

PFT Feeder Fund -
Variable Rate Loan Notes

Research Review

9 September 2022

This Report is for Wholesale Investors Only

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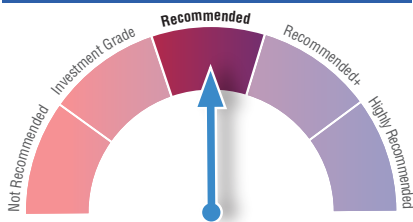
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Note: This report is based on information provided by the Manager as at June 2022 and the Information Memorandum dated April 2022. This report is for Wholesale Investors Only.

Rating



Key Investment Information

Name of Fund	PFT Feeder Fund - Variable Rate Loan Notes
Trustee	Pallas Funds Pty Limited
Investment Manager	Pallas Capital Pty Limited
Investment Structure	Unlisted Unit Trust
Eligible Investors	Wholesale
Notes on Offer	A Notes
Target Issue Size	\$150m
Note Price	\$1.00
Minimum Investment	\$100,000
Interest Rate	A Notes: 30-day BBSW + 6.50%p.a.*
Interest Payment Frequency	Monthly**
Issue Term	Open-ended. Minimum issue term of 1 November 2023.#
Redemption	Monthly, subject to 12-months written notice, post minimum issue term.
Distribution Frequency	Monthly
Offer Document	Information Memorandum

*The Fund currently issues A Notes only. The Trustee may issue other tranches of Notes in future.

**Generally within 15 business days after month-end.

#Noteholders may request redemption prior to the minimum issue term, subject to 12-months written notice being received, however the Trustee is under no obligation to accept the request. The Fund would seek to grant the request provided there was sufficient liquidity for it to do so.

Fees Commentary

Fees are paid by the borrower, not by investors. Fees paid by borrowers range from 1.5%-2.0%, in line with industry rates.

The investment opinion in this report is current as at the date of publication. Investors and advisers should be aware that over time the circumstances of the issuer and/or product may change which may affect our investment opinion.

PRODUCT SUMMARY

The PFT Feeder Fund - Variable Rate Loan Notes (the "Fund" or the "Notes") is issued by Pallas Funds Pty Limited (the "Trustee") and provides investors the opportunity to invest through the Fund in the Pallas Funding Trust No. 1 (PFT), a warehouse loan facility funded to date by an institutional funding partner, Pallas Group and other parties. PFT makes commercial real estate (CRE) loans to Australian SMEs secured by a registered first mortgage against Australian property. Loans are expected to generally be \$2m-\$10m in size. The Trustee has appointed Pallas Capital Pty Limited as the Manager of the Fund. Both the Trustee and the Manager form part of the Pallas Group. The Pallas Group was established in 2016 and comprises Fortis, a property development business, and Pallas Capital, a specialist commercial real estate (CRE) financier and investment manager. PFT issues four tranches of Notes - PFT A, B, C and S Notes. PFT S Notes are solely held by a company that is controlled and managed by Pallas Group, providing a first loss mechanism for Noteholders. Investors through the Fund will be issued with A Notes, which invest in PFT B2 and PFT C Notes at a 3:2 ratio, and pay an interest rate of 30-day BBSW + 6.5%p.a. The Fund may issue other tranches of Notes in future. The Fund is open-ended with no fixed end-date. Notes will be redeemable on the last business day of each month provided the Noteholder has given the Trustee at least 12-months written notice. Notes have a minimum issue term of 1 November 2023. There are no fees paid directly by investors with the Manager receiving fees from the borrowers.

PFT has strict eligibility criteria for loans and portfolio parameters that must be adhered to. These criteria and parameters have been agreed upon with the institutional funding partner. PFT cannot invest in construction loans or related party loans and has maximum LVR limitations for eligible loans ranging from 50% to 70% depending on the loan type. Loans will be short-to-medium term in nature with the maximum loan term ranging from 18 to 36 months, depending on the loan type. In addition to this there are a range of exposure limitations to ensure there is sufficient diversification in portfolio and reduce the concentration risk to any single borrower.

INVESTOR SUITABILITY

The Fund provides wholesale investors access to the CRE debt market which can provide diversification to an investors broader portfolio. The A Notes (which the Fund will issue initially) provides an attractive regular monthly income. With regards to the asset class, we view the risk associated with the Fund to be at the lower-end of the risk spectrum, given the conservative LVR limitations and the stringent eligibility criteria and portfolio parameters of loans eligible for investment. Further to this the Fund cannot invest in construction loans which are at higher-end of the risk scale in the CRE debt market. Investors are exposed to default risk. In the event the borrower is unable to repay the loan this may result in a capital loss to investors. Portfolio diversification, the disciplined loan assessment and loan management process, the first mortgage security, the short-to-medium term duration of the loans, personal guarantees and conservative LVR limitations minimises the inherent risk associated with the Notes, however it does not eradicate it. We note investors will only experience a capital loss in the event the loan amount cannot be recouped in full and the default amount is greater than the value of the PFT S Notes which are held by the Pallas Group. Given the illiquid nature of the underlying loans, there is limited liquidity offered by the Notes. The Notes have a minimum issue term of 1 November 2023 and Noteholders are required to provide 12-months written notice to request redemption. As such, investors should be in a position to not require the capital invested for at least a 12-month period.

RECOMMENDATION

IIR has assigned the PFT Feeder Fund - Variable Rate Loan Notes a **Recommended** rating. The Notes provide an attractive variable interest rate return from a portfolio of CRE loans that have the security of a registered first mortgage over the property. The Manager of PFT has a diligent loan assessment and loan management process and while the Manager has a limited history, the team are highly experienced in the Australian property market. PFT has strict eligibility criteria and portfolio parameters that have been agreed upon with the institutional funding partner with the funding partner providing an additional layer of oversight and compliance regarding the investments of PFT and the portfolio construction.

SWOT ANALYSIS

Strengths

- ◆ The A Notes provide investors an attractive monthly interest payment of 30-day BBSW +6.50%p.a.
- ◆ The Notes pay a floating interest rate thereby reducing interest rate risk for Noteholders.
- ◆ Loans will have a conservative LVR with a maximum LVR of between 50%-70% depending on the loan type. This provides for a substantial decline in valuations before the Fund will realise a capital impairment on loans.
- ◆ In addition to the loans being secured by a first mortgage over the property, the Manager typically takes a personal guarantee from the directors or other sponsors of the borrower, which further insulates the loan from impairments.
- ◆ The PFT S Notes provide first loss protection against loan impairments with the PFT S Notes representing 5% of the Issue Size when the Target Issue Size is reached. At 31 May 2022, the PFT S Notes represented 18.8% of the Notes issued.
- ◆ The Manager has a disciplined loan assessment and loan management process which has resulted in the Pallas Group experiencing very low default rates to date and all default events having a positive outcome. We do note that Pallas Capital has a limited track record, commencing operations in 2016 and past performance is not an indicator of future performance.
- ◆ The Pallas Group is well resourced with 100+ staff employed across the two operating businesses of the Group.
- ◆ The team is highly experienced in Australian and global financial markets and CRE debt and equity.
- ◆ The Manager is highly selective when making loans as is highlighted by the low loan conversion rate of 8%-10% of loans reviewed.

