Fund Research

MA Priority Income Fund

BondAdviser

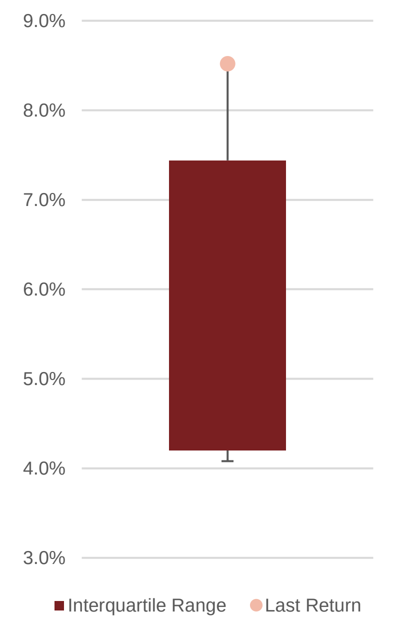
Overview

The MA Priority Income Fund (MAPIF) is an open-ended, unlisted unit trust designed to offer both retail and wholesale investors a stable, monthly income. The MA Master Credit Trust's ('the Master Trust') investment strategy targets a broad spectrum of credit market segments, with a focus on Australian private credit. The Fund aims to distribute a net cash yield (after all fees and costs) equal to the RBA Cash Rate plus 4.00% per annum (Target Return).

The Fund invests in Class A units of the Master Trust, which provides exposure to various types of credit investments, including commercial, consumer, and real estate debt instruments. This encompasses a range of investments such as trade and debtor finance, legal disbursement funding, fleet and auto finance, insurance premium funding, personal loans, strata finance, as well as residential and commercial real estate lending.

Established by MA Investment Management Pty Ltd ('the Manager') in 2018, MAPIF has a fund size of $1,589 million as of 31 August 2024. Of this, ~$145 million represents a co-investment by MA Financial Group (ASX: MAF) through Class B units, equivalent to 10% of the Fund's capital. This co-investment feature serves as a key characteristic of the Fund, offering a loss absorption mechanism for Class A investors. In this structure, any losses incurred at the portfolio level are initially absorbed by the Manager's co-investment, providing additional security for Class A investors.

Figure 1. Monthly Returns* Box Plot



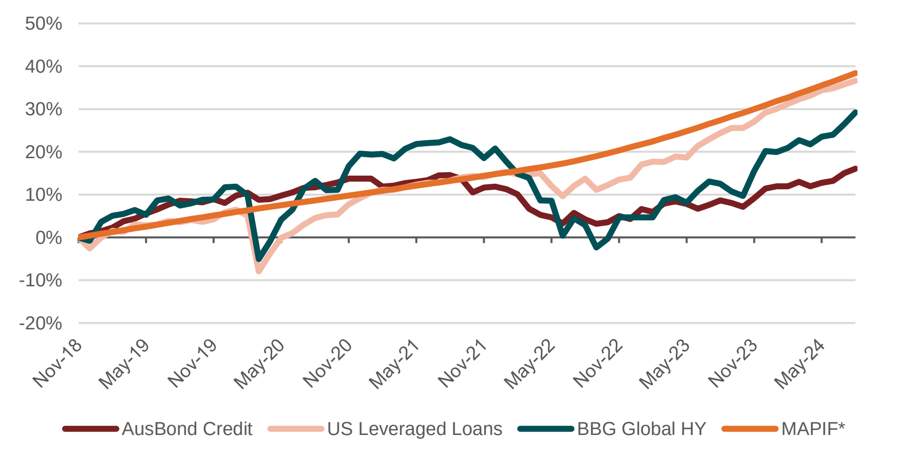
Source: BondAdviser, MA. Annualised monthly returns of the Fund, after fee returns since inception.

Figure 2. Monthly Net Returns* (%)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2024	0.71	0.66	0.71	0.68	0.71	0.68	0.71	0.71					**5.57**
2023	0.60	0.56	0.64	0.62	0.67	0.66	0.69	0.69	0.66	0.69	0.68	0.71	**7.87**
2022	0.34	0.34	0.35	0.35	0.37	0.39	0.45	0.50	0.52	0.56	0.56	0.60	**5.33**
2021	0.34	0.34	0.34	0.34	0.34	0.34	0.34	0.34	0.34	0.34	0.34	0.34	**4.10**
2020	0.40	0.40	0.37	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.34	0.34	**4.32**
2019	0.42	0.42	0.42	0.42	0.42	0.44	0.42	0.42	0.42	0.40	0.40	0.40	**4.96**
2018												0.42	**0.42**

Source: BondAdviser, MA, as at 31 August 2024.
** Return is monthly net investor distribution.*

Figure 3. Relative Cumulative Performance



Source: BondAdviser, MA, Bloomberg, as at 31 March 2024.
** Calculated from cumulative net monthly investor distributions of the Fund.*

Since inception in late 2018, the Fund has met its distribution target each month and there have been no losses in the underlying Fund.

The Fund's structure provides a protection for investors whereby a 10% capital buffer is provided by MA Financial. This not only protects investors but the skin in the game from the Manager instils an alignment of interests.

