



PROPERTY FINANCE

## EXPLANATORY MEMORANDUM

This Explanatory Memorandum dated the 6<sup>th</sup> December 2007 details the proposal for restructuring of debenture stock issued by the Company to be considered at the Company's Meeting of Stockholders in Auckland on 21 December 2007.

If Stockholders agree to pass the Extraordinary Resolution to restructure the terms and conditions of the Company's debenture stock, it is intended that the Company will be removed from receivership and will wind-down its affairs under the control of its directors.

### **INDEPENDENT ADVICE**

This Explanatory Memorandum and the accompanying Notice of Meeting and Proxy Form are important documents and should be read in their entirety. Stockholders should make their own investigations on the matters set out in this Explanatory Memorandum and seek independent advice.

DECEMBER 2007



# BACKGROUND

Propertyfinance securities limited (In Receivership) (**PFSL or the Company**), since its formation in 2001, has acted as a mortgage finance specialist. In the earlier years, its loans were predominantly secured by second mortgage. In October 2004, the Company changed its strategy to be a first mortgage lender. Its lending activities through these stages of the Company's development were exclusively funded by the public issuance of secured debenture stock.

In 2005, the Company further evolved when it established a loan securitisation funding programme. The securitisation enabled the Company to bundle together groups of like mortgages and to sell these bundles to special purpose trusts. The special purpose trusts funded their purchase of the mortgages by issuing debt notes in the wholesale money market.

The propertyfinance securitisation programme involved the Company establishing four of these special purpose trusts, enabling the Company to compete in the mainstream mortgage markets by selling its products through the mortgage broker channel.

The Company's total assets under management grew quickly from \$77m as at 31 March 2005 to over \$533m as at March 2007.

In August 2007, the Company experienced severe liquidity challenges when there were disruptions in the money markets both domestically and internationally, as has been widely reported in the media. The liquidity squeeze which the Company encountered resulted in the need to protect all stakeholders and the directors made the difficult decision to request the Trustee (Covenant Trustee Company Limited) to appoint receivers to the business.

On 29 August 2007, Messrs Grant Graham and Brendon Gibson of KordaMentha were jointly appointed receivers of the Company.

# THE RESTRUCTURING PROPOSAL

## Introduction

This Explanatory Memorandum contains details of a proposal for restructuring by the Company of debenture stock issued to existing stockholders (**Stockholders**) over a three-year term. If the Extraordinary Resolutions that sets out the terms of the restructuring proposal is approved by Stockholders, the Company will be removed from receivership and enter into a wind-down under the control of its directors.

Further details of the restructuring proposal are set out in this Explanatory Memorandum. Stockholders should be aware that under the restructuring proposal and wind-down, the Company will:

- use the proceeds from asset realisations to make principal repayments to Stockholders as these assets are realised over the three-year term, with the requirement to make payments of a minimum aggregate amount in each year;
- accrue interest to all Stockholders at a new rate of 9.33% from 1 July 2007 to the end of the principal repayment term, payable at the end of the principal repayment term; and
- make a bonus payment of interest calculated at 0.67% per annum over the term of wind-down payable at the end of the principal repayment term, to the extent there are sufficient surplus funds.

During the wind-down period the Company will be controlled by its directors, with any routine management and compliance obligations performed by the Company's parent Propertyfinance Group Limited (**PFG**) under a management contract. During the three-year wind-down period, the Company will not:

- trade, except to the extent necessary to service existing loans and to realise its assets for the benefit of Stockholders;
- issue any new debenture stock;
- employ any staff;
- make any distributions to its shareholders; or
- provide any new loans.

In a practical sense, Stockholders have two options:

- approve the Extraordinary Resolution at the meeting, which will allow the directors' restructuring proposal to proceed with the Company's assets and affairs wound-down by the directors;

**OR**

- refuse to approve the Extraordinary Resolution at the meeting, which would leave the Company's assets to be managed and wound-down by the receivers.

It is important to note that under both scenarios the assets of the Company will be the same. Accordingly, it is a question of how to best deal with those assets and by whom.

## The Position Today

Due to the Company's loan securitisation programme, the Company had a unique business model and this has led it to having a mixture of assets which can be separated into two key categories:

**First Mortgage Secured Loans:** The first category are traditional first mortgage-secured loans over both developed and development properties. These represent approximately 20% of the Company's assets. The Company currently has three remaining development loans. The loan facilities made available to the borrowers total approximately \$4.5 million. At the date of receivership the Company had advanced \$3.2 million and therefore had available for drawing approximately \$1.3 million. Since the date of receivership the directors have not been involved in the management of these loans. It is likely the Company will need to provide further loan advances (to a maximum \$1.3 million) so that the respective developments can be finished.

**Investments in Mortgage-backed Securities:** The second category, which represents approximately 80% of the Company's assets are investments in mortgage-backed securities, resulting from it investing in the loan securitisation trusts which the Company developed. These are discussed in detail below.

## Unsecured Creditors

The Company has three primary categories of unsecured creditors, comprising normal trade creditors, upfront brokerage and trail commissions payable to mortgage brokers, and redundancy and related payments payable to the Company's staff.

Prior to the restructuring proposal being voted on by Stockholders, the Company will obtain agreement from each unsecured creditor to a payment programme in respect of amounts owed to them and to the restructuring proposal generally. This will ensure that payments to unsecured creditors are not preferred to payments to Stockholders. The Trustee will review and approve the form of the agreement entered into with each creditor.

The Trustee's approval of the arrangements with each creditor is a condition which must be satisfied prior to the Extraordinary Resolution becoming effective.

