AUSTRALIAN
RESEARCH
INDEPENDENT INVESTMENT RESEARCH

Pallas FM Trust - Fixed Rate Bonds

Research Review

7 July 2023

This Report is for Wholesale Invstors Only

INDEPENDENT INVESTMENT RESEARCH

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Independent Investment Research, "IIR", is an independent investment research house based in Australia and the United States. IIR specialises in the analysis of high quality commissioned research for Brokers, Family Offices and Fund Managers. IIR distributes its research in Asia, United States and the Americas. IIR does not participate in any corporate or capital raising activity and therefore it does not have any inherent bias that may result from research that is linked to any corporate/ capital raising activity.

IIR was established in 2004 under Aegis Equities Research Group of companies to provide investment research to a select group of retail and wholesale clients. Since March 2010, IIR (the Aegis Equities business was sold to Morningstar) has operated independently from Aegis by former Aegis senior executives/shareholders to provide clients with unparalleled research that covers listed and unlisted managed investments, listed companies, structured products, and IPOs.

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1) The research process has complete editorial independence from the company and this is included in the contract with the company;
2) Our analyst has independence from the firm's management, as in, management/ sales team cannot influence the research in any way;
3) Our research does not provide a recommendation, in that, we do not provide a "Buy, Sell or Hold" on any stocks. This is left to the Adviser who knows their client and the individual portfolio of the client.
4) Our research process for valuation is usually more conservative than what is adopted in Broking firms in general sense. Our firm has a conservative bias on assumptions provided by management as compared to Broking firms.
5) All research mandates are settled upfront so as to remove any influence on ultimate report conclusion;
6) All staff are not allowed to trade in any stock or accept stock options before, during and after (for a period of 6 weeks) the research process.

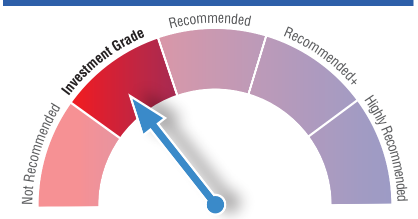
For more information regarding our services please refer to our website www.independentresearch.com.au.

Pallas FM Trust - Fixed Rate Bonds

Research Review - 7 July 2023

Note: This report is based on information provided by the Manager as at October 2022 and the Information Memorandum dated December 2020. **This report is for Wholesale Investors Only.**

Rating



Key Investment Information

Issuer	Pallas FM Trust
Issuer Trustee	Pallas Funds Pty Limited
Investment Manager	Pallas Capital Pty Limited
Note Trustee	AMAL Trustees Pty Limited
Security Trustee	AMAL Security Services Pty Limited
Registrar & Issuing/ Paying Agent	AMAL Management Services Pty Limited
Clearing Agent	Austraclear
Sponsors	Family trusts associated with the Directors of the Manager.
Investment Structure	Fixed Rate Bond
Eligible Investors	Wholesale
Notes Issued (as at 31 October 2022)	$92.16m
Maximum Issue Size	$150m
Note Face Value	$10,000
Minimum Investment	$500,000
Interest Rate	7.5%p.a*
Distribution Frequency	Quarterly
Redemption Date	31 December 2024 unless the redemption date is extended to 30 June 2025
Issuer Call Dates	The Issuer may redeem some or all of the Notes at any time after 1 June 2021, subject to a Call Premium being paid prior to the redemption date. See Product Overview for further details.
Offer Document	Information Memorandum

*The interest rate will increase to 9.5%p.a. in the event of a term extension.

Fees Commentary

Fees are paid by the borrower in the form of upfront establishment fees and line fees, not by investors. Fees paid by borrowers range from 1.5%-2.0%.

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

PRODUCT SUMMARY

The Fixed Rate Bonds (the "Notes") are issued by the Pallas FM Trust ("PFM Trust"). The purpose of the Notes is to fund the PFM Trust, a warehouse facility that provides commercial real estate (CRE) loans to Australian SMEs secured by a registered first mortgage against Australian property. The PFM Trust is managed by Pallas Capital Pty Limited, a member of the Pallas Group. The Pallas Group was established in 2016 and comprises Fortis Development Company ("Fortis"), a property development business, and Pallas Capital, a specialist commercial real estate (CRE) financier and investment manager. The Notes have a face value of $10,000 per Note with a minimum investment of $500,000. The maximum value of Notes that can be issued is $150m. As at 31 October 2022, there were $96.5m Notes on issue. The Notes will be redeemed in full on 31 December 2024 unless the redemption date is extended to 30 June 2025. The Issuer may redeem some or all of the Notes at any time on the giving of at least 30 days and no more than 90 days' notice to the required parties. In the event the Issuer redeems the Notes prior to the maturity date, the Issuer will pay a Call Premium (see Product Overview for further details regarding the Call Premium). The Notes have an Investment Protection Mechanism whereby the Sponsors (the family trusts associated with the Directors of the Manager) will make advances as required to ensure that the PFM Trust holds bank guarantees and/or cash equal to 5% of the Issue Size. There are no fees paid directly by investors with the Manager receiving fees from services provided to borrowers and/ore excess interest generated by the PFM Trust.

The PFM Trust invests capital raised in a portfolio of CRE loans secured by a registered first mortgage against Australian property. Each loan made by the PFM Trust must be supported by one or more loans which meet the parameters of the PFM Trust. The parameters include a maximum LVR of 65% and a maximum loan term of 24 months. The Manager will diversify the portfolio to reduce the PFM Trust's exposure to any individual investment. The PFM Trust has maximum exposure limits in place to ensure a level of diversification is achieved (see Product Overview section for details). If a breach of this covenant is not rectified within 20 business days this will represent an event of default.

INVESTOR SUITABILITY

The Notes provide wholesale investors access to the CRE debt market which can provide diversification to an investors' broader portfolio. The Notes provide a fixed quarterly income stream for investors. We note that given the increasing interest rate environment, Noteholders are exposed to interest rate risk. The attractiveness of the risk return profile will likely decline in the event of further interest rate increases. We view the risk associated with the Fund to be at the higher-end of the spectrum given the exposure to construction loans and the related party transactions. The PFM Trust is diversified with 19 investments at 31 October 2022. Portfolio diversification will likely improve in the event additional Notes are issued. The key risk associated with loans is default risk. In the event the borrower is unable to repay the loan this may result in a capital loss to investors. Portfolio diversification, the disciplined loan assessment and loan management process, first mortgage security, the short-to-medium term duration of the loans, personal guarantees and conservative LVR limitations minimises the inherent risk associated with the Notes, however it does not eradicate it. The Investment Protection Mechanism provides investors with first loss protection of 5% of the Issue Size. The Notes have a fixed term of 31 December 2024 (unless extended) however, there is a secondary market for those that seek to exit the investment prior to maturity. There may be limited levels of liquidity in the secondary market with a seller needing to find a buyer to exit. Investors are exposed to significant related party transactions with regards to the PFM Trust with a high percentage of the portfolio being invested in loans to Fortis at any given time. Investors should be comfortable with the related party transactions and the conflicts of interest associated with such transactions.

RECOMMENDATION

IIR has assigned the Pallas FM Trust - Fixed Rate Bonds an **Investment Grade** rating. The Notes have delivered the quarterly interest rate payments to date, however there is significant interest rate risk associated with the Notes given the increasing interest rate environment. The notes can be bought on the secondary market at less than par value, however if interest rates continue to rise the value of the Notes is expected to continue to fall. This is not an ideal scenario for current investors, however may provide some opportunities for new investors prior to the maturity of the Notes. There is significant related party and borrower concentration risk associated with the Notes with a large portion of loans in the portfolio being provided to Fortis. While the loans are spread across a number of projects, the concentration risks to a single borrower, and the fact that it is a related party borrower, is substantial and something that investors should be cognisant of and comfortable with prior to making an investment.