Weaknesses

- ◆ Liquidity is limited with the Notes redeemable on the last business day of each month provided the Noteholder has given the Trustee at least 12-months written notice. Notes have a minimum issue term of 1 November 2023.
- ◆ While the team is highly experienced, the Pallas Group is relatively new with operations commencing in 2016 and PFT having a track record of less than 12-months.

Opportunities

- ◆ An investment in the Fund provides investors the opportunity to diversify the income portion of their investment portfolio. Direct loans provide for low levels of capital volatility, assuming no capital impairments, with CRE debt returns historically having a low correlation with other major asset classes.
- ◆ The market share of non-bank lenders in the CRE debt market is expected to continue to increase as the banks share of the market continues to decline. This is expected to result in a strong pipeline of investment opportunities.

Threats

- ◆ The key risk associated with an investment in the Notes is the risk of default by a borrower and the Manager not able to recover the loan amount potentially resulting in investors experiencing a capital impairment. There are a number of risk mitigation strategies implemented to reduce this risk such as conservative LVRs, diligent loan assessment and approval process, loan monitoring and management of loans off the books if the risk materially changes. The Pallas Group is yet to experience an impairment with regards to its loans.
- ◆ The Trustee and the Manager are related parties which provides for conflicts of interest. We note that the related party risk for the PFT Feeder Fund is reduced given the Fund is unable to invest in related party loans. Further to this, the Pallas Group is providing a first loss mechanism through the PFT S Notes aligning the interests of the Trustee and Manager with investors. While there are related party risks for the Fund, PFT has a third party trustee, which provides an external level of oversight for the portfolio.
- ◆ The Pallas Capital business has grown rapidly in recent years, which can put undue pressure on a business. We note that the business has invested in people, systems and processes to support the growth and is expected to continue to do so to support future growth. However, in the event the business cannot secure the resources needed this may hamper the growth aspirations of the business and opportunities for investors.
- ◆ The macroeconomic outlook potentially provides for some challenges in the property market. In its Statement of Monetary Policy released in May 2022, the RBA is forecasting GDP growth of 4.2% for 2022 with GDP growth forecast to slow in 2023, however, the RBA also expects

inflation outcomes and continuing implications with COVID-19 provide significant uncertainty. A deterioration in the economic conditions could result in increased borrower stress and the potential for defaults in the portfolio.

- ◆ There is increasing competition in the CRE debt market. This may put pressure on the ability of the Manager to achieve the objectives of the Fund.

PRODUCT OVERVIEW

The PFT Feeder Fund - Variable Rate Loan Notes (the "Fund" or the "Notes") provides investors the opportunity to invest through the Fund in the Pallas Funding Trust No. 1 (PFT), a warehouse loan facility funded to date by an institutional funding partner, Pallas Group and other parties. The Notes are issued by Pallas Funds Pty Limited (the "Trustee"). The Trustee has appointed Pallas Capital Pty Limited as the Manager of the Fund. Both the Trustee and the Manager form part of the Pallas Group. The Pallas Group was established in 2016 and comprises Fortis, a property development business, and Pallas Capital, a specialist commercial real estate (CRE) financier and investment manager.

PFT issues four tranches of Notes - PFT A, B, C and S Notes. PFT S Notes are solely held by a company controlled and managed by Pallas Group, providing a first loss mechanism for Noteholders. PFT S Notes will represent 5% of the Notes issued when the target issue size is reached. At 31 May 2022, the PFT S Notes represented 18.8% of Notes on issue. PFT A Notes are currently issued to the institutional funding partner. Investors through the Fund will be issued with A Notes, which comprise PFT B2 and PFT C Notes at a ratio of 3:2 and offer an interest rate of 30-day BBSW + 6.5%p.a. The Fund may offer other tranches of Notes in future, providing investors more choice with regards to the risk/return profile of their investment. PFT B and PFT C Notes will rank behind PFT A Notes and above PFT S Notes.

PFT Notes on Offer				
Tranche	A Notes	B Notes	C Notes	S Notes
Ranking	Ahead of all other PFT Notes	Behind A Notes but ahead of all other PFT Notes.	Behind A and B Notes but ahead of S Notes.	Behind all other Notes.
Subscriber	Institutional funding partner/ Other	Institutional funding partner/the Fund/Other	The Fund/Other	Pallas Group
Pool Slice	0%-70%	70%-85%	85%-95%	95%-100%

PFT has issued a total of \$152.1m in Notes across the four tranches as at 11 May 2022 as shown in the below table. Notes issued through the PFT Feeder Fund as at 11 May 2022 totalled \$32.7m. The Fund has a target issue size of \$150m.

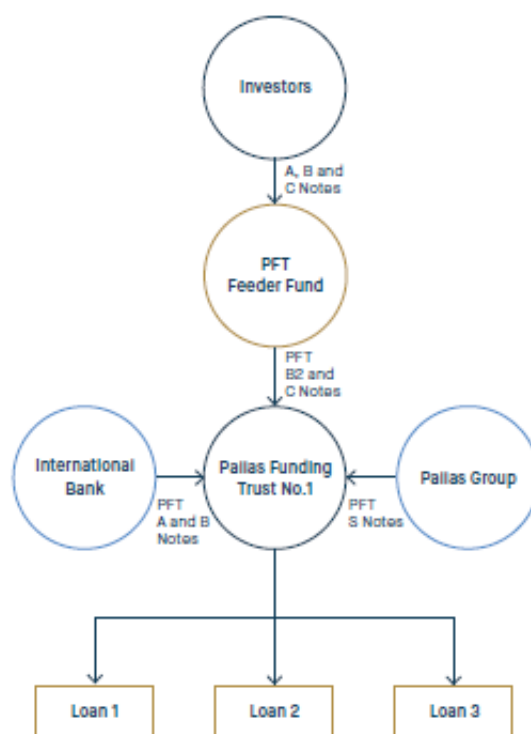
PFT Notes on Issue as at 11 May 2022		
Tranche	Amount on Issue (\$m)	% of Notes on Issue
A Notes	\$107.7	70.8%
B2 Notes	\$9.5	6.2%
C Notes	\$6.3	4.2%
S Notes	\$28.6	18.8%
Total	\$152.1	100%

The Fund is open-ended with no fixed end-date. Notes will be redeemable on the last business day of each month provided the Noteholder has given the Trustee at least 12-months written notice. Notes have a minimum issue term of 1 November 2023. While Noteholders can request redemption prior to the minimum issue term, the Trustee is not obligated to accept the request. The Trustee may suspend redemptions in the event the Fund does not have sufficient cash available to fund the redemptions or it would be in the best interest of Noteholders to suspend redemptions. The Trustee may redeem the Notes at any time upon providing 90 days' notice (or such lesser period as may be agreed between the Trustee and Noteholders).

Neither the Trustee nor the Manager will charge fees to any Noteholder or to the Fund itself. The Manager is also the Manager, Servicer and Originator of PFT. The Manager (and related parties) will receive certain fees and other income from PFT, including establishment and administration fees.

In the event of Default (unless waived) monies owed under the various Notes may become immediately due and payable. A Maturity Event of Default occurs if the Fund fails to redeem Notes within the scheduled time frame. In this case PFT provides for an additional grace period. Thereafter, the senior PFT Noteholders (A Noteholders) may require that the PFT loan book is sold to recover monies owned.

