Pendfund Income Fund I: Where does it fit in the Securities World?

Pendfund Income Fund I (Pendfund) is structured as an investment trust and trades as a private placement security. The mutual fund trust/unit purchase structure rather than another was selected for Pendfund for a few main reasons as follows:

1. ***Main Reason***: to eliminate 'equity risk' which is the risk of loss because of a drop in the market price of shares. *Pendfund units do not fluctuate in value due to market events unassociated with it;*
2. To place greater net fund returns into the hands of the investor by minimizing operating expenses; *Private placement vs. publicly-traded equity allows this;*
3. To invest strictly in commercial mortgages rather than residential loans and obtain the safety of income bearing property as security; *'Trust' structure vs. Mortgage Investment Corporation allows this;*
4. To maximize the potential for higher returns through commercial rather than residential lending; *'Trust' structure vs. Mortgage Investment Corporation allows this;*
5. To generally hedge risk; *All of the above allows this.*

Pendfund uses mortgage loans from a debt sector which has amongst the highest levels of securement possible and lowest predictable losses (<1%).

The trade of Pendfund in the exempt market where speculative/high risk investments may be found has no bearing on the underlying risk factors and investments within Pendfund. The loans Pendfund funds are low risk.

Here is a framework of investment and some theory of the operation of capital markets. It is important to understand the structure and 'fit' prior to investing.

The Exempt Market- A Brief Rundown

Generally, securities offered to the public in Canada must be offered with a prospectus – a document that provides detailed information about the security and the company offering it. There are some 'exemptions' that allow securities to be offered without a prospectus – these result in exempt market securities (EMS). EMS are offered with a similar document called an offering memorandum. These documents have varying levels of detail and length and can be as large and detailed as a prospectus, as in the case of Pendfund.

The exempt market provides another option for diversifying investment portfolios with classes other than stocks, bonds and cash. Issuers of exempt market securities do not have to report as often as issuers of publicly traded securities traded under a prospectus.

Pendfund produces audited financial statements annually, issues quarterly reports and statements from management and reports to its principal securities regulator on every investment made within 10 days of it occurring. It does not report to SEDAR.

Aspects of the Exempt Market

1. Investments like debt, equity, asset-backed securities, investment funds and derivatives can be sold in the exempt market.
2. Prospectus exemptions allow business to raise money without the expense of preparing a prospectus and continuous reporting expenses.
3. There are different prospectus exemptions and each has its own rules about who can sell securities and who can buy securities under the prospectus exemption.
4. In many cases, a security sold under a prospectus exemption can only be resold if certain conditions are met.
5. As with public equities the 'suitability' of the investment for the investor is closely monitored and regulated.

9 Types of Investment Risks and ***How They Bear on Pendfund in the Exempt Market***

1. Market risk: The risk of investments declining in value because of economic developments or other events that affect the entire market. The main types of market risk are equity risk, interest rate risk and currency risk.

Equity risk: is the risk of loss because of a drop in the market price of shares. *Zero risk with Pendfund as it is not publicly traded. Pendfund unit prices are based on a 'net asset value' (NAV) calculation and generally remain the same, independent of any market.*

Interest rate risk: Is the risk of losing money due to a change in interest rate. For example, if the interest rate goes up, the market value of bonds will drop. *Minimized risk with Pendfund; portfolio turnover and loan renewals increase returns as rates rise, uses longer loan terms in times of falling interest rates.*

Currency risk: applies when you own foreign investments. It is the risk of losing money because of a movement in the exchange. *Zero risk with Pendfund as Units can only be purchased by Canadian residents.*

2. Liquidity risk: The risk of being unable to sell your investment when your time is right without losing capital. To sell the investment, you may need to accept a lower price*. Minimized risk with Pendfund; units are conditionally redeemable and without penalty after 3rd anniversary.*