SWOT ANALYSIS

Strengths

- Loans and SPV investments have a conservative LVR with loans required to have a maximum LVR of 65%. This means that valuations would have to fall by more than 35% from the time the loan is made for a capital impairment to be incurred by the PFM Trust.
- In addition to the loans being secured by a registered first mortgage over the property, the Manager typically takes a personal guarantee from the directors or other sponsors of the borrower, which further insulates the loan from impairments.
- The Manager has a disciplined loan management and assessment process which has resulted in the Pallas Group experiencing low default rates to date and all resolved default events having a positive outcome (ie. no capital impairment). We do note that Pallas Capital has a limited track record, commencing operations in 2016 and past performance is not an indicator of future performance.
- The Notes have an Investment Protection Mechanism which provides for first loss protection of 5% of the Issue Size.
- The Pallas Group is well resourced with over 130 staff employed across the two operating businesses of the Group.
- The team is highly experienced in Australian and global financial markets and CRE debt and equity.
- The Manager is highly selective when making loans as is highlighted by the low loan conversion rate of 8%-10% of loans reviewed.

Weaknesses

- In the current rising interest rate environment, the Notes are exposed to interest rate risk with the risk/return profile deteriorating in the event interest rates continue to rise.
- There is significant related party risk associated with the PFM Trust portfolio with a substantial amount of loans being made to Fortis, a member of the Pallas Group. At 31 October 2022, 57.8% of the portfolio was invested in Fortis loans. While the risk is spread across projects, there is significant risk associated with having such as a large portion of the portfolio exposed to a single borrower.

Opportunities

- The Notes provide investors the opportunity to diversify the income portion of their investment portfolio. Direct loans provide for low levels of capital volatility, assuming no capital impairments, with CRE debt returns historically having a low correlation with other major asset classes.
- The market share of non-bank lenders in the CRE debt market is expected to continue to increase as the banks share of the market continues to decline. This is expected to result in a strong pipeline of investment opportunities.
- While the Notes haves a fixed term to maturity they are tradable providing an element of liquidity to Noteholders that seek to exit prior to maturity. While the Notes are tradable, liquidity will be reliant on the ability to match the seller with a buyer.

Threats

- The key risk associated with an investment in the Notes is the risk of default by a borrower and the Manager not able to recover the loan amount potentially resulting in investors experiencing a capital impairment. There are a number of risk mitigation strategies implemented to reduce this risk such as conservative LVRs, a diligent loan assessment and approval process, loan monitoring and management of loans off the books if the risk materially changes. The Pallas Group is yet to experience an impairment with regards to its loans.
- In addition to the related party risks associated with the loans to Fortis, the Trustee and Manager of the PFM Trust are both members of the Pallas Group, further exacerbating related party risks.

- Pallas Capital has grown rapidly in recent years, which can put undue pressure on a business. We note that the business has invested in people, systems and processes to support the growth and is expected to continue to do so to support future growth. However, in the event the business cannot secure the resources needed this may hamper the growth aspirations of the business and opportunities for investors.
- The macroeconomic outlook potentially provides for some challenges in the property market. A deterioration in the economic conditions could result in increased borrower stress and the potential for defaults in the portfolio.
- There is increasing competition in the CRE debt market. This may put pressure on the ability of the Manager to achieve the objectives of the Fund.

PRODUCT OVERVIEW

The Fixed Rate Bonds (the "Notes") are issued by the Pallas FM Trust ("PFM Trust"). The purpose of the Notes is to fund the PFM Trust, a warehouse facility that provides commercial real estate (CRE) loans to Australian SMEs secured by a registered first mortgage against Australian property.

The PFM Trust is managed by Pallas Capital Pty Limited, a member of the Pallas Group. The Pallas Group was established in 2016 and comprises Fortis, a property development business, and Pallas Capital, a specialist commercial real estate (CRE) financier and investment manager.

The PFM Trust issues Notes with a Face Value of $10,000 per Note with a minimum investment amount of $500,000. The maximum value of Notes that can be issued is $150m. As at 31 October 2022, there were $96.5m Notes on issue.

The Notes will pay a fixed interest rate of 7.5%p.a, paid quarterly in arrears. The Notes will be redeemed in full on 31 December 2024 unless the redemption date is extended to 30 June 2025. The Issuer may redeem some or all of the Notes at any time on the giving of at least 30 days and no more than 90 days notice to the required parties. In the event the Issuer redeems the Notes prior to the maturity date, the Issuer will pay a Call Premium (detailed in the below table). In the event the Redemption Date for the Notes is extended, the interest rate will increase to 9.5%p.a.

Issuer Call Premium	
Redemption Date	**Call Premium Per Note**
1 July 2021 - 30 June 2022	$300
1 July 2022 - 30 June 2023	$200
1 July 2023 - 30 June 2024	$100
On or after 1 July 2024	$0

The PFM Trust will invest in CRE loans that meet the following criteria:

- The loan is secured by a registered first mortgage on Australian real estate and supported by the personal guarantee of the Sponsor behind the borrower and in some cases, security over other assets;
- The property securing the loan is a developments site, residential property or commercial property;
- Loan types include investment loans, construction loans and residual stock loans;
- The security property is supported by a Pallas Capital Panel Valuer dated no more than three months prior to the date on which the lender commits itself to make the loan;
- Maximum LVR of 65% - construction loans will be based on the "as if completed" value;
- Maximum loan term of 24 months;
- The borrower and sponsor/s are experienced and have the skill set to manage their position and perform their obligations under the loan;
- The loan falls within the maximum exposure limitations; and
- There is a clear exit strategy/path to repayment.

The PFM Trust can invest in qualifying CRE loans by investing in:

1) A qualifying loan (as detailed above);

2) Co-lend on qualifying loans; and/or

3) Invest in SPV Lenders that have made or will make qualifying loans.

Each SPV Lender will be controlled and/or managed by a member of the Pallas Group. Typically the SPV Lender will be a unit trust and investment will take the form of holding units in the trust. The PFM Trust may not hold all of the units in the SPV Lender.

The PFM Trust may make a loan to a related party and/or invest in a SPV Lender that has made or will make a qualifying loan to a related party, but only if:

- The qualifying loan is made on an arms-length commercial basis and such SPV Lender investment is made on an arms-length commercial basis;
- The qualifying loan and SPV Lender has been approved by the Independent Supervisor; and
- The qualifying loan is jointly and severally guaranteed by the related persons that hold a beneficial interest in the borrower.

The Independent Supervisor is an independent expert appointed by the Trustee for the purpose of scrutinising any proposed loan to a related party or proposed investment in a SPV Lender where the lender has or will make a loan to a related party.

The PFM Trust will diversify the investment portfolio between various loans and SPV Lenders. The PFM Trust has imposed a number of limitations to ensure a level of diversification is achieved. The PFM Trust will not:

- Incur any loan commitment or make an investment in a SPV Lender in excess of an amount equal to 25% of the Issue Size if the Issue Size is less than $75m;
- Incur any loan commitment or make an investment in a SPV Lender in excess of an amount equal to 15% of the Issue Size if the Issue Size is $75m or greater;
- Allow a loan commitment or make an investment in a SPV Lender in excess of an amount equal to 15% of the Issue Size to continue for a period exceeding 90 days if the Issue Size is less than $75m;
- Allow a loan commitment or make an investment in a SPV Lender in excess of an amount equal to 10% of the Issue Size to continue for a period exceeding 90 days if the Issue Size is $75m or greater.

At 31 October 2022, the Notes on issue was $96.5m meaning the PFM Trust will limit its investments to 15% of the Issue Size with the investment not to be greater than 10% of the Issue Size for a period exceeding 90 days. The largest exposure at October-end was 9.9% of the Issue Size.