PFT Funding Structure



Pallas Funding Trust No. 1 (PFT)

PFT makes commercial real estate (CRE) loans to Australian SMEs secured by a registered first mortgage against Australian property. Loans are expected to generally be \$2m-\$10m in size. PFT was launched in November 2021 and has a maximum issue size of \$588.3m. At the current growth rates the Fund is expected to reach capacity in the 1H'CY2023. Once PFT has fully deployed its initial funding, the institutional funding partner and the Trustee will consider expanding the funding.

The Trustee and Custodian of PFT is AMAL Trustees Pty Ltd. The Trustee has appointed Pallas Capital Pty Limited as the Manager of the Trust.

PFT provides five types of CRE loans:

- ◆ Residual Stock - unsold residential units, commercial units (retail, office or industrial) or land from a recently completed development;
- ◆ Pre-development - loans secured by property with existing improvements which are expected to be demolished or refurbished upon commencement of construction funding;
- ◆ Investment - income or potential income producing commercial offices, retail or industrial properties and acceptable specialised assets, whether tenanted or owner occupied;
- ◆ Specialised Investment - income or potential income producing properties; and
- ◆ Vacant Land - land bank to be developed, with or without planning permit/s. Land must be capable of and intended to be developed within two years.

PFT is not permitted to make construction loans or related party loans.

PFT lends to company or trust borrowers only for business purposes. PFT does not provide loans to retail borrowers. Company/trust borrowers are not covered by the National Consumer Credit Protection act which, under the hardship regulations, allows borrowers up to six months in which to sell a property to repay a loan. In contrast, lending to a company borrower, the Manager can instruct a property to be sold as soon as a default notice has been served.

Eligibility Criteria

PFT may only include loans that meet the Eligibility Criteria established by the PFT Documentation. The assessment of each loan is carried out by the Investment Manager in accordance with the below Eligibility Criteria and in accordance with a detailed set of criteria and a methodology agreed with the institutional funding partner. Loans must meet stringent criteria, including:

- ◆ Maximum loan term:
 - 18 months for residual stock, vacant land and development loans.
 - 36 months for investment loans and specialised investment loans.
- ◆ Maximum LVR:
 - 65% for residual stock receivable.
 - 65% investment (development potential) receivable.
 - 70% investment receivable.
 - 60% specialised investment receivable.
 - 50% vacant land receivable.

Portfolio Parameters

PFT must ensure that the loan portfolio complies with detailed portfolio parameters. We have provided an overview below:

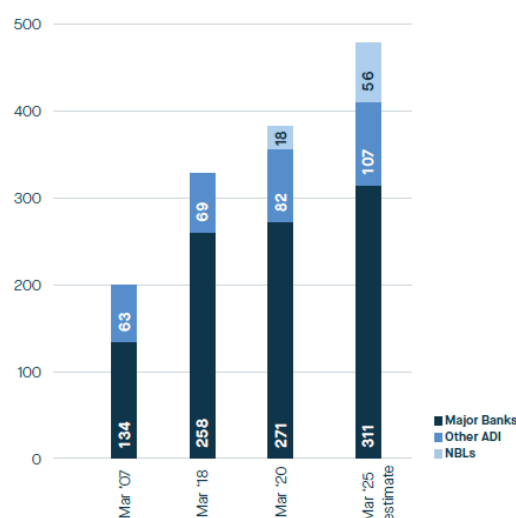
- ◆ Loans secured against residential property must represent at least 25% of the portfolio;
- ◆ Maximum and minimum limits on the proportion of various loan types (by value) within the portfolio; and
- ◆ Parameters relating to the location of various security properties supporting loans in the portfolio, the balance sheet strength of sponsors and other factors.

COMMERCIAL REAL ESTATE (CRE) DEBT MARKET

The CRE debt market is serviced by the major banks, other authorised deposit taking institutions (ADIs) and non-bank lenders (NBLs). The major banks service the majority of the market, however the major banks have tightened the lending requirements to the CRE market which is resulting in growth in the NBLs market share.

As at 31 March 2020, APRA reported CRE loans of \$371b. Of this approximately 5% of loans were provided by NBLs. APRA projects that the CRE loan market will grow to ~\$474b by March 2025 and NBLs are projected to increase the market share from 5% to 12%. The forecast suggest the CRE debt market is expected to grow at ~5%p.a., with NBLs growing at ~25%p.a. Growth in the market share of NBLs provides an opportunity for investors to participate in this market.

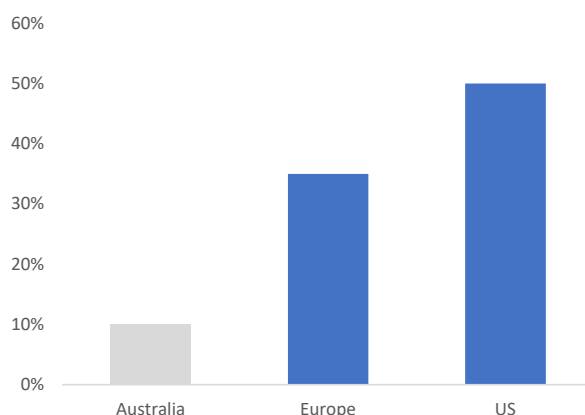
Australian CRE Debt Market



Source: Pallas Capital Business Overview.

Even with the strong projected growth, the NBL share of the Australia CRE debt market is significantly below that of international markets with NBLs representing approximately 35% of CRE debt in Europe and 50% in the USA, according to Pallas Capital. Over time, market participants are expecting the Australian CRE debt market to follow the experience of international markets with regards to the acceptance of NBLs.

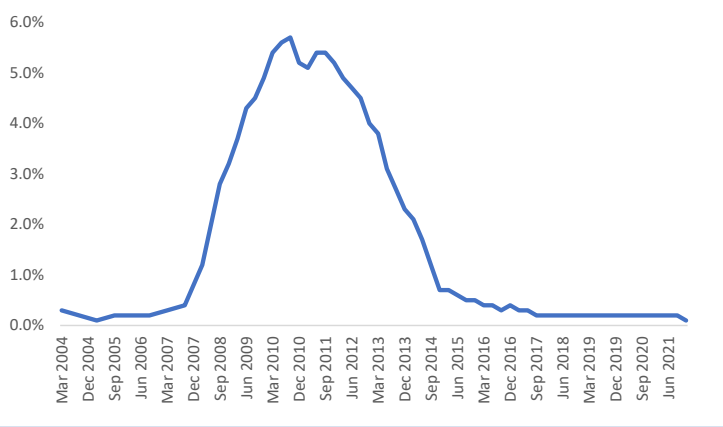
Global NBL CRE Debt Market Share



Source: Pallas Capital.

