



	Key operational capability strengths	Key risk factors
<p>Analyst Natasha Hall 0435 610 293 natasha.hall@australiaratings.com</p> <p>Operational Capability Assessment 'Very Strong' An assessment of 'Very Strong' reflects the very strong capacity of an operating party to perform its operational role and assist the issuer or fund to meet financial obligations in a timely manner.</p>	<ul style="list-style-type: none"> Clear, consistent, embedded Governance, Risk Management and Compliance policies and practices that support LFAM's operations and the required objectives of the Fund. Consistently diligent and experienced staff with clear accountability. Evident focus to protect investor capital and interest. Very strong operational and financial support from the wider La Trobe Financial Group backed by the Blackstone Group. 	<ul style="list-style-type: none"> LFAM is a lender and manager of specialist mortgages. Management of arrears is essential in protecting members' investments.

OCA Ranking - Very Strong

Australia Ratings has affirmed its Operational Capability Assessment of La Trobe Financial Asset Management Limited (LFAM), in its role as the Responsible Entity for the La Trobe Australian Credit Fund (the Fund), as 'Very Strong'. This affirmation is underpinned by LFAM's continued focus to prudently manage the Fund and foster its growth and performance to current levels, whilst preserving investor capital.

LFAM's Very Strong ranking reflects sound Governance, Risk Management and Compliance frameworks, experienced and focussed staff, prudent management to protect investor capital and interest, and continued solid support from its parent and related entities within the La Trobe Financial Group of Companies and the broader, US\$400 billion Blackstone Group.

Current arrears on loans remains a key risk to the Fund and LFAM given the near-prime mortgages allocated to the Fund. However, LFAM's policy and practice of managing asset quality and performance has kept arrears to levels that are comparable to industry performance.

Owing to the operating relationships LFAM has with the wider La Trobe Financial Group and the global giant, Blackstone Group, Australia Ratings has given consideration to the operational and financial profiles of the key La Trobe Financial companies. Furthermore, Australia Ratings considers the profile and

performance of the Fund itself, given that they are a reflection of LFAM's performance as Responsible Entity (RE).

Australia Ratings' operational capability assessment of LFAM included a review and ranking of LFAM's operational components. The combination of the weighted rankings of these components underlies LFAM's Very Strong operational capability assessment. The rankings of each operational component are outlined in Table 1.

Ownership, Performance, Outlook	Very Strong
Experience & Skill of Management & Staff	Very Strong
Governance	Very Strong
Risk Management and Compliance	Very Strong
Custody of Fund Assets	Very Strong
Investment Management	Very Strong
Fund Liquidity	Strong
Systems and Technology	Strong
Financial Adequacy and Stability	Very Strong

La Trobe Australian Credit Fund

The Fund is a registered managed investment scheme that has historically invested in mortgages and cash. It is available to retail and wholesale investors by way of a Product Disclosure Statement, and has been in operation since 1990.

The Fund currently has four separate investment accounts to choose from:

- (a) Classic 48 hour Account (renamed from Cash & Mortgages);
- (b) 12 Month Term Account (renamed from Pooled Mortgages);
- (c) Select Investment Account; and
- (d) High Yield Investment Account, with a further sub-pool named High Yield Credit Portfolio.

The Fund's overall objective is to provide investors with capital stability and a regular income. Each of the Fund investment accounts has its own specific objective and level of investment risk, providing a commensurate return on investment.

Investors in the Classic 48 hour and 12 Month Term Accounts benefit from the diversification of the pooled loans, while investors in the Select Investment and High Yield Investment Accounts have a direct exposure to the loans they select. High Yield Credit Portfolio investors have a reduced exposure to concentration risk relative to the High Yield Investment Accounts investors, given their investment in a portfolio of securitised mortgages via notes.

LFAM strategically diversifies the Fund at a number of levels:

- Number of loans;
- Size of loans;
- Loan sector (e.g.: residential, commercial, industrial, construction, rural and land);

The Fund also has a 'co-investment model', which means that mortgages can be funded by more than one of the Fund's investment accounts. This decreases the average size of each Account's investment and increases the total number of investments in each Account (except the High Yield Investment Account). A default of a mortgage funded by more than one investment account would still affect investors in each account, but their loss of income would be limited to their proportional investment in that particular mortgage. Returns from other mortgages within the respective accounts would continue.

