



*GROUP INVESTMENT FUND*

**ANNUAL  
REPORT** **2018**

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## Chairman's Statement

Dear Investor,

The Directors of Fund Managers Otago Limited are pleased to present the Annual Report of the New Zealand Mortgage Income Trust No. 2 Fund for the year ending 31 March 2018.

The Fund recorded an operating surplus of \$655,003 before the loss on realisation of mortgage receivables which amounted to \$660,697 resulting a loss of \$5,694 for the full year.

The result was adversely affected by the cost of defending the Crown's forfeiture claim and the subsequent appeal of the initial judgement which went against the No. 2 Fund. We continue to pursue our legal remedies against the lawyer who acted for the Fund when the loans were first granted. We are hopeful of recovery from him but only time will tell.

As you will be aware distribution of income has been completed promptly and the Directors are confident that the Fund will continue to produce improved returns to unitholders over the year ahead. This is especially important as term deposit interest rates remain low for Kiwi investors.

It has been a successful year despite the challenges and the Directors sincerely appreciate your continuing support.

For and on behalf of the Board of:

FUND MANAGERS OTAGO LIMITED

  
JOHN FARRY  
Chairman

Nature of Business	New Zealand Mortgage Income Trust (No. 2 Fund) is a Group Investment Fund for the pooling of investor funds for investment in registered first mortgage securities.
Address	Fund Managers Otago Limited Level 8, 248 Cumberland St, DUNEDIN
Telephone	03 471 6500
Address for Service	Fund Managers Otago Ltd PO Box 5741, DUNEDIN 9058
Directors of the Manager	John Edward Farry David Joseph Ehlers John Francis Gallaher Donald Eric Forsyth Nicholas Peter Moore Peter James Hutchison
Supervisor	Trustees Executors Limited Level 5, 10 Customhouse Quay, WELLINGTON
Accountants	Deloitte Limited (as trustee for the Deloitte Trading Trust) Chartered Accountants Level 13, Otago House, 481 Moray Place, DUNEDIN
Auditor	PricewaterhouseCoopers Chartered Accountants PO Box 5848, DUNEDIN 9058
Bankers	ANZ Banking Group New Zealand Ltd
Solicitors to the Manager	Anderson Lloyd Lawyers Level 9, Otago House, 481 Moray Place, DUNEDIN  Webb Farry 79 Lower Stuart St, DUNEDIN

# Statement of Comprehensive Income

For the year ended 31 March 2018

## Operating Income

Interest- Mortgages  
Interest - Bank Deposits  
Interest - Default Mortgages

## Less Expenses

Accounting Fees  
Allowance for LVR's  
Audit Fees  
Bank Charges  
Computer Service Charge  
Default Interest Fees  
General Expenses  
Legal Expenses Deductible  
Loss on Realisation of Investments  
Management Fees  
Supervisors Fees

## Total Expenses

## Surplus before Income Tax

Income Tax Expense

## Surplus after Income Tax

Other Comprehensive Income

## Net Surplus

# Statement of Changes in Unitholders' Funds

For the year ended 31 March 2018

Net Surplus/ (Deficit)

## Transactions With Unitholders

Net (Withdrawals)/Contributions from Unitholders  
Distributions to Unitholders

## Other Transactions

Unit Valuation Adjustments

Unitholders' Funds at the Beginning of the Year

## Unitholders' Funds at the End of the Year

Note	March 2018 \$	March 2017 \$
	872,885	893,752
	16,351	33,265
	185,491	-
	<b>1,074,727</b>	<b>927,017</b>
	18,842	20,742
11	1,442	-
9	37,425	45,032
	589	631
	15,000	18,750
	46,373	-
	31,190	17,691
	21,503	48,805
24	660,697	334,487
4	212,860	229,098
4	34,500	34,500
	<b>1,080,421</b>	<b>749,736</b>
	<b>(5,694)</b>	<b>177,281</b>
10	-	-
	<b>(5,694)</b>	<b>177,281</b>
	-	-
	<b>(5,694)</b>	<b>177,281</b>

Note	March 2018 \$	March 2017 \$
	(5,694)	177,281
3	(381,419)	(1,204,913)
7	(516,498)	(464,316)
	13,175	(1,258)
	12,695,299	14,188,505
	<b>11,804,863</b>	<b>12,695,299</b>

# Statement of Financial Position

As at 31 March 2018

## Assets

ANZ Cheque Account  
Bank Deposits On Call  
Short Term Deposits  
Accounts Receivable  
Prepayments  
Mortgage Interest Due  
Term Deposit Interest Due  
Webb Farry Receivable  
Current Portion of Mortgage Receivables  
Non Current Portion of Mortgage Receivables

## Total Assets

## Liabilities Excluding Unitholders' Funds

Accounts Payable and Accruals

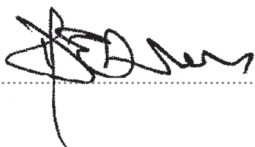
## Net Assets

## Unitholders' Funds

Unitholders' Funds  
Accumulated Losses

## Total Unitholders' Funds

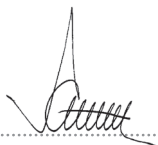
Signed for on behalf of the Manager,  
Fund Managers Otago Limited



Director  
Fund Managers Otago Limited

Date: *20 July 2018*

Note	March 2018 \$	March 2017 \$
	4,978	4,974
	2,134,069	1,513,949
	300,000	300,000
	4,495	12,000
	-	23,305
8	57,851	102,394
	6,214	4,972
24	-	594,433
11	3,875,840	4,415,062
11	5,546,351	5,826,913
	<b>11,929,798</b>	<b>12,798,002</b>
12	124,935	102,703
	<b>11,804,863</b>	<b>12,695,299</b>
3	12,688,083	13,069,502
7	(883,220)	(374,203)
	<b>11,804,863</b>	<b>12,695,299</b>



Director  
 Fund Managers Otago Limited

# Statement of Cash Flows

For the year ended 31 March 2018

## Cash Flows from Operating Activities

Cash was provided from:

Interest Received

Repayments of Mortgage Investments

Cash was disbursed to:

Payments to Suppliers

Mortgage Advances Made

Purchase of Mortgage Investments

## Net Cash Flows from Operating Activities

## Cash Flows from Financing Activities

Cash was provided from:

Contributions from Unitholders

Cash was disbursed to:

Distributions to Unitholders

Redemptions to Unitholders

## Net Cash Flows from Financing Activities

Net Increase/(Decrease) in Cash Held

Cash at the Beginning of the Year

## Cash at the End of the Year



March 2018 \$	March 2017 \$
1,098,592	855,595
4,635,952	3,387,654
<b>5,734,544</b>	<b>4,243,249</b>
381,156	434,381
3,856,933	5,015,780
-	52,057
<b>4,238,089</b>	<b>5,502,218</b>
<b>1,496,455</b>	<b>(1,258,969)</b>
94,191	1,208,175
<b>94,191</b>	<b>1,208,175</b>
210,879	197,262
759,643	2,653,731
<b>970,522</b>	<b>2,850,993</b>
<b>(876,331)</b>	<b>(1,642,818)</b>
620,124	(2,901,787)
1,518,923	4,420,710
<b>2,139,047</b>	<b>1,518,923</b>