Product Assessment

Highly Recommended

The MA Priority Income Fund (MAPIF) offers wholesale and retail investors access to a uniquely structured, diversified portfolio constructed of primarily private credit investments, with a focus on niche lending segments within Australia. The Fund's investment strategy focuses on creating a portfolio of Australian private credit assets that possess defensive characteristics combined with asset-backed securities.

The Fund includes a notably unique credit enhancement. This is provided by a 10% Capital Buffer whereby MA Financial Group co-invests in the Fund alongside investors to an amount equal to 10% of the Fund's total capital. The co-investment acts as a barrier to investors where any losses experienced will be first absorbed by MA Financial Group up to 10%. This enhancement structure provides both a priority claim for investors in the Fund and a strong alignment of interests between the Manager and investors, as this Class B investment represents a material amount of balance sheet equity of the parent, **MA Financial** (ASX: MAF). Additionally, unitholders also benefit from excess spread, which yields a significant degree of capital and income protection. This means MA Financial Group will only receive a return on the Manager co-investment if Unitholders have been paid the full target return (in all prior periods) and the Capital Buffer is equal to 10% of the Fund's invested capital. The Fund has an unbroken track record since inception in November 2018, with Unitholders receiving the full monthly distribution and the Capital Buffer remaining fully intact.

The Manager has developed expert systems in niche lending that act as a competitive advantage in pricing such risk. That said, the recent growth in Funds Under Management (FUM) has been exceptionally strong, and this has resulted in less portfolio weighting to niche investments with stronger risk-adjusted returns, given the finite amount of niche opportunities available.

We view MAPIF's structure to be best in class. From a structure perspective, the 10% first-loss equity contribution from the Manager which aligns interests and adds a buffer to MAPIF investor returns has proven to be a sensational strategy. It provides better certainty around investor returns, with the target having been met every month since inception.

When discussing the processes and policies, the Fund again meets best-in-class criteria, having established a heavy focus on engaging independent trustees for securitisation valuations (i.e. principal write-off) that are kept at arm's length as well as strict criteria surrounding intercreditor agreements at each individual asset. We view these protective features as especially pertinent given the Fund is 86% exposed to private assets.

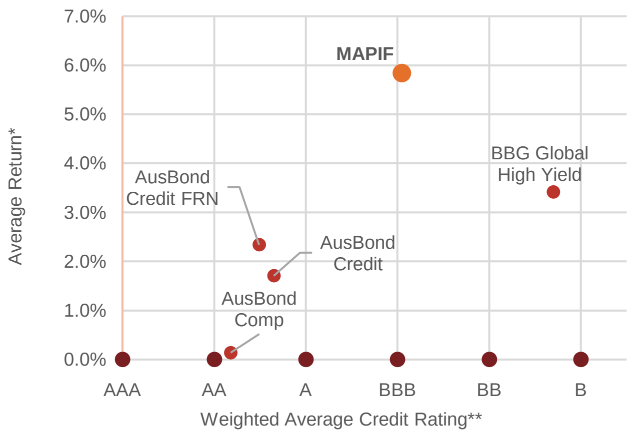
The high degree of independence is underlined by the numerous layers of external counterparties engaged to oversee the cashflow waterfall of the securitised investments. For such holdings of the Fund, there is always a trustee and a servicer, along with there often being a security trustee and a back-up servicer, with each being independent third parties. In an event whereby cash waterfalls for a monthly payment do not fully meet the obligations, these independent third parties would trigger an initial charge-off in the excess spread / reserves / most junior layer of the securitisation vehicle. We note that the Fund has never had a charge-off in an equity piece of its investments, let alone in the more senior tranches it holds.

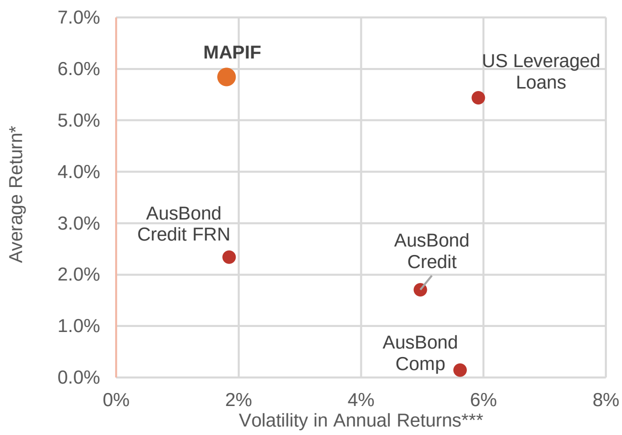
We also view the Manager's approach to obtaining credit ratings for privately held unrated assets to be the of a high standard. If a bond or loan is not externally rated, investments are assessed using S&P and Moody's rating methodologies and sense checked against public transactions where levels of portfolio diversification and credit enhancement can be readily observed.