The Fund's total funds under management (FUM) has grown materially and as at 31 October 2017 reached \$1.8 billion. The total number of mortgages in the Fund was 2,596 and the single largest mortgage investment was \$14.5m (0.91% of total FUM) as at 30 June 2017. Table 2 below summarises the Fund's profile as at 30 June 2017, with comparative data for prior financial year

Table 2: La Trobe Australian Credit Fund metrics

Month ended 30 June	2017	2016
Total funds under management (\$A million)	1,594	1,109
Total number of mortgages	2,596	1,951
Total value of mortgages (\$A million)	1,423	1,039
Weighted average LVR (%)	62.8	62.7
Investment in cash and liquidity (% of total funds under management)	8.8	3.8
Investment in mortgages (% of total funds under management)	89.3	93.7
Investment in credit assets (% of total funds under management)	1.9	2.5
Top 10 largest mortgage investments in aggregate (% of total funds under management)	4.8	5.6

Ownership, Performance, Outlook

LFAM's ownership, performance and outlook provide robust support for LFAM's operational capability and, in turn, support for the Fund.

LFAM is wholly owned by La Trobe Financial Pty Limited and forms part of the La Trobe Financial Group of companies. The La Trobe Financial Group is 80% owned by the Blackstone Group L.P., the world's largest alternative asset manager with US\$400 billion in assets under management. The remaining 20% is owned by long-time President & CEO, Mr Greg O'Neill. We regard this ownership structure as a credit positive for the operational capability of LFAM.

The La Trobe Financial Group's key business as a credit specialist is to originate loans and offer investors (institutional and retail) an opportunity to invest in those loans secured by registered mortgages and other credit assets.

The two relevant operating entities of the group are LFAM and La Trobe Financial Services Pty. Limited (LFS). LFAM is the Responsible Entity for the Fund. LFS is the Investment Manager for the Fund and is responsible for group administration and asset servicing, third party outsourcing services, group insurance sales, and wholesale institutional funding mandates. LFAM and LFS each hold an Australian Credit Licence and LFAM holds an Australian Financial Services Licence (AFSL).

The La Trobe Financial Group provides reliable support to LFAM in the form of sourcing sufficient and relevant mortgage assets to meet the Fund's asset requirements and investors' appetites.

LFAM's performance has been consistent and positively supports the Fund's Constitution. The Fund currently has more than \$1.8 billion of FUM and has over 13,000 active investors. Growth in the Fund is expected to remain strong over the next 12 months, with some moderation from 43% growth in FUM for fiscal 2017 to around 33% growth for fiscal 2018

Australia Ratings ranks LFAM's ownership, performance and outlook as Very Strong.

Experience and Skill of Management and Staff

LFAM has been managing retail investment funds successfully for more than 20 years. This success is attributable to a combination of factors including the experience and culture of its people to undertake their respective roles ethically and in line with documented processes and procedures.

LFAM operates within the Wealth Management & Treasury Division of the La Trobe Financial Group. Martin Barry, an experienced externally recruited banker, leads the Division as Chief Corporate Treasurer. Chris Andrews is the Chief Investment Officer and is supported by Ryan Harkness (Deputy CIO and Head of Debt Capital Markets) and Jason Gidman (Head of Fund Portfolio Management). Martin joined La Trobe Financial in 2014 as Head of Wealth & Funds Management while Chris joined the La Trobe Financial Group in 2006 as Senior Legal Counsel and transferred to the Funds division in 2009. Ryan Harkness re-joined La Trobe Financial in 2013 after working abroad for two years. Ryan has experience in credit and RMBS as well as funds management. Jason Gidman joined the La Trobe Financial Group in December 1992 and is responsible for the full range of portfolio construction and management issues for the Fund, including asset selection, funding allocation and risk management.

The group has a key personnel succession plan to mitigate the risk of depending on any one person and to minimise the risks associated with filling vacant roles. Each key manager in the group is aware of the succession plan and it is reviewed regularly to ensure staff back up.

There is clear separation of duties and responsibilities. Staff members are informed of all role requirements, procedures and processes at induction training as well as ongoing training as required. Support is offered via access to relevant policy & procedure manuals as well as experienced team members. Internal firewalls are used to prevent conflicts of interest and other unethical activities. This segregation and rotation of duties removes single point dependence.

The combination of skills and experience of the La Trobe Financial staff underlies LFAM's strong performance and is considered by Australia Ratings a Very Strong factor of LFAM's Operational Capability Assessment.

Governance

Governance provides solid direction to LFAM's operational capability and is key in LFAM succeeding as RE. LFAM's Board of Directors consists of 5 members, of which 4 are independent to the La Trobe Financial Group. All directors must complete an annual declaration of independence, together with a certification on conflicts of interest, relevant training undertaken and a summary of their areas of competence.