# Statement of Cash Flows (cont)

For the year ended 31 March 2018

## **Reconciliation of Surplus after Tax with Net Cashflow from Operations**

Surplus (loss) after tax

Add (less) non cash items:

Capitalised Interest Income

Capitalised Interest Income - Impaired Loans

Loss on Realisation of Mortgage Receivables

Allowance for Impairment of Mortgage Receivables

**Add (less) movements in working capital items:**

(Increase)/Decrease in Accounts Receivable

(Increase)/Decrease in Webb Farry Interest Due

Increase/(Decrease) in Accounts Payable

Accounts Payable Cash Flow Not Relating to Operating Activities

(Increase)/Decrease in Mortgage Interest Due

(Increase)/Decrease in Mortgage Receivables

(Increase)/Decrease in Term Deposit Interest Due

(Increase)/Decrease in Prepayments

## **Net Cash from Operating Activities**

Note	March 2018	March 2017
	\$	\$
	(5,694)	177,281
	(26,941)	(38,082)
	-	-
	660,697	-
	-	334,487
	<b>628,062</b>	<b>473,686</b>
24	7,505	(11,692)
	594,433	(594,433)
	22,232	27,114
	(8,411)	(27,669)
	44,543	(20,417)
	186,028	(1,085,750)
	(1,242)	(1,231)
	23,305	(18,577)
	<b>868,393</b>	<b>(1,732,655)</b>
	<b>1,496,455</b>	<b>(1,258,969)</b>

# Notes to the Financial Statements

For the Year Ended 31 March 2018

## 1. Statement of Accounting Policies

### Reporting Entity

New Zealand Mortgage Income Trust (No. 2 Fund) Group Investment Fund ("the Fund") is a Group Investment Fund. The Fund is a profit-orientated entity, which was formed on 18 October, 2007 and commenced operation on 12 November, 2007. It is registered under the Trustee Companies Act 1967. New Zealand Mortgage Income Trust (No. 2 Fund) Group Investment Fund is a Financial Market Conduct ("FMC") reporting entity under the Financial Markets Conduct Act 2013 that registered on 1 December 2016.

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

These financial statements have been prepared for New Zealand Mortgage Income Trust (No. 2 Fund) Group Investment Fund by Fund Managers Otago Limited (the Manager), in accordance with the Financial Reporting Act 2013 and the provisions of the Trust Deed. The Trust Deed is amended on 18 November 2016.

The supervisor is Trustees Executors Limited ("the Supervisor").

The financial statements were authorised for issue by the Directors on 20 July 2018.

### 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, 2018 and the corresponding information presented in these financial statements for the year ended 31 March, 2017. There have been no changes in accounting policies, unless otherwise stated.

The financial statements have been prepared on the going concern assumption. The basis for this assumption is detailed in note 21.

### 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 year in which the estimate is revised if the revision affects only that year or in the year of the revision and future years if the revision affects both current and future years.

The estimates and assumptions that have a significant risk of causing material adjustments to the carrying amounts of assets and liability within the next financial year are discussed below;

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 prudent 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.

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 and accordingly is taxed as a trust. Usually all income of the Fund is allocated to unitholders throughout the income year or is paid and applied within twelve months of year end. In these circumstances the Fund will have no liability for income tax, with the income being taxed as beneficiary income to the unitholders. To the extent income is retained by the Fund it will be taxable to the Fund at 33%.

# Notes to the Financial Statements

For the Year Ended 31 March 2018

## 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 Year

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 unitholders' funds, 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 assets 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 are 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 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 year. 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 year.

#### 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.

Exit fees charged when unitholders redeem their units within two years of investing are deducted from the redemption and recognised as income when the redemption is paid.

#### **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

# Notes to the Financial Statements

For the Year Ended 31 March 2018

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 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 year. 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 Cashflows 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 Cashflows 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 Cashflows 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 Cashflows:

“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. Any funds retained will be treated as undistributed income, and recorded in the New Zealand Mortgage Income Trust (No. 2 Fund) Group Investment Fund Capital Reserve (refer Note 6). To date, no amounts have been transferred to the Capital Reserve.

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 three months or less, that are readily convertible to a known amount of cash and are subject to an insignificant risk of change 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**

Various standards, amendments and interpretations have been issued by the External Reporting Board but have not been adopted by the Fund as they are not yet effective.

### ***IFRS 15 Revenue from Contracts with Customers***

(Effective date: periods beginning on or after 1 January 2018)

The IASB has issued a new standard for the recognition of revenue. This will replace IAS 18 which covers contracts for goods and services and IAS 11 which covers construction contracts.

The new standard is based on the principle that revenue is recognised when control of a good or service transfers to a customer – so the notion of control replaces the existing notion of risks and rewards.

The standard permits a modified retrospective approach for the adoption. Under this approach entities will recognise transitional adjustments in retained earnings on the date of initial application (eg 1 January 2018), therefore without restating the comparative period.

They will only need to apply the new rules to contracts that are not completed as of the date of initial application.

# Notes to the Financial Statements

For the Year Ended 31 March 2018

The standard is effective for accounting periods beginning on or after 1 January 2018. Early adoption is permitted. The Fund intends to adopt NZ IFRS 15 on its effective date and will assess its full impact post year end to ensure compliance with this standard.

## **NZ IFRS 9: Financial Instruments**

(Effective date: years beginning on or after 1 January 2018)

NZ IFRS 9, 'Financial instruments', addresses the classification, measurement and recognition of financial assets and financial liabilities. The complete version of NZ IFRS 9 was issued in September 2015. It replaces the guidance in NZ IAS 39 that relates to the classification and measurement of financial instruments. NZ IFRS 9 retains, but simplifies, the mixed measurement model and establishes three primary measurement categories for financial assets: amortised cost, fair value through other comprehensive income and fair value through profit or loss. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. Investments in equity instruments are required to be measured at fair value through profit or loss with the irrevocable option at inception to present changes in fair value in other comprehensive income not recycling. There is now a new expected credit losses model that replaces the incurred loss impairment model used in NZ IAS 39. For financial liabilities there were no changes to classification and measurement except for the recognition of changes in own credit risk in other comprehensive income, for liabilities designated at fair value through profit or loss. NZ IFRS 9 relaxes the requirements for hedge effectiveness by replacing the bright line hedge effectiveness tests. It requires an economic relationship between the hedged item and hedging instrument and for the 'hedged ratio' to be the same as the one management actually use for risk management purposes. Contemporaneous documentation is still required but is different to that currently prepared under NZ IAS 39.

