

# Unlisted Private Debt Fund Report

Keystone Capital

KC Diversified Income Fund

May 2019

Pooled first mortgage fund targeting income returns of 9.0%+

## Keystone Capital KC Diversified Income Fund

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## About Core Property Research

Core Property Research Pty Ltd was established in July 2017 to provide market leading and insightful research on the property funds sector for its clients and investors. Our ratings and research cover sector level research, ratings and recommendations on listed and unlisted property funds, and is built upon the extensive research experience of its staff.

The Core Property team collectively, has over 50 years' experience across property, financial services and investment markets. The team has also evaluated over 500 different funds across multiple sectors and a range of investment structures over the last decade.

### IMPORTANT NOTICE

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# Keystone Capital KC Diversified Income Fund

May 2019

The Keystone Capital KC Diversified Income Fund (*"the Fund"*) is a pooled mortgage fund that invests in a portfolio of loans secured by first ranked mortgages over commercial and residential property and developments in Australia.

The Fund Manager, Keystone Capital (*"the Manager"*) was established in 2013 and specialises in the origination and management of property backed loans. The Fund was set up in January 2017 and has delivered an average net return of 9.1% p.a. in distributions with a 100% preservation of capital since inception. The Fund is open ended with an entry unit price of \$1.00 per unit with a minimum investment of \$10,000 (*"the Offer"*).

The Fund operates a pooled investment structure whereby investor funds are aggregated and used to provide loans to Borrowers secured by first ranked mortgages. Loans are diversified across commercial and residential properties, including development projects which carry a higher risk with a higher interest rate charged.

A key feature of the Fund is that it provides an exposure to loans in other funds managed by Keystone Capital (the KC Select Income Fund), thereby providing diversification for investors via a single investment.

The Fund has well defined lending guidelines to ensure risks are matched to return expectations and includes:

- a maximum \$5.0M or 10% of the portfolio weighting to any one loan,
- a maximum \$10.0M or 20% of the portfolio exposure for any one Borrower,
- initial loan term no more than 24 months,
- loans to be secured by a first ranked mortgage over real property, and
- maximum LVR of 70%, with development projects valued on an "as if complete" basis.

While the fund size is small (less than \$50M), the Manager may deviate from its stated portfolio diversification guidelines for periods of time. This is expected to be rectified as the loan book grows and funds under management increase.

The current portfolio consists of \$20.8M of assets, with \$20.2M invested across 19 loans and the balance held in cash. The portfolio is predominantly in NSW (75%) and in development properties (69%) with loans used to acquire (29%), construct (29%) or for refinancing (28%). The average portfolio loan maturity is 9.9 months.

Core Property considers the Fund to offer an attractive return as it targets short-to-medium term funding opportunities that are less correlated to the broader market returns, returns that are contractual, and the Manager being in a strong position to regulate the risk/return trade off. Investor capital is supported by a maximum 70% LVR on first ranked mortgage security. The expected returns from the Fund are higher than most income yields, albeit with a higher risk profile, currently available to investors from cash and fixed income products.

Core Property's rating is based on the Manager's processes and ability to closely manage its loan portfolio to deliver higher returns commensurate with underlying risk. This includes the Manager's ability to fully recover its principal and outstanding interest on any loans in default in order to maintain its track record of capital preservation. The majority of loans (73.9%) fall due within 12 months and, as such, investors should expect the risk profile of the portfolio to continually change over time.

### Investor suitability

Core Property considers the Fund would be best suited to investors who understand the nature of lending into property development and investment projects which provide higher returns with higher risks over a shorter time period. Investors should expect a high yielding income-only return, with no capital gain in unit price. The Manager has maintained a strong record with 100% capital preservation. Investors should be aware that, by its nature, debt funds may incur a capital loss if any loan amount is not fully recovered, which will impact investor returns.

## Recommended

See the Appendix for a description of our ratings. The above rating must be viewed in the context of comparable Funds and not across all products

## Fund Details

Offer Open:	Open-ended
Minimum Initial Investment:	\$10,000 <sup>1</sup>
Unit Entry Price:	\$1.00
Fund Term:	Open
Target return	9.0%+ p.a. (net of fees)
Distribution Frequency:	Monthly, within 14 days
Distribution Reinvestment Option:	Available

Note 1: Additional investment can be made in \$1,000 increments. Investors must maintain a minimum balance of \$10,000.

## Fund Contact Details

Lachlan Perks  
Executive Director  
[lperks@keystonecapital.com.au](mailto:lperks@keystonecapital.com.au)  
Phone: (02) 8960 9180

Tom Waltham  
Executive Director  
[twaltham@keystonecapital.com.au](mailto:twaltham@keystonecapital.com.au)  
Phone: (08) 7231 8777

Note: This report is based on the KC Diversified Income Fund Product Disclosure Statement dated 12 January 2017, together with other information provided by Keystone Capital.

## Key Considerations

**Management:** Keystone was established in 2013 and specialises in the origination and management of loans which are secured over real property assets in Australia. The Manager has undertaken over \$223M of loans (predominantly first mortgages) since inception with 100% preservation of capital for investors. The Fund operates as a managed investment scheme which is registered with ASIC. All loans must be unanimously approved by the Credit Committee which includes at least one independent member.

**Fund history:** The Fund was established in January 2017 and has undertaken over \$25M of lending across 41 separate loans secured by way of first ranked mortgages. Since inception, the Fund has delivered an average 9.1% p.a. net distribution for investors paid monthly with 100% preservation of capital.

**Fund structure:** The Fund is open-ended. Investors funds are pooled by the Fund and loaned either directly to borrowers, or indirectly via investments in the KC Select Income Fund. A portion of the portfolio is held in cash and short-term deposits.