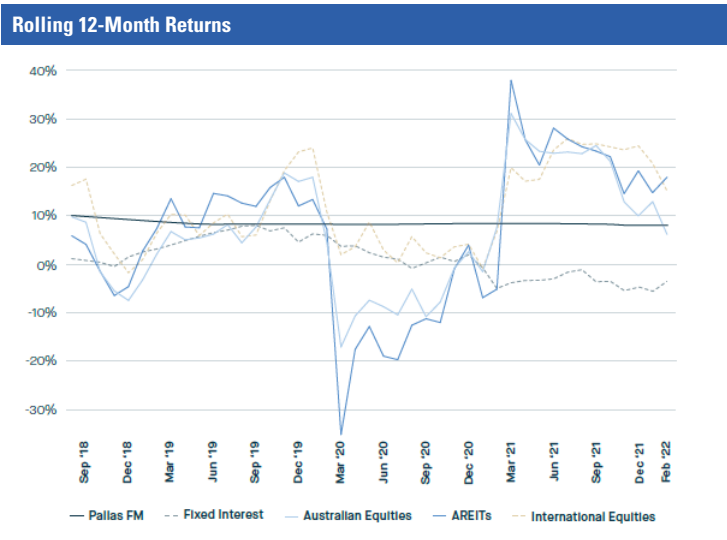
Impairments in commercial real estate loans by ADIs has historically been low. The below chart shows the percentage of impaired commercial real estate loans by ADIs from March 2004 to 31 December 2021. Impairments hit a peak of 5.7% in September 2010 with impairments accelerating post the GFC in 2008. Impairments have subsequently declined to less than 1% with an impairment rate of 0.1% at 31 December 2021. As highlighted by the below chart, Impairments tend to cluster around periods of prolonged economic weakness.

ADI Commercial Real Estate Loan Impairments (March 2004 to 31 December 2021)



Source: APRA

CRE debt has the potential to diversify an investors broader portfolio with the asset class offering a different risk/return profile to other major asset classes. The Pallas Group has provided the below chart which shows the returns of its first mortgage loan book compared to other major asset classes. The asset class offers low capital volatility with capital volatility only occurring in the event of capital impairment from a default event. While the CRE debt asset class has offered low returns volatility compared to other major asset classes, we note that this is accompanied by low levels of liquidity.



Source: Pallas Capital Business Overview.

TRUSTEE & INVESTMENT MANAGER

The Trustee of the Fund is Pallas Funds Pty Limited. The Trustee has appointed Pallas Capital Pty Limited as the Manager of the Fund. Both the Trustee and the Manager form part of the Pallas Group.

The Pallas Group is 100% owned by the family trusts associated with the five senior executives of the Group being Dan Gallen, Patrick Keenan, Charles Mellick, Mark Spring and Craig Bannister.

The Pallas Group has two primary operating businesses: (1) Fortis - a property development business; and (2) Pallas Capital - a specialist commercial real estate (CRE) financier and investment manager.

1) Fortis

Fortis was established in 2015, and is a developer focused on boutique residential and commercial projects in the affluent, inner-metro suburbs of Melbourne and Sydney. Fortis currently has 30 development projects underway representing a total project end value in excess of A\$3.5b.

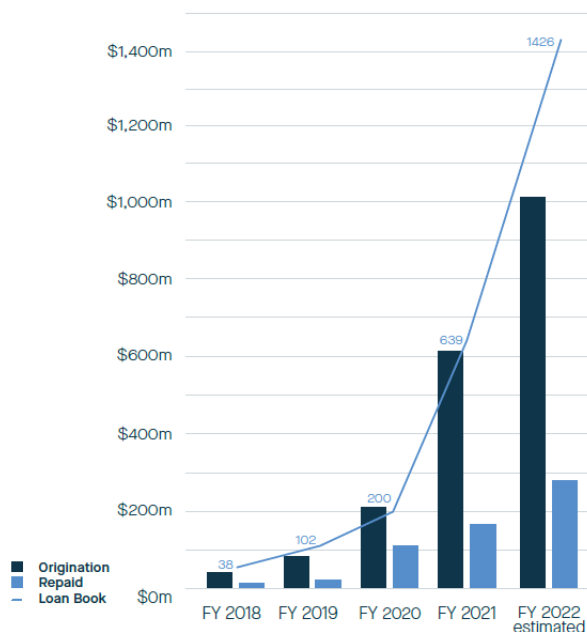
2) Pallas Capital

Pallas Capital is a wholesale debt and equity fund manager, specialising in commercial real estate (CRE). The business was established in 2016 in direct response to the structural dislocation within the Australian credit landscape and in particular the growing lack of credit in Australia's mid-range CRE market.

As at 31 May 2022, Pallas Capital has written A\$2.1b of total investments (debt and equity) across 291 transactions, supported by properties covering a wide range of real estate sectors (land, retail, commercial, residential and industrial). Of those transactions, 125 have been completed and \$749 million repaid with no loss of capital.

The loan book has grown rapidly for the business since being established in 2016, as highlighted by the below chart. The business is forecasting a loan book in excess of \$1.4b as at 30 June 2022. Of the \$1b in FUM, \$323m is under discretionary management through the five discretionary pooled funds currently on issue. Growth is attributed to the investment in people, systems and processes over the last 24 months which has driven FUM growth and the loan pipeline with the business having a pipeline valued at more than \$900m. The business is expecting that the investment pipeline and FUM will continue to grow over the coming years given the recent additions and with the recruitment of further industry leading executives and new mandates being explored along with investment into the ongoing refinement of the business' risk management framework and operational systems and processes.

Pallas Capital Loan Book



Transactions to 31 March 2022

Loan Type	Loan Limit (\$M)	Number of Loans	Average Loan Size (\$m)	% of Total Loans
Construction	\$813.8	61	\$13.3	46.7%
Pre-Development*	\$698.3	136	\$5.1	40.1%
Residual Stock	\$175.2	26	\$6.7	10.1%
Investment	\$55.3	18	\$3.1	3.1%
Total	\$1,743	241	-	100%

*Includes Fortis Equity & Preferred Equity transactions.

Relationship Between Fortis & Pallas Capital

Pallas Capital has provided a reliable source of funding to Fortis to enable it to acquire and develop more sites. In return, Fortis has provided Pallas Capital with the CRE loans needed to generate an income stream for its investors and grow its lending business. Fortis has developed strong and deep relationships with other developers, builders, lenders, architects, planners, estate agents and valuers. These relationships generate a significant flow of loan opportunities for Pallas Capital.

As both businesses have grown, they have become less reliant upon each other. Fortis loans now make up approximately one third of Pallas Capital's loan book. Fortis now borrows from lenders other than Pallas Capital including other non-bank lenders and the big four banks.

Potential conflicts arising from the interaction between Pallas Capital and Fortis are managed by the implementation of compliance and governance safeguards set out in the company's Conflict of Interest Policy. In particular, Pallas Capital assesses all loan applications from Fortis on an arms length basis, as if the loan application were submitted by an unrelated third party borrower. The members of the Investment Committee that are also owners or directors of Fortis development projects recuse themselves from all consideration of Fortis loan applications, and an independent member with significant real estate lending experience steps in for these decisions.

It is important to note that PFT cannot invest in construction or related party loans and therefore will have no exposure to Fortis projects.

Investment team

The business has grown to have 100+ staff with staff located across Melbourne, Sydney and Brisbane. This is an increase from 48 as at 30 June 2021. Growth in the team has included a number of senior hires which has been a key driver of growth.

The expansion of the team and in particular the senior hires has reduced key man risk associated with the directors of the Pallas Group. Further to this, the Manager ensures that no one individual exclusively possesses critical information (including IP) that could compromise the business' ability to continue to operate at the standards it requires if that individual were to leave.

