds received	2,345	–
Less:		
RWT paid	–	2,345
Balance at the End of the Period	<u>–</u>	<u>(2,345)</u>

The Fund had, at 31 March, 2010, recognised a deferred tax asset of \$379,430. This asset related to the expected tax benefit for the Fund in relation to tax deductions on unrealised losses that the Fund has not previously included in the calculations of PIE tax payable to Inland Revenue (refer to note 2 (b) for details of how PIE tax is calculated). These tax deductions were included in the PIE tax calculations for the June 2010 quarter and the benefit of the deductions has been utilised and offset against PIE tax payable in accounts payable.

11. Investments
a) Mortgage Receivables

	31 March 2011	March 2010
	\$	\$
Mortgages	<u>59,832,464</u>	<u>72,376,186</u>
Balance at Beginning of the Period	72,376,186	92,324,483
New mortgages paid out	663,803	11,348,014
Expenses and arrears charged	5,512,577	4,592,730
Principal instalments paid	(115,527)	(149,999)
Repayment of existing mortgages	(14,272,995)	(32,543,418)
Mortgage principal transferred to NZ Mortgage Income Trust (No.2 Fund) Group Investment Fund	(966,746)	(1,935,107)
Allowance for impairment / loss on realisation recognised	(3,364,834)	(1,260,517)
Balance at the End of the Period	<u>59,832,464</u>	<u>72,376,186</u>
Due within 12 months	53,019,729	56,759,962
Due over 12 months	6,812,735	15,616,224
	<u>59,832,464</u>	<u>72,376,186</u>

	31 March 2011		March 2010	
	\$	%	\$	%
Mortgages by loan type				
Home	4,519,765	7.6	4,570,448	6.3
Residential	24,105,781	40.3	30,239,313	41.8
Commercial	29,099,625	48.6	33,740,127	46.6
Rural	2,107,293	3.5	3,826,298	5.3
	<u>59,832,464</u>	<u>100%</u>	<u>\$72,376,186</u>	<u>100%</u>
Mortgages by region				
Otago / Southland	9,558,000	16.0	12,782,159	17.7
Auckland	21,423,961	35.8	20,948,575	28.9
Wellington	13,297,840	22.2	14,347,792	19.8
Other North Island	13,896,440	23.2	21,981,943	30.4
Other South Island	1,656,223	2.8	2,315,717	3.2
	<u>59,832,464</u>	<u>100%</u>	<u>\$72,376,186</u>	<u>100%</u>

Mortgages by nature of underlying security

	31 March 2011	March 2010
	\$	\$
Standard homes	4,014,962	4,513,448
Bare land	–	57,000
Cross lease	504,803	–
<i>Home total</i>	<u>4,519,765</u>	<u>4,570,448</u>
Apartments	12,105,679	14,989,555
Bare land	738,680	3,708,247
Development	2,857,898	2,457,553
Standard homes	7,304,492	7,731,189
Terrace houses	1,099,032	1,352,769
<i>Residential total</i>	<u>24,105,781</u>	<u>30,239,313</u>
Bare land	–	900,000
Development	–	2,235,551
Investment properties	23,717,739	23,099,476
Owner occupied	5,381,886	7,505,100
<i>Commercial total</i>	<u>29,099,625</u>	<u>33,740,127</u>
Beef	–	–
Bare land	1,967,518	3,464,069
Dairy	100,000	100,000
Sheep	–	231,729
Other	39,775	30,500
<i>Rural total</i>	<u>2,107,293</u>	<u>3,826,298</u>
	<u>59,832,464</u>	<u>72,376,186</u>

The effective interest rates on the mortgage investments as at 31 March 2011 are in the range of 0% p.a. – 12.50% p.a. The standard lending rates were as follows:

Home mortgages	11.25%	(March 2010 11.25%)
Residential rental mortgages	12.50%	(March 2010 12.50%)
Commercial mortgages	12.50%	(March 2010 12.50%)
Rural mortgages	11.75%	(March 2010 11.75%)

As detailed in note 15 (l) there are eight impaired assets totalling \$23,224,243 at the reporting date (March 2010: \$10,115,449). There is \$1,102,248 of outstanding loan principal and interest included in impaired assets at 31 March, 2011 (March 2010: \$757,104). There is no interest income included in the Statement of Comprehensive Income on impaired loans. The Manager carefully manages impaired loans by early identification and actively pursuing remedies to recover the outstanding loan and interest amounts.

During the period to 31 March, 2011 mortgage principal transferred to the NZ Mortgage Income Trust (No. 2 Fund) Group Investment Fund was \$966,746 (March 2010 \$1,935,107). Refer to note 22 for details of the NZ Mortgage Income Trust (No. 2 Fund) Group Investment Fund.

b) Cash Deposits

The effective interest rate on deposits held with financial institutions as at 31 March, 2011 was 2.74% (March 2010: 2.50% – 4.75%).