The standard is effective for accounting years beginning on or after 1 January 2018. Early adoption is permitted. The Fund intends to adopt NZ IFRS 9 on its effective date will assess its full impact post year end to ensure compliance with this standard.

## **n) New and Amended Standards Adopted by the Fund**

There are no new NZ IFRSs or amendments to NZ IFRSs effective for years beginning 1 April 2017 that are relevant to the Fund.

## **3. Unitholders' Funds**

	March 2018	March 2017
	\$	\$
<b>Balance at the Beginning of the Year</b>	13,069,502	14,274,415
<b>Plus:</b>		
Investor units purchased	94,191	1,208,175
Investor distributions reinvested	284,033	240,643
	<u>378,224</u>	<u>1,448,818</u>

	March 2018	March 2017
<b>Less:</b>		
Investor units withdrawn	759,643	2,653,731
Net contributions / (withdrawals)	(381,419)	(1,204,913)
<b>Balance at the End of the Year</b>	<b>\$12,688,083</b>	<b>\$13,069,502</b>

### Unitholders' Funds by Region

	March 2018		March 2017	
	\$	%	\$	%
Otago / Southland	7,422,528	58.5	7,590,423	58.1
Other – NZ	3,768,361	29.7	3,868,232	29.6
New Zealand resident total	11,190,889	88.2	11,458,655	87.7
Overseas residents	1,497,194	11.8	1,610,847	12.3
	<b>12,688,083</b>	<b>100%</b>	<b>\$13,069,502</b>	<b>100%</b>

Unitholders' funds are disclosed as equity as in prior years consistent with the accounting standard, NZ IAS 32, because: they are puttable financial instruments; the unitholders' are entitled to receive a pro-rata share of the Fund's net assets on winding up; unitholders' funds are subordinate to all liabilities of the Fund; units have identical features; apart from the contractual obligation for the Fund to redeem the units for cash, the units do not include any contractual obligation to deliver cash; and the total expected cash flows over the life of the units are substantially based on the profit or loss of the Fund.

The expected cash flows for the repayment of unitholders' funds depends on circumstances of each of the unitholders and cannot be determined precisely. All unitholders' funds are normally repayable on request in accordance with the Trust Deed. The Trust Deed permits the Manager, in certain circumstances, to suspend all withdrawals until such time as the Manager so determines. Such suspension notices generally operate for a term of 90 business days, however further suspensions beyond 90 business days are permitted. All unitholders are repaid in cash. IAS 32 requires the directors to disclose the expected cash outflow on redemption or repurchase of the financial instrument, and information on how that has been determined. The directors of the Manager, in arriving at the projected cash flows of unitholders' funds have made the following assumptions:

- There will be no significant financial market shocks that further undermine confidence, and consequently cause a protracted run on funds. (Note: In the event that such an occurrence was to occur, the directors, could invoke their rights to suspend repayments for 90 business days or indefinitely, to ensure that the financial stability of the Fund was not put at risk).

# Notes to the Financial Statements

For the Year Ended 31 March 2018

- The Fund is expecting to increase in size over time as interest rates continue to ease as it is providing a competitive return to unitholders and potential new investors.
- In any month there is a change of individual investors, with investments being redeemed, and new investments being made. Over the reporting year, approximately 5.8% of the units on issue were redeemed with new investment funds of 2.9% being received over the same year (31 March 2017: 18.6% and 10.15%).

While the directors of the Manager have based their views on the above assumptions, they nevertheless recognise that actual results are likely to be different from their assumptions since anticipated events frequently do not occur as expected and the variation could be material. However, there are measures that can be taken by the directors of the Manager as noted above, to help control liquidity for the Fund.

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. There are 12,688,083 units on issue at 31 March, 2018 (31 March 2017: 13,069,502), where each unit represents a right to an individual share in the Fund per the Trust Deed.

The value of each unit in the Fund at 31 March 2018 was \$0.929 (March 2017: \$0.979). On 1 April each year the quarterly income distribution to investors is made which affects the unit value as accrued income makes up part of the unit value as at 31 March each year. The value of each unit in the Fund at 1 April 2018 after the quarterly distribution had been made was \$0.931 (April 2017: \$0.971). A portion of each distribution is reinvested in new units in the Fund which in itself has a dilutive effect. The unit valuation adjustment is the difference that arises between the unit value at withdrawal and a full \$1 unit. The withdrawal results in an allocation of accumulated income.

There were \$14,250 of withdrawal requests for units to be withdrawn that have been received but have not been paid by the Fund at 31 March, 2018 (March 2017: \$70,521).

During the period under review the Fund experienced shrinkage in the funds under management. This was due to the Fund not being in the market for new deposits and the shrinkage equated to normal fund attrition.

## 4. Manager's and Supervisor's Fees

The Manager is entitled to be paid an annual fee as may be agreed between the Manager and the Supervisor. Currently, the annual fee for the Manager is 1.75% (March 2017: 1.75%) 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 current rate of 1.75% has been effective from 1 July 2015. 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 Supervisor is entitled to be paid an annual fee as may be agreed between the Manager and the Supervisor. Currently the Supervisor receives an annual fee of \$34,500 per annum. This is paid quarterly in arrears from the distributable income. Refer to Note 13 for details of current year payments.

Both the Supervisor 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 excluding commissions paid to advisors. Both the Supervisor and the Manager are entitled to alter their fees by agreement between the Supervisor and the Manager. The Manager's and Supervisor'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

There were no payments received on 31 March, 2018 applying for units which had not been created by the Supervisor at that date (31 March 2017: \$Nil). Any money received is included in accounts payable at the reporting date.

## 6. New Zealand Mortgage Income Trust (No. 2 Fund) Capital Reserve

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. To date no amounts have been transferred to the reserve.

## 7. Undistributed Accumulated Income / (Loss)

	March 2018	March 2017
	\$	\$
<b>Balance at the Beginning of the Year</b>	(374,203)	(85,910)
<b>Plus:</b>		
Net surplus/(deficit) for the Year	(5,694)	177,281
Unit valuation adjustments*	13,175	(1,258)
	<u>7,481</u>	<u>176,023</u>
<b>Less:</b>		
Distributions to unitholders	<u>516,498</u>	<u>464,316</u>
	<u>516,498</u>	<u>464,316</u>
<b>Balance at the End of the Year</b>	<b><u>(\$883,220)</u></b>	<b><u>(\$374,203)</u></b>

The over distributions of income for the Fund have occurred due to higher than anticipated losses on realisation in the previous period

# Notes to the Financial Statements

For the Year Ended 31 March 2018

this related to the Webb Farry Receivable – note 24. The Manager will consider the over distributions that have occurred when determining future distributions to unitholders balanced against recoveries from provisioning as impaired assets are realised.