Since our previous report (February 2023) the RBA Cash Rate has risen by 100bps, which has benefitted MAPIF investors as they are now receiving greater returns given the distribution benchmark is tied to the cash rate (RBA +4.00%). Additionally, the underlying portfolio has become entirely comprised of floating rate investments, which matches the distribution target. We expect for the Fund to continue meeting its target return, noting the impressively unblemished track record spanning nearly six years now.

With our underlying comfort in the strategy since inception over five years ago, the general expectation that the Fund continues to deliver on its target return, and our view that both the Fund's structure and processes being best in class, we upgrade the Product Assessment to our top-tier rating of **Highly Recommended**.

Figure 4. Estimated Risk-Adjusted Comparison (Underlying Portfolio for Wgt. Avg. Credit Rating)





*All returns for indices and the Underlying Fund are calculated using annualised monthly returns for the past five years. Average return for the Fund is calculated since inception in December 2018. ** Credit Ratings based on BondAdviser estimates. *** Calculated based on annualised monthly returns data for past five years for indices and since inception for the Fund. Source: BondAdviser, MA, Bloomberg, as at 31 August 2024.*

Construction and Investment Process

There have been **no material changes** to the construction and investment process.

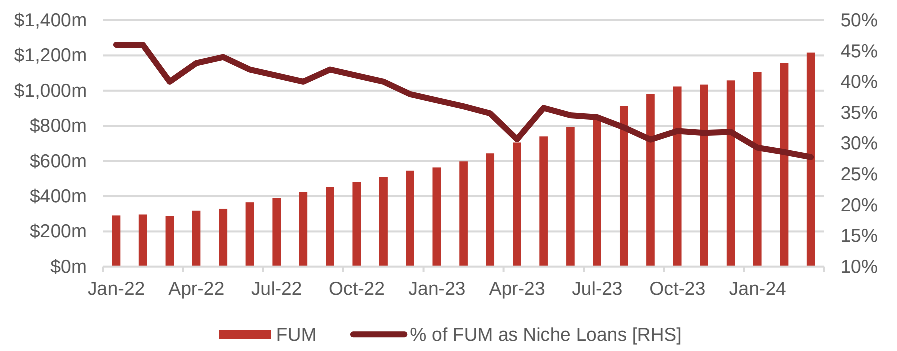
Portfolio Risk Management

We think there is a strong alignment of interests between the Manager/Group and investors given such a sizeable Class B investment in the Fund. As of 31 August 2024, **MA Financial Group** (ASX: MAF) holds an estimated $144 million position in the Fund via Class B units. This amount is more than triple the net profit after tax (NPAT) generated by MAF in FY23 ($41.6 million). A complete write-off of Class B units would significantly impact the Group's profitability and erase ~17% of its equity ($461 million as at 31 December 2023). This substantial stake suggests that the Manager is more likely to be highly diligent in selecting credits for the portfolio, as it bears the initial losses, which are significant for the Parent Company. This diligence helps limit losses for Class A investors should there be any losses recognised on underlying assets. It is also worth noting that the Master Trust generally takes mezzanine positions in underlying securitised assets, with equity tranches below each investment (and the excess spread income first being impacted) where losses are realised on underlying assets. As such, there is also cushion below the Fund's investments which must take first losses prior to Class B units before investor funds (Class A units) are impacted. As at 31 August 2024, the 10% capital buffer has not been impacted over the life of the Fund.

As there has been significant growth in Funds Under Management (FUM), the underlying portfolio of MAPIF has seen a reduction in the percentage allocation to niche loans (defined by BondAdviser as Legal Disbursements, Specialty Finance, and Supply Chain

Finance). Albeit the total weighting of niche loans has reduced, the Manager has still provided the Fund with significant growth in such loans, increasing the total FUM of niche loans by 57% since our prior report to $337 million as at 31 March 2024. This lags the substantial 103.5% FUM growth within the same period, however the ability to source new niche loans becomes more difficult as FUM grows as the borrowing demand is finite, and new deals should be of worthy credits that provide strong risk-adjusted returns. This, coupled with attractive risk/return dynamics in the residential securitisation sector that were subsequently capitalised on, has led to increased deployment into residential securitisation exposure at this point in time. We note that this is a benefit to the Fund's dynamic strategy, allowing for the portfolio to weight in or out of sectors the Manager views most attractive.

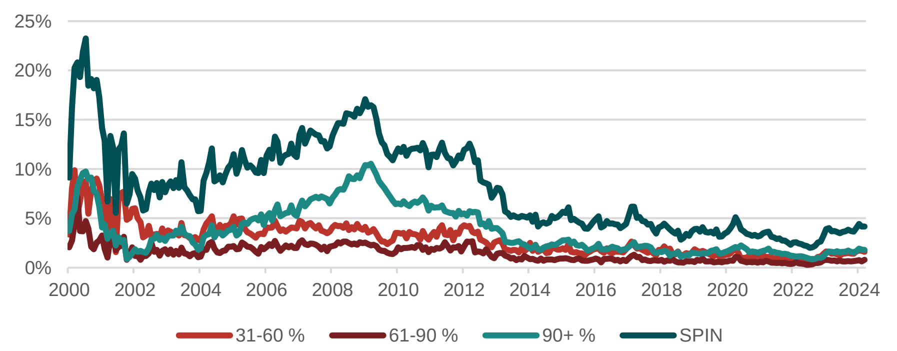
Figure 5. Niche Loans Portfolio Mix*



*Source: BondAdviser, MA. As at 31 March 2024. * Niche Loans include Legal Disbursements Specialty Finance Supply Chain Finance.*

