

## Equitable Mortgages Limited ('EML') (In Receivership) Company No. 868536

EQU30516  
2 December 2011

### Introduction

On 8 August 2011 investors received the first partial repayment of their investments. That payout equated to approximately 18.2% of the total amount owing to investors as at 29 November 2010 (although there were very small differences in the amount each investor received depending on individual entitlements).

As noted in our covering letter, we are now able, on behalf of the Trustee, to make a further payout, which will be paid on 15 December 2011.

We are also now in a position to provide a preliminary estimate of the total amount we might be able to recover from EML's assets. Consequently, we can provide an estimate of the amount investors might be repaid. These are only estimates at this stage. The actual amount that investors will receive will not be known until all assets have been realised.

We will provide further updates during the receivership. We expect the next update will be in April 2012. If you have any questions in the meantime, you can contact us using the contact details in our covering letter.

### Overview of assets

EML had two assets at the date of receivership:

1. A significant amount of cash on hand, approximately \$32 million. The cash on hand enabled us to make the first payout to investors in August 2011, when we repaid \$35 million.
2. Loans that were advanced to third party borrowers. EML was in the business of lending money, primarily to property investors and developers. Further repayments to EML's investors will be funded by money collected from the loan book. We discuss the loans in the section below titled 'Overview of loan book'.

### Overview of loan book

In the period leading up to receivership the loan book was contracting as EML had been unable to identify sufficient volumes of lending that fitted within its credit criteria. This was one of the reasons why there was a large amount of cash on hand on the day Receivers were appointed.

### Key Characteristics

- At the date of receivership, \$190.6 million was owing by EML's borrowers across 50 individual loans. There was a slightly higher concentration of borrowers because in some cases more than one loan was

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advanced to a borrower group (by borrower group we mean a group of borrowers related to each other). This creates a concentration risk in that recoveries on some loans will have a large (and disproportionate) negative impact on total recoveries (and therefore on the amount we can repay investors).

| Loan values                 | # of Loans |
|-----------------------------|------------|
| \$0 - \$1,000,000           | 10         |
| \$1,000,001 - \$3,000,000   | 16         |
| \$3,000,001 - \$5,000,000   | 6          |
| \$5,000,001 - \$7,000,000   | 11         |
| \$7,000,001 - \$10,000,000  | 4          |
| \$10,000,001 - \$15,000,000 | 3          |
| <b>Total</b>                | <b>50</b>  |

- All loans were advanced on a first mortgage basis.
- In a number of cases valuations for security properties were out of date and accordingly were not an accurate assessment of current market value, due to changed market conditions. We have not therefore provided information in this report on loan-to-valuation ratios ('LVR') but we have now updated valuations where it was necessary and appropriate to do so.
- 69.2% of the loan book by value was secured over commercial property:

| Security type        | \$000                | %             |
|----------------------|----------------------|---------------|
| Commercial (trading) | \$ 71,371.52         | 37.4%         |
| Commercial (leased)  | \$ 60,535.84         | 31.8%         |
| Bare land            | \$ 45,585.24         | 23.9%         |
| Residential          | \$ 13,126.24         | 6.9%          |
| <b>Total</b>         | <b>\$ 190,618.83</b> | <b>100.0%</b> |

- 10.8% of loans (by value) are secured over properties in Christchurch. Most of these properties have been affected by the earthquake but it is still not clear what will happen to them and therefore what EML will be able to recover.

| Geographic concentration | \$000                | %             |
|--------------------------|----------------------|---------------|
| Auckland                 | \$ 63,581.58         | 33.4%         |
| Wellington               | \$ 61,279.45         | 32.1%         |
| Christchurch             | \$ 20,582.97         | 10.8%         |
| Dunedin                  | \$ 12,607.33         | 6.6%          |
| Other North Island       | \$ 18,487.14         | 9.7%          |
| Other South Island       | \$ 14,080.37         | 7.4%          |
| <b>TOTAL</b>             | <b>\$ 190,618.83</b> | <b>100.0%</b> |

- We have not identified any loans to parties related to EML's directors, shareholders or managers.
- Only 30% of loans (by number) were being serviced, in the sense that full contractual interest and (if relevant) principal was being paid. The remaining loans were either in arrears or on capitalising interest terms.