A summary of these unsecured creditors as at the date of this Explanatory Memorandum is set out below:

Type	Approximate Amount
Trade Creditors	\$1.2m
Mortgage Brokers	\$400,000
Staff	\$400,000
	<b>\$2.0m</b>

Under the proposed payment programme, and conditional upon the approval by Stockholders of the restructuring proposal, PFG will purchase the major trade creditors and will be responsible to pay these amounts in the future, with no further liability being owed by the Company. PFG will also assume 50% of staff costs on a similar basis.

After allowing for the liabilities being settled by PFG and then to be forgiven against the Company, the Company will have the following unsecured liabilities:

Type	Approximate Amount
Trade Creditors (small balances)	\$107,000
Mortgage Brokers	\$403,000
Staff	\$200,000
	<b>\$710,000</b>

Provided the restructuring proposal is approved, PFG has undertaken as a condition of the restructuring proposal to inject into the Company either as capital or as a subordinated loan (which will be fully subordinated to the Stockholders interests) the sum of \$710,000. Injection of this sum is also a condition to the Extraordinary Resolution becoming effective.

The amount will be used by the Company to repay the unsecured creditors as follows:

Type	Approximate Amount	Proposed Payment Terms
Trade Creditors (small balances)	\$107,000	Payment on 21/12/07
Mortgage Brokers	\$403,000	50% payable on 21/12/07, balance payable 31/03/09
Staff	\$200,000	Payment on 21/12/07
	<b>\$710,000</b>	

## Contingent Liabilities

The directors have taken advice regarding any pending contingent liabilities or other claims against the Company that could affect the interests of the Company, and therefore the position of Stockholders, if the restructuring proposal is approved and the Company is taken out of receivership.

To the best of the directors' knowledge and belief, on the information available at the date of this Explanatory Memorandum, there are no pending or contingent claims or liabilities that are likely to be material to the Company's position during the wind-down period.

If a contingent liability or other claim that is material to the position of the Company comes to the attention of the directors and the Company during the period between the date of this Explanatory Memorandum and the date of the meeting, the Company will notify the Trustee and will obtain agreement from the Trustee regarding its proposal for dealing with such claim.

If approval from the Trustee is not obtained before the meeting, the meeting will not proceed. The Trustee's approval of the arrangements in respect of all material claims (if any) is a condition which must be satisfied prior to Stockholders' voting on the Extraordinary Resolution.

## Mortgage-Backed Securities

In order to consider the restructuring proposal put forward by the directors, it is helpful to consider in detail the mortgage-backed securities which the Company owns.

The Company has invested in four securitisation trusts (**Trusts**) which it formed and managed. Loans made to borrowers are owned by each Trust, and each Trust was restricted as to the types of loans it was permitted to purchase.

Trust Name	Permitted Loans
Propertyfinance RM 2005-1 Trust	Residential Mortgages
Propertyfinance CM 2005-2 Trust	Commercial Mortgages
Propertyfinance RML 2005-3 Trust	Residential Mortgages
Propertyfinance LS 2005-4 Trust	Home Equity Release Mortgages

Each Trust has raised money by issuing debt notes to third party investors who are unrelated to the Company. The Company also holds debt notes in each Trust.

The Company is therefore unlike many other finance companies, as the Company is owed money by each Trust, and the majority of its assets are not loans owed directly by borrowers. Borrowers owe their money to each Trust, and each Trust owes money to its noteholders, including the Company.

It may be helpful for Stockholders, when considering the restructuring proposal, to now view the Company as an investment company instead of a finance company.

A breakdown of each Trust's position follows.

**i) Propertyfinance RML 2005-3 Trust**

<b>Summary Loan Pool Analysis</b>	<b>31-Oct-07</b>
Loan Pool Size <sup>1</sup>	294,402,273
Number of Loans <sup>1</sup>	965
Average Loan Size	381,350
Median Loan Size	303,692
Maximum Loan Size	1,507,462
Minimum Loan Size	19,966
Weighted Average LVR	78.6%
% of Loans with LVR >80%	51.2%
Weighted Average Seasoning (Months)	6.93

<sup>1</sup> Fixed and floating advances to a single borrower are reported as two loans.

<b>Geographical Distribution</b>	<b>31-Oct-07</b>
Auckland / Northland	44.1%
Waikato / Bay of Plenty	17.2%
Taranaki / Hawkes Bay	6.4%
Wellington / Manawatu	16.1%
Nelson / Marlborough	2.2%
Canterbury / Westland	10.7%
Otago / Southland	3.3%
	<b>100%</b>

<b>Occupancy</b>	<b>Amount of loans total</b>	<b>% of loan pool</b>
Owner-Occupied	\$160,794,014	54.6%
Investment	\$133,608,259	45.4%
<b>Total</b>	<b>\$294,402,273</b>	<b>100.0%</b>

<b>Delinquency Information</b>	<b>Amount of loans in arrears total</b>	<b>% of loan pool</b>
Current	249,985,637	84.9%
1 day to 30 days <sup>1</sup>	28,188,124	9.5%
31 days to 60 days <sup>1</sup>	9,000,095	3.1%
61 days to 90 days <sup>1</sup>	4,013,244	1.4%
90+ days <sup>1</sup>	3,215,173	1.1%
<b>Total</b>	<b>294,402,273</b>	<b>100%</b>

<sup>1</sup> Arrears are reported based on the last working day of the month.

**ii) Propertyfinance RM 2005-1 Trust**

<b>Summary Loan Pool Analysis</b>	<b>31-Oct-07</b>
Loan Pool Size <sup>1</sup>	82,212,983
Number of Loans <sup>1</sup>	308
Average Loan Size	284,474
Median Loan Size	274,449
Maximum Loan Size	748,027
Minimum Loan Size	147,658
Weighted Average LVR	95.2%
% of Loans with LVR >80%	96.5%
Weighted Average Seasoning (Months)	12.68

<sup>1</sup> Fixed and floating advances to a single borrower are reported as two loans.