In the post-cash rate hike environment, arrears for non-conforming loans have risen rapidly, having doubled from August 2022 lows to 4.18% as at March 2024. It is worth noting that this is still well below GFC levels that held above 10% for seven years. Consequently, as interest rates have rapidly increased, borrowers are experiencing greater pressure on the ability to meet the higher interest payments. Although there is a heightened risk with these investments in the current environment, the Fund has a significant loss waterfall buffer. However, given that over a third of the FUM is invested in residential mortgage-backed securities, the rising arrears rates are an issue that investors should be conscious of regardless. Credit enhancements such as excess spread, loss reserves, and credit subordination help protect Class A investors alongside the 10% Capital Buffer.

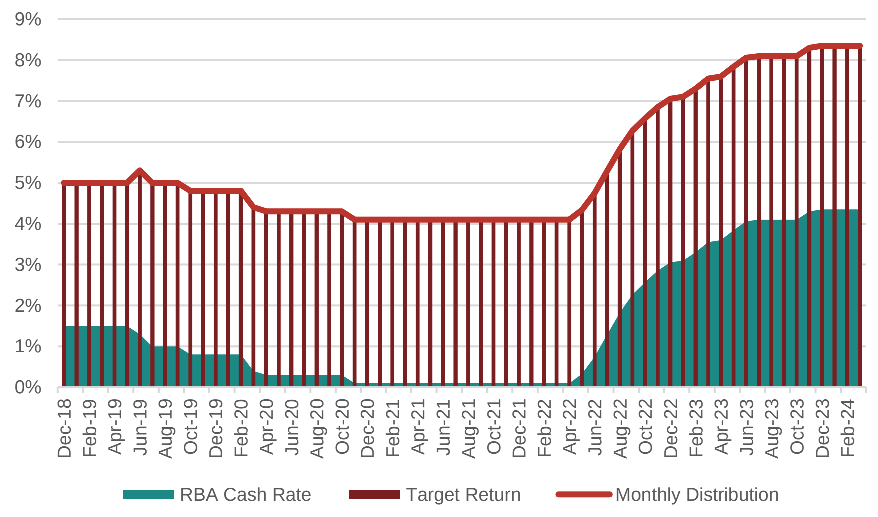
Figure 6. Australian Non-Conforming RMBS Arrears



Source: BondAdviser, S&P. As at 31 March 2024. SPIN is the addition of 31-60, 61-90, and 90+ days in arrears.

As discussed in the Product Assessment, the Fund has met its distribution target of the RBA Cash Rate +4.00% every month since inception.

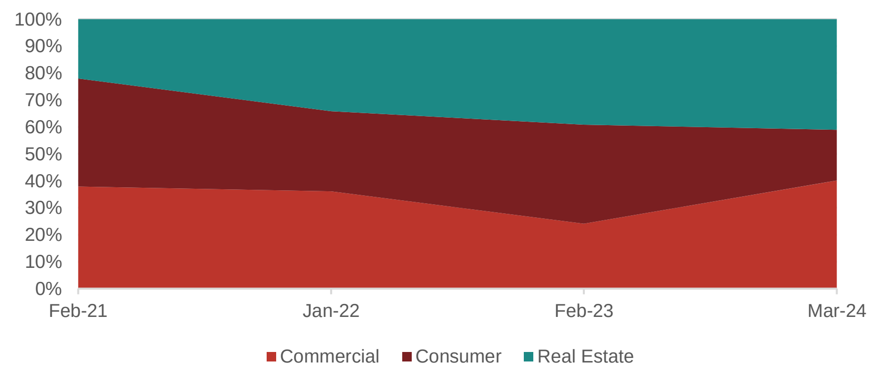
Figure 7. Annualised Distribution to Target



Source: BondAdviser, MA. As at 31 March 2024.

As at 31 March 2024, the underlying portfolio has reduced the weighting of consumer investments, opting to instead increase allocations to real estate and commercial (corporate) exposures. MAPIF's strategy allows for sectoral allocations to tilt towards where Management expects to achieve the best risk-adjusted returns.