\* As the units currently have a value of less than \$1 per unit, when investor funds are withdrawn the difference between the \$1 unit and its current value results in an allocation of the accumulated losses of the Fund.

## 8. Mortgage Receivables Interest Due

	March 2018	March 2017
	\$	\$
Mortgage interest	57,851	102,394
	<b>\$57,851</b>	<b>\$102,394</b>

## 9. Remuneration to Auditors

	March 2018	March 2017
	\$	\$
Auditing the annual financial statements	29,584	28,980
Other non-audit assurance services (note 1)	4,226	4,226
Other services (note 2)	-	6,038
Under-accrual of prior year fee relating to auditing the financial statements.	3,615	5,788
	<b>\$37,425</b>	<b>\$45,032</b>

Notes:

1. Other non-audit assurance services comprise reporting on trust deed requirements and unitholders register compliance.
2. Other services comprise an agreed upon procedures engagement in relation to proxy vote scrutinising.

## 10. Taxation

	March 2018	March 2017
<b>Current Year Taxation</b>	\$	\$
<b>Net Surplus / (Deficit) for the Year</b>	(5,694)	177,281
<b>Plus:</b>		
Distribution applied to prior year	-	128,179
Non-deductible Allowance for LVR Impairment	1,442	
Non-deductible Allowance for Impairment	-	-
	<u>(4,252)</u>	<u>305,460</u>
<b>Less:</b>		
Distributions to unitholders	516,498	464,316
Prior Year Impairment Losses now Deductible	-	203,405
Distributions payable to unitholders within six months of balance date	-	-
	<u>516,498</u>	<u>667,721</u>
<b>Taxable (Deficit) Surplus for the Year</b>	<b><u>(\$520,750)</u></b>	<b><u>(\$362,261)</u></b>
Taxation at 33 cents	\$Nil	\$Nil

The Fund has estimated tax losses of \$873,164 available to carry forward to the 2019 income year.

## 11. Investments

### a) Mortgage Receivables

	March 2018	March 2017
	\$	\$
<b>Mortgages</b>	<b><u>9,422,191</u></b>	<b><u>\$10,241,975</u></b>
Balance at Beginning of the Year	10,241,975	9,452,630
New mortgages advanced	3,514,369	4,461,602
Capitalised interest	26,941	38,082
Interest income – impaired mortgages		
Expenses and arrears charged	342,564	606,235
Principal instalments received	(134,752)	(98,353)
Transfer to accounts receivable	-	(12,000)
Repayment of existing mortgages	(4,567,464)	(3,871,734)
Allowance for LVR	(1,442)	

# Notes to the Financial Statements

For the Year Ended 31 March 2018

	March 2018	March 2017
Allowance for impairment / loss on realisation recognised	-	(334,487)
<b>Balance at the End of the Year</b>	<b>\$9,422,191</b>	<b>\$10,241,975</b>
Due within 12 months	3,875,840	4,415,062
Due over 12 months	5,546,351	5,826,913
	<b>\$9,422,191</b>	<b>\$10,241,975</b>

The carrying value for mortgage receivables is \$9,422,191 (March 2017: \$10,241,975) which includes impairment provisions of \$Nil (March 2017: \$Nil). In order for the Fund to realise its mortgage security in the event that no other resolution of an impaired or past due asset can be achieved, the Fund may require the mortgagor to sell the secured property. The estimated value of secured properties is \$25,674,000 (March 2017: \$28,906,217). Therefore the carrying value of the mortgage investments is currently 63.3% lower than the estimated value of the secured properties (March 2017: 64.6%). The carrying value is prepared in accordance with NZ IFRS. Some securities may sell above value and some below. This is because the circumstances which arise from a mortgagor sale may have an impact on the estimated fair value. This as well as other objective factors have been included in assessing the impairment provision.

## Mortgage by Loan Type

	March 2018		March 2017	
	\$	%	\$	%
Home	4,311,787	45.8	5,517,319	53.9
Residential rental	1,657,726	17.5	1,289,762	12.6
Commercial	2,749,452	29.2	2,763,749	27.0
Rural	704,669	7.5	671,145	6.5
Allowance for LVR	(1,442)	-	-	-
	<b>9,422,191</b>	<b>100%</b>	<b>\$10,241,975</b>	<b>100%</b>

## Mortgages by Region

	March 2018		March 2017	
	\$	%	\$	%
Otago / Southland	3,024,958	32.2	4,628,169	45.2
Auckland	1,130,978	12.0	1,299,057	12.7
Wellington	1,161,094	12.3	1,184,061	11.5



Other - South Island	2,482,623	26.3	2,370,688	23.2
Other - North Island	1,623,980	17.2	760,000	7.4
Allowance for LVR	(1,442)	-	-	-
	<b>9,422,191</b>	<b>100%</b>	<b>\$10,241,975</b>	<b>100%</b>

### Mortgages by Nature of Underlying Security

	March 2018	March 2017
	\$	\$
Standard homes	3,883,827	4,683,483
Development	427,960	833,836
Bare land	-	-
Cross lease	-	-
<b>Home total</b>	<b>4,311,787</b>	<b>5,517,319</b>
Standard homes	1,036,540	585,844
Bare land	-	-
Development	122,670	329,450
Apartments	498,516	374,468
<b>Residential rental total</b>	<b>1,657,726</b>	<b>1,289,762</b>
Investment properties	1,904,709	1,869,182
Bare land	140,000	243,500
Development	206,000	-
Owner occupied	498,742	651,067
<b>Commercial total</b>	<b>2,749,452</b>	<b>2,763,749</b>
Sheep	605,840	551,920
Other	-	-
Horticulture	98,828	119,225
<b>Rural total</b>	<b>704,669</b>	<b>671,145</b>
<b>Allowance for LVR</b>	<b>(1,442)</b>	<b>-</b>
	<b>\$9,422,191</b>	<b>\$10,241,975</b>

Customer sectors are identified by confirming the nature of the security provided.

The effective interest rates on the mortgage investments as at 31 March, 2018 are in the range of 8.00% p.a. – 12.25% p.a. (March 2017: 7.95% p.a. – 12.25% p.a.). The standard lending rates were as follows:

Home mortgages	9.00% p.a.	(March 2017: 8.00%)
Residential rental mortgages	9.00% p.a.	(March 2017: 8.50%)
Commercial mortgages	9.00% p.a.	(March 2017: 9.00%)
Rural mortgages	9.00% p.a.	(March 2017: 8.50%)

# Notes to the Financial Statements

For the Year Ended 31 March 2018

There are no impaired assets at the reporting date (March 2017: Nil). The Manager carefully manages impaired loans by early identification and actively pursuing remedies to recover the outstanding loan and interest amounts. As detailed in note 15(m), there is \$1,468,292 outstanding loan principal and interest included in past due, but not impaired, assets at 31 March, 2018 (March 2017: \$2,203,826).