<b>Geographical Distribution</b>	<b>31-Oct-07</b>
Auckland / Northland	45.8%
Waikato / Bay of Plenty	12.7%
Taranaki / Hawkes Bay	8.3%
Wellington / Manawatu	14.7%
Nelson / Marlborough	1.5%
Canterbury / Westland	14.0%
Otago / Southland	3.0%
	<b>100.0%</b>

<b>Occupancy</b>	<b>Amount of loans total</b>	<b>% of loan pool</b>
Owner-Occupied	82,212,983	100.0%
Investment	-	0.0%
<b>Total</b>	<b>82,212,983</b>	<b>100.0%</b>

<b>Delinquency Information</b>	<b>Amount of loans in arrears total</b>	<b>% of loan pool</b>
Current	73,147,492	89.0%
1 day to 30 days <sup>1</sup>	6,931,816	8.4%
31 days to 60 days <sup>1</sup>	730,328	0.9%
61 days to 90 days <sup>1</sup>	0	0.0%
90+ days <sup>1</sup>	1,403,347	1.7%
<b>Total</b>	<b>82,212,983</b>	<b>100.0%</b>

<sup>1</sup> Arrears are reported based on the last working day of the month.

**iii) Propertyfinance CM 2005-1 Trust**

<b>Summary Loan Pool Analysis</b>	<b>31-Oct-07</b>
Pool Size <sup>1</sup>	147,622,769
Number of Loans <sup>1</sup>	104
Average Loan Size	1,587,342
Median Loan Size	901,366
Maximum Loan Size	8,293,840
Minimum Loan Size	182,430
Weighted Average LVR	68.6%
% of Loans with LVR >80%	3.2%
Weighted Average Seasoning (Months)	10.29

<sup>1</sup> Fixed and floating advances to a single borrower are reported as two loans.

<b>Geographical Distribution</b>	<b>31-Oct-07</b>
Auckland / Northland	46.2%
Waikato / Bay of Plenty	12.6%
Wellington / Manawatu	19.5%
Nelson / Marlborough	2.8%
Canterbury / Westland	12.9%
Otago / Southland	3.7%
Other	2.3%
	<b>100.0%</b>

<b>Occupancy</b>	<b>Amount of loans total</b>	<b>% of loan pool</b>
Owner-Occupied	101,322,916	68.6%
Investment	46,299,854	31.4%
<b>Total</b>	<b>147,622,769</b>	<b>100.0%</b>

<b>Delinquency Information</b>	<b>Amount of loans in arrears total</b>	<b>% of loan pool</b>
Current	136,465,084	92.4%
1 day to 30 days <sup>1</sup>	9,586,073	6.5%
31 days to 60 days <sup>1</sup>	–	0.0%
61 days to 90 days <sup>1</sup>	1,571,612	1.1%
90+ days <sup>1</sup>	–	0.0%
<b>Total</b>	<b>147,622,769</b>	<b>100.0%</b>

<sup>1</sup> Arrears are reported based on the last working day of the month.

**iv) Propertyfinance LS 2005-4 Trust**

<b>Summary Loan Pool Analysis</b>	<b>22-Aug-07</b>
Loan Pool Size	46,239,306
Number of Loans	986
Average Loan Size	38,706
Weighted Average LVR	21.79%
Weighted Average Seasoning (Months)	16.47

<b>Geographical Distribution</b>	<b>22-Aug-07</b>
Auckland / Northland	27.25%
Waikato / Bay of Plenty	18.13%
Taranaki / Hawkes Bay	6.38%
Wellington / Manawatu	11.51%
Nelson / Marlborough	6.56%
Canterbury / Westland	23.04%
Otago / Southland	7.14%
	<b>100%</b>

<b>Occupancy</b>	<b>Amount of loans total</b>	<b>% of loan pool</b>
Owner-Occupied	100%	100%
Investment	0%	0%
<b>Total</b>	<b>100%</b>	<b>100%</b>

<b>Delinquency Information</b>	<b>All loans are current</b>	<b>% of loan pool</b>
Current	46,239,306	100%
1 day to 30 days	-	-
31 days to 60 days	-	-
61 days to 90 days	-	-
90+ days	-	-
<b>Total</b>	<b>46,239,306</b>	<b>100%</b>

## The Debt Notes held in the Trusts

A key point for Stockholders to consider in later analysis of the restructuring-versus-receivership scenarios is how each Trust is funded.

The Company holds debt notes in each Trust. Each Trust is owed money by borrowers which is secured by first registered mortgages. These loans were funded by each Trust issuing different classes of debt notes. The debt notes held by the Company entitle it to receive interest payments and principal repayments from each Trust, which vary according to the type of debt notes held.

The debt notes are ranked in a “waterfall” priority method.

An example: ABC Trust has \$100m in mortgage loans funded by \$100m in debt notes. If, for example, there are four classes of debt notes in the ABC Trust, they could be:

	(\$m)
Class A	75.0
Class B	15.0
Class C	7.5
Class D	2.5
	<b>\$100.0m</b>

The debt notes that the Trusts have issued to their investors are ranked in priority (generally from A to G) and the higher classes of notes are rated by Fitch Ratings (further details of Fitch Ratings definitions and other information can be found at [www.fitchratings.com](http://www.fitchratings.com)). Due to this “waterfall” arrangement, the Class A debt notes have the highest credit rating, say AAA, the Class B will have the next best credit rating, and so on. The lower classes of notes do not carry a credit rating.