Figure 8. Underlying Portfolio Sector Mix*



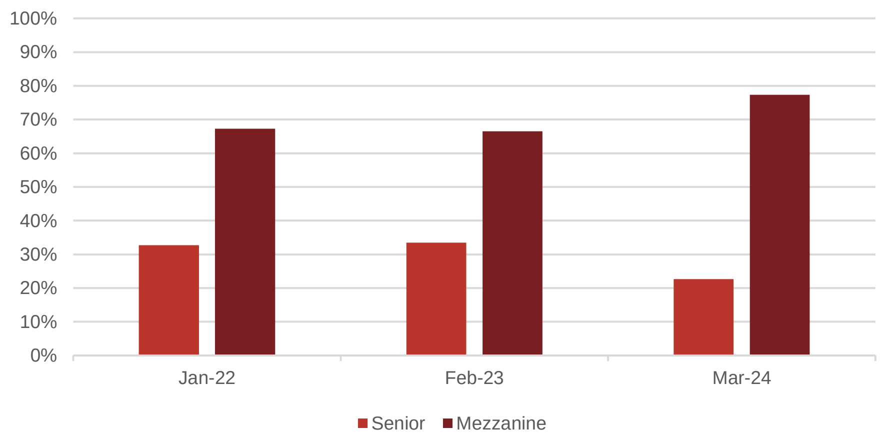
*Source: BondAdviser, MA. As at 31 March 2024. * Excludes cash and cash equivalents. Weightings based on drawn value.*

The Fund has notable exposure to subordinated assets within structured products, with 77.3% weighting of the underlying portfolio drawn allocation (ex-cash) comprised of mezzanine investments, reflecting an increase of 10.8% from the last iteration of this report.

However, despite their subordinated status, significant credit enhancements are in place to mitigate credit risk. For instance, there are mechanisms such as excess spread within the structures as well as subordinated tranches (i.e. equity tranches) below the Fund's investment. This means that the first cost is felt by the originator of the loan via the loss of their excess spread, then by the subordinated (equity) tranches followed by the Fund's investment. Therefore, there is meaningful protection against default for the assets that comprise the underlying portfolio.

Moreover, the Manager's 10% co-investment acts as an additional buffer against portfolio losses, and this buffer has remained intact since inception. This 'Class B' co-investment has now grown to approximately $144m as at 31 August 2024, (Fund size: $1,589m) which is now larger than any individual investment in the underlying portfolio. This means that if any one investment experiences an event of default, causing an unlikely loss of all capital tied to it, Class A investors principal would remain completely unaffected.

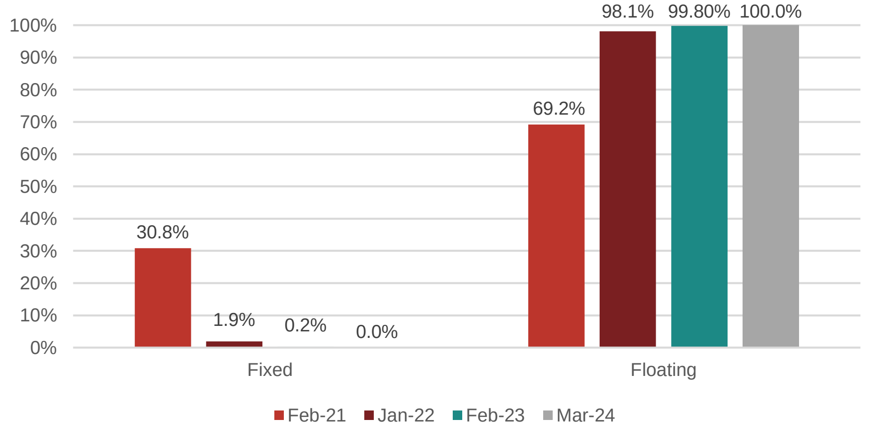
Figure 9. Underlying Portfolio Seniority*



*Source: BondAdviser, MA. As at 31 March 2024. * Excludes cash and cash equivalents. Weightings based on drawn value.*

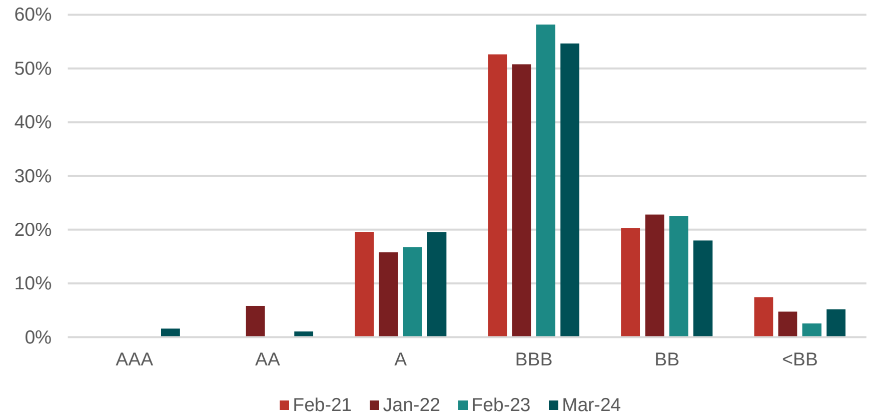
As at 31 March 2024, the underlying portfolio for MAPIF is now fully allocated to floating rate investments. This removes duration risk (interest rate risk) which both reduces NAV volatility but also matches the Fund's returns with its target distribution.