3. Concentration risk: The risk of loss because your money is concentrated in one investment or type of investment. In diversifying, risk is spread over different sectors, industries and geographic locations. *Mitigated risk with Pendfund; it is a debt investment secured by commercial tenants paying rent that are from different industries, loans are geographically diverse.*

4. Credit risk: The risk that the government entity or company that issued the debt will be unable to make timely interest payments or repay principal at maturity. *Mitigated risk with Pendfund; covenantors/borrowers closely scrutinized, high margin of security, tenants are from diversified industries, loans are marketable.*

5. Reinvestment risk: The risk of loss from reinvesting principal or income at a lower interest rate. Suppose you buy a bond paying 3%. It will affect you if the bond matures, interest rates drop and you have to reinvest at 2%. *Mitigated risk with Pendfund; units are redeemable, portfolio turnover and loan renewals increase returns as rates rise, Pendfund uses longer loan terms in times of falling interest rates.*

6. Inflation risk: The risk of a loss in your purchasing power because the value of your investments does not keep up with inflation. Inflation risk is relevant if you own cash or debt investments like bonds. *Mitigated risk with Pendfund; fixed income with greater than bond or GIC returns, interest/lending rates typically rise with inflation.*

7. Horizon risk: The risk that your investment horizon may be shortened because of an unforeseen event. This may force the sale of investments that were expected to be held for the long term. If you must sell at a time when the markets are down, you may lose money. *Minimized risk with Pendfund due to zero equity risk and ability to redeem.*

8. Longevity risk: The risk of outliving your savings. This risk is particularly relevant for people who are retired, or are nearing retirement. *Pendfund maximizes returns which increases longevity of investment.*

9. Foreign investment risk: The risk of loss when investing in foreign countries *Zero risk with Pendfund.*

Registration of Exempt Securities Dealers

Individuals or firms that are in the business of trading or advising in securities are required to register as a dealer or portfolio manager (also known as a "registrant"). *Pendfund is currently registered as an Exempt Market Dealer with both the British Columbia and Alberta Securities Commissions and will be activating registration in Manitoba and Saskatchewan and Ontario in the near future.*

Resale restrictions

Exempt securities can often only be resold or redeemed if certain conditions are met. These resale conditions are designed to ensure that there is sufficient disclosure available for a subsequent purchaser to make an informed investment decision.

7 Common types of Fixed Income Mutual Funds *and How Pendfund Compares**

1. Money market funds

These funds invest in short-term fixed income securities such as government bonds, treasury bills, bankers' acceptances, commercial paper and certificates of deposit. They are generally a safer investment, but with a lower potential return then other types of mutual funds. Canadian money market funds try to keep their net asset value (NAV) stable at $10 per security. *Higher Management Expense Ratio (MER) thus generally lower returns than Pendfund.*

2. Fixed income funds

These funds buy investments that pay a fixed rate of return like government bonds, investment-grade corporate bonds and high-yield corporate bonds. They aim to have money coming into the fund on a regular basis, mostly through earned interest. High-yield corporate bond funds are generally riskier than funds that hold government and investment-grade bonds. *Higher MER, thus lower yields and in the case of high yield corporates, more risk than Pendfund.*

3. Equity funds

These funds invest in stocks. These funds aim to grow faster than money market or fixed income funds, so there is usually a higher risk that you could lose money. You can choose from different types of equity funds including those that specialize in growth stocks (which don't usually pay dividends), income funds (which hold stocks that pay large dividends), value stocks, large-cap stocks, mid-cap stocks, small-cap stocks, or combinations of these. *Equity risk and fluctuation of capital value at hand in publicly traded equities. Zero equity risk in Pendfund.*

4. Balanced funds

These funds invest in a mix of equities and fixed income securities. They try to balance the aim of achieving higher returns against the risk of losing money. Most of these funds follow a formula to split money among the different types of investments. Usually more risk than fixed income funds, but less risk than pure equity funds. Aggressive funds hold more equities and fewer bonds, while conservative funds hold fewer equities relative to bonds. *Greater MER and general risk than Pendfund but greater access to growth.*

