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STATEMENT OF INVESTMENT POLICY AND OBJECTIVES ("SIPO")

For

NZ MORTGAGE INCOME TRUST [No2 FUND]
GROUP INVESTMENT FUND
("the Scheme")

Version Control	Date	Reviewer	Approved
Version 1	1 December 2016	MD & Board	FMO Board
Version 2	1 February 2017	MD & Board	FMO Board
Version 3	17 December 2019	MD & Board	FMO Board

EFFECTIVE DATE: 17 December 2019

The most current version of the SIPO is available on the Disclose register at www.business.govt.nz/disclose.

DESCRIPTION OF THE SCHEME

The Scheme is a pooled investment vehicle established under the Trustee Companies Act 1967. The scheme is a designated Group Investment Fund. The Scheme is a profit orientated entity, which was formed on 18 October 2007 and commenced operation on 12 November 2007. The Scheme is an issuer for the purposes of the Financial Reporting Act 1993 and is a reporting entity under the Financial Markets Conduct Act 2013 as from 1 September 2016. The Scheme is to continue, until wound up.

ROLES & RESPONSIBILITIES

The Supervisor, Trustees Executors Limited is, among other things, responsible for holding the Scheme's assets and for supervising the performance by the Manager of its functions and obligations.

The Manager, Fund Managers Otago Limited, among other things, is responsible for the day to day management of the Scheme property and investments and must ensure that the Scheme has a statement of investment policy and objectives that provides adequately for the following matters:

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

The Scheme invests in loans secured by registered first mortgages of land and buildings. These must be first mortgages within defined lending ratios. The Scheme also invests in deposits with registered banks. The Manager generally has the discretion as to which authorised investments are acquired, held or disposed of in and for the Scheme.

INVESTMENT OBJECTIVES

Investment Objective

The investment objective is the provision to investors of an income return that will normally be better than bank term deposits and competitive with comparable investment products. While this cannot be assured, the Manager's objective is to give investors a pre-tax (but after fees and expenses) return per quarter higher than registered bank term deposits and competitive comparable investment products.

Investment Policy

The policy of the Manager in placing investments for the Scheme in regard to its two types of securities are;

1. The policy of the Manager in relation to investing in bank deposits with registered banks within the New Zealand banking system is to have a mixture of on-call deposits and term deposits (with maturities of up to 12 months)

2. The policy of the Manager in relation to the mortgage lending is to establish and maintain a broad range of mortgage investments with a mix of mortgage types, interest rates, maturity dates and physical location of the mortgaged properties.

The Scheme does take collateral security in the form of General Security Agreements, but these are for control and collateral purposes and no value is attributed when calculating the underlying asset value of the Scheme's securities.

The objectives underlying the mortgage portfolio are:

- Preservation of the capital of the Scheme ensuring that portfolio assets are invested in a prudent manner and in terms of the lending policies and guidelines.

- Maximisation of income from the mortgage portfolio and in the long term, to achieve investment objective of the Scheme in regard to the return to investors.

Risk Posture
The lending portfolio risk posture comprises two elements:
- The ability to tolerate volatility in investment returns (risk tolerance).
- The Scheme's willingness to assume risk (risk preference).

Risk Tolerance
The following points are relevant to a consideration of risk tolerance:
- The portfolio bears the risk of any adverse investment decisions.
- The Scheme is expected to be a continuing entity.
- The Scheme financial position is such that volatility must be constrained.

Risk Preference
- The Manager accepts the long-term emphasis on the need to have investments which will protect the value in real terms in order to maintain income objective in regard to the return to investors.
- The Manager will ensure that the lending portfolio includes a maturity profile that recognises the need to have a strong cash flow over time.
- The Manager will ensure that the setting of interest rates relating to lending, new and existing, is based on a risk assessment of the proposition being funded.