Figure 10. Underlying Portfolio Interest Rate Exposure*



*Source: BondAdviser, MA. As at 31 March 2024. * Excludes cash and cash equivalents. Weightings based on drawn value.*

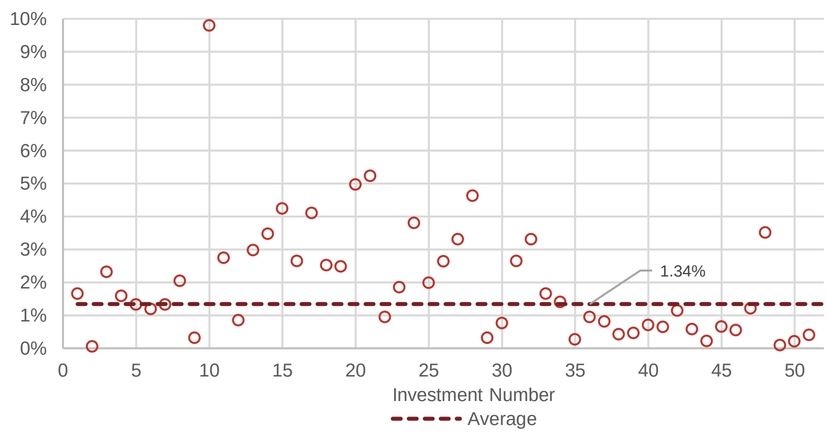
Figure 11. Underlying Portfolio Credit Rating Mix*



*Source: BondAdviser, MA. As at 31 March 2024. Based upon public and MA internal ratings. * Excludes cash and cash equivalents. Weightings based on drawn value.*

In the 13 months to March 2024 since our last review of the underlying portfolio, the number of individual investments held has increased from 44 to 52. Diversity in counterparties, both in terms of number and industry exposure, are positive risk reduction techniques in a credit portfolio. Additionally, the underlying loan count has increased from 221,370 to 316,283 since our previous report in February 2023, which increases the benefits of diversification given the lesser impact a single loan default will have.

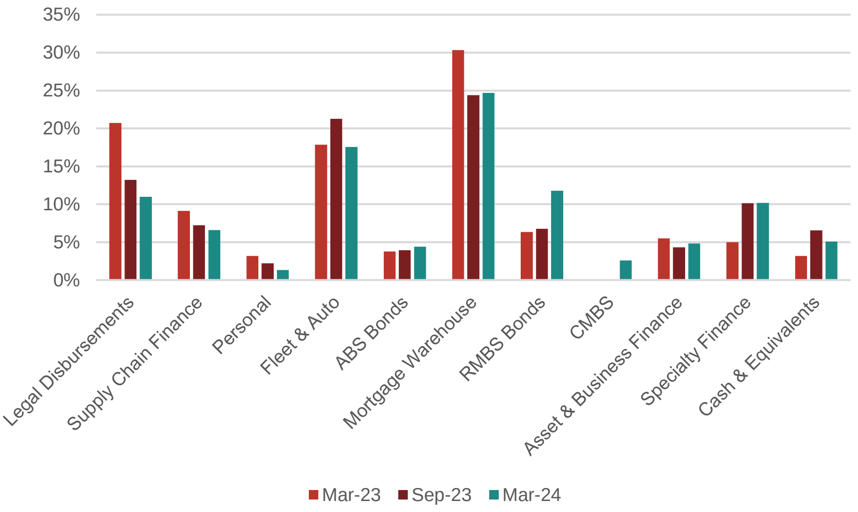
Figure 12. Underlying Portfolio Individual Asset Weighting*



*Source: BondAdviser, MA. As at 31 March 2024. * Excludes cash and cash equivalents. Weightings based on drawn value.*

Over the past twelve months, the underlying portfolio's weighting in niche loans (defined by BondAdviser as including legal disbursements, specialty finance, and supply chain finance) has decreased by 8% as a function of significant FUM growth. The Legal Disbursements allocation has nearly halved, falling from 20.7% to 11% as at 31 March 2024. Additionally, Supply Chain Finance has also decreased marginally by 2.5% over the same period. This is a reflection of niche allocation restraints given the finite supply relative to FUM growth. As MAPIF continues to grow, it will be increasingly difficult for the Manager to allocate the same weighting of niche loans given the supply is significantly smaller in comparison to other markets. We view that as the Fund continues to expand, niche loans will become a smaller part of the fund even though this is the specialisation of the Fund.

Figure 13. Underlying Portfolio Sub-Sector Mix



Source: BondAdviser, MA. As at 31 March 2024.

Fund Governance

There have been **no material changes** to fund governance.

The structure of the Fund was changed in 2021 to allow it to be offered to retail investors, as outlined in our April 2021 Update Report (see page 5).

