



ASIC

Australian Securities & Investments Commission



# INVESTING IN MORTGAGE FUNDS?

Independent guide for investors  
about unlisted mortgage funds

Mortgage funds can also be called  
'mortgage trusts' or 'mortgage schemes'.

## About ASIC

The Australian Securities and Investments Commission (ASIC) regulates financial advice and financial products (including credit).

Our website for consumers and investors, MoneySmart, offers you free and independent tips and safety checks about the financial products and services we regulate.

Visit [www.moneysmart.gov.au](http://www.moneysmart.gov.au) or call ASIC's Infoline on 1300 300 630.

## How can this booklet help you?

Read the Product Disclosure Statement (PDS) and any other disclosure documents together with this booklet. ASIC does not endorse specific investments. However, this independent guide can help you:

### Know what the investment is

Find out about the investment product itself

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### Consider the risks

Use the information in the PDS and in other disclosure documents to assess the risk

Page 10

### Think about your own situation and needs

Decide if the investment suits your financial goals and objectives

Page 24

This guide is for you, whether you're an experienced investor or just starting out.

## Key tips

## from ASIC about investing

- 1 Anything you put your money into should meet your goals and suit you.
- 2 No one can guarantee the performance of any investment. You might lose some or all of your money if something goes wrong.
- 3 The rate of return offered is not the only way to assess how risky an investment is.
- 4 'High return means high risk' is a familiar rule of thumb. Some investments, even if they seem to offer relatively modest returns, can be extremely risky.
- 5 Take your time and do your research before deciding what to invest in. Visit ASIC's website for investors, MoneySmart, at [www.moneysmart.gov.au](http://www.moneysmart.gov.au) for more information.
- 6 You are taking a big risk if you put all your money into one investment. Spreading your money between different investment types ('diversification') reduces the risk of losing everything.
- 7 Consider seeking professional advice from a licensed financial adviser.

## Know what the investment is

### What is a 'mortgage fund'?

A mortgage fund is a type of investment in which you buy units in a fund that is operated by a professional fund manager. Other investors also buy units in the mortgage fund.

The mortgage fund's money is lent out (as mortgage loans) to a range of borrowers who use the money to buy and/or develop properties. It might also be used for other investments (for example, investing in other mortgage funds).

In return for investing your money (your 'capital'), the fund manager promises to pay you a regular income, usually quarterly or half-yearly (called 'distributions'). There are two types of mortgage funds.

Pooled mortgage funds	Contributory mortgage funds
<ul style="list-style-type: none"><li>• All investors share in all mortgages/investments.</li><li>• All investors share the income and spread the risks of all mortgages/investments.</li><li>• Some funds promote that you can withdraw your money at short notice, but it might take a while (e.g. 12 months) to get it back.</li></ul>	<ul style="list-style-type: none"><li>• You or the fund manager choose which mortgage(s) you invest in.</li><li>• Your mortgage(s) might pay a different income than other mortgages in the fund.</li><li>• Your risk depends on the quality of the borrower(s) you or the fund manager lend to.</li><li>• For most funds, you can only withdraw your money when your mortgage(s) mature.</li></ul>

### What is an 'unlisted' mortgage fund?

An unlisted mortgage fund is not listed on a public market, such as the Australian Securities Exchange (ASX).

There are differences between listed and unlisted mortgage funds that can make it harder for investors to easily know what's going on with their investment. For example:

- with an unlisted mortgage fund, you can't see the price of the investment (and whether it is going up or down) and decide to buy or sell when you want to
- unlisted mortgage funds are not subject to ongoing supervision by a market supervisor, such as the ASX.

## What's the difference between a mortgage fund and other investments?

Investment	How it works
Term deposit	You <i>deposit</i> your money (capital) with a specially regulated financial institution such as a bank, building society or credit union for a fixed term in return for a fixed rate of interest.
Debenture	You <i>lend</i> your money to a business, usually for a fixed term. You are not guaranteed a fixed rate of interest or return of your capital. The business might invest in mortgages and/or properties.
Mortgage fund	You <i>invest</i> money in a mortgage fund. You might not be able to withdraw from the fund at short notice. You are not guaranteed a fixed rate of interest or return of your capital. The mortgage fund invests in residential and commercial mortgages.
Property trust	You <i>invest</i> money in a property trust. You only get your money back when the property trust ends or if you have a right to withdraw. You are not guaranteed a return on your investment or the return of your capital. The property trust invests directly in property, rather than in mortgages over property.