12. Accounts Payable

	31 March 2011	March 2010
	\$	\$
Trade creditors	90,529	25,725
Payments received in advance	–	1,673
Distribution payments to unitholders	519,592	464,269
Statutory requirements	15,000	10,000
Unitholders' deposits repayable	270	–
PIE Tax payable	–	680,994
Mortgage prepayments	72,402	93
Total Accounts Payable	<u>697,793</u>	<u>1,182,754</u>

13. Related Party Transactions

The related parties are Trustees Executors Limited, who provide trustee services to the Fund, Fund Managers Otago Limited, who provide management services to the Fund, and Anderson Lloyd Lawyers, and Webb Farry who provide legal services to the Fund and to Fund Managers Otago Limited.

Fund Managers Otago Limited (the Manager) and its directors and key management personnel are related to the Fund by virtue of being its manager. Details of key management personnel are included in the financial statement of Fund Managers Otago Limited.

The shareholders and directors of the Manager have no related party lending or connections with borrowers other than through professional services provided by Webb Farry and Anderson Lloyd in the preparation of loan documentation. The shareholders and directors of the Manager who are present and past partners in the law firms of Webb Farry and Anderson Lloyd and financial advisory firm Forsyth Barr Limited wish to disclose that all of these firms have investors in the Fund that arose from their respective nominee companies being transferred to the Fund in 1994 and 1996 respectively and other clients of the firms who have invested in the Fund since then. The current Webb Farry nominated director is David Ehlers. John Gallaher is an independent director and is a key person in Forsyth Barr Limited. Their respective investment ledgers as at balance date were; Webb Farry \$3,063,084; Anderson Lloyd \$4,921,328; Forsyth Barr Ltd \$477,484. All direct and indirect investments associated with the directors of the Manager are set out below. Several shareholders and directors of the Manager have investments in the Fund, both direct and indirect (through trusts and as trustees for investors).

Fund Managers Otago Limited is also the manager for NZ Mortgage Income Trust (No.2 Fund) Group Investment Fund. Information about the establishment of NZ Mortgage Income Trust (No.2 Fund) Group Investment Fund is included in note 22 and details of mortgage transactions between the Fund and NZ Mortgage Income Trust (No.2 Fund) Group Investment Fund are included in note 11a).

The following transactions occurred during the period under review in regard to parties directly related to the Fund:

Transactions for the period

	31 March 2011	March 2010
	\$	\$
Trustees fees to Trustees Executors Limited	73,718	88,928
Management fees to Fund Managers Otago Limited	972,413	560,102
Legal fees to Anderson Lloyd	20,519	15,226
Legal fees to Webb Farry	1,480	11,427
Mortgages transferred to NZ Mortgage Income Trust (No.2 Fund) Group Investment Fund	966,746	1,935,107

The following is the balance payable to each related party at each balance date.

Balance payable at balance date	31 March 2011		March 2010	
	\$		\$	
Trustees fees to Trustees Executors Limited	–		198	
Management fees to Fund Managers Otago Limited	–		–	
Legal fees to Anderson Lloyd	–		354	
Legal fees to Webb Farry	874		–	

Employees and Directors of Fund Managers Otago Limited are allowed to invest in the Fund on ordinary commercial terms. However, all employees and Directors of Fund Managers Otago Limited are prohibited from making any borrowings from the Fund.

At 31 March, 2011 there was one employee of Fund Managers Otago Limited with personal investments (including investments of immediate family members) in the Fund. The employee's investments in the Fund collectively total \$2,281. The Directors of Fund Managers Otago Limited had the following direct investment in the Fund at 31 March, 2011: D Ehlers \$312,249, B Smaill \$16,860. The Directors of Fund Managers Otago Limited had the following indirect investments in the Fund at 31 March, 2011: D Ehlers \$722,758, J Gallaher \$46,489 and J Farry \$421,500.

14. Financial Instruments

All financial assets are classified as 'loans and receivables'. Bank deposits and term deposit interest due are further classified as 'placements with, and loans to and receivable from, other banks' while mortgage receivables, mortgage interest due and accounts receivable are 'loans to and receivable from customers'.

Financial liabilities, excluding accounts payable, are classified as 'amounts owed to other depositors'.

15. Financial Risk Management

a) Credit Risk

Financial instruments which potentially subject the Fund to credit risk consist of mortgage receivables, bank balances, short term deposits, interest receivable and other receivables. The maximum exposure to credit risk at balance date is the carrying value of the financial instruments as stated in the Balance Sheet.