A breach of the maximum exposure limitations will be an event of default if the breach is not rectified within 20 business days. In the event of default, monies owed under the Notes may become immediately due and payable.

The PFM Trust reports to Noteholders on a quarterly basis with detailed quarterly performance reports. Audited annual financial statements will be available to Noteholders upon request.

Neither the Trustee nor the Manager will charge fees directly to any Noteholder or to the PFM Trust itself. The Manager (and related parties) will receive certain fees and other income from the PFM Trust, including establishment and administration fees.

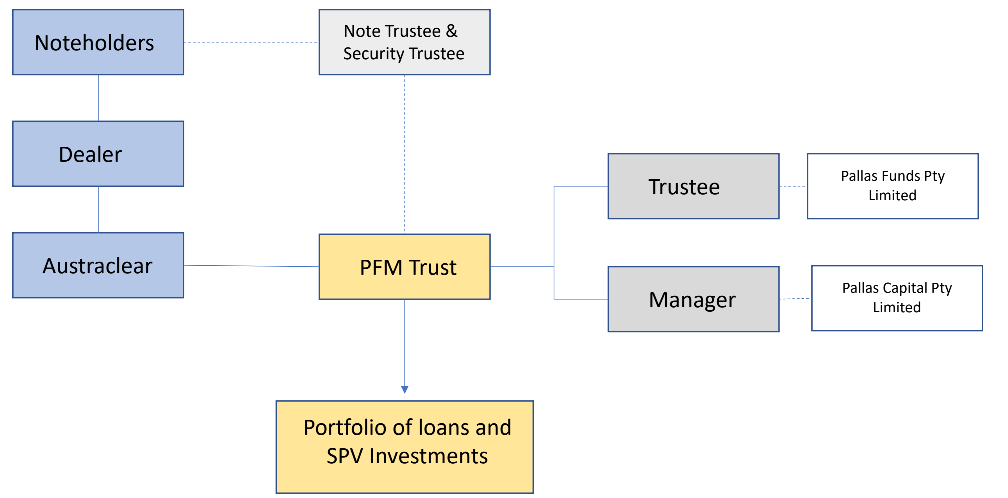
Notes Structure

Notes will be issued by Pallas Funds Pty Limited, as trustee for the PFM Trust. The offer of Notes to investors will be arranged by Pallas Capital Pty Limited through various dealers holding appropriate financial services licences. Once issued, transactions concerning any Note will be cleared through the Austraclear System. The Austraclear system is a settlement system and central securities depository for the wholesale debt market operated by Austraclear Limited, a wholly owned subsidiary of the ASX.

Investors will purchase and sell Notes through a dealer that is an Authorised Representative (directly or through an agent) in the Austraclear System. PFM Trust will interact with the Austraclear System through the Issuing and Paying Agent/Registrar, AMAL Trustees Pty Limited ("AMAL Trustees").

Once Notes are issued, they will be registered and assigned within the Austraclear System by AMAL Trustees. The purchase and sale of Notes will be transacted with the relevant Dealer who, in turn, will report those transactions to the Austraclear System through the relevant Custodian. PFM Trust will put AMAL Trustees in funds to enable it, as IPAR, to make interest payments and redemption payments in accordance with the terms on which the Notes are issued.

Notes Structure



Investment Protection Mechanism

The Sponsors (family trusts associated with the Directors of the Manager) will make advances as required to ensure that the PFM Trust holds bank guarantees and/or cash equivalent to 5% of the Issue size (the Base Reserve). The Investment Protection Mechanism is designed to provide first loss protection for Noteholders in the event of a capital impairment.

In addition, if the PFM Trust incurs a loss on any loan or SPV investment made by it, the Sponsors are obliged to increase the bank guarantee and/or advance further monies to the PFM Trust (the Top-Up Amount) up to an amount equal to the greater of:

- $1.5m;
- 20% of the largest loan or SPV investment; and
- In respect of each such loss, the lesser of the amount of the loss and 5% of the Issue size calculated at the time the relevant loss was incurred.

The reserves will be applied by the Trustee as required to assist with the Fund meeting its obligations to Noteholders.

If a claim is made against the Investment Protection Mechanism the following will occur:

- Within 10 business days the Sponsors must increase the amount of the bank guarantee and/or cash available to the PFM Trust as part of the Base Reserve so that it is equivalent to 5% of the Issue Size; and
- The PFM Trust may not make any further investments until the Base Reserve is restored to at least 5% of the Issue Size.

The maximum amount that Sponsors are required to advance in respect of any one loss is the Top-Up Amount.

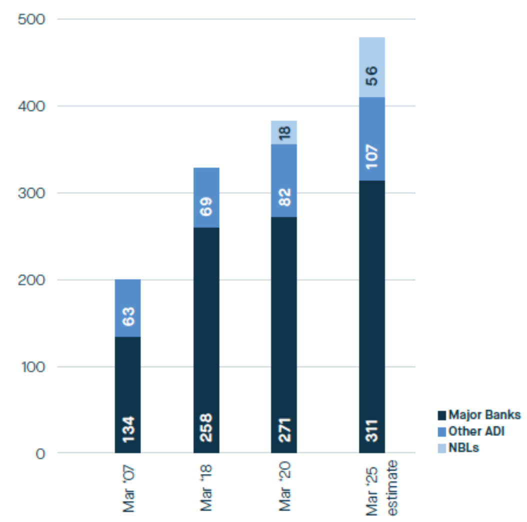
Any failure by the Sponsors to increase or procure the increase of the amount of bank guarantee and/or cash available to the PFM Trust as part of the Investment Protection Mechanism within 10 business days will represent an event of default.

COMMERCIAL REAL ESTATE (CRE) DEBT MARKET

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

As at 31 March 2020, APRA reported CRE loans of $371b. Of this, ~95% was held by major banks and other authorised deposit-taking institutions and ~5% of loans was provided by NBLs. APRA projects that the CRE loan market will grow to ~$474b by March 2025 and NBLs are projected to increase the market share from 5% to 12%. The forecast suggest the CRE debt market is expected to grow at ~5%p.a., with NBLs growing at ~25%p.a. Growth in the market share of NBLs provides an opportunity for investors to participate in this market.

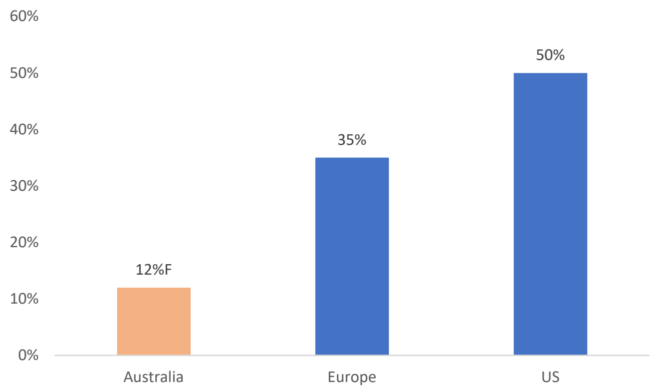
Australian CRE Debt Market



Source: PFT Feeder Fund IM, February 2023

Even with the projected growth, the NBL share of the Australia CRE debt market is significantly below that of international markets, as shown in the below graphic. Over time, market participants are expecting the Australian CRE debt market to follow the experience of international markets with regards to the acceptance of NBLs.