 A mortgage fund is not the same as a term deposit.

## Why is the PDS important?

The fund manager must give you a Product Disclosure Statement (PDS). The PDS tells you how the mortgage fund works and you should read it in full. Under the law, the PDS must include enough detail for you to compare similar financial products so you can make an informed decision about which one to invest in.

Concentrate on the sections that:

- explain the key features and risks of the investment
- tell you about the fees you will pay for this investment
- give you information about certain indicators (or 'benchmarks'), which can help you assess the risks of unlisted mortgage funds (see pages 11–23).

You should find this information in the first few pages of the PDS. The fund manager must also tell you if there are significant changes to the information in the PDS (this is called 'ongoing disclosure'). Check the mortgage fund's website and/or look for regular updates in the mail (if you decide to invest).



A PDS does not have to be lodged with ASIC before it can be used to raise money from investors. ASIC does not endorse the underlying investment in any way.

## What are 'investment ratings'?

An 'investment rating' is an opinion by a ratings agency about the likely performance of an investment, or its relative performance compared to other similar investments. This is different from a 'credit rating', which is an opinion about a company's ability to pay all its debts on time and in full.

An investment rating is only one factor to consider when deciding whether or not to invest in a mortgage fund. And not all investment ratings are the same:

- Some ratings agencies rate investments with stars (the more stars the stronger the recommendation) and some use words like 'recommended'.
  - Some ratings agencies only assess investments using publicly available information about the investment (such as price and returns), while others do more in-depth research (for example, speaking directly to fund managers).
  - Some ratings agencies might receive payments from the fund being rated.
- 
- If you don't understand how the rating was calculated or how to use it, contact the relevant ratings agency or discuss it with your financial adviser.
  - Only use ratings from agencies that hold an Australian financial services licence.

## Do you need advice?

Take your time and think things over before you invest. Get professional advice from a licensed financial adviser if you're not sure what to do.

ASIC's booklet *Getting advice* can help you find out how to get personal financial advice. If your financial adviser recommends that you invest in a mortgage fund, make sure you ask questions about this recommendation.

- How does this product fit into your overall financial plan and how will it help you achieve what you want?
- Do you understand the risks associated with this type of investment?
- Do you know exactly what the mortgage fund will do with your money?
- Could you explain the business model of the mortgage fund to a friend or colleague?

## Consider the risks

The return offered on an investment is not the only way to assess how risky it is. ASIC has developed 8 benchmarks for unlisted mortgage funds to help you assess the key risks.

In the PDS, the fund manager should tell you if the mortgage fund meets each benchmark. If the fund doesn't meet a benchmark, the fund manager should explain why not, so you can decide whether you're comfortable with the explanation.

The fund manager should also update you about any significant changes to the mortgage fund's performance against the benchmarks (through ongoing disclosure).

Here's how you can use ASIC's benchmarks to assess the risks in unlisted mortgage funds.

Look for information about each benchmark in the PDS and/or ongoing disclosure documents.

See if the mortgage fund meets the benchmark.

If not, does the fund manager say why not and how they deal with this risk in another way?

Are you are satisfied with how they deal with this risk?

If not, are you willing to risk your money in this mortgage fund?

**Remember:** The benchmarks are not a guarantee that an unlisted mortgage fund will perform well. Even if the fund meets all the benchmarks, you could still lose some or all of your money if things go wrong. The benchmarks are simply designed to help you understand the risks and decide whether or not to invest your money.