Significant concentrations of credit risk apply principally in respect of mortgage receivables and short term deposits. Collateral may be taken as security for mortgage receivables in addition to first mortgage security for all mortgage receivables.

b) Concentrations of Credit Risk

In the normal course of business the Fund has a credit risk on loans and investments. The Fund has a credit policy which is used to manage this credit risk. As at 31 March, 2011 there were no significant concentrations of credit risk, except as outlined below;

- that \$1,850,510 or 2.91% (March 2010: \$3,133,391, 4.07%) of total assets were invested at the National Bank and the ASB Bank. The maximum exposure to credit risk is represented by the carrying value of each financial asset in the balance sheet, and
- Security for all mortgage receivables is by way of first mortgages. The fund regularly monitors the credit quality of its customers. Credit exposure is concentrated on lending on first mortgage security to borrowers in the commercial property sector and is concentrated in the North Island of New Zealand. The concentrations of loans as a percentage of total equity at balance date are as follows:

% of Equity	31 March 2011		March 2010	
	\$	Number of Loans	\$	Number of Loans
> 100	–	–	–	–
20 – 100	–	–	–	–
10 – 19	7,511,569	1	8,048,584	1
0 – 9	52,320,895	67	64,327,602	106
	59,832,464	68	72,376,186	107

The concentrations of loans as a percentage of estimated security for each loan at balance date are as follows:

% of Security	31 March 2011		March 2010	
	\$	Number of Loans	\$	Number of Loans
> 100	23,022,844	9	240,484	1
90 – 99	–	–	4,390,215	1
80 – 89	7,802,831	2	–	–
70 – 79	4,624,715	5	14,324,788	10
60 – 69	10,034,022	8	22,701,513	15
50 – 59	9,291,135	3	9,061,548	10
40 – 49	2,791,397	6	12,325,630	11
30 – 39	1,219,823	5	4,991,439	10
20 – 29	378,100	8	490,568	9
10 – 19	439,495	13	3,094,156	28
0 – 9	228,102	9	755,845	12
	59,832,464	68	\$72,376,186	107

As noted in note 15 (g) lending is limited to a maximum of 80% of a registered valuer's report at the time of the advance. The eleven loans in excess of this guideline at 31 March, 2011 were within the lending limits at the time the loan was advanced. However, arrears charged to the loans and revised valuations have caused the percentage of security held to exceed the 80% threshold at reporting date. The allowance for impairment that has been provided for on these loans totals \$1,634,044.

c) Market Risk

The Fund's exposure to market risk is as follows:

Market Risk:

- Foreign Exchange Risk – The Fund operates locally and is not exposed to any significant foreign exchange risk.
- Price Risk – The Fund is not exposed to price risks during the normal course of operations as it does not have any investments in equity instruments, nor does it trade or invest in commodities.
- Interest Rate Risk – The Fund is invested in mortgages that have floating or short-term fixed interest rates. The change in interest rates has a large impact on income and therefore on the amounts distributed to unitholders.

The Manager is of the opinion that the Fund's exposure to market risk at reporting date is defined as:

Risk Factor	Description	Sensitivity
(i) Currency risk	All assets and liabilities are denominated in New Zealand dollars	Nil
(ii) Interest rate risk	Refer to the first paragraph of Note 15(j)	Note 15(k)
(iii) Other price risk	No securities are bought, sold or traded	Nil

d) Funding Risk

The funding risk of the Fund is its continuing ability to raise funds from the public in New Zealand financial markets. There is a risk that current unitholders may redeem their units and new issues of units may not be sufficient to meet the mortgage maturity profile of the Fund.

The Manager issued a new Prospectus on 15 December 2009. Prior to this the Fund had not been able to accept any new investments in the comparative period until this Prospectus was registered. The Manager issued a further prospectus on 21 September, 2010.

e) Fair Values

The fair value of assets and liabilities equate to their book values, except for mortgage receivables. The fair value of mortgage receivables cannot be determined with an acceptable level of reliability within the constraints of timeliness and cost, because it is not practicable to consider all relevant factors to determine a fair value for each loan. Mortgage receivables are valued in these financial statements at the effective interest rate method less any losses due to impairment.

There are no unrecognised financial instruments (March 2010: \$Nil).

f) General Lending Policy

The policy of the Manager is to establish and maintain a broad and secure range of mortgage investments. The skill of the Manager lies in maintaining a mortgage portfolio with a proper mix of mortgage types, interest rates, maturity dates and physical locations of the mortgaged property.

g) Specific Policy Guidelines

Specific investment policy guidelines are agreed between the Manager and the Trustee from time to time. These guidelines are as follows:

- i) Interest Rates – Most investments will be in mortgages with floating interest rates but the Manager may maintain some fixed rate mortgages to help protect investors against falls in interest rates;
- ii) Mix of Mortgage Types – The mortgage portfolio will be spread between residential, residential rental, commercial and farming properties with a minimum of 25% and a maximum of 45% (March, 2010 and September 2009: 25% – 45%) of the unitholders' funds invested in the residential rental sector and a minimum of 25% and a maximum of 75% of the unitholders' funds invested in the commercial sector (March, 2010 and September 2009: 25% – 75%). As at 30 September, 2010, lending on farming properties was limited to a maximum of 25% of the unitholders' funds (March, 2010 and September 2009: 25%);
- iii) Lending Limits – The maximum size of any mortgage at the time of the advance is limited in relation to both the value of the property provided as security and to the total funds of the Group Investment Fund at that time.