Payments of principal and interest to investors are treated differently, but both are made in priority. Each class of debt note is only paid principal and interest if all of the principal and interest has been paid to the higher credit ranking classes of debt notes.

Accordingly, when ABC Trust customers repay their mortgages, ABC Trust must use the loan principal money to repay in full the Class A debt notes first and then the Class B debt notes in full, and so on. As customers pay their monthly interest, this is paid out to investors in the same order, ie. Class A first, Class B second, and so on. If in any month there is a shortfall of interest receipts from customers, then the Class D debt note would first be written down in value.

This “waterfall” arrangement has a material impact on the position of Stockholders when considering the Company's position:

- In general, the Company holds lower-ranked debt notes (Class D and lower) in each Trust;
- Whilst the Company will continue to receive regular income on its debt notes from scheduled interest payments, it will not receive principal until the higher-rated notes are first repaid in full;
- As the higher-rated notes are repaid, it is expected that the lower-rated notes will, over time, be upgraded, i.e. an existing debt note rated BB is expected to improve to BBB;
- Due to the changes in both national and international credit markets, it is widely accepted that there exists no ready market for debt notes of this nature and if they were to be sold then it would be at a deep discount to face value, resulting in significant losses to Stockholders.

- ✦ Various factors can impact on the ratings at each level of the waterfall. If market conditions or defaults in the loan book affect the rating of a particular class of note, then the Trustee may be obliged to increase interest rates to take other steps which may impact on the value of the lower ranked debt notes owned by the Company. This action may result in more defaults and further reduction in the value of the debt notes owned by the Company.

## The Extraordinary Resolution

Attached to this Explanatory Memorandum is the Notice of Meeting which sets out the meeting details and the Extraordinary Resolution which Stockholders are being asked to vote on. If the Extraordinary Resolution is passed at the meeting of Stockholders, the Company can be removed from receivership and enter into a wind-down of its operations under the control of its directors.

The Extraordinary Resolution is set out in full below, and an explanation of the consequences for the Company and for Stockholders if the Resolution is passed, follows.

### Resolution

*That, subject to the following conditions below being satisfied by 31 December 2007 to the entire satisfaction of the Trustee:*

- (a) all unsecured creditors have entered into binding arrangements agreeing to the proposed payment programme for unsecured creditors as described in the Explanatory Memorandum issued by the Company in support of this Extraordinary Resolution; and*
- (b) the directors certifying to the Trustee that any known disputes involving the Company have been satisfactorily resolved; and*
- (c) the Company has received the sum of \$710,000 by way of an increase in capital or a subscription for subordinated debt,*

*the Company be removed from receivership and the Stock Trust Deed be amended as follows:*

*1 by deleting clause 6.1(a) and inserting the following new clause 6.1(a):*

- (a) Permit Liabilities (including Total Contingent Liabilities) to exceed 95% of Total Tangible Assets;*

*2 by deleting clause 6.2(h);*

*3 by inserting a new sub-paragraph (iii) in clause 7.1(e) as follows:*

- (iii) a report in a form acceptable to the Trustee signed by 2 Directors on behalf of all of the Directors, detailing any change in the status of the Charged Assets of the Company since the last such report from the Directors and attaching correspondence and notices received by the Company from the trustee or the manager of each securitisation trust in respect of which the Company holds mortgaged backed securities;*

*4 by inserting a new Section 12 as follows:*

#### ***"Section 12***

#### ***12. Restructuring of Stock Conditions***

***12.1 Restructuring of Stock Conditions:*** *Notwithstanding any other provisions of this Deed or the existing terms and conditions of any Stock issued and outstanding hereunder, the terms and conditions attaching to all Stock issued and outstanding as at 29 August 2007 shall be amended as follows with effect from 21 December 2007:*

- (a) *Stock shall bear Interest at a base rate of 9.33% per annum with effect from 1 July 2007;*
- (b) *Interest payable under clause 12.1(a) shall be accrued to Stockholders on a quarterly basis, on 31 December, 31 March, 30 June and 30 September in each year and shall be payable to Stockholders on or before 21 December 2010;*
- (c) *Stock shall also bear Interest at a bonus rate of 0.67% per annum (**Bonus Interest**);*
- (d) *Bonus Interest payable under clause 12.1(c) shall be accrued to Stockholders on an annual basis and such Bonus Interest or part thereof shall be payable to Stockholders on or before 21 December 2010 from the surplus funds of the Company after all other obligations of the Company to Stockholders under this Deed have been satisfied but before any distribution to shareholders in the Company;*
- (e) *The Principal Moneys of the Stock shall be repayable on or before 21 December 2010, by quarterly instalments or at more frequent intervals, as the Directors determine in their absolute discretion, subject to the following terms and conditions:*
  - a. *All of the net cash receipts of the Company for each quarter (after deduction of operating expenses of the Company due and payable during the quarter, other than interest, and an amount estimated by the Directors to be sufficient to meet the operating expenses of the Company for the next ensuing 6 months) shall be paid to the Stockholders in reduction of the Principal Moneys of the Stock;*
  - b. *Subject to (a) above, the Company shall make repayments of such Principal Moneys of no less than the following amounts:*
    - i. *for the 12 month period ending 21 December 2008, \$15,000,000;*
    - ii. *for the 12 month period ending 21 December 2009; \$15,000,000; and*
    - iii. *for the 12 month period ending 21 December 2010 the balance of all outstanding Principal Moneys payable to Stockholders.*