The Group has appointed an Investment Committee (IC) which plays a central part in the lending process. The IC is comprised of six senior team members with one independent member, who provides independent representation for assessing loans to Fortis. For related party loans (loans to Fortis), the members of the IC that are also shareholders of the Pallas Group recuse themselves from the assessment and consideration of transactions. Under the current lending policy, investment decisions of >\$5m must be approved by the IC by way of unanimous decision of those that are in attendance (minimum of three IC members required for an investment decision).

Pallas Capital has also appointed a Compliance & Risk Committee (CRC) which sits on a quarterly basis. The key responsibility of the CRC is to monitor the funds with a specific focus on ensuring the funds are operating within the relevant laws, trust deeds, constitutions and contractual obligations regarding the business conducted by Pallas Capital. We note there is only one independent representative on the CRC.

Pallas Group Board of Directors				
Name	Role	Independent	Years at Firm	Years in Industry
Patrick Keenan	Executive Chairman	N	6	31
Dan Gallen	Chief Investment Officer	N	6	21
Charles Mellick	Executive Director	N	6	31
Mark Spring	Executive Director	N	6	7
Average			6	22.5

Investment Committee				
Name	Role	Independent	Years at Firm	Years in Industry
Patrick Keenan	Executive Chairman	N	6	31
Dan Gallen	Chief Investment Officer	N	6	21
Charles Mellick	Executive Director	N	6	31
Ben Keenan	General Counsel	N	0.5	19
Alexis Holloway	Head of Credit	N	1	14
Anonymous	Independent (Fortis Loans)	Y	1.5	20

Compliance & Risk Committee				
Name	Role	Independent	Years at Firm	Years in Industry
Jarrod Brooks	General Counsel	N	2	21
Ben Keenan	General Counsel	N	0.5	19
David McGilvray	Group Manager - Operations	N	2	6
Steve Lawrence	Executive Director - Lending	N	2	24
Alexis Holloway	Head of Credit	N	1	14
Craig Bannister	Executive Director - Distribution	N	6	7
Mabel Zhou	Group Manager - Finance	N	5	5
Sharman Grant	Compliance Officer	Y	1	21
Sharon Woodley	Group Manager - HR	N	0.5	20

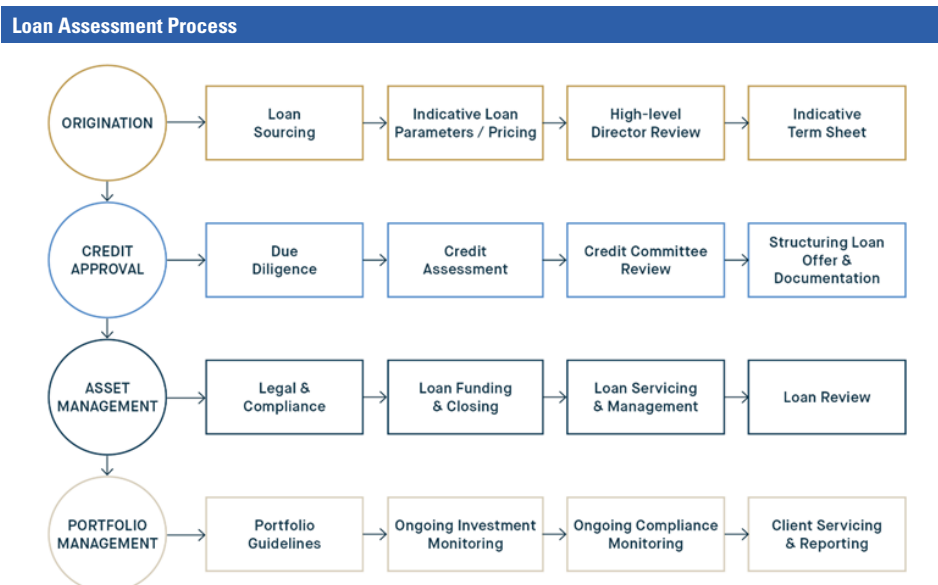
The investment team comprises 20 team members, tabled below. The team has an average of 10.8 years industry experience as at 23 May 2022. The team is led by the Chief Investment Officer, Dan Gallen, who has 21 years experience in the industry and is a Director of the Pallas Group.

Investment Team				
Name	Role	Location	Years at Firm	Years in Industry
Dan Gallen	Chief Investment Officer	Sydney	6	21
Steve Lawrence	Executive Director - Lending	Melbourne	2	24
Mark Hood	Director - Lending	Melbourne	0.5	20
Denis Dundovic	Associate Director - Lending	Sydney	0.5	17
Alexis Holloway	Head of Credit	Melbourne	1	14
Les Buxton	Credit Manager	Sydney	1	8
Peter Blanc	Senior Credit Manager	Brisbane	0.1	16
Gary Iam	Senior Associate - Credit Services	Melbourne	2	9
Lovey Verma	Credit Analyst	Sydney	0.5	4
Madeline Brooks	Associate - Credit Services	Sydney	0.5	5
Jacky Kwok	Credit Analyst	Melbourne	0.5	1
Cameron Dunn	Manager - Loan Management & Const.	Melbourne	3	21
Lisa Chai	Senior Associate - Loan Mgt and Const.	Melbourne	0.5	12
Matthew Staffenoni	Associate - Loan Mgt and Const.	Melbourne	1.0	5.5
Joyce Fei	Associate - Loan Mgt and Const.	Melbourne	0.5	3.5
Liam Higgins	Associate - Loan Mgt and Const.	Melbourne	0.1	5
David McGilvray	Group Manager - Operations	Sydney	2	6
Anne-Louise Wills	Product Development & Strategy	Melbourne	3	12
Sabab Khan	Portfolio Analyst - Operations	Sydney	0.5	8
Matt Taylor	Technical Business Analyst - Operations	Melbourne	1.5	4

PFT LOAN ASSESSMENT & MANAGEMENT PROCESS

The Manager has a disciplined loan assessment and loan management process that is documented in its Lending Manual and associated documentation.

The loan assessment and management process is depicted in the below chart. The process can be broken down into four key stages: (1) Origination; (2) Credit Approval; (3) Asset Management; and (4) Portfolio Management.



Origination

The origination team comprises seven team members with two senior team members who report to the Executive Director of Lending, Steve Lawrence. Loans are sourced via direct and indirect channels. The addition of the indirect channel has been a key contributor to the recent growth in the business.

Pallas Capital originates the majority of its loans through the indirect channel, whereby loans are sourced through brokers. This channel provides access to a much wider network of borrowers at a variable business cost and there is the added benefit of loans typically already having the initial due diligence completed by the broker resulting in a quicker turnaround time than loans that sourced through the direct channel.

For the indirect channel the Group has implemented an Introducer Accreditation program, with all brokers required to meet the requirements of the program and all brokers are required to execute an Introducer Agreement to be able to become a member of the network. The Group is currently onboarding select Aggregators that service CRE loans. Aggregators provide access to a wide range of brokers and will provide the Manager with expanded access to potential deals.

The initial source of loans was from direct channels. The direct channel currently accounts for a small percentage of loans however is expected to grow over time as larger loan are made, as brand recognition increases and a wider suite of products is issued. The direct channel offers the benefits of the Group retaining the full establishment fees and interest rate.