## b) Cash Deposits

The effective interest rate on deposits held with financial institutions as at 31 March, 2018 was 0.82% p.a. (March 2017: 0.97% p.a.).

## 12. Accounts Payable and Accruals

	March 2018	March 2017
	\$	\$
Trade creditors	32,430	24,699
Contributions received in advance	2,115	25
Distribution payments to unitholders	62,390	53,979
Audit fees	28,000	24,000
<b>Total Accounts Payable</b>	<b>\$124,935</b>	<b>\$102,703</b>

## 13. Related Party Transactions

The related parties are Trustees Executors Limited, who provides Supervisor services to the Fund, Fund Managers Otago Limited, who provides 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 statements 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, Anderson Lloyd, and Fletcher Vautier Moore, Brandons, and financial advisory firm Forsyth Barr Limited wish to disclose that all of these firms have clients who have invested in the Fund. The current Webb Farry nominated director is David Ehlers. The current Fletcher Vautier Moore director is Nicholas Moore. The current Brandons nominated director is Donald Forsyth. John Gallaher is an independent director and holds an executive position at Forsyth Barr Limited. Their respective investment ledgers as at balance date were; Webb Farry \$433,716; Anderson Lloyd \$462,054 Fletcher Vautier Moore \$703,959; Forsyth Barr Limited \$Nil; Brandons \$75,841 (31 March, 2017: \$445,478; \$487,860; \$809,029; Nil; \$78,575). 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 Supervisors for investors).

Fund Managers Otago Limited is also the manager for New Zealand Mortgage Income Trust Group Investment Fund and Capital Mortgage Income Trust Group Investment Fund. Details of mortgage transactions between the Fund and these other funds are included below.

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

	March 2018	March 2017
	\$	\$
<b>Transactions for the Year</b>		
Supervisor fees to Trustees Executors Limited	34,500	34,500
Management fees to Fund Managers Otago Limited	212,860	229,098
Legal fees to Anderson Lloyd	1,561	28,016
Legal fees to Webb Farry	1,295	24,794

In the current year, the Fund advanced six mortgage receivables that are shared with Capital Mortgage Income Trust. The total of the advances for both funds was \$3,297,945 (March 2017: \$2,685,099). The Fund's receivable on these advances at 31 March, 2018 is \$2,043,000 (March 2017: \$1,654,999) with interest rates charged between 8.50% and 9.50% p.a.

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

	March 2018	March 2017
	\$	\$
<b>Balance Payable at Balance Date</b>		
Management fees to Fund Managers Otago Limited	8,284	-

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, 2018 there were no employees of Fund Managers Otago Limited with personal investments (including investments of immediate family members) in the Fund (March 2017: \$Nil). The Directors of Fund Managers Otago Limited had the following direct investments, in the Fund at 31 March, 2018: D Ehlers \$79,862, N Moore \$152,536 (March 2017: D Ehlers \$83,260; N Moore \$132,357). The Directors of Fund Managers Otago Limited had the following indirect investments, in the Fund at 31 March, 2018: D Ehlers \$274,940, N Moore \$388,857 (March 2017: D Ehlers \$279,827; N Moore \$480,270).

# Notes to the Financial Statements

For the Year Ended 31 March 2018

## 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, 2018 there were no significant concentrations of credit risk, except as outlined below;

- i) That \$2,439,047 or 20.44% (March 2017: \$1,818,923, 14.21%) of total assets were invested at ANZ Bank. The maximum exposure to credit risk is represented by the carrying value of each financial asset in the balance sheet, and
- ii) 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 and residential property sectors and is concentrated in the South Island of New Zealand.

The concentrations of loans as a percentage of total equity at balance date are as follows:

% of Equity	March 2018		March 2017	
	\$	Number of Loans	\$	Number of Loans
> 100	-	-	-	-
10 – 100	-	-	-	-
5 - 9	-	-	-	-
0 - 4	9,423,633	60	10,241,975	60
	<b>9,423,633</b>	<b>60</b>	<b>10,241,975</b>	<b>60</b>
Allowance for LVR	(1,442)	-	-	-
	<b>\$9,422,191</b>	<b>60</b>	<b>\$10,241,975</b>	<b>60</b>

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

% of Security	March 2018		March 2017	
	\$	Number of Loans	\$	Number of Loans
> 100	-	-	-	-
90 - 99	-	-	-	-
80 - 89	-	-	603,774	2
70 - 79	3,336,788	13	1,450,230	7
60 - 69	1,625,119	9	1,774,169	8
50 - 59	1,057,415	8	692,998	5
40 - 49	1,333,288	4	2,771,072	10
30 - 39	602,195	5	1,323,872	7
20 - 29	1,009,127	10	882,812	8
10 - 19	280,623	2	541,376	6
0 - 9	179,078	9	201,672	7
	<b>9,423,633</b>	<b>60</b>	<b>10,241,975</b>	<b>60</b>
Allowance for LVR	(1,442)	-	-	-
	<b>\$9,422,191</b>	<b>60</b>	<b>\$10,241,975</b>	<b>60</b>

### 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

# Notes to the Financial Statements

For the Year Ended 31 March 2018

current unitholders may redeem their units and new issues of units may not be sufficient to meet the mortgage maturity profile of the Fund. Under the Trust Deed the Manager or Supervisor may suspend withdrawal notices for up to 90 days. If the Manager suspends withdrawal notices in accordance with the Trust Deed then the time for repayment may be extended by 90 days or such year as the Manager determines. The ten largest unitholders hold 21.84% of the total unitholders' funds (March 2017: 20.80%).

## e) Fair Values

The following table analyses the fair value hierarchy of the Fund's assets and liabilities not measured at fair value at 31 March, 2018 but for which fair value is disclosed. The different levels have been defined as follows:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;

Level 2 inputs are inputs other than quoted prices included within level 1 that are observable for the assets or liability, either directly or indirectly; and

Level 3 inputs are unobservable inputs for the asset or liability.

	Fair Value	Carrying Value
<b>Assets</b>	\$	\$
<b>Level 1</b>		
Cash and cash equivalents	2,439,047	2,439,047
<b>Level 2</b>		
Accounts Receivable	4,495	4,495
Prepayments	-	-
Mortgage interest due	57,851	57,851
Term deposit interest due	6,214	6,214
<b>Level 3</b>		
Mortgage receivables	9,423,633	9,423,633
<b>Liabilities</b>		
<b>Level 2</b>		
Accounts payable	124,935	124,935

The assets and liabilities included in the above table are carried at amortised costs; their carrying values are a reasonable approximation of fair value, with the exception of mortgage receivables. The fair value of mortgage receivables is based on cashflows discounted using rates currently reflective of the prevailing interest rate environment and the perceived risk associated with each mortgage.