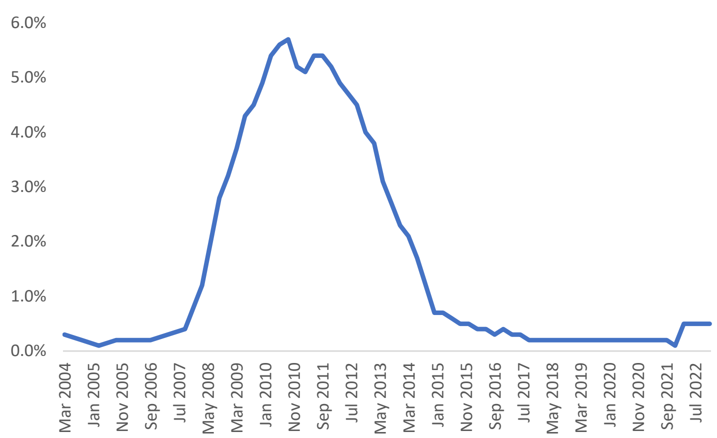
Global NBL CRE Debt Market Share



Source: PFT Feeder Fund IM, February 2023

Impairments/non-performing loans in commercial real estate loans by ADIs has historically been low. The below chart shows the percentage of impaired commercial real estate loans by ADIs from March 2004 to 31 December 2022. Impairments hit a peak of 5.7% in September 2010 with impairments accelerating post the GFC in 2008. Impairments have subsequently declined to less than 1% with an impairment/non-performing loan rate of 0.5% at 31 December 2022. As highlighted by the below chart, defaults tend to cluster around periods of prolonged economic weakness.

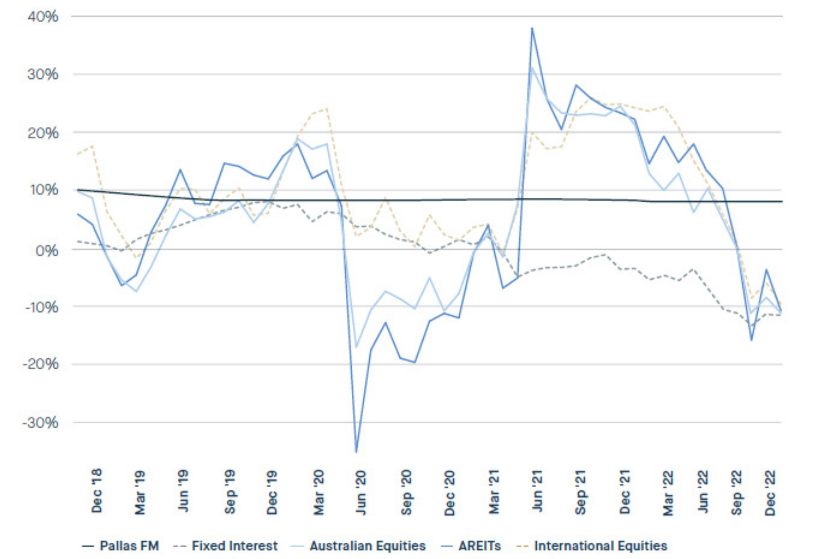
ADI Commercial Real Estate Loan Impairments (March 2004 to 31 December 2022)



Source: APRA

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

Rolling 12-Month Returns of Varying Asset Classes



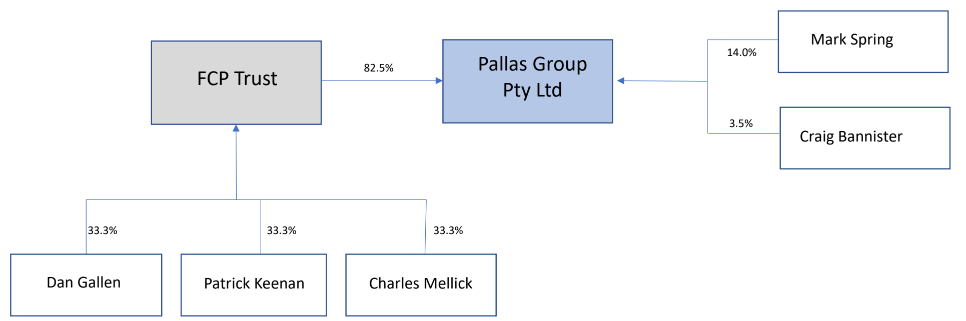
Source: PFT Feeder Fund IM, February 2023

PFM TRUST TRUSTEE & INVESTMENT MANAGER

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

The Pallas Group is 100% owned by five family trusts associated with employees of the Group. The family trusts of Dan Gallen, Patrick Keenan and Chris Mellick own an equal share of the FCP Trust, which has a 82.5% interest in the Pallas Group, while the family trusts of Mark Spring and Craig Bannister hold a direct interest totalling 17.5% of the Pallas Group.

Pallas Group Ownership Structure



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

1) Fortis

Fortis was established in 2015, and is a developer focused on boutique residential and commercial projects in the affluent, inner-metro suburbs of Melbourne and Sydney. Fortis currently has 35 development projects representing a total project end value in excess of A$5.0b.

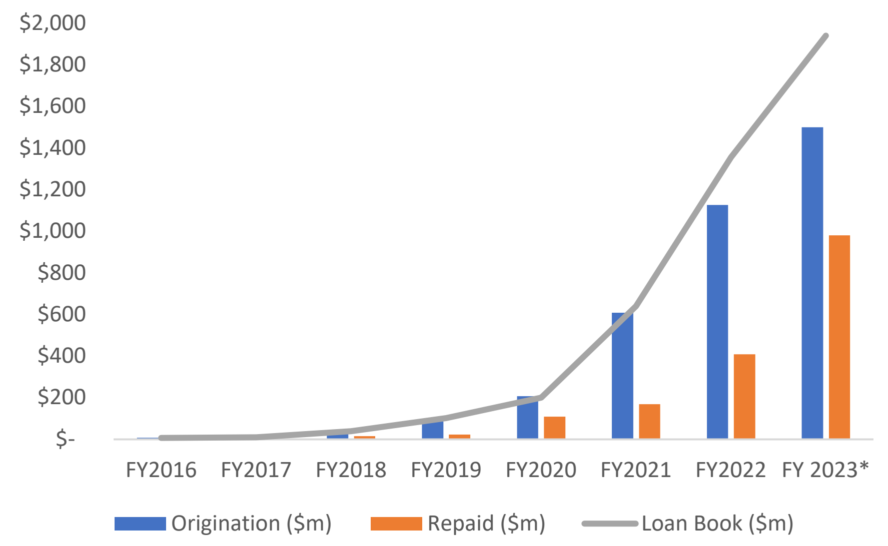
2) Pallas Capital

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

Pallas Capital has written A$2.8b of total investments (debt and equity) across 389 transactions, supported by properties covering a wide range of real estate sectors (land, retail, commercial, residential and industrial). Of those transactions, 182 have been completed and $1.2 billion repaid with no loss of capital.

The loan book has grown rapidly since being established in 2016, as highlighted by the below chart. The business is forecasting a loan book in excess of $1.9b as at 30 June 2023. Of the $1.6b in FUM as at 31 October 2022, ~$300m is under discretionary management through the five discretionary pooled funds currently on issue. Growth is attributed to the investment in people, systems and processes in recent years which has driven FUM growth and the loan pipeline. The business is expecting that the investment pipeline and FUM will continue to grow over the coming years given the recent additions and with the recruitment of further industry leading executives and new mandates being explored along with investment into the ongoing refinement of the business' risk management framework and operational systems and processes.

Pallas Capital Loan Book



Transactions to 31 October 2022

Loan Type	Loan Limit ($M)	Number of Loans	Average Loan Size ($m)	% of Total Loans
Construction	$1,150.2	79	$14.6	47.93%
Pre-Development*	$938.0	183	$5.1	39.09%
Residual Stock	$194.0	30	$6.5	8.09%
Investment	$117.3	36	$3.3	4.89%
Total	**$2,399.6**	**328**	**na**	**100%**

*Includes Fortis Equity & Preferred Equity transactions.