In addition, the La Trobe Financial Group has established an origination and credit committee (OCC); markets, funding and rates committee (MFR), audit and risk committee (ARC), and remuneration and finance committee (RFC). LFAM is subject to the La Trobe Financial Group's policies that stem from these committees.

Australia Ratings ranks Governance as Very Strong owing to its clear direction and supportive framework through which LFAM can operate prudently.

Risk Management and Compliance

Australia Ratings ranks LFAM's Risk Management and Compliance policies and procedures as Very Strong. In line with the policies of the wider La Trobe Financial group of companies, LFAM has established clear, consistent and prudent processes to ensure that its operations as RE are in accordance with legal, regulatory and licensing requirements. Furthermore, LFAM maintains regular monitoring and reporting of all its risks, and undertakes periodic reviews for improvement, ensuring accountability and tie-in of its senior managers.

The Fund has a Compliance Plan that sets out the key processes, systems and structures that LFAM (and its contracted parties) must follow. The aim of the Fund Compliance Plan is to ensure protection of all Fund members as well as compliance with the Fund Constitution, AFS Licence and Corporations Act 2001. It has been prepared following ASIC's Regulatory Guide 132 - Managed Investments: Compliance Plans. The Plan clearly sets out reporting obligations for compliance and non-compliance. Moreover, it specifies what compliance is required for the key facets and risks of managing the Fund, and how and by whom that compliance is monitored and reported.

Adherence to the Plan is monitored through a system of certifications and random reviews of internal files and business

practices. The Plan and its compliance are audited annually by the external auditor and any material breaches must be ultimately reported to the Board and to ASIC.

LFAM's approach to risk management is in accordance with the La Trobe Financial Group's Risk Management Policy and all material risks must be recorded in a central Risk Register, which is reviewed annually by the Chief Risk Officer, Randal Williams who joined the La Trobe Financial Group in 2003.

Custody of Fund Assets

On 31 July 2017, LFAM appointed Perpetual Corporate Trust Limited as custodian for mortgage investments of the Fund. Perpetual was selected as the preferred external provider to replace LFAM as custodian and LFS as sub-custodian of the Fund's mortgage investments, to support the expected continued growth of the Fund that is underpinned by the more flexible funding structures now in place.

The Custodian Agreement is a commercial agreement between the two parties that incorporates the matters required by ASIC Regulatory Guide 133 (Managed Investments: Scheme Property Arrangements).

The custodian holds all the certificates of title of the mortgaged properties in a special purpose vault located in Collins Street, Melbourne. Security packets are audited by LFS to ensure that the packets are physically held and that the security seals on the packets have not been tampered with.

Part of the Fund Compliance Plan requires the performance of Perpetual as custodian to be overseen and reported on periodically. Perpetual prepares a quarterly Custodian's Compliance Report detailing such matters as insurance coverage, adherence to RG 133 and service standards for the safe keeping of Fund property. The Compliance Plan Auditor will review these records as part of its audit of the Plan. In addition to this, Perpetual has its annual reporting requirements under GS007.

Australia Ratings considers the custodial arrangements implemented by LFAM to be Very Strong, reflecting the comprehensive audit and oversight of the activities of the independent custody service provider, supported by the group's in-house custody experience and expertise.

Investment Management

Despite the challenges of investing in the near-prime mortgage market, LFAM's appointment of LFS, an experienced specialist lender who originates over \$3 billion of loan applications annually, as Investment Manager has proven effective in matching investments to the Fund's requirements.

Investment Management is now considered to be "Very Strong", given the continued strong investment performance of the Fund relative to its benchmark returns over recent years, as well as LFAM's access to the considerable asset management capabilities of the Blackstone Group L.P. going forward. Over the twelve months to 31 October 2017, the 12 Month Term Account achieved a return of 5.33% p.a., with outperformance of the Bloomberg Ausbond BBI +1.5% benchmark by 1.95% p.a. The Classic 48 Hour Account achieved a return of 3.25% p.a. over the same period, with outperformance of the Official Cash Rate + 0.5% by 1.15% p.a.

LFS' role as Investment Manager is outlined under a commercial agreement with LFAM. The agreement outlines the management services required by the Responsible Entity for the retail fund, and is linked to the Fund Constitution and the Fund Compliance Plan to ensure LFS undertakes its services with a focus on supporting LFAM in achieving the relevant objectives of the Fund. LFS has no rights to terminate the Agreement but can retire giving 3 months' notice.

LFS manages not only the assets of the Fund but also the group's institutional funds. It has demonstrated a good operating capability, contributing to the La Trobe Financial Group's successful track record of over 65 years, covering many economic cycles including the financial crisis of 2008. Key to LFS' sound operation is the experience and knowledge of its management together with its approach in choosing the right investments to match investor appetite.