**12.2 Conditions of Restructuring:** *Subject to full and complete compliance by the Company with the conditions following in this clause 12.2, the Trustee shall not enforce the security constituted by this Deed or exercise any of its other rights of enforcement hereunder for any failure by the Company to comply with the conditions of issue of any Stock in the period prior to 21 December 2007. These conditions are as follows:*

- (a) *the Company shall comply with its obligations under this Deed in all respects;*
- (b) *except pursuant to a further Extraordinary Resolution, for the period from 21 December 2007 to 21 December 2010, the Company shall not:*
  - (i) *issue any further Stock;*

- (ii) trade, except to the extent necessary to fulfil the Company's commitments under existing Development Loans and to realise its Charged Assets;*
  - (iii) enter into any loan or other arrangement pursuant to which a third party owes an obligation to the Company;*
  - (iv) pay a monthly management fee to its parent company of an amount greater than \$20,000 plus GST;*
  - (v) make or attempt to make a Distribution to any person, and for the avoidance of doubt the management fee payable by the Company in accordance with clause 12.2(b)(iv) shall not be deemed to be a Distribution for the purposes of this Deed or the Companies Act 1993;*
  - (vi) employ any employees;*
  - (vii) provide any remuneration to the Directors of the Company for their services to the Company;*
- (c) the Company shall duly report to the Trustee from time to time as required by this Deed and by the Securities Regulations 1983.*

**12.3 No Event of Default:** *Neither the Extraordinary Resolution passed by the Stockholders whereby this clause 12 was approved, nor the process that led to such Extraordinary Resolution, constitutes an Event of Default such that would enable the Trustee to exercise any enforcement rights under this Deed.*

**12.4 Stock Certificates:** *This Section 12 shall be deemed to be incorporated into all Stock Certificates currently on issue."*

## **The Restructuring Proposal – The Extraordinary Resolution**

The Extraordinary Resolution provides for the Company to be removed from receivership and a restructuring of the terms and conditions of the debenture stock held by Stockholders. Currently, all payments of interest and principal to Stockholders remain suspended, and the receivers are working to determine potential returns to Stockholders under the receivership.

The effect on Stockholders if the Extraordinary Resolution is passed is as follows:

- ✦ **New Three-Year Term:** The terms and conditions of all Debenture Stock held by Stockholders will convert to a new three-year term which will expire on 21 December 2010.
- ✦ **Principal Repayments:** Under the new terms and conditions of the Debenture Stock, the Company must apply the whole of its net cash flow in repayment of principal on the Debenture Stock during this new three-year term subject to the following minimum aggregate amounts:
  - **Year One:** in the first year (ending 21 December 2008), the minimum amount that the Company must repay is \$15 million, this principal must be paid equally to all Stockholders.

Given that the Company has on issue some \$79.5 million in total, each Stockholder must receive a minimum payout of 19¢ for each dollar invested;

- **Year Two:** in the second year (ending 21 December 2009) the Company must repay a further \$15 million on the same basis, i.e. a further 19¢;
  - **Year Three:** Finally, in the third year (ending 21 December 2010) the Company must repay all of the remaining Debenture Stock.
- ✦ **Interest on Principal:** From 1 July 2007 until the end of the three-year restructured term, the Company will accrue interest at a rate of 9.33% per annum to all Stockholders. Interest will be accrued quarterly (at the end of March/June/September and December in each year) and will be payable on or before 21 December 2010.
- ✦ **Bonus Interest:** Provided that all other conditions to be satisfied under the Trust Deed owed to Stockholders have been met by the Company, Stockholders will be entitled to a bonus interest payment up to but not exceeding 0.67% per annum payable from the earnings of the Company during the three-year principal repayment period. This entitlement to bonus interest must be repaid before any moneys can be distributed to the Company's shareholders.
- ✦ **Restrictions on Company:** Unless permitted by Extraordinary Resolution, the Company will be subject to the following restrictions for the period to 21 December 2010:
- the Company will not issue any new debenture stock;
  - the Company will not trade, except to the extent necessary to service existing development loans and to realise the Company's assets;
  - the Company will not provide any new loans or other lending arrangements;
  - the Company shall pay a monthly management fee to PFG of not more than \$20,000 plus GST;
  - the Company will not make any distributions to shareholders.
  - the Company will not employ any staff;
  - the Company will not make any payments of remuneration to directors;
- ✦ **Unsecured Creditors:** All unsecured creditors will be subject to a creditor plan which has been agreed to the reasonable satisfaction of the Trustee prior the date of the meeting. Unsecured creditors will not be able to require payment of moneys due to them other than in accordance with the agreed payment plan.

In addition there are three consequential amendments to the Trust Deed.

1. Clause 6.2(h) of the Trust Deed regulates the maximum size of any one loan (or loans) to any one debtor (or group of debtors) to 12.5% of the Company's total tangible assets, or \$250,000 whichever is the greater.

As the Company winds down its affairs, it must at some point in time breach this specific clause, i.e. the Company's very last asset must be 100% of the Company's total tangible assets.

This resolution deletes this clause from the Trust Deed and therefore removes the need of the Company to comply with the clause.

2. Clause 6.1(a) of the Trust Deed provides that Total Liabilities must not exceed 90% of Total Tangible Assets. This effectively means that the Company must have capital of at least 10% of its total assets. Any diminution in the value of the Company's assets, which is largely beyond the control of the directors, could cause a breach of the 90% ratio.

While the 90% ratio is an appropriate measure in a normal business situation, in a wind-down where no new assets are being acquired, Stockholders will be repaid in full if ultimately Total Liabilities do not exceed 100% of the realised value of total assets. However due to the imprecise nature of valuations, the Trustee believes that a 5% buffer is appropriate. If the value of the assets declines such that liabilities exceed 95% of the value of assets, the Trustee will have the right to call a default and exercise its powers, one of which is to put the Company back in receivership.