Relationship Between Fortis & Pallas Capital

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

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

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

Investment team

The business has grown to have over 130 staff located across Melbourne, Sydney, Brisbane and Auckland. This is an increase from 48 as at 30 June 2021. Growth in the team has included a number of senior hires which has been a key driver of growth.

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

The Group has appointed an Investment Committee (IC) which plays a central part in the lending process. The IC is comprised of six senior team members with one independent member, who provides independent representation for assessing loans to Fortis. For related party loans (loans to Fortis), the members of the IC that are also shareholders of the Pallas Group recuse themselves from the assessment and consideration of transactions. Under the current lending policy, investment decisions of >$10m must be approved by the IC by way of unanimous decision of those that are in attendance (minimum of three IC members required for an investment decision).

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

Pallas Group Board of Directors

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

Investment Committee

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

Compliance & Risk Committee

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

The investment team comprises 21 team members, tabled below. The team has an average of 10.6 years industry experience as at 31 October 2022. The team is led by the Chief Investment Officer, Dan Gallen, who has 21 years experience in the industry and is a Director of the Pallas Group.

Investment Team

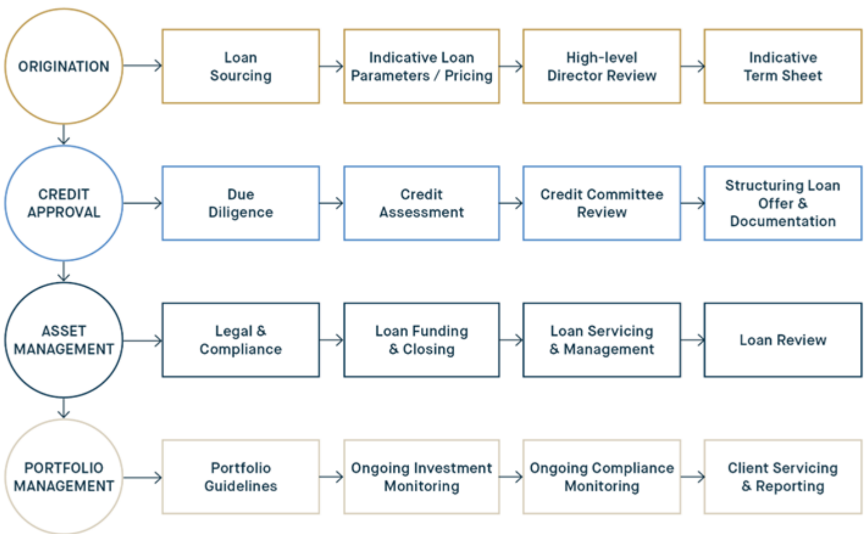
Name	Role	Location	Years at Firm	Years in Industry
Dan Gallen	Chief Investment Officer	Syd	6	21
Steve Lawrence	Executive Director - Lending	Melb	2	24
Mark Hood	Director - Lending	Melb	0.5	20
Denis Dundovic	Associate Director - Lending	Syd	0.5	17
Alexis Holloway	Head of Credit	Melb	1	14
Les Buxton	Credit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

PFM TRUST LOAN ASSESSMENT & MANAGEMENT PROCESS

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

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

Loan Assessment Process



Origination

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

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

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

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

Credit Approval

A detailed due diligence is undertaken for all loan applications that make it through the Origination process. Loan applications are assessed in accordance with the Credit Policy and Credit Procedures and by reference to the Lending Matrix and the Funding Source from which the capital is being deployed. There are specific loan eligibility and portfolio parameters that the loans must meet to be able to be included in the portfolio.

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

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

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

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

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

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

Assessment of Construction Loans

Construction loans are inherently riskier than non-construction loans due to the fact they generally comprise:

- A construction component that incorporates risks such as delivery risk, contamination and force majeure events;
- Market risk incorporating pre-sales and/or leasing risk; and
- A greater sponsor risk given the sponsor is generally more critical in a development transaction.

Given the increased risks the due diligence process for construction loans incorporates an additional assessment to identify and assess these risks. The additional areas that are covered in addition to the standard CRA includes:

1) Project Feasibility - Pallas requires that any construction transaction has a robust due diligence completed in respect of the project feasibility. Pallas will prepare its own project feasibility based on inputs provided by the borrower, quantity surveyor, valuer, consultants or independent assumptions where data is not yet available. The assessment will also include a sensitivity analysis on key cost and revenue inputs to evaluate risks that may arise and impact on loan performance. The project feasibility assessment is designed to confirm the deliverability and profitability of the project.

2) Builder and Construction Contract - An assessment of the builder and construction contract is important because the capability, capacity and performance of a builder is paramount to the successful delivery of a project. The credit team will review the construction costs against market rates and recent developments of a similar nature as well as investigate the proposed construction costs for the project.

3) Quantity Surveyor - All quantity surveyor reports will be completed by a panel surveyor. Reports from non-panel quantity surveyors will be accepted if they can meet the requirements to be added to the panel. The initial report is to be received by the lender as a condition precedent to first drawdown of a construction loan. The quantity surveyor will provide monthly progress reports until practical completion/occupation certificate is achieved for a project. The progress reports will be used by the lender to confirm the monthly progressive drawdown amount, as well as project status, cost to complete, insurance certificates, and other items as requested by the lender in the quantity surveyor instructions.

In circumstances where the Pallas Loan Management Team assess there has been a material change to the project program, cost to complete, or quality of works undertaken, then the matter is to be raised with a DLA for assessment. Where there is no clear path to rectification, the DLA and IC will evaluate alternative commercial strategies for negotiation with the borrower. Pallas shall reserve the right to charge default rates where there has been a breach of covenants or an event of default.

4) Progressive Drawdowns - All drawings under a construction loan are to be made on a "cost to complete" basis, which means that the undrawn component of the facility must be sufficient to fund development costs identified in the feasibility that have yet to be paid or incurred. All progress claims under the building contract are to be supported by a report and recommendation from the quantity surveyor.

In addition to the above, additional security requirements are required for construction loans that include a General Security Agreement over the assets of the borrower and incorporates all assets pertaining to the project. Pallas will also require a tripatite deed between the lender, the builder and the borrower which grants Pallas the right to step in following a default or termination event in the construction contract and acknowledges that neither the borrower or the builder can consent to an amendment, termination or assignment of the construction contract without the lender's written consent.

Delegated Lending Authority (DLA)

There are five team members of the Pallas Group that have been designated as a Delegated Lending Authority (DLA). There are delegated approval limits for loans of different sizes, tabled below. The larger the loan the greater the sign-off requirements. A DLA cannot be involved in the approval of a loan that they originated. Loans of more than $10m are required to be approved by the Investment Committee.

Delegated Approval Limits

Loan Size	Requirement
$0 - $3m	1 DLA
$3m - $5m	1 DLA Holder with one of either Head of Credit or CIO
$5m - $10m	Head of Credit and the CIO
>$10m	Investment Committee

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

Asset Management

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

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

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

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

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

AMAL

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

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

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

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

- Segregation of duties, approvals, authorisations and verifications.
- Comprehensive data quality checking procedures across all client functions.
- A wide range of automated system checks, alerts and reports to identify data anomalies.
- Maintenance of a comprehensive, ongoing internal audit process across all areas of the business, overseen by the Executive Director — Governance, Risk and Compliance.
- In addition to regular audits by their clients and advisors AMAL is subject to an annual servicer evaluation by Standard & Poor's Ratings Services (S&P), now in its 15th year. In 2019 S&P affirmed its overall STRONG ranking for AMAL (the highest possible ranking) as a servicer in Australia and New Zealand.