## ASIC's 8 benchmarks for unlisted mortgage funds

Benchmark	What to look for	Page
Liquidity*	Does the mortgage fund have enough cash and liquid assets to meet its financial obligations to you and all other parties?	12
Fund borrowing	How much has the mortgage fund borrowed and, for debts due within 12 months, can the fund repay/refinance them?	13
Portfolio diversification*	Does the mortgage fund manage risk by spreading the money it lends and invests between different loans, borrowers and investments?	16
Related party transactions	How many of the mortgage fund's transactions involve parties that have a close relationship with the fund manager?	17
Valuation policy	How are the mortgage fund's underlying assets valued?	18
Loan-to-valuation ratio	How much money will the mortgage fund lend compared to the value of what the loan is secured against? Is this proportion too high?	20
Distributions	Where is the money paid to you coming from and is this sustainable?	21
Withdrawing from the fund	Can you withdraw from the mortgage fund and how long will it take to get your money back?	22

\* These benchmarks apply only to pooled mortgage funds.

Each benchmark is explained in more detail in the following pages.

## 1 Liquidity: Does the mortgage fund have enough cash and liquid assets to meet its financial obligations to you and all other parties?

'Liquidity' means a mortgage fund's ability to meet its short-term cash needs. To meet this benchmark, the fund manager must:

- estimate the fund's cash needs for the next 3 months
- ensure the fund has enough cash or other liquid assets to meet those cash needs ('liquid assets' are assets that can be readily converted into cash)
- describe the fund's policy on balancing its assets against its debts (or 'liabilities').

Note: This benchmark applies only to pooled mortgage funds.



### What's at stake for you?

Liquidity is an important measure of a mortgage fund's ability to meet its payment obligations to you as an investor and to other parties.

If the fund hasn't enough cash or liquid assets, there might not be enough money to pay you regular distributions, or pay your money back when you expect it.

### An example using personal finance

Unless you have enough cash income each month, you might not be able to pay your regular bills (for example, telephone and utility bills, and/or rent).

## 2 Fund borrowing: How much has the mortgage fund borrowed and, for debts due within 12 months, can the fund repay/refinance them?

You can get a good idea of a mortgage fund's financial status by knowing:

- how much money the fund owes (its debts) and when these debts are due to be repaid (their 'maturity profile')
- how much money the fund can borrow compared to how much it has already borrowed (its 'undrawn credit facility').

To meet this benchmark, the fund manager must tell you the following information about the mortgage fund's borrowing.

Debts due in	What the fund manager must tell you
Less than 1 year	<ul style="list-style-type: none"><li>• Total debts due and their maturity profile</li><li>• Undrawn credit facility (i.e. how much can still be borrowed)</li><li>• Whether refinancing or sale of assets is likely during this period</li></ul>
1–5 years	<ul style="list-style-type: none"><li>• Total debts due and their maturity profile for each 12-month period</li><li>• Undrawn credit facility (i.e. how much can still be borrowed)</li></ul>
5 years+	<ul style="list-style-type: none"><li>• Total debts due</li></ul>



The fund manager must also tell you:

- why they have borrowed the money (including whether it will be used to pay distributions or withdrawal amounts)
- if they have broken any promises made in loan agreements (called ‘loan covenant breaches’).



### What’s at stake for you?

If a mortgage fund has debts that are due to be repaid in a relatively short timeframe, this can be a significant risk factor, especially during times when credit is more difficult and costly to get.

Unless the mortgage fund can renew or extend the due date of its debts, it might be forced to sell assets (possibly for less than their estimated value) to repay them. It might even have to stop operating. In this case, you could lose all or part of your capital because other creditors of the mortgage fund will be repaid before you.

## Some examples using personal finance

### Example 1: Maturity profile

You might have a debt that is due to be repaid in 2 years. If you pay off the original loan amount (‘principal’) together with the interest, your debt reduces to \$0 over the 2 years.

If you choose an ‘interest-only’ loan, you only pay the interest part before the debt is due. You would then have to pay off all of the principal at the end of the 2 years.

If you didn’t have enough money to pay off the principal at that time, refinancing your loan to extend the due date would be very important.

### Example 2: Undrawn credit facility

If you have a \$5,000 limit on your credit card and you have bought \$1,000 worth of goods on it, your undrawn credit facility would be \$4,000.

You could repay \$1,000 on the due date (say, within 30 days) without paying interest, or on an extended date (usually within 12 months) and pay interest.



### 3 **Portfolio diversification:** Does the mortgage fund manage risk by spreading the money it lends and invests between different loans, borrowers and investments?