Quantitative Analysis

The Fund is unique in the way it insulates the Class A units from volatility through its 10% Capital Buffer. This provides MAPIF investors with an extra layer of protection from volatility. In the QA simulations, we have analysed the portfolio under two stressed scenarios: (1) replicating conditions akin to the Global Financial Crisis (GFC), employing historical credit migration rates, default rates, and recovery rates observed globally for Residential Mortgage-Backed Securities (RMBS) assets, and (2) mimicking GFC conditions but utilising empirical data from the Asia-Pacific (APAC) region for RMBS assets. The reasoning behind conducting two stressed environment simulations is a reflection of the relatively strong performance within the APAC region due to stricter lending policies preventing the significant downfall in asset prices experienced in the US. Additionally, sub-prime and high-risk loans were a small share of lending in Australia. This is shown in the simulations with the difference between Jump-To-Default (JTD) rates for RMBS for both scenarios,

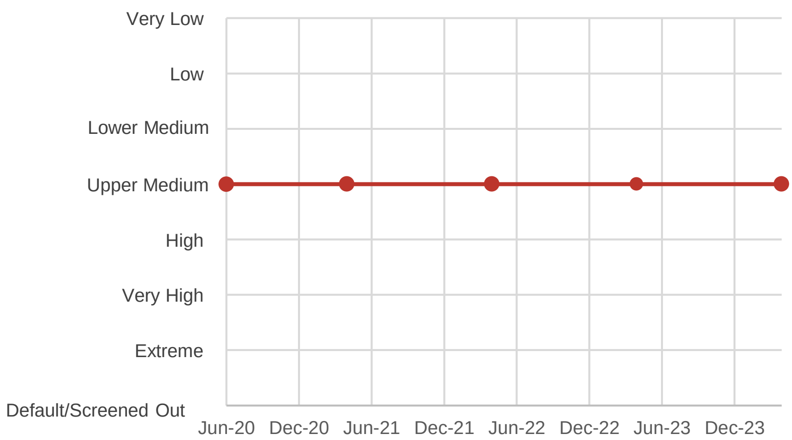
High rates increase both the distribution the Fund provides to the investor (RBA +4.00%) and the return of the underlying portfolio, ultimately improving return outcomes in our models. Under the 2018 scenario, which assumes no material stress in the economy, **all of 10,000 simulations provided an 8.35% return to Class A investors**. Interestingly, the underlying portfolio did not return a net loss in any of the simulations, with the worst return being +1.96%. Furthermore, there were no scenarios within the simulation where Class B investors were completely written off within the 2018 scenario.

The impact on RMBS returns significantly affects underlying portfolio returns under the Global Stressed scenario. In our first stressed scenario (1), replicating conditions akin to the Global Financial Crisis (GFC), Class A investors still realise a positive average net return of 5.31% across 10,000 simulations. However, in 57.82% of the simulations Class B investors (MA Financial balance sheet) record a complete loss of capital (net loss in the underlying portfolio exceeds 10%). Despite Australia experiencing relatively lower default rates in ABS structures compared to the global average during the GFC, this modelling remains highly conservative, envisaging a worst-case scenario that, from our perspective, it is an unlikely situation to happen in the medium term, but is worth modelling to see how the portfolio performs in an absolute crisis of a downside scenario.

Our final scenario examines RMBS exposures using empirical data from the APAC region during the GFC. Like the Global Stressed scenario, this scenario is cautious, though less so than the global scenario. Australia was comparably sheltered from the GFC compared to the broader APAC region, experiencing less severe credit impacts on securitised structures. In our modelling, 99.80% of portfolio simulations achieve the current target return of 8.35% for Class A units. In this scenario, BBB JTD rate for RMBS is 2%, which is significantly better than the 26% observed during the Global GFC scenario. This results in substantially improved simulated portfolio performance compared to global stressed conditions.

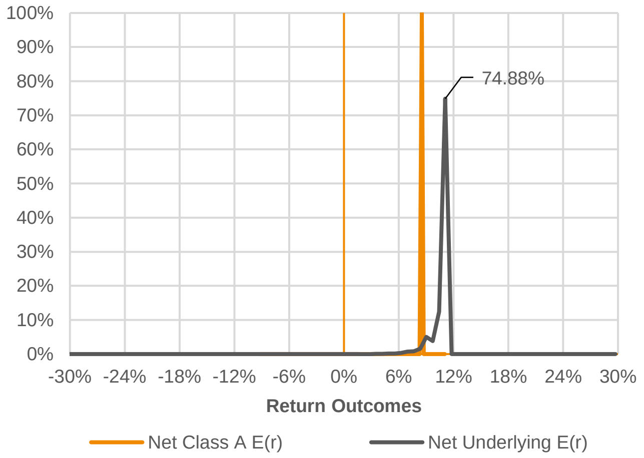
The defensive traits of the portfolio have improved results within our stressed scenarios from the improvement of diversity in the Fund. Improvements to counterparty diversification and underlying loans have helped reduce the probability of losses for both Class A investors and the MA Financial balance sheet in global stressed conditions which underscore our Risk Score of **Upper Medium** or “BBB”.

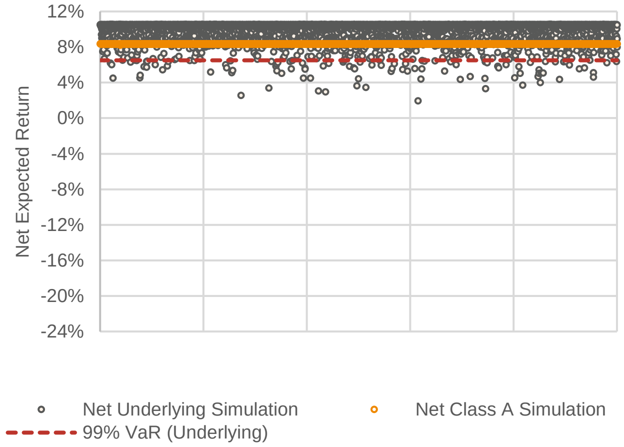
Figure 14. Risk Assessment



Source: BondAdviser, MA.