Credit Approval

A detailed due diligence is undertaken for all loan applications that make it through the Origination process. Loan applications are assessed in accordance with the Credit Policy and Credit Procedures and by reference to the Lending Matrix and the Funding Source from which the capital is being deployed. As discussed above there are specific loan eligibility and portfolio parameters that the loans must meet to be able to be included in the PFT portfolio. PFT cannot invest in construction loans or related party loans.

The Credit Team is responsible for the evaluation of each loan application and the preparation of the Credit Risk Assessment (CRA), which is distributed to the appropriate Delegated Lending Authority (DLA) for approval. There are CRA templates for each property type which the team are required to complete as part of the CRA process. Each CRA template provides a list of input fields and specific requirements to be addressed for each loan type to assist the Credit Team complete the CRA and make a recommendation. The CRA templates are not intended to be exhaustive. It is the responsibility of the Credit Team to address the specific risks and requirements of each individual loan within the CRA on a case-by-case basis.

The underwriting guidelines for the assessment of a loan application are documented within the CRA template for each Loan Type, and covers the following key areas:

- 1) Executive Summary;
- 2) Sponsors and Guarantors;
- 3) Security Property;
- 4) Planning;
- 5) Future Project Overview;
- 6) Valuation;
- 7) Transaction Structure;
- 8) Capacity and Serviceability;
- 9) Exit Strategies; and
- 10) Risk Analysis and Mitigants.

With respect to Valuations, all properties are required to have an independent valuation performed by a panel valuer. All valuations must be prepared and dated less than three months from the time of settlement. Valuations beyond the three month period will need to be accompanied with an updated report or letter extending the reliance of the valuation report prior to settlement.

In circumstances where a DLA or the IC assess there has been a material change that affects the value of the security property and there is no clear path to rectification, the Credit Team will instruct an updated valuation for the security property. Examples of changes may include adverse market conditions specific to the security property/sector, the income generated from the security property adversely changing with no path to rectification, or Pallas becoming aware of a breach of facility terms. Pallas shall reserve the right to revalue the security property at any time and at the borrower's cost within the relevant loan documentation for each transaction.

Prior to lodging of a CRA for approval with a DLA or IC, the Valuation Checklist must be completed by the Credit Team. In instances where the Credit Team or DLA does not agree with the findings of the valuation report or believes there has been a mistake in the valuation report, a DLA or Credit Team member will discuss the matter directly with the valuer to seek a satisfactory explanation and/or amendments to the valuation report. If the matter is not resolved it will be referred to IC for a decision on the acceptance of the valuation report and review of the valuer's panel status.

Delegated Lending Authority (DLA)

There are five team members of the Pallas Group that have been designated as a Delegated Lending Authority (DLA). There are delegated approval limits for loans of different sizes, tabled below. The larger the loan the greater the sign-off requirements. A DLA cannot be involved in the approval of a loan that they originated. Loans of more than \$5m are required to be approved by the Investment Committee.

Delegated Approval Limits	
Loan Size	Requirement
\$0 - \$3m	1 DLA
\$3m - \$5m	Head of Credit or the CIO
>\$5m	Investment Committee

Once loans have been reviewed and approved the loan offer and documentation is finalised for completion of the loan with the borrower.

Asset Management

Once a loan has been approved and the Letter of Offer executed the loan goes through the legal requirements for settlement. Following settlement, the Loan Management Team is responsible for the portfolio loan servicing, management, reporting and default management requirements, in conjunction with AMAL Asset Management (AMAL) who have been appointed for loan servicing activities.

Loans are reviewed regularly and the underlying security property is subject to revaluation at any time, where Pallas has cause to believe there has been a reduction in the value of the security property. Once received, the updated valuation should be reviewed to confirm the ongoing acceptability of the property for security purposes. The opportunity should also be used to confirm that the facility complies with the:

- ◆ Maximum LVR, RLVR and LCR (as required) covenant imposed when the facility was first approved (as subsequently varied);
- ◆ Minimum ICR covenant imposed when the facility was first approved (as subsequently varied); and
- ◆ Any other covenants impacted by the valuation or which can be measured using information contained within the valuation.

Unless a reporting or covenant testing condition has been included in the Loan Agreement, a revaluation effectively represents the sole opportunity for Pallas to verify the compliance of the borrower against these key covenants during the loan term.

In the event that one or more of these covenants are breached, then appropriate steps are taken to rectify the default or renegotiate the facility, provided it remains within acceptable parameters and the key policies of the lender.

AMAL

Pallas Capital has appointed AMAL Asset Management (AMAL) to assist it in the servicing and management of its loan book under a Loan Servicing Agreement.

AMAL operates across Australia and NZ and was established in 1994 as a specialist third-party servicer of commercial mortgages for the retail mortgage trust sector. Clients of AMAL include Colonial First State, AXA, ING Funds Management, ANZ, Westpac, Nomura, Credit Suisse, Deutsche Bank, Challenger, Morgan Stanley, Blackstone and many others. AMAL's current ground funds under administration and supervision is c. \$13 billion.

AMAL Group entities provide various functions for the business including Note Trustee, IPAR and Security Trustee for Pallas FM Trust Bond as well as acting as a variation agent of the Bonds parameters at the end of each quarter.

AMAL's corporate governance framework is overseen by its Board of Directors. AMAL's internal controls framework is based on ISO9001:2015 Quality Management System, and includes both preventative and detective controls such as:

- ◆ Segregation of duties, approvals, authorisations and verifications.
- ◆ Comprehensive data quality checking procedures across all client functions.
- ◆ A wide range of automated system checks, alerts and reports to identify data anomalies.
- ◆ Maintenance of a comprehensive, ongoing internal audit process across all areas of the business, overseen by the Executive Director — Governance, Risk and Compliance.

- ◆ In addition to regular audits by their clients and advisors AMAL is subject to an annual servicer evaluation by Standard & Poor's Ratings Services (S&P), now in its 15th year. In 2019 S&P affirmed its overall STRONG ranking for AMAL (the highest possible ranking) as a servicer in Australia and New Zealand.

Default & Arrears Management

The Manager has a detailed default and arrears management process. Interest is typically prepaid for the life of the loan and therefore there tends to be little arrears risk from loans. The key risk is the risk that a borrower defaults on the repayment of the loan amount.

The Manager requires borrowers to provide the payment strategy for the loan three months from the maturity date of the loan which provides for visibility regarding the borrowers ability to pay with time to work through any issues if they arise.

For a borrower experiencing difficulty in meeting payments or material loan obligations or where Pallas anticipates a general change to the risk profile of a loan, Pallas may implement loan management procedures to ensure the loan remains compliant. In certain circumstances where Pallas determines appropriate, the Lender may formally reserve its rights with the borrower as it works through any remedy actions set by Pallas.

The intent of this strategy reflects Pallas' pragmatic approach to loan management to maximise financial and reputational outcomes all the while taking a proactive 'high touch' approach to deal with any issues as they arise. Pallas will not waive obligations that affect the risk profile of loans.

Most instances of loan management deal with non-monetary defaults and usually involve a request from the borrower for additional time to meet a pre-agreed condition of the loan. In forming a decision to such a request, Pallas will consider factors such as the borrowers loan conduct, evidence for the delay and proof of measures taken by the borrower to rectify the outstanding condition.

