

Our Investment Insights

How to assess *First Mortgage Private Credit Funds* Before Investing

A practical framework for evaluating risk, structure
and manager quality



A practical framework for high net worth investors navigating the private credit landscape, in particular 'first mortgage funds'.

The private credit sector in Australia has had a remarkable run. As banks retreated from lending following the global financial crisis, a new ecosystem of non-bank lenders emerged to fill the void and investors followed.

Today, first mortgage private credit funds are a staple of many high net worth portfolios, targeting attractive risk-adjusted yields secured against real property.

Although, not all funds are created equal. As an adviser, I've reviewed many of them and met with the fund managers. What separates the funds I recommend from the ones I pass on is rarely obvious from a product disclosure statement alone. It comes down to a handful of specific things I look for, aspects that tell me whether a manager (and their team) truly understands risk or whether they're simply riding a benign credit cycle.

FUND OBSERVATION ONE

Manager Track Record & Team Background

I start with the people. Always. A fund's strategy is only as good as the team executing it and in private credit this matters even more than in listed markets. There is no daily pricing mechanism to enforce discipline. It is the manager's culture, mandates and judgement that acts as the check.

Origination Lineage

How did the team get here? I look at their background and want to see people who spent time inside banks, family offices or other large financial institutions, specialising in areas such as real estate, financial services, equity transactions, corporate strategy, distressed investing, credit strategies, investment sourcing, or portfolio management. I want to see people who understand risk and can conduct careful due diligence. After all, as much as the performance is derived from the interest repayments from the borrower, it is also based on the value of the asset they lend against and the manager's ability to ensure they are never lending more than that value.

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Has the team navigated a full credit cycle?

This is perhaps the single most important question I ask and one that requires extra scrutiny given that many first mortgage funds in Australia are relatively new, with a number having launched within the last five years. A short track record doesn't automatically disqualify a fund, but it does raise the bar on every other aspect of due diligence.

Since these funds are relatively new we cannot back test to times of extreme stress such as the global financial crisis. In this case I look at other aspects such as:

- Are there any loans that have defaulted in the portfolio yet?
- How has it been managed?
- Does the fund stress test the portfolio?
- How often are the assets valued?

A manager who has navigated a defaulting loan and can speak candidly about it tells me far more than one with a clean record they've never had to defend.

I need to be confident that their lending mandate, credit policies and internal governance are robust enough to hold firm when conditions deteriorate. I look closely at how tightly their mandate is written, whether their investment committee has genuine independence and whether the people making final decisions have the experience and discipline to say no when a deal may look attractive but is not worth the risk of having it in a portfolio.

FUND OBSERVATION TWO

LVR Limits & Credit Risk Controls

The loan-to-value ratio (LVR) is the primary lever of risk in a first mortgage fund. It determines how much of a property's value sits as a buffer between the loan and a potential loss. The lower the LVR, the more the property can fall in value before the fund faces a principal loss.

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LVR Targets & A Disciplined Mandate

I look at whether the fund has a clearly defined and disciplined LVR mandate. One that is explicitly documented in either the factsheet or PDS. A well-structured fund will articulate a maximum average LVR across the portfolio as a whole (typically 65%) as well as a ceiling on any single loan (typically up to 75%). The better managers go further, applying more granular limits by sector or loan type. For example, setting tighter LVR caps on construction loans, commercial property, or development exposure, which carry a different risk profile to standard residential lending.

My general benchmark is a portfolio average LVR of no more than 65%, with the flexibility to go up to 75% on a single deal. If a fund's mandate permits higher LVRs than this without a compelling rationale, I will look very carefully at what else in the structure compensates for that additional risk.

I also look at whether the LVR being reported is based on the current "as is" value of the asset rather than a projected future value. I discuss this in more detail in the valuation section below.

Conservative Valuations & Further Due Diligence

A crucial part of the process is how the fund values the asset it is lending against, both the method and the frequency matter. The two questions I always ask are:

- **Who obtains the valuation?**
- **How often is it reviewed?**

On the who: An independent valuer who is a certified practising valuer (CPV) and a member of the Australian Property Institute (API), appointed by the fund, not the borrower, is non-negotiable. I have seen funds where borrowers supply their own valuations. That is not a lending standard; it is a conflict of interest waiting to crystallise. Bonus points go to funds that also maintain an internal team to assess valuations independently and push back where they believe a figure is higher than it should be.