As at 31 March, 2011 the limits are:

- 80% of registered valuer's report for residential properties, 60% of registered valuer's report of farming properties, 66.67% of registered valuer's report for other commercial properties or 50% of registered valuer's report of vacant land. Details of the current size of mortgages against current security valuations is set out in note 15 (b);
- In the case of leasehold property the limits are set at 50% of the value of the lessee's interest, and
- No more than 5% of the Fund will be invested in any one mortgage or advanced to any one borrower (or related party borrower) at the time of the initial advance being made and the top six exposures of the Fund may not exceed 20% of the total assets of the Fund at the time of the advance

without the approval of the Trustee. The current percentage of the top six exposures of the Fund is 47.36% of the total assets. The individual advances within the current top six exposures were within the guidelines at the time each of the loans were advanced. However, arrears charged to the loans and a continued decrease in the total assets of the fund has resulted in the exposure at reporting date exceeding the 20% guideline.

- iv) Ranking – The Manager's policy is to maintain the bulk of investments in first ranking mortgages.
- v) Cash Reserves – The Manager will maintain a minimum of 5% of the Fund in liquid investments to provide for withdrawals and running expenses. This portion of the Fund may be partially invested in bank deposits, government securities or other local authority securities. The Manager was in breach of this manager's guideline at 31 March, 2011 (2.91%) due to the timing of exit requirements of unitholders. As at the date of issue of these financial statements the cash reserves were at 3.25%.

h) Liquidity Risk

The Fund receives investments from unitholders and lends these to mortgagors on a short, medium or long term basis.

Liquidity risk is the risk that the Fund may encounter difficulty in raising funds at short notice to meet its commitments, and arises from the mismatch of the maturity of monetary assets and liabilities.

The Manager manages the liquidity risk as follows:

- Maintaining liquid cash target at a minimum of 5% of total assets;
- The Trust Deed permits the Manager to arrange repayment of unitholders' funds over, or at the end of a period of up to, 90 business days;
- All mortgages are advanced on an "on demand" basis. The ability to demand repayment of such loans provides the Trust with ready access to funds if some or all of the unitholders demand repayment.

During the comparative period and the period under review the Fund has faced uncertain market conditions following the collapse of some second tier and similar financial intermediaries in New Zealand and in the USA. These conditions, together with the fact that the Fund had not been able to accept new investment monies following the expiry of the Prospectus in December 2008 (refer below), have caused the inflow of funds to slow restricting the Fund's lending activities and leakage in terms of the funds under management. Since 25 June, 2008 the Manager has been exercising the right to arrange repayment of unitholders' funds over, or at the end of a period of up to, 90 business days. The Manager has not had to use any of the other liquidity management measures available to it under its Trust Deed during this period.

Should market uncertainty continue, and the Fund experiences further unexpected calls for repayment of unitholders' funds, the Manager believes that the Fund has the ability to sell further loans to assist with liquidity, if required.

The Manager issued a new Prospectus on 15 December 2009. Prior to this the Fund had not been able to accept any new investments in the comparative period until this Prospectus was registered. A further prospectus was registered on 21 September, 2010.

The maturity profile below in note 15 (i) analyses the liquidity position of the Fund's assets.

i) Liquidity Profile

The maturities of financial instruments are as follows:

	31 March 2011						
	On Demand	Current 0-6 mths	Current 6-12 mths	1-3 years	3-5 years	5+ years	Total
	\$	\$	\$	\$	\$	\$	\$
Bank accounts							
Cheque account	4,964	-	-	-	-	-	4,964
Bank deposits	1,845,546	-	-	-	-	-	1,845,546
Total bank	1,850,510	-	-	-	-	-	1,850,510
Mortgages							
Home	1,536,092	1,579,843	3,893	231,684	49,013	1,119,240	4,519,765
Residential	23,264,999	738,680	-	102,104	-	-	24,105,781
Commercial	19,857,897	3,429,410	541,397	5,078,281	19,205	173,435	29,099,625
Rural	1,967,518	-	100,000	-	-	39,775	2,107,293
Total mortgages	46,626,506	5,747,933	645,290	5,412,067	68,218	1,332,450	59,832,464
Accrued interest	-	465,743	-	-	-	-	465,743
Accounts receivable	-	1,426,139	-	-	-	-	1,426,139
Anticipated income receipts	-	1,820,418	1,820,418	7,281,672	7,281,672	3,640,836	21,845,016
Deferred PIE taxation	-	-	-	-	-	-	-
Taxation refund due	-	-	-	-	-	-	-
	48,477,016	9,460,233	2,465,708	12,693,739	7,349,890	4,973,286	85,419,872
Liabilities							
Accounts payable	-	697,793	-	-	-	-	697,793
Anticipated income distributions	-	1,784,010	1,784,010	7,136,039	7,136,039	3,568,019	21,408,117
Net	48,477,016	6,978,430	681,698	5,557,700	213,851	1,405,267	63,313,962

At balance date, 57.94% of mortgages are in arrears (March, 2010: 32.12%) and 50.32% is owed by the six largest debtors (March, 2010: 39.98%).