The Manager's loan management and default management process has proven effective to date with the loan book only experiencing three material defaults. The Manager was able refinance two of the three loans with other financiers and receivers have been appointed for the remaining loan with 100% of the capital expected to be recovered. To date the Manager has been able to identify loans where the risk has risen to levels above what they are comfortable with and been able to move them off their books, highlighting the discipline of the loan management process.

Portfolio Management

There are strict eligibility criteria and portfolio parameters for PFT loans. These criteria and portfolio parameters have been set with the institutional funding partner who are currently financing a large portion of the facility. The portfolio construction considers these requirements before a loan is added to the portfolio. The criteria includes LVR limitations for eligible property types, maximum exposure borrow limits for eligible property types, geographic limitations, minimum and maximum exposure to loan types and maximum loan terms for eligible loan types. We are unable to provide comprehensive details regarding these parameters for confidentiality reasons.

The Fund is open-ended and as such the cashflow needs to be managed effectively to reduce any potential cash drag. The Manager will seek to ensure there is sufficient loans in the pipeline when issuing new Notes to deploy capital raised. The Manager is currently writing \$35m of new loans per month and has a significant pipeline for additional capital to be deployed. Further to this the restrictive redemption facility means the Manager has the ability to manage the cashflow of the Fund in line with the loans which are typically short dated.

PORTFOLIO

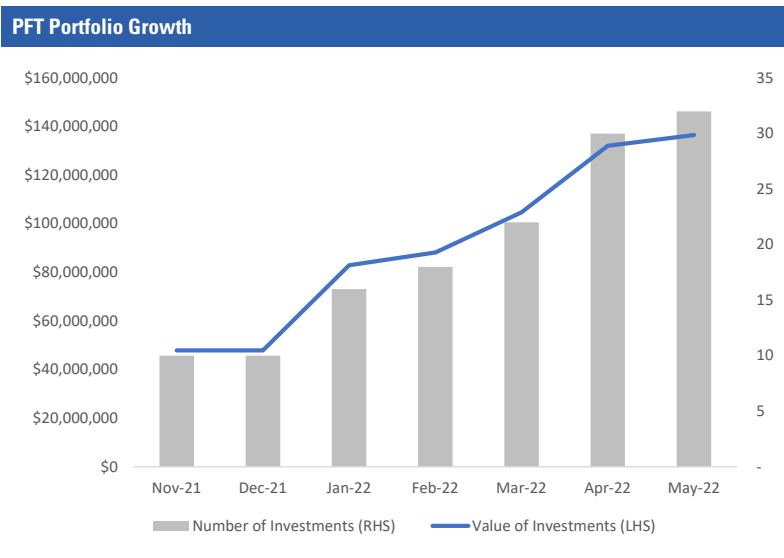
PFT was established in November 2021 and has grown to have funded 32 loans for a total value of \$136.5m as at 31 May 2022. Given the limited history of PFT there has only been one loan that has reached maturity to 31 May 2022 with a maturity date of 28 May 2022. This loan has been informally extended and the Manager intends to write a new loan for a further six month term. The extension is due to the property being sold with a six month settlement period, therefore there are no concerns regarding the ability of the borrower to repay the loan.

PFT Portfolio Summary as at 31 May 2022

Number of Loans	32
Weighted Average Interest Rate	7.03%
Weighted Average LVR	62.6%
Weighted Average Term to Maturity	12.53 months
Largest Loan	\$8.85m

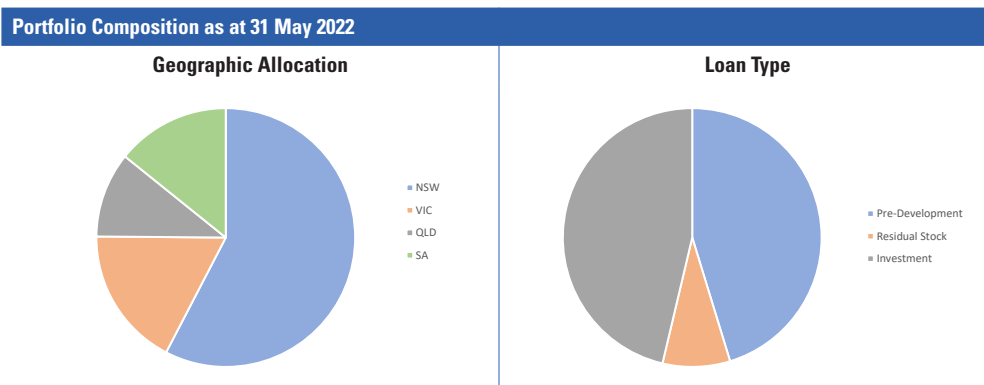
PFT Portfolio Summary as at 31 May 2022	
Smallest Loan	\$1.125m
Top 5 loans	27.9% of the Portfolio
Pre-Development Loans	45.3%
Residual Stock Loans	8.4%
Investment Loans	46.3%

The portfolio has grown substantially since its inception in November 2021 with the portfolio diversified as at 31 May 2022. As additional capital is raised by the Fund the diversification is expected to continue to increase. The Manager has a pipeline of investment opportunities that it has identified for PFT.



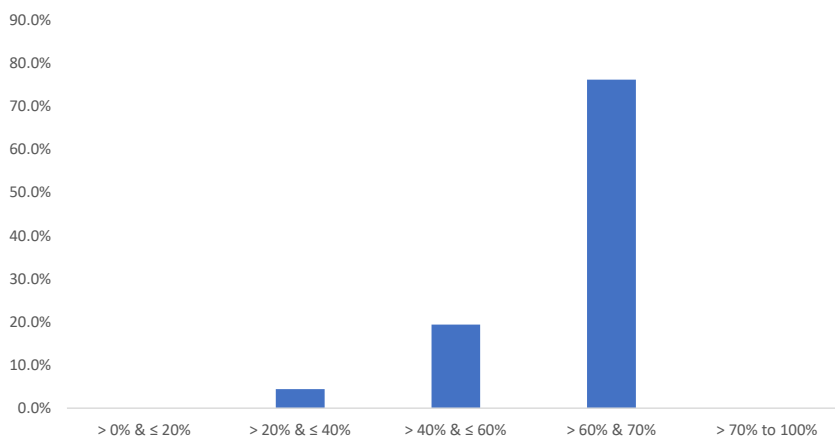
The portfolio is weighted towards NSW with 57.3% of the portfolio allocated to property in NSW. Based on the portfolio parameters, NSW and Victoria are expected to be the largest allocations in the portfolio throughout its life.

The portfolio is largely allocated to Pre-Development and Investment loans as at 31 May 2022 with 91.6% allocated to these loan types. There is a small allocation to Residual Stock loans. While PFT is allowed to provide Specialised Asset and Vacant Land loans, no loans for these purposes have been provided to date.



Maximum LVRs for investments in PFT range from 50%-70% depending on the loan type. The weighted average LVR of the portfolio at 31 May 2022 was 62.6% with 76.2% of loans with an LVR of 60%-70%.