3. Clause 7.1(e) requires the Company to provide to the Trustee certain monthly information. To enable the Trustee to monitor compliance by the Company, the Directors are required to provide a monthly report with more detailed information on the Company's assets.

## THE RESTRUCTURING PROPOSAL

### TAKING THE COMPANY OUT OF RECEIVERSHIP AND COMMENCING A WIND-DOWN

The directors consider that a wind-down by the Company will allow the directors to take advantage of a number of benefits and tools available to the Company in dealing with its assets, which are not available to the receivers.

#### ***Directors' experience***

Stockholders should be aware that their interests in a successful work out would be fully aligned with the intentions of the directors. The directors are fully committed to repaying stockholders all of their principal and all of their interest as quickly as possible.

Having established the Company's loan securitisation programme over the last few years, the directors are intimately familiar with the Company's assets, customer base, institutional investors, rating agency and all other parties. The Company is in the best position to hold these third parties to account for the benefit of Stockholders.

The directors have the ability to manage and/or conclude the collection of the monies from the loans and land acquired under the securities for defaulting loans.

#### ***Benefits available to the Company that are not available to the receivers***

The Company has a range of tools available to it that may not be or are not available to the receivers:

- The Company is a wholly-owned subsidiary of propertyfinance group limited (PFG), which is a listed entity and whose shares trade on the NZAX. PFG has the ability to raise fresh capital to either acquire assets from the Company (enabling principal payments to be made to Stockholders) or to inject fresh capital into the Company, or a contribution of both;
- PFG has established and promotes a retail mortgage-backed investment programme called Rated Mortgage Bonds™ (RMB). The RMB's are a rated, tradeable debt security listed on the NZDX. PFG has on issue \$38.1m of five-year securities backed by either commercial mortgages or residential mortgages. The RMB's carry a "BBB" rating from international rating agency Fitch Ratings. PFG is able to consider increasing this programme to purchase at face value BBB-rated mortgage-backed securities from the Company, enabling principal pay-outs to Stockholders;
- It may be possible to consider, in conjunction with senior noteholders, and the trustee of each Trust, strategies to accelerate the pay-down of loans in each Trust and/or enhancing the loans by mortgage insuring some of the residential loans.
- Finally, PFG may look at other means of creating new instruments comprising either capital or debt, itself or with third parties, which may be used to assist the Company to enable an orderly and accelerated wind-down and payment of amounts outstanding to Stockholders.

Clearly, under a scenario where the Company remains in receivership it is highly unlikely that these options can be explored or realistically considered, due to the stigma which attaches to companies in receivership.

### ***The Strategy to meet the Company's Obligations under the Restructuring Proposal***

The directors have prepared a business proposal and strategy to determine how the Company can realise its assets as permitted under the Extraordinary Resolution in order to repay both principal and interest to Stockholders. The directors anticipate that this will be achieved as follows, over the three-year principal repayment period ending on 21 December 2010:

- ✦ It is anticipated that the Company will receive a full repayment of a number of on-balance sheet loans that have matured or will mature within the first year of the restructuring. These loans total \$16.122 million;
- ✦ The Company has a long-term Prime First loan receivable of \$4.6 million. The Company anticipates that this loan can be sold either to a mainstream lender or to PFG's CM Trust by June 2008;
- ✦ The Company holds a highly rated (AA) debt note issued by the LS Trust (Lifestyle Security mortgages) (\$1.6m). The directors believe this can be sold to an institutional investor at par during the first year of the restructure;
- ✦ The Company has a land holding of \$1.3 million. This arose from a defaulting loan. The directors believe that the Company may possibly need to also convert another existing loan of \$1.8 million giving rise to total land holdings of \$3.1 million. The directors anticipate that these land holdings can be sold by March 2009;
- ✦ The directors have made a principal assumption that as the higher classes of notes pay down the same credit enhancement levels will apply within each Trust. This will lead to a natural upgrading of the lower ranked notes. It is assumed that once a debt note is upgraded to "BBB" it can be sold through PFG's NZDX listed Rated Mortgage Bond™ bond programme. The anticipated dates, Trusts and amounts of the upgrade and sales for the CM, RM and RML Trusts are:

<b>Trust</b>	<b>Amount</b>	<b>Date of Upgrade</b>
Propertyfinance CM 2005-1 Trust		
Class E	\$6,145,000	August 2008
Class F	\$945,000	August 2008
Class G – partial	\$11,500,000	May 2010
Class G – balance	\$7,840,000	Aug 2010
Class H	\$400,000	Aug 2010
Propertyfinance RM 2005-1 Trust		
Class D	\$6,240,000	Jul 2010
Class E	\$400,000	Jul 2010
Propertyfinance RML 2005-3 Trust		
Class F	\$9,028,333	Jun 2010
Class G	\$380,000	Jun 2010

- ✦ It is assumed the LS Trust debt notes can be sold to PFG on or before August 2010. The anticipated value of these debt notes at this time is:

<b>Trust</b>	<b>Amount</b>
Propertyfinance LS 2005-4 Trust	
Class A4	\$334,831
Class B	\$10,864,980
Class C	\$1,454,092

- ✦ The directors assume that PFG can either place fresh capital and/or debt facilities to complete the purchase.

In order to carry out this proposal for the wind-down of the Company, the obligations of the Company for the management of its realisation of assets, together with its statutory and other compliance obligations, will be overseen by the directors. PFG will be retained by the Company to perform all required routine compliance and administration services. PFG will be paid a monthly management fee of \$20,000 plus GST for its services to the Company.