Default & Arrears Management

The Manager has a detailed default and arrears management process. Interest is often prepaid for the life of the loan. There tends to be little arrears risk from these loans, with the key risk being that a borrower defaults on the repayment of the loan amount in these circumstances.

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

For a borrower experiencing difficulty in meeting payments or material loan obligations or where Pallas anticipates a general change to the risk profile of a loan, Pallas may implement loan management procedures to ensure the loan remains compliant. In certain circumstances where

Pallas determines appropriate, the Lender may formally reserve its rights with the borrower as it works through any remedy actions set by Pallas.

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

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

The Manager's loan management and default management process has proven effective to date with the loan book experiencing low levels of defaults. The difficult economic environment has seen the number of defaults experienced by the Manager increasing yet still low. We note that this also coincides with the increased number of loans made. The Manager has been able to refinance loans with other financiers and appoint receivers where necessary and sell the assets with all capital being recouped through this process. The Manager has been able to identify loans where the risk has risen to levels above what they are comfortable with and been able to move them off their books, highlighting the discipline of the loan management process.

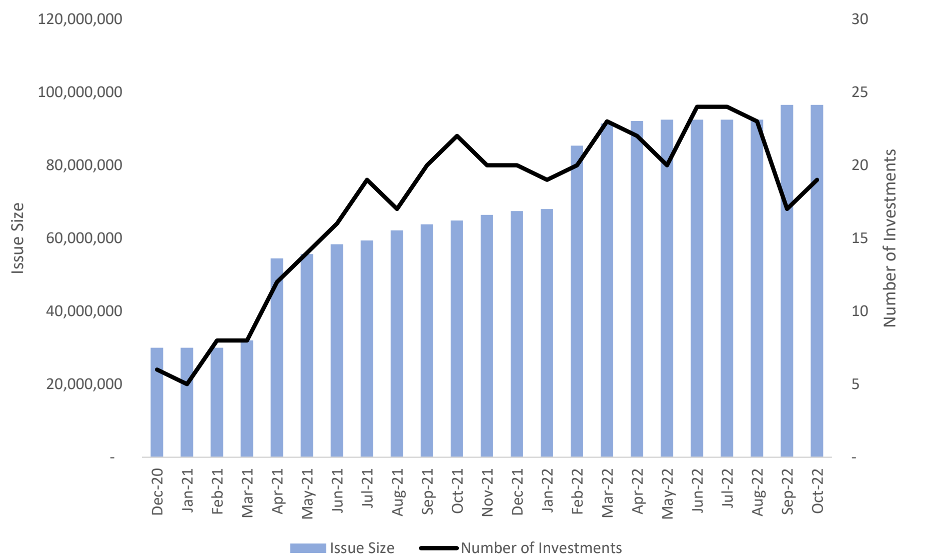
Portfolio Management

The portfolio is required to adhere to eligibility and maximum exposure requirements. The portfolio construction considers these requirements before a loan is added to the portfolio.

PORTFOLIO

The Notes commenced in December 2020 with a target issue size of $150m. Notes can be issued up until the redemption date of 31 December 2024. As Notes are issued, the capital raised is deployed to fund loans and SPV investments made by the PFM Trust. The portfolio of the PFM Trust has grown as the Notes on issue has grown. At 31 October 2022, the portfolio was exposed to 19 investments with the PFM Trust growing to $96.5m, $96.0m of which was invested.

PFM Trust Growth



The below table provides a summary of the PFM Trust portfolio as at 31 October 2022. The weighted average interest rate paid by borrowers to the lender was 9.24%p.a. and the portfolio had a weighted average LVR 63.0%. The largest investment of the PFM Trust was $9.6m, which represented 9.9% of the portfolio. The loan is a construction loan with a maturity date of January 2024.

Portfolio Summary as at 31 October 2022	
Notes on Issue	$96.5m
Total Value of Investments	$96.0m
Number of Investments	19
Weighted Average Interest Rate	9.24%p.a.
Weighted Average LVR	63.0%
Weighted Average Term to Maturity	5.3 months
Largest Investment	$9.6m

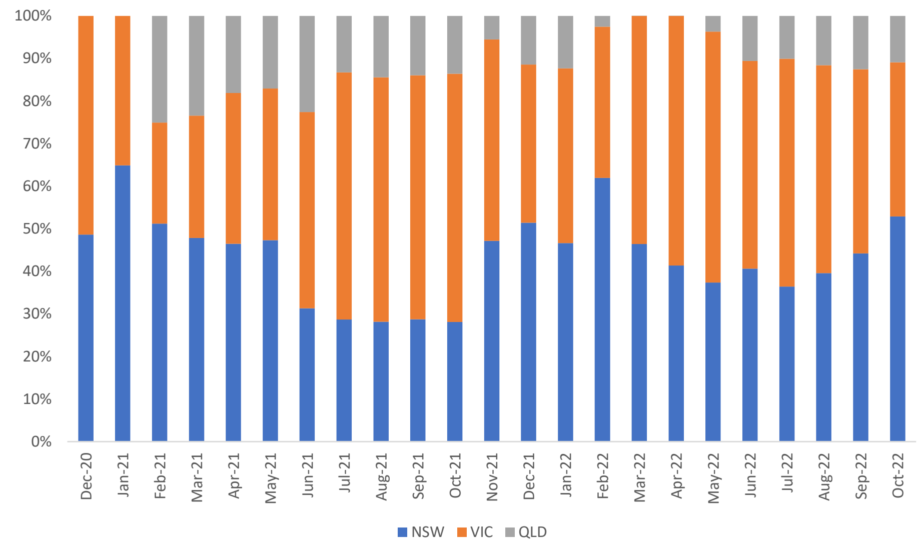
At 31 October 2022, the top five investments accounted for 43.0% of the portfolio. The portfolio was predominantly exposed to construction and pre-development loans at October-end. Construction loans are drawdown as the project progresses through its various stages. As such the exposure to these loans will increase as capital is drawndown.

Top 5 Investments as at 31 October 2022

Investment	Loan Type	Percentage of Fund
Cremorne, VIC First Mortgage Class A	$9,567,275	9.91%
Double Bay, NSW First Mortgage Class B	$9,501,498	9.85%
Darling Point, NSW First Mortgage Class A	$8,670,000	8.98%
Bulimba, QLD First Mortgage	$7,120,645	7.38%
South Melbourne, VIC First Mortgage	$6,639,233	6.88%
		43.0%

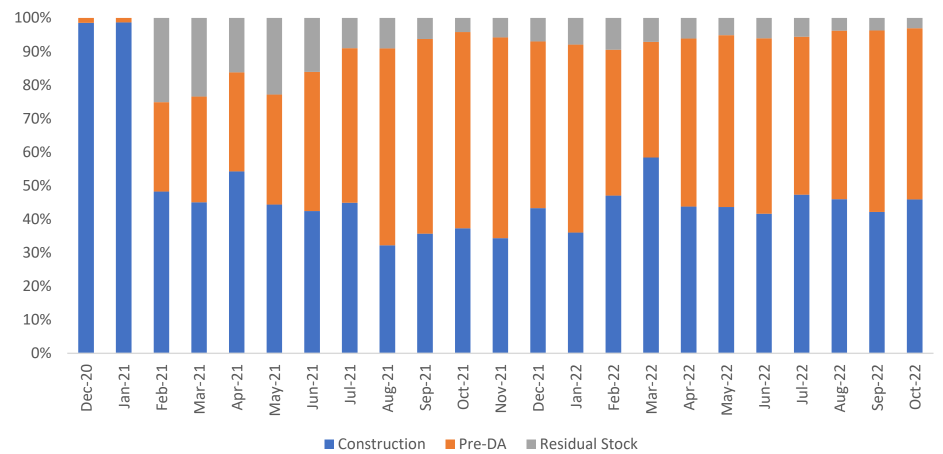
The portfolio has historically been weighted to properties located in Victoria and NSW. The Fund has had a small exposure to properties located in QLD throughout its history. At 31 October 2022, 96.9% of properties were located in NSW and VIC.

