

Australian Bond Exchange

Credit Analysis

of

Pallas FM Trust



Dear Investor,

The Australian Bond Exchange has been engaged by Pallas Capital regarding the Australian Bond Exchange (“ABE”) leading a Senior Secured Note offering for Pallas FM Trust (“Pallas”) and the potential interest from one or more of your clients to initially subscribe for up to AUD \$30 million of such a transaction (“the Secured Notes”).

For the benefit of financial advisers and their clients, ABE has undertaken an analysis of the following items in relation to the potential Secured Notes transaction:

- Transaction Overview
- Relative Value Analysis
- Refinancing Options

The analysis we have provided is confidential and for discussion purposes only and should not be construed in any way as an offer or recommendation to buy or deal in any future Secured Notes issue by Pallas or any other financial instrument.

The risks associated with Pallas’s ability to fulfil its obligations under the terms of any Secured Notes issue are borne solely by Pallas. ABE has undertaken its own due diligence on Pallas and you and your client should take appropriate steps to make an assessment on Pallas’s ability to meet its ongoing obligations before considering any transaction. ABE would be happy to facilitate any management meeting and site visits as part of this process.

In addition, any potential Secured Notes issue by Pallas will only be offered to qualified professional and sophisticated investors as defined in the Corporations Act 2001 (Cth) (“Corporations Act”) and without disclosure to investors under Part 6D.2 or Chapter 7 of the Corporations Act.

If the Secured Notes were to eventuate, ABE recommends that you and your client consider all of the disclosure documentation before making any decisions regarding such a transaction.

We look forward to discussing with you and your client in due course.

Kindest Regards,
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1 Transaction Overview

1.1 Situation Overview

Pallas FM Trust is a funding vehicle for Pallas Capital Pty Ltd, a property company based in Sydney Australia. Pallas was founded in 2016 by an experienced team to offer a range of quality risk adjusted Australian real estate asset backed investment and has been followed by ABE for some time.

Pallas Capital has built a strong track record and robust investment book since its inception. It has written over A\$415 million of total investments in 73 transactions (debt and equity) across a range of real estate sectors (land, retail, commercial, residential and industrial). It currently has over A\$250m of funds under management. Pallas Capital has a pristine record of capital preservation with over \$150 million of investments fully repaid with no impairments.

Due to its continued success Pallas is considering a bond offering to enable it to manage short term cash flow associated with new deal flow more efficiently. This is expected to enable Pallas to commit funding lines to preferred investments in a timelier fashion, resulting in Pallas securing deals based on response time compared to other lenders in the space.

1.2 Secured notes – Security and Ranking

The proposed Secured Notes will be fully secured by a first registered mortgage security over the assets supporting each loan issued by the trust. In addition to the underlying real estate assets covered by the registered first mortgage position, throughout the term the family trusts associated with the Directors of Pallas will ensure that the PFM Trust holds bank guarantees and/or cash equivalent to 5% of total funds under management (FUM) in the PFM Trust at all times during the Term. This requirement is the First Loss Capital Protection (FLCP) feature further supporting noteholders security.

The Security will be held by the Security Trustee and subject to the terms of the Security Trust Deed and the General Trust Deed. The Deeds contain:

- (a) provisions which set out the terms on which the Security Trustee holds the Security for the benefit of all of the Beneficiaries
- (b) voting provisions, including in relation to providing instructions to the Security Trustee to amend or waive a provision of the Security Trust Deed or the rights of Beneficiaries to instruct the Security Trustee to enforce the Security.

The notes benefit from a negative pledge whereby noteholders will remain senior secured security holders.