### ***Key Assumptions***

The directors' strategy for realising the assets of the Company for the benefit of Stockholders is based on a number of key assumptions. These assumptions are as follows:

- ✦ The average life of the residential loans is three years;
- ✦ The restructuring proposal assumes two key events:
  - That the directors can take out third party mortgage insurance over some of the residential loans. This will lead to a positive rating migration for the lower ranking notes and is simulated in the financial model set out below using a shorter average loan life; and
  - The RM and/or RML Trusts will be able to sell blocks of mortgages to mainstream lenders. As outlined above, this would have a positive rating effect and is also simulated in the financial modelling below by adjusting the average loan life;
- ✦ The present strategy does not forecast the sale or refinance of a number of ancillary securitisation assets held by the Company. At the conclusion of the three-year repayment proposal term, these assets are forecast at \$12.4 million and comprise a number of cash reserves/indemnity funds. It is the directors' intention to investigate other options for the long term funding of these assets during the restructure period and in particular the potential for PFG to acquire them at face value as a long term investment.

## FINANCIAL MODELLING ANALYSIS

In preparing the business case for this restructuring proposal, the directors instructed external securitisation consultants (Infiniti Capital Markets (NZ) Limited) to prepare a specific financial cashflow model (**Model**) of the Company's debt notes held in the Trusts for the Company over a 10-year term.

This Model tested a number of likely scenarios from which this restructuring proposal has arisen.

The Model created two distinct scenarios: (i) a long term receivership scenario; and (ii) the directors' wind-down scenario.

When considering these scenarios, Stockholders should be aware that the assumptions on which the Model is based represent the directors' "best guess". The actual result may vary considerably depending on what the actual key inputs work out to be.

### i) Key Assumptions

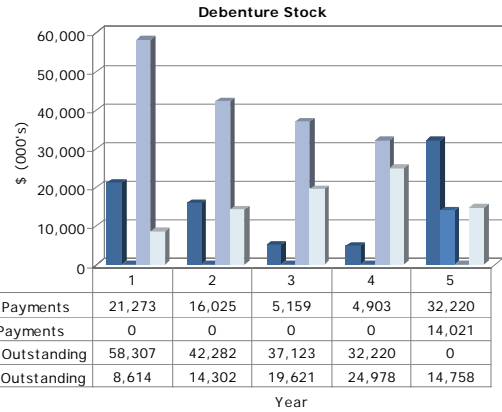
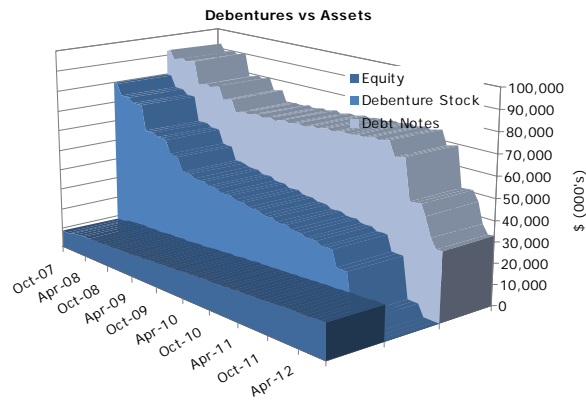
The key assumptions on which the Model is based follow:

Matter	Receivership	Directors	Variance
Repayment of on-balance sheet loans	Dec-08	Completed by Dec-08	–
Residential average life – years	5	3	2 years – insure loans/accelerated
Commercial average life – years	5	3	2 years – insure loans/accelerated
Home Equity average life – years	20	20	–
Sale of BBBs when upgraded	Pay-down	Sold when upgraded	Directors use RMB to sell
BKBM (wholesale interest rate)	8.60%	8.60%	–
Timing of sale of A2 LS debt note	Not sold	Dec-07	Able to be sold if not in receivership
Operating costs per annum	\$500,000	\$240,000	Higher costs for the Receiver

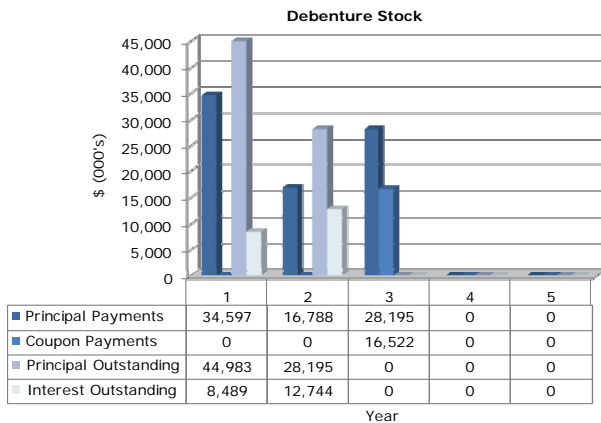
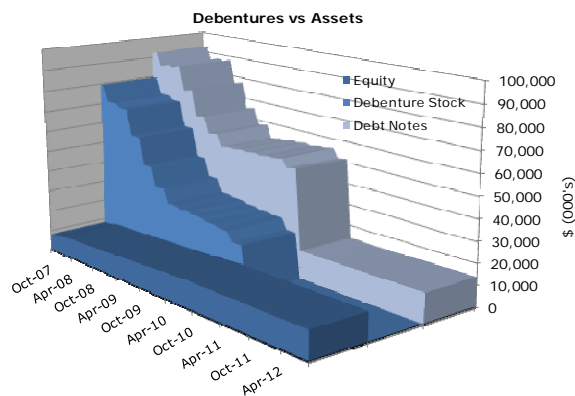
## ii) Key Outputs

The key outputs resulting from the Model are depicted below:

### Receivership Strategy



### Directors' Strategy



## Expert's Report

The Trustee has commissioned a report on this Model and on other aspects of the restructuring plan from Northring Partners Limited. A copy of that report is enclosed with this Explanatory Memorandum.