On frequency: Valuations should be reviewed regularly, not just at the time of loan origination. Average loan maturities are different in all funds, however they tend to range from 6-24 months. Property values can move so I look to see if the fund stress tests liquidity and credit loss across the portfolio.

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I look at how the fund stress tests its portfolio. The best managers don't simply rely on current valuations and LVR compliance, they run regular, structured stress tests to understand what happens to the portfolio under adverse conditions. What I want to see is a multi-layered approach: stress testing each loan against a meaningful decline in the underlying asset value (say, 10–50%) to assess LVR headroom; scenario-based impairment testing at the portfolio level in accordance with Australian Accounting Standards to model expected credit losses under different default scenarios; and liquidity stress testing to assess the fund's ability to meet redemptions over an extended period if new applications ceased. Monthly stress testing across all three of these dimensions, asset value, expected credit loss and fund liquidity, is the gold standard. A manager who can show you this work and explain what it tells them, is one who is genuinely managing risk rather than simply reporting on it.

Finally, I also look carefully at whether the fund values assets on an "as is" basis rather than "as if complete." This distinction matters most for construction and development loans. An "as if complete" valuation reflects the projected value of a finished asset, a future prediction that can be materially affected by cost overruns, delays, or changes in market conditions between the start and completion date. A fund accepting "as if complete" valuations is, in effect, lending against an outcome that hasn't happened yet.

Due Diligence on Borrowers and Assets

Beyond the numbers, I want to understand the rigour of the fund's due diligence process on the individual loans it writes. A strong manager isn't simply assessing the value of the security, they are conducting a thorough review across multiple dimensions before a single dollar is lent.

What good looks like is a structured process that covers project due diligence including;

- **Exit strategy.**
- **Cashflow forecasts.**
- **Market conditions for sales and leasing.**
- **Credit review: Stress testing pre-sales levels, testing income for debt serviceability and identifying project risk factors that could trigger default.**
- **Borrower review: Assessing the borrower's background, track record, credit history, gearing and their capability to actually deliver the business plan.**
- **Security review: Stress testing the security value and LVR across different project stages and understanding the fund's rights as first mortgage holder in a default scenario.**

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I also want to see clearly defined risk control measures, things like step-in rights that allow the manager to take over a project if the borrower defaults, conservative LVR limits, the use of third-party valuers and milestone-based conditions the borrower must meet to access funds. A fund that can walk me through this framework in detail and show me how it is applied consistently across every loan, is one that takes its fiduciary responsibility seriously.

Concentration Limits & Loan Diversification

What I am really focused on here is single-loan concentration risk. A fund with a large proportion of its capital tied up in one loan is deeply exposed, if the value of that asset falls sharply or the borrower defaults, it can have a material impact on the entire fund. That is the scenario I want to avoid.

To understand diversification properly it helps to know the main types of loans that typically sit inside a first mortgage private credit fund. Land loans are secured against vacant or undeveloped land, generally awaiting a planning or development outcome; these tend to carry higher LVRs relative to the illiquidity of the asset. Construction loans fund the building of a project, with capital drawn down in stages as milestones are met, these carry execution risk as discussed elsewhere. Investment loans are secured against income-producing properties such as commercial buildings, industrial assets, or residential investment properties, generally considered the most straightforward of the three given the asset is already complete and generating cashflow.

A fund might naturally be weighted toward one of these loan types depending on the manager's expertise and the opportunities available in the market. I am not concerned if a fund has a higher allocation to residential land lending, for example, or if the majority of its loans are in NSW. These are reasonable outcomes of where a manager operates. What I am focused on is ensuring that no single loan represents an outsized share of the total portfolio because the more loans in the book, the less damage any one bad outcome can do to investors' capital.

As a guide, I am cautious about any single loan exceeding 10% of the total portfolio and I prefer to see individual loan limits clearly documented in the fund's mandate.

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Construction & Development Loan Exposure

I approach funds with meaningful construction and development exposure carefully and I am particularly cautious about apartment construction lending, which carries a distinct layer of risk that is worth understanding.

The core issue with any construction loan is that the asset does not yet exist in its completed form, cost overruns, delays and shifts in market conditions can erode the buffer between the loan and the value of the security faster than most investors appreciate. But apartment construction takes this further. If a builder defaults mid-project, the fund manager is left with a half-completed building, an asset that is difficult to sell, difficult to finance and difficult to complete. Engaging a new builder brings its own complications: many will be reluctant to warranty work they did not perform and the costs and timeframes involved in restarting a stalled project can be significant.