LFS' approach in undertaking its investment management role is aligned to the Fund's general investment mandate as well as the specific investment mandates of each account within the Fund.

LFS undertakes its own credit analysis of each loan application. When assessing a loan application, there are two questions that LFS must positively satisfy:

1. Whether an asset meets its lending criteria, and
2. Whether the loan is suitable for inclusion in the Fund.

The decision-making for these two assessments is undertaken by separate teams. If the loan satisfies the credit lending criteria it will then be reviewed by the Portfolio Management team in light of the funding appetite, investment mandate and existing allocations. If the loan applications do not meet both requirements, the loans are declined.

LFS has allocated responsibility for different stages of its asset origination to different teams. Those who originate loans are not the same people who underwrite the risk of loans, who in turn are not the same people or department who document the loan, and finally are not the same people or department responsible for closing the loan and advancing monies to borrowers. This segregation of responsibilities maintains the independence of each team and can help to mitigate fraud and conflicts of interest.

Property valuations are undertaken only by external valuers that form part of La Trobe Financial Group's panel of valuers.

Substantial focus is placed on the performance of assets and asset management. The Asset Management Team is responsible for all credit management and negotiations with arrears control and loan workouts, and reports significant matters to the Board on a quarterly basis.

Australia Ratings periodically monitors the Fund's levels of arrears as an indicator of LFAM's ongoing capability to successfully execute its role. Given the nature of the specialist mortgages within the Fund, the Fund is exposed to a higher level of loan arrears than industry averages for prime residential mortgages. However, the Fund's levels of arrears are comparable to arrears on non-conforming loans in the market. As at 31 October 2017, total loan arrears greater than 30 days for the 12 Month Term Account was 2.6% of FUM (2.7% as at 31 December 2016).

LFAM has also managed shortfalls effectively, with investors in the Classic 48 hour and 12 Month Term Accounts not incurring any capital losses since inception. Shortfalls have been relatively low and have been met through cash holdings or the Investor Reserve. Since inception (2002) shortfalls on loans in the 12 Month Term Account have averaged 0.1% per annum and the Investor Reserve represented 0.61% of FUM as at 30 June 2017.

In prior years, LFAM has acquired fully funded portfolios. These portfolios are kept separate and quarantined from the current assets within the Fund's account. Existing and new investors bear no credit risk in relation to these acquisitions.

Australia Ratings ranks Investment Management as Strong. LFS undertakes its challenging role effectively and identifies assets with qualities that match Fund requirements and investors' risk appetites. The formal and clear segregation of duties in originating, pricing and documenting loans and valuing properties are key factors in supporting the ranking. Loan arrears and shortfalls require continued prudent management and review to protect Fund investors' capital and expected return.

Fund Liquidity

Australia Ratings ranks LFAM's management of the Fund's liquidity profile as Strong. The illiquid nature of the Fund's assets can expose investors to high risk. However, LFAM has continued to meet its ongoing liquidity needs, maintain additional asset reserves, and preserve investors' capital.

Fund liquidity is managed in accordance with the Fund's Constitution and investment mandates, and more than meets its current regulatory requirements. The illiquid nature of the Fund assets can pose a liquidity issue if investors are seeking withdrawal from the Fund. However, LFAM has clearly spelt out members'

rights to withdraw from the Fund in the Fund's Constitution and PDS. In the circumstance where the Fund is not liquid, LFAM has the right to suspend redemption requests.

Investors in the 12 Month Term Account benefit from an Investor Reserve maintained by the Responsible Entity, representing the difference between earnings on the pool of mortgages and income payments to investors after a flat management fee of 1.50%. This Investor Reserve provides three levels of accumulated support to investors in 12 Month Term Account. The first is to provide income smoothing between different interest periods thereby providing stability of income paid to investors from month to month. The second is that it can be called upon to make good any decline in the value of the assets in 12 Month Term Account thereby providing capital stability. Finally, it provides a more equitable matching of the risk and reward profile of the investment account overtime. The objective for the Investor Reserve is presently between 0.55% and 0.90% of the FUM of the 12 Month Term Account.

From a liquidity perspective, the peer to peer Select Investment and High Yield Investment Accounts carry the least amount of liquidity risk for the Fund, given that investors have no right of early withdrawal (matched to loan term investment) from the underlying mortgage assets. The Fund's Product Disclosure Statement informs all investors that withdrawals are not available for Select Investment and High Yield Investment investors during the agreed term of each selected asset. Liquidity in these investment accounts simply lies with the borrower's legal obligation to repay the loan. The Fund does not have to provide any further liquidity. At maturity of an individual loan, investors are legally entitled to redeem their investment, subject to the repayment of the loan by the borrower.