**Loan guidelines and criteria:** The Fund aims to provide a diversified portfolio to support regular and consistent income distributions for investors. The key loan guidelines ensure risks are adequately managed for expected returns including: 1) all loans are secured by a first ranked mortgage over real property assets in Australia, 2) a maximum initial Loan to Valuation Ratio (LVR) of 70%, with development property valued on an "as if complete" basis, and 3) an initial loan period of no more than 24 months. The Fund also seeks to limit a maximum \$5M or 10% of Funds Under Management to any single loan and a maximum \$10M or 20% of FUM exposure to a single borrower, however the Manager expects to meet this limit when it achieves a scale of \$50M in FUM.

**Current portfolio:** The Fund portfolio consists of \$20.8M of assets with \$20.2M held in 19 loans and the remainder in cash. The loans are all first mortgages held in the related KC Select Income Fund and have a weighted average LVR of 55.1%. The current portfolio is currently delivering a 9.0% p.a. net return with an average loan maturity of 9.9 months. Around 73.9% of loans fall due within the next 12 months (as at March 2019). As such, investors should expect the portfolio book to continually change over the term of their investment.

**Distributions:** The Fund is targeting distributions of 9.0%+ p.a. (net) for investors. Distributions are paid monthly, within 14 days of the end of the month.

**Total return expectations:** Total returns are expected to be in line with the distribution yield of 9.0%+ p.a. (net) based on the Fund maintaining a \$1.00 per unit price. The Fund has maintained a 100% preservation of capital since inception however investors should be aware the unit price may reduce if the Fund cannot recover any principal loan amount and investor returns will be affected. Core Property considers the level of distribution to be attractive based on the underlying exposure to first ranked mortgages.

**Fees:** Core Property considers the fees charged to be at the mid-point of what is typically charged in the market for debt funds of this nature.

**Investment risks:** Core Property is unable to comment on the risks associated with specific loans that the Fund would invest in. The performance of the Fund will depend on, but not be limited to 1) risks specific to the property sector in which the loans are made, 2) prevailing market conditions specific to the investments, and 3) the cost and availability of debt financing. It is possible that the escalation of any of these risks could negatively affect expected returns.

**Liquidity:** The Manager provides Withdrawal Offers to investors on a quarterly basis upon completion of a withdrawal application form. Withdrawals are undertaken on a best endeavours basis and there is no guarantee that a Withdrawal can be fulfilled.

## Investment Scorecard

### Management Quality



### Governance



### Portfolio



### Income Return



### Total Return



### Gearing

NA

### Liquidity



### Fees



Fund Structure		Fees Paid	
The Fund is an unlisted managed investment scheme, which is registered with ASIC. The Fund aims to provide investors with a high yielding monthly distribution from the financing of debt via first ranking mortgages on development and investment properties in Australia.		Core Property considers the fees charged to be at the mid-point of similar debt funds in the market.	
<b>Management</b>		Entry Fees:	Nil
Keystone Capital is a fund manager which specialises in the origination and management of loans secured by registered mortgages over real property in Australia. Since it was established in 2013, Keystone has managed over \$223M in lending across over 100 loans through two mortgage funds, the KC Select Income Fund and the KC Diversified Income Fund. The Manager adopts an active management of its loans with a 100% preservation of investor capital across its funds since inception.		Exit Fees:	Nil
<b>Portfolio Guidelines</b>		Management Fee:	2.5% p.a. (inclusive of GST) of FUM. Paid monthly out of the assets of the Fund.
Investment strategy:	Capital for loans secured on commercial, residential, development and agricultural properties in Australia.	<b>Portfolio Metrics</b> <b>As at March 2019</b>	
Loan Amount:	When FUM exceeds \$50M: Maximum \$5.0M or 10% of FUM to any one loan Maximum \$10.0M or 20% of FUM to any one borrower	Loan Book:	\$20.2M
Term:	Initial term to be no more than 24 months.	Cash at Bank:	\$0.6M
Security:	First ranked mortgage on real property	Total Portfolio:	\$20.8M
Loan to Valuation Ratio:	Maximum 70% LVR <sup>1</sup>	Mortgage Type:	First Mortgage (100%)
Note 1: Development loans valued on an "as if complete" basis.		Weighted Average LVR:	55.1%
<b>Return Profile</b>		Average Loan Maturity:	9.9 months
Target Distribution:	9.0%+ p.a. (net of fees)	Type of Security Property:	Commercial Development (12.6%) Residential (27.3%) Residential Development (56.7%) Agricultural (3.4%)
Distribution Frequency:	Monthly, within 14 days	Loan Expiry:	<6 months (25.6%) 6-12 months (48.3%) 12-18 months (16.4%) 18-24 months (9.8%)
Distribution Reinvestment Option:	Available	Loan Purpose:	Equity Release (8.2%) Site Acquisition (29.0%) Construction (29.1%) Refinance (28.0%) Working Capital (5.7%)
Tax:	Tax consequences depend on individual circumstances and investors should seek their own taxation advice.	Loan Location:	NSW (75.3%) VIC (2.4%) SA (16.2%) WA (6.1%)
Investment Period:	The Fund is open-ended and offers a quarterly withdrawal facility.	Loan Status:	Current (98.0%) Default (2.0%)
<b>Risk Profile</b>		<b>Legal</b>	
Property/Market Risk:	Investors may be exposed to a potential capital loss from property development and investment risks.	Offer Document:	KC Diversified Income Fund Product Disclosure Statement dated 12 January 2017.
Counterparty Risk:	Investors are exposed if any selected borrower fails to perform their contractual obligations, either in whole or in part, which may affect targeted returns.	Wrapper:	Unlisted Property Debt Fund
Manager Risk:	The performance of the Fund relies on the ability of the Manager to originate, manage and profitably realise loan investments within a specific period of time.	Investment Manager & Responsible Entity:	Keystone Capital Limited (ACN 163 616 064, AFS License no 439327)
Liquidity Risk:	Investors may not be able to recover their investment, if the assets cannot be sold or cannot be converted into cash.	Custodian:	Sargon CT Pty Limited (ABN 12 106 424 088, AFS License No 258829)
Valuation Risk:	Loans are supported by a valuation that is no more than 3 months old. Despite all the valuations being undertaken by qualified valuers there is a risk that a valuation may overstate a property's true value, which may impact upon the Manager's ability to recover on a loan in default.		
For a more detailed list of the key risks, refer to Section 7 "Risks of Investing" of the Product Disclosure Statement.			