None of this means I will automatically rule out funds that participate in construction or apartment development lending. What I want to see is evidence that the manager has the right processes in place to assess whether a development is compelling enough to justify the risk, a rigorous project due diligence process, conservative LVR settings for construction deals, clear milestone conditions and step-in rights that give the fund genuine control if things go wrong.

Leverage

One area I always investigate is whether the fund uses leverage. That is, whether the fund itself has borrowed money, typically through a bank warehouse facility, to increase the amount it can deploy into loans.

On the surface this can look attractive. Leverage can amplify returns when conditions are favourable. However, it introduces a layer of risk that is important for investors to understand. If something goes wrong in the portfolio, a loan defaults, asset values fall, or redemption requests spike, the fund's obligation to its lender does not disappear. A bank with a warehouse facility will sit ahead of investors in the capital structure, meaning that if the fund needs to sell assets or wind down, the bank gets repaid first. Investors wear the residual risk.

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This does not mean a fund that uses a warehouse facility is automatically one to avoid. Some managers use leverage conservatively and with clear limits. What I want to understand is how much leverage the fund is running, what the terms of the facility are, whether there are any covenants that could force the manager's hand at the worst possible time and how the fund would manage a situation where the lender called the facility. If a manager cannot answer these questions clearly and confidently, that tells me something important about how well they understand the risks they are taking on behalf of their investors.

As a general preference, I favour funds that are unleveraged or that use warehouse facilities conservatively and transparently. The simpler the capital structure, the clearer the risk.

Handling Defaults

Given that many of these funds are relatively new, there may not be a long history of defaults to draw from, but that does not mean I skip this conversation. In fact, how a manager talks about defaults and what provisions they have in place to deal with them, tells me a great deal about the maturity of their credit process.

The first thing I want to understand is whether the fund has experienced any defaults to date and if so, how they were managed. A manager who can walk me through a default scenario, what triggered it, how they responded, what the outcome was for investors, demonstrates a level of operational experience that gives me genuine confidence. A manager who has never had a default and has given little thought to how they would handle one is a different proposition entirely.

It is also worth understanding that defaults do not always look the same. The most obvious is a borrower simply failing to make their loan repayments, but there are other triggers that can cause a loan to fall into default or create significant complications for the fund. A business partner or related party placing a caveat on a secured property can cloud the title and impede the fund's ability to enforce its security. A borrower breaching the terms of their loan agreement, for example, taking on additional debt without consent, failing to meet construction milestones, or allowing the property to fall into disrepair, can also constitute a default event. In development lending, a builder becoming insolvent mid-project is another scenario that can rapidly change the risk profile of a loan. I want to know that the fund's loan agreements are drafted tightly enough to capture these events and that the manager has a clear and tested process for responding to each of them.

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I also look closely at the provisions built into the fund's loan agreements for when a borrower goes into default. A well-structured fund will have a default interest clause, meaning that if a borrower defaults, they are liable for an additional interest charge on top of their existing repayment obligation. Importantly, I want to see that this default interest is allocated back into the fund and distributed to unitholders, rather than being absorbed as a fee or retained elsewhere. It is a small but telling detail, it shows that the manager's incentives are aligned with investors even in a stress scenario.

Beyond interest provisions, I want to understand what enforcement rights the fund holds as first mortgage holders, how quickly they can act and whether they have the internal capability or external relationships to manage a workout or asset sale without it dragging on and eroding value.

FUND OBSERVATION THREE

Liquidity Terms & Redemption Mechanics

First mortgage private credit funds are inherently illiquid by nature. Loans typically run for 6 to 24 months and a portfolio of loans cannot be converted to cash overnight. It is important for investors to understand this going in. Most well-structured funds offer monthly or quarterly liquidity windows with appropriate notice periods, which is a reasonable reflection of the underlying assets they hold.

Liquidity Terms That Match The Underlying Assets

Monthly or quarterly redemption windows with appropriate notice periods of 30 to 90 days are reasonable and consistent with the illiquid nature of the underlying loans. Funds offering instant liquidity should be scrutinised carefully, it is worth understanding exactly how they are able to offer this and whether it is genuinely sustainable under stress.