Just as you can spread your own investments to manage risk, a mortgage fund can manage risk by spreading the money it lends and invests between different loans, borrowers and investments. This is called 'portfolio diversification'.

To meet this benchmark, the fund manager must describe:

- the fund's assets (including number and types of loans, largest loans, defaults or late payments, upcoming loan commitments and any security taken over loans)
- the fund's policy for lending money (including how much it will lend to each borrower and rollover terms)
- the fund's policy on investing in other mortgage funds and if those funds should meet ASIC's benchmarks.

**Note:** This benchmark applies only to pooled mortgage funds, but diversification is important for all investments.



#### What's at stake for you?

Is the mortgage fund's portfolio heavily concentrated on a small number of loans, or loans to a small number of borrowers? If so, there is a higher risk that a single negative event affecting one loan will put the overall portfolio (and your money) at risk.

#### An example using personal finance

If you put all your eggs in one basket (or all your money in one investment) and something goes wrong, you risk losing everything.

### 4 **Related party transactions:** How many of the mortgage fund's transactions involve parties that have a close relationship with the fund manager?

A 'related party transaction' is a transaction (for example, a loan) involving parties that have a close relationship with the fund manager.

To meet this benchmark, the fund manager must tell you:

- the number and value of loans, investments and other transactions they have made with related parties
- how they assess, approve and monitor related party transactions.



#### What's at stake for you?

The risk with related party transactions is that they might not be made with the same rigor and independence as transactions made on an arm's length commercial basis.

There could be a greater risk of the loans defaulting (putting your money at greater risk) if:

- the mortgage fund has a high number of loans to, or investments with, related parties, and
- the processes for assessing, approving and monitoring these loans and investments are not rigorous.

#### An example using personal finance

If you lend money to family members or friends, your loan terms and conditions might be very different to a bank's. You might also not expect to get your money back on time or in full. And you are less likely to sue your family or friends for repayment.

## 5 Valuation policy: How are the mortgage fund's underlying assets valued?

Knowing exactly how much a mortgage fund's underlying assets are worth (that is, accurate valuations of the mortgage security) can help you assess its financial position. To work out how accurate these valuations are likely to be, you need to know how they're done.

To meet this benchmark, the fund manager must:

- tell you how often valuations are done (and how recent a valuation must be for a new loan)
- establish a panel of valuers
- ensure that no one valuer conducts more than one third of the valuation work
- value property in the following way.

Type of asset	Basis for valuation
Property development	'As is' basis and 'As if complete' basis
Other property (e.g. established buildings)	'As is' basis

For pooled mortgage funds, the fund manager must also tell you about the valuation of a particular property if the loan secured against that property is 5% or more of the value of the total loan portfolio.

For contributory mortgage funds, the fund manager only needs to tell you about the valuation of a property securing a loan if you are being offered an interest in that loan.



### What's at stake for you?

Without information about how valuations are done, it will be more difficult for you to assess how risky a mortgage fund's loan portfolio is.

Keeping valuations up-to-date and shared among a panel means they are more likely to be accurate and independent.

### An example using personal finance

If you own a house, you know that putting a value on it before it's sold is not an exact science—you can only estimate what you think your house might be worth at any point in time. These estimates might vary depending on who is doing the valuation. The valuation would be even more difficult to do before the house is built.

**6 Loan-to-valuation ratio:** How much money will the mortgage fund lend compared to the value of what the loan is secured against? Is this proportion too high?

The loan-to-valuation ratio (LVR) tells you how much of the value of an asset is covered by loan money. This ratio is a key risk factor when assessing whether to lend money to someone.

To meet this benchmark, the fund manager must:

- only lend money for property development in stages based on progress made
- maintain the following loan-to-valuation ratios.

Business activity	Loan-to-valuation ratio
Property development	70% of the latest 'As if complete' valuation
All other types	80% of the latest market valuation

For contributory mortgage funds, the fund manager only needs to maintain these loan-to-valuation ratios for loans you are being offered an interest in.



**What's at stake for you?**

A high loan-to-valuation ratio means that a mortgage fund is more vulnerable to changing market conditions, such as a downturn in the property market. Therefore, the risk of losing your money could be higher.