## Fund Overview

The Keystone Capital KC Diversified Income Fund (*the Fund*) is a pooled mortgage fund which aims to provide investors a high distribution yield from investing in a portfolio of loans secured by first ranked mortgages over real property in Australia. The Fund generates returns by pooling investor’s funds which are then either invested directly into loans or indirectly via units in the KC Select Income Fund, with the balance invested in cash (at call or term deposits).

The Fund was established in January 2017 and has delivered a 9.1% p.a. distribution (net of fees) since inception, with distributions paid monthly. Higher returns are generated by lending into residential and commercial development projects, with loan periods of less than 24 months.

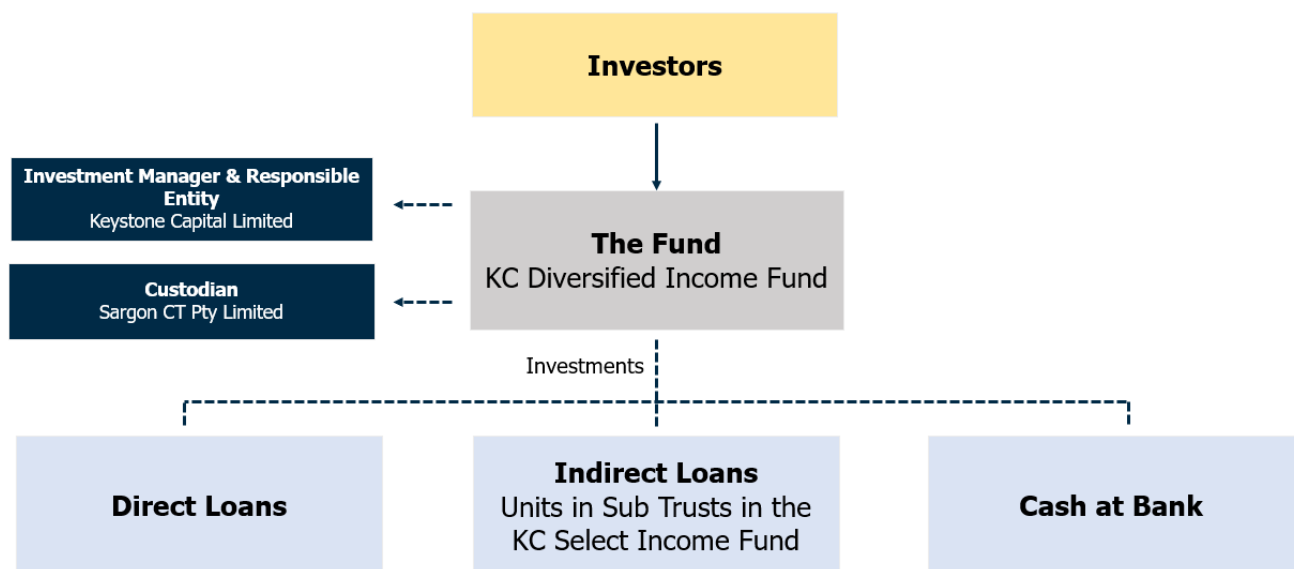
A key feature of the Fund is that, whilst it can issue loans directly with borrowers, in practice, all loans to date have been undertaken indirectly via the KC Select Income Fund. This works well by allowing the Fund to invest different amounts (up to 100%) in the loans, thereby providing investors with a diversified exposure to the loans being managed by Keystone. Currently the KC Select Income Fund has 29 loans totalling \$97.5M, of which the Fund has an interest in 19 loans totalling \$20.2M. The KC Select Income Fund has a minimum investment of \$25,000 for each individual loan which needs to be accepted separately by investors under each Sub-Trust, however the Fund provides a diversified exposure across the loans with a \$10,000 minimum investment.

The loan guidelines of the Fund aim to ensure investors receive an attractive return that is commensurate with the underlying risks:

- All loans to be secured by a first ranked mortgage over real property in Australia.
- A maximum Loan to Valuation Ratio (LVR) of 70% at the time of approval (with construction and development loans calculated on an “as if complete” basis).
- Initial loan term of no more than 24 months.
- Once the Fund exceeds total Funds Under Management (FUM) of \$50M or more:
  - Maximum single exposure of \$5.0M or 10% of the total FUM, and
  - Maximum exposure to any single Borrower of \$10.0M or 20% of FUM.

The current portfolio consists of \$20.8M of assets, with \$20.2M (97%) in loans and \$0.6M (3%) held in cash. The loans currently consist of 19 investments in first mortgages loans held in the KC Select Income Fund, with a weighted average LVR of 55.1%. The average loan maturity is 9.9 months with the majority of loans (73.9%) falling due within 12 months. The Manager has advised that over the life of the Fund it has maintained a 100% preservation of capital for investors.