What many investors overlook is the fine print around redemptions buried in the PDS. Beyond the headline liquidity terms, a fund's disclosure documents will typically outline the trustee's discretion to accept or decline redemption requests, the notice periods required and critically, the worst-case timeframe for receiving funds back, which in some cases can extend to 36 months. This is not necessarily a red flag, but it is something investors need to be made aware of and comfortable with before committing capital. Managing expectations around liquidity, both in the good times and under stress, is part of my job as an adviser and it starts with making sure investors have read and understood these provisions before they invest.

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Gate Provisions

A well-structured fund will have clearly disclosed gate provisions, mechanisms that allow the manager to limit redemptions if a large number of investors want to exit simultaneously. Far from being a red flag, sensible gate provisions are a sign of good fund governance. They exist to protect remaining investors from a scenario where the manager is forced into a fire-sale of loans to meet redemptions, which could destroy value for everyone still in the fund.

A common example of how this works in practice: if redemption requests in a given window exceed a set threshold, say 5% of the total fund, any requests above that threshold are deferred to the next liquidity window. This ensures the fund can meet redemptions in an orderly way without compromising the integrity of the remaining portfolio. It is a sensible safeguard and I would rather see it clearly documented in the PDS than absent altogether.

Redemption History

I always ask: have you ever suspended or gated redemptions? How long for and why? A manager who has navigated a redemption challenge and resolved it well tells me more about their governance quality than one who has never been tested.

Cash Buffer Management

A fund that is fully deployed with little to no cash reserve is one unexpected shock away from a problem. I always want to understand what percentage of the fund is held in cash or liquid assets to meet redemptions, how that target is set and how it is actively managed.

That said, cash buffer management is not as simple as looking at a single number. A fund with a large proportion of short-dated loans, say, loans maturing within six to twelve months, has a natural source of liquidity that does not sit on the balance sheet as cash. In practice, a well-managed fund will meet redemptions from a combination of maturing loans, new investor applications coming into the fund and a cash buffer. When all three of these are working together, the fund can operate with a relatively modest cash reserve without taking on undue liquidity risk.

What I want to see is that the manager has thought carefully about this balance and can articulate how they manage it, not just in normal conditions, but under stress, when new applications slow and redemption requests pick up at the same time.

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FUND OBSERVATION FOUR

Transparency & Reporting Quality

I have a simple rule: if a manager is reluctant to show me their loan book details, I'm reluctant to recommend their fund. Transparency is not just a nice-to-have, it's a proxy for the entire culture of how a manager runs money.

1. Regular & Granular Reporting

Monthly investor reports should include weighted average LVR, loan maturity profile, geographic and asset class breakdown, arrears and impairment status, performance data and cash position. Anything less and I'm working blind. Quarterly reports should be more extensive and include market updates and commentary on the performance outlook.

2. Loan Book Transparency

Some managers will provide a detailed loan schedule on request, anonymised at the individual borrower level is fine. Others resist. I treat resistance as a signal. If the book is clean and the strategy is sound, why wouldn't you show it?

3. Fee Transparency

The management fee is usually straightforward. What I probe for are the less obvious fees: origination fees shared with related parties, valuation fees, line fees and any performance fee structures. Fees aren't inherently bad, misaligned or undisclosed fees are.

4. Related Party Lending

Does the manager lend to related parties or associated entities? If so, how is this governed, disclosed and approved? Related party lending at arm's length with proper governance is manageable. Undisclosed related party lending is not something I'm prepared to overlook.

5. External Audit & Independent Oversight

Who audits the fund? Is there an independent responsible entity, trustee, or custodian? External oversight adds meaningful accountability. I'm cautious of any structure where the manager, RE and custodian are effectively the same organisation.

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FUND OBSERVATION FIVE

Putting It All Together

When I sit across from a private credit fund manager, I'm not trying to catch them out, I'm trying to understand whether they think about risk the way I need them to. A manager who answers my questions with specific examples, who can articulate their worst loan and what they learned from it, who shows me a thick deck of loan-level data without prompting, that's a manager I'll look at seriously.

For high-net-worth investors, first mortgage private credit can be an excellent component of a diversified income portfolio. But it is not a set-and-forget allocation. The due diligence required to select a quality fund is real and the ongoing monitoring of that fund is equally important.

If your adviser hasn't asked the fund manager these questions on your behalf, it's worth asking why.

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