	31 March 2010						
	On Demand	Current 0-6 mths	Current 6-12 mths	1-3 years	3-5 years	5+ years	Total
	\$	\$	\$	\$	\$	\$	\$
Bank accounts							
Cheque account	4,952	-	-	-	-	-	4,952
Bank deposits	2,128,439	1,000,000	-	-	-	-	3,128,439
Total bank	2,133,391	1,000,000	-	-	-	-	3,133,391
Mortgages							
Home	1,426,400	38,648	333,791	1,327,831	19,344	1,424,435	4,570,449
Residential	20,795,554	3,928,887	4,425,626	1,052,958	36,287	-	30,239,312
Commercial	510,497	5,289,127	16,335,363	8,051,792	3,374,940	178,407	33,740,126
Rural	100,000	30,500	3,545,569	150,230	-	-	3,826,299
Total mortgages	22,832,451	9,287,162	24,640,349	10,582,811	3,430,571	1,602,842	72,376,186
Accrued interest	-	860,236	-	-	-	-	860,236
Accounts receivable	-	68,512	-	-	-	-	68,512
Anticipated income receipts	-	2,957,715	2,957,715	11,830,861	11,830,861	5,915,431	35,492,583
Deferred PIE taxation	-	379,430	-	-	-	-	379,430
Taxation refund due	-	2,345	-	-	-	-	2,345
	24,965,842	14,555,400	27,598,064	22,413,672	15,261,432	7,518,273	112,312,683
Liabilities							
Accounts payable	-	1,182,754	-	-	-	-	1,182,754
Anticipated income distributions	-	2,898,561	2,898,561	11,594,244	11,594,244	5,797,122	34,782,732
Net	24,965,842	10,474,085	24,699,503	10,819,428	3,667,188	1,721,151	76,347,197

j) Interest Rate Risk

Cash Flow and Fair Value Interest Rate Risk:

Interest rate risk is the risk that fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The majority of mortgages are subject to interest receivable at floating interest rates or fixed rates of less than 12 months. Interest rates on mortgages are continually reviewed by the Manager and these rates are varied in accordance with movements in the market.

An increase in mortgage interest rates charged by the Fund has a significant impact on the distribution of funds to unitholders, all other things remaining unchanged. This will impact on the net assets attributable to unitholders depending on the level of distributions reinvested in the Fund. The following tables detail the Fund's exposure to interest rate risk as at, 31 March, 2011 and comparatives at 31 March, 2010. The tables include the Fund's assets and liabilities at their carrying amount, categorised by the earlier of contractual repricing or maturity dates.

31 March, 2011	Weighted Average Effective Interest Rate	Variable Interest Rate	Fixed Interest Rate Less than 1 year	Non Interest Bearing	Total
	%	\$	\$	\$	\$
Financial Assets					
Cash and cash equivalents	2.74	1,850,510	–	–	1,850,510
Accounts receivable	–	1,426,139	–	–	1,426,139
Accrued interest	–	465,743	–	–	465,743
Loans secured by first mortgage	5.13	48,229,791	–	11,602,673	59,832,464
		<u>51,972,183</u>	<u>–</u>	<u>11,602,673</u>	<u>63,574,856</u>
Financial Liabilities					
Accounts payable	–	–	–	177,931	177,931
Distribution payable	–	–	–	519,592	519,592
Contributions received in advance	–	–	–	270	270
		<u>–</u>	<u>–</u>	<u>697,793</u>	<u>697,793</u>

Accrued interest relates to mortgage interest and term deposit interest due.

31 March, 2010	Weighted Average Effective Interest Rate	Variable Interest Rate	Fixed Interest Rate Less than 1 year	Non Interest Bearing	Total
	%	\$	\$	\$	\$
Financial Assets					
Cash and cash equivalents	3.21	3,133,391	–	–	3,133,391
Accounts receivable	–	68,512	–	–	68,512
Accrued interest	–	860,236	–	–	860,236
Loans secured by first mortgage	7.04	43,918,542	20,613,306	7,844,338	72,376,186
		<u>47,980,681</u>	<u>20,613,306</u>	<u>7,844,338</u>	<u>76,438,325</u>
Financial Liabilities					
Accounts payable	–	–	–	716,812	716,812
Distribution payable	–	–	–	464,269	464,269
Contributions received in advance	–	–	–	1,673	1,673
		<u>–</u>	<u>–</u>	<u>1,182,754</u>	<u>1,182,754</u>