Figure 1: Fund structure



Source: Core Property, Keystone Capital

## The Offer

Investors may apply for Units at a Unit Price of \$1.00 per unit ("the Offer"). The minimum investment is \$10,000 with a minimum additional investment of \$1,000 thereafter.

## Unit Pricing

The current unit price is \$1.00 per unit for entry and exit of the Fund. The Unit Price is calculated by taking the Net Asset Value of the Fund which is then divided by the aggregate number of units in the Fund to calculate the per unit price.

Core Property notes the Unit Price has remained at \$1.00 per unit with the Manager maintaining a 100% preservation of capital since inception. Investors should be aware that debt funds, by definition, are exposed to a loss of capital if a Manager is unable to fully recover the principal loan amount. In such instances the Unit Price may fall below \$1.00 per unit and the Manager may undertake a consolidation of units which would result in investors realising the capital loss.

The Fund provides the option for investors to reinvest their monthly distributions as additional units in the Fund rather than a cash payment. The Manager advises that currently around 31.6% of units undertake this option.

## Lending Guidelines

The PDS sets out the lending guidelines for the Manager, which are summarised in the table below.

Figure 2: Lending Guidelines

Criteria	
Loan Amount	<ul style="list-style-type: none"> <li>Loans are secured by registered first ranked mortgages over real property in Australia.</li> <li>The maximum exposure to any one borrower must not exceed \$10.0M or 20% of total FUM as at the date the most recent loan gets approved. The Fund expects this will be met once FUM exceeds \$50M.</li> <li>The maximum exposure to any single loan must be the greater of \$5.0M or 10% of total FUM as at the date the most recent loan gets approved. The Fund expects this will be met once FUM exceeds \$50M.</li> </ul>
Term	<ul style="list-style-type: none"> <li>The Initial term must be no more than 24 months.</li> </ul>
Security	<ul style="list-style-type: none"> <li>The Security Property can be a real property including office, retail, industrial, residential, vacant land, construction or development sites, hotels or specialist property located in any region of Australia.</li> <li>Additional security may be taken in the form of personal or corporate guarantees and additional security interest over other assets. This could include subsequent mortgages.</li> <li>Credit Committee decisions must be based on a valuation that is not more than three months old. All valuations must be undertaken by a registered valuer that is on Keystone's valuation panel.</li> </ul>
Loan to Valuation Ratios (LVR)	<ul style="list-style-type: none"> <li>The commencing LVR of a loan must not exceed 70%.</li> <li>LVR for Development loans must not exceed 70% as assessed against "as if complete" market valuation.</li> </ul>
Valuation	<ul style="list-style-type: none"> <li>Valuation of security is done by registered and independent valuer who is also an appointed Panel Valuer by the Manager.</li> <li>Each valuer is independent, properly qualified, licenses and has no less than three years of continuous experience in similar property valuations.</li> <li>Valuation report must not exceed 3 months on the date of approval.</li> <li>The Fund accepts two valuation methods: Market Valuation and Construction Valuation. Market Valuation provides an estimated price at the time of sale. Construction Valuation is applied for construction or development loan based on "as is" basis or "as if complete" basis.</li> <li>One valuer can only value up to one third of the total number of security properties.</li> <li>One valuer can only value the same security property three consecutive times.</li> <li>For Development Loans, the valuation must be prepared on the basis of "as is" or 'as-if-complete'.</li> </ul>

Source: Keystone Capital

## Loan Approval Process

The Mortgage team consists of Jason Cooke (General Manager) and Owen Peacock (Senior Analyst) who review and assess every loan submission received by Keystone. The team will send out indicative terms for any suitable loan. If the indicative terms are agreed to by the borrower, the team will proceed to undertake due diligence for the loan and prepare a credit submission for the Credit Sub-Committee. The Sub-Committee consists of two executive directors (Lachlan Perks and Tom Waltham) plus one external member. The Credit Sub-Committee must unanimously approve a loan for it to proceed and may impose additional conditions on the loan.

The Loan Approval process is summarized in the figure below.

Figure 3: Loan Approval Process

Criteria	Description
Initial Assessment	<ul style="list-style-type: none"> <li>• Mortgage team undertakes initial assessment on the loan quality.</li> <li>• Creditworthiness of the prospective borrower.</li> <li>• Analysis on borrower's capacity to meet financial obligations.</li> <li>• Type of property security.</li> <li>• Valuation report by a registered valuer (and Panel Valuer of the Fund).</li> <li>• Loan to Valuation Ratio position.</li> <li>• Strength of the proposed loan exit.</li> </ul>
Lending Policy	<ul style="list-style-type: none"> <li>• Compliance check with lending policy by the mortgage team.</li> </ul>
Loan Funding Submission	<ul style="list-style-type: none"> <li>• The loan is submitted to the credit committee with a recommendation given by the mortgage team.</li> </ul>
Review and Approval	<ul style="list-style-type: none"> <li>• The credit sub-committee must review the loan application to determine whether it should be approved or not.</li> <li>• A unanimous approval from a three-member credit sub-committee, consisting of two executive directors and one external member.</li> </ul>
Documentation	<ul style="list-style-type: none"> <li>• Loan and security documents.</li> <li>• Financial documents as per lending requirements.</li> </ul>

Source: Keystone Capital

**Loan Default:** Default is considered when the borrower fails to meet payments for the interest and fees from its own resources or fails to repay the loan at expiry. Keystone has developed a policy in pursuing defaults and late payments. This policy includes monitoring all due dates, following up on overdue payments usually within 5 business days and issuing notices of repayment. Furthermore, Keystone can instigate legal action to acquire possession of the Security Property if these notices aren't complied with.