Systems Technology

Information Technology (IT) software is wholly owned by La Trobe Financial and its IT requirements are managed in-house.

The Fund administration system, called PASSPORT, handles all daily data processing for the Fund and maintains the data required to service the investors in the Fund. This software is separate from all other accounting applications of the Investment Manager and the Responsible Entity.

LFS uses a proprietary borrower system called CLASS to record, track and monitor all servicing assets. A unique account number is allocated to each borrower during loan assessment and is used as the unique identifier of a loan for its duration.

The IT Platform assists with risk management and compliance. The system contains a specially designed compliance function which runs a set of specified compliance rules across all mortgage portfolios to ensure commercial, regulatory and corporate policy obligations are satisfied. Internal auditors also test these controls on a regular basis while external auditors test the controls annually.

Backup and disaster recovery procedures are in place and are regularly tested and documented. Detailed policy and procedures in respect to disaster recovery and business continuation have been developed by LFS and reviewed by LFAM. Testing under a disaster scenario concludes that LFAM can continue its operations from the Sydney office or its disaster recovery center provided by Interactive Systems Availability located in Port Melbourne with minimal disruption to business should the Head Office in Melbourne be disrupted.

Australia Ratings' assessment of LFAM's Systems Technology as Strong reflects the key aspects of:

- Complementary yet independent in-house computer systems to store and match asset information and investor data;
- Formal, consistent security processes and protocols to manage relevant systematic and data risks; and
- Sound business continuity practices that are tested annually to ensure they meet LFAM's prescribed operational requirements and principles.

Financial Adequacy and Stability

Australia Ratings ranks LFAM's financial viability and stability as Very Strong. LFAM has demonstrated sound financial performance and continually manages its finances to ensure all regulatory requirements are satisfied and to protect the returns of the investors. LFAM benefits from the financial strength and support of the wider La Trobe Financial group.

As at 31 October 2017, the Fund's FUM reached \$1.8 billion. LFAM's revenue grew to \$44.5 million from \$37.9 million in 2016, while net profit after tax amounted to \$5.7 million (2016: \$5.4m). The financial accounts for the Fund and LFAM for the year ended 30 June 2017 have been audited with no qualification.

Table 3: Key Financial Statistics – La Trobe Financial Asset Management

Financial Year Ended June 30	2017	2016	2015	2014
Gross Revenue	44.5	37.9	23.3	19.1
Total Expenses (before tax)	36.4	30.2	17.8	13.7
Net Profit After Tax	5.7	5.4	3.9	3.8
Total Assets	27.6	28.9	20.8	18.3
Total Liabilities	12.4	7.5	4.9	6.2
Equity	15.2	21.3	15.9	12.0

Owing to LFAM's reliance on LFS as Investment Manager, Australia Ratings also assessed the financial adequacy and stability of LFS. Australia Ratings is satisfied that LFS is capable of financially supporting and fulfilling its role over the medium term.

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Operational Capability Assessment Ranking Scale

Assessment	Definition
Superior	An assessment of 'Superior' reflects the superior capacity of an operating party to perform its operational role and assist the issuer or fund to meet financial obligations in a timely manner. An operating party's superior capacity is supported by many superior and reliable operational abilities, and strong financial status.
Very Strong	An assessment of 'Very Strong' reflects the very strong capacity of an operating party to perform its operational role and assist the issuer or fund to meet financial obligations in a timely manner. An operating party's very strong capacity is supported by many very strong and reliable operational abilities and possibly some superior qualities.
Strong	An assessment of 'Strong' reflects the strong capacity of an operating party to perform its operational role and assist the issuer or fund to meet financial obligations in a timely manner. An operating party's strong capacity is supported by many strong and reliable operational abilities and some very strong qualities.
Adequate	An assessment of 'Adequate' reflects the adequate capacity of an operating party to perform its operational role and assist the issuer or fund to meet financial obligations in a timely manner. An operating party's adequate capacity will support its role but its resilience to unexpected operational or financial changes is limited.
Weak	An assessment of 'Weak' reflects the weak capacity of an operating party to perform its operational role and assist the issuer or fund to meet financial obligations in a timely manner. The operating party's weak capacity displays material operational, financial or risk management and compliance deficiencies.
Failure to Perform	Assigned when a party contracted to perform an operational role has failed to meet the required standards and terms and conditions of the contract.