INVESTMENT BELIEFS

The Manager believes that there are opportunities in the financial markets for an active niche lender such as the Scheme. The investor profile is the semi and fully retired investor wishing to earn valuable income on their retirement capital while taking an acceptable level of risk. The creation of a mortgage portfolio of registered first mortgages at non-bank second tier lenders yields is therefore a real opportunity for an entity such as the Scheme. The Manager believes that New Zealand has a relatively volatile interest rate environment and has traditionally produced higher interest rate yields than other parts of the world. There is generally a shortage of funding for property-based investment for a variety of reasons, and these opportunities offer above average yields rather than the, traditionally over competitive banking sector. The Manager's style is generally described as risk averse given the sector in which its Scheme invests. Therefore, emphasis is on careful analysis of lending propositions at the outset.

INVESTMENT STRATEGY

Restriction on investments

There are restrictions on the types of investments that the Scheme can make, as set out in its Trust Deed. These restrictions align with the Scheme's investments for it to retain its character as a designated group investment fund as defined in section HR3 (6) of the Income Tax Act 2007. Under the Act, designated group investment funds must primarily invest in first mortgage securities.

Under the Trust Deed, the Scheme must always be invested in "authorised investments", which are as follows; -

- cash, deposits with, loans to, or other debt securities of any registered bank under the Reserve Bank of New Zealand Act 1969 or a bank authorised to carry on general banking business in New Zealand ("bank") whether secured or unsecured;

- loans made upon the security of any registered first mortgages or registered first mortgage backed securities;

- the acquisition of any registered first mortgages or registered first mortgage backed securities by way of transfer or assignment of the mortgagee or charge holder's interest in the mortgage or security;

- property which comes into the possession, ownership or control of the Supervisor by virtue of the exercise of the powers, authorities and discretions vested in the Supervisor by any mortgage or mortgage backed security held by the Supervisor;

- public sector securities.

- Derivatives: and

- Any trust which invests primarily or wholly in one or more of the investments referred to in the preceding bullet points.

To meet the designated group investment fund requirements referred to above, until such time as the Manager and Supervisor agree otherwise, the Scheme shall:

- primarily invest in loans made upon the security of registered first mortgages or registered first mortgage backed securities; and

- only be invested in investments in which a designated group investment fund is permitted to invest in order to fall within the definition of a group investment fund as defined in section HR3 (6) of the Income Tax Act 2007.

With the intent that (unless agreed by the Manager and the Supervisor) the Scheme shall always be a designated group investment fund for taxation purposes.

Notwithstanding the range of authorised investments described above, the Manager shall only invest the Scheme's property pursuant to the specific guidelines, benchmark asset allocations and lending limits described further below.

Specific policy guidelines

Specific investment policy guidelines determined by the Manager in relation to the Scheme are as follows:

(i) ***Interest rates*** - most investments by the Scheme will be in registered first mortgages with mostly floating interest rates but the Manager may maintain some fixed rate mortgages.

(ii) ***Mix of mortgage typ*es** - the mortgage portfolio will be spread mainly between residential commercial and rural properties within the guidelines contained the following table.

	Residential	**Commercial**	**Rural**
Mix of mortgage types	Minimum 10% Maximum 75%	Minimum 15% Maximum 75%	Minimum 0% Maximum 50%

(iii) ***Lending Limits*** - there are limits on the maximum size of any mortgage in relation both to the value of the property provided as security and to the total net asset value of the Scheme. The limits are:

Lending limits (mortgage types)

	Residential	Commercial	Rural
Limits for net asset value of the Scheme	10% – 75%	15% - 75%	0% - 50%

Lending Limits (Valuations)

Residential Mortgages	Commercial Mortgages	Rural Mortgages
Fee simple land and buildings: up to 80% LVR	Fee simple land and buildings: up to 66.7% LVR	Fee simple land and buildings: up to 60% LVR
Leasehold: up to 50% LVR	Leasehold: up to 50% LVR	Leasehold: up to 50% LVR
Vacant land with power, water, sewage and associated services ("Services') completed: up to 70% LVR	Vacant land with power, water, sewage and associated services ("Services') completed: up to 60% LVR	
Land which does not have Services: up to 50% LVR	Land which does not have Services: up to 50% LVR	Land which does not have Services: up to 50% LVR

No more than 5% of the net assets of the Scheme 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. The total of the six largest loans in the Scheme may not exceed 20% of the value of the Scheme.