Portfolio LVR

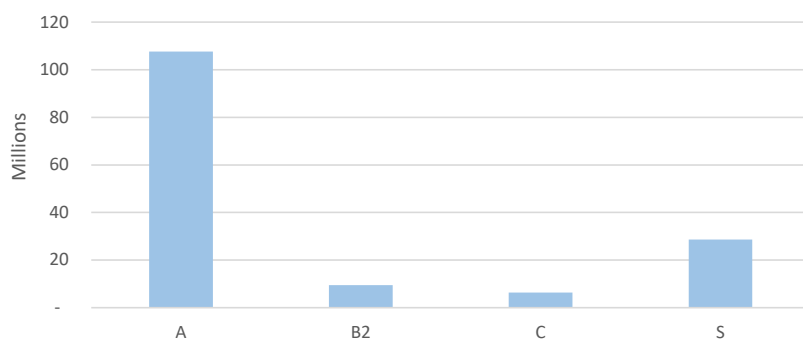


PERFORMANCE ANALYTICS

Returns to investors are purely in the form of income, with monthly distributions based on the interest generated from the portfolio of loans, net of the fees and costs. Upon redemption, investors will receive the capital invested plus any outstanding interest payments, subject to no capital impairments being experienced.

PFT has met all its distribution obligations to date in its short history. Based on the weighted average interest rate of loans in the portfolio and the high level of prepaid interest, we expect the Fund to be able to continue to meet its distribution obligations. We note that there has only been one loan that has reached maturity to 31 May 2022 and while the loan has been extended it is expected to be settled and the full loan amount redeemed. The low level of defaults of the Pallas Group loan book bodes well for investors, although we note that default risk is a key risk for investors and defaults that equate to an amount exceeding the PFT S Notes on issue may result in a capital loss to investors. Investors should note that a capital impairment will only be incurred in the event the loan amount cannot be recouped in full. Conservative LVRs provide an element of protection from declines in valuations and personal guarantees from borrowers provides an additional layer of protection.

PFT Issued Notes (as at 11 May 2022)

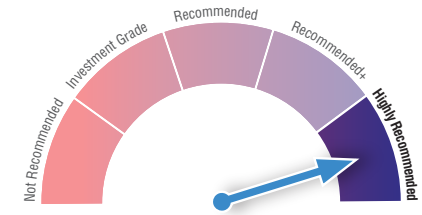


APPENDIX A – RATINGS PROCESS

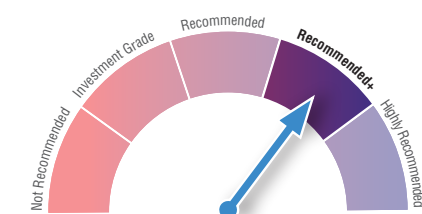
Independent Investment Research Pty Ltd “IIR” rating system

IIR has developed a framework for rating investment product offerings in Australia. Our review process gives consideration to a broad number of qualitative and quantitative factors. Essentially, the evaluation process includes the following key factors: management and underlying portfolio construction; investment management, product structure, risk management, experience and performance; fees, risks and likely outcomes.

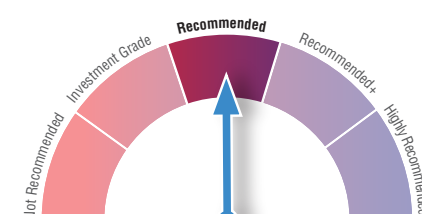
LMI Ratings	SCORE
Highly Recommended	83 and above
Recommended +	79–83
Recommended	70–79
Investment Grade	60–70
Not Recommended	<60



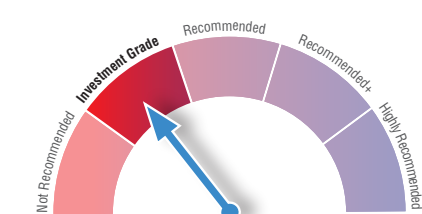
This is the highest rating provided by IIR, indicating this is a best of breed product that has exceeded the requirements of our review process across a number of key evaluation parameters and achieved exceptionally high scores in a number of categories. The product provides a highly attractive risk/return trade-off. The Fund is likely effectively to apply industry best practice to manage endogenous risk factors, and, to the extent that it can, exogenous risk factors.



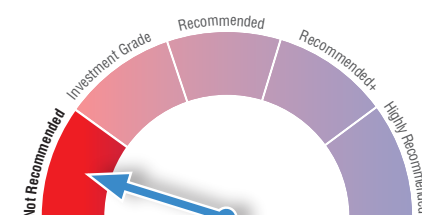
This rating indicates that IIR believes this is a superior grade product that has exceeded the requirements of our review process across a number of key evaluation parameters and achieved high scores in a number of categories. In addition, the product rates highly on one or two attributes in our key criteria. It has an above-average risk/return trade-off and should be able consistently to generate above average risk-adjusted returns in line with stated investment objectives. The Fund should be in a position effectively to manage endogenous risk factors, and, to the extent that it can, exogenous risk factors. This should result in returns that reflect the expected level of risk.



This rating indicates that IIR believes this is an above-average grade product that has exceeded the minimum requirements of our review process across a number of key evaluation parameters. It has an above-average risk/return trade-off and should be able to consistently generate above-average risk adjusted returns in line with stated investment objectives.



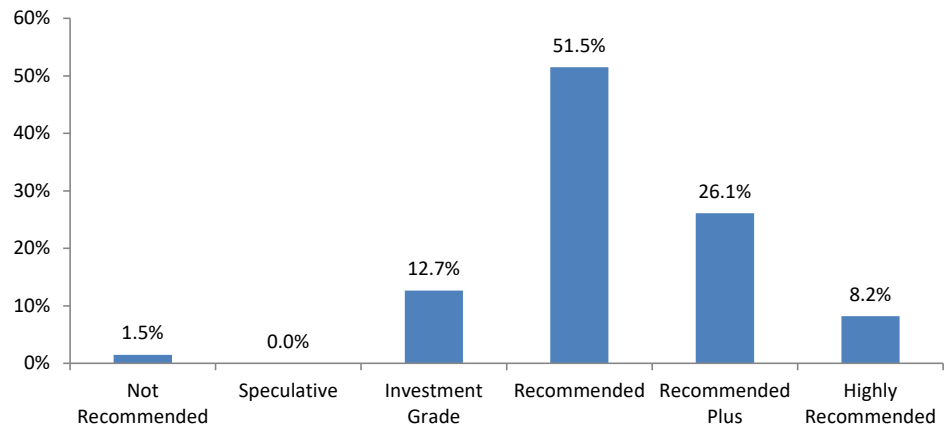
This rating indicates that IIR believes this is an average grade product that has exceeded the minimum requirements of our review process across a number of key evaluation parameters. It has an average risk/return trade-off and should be able to consistently generate average risk adjusted returns in line with stated investment objectives.



This rating indicates that IIR believes that despite the product’s merits and attributes, it has failed to meet the minimum aggregate requirements of our review process across a number of key evaluation parameters. While this is a product below the minimum rating to be considered Investment Grade, this does not mean the product is without merit. Funds in this category are considered to be susceptible to high risks that are not reflected by the projected return. Performance volatility, particularly on the down-side, is likely.

APPENDIX B – MANAGED INVESTMENTS COVERAGE

The below graphic details the spread of ratings for managed investments rated by Independent Investment Research (IIR). The managed investments represented below include listed and unlisted managed funds, fund of funds, exchange traded funds and model portfolios.



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