## Liquidity / exit strategy

Withdrawals from the Fund can only be made after a Withdrawal Offer is made to Eligible Investors (defined as investors who lodge a withdrawal request). The Withdrawal Offer is based on the estimate of the available liquidity in the Fund and market conditions at the time. Withdrawal Offers are made to Eligible Investors by email and remain open for 21 days, with payments made within 21 days of close of the Withdrawal Offer.

Withdrawal Offers are not guaranteed and where the withdrawal requests exceed the amount available under the offer, the requests may be satisfied on a proportional basis. The Manager has confirmed that it does not undertake any new loan applications unless it has fulfilled all Withdrawal Offers from the prior quarter.

The Manager has confirmed the Fund has made Withdrawal Offers to investors on a quarterly basis since March 2018. Since then, the Fund has received a total of 9 withdrawal requests totaling \$0.9M with all withdrawals completed within the requested timeframes.

Core Property notes the Fund is able to support its liquidity needs through a combination of 1) a small amount of funds held in cash (typically at least 2%), 2) new investments in the Fund, and 3) upcoming loan maturities with the current portfolio having around 25% of loans falling due within the next 6 months and over 73% falling due within 12 months.



## History of the Fund

The Fund was launched in January 2017 as an unlisted registered managed investment scheme offering investors the opportunity to gain exposure to a diversified portfolio of loans secured by registered first ranking mortgages.

Since inception the Fund has provided funding for 41 loans totaling over \$25M with average monthly distributions of 9.1% p.a. (net of fees).

To date, all loans in the Fund have been held indirectly through an investment in units in individual Sub-Trusts in the KC Select Income Fund. The structure assists in the Fund's liquidity, as the Fund is able to acquire or dispose of units in the Sub-Trusts whilst retaining the structure of the underlying loan agreement.

The Manager has confirmed that since inception the Fund has had eight loans in "technical default", where the borrower has either been late on an interest payment or not repaid the loan by the expiry date, however the Fund has recovered 100% of capital plus interest in all cases.

The table below shows the growth of the Fund since inception.

Figure 4: Fund History

Key Metrics	Mar 17	Jun 17	Sep 17	Dec 17	Mar 18	Jun 18	Sep 18	Dec 18	Mar 19
FUM	\$0.2M	\$0.6M	\$1.3M	\$3.6M	\$4.8M	\$7.5M	\$13.3M	\$17.7M	\$20.8M
No of Loans	2	7	10	14	16	13	17	18	19
Total Loan Amount	\$0.2M	\$0.6M	\$1.3M	\$3.4M	\$4.8M	\$5.3M	\$11.4M	\$17.0M	\$20.2M
Cash at Bank	-	\$0.0M	\$0.0M	\$0.3M	\$0.1M	\$2.2M	\$1.9M	\$0.7M	\$0.6M
Return for Month	9.2%	9.2%	9.2%	9.2%	9.2%	9.1%	9.0%	9.0%	9.0%
Ave Return since Inception	8.9%	9.1%	9.1%	9.1%	9.2%	9.2%	9.1%	9.1%	9.1%
LVR Range	55%-65%	49%-70%	34%-70%	49%-70%	30%-70%	30%-70%	30%-70%	24%-70%	24%-70%
LVR Average	60.9%	61.6%	55.9%	55.8%	53.5%	49.8%	58.2%	54.8%	55.1%
<b>Loan Maturity</b>									
Loans due <6 mths	40.6%	25.8%	15.1%	8.1%	34.0%	64.1%	23.5%	7.6%	25.6%
Loans due 6-12 mths	59.4%	63.9%	85.0%	91.9%	50.0%	5.1%	47.0%	46.0%	48.3%
Loans due 12-18 mths		10.3%					29.5%	35.1%	16.4%
Loans due 18-24 mths					16.0%	30.8%		11.3%	9.8%
<b>Loan Type</b>									
Commercial									
Commercial Dev								11%	13%
Residential		9%	7%	0%			32%	29%	27%
Residential Dev	100%	91%	89%	97%	98%	99%	62%	57%	57%
Farm/Agricultural			4%	3%	2%	1%	6%	4%	3%
<b>Location</b>									
QLD					6%	5%	3%	2%	
NSW	41%	74%	82%	82%	77%	81%	67%	71%	75%
VIC					5%	4%	2%		2%
SA	59%	26%	18%	18%	12%	10%	28%	20%	16%
WA							0%	7%	6%
ACT/NT/TAS									

Source: Keystone Capital

## Fees Charged by the Fund

The fee structures in the mortgage and property funds industry vary widely depending on the fund style, the underlying structure of a fund, and complexity of the product. In some instances, fees are charged within the Fund, whilst in other cases fees or higher transaction costs may be charged directly to the borrowers.

Given the range of fee structures, Core Property has attempted to look at an all-in fee payable to the manager from an industry perspective based on publicly available information on comparable managers and the estimated range is 0% - 5% of net assets. Against this range, the all-in fee payable to the manager is at the mid-point of the industry fee range.

Core Property notes the following:

- Where the Fund invests in a loan product in the Keystone Capital KC Select Income Fund, the management fee that would be payable in the KC Select Income Fund will be waived in its entirety. This ensures the Manager only receives a fee in the Fund and there is no double charging of fees in the underlying fund.
- In addition to the fees listed below, the Manager may also receive fees and costs associated with the lending process. This includes fees paid by a Borrower such as establishment fees, underwriting fees, extension fees, legal fees, mortgage insurance, valuation costs and other administration fees. These fees are paid directly by a Borrower and are not an additional cost to Investors in the Fund.
- The fees also do not include any fees or indirect costs and expenses incurred in the preserving, exercising, protecting or enforcing of the Lenders rights under a loan agreement. For example, the Fund may incur additional fees and costs in the event of default and sale of a property.
- The PDS provides the option for the Manager to charge certain investors a differential fee. However, the Manager has confirmed that this has not occurred and all investors have been charged the same fee. The Manager advises that it does not intend to charge any differential fees in the future.