## 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 Supervisor 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 mainly between residential, residential rental, commercial and farming purposes with a minimum of 10% up to a maximum of 75% of the unitholders' funds invested in residential rental purposes and a minimum of 15% up to a maximum of 75% of the unitholders' funds invested for commercial purposes. Lending for farming purposes is limited to a minimum of 0% up to a maximum of 50% of the unitholders funds;
- iii) Lending Limits - The maximum size of any mortgage is limited in relation to both the value of the property provided as security and to the total funds of the Group Investment Fund. As at 31 March, 2018 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;
  - In the case of leasehold property the limits are set at 50% of the value of the lessee's interest, and
  - That no more than 5.00% of the total assets of the Fund will be invested in any one mortgage or advanced to any one borrower (or related party of a borrower) at the time of the initial advance being made and the top 6 exposures of the Fund may not exceed 20.0% of the total assets of the Fund at the time of the advance. As at 31 March, 2018 the largest advance was 3.72% (March 2017: 4.11%) of the total assets of the Fund and the top six exposures equalled 20.35% of the total assets of the Fund (March 2017: 20.05%). The top six advances were within the guidelines at the time each of the advances were made. However the 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 or local authority securities.  
At 31 March, 2018 20.44% of total assets were invested in liquid investments (March 2017: 14.21%).

The investment policy guidelines noted above have been complied with during the year.

### **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

# Notes to the Financial Statements

For the Year Ended 31 March 2018

funds at short notice to meet its commitments, and arises from the mismatch of the maturity of monetary assets and liabilities.

Management 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 defer repayment of unitholders' funds over, or at the end of a year of up to, 90 business days;
- Some mortgages are advanced on an "on demand" basis. The ability to demand repayment of such loans may provide the Fund with

## i) Liquidity Profile

The maturities of financial instruments are as follows:

March 2018	On Demand	Current 0-6 mths	Current 6-12 mths
	\$	\$	\$
<b>Bank accounts</b>			
Cheque account	4,978	-	-
Bank deposits	<u>2,134,069</u>	<u>300,000</u>	<u>-</u>
Total bank	2,139,047	300,000	-
<b>Mortgages</b>			
Home	1,275,484	727,339	470,059
Residential	-	68,000	-
Commercial	192,808	479,461	408,291
Rural	-	255,840	-
Allowance for LVR	<u>-</u>	<u>(1,442)</u>	<u>-</u>
Total mortgages	1,468,292	1,529,198	878,350
Accrued interest	-	64,065	-
Accounts receivable	4,495	-	-
Anticipated income receipts	<u>-</u>	<u>428,912</u>	<u>428,912</u>
	<u>3,611,834</u>	<u>2,322,175</u>	<u>1,307,262</u>
<b>Liabilities</b>			
Accounts payable	-	124,935	-
Anticipated income distributions	<u>-</u>	<u>420,334</u>	<u>420,334</u>
<b>Net</b>	<b><u>3,611,834</u></b>	<b><u>1,776,906</u></b>	<b><u>886,928</u></b>

Maturities detailed above for mortgage receivable are based on contractual maturities.

At balance date, there were seven mortgages in arrears (March 2017: six). The six largest exposures must not exceed 20.00% of the value of the Fund and no more than 5.00% of the Fund will be invested in any



ready access to funds if some or all of the unitholders demand repayment. However, the likelihood of the mortgagor being able to meet such a request depends on their financial strength and creditworthiness.

The Manager has not had to use any of the liquidity management measures available to it under its Trust Deed during the year.

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

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

1-3 years	3-5 years	5+ years	Total
\$	\$	\$	\$
-	-	-	4,978
-	-	-	2,434,069
-	-	-	2,439,047
570,720	82,375	1,185,809	4,311,786
875,942	353,768	360,016	1,657,726
928,524	370,067	370,301	2,749,452
350,000	98,829	-	704,669
-	-	-	(1,442)
2,725,186	905,039	1,916,126	9,422,191
-	-	-	64,065
-	-	-	4,495
1,715,648	1,715,648	857,824	5,146,944
4,440,834	2,620,687	2,773,950	17,076,742
-	-	-	124,934
1,681,335	1,681,335	840,668	5,044,006
<b>2,759,499</b>	<b>939,352</b>	<b>1,933,282</b>	<b>11,907,801</b>

one mortgage or advanced to any one borrower (or related party of a borrower) at the time of the initial advance being made. At balance date, 20.35% of the total assets of the Fund is owed by the six largest mortgagees (March 2017: 20.05%) and 3.72% of the total assets is advanced to the largest mortgagee (March 2017: 4.11%).

# Notes to the Financial Statements

For the Year Ended 31 March 2018

The mortgage portfolio of the Fund consists of 60 mortgages, all of which are "On Demand", or pending demand for a term of between 1 and 25 years. The table above shows the term of the mortgage. The term 'On Demand' means that the Fund could demand the borrower to repay the mortgage when called upon to do so. Such a request would only be made if the Fund felt the mortgage represented an unacceptable risk to the Fund or the Fund had a need to create liquidity within the Fund. The likelihood of the Mortgagor being able to meet such a request will depend on their financial strength and creditworthiness. The Fund has never made demand on any borrower since inception of the Fund in 2007, and therefore the 'On demand' facility has never been tested. Mortgages approaching maturity are renewed in terms of the Funds approved lending policies and guidelines.

The liquidity table does not include unitholders' funds as a liability, as they are classified as equity (as discussed in note 3), however in the normal course of business the Fund receives redemption requests

March 2017	On Demand	Current 0-6 mths	Current 6-12 mths
	\$	\$	\$
<b>Bank accounts</b>			
Cheque account	4,974	-	-
Bank deposits	1,513,949	300,000	-
Total bank	1,518,923	300,000	-
<b>Mortgages</b>			
Home	1,418,777	938,887	577,489
Residential	329,450	245,844	-
Commercial	661,115	-	243,500
Rural	-	-	-
Total mortgages	2,409,342	1,184,731	820,989
Accrued interest	-	107,366	-
Prepayments	-	23,305	-
Accounts receivable	-	12,000	-
Webb Farry receivable	-	-	-
Anticipated income receipts	-	461,324	461,324
	3,928,265	2,088,726	1,282,313
<b>Liabilities</b>			
Accounts payable	-	102,703	-
Anticipated income distributions	-	452,098	452,098
<b>Net</b>	<b>3,928,265</b>	<b>1,533,925</b>	<b>830,215</b>

regularly and are usually as the result of the death of an investor and eventual winding up of the investor's estate, personal need for funds (buying a new home, car, furniture or holiday), assisting family with debt, retirement living expenses such as rest home fees, and a change in their investment portfolio weighting.