Historical Geographic Diversification



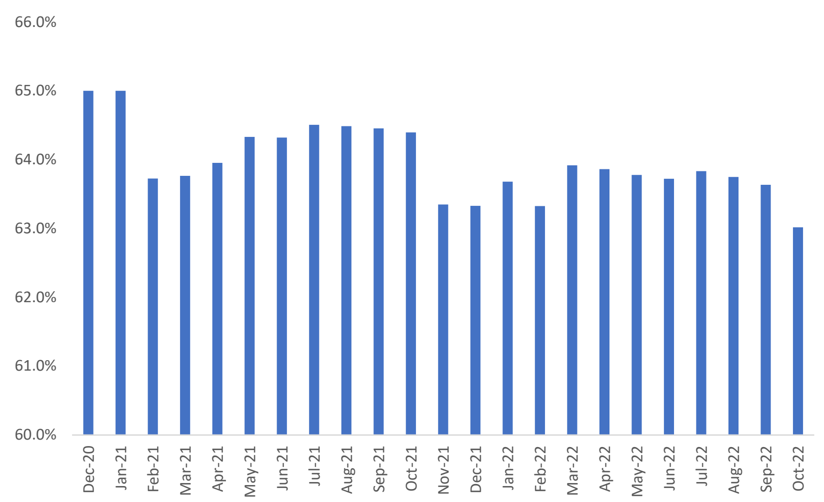
The portfolio has primarily been exposed to construction and pre-development loans to date. At 31 October 2022, 51.0% of the portfolio was allocated to pre-development loans and 45.9% to construction loans. As is highlighted by the below chart, the allocation to loan types will vary over time depending on the loans made by the Manager.

Historical Loan Type Allocation



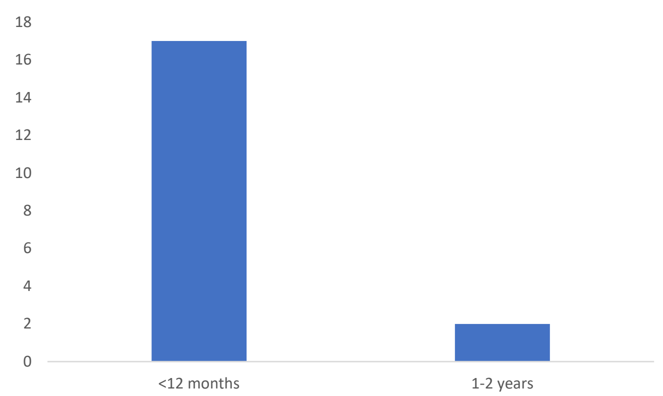
The maximum LVR for loans by the PFM Trust is 65%. The portfolio had a weighted average LVR of 63.0% at 31 October 2022 with the weighted average LVR of the portfolio ranging from 63% to 65% over the life of the Trust. The below chart shows the historical weighted average LVR of the portfolio. A maximum LVR of 65% is considered conservative and provides for a decline of 35% of the valuation at the time of the loan before a capital impairment will be incurred.

Historical Portfolio Weighted LVR



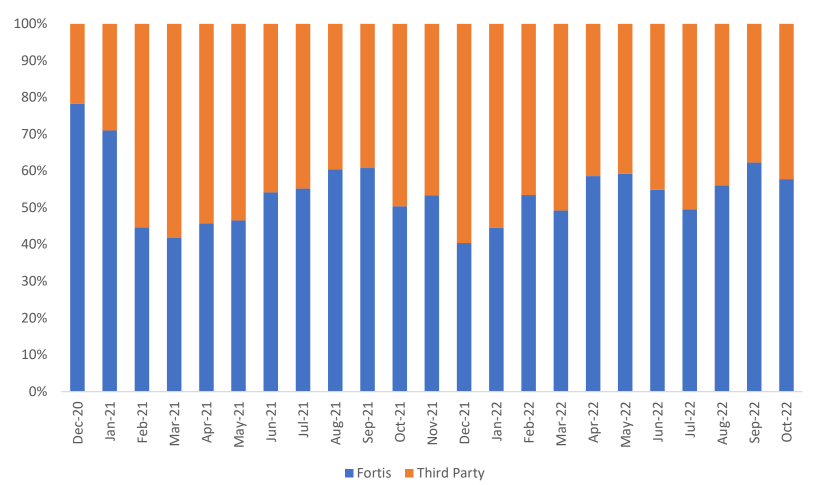
The PFM Trust has a maximum loan term of 24 months (2 years). At 31 October 2022, 17 of the 19 loans the portfolio was exposed to had a term to maturity of less than one year.

Portfolio Maturity Profile as at 31 October 2022



The PFM Trust has the ability to invest in related party loans (loans to Fortis). As shown in the below chart, exposure to loans provided to Fortis has varied throughout the life of the PFM Trust. Loans made to Fortis have at times made up a significant portion of the portfolio. Exposure to Fortis loans has ranged from a low of 40.4% to a high of 78.2% of the portfolio. At 31 October 2022, the portfolio had a 57.8% exposure to Fortis loans, with 11 of the 19 loans being to Fortis. At these levels there is significant borrower concentration risk.

Related Party Loans

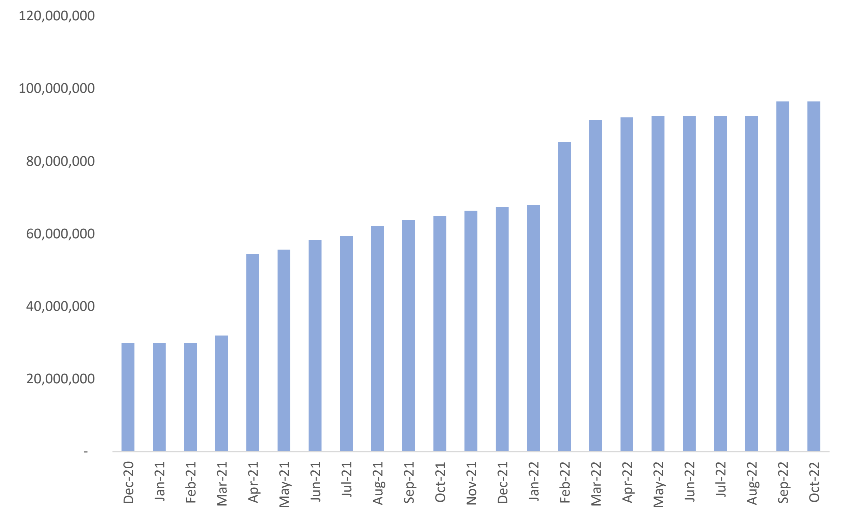


PERFORMANCE ANALYTICS

Returns to investors are purely in the form of income, with monthly distributions based on the interest generated from the portfolio of loans, net of fees and costs. At the redemption date, Noteholders will receive the capital invested plus any outstanding interest payments, subject to no capital impairments being experienced. The Issuer may redeem outstanding Notes at any time prior to the redemption date with a Call Premium paid if redeemed prior to the redemption date, as detailed above in the report.

The Trustee has a target issue size for the Notes of $150m. The Fund has steadily increased the Notes on issue with $96.5m Notes on issue as at 31 October 2022.