Figure 5: Summary of Fees charged by the Fund

Fee Type	Fee Charged	Core Property Comment
Management Fee	2.5% p.a. of funds under management. Payable Monthly in arrears out of the assets of the Fund.	Core Property considers the Management Fee to be at the mid - point of total management fees typically charged by debt funds in the market.
Default Management Fee	The Manager is entitled to: <ul style="list-style-type: none"> <li>• 50% of any default interest paid above the lower rate in normal cases.</li> <li>• 100% of any default interest paid above the lower rate in special circumstances in which Keystone elects to provide income support.</li> </ul>	Core Property considers the 50% fee charged will be used to cover additional costs required to manage the loan during default.  Where Keystone provides income support for the loan, it will receive the full default interest rate to cover its additional risk.

Source: Keystone Capital, Core Property

## Fund Portfolio

The Fund portfolio currently has \$20.8M of assets with \$20.2M (97%) deployed in mortgages and \$0.6M (3%) held in cash at 31 March 2019. All loans in the Fund are currently held via units in Sub Trusts under the KC Select Income Fund.

The total loan book of \$20.2M is held in 19 loans with current interest rates between 11.5% - 12.5% p.a. (gross) with an average expected interest rate of 11.8%. Distributions are currently tracking at 9.0% p.a., payable monthly, after deductions for Management Fees (2.5%) and dilution from cash holdings.

The loan portfolio has a weighted average LVR of 55.1% with a weighted average expiry of 9.9 months. Investors should consider the current portfolio as indicative only and expected to change over time. Please note that Core Property is unable to assess the current individual loan transactions or future loan transactions in the portfolio.

A summary of the current loan portfolio is provided below.

Figure 6: Portfolio Summary – as at 31 March 2019

Loan	Mort Type	Purpose	Security Type	Loan Amount \$M	LVR	Loan Expiry	Expected Return	Portfolio Weight
Loan 1, NSW	First	Equity Rel	Res Dev Site	1.7	30.0%	Feb 2020	12.25%	8.0%
Loan 2, WA	First	Refinance	Res Dev Site	0.0	60.0%	May 2019	12.50%	0.2%
Loan 3, SA	First	Site Acqn	Res Dev Site	0.4	60.9%	Mar 2019 <sup>1</sup>	12.00%	2.0%
Loan 4, SA	First	Site Acqn	Residential	1.6	65.0%	July 2019	11.50%	7.8%
Loan 5, NSW	First	Working Capital	Residential	1.2	70.0%	July 2019	11.50%	5.5%
Loan 6, SA	First	Refinance	Farm / Agri	0.7	59.1%	Aug 2019	12.25%	3.3%
Loan 7, NSW	First	Refinance	Res Dev Site	1.7	55.0%	Mar 2020	11.50%	8.2%
Loan 8, NSW	First	Refinance	Residential	0.9	67.5%	Sep 2019	12.00%	4.2%
Loan 9, SA	First	Refinance	Residential	0.6	24.4%	Nov 2020	12.00%	2.6%
Loan 10, NSW	First	Construction	Comm Dev	2.5	65.1%	Oct 2019	11.75%	12.2%
Loan 11, NSW	First	Refinance	Res Dev Site	1.4	50.0%	Nov 2020	11.75%	6.8%
Loan 12, NSW	First	Construction	Res Dev Site	0.5	61.5%	Dec 2019	11.95%	2.3%
Loan 13, WA	First	Construction	Res Dev Site	1.2	34.5%	Dec 2019	12.00%	5.8%
Loan 14, NSW	First	Site Acqn	Res Dev Site	2.0	60.0%	May 2020	11.75%	9.5%
Loan 15, NSW	First	Site Acqn	Residential	1.3	50.9%	May 2020	11.50%	6.4%
Loan 16, NSW	First	Refinance	Res Dev Site	0.4	68.6%	May 2020	12.25%	1.8%
Loan 17, VIC	First	Construction	Res Dev Site	0.5	54.9%	Dec 2019	11.75%	2.3%
Loan 18, NSW	First	Construction	Res Dev Site	1.2	60.1%	Mar 2020	12.00%	5.6%
Loan 19, NSW	First	Site Acqn	Res Dev Site	0.5	50.0%	Mar 2020	12.25%	2.5%
<b>Subtotal / Weighted Average</b>				<b>20.2</b>	<b>55.1%</b>	<b>9.9 months</b>	<b>11.8%</b>	<b>97.1%</b>
Cash & equivalents				0.6			0%	2.9%
<b>Total Portfolio</b>				<b>20.8</b>			<b>11.5%</b>	<b>100.0%</b>
<b>Gross Return - % p.a.</b>							<b>11.5%</b>	
Fees							-2.5%	
<b>Net Return to investors - % p.a.</b>							<b>9.0%</b>	