**An example using personal finance**

You might take out a loan for \$450,000 to buy a house valued at \$500,000 (a loan-to-valuation ratio of 90%). If there's a downturn in the property market when you want to sell the house and you only get \$440,000 for it, you won't get enough cash from the sale to repay the loan.



**7 Distributions:** Where is the money paid to you coming from and is this sustainable?

'Distributions' are payments you receive from the mortgage fund during the year. These payments could come from:

- income received (for example, interest from borrowers), and/or
- other borrowing by the fund or selling off assets.

To meet this benchmark, the fund manager must tell you:



- the source of the current distribution being paid to you and any forecast distributions
- if the distributions are not sourced solely from income received, why the distributions are being made and whether they can be maintained over the next 12 months
- the circumstances in which a promised return (if applicable) might not be paid to you.



**What's at stake for you?**

Some mortgage funds promise to pay you a regular distribution regardless of whether the fund actually receives the expected income. Other mortgage funds only pay you regular distributions if the fund earns enough interest from borrowers and other investments during a particular period.

If a mortgage fund pays distributions from sources other than income received, this could be unsustainable. This is important if you are depending on distributions from the mortgage fund for regular income.



## 8 **Withdrawing from the fund:** Can you withdraw from the mortgage fund and how long will it take to get your money back?

Most contributory mortgage funds only offer you the right to withdraw from the fund when the particular mortgage you have invested in matures. On the other hand, most pooled mortgage funds say that you can withdraw from the fund at short notice. Either way, it might take a while (for example, as long as 12 months) to get your money back.

To meet this benchmark, the fund manager must clearly state (if relevant to the fund):

- the longest period of time you might have to wait before you can get your money back
- any significant risks that could stop you being able to get your money back
- the fund's policy on re-investing ('rolling over') your money at the end of the initial period (for example, whether this happens automatically)
- if the price of each unit in the fund is fixed (for example, at \$1 per unit), the circumstances when the price you can sell your units at might vary.

For contributory mortgage funds, the fund manager only needs to tell you this information if you can withdraw from the fund before your mortgage(s) mature.

**Note:** Each mortgage fund might have a different set of rules about withdrawing from the fund so only parts of this benchmark might apply.



## **What's at stake for you?**

Even if a mortgage fund lets you take your money out at short notice, you might have to wait a while (often as long as 12 months) to get it back. If too many investors want to get their money out at the same time the fund may put a cap on the number of units you can cash out or freeze all withdrawals. Before you invest, make sure you can wait for the maximum withdrawal period to get your money back.

If a mortgage fund's policy is to re-invest your money and you don't withdraw it before it's rolled over, your money might be tied up for longer than you planned.

A 'fixed unit price' might not remain fixed under certain circumstances. This could mean you won't get back the money you expect when you withdraw from a mortgage fund if the value of the fund's assets falls.

If withdrawals from your mortgage funds are frozen, you may be able to access your funds, up to a cap, if you are in hardship (assuming the fund has enough cash to pay such requests). This would generally only be in one of the following situations:

- If you are unable to meet reasonable and immediate family living expenses;
- On compassionate grounds (for example, medical costs for serious illness, funeral expenses, to prevent foreclosure); or
- If you suffer permanent incapacity.

## Think about your own situation and needs

### Does the investment meet your goals?

Whenever you invest your money, it's important to have a financial goal in mind, and a strategy for meeting that goal. For example, your goal might be to have a secure income for your retirement.

Think about getting professional advice from a licensed financial adviser to help you develop a suitable investment strategy based on the level of risk you're comfortable with. Then measure all investments against that strategy.



### Is it important to you to protect your capital?

Be careful about words like 'safe' and 'guaranteed' in advertisements. They might imply that an investment is secure, when in reality it is not.

Certain financial institutions like banks, building societies or credit unions are specially regulated by the Australian Prudential Regulation Authority (APRA) to make sure that, under all reasonable circumstances, they can meet their financial promises to you.



This type of regulation, called 'prudential regulation', protects you, for example, if you put your money in a term deposit with one of these institutions.