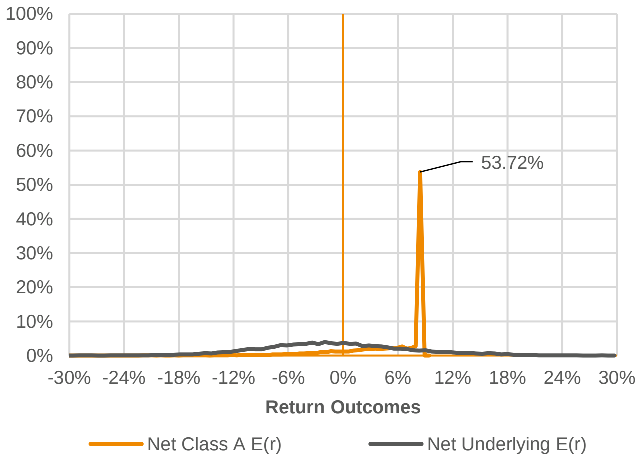
Scenario 1. Baseline Asset Assessment

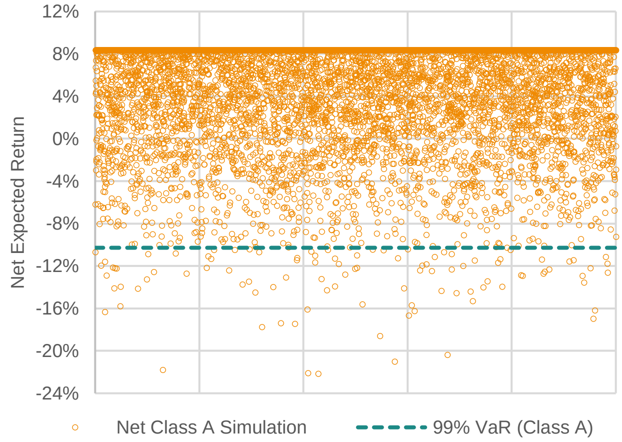




Source: BondAdviser Estimates as of 31 March 2024 portfolio. Net includes impact of fees, gross excluded.

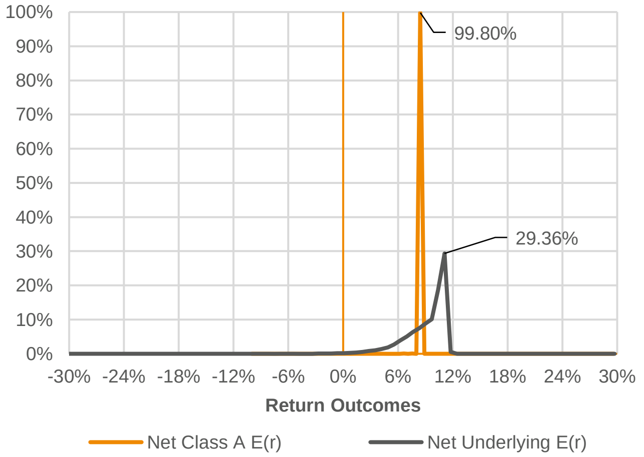
Scenario 2. Stressed Asset Assessment – Global RMBS Data

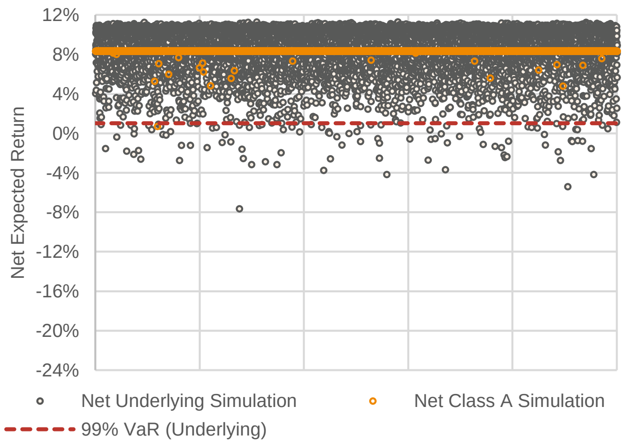




Source: BondAdviser Estimates as of 31 March 2024 portfolio. Net includes impact of fees, gross excluded.

Scenario 3. Stressed Asset Assessment – APAC RMBS Data





Source: BondAdviser Estimates as of 31 March 2023 portfolio. Net includes impact of fees, gross excluded.

Reporting History

MAPIF Update Report – 15 May 2023

MAPIF Update Report – 26 April 2022

MAPIF Update Report – 9 April 2021

MAFIF Initial Report – 19 June 2020

Alternative Investment Fund Research Methodology

Click here to view

Important Information

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Report created on 12 September 2024.