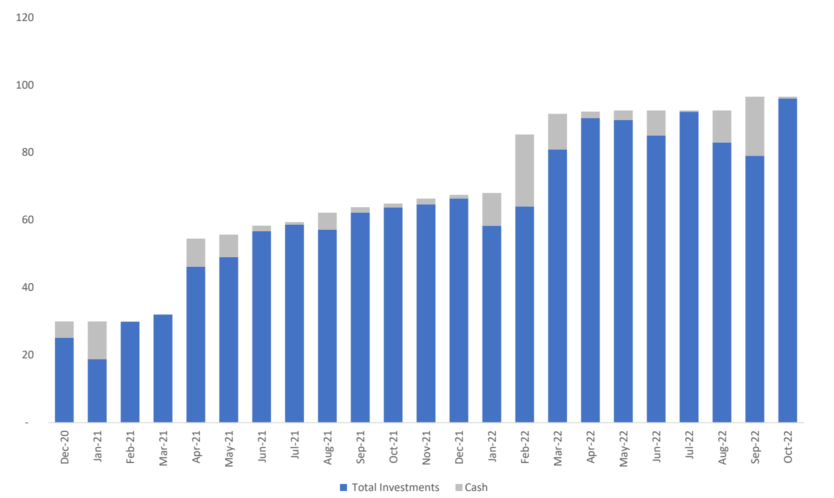
Notes on Issue (to 31 October 2022)



Source: Pallas Capital

The below graphic shows the growth in the PFM Trust providing a breakdown of the investments made and cash available. As is detailed in the below chart, the Manager has been able to deploy capital relatively quickly, reducing the cash drag for Noteholders.

Fund Growth (to 31 October 2022)

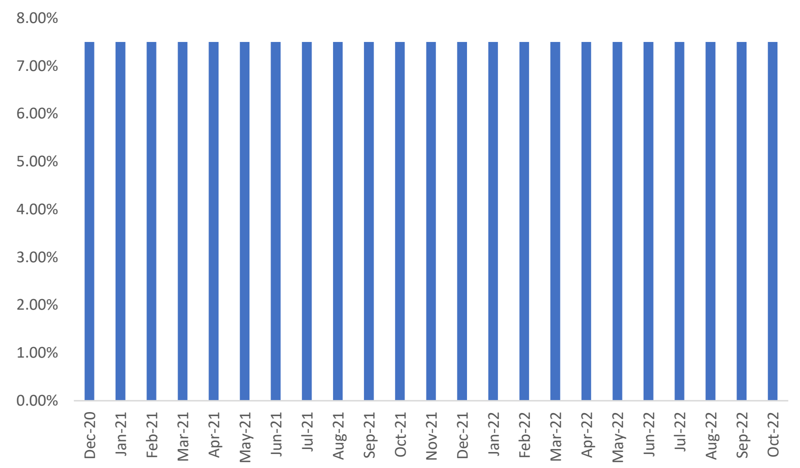


Source: Pallas Capital

The PFM Trust has met its interest rate payment obligations to Noteholders since inception. Given the high level of pre-paid interest for loans made by the Fund, we view the risk to distributions to be low.

The low level of defaults experienced by the Pallas Group loan book bodes well for investors, although we note that default risk is a key risk for investors and defaults that equate to an amount exceeding the Investment Protection Amount may result in a capital loss to investors. Investors should note that a capital impairment will only be incurred in the event the loan amount cannot be recouped in full. Conservative LVRs provide an element of protection from declines in valuations and personal guarantees from borrowers provides an additional layer of protection.

Historical Annualised Quarterly Distributions (to 31 October 2022)

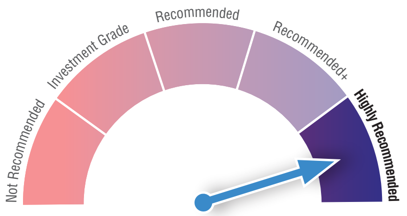


APPENDIX A – RATINGS PROCESS

Independent Investment Research Pty Ltd "IIR" rating system

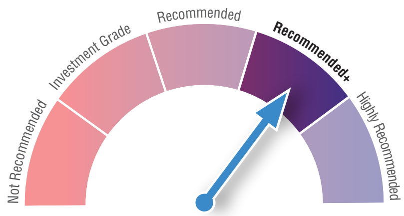
IIR has developed a framework for rating investment product offerings in Australia. Our review process gives consideration to a broad number of qualitative and quantitative factors. Essentially, the evaluation process includes the following key factors: management and underlying portfolio construction;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

LMI Ratings	SCORE
Highly Recommended	**83 and above**



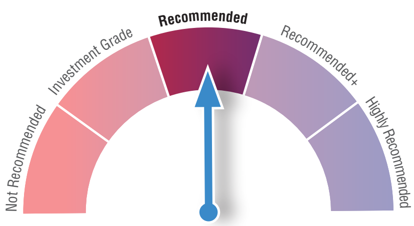
This is the highest rating provided by IIR, indicating this is a best of breed product that has exceeded the requirements of our review process across a number of key evaluation parameters and achieved exceptionally high scores in a number of categories. The product provides a highly attractive risk/return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

Recommended +	**79–83**



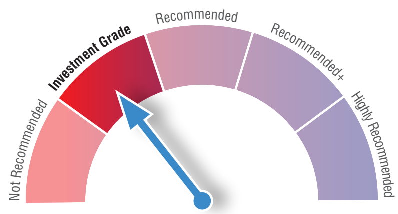
This rating indicates that IIR believes this is a superior grade product that has exceeded the requirements of our review process across a number of key evaluation parameters and achieved high scores in a number of categories. In addition, the product rates highly on one or two attributes in our key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

Recommended	**70–79**



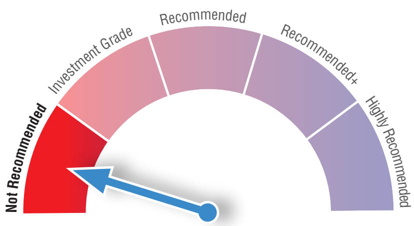
This rating indicates that IIR believes this is an above-average grade product that has exceeded the minimum requirements of our review process across a number of key evaluation parameters. It has an above-average risk/return trade-off and should be able to consistently generate above-average risk adjusted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

Investment Grade	**60-70**



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

Not Recommended	**<60**

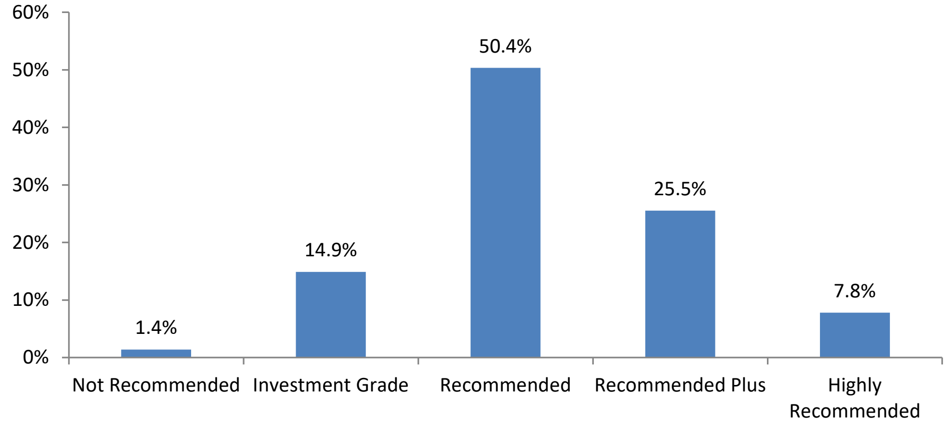


This rating indicates that IIR believes that despite the product's merits and attributes, it has failed to meet the minimum aggregate requirements of our review process across a number of key evaluation parameters. While this is a product below the minimum rating to be considered Investment Grade, this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

APPENDIX B – MANAGED INVESTMENTS COVERAGE

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

SPREAD OF MANAGED INVESTMENT RATINGS



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