The report summarises the position on page 14 as follows:

*"... the PFSL Directors strongly believe that the assets of PFSL can be better managed if the Company is taken out of receivership. This will allow the Directors and their advisors to apply all of the specialised skill and experience to put in place the strategies outlined above, and ensures that the management of the Company and the interests of the debenture holders are fully aligned. There is no doubt that the interests of both parties will be best served by the full realisation of the PFSL assets as quickly as possible and, as discussed above, this outcome is in large part dependent on the optimal management of the securitisation trusts. Although it is not proposed that PFSL will seek direct control of the trusts, the PFSL Directors expect to be in a position to strongly influence trust management to the benefit of debenture holders under the restructuring plan.*

*Ultimately, the PFSL Directors are suggesting that they are in a far better position to manage the wind-down of the Company compared to the Receiver. While on the face of it, some of the plans and strategies under consideration by the PFSL Directors could also be implemented by the Receiver with cooperation and assistance from the PFSL Directors and advisers, the PFSL Directors argue that the active day-to-day management of the assets could be enhanced under the direct control of the PFSL Directors. The PFSL Directors clearly have the appropriate incentive and time commitment to dedicate considerable effort to the task, recognising that a timely and efficient repayment of the debentures will help to maximise the residual equity of the Company.”*

## Risks for Stockholders in approving Restructuring Proposal

The approval of the restructuring proposal is not free from risk. The risks described below are some of the key risks inherent for Stockholders in approving the Extraordinary Resolution. However, this is only a summary of some particular risks. Stockholders should make their own independent investigation and seek their own independent advice as to the potential risks involved in accepting the restructuring proposal contemplated by the Extraordinary Resolution and as set out in detail in this Explanatory Memorandum.

The principal risks for Stockholders are as follows:

- the Company may not be able to realise its assets in the manner contemplated by the directors and so payments of principal and interest may not be received in a timely manner as contemplated by the Extraordinary Resolution; and/or
- the Company may not be able to realise all of its assets in the manner contemplated by the directors and so payments of principal and interest may not be received at all, and Stockholders will be unable to recoup their original investment amount.

This could happen for a number of reasons, including if:

- the assumptions on which the directors' proposal and the Model is based prove to be incorrect;
- the directors are not able to influence the managers of the Trusts in order to ensure the interests of Stockholders are taken into account in dealings with the debt notes;
- the assets of the Company, and particularly, the mortgage-backed securities do not perform as anticipated by the directors. The mortgage-backed securities are backed by first-ranking registered mortgages over land. The ability of the Trusts as issuers of the mortgage-backed Securities to pay interest and principal on the mortgage-backed securities when due will depend in large part on timely and sufficient receipts under or in respect of the loans and mortgages which are the effective security for the mortgage-backed securities. In particular the Trusts have the ability to increase the mortgage interest rates payable by the borrowers from the Trusts. The Trusts would do this to maintain the credit rating on the mortgage-backed securities issued by the Trusts which have a credit rating (these securities are not held by the Company) but this action could have a negative impact on the value of the mortgage-backed securities held by the Company. This action is beyond the control of the directors; The resulting loss in capital value may place the Company in breach of the Total Liabilities to Total Tangible Assets ratio under the Trust Deed;
- local or international developments of a legal, social, economic, political or other nature which differ from the assumptions on which the proposal is based, affect the performance of the Company's assets;
- the inability of the Company to control the price at which the Company is able to, or needs to, sell its debt notes is less than the price anticipated by the directors' will be paid for them, due to a downgrade in the rating of debt notes, interest rate movements, supply and demand or for other reasons.

## REMAINING IN RECEIVERSHIP

Under this scenario we can consider likely outcomes for Stockholders. Ultimately, it is the decision of the receivers as to how the assets are managed.

Points for consideration are:

- ✦ The receivers are currently unable to advise Stockholders of potential returns and the timing of returns to Stockholders due to the uncertain market conditions;
- ✦ It is widely accepted that there exists no ready market for debt notes of the nature held by the Company. If the receivers or the directors were obliged to sell the debt notes during the receivership, it is very likely they would be sold at a deep discount to face value, resulting in significant losses to Stockholders;
- ✦ The costs of remaining in receivership will be significant and higher than the restructuring proposal put forward by the directors for the Company;
- ✦ The Company has highly specialised assets and the receivers may need to contract third party advisers to deal with these;
- ✦ The directors estimate that the receivership may take significantly longer than the three-year principal repayment period envisaged under the restructuring proposal and means that Stockholders may face a very long term receivership scenario.

## RECOMMENDATION

The directors strongly recommend Stockholders vote to pass the Extraordinary Resolution and enable the Company to be removed from receivership.

It is the directors' view that Stockholders will be repaid more quickly and in full under this scenario.

## NEXT STEPS

As noted at the introduction of this Explanatory Memorandum, it is strongly advised that Stockholders seek independent advice.

If stockholders wish to clarify any matter contained in this Explanatory Memorandum then they can contact the Company:

- ✚ by email – [liz@propertyfinance.co.nz](mailto:liz@propertyfinance.co.nz); or
- ✚ by phone – 0800 00 16 16

It is very important that Stockholders vote at the Special Meeting, as the Extraordinary Resolution will be binding on all Stockholders. Voting can be by one of two ways:

- ✚ attending the meeting and voting in person; or
- ✚ by completing a proxy and returning this to the Company no less than 48 hours prior to the meeting.