Redemption requests are treated in the order received. For those who redeem their units within 2 years of investing they will be charged an exit fee of 1% and for those redeeming within 1 year they will be charged an exit fee of 2%. Redemptions can be affected by adverse publicity surrounding financial services organisations where there is a modest increase immediately after each event. However, there were no such events during the financial year. The actual reasons for redemptions remain the same, winding up of estates, purchasing a car or house, general expenditure and a few because of a desire to switch to another form of investment. In the reporting year redemptions totalled \$759,643 (March 2017: \$2,653,731).

1-3 years	3-5 years	5+ years	Total
\$	\$	\$	\$
-	-	-	4,974
-	-	-	1,813,949
-	-	-	1,818,923
1,317,516	31,401	1,233,249	5,517,319
340,000	-	374,468	1,289,762
1,157,509	322,396	379,229	2,763,749
551,920	119,225	-	671,145
3,366,945	473,022	1,986,946	10,241,975
-	-	-	107,366
-	-	-	23,305
-	-	-	12,000
594,433	-	-	594,433
1,845,296	1,845,296	922,648	5,535,888
5,806,674	2,318,318	2,909,594	18,333,890
-	-	-	102,703
1,808,390	1,808,390	904,195	5,425,171
<b>3,998,284</b>	<b>509,928</b>	<b>2,005,399</b>	<b>12,806,016</b>

# Notes to the Financial Statements

For the Year Ended 31 March 2018

Maturities detailed above for mortgage receivable are based on contractual maturities.

## 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.

31 March 2018	Weighted Average Effective Interest Rate	Variable Interest Rate
	%	\$
<b>Financial Assets</b>		
Cash and cash equivalents	0.82	2,134,069
Accounts receivable	-	-
Accrued interest	-	-
Loans secured by first mortgage	8.89	9,423,633
		<b>11,557,702</b>
<b>Financial Liabilities</b>		
Accounts payable	-	-
Distribution payable	-	-
		<b>-</b>

31 March 2017	Weighted Average Effective Interest Rate	Variable Interest Rate
	%	\$
<b>Financial Assets</b>		
Cash and cash equivalents	0.97	1,513,949
Accounts receivable	-	-
Webb Farry receivable	2.04	594,433
Accrued interest	-	-
Prepayments	-	-
Loans secured by first mortgage	8.84	9,550,349
		<b>11,658,731</b>

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 would 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, 2018 and the comparative years at 31 March, 2017. The tables include the Fund's assets and liabilities at their carrying amount, categorised by the earlier of contractual repricing or maturity dates.

Fixed Interest Rate	Non Interest Bearing	Total
\$	\$	\$
300,000	4,978	2,439,047
-	4,495	4,495
-	64,065	64,065
-	-	9,423,633
<b>300,000</b>	<b>73,538</b>	<b>11,931,240</b>
-	62,545	62,545
-	62,390	62,390
-	<b>124,935</b>	<b>124,935</b>

Fixed Interest Rate	Non Interest Bearing	Total
\$	\$	\$
300,000	4,974	1,818,923
-	12,000	12,000
-	-	594,433
-	107,366	107,366
-	23,305	23,305
691,626	-	10,241,975
<b>991,626</b>	<b>147,645</b>	<b>12,798,002</b>

# Notes to the Financial Statements

For the Year Ended 31 March 2018

31 March 2017	Weighted Average Effective Interest Rate	Variable Interest Rate
<b>Financial Liabilities</b>		
Accounts payable	-	-
Distribution payable	-	-
Contributions received in advance	-	-
		<u>                    </u>
		<u>                    </u>
		-

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

## k) Sensitivity Analysis – Interest Rate Risk

The sensitivity of Net Surplus After Taxation for the year ended 31 March, 2018, 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 After Taxation	118,267	(113,980)
Impact on Unitholders' Funds	118,267	(113,980)

## 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:

	March 2018	March 2017
	\$	\$
<b>Impaired Assets</b>		
<b>Balance at Beginning of the Year</b>	-	654,275
New impaired assets	-	-
Property disposed	-	(319,788)
Loss on impairment provided	-	-
Loss on realisation	-	(334,487)
	<u>                    </u>	<u>                    </u>
<b>Balance at End of the Year</b>	<b>\$Nil</b>	<b>\$Nil</b>

Fixed Interest Rate	Non Interest Bearing	Total
-	48,699	48,699
-	53,979	53,979
-	25	25
-	<b>102,703</b>	<b>102,703</b>

	March 2018	March 2017
<b>Impaired Assets</b>		
Value of mortgage receivables	-	-
Estimated fair value of collateral held	-	-
Impaired assets with a past due component:		
Up to 3 months	-	-
3 - 12 months	-	-
Over 12 months	-	-
<b>Impaired Assets with Payments Overdue</b>	<b>\$Nil</b>	<b>\$Nil</b>

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 no assets held or owned by the Fund are impaired as at 31 March, 2018 (March 2017: none).

The terms and conditions associated with collateral have no significant unusual requirements from usual practice of recourse when a default occurs.

	March 2018	March 2017
	\$	\$
<b>Provision for Impairment</b>		
<b>Balance at Beginning of the Year</b>	-	293,148
Allowance for impairments written off	-	(293,148)
<b>Balance at End of the Year</b>	<b>\$Nil</b>	<b>\$Nil</b>

There were no other forms of impaired assets at balance date (March 2017: \$Nil).

# Notes to the Financial Statements

For the Year Ended 31 March 2018

## 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 2018	March 2017
	\$	\$
<b>Mortgages considered past due</b>		
<b>Balance at Beginning of the Year</b>	2,203,826	1,096,555
New past due assets	861,121	1,436,551
Settled past due assets	(1,596,655)	(329,280)
Transferred to impaired assets	-	-
<b>Balance at End of Year</b>	<b>\$1,468,292</b>	<b>\$2,203,826</b>
<b>Mortgages considered past due</b>		
Value of mortgage receivables	1,468,292	2,203,826
Estimated fair value of collateral held	3,406,000	5,217,000
<b>Age analysis of past due assets</b>		
All payment instalments overdue:		
Up to 3 months	131,336	61,641
3 - 6 months	1,952	20,937
6 - 12 months	-	-
Over 12 months	-	-
<b>Total Payments Overdue</b>	<b>\$133,288</b>	<b>\$82,578</b>
Assets with a past due component:		
Up to 3 months	1,092,489	1,130,621
3 - 6 months	375,803	1,073,205
6 - 12 months	-	-
Over 12 months	-	-
<b>Total Past Due Assets</b>	<b>\$1,468,292</b>	<b>\$2,203,826</b>

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 the past due assets and the past due portion (payment instalments that are overdue). At 31 March, 2018 there were seven past due assets (March 2016: six). 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.

The terms and conditions associated with collateral have no significant unusual requirements from usual practice of recourse when a default occurs.