Accrued interest relates to mortgage interest and term deposit interest due.

k) Sensitivity Analysis – Interest Rate Risk

The sensitivity of Net Surplus before distributions to unitholders for the period to 31 March, 2011, and unitholders' funds at that date, to reasonably possible changes in conditions is as follows:

	Interest Rates Increase by 100 Basis Points (1%)	Interest Rates Decrease by 100 Basis Points (1%)
	\$	\$
Impact on Net Surplus	617,000	(617,000)
Unitholders' Funds	617,000	(617,000)

l) Impaired Assets

An impaired asset is an asset where the Manager considers that there is a measurable decrease in the estimated future cash flows from the asset. The amounts of impaired assets are:

	12 Months March 2011	12 Months March 2010
	\$	\$
Impaired Assets		
Balance at Beginning of the Period	10,115,449	21,194,891
Mortgage principal transferred	20,059,152	(1,615,721)
Legal cost incurred	98,997	85,098
Property disposed	(3,685,160)	(8,288,302)
Loss on impairment provided	(2,027,185)	(587,397)
Loss on impairment reversed	639	194,689
Loss on realisation	(1,337,649)	(867,809)
Balance at the End of the Period	23,224,243	10,115,449
Impaired Assets		
Value of mortgage receivables	23,224,243	10,115,449
Estimated fair value of collateral held	23,224,243	10,115,449
Age analysis of impaired assets		
All payment instalments overdue:		
Up to 3 months	216,821	95,455
3 – 6 months	319,331	17,542
6 – 12 months	237,897	192,674
Over 12 months	328,199	451,433
Impaired Asset Payments Overdue	1,102,248	757,104
Impaired assets with a past due component:		
Up to 3 months	–	77,921
3 – 6 months	1,099,032	–
6 – 12 months	5,822,263	2,055,891
Over 12 months	16,302,948	7,981,637
Impaired Assets with Payments Overdue	23,224,243	10,115,449

Impaired assets include the total amounts owing by the borrowers, not just the past due portion. The table above details all of the impaired assets and the past due portion (payment instalments that are overdue)

In the opinion of the Manager eight of the assets held or owned by the Fund are impaired as at 31 March, 2011 (March 2010: 8). Since 31 March, 2011, one of these assets has been partially sold and settled, realising the asset with no additional loss to the Fund. The balance of the asset and the seven remaining impaired assets are currently being marketed for sale by the Manager to achieve the best possible recoveries. The impaired assets at the date the Directors authorise the issue of these financial statements is \$21,905,459.

	March 2011	March 2010
	\$	\$
Provision for impairment		
Balance at Beginning of the Period	1,611,883	1,219,175
New allowance for impairments provided	2,027,185	750,397
Allowance for impairments realised	(393,141)	(357,689)
Allowance for impairments written off	(1,611,883)	–
Balance at End of the Period	1,634,044	1,611,883

Any known or anticipated losses have been provided for as specific impairments in these financial statements. The Fund has not provided for any collective impairment. In the opinion of the Manager, a collective impairment is not required as the estimated decrease in future cash flows from the mortgage receivables is provided for by the specific impairment provision.

The Fund holds a first ranking mortgage security on properties for the impaired assets with a weighted average LVR, at reporting date, of 97.21% (March 2010 : 68.02%)

There were no other forms of impaired assets at balance date (March, 2010).

As detailed in note 6, the Fund has a capital reserve available to assist in meeting any impairment losses on individual loans that may arise in the future.

m) Past Due Assets

Past due assets are any assets which have not been operated by the counterparty within its key terms which are not considered impaired assets. Details are as follows:

	March 2011	March 2010
	\$	\$
Mortgages considered past due		
Balance at Beginning of the Period	13,131,584	12,779,719
New past due assets	11,744,044	1,876,514
Settled past due assets	–	(1,878,063)
Mortgage principal transferred	(13,432,963)	353,414
Balance at the End of the Period	11,442,665	13,131,584
Mortgages considered past due		
Value of mortgage receivables	11,442,665	13,131,584
Estimated fair value of collateral held	15,580,000	16,810,000
Age analysis of impaired assets		
All payment instalments overdue:		
Up to 3 months	170,490	4,485
3 – 6 months	305,695	–
6 – 12 months	–	–
Over 12 months	–	666,463
Total Payments Overdue	476,185	670,948
Assets with a past due component:		
Up to 3 months	2,857,897	548,117
3 – 6 months	8,584,768	–
6 – 12 months	–	–
Over 12 months	–	12,583,467
Total Assets with Payments Overdue	11,442,665	13,131,584

Past due assets include the total amounts owing by the borrowers who are in arrears, not just the past due portion. The table above details all of the past due assets and the past due portion (payment instalments that are overdue). The Manager commences appropriate action, when payment instalments are overdue by 14 days, to either obtain the payment due, or if necessary, to realise the secured property.