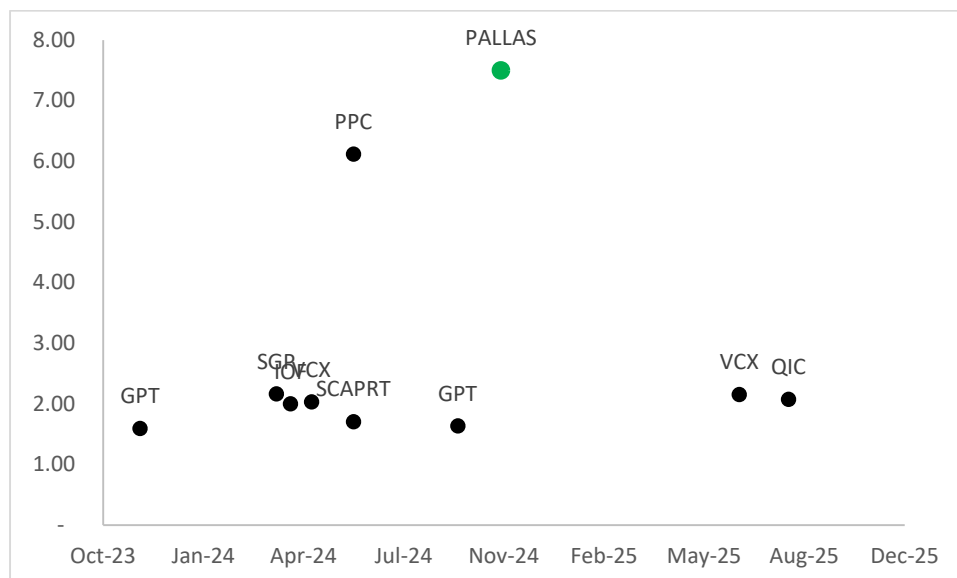
1.3 Indicative Terms and Conditions

A summary of the indicative terms and conditions for the proposed A\$30 million Secured notes are contained in Appendix 1.

2 Relative Value Analysis

2.1 Secondary Market Comparables

The graph below details the secondary performance of a range of Australian property bond issuers with maturities between 2024 and 2025.



While the comparable bonds are issued by significantly larger organisations, the underlying asset class, access to deal flow and business model is the same.

3 Refinancing Options

In terms of market access, Pallas will have a range of options available for where to source liquidity to refinance the Secured Notes. A summary of Pallas's refinancing options include:

- 1) Loan Markets;
- 2) Debt Capital Markets;
- 3) Government Support

We have provided a brief market update on these markets and Pallas’s ability to access them. However, we note that past performance is not a guide to future performance.

Finally, if none of these are open or available to refinance the Secured Notes, Noteholders will have the option to enforce the Security and instruct the Security Trustee to liquidate assets to repay the Secured Notes as the non-payment of principal is an Event of Default able to be exercised unilaterally by Noteholders.

3.1 Loan Markets

The Australian loan market for real estate finance is relatively deep and liquid. In the calendar year 2020, despite being in the depths of the coronavirus pandemic, loan commitments to business totalled \$51.5 billion (\$18.2 billion for construction, \$33.3 billion for purchase of property) showing that there is significant resilience for real estate finance in Australia.

Pallas has a history of being able to attract private funding from their significant investor client base with over \$450 million in direct investment since 2016 from an investor base of circa 450 high net worth individuals. The reinvestment rate of these investors is over 90% showing significant investor loyalty.

3.2 Debt Capital Markets

This transaction will be the first offering to the debt capital markets for Pallas and therefore there is no direct history to draw from in this market. However, there is a long history of property asset supported bond issuance in Australia. The table below shows the primary bond issuance during calendar year 2020.

Issuer	Pricing Date	Maturity	Coupon	Yield to Maturity	Amount Issued (\$m)
Rikshem	14/01/2020	23/01/2035	2.90	3.19	34
DEXUS	23/01/2020	3/02/2032	3.00	2.84	334
Square Mile Developments	9/02/2020	11/08/2021	7.50	11.35	3
General Property Trust	12/02/2020	20/02/2032	2.85	2.85	199
Hemso Fastighets	1/07/2020	10/07/2035	2.68	2.63	35
Vasakronan	18/08/2020	26/08/2030	2.08	2.12	58
GTA Finance Co	19/08/2020	26/08/2027	2.20	1.94	289
Shopping Centres Australasia	2/09/2020	16/09/2035	3.50	3.36	15
Shopping Centres Australasia	2/09/2020	16/09/2030	3.25	3.08	22
Charter Hall Exchange Finance	16/09/2020	25/09/2030	2.32	2.18	210
Total					1,199

3.3 Government Support of the Industry

The Australian federal government has signalled to the market that it is willing to support the financing of real estate loans. Most notably in evidence of this is the Australian Federal Government announcing the creating of the Structured Finance Support Fund (SFSF) administered by the Australian Office of Financial Management (AOFM). The AOFM has and will continue to make targeted investments in structured finance markets used by smaller lenders that provide consumer and business finance, investing in rated term securitisations and in rated and unrated securitisation warehouses. The Pallas structure would likely fall into the investment criteria should Pallas fall into difficulty should the COVID pandemic be prolonged. As of 30 September 2020, total funds invested or committed by the SFSF were \$3.6 billion.

With regards to the AOFM public securitisation support, market conditions improved during the quarter, reducing the need for SFSF support for primary and secondary markets. Market feedback received by the AOFM is that its preparedness to invest SFSF funds to fill gaps across investment grade tranches has reduced the execution risk for issuers of public securitisation transactions which provides investor support for the Pallas business model.

Cumulative public market investments made since the SFSF's inception stood at around \$1.36 billion as at 30 September, and around \$119 million was invested in the quarter, specifically in early July.