There were no expired mortgages, in addition to the above past due mortgages, as at 31 March, 2018 (31 March, 2017 Nil). These are mortgages where the mortgagor is up-to-date with their regular interest and principal payments. The process of renewing mortgages is ongoing year round. Mortgages are assessed for renewal based on the same criteria as new mortgages and strictly in terms of the agreed lending policies and guidelines of the Fund. Where for whatever reason a mortgage no-longer meets those criteria they are asked to refinance or repay. Normal collection action follows in cases where repayment cannot be made. Seldom does this occur.

#### **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 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 classified as restructured assets at 31 March, 2018 (March 2017: None).

#### **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 had no financial or non-financial assets acquired through the enforcement of security at 31 March, 2018 (March 2017: None).

### **16. Commitments for Expenditure**

There are no capital commitments at 31 March, 2018 (March 2017: \$Nil).

### **17. Commitments to Lend**

Lending commitments total \$728,900 as at 31 March, 2018 (March 2017 \$420,402).

### **18. Contingent Liabilities**

There were no contingent liabilities as at 31 March, 2018 (March 2017: \$Nil).

### **19. Unrecognised Contractual Commitments**

As at 31 March, 2018, the Fund:

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

# Notes to the Financial Statements

For the Year Ended 31 March 2018

- b) 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;
- c) Had no certain transaction-related contingent liabilities, including performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions;
- d) 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
- e) 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. Going Concern

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

The considered view of the Directors of the Manager is that, after making due enquiry, 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 year 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.

If the Fund was not a going concern some assets may not realise the values recorded and the unit value of the unitholders' funds would reduce accordingly.

## 22. Capital Management

The Manager endeavours to ensure the value of units remain at or above \$1 in accordance with the Trust Deed. There is no requirement in the Trust Deed for the Manager to guarantee the value of units remain at or above \$1. The Manager can also retain earnings in the Fund to meet anticipated losses.

The Fund's policy is to hold a minimum 5% of unitholders' funds in cash to meet redemptions in the normal course of business. As at 31 March, 2018, cash holdings equated to 20.66 and this will fluctuate, increasing due to the receipt of loan repayments and new investor monies and reducing by new lending, investors' withdrawals and Fund expenses.

The Manager on behalf of and with the approval of the Supervisor determines the unit income for the distribution made to unitholders

each quarter. The average rate of return for the year is 4.04% (March 2017: 3.54%).

Investments in bank deposits are maintained so as they have a duration of no more than twelve months. Investments in mortgages are actively managed and the applicable interest rates are kept under regular review to ensure an adequate return is paid to unitholders.

Mortgage investments are repayable "on demand" but in the normal course of business can be agreed for terms of up to 25 years. Currently, a 2 year term is most common for new mortgages written out by the fund.

No single loan is to exceed 5% of the Fund at the time of the first advance. At balance date, there was no loan made during the reporting year exceeded 5% of the Fund. The largest loan is 3.76% of the Fund.

### **23. Subsequent Events**

There were no material events occurring post 31 March, 2018 that require disclosure.

### **24. Webb Farry Receivable**

During 2016, the Fund received notice of District Court proceedings seeking an order for the forfeiture of properties over which the fund holds first mortgages. At that time of the notification the first mortgages supported two loans owing to the Fund. Since then all of the relevant securities have been sold and some of the cash realised was being held in the trust account of the Fund's lawyers, pending the outcome of those proceedings. The forfeiture proceedings followed a criminal offence committed by one of the legal owners of the securities with the case being heard in the Christchurch District Court late December 2016. On 27 September 2017 the Crown issued an instrument forfeiture order which required the Fund to transfer the cash held by its solicitors of \$594,433 to the Crown, and as a result changed the manner in which the forfeiture claim was treated in No. 2 Fund's accounts. The amount transferred to the Crown has increased loss of realisation of investment expense by \$594,433 and has reduced the net assets of the Fund and accordingly the unit valuation has been reduced to 92.9 cents per unit as at 31 March 2018.



## ***Independent auditor's report***

To the unitholders of the NZ Mortgage Income Trust (No.2 Fund) Group Investment Fund

NZ Mortgage Income Trust (No.2 Fund) Group Investment Fund's financial statements comprise:

- the statement of financial position as at 31 March 2018;
- the statement of comprehensive income for the year then ended;
- the statement of changes in unitholders' funds for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of specific accounting policies.

### ***Our opinion***

In our opinion, the financial statements of NZ Mortgage Income Trust (No.2 Fund) Group Investment Fund ("the Fund") present fairly, in all material respects, the financial position of the Fund as at 31 March 2018, their financial performance and their cash flows for the year then ended in accordance with New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and International Financial Reporting Standards (IFRS).

### ***Basis for opinion***

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs NZ) and International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements* section of our report.

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: PricewaterhouseCoopers, Westpac Building, 106 George St, Dunedin, PO Box 5848, Dunedin 9058, New Zealand  
T: +64 3 470 3600, F: +64 3 470 3601, [pwc.co.nz](http://pwc.co.nz)

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

We are independent of the Fund in accordance with Professional and Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* (PES 1) issued by the New Zealand Auditing and Assurance Standards Board and the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Our firm carries out other services for the Fund in the areas of Unitholders register compliance assurance and trust deed reporting. The provision of these other services has not impaired our independence as auditor of the Fund.

### ***Information other than the financial statements and auditor's report***

Fund Managers Otago Limited (the Manager) is responsible for the annual report.

Our opinion on the financial statements does not cover the other information included in the annual report and we do not express any form of assurance conclusion on other information.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of our auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

### ***Responsibilities of the Fund Manager for the financial statements***

The Manager is responsible for the preparation and fair presentation of the financial statements in accordance with NZ IFRS and IFRS, and for such internal control as the Manager determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Manager is responsible for assessing each Fund's ability to continue as

a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Manager either intends to liquidate the Fund or to cease operations, or have no realistic alternative but to do so.

## ***Auditor's responsibilities for the audit of the financial statements***

Our objectives are to obtain reasonable assurance about whether the financial statements, as a whole, are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs NZ and ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located at the External Reporting Board's website at:

<https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-6/>

This description forms part of our auditor's report.

## ***Who we report to***

This report is made solely to the Fund's unitholders, as a body. Our audit work has been undertaken so that we might state those matters which we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Fund's unitholders, as a body, for our audit work, for this report or for the opinions we have formed.

The engagement partner on the audit resulting in this independent auditor's report is Nathan Wylie.

For and on behalf of:



Chartered Accountants

Dunedin

20 July 2018



*GROUP INVESTMENT FUND*

Registered Office of the Manager: Fund Managers Otago Ltd  
Level 8, 248 Cumberland Street, PO Box 5741, Dunedin 9058  
Phone (03) 471 6500 Tollfree 0800 800 212 Fax (03) 479 0598  
Website: **[www.nzmit.co.nz](http://www.nzmit.co.nz)**