In the opinion of the Manager, none of the assets considered past due are impaired as, in each case, the Fund holds a first ranking mortgage security on property with collateral at an estimated fair value exceeding the mortgage receivable balance, with an weighted average LVR, at reporting date, of 73.44% (March 2010: 78.12%).

n) Restructured Assets

Restructured assets are assets which, were it not for the Fund agreeing to vary the original terms of the asset, would have been considered either past due or impaired. These varied terms are not generally comparable with those offered to new borrowings with comparable risk. No assets would ever be restructured on terms which might potentially result in increased risk for the Fund. If a restructured asset subsequently becomes past due or impaired it is classified accordingly and is no longer regarded as a restructured asset.

The Fund had no mortgage receivables which were classified as restructured assets at 31 March, 2011 (March, 2010: Nil).

	12 Months March 2011	12 Months March 2010
	\$	\$
Restructured Assets		
Balance at Beginning of the Period	–	–
New restructured assets	–	–
Transferred to past due or impaired assets	–	–
Balance at End of Period	–	–

o) Security Held Through the Enforcement of Security

The Fund, in order to realise a mortgage security in the event that no other resolution of a past due asset can be achieved, may require the mortgagor to sell the secured property with all proceeds initially being to the credit of the Fund. Funds which are surplus to those amounts required to settle the debt secured by the property in question are returned to the mortgagor.

The Fund has placed a number of assets under close management by becoming mortgagee in possession through the enforcement of security, of which three are impaired. Any losses realised by the Fund have been included in these financial statements. As at 31 March, 2011 the Fund had six financial or non-financial assets, totalling \$22,045,535, under management through the enforcement of security (March, 2010: \$19,554,229).

16. Commitments for Expenditure

There are no capital commitments at 31 March, 2011 (March 2010: \$Nil).

17. Commitments to Lend

There are no lending commitments at 31 March, 2011 (March, 2010: \$951,375).

18. Contingent Liabilities

There were no contingent liabilities as at 31 March, 2011 (March 2010: \$Nil).

19. Unrecognised Contractual Commitments

As at 31 March, 2011, the Fund:

- Had no commitments to extend credit that were irrevocable because they cannot be withdrawn at the discretion of the financial institution without the risk of incurring significant penalty or expense;

- Had no direct credit substitutes, including general guarantees of indebtedness, bank acceptance guarantees and standby letters of credit serving as financial guarantees for loans and securities;
- Had no certain transaction-related contingent liabilities, including performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions;
- Had no short-term self-liquidating trade-related contingent liabilities arising from the movement of goods, such as documentary credits where the underlying shipment is used as security; and
- Had no commitments, note issuance facilities and revolving underwriting facilities.

20. Segmental Reporting

The Fund operates in the financial service segment in New Zealand, providing flexible mortgage packages to families, landlords, businesses and farmers.

21. Portfolio Investment Entity Election

The Fund elected to become a Portfolio Investment Entity (PIE), effective 1 October, 2007. The Fund retains its existing Group Investment Fund status, but unitholders' investments in the Fund are taxed differently.

Up to 30 September, 2007, the Fund was taxed as a qualifying trust, whereby income was distributed to investors as beneficiary income, and resident withholding tax was deducted at the appropriate rates of either 0%, 19.5%, 33%, or 39%.

From 1 October, 2007, the Fund must allocate income to investors under one of the options available under PIE rules, daily or quarterly, and then deduct tax at the investor's prescribed investor rate (PIR) of either 0%, 19.5%, or 33%. The PIR was capped at a maximum of 33%, which was reduced to 30% from 1 April, 2008. From 1 April, 2010 the PIRs were changed to either 0%, 12.5%, 21% or 30%. From 1 October, 2010 the PIRs changed again to 0%, 10.5%, 17.5%, or 28%.

22. NZ Mortgage Income Trust (No. 2 Fund) Group Investment Fund

The NZ Mortgage Income Trust (No. 2 Fund) Group Investment Fund was established in October, 2007. The fund was established to cater for those investors who do not wish to continue their investments in the existing fund under the PIE regime. The fund operates on exactly the same basis as the existing fund.

23. Subsequent Events

The Manager elected to remove the prospectus of the Fund as at 2 July, 2011. The election was made on the basis that only modest new money was being invested and the cost of a new prospectus was not in the best interests of existing unitholders. A prospectus is not required to continue to manage the Fund for existing unitholders. The Manager will review the decision after the Fund's interim reporting date on 30 September, 2011.

The Manager was appointed the manager of Capital Mortgage Income Trust effective from 1 April, 2011.