In October 2008, the Commonwealth government announced a three year guarantee of deposits in Australian owned banks, locally incorporated subsidiaries of foreign banks, credit unions and building societies (institutions known as 'ADIs'). The government guarantee is automatic and free for deposits up to \$1 million. Deposits of more than \$1 million can be guaranteed if your ADI applies for and pays a fee to the government in relation to the guarantee. Most issuers of mortgage funds are not subject to prudential regulation and do not have a government guarantee.

### Have you spread your investments to manage risk?

Most people have heard the saying, 'Don't put all your eggs in one basket'. When it comes to investing your money, a good



way of managing risk is to spread your money between different investment types, such as cash, fixed interest, property and shares. These different investment types are known as 'asset classes'.

By spreading your money both across different asset classes and between different investments within the same asset class, you reduce the risk of losing everything if one of your investments produces poor results or fails completely.

Spreading your investments to manage risk is called 'diversification'. The spread will depend on your financial goals and how much risk you're comfortable with. Just investing in unlisted mortgage funds is not diversification.

### What returns are you being offered?

'High return means high risk' is a familiar rule of thumb. However, as with all rules, there are exceptions to look out for. Some investments that appear to offer relatively modest returns can be extremely risky.

That's why it's important to think about more than just the return when deciding whether to invest in something. When comparing rates of return, make sure you compare 'apples' with 'apples' (that is, similar investments).

### Can you get your money back early?

What happens if you need to get your money out quickly? Are there penalties and/or restrictions? How long might you have to wait?

If you need flexibility, think about investing in other financial products that allow you to withdraw your money without heavy fees or penalties.

### Do you know how risky the investment is?

Unlisted mortgage funds are generally a riskier type of investment than term deposits issued by banks, building societies and credit unions that are prudentially regulated in Australia (see page 6 to compare these investments).



Ask yourself, is the return you are being offered high enough to compensate you for the risk you are taking by putting your money in this investment?

### Can you accept the risks?

The main risk with an unlisted mortgage fund is that the fund might not be able to pay you distributions when they are due, or pay back your money when you ask for it or at the end of the initial period (if applicable).

If you don't understand the risks of this investment or you're not comfortable taking any risks with your money, look at other financial products instead. Get professional financial advice if you're not sure about an investment decision.

### Do you know what you're investing in?

Check what the mortgage fund plans to do with your money. This information should be clearly set out in the PDS, but keep asking questions until you really understand.

Knowing what your money will be used for can help you assess the risks and decide whether you are comfortable with this investment.

### Is the investment related to property development?

If your money will be used for property development (rather than established properties), think about these extra risks:

- Will the property development be completed on time and on budget?
- How is the property development valued?
- How will the mortgage fund meet its cash flow needs before the property development is completed and sold (or rented out)?

The PDS should help you to answer these questions.

People like to think that investing in property is 'safe as houses'. In reality, it involves the same risk as any other investment—the risk of losing as well as gaining money.



## Misleading advertising? Hard sell?

Have you come across an advertisement for a financial product that you think is misleading?

Or have you been pressured by a sales person to make a decision when you didn't have enough information, or weren't sure that the product was right for you?

📞 Phone ASIC on **1300 300 630** to tell us about it. You can lodge a formal complaint at **[www.moneysmart.gov.au](http://www.moneysmart.gov.au)**.

📞 See **[www.moneysmart.gov.au](http://www.moneysmart.gov.au)** for some strategies to help you resist pressure selling, so you don't end up investing in a financial product that doesn't suit your needs.

📞 For more information on what to look out for in general investing, go to **[www.moneysmart.gov.au](http://www.moneysmart.gov.au)**.

# ASIC's benchmarks

The following benchmarks can help you:

- understand the risks, and
- decide whether to invest your money.

1	Liquidity*	Page 12
2	Fund borrowing	Page 13
3	Portfolio diversification*	Page 16
4	Related party transactions	Page 17
5	Valuation policy	Page 18
6	Loan-to-valuation ratio	Page 20
7	Distributions	Page 21
8	Withdrawing from the fund	Page 22

\* These benchmarks apply only to pooled mortgage funds.

## Remember:

- The benchmarks are not a guarantee that an unlisted mortgage fund will perform well.
- Even if an unlisted mortgage fund meets all the benchmarks, you could still lose some or all of your money if things go wrong.
- Any investment should meet your goals and suit you.
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