The following table summarises the twelve primary market transactions supported by the SFSF in the quarter, with a total volume of just under \$7.9 billion. This table excludes one eligible non-ADI sponsored RMBS transaction for which SFSF support was not sought. All but the first two transactions cleared without SFSF investment.

The circa \$1.4 billion invested since late March has thus supported 21 transactions totalling around \$13.9 billion.

Table 1: Analysis of primary market support

Date	Sponsor	Primary (\$)	Secondary (\$)	Total (\$)	Deal Volume (\$)	SFSF Share
2-Jul-20	Metro Finance	-	168,545,359	168,545,359	300,000,000	56.18%
9-Jul-20	FirstMac	-	3,700,000	3,700,000	1,300,000,000	0.28%
15-Jul-20	Columbus Capital	-	-	-	400,000,000	0.00%
22-Jul-20	AFG	-	-	-	700,000,000	0.00%
23-Jul-20	Resimac	-	-	-	1,000,000,000	0.00%
12-Aug-20	CNHI Capital	-	-	-	435,000,000	0.00%
12-Aug-20	Pepper	-	-	-	1,000,000,000	0.00%
3-Sep-20	Bluestone	-	-	-	350,000,000	0.00%
3-Sep-20	Liberty	-	-	-	600,000,000	0.00%
4-Sep-20	Red Zed	-	-	-	400,000,000	0.00%
17-Sep-20	Mortgage House	-	-	-	400,000,000	0.00%
24-Sep-20	Resimac	-	-	-	1,000,000,000	0.00%
		-	172,245,359	172,245,359	7,885,000,000	2.18%

In addition to the public market support identified above, the AOFM continued invest in private warehouse facilities throughout the quarter. As at 30 September 2020, SFSF commitments of circa \$2.1 billion have supported 39 individual warehouses sponsored by 29 eligible lenders (excluding

one proposal that was withdrawn by the proponent following approval). In the quarter ending 30 September, 15 individual warehouse investments, sponsored by 12 eligible lenders were approved. The total capacity of warehouses for which support has been committed since the SFSF's inception is circa \$17 billion.

Further, during the course of the September 2020 quarter, arrangements were finalised for the establishment of the Forbearance SPV (fSPV) and 63 trusts sponsored by five participating originators were approved for inclusion. The total approved limits for these participants is \$95.5 million. The first draw on the fSPV occurred in September.

3.4 Enforcement of Security

Non-payment of principal at maturity by Pallas is an Event of Default and secured creditors can exercise their rights to secure and sell assets for repayment. The assets in the Pallas trust generally meet the following criteria.

Each loan arranged by Pallas Capital is secured against one or more property assets with a recent valuation and further supported by:

- i. detailed due diligence in relation to the experience, financial position and reputation of the borrower and sponsor/guarantors;
- ii. a clear and achievable exit strategy, typically including at least two or three alternative exits;
- iii. experienced third-party legal firms to ensure each loan is correctly secured; and
- iv. active management of all loans by the Pallas Capital team throughout the term, including asset recovery if required.

Pallas Capital arranges loans secured against the following real property asset types:

- i. Eastern Seaboard cities, with a focus on metropolitan Sydney and Melbourne;
- ii. secured property values generally in the \$5 - \$20 million range, where buyer and refinance liquidity is relatively deep; and
- iii. non-specialised property assets including land with residential use, completed apartments, generic commercial property and construction loans.

As part of the credit assessment, Pallas Capital also considers other matters including:

- i. land acquisition value and terms relative to independent valuations;
- ii. conditions precedent and ongoing covenants and conditions subsequent;
- iii. the security structure; and
- iv. borrower income, other net assets and repayment history.

In the case of a loan secured by a development site, including a construction loan, Pallas Capital will also look at:

- i. the amount of equity invested to date and available from the sponsor, funding sources and expected terms and sponsor track record, professionalism and credit checks;
- ii. the projected development margin and contingency allowance;
- iii. presales debt cover and other factors mitigating risk;
- iv. planning controls, and the likelihood of achieving a positive planning outcome;
- v. attributes including any contamination or heritage issues;

- vi. design efficiency and attractiveness to purchasers/end users;
- vii. the product target market, expected pricing and absorption;
- viii. construction costs and support for cost estimates; and
- ix. the sales and marketing plan, program and expertise of sales agents.

Pallas Capital's credit analysis focusses on risk assessment, mitigation and management and it considers the competence, experience and reputation of the borrower and the underlying sponsor.

3.5 Summary

ABE has undertaken its own analysis and assessment of these markets and Pallas's ability to access the refinance risks associated with the bond issuance. You and your client should also make an assessment on Pallas's ability to meet its ongoing obligations before considering any transaction.

This document should be read in conjunction with the Key information Document (KID) and the Target Market Assessment document.