24. Critical Accounting Estimates

The Fund makes estimates surrounding the collectability of amounts owing for impaired and past due mortgages receivable. The Manager continually monitors and assesses the collectability of amounts owing by borrowers, including those loans which are classified as past due or impaired. Should the Manager's assessment of the likelihood of payment be incorrect, notwithstanding the fact that all lending by the Fund is secured by registered first mortgage and is subject to the conservative lending policies adopted by the Manager, there remains a risk that further, possibly significant, adjustments may be required to the carrying amounts of assets within the next financial year.

25. Going Concern

The Financial Statements have been prepared using the going concern assumption.

The Fund has not been immune from the effects of the global credit crisis and its impact on the confidence of the investing public of New Zealand in collective investment schemes. For the Fund this has manifested itself in a significant reduction in funds under management over the period covered by the financial statements.

The considered view of the Directors of the Manager is that, after making due inquiry, there is a reasonable expectation that the Fund has adequate resources to continue operations at existing levels for the next twelve months from the date of approving the financial statements. Consequently the Manager believes the going concern assumption is a valid basis on which to prepare the financial statements.

The Directors of the Manager reached this conclusion, having regard to the circumstances which they consider likely to affect the Fund during the period of one year from the date of the financial statements and other circumstances which they believe will occur after that date, which could affect the validity of the going concern assumption.

The Manager issued a new Prospectus on 15 December 2009. Prior to this the Fund had not been able to accept any new investments in the comparative period until this Prospectus was registered. A further prospectus was registered by the Manager on 21 September, 2010.

26. Fundamental Uncertainty

The Fund has been affected by increased withdrawals of investments by unitholders, and by decreases in the value of a significant number of the properties securing mortgage advances. The validity of the going concern assumption on which the financial statements are prepared depends upon the Manager's ability to successfully match withdrawal requests with repayment of mortgage advances. The Manager's considerations regarding going concern are set out in Note 24, and an explanation of liquidity risk is provided in Note 15 (h). If the Fund were unable to continue in operational existence for the foreseeable future, adjustments may have to be made to reflect the situation where assets that have become impaired may need to be realised at other than the amounts at which they are currently recorded in the Statement of Financial Position. In addition, the Fund may be required to provide for further liabilities that might arise, and to reclassify non-current assets as current assets.

Independent Auditor's Report

To the Trustee (on behalf of the Unit Holders) of the NZ Mortgage Income Trust Group Investment Fund

Report on the Financial Statements

We have audited the financial statements of the NZ Mortgage Income Trust Group Investment Fund (the Fund) on pages 3 to 17, which comprise the balance sheet as at 31 March 2011, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended, and a summary of specific accounting policies and other explanatory information.

Manager's Responsibility for the Financial Statements

The Manager on behalf of the Trustee, is responsible for the preparation of financial statements in accordance with generally accepted accounting practice in New Zealand and that give a true and fair view of the matters to which they relate, and for such internal control as the Directors determine necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (New Zealand). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial statements that give a true and fair view of the matters to which they relate in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our unmodified opinion.

Other than in our capacity as auditor we have no relationship with, or interests in the Fund.

Opinion

In our opinion, the financial statements on pages 3 to 17:

- comply with generally accepted accounting practice in New Zealand;
- comply with International Financial Reporting Standards; and
- give a true and fair view of the financial position of the Fund as at 31 March 2011 and the financial performance and cash flows for the year ended on that date

Emphasis of Matter – Fundamental Uncertainty, Going Concern

We draw attention to disclosures made in Note 15 of the financial statements concerning the impact on the Fund of the recent volatility in the financial markets. The Fund has been affected by increased withdrawals of investments by unit-holders, and by decreases in the value of properties securing mortgage advances. The validity of the going concern assumption on which the financial statements are prepared depends upon the Manager's ability to successfully match withdrawal requests with repayment of mortgage advances.

The Manager's considerations regarding going concern are set out in Note 24, and further details of fundamental uncertainty are outlined in Note 25. If the Fund was unable to continue in operational existence for the foreseeable future, adjustments may have to be made to reflect the situation where assets that have become impaired may need to be realised at other than the amounts at which they are currently recorded in the Balance Sheet. In addition, the Fund may be required to provide for further liabilities that might arise, and to reclassify non-current assets as current assets.

Our opinion is not modified in respect of the above emphasis of matter on going concern.

Report on Compliance with Regulatory Requirements

Sections 16(1)(d) and 16(1)(e) of the Financial Reporting Act 1993 require us to comment on whether we have obtained all the information and explanations we have required from the Fund and whether we consider that proper accounting records have been kept.

We have obtained all the information and explanations that we have required.

In our opinion proper accounting records have been kept by the Fund as far as appears from an examination of these records.





**NZ MORTGAGE
INCOME TRUST**

Registered Office of the Manager: Fund Managers Otago Ltd
Level 5, 165 Stuart Street, PO Box 5741, Dunedin 9058
Phone (03) 471 6500 Tollfree 0800 800 212 Fax (03) 479 0598
Website: www.nzmit.co.nz