Valuations are generally based on a report from a registered valuer, who is independent from the borrower. However, for loans up to $1 million which are secured either against and residential or a lifestyle property with a residential dwelling or against a bare section which does have services provided, the Manager may elect to rely upon a market value valuation report, a council ratings valuation or a ratings valuation as supplied by Quotable Value.

The Manager reviews valuations by registered valuers for security properties where the Scheme has or is likely to suffer a loss on realisation of security properties to ascertain if values may have been overstated and/or the valuations may not have been prepared in accordance with industry guidelines. The Scheme may to take legal proceedings in instances where the Scheme has suffered a loss as a consequence of any incorrectly prepared valuations.

As referred to above all lending limits are determined and are solely applicable as at the initial loan approval date and at the date of any renewal of a loan. The value of any individual loan or the proportionate value of a loan in relation to the net asset value of the Scheme may change subsequent to initial approval or renewal and, as a result, the above limits may be exceeded after those dates.

(iv) **Cash** – The Scheme also holds cash. The Manager shall maintain at least 5.00% of the net asset value of the Scheme in cash deposits and other liquid assets to meet redemption requests and for payment of the Scheme operating expenses. Greater amounts of cash may be held from time to time when the Manager determines that the Scheme requires greater liquidity. The Scheme's cash holdings may only be invested in on-call or term deposits (with maturities of up to 12 months) with registered banks.

Benchmark Asset Allocation Ranges

Lending limits (mortgage types)

	Residential	Commercial	Rural
Limits for net asset value of the Scheme	10% – 75%	15% - 75%	0% - 50%

Lending Limits (Valuations)

Residential Mortgages	Commercial Mortgages	Rural Mortgages
Fee simple land and buildings: up to 80% LVR	Fee simple land and buildings: up to 66.7% LVR	Fee simple land and buildings: up to 60% LVR
Leasehold: up to 50% LVR	Leasehold: up to 50% LVR	Leasehold: up to 50% LVR
Vacant land with power, water, sewage and associated services ("Services') completed: up to 70% LVR	Vacant land with power, water, sewage and associated services ("Services') completed: up to 60% LVR	
Land which does not have	Land which does not have Services:	Land which does not have

Services: up to 50% LVR	up to 50% LVR	Services: up to 50% LVR

Benchmark Asset Allocations

The benchmark asset allocation is long-term average expected weighting for each class of assets. For the Scheme the benchmark asset allocation is as follows;

Asset Class	Asset Allocation
Cash	5% to 25% of the value of the Scheme
Residential first mortgage lending	20% to 60% of the value of the Scheme
Commercial first mortgage lending	15% to 50% of the value of the Scheme
Rural first mortgage lending	5% to 25% of the value of the Scheme

Appropriate benchmark index

The NZ Mortgage Income Trust (No2 Fund) ("the No2 Fund") is an exempt scheme under the Financial Markets Conduct (Market Index) Exemption Notice 2018 ("Exemption Notice").

Under the exemption Notice managers of certain exempt schemes are exempted from the need to supply comparative information, comparing the performance of a scheme with an appropriate market index or peer group.

The No2 Fund invests in bank deposits and predominately, loans secured by first mortgages over land and buildings within New Zealand. Fund Managers Otago Limited ("Manager") had, prior to the Exemption Notice, been using the weighted average 6-month bank term deposit rate as published by the Reserve Bank of New Zealand. However, the Manager is of the view that this is not an appropriate comparative market index as it relates to bank debt products. The No2 Fund issues units in managed investment products, not debt, and the Manager is not a registered bank.

The Manager has also given consideration as to whether there is a suitable group index or composite index which could be used for comparison purposes. There are few first mortgage schemes in New Zealand. A peer group index is one that:

- Is based on the performance of a group of schemes that invest in a particular sector or particular sectors; and
- Is either or both of the following:
  - widely recognised and widely used in the financial markets
  - administered by a person who is suitably independent; and
- Is likely to be useful to investors when assessing the performance of the relevant assets and the scheme as a whole.

