

Attachment D - Report from Trowbridge Deloitte

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Dear

Re: Deferred Establishment Fees

Trowbridge Deloitte ("Trowbridge") have been asked to provide a high level analysis on the effect of removing Deferred Establishment Fees (DEF) from a range of residential mortgage loans.

This letter provides a summary of our results along with some background information on the purpose of DEFs and alternative strategies that could be employed by lenders to facilitate the recovery of upfront costs incurred when writing new loans.

Scope

Trowbridge have been asked to demonstrate the effect of removing DEFs from a range of residential mortgage loans. In particular, we were requested to calculate the potential increase in the borrower interest rate required to maintain profitability if DEFs were not charged.

This was requested as a high level indicative illustration, using certain assumptions. We are not stating that the results are definitive in any way. They are included for illustrative purposes only.

DEFs Explained

A DEF is a charge levied upon early full repayment by the borrower. It is charged in an attempt to recover establishment costs which were not directly recouped by any direct charge to the borrower at time of settlement.

Ideally, the use of a DEF and its method of charging should be done in such a way that it equitably charges borrowers ie. so that each borrower is paying their fair allocation of such costs. It is also desirable that the DEF approach be objective and easily understandable by the borrower at the time of application. That is, it must be disclosed up front and be clear as to how it will apply thereafter.

In practice, lenders tend to charge DEFs as either:

- A percentage amount applied to loan size over a period (up to 5 years); and/or
- A flat dollar fee (for up to 5 years)

Alternatives to Charging a DEF

If a DEF is not charged, a mortgage lender could alternatively recoup its new loan settlement costs using the following:

- Charge higher upfront fees.
- Charge a higher rate of interest to all borrowers.

Higher upfront fees may be significant and add to the settlement cost strain for borrowers. This could deter borrowers from taking out a home loan or make such loans less affordable.

Charging a higher rate of interest implies a level of cross-subsidisation between borrowers. That is, those who keep their loan contract for longer will be subsidising those who discharge early. Borrowers who discharge early would have paid relatively few interest payments and hence less contributions to recouping upfront establishment expenses. These must therefore be borne at a portfolio level by remaining borrowers via higher interest rates.

Charging a DEF seeks to provide an equitable solution. That is, only those who elect to discharge early will be charged the fee, whilst the remainder of borrowers do not suffer the upfront costs or higher interest rate that would otherwise be required.

Impact on Borrower Rate if DEF Not Charged

One way to analyse the impact of removing the DEF is to calculate the increase in the borrower rate required to maintain the present value of the lender's cash flows emerging from the loan contract.

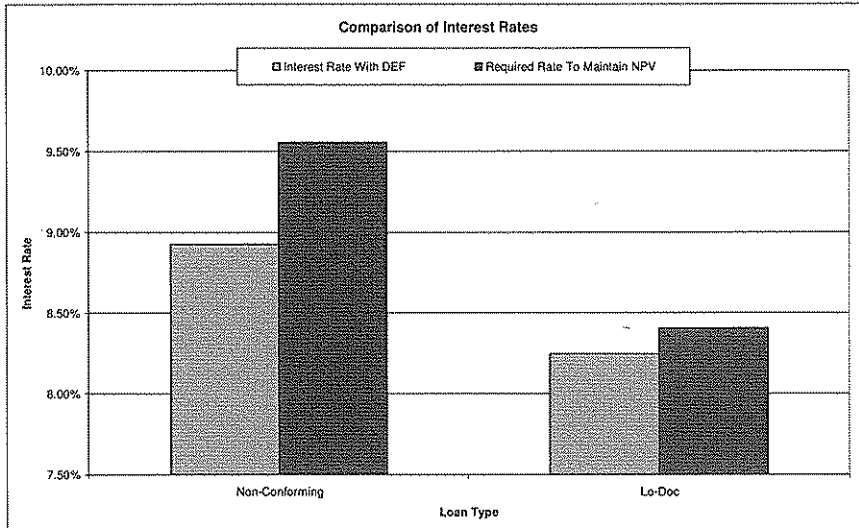
From our analysis performed, the increase in annual interest rates required to maintain the present value of cash flows could range from:

- 0.60% - 0.65% pa for the non-conforming loan; and
- 0.15% - 0.20% pa for the Lo-Doc Loan.

The above are based upon the following loan assumptions.

	Non-Conforming	Lo-Doc
Variable Interest Rate	8.92%	8.24%
Loan Type	Variable Rate	Variable Rate
Loan Term	30 Years	30 Years
Loan Amount	\$320,000	\$380,000
DEF	Year 1: 3% Year 2: 3% Year 3: 2%	Year 1: 2% Year 2: 1.5% Year 3: 1%
Loan Prepayment Rate	0 ramping to 40% over 18 months	0 ramping to 25% over 18 months

The chart below shows the interest rates currently assumed for each loan product (with the DEF in place) along with the interest rate required if the DEF is removed.



The level of the increase in interest rates is dependent on the amount of the DEF charged and the discharge rates assumed. The increase required for the Non-conforming loan is greater than for the Lo-Doc loan as the DEFs applied to the non-conforming loan are higher and the discharge rates are also higher over the DEF period..

Impact on Total Repayments Made

Another measure of the impact of removing DEFs is to consider the repayments made by the borrower under various scenarios. In particular, the repayments in total should a borrower leave early, compared to the payments required if they remain for the entire loan contract term.

Using the Lo-Doc loan as an example, and assuming an upfront cost of 2% of loan amount settled (ie. \$7,600), the following total repayments could occur.

With a DEF (and interest rate of 8.24%):

- Monthly repayments equal \$2,855
- If leave after 1 year - a 2% DEF is applied equal to \$7,600
- If remain for 30 years - total repayments are \$1,027,733

Without a DEF and assuming a correspondingly higher interest rate (of 8.4%):

- Monthly repayments equal \$2,898 (\$43 higher than with a DEF)
- If leave after 1 year – extra repayments only \$516 (ie \$7,084 unrecovered)
- If remain for 30 years - total repayments are \$1,043,161 (\$15,428 higher than with a DEF).

In the above, it demonstrates that without a DEF, borrowers discharging early are not paying enough contribution to cover the unrecouped upfront costs. However, at the other extreme, borrowers who remain for the entire contract term, will have paid significantly more than the initial costs. This highlights the considerable subsidisation that would be implicitly occurring in the portfolio.

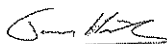
Reliances and Limitations

We have made assumptions based on hypothetical, although not unrealistic, scenarios to analyse the impact on interest rates of removing the DEF.

Our scope has been limited to providing a high level analysis of the impact on borrower interest rates of removing DEFs such that the present value of cash flows is maintained. We are not providing an opinion or definitive results. They are illustrative only.

No other use of, or reference to, this letter should be made without prior written consent from Trowbridge Deloitte, nor should the whole or part of this presentation be disclosed to any other person without prior explicit authorisation from Trowbridge Deloitte. We accept no responsibility for the use of the contents of this letter in addressing any other matters.

Yours Sincerely



James Hickey
Partner
Trowbridge Deloitte Limited