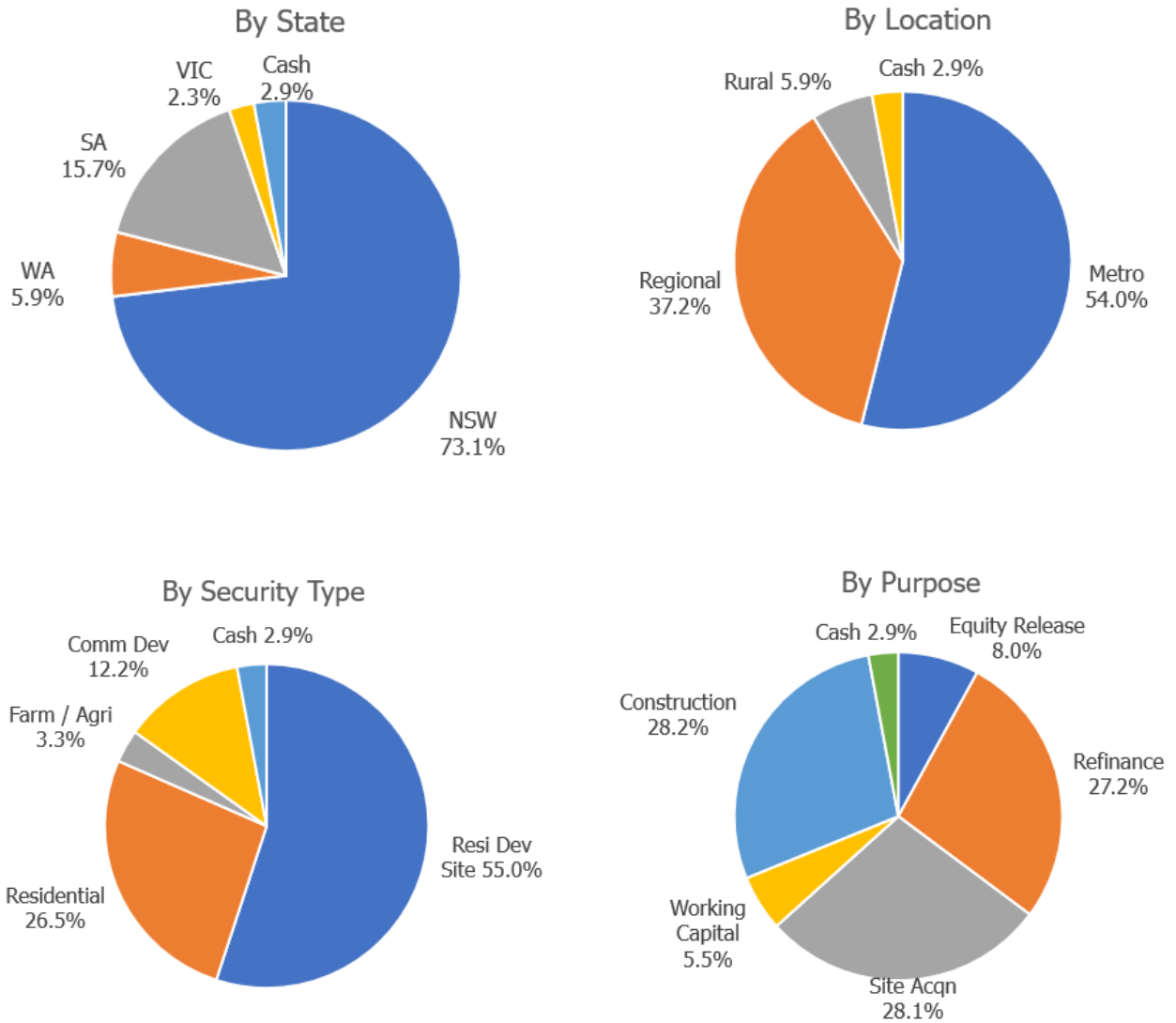
Note 1: The Manager has advised that, as at 16 April 2019, the loan has been refinanced by another lender and the Fund has recovered all principal and accrued interest owing.

Source: Keystone Capital, Core Property

### Diversification

The Fund portfolio is currently weighted to NSW properties in the Residential and Residential Development sector. Lending is undertaken mainly for the purposes of site acquisition, construction and refinancing of the projects. The following shows a split of the current portfolio as at 31 March 2019.

Figure 7: Portfolio Diversification



Source: Keystone Capital, Core Property

## Management & Corporate Governance

### Background of the Responsible Entity & Fund Manager

Keystone Capital is a boutique fund manager that specialises in the origination and management of loans which are secured by mortgages over property across Australia. Keystone has been involved in the management of mortgage investment opportunities since 2013 and has provided loans totalling over \$223M across 2 mortgage funds, the KC Select Income Fund and the KC Diversified Income Fund. The Manager has maintained a 100% preservation of capital across all funds. Since inception in January 2017, the Fund has delivered an average net return 9.1% p.a.

The Manager advises that, as a registered managed investment scheme, the Fund is subject to:

- An audit twice a year,
- An annual audit of the Compliance Plan, as well as Keystone’s AFSL conditions,
- The Fund’s Compliance Committee has a majority of independent members.

### Board of Directors and Senior Management of the Fund

Management of the Fund is undertaken by a team with complementary experience in financial services, banking, property finance, accounting and property investment and development. A summary of key management personnel is provided in the table below.

Figure 8: Keystone’s Board of Directors and Management team

Name & Role	Experience
Colin Taylor – Non-Executive Chairman	Member of the Australian Institute of Company Directors and Fellow of the Financial Services Institute, and the National Institute of Accountants, Colin has worked in the banking and finance sector for over 35 years. He has held senior management positions with Westpac and Bank SA. With professional experience in network management, marketing, property and finance he has also worked as General Manager at AWB Limited. Colin was previously a Director of the National Heart Foundation and Chairman of their National Finance Advisory Committee.
Lachlan Perks – Executive Director	Lachlan has over 19 years’ experience in property investment, property development, funds management, corporate finance, interest rate trading, debt originations and risk management. In addition to his involvement with Keystone Capital, Lachlan is the Managing Director of PPI Funds Management Pty Ltd a property fund manager with in excess of \$750M of assets under management.
Tom Waltham – Executive Director	Tom has over 20 years’ experience in the finance sector with a background in accounting, private equity and debt financing. In addition to his involvement with Keystone Capital, Tom is the Managing Director of Capital United Pty Ltd a multiple award winning finance intermediary specialising in corporate, property, commercial and residential debt transactions.
Jason Cooke – General Manager	Jason holds over 17 years of experience in corporate financial services, business banking and institutional banking. He worked as a Senior Relationship Executive and member of the SA Regional & Agribusiness Leadership Team in Commonwealth Bank of Australia across diverse sectors including property development, wine manufacturing and agriculture services.
Owen Peacock – Senior Analyst	Owen has over 13 years’ experience in the finance sector, having worked in a variety of roles across investment banking, commercial banking, corporate finance and agribusiness. Most recently, Owen has worked in relationship management roles with Bendigo and Adelaide Bank and BankSA as well as a Senior Risk role at SecurePay and as a Constable with the Australian Federal Police.

Source: Keystone Finance

## Keystone's Credit Committee & Sub-Committee

The role of the Credit Committee is to evaluate the mortgage funding opportunities that are presented by the mortgage team in accordance with the loan criteria and lending policies manual. The team also has responsibility of monitoring any defaults and deciding on the appropriate steps to take to manage the issue.

The Keystone Credit Committee consists of two executive directors (Lachlan Perks and Tom Waltham) and two external members (Darryl Royans and David Hawkes).

All loans must be unanimously approved by the Credit Sub-Committee which consists of the two executive directors plus at least one external member of the committee. The external members are listed in the table below.

Figure 9: Keystone's External members of the Credit Committee

Name & Role	Experience
Darryl Royans – External Credit Committee Member	Darryl is a career banker with over 45 years' experience, over 40 of which was with the Commonwealth Bank of Australia. Throughout his career, Darryl held a number of management positions across various divisions culminating in him spending 7 years as the Regional Manager, Risk SA, NT & Nth Western Victoria for the Corporate Banking Division with an unrestricted approval authority up to \$15M.
David Hawkes – External Credit Committee Member	David has over 20 years of experience in various credit departments within the Commonwealth Bank of Australia, culminating in 7 years spent as the State Manager (Commercial Lending Solutions). During his 41 years of association with the bank, he has worked in numerous departments including lending, internal audit and external inspection.

Source: Keystone Capital

## ASIC Disclosure Principles

The Manager has provided details of the fund's compliance with ASIC's disclosure benchmarks under ASIC Regulatory Guide 45: "Mortgage schemes: Improving disclosure for retail investors" (RG45). The following is a summary of the Fund's position as at December 2018.

Figure 10: Summary of ASIC retail disclosure benchmarks – as at December 2018

ASIC Benchmark & Disclosure	Compliant (Y/N)	Comment
Liquidity	Yes	Keystone monitors the Fund's capacity to meet its cash flow needs for the next 12 months. Directors approve the cash flow forecast at least every three months.
Scheme Borrowing	Yes	Keystone meets this benchmark. Keystone does not and does not intend to borrow on behalf of the Fund.
Portfolio Diversification	No	As the Fund is commencing the portfolio of loans and the level of diversification is rapidly changing as funds are received and loans are made.
Related Party Transaction	Yes	Keystone maintains and complies with a written policy that governs related party transactions and the management of real and potential conflicts of interests.
Valuation Policy	Yes	Details of Keystone's valuation policy are set out in Section 5 of the PDS.
Lending Principles - LVR	Yes	Keystone intends that all loans will comply with this benchmark.
Distribution Practices	Yes	The payment of distributions is dependent on the Borrowers meeting their interest and repayment obligations in full.
Withdrawal Arrangements	Yes	Keystone intends to make quarterly withdrawal offers to Eligible Investors as described in Section 4 of the PDS.

Source: Keystone Capital

## Appendix – Ratings Process

Core Property has developed a framework for rating property and property related investment product offerings in Australia. The methodology gives consideration to a number of qualitative and quantitative factors. Essentially, the evaluation process includes the following key factors: product and underlying portfolio construction; strength and depth of management team, product structure, risk management, financial analysis, and likely outcomes.

**It is important for financial planners and investors to view the recommendation and rating in the context of comparable products only and not across all products rated by Core Property.**

### The Ratings

Financial Advisers and investors should note that for all ratings categories, the product may not suit the risk/return profiles of all investors.

Rating	Definition
Highly Recommended	This is the highest rating provided by Core Property and is indicative of the product exceeding the requirements of our review process across a number of parameters.
Recommended	Indicates that the product has an above average grade profile across a number of Core Property's parameters and has the potential to deliver above average risk adjusted total returns.
Approved	Indicates that the product has met the aggregate requirements of Core Property's criteria. The product has an acceptable risk/return trade-off and is potentially able to generate risk-adjusted returns in line with stated investment objectives.
Speculative	Core Property believes this is a product that has a number of positive attributes; however, there are a number of risks that make investing in this product a speculative proposal. While Core Property does not rule out investing in this product, investors should be very aware of, and be comfortable with the specific risks. The product may provide unique diversification opportunities, although concerns over one or more features mean that it may not be suitable for most investors.
Not Approved	Indicates that the product has failed to meet the minimum aggregate requirements of Core Property's criteria. While the product may have some positive attributes, Trusts in this category are considered high risk.

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