There is no such index for the first mortgage schemes in New Zealand. In the view of the Manager, overseas based indices are not "peer group" comparators because the difference between the New Zealand mortgage lending market (and its potential returns) and overseas jurisdictions' mortgage lending. Accordingly, the Manager has taken the view that there is no appropriate peer group index.

Rebalancing Policy

Monitoring of asset allocation in relation to the benchmark asset allocation ranges to ensure compliance is ongoing. New lending is driven by the asset allocation policy. The allocation to each asset class will vary, due primarily to market movements, within the ranges set.

Mortgage portfolios are in general relatively illiquid therefore the cash flow (either to or from the Scheme) is the primary mechanism for ensuring that the asset allocation is maintained broadly in line with the benchmark asset allocation weightings for each asset class.

Monitoring of the asset allocations is done monthly by the Board of the Manager. If this highlights that a particular class of asset has moved outside of its asset allocation, then the assets are rebalanced to bring the asset allocation within the permitted range. A practical approach is taken to rebalancing.

Hedging Policy

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

Conflicts of Interest

The Manager does not allow lending to any related parties but does allow related parties to invest in the Scheme as long as these are disclosed to the Supervisor and in the financial statements.

Liquidity and cash flow management policy

The Manager will maintain at least 5% of the net assets of the Scheme in cash deposits and other liquid assets to meet the redemption requests and for the payment of the Schemes operating expenses. In addition, the Manager will target a liquidity range of 5% to 25% of the net asset value of the Scheme.

METHODOLOGY FOR MONITORING, AMENDING & DEVELOPING INVESTMENT STRATEGY

Investment Policies

The Scheme as described above invests in loans secured by first mortgages of land and buildings and deposits with registered banks which are intended to provide returns higher than registered bank term deposits and competitive comparable investment products. and also comparable with similar investment products. The lending decisions are made in light of this objective and are subject to the specific lending policies and guidelines referred to in the SIPO. The Schemes liquidity (cash) may be held with any registered bank (as defined by the Reserve Bank Act) and the policy of the Manager is to have a variety of deposit terms to provide a balance between greater liquidity and higher interest returns for the Scheme. This also requires the manager to be aware of the need for cash to available to meet the redemptions requests based on historical redemption data.

Subject to maintaining the Schemes cash liquidity buffer the Manager will arrange mortgage lending with the objective of providing investors pre-tax (but after fees and expenses) return per quarter of at least 100 basis points higher than the weighted average six month term deposit rate published by the Reserve Bank and competitive comparable investment products. Mortgage lending decisions are made with tis object in mind.

Investment Performance monitoring

The Manager monitors the investment performance of the Scheme quarterly in March, June, September and December of each year on a rolling 12-month basis. The investment performance is also monitored annually. The Manager reports monthly to the Supervisor as to the performance of the Scheme and as to whether there have been any material breaches of any limits set out in this SIPO in relation to the nature or type of investments that may be made or the proportion of each type of assets that may be invested in ("limit breaks"). These reports carry all of the necessary confirmations as to adherence to the SIPO for the Scheme and that all entitlements of investors have been correctly calculated and valuations of used carried out in accordance with the trust deed provisions and that proper accounting and internal control procedures have been maintained.

In accordance with the requirements of the Financial Markets Conduct Act 2013 ("FMCA") and the Financial Markets Conduct regulations 2014 ("the Regulations'), the Manager will report to the Supervisor, as soon as practicable, any limit breaks that have not been corrected within 5 working days after the date that the Manager became aware of the limit break.

Investment strategy review and amendment

This document is formally reviewed by the board of directors of the Manager annually and may also be reviewed at any other time if the Manager considers that such a review is required as a result of the prevailing market conditions. In the course of the review the Manager's board of directors in consultation with the Managing Director will consider whether the benchmark asset allocations remain appropriate given the prevailing market conditions. This will also equally apply to the Schemes liquidity policy. In accordance with the FMCA, the Manager may amend or replace this SIPO only after having given reasonable prior written notice to the Supervisor.