5. Index funds

These funds aim to track the performance of a specific index such as the S&P/TSX Composite Index. The value of the mutual fund will go up or down as the index goes up or down. Index funds typically have lower costs than actively managed mutual funds because the portfolio manager doesn't have to do as much research or make as many investment decisions. *Highest diversification in equities possible, subject to equity risk and growth in a positive market.*

6. Specialty funds

These funds focus on specialized mandates such as real estate, commodities or socially responsible investing. For example, a socially responsible fund may invest in companies that support environmental stewardship, human rights and diversity, and may avoid companies involved in alcohol, tobacco, gambling, weapons and the military. *Pendfund is a debt fund and not considered a specialty.*

7. Fund-of-funds

These funds invest in other funds. Similar to balanced funds, they try to make asset allocation and diversification easier for the investor. The MER for fund-of-funds tend to be higher than stand-alone mutual funds. *Higher MER than Pendfund, usually always.*

*This a comparison only and should not be construed as investment advice. Consult your professional advisor for portfolio advice.

Before you invest, understand the fund's investment goals and make sure you are comfortable with the level of risk. Even if two funds are of the same type, their risk and return characteristics may not be identical. A simple broker who sells you the product is powerless to make it better after the sale and Mutual fund companies often build relationships with advisors and encourage them to sell their funds. They are brokers not manufacturers of securities.

Most investing is simple money lending. The art is to achieve maximum return for a given risk and be sure capital will be preserved.

Why give your returns to huge companies? With Pendfund you get pure return without layers of management fees. Pendfund is originated and actively serviced by 'your' fund Manager. Its like eating the vegetables from the hand of organic farmer who grew them. *He must stand behind the quality of his product*.

Definitions:

1*. Equity*: has two meanings: **a)** The part of investment you have paid for in *cash*. Example: you may have equity in a home or a business. **b)** *Investments* in the stock market. Example: equity mutual funds. *risk* – applies to an investment. An item of value you buy to get income or to grow in value.

3. *Market price* (the amount you must pay to buy one unit or one share of an investment) of shares varies all the time depending on demand and supply. The market price can change from day to day or even minute to minute. Equity risk is the risk of loss because of a drop in the market price of shares.

4. *Market value*: The value of an investment on the statement date. The market value tells you what your investment is worth as at a certain date. Example: If you had 100 units and the price was $2 on the statement date, their market value would be $200.

5. *Exchange Rate:* The discount or bonus at which one currency can be exchanged for another. For example, if the U.S. dollar becomes less valuable relative to the Canadian dollar, your U.S. stocks will be worth less in Canadian dollars.

6. *Bond:* A structure of loan you make to the government or a company. In turn, you get back a set amount of interest once or twice a year. If you hold bonds until the maturity date, you will get all your money back as well.

7. *Credit rating*: A way to score a person or company's ability to repay money that it borrows based on credit and payment history. Your credit score is based on your borrowing history and financial situation, including your savings and debts.

8*. Inflation*: A rise in the cost of goods and services over a set period of time. This means a dollar can buy fewer goods over time. In most cases, inflation is measured by the Consumer Price Index.

9. *Active vs. Passive management:* Active management means that the portfolio manager buys and sells investments, attempting to outperform the return of the overall market or another identified benchmark. Passive management involves buying a portfolio of securities designed to track the performance of a benchmark index. The fund's holdings are only adjusted if there is an adjustment in the components of the index.

10*. Share:* A piece of ownership in a company. A share does not give you direct control over the company's daily operations. But it does let you get a share of profits if the company pays dividends.

11. *Estate:* The total sum of money and property you leave behind when you die.

12*. Investment Horizon:* The length of the period of time that you plan to hold an investment before you sell it. This may be a brief period of time or span as long as decades, depending on your financial goals.

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