## Quality and Performance

The loan book was of average to poor quality and at the time of the appointment of Receivers was generally distressed. We understand that the reported value of past due and impaired loans had increased in the six month period prior to the receivership and on the date of receivership approximately 83% of the amount owing (by value) was either in arrears (i.e. had not been repaid on the due date) or subject to enforcement action:

| Loan book               | \$000                | # of Loans |
|-------------------------|----------------------|------------|
| Performing              | \$ 32,347.87         | 15         |
| Arrears                 | \$ 78,094.42         | 21         |
| Receivers appointed     | \$ 54,200.25         | 10         |
| Mortgagee in possession | \$ 25,976.29         | 4          |
| <b>TOTAL</b>            | <b>\$ 190,618.83</b> | <b>50</b>  |

Although the loan book is secured by first mortgages, it was apparent that some form of enforcement action was needed for the majority of loans.

## Estimated loan recoveries

Since receivership we have worked with EML's loan management personnel to devise strategies to recover all loans within an appropriate timeframe. In some cases borrowers have been able to repay their loan in full (or we expect they will be able to when the loan expires) but in most cases it has been necessary to initiate recovery action (usually via the appointment of receivers) because borrowers have been placed in liquidation, have been bankrupted or have been unwilling to sell collateral when it was clearly in EML's best interests for them to do so.

As a consequence, by 30 September 2011 \$30.8 million had been recovered from loans but a significantly higher portion of the total advances were subject to enforcement action (as compared to their status on the date of receivership):

| Loan book               | 30-Sep-11            |            | Date of Receivership |            |
|-------------------------|----------------------|------------|----------------------|------------|
|                         | \$000                | # of Loans | \$000                | # of Loans |
| Performing              | \$ 11,799.68         | 4          | \$ 32,347.87         | 15         |
| Arrears                 | \$ 37,133.67         | 11         | \$ 78,094.42         | 21         |
| Receivers appointed     | \$ 94,598.86         | 20         | \$ 54,200.25         | 10         |
| Mortgagee in possession | \$ 23,448.34         | 3          | \$ 25,976.29         | 4          |
| <b>TOTAL</b>            | <b>\$ 166,980.55</b> | <b>38</b>  | <b>\$ 190,618.83</b> | <b>50</b>  |

While six loans have been collected in full to date, it will not be possible to recover the full amount owing on most of the remaining loans. Many of the loans are secured over difficult assets that need to be realised in difficult commercial and development market conditions. We anticipate shortfalls on 34 of the remaining 38 advances. Our current estimate is that we will recover approximately \$76.3 million of the amount owing at 30 September 2011 (in addition to the \$30.8 million already recovered). This is only an estimate and our estimate will change over time but at this stage, as is discussed below, we believe the shortfall will mean that it will not be possible to repay investors the full amount they are owed.

## Loan loss insurance provided by Equitable General Insurance ('EGI')

As you may be aware, EGI provided mortgage loss insurance over EMLs' advances. EGI is related to EML by shareholding.

EGI issued insurance contracts for individual loans. EML can only make claims against EGI when it has crystallised its loss. To do so, all the security that is held for individual loans has to be pursued (including, for example, personal guarantees). This process takes some time so we have not yet reached a position where we can make claims under the EGI insurance contracts. We expect however that we will be able to do so soon.

Each insurance contract covers the principal owed by the borrower and a limited amount of unpaid interest, as well as certain other costs.

We have recently started discussing the position with EGI but at this point it is too early to estimate what might be recovered. We expect however that the amount of EML's claims will almost certainly exceed EGI's current resources.

Because of the difficulty in estimating the amount we will receive from EGI, for the purposes of the estimate of investors' returns provided in this letter, we have not allowed for any recovery from EGI. Any amount EGI pays will therefore increase the amount investors receive.

## Estimated potential return to investors

Estimating returns at this early stage is difficult, considering the state of the loan book. We can however estimate that loan recoveries (which cannot of course be guaranteed) might enable us to repay between 65% and 70% (\$124.9 to \$134.6 million) of the total amount that was owing to investors on the day Receivers were appointed. This estimate includes the amount we paid investors on 8 August 2011 and the amount that we will pay investors on 15 December 2011. It is exceedingly unlikely that we will be able to pay any interest.

This estimate does not allow for any recovery from the mortgage loss insurance that EGI issued, which is discussed above.

### Timing

The timing of distributions to investors is determined by the timing of loan recoveries so it is difficult to advise timeframes for repayments. We believe however that we will be able to make another repayment to investors around April 2012 and we currently expect it may take at least two years to recover all the assets.

Over this period we will make partial payments to investors as and when we can. We will always provide you with at least 14 days' notice of our intention to pay a distribution.

## Investigations

As Receivers we are obligated to report certain matters to the regulatory authorities. As is usual in a receivership, we have started investigating a number of issues (with the Trustee's assistance) and will report any issues to the relevant regulatory authority. Investors